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## FOREWORD

The publication of the *2016 Budgetary Policy Report* marks the completion of the first full year of operations of the Parliamentary Budget Office (PBO). After its establishment in April 2014 and the start of actual operations the following September, during 2015 the PBO has built up to full capacity to perform its duties of analysing macroeconomic and public finance forecasts and assessing compliance with national and European fiscal rules.

The Report examines the fiscal policy documents and the Stability Bill for 2016, representing here its reports to the appropriate parliamentary committees in hearings held on 29 September and 3 November, with additions and further developments. Additional analysis of specific aspects of the budget measures for 2016 will be published shortly in the PBO's Focus Paper series.

The Report is organised into three chapters. The first addresses the macroeconomic environment, assessing economic conditions (on the basis of information available at the end of November), reporting the PBO's analysis of the Government's macroeconomic forecasts and their validation for the 2015-16 period and discussing the risks underlying the entire forecasting horizon (which extends to 2019).

The next chapter examines the trend and policy scenario for the public finances as well as the structure of the measures provided for in the 2016 Stability Bill. The chapter also assesses compliance with national and European fiscal rules.

The third chapter focuses on an analysis of the main public finance measures (elimination of the municipal services tax (Tasi) for primary residences, business taxation, public expenditure reduction measures, and anti-poverty initiatives).



# 1 THE MACROECONOMIC ENVIRONMENT

## 1.1 *International economic conditions*

The signs of a slowdown in global growth have intensified in recent months. The slowdown in China and the emerging economies has caused a sharp deceleration in international trade. The recovery in the advanced economies, which proceeded apace in the first half of the year, has slackened since the summer, reflecting the smaller impulse from foreign demand. The terrorist attacks in Paris on 13 November have impacted this environment, both by increasing uncertainty and discouraging certain types of consumption on the one hand and by triggering increases in spending on defence and security on the other.

The deceleration in the global economy has prompted international organizations to revise their forecasts for world growth. In its October projections, the IMF estimated an expansion of 3.2 per cent in trade this year (0.9 points less than six months earlier), 4.1 per cent in 2016 (-0.3 points) and 4.6 per cent in 2017 (-0.5 points). The revisions made by the European Commission and the OECD for the current year and the next were even larger. In November, they forecast that trade would rise by about 2 per cent this year and 3.6 per cent in 2016, with corrections of previous estimates of 1.5 percentage points for the European Commission and from 1.7 to 1.9 points for the OECD. The Government's forecasts prepared in September in the Update to the Economic and Financial Document (EFD) for 2015, lowered projections from their level in April, but remained higher than the most recent estimates of the international forecasters (for the Government, world trade is expected to grow by 3 per cent in 2015, 4.5 per cent next year and 5.2 per cent in 2017; Table 1.1).

The slowdown in China has had an impact on commodities markets, suppressing inflation. Oil prices, which in the first six months of the year rose to \$64 a barrel from their lows of January, have decreased again since the summer, falling below \$45 in November. The imbalance between production and consumption that has characterized the oil market in the last year and a half is increasingly driven by the weakening of demand. The average price of Brent in 2015 should be close to that assumed by the Government (\$53.7 a barrel). The Government's forecasts for next year appear more uncertain. The forecasts in the Update and in the Draft Budgetary Plan (DBP) for 2016 reflect a gradual strengthening of oil prices next year, in contrast with the expectations of international organizations, which incorporate the additional decline experienced in recent months, projecting a fall in average prices in 2016 (Table 1.2).

The slowdown in the emerging economies has been accompanied by financial instability and significant depreciation in their currencies against those of the industrialised countries. After hitting a low in April, the euro appreciated over the next seven months by about 7 per cent compared with a broad basket of currencies and by 4 per cent against the dollar. Expectations of further monetary easing in Europe, together with a likely rise in US

interest rates, has triggered a new weakening of the euro in recent weeks, which has fallen against the dollar to its level in April. The average dollar/euro exchange rate in 2015 could be slightly lower than that assumed by the Government (1.118). Looking ahead to the coming years, the Government's forecast is based on the technical assumption of a stable dollar/euro rate at the level prevailing at the end of August (\$1.125 per euro); similar assumptions have been adopted by international organisations.

The pace of recovery in the developed countries has slowed since the summer, reflecting the slowdown in international growth. In the United States, estimates indicate a deceleration in GDP in the third quarter (+0.5 per cent, after a 1 per cent increase in the previous quarter). The outlook for the American economy remains positive, although the most recent forecasts for 2016 point to less robust growth compared with earlier projections: +2.5 per cent according to the OECD (+2.8 per cent six months ago) and +2.2 per cent according to the IMF (compared with +3 per cent). In view of the depressionary impact of international economic conditions, uncertainties remain about the timing of any increase in the federal funds rate after seven uninterrupted years at zero. Consensus expectations point to an initial increase in December or early 2016.

Japan has slipped back into recession (-0.2 per cent in the second and third quarters), reflecting the slowdown in China and the Asian continent more directly than the other major economies. The weakening of the economic outlook has weighed especially heavily on investment expenditure, which has contracted significantly in recent quarters.

**Table 1.1** – World trade (1)

|                        | Percentage growth rates |      |      |      | Difference in percentage points on previous forecasts |      |      |
|------------------------|-------------------------|------|------|------|---|------|------|
|                        | 2014                    | 2015 | 2016 | 2017 | 2015  | 2016 | 2017 |
| Update, September 2015 | 3.6                     | 3.0  | 4.5  | 5.2  | -1.0  | -0.8 | -0.1 |
| IMF, October 2015      | 3.3                     | 3.2  | 4.1  | 4.6  | -0.9  | -0.3 | -0.5 |
| EC, November 2015      | 3.3                     | 2.3  | 3.6  | 4.5  | -1.5  | -1.5 | ..   |
| OECD, November 2015    | 3.4                     | 2.0  | 3.6  | 4.8  | -1.9  | -1.7 | -0.5 |

(1) Average of changes in the volume of imports and exports; for the European Commission (EC), change in the volume of imports.

**Table 1.2** – Oil prices in dollars  
(Percentage changes)

|                         | 2015  | 2016 | 2017 |
|-------------------------|-------|------|------|
| DBP, October 2015 (1)   | -45.8 | 0.7  | 9.4  |
| IMF, October 2015 (2)   | -46.4 | -2.4 | 10.1 |
| EC, November 2015 (1)   | -45.0 | -1.3 | 8.5  |
| OECD, November 2015 (1) | -45.3 | -7.6 | 0.0  |

(1) Bent; (2) Average of Brent, Dubai and WTI.



In the euro area, the gradual recovery continued in the third quarter, albeit at a slower rate (+0.3 per cent) than in the first half of the year (+0.5 per cent in the first quarter, +0.4 in the second). The strengthening of domestic demand, fostered by the easing of financial conditions, was offset by the slowdown in exports, which have been affected by the downturn in sales in emerging markets. Cyclical indicators point to a continuation of moderate growth in the remaining months of the year. However, threats to expansion can be perceived looking forward. A number of signals have emerged since the summer in Germany (the slowdown in industry, a contraction in exports and a decline in new foreign orders) suggesting that the pace of German economic growth is flagging, held back in part by the uncertainty about the impact of the Volkswagen scandal (the company's new car registrations fell in October). A possible slowdown in German automobile production could affect the Italian parts and components industry, given the close integration between the two systems that has developed in recent years. In view of recent developments and the poor results achieved in the effort to revive euro-area inflation, the European Central Bank is considering the possibility of expanding its programme of purchasing government and corporate securities initiated last March and, if necessary, to further lower the interest rate on bank deposits with the Eurosystem, which is already negative (-0.2 per cent).

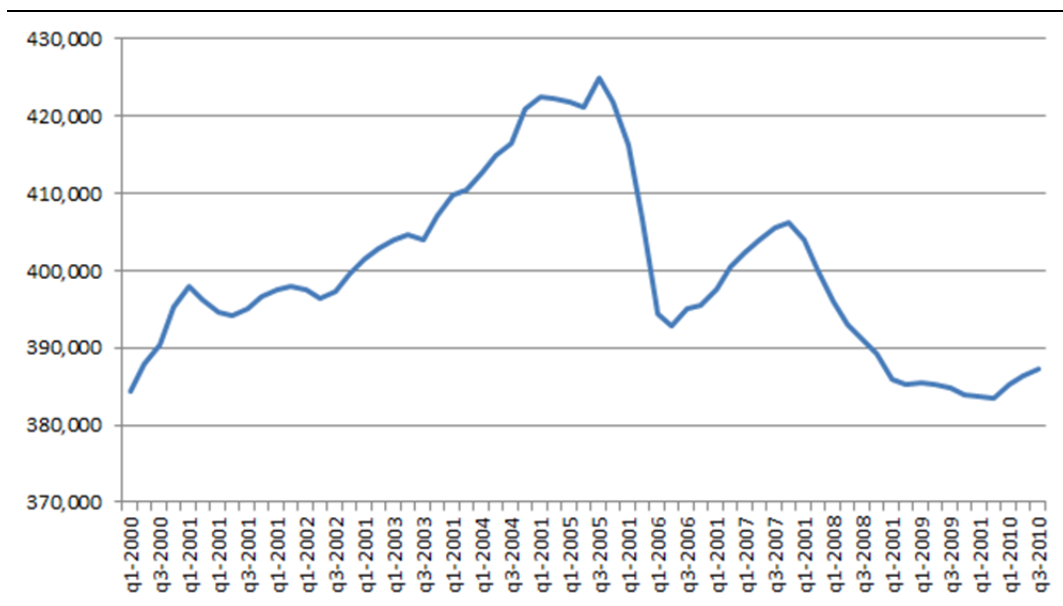
The projections of international forecasters in October and November partly incorporate these risks for the euro area, remaining essentially unchanged compared with the forecasts issued six months earlier with regard to growth in 2015 (+1.5/+1.6 per cent) and decreasing for 2016 (one tenth of a point, to 1.8 and 1.6 per cent, respectively, for the European Commission and the IMF, and three tenths of a point, to 1.8 per cent, for the OECD).

## **1.2 The Italian economy**

In Italy, economic activity remains on a path of moderate recovery (Figure 1.1). After accelerating in the first two quarters of this year (+0.4 and +0.3 per cent, respectively), the rate of expansion slowed in the third (+0.2 per cent), similar to developments in the euro area. Preliminary Istat data show increases in value added in the main productive sectors (industry, services and agriculture). On the demand side, GDP growth has been driven by internal components (gross of inventories), while net exports made a negative contribution.

According to the most recent data, in the third quarter household consumption expenditure continued the moderate expansion seen in the spring. Consumers have benefited from the gains in purchasing power generated by low inflation and the improvement in the labour market. Household confidence has continued to increase, rising in October to just below the level registered at the end of 2001.

**Figure 1.1** – Gross domestic product  
(millions of euros, chained-linked data; reference year = 2010; seasonally adjusted)



Source: Istat.

The pronounced volatility in expenditure on capital goods (machinery, equipment and transport equipment), together with the still unfavourable conditions in construction, contained the contribution of gross fixed investment to economic growth. The most recent indicators are on the whole consistent with a modest increase in spending on capital goods. In the third quarter, the capacity utilization rate in the capital goods sector was stable at the high levels recorded in the previous three months (77.8 per cent). Expectations of a recovery in production levels sustained business confidence. The weakening of the outlook for foreign demand could dampen investment spending.

In the first half of the year, exports benefited from the depreciation of the euro and the shift in geographical emphasis to the growing markets of North America and Europe. This trend has weakened in the third quarter, due to the deceleration of the emerging countries. Based on foreign trade data in value terms, Italian sales abroad were down 2.3 per cent on the previous quarter, mainly reflecting the sharp drop in exports to markets outside the European Union. Given prices developments for exports of industrial goods (-0.8 per cent), the evolution in foreign trade in value terms reflects a contraction in export volumes in the third quarter.

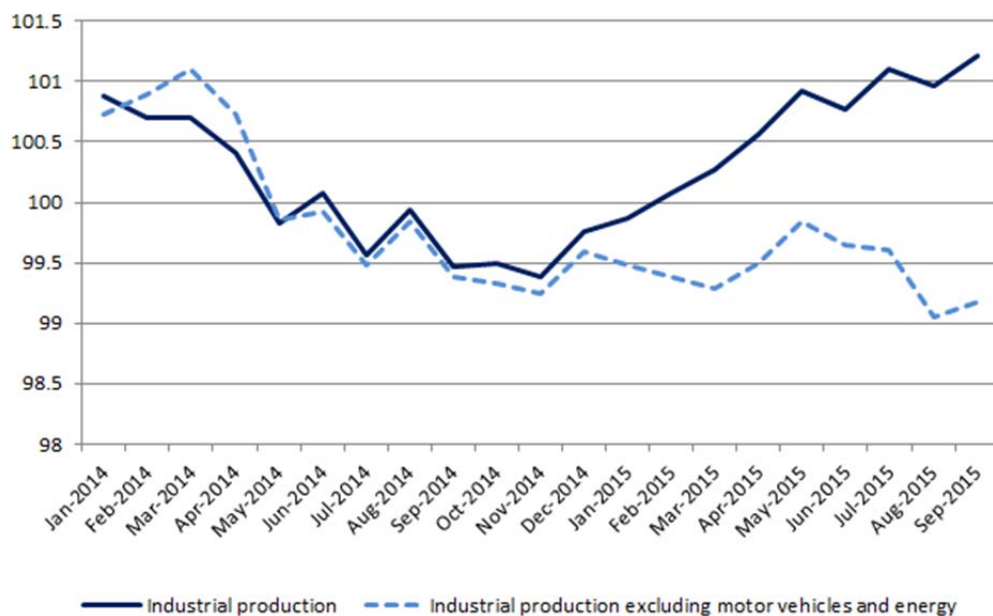
At the sector level, data for the third quarter show a continuation of the moderate recovery. The index of industrial production posted a modest rise in September (+0.2 per cent), partially offsetting the fall in August. On average for the quarter, industrial activity (excluding construction) expanded by 0.4 per cent, a pace similar to that in the previous quarter. The intensity of the recovery is still modest, held back by differences in the strength with which the recovery has spread to the main industrial segments. In the first nine months of the year, the general index increased by 0.7 per cent compared with the same period of 2014. This performance was largely supported by the production of

capital goods, especially transport equipment, and to a lesser extent by energy goods (Figure 1.2). By contrast, the consumer goods sector made no contribution, while that of the intermediate goods segment was negative. In the short term, expectations of industry operators are consistent with a continuation of growth at its current pace.

Activity in the construction industry remains weak. Output contracted in September (-0.3 per cent), following on from the stagnation of August and the temporary upturn in July. On average in the third quarter, activity declined by 0.4 per cent compared with the previous quarter (2.2 per cent on average in the first nine months compared with the same period of 2014). Recent qualitative surveys paint a less unfavourable picture for the sector. The climate of business confidence improved thanks to more positive assessments of demand conditions and the outlook for employment. The easing of strains in the credit market has also fostered a recovery in the residential housing sector. According to the Housing Market Survey of the Bank of Italy, the proportion of real estate agents reporting a fall in house prices declined further. In summary, these developments appear to delineate a gradual end to contraction in the sector.

The recovery in output in the services sector appears to be strengthening, reflecting the improvement in domestic demand, especially in consumption. In the third quarter, retail sales continued to expand moderately (+0.2 per cent compared with the previous quarter). Confirming the ongoing improvement, confidence also showed a marked recovery among firms in both the trade and business services segments.

**Figure 1.2** – Overall industrial production and excluding leading sectors  
(2014 = 100; quarterly moving averages of seasonally-adjusted monthly data)



Source: Based on Istat data.

Taken together, these trends are consistent with a continuation of economic growth in the final quarter of the year at the same pace as or slightly faster rate than that observed in the third. On average in 2015, these developments would produce GDP growth (seasonally adjusted and corrected for differences in the number of business days) of 0.7 per cent for the year. Taking account of the fact that 2015 has three more working days than 2014, unadjusted GDP (ignoring calendar differences) could expand by 0.8 per cent.

In October, consumer prices rose slightly (+0.3 per cent, after slowing in September) due to increases of the prices of unprocessed food products and certain services. Excluding energy and fresh food products, the year-on-year increase in the harmonized index remained at the same level as the previous month (+0.8 per cent). Overall, upward pressures on consumer prices appear weak and are limited to a relatively small share of goods and services. Within the basket of elementary items of the HICP, the proportion accounted for by items showing a decrease in price in September was about one third. The proportion of goods and services experiencing very low inflation (below 0.5 per cent) included nearly half of total items, while nearly two-thirds of items showed year-on-year price increases of less than 1 per cent. Looking ahead to the coming months, inflation is expected to remain very low, albeit with a higher likelihood of increases, as a result of a comparison with a period in 2014 marked by a reduction in energy prices. Firms' expectations, as drawn from Istat surveys, point to stagnation in sales price formation in the coming months. Consumer surveys also reveal especially low inflation expectations.

In 2015, the labour market has responded swiftly to developments in cyclical conditions. The increase in the number of employed has outpaced growth in the economy on average. According to the Labour Force Survey, in the third quarter overall net employment increased by 0.5 per cent over the previous period (+0.9 per cent in the first nine months of the year), despite the decline in September (-0.2 per cent). The increase in employment in the third quarter was entirely attributable to growth in payroll employees (+0.7 per cent), characterized by a recovery in permanent hiring (+0.2 per cent) and an even faster rise in fixed-term employment (+3.8 per cent). Among other indicators, the improvement in the demand for labour is confirmed by the job vacancy rate (in the third quarter, it remained at the level of the previous quarter). Against this background, the unemployment rate declined from the peaks reached in late 2014, falling to 11.8 per cent in September (11.9 per cent on average in the third quarter), a trend fostered by an increase in the inactive population. According firms' assessments, developments in labour demand are expected to improve further in the short term, especially in manufacturing, construction and retail trade.

## **1.3 Macroeconomic forecasts**

### **1.3.1 The Government's scenario**

The macroeconomic scenario of the DBP confirms, with some marginal differences, the policy scenario in the Update to the EFD: GDP is expected to grow by 0.9 per cent this year and 1.6 per cent in 2016.

The forecast for 2015 implies economic growth in the third and fourth quarters in line with that observed in the first half of the year (0.3-0.4 per cent). As we have seen, the recent preliminary estimate by Istat for July-September (+0.2 per cent) is below this level. Taking account of expectations for the fourth quarter, average economic growth in 2015 could be marginally lower than the DBP forecast. In the Government's scenario, GDP for 2015 is driven by stronger consumption and investment, and stockbuilding. These developments more than offset the negative contribution of net external demand, which is affected by import growth outpacing exports. Overall, the trends in the components of demand set out in DBP for 2015 are in line with ongoing developments in the economy.

As for 2016, bearing in mind the trend forecast in the Update to the EFD (+1.3 per cent), the DBP scenario continues to reflect the expected positive impact of public finance measures of three-tenths of a point, reflecting the further strengthening final domestic demand. A comparison of the policy assumptions in the DBP with those in the trend scenario of the Update shows that household expenditure benefits from the increase in real disposable income, thanks in part to lower inflation as a result of the deactivation of the safeguard clauses. Investment is buoyed by the improvement in the overall economic outlook and the stimulus measures for firms contained in the budget measures. The DBP's inflation forecast, although half a point lower than the trend forecast, shows an acceleration: the deflators of GDP and household consumption rise by 1 per cent. Labour market conditions are expected to continue to improve in 2016.

The DBP also provides forecasts for real and nominal GDP growth in 2017-19, confirming the policy projections contained in the Update to the EFD. GDP is expected to increase in real terms by 1.6 per cent in 2017 (three-tenths faster than the trend scenario in the Update), 1.5 per cent in 2018 (two-tenths faster) and 1.3 per cent in 2019 (one-tenth faster). Nominal GDP increases by 3.3 per cent in 2017 (three-tenths faster), 3.4 per cent in 2018 (four-tenths faster) and 3.1 per cent in 2019 (three-tenths faster). According to the Update (the DBP does not break out the components of demand for 2017-19), the faster policy growth continues to be driven by the more favourable performance of the components of final domestic demand, while the contribution of net foreign demand turns negative in the last two years. The policy growth in nominal GDP strengthens as a result of faster real growth and higher inflationary pressures generated by the more robust economic conditions. These developments have a positive impact on the labour market, with the unemployment rate falling to 10 per cent in the last year of the scenario period.

### **1.3.2 The validation procedure and estimated impact of the budget measures**

On September 16 this year the PBO validated the macroeconomic trend scenario for 2015-16 published in the Update on 18 September. Subsequently, on September 25, the PBO validated the policy forecasts for 2015 and 2016 published in the same document. As noted, the forecasts in the Update were, with only marginal changes, confirmed by the Government after the approval on October 15 of the 2016 Stability Bill by the Council of Ministers and included in the DBP submitted to the European Commission.

The validation of the 2015-16 policy scenario presented in the Update was based on assumptions concerning possible budget measures, the broad outlines of which were drawn from the information available in that document and through dialogue with the Ministry for the Economy and Finance (MEF). The PBO then replicated the validation exercise on the basis of the actual composition of the budget as set out in the Stability Bill. This is only available for the 2016-18 period. The exercise was conducted in the same manner as that used for the Update, i.e. on the basis of a comparison with the scenarios produced by the PBO panel forecasters (CER, Prometeia, REF and the PBO forecasts using the Istat model) obtained, to ensure consistency of comparison, by adopting the assumptions for international exogenous variables used for the DBP forecasts.

The findings of the exercise confirm the conclusions reached for the policy scenario of the Update. Growth forecasts for 2015-16, the years covered by the validation, lie within the range produced by the PBO panel, although those for 2016 were at the upper end of that range (Figure 1.3). The projections for 2017 and 2018 (it was not possible to assess those for 2019 due to a lack of information on the budget measures) fall outside the range of PBO panel. More specifically, the GDP growth assumed in the DBP is four-tenths of a point higher than the average of the panel forecasters in both 2017 and 2018. If we exclude the panel forecaster with the highest projection (which is still lower than that used by the Government), the difference between the DBP and the remaining three forecasters amounts to 0.5 points in 2017 and 2018.

Considering the details of the macroeconomic policy scenario as described in the Update, the divergence is essentially attributable to the Government's more optimistic forecast, compared with the PBO panel, for growth in consumption and gross fixed capital formation.

To complete the assessment of the macroeconomic situation of the Government, the PBO carried out a review of the effects of the budget measures using Istat's annual econometric model. The quantification of the impact is measured with respect to a trend scenario where no budget measures are taken. For facilitate understanding, the measures were classified into three main categories: measures for households, measures for firms and measures for financial coverage (Table 1.3).

The recovery in output in the services sector appears to be strengthening, reflecting the improvement in domestic demand, especially in consumption. In the third quarter, retail sales continued to expand moderately (+0.2 per cent compared with the previous quarter). Confirming the ongoing improvement, confidence also showed a marked recovery among firms in both the trade and business services segments.

The primary economic policy measures intended to support households include interventions to impact the real disposable income of consumers. These include the reduction of household income taxes through the adjustment of tax brackets, the cancellation of the tax on primary residences, an increase in social services benefits and the deactivation of the safeguard clauses and the reduction in excise taxes. The combination of these measures produces an expansionary effect on GDP of 0.1 percentage points in 2016, 0.3 points in 2017 and 0.1 points in 2018. In 2016 and 2017, more than 50 per cent of the stimulus for households compared with the trend scenario is due to the deactivation of the safeguard clauses.

**Figure 1.3** – Comparison of the forecasting scenarios of the Government and the PBO panel



**Table 1.3** – Impact on GDP of budget measures provided for in the 2016 Stability Bill (difference in percentage points against trend scenario without budget measures)

|   | 2016         | 2017         | 2018         |
|---|--------------|--------------|--------------|
| Measures for households   | 0.12         | 0.292        | 0.12         |
| - Reduction in taxes  | 0.057        | 0.141        | 0.08         |
| - Deactivation of safeguard clauses and reduction in excise taxes | 0.063        | 0.151        | 0.04         |
| Measures for firms  | 0.008        | 0.029        | 0.034        |
| Measures for financial coverage                                   | -0.081       | -0.057       | -0.035       |
| <b>Total impact of budget measures</b>                            | <b>0.055</b> | <b>0.263</b> | <b>0.119</b> |

The measures in favour of firms include the reduction in the rate of corporate income tax (Ires) from 2017, the expansion of deductions from the tax base for IRAP (regional business tax), the abolition of municipal property tax for agricultural land and so-called “immovable” machinery, and the extension of contribution relief for permanent hiring. The measures to assist firms would have a greater impact in 2017 and 2018, leading to greater GDP growth of three-hundredths of a percentage point in each of the two years.

The expansionary effect of these measures would be attenuated by the measures for financial coverage (in particular, the reduction in the intermediate consumption expenditure of general government and in public investment), equal to about 0.1 percentage points in 2016 and in 2017, and marginally less in 2018.

Taken together, the increase in GDP growth would amount to about 0.1 percentage points in 2016, 0.3 points in 2017 and 0.1 points in 2018.

#### **1.4 The macroeconomic risks**

We have seen that the Government’s macroeconomic scenario rests on relatively optimistic assumptions about exogenous variables compared with the trends that have emerged in recent months and the projections published in October and November by international organisations. The Government’s assumptions were adopted by the PBO panel of forecasters in the validation exercise in order to ensure comparability. However, in their independent assessments, even these forecasters adopted less favourable assumptions for exogenous factors in growth and inflation compared with the Government. There are, then, elements of risk in the scenarios that should be evaluated.

The following section discusses the results of a number of simulations conducted with an international econometric model<sup>1</sup> for the two exogenous variables that seem to differ most between the Government’s assumptions and the more recent assessments of the forecasters: world trade and oil prices. In particular, we simulated the impact of: a) world trade growing by 1 percentage point less in 2016 and 0.5 percentage points less in 2017; b) oil prices that, reflecting the developments in prices of futures contracts at the end of November, are set at \$48 a barrel in 2016 (-11 per cent compared with the baseline forecast), \$54 in 2017 (-9 per cent), \$57 in 2018 (-8 per cent) and \$59 in 2019 (-7.5 per cent). The variation in each exogenous variable is simulated *ceteris paribus*, i.e. assuming that the other variable remains at its benchmark value.

The results of the PBO exercise (Table 1.4) show, with regard to real GDP growth: a) the negative impact of slower world demand growth in 2016 and 2017; and b) the

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<sup>1</sup> The Oxford econometric model.



positive impact in 2017 of lower oil prices compared with the assumptions in the trend scenario.

However, observing the impact on growth is not sufficient. In the current environment, considering the impact on inflation (the GDP deflator) and, consequently, on nominal GDP growth is also especially important, given the risks, in the current monetary policy conditions, of a decline in inflation for economies that need to reduce their public or private debt burdens.

The results of the simulations underscore the following points.

- 1) slower global trade growth (simulation 1) in the next two years would be accompanied by lower inflation as from 2017. These effects, together with the negative impact on real GDP in 2017 and acting only in subsequent years, would lead to lower nominal GDP growth not only in 2016 (when slower real growth would exercise its impact), but also in the following period, with an average effect of two-tenths of a point.
- 2) lower oil prices (simulation 2) would result in slower growth in the GDP deflator in 2017 (which would offset the positive effect on real growth), in 2018 and, marginally, in 2019. This would produce a reduction in nominal GDP growth of about a tenth of a point in the last two years of the forecasting period.
- 3) Finally, dropping the assumption of invariance in the other variable, we considered the possibility of a slowdown in international trade accompanied by lower oil prices than those in the baseline scenario. The results, which are reported in the final part of Table 1.4, reveal the predominance of the disinflationary impact on the economy. The positive impact on real GDP of lower oil prices in 2017 would be cancelled by the negative impact of slower world trade. Both shocks together (lower oil prices and slower demand growth) would induce slower growth in domestic prices over the forecasting period. Nominal GDP growth would be two-tenths of a point lower than in the baseline scenario in 2016 and 2017, four-tenths in 2018 and three-tenths in 2019.

These simulations demonstrate that a less dynamic external environment than that assumed by the Government would have a negative or, at best, no impact (thanks to lower oil prices) on real growth, but would, through the price channel, have a uniformly depressionary impact on nominal GDP growth.

**Table 1.4** – Impact on real GDP, the GDP deflator and nominal GDP of different assumptions for world trade and oil prices  
(differences in percentage points in growth rates compared with baseline scenario)

|  | 2016 | 2017 | 2018 | 2019 |
|--|------|------|------|------|
| <i>Simulation 1</i>  |      |      |      |      |
| World trade (1 p.p. lower in 2016, 0.5 p.p. lower in 2017, 0.2 p.p. lower in 2018) |      |      |      |      |
| Real GDP   | -0.2 | -0.1 | 0.0  | 0.0  |
| GDP deflator   | 0.0  | -0.1 | -0.2 | -0.3 |
| Nominal GDP  | -0.2 | -0.2 | -0.2 | -0.2 |
| <i>Simulation 2</i>  |      |      |      |      |
| Oil prices (11% lower in 2016, 9% in 2017, 8% in 2018 and 7.5% in 2019)            |      |      |      |      |
| Real GDP   | 0.0  | 0.1  | 0.0  | 0.0  |
| GDP deflator   | 0.0  | -0.1 | -0.1 | 0.0  |
| Nominal GDP  | 0.0  | 0.0  | -0.1 | -0.1 |
| <i>Simulation 3</i>  |      |      |      |      |
| World trade + oil prices   |      |      |      |      |
| Real GDP   | -0.2 | 0.0  | -0.1 | 0.0  |
| GDP deflator   | 0.0  | -0.2 | -0.3 | -0.3 |
| Nominal GDP  | -0.2 | -0.2 | -0.4 | -0.3 |

## Appendix 1.1

### Potential output and the output gap

#### *The Government's estimate in the DBP*

Estimates of potential output and the closely linked output gap (OG) play a central role in the multilateral surveillance procedure provided for in the Stability and Growth Pact of the European Union, since they are at the basis of the structural budget balance, a key indicator in specifying the level of the medium-term objective (MTO) and the adjustment path towards it. In addition, the cyclical position of the economy as estimated by the output gap also determines the magnitude of the structural public finance adjustment required for Member States that have not achieved the MTO.<sup>2</sup>

However, potential GDP, i.e. the maximum level of output that can be obtained with the full use of resources and is consistent with stable inflation, and therefore the output gap (the difference between actual and potential GDP), are unobservable aggregates and must therefore be estimated. There are various approaches to estimating these variables, essentially falling into three broad categories: 1) purely statistical methods, based on filters or main components that extract the cyclical component of output indicators (such as GDP) or indicators of the cyclical position of the economy (such as survey data); 2) methods based on the production function, which considers total factor productivity (TFP) and the allocation of production factors (labour and capital) in relation to the balance between long-term unemployment and technological progress; 3) multivariate estimation procedures, which use econometric techniques based on economic relationships (typically Okun's law and the Phillips curve).

As part of the multilateral surveillance process, the European Commission has opted for the production function approach.<sup>3</sup>

More specifically, the procedure for estimating the output gap agreed at the European level uses the index of capacity utilization (called CUBS, for Capacity Utilisation and Business Sentiment) in calculating the trend component of TFP. This variable is a composite index constructed by the European Commission by aggregating the quarterly and monthly data generated by Istat surveys of the various sectors (industry, construction and services), with appropriate weights and rescaling the value against the average.<sup>4</sup> The output gap in the Update to the EFD was estimated without considering the final data for production capacity for the current year, because in September the European Commission had not yet updated the CUBS index on the basis of the new Istat

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<sup>2</sup> Communication from the Commission to the European Parliament [...] - "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact", Strasburg 13 January 2015.

<sup>3</sup> DG Ecofin, "The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps", Economic Papers 535, November 2014.

<sup>4</sup> The index is calculated as the deviation from the mean (and divided by the mean itself) so that it is equal to zero when capacity utilisation is equal to the long-term average.

series.<sup>5</sup> The Government therefore extrapolated the value for production capacity in 2015 using statistical techniques agreed at the EU level.

However, subsequent to the presentation of the Update, the capacity utilization data for the second half were published, enabling an estimation of capacity utilization for the entire year.<sup>6</sup> In particular, considering that the survey data were better than expected for the current year, the CUBS indicator is now significantly higher than estimated at the time of the Update. Using only this variable as an indicator of the cyclical component of TFP, as agreed at the European level, we obtain a lower estimate (in absolute value) for total factor productivity than previously calculated for both the past few years and for the forecasting period. This ultimately results in an output gap that would narrow more quickly.

Partly in order to preserve historical developments in the trend and cyclical components of TFP and to limit revisions of that data, in the Stability Bill the Government revises the initialization parameters for the model (priors) for their estimation, virtually eliminating the impact of the 2015 CUBS figure on the estimation of potential output and the output gap.<sup>7</sup>

### ***Sensitivity of the estimate of the output gap to CUBS, priors and forecast***

The above considerations point to the considerable sensitivity of potential output and the output gap to even small changes in the parameters and variables involved in the estimation. This sensitivity casts doubt on a key indicator (the output gap) on which the calculation of structural budget balances and, therefore, the country's fiscal policy decisions, depend.

More specifically, recent applications have shown how the estimation procedure for potential output is especially sensitive to the values of the CUBS index or, more precisely, to the addition of even a single datum for the indicator. If one gave total credit to the signal that comes from this variable and the impact it has on potential output, the Italian economic situation would look radically improved compared with expectations in the spring, and in line with the phase of the cycle observed in Italy on the cusp of the financial crisis, which is not yet fully reflected in the quantitative data.

However, other elements contribute to the revision of the estimates of the output gap compared with the values calculated in the spring.

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<sup>5</sup> In March 2015, Istat revised its business confidence survey, updating the base year from 2005 to 2010.

<sup>6</sup> Bear in mind, however, that there is a mismatch in the timing of the attribution of survey data between Istat and the European Commission. The quarterly data on capacity utilization are collected in January, April, July and October. Istat attributes the data so collected to the quarter ending in the month prior to the observation (for example, the utilisation rate measured in October is attributed to the third quarter. By contrast, the Commission attributes the data to the quarter under way (i.e. the October data are attributed to the fourth quarter).

<sup>7</sup> For a discussion of the sensitivity of the output gap estimates to assumptions about initialization parameters, see Fioramanti., Padriani, F. and Pollastri, C. (2015), "*La stima del PIL potenziale e dell'output gap: analisi di alcune criticità*", Ufficio parlamentare di bilancio, Nota di lavoro n. 1.

For illustrative purposes, beginning with the estimates of the Economic and Finance Document published in the spring, a simulation was carried out (Table A1.1.1) to evaluate the sensitivity of the output gap to three factors: 1) the new macroeconomic scenario through 2019; 2) data on production capacity for 2015;<sup>8</sup> 3) the initialization parameters of the TFP model. The results shown in the table below demonstrate that the new policy macroeconomic scenario (the second column of the table) does not fundamentally change the spring estimates. By contrast, however, the introduction of the CUBS figure for 2015 (third column) has a significant impact, making the output gap progressively less negative, bringing forward elimination of the gap by at least one year. The Government's decision to modify the priors of the TFP estimation model (fourth column) returns the values for the output gap to levels similar to those in the Update for the forecasting period, but also produces a revision of historical values. The fifth column shows the estimates in the Stability Bill obtained adopting the same assumptions as those in the fourth column for CUBS and priors, but using the macroeconomic scenario set out in the Stability Bill, i.e. including the revisions of national accounts data published by Istat on 23 September 2015.

The choice of priors is therefore important to the result and must be defined in accordance with the assumptions of the macroeconomic scenario. However, if these are the consequences, we should also reconsider using a single indicator, and one based on survey data at that (i.e. measured on the basis of the perception of firms of the capacity utilization rate), in the estimation of total factor productivity.

**Table A1.1.1** –Factors involved in the revision of the estimate of the output gap between the EFD and the Stability Bill

|      | EFD  | QM Update | QM Update +<br>CUBS 2015 | QM Update +<br>CUBS 2015 +<br>new priors<br>MEF | Stability Bill |
|------|------|-----------|--------------------------|---|----------------|
| 2010 | -    | -2.2      | -2.2                     | -2.4  | -              |
| 2011 | -    | -1.8      | -1.7                     | -2  | -              |
| 2012 | -    | -3.8      | -3.6                     | -3.9  | -              |
| 2013 | -4.7 | -4.8      | -4.7                     | -5.1  | -              |
| 2014 | -4.6 | -4.8      | -4.5                     | -5.1  | -              |
| 2015 | -3.8 | -4        | -3.5                     | -4.2  | -4             |
| 2016 | -2.5 | -2.5      | -1.9                     | -2.6  | -2.5           |
| 2017 | -1.3 | -1.3      | -0.6                     | -1.3  | -1.2           |
| 2018 | -0.3 | -0.2      | 0.5                      | -0.2  | -0.2           |
| 2019 | 0.5  | 0.5       | 1.3                      | 0.6   | 0.5            |

Source: based on data from the Ministry for the Economy and Finance.

<sup>8</sup> The simulations use the CUBS indicator consistent with the timing of the presentation of the Stability Bill (15 October 2015) and therefore including the figures for production capacity for only the first three quarters of the year (the Istat release completing 2015 was published on 28 October).

## ***Results differ depending on estimation methods***

In addition to the above, it should be noted that the production function method used by the European Commission is only one of the possible choices for estimating the output gap. The literature has long focused on the problems associated with measuring the gap between actual and potential output without reaching a definitive conclusion, since the peculiar non-observability of potential output introduces the inevitable complication of not being able to assess which method is the best estimation approach by calculating the difference between the estimated and observed values.

The fact is that the leading international institutions provide different values for the gap, offering very different pictures of cyclical conditions in the Italian economy (Table A1.1.2). Moreover, in the current economic situation, stressing the favourable signal from the surveys and using, for instance, a calculation method based on the extraction of the underlying component of the economy from cyclical indicators, as the United Kingdom's Office for Budget Responsibility (OBR) does to measure the output gap, the would gap close as early as 2015 (see the last column of Table A1.1.2).<sup>9</sup>

The fiscal policy consequences of one result rather than another are not irrelevant. For example, take the fact that given the OECD estimates the structural budget balance (i.e. the MTO) would have already been achieved by Italy in 2014. Given this variety of results, it appears advisable to use a set of different models rather than a single method, so as to build a range of variability of estimates that gives a measure of the uncertainty of the measurement, as some authors suggest<sup>10</sup> and is in fact done in Britain by the OBR to assess fiscal policy.

The European Commission<sup>11</sup> has itself identified minimizing revisions to the estimated series as a feature to be considered in selecting the measurement method. While this is an acceptable approach, we must not forget that it does not consider whether the method is or is not correct, and is therefore risky. If the measurement was distorted in one direction or another, an absence of revisions would mean a persistent positive or negative error.

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<sup>9</sup> Following the example of the OBR, the cyclical component of the economy was calculated on the basis of the first main component extracted from the Istat survey data (including sector data on the climate of confidence, employment expectations, capacity utilisation and price expectations) re-based with respect to the mean and variance of the OECD series for the output gap. See Murray, J. (2014), *"Output gap measurement: judgement and uncertainty"*, OBR Working Paper no. 5.

<sup>10</sup> See Bassanetti, A., Caivano, M. and Locarno, A. (2010), *"Modelling Italian potential output and the output gap"*, Bank of Italy Working Papers, September.

<sup>11</sup> European Commission (2015), *"Quarterly Report on the Euro Area"*, Institutional paper n. 101, October.

**Table A1.1.2** – Estimated output gap using various methodologies

|      | IMF  | OECD | EC   | MEF (DPB) | Statistical method |
|------|------|------|------|-----------|--------------------|
| 2010 | -1,4 | -2.3 | -2.2 | -2.2      | -4.9               |
| 2011 | -0,6 | -1.5 | -1.6 | -1.8      | -0.1               |
| 2012 | -3,0 | -4   | -3.3 | -3.8      | -0.2               |
| 2013 | -4,3 | -5.3 | -4.3 | -4.8      | -3.5               |
| 2014 | -4,6 | -5.5 | -4   | -4.8      | -3                 |
| 2015 | -3,9 | -4.7 | -2.9 | -4        | -1.5               |
| 2016 | -3,1 | -3.4 | -1.5 | -2.5      | -0.1               |
| 2017 | -2.4 | -2.3 | -0.2 | -1.2      |                    |
| 2018 | -1.7 |      |      | -0.2      |                    |
| 2019 | -1,2 |      |      | 0.5       |                    |

Source: IMF (World Economic Outlook, October 2015); OECD (Economic Outlook, November 2015); European Commission (European Economic Forecast, November 2015); MEF (Draft Budgetary Plan 2016, October 2015).

In addition to assessing revisions and therefore the accuracy of the calculation method, it would be appropriate to consider the economic significance of the results so obtained. More specifically, the evaluation of the phase of the economy should not be divorced from the consideration of the congruity of the estimates developed from observation, such as, for example, the fact that unemployment in Italy today is still high and inflation virtually nil. Some authors have recently advanced doubts about the ability of the EC methodology to capture the peculiarities of the Italian economic situation, especially as regards the estimation of structural unemployment (NAWRU, non-accelerating wage rate of unemployment), which is considered pro-cyclical or, more precisely, distorted in the adverse phases of the cycle.<sup>12</sup>

<sup>12</sup> See Fantacone S., Garalova P. and Milani C., “Deficit strutturali e politiche di bilancio: i limiti del modello europeo”, Rivista di Politica Economica, Jan/Mar 2015 and the discussion on Lavoce.info on the basis of the article of Cottarelli C., Giannusso F. and Porello C. “Politica di bilancio ostaggio della stima del PIL potenziale”, www.lavoce.info of 4 November 2014, with a reply from the European Commission (Mc Morrow K. and Roeger W. “Per l’Italia non è solo un problema di metodo” of 7 November 2014) and the subsequent rebuttal of the authors (of 11 November 2014).

## Appendix 1.2

### Fiscal multipliers in time of crisis

With the outbreak of the financial crisis and the adoption, above all in Europe, of public finance consolidation measures, numerous theoretical and empirical studies have brought the issue of the size of fiscal multipliers to the centre of the economic debate.

In normal conditions, the size of fiscal multipliers varies depending on the structural characteristics of an economy.<sup>13</sup> They are higher in economies that are relatively closed to imports, or those with low automatic stabilizers, with rigidities in the labour market, with fixed exchange rates (and, to an even greater extent, if participating in a monetary union), with a relatively low debt/GDP ratio, and with a government administration that is efficient in the collection of taxes and the implementation of spending programs.

The abundant empirical literature has also shown that it is possible to find heterogeneity in fiscal multipliers, not just between economies, but also within the same economic system, as cyclical conditions change. In particular, multipliers are higher in periods of recession, when the economy has spare capacity and there is less chance of crowding out private expenditure, compared with phases of cyclical recovery.<sup>14</sup>

These state dependency factors have become particularly important in this last deep recession, when they were accompanied by other conditions (in addition to the recession) that presumably produced larger-than-normal fiscal multipliers (including those that characterise normal recessions). These conditions have not been adequately considered by forecasters and policy-makers, inducing underestimation of the effects on GDP of the fiscal consolidation measures adopted during the crisis, especially in Europe.<sup>15</sup> They can be summarized in three points: a) monetary policy unable to compensate the depressionary effects of consolidation through stimulus measures, owing to the rapid convergence of nominal policy rates towards zero (liquidity trap); b) the deterioration of the functioning of the financial-banking system exacerbated liquidity constraints, so the spending decisions of broad groups of consumers and firms came to depend on current income (falling) rather than future income; and c) the economy was already in a situation of cyclical weakness, with a negative output gap, when the fiscal consolidation measures were adopted, worsening the adverse effects passing through the credit channel (if, following a fiscal correction, the output gap goes from -2 to -4 per cent, the impact on consumer and business insolvencies tends to be greater than when the output gap changes from 0 to -2 per cent). In the specific case of

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<sup>13</sup> See Batini, N., Eyraud, L. and Weber, A. (2014), "A Simple Method to Compute Fiscal Multipliers", IMF Working Paper wp/14/93, June.

<sup>14</sup> Auerbach, A.J. and Gorodnichenko, Y. (2012), "Measuring Output Responses to Fiscal Policy", American Economic Journal: Economic policy, 4(2) 1-27; Baum, A., Poplawski-Ribeiro, M., and Weber A. (2012), "Fiscal Multipliers and the State of the Economy", IMF Working Papers wp/12/286, December.

<sup>15</sup> Blanchard, O. and Leigh, D. (2013), "Growth Forecast Errors and Fiscal Multipliers", American Economic Review, vol 103, no. 3, pp. 117-20.



Europe, an additional factor was the concomitance of consolidation processes in a highly integrated area, one that was therefore especially vulnerable to the spillover effects of economic policy measures. In these circumstances, fiscal multipliers tend to exceed one, so that a consolidation (or stimulus) measure may result in a short-term decline (or increase) in economic activity that is more than proportionate to the size of the public finance correction.

An additional consideration regards the fact that the size of the multipliers differs depending on whether the exogenous impulse on GDP is imparted by an expenditure or revenue aggregate. Much of the literature shows that, under normal conditions, expenditure fiscal multipliers are larger than revenue multipliers. This difference tends to increase in a recession, because the multipliers of actual expenditure (for example, government purchases of goods and services) increase more than revenue multipliers. It follows that considering only the general multiplier (of the deficit) to assess the effects of fiscal restriction/stimulus can be misleading.<sup>16</sup>

The assessment of fiscal multipliers is of course also affected by the estimation methods (time series modelling, structural VAR models, DSGE models with nominal rigidities, forecast error analysis) and the approaches pursued in quantifying budget measures (consideration of the changes in public finance measures adjusted for the cycle or a narrative approach based on the economic policy measures actually adopted). Despite the variety of estimation methods, a meta-analysis of 98 studies published between 1992 and 2013 shows broad agreement that fiscal multipliers tend to increase significantly in periods of recession, and that this is especially true for those associated with expenditure measures.<sup>17</sup>

There is no specific evidence on changes in the size of fiscal multipliers for Italy. The 2015 EFD, taking account of the macroeconomic environment in Italy, assumes an increase in the budget multiplier, assuming a value of slightly less than one in the case of a budget correction equally distributed between revenue and expenditure measures.

The following describes a preliminary exercise to evaluate the possibility of identifying changes in fiscal multipliers in a recession in traditional structural models, which are generally used to develop macroeconomic scenarios at government agencies and research departments. The model used for this exercise was the Istat MeMo-It.<sup>18</sup> The fiscal multiplier in a multi-equation econometric model provides a summary measure of

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<sup>16</sup> Mineshima, A. and Weber, A. (2014) "*Fiscal Multipliers*", in Cottarelli, C., Gerson, P. and Sendhadji, A. (eds.), "*Post-Crisis Fiscal Policy*", Cambridge, MIT Press.

<sup>17</sup> Gechert, S., Hughes-Hallet, A. and Rannenberg, A. (2015), "*Fiscal Multipliers in Downturns and the Effects of Eurozone Consolidation*", CEPR, Policy Insight no. 79, February. Contrasting results, with lower expenditure multipliers than those associated with tax measures, are estimated in Alesina, A., Barberio, O., Favero, C., Giavazzi, F. and Paradisi, M. (2015), "*Austerity in 2009-2013*", Economic Policy 30 (83), pp. 383-347.

<sup>18</sup> For a discussion of the model, see Bacchini, F., Brandimarte, C.; Crivelli, P.; De Santis, R., Fioramanti, M., Girardi, A., Golinelli, R., Jona-Lasino, C.; Mancini, M.; Pappalardo, C., Rossi, D.; Ventura, M. and Vicarelli, C. (2013), "*Building the core of the Istat system of models for forecasting the Italian economy: MeMo-it*", Rivista di Statistica Ufficiale, no.1, pp. 27-45.

the impulse-response mechanism through the reduced form of the model, which is affected by the structural parameters.

To ensure the comparability of the results, the changes in the deficit and the individual components are normalized so as to give rise to a stimulus (positive or negative) that, ex ante, is equal to 1 per cent of nominal GDP for the initial year of the baseline scenario.

In normal operation, the Istat model is estimated for the 1970-2014 period. This means that the reduced form (used to calculate the multipliers) reflects the value of structural parameters estimated for a period that includes a preponderant phase of normal cyclical fluctuations (1970-2007), followed by the severe recession in the final part of the time series (2008-2014).

Given the brevity of the series during the crisis phase (7 years), it is not possible to estimate the structural parameters of the model and the corresponding fiscal multipliers for this sub-period. We can, however, verify whether the exclusion of the crisis years from the estimate produces different multipliers than those of the model. More specifically, we compared the fiscal multipliers obtained on the basis of estimated parameters for two distinct periods: the “normal” 1970-2007 period, excluding the crisis years, and the complete 1970-2014 period. Table A1.2.1 shows the impact multipliers (first year) for both estimation exercises.

**Table A1.2.1** – Fiscal multipliers (first year) in the Istat MeMo-It model

|                               | Multipliers based on estimation for entire 1970-2014 period | Multipliers based on estimation for 1970-2007 period |
|-------------------------------|---|--|
| Intermediate consumption      | 0.602   | 0.504  |
| Social benefits               | 0.150   | 0.112  |
| Capital expenditure           | 0.634   | 0.462  |
| - <i>Public investment</i>    | <i>0.588</i>  | <i>0.551</i>   |
| - <i>Investment grants</i>    | <i>0.743</i>  | <i>0.252</i>   |
| <b>Total expenditure</b>      | <b>0.332</b>  | <b>0.261</b>   |
| Direct taxes                  | 0.127   | 0.098  |
| - <i>Irpef</i>                | <i>0.160</i>  | <i>0.122</i>   |
| - <i>Ires</i>                 | <i>0.017</i>  | <i>0.018</i>   |
| Indirect taxes                | 0.061   | 0.042  |
| - <i>VAT</i>                  | <i>0.074</i>  | <i>0.056</i>   |
| - <i>IRAP</i>                 | <i>0.023</i>  | <i>0.002</i>   |
| Social contributions          | 0.197   | 0.156  |
| - <i>Charged to employers</i> | <i>0.221</i>  | <i>0.179</i>   |
| - <i>Charged to workers</i>   | <i>0.141</i>  | <i>0.105</i>   |
| <b>Total revenues</b>         | <b>0.138</b>  | <b>0.107</b>   |

First, the exercises appear to confirm the considerable diversity of multipliers associated with the various exogenous public finance variables: spending variables (intermediate consumption and capital expenditure, including public investment and investment grants) have larger multipliers than those for revenue and social benefits (whose multiplier is similar to that for personal income tax). Second, the multipliers for the complete period are larger than those obtained for the 1970-2007 period. This holds for both expenditure items and revenue items. The increase in the multipliers calculated for the longer time interval appears more pronounced for intermediate consumption and for capital expenditure compared with other exogenous public finance aggregates. Taken together, these preliminary results appear to show that the crisis period (after 2007) is marked by an amplification of the effects of fiscal policy on GDP in the Istat model as well.



## 2. THE PUBLIC FINANCES

### 2.1 *The public finances in 2015 and the policy scenario for the subsequent years*

The public finances in 2015 have improved on those of 2014 owing to the more favourable developments in interest expenditure. The expected improvement in net borrowing, with a reduction in both the absolute amount and as a percentage of GDP, going from €49 billion to €42.8 billion and from 3.0 per cent to 2.6 per cent of GDP (Table 2.1), is the result of a decrease in interest expenditure from 4.6 per cent to 4.3 per cent of GDP, which benefitted from the decline in interest rates as a result of quantitative easing. The primary surplus rises only slightly since both primary expenditure and overall revenue remain constant as a proportion of GDP, at 46.6 per cent and 48.2 per cent, respectively. The tax burden increased slightly from 43.6 per cent to 43.7 per cent.

This increase reflects the rise in direct taxes, the forecast for which appears to be optimistic given the virtual lack of participation in the mechanism for payments of advances on severance benefits directly in worker paycheques as provided for in the 2015 Stability Act, which was projected to generate a significant increase in taxes. Likewise, proceeds generated by social contributions could also be higher, as recent information also seems to indicate. Indirect taxes are down from 2014, owing to unfavourable developments in many of their components during the year, but could show better performance by the end of the year.

The constant level of expenditure net of interest as a proportion of GDP reflects a reduction in current expenditure (from 43 per cent to 42.6 per cent of GDP) essentially offset by an increase in expenditure on capital account (from 3.6 per cent to 3.9 per cent of GDP). The latter is the result of a number of factors: the effect the one-off payment in arrears accrued in 2012-14 in respect of the revaluation of pension benefits provided for under Decree Law 65/2015, with which the Government implemented the principles set out in Constitutional Court ruling no. 70/2015, which deemed unconstitutional the 2011 freeze on the revaluation of pensions amounting to more than three times the minimum pension; the provisions introduced following the presentation of the EFD; and the lower-than-expected proceed from real estate disposals, especially those of social security institutions.

With regard to current primary expenditure, only social security benefits increase as a percentage of GDP, mainly due to the effects of the confirmation of the €80 per month tax credit introduced in 2014. The increase is more than offset by the expected reductions in other expenditure components, in particular in intermediate consumption, which the Government forecasts will also decrease in absolute terms. The 2015 budget measures for the healthcare sector classified under immediate consumption could generate lower savings than forecast since the details of the measures to be adopted were only determined over the summer<sup>19</sup> and a number of the measures require a relatively long implementation period. However certain regions may have begun to implement the measures early in the year, specifically following the State-Regions agreement of 26 February 2015 establishing the amount of the cuts to healthcare. In the accounts published by ISTAT on 1 October 2015 for the first half of the year, intermediate consumption proper (which accounts for about two thirds of intermediate consumption) rose 0.9 per cent over the same period of 2014. This development appears to confirm the less favourable than forecast results. On the other hand, compared with the Government's forecasts, investment spending could increase by a smaller amount.

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<sup>19</sup> With the 2 July 2015 Agreement between the central and regional governments and with the amendment to Decree Law 78/2015, ratified by Law 125/2015 of 6 August.

Table 2.1 – General government accounts for 2016-2018: trend scenario and policy scenario

|  | millions of euros |                  |                |             |   | TREND       |                  |                  |                  |   | POLICY           |             |              |             |                  |                  |                  |
|--|-------------------|------------------|----------------|-------------|---|-------------|------------------|------------------|------------------|---|------------------|-------------|--------------|-------------|------------------|------------------|------------------|
|  | 2014              |                  | 2015           |             | Technical Note to the 2016 Stability Bill |             |                  |                  |                  | Technical Note to the 2016 Stability Bill |                  |             |              |             |                  |                  |                  |
|  | rate of change    |                  | rate of change |             | as a percentage of GDP                    |             |                  |                  |                  | as a percentage of GDP                    |                  |             |              |             |                  |                  |                  |
|  | 2014              | 2015             | 2015           | 2016        | 2017                                      | 2018        | 2014             | 2015             | 2016             | 2017                                      | 2018             | 2016        | 2017         | 2018        | 2016             | 2017             | 2018             |
| <b>EXPENDITURE</b>                         |                   |                  |                |             |   |             |                  |                  |                  |   |                  |             |              |             |                  |                  |                  |
| Compensation of employees                  | 163,814           | 164,868          | 0.6            | 0.9         | -0.4                                      | -0.1        | 10.2             | 10.1             | 9.9              | 9.6                                       | 9.3              | 1.0         | -0.4         | -0.2        | 9.9              | 9.6              | 9.2              |
| Intermediate consumption                   | 134,153           | 129,905          | -3.2           | 1.6         | 1.5                                       | 0.9         | 8.3              | 7.9              | 7.8              | 7.7                                       | 7.6              | -0.2        | 1.5          | 0.1         | 7.7              | 7.6              | 7.3              |
| Social benefits                            | 328,304           | 335,500          | 2.2            | 1.8         | 2.3                                       | 2.5         | 20.3             | 20.5             | 20.3             | 20.2                                      | 20.1             | 1.9         | 2.4          | 2.4         | 20.4             | 20.2             | 20.0             |
| Pensions                                   | 256,902           | 258,950          | 0.8            | 1.2         | 2.4                                       | 2.8         | 15.9             | 15.8             | 15.6             | 15.5                                      | 15.5             | 1.1         | 2.4          | 2.6         | 15.6             | 15.5             | 15.3             |
| Other social benefits                      | 71,402            | 76,550           | 7.2            | 3.7         | 1.9                                       | 1.4         | 4.4              | 4.7              | 4.7              | 4.7                                       | 4.6              | 4.7         | 2.2          | 1.7         | 4.8              | 4.7              | 4.6              |
| Other current expenditure                  | 66,922            | 66,916           | 0.0            | -0.3        | -3.3                                      | 0.5         | 4.1              | 4.1              | 4.0              | 3.7                                       | 3.6              | -1.2        | -4.1         | -0.9        | 3.9              | 3.7              | 3.5              |
| <b>Current expenditure net of interest</b> | <b>693,193</b>    | <b>697,188</b>   | <b>0.6</b>     | <b>1.3</b>  | <b>1.0</b>                                | <b>1.4</b>  | <b>43.0</b>      | <b>42.6</b>      | <b>42.0</b>      | <b>41.2</b>                               | <b>40.5</b>      | <b>1.0</b>  | <b>0.9</b>   | <b>1.1</b>  | <b>41.9</b>      | <b>41.0</b>      | <b>40.1</b>      |
| Interest                                   | 75,043            | 70,031           | -6.7           | 1.9         | -0.3                                      | 1.0         | 4.6              | 4.3              | 4.2              | 4.1                                       | 4.0              | 1.9         | -0.3         | 1.0         | 4.3              | 4.1              | 4.0              |
| <b>CURRENT EXPENDITURE</b>                 | <b>768,236</b>    | <b>767,219</b>   | <b>-0.1</b>    | <b>1.4</b>  | <b>0.9</b>                                | <b>1.4</b>  | <b>47.6</b>      | <b>46.9</b>      | <b>46.2</b>      | <b>45.3</b>                               | <b>44.6</b>      | <b>1.1</b>  | <b>0.8</b>   | <b>1.1</b>  | <b>46.2</b>      | <b>45.1</b>      | <b>44.1</b>      |
| Gross fixed capital formation              | 35,678            | 37,473           | 5.0            | 2.4         | 2.5                                       | -0.2        | 2.2              | 2.3              | 2.3              | 2.3                                       | 2.2              | 0.4         | 3.4          | -0.9        | 2.2              | 2.2              | 2.2              |
| Investment grants                          | 12,936            | 15,114           | 16.8           | -2.9        | -19.0                                     | 6.3         | 0.8              | 0.9              | 0.9              | 0.7                                       | 0.7              | -5.4        | -17.6        | 6.3         | 0.9              | 0.7              | 0.7              |
| Other transfers                            | 9,776             | 11,712           | 19.8           | -18.1       | -28.2                                     | -3.1        | 0.6              | 0.7              | 0.6              | 0.4                                       | 0.4              | -18.1       | -28.2        | -3.1        | 0.6              | 0.4              | 0.4              |
| <b>CAPITAL EXPENDITURE</b>                 | <b>58,390</b>     | <b>64,299</b>    | <b>10.1</b>    | <b>-2.6</b> | <b>-7.3</b>                               | <b>0.8</b>  | <b>3.6</b>       | <b>3.9</b>       | <b>3.7</b>       | <b>3.4</b>                                | <b>3.3</b>       | <b>-4.3</b> | <b>-6.4</b>  | <b>0.3</b>  | <b>3.7</b>       | <b>3.3</b>       | <b>3.2</b>       |
| Expenditure net of interest                | 751,583           | 761,487          | 1.3            | 1.0         | 0.3                                       | 1.3         | 46.6             | 46.6             | 45.7             | 44.5                                      | 43.8             | 0.5         | 0.3          | 1.0         | 45.6             | 44.3             | 43.3             |
| <b>TOTAL EXPENDITURE</b>                   | <b>826,626</b>    | <b>831,517</b>   | <b>0.6</b>     | <b>1.1</b>  | <b>0.3</b>                                | <b>1.3</b>  | <b>51.2</b>      | <b>50.9</b>      | <b>50.0</b>      | <b>48.6</b>                               | <b>47.8</b>      | <b>0.7</b>  | <b>0.3</b>   | <b>1.0</b>  | <b>49.9</b>      | <b>48.4</b>      | <b>47.3</b>      |
| <b>REVENUE</b>                             |                   |                  |                |             |   |             |                  |                  |                  |   |                  |             |              |             |                  |                  |                  |
| Direct taxes                               | 237,567           | 248,986          | 4.8            | 2.9         | 2.2                                       | 2.2         | 14.7             | 15.2             | 15.2             | 15.1                                      | 15.0             | 2.1         | -0.5         | 1.4         | 15.2             | 14.6             | 14.3             |
| Indirect taxes                             | 247,419           | 245,588          | -0.7           | 7.7         | 5.7                                       | 3.2         | 15.3             | 15.0             | 15.7             | 16.1                                      | 16.2             | 0.1         | 8.8          | 4.0         | 14.7             | 15.4             | 15.5             |
| Social contributions                       | 216,404           | 217,901          | 0.7            | 1.4         | 2.3                                       | 3.4         | 13.4             | 13.3             | 13.1             | 13.0                                      | 13.1             | 1.3         | 1.7          | 3.7         | 13.2             | 12.9             | 13.0             |
| Other current revenue                      | 69,173            | 69,063           | -0.2           | 0.1         | 1.7                                       | 2.0         | 4.3              | 4.2              | 4.1              | 4.1                                       | 4.0              | 1.0         | 0.8          | 2.0         | 4.2              | 4.1              | 4.0              |
| <b>CURRENT REVENUE</b>                     | <b>770,563</b>    | <b>781,538</b>   | <b>1.4</b>     | <b>3.7</b>  | <b>3.3</b>                                | <b>2.8</b>  | <b>47.7</b>      | <b>47.8</b>      | <b>48.2</b>      | <b>48.3</b>                               | <b>48.3</b>      | <b>1.2</b>  | <b>3.1</b>   | <b>2.9</b>  | <b>47.1</b>      | <b>47.0</b>      | <b>46.8</b>      |
| Capital taxes                              | 1,581             | 1,979            | 25.2           | -46.0       | -10.5                                     | 0.8         | 0.1              | 0.1              | 0.1              | 0.1                                       | 0.1              | 55.0        | -68.8        | 0.8         | 0.2              | 0.1              | 0.1              |
| Non-tax capital revenue                    | 5,444             | 5,181            | -4.8           | 5.4         | -18.3                                     | -1.9        | 0.3              | 0.3              | 0.3              | 0.3                                       | 0.2              | 5.4         | -18.3        | -1.9        | 0.3              | 0.3              | 0.2              |
| <b>CAPITAL REVENUE</b>                     | <b>7,025</b>      | <b>7,160</b>     | <b>1.9</b>     | <b>-8.8</b> | <b>-17.0</b>                              | <b>-1.4</b> | <b>0.4</b>       | <b>0.4</b>       | <b>0.4</b>       | <b>0.3</b>                                | <b>0.3</b>       | <b>19.1</b> | <b>-36.5</b> | <b>-1.4</b> | <b>0.5</b>       | <b>0.3</b>       | <b>0.3</b>       |
| <b>TOTAL REVENUE</b>                       | <b>777,588</b>    | <b>788,698</b>   | <b>1.4</b>     | <b>3.6</b>  | <b>3.2</b>                                | <b>2.8</b>  | <b>48.2</b>      | <b>48.2</b>      | <b>48.6</b>      | <b>48.7</b>                               | <b>48.6</b>      | <b>1.3</b>  | <b>2.7</b>   | <b>2.9</b>  | <b>47.6</b>      | <b>47.3</b>      | <b>47.1</b>      |
| Tax burden                                 | 43.7              | 43.7             |                |             |   |             |                  |                  |                  |   |                  |             |              |             |                  |                  |                  |
| <b>PRIMARY BALANCE</b>                     | <b>26,005</b>     | <b>27,211</b>    |                |             |   |             | <b>1.6</b>       | <b>1.7</b>       | <b>2.9</b>       | <b>4.1</b>                                | <b>4.8</b>       |             |              |             | <b>2.0</b>       | <b>3.0</b>       | <b>3.8</b>       |
| <b>NET BORROWING</b>                       | <b>-49,038</b>    | <b>-42,820</b>   |                |             |   |             | <b>-3.0</b>      | <b>-2.6</b>      | <b>-1.4</b>      | <b>0.0</b>                                | <b>0.7</b>       |             |              |             | <b>-2.2</b>      | <b>-1.1</b>      | <b>-0.2</b>      |
| <i>Nominal GDP (millions of euros)</i>     | <i>1,613,859</i>  | <i>1,635,144</i> |                |             |   |             | <i>1,681,893</i> | <i>1,732,988</i> | <i>1,784,568</i> | <i>1,838,144</i>                          | <i>1,894,712</i> |             |              |             | <i>1,678,566</i> | <i>1,734,508</i> | <i>1,792,769</i> |

Source: based on data in the Technical Note attached to the 2016 Stability Bill.

For the subsequent years, the policy scenario in the DBP confirmed the more gradual adjustment of the public finances contained in the Update to the EFD than that envisaged in the EFD itself last April. The adoption of this approach is associated with the Government's desire to use the flexibility allowed under European legislation, for which the DBP illustrates the content of the additional measures beyond that already requested on the occasion of the presentation of the EFD.

The achievement of the MTO, i.e. structural budget balance, has therefore been postponed to 2018. Consistent with this decision, the nominal general government budget balance – in which year-on-year deficits would gradually decline from 3 per cent of GDP in 2014 to balance in 2017, followed by a surplus of 1 per cent of GDP in 2019 – resulting from the budget measures contained in the Stability Bill improves more gradually and is forecast to move into surplus only at the end of the planning period (equal to 0.3 per cent of GDP in 2019)

Compared with the objectives of the EFD, the budget measures reinforce the Government's intention to support the economy by reducing the tax burden. However, the measures modifying taxes are now offset to a lesser extent by expenditure cuts from the spending review (slipping from the 0.6 per cent of GDP envisaged in the EFD to 0.4 per cent in 2016, 0.5 per cent in 2017 and 0.6 per cent in 2018,<sup>20</sup> but with lower net expenditure equal to 0.2-0.3 per cent of GDP), and no measures to rationalise tax expenditures have been introduced (Table 2.2).

As a result, a larger proportion of the reduction in the tax burden is now financed by allowing the balance to worsen by about an additional 0.5 per cent of GDP per year compared with the EFD (Table 2.3). The goal of the Government's strategy is to "shield" the start of the recovery in a period in which external conditions appear to be worsening and could deteriorate further.

**Table 2.2** – Budget proposals in 2015 EFD  
(percentage of GDP)

|                                   | 2016 | 2017 | 2018 |
|-----------------------------------|------|------|------|
| Deactivation of safeguard clauses | -1.0 | -1.2 | -1.2 |
| Spending review                   | -0.6 | -0.6 | -0.6 |
| Deterioration in balance          | -0.4 | -0.6 | -0.5 |

Source: based on data from the EFD.

<sup>20</sup> In the amount, respectively, of €7.3 billion, €8.4 billion and €10 billion, as set out in the Technical Note attached to the 2016 Stability Bill, as net effects that take account of contributions, withholdings and other charged to employers generated by a number of measures.

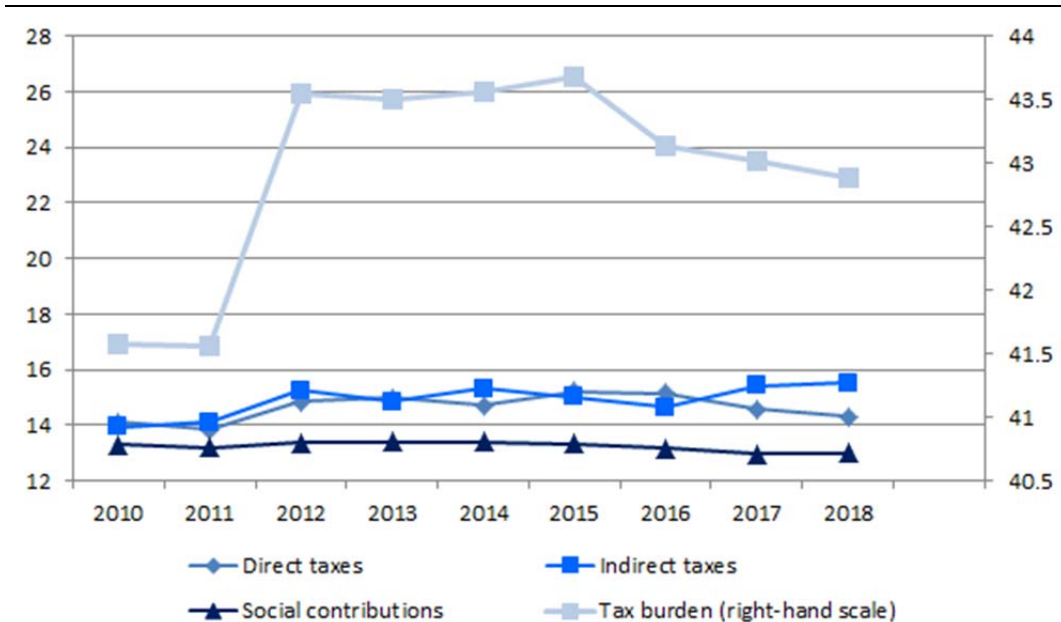
**Table 2.3** – Breakdown of impact of 2016 Stability Bill  
(percentage of GDP)

|                                   | 2016 | 2017 | 2018 |
|-----------------------------------|------|------|------|
| Deactivation of safeguard clauses | -1.0 | -0.6 | -0.5 |
| Other revenue cuts                | -0.4 | -0.9 | -0.9 |
| Revenue increases                 | 0.3  | 0.3  | 0.2  |
| Net revenue reductions            | -1.1 | -1.3 | -1.2 |
| Net expenditure reductions        | -0.2 | -0.2 | -0.3 |
| Deterioration in balance          | -0.9 | -1.1 | -0.9 |

Source: based on data from the financial schedules attached to the 2016 Stability Bill.

The primary surplus in 2016 is expected to rise to 2 per cent of GDP, to then continue to increase up to the 3.8 per cent forecast for 2018 and necessary to achieve the MTO. Compared with 2015, the growth in the primary surplus of around 2.2 percentage points of GDP arises from a 3.3 percentage point of GDP reduction in primary expenditure offset by a decline of 1.1 points in revenue. The tax burden is forecast to decline by a lesser extent, 0.8 points, to 42.9 per cent of GDP in 2018, reflecting, on the one hand, the reduction in direct taxes as a percentage of GDP (due in large part to measures affecting Ires (corporate income tax)) and a smaller decline in social contributions (for contribution relief measures to encourage the hiring of employees with permanent contracts) and, on the other, an increase in indirect taxes due to the VAT rate increases that have been retained in the safeguard clause as from 2017 (Figure 2.1).

**Figure 2.1** – The tax burden and its main components – Policy scenario figures  
(percentage of GDP)



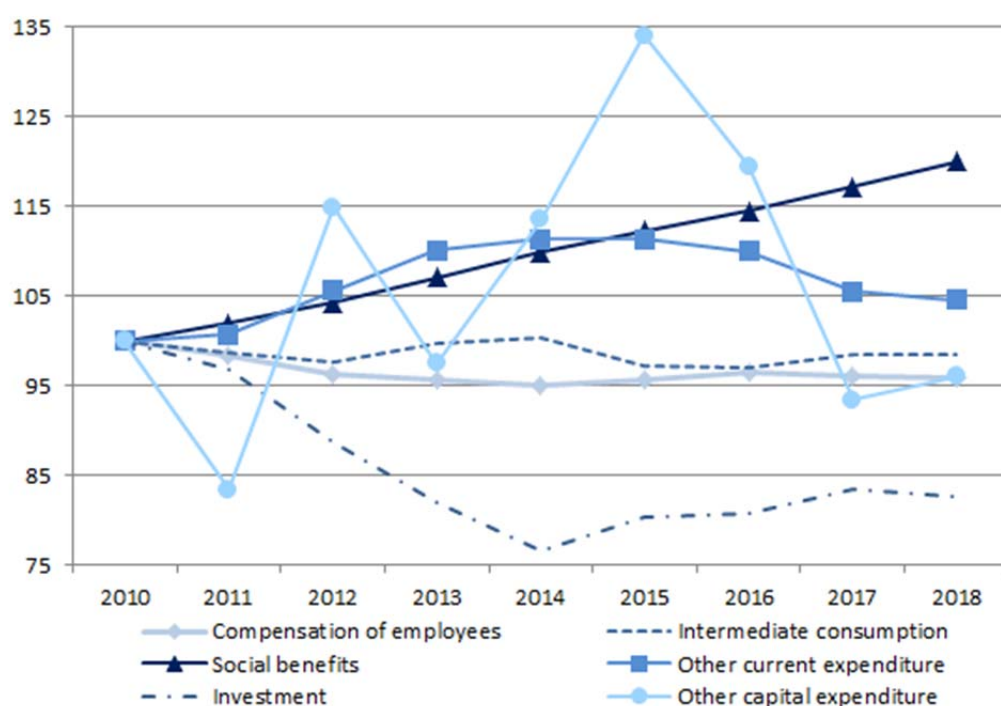
Source: based on data from the financial schedules attached to the 2016 Stability Bill.



The decrease in primary expenditure as a percentage of GDP from 2015 to 2018 is attributable in large part to current expenditure (-2.6 percentage points of GDP) and to a lesser extent to capital expenditure (-0.7 points). All the components are expected to decline as a percentage of GDP, particularly compensation of employees and intermediate consumption. In examining the dynamics in absolute terms (Figure 2.2), these two spending items should essentially remain stable between 2016 and 2018: the former due to the limited resources allocated for the renewal of contracts for public-sector employees and the continuing limitations on turnover and the variable component of compensation; the latter as a result of repeated measures impacting intermediate consumption, including the healthcare measures in the 2016 Stability Bill, generally borne by the regional governments. The effort required of the regional governments is also expected to have an effect on developments in other current expenditure, which is forecast to decline in absolute terms starting in 2015.

Investments are expected to increase slightly, given the positive current-legislation baseline, due among other things to the easing of the objectives of the Domestic Stability Pact provided for by the 2014 Stability Act, which nonetheless is limited – despite the greater latitude given to local governments – by the effects of the spending cuts in the 2016 Stability Bill. The greatest rise is forecast for social benefits, which are rising structurally and are being increased with the Stability Bill measures to combat poverty and social exclusion. However, the pension component will be contained specifically starting from 2018 as a result of measures limiting the indexing of pensions more than three times the minimum pension benefit.

**Figure 2.2** – Components of primary expenditure – Policy scenario figures  
(cumulative growth; 2010=100)



Source: based on data from the financial schedules attached to the 2016 Stability Bill.

The developments in other capital expenditure are more irregular, peaking in 2015 owing to considerable expenditure on measures for persons impacted by natural disasters in recent years and the one-off effects of payments of arrears associated with the revaluation of pensions. Subsequent years reflect the elimination of tax credits due to the change in the rules on the deductibility of loan writedowns and losses of banks and financial institutions, which can be fully deducted in the reference year, unlike under the previous system in which they could be deducted over 5 years (with the consequent generation of deferred tax assets, DTAs).

As a result of these developments, primary expenditure is expected to rise on average by 0.6 per cent from 2016 to 2018 and current expenditure net of interest by 1 per cent. This compares with an increase in the trend scenarios for the same period equal to 0.9 per cent and 1.2 per cent, respectively. The evolution in policy expenditure is in line with the average recorded over the most recent four-year period (equal respectively to 0.7 per cent and 1 per cent on average for 2011-14). However, these rates of growth are difficult to maintain over time.

The expansionary fiscal stance in 2016, although adopted to cope with what is still a relatively fragile macroeconomic environment, nevertheless presents non-negligible risks thereafter. Very briefly, the budget envisages, as from 2016, the assumption of commitments of a permanent nature that in the first year are largely funded by temporary resources: first and foremost, the budgetary flexibility permitted under European rules for that year, but also one-off sources of revenue, such as the voluntary disclosure programme. In 2017 and subsequent years, when those temporary resources are no longer available, preserving the health of the accounts would essentially be left to favourable developments in the trend scenario for the public finances.

Such favourable developments depend on two factors. The first is economic growth in line with official forecasts, which incorporate – as was pointed out earlier – higher growth rates than the consensus view. If the path of growth should remain below the Government's projections, achievement of the objectives for 2017-19 (a further reduction in the tax burden and lowering the debt/GDP ratio) would be at risk. The second factor incorporated in the trend forecasts for the public finances is, as we have seen, a substantial contribution from the safeguard clause, reflecting an increase in VAT rates.

The use of safeguard clauses to ensure the achievement of budget goals makes it difficult to discern the budget policy objectives for the years after the first. For example, consider the effects of last year's Stability Act on 2016. It provided for a net increase in expenditure of about €6.5 billion and a net reduction in revenue of similar size, offset by €13.5 billion from triggering the safeguard clauses for VAT and excise taxes (although the Government also declared its intention to deactivate the clauses in the future), thereby producing no impact on the 2016 budget balance in practice. In the Stability Bill for 2016, those clauses are deactivated for 2016, offset by an increase in the deficit, which thus essentially finances the effects on 2016 of the decisions taken in the 2015 Stability Act (Table 2.4).

**Table 2.4** – Cumulative effects for 2016 of 2015 Stability Act and 2016 Stability Bill  
(millions of euros)

| USES   |         | SOURCES                                   |         |
|--|---------|---|---------|
| Deactivation of VAT and excise tax increases 2016 Stability Bill | -13,542 | VAT and excise tax increases 2015 Stat    | 13,542  |
| Net expenditure increases 2015 Stab. Act                         | 6,838   | Net expenditure decreases 2016 Stab. Bill | -3,465  |
| Net revenue decreases 2015 Stab. Act                             | -6,557  |   |         |
| Net revenue decreases 2016 Stab. Bill                            | -4,505  | Balance                                   | -14,435 |

Source: based on data from the financial schedules attached to the 2015 Stability Act and the 2016 Stability Bill.

Similarly, the policy scenario for 2017 and 2018 is unclear. The Government could be considered to have confirmed its intention, set out in the April EFD, to deactivate the safeguard clauses for those years as well. In this case it will be necessary to find resources equal to more than 1 percentage point of GDP. However, we cannot rule out the possibility that the reduction in Ires provided for 2017 in the 2016 Stability Bill and that in Irpef (personal income tax) announced for 2018 will be financed at least in part in those years by an increase in VAT. This would essentially follow the European Commission's recommendation to shift the burden of taxation from labour and production to consumption. Which of the two options will be chosen will only be known next year, underscoring the difficulty of interpreting medium-term fiscal policy.

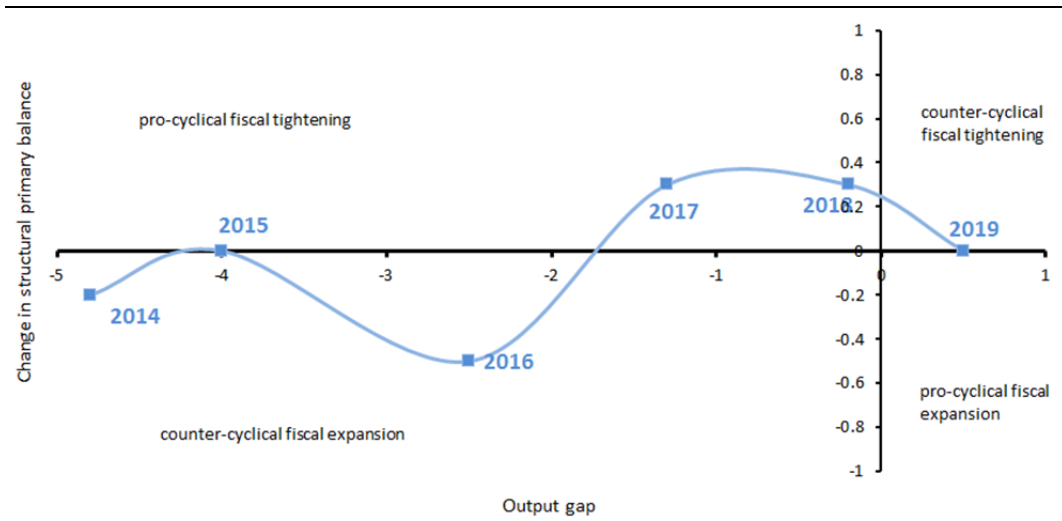
## 2.2 Analysis of the fiscal stance

By comparing developments in the structural primary balance (the primary balance adjusted for the cycle and net of one-off items) and the output gap (the gap between actual and potential GDP) it is possible to provide an immediate visualization of the fiscal stance, which represents the expansiveness or restrictiveness of the economic policy underlying macroeconomic developments.

Using the changes in the structural primary balance and the output gap for the years 2013 through 2019 as reported in the Update, we see that the albeit contained expansive and counter-cyclical budgetary policy in 2014 was not continued in 2015, but is revived again in 2016, with even greater vigour (Figure 2.3). To achieve the MTO it is assumed that the expansionary stance in 2016 is offset in 2017 and 2018, with two consecutive increases in the primary structural balance in a negative but improving cyclical phase.

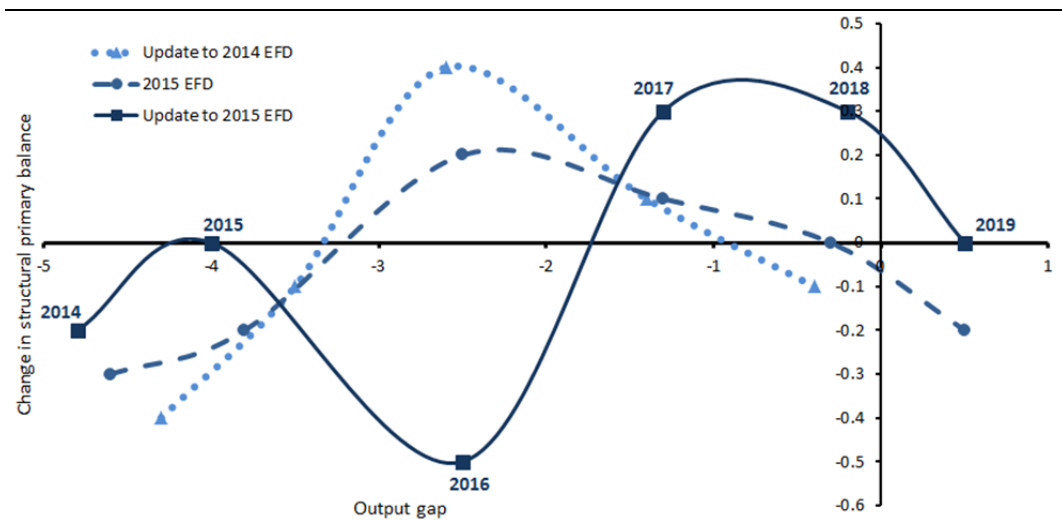
The fiscal stance set out in the Update to the 2015 EFD can be read in comparison with those in the Update to the 2014 EFD and in the 2015 EFD, so as to identify any changes in tenor over time (Figure 2.4).

**Figure 2.3** – Changes in the structural primary balance and the output gap (percentage of GDP)



Source: based on data from the Update to the 2015 EFD.

**Figure 2.4** – Changes in the structural primary balance and the output gap (percentage of GDP)



Source: based on data from the Update to the 2014 EFD, the 2015 EFD and the Update to the 2015 EFD.

In the policy scenario drawn up in the autumn of 2014, the fiscal stance was to have been restrictive by 0.4 percentage points of GDP in 2016, somewhat less restrictive in 2017, before becoming slightly expansive in 2018. In the 2015 EFD prepared in April, the tightening was to be less severe in 2016, at 0.2 percentage points, with a corresponding slower transition to a less restrictive stance. In the Update, fiscal policy for 2016 is inverted and becomes expansionary, with a difference with respect to the structural primary balance of 0.9 percentage points of GDP compared with a year earlier and 0.7 points compared with the 2015 EFD. As a result, the Update states that the 2016 fiscal expansion will be offset by fiscal tightenings in 2017 and 2018.

## **2.3 The Government's request for flexibility and the European Commission's position**

### **2.3.1 The Government's request for flexibility**

The DBP provides information on the underlying reasons for the requests submitted to the EU for additional flexibility in the adjustment path towards the MTO that would permit the public finance policy scenario described above.

The additional flexibility associated with the structural reform process (0.1 per cent of GDP) is essentially justified, according to the Government, by the introduction of new legislation in bankruptcy and civil law and changes in the tax treatment of loan writedowns and losses of banks and financial institutions. Account should also be taken of the completion of the legislative process for certain reforms after the presentation of the EFD, in particular the approval – in August – of the enabling act for reform of the public administration.

As regards the investment clause, the Plan quantifies the eligible expenditure that can be used for the flexibility.

It includes the co-financing for investment projects financed in part by the European Fund for Strategic Investments (EFSI), national co-financing for EU structural funds (divided into four types, as well as the youth employment initiative), spending on Trans-European Networks (TEN) and that of the Connecting Europe Facility (CEF).

Trend expenditure for 2016 includes a significant amount of national expenditure for projects co-financed by the European Union: the funds, totalling €2.85 billion, associated with the four European structural funds (ERDF, ESF, EAFRD and EMFF), plus the resources for youth employment initiative (YEI) of €200 million, the CEF resources totalling €1.05 billion and those associated with national co-financing of projects also funded by the EFSI, which add another €1.05 billion.

The total expenditure comes to €5.15 billion and is the basis for the request for activation of investment clause in an amount totalling 0.3 percentage points of GDP. These resources are accompanied by €6.15 billion in European co-financing. In total, therefore, the projects that the Government intends to pursue thanks to the clause amount to €11.3 billion. The main resources have been appropriated for the thematic objectives of transport and infrastructure networks, the digital agenda, SME competitiveness and employment.

The DBP also provides an analysis of the spending associated with the influx of immigrants (for sea rescue operations, reception, health and education) in order to highlight an emergency that could – in the Government's view – offer room for additional flexibility of 0.2 per cent of GDP. More specifically, the Plan provides an estimate of the spending incurred and expected, reflecting an increase in costs in 2015-2016 of about 2.5 times the average spending registered in 2011-13. The Government argues that it should be able to consider the difference between the estimated

expenditure for the next year and the average expenditure in the 2011-2013 period as an additional margin of flexibility.

With regard to the request to activate the investment clause, the volume of expenditure registered for this purpose in the trend accounts appears substantial. The flexibility requested under the clause is equal to 0.3 per cent of GDP, which regards the national co-financing, the part that impacts the public finances, but the actual investment expenditure involves the total of €11.3 billion mentioned above. The EU co-financing is not relevant for the purposes of determining the general government budget balance, since the EU flows are recorded in the same amount in both directions (inflows and outflows).

The volume of the funds referred to in the DBP also appears very large when compared with investment in previous years under the 2007-2013 Community programming, which will actually close at the end of 2015. The expenditure relating thereto, certified until 2014, was lower in all the years than the outlays planned for 2016. In the period 2011-14, average total annual expenditure – national and co-financed by the EU – was equal to about €8.4 billion, but it was considerably lower in the initial years of the programming cycle.

In the DBP, the share of national co-financing in overall expenditure also appears high (over 45 per cent) and runs counter to developments in recent years, when it fell gradually, reaching about 30 per cent in 2014.

In addition, the Plan refers to general areas of intervention, with no indication of specific projects. The European Commission may need to have a list of individual projects in order to assess the feasibility of actually implementing the expenditure in 2016.

It is still unclear whether the European Commission will consider all four structural funds in its assessment, in addition to CEF, the TEN-T and EFSI, or only the ERDF and the ESF, as they are the only European funds intended for territorial cohesion under Regulation (EC) no. 1083/2006, which was in force for the first version of the investment clause, to which the Commission's Communication on flexibility of 13 January 2015 refers.

The four funds indicated in the DBP also involve expenditure other than investments, including that for investment grants, as well as current expenditure such as production grants and current transfers to enterprises. If the EU were to consider only expenditure for investments as eligible, the amount of eligible co-financed expenditure for the purposes of the clause would decrease.

In order to facilitate the implementation of the measures, the Stability Bill establishes rules to accelerate the investments involved, which give the Regions the possibility to establish bodies for the exclusive purpose of managing European interventions under special accounting rules, with special treatment with regard to the rules on budget

balance (see Section 3.3.1). The financing of interventions is also facilitated by advances for the Regions.

Expenditure by municipalities can contribute to implementing eligible investments, considering the active role they play in local development policies. Increased investment spending is in fact made possible by the room for manoeuvre that was created by the combined effect of the shift in budget constraints from surpluses to budget balance and the use of the restricted long-term fund envisaged in the 2016 Stability Bill (see Section 3.3.1).

More generally, the objectives of the investment plan appear ambitious, bearing in mind the governance issues associated with the implementation of infrastructure policy in Italy, as shown in Box 2.1. The goal of mobilizing private capital to fund Italian infrastructure as envisaged by the Juncker Plan also seems to be optimistic.

## Box 2.1 – Critical issues affecting public investment in Italy

### *Governance of public investment in Italy*

Significant corrective measures should be made to the governance of public investment to increase the quantity and improve the quality of Italian infrastructure, an issue on which the PBO recently conducted an in-depth study.<sup>21</sup> The main problems concern the unsatisfactory state of *ex ante* and *ex post* evaluation of investments, the lack of a continuously updated and renewed pipeline of investment projects, and the need to develop structures that can provide technical assistance to government departments in preparing projects and financing.

Existing legislation in Italy already in part establishes tools and standards that are consistent with international good practice. However, Italian governance arrangements must be better implemented and, in certain areas, must be supplemented and adapted. The greatest problem lies in the need to develop and integrate technical units in the decision-making and implementation process that possess appropriate expertise enabling them to navigate the complex system of public interests, European constraints, private operators and the banking system.

A number of aspects of the Juncker Plan, especially its emphasis on additionality, the technical and economic viability of projects, the ability to act as a catalyst for private capital, as well as the desire to create a project pipeline and establish a technical advisory hub, could provide an opportunity for introducing improvements in public investment governance in Italy.

### *Public-private partnerships in Italy*

Given that one of the main objectives of the Juncker Plan is to stimulate the use of private capital for investment projects, some remarks about so-called public-private partnerships (PPPs) should be made.

First, as emphasised by a number of international organisations (IMF and OECD<sup>22</sup>), PPPs pose potential risks for public budgets, specifically when they are used to circumvent budgetary constraints rather than to improve the quality of the infrastructures themselves. Risks arise with respect to both direct costs and explicit and implicit contingent liabilities. Furthermore, PPPs tend to make public budgets less flexible in the long term. Second, PPPs are more complex than traditional tender processes and require that the public sector possess specific technical expertise that is not normally needed in managing conventional tenders.

At present in Italy PPPs face considerable challenges, although government departments have demonstrated a growing interest in this tool, in part due to the progressive contraction in public resources allocated for investments in recent years, given the limitations imposed by the Domestic Stability Pact. More specifically, note has been made of:<sup>23</sup> 1) the lack of any preliminary determination of the real benefits of using a PPP in terms of optimizing government's costs; 2) government departments' poor ability to engage with private parties, to identify their respective contractual obligations, to perform economic and financial assessments and to monitor contract performance; 3) the high failure rate for tenders, which suggests that the projects proposed have difficulty attracting market interest; 4) the scant number of financial closings, which demonstrates that winning projects are unable to obtain the financing needed for completion; 5) the absence, prior to the start of the tender, of most of the required authorizations (projects are put out to tender without a final plan in place).

<sup>21</sup> See Parliamentary Budget Office (2015), *"Il Piano di investimento europeo. Un'opportunità per una migliore governance delle infrastrutture pubbliche in Italia?"*, Focus no. 5.

<sup>22</sup> IMF (2004), *"Public-Private Partnerships"*; IMF (2015), *"PPP Fiscal Risk Assessment Model (P-FRAM)"*; OECD (2012), *"Recommendation of the Council on Principles for Public Governance of Public-Private Partnerships"*.

<sup>23</sup> See the document produced by the project finance technical unit (UTFP) within the Prime Minister's Office: UTFP (2014), *"UTFP: 100 Domande e risposte"*, 2nd edition.



The Italian PPP market has traditionally consisted of mainly small and medium-sized projects, sponsored by local governments, and carried out by operators that utilize less onerous forms of financing (e.g. corporate finance) in terms of cost and the complexity of necessary contracts than project finance.<sup>24</sup>

The bill being examined by Parliament to overhaul existing laws on public contracts for works, services and procurement (reform of the Contracts Code) and to transpose EU Directives nos. 23, 24 and 25 of 2014 (on concession contracts, on public procurement and procurement by entities operating in the water, energy, transport and postal services sectors), addresses some of the problems cited, envisaging, for example, rationalization of the types of PPPs and performance of feasibility studies so that projects tendered are financially covered (verification of the level of bankability), as well as guaranteeing that the necessary authorizations, opinions and consents are obtained before the contract is awarded.

However, given the difficulties encountered in getting the process started and the fact that changes to the law and regulations are still being made and are yet to be fully implemented at the administrative level, it appears unlikely that the Government's investment plan will be able to make significant use of PPP resources in the short term.

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<sup>24</sup> See UTFP (2014), "*Relazione sull'attività svolta nel 2013*".

### **2.3.2 The European Commission's position on flexibility clauses**

Within the scope of the opinion on the DBP published on 17 November 2015,<sup>25</sup> the European Commission provided certain guidance on the possibility for the Italian Government to use further budgetary flexibility, but essentially postponed a final decision to the spring of 2016.

With regard to the request procedures for Italy, the Commission noted that granting additional flexibility now would not be consistent with process envisaged in the related Communication as it would take place outside of the ordinary cycle of the European Semester, i.e. the spring prior to the year for which flexibility is being requested.

In this regard, the Commission feels that Italy could meet the requirements for the investment clause. The Commission has also underscored that, in order to evaluate the request for further flexibility for structural reforms, actual implementation of those reforms will continue to be monitored.

The Commission said that, within the context of evaluating the Stability Programme for next year, it will take account of previous considerations regarding Italy's potential eligibility for flexibility. Specifically, this will include whether: 1) a deviation from the adjustment path towards the MTO is being effectively used for increasing investment; 2) progress has been made with the structural reform agenda, including in relation to recommendations adopted by the EU Council last July; and 3) a credible plan is presented for the resumption of the adjustment path towards the MTO.

Practically speaking, the Commission has postponed until spring 2016 any decision to grant Italy flexibility under the investment clause and extend the clause for structural reforms. This decision is to be made based, above all, on careful monitoring of the investment plan and actual implementation of the reform strategy.

As concerns the request for greater flexibility for refugee spending, as granted to other countries besides Italy, the Commission has decided that such spending cannot be considered a one-off and so cannot be excluded from the calculation of structural budget balances. Nonetheless, the increase in this spending compared with the prior year will be taken into account in the *ex-post* evaluation of the adjustment path towards the MTO.

For Italy, this interpretation entails very limited changes to the evaluation of the adjustment path towards the MTO in that, according to data published by the Government in the DBP, refugee spending in 2015 is expected to be just 0.1 percentage

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<sup>25</sup> For the Commission's opinion, see: [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/pdf/dbp/2015/it\\_2015-11-16\\_co\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/dbp/2015/it_2015-11-16_co_en.pdf); and for the working document, see: [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/pdf/dbp/2015/lv\\_2015-11-16\\_swd\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/dbp/2015/lv_2015-11-16_swd_en.pdf).

points of GDP greater than the year before, whereas in 2016 it is expected to be virtually identical to 2015 levels.

Finally, it is important to note that the Commission's staff working document acknowledges that the Government has included the increase in refugee spending compared with 2011-13 as a one-off from 2014 in the DBP. However, as mentioned, the Commission's interpretation calls for such spending to be excluded from one-off measures, thereby worsening the structural balance for these two years compared with Government forecasts.

## **2.4 The 2016 Stability Bill<sup>26</sup>**

The net impact of the Stability Bill will be a deterioration in the general government budget balance of €14.6 billion in 2016 (about 0.9 per cent of GDP), €19.2 billion in 2017 (1.1 per cent of GDP) and €16.2 billion in 2018 (0.9 per cent of GDP) (see Table 2.5 for a summary view and Table A2.1.1 for a detailed breakdown). Against the acquisition of resources of around €14 billion annually, uses will amount to €28.7 billion next year and €32.3 and €30.2 billion in the next two years. In 2016-18, revenue is expected to decline, on average, by about €21 billion per year (€18 billion in 2016, or 1.1-1.3 per cent of GDP) and expenditure by about €4 billion (€5.7 billion in 2018, or 0.2-0.3 per cent of GDP), while the decline in current revenue is expected to be greater and increasing over time.

On the uses side, various areas of intervention can be identified for the main measures.

First, the budget calls for the safeguard clauses to be deactivated entirely in 2016 and involve a revenue reduction of €16.8 billion. They will be partially deactivated in the following years, with an impact of €11.1 billion in 2017 and €9.4 billion in 2018. In essence, VAT increases are maintained as from 2017. Accordingly, safeguard measures will produce revenue of €15 billion in 2017 and about €20 billion in the following years (Table 2.6). For 2016, the budget measures contain a new safeguard clause such that, if monitoring of the voluntary disclosure programme should find that the revenue generated diverges from the forecast of €2 billion – given the uncertainty of the calculation – a corresponding increase in excise taxes will come into force as from 1 May 2016, limited to the subsequent year.

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<sup>26</sup> This section refers to the Stability Bill presented to the Senate at first reading.

**Table 2.5** – Impact of 2016 Stability Bill on general government accounts  
(millions of euros)

|   | 2016           | 2017           | 2018           |
|---|----------------|----------------|----------------|
| <b>REVENUE</b>  | <b>-18,047</b> | <b>-22,393</b> | <b>-21,852</b> |
| Safeguard clauses   | -16,814        | -11,088        | -9,394         |
| <i>Reduction safeguard clause for VAT and excise tax rates - 2015 Stab. Act</i>   | -12,814        | -4,088         | -2,394         |
| <i>Abrogation excise tax increase from 2016 - 2015 Stab. Act</i>  | -728           | -728           | -728           |
| <i>Elimination of safeguard clause - 2014 Stab. Act</i>   | -3,272         | -6,272         | -6,272         |
| Abolition municipal services tax on principal residence and exemption of tenants  | -3,591         | -3,593         | -3,592         |
| Exception of agricultural land and immovable equipment from municipal property tax  | -935           | -935           | -935           |
| Tax deduction for home eco works and renovations  | -113           | -1,077         | -953           |
| 40% increase in depreciation on capital equipment   | -170           | -943           | -1,258         |
| Reduction in IRES rates from 2017   | 0              | -2,978         | -3,970         |
| Changes in special tax regime for low-income self-employed (balance)  | 283            | -512           | -293           |
| Abolition of IRAP for agricultural and fishing enterprises and increase in deduction  | -167           | -535           | -379           |
| Extension of contribution relief for permanent hiring and contribution relief for agriculture   | -834           | -2,094         | -1,337         |
| Tax exemption on productivity bonuses (balance)   | -89            | -263           | -264           |
| Voluntary disclosure  | 2,000          | 0              | 0              |
| Lotteries   | 1,108          | 600            | 600            |
| Revaluation of assets (IRES and separate tax)   | 309            | 100            | 100            |
| Use of Fund for reduction of tax burden   | 810            | 413            | 411            |
| Other measures (balance)  | 157            | 509            | -589           |
| <b>EXPENDITURE</b>  | <b>-3,465</b>  | <b>-3,215</b>  | <b>-5,668</b>  |
| Fund for the fight against poverty and other social measures  | 894            | 1,294          | 1,294          |
| Expenditure for local authorities (Grants to provinces and metropolitan areas in ordinary statute regions, Fund for Municipal budget balance) | 1,066          | 400            | 400            |
| Public-sector employment (balance of various measures)  | 186            | 73             | -89            |
| Increase in Fund for economic policy intervention and Fund for urgent requirements  | 300            | 1,171          | 300            |
| National health service funding requirement   | -1,783         | 0              | 0              |
| Regional finance  | -1,850         | -5,002         | -6,140         |
| Reduction in expenditure of ministries and strengthening of Consip  | -2,319         | -2,055         | -2,150         |
| Pension measures (balance of various measures)  | -124           | -298           | -457           |
| Reduction in funding of tax assistance centres, citizens assistance agencies, political parties and spending of social security agencies      | -211           | -221           | -221           |
| Other measures (balance)  | 376            | 1,423          | 1,395          |
| <b>NET BORROWING</b>  | <b>-14,582</b> | <b>-19,178</b> | <b>-16,184</b> |

Source: based on data in financial schedules attached to the 2016 Stability Bill and in the Technical Note

As shown in Table 2.6, the enabling provisions, as introduced with the 2014 Stability Act and amended in the 2015 Stability Act, to modify its scope, concerning the reduction of tax relief and the increase in tax rates to be defined by specific measures and activated in the absence of the approval of measures that would increase revenue or have an analogous financial impact through actions to rationalise and review government expenditure, which are considered preferable but uncertain in terms of size and timing – were abrogated (the loss in revenue is about €3.3 billion for 2016 and €6.3 billion as from 2017). The clause of the 2015 Stability Act that called for an increase in excise taxes on fuel in the event of an EU prohibition (as in fact occurred) of the feasibility of the reverse charge mechanism in large-scale distribution – i.e. the mechanism that requires the buyer, rather than the seller, to pay VAT on retail transactions, a tax subject to EU regulation – was also abolished (resulting in a loss of revenue of €0.7 billion for each year in the forecasting period). Finally, the clause in the 2015 Stability Act establishing measures resulting in greater deferred revenue (related to VAT and fuel excise taxes) that have already received all legislative approvals and do not require subsequent implementation, but for which there was a policy commitment to develop alternate measures, has been partially deactivated. Specifically, the 2016 Stability Bill cuts the amount of excise duties envisaged under the 2015 Stability Act in half beginning in 2018 (with a reduction in revenue from €700 million to €350 million). In addition, the bill deactivates the increases in VAT envisaged for 2016 in the 2015 Stability Act (the two percentage point increase, to 12 and 24 per cent, in the reduced and ordinary rate will not be implemented) and redefines the increases for subsequent years (for a total loss of revenue from VAT and excise taxes of €12.8 billion in 2016, €4.1 billion in 2017 and €2.4 billion beginning in 2018). Given these abrogations and partial deactivations, the safeguard clauses that remain in force concern excise taxes, the increase in which, as mentioned previously, has been halved beginning in 2018 (the year in which the increase in revenue is to equal €350 million), and VAT. With regard to VAT, the reduced and ordinary rates are to be increased by three and two percentage points, respectively (to 13 and 24 per cent instead of the previous 13 and 25 per cent) in 2017. In 2018, the ordinary rate is to be increased by a further percentage point (to 25 per cent instead of the previous 25.5 per cent). Therefore, revenue that remains available for improving the public accounts totals €15.1 billion for 2017 and €19.6 billion beginning in 2018.

**Table 2.6** – 2016 Stability Bill: abrogated, deactivated and active safeguard clauses  
(millions of euros)

| Measure   | 2016           | 2017           | 2018          | 2019          |
|---|----------------|----------------|---------------|---------------|
| <b>Safeguard clauses abrogated or deactivated by the 2016 Stability Bill</b>          |                |                |               |               |
| Abrogation of 2014 Stability Act clause (direct and indirect taxes)                   | -3,272         | -6,272         | -6,272        | -6,272        |
| Abrogation of excise tax increase as from 2016 (Art. 1, par. 632, 2015 Stability Act) | -728           | -728           | -728          | -728          |
| Deactivation of VAT and excise tax increases (Art. 1, par. 718, 2015 Stability Act)   | -12,814        | -4,088         | -2,394        | -2,394        |
| <b>Total safeguard clause abrogations and deactivations</b>                           | <b>-16,814</b> | <b>-11,088</b> | <b>-9,394</b> | <b>-9,394</b> |
| <b>Safeguard clauses active following 2016 Stability Bill</b>                         |                |                |               |               |
| Increase in VAT rate from 10% to 13% from 2017 (Art. 3, par. 2, lett. a)              | 0              | 6,957          | 6,957         | 6,957         |
| Increase in VAT rate from 22% to 24% from 2017 (Art. 3, par. 2, lett. b)              | 0              | 8,176          | 8,176         | 8,176         |
| Increase in VAT rate from 24% to 25% from 2018 (Art. 3, par. 2, lett. b)              | 0              | 0              | 4,088         | 4,088         |
| Increase in fuel excise tax from 2018 (Art. 3, par. 2, lett. c)                       |                |                | 350           | 350           |
| <b>Total VAT and excise tax increases</b>   | <b>0</b>       | <b>15,133</b>  | <b>19,571</b> | <b>19,571</b> |

Source: based on data from the Technical Report for the 2016 Stability Bill.

Additional measures for reducing the tax burden affect both households and firms (see Sections 3.1 and 3.2): 1) the abolition of the Tasi (the municipal services tax) on primary residences (including tenants) and the tax on real estate held abroad (IVIE), with the exception of luxury properties; 2) the reduction in the corporate income tax (Ires) rate from 27.5 to 24 per cent beginning in 2017; 3) a temporary tax incentive for new investment in plant and machinery in the form of an increase in depreciation charges deductible for tax purposes; 4) exemption from the payment of IRAP (the regional business tax) for agriculture, forestry and fishing businesses and an increase in the standard deduction for IRAP for small businesses; 5) municipal property tax (Imu) exemptions for land held by farmers and a change in the taxation of category D and E industrial buildings with regard to immovable machinery); 6) favourable changes in the tax regime for low-turnover sole proprietorships.

Other measures have been developed to promote economic recovery and support the labour market (see Section 3.5): 1) the deductibility of costs for renovations and energy upgrading costs has been extended and the deductibility of property purchases by young couples introduced; 2) contribution relief for permanent hires in 2016 has been extended, although reduced in both amount and duration compared with 2015; 3) reduced taxation of productivity bonuses for private-sector employees by way of a separate tax replacing personal income tax.

Other resources have been earmarked to support income and combat social exclusion (see Section 3.4): 1) a new fund to fight poverty and social exclusion has been established, with funding earmarked in 2016 for low-income beneficiaries (the “new purchase card”) and for increasing unemployment benefits and, as from 2017, for other welfare measures; 2) extended “social shock absorbers” are refinanced; 3) additional funds have been earmarked for the non-self-sufficient; 4) funds have been appropriated to assist individuals with serious disabilities, in conditions of severe poverty and without immediate family.

Further measures in the pension sector have been taken, partly with the same goals as those of previous measures (see Section 3.5): 1) an increase in tax credits for less affluent pensioners beginning in 2017; 2) a seventh relief measure for former workers no longer eligible for a pension following the latest pension reform; 3) an extension of the early-retirement option for women, tied to the payment of pension benefits under the rules for the defined contribution system; 4) the introduction of an option to agree to work part-time with one's employer for private-sector employees on permanent, full-time contracts who will become eligible for an old-age pension by a given date.

A number of measures target specific industries (see Section 3.3.1): 1) room for financing granted for local government to promote investment; 2) additional funding granted to the governments of provinces and metropolitan areas in ordinary-statute regions for roadways and school buildings; and 3) funds have been allocated for contract renewals for central government employees.

The main measures to generate resources to cover these commitments involve reductions in current spending and one-off revenue measures.

Notable measures in the area of expenditure savings include: 1) reductions in the spending of regional governments, both to achieve budget balance and as a further contribution to the public finance measures (see Section 3.3.1); 2) savings expected in the healthcare segment (see Section 3.3.2); 3) the reduction in funds allocated to health service construction projects; 4) ministry participation in the measures established in the various annexes to the Stability Bill and the further centralization of procurement for public entities (see Section 3.3.3); 6) savings in the pension segment, both in funding cuts regarding protected workers (unemployed workers who found themselves ineligible for a pension following the reforms) and those in physically demanding jobs and in the reduction in spending resulting from the smaller indexing of pensions greater than three times the minimum benefits (see Section 3.5); and 7) measures regarding public-sector employment, notably those concerning turnover and variable employee compensation.

Revenue increases include: 1) the one-off effects in 2016 of measures regarding the voluntary disclosure of assets held abroad, which are secured by the safeguard clause mentioned previously; 2) amounts expected from the lotteries segment, a portion of which is of a temporary nature; 3) the (also temporary) effects of the retaining of the recalculation of cadastral land values and the value of equity investments and the revaluation of corporate assets; 4) the use of the fund for the reduction of the tax burden; and 5) a reduction in the contribution relief for company-level bargaining.

## ***2.5 Risk factors for the financial effects of the budget measures***

One general risk for the public finances concerns the Government's preparation of a macroeconomic scenario based on assumptions for the exogenous variables that, in the light of trends in recent months and the recent forecasts issued by international bodies, would appear to be relatively favourable, with an adverse impact on the real growth of Italy's economy as well as, and above all, on inflation and, consequently, on the expected performance of nominal GDP growth. These factors could create problems, especially in the latter years of the forecasting period, in complying with objectives for the public finance balances and, in particular, for the reduction in the ratio of government debt to GDP.

Based on the analyses presented in Chapter 3, a number of observations can be made in terms both of the effectiveness of the measures regarding spending and revenue in order to finance the measures envisaged under the Stability Bill and of

quantifying the effects of certain measures that would entail a deterioration in the accounts.

With regard to the reduction of healthcare spending, the reduction in funds from the amounts agreed with the Healthcare Pact may not be entirely realistic owing to a number of factors: the commitment for National Healthcare Service entities to adopt new essential care standards and new nomenclatures; the recent introduction of expensive innovative drugs, the start of collective bargaining for employees (and perhaps the staff of entities operating under contracts with the NHS), and the introduction of new service quality/quality standards. Conversely, the potential effects of deficit reduction plans for hospitals and other healthcare entities, the further centralization of procurement procedures, and the potential definition of a new pharmaceutical payback mechanism that would be more favourable to government, would all work towards reducing costs.

With regard to local government finances, the Stability Bill calls for the superseding of the Domestic Stability Pact, replacing it with an interim rule – pending full implementation of Law 243 of 2012 – based on the balance of final revenue and expenditure on an accruals basis, within which certain specific funds are included/excluded. The rule expressly indicates the inclusion of incoming and outgoing appropriations for the restricted long-term fund, solely for the portion related to own revenue, in the reference aggregate in determining balance for 2016. However, allocations to the provision for doubtful accounts are not included. The inclusion of unsterilized, uncollectable revenue in the calculation of balance entails the recognition of a deficit for the purposes of the general government accounts. For an estimate of this effect, it should be noted that the Technical Report for the 2015 Stability Law placed the provision for doubtful accounts at €1.9 billion.

As regards pension-related measures, the Stability Bill expands the range of potential beneficiaries of the so-called “female worker option”. Official estimates calculate the increase in costs resulting from this measure based on historical trends in retirements and a sample of contribution histories. If, in conjunction with this increase in the number exercising the option, which is partly attributable to the tightening of requirements due to take effect as from 1 January 2016, we consider the fact that the Stability Bill expands the pool of eligible women, the number of new pensions granted under the female worker option could exceed the level that historical data – on which the Technical Report estimates are based – would suggest.

Finally, with regard to revenue – and lottery revenue in particular—there are a number of critical issues that concern the measures that call for an increase in the single lottery tax (PREU) for various types of lottery and the execution of a tender for some 15,000 new lottery and betting points of sale. As concerns the increases in the tax, the assumption of no change in the volume of betting and lottery activity over 2014 that underlies the estimates of revenue increases would seem unrealistic given the fact that



the data for the first few months of 2015 point to a decline (of about 6 per cent) in volumes. The establishment of a single 5.5 per cent tax for video lottery terminals (VLTs) appears not to take account of the fact that the tender process by which current licences were granted excluded the possibility for the PREU to rise above 4 per cent. We could therefore expect an substantial volume of litigation against such an increase. It should also be noted that the tax burden on the gaming device concession holders would increase to about 67 per cent (if based on margins and not on total collections), which would both threaten the medium/long-term sustainability of the industry—and the tax revenue it generates—and make it difficult to assume that all of the licences for points of sales envisaged under the new tenders will be assigned.

## **2.6 Fiscal policy targets in the light of European fiscal rules**

### **2.6.1 Adjustment of the structural budget balance towards the medium-term objective**

In both the Update of the 2015 EFD and the 2016 DBP, the Government has postponed achievement of the medium-term objective by one year compared with the Stability Programme of last April. Structural budgetary balance is planned for 2018.

It is important to underscore that, compared with last April, the estimate of the structural budget balance for 2015 has improved by 0.2 percentage points – from 0.5 to 0.3 per cent – while the nominal balance has remained essentially unchanged. This is due in part to an upward revision of the estimated series for potential output (particularly in the labour factor) as a result of the forecast of greater growth for 2015-19. Indeed, the method used to calculate potential output agreed at the European level and used in the Update, given this improvement in the growth forecasts, produces greater potential growth for both the forecast period and for prior years.

This frequent revision of estimates of potential GDP growth and the output gap is an issue that the UPB has explored in a number of studies,<sup>27</sup> which show that the adoption of these indicators in order to establish fiscal policy does not facilitate public finance planning.

However, based solely on the information found in the 2016 DBP, it is not possible to evaluate the rule for adjustment towards the MTO in 2015 given that no estimate of the structural balance for the previous year is published. Such an estimate may have changed from the figure published in the Update because the Government updated the estimates of the output gap in response to the release of new information, as described in Chapter 1. Furthermore, changes will likely have affected the one-offs given that, unlike in the Update, the additional spending for refugees has been included in the 2016 DBP as indicated in the Commission documents.

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<sup>27</sup> Fioramanti, M.; Padrini, F. and Pollastri, C. (2015), “*La stima del PIL potenziale e dell’output gap: analisi di alcune criticità*”, Ufficio parlamentare di bilancio, Nota di lavoro no. 1.

According to the Commission, the 2015 structural balance in the DBP, recalculated based on their estimate of the output gap, shows a deviation – albeit not a significant one – from the adjustment path towards the MTO. This conclusion is further strengthened if we remove additional refugee spending compared with 2011-13 from the one-offs as specified by the Commission.

Therefore, for these reasons, it would be very important for the Government to publish detailed information regarding the estimates of the structural budgetary balances, including one-offs, not only for the forecast period, but also for prior years, in order to fully evaluate the adjustment path towards the MTO.

For 2016, the Government has decided to request greater flexibility in achieving the MTO, as discussed in Section 2.3. On the assumption the requests will be granted, the Government intends to implement an expansionary budget in 2016. The structural balance would consequently worsen by 0.4 percentage points in 2016 compared with 2015, rather than an improvement of 0.3 percentage points as required of Italy under the Pact in the absence of the request to activate the clauses.

For subsequent years, the Government is forecasting a structural adjustment of 0.4 percentage points in 2017, which is lower than the correction of 0.5 percentage points set by the Pact for countries during “normal” economic times (as is expected to be the case for Italy at that time). In 2018, a correction of 0.3 points is expected to be implemented, which would enable Italy to achieve the MTO in accordance with the Pact rules.

Obviously, the ability to implement this strategy in compliance with the Stability and Growth Pact is now exposed to considerable risk given the position contained in the Commission’s opinion of the DBP as described in Section 2.3.2. If the Government’s request for greater flexibility is not approved for in the spring of 2016, the permitted deviation from the adjustment path would be 0.4 percentage points, rather than the 0.8 points assumed by the Government. Furthermore, the additional refugee costs compared with the 2011-13 period cannot be considered a one-off.

Taking both of these aspects into account and keeping the rest of the public finance framework unchanged, preliminary estimates indicate that the deviation from the adjustment path in 2016 would be about 0.5 percentage points and would therefore be at great risk of being deemed significant, as it would also appear when using the Commission’s forecasts. Should the final figures confirm this significant deviation, the associated procedure could be opened against Italy (see Box 2.2 for the potential consequences of the procedure).

Yet another risk for compliance with the structural balance rule regards the uncertainty about the actual position of the Italian economy in the cycle, as measured by the output gap using the method agreed at the European level. As explained in Appendix 1.1 of Chapter 1, this method employs the rate of capacity utilization as one of the indicators for measuring the cyclical component of total factor productivity and thus the output gap. The capacity utilization

rate has improved significantly for Italy in 2015. This could suggest that the output gap is improving faster than assumed by the Government in the Update and the DBP. For any given actual budget balance, this would imply that structural balance performance is worse than projected by the government, with the risk that the planned adjustment will not be consistent with that required by the Stability Pact.

## Box 2.2 – Procedure for significant deviations from the adjustment path towards the MTO

The goal of the preventive arm of the Stability and Growth Pact is to encourage Member States to adopt prudent fiscal policies over the medium term, i.e. periods in which actual output is close to its potential. The medium-term objective (MTO) and the expenditure benchmark are analysed by the Commission on both *ex ante* and *ex post* bases twice each year: 1) in the spring, in conjunction with evaluating the Stability Programme, with an *ex post* evaluation for the previous year and an *ex ante* assessment for subsequent years; 2) in the autumn, in conjunction with evaluating the Draft Budgetary Plans of euro-area Member States, both on an interim basis for the current year and an *ex ante* basis for the following year. This analysis is conducted with reference to both individual years and averages for two consecutive years.

Whereas the Commission's *ex ante* and interim evaluations are generally conducted for the purpose of providing the Member States with policy guidance, *ex post* evaluations may result in the assessment of sanctions for euro-area Member States in the event of significant deviations from the adjustment path towards the MTO.

The significant deviation procedure involves a complex series of steps, with different majorities required for the purposes of European Council decision-making from phase to phase.

Specifically, if the Commission finds, after an *ex post* evaluation, that a significant deviation has occurred, a warning is issued to the Member State in accordance with Article 121(4) of the Treaty on the Functioning of the European Union in order to prevent a breach of the threshold of 3 per cent for the nominal deficit or threatening the proper functioning of monetary union. Upon a recommendation of the Commission, the European Council then issues recommendations to the Member State within one month of the issuance of the warning. These recommendations concern the steps to take within a certain timeframe (no more than 5 months, but as short as 3 months if the Commission deems the situation to be particularly serious) in order to correct the deviation. Council recommendations require a qualified majority in order to be adopted.<sup>28</sup> Should the Member State fail to take corrective action by the Council's deadline, the Commission then immediately issues a new recommendation for the Council to approve a decision concerning this lack of effective action. Here, too, a qualified majority in the European Council is required. The Commission may recommend that the Council issue a revised recommendation for corrective action by the Member State (again in accordance with Article 121(4)).

If the Council does not approve the decision proposed by the Commission concerning the lack of effective action and the Member continues not to take such action, the Commission then issues a new recommendation for the Council within one month of the previous measure for a decision to be made concerning this lack of effective action. This second recommendation shall be approved by a "reverse simple majority", i.e. if a simple majority of the Member States does not vote against the Commission's proposal.

Within twenty days of the Council's decision concerning the lack of effective action, the Commission will recommend that the Council issue sanctions in the form of an interest-bearing deposit in the amount of 0.2 per cent of the previous year's GDP. This Commission recommendation shall be passed by the Council unless a qualified majority opposes it (i.e. approval by reverse qualified majority). The Commission may consider reducing or cancelling the deposit upon reasoned request of the Member State, recommending that the Council take appropriate action. The deposit and related interest are returned to the Member State when the

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<sup>28</sup> Since 1 November 2014, in accordance with the Treaty of Lisbon, approval by qualified majority requires that 55 per cent of the countries participating in the decision, accounting for at least 65 per cent of the EU population, vote in favour of the Commission's recommendation. However, until the end of the transition period envisaged by the Treaty, i.e. 31 March 2017, a member of the Council may request application of the qualified majority as defined under the Treaty of Nice, i.e. a two-thirds majority of weighted votes of the countries participating in the decision, representing at least 62 per cent of the population.

Council, upon recommendation of the Commission, determines that the situation that gave rise to the previous decision concerning the lack of effective action no longer exists.

The interest-bearing deposit ceases to bear interest if the European Council, having subsequently ascertained a violation of the Maastricht parameters regarding nominal net borrowing or the debt-to-GDP ratio, opens an excessive-deficit procedure against the Member State upon recommendation of the Commission and within the scope of the corrective arm of the Pact.

Within the procedure of the preventive arm, countries that do not belong to the euro area do not participate in Council decisions concerning the lack of effective action and the assessment of sanctions (i.e. the interest-bearing deposit) that concern euro-area countries. Finally, the country involved does not vote on any Council decisions within the scope of the preventive and corrective arms of the Stability and Growth Pact.

### **2.6.2 The expenditure benchmark**

As regards the expenditure benchmark, in 2015 the expenditure aggregate used for the rule is expected to increase by about 0.5 per cent in real terms, above the level that would be consistent with the adjustment path towards the MTO (a rate of change of about -0.5 per cent). The indications of the expenditure benchmark for 2015 confirm the discussion in the previous section about the possible deviation from the adjustment path towards the MTO.

In 2016, assuming that next spring the EU institutions grant the Italian request for more flexibility, Italy would comply with expenditure rule. In fact, the expenditure aggregate used for the rule would expand at a rate of 0.7 per cent in real terms, slower than the pace permitted with the full application of the flexibility clauses.

Conversely, if the Government's request for flexibility were not granted, there would be a deviation from the expenditure benchmark. However, using the benchmark for spending growth implicit in the Government's forecasts, the deviation could still be insignificant.<sup>29</sup> Considering the entire 2015-16 period, the deviation would be significant.

### **2.6.3 The evolution of the debt/GDP ratio**

In last April's Stability Programme, the current legislation scenario showed non-compliance with the debt rule, while the forward-looking criterion was complied with in the policy scenario in 2016. Compliance with that parameter was subject to the achievement of a rising primary surplus in the policy scenario (from 1.6 per cent in 2015 to 4.0 per cent in 2019) and the generation of privatization proceeds amounting to 0.4 per cent in 2015, 0.5 per cent in each of 2016 and 2017 and 0.3 per cent in 2018.

In the policy scenario in the Update and the DBP, the debt/GDP ratio has changed compared with that in the 2015 EFD. In each of the years 2015 to 2018, the ratio is higher by a number of tenths of a point (ranging from three- to five-tenths, depending on the year). Only in 2019 does the ratio decrease (by two-tenths of a point). As in the EFD, the debt/GDP ratio indicated in the Update continues to increase in 2015 compared with 2014, before descending as from 2016, bringing it to 119.8 per cent in 2019.

Despite the deterioration in the ratio, the debt rule, again in the forward-looking version, appears to be complied with in 2016 on the basis of the projections to 2018 contained in the Update: in 2018 the policy debt/GDP ratio stands at 123.7 per cent,

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<sup>29</sup> The expenditure benchmark for 2016 depends on the level of the structural balance in 2015. According to Government estimates, the structural balance is less than 0.5 (it is equal to 0.3). This would require a smaller expenditure reduction effort than that estimated by the Commission, for which the structural balance in 2015 is greater than 0.5.

while the forward-looking benchmark provides for a ratio of 123.8 per cent. It follows that compliance with the debt rule in 2016 is achieved by just one tenth of a point. In 2017, the margin of compliance is greater (1.2 percentage points).

So, compliance with the rule is still achieved despite the increase in the debt/GDP ratio in the Update compared with the EFD, where the margins were quite small. The reasons for this result, at first sight surprising, are to be found in a number of areas.

First, the method for calculating the debt benchmark, i.e. the level below which the debt/GDP ratio must lie to comply with the rule, is a key factor. If the debt/GDP ratio is higher in the three previous years, the benchmark is also higher, making compliance less difficult. In addition, this approach makes compliance more likely when the adjustment of the ratio is shifted to the final year of the three-year period.

Another factor contributing to compliance with the rule is the increase of two-tenths of a point in the nominal GDP growth forecast for 2018 compared with the EFD (3.4 per cent compared with 3.2 per cent), thereby increasing the denominator of the debt/GDP ratio. Recall that the forecasts for growth in 2017-19 in the Update and the DBP appear optimistic compared with those of the PBO panel (see Chapter 1).

It is therefore important to assess the sensitivity of the developments in the debt/GDP ratio presented in the Update considering alternative scenarios for the growth of nominal GDP, based on the results of the PBO panel.

In these exercises, the baseline simulation is represented until 2019 by the policy scenario presented in the Update and the DBP, while as from 2020 it was designed on the basis of a series of ad hoc assumptions: a primary balance that ensures an overall budget close to balance, no stock-flow adjustment, the convergence of real growth to 1 per cent, an inflation rate of 2 per cent and short- and long-term interest rates of 3 per cent and 4.5 per cent, respectively. The debt/GDP ratio after 2020 – like that of the simulations from 2015 discussed later – was extrapolated using a methodology similar to that adopted by the European Commission to analyse the sustainability of the public debt (see also Appendix 2.2).

According to the baseline scenario, the debt/GDP ratio is expected to decline gradually to a level just above 100 per cent in 2024 (Figure 2.5). As noted in the Update, the compliance with the debt rule would also be achieved in accordance with the backward-looking criterion as from 2018; compliance would continue, even more clearly, in subsequent years.

Two alternative simulations were then conducted, changing both real growth and inflation compared with the Update and the DBP, taking the macroeconomic scenarios for 2015-19 with the least and most favourable outlook for nominal GDP growth from among those presented by the PBO panel forecasters. The same convergence criteria for

real growth and inflation as those described above for the baseline scenario were assumed for the two scenarios as from 2020.

In the least favourable scenario of the PBO panel, nominal GDP grows at an average annual rate of 1.6 per cent in 2015-19, the result of an average annual real rate of growth of 1.1 per cent and an average annual inflation rate of 0.5 per cent. In the most favourable scenario, nominal GDP increases at an average annual rate of 2.5 per cent, the result of average real growth of 1.2 per cent and an average inflation rate of 1.3 per cent. These scenarios are less optimistic than that in the Update and the DBP, in which the average annual growth rate of nominal GDP amounts to 2.7 per cent, of which 1.4 per cent is due to real growth and 1.3 per cent to the inflation rate.

The simulations also assume that the slower real growth adversely impacts the primary balance/GDP ratio. This assumption amplifies the negative impact of lower growth on the debt/GDP ratio. The exercise also adopts the assumption of partial translation (equal to 0.5) of lower inflation onto interest rates. This contributes to attenuating the impact of the former on the debt/GDP ratio.

In both alternative scenarios, the dynamics of the ratio appear less favourable than indicated in the Update, although it still presents decreases from 2017 (Figure 2.5). In the least favourable PBO panel scenario, compliance with the debt rule is never achieved, while in the most favourable it is achieved only in 2019 and 2020. The ratio would remain just above the benchmark in subsequent years.

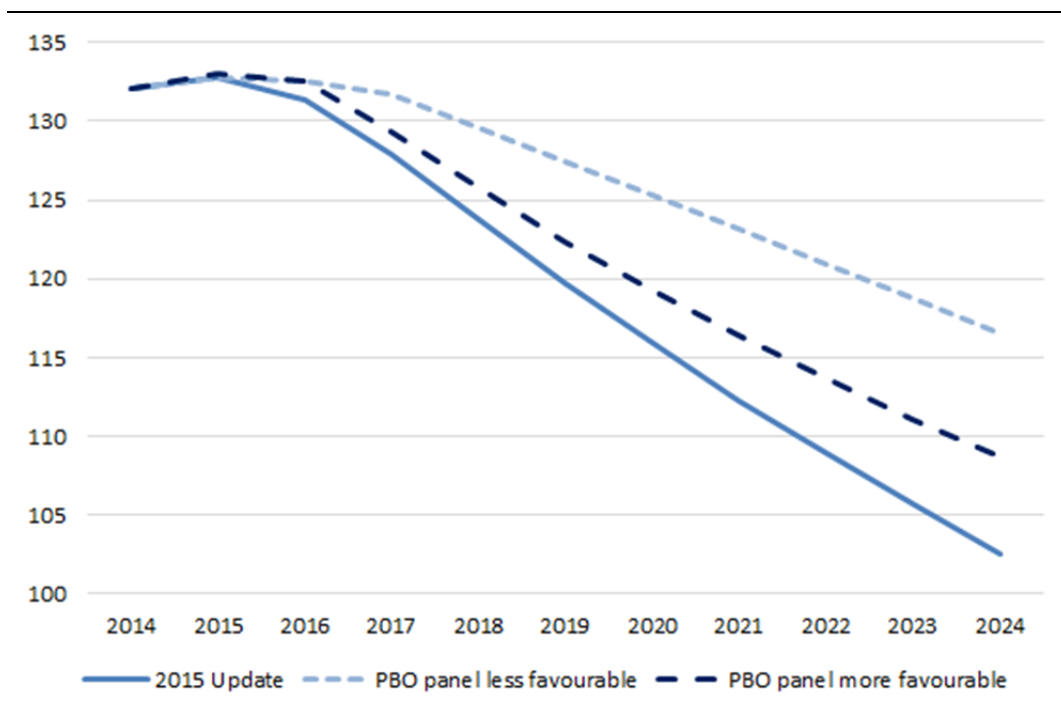
This exercise shows that the debt/GDP ratio is generally declining even in less favourable scenarios for its drivers compared with the Update and the DBP. However, it appears difficult to maintain a pace of reduction in line with the rules set in the Stability Pact unless the macroeconomic and financial scenarios envisaged in the Update and the DBP are achieved, which at least from 2017 appear more optimistic than the forecasts of the PBO panel.

The risks to developments in the debt can also be highlighted by decomposing the change in the debt/GDP ratio into its components (Table 2.7). After an increase of 0.5 percentage points in 2015, the ratio is expected to decline by 1.4 percentage points in 2016 and by 3.5 percentage points in 2017.

The reduction scenario becomes more favourable over time for a number of reasons. First, the policy objective of the Government provides for a significant increase in the primary surplus, especially in 2017, due to the retention of the safeguard clause increases in VAT rates. An additional overall fiscal effort would have to be undertaken by the Government if, together with the improvement in the primary balance, it intends to continue its strategy of reducing the tax burden.



**Figure 2.5** – Developments in the debt/GDP ratio in different macroeconomic scenarios



Source: PBO estimates and calculations based on the data from the Update and the DBP.

Second, the adverse impact of the "snowball effect", i.e. the effect linked to the debt accumulated in previous years, decreases over time thanks to the assumption that the average cost of debt will remain slightly above current levels, while nominal GDP is forecast to increase considerably. There are clear risks that such a scenario could be too optimistic, mainly in the case of an inflation rate more consistent with current market expectations and therefore considerably lower than that projected by the Government or, conversely, if interest rates should rise abruptly in response to possible international tensions.

Finally, the improvement in the debt depends on negative stock-flow adjustments in 2015. This is due in part to the Government's privatization programme.

In the 2015 EFD, privatization receipts were quantified at a total of 1.7 percentage points of GDP between 2015 and 2018 (0.4 percentage points in 2015, 0.5 points in 2016 and in 2017 and 0.3 points in 2018). In the Update to the EFD 2015, privatization receipts have been revised upward by the Government to 0.4 percentage points of GDP in 2015 and 0.5 points in 2016, 2017 and 2018, for a total of 1.9 points of GDP.

As regards the disposal of the State's direct equity investments,<sup>30</sup> in February 2015 the sale of 5.74 per cent of the share capital of Enel was completed, generating proceeds for the MEF of about €2.2 billion. Subsequently, in October, the global offering of shares of the Italian Post

<sup>30</sup> The receipts from the disposal of direct state equity holdings are to be used to amortize the public debt, while those generated by transactions involving indirect investments can be used to pay a dividend to the MEF or to strengthen the financial position of parent companies. To date, the second option has been used.

Office was completed, with a view to listing the company on the stock market.<sup>31</sup> The proceeds for the MEF were estimated at about €3.1 billion, gross of placement fees, including the exercise of the greenshoe option granted to institutional investors.<sup>32</sup>

As for other privatizations announced by the Government, in 2016, once the preliminary preparations have been completed, disposals will include ENAV (listing and sale of up to 49 per cent) and the State Railway Group.<sup>33</sup> The Update also mentions the stakes held by the MEF in STMicroelectronics and in the Fondo Italiano di Investimento; these interests will be sold to Cassa Depositi e Prestiti.

Finally, the Update provides no information on privatizations to be implemented in 2017 and in 2018, the year for which total receipts from monetizing public assets were revised upwards from 0.3 to 0.5 percentage points of GDP, as noted above.

The Government's objectives for revenue from the sale of equity holdings (or similar transactions) were met in 2015, while in 2016 it will be necessary to assess whether market conditions are sufficiently favourable in terms of price and liquidity for the sale of such relatively large companies as the State Railways. For subsequent years, there is currently not enough information to assess whether the Government's privatization programme, and the pace of debt reduction, is credible. In the absence of further information, the increased objective for privatization receipts set by the Government for 2018 in the Update (compared with the EFD) appears ambitious.

Among the other components, the stock-flow adjustment includes the effect of derivatives. This includes the net flows arising from the derivative contracts outstanding or expiring and any reclassification as debt of contracts unmatched at inception, such as, for example, following the exercise of swaptions. Further changes could occur in the event of restructurings of contracts already reclassified as debt that modify their market value.

In recent years, derivatives have had a significant negative impact on debt developments. Istat's notification of net borrowing of 21 October 2015 shows an average annual increase in debt in the period 2011-2014 of €4.2 billion (about €5.5 billion in 2014) due to derivatives.

Considering the importance of this component in the evolution of the debt, it would be appropriate for the public finance forecasting documents to give an accounting of the expected impact of flows connected with derivatives on developments in stock-flow adjustments for 2015 and future years. In particular, the expected impact of the exercise of swaptions at maturity and the forecast amount of cash flows generated by outstanding or expiring contracts should be reported.

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<sup>31</sup> Prior to the offering the shares were valued within a range from €6 to €7.50 per share. Following the placement, the share price was set at €6.75.

<sup>32</sup> A greenshoe is the option available to the issuer to increase the size of the offering at the time the securities are placed in an operation to list the company in order to meet investor demand for the securities.

<sup>33</sup> In 2015, the share capital of ENAV was reduced, generating a special dividend of €200 million for the MEF. Conversely, the value of the MEF's stake in ENAV declined following the operation.

To conclude, if the 3 per cent limit for the deficit/GDP ratio is to be met in the coming years, as indicated by the Government, we must note that the overall consistency of the budgetary strategy with the other rules of the Stability Pact appears to be exposed to serious risks as regards both the preventive arm and the debt rule. As regards the preventive arm, in 2015, both the structural adjustment path and the expenditure aggregate appear to deviate from the targets set by the rules of the Stability and Growth Pact. For 2016, the deviation could well be considered significant if EU institutions do not grant the Government's request for more flexibility than that already agreed last July. Finally, as from 2016 Italy appears to comply with the debt rule thanks to assumptions about the macroeconomic environment and the privatization programme that could prove overly optimistic.

**Table 2.7** – Contributions to change in debt/GDP ratio (1)  
(percentages)

|                                  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|----------------------------------|-------|-------|-------|-------|-------|-------|
| Debt/GDP                         | 132.3 | 132.8 | 131.4 | 127.9 | 123.7 | 119.8 |
| Change in Debt/GDP               | 3.8   | 0.5   | -1.4  | -3.5  | -4.2  | -3.9  |
| <b>Contributions to changes:</b> |       |       |       |       |       |       |
| Primary surplus                  | -1.6  | -1.7  | -2.0  | -3.2  |       |       |
| Snowball effect                  | 4.0   | 2.6   | 0.8   | 0.1   |       |       |
| caused by:                       |       |       |       |       |       |       |
| Average cost of debt             | 3.6   | 3.3   | 3.2   | 3.4   |       |       |
| Nominal GDP growth               | 0.4   | 1.3   | 2.6   | 3.3   | 3.4   | 3.1   |
| Stock-flow adjustment            | 1.5   | -0.4  | -0.3  | -0.3  |       |       |

Source: based Istat and DBP data.

(1) Any discrepancies between totals and the sum of the individual components are due to rounding.

## Appendix 2.1

### Impact of the 2016 Stability Bill

**Table A2.1.1** – Impact of 2016 Stability Bill on general government accounts  
(millions of euros)

|  | 2016          | 2017          | 2018           |
|--|---------------|---------------|----------------|
| <b>SOURCES</b>   | <b>14,161</b> | <b>13,234</b> | <b>14,104</b>  |
| <i>percentage of GDP</i>   | <i>0.8</i>    | <i>0.8</i>    | <i>0.8</i>     |
| <b>Revenue increases</b>   | <b>5,729</b>  | <b>4,512</b>  | <b>3,213</b>   |
| Voluntary disclosure (with safeguard clause for excise taxes)  | 2,000         | 0             | 0              |
| Taxes on lotteries   | 600           | 600           | 600            |
| Lotteries tenders  | 508           | 0             | 0              |
| Recalculation of purchase value of land and equity investments                                       | 200           | 100           | 100            |
| Revaluation of corporate assets - separate tax   | 109           | 0             | 0              |
| Use of Fund for reduction of tax burden  | 810           | 413           | 411            |
| Reduction of fund for contribution relief for local/company-level bargaining                         | 345           | 326           | 320            |
| Minor measures   | 233           | 219           | 151            |
| Tax effects  | 613           | 2,560         | 1,320          |
| <i>Changes in special tax regime for low-turnover sole proprietors</i>                               | <i>469</i>    | <i>1,212</i>  | <i>821</i>     |
| <i>Tax deduction for home eco works and renovations</i>  | <i>145</i>    | <i>636</i>    | <i>0</i>       |
| <i>Increase in IRPEF from abolition of municipal property tax on agricultural land - state IRPEF</i> | <i>0</i>      | <i>162</i>    | <i>95</i>      |
| <i>Extension of contribution relief for permanent hiring</i>   | <i>0</i>      | <i>550</i>    | <i>349</i>     |
| <i>Testing of early retirement for women</i>   | <i>0</i>      | <i>0</i>      | <i>55</i>      |
| Contributions, withholdings and other charged to employer  | 312           | 293           | 311            |
| <b>Expenditure decreases</b>   | <b>-8,432</b> | <b>-8,722</b> | <b>-10,891</b> |
| <b>Decreased current expenditure</b>   | <b>-6,413</b> | <b>-7,596</b> | <b>-9,597</b>  |
| Recalculation of level of financing of standard national healthcare system funding requirement       | -1,783        | 0             | 0              |
| Contribution of regions and autonomous provinces to public finances                                  | 0             | -3,980        | -5,480         |
| Effect of transition to budget balance on regions  | -1,850        | -1,022        | -660           |
| Contribution of ministries to budget measures - text of law  | -266          | -220          | -220           |
| Contribution of ministries to budget measures - list 2   | -375          | -387          | -369           |
| Contribution of ministries to budget measures - tables   | -243          | -234          | -282           |
| Reduction in Fund for additional intervention for workers safeguarded from impact of pension reform  | -497          | -436          | -394           |
| Additional centralized purchasing (ministries, agencies, social security institutions)               | -216          | -217          | -218           |
| Reduction in Fund for workers in physically demanding jobs   | -150          | -140          | -110           |
| Turnover and ancillary personnel remuneration  | -114          | -227          | -389           |
| Reduction in funds for central government department hiring  | -100          | 0             | 0              |
| Pension indexation measures  | 0             | -514          | -1,146         |
| Minor measures   | -819          | -219          | -329           |
| <b>Decreased capital expenditure</b>   | <b>-2,019</b> | <b>-1,126</b> | <b>-1,294</b>  |
| Contribution of ministries to budget measures - text of law  | -226          | -33           | -18            |
| Contribution of ministries to budget measures - list 2   | -103          | -164          | -172           |
| Contribution of ministries to budget measures - tables   | -890          | -800          | -871           |
| Development and Cohesion Fund  | -670          | 0             | 0              |
| Minor measures   | -130          | -129          | -233           |

**Tab. A2.1.1** – (cont.) Impact of 2016 Stability Bill on general government accounts  
(millions of euros)

|  | 2016           | 2017           | 2018           |
|--|----------------|----------------|----------------|
| <b>USES</b>  | <b>28,743</b>  | <b>32,412</b>  | <b>30,288</b>  |
| <i>percentage of GDP</i>   | 1.7            | 1.9            | 1.7            |
| <b>Expenditure increases</b>   | <b>4,967</b>   | <b>5,507</b>   | <b>5,223</b>   |
| <b>Increased current expenditure</b>   | <b>4,052</b>   | <b>4,894</b>   | <b>4,708</b>   |
| Fund for the fight against poverty and social exclusion  | 654            | 1,054          | 1,054          |
| Grants to provinces and metropolitan areas in ordinary statute regions   | 400            | 400            | 400            |
| Contract renewals  | 300            | 300            | 300            |
| Increase in Fund for economic policy intervention  | 300            | 300            | 300            |
| Benefits of 7th safeguard measure for former workers no longer eligible for a pension following pension reform | 213            | 387            | 436            |
| Testing of early retirement for women  | 160            | 405            | 757            |
| Increase in Fund for the non-self-sufficient   | 150            | 150            | 150            |
| Refinancing of extended social shock absorbers   | 150            | 0              | 0              |
| Increase in National Healthcare Fund - medical students  | 57             | 86             | 126            |
| International development cooperation  | 120            | 240            | 360            |
| Fund for financial support of excess personnel of former provinces   | 100            | 0              | 0              |
| Ordinary university fund for hiring of professors and young researchers  | 93             | 135            | 135            |
| Support for persons with serious disabilities, in poverty and no immediate family                              | 90             | 90             | 90             |
| Measures for the Terra dei Fuochi emergency  | 100            | 100            | 0              |
| Fund for urgent requirements   | 0              | 671            | 0              |
| Minor measures   | 1,165          | 576            | 600            |
| <b>Increased capital expenditure</b>   | <b>915</b>     | <b>613</b>     | <b>515</b>     |
| Long-term restricted fund for budget balance - local authorities   | 676            | 10             | 10             |
| Fund for urgent requirements   | 0              | 200            | 0              |
| Measures for the Terra dei Fuochi emergency  | 0              | 50             | 50             |
| Fund for national emergencies  | 70             | 80             | 85             |
| Minor measures   | 169            | 273            | 370            |
| <b>Revenue reductions</b>  | <b>-23,776</b> | <b>-26,905</b> | <b>-25,065</b> |
| Reduction safeguard clause for VAT and excise tax rates - 2015 Stab. Act                                       | -12,814        | -4,088         | -2,394         |
| Elimination of safeguard clause - 2014 Stab. Act   | -3,272         | -6,272         | -6,272         |
| Abrogation excise tax increase from 2016 - 2015 Stab. Act  | -728           | -728           | -728           |
| Abolition municipal services tax on principal residence and exemption of tenants                               | -3,591         | -3,593         | -3,592         |
| Exception of agricultural land and immovable equipment from municipal property tax                             | -935           | -935           | -935           |
| Reduction of IRES from 27.5% to 24% from 1 January 2017  | 0              | -2,978         | -3,970         |
| Changes in special tax regime for low-turnover sole proprietors  | -186           | -1,725         | -1,113         |
| 40% increase in depreciation on capital equipment  | -170           | -943           | -1,258         |
| Tax deduction for home eco works and renovations   | -113           | -1,077         | -953           |
| Abolition of IRAP for agricultural and fishing enterprises and increase in deductions                          | -167           | -535           | -379           |
| VAT for uncollected receivables in bankruptcy proceedings  | 0              | -340           | -340           |
| Extension of contribution relief for permanent hiring and contribution relief for agriculture                  | -834           | -2,094         | -1,337         |
| Tax exemption on productivity bonuses  | -434           | -589           | -584           |
| Minor measures   | -285           | -513           | -459           |
| Tax effects:   | -23            | -295           | -471           |
| Fund for contribution relief for local/company-level bargaining  | -23            | -116           | -72            |
| Pension indexation measures  | 0              | -179           | -399           |
| Contributions, withholdings and other charged to employer  | -224           | -201           | -280           |
| <b>NET REVENUE</b>   | <b>-18,047</b> | <b>-22,393</b> | <b>-21,852</b> |
| <b>NET EXPENDITURE</b>   | <b>-3,465</b>  | <b>-3,215</b>  | <b>-5,668</b>  |
| <i>current</i>   | -2,361         | -2,702         | -4,889         |
| <i>capital</i>   | -1,104         | -513           | -779           |
| <b>NET BORROWING</b>   | <b>-14,582</b> | <b>-19,178</b> | <b>-16,184</b> |
| <i>percentage of GDP</i>   | -0.9           | -1.1           | -0.9           |

Source: based on data in financial schedules attached to the 2016 Stability Bill and in the Technical Note.

## Appendix 2.2

### Measuring medium-term developments in the public debt

Developments in the public debt can be formalised as follows:

$$(1) D_t = D_{t-1} - PB_t + IP_t + SFA_t$$

where:

$D_t$ : stock of public debt at the end of time  $t$ ;

$PB_t$ : primary balance at time  $t$ ;

$IP_t$ : interest expenditure on public debt at time  $t$ ;

$SFA_t$ : stock-flow adjustment at time  $t$ .

From equation (1), developments in the public debt as a proportion of GDP can be formalised as:

$$(2) d_t = \frac{d_{t-1}}{(1 + g_t)(1 + \pi_t)} - pb_t + ip_t + sfa_t$$

where:

$d_t$ : stock of public debt as a proportion of GDP at the end of time  $t$ ;

$g_t$ : real GDP growth rate at time  $t$ ;

$\pi_t$ : rate of growth in GDP deflator at time  $t$ ;

$pb_t$ : primary balance as a proportion of GDP at time  $t$ ;

$ip_t$ : interest expenditure as a proportion of GDP at time  $t$ ;

$sfa_t$ : stock-flow adjustments as a proportion of GDP at time  $t$ .

In line with the method adopted by the European Commission to analyse debt developments,<sup>34</sup> interest expenditure at time  $t$  is expressed as the sum of three components. The first ( $IP^S$ ) is interest expenditure on short-term public debt.<sup>35</sup> This component includes both short-term debt from the previous year that is refinanced and any new borrowing requirement arising during the year funded with new issues of short-term debt.<sup>36</sup> The second component ( $IP^{L,M}$ ) comprises interest paid on medium/long-term debt<sup>37</sup> that matures during the year and is refinanced, including refinanced debt and any new borrowing requirement that arises during the year that is funded with new

<sup>34</sup> Berti, K. and Carone, G. (2014), "Assessing Public Debt Sustainability in EU Member States: A Guide", European Economy Occasional Papers, n. 200, August.

<sup>35</sup> Short-term debt is debt with an original maturity of less than one year. In our simulations, that debt also comprised variable rate medium/long-term debt and inflation-linked medium/long-term debt.

<sup>36</sup> A negative borrowing requirement, i.e. a surplus, would reduce interest expenditure, as part of the maturing debt could be covered with that surplus rather than with new issues.

<sup>37</sup> Medium/long-term debt is debt with an original maturity of more than one year. In our simulations, that debt comprised only fixed-rate medium/long-term debt, while variable rate or inflation-linked medium/long-term debt was included in short-term public debt (see note 35).

issues of medium/long-term debt.<sup>38</sup> The third component ( $IP^{L,NM}$ ) is represented by interest expenditure on medium/long-term debt that does not mature during the year.

Interest expenditure can therefore be expressed as:

$$(3) IP_t = IP_t^S + IP_t^{L,M} + IP_t^{L,NM} \\ = i_t^S \cdot \alpha^S \cdot (D_{t-1} + \Delta D_t) + i_t^L \cdot (\alpha^{L,M} \cdot D_{t-1} + \alpha^L \cdot \Delta D_t) + i_t^{L,NM} \cdot \alpha^{L,NM} \cdot D_{t-1}$$

where:

$\alpha^S$ : short-term public debt as a proportion of total public debt;

$\alpha^L$ : medium/long-term public debt as a proportion of total public debt;

$\alpha^{L,M}$ : medium/long-term public debt maturing during the year as a proportion of total public debt;

$\alpha^{L,NM}$ : medium/long-term public debt not maturing during the year as a proportion of total public debt;<sup>39</sup>

$i_t^S$ : short-term interest rate at time t;

$i_t^L$ : long-term interest rate at time t;

$i_t^{L,NM}$ : implicit interest rate on medium/long-term debt not maturing during the year at time t.

For the historic data, the implicit interest rate  $i_t^{L,NM}$  is drawn from the identity (3), as all the other variables are known.<sup>40</sup> In the simulation, in line with the Commission method, we assume that the implicit rate at time T+1 (where T is the most recent historical data) is a weighted average of the implicit rate at time T and the medium/long-term rate for the year T. At time T+1 – and analogously in subsequent years – the implicit rate is therefore given by the following equation:

$$(4) i_{T+1}^{L,NM} = \frac{\alpha^{L,NM} \cdot D_{T-1}}{\alpha^L \cdot D_T} \cdot i_T^{L,NM} + \left(1 - \frac{\alpha^{L,NM} \cdot D_{T-1}}{\alpha^L \cdot D_T}\right) \cdot i_T^L$$

Multiplying and dividing the right side of equation (4) by GDP at time T, the implicit interest rate is given by the following expression:

$$(5) i_{T+1}^{L,NM} = \frac{\alpha^{L,NM} \cdot \left(\frac{d_{T-1}}{(1+g_T)(1+\pi_T)}\right)}{\alpha^L \cdot d_T} \cdot i_T^{L,NM} + \left(1 - \frac{\alpha^{L,NM} \cdot \left(\frac{d_{T-1}}{(1+g_T)(1+\pi_T)}\right)}{\alpha^L \cdot d_T}\right) \cdot i_T^L$$

<sup>38</sup> See note 36.

<sup>39</sup> We therefore have  $\alpha^L = \alpha^{L,M} + \alpha^{L,NM}$ . In the simulation, we also assume that the shares  $\alpha$  remain constant over time and equal to that given by the most recent available data.

<sup>40</sup> Istat is the source for interest expenditure, as well as the primary balance, the rate of real GDP growth and the GDP deflator. The source for short and medium/long-term rates of interest is Banca d'Italia, Supplementi al Bollettino Statistico "Mercato finanziario", while that for the public debt is Banca d'Italia, Supplementi al Bollettino Statistico, "Finanza pubblica, fabbisogno e debito". The stock-flow adjustments were taken from differences for the period covered by the EFD and were assumed to be zero in the simulation.

In addition, substitution the expression for debt from equation (1) in equation (3), after some arithmetic<sup>41</sup> and expressing the variables as a proportion of GDP, we obtain the following equation for interest expenditure as a proportion of GDP used in the simulation at time T+1 (and subsequently):

$$(6) \quad ip_{T+1} = \frac{1}{1 - i_{T+1}^S \cdot \alpha^S - i_{T+1}^L \cdot \alpha^L} \cdot \left[ (i_{T+1}^S \cdot \alpha^S + i_{T+1}^L \cdot \alpha^{L,M} + i_{T+1}^{L,NM} \cdot \alpha^{L,NM}) \cdot \frac{d_T}{(1+g_{T+1})(1+\pi_{T+1})} - (i_{T+1}^S \cdot \alpha^S + i_{T+1}^L \cdot \alpha^L) \cdot (pb_{T+1} - sfa_{T+1}) \right]$$

To simulate developments in the debt/GDP ratio from time T+1 and subsequently, equations (5), (6) and (2) are used recursively.

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<sup>41</sup> Available upon request.



### 3. THE MAIN MEASURES IN THE STABILITY BILL

This chapter offers a brief discussion of some of the key measures contained in the 2016 Stability Bill, as originally presented in Parliament on 25 October this year (AS 2111). In particular, on the revenue side, we focus on the abolition of the municipal services tax (the Tasi) for primary residences and on measures affecting corporate taxation. On the expenditure side, attention is focused on measures that affect local government finance, the healthcare sector and, for central government, the ministries. Other measures regard income support and combatting social exclusion, contribution relief for new hiring, tax relief for productivity bonuses and pension measures.

#### 3.1 *The abolition of the Tasi for primary residences*<sup>42</sup>

The 2016 Stability Bill contains various property taxation measures. The most significant concerns the abolition of the Tasi on primary residences (€3.6 billion).<sup>43</sup> Measures with a smaller financial impact include the elimination of the share of the Tasi paid by tenants, the redefinition of municipal property tax (Imu) on agricultural land, with the total exemption of land owned and cultivated by farmers and the revision of the scope of exemption for other owners, and changes in the criteria for determining the tax base for industrial buildings in categories D and E as regards immovable machinery (Table 3.1).

The abolition of the levy on primary residences was justified in the political debate by its potential expansionary effects on the economy through its support for household consumption and the possible impact on the real estate market and the construction industry.

It is therefore necessary to assess this intervention from multiple perspectives: consistency with the overall design of the tax system, the redistributive effects generated, the impact on consumption driven by increased disposable income, the possible effects on the real estate market and the construction industry and the consequences for municipal finances.

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<sup>42</sup> The section draws extensively on the hearing of the Chairman of the PBO as part of the examination of the budget for 2016-18 before the joint Budget Committees of the Senate and the Chamber of Deputies on 3 November 2015. The issues are addressed in even greater detail in *“La cancellazione della Tasi sull’abitazione principale”* (by C. Pollastri), in Focus Paper no. 6, published on 13 November 2015 on the website of the Parliamentary Budget Office.

<sup>43</sup> Value added tax on buildings used as primary residences located abroad (IVIE) was also abolished (IVIE).

**Table 3.1** – Impact on net general government borrowing of property tax measures  
(millions of euros)

| Measures   | Net general government borrowing |               |               |
|--|----------------------------------|---------------|---------------|
|  | 2016                             | 2017          | 2018          |
| Elimination of the TASI on primary residences            | -3,575                           | -3,575        | -3,575        |
| Elimination of share of TASI paid by tenants             | -16                              | -16           | -16           |
| Elimination of IVIE on primary residences                | 0                                | -2            | -1            |
| Partial exemption from IMU of agricultural land (1)      | -405                             | -243          | -310          |
| Redefinition of tax base for building categories D and E | -530                             | -530          | -530          |
| <b>Total</b>   | <b>-4,526</b>                    | <b>-4,366</b> | <b>-4,431</b> |

(1) The measurement includes the impact of the recovery of income tax revenue associated with exemptions from Imu.

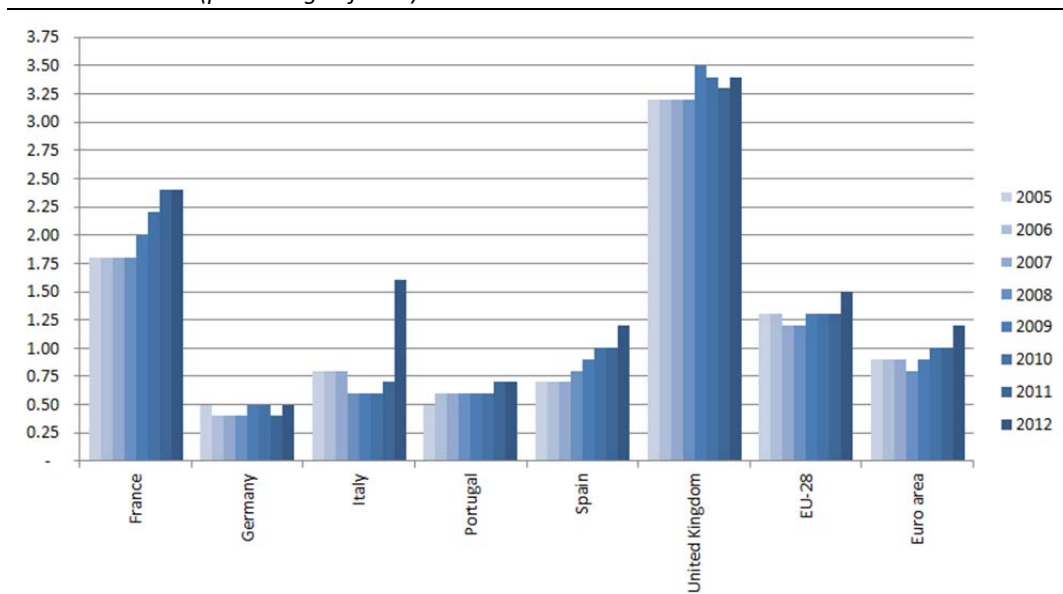
*The international framework.* – Since 2008, recurrent taxation of real estate has increased in all the countries of the European Union and the euro area (Figure 3.1), reaching, respectively, 1.5 per cent and 1.2 per cent of GDP in 2012 (up from 1.2 per cent and 0.8 per cent). It is highest in France and the United Kingdom, where in 2012 it reached 2.4 and 3.4 per cent, respectively; it is lowest in Germany, amounting to about 0.5 per cent of GDP in each year from 2005 to 2012. In Spain, it has risen from 0.7 per cent to 1.2 per cent of GDP.

In Italy developments in recurrent taxation of property have been less uniform: it amounted to about 0.8 per cent of GDP between 2005 and 2007, before declining to 0.6 points in 2008 and 2010 and then rising to 0.7 points in 2011. After the introduction of Imu in 2012, the recurrent property tax burden fell into line with the average for the other EU countries in terms of share of total property taxation and as a percentage of GDP. More specifically, according to Eurostat data, between 2011 and 2012 the ratio of recurrent property tax to GDP rose to 1.6 per cent, compared with the average of 1.5 per cent for the other EU countries (Figure 3.1).

A similar pattern emerges if we analyse the share of recurrent property tax and that of other taxes on property (transaction taxes, inheritance tax, etc.) in total property tax. In 2011, Germany was the only country in which the share of recurrent property tax revenue in total property tax revenue was smaller than in Italy (Figure 3.2). In Germany, however, this occurred in a context in which total property taxation was very low and significantly less than the European average.

In the same year, the share of other taxes on property was highest in Italy. In 2012, the introduction of Imu brought Italy closer to the European average: the share of property tax increased over its level in 2011 and, within total property tax, recurrent property tax revenue became predominant.

**Figure 3.1** – Recurrent property taxation in 2005-2012  
(percentage of GDP)



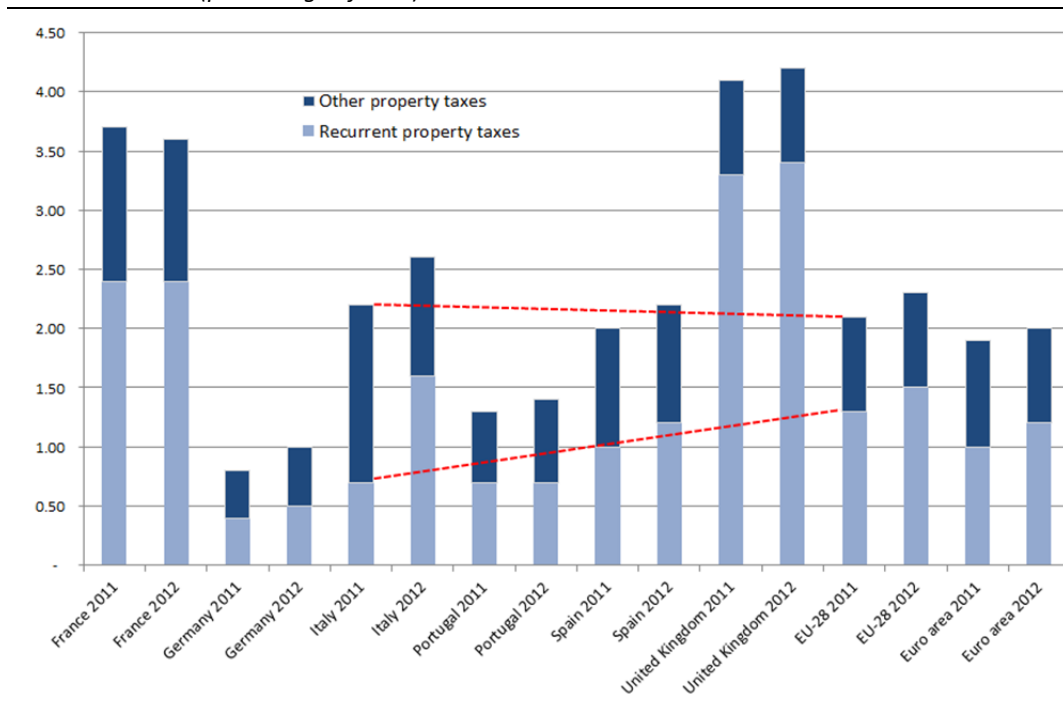
Source: based on Eurostat data.

The reform of 2012 reflected the findings of much of the economic literature and the country specific recommendations of the European Commission, which recommended shifting the tax burden from taxation of the factors of production (capital and labour) to recurrent taxation of real estate, which is less harmful to growth.<sup>44</sup> Compared with this trend towards recurrent property taxation and convergence towards the European average, the abrogation of the Tasi on primary residences would mark a reversal of course, similar to the change that occurred in 2013 with the abolition of Imu on primary residences. In addition, as a result of the measure envisaged in the Stability Bill, Italy would be one of the few countries in which primary residences are exempt from any form of levy, whether in the form of a recurrent wealth tax or of property income, despite levels of ownership of primary residences comparable to the European average.

*The redistributive effects on taxpayers.* – Measuring the redistributive effects for taxpayers of the cancellation of the Tasi on primary residences must first take account of the fact that municipalities have adopted very different approaches in setting the tax rate and, above all, determining deductions.

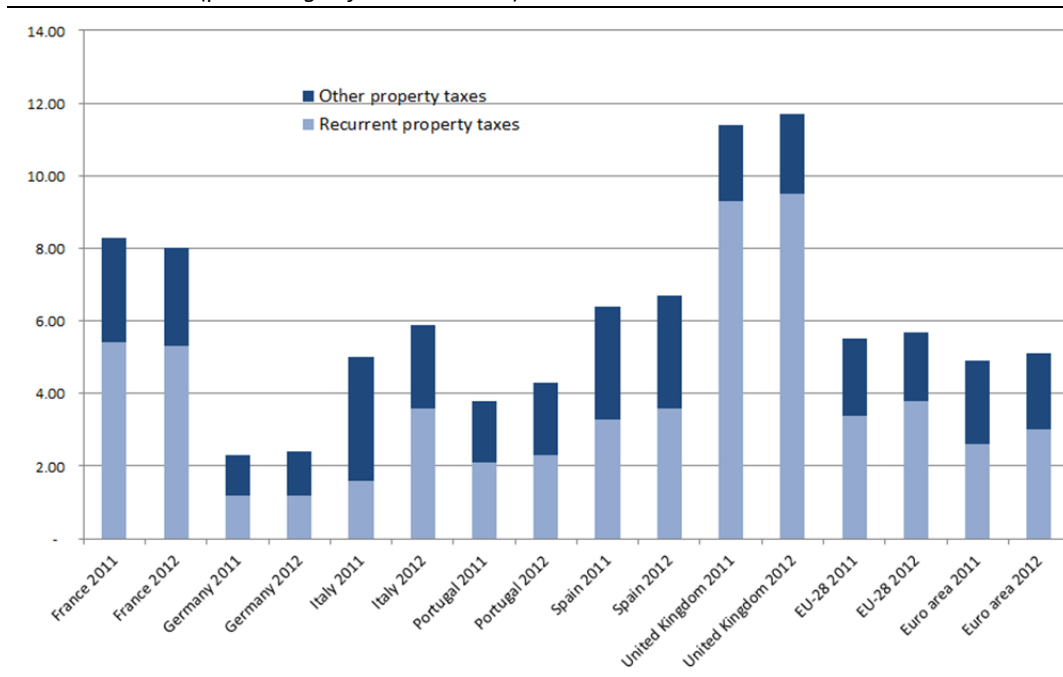
<sup>44</sup> For a summary of the European Commission's recommendations on property taxation, see Agenzia delle entrate (2015), *"La tassazione immobiliare: un confronto internazionale"*, available online. The recommendations for Italy and the other European countries can be consulted directly on the official site of the European Commission ([http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index\\_en.htm](http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm)).

**Figure 3.2** – Property taxation in 2011 and 2012  
(percentage of GDP)



Source: based on Eurostat data.

**Figure 3.2** – (cont.) Property taxation in 2011 and 2012  
(percentage of total taxation)



Source: based on Eurostat data.

In 2014 (the latest year available), only 18 per cent of municipalities, accounting for 8.5 per cent of the Italian population, maintained the standard rate on primary residences (a rate of 0.1 per cent with no deductions). More than 60 per cent of municipalities set a higher rate, while 16 per cent adopted a lower rate. Some 6.8 per cent of municipalities, accounting, however, for almost a quarter of the Italian population, applied the surtax of 0.08 per cent in full or in part. Moreover, almost 30 per cent of municipalities introduced deductions, with two-thirds varying the relief on the basis of various indicators (mainly imputed cadastral income/value, but also the ISEE economic situation indicator, number of dependent children, etc.) or restricting it to particular categories of taxpayer. Ultimately, about 48 per cent of the population resides in municipalities that have introduced variable deductions and about 10 per cent in municipalities that have approved a fixed deduction. Despite this diversity of approaches, it is still possible to identify certain significant regularities. The average levy is higher in large municipalities than it is in smaller communities (0.25 per cent in municipalities with over 15,000 inhabitants and about 0.11 per cent in municipalities with up to 1,000 inhabitants), and in Central Italy, Piedmont and Emilia Romagna than it is in the regions in the South and special statute regions.

The heterogeneity of tax systems among municipalities makes it difficult to obtain a comprehensive view of the redistributive effects of the Tasi on primary residences (and therefore, with the opposite sign, the impact of its cancellation) because taxpayers with the same relevant characteristics are subject to different levels of tax depending on where they reside (horizontal equity issues). A summary indicator can still be obtained by focusing solely on the average implicit rate for households ranked in accordance with different indicators of ability to pay.<sup>45</sup>

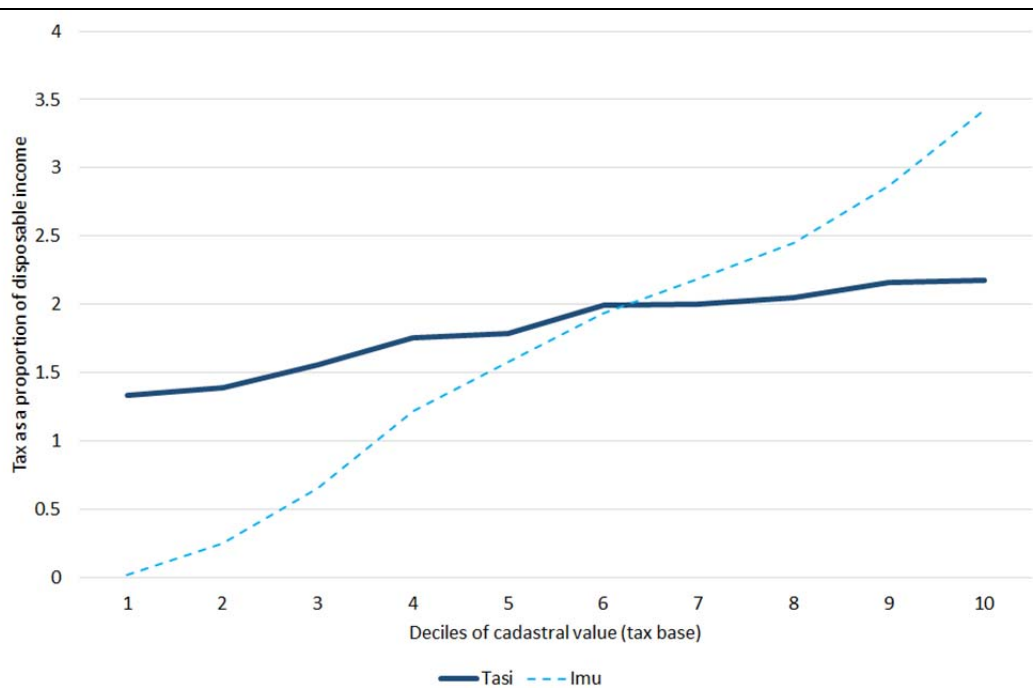
Figure 3.3 shows the trend in the size of the levy in relation to the cadastral value of the primary residence for all Italian households (including owners and non-owners of the residence) ordered by deciles of imputed cadastral income.<sup>46</sup> The tax is slightly progressive with respect to its tax base: the implicit rate increases with the value of the property, from a low of 0.13 per cent for the first decile to about 0.22 per cent for the tenth. Owing to the different structure of the tax, the progressivity of the Tasi is much less pronounced than that of the earlier property tax on primary residences (Imu), which was characterized by a basic deduction determined centrally and applied by all municipalities. Consequently, the tax relief resulting from the elimination of the Tasi is greater as a proportion of cadastral value for the owners of higher value homes.

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<sup>45</sup> The results discussed here were obtained through a microsimulation based on data drawn from the Bank of Italy's 2012 Survey on Household Income and Wealth. The study measured the amount of IMU paid on households' primary residence in 2012. On the basis of the IMU actually applied by municipalities in 2012 (source: Istituto per la Finanza e l'Economia Locale – IFEL), it was possible to reconstruct the tax base of the tax and subsequently to simulate the corresponding Tasi revenue for 2014 (using the Tasi on the main residence as applied in 2014; source: IFEL). The raw data, which overestimate 2012 revenue from IMU on primary residences, underwent a process of post-stratification and calibration so as to reproduce the distribution of payments by amount class.

<sup>46</sup> This analysis considers only general deductions and those linked to imputed cadastral income/value. The simulation did not take account of deductions linked to other indicators or specific to certain taxpayer categories.

**Figure 3.3** – Implicit Tasi and Imu rates on primary residences by decile of imputed cadastral income in 2014



Source: based Bank of Italy and IFEL data.

Changing analytical perspective, different results are obtained when we consider the size of the levy with respect to a general indicator of ability to pay such as disposable income.<sup>47</sup> Figure 3.4 shows the trend in the size of the levy in relation to income for all the Italian households ranked by decile of equivalent disposable monetary income. The proportion in respect of income is highest for the first decile (1.2 per cent), while it remains broadly constant for subsequent deciles, with values of between 0.7 and 0.5 per cent. The tax is therefore broadly neutral with respect to income, with the notable exception of the first decile, where households with low incomes that own their homes incur an especially large tax burden in relation to their disposable income.<sup>48</sup> These households are therefore those which, in relation to income, would see their disposable resources increase the most from the elimination of the tax. The percentage increase in income for other households appears to be virtually independent of their economic status. Obviously, because the tax savings for deciles above the first are essentially

<sup>47</sup> The study considers household aggregates to capture actual standards of living, taking account of all forms of income produced within the household and the needs of its members. The monetary income considered here is equal to the sum of compensation of employees, net returns on financial assets and transfers. In order to adjust for the size of households, the total income received by household members was rendered equivalent by dividing by the square root of the number of household members (OECD square root scale) in order to obtain a measure of per capita income that takes account of the economies of scale achieved in larger households.

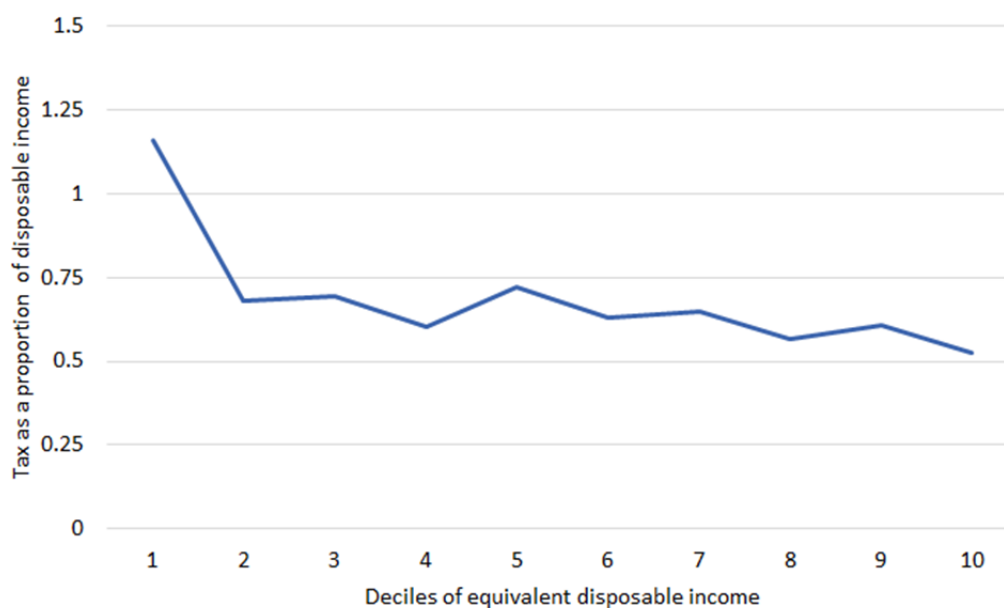
<sup>48</sup> The simulation did not consider deductions applied on the basis of specific requirements, such as, for example, those that varied in relation to a household's economic situation indicator (ISEE). This may have led to the overestimation of the amount of tax paid by the poorest households. Bear in mind, however, that deductions based on the ISEE involved only 2.5 per cent of municipalities.

proportional to income, the benefit in absolute value will be greater for households with higher income.<sup>49</sup>

The abolition of the tax thus makes the tax system more progressive if we do not consider the influence of home ownership on household well-being, and this is due solely to the high rate of tax for homeowners with low monetary incomes. If, however, the influence of home ownership is also considered, the abolition of the tax should be seen as mildly regressive.

Figure 3.5 highlights the redistributive profile of the Tasi for selected segments of the population. The impact of the levy on income is higher for households with older heads of household, who generally have a higher ratio of assets to income compared with those of working age (due to greater accumulation of wealth over a lifetime) and for households with one or two members. As for employment status, the tax burden is heavier for the self-employed than for employees and increases as the professional status of latter rises. Consistent with the distribution by age group, the tax burden is highest among pensioners. Finally, the tax weighs less, albeit modestly, on holders of homes located in central urban areas, partly due to the misalignment between imputed cadastral values and market values, which presumably generates the most unfavourable effects for areas of more recent construction.

**Figure 3.4** – Tasi on primary residences as a proportion of disposable income



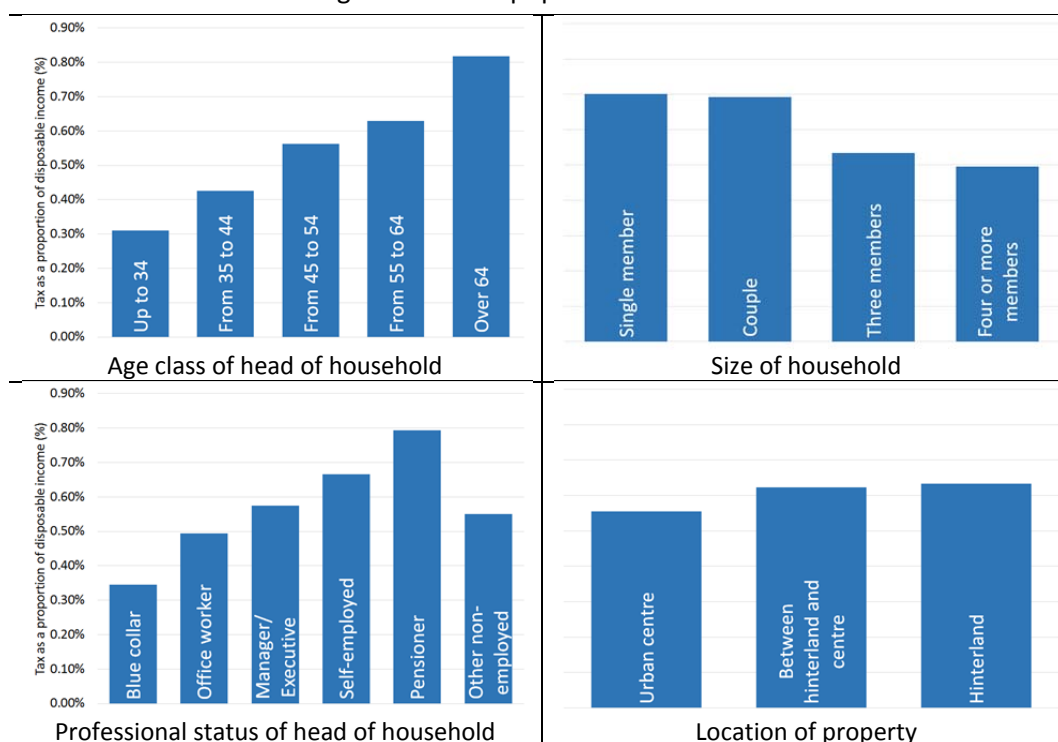
Source: based on Bank of Italy and IFEL data.

<sup>49</sup> The Department of Finance, in responding to a Parliamentary question from the Hon. Paglia of 24 September 2015, provided some information on the distribution of revenue from the Tasi on primary residences by taxpayer income class. However, the data does not permit a full assessment of the distributive effects of the Tasi in relation to the economic condition of Italian households. The Department's figures regard: personal income subject to personal income tax rather than household income including net income from financial assets and income exempt from personal income tax; and Tasi taxpayers only, rather than the entire universe of Italian households. Accordingly, while the information provided by the Department offers clues to the distribution of the tax liability, it permits no conclusions about the progressivity of the tax with respect to household income.

*The effects on consumption.* – Some idea of the potential effect on consumption of the greater disposable income resulting from the cancellation of the Tasi on primary residences can be gleaned from an estimate of the marginal propensity to consume of households owning their primary residence broken down by income decile.<sup>50</sup> The overall increase in consumption resulting from multiplying the tax savings by the marginal propensity to consume would amount to about 44 per cent of the total reduction of the tax, or about €1.5 billion. Assuming a propensity to import of 30 per cent, the boost to domestic consumption would be around €1.1 billion.

The expansionary impact of the cancellation the Tasi on primary residences is partly limited by the fact that, in absolute terms, the largest share of the additional income resulting from the tax reduction would go to the wealthiest households, which have a lower marginal propensity to consume. As shown in Figure 3.6, the fifth to tenth deciles, whose average propensity to consume is about 10 points lower than that of the poorest households (deciles one through five), receive about 68 per cent of the additional resources generated by the abolition of the tax.

**Figure 3.5** – Tasi on primary residences as a proportion of disposable income for different segments of the population



Source: Based on Bank of Italy and IFEL data.

<sup>50</sup> Marginal propensities to consume can be estimated using the information collected in the Bank of Italy's 2010 Survey of Household Income and Wealth. As part of that survey, the respondents were asked the following question: "Imagine you unexpectedly receive a reimbursement equal to the amount your household earns in a month. How much of it would you save and how much would you spend?"

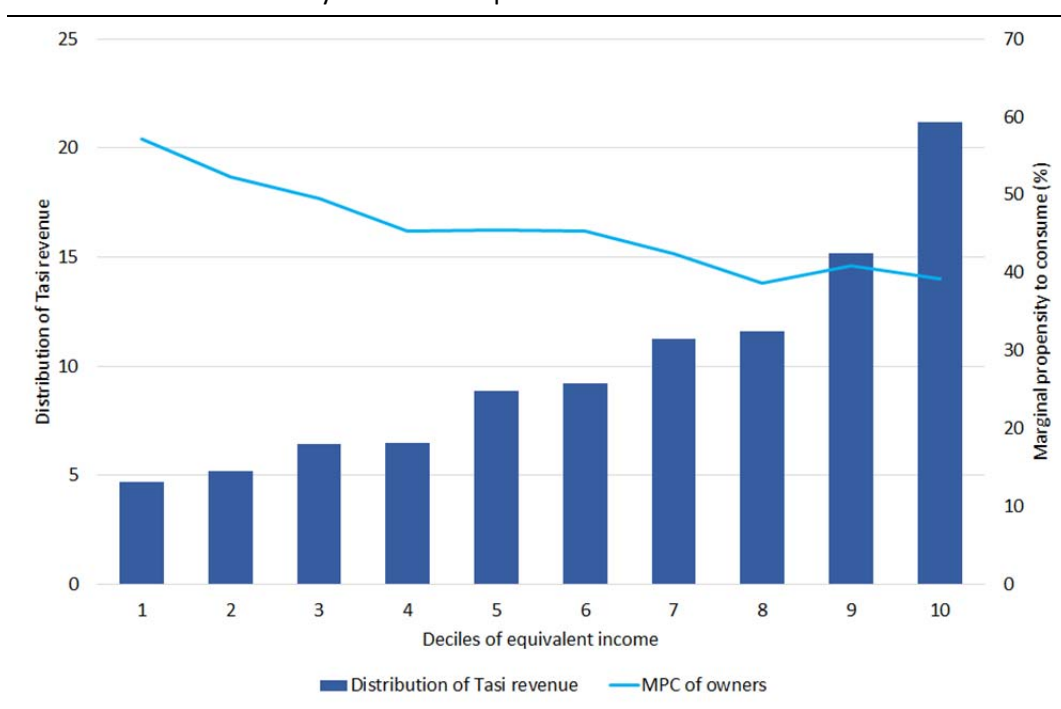


An alternative assessment can be derived by applying the estimates obtained by Surico and Trezzi (2015),<sup>51</sup> who use the data from the Bank of Italy survey to study the negative impact on consumption that the reintroduction of the tax on primary residences would have had in 2012. Overall, the authors estimate that consumption would decline by 42 per cent of the total tax, due entirely to the decrease in spending on durable goods, in particular motor vehicles, by households with a mortgage. For the latter, the reduction in spending would be equal to about 2.7 times the increase in the tax. Assuming a symmetrical recovery in previously reduced consumption when the tax is abolished, the aggregate results would be very similar to the findings noted above.

The magnitude of the impact on consumption is also determined by the perception that taxpayers have of the effective structural nature of the reduction in the tax burden.

The more the tax cut is perceived as permanent, the larger the impact on consumption.<sup>52</sup> Moreover, the sequence of abolition and reintroduction of the tax on primary residences experienced in the recent past can influence the formation of taxpayer expectations.

**Figure 3.6** – Estimate of the marginal propensity to consume and distribution of Tasi revenue by deciles of disposable income



<sup>51</sup> Surico, P. and Trezzi, R. (2015), “Consumer Spending and Property Taxes”, FEDS Working Paper No. 2015-057.

<sup>52</sup> The estimates of the increase in consumption reported above, based on the question in the Bank of Italy survey, regard a temporary income shock. If the increase in income were perceived as permanent, the corresponding increase in consumption should be larger.

*The effects on the real estate market.* – Even more uncertain to evaluate are the potential effects of the abolition of the Tasi on the real estate and construction industries. The crisis in real estate market was very severe in the past few years: between 2007 and 2013 total sales of buildings and those of principal residences contracted by about 40 per cent and 35 per cent,<sup>53</sup> respectively, while the index of production in construction decreased by more than 45 per cent between January 2008 and August 2015.<sup>54</sup> Together with the general contraction in economic activity, a number of other factors have also contributed to the crisis in the sector, probably including property taxation, which expanded from about €9.6 billion in 2011 to €23.8 billion in 2012. However, unlike the positive effects on the construction industry generated by tax deductions of expenses for building renovations and energy efficiency initiatives – as demonstrated by analyses of data from the Bank of Italy and Cresme – it is no simple task to isolate the impact on the real estate sector of a change in taxes, even one as large as the abolition of the Tasi on primary homes.

One consideration is that the abolished tax was relatively small compared with the aggregates involved. As the imputed cadastral value is on average about 3.6 times lower than market value,<sup>55</sup> a tax of 0.1 per cent of the Tasi tax base is equal to about 0.05 per cent of the purchase value of the property. The present value of the stream of taxes paid in the future over an infinite horizon,<sup>56</sup> is about 2.4 per cent of the market value of the property using a discount rate of 2 per cent.

It can be assumed that the primary residence segment is less sensitive to the impact of the introduction or abolition of a recurrent tax compared with other residential property, as we can plausibly assume that in the former case demand is less elastic to price.

*The municipal solidarity fund and effects on local finances of property tax measures.* – The elimination of the Tasi on primary residences (and the exemption from Imu for land owned and cultivated by farmers) impacts municipal finances in different ways. The abolition of the levy on primary residences deprives municipal governments of an important tool of fiscal autonomy, which was widely exploited in 2015 with variations in tax rates and deductions. In the same vein, the Stability Bill, pending a comprehensive reform of municipal property taxation to be implemented in 2016, blocks any increase in the rates of taxes that can be adjusted by local governments<sup>57</sup> from the level approved

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<sup>53</sup> See Dipartimento delle Finanze, Dati sul registro e successioni ([http://www1.finanze.gov.it/pagina\\_dichiarazioni/registro.html](http://www1.finanze.gov.it/pagina_dichiarazioni/registro.html)).

<sup>54</sup> See Istat, *Indice della produzione nelle costruzioni* (<http://www.istat.it/it/congiuntura>).

<sup>55</sup> See Agenzia delle entrate (2010), *“Gli immobili in Italia”*.

<sup>56</sup> The introduction of a capital tax generates a loss of value for the asset owner equal to the present value of the sum of future taxes where the transfer of the capitalisation of the tax to the price is effective. This depends on market conditions.

<sup>57</sup> The freeze also regards regional governments, with the exception of those subject to measures for the health sector. Recall that the Technical Report to the Stability Bill states that, on the basis of current regulations governing that sector, if the regions do not reduce expenditure sufficiently, fiscal measures and other automatic mechanisms will be used to prevent deficits. The freeze does not apply to the Tari (waste

for 2015. It also maintains for 2016 –for municipalities that had approved the measures in 2015 – increases in the Tasi for properties other than primary residences at their 2015 level. The budget measures also provide for each municipality to receive full compensation via transfers of lost revenue from the levies abolished, which entails a revision of the funding and allocation criteria of the municipal solidarity fund (MSF).

As regards the impact on municipal fiscal autonomy, it should be emphasized that the cancellation of the Tasi on primary residences and the freezing of local tax rates at their 2015 levels subtract a large portion of local government fiscal flexibility. For the Tasi on primary residences, in 2014 about 73 per cent of municipalities (45 per cent in terms of population) had not raised the rate to the maximum of 0.25 per cent. Although some municipalities had exhausted their room for manoeuvre with the other municipal taxes also affected by the freeze, ample room for flexibility remained unused: about a third of the average residual fiscal effort in respect of Imu for other properties had not yet been exploited in 2013, while more than two-thirds of municipalities (corresponding to more than 40 per cent of the Italian population) would be able to increase personal income tax rates.<sup>58</sup>

It should also be pointed out that the procedures established in the Stability Bill for compensation via transfers of the reduction in revenue due to the cancellation of the Tasi on primary residences impact the issue of fiscal autonomy granted to municipalities. The budget establishes that compensation shall not be based on revenue at the standard rates of the abolished levy but rather the actual fiscal effort of each municipality in 2015.<sup>59</sup> Given the freeze on the independent powers of taxation of the municipalities, the measure is necessary to ensure that the local governments that increased the levy on now-exempt tax bases are able to maintain the same level of resources as the previous year. At the same time, it produces distorted incentives for fiscal choices at the municipal level: this approach to compensation gives municipalities that exercised a larger fiscal effort in the past a higher level of resources in the future without the burden falling on their own citizens. A similar approach had been adopted several times in the past, in the case of the abolition of the ICI on primary residences, and with the shift from the ICI to the Imu, offsetting the actual revenue generated by the taxes abolished. A simulation exercise enables us to identify the amount of extra transfers that municipalities with higher tax

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disposal tax) and measures taken by municipalities to gain access to the advances of liquidity provided for in Decree Law 35/2013. Municipalities in financial distress or close to that state are also exempt from the freeze.

<sup>58</sup> Some 15.9 per cent of municipalities – accounting for 18.5 per cent of the Italian population – had used all their room for revenue raising from the municipal personal income surtax, while 14.5 per cent of municipalities – 39.8 per cent of the population – would have to increase taxes on the lowest incomes if they wanted to raise revenue (given that the highest incomes were already taxed at the maximum rate) with fairly severe political costs. See Ufficio parlamentare di bilancio (2015), *“Tendenze dell’autonomia tributaria degli enti territoriali”*, hearing of Alberto Zanardi on the implementation and outlook for fiscal federalism before the Parliamentary Committee on the Implementation of Fiscal Federalism, 22 January.

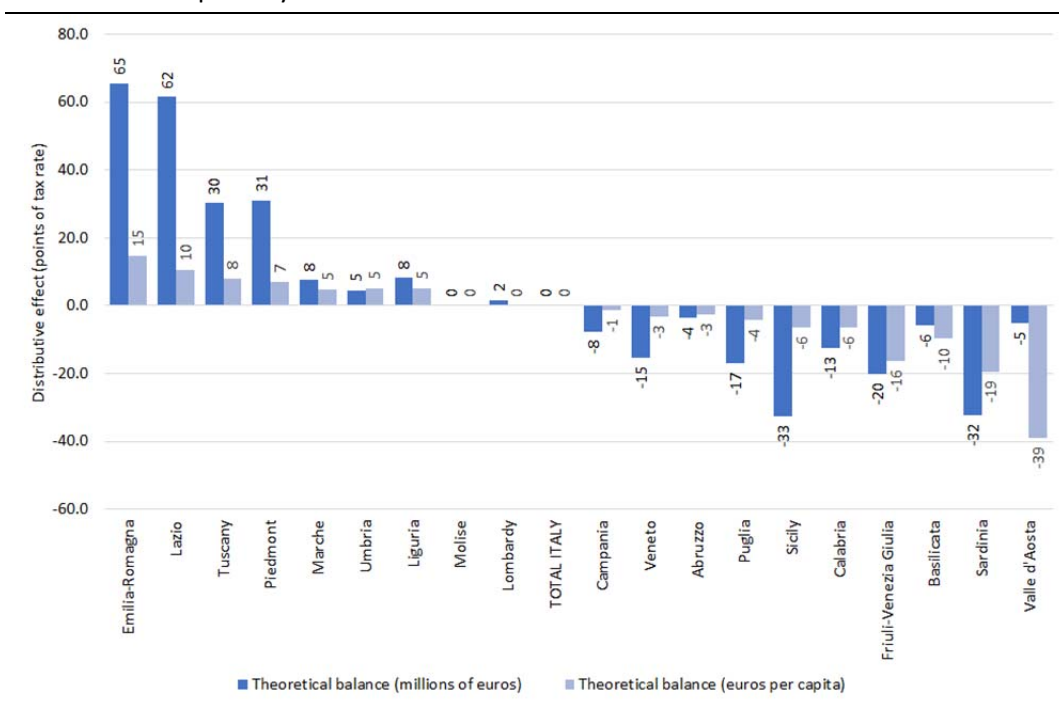
<sup>59</sup> The resolutions approved in the city council approved by 30 July are approved (with the exception of municipalities in Sicily, the provinces and metropolitan areas, for which the deadline is 30 September).

rates receive thanks to the compensation mechanism.<sup>60</sup> Municipalities in Emilia-Romagna are the biggest beneficiaries of the compensation scheme (+€65 million in all, or €15 per capita) while those in Sardinia and Valle d’Aosta (which applied lower Tasi rates) are the most disadvantaged (Figure 3.7).

With regard to the impact of the compensation of abolished revenue on the municipal solidarity fund (MSF), the Stability Bill provides for an increase of €3,668 million in fund resources, to offset the €3,500 million loss of revenue with abolition of the Tasi on primary residences, the €152.4 million loss of revenue with the exemption from the Imu of land owned and cultivated by farmers and the €15.6 million loss in respect of Tasi charged to tenants in municipalities located in the ordinary statute regions (RSO), Sicily and Sardinia. In municipalities located in the other special statute regions (RSS) the foregone revenue amounts to about €82.7 million, which were offset by reducing the amount set aside in the mechanism for contributing to national tax revenue.

For each municipality, in 2016 the amount of “historic” MSF resources (not resulting from the application of standard requirements) is the sum of 2015 resources reduced by the lower amount of contributions and increased by the new Imu-Tasi compensation. The total “historic” resources for each municipality thereby remain unchanged.

**Figure 3.7** – Distributive effects of the compensation mechanism for the Tasi on primary residences



<sup>60</sup> In order measure the increase in revenue from the compensation mechanism introduced to offset the abolition of the Tasi, we can quantify the difference between the compensation provided for under the Stability Bill and an alternative arrangement that, while maintaining the overall resources for the segment, distributes the Tasi revenue in relation to the distribution of the tax base. The analysis used the distribution of actual revenue from the Tasi on primary residences for 2014, meaning that it does not take account of the additional fiscal effort applied in 2015.

### 3.2 Corporate taxation

The budget for 2016 includes measures with a significant impact for firms: they provide for a reduction in their tax burden totalling about €5.3 billion in 2017 and €6.3 billion in 2018 (Table 3.2). This accounts for about a quarter of the total value of the budget measures on the revenue side and a third of a point of reduction in the tax burden. Over 60 per cent of the reduction will go to corporations, proportionately, due to the change in the official Ires rate.

From a qualitative point of view, the measures can be divided into three groups (Table 3.3):

- 1) The first involves a number of changes in the structure of taxation, both for corporations, with a reduction in the Ires rate, and for those engaged in agriculture and cooperatives and consortia that provide services to the sector, with their exclusion from the application of IRAP. In addition, the budget provides for more generous deductions from the IRAP tax base for companies with a low turnover.

For corporations the official Ires rate falls from 27.5 per cent to 24 per cent as from 2017. The measures envisage two possible scenarios. In the first, the entire decrease in the tax rate would come in 2017; in the second, the rate would fall by 3 points in 2016 and by an additional half a point in 2017. The Bill subordinates the latter scenario to receiving European approval of budget flexibility in reflection of the burdens of coping with the flow of migrants and the consequent consistency with the European regulations of a net policy borrowing target of 2.4 per cent of GDP.

Those working in agriculture and fisheries (already taxed at a subsidized rate of 1.9 per cent) are granted an exemption from IRAP, while small taxpayers (taxable income not exceeding €180,999.91) are granted an increase in amounts deductible from IRAP, while deductions are increased for certain types of taxpayer.<sup>61</sup> These measures represent a further erosion of this levy, which has undergone a gradual emptying of its tax base, now increasingly distant from the definition of net value added, since the year following its introduction in 1998.

- 2) A second group of measures is aimed at modifying of the criteria for access to flat-rate regimes for professionals and small businesses (see below) and at reducing and rationalising the fiscal status of certain operations that should mainly regard non-operating companies. In the latter case, the solution has been to apply separate taxation, more favourable than the ordinary taxation system, to remove property defined as “non-profit-generating” from the system of corporate taxation.
- 3) A third area of intervention establishes tax incentives for new investment in plant and equipment by firms in the period between 15 October 2015 and 31 December 2016. The relief measure provides tax savings in the form of reduced tax with an increase of 40 per cent of the corresponding depreciation charges.

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<sup>61</sup> General and limited partnerships (and equivalent entities) and individuals engaged in commerce, as well as simple partnerships and self-employed individuals engaged in the trades and professions.

This measure gives rise to an annual reduction in income tax proportional to the depreciation charge deductible for the purpose of determining taxable income for Ires or Irpef, depending on the legal status of the company.<sup>62</sup>

The measures on the one hand reflect continuity with the process of structural reform that has characterized the last fifteen years, while on the other they appear to respond, more or less explicitly, to predominantly contingent needs, seeking to accommodate the signs of recovery and the improving confidence of economic agents that have emerged in recent months.

In these terms, the reduction in the official rate of Ires reconciles the desire to ease the tax burden on companies with the need to react dynamically to the pressures of international tax competition (Figure 3.8). The investment incentives represent a more explicit response to a contingent need not only to support but also to drive the economic recovery on the supply side. Other measures, such as the reduction of IRAP, the rules on the separate taxation regime and the incentive scheme for the disposal of “non-profit-generating” assets, appear to form part of a policy to protect smaller businesses in order to compensate, on the one hand, for the competitive advantage of larger enterprises, which have access to more instruments for tax avoidance and tax planning and, on the other, their greater vulnerability in the recession.

**Table 3.2** – Impact of the budget measures on firms

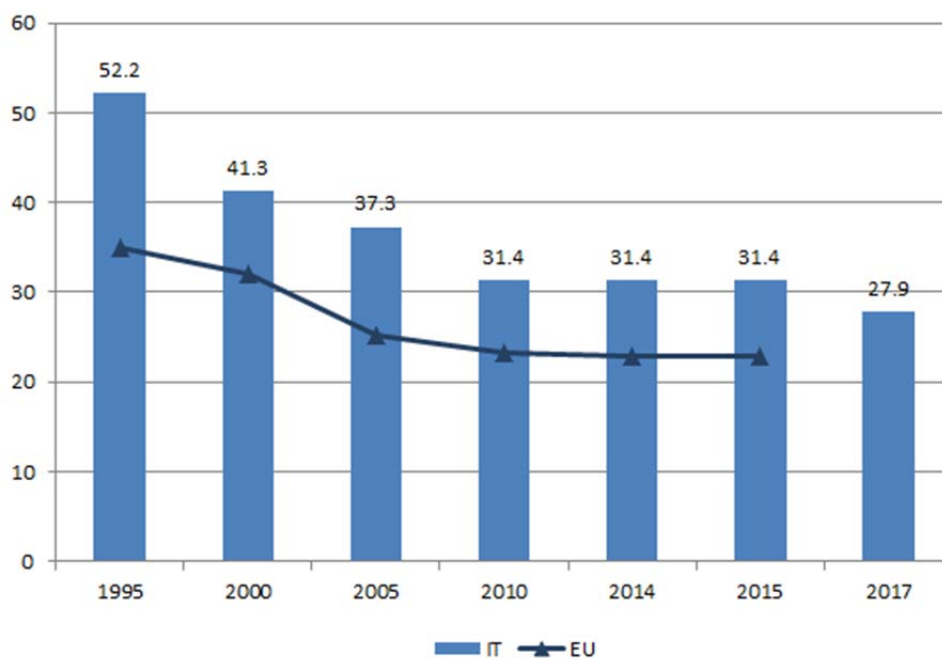
|                 | Millions of euros |        |        | % of GDP |       |       | % of total revenue measures |       |       |
|-----------------|-------------------|--------|--------|----------|-------|-------|-----------------------------|-------|-------|
|                 | 2016              | 2017   | 2018   | 2016     | 2017  | 2018  | 2016                        | 2017  | 2018  |
|                 | Net impact        | -45    | -5,364 | -6,283   | 0.00  | -0.31 | -0.35                       | 0.25  | 23.95 |
| lower revenue   | -563              | -6,596 | -7,108 | -0.03    | -0.38 | -0.40 | 3.12                        | 29.45 | 32.53 |
| greater revenue | 518               | 1,232  | 825    | 0.03     | 0.07  | 0.05  | -2.87                       | -5.50 | -3.78 |

**Table 3.3** – Key measures affecting business  
(millions of euros)

|  | 2016         | 2017            | 2018            |
|--|--------------|-----------------|-----------------|
| 1st category of measures                             |              |                 |                 |
| Reduction in IRES rate                               | 0.0          | -2,977.5        | -3,970.0        |
| Abolition of IRAP for agricultural firms and fishing | -166.9       | -196.4          | -196.4          |
| Increase in deductions from IRAP income              | 0.0          | -338.6          | -177.0          |
| 2nd category of measures                             |              |                 |                 |
| Separate taxation for low-turnover sole proprietors  | 282.6        | -512.1          | -292.5          |
| Tax relief on allocation of assets to partners       | 49.4         | -56.4           | -48.6           |
| 3rd category of measures                             |              |                 |                 |
| 40% increase in depreciation charges                 | -170.0       | -943.0          | -1,258.0        |
| Other  |              |                 |                 |
| VAT for receivables not collected in bankruptcy      | 0.0          | -340.0          | -340.0          |
| Bringing forward revision of penalty system          | -40.0        | 0.0             | 0.0             |
| <b>Total</b>   | <b>-44.9</b> | <b>-5,364.0</b> | <b>-6,282.5</b> |

<sup>62</sup> The relief does not apply to investment in construction and building and any other assets with an annual depreciation charge of less than 6.5 per cent.

**Figure 3.8** – Official Ires and IRAP tax rates (1995-2017)



Source: Eurostat (2015), "Taxation trends in the EU".

However, taken together these measures conspire to further fragment the tax system. This marks a reversal of past policies inspired by the principles of tax neutrality and uniformity, accepting and favouring the complexity and diversity of the business world through the tax system.

### 3.2.1 The reduction in the official Ires rate

The tax rate is a starting point for assessing corporate tax policy. In Italy, total ordinary taxation of profits has decreased substantially since the mid-1990s: in 1995 it stood at 52.2 per cent, and corresponded to the sum of the IRPEG and ILOR rates. Since 2008 it has amounted to 31.4 per cent (Figure 3.8), the sum of the statutory Ires rates (27.5 per cent) and IRAP rate (3.9 per cent).<sup>63</sup> In the same period, the same trend has been evident at the European level as well, with an average reduction rate of about 12 percentage points.

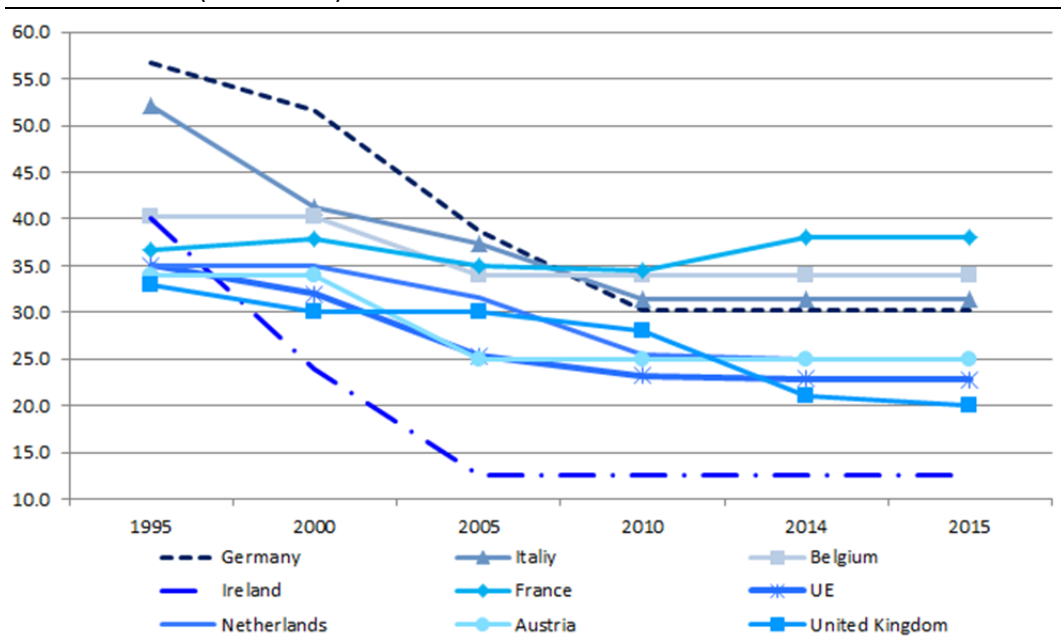
Germany, which in the 1990s – together with Italy – was among the countries with the highest corporate taxation, has reduced its statutory rate by 26.6 percentage points. The same policy was also adopted in countries that had lower-than-average rates, such as Austria, the Netherlands and the United Kingdom. A particularly aggressive policy was

<sup>63</sup> Recent legislation introduced surtaxes equal to 6.5 per cent of IRES taxable income (4 points in 2011-13) for large enterprises operating in the oil, gas and electricity industries and in the hydrocarbon exploration and production sector. The IRAP rate is higher for banks and insurance companies and lower for agricultural enterprises, and may vary on a regional basis.

adopted by Ireland, which has reduced its corporate tax rate by more than 27.5 percentage points, from 40 per cent in 1995 to 12.5 per cent at the beginning of the 2000s (Figure 3.9).

The level of the official tax rate is relevant in quantifying the tax savings associated with tax relief measures (such as, for example, accelerated depreciation, deduction of research and development expenses, investment incentives) and to evaluate the attractiveness of international tax planning (multinational groups can minimize their overall income tax burden by allocating revenue and costs among the countries in which they operate, taking advantage of rate differentials), but does not provide an adequate measure of actual taxation of profits. For this reason, the statutory rates are accompanied by actual (or implicit) rates, or indicators that take account of the specific definition of taxable income and the main tax relief measures. These rates are calculated as the ratio between taxes paid and an economic reference base (at the aggregate level: GDP, gross operating margin, value-added).<sup>64</sup> As they are average rates, they enable measurement of the amount of self-financing taken from enterprises and, accordingly, define the revenue generating capacity for the government.<sup>65</sup>

**Figure 3.9** – Reduction and convergence of official statutory corporate tax rates (1995-2015)



Source: based on Eurostat data (2015).

<sup>64</sup> The difference (positive or negative) between the effective rate and the official statutory rate depends on the combined effect of the definition of taxable income (which may be broader or narrower than statutory reporting profit or loss) and the existence of different statutory tax rates.

<sup>65</sup> Various studies have measured implicit tax rates using aggregate national accounts data. The approach began to be developed in the 1990s, in parallel with the liberalisation of trade and capital movements, in order to identify the role of tax competition in the functional structure of taxation (labour, capital, and consumption). The approach was first developed by Mendoza et al. (1994), using OECD data, and then further developed by Eurostat (*"Taxation trends in the EU"*). A more detailed assessment can be obtained from micro data drawn from corporate financial statements. One advantage of this approach is that it enables simulation of the impact of specific tax policies at both the aggregate level and by sector and firm size, as well as enabling incorporation of any differentiated tax treatment.



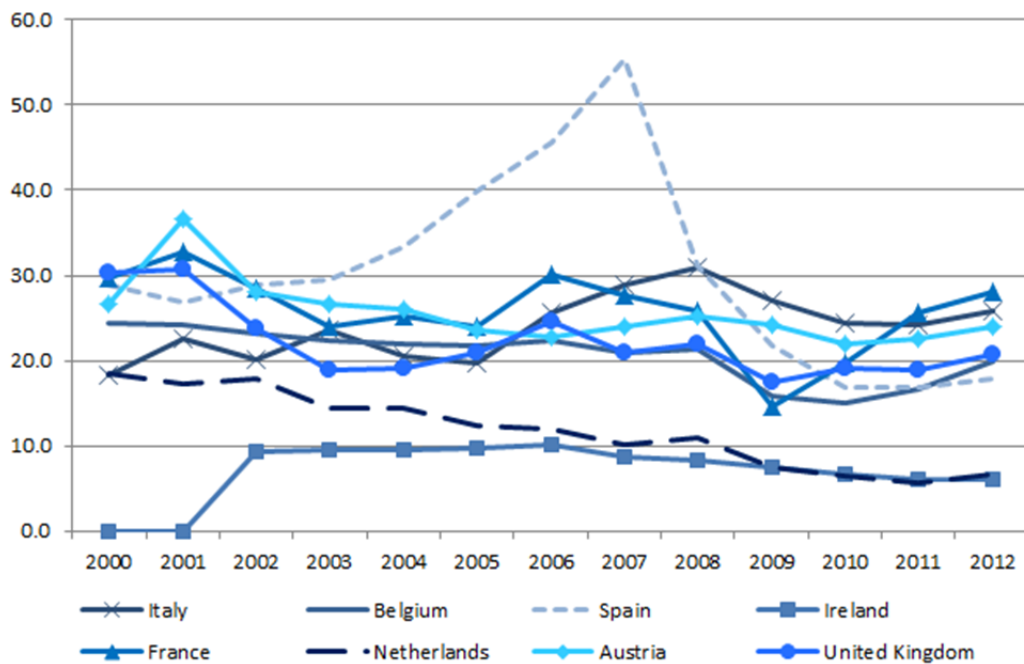
Eurostat calculates the implicit tax rates on corporate profits by using gross operating margin data drawn from the national accounts as taxable income. Note that a reduction in the statutory tax rate does not necessarily correspond to a reduction in the implicit rate (in Italy, the implicit rate increased between 2004 and 2008) and in any case its effect is generally attenuated (Figure 3.10).

In the past, the objectives of tax policy in Italy alternated between trying to respond to the pressures of international competition and the need to preserve revenue.

Until 2007, despite the reduction in rates, revenue was stable and in some cases grew in relation to GDP and total revenue, a development also seen in other countries. For Italy, this can be explained by the expansion of the number of taxpayers and their profitability and, at the fiscal policy level, by a broadening of tax bases.

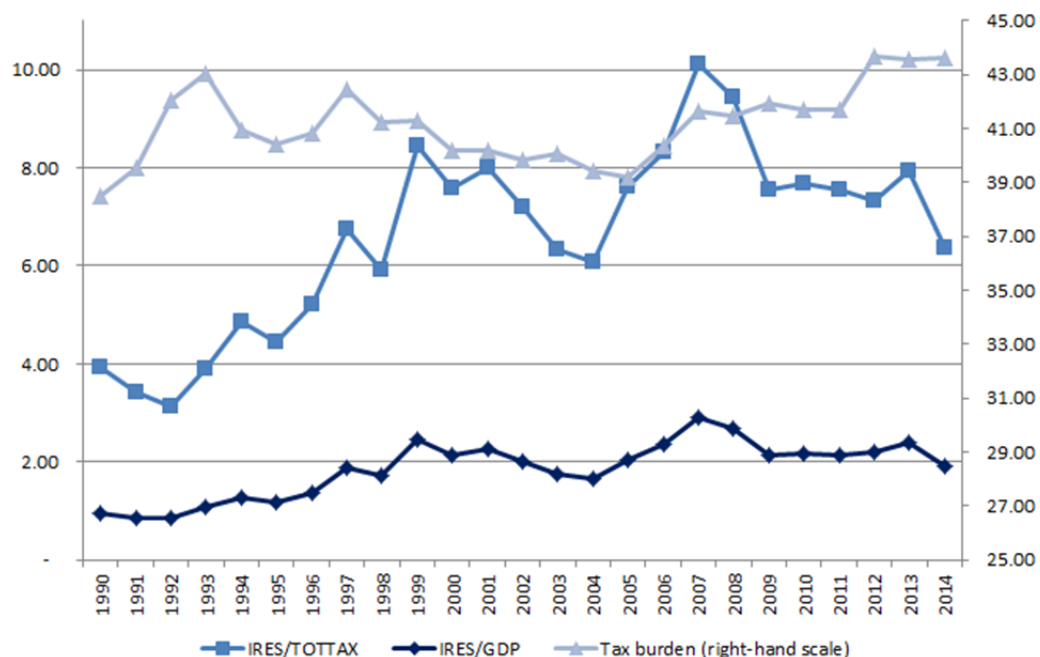
With the recession, corporate profitability declined (especially since 2010) and, consequently, revenue from corporate income tax contracted appreciably (Figure 3.11). Once again, fiscal policy factors contributed (in the opposite direction to their impact in the past) to the erosion of tax bases and amplified the impact of the economic slowdown on corporate income tax revenue. These factors included aid for economic growth and the unlimited carry forward of losses.

**Figure 3.10** – The implicit rate of corporation tax (2000 to 2012)



Source: based on Eurostat data (2015).

**Figure 3.11** – Revenue from corporation tax and the tax burden (1980-2014)



Source: based on Eurostat data (2015).

### 3.2.2 The increase in deductible depreciation for new investments

The Stability Bill introduces of a tax incentive for new investment in plant and equipment made by enterprises between 15 October 2015 and the end of 2016. Specifically, it consists of an increase of 40 per cent in the depreciable cost of the assets acquired. This results in a corresponding increase in the annual depreciation charges that can be deducted for the purpose of determining taxable income and thus in a proportional reduction in income tax.

Among industrial policy measures, tax incentives for investments can take different forms, including accelerated depreciation, tax credits and allowances.

Until 2008, Italy had a system of *accelerated depreciation*, which allowed firms to deduct up to twice the amount of ordinary depreciation charges in the first three years of the life of the capital good, leaving the asset's depreciable amount unchanged. This acceleration of depreciation represented a temporary postponement of revenue by the government. In the most extreme case, this permitted the deduction of the entire cost of investment in the year of acquisition. If a company has sufficient profits to offset this increase in deductibility, we can say that the government participates in the financing of private investment spending in a percentage determined by the statutory tax rate. Subsequently, however, it participates to the same extent in the reduction of pre-tax profits.

The investment policy adopted by a firm influences depreciation charges and therefore the impact of the incentive. In general: a) in the case of a one-off investment, accelerated depreciation is comparable to an interest-free loan granted by the government to firms (temporarily waiving tax revenue); b) in the case of a constant rate of investment, the relief represents a definitive benefit

for the firm and the loan is never repaid; c) in the case of an increasing rate of investment, the annual tax savings will also be definitive (the tax advantage decreases initially, but then grows at the same rate as investment).

One of the main reasons for which accelerated depreciation is frequently adopted as a tool to encourage private investment expenditure lies in its ability to discriminate in favour of companies that are expanding the most.

The *investment tax credit* is a reduction in a firm's tax liability in an amount proportional to the cost of new capital goods: businesses can deduct a certain proportion of the investment cost directly from their tax liability. Changes in the percentage credit granted or in investments change the amount of the tax savings/revenue loss in each period and thus affect the internal funds available to firms. However, the percentage of investment expenditure financed by the tax savings is independent of the investment policy followed by the company. Compared with accelerated depreciation, tax credits do not make any distinction between growing businesses and stable ones, although the tax reduction is greatest when investment is growing.

From the point of view of its economic effects, a tax credit for investment (not deductible from the depreciable amount of the capital good) is comparable, where the firm can absorb the credit, to an investment grant from the government to firms in proportion to their investment expenditure.

A third form of tax incentive is constituted by the *exemption of investments* (investment allowances). This can be likened to accelerated depreciation, but it differs in that it usually does not contribute to reducing the depreciable amount of the asset and is therefore additional to the ordinary statutory depreciation charges.<sup>66</sup>

The effects of different types of incentives also depend on the capacity of enterprises to generate taxable income. In the case of accelerated depreciation or when the deductible amortization charge is increased, as in the case of the increase provided for in the Stability Bill, the incentive is effective only to the extent that the firm has sufficient profits or the capacity to use the tax relief in subsequent tax years through the carry-forward of losses. By contrast, in the case of refundable tax credits, the incentive is effective regardless of the tax position of the firm; if it is non-refundable, it is only effective for firms that have positive taxable income (this effect is attenuated if the credit can be used to reduce a liability for other taxes and if it can be carried forward).

The carrying forward of losses is clearly not equivalent to an immediate and full refund: in the first case, the company incurs a cost equal to the interest that could have earned if it had been able to collect receivables arising upon the determination of its tax payments immediately, without having to postpone receipt until it has sufficient profits to recognize the deductions. If there is a time limit on loss carry-forward, there may not be time, especially in the event of a prolonged recession, for the firm to recover past tax credits, even if it bears the cost of lost interest.

The increase in allowable depreciation introduced with the bill can essentially be considered a tax incentive even though the manner in which it is delivered makes it more like a form of aid.

From an economic point of view, this type of incentive differs from accelerated depreciation, which was used in Italy until 2008, and from traditional tax credits for investments. Compared with the former, the proposed incentive is more generous in that,

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<sup>66</sup> Tax credits and investment allowances differ in the same way as tax credits differ from deductions. They are equivalent when the depreciable amount of the asset is unchanged, the tax is proportional and the percentage allowance is equal to  $k/t$ . With a tax rate of 27.5 per cent, an allowance of 40 per cent and a tax credit of 11 per cent of the value of the asset are equivalent in terms of tax savings for the firm (with sufficient taxable income) and lost tax revenue for the government.

within the limits of the taxable income of the firm, it effectively brings forward depreciation with greater tax savings in the first years of life of the asset, without leading to higher taxes in subsequent years. Essentially, the incentive represents, like a tax credit, an investment grant, but the incentive effect could be reduced because the benefit is spread over the useful life of the asset and it depends on the fiscal capacity of the firm.

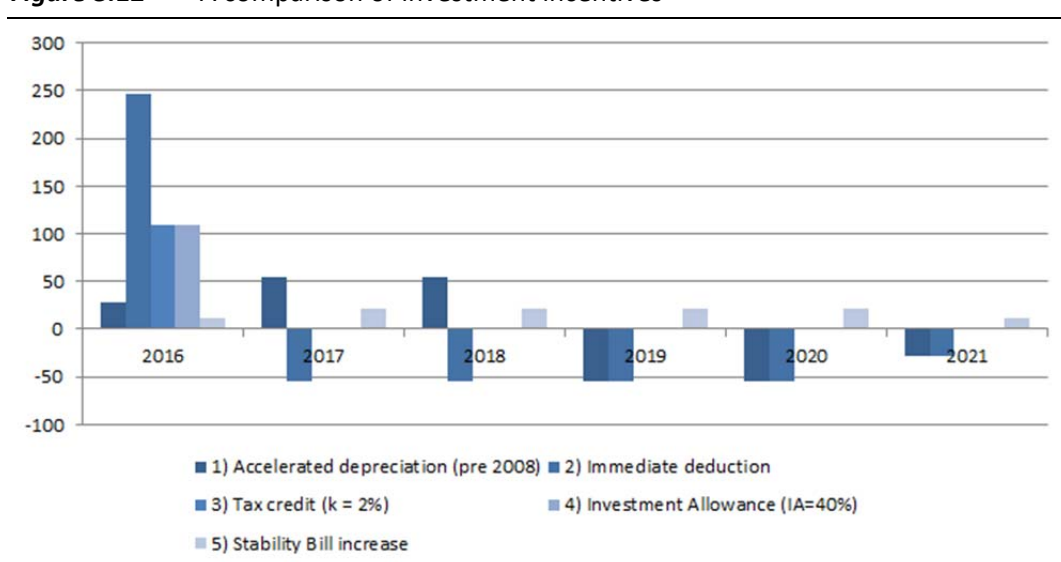
The various incentives can be compared by assuming an investment of €1,000 made by a corporation, depreciable at a rate of 20 per cent<sup>67</sup> and an Ires rate of 27.5. Table 3.4 and Figure 3.12 show the distribution of the additional tax savings for the different types of incentive. For accelerated depreciation, we considered the legislation in force until 2008 (a double depreciation charge in the first three years of the asset's life and a corresponding reduction in the remaining years of life). The tax credit and the investment allowance were designed so as to ensure their equivalence with the increase in the cost of the depreciable asset envisaged in the Stability Bill.

**Table 3.4** – A comparison of investment incentives

|  | Annual tax saving |             |             |             |             |             | Cumulative total | Total present value (rate = 2%) |
|--|-------------------|-------------|-------------|-------------|-------------|-------------|------------------|---------------------------------|
|  | 2016              | 2017        | 2018        | 2019        | 2020        | 2021        |                  |                                 |
| Ordinary depreciation                  | 27.5              | 55.0        | 55.0        | 55.0        | 55.0        | 27.5        | 275.0            | 256.7                           |
| <b>Change with respect to baseline</b> | <b>2016</b>       | <b>2017</b> | <b>2018</b> | <b>2019</b> | <b>2020</b> | <b>2021</b> |                  |                                 |
| Stability Bill increase                | 11.0              | 22.0        | 22.0        | 22.0        | 22.0        | 11.0        | 110.0            | 102.7                           |
| 1) Accelerated depreciation (pre 2008) | 27.5              | 55          | 55          | -55         | -55         | -27.5       | 0.0              | 6.6                             |
| 2) Immediate deduction                 | 247.5             | -55.0       | -55.0       | -55.0       | -55.0       | -27.5       | 0.0              | 12.9                            |
| 3) Tax credit (k=11%)                  | 110.0             | 0.0         | 0.0         | 0.0         | 0.0         | 0.0         | 110.0            | 107.8                           |
| 4) Investment allowance (IA=40%)       | 110.0             | 0.0         | 0.0         | 0.0         | 0.0         | 0.0         | 110.0            | 107.8                           |

Assumptions: Ires rate of 27.5 per cent; straight-line depreciation at 20 per cent (1st year 10 per cent and 6th year remainder).

**Figure 3.12** – A comparison of investment incentives



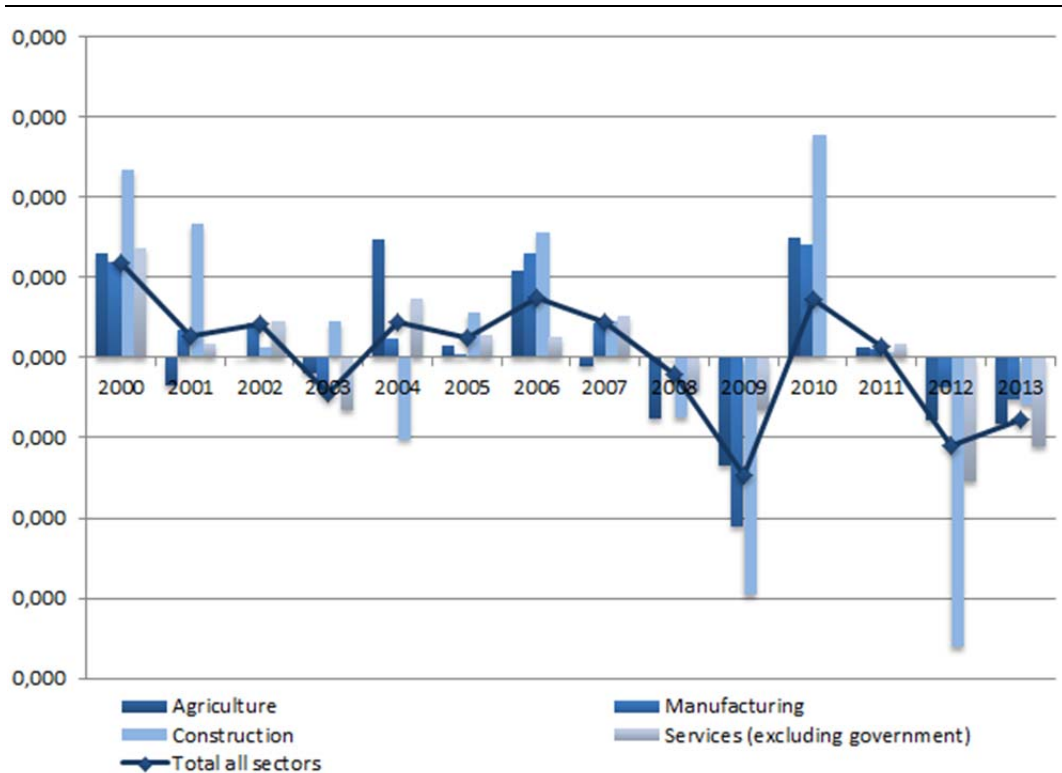
<sup>67</sup> Under current Italian law, the depreciation charge is equal to 10 per cent in the first and sixth year of the asset's life and 20 per cent from the second to the fifth year.

The economic evaluation of the increase in allowable depreciation in terms of encouraging firms to invest must take account of a number of aspects.

- a) On the one hand, the tax relief has been introduced at a special stage of the economic cycle: firms in recent years have significantly reduced the amount of their investments. The national accounts data in Figure 3.13 show developments in gross fixed investment for plant, machinery and equipment from 2000 to 2013, revealing a downward trend since 2007. The same pattern is confirmed at both the sector level (selected industries are reported in Figure 3.13 and Table 3.5) and for the three main components of investments in plant, machinery and equipment: transport equipment, ICT investment and other plant and machinery.

In this context, the impact of the incentive may not be negligible, not only in terms of reducing the cost of capital, but also with regard to the self-financing capacity of firms, easing the borrowing constraint.

**Figure 3.13** – Developments in gross fixed investment (plant, machinery and equipment): total sectors of activity (excluding government) and the main sectors (2000-2013)



Source: based on Istat data.

**Table 3.5** – Developments in gross fixed investment (plant, machinery and equipment): total segments of activity (excluding government) and main industries

| NACE sectors   | Plant and machinery |              |               |               |
|--|---------------------|--------------|---------------|---------------|
|  | 2010                | 2011         | 2012          | 2013          |
| Agriculture, forestry and fishing  | 0.150               | 0.014        | -0.078        | -0.082        |
| Mining and quarrying   | 0.407               | -0.014       | -0.169        | 0.297         |
| Manufacturing  | 0.140               | 0.011        | -0.038        | -0.053        |
| <i>Food, beverages and tobacco products</i>  | 0.259               | 0.003        | -0.014        | n.a.          |
| <i>Textiles, wearing apparel, leather and related products</i>   | 0.121               | -0.009       | -0.054        | n.a.          |
| <i>Wood, paper and printing</i>  | 0.236               | 0.016        | -0.046        | n.a.          |
| <i>Manufacture of coke and refined petroleum products</i>  | -0.158              | 0.016        | 0.112         | n.a.          |
| <i>Manufacture of chemicals and chemical products</i>  | 0.046               | 0.015        | -0.138        | n.a.          |
| <i>Manufacture of basic pharmaceutical products and pharmaceutical preparations</i>                      | 0.048               | 0.019        | 0.013         | n.a.          |
| <i>Manufacture of rubber and plastic products and other non-metallic mineral products</i>                | 0.351               | 0.009        | -0.044        | n.a.          |
| <i>Manufacture of basic metals and fabricated metal products, except machinery and equipment</i>         | 0.122               | 0.007        | -0.054        | n.a.          |
| <i>Manufacture of computer, electronic and optical products</i>  | -0.053              | 0.008        | -0.105        | n.a.          |
| <i>Manufacture of electrical equipment</i>   | 0.249               | 0.021        | -0.258        | n.a.          |
| <i>Manufacture of machinery and equipment n.e.c.</i>   | 0.236               | 0.020        | -0.077        | n.a.          |
| <i>Manufacture of motor vehicles</i>   | -0.011              | 0.019        | 0.291         | n.a.          |
| <i>Manufacture of furniture, other manufacturing, Repair and installation of machinery and equipment</i> | 0.052               | 0.028        | -0.203        | n.a.          |
| Electricity, gas, etc. supply  | 0.107               | 0.021        | -0.077        | 0.118         |
| Water supply; sewerage; waste management and remediation activities                                      | 0.123               | 0.012        | 0.252         | -0.161        |
| Construction   | 0.275               | 0.005        | -0.362        | -0.060        |
| Services (excluding government)  | 0.002               | 0.016        | -0.155        | -0.110        |
| <b>Total sectors (excluding government)</b>  | <b>0.073</b>        | <b>0.014</b> | <b>-0.110</b> | <b>-0.076</b> |

Source: based on Istat data.

- b) On the other hand, the recession has reduced corporate profits, generating more losses in recent years. The ability to use losses carried forward as a deduction from income already represents a major factor in limiting the corporate tax burden in the coming years. A new deduction from taxable income could further reduce corporate fiscal capacity, diminishing the attractiveness of the incentive in the short term. This weakens the economic effectiveness of the incentive compared with expectations and reduces the elasticity of revenue in the coming years as well. Recall that the mechanism for calculating aid for economic growth produces a dynamic increase in the deductibility of ordinary remuneration. Moreover, to the extent that new investments are financed with own resources, the effects of the tax relief in terms of the erosion of the tax base are amplified.
- c) While its temporary nature strengthens the incentive for companies to undertake and even bring forward investment planned for subsequent years, the relief measure is generalized to the amount of new investment in a certain time period, without distinguishing, as has happened in the past, between the trend portion of investment and the portion dedicated to incremental and/or replacement investment: the “dead weight” effect of the subsidy is implicitly accepted. Legislators have accepted a revenue loss corresponding to a subsidy

for investments already planned by firms. In general, an investment incentive should be distinguished from a mere subsidy for its selective capacity to stimulate “additional” investments, also enabling the government to minimize its cost in terms of lost revenue. In this case, the formulation of the incentive clearly shows the broader objective of supporting and consolidating the signs of economic recovery.

- d) An additional factor concerns the interaction of the tax incentive with the other features of the tax system. In particular, as with any deduction from taxable income, the amount of savings depends negatively on the level of the tax rate. As seen above, the statutory rate of Ires has declined in recent years and the Stability Bill lowers it by an additional 3.5 percentage points from 2017, weakening the effect of subsidy.

As for the financial impact of the measure, the Technical Report estimates a reduction of tax revenue from Ires and Irpef of €0.2 billion in 2016, €0.9 billion in 2017, €1.3 billion in 2018 and €1.0 billion from 2019 to 2022.

The accrual and cash accounting effects already reflect a reduction in the Ires rate already in 2016 and a profile of payments on account that does not take account of this reduction (the provisions establish that firms cannot use forward-looking methods to determine those payments). The amount and extent of the annual revenue losses also reflect assumptions about the average useful life of assets. In addition, quantification is based on a number of assumptions:

- a) Facilitated investments in 2016 should amount to about €17 billion in 2015 and €80 billion in 2016. The estimate refers to the figures for gross fixed investment by type of investment and owner branch for 2014, using in particular the data for plant, machinery and equipment net of general government investment. The increase in allowable depreciation is expected to total €6.8 billion in 2015 and €32 billion in 2016. According to the Technical Report, the national accounts data include some assets that do not qualify for relief and therefore we can implicitly assume a share of investment induced by the relief measures.
- b) Depreciation charges are specified on the basis of an average useful life of seven years and the tax savings are calculated using an average rate of Irpef/Ires of 20 per cent in 2015, 17.8 per cent in 2016 and 17.45 per cent from 2017 to take account of the reduction in the statutory Ires tax rate provided for in the Stability Bill.

Although this is a generalized and theoretically proportional incentive, its impact on the tax burden will presumably differ on the basis of three different factors.

- 1) The legal form of firms and the tax regime: companies and partnerships have a different marginal tax rate and may also be subject to different regimes

depending on their specific characteristics (for example, the facilitated regime for new businesses included in the Stability Bill).

By way of example, we can calculate that for a corporation with sufficient taxable income paying the statutory tax rate, the tax savings is equal to 8.5 per cent of the investment; for a new business under the facilitated regime (at a rate of 5 per cent), the savings decline to 1.8 per cent.

- 2) The timing of the tax savings depends on the composition of firms' investment. In general, the shorter the life of the asset, the greater its initial concentration and the greater the benefit for the firm in terms of liquidity.

To highlight this latter aspect, we can use national accounts data disaggregated by sector and type of investment. In general, the total amount of investment that can potentially benefit from the tax relief appears concentrated in certain sectors: more than 80 per cent of total investments are carried out by the manufacturing sector and the services sector (Table 3.6).

We can also observe a significant difference in the composition of the tangible assets that qualify for relief depending on the sector: compared with an average of 74 per cent of investment going into other plant and machinery, the manufacturing sector invests 92 per cent and the services industry only 48 per cent (Table 3.6). This issue is important if we consider that other plant and machinery can be depreciated (depending on the industry) at higher depreciation rates (in most cases eight years) than those for transport equipment and ICT investments (five and four years, respectively).

Replicating the assumptions of the Technical Report and, however, using the sectoral breakdown, we reproduced the theoretical loss of tax revenue. The simulation shows two results:

- a) the tax savings are not proportional to the share of total investment for each sector. This difference is even more pronounced at a more disaggregated level (Table 3.7);
- b) there are differences in the timing of revenue compared with the findings of the Technical Report due to the heterogeneity of the assets eligible for relief and differences in their depreciation rates (Figure 3.14).

- 3) The actual tax savings depends on the profitability of firms. Lack of taxable income may defer the tax savings, thereby negating the theoretical effect of the incentive.

Tax statistics, which are available only for the 2012 tax year, show that an average of 30 per cent of firms posted losses, with significant differences by sector, region and enterprise size class.



**Table 3.6** – Composition of gross fixed investment by type of asset and sector (2013)

| NACE sectors   | % of total investment | Transport equipment | ICI equip.  | Other plant |
|--|-----------------------|---------------------|-------------|-------------|
| Agriculture, forestry and fishing  | 6.160                 | 0.07                | 0.01        | 0.92        |
| Mining and quarrying   | 0.424                 | 0.06                | 0.02        | 0.93        |
| Manufacturing  | 40.089                | 0.04                | 0.03        | 0.92        |
| <i>Food, beverages and tobacco products</i>  | 5.490                 | 0.04                | 0.03        | 0.93        |
| <i>Textiles, wearing apparel, leather and related products</i>   | 2.196                 | 0.07                | 0.05        | 0.87        |
| <i>Wood, paper and printing</i>  | 2.841                 | 0.05                | 0.06        | 0.89        |
| <i>Manufacture of coke and refined petroleum products</i>  | 1.557                 | 0.01                | 0.01        | 0.99        |
| <i>Manufacture of chemicals and chemical products</i>  | 2.451                 | 0.02                | 0.02        | 0.96        |
| <i>Manufacture of basic pharmaceutical products and pharmaceutical preparations</i>                      | 1.420                 | 0.01                | 0.02        | 0.97        |
| <i>Manufacture of rubber and plastic products and other non-metallic mineral products</i>                | 4.861                 | 0.04                | 0.03        | 0.94        |
| <i>Manufacture of basic metals and fabricated metal products, except machinery and equipment</i>         | 7.330                 | 0.04                | 0.03        | 0.93        |
| <i>Manufacture of computer, electronic and optical products</i>  | 1.187                 | 0.02                | 0.05        | 0.93        |
| <i>Manufacture of electrical equipment</i>   | 1.439                 | 0.03                | 0.03        | 0.94        |
| <i>Manufacture of machinery and equipment n.e.c.</i>   | 3.181                 | 0.06                | 0.05        | 0.89        |
| <i>Manufacture of motor vehicles</i>   | 4.349                 | 0.04                | 0.02        | 0.94        |
| <i>Manufacture of furniture, other manufacturing, Repair and installation of machinery and equipment</i> | 1.786                 | 0.11                | 0.05        | 0.84        |
| Electricity, gas, etc. supply  | 4.515                 | 0.01                | 0.02        | 0.96        |
| Water supply; sewerage; waste management and remediation activities                                      | 3.222                 | 0.14                | 0.04        | 0.83        |
| Construction   | 4.107                 | 0.24                | 0.05        | 0.70        |
| Services (excluding government)  | 41.483                | 0.33                | 0.19        | 0.48        |
| <b>Total sectors (excluding government)</b>  | <b>100.00</b>         | <b>0.14</b>         | <b>0.11</b> | <b>0.74</b> |

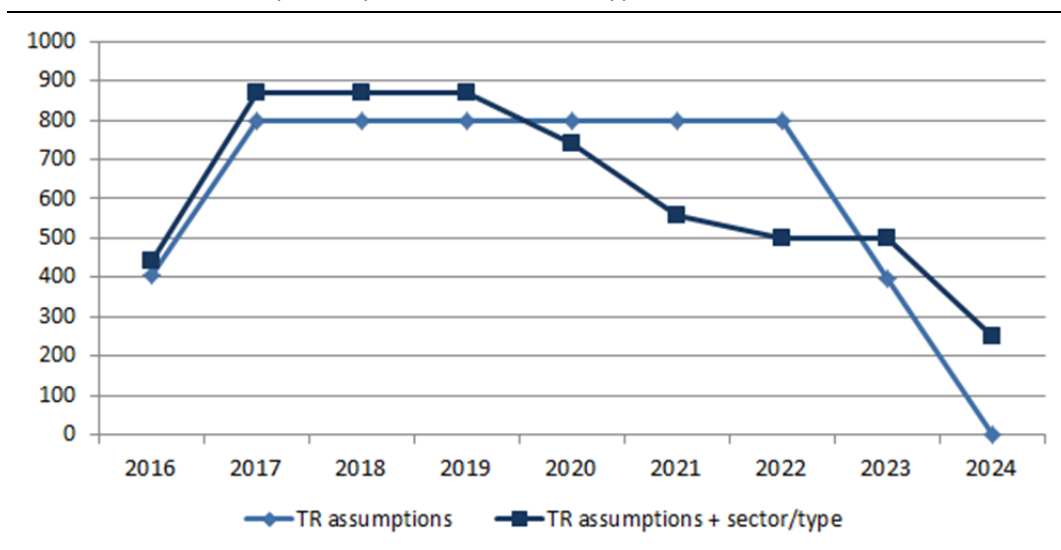
Source: based on Istat data.

**Table 3.7** – Effect of the increase in allowable depreciation: analysis by macro-sector and type of investment

| NACE sectors  | % of total investment | % of tax savings |
|---|-----------------------|------------------|
| Agriculture, forestry and fishing                                   | 6.2                   | 5.3              |
| Mining and quarrying  | 0.4                   | 0.4              |
| Manufacturing   | 40.1                  | 34.3             |
| Electricity, gas, etc. supply                                       | 4.5                   | 3.7              |
| Water supply; sewerage; waste management and remediation activities | 3.2                   | 3.0              |
| Construction  | 4.1                   | 4.2              |
| Services (excluding government)                                     | 41.5                  | 48.2             |
|   | 100.0                 |                  |

Source: based on Istat data.

**Figure 3.14** – Profile of depreciation: Technical Report assumptions and additional assumption by macro-sector and type of asset



Source: based on Istat data.

### 3.2.3 The tax regime for low-turnover sole proprietorships

The Stability Bill extends the scope of application of the special taxation system for sole proprietors operating as businesses or in the trades or the professions, originally introduced with the Stability Act of 2015.

Under existing legislation, eligibility for the scheme is determined on the basis of revenue thresholds that vary depending on the type of activity. In addition, the income earned in the business or profession in the previous year must be predominant compared with any other income from employment or similar income. The latter condition lapses where the employment relationship has been terminated or when total income from business, the trades or the professions and from employment or similar income does not exceed €20,000.

The separate flat-rate taxation regime provides for: 1) a 15 per cent tax (in place of Irpef, any regional or municipal surtaxes and IRAP); 2) for new businesses, additional relief in the form of a one-third reduction in taxable income for the first two years; 3) simplification of other requirements (for example, exemption from large expenditure filings (the so-called *spesometro*), reporting of transactions with black-listed countries and declarations of intent); 3) a more favourable contribution system, allowing eligible taxpayers to opt out of the minimum social security contribution system and calculate contributions on the basis of declared income.

The legislation under review here expands the number of eligible taxpayers by increasing the income thresholds and eliminating the limits on mixed income. In this case, the separate system is extended to employees and pensioners with their own business, in compliance with the income thresholds established for each sector, provided that their income from employment or pensions did not exceed €30,000 in the previous year. In addition, the duration of the facilitated regime for new businesses is extended from two to five years and the reduction in taxable income is replaced by the

application of a reduced tax rate (5 per cent instead of the 15 per cent provided for previously).

For a given taxable income, the combined effect of the two changes (higher taxable income and lower tax rate) is an implicit reduction in the tax rate from 10 per cent to 5 per cent. This change is not neutral for enterprises that post a loss in the early years of operation: the reduction in taxable income in the original system can generate losses that can be used in subsequent years, while the reduced rate requires taxable income in order to generate a benefit, and has no effect in future years in the case of a loss. The new rules also apply to persons who started a new business in 2015 and therefore are already taking advantage of the existing facilitated system.<sup>68</sup>

Finally, the legislation also modifies the calculation of social security contributions, introducing an optional scheme that provides for a reduction of 35 per cent in amounts due compared with ordinary INPS pension contributions.

For new businesses, the current regime has replaced the “privileged” systems previously in force, i.e. facilitated treatment of new businesses and self-employment (with a rate of 10 per cent), the facilitated system for youth entrepreneurship and laid-off workers (with a rate of 5 per cent) and the facilitated accounting regime (for taxpayers who qualified under the former facilitated system).<sup>69</sup>

The most recent figures from the VAT Observatory of the Ministry for the Economy and Finance shows that in July, 1,249 people joined the new separate regime, while 4,016 opted for the facilitated system. Altogether, this represents 32.4 per cent of total new VAT positions. The new rules could be an incentive for a greater degree of participation than that expected under existing legislation.

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<sup>68</sup> In order to be eligible for the facilitated system it is necessary that: 1) the taxpayer has not engaged in the arts, professions or business, individually or with others including family, in the previous three years; 2) the business in which the taxpayer intends to operate does not represent, in any way, the mere continuation of another activity previously carried out as an employee or in self-employment, except where the activity previously carried out was the mandatory apprenticeship/internship required to engage in a trades or profession; 3) where the taxpayer is continuing a business performed previously by another person, the amount of the associated revenue registered in the tax year prior to the granting of the benefits under the system did not exceed the specified ceilings.

<sup>69</sup> The tax equity enabling law (Law 23/2014, Art. 11, par. 1, letter b)) established an overall reform of the separate taxation system for very small businesses, with the establishment of simplified regimes for small taxpayers, while low-turnover sole proprietorships qualified for regimes involving the payment of a single tax in replacement of multiple ordinary taxes. The enabling legislation also provided for relief for taxpayers who incurred costs for use of traceable means of payment. The issue was addressed further by the Stability Act for 2015 and Decree Law 192/2014. In any case, these latter aspects of the enabling law, which expired on 27 June 2015, were not implemented.

### **3.3 Cost containment measures**

#### **3.3.1 Local government finances**

The Stability Bill contains measures requiring local governments to contribute to achieving the public finance objectives, leading to an overall net improvement in the budget balance of government departments of some €2.4 billion in 2016, €4.5 billion in 2017 and €5.6 billion in 2018 according to official estimates (Table 3.8). This improvement is the net effect of measures involving significant and rising cuts over the years for the regions and measures of the opposite sign for municipalities and provinces, as compared with current legislation. Beyond these measures, which reduce or increase the expenditure capacity of the various segments, the bill also authorizes the distribution of grants for 2016 only equal to €1.3 billion for the regions and €0.39 billion for municipalities. These grants can be used to pay down their debts and, therefore, do not impact the expenditure capacity of local governments and are not recognized for budget balancing purposes.

The bill also contains fiscal measures involving local taxation (reduction of the tax bases for IRAP, Imu and Tasi, prohibition on increases in local tax rates). These measures, equal to €4.3 billion for 2016 and €4.8 billion for both 2017 and 2018, have a neutral effect on the budgets of the affected local government in that they are fully offset by transfers, although they restrict fiscal autonomy.

According to official estimates, the budget's effect on the regions is to improve their net borrowing by €3.6 billion in 2016, €4.9 billion in 2017 and €6.0 billion in 2018 (Table 3.9). The main measures significantly compress transfers and amend the balanced budget rule. In 2016 only the healthcare segment of the ordinary statute regions (OSRs) are affected by the reduction in transfers, with €1.8 billion in total cuts. In subsequent years the reduction in resources is extended to other expenditure segments and to the special statute regions (SSRs), for a total amount of €3.98 billion for 2017 and €5.48 billion for each of 2018 and 2019. The €2.202 billion in cuts envisaged for non-healthcare sectors under current legislation has been extended from 2018 to 2019.<sup>70</sup>

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<sup>70</sup> This amount is the result of a succession of measures: a) Decree Law 66/2014, which initially envisaged a reduction of €0.750 billion; b) the 2015 Stability Act, which increased this reduction by €3.452 billion; c) Decree Law 78/2015, which made the portion referring to healthcare, equal to €2 billion for SSRs, permanent. For more information on the budget measures concerning the healthcare sector, see Section 3.3.2.

**Table 3.8** – The 2016 budget for local governments  
(millions of euros)

|   | Impact on net borrowing                  |               |               |
|---|--|---------------|---------------|
|   | 2016                                     | 2017          | 2018          |
| Net impact of measures on regions                                     | -3,583                                   | -4,914        | -6,012        |
| Net impact of measures on municipalities                              | 996                                      | 197           | 72            |
| Net impact of measures on provinces                                   | 180                                      | 210           | 335           |
| <b>Total net impact of measures on local governments</b>              | <b>-2,407</b>                            | <b>-4,506</b> | <b>-5,605</b> |
|   | Measures with no impact on net borrowing |               |               |
| Grants to regions not included in balanced budget computations        | 1,300                                    | -             | -             |
| Grants to municipalities not included in balanced budget computations | 390                                      | -             | -             |

Source: based on data from the schedule attached to the 2016 Stability Bill.

It should be noted, however, that agreements among the regions identifying the non-healthcare transfers<sup>71</sup> to be cut provided for in early measures only do so for 2015, while those for 2016 and subsequent years have not yet been specified. In fact, the regions tend to take an annual view in implementing the budget measures, although the measures themselves cover a multi-year time horizon. This tendency derives from the fact that, in many cases, the regions choose to take action based on the grants allocated to them year by year for specific purposes so as to limit the impact of cuts on budget chapters to be used to finance past expenditure. This allocation of grants by the central government, in conjunction with reductions in resources, appears to give weight to this policy of the regions, which prefer to sacrifice the new grants in order to avoid cutting permanently funded items.

**Table 3.9** – 2016 budget: impact on the expenditure capacity of the regions  
(millions of euros)

|  | Impact on net borrowing                  |               |               |
|--|--|---------------|---------------|
|  | 2016                                     | 2017          | 2018          |
| Redetermination of financing of national standard healthcare requirements        | -1,783                                   | 0             | 0             |
| Increase in national healthcare fund - medical students                          | 57                                       | 86            | 126           |
| Reduction in OSR resources for contribution to public finance effort             | 0  | -3,980        | -5,480        |
| Maintenance of grant under Decree Law 66/2014 and Law 190/2014 (-1,850 for 2019) | 0  | 0             | 0             |
| Effect of balanced budget on regions   | -1,850                                   | -1,022        | -660          |
| Other  | -7                                       | 2             | 2             |
| <b>Impact of budget measures on regions (a)</b>                                  | <b>-3,583</b>                            | <b>-4,914</b> | <b>-6,012</b> |
|  | Measures with no impact on net borrowing |               |               |
| Grants not included in balanced budget computations                              | 1,300                                    | 0             | 0             |

Source: based on data from the schedule attached to the 2016 Stability Bill.

<sup>71</sup> A total of €3.252 billion, of which €1.050 billion under Article 16, paragraph 2, of Decree Law 95/2012, and €2.202 billion under Article 46, paragraph 6, of Decree Law 66/2014, as redetermined by Article 1, paragraph 398, of Law 190/2014.

Most recently, in the agreement of 26 February 2015 concerning the implementation of prior budget measures for 2015, the regions opted to mainly reduce capital transfers,<sup>72</sup> which primarily affects the Development and Cohesion Fund, as well as transfers for which funding was limited to 2015. Examples include the amount allocated annually to incentivise the application of the vertical pact, which can be used to reduce the regions' debt, and resources for healthcare facility construction. In the examples cited, the items cut in 2015 had no effect on the net borrowing balance. In order to make the savings have an impact on the balance, given the cuts to items irrelevant to that balance, the regions renounced the financial flexibility offered them by the waiver of the balanced budget requirement in the amount of €2 billion envisaged for 2015. If, for 2016, the decision is again made to cut items that have no impact on net borrowing – such as the €1.3 billion grant envisaged in the 2016 Stability Bill, not computable for balanced budget purposes – the regions will achieve additional savings on existing items beyond those introduced in 2015: in 2016 the regions will not benefit from a balanced budget requirement waiver, as they did for 2015.

In any case, the Technical Report accompanying the Stability Bill indicates that the regions can achieve savings through a number of the spending review measures provided for in the measures, including by centralizing procurement (which would save the regions €0.48 billion starting from 2016), consolidating secondary offices and enacting more rigorous hiring practices. The savings achieved by centralizing procurement can contribute to reaching those additional savings forecast for the regions for 2016 as part of the measures for achieving a balanced budget and, from 2017, will be among the cuts required of the regions as their contribution to readjusting the public finances.

These measures are flanked by the impact of the balanced budget constraint, which was made permanent last year, albeit in a different formulation. As will be discussed further on, its effects therefore do not appear to be attributable to the budget measures under review (see Section 3.3.1).

Finally, a number of measures centralize the management of amounts allocated to support investments by the regions to make them more readily spendable. These measures include forming regional bodies, with their own budgets, to manage projects co-financed with European funds and establishing a Fund for the participation of central government in the purchase of vehicles for local and regional public transportation, which will be funded with the resources available for such purpose that are currently transferred to the regions, subject to the prior agreement of the regions.

In order to determine the effect of the budget correction required of the regions, including interventions in the healthcare sector, it is helpful to examine their spending practices starting from the early 2000s.

Between 2000 and 2009 the primary expenditure of the regions<sup>73</sup> rose on average at a rate of 4.1 per cent, with an increase in its ratio to GDP of 1.5 percentage points, to 10.1 per cent. During the 2010-14 period, expenditure instead fell on average by 0.1 per cent and its ratio to GDP decreased by three tenths of a point, to 9.8 per cent.

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<sup>72</sup> An exception applies to the permanent amount of €2 billion allocated for healthcare described previously.

<sup>73</sup> Calculated net of an accounting item registered in 2009 and in 2010 posted under both expenditure and revenue in the same amount and therefore with no effect on the balances.

The correction in primary expenditure over the most recent five-year period derives, in part, from the containment of growth in the main item, i.e. current transfers to public entities (most of which accounted for by healthcare expenditure, equal in 2014 to about 78 per cent of primary expenditure), which rose on average by 1.5 per cent, compared with 5.3 per cent for the 2002-09 period. It is also the result of an average reduction in all the other components – with the exception of social benefits – and specifically in capital expenditure. Capital expenditure decreased on average by around 7.6 per cent (compared with a previous increase of 0.6 per cent), while current primary expenditure rose on average by 1 per cent (a prior increase of 5 per cent).

The decrease in capital expenditure reflects developments in investments that, after having changed irregularly between 2002 and 2009, showed a cumulative drop of more than 37 per cent in recent years. All this reflects the inclusion since 2005 of investments within the constraints of the Domestic Stability Pact as well as the exclusion, starting from 2008, of a number of expenditure components relating to initiatives co-financed with EU funds. Investment grants, which are more easily reduced, were also heavily impacted by the cuts made by the regional governments in order to comply with the constraints of the DSP, with a cumulative contraction of around 42 per cent since 2010.

Looking forward, with respect to trend developments for the present year and subsequent years, the recent effects of the budget measures will continue to have an impact – especially in 2015-16 – on intermediate consumption and production grants, as well as on current transfers to public entities, specifically in connection with the forecast savings in healthcare expenditure. On average, developments in trend primary expenditure are expected to be similar to the slow growth registered over the last five years. The Stability Bill's measures also appear to impact these spending components, in addition to regional investments, based on the local government policy scenario set out in the Technical Note to the Stability Bill (mainly for the 2017-18 period). Unlike the past, the Government's accounts show the current transfers of the regions to public entities decline in absolute terms as a result of a correction in healthcare spending and in spending by other entities to which the regions transfer resources. The regions' planned primary expenditure should fall even further. These dynamics, as compared with the average effort made in the recent past, suggest that it could be challenging to achieve the significant savings expected from the participation of the regions in the budget correction.

For municipalities, official estimates show the budget measures producing in a deterioration in net borrowing of around €1 billion in 2016, €0.2 billion in 2017 and €0.1 billion in 2018 (Table 3.10). This is due to both the introduction of the balanced budget principle, which is less rigorous than the previous constraints under the DSP, and to the inclusion, for 2016 only, of the restricted long-term fund (RLTF) in the balance subject to the constraint, resulting in greater flexibility in financing investments. An additional effect, not quantified in the technical report, is imparted by the non-inclusion of the provision for doubtful accounts in the balance subject to the balanced budget requirement (see Section 3.3.1). By contrast, the recalculation of the municipal solidarity fund, modified to account for the change in Imu revenue while leaving the existing equalisation mechanism unaltered, has no impact on the public finances except for an expansion in the portion to be allocated based on the difference between standard requirements and standard revenue generating capacity.

**Table 3.10** – 2016 budget: impact on the expenditure capacity of municipalities  
(millions of euros)

|  | Impact on net borrowing                  |            |           |
|--|--|------------|-----------|
|  | 2016                                     | 2017       | 2018      |
| Transition to balanced budget constraint for municipalities  | 400                                      | 200        | 75        |
| Inclusion of restricted long-term fund in the balance subject to budget balance requirement for 2016 | 596                                      | 0          | 0         |
| Decrease in interest expense on liquidity advances   | 0  | -3         | -3        |
| <b>Impact of budget measures on municipalities (a)</b>   | <b>996</b>                               | <b>197</b> | <b>72</b> |
|  | Measures with no impact on net borrowing |            |           |
| Grants not included in balanced budget computations  | 390                                      | 0          | 0         |

Source: based on data from the schedule attached to the 2016 Stability Bill.

For the provinces, the budget measures produce a slight deterioration in borrowing (€0.2 billion in the first two years and €0.3 billion in 2018; Table 3.11), due to the allocation of greater resources – equal to €0.5 billion for 2016 and €0.4 billion starting from 2017 – to them, partially offset by the effect of the balanced budget constraint, which is more stringent for this segment than the DSP.

Under the 2015 Stability Act (Law 190/2014) resources to the provinces and metropolitan areas were cut by some €1 billion in 2015, which was to be doubled in 2016 and tripled in 2017. Given the partial restoration of these resources with the 2016 Stability Bill, these cuts are reduced in 2016 and as from 2017 to €1.5 billion and €2.6 billion, respectively.

*The balanced budget requirement for local governments.* – The Stability Bill provides that the DSP be replaced starting from 2016 with a rule based on the balance between final accrued revenue and expenditure for the year (therefore net of items relating to debt issuance and repayment). This balance may not be negative either *ex ante* or *ex post*. This approach applies to the local governments referred to in Law 243/2012: OSRs, SSRs, municipalities, provinces, autonomous provinces and metropolitan areas.

**Table 3.11** – 2016 Budget: impact on the expenditure capacity of provinces  
(millions of euros)

|  | Impact on net borrowing |            |            |
|--|-------------------------|------------|------------|
|  | 2016                    | 2017       | 2018       |
| <b>Provinces and metropolitan areas</b>  |                         |            |            |
| Transition to balanced budget constraint for provinces   | -390                    | -190       | -65        |
| Inclusion of restricted long-term fund in the balance subject to budget balance requirement for 2016 | 70                      | 0          | 0          |
| Grant to provinces and metropolitan areas in OSRs  | 400                     | 400        | 400        |
| Fund for financial support of excess personnel of former provinces                                   | 100                     | 0          | 0          |
| <b>Impact of budget measures on provinces</b>  | <b>180</b>              | <b>210</b> | <b>335</b> |

Source: based data from the schedule attached to the 2016 Stability Bill.



The impact on these measures on the governance of local finances is not insignificant, affecting the budget balance of government departments as well.

As to the regions, the Technical Report estimates that the budget balance will be cut by €1.850 billion in 2016 (Table 3.9). However, it should be pointed out that the 2015 Stability Act already envisaged the introduction of a permanent balanced budget constraint. For 2015 only, this was accompanied by a waiver to be proportionally allocated across budget surpluses and liquidity and, starting from 2016, was to be more rigorous than that now presented.

The technical report accompanying last year's Stability Act estimated that the introduction of the balanced budget requirement for the regions could improve the budget balance by around €2 billion. The measure, although permanent, was quantified for 2015 only. In its October 2014 report, the PBO suggested that the savings from the balanced budget constraint for the regions be considered permanent.

The present quantification appears to be a projection to 2016 of that presented in last year's Technical Report for 2015, reduced slightly to take account of the less stringent nature of the current constraint compared with the prior restriction.

Essentially, the introduction of the balanced budget requirement, with its implications for the regions in terms of consolidation measures, was already envisaged in current legislation, structured to provide additional savings starting from 2016. The regions would therefore have been able to implement permanent containment measures in 2015 (the waiver year) to comply with the targets for 2016 and subsequent years. The presentation of the effects of the measures described on the public accounts (in the financial schedules attached to last year's Stability Act and in the trend-scenario accounts), were unclear, perhaps obscuring the benefits of undertaking the measures needed to achieve the targets for 2016, which are now proposed again with this Stability Bill.

The introduction of the balanced budget requirement leaves greater room for manoeuvre for municipalities in 2016 (the budget balances are expected to deteriorate by €0.4 billion), while the provinces will see their expenditure capacity fall (a projected improvement in balances of €0.4 billion). The negative effect on the provinces is offset by the transfer of an equivalent grant (€0.4 billion) to them.

Although the requirements of the DSP were recently eased, the municipalities were still required to show an overall surplus. By contrast the provinces, although they have faced sharper cuts than the municipalities in recent years (given their planned elimination), have maintained a deficit in the trend targets for the segment.

For 2016, only the portion of the revenue and expenditure attributed to the RLTF deriving from their own revenue will be computed in the budget for balanced budget purposes.

The revenue and expenditure associated with the RLTF are recognized in the entities' accounts. Amounts accrued during the year but deferred to the future since they are to be used to fund long-term expenditure that has been authorized in the current year (or in prior years) but not yet been completed are recognized under the RLTF, amounts recognized as revenue attributed to the RLTF in the subsequent year. The RLTF can be funded through the entity's own revenue or by borrowing.

This benefits the municipalities significantly (estimated at € 0.6 billion), since they among all of public entities carry out most local government investment expenditure and therefore make greater use of the RLTF. The estimated impact on the provinces is smaller.

This component has no effect on the regions, presumably because the 2015 Stability Act already included the RLTF in the reference budget balance and thus the calculation made last year already incorporates the effects of the inclusion of the RLTF.

For the years 2017-18, the Technical Report forecasts that the regions and other local governments will experience a gradual decline in the expected effects of the balanced budget constraint, presumably because current legislation assumes that the accounts of local governments will "spontaneously" adjust to the balanced budget requirement.

The expansionary effect attributed to the measure (equal to €400 million, consistent with the budget surplus indicated in the trend scenario for the municipalities segment) could be underestimated since the trend scenario takes account of the reduction in spending by the entities themselves, in an amount corresponding to the portion of revenue deemed doubtful and neutralized via allocations to the corresponding provision.<sup>74</sup> The balanced budget requirement, which excludes the provision for doubtful accounts, therefore creates a situation in which entities can make expenditures corresponding to the revenue accrued for the year in their accounts, even if such revenue is ultimately not collected, producing a deficit in the general government accounts. As an estimate of this effect, the Technical Report attached to the 2015 Stability Act quantified the allocations to the provision for doubtful accounts in €1.9 billion.

The expansionary effect should produce greater capital expenditure capacity for municipalities, without prejudice to the obligation to recognize allocations to the provision for doubtful accounts for the purposes of compliance with the requirement for budget balance on current account, pursuant to Article 162, paragraph 6, of the Consolidated Local Government Act.

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<sup>74</sup> The 2015 Stability Act envisaged the inclusion of allocations to the provision for doubtful accounts in the target of the Domestic Stability Pact, attributing permanent positive effects of around €1.9 billion per year starting from 2015 from such inclusion. Decree Law 78/2015 then introduced a number of amendments intended to encourage the recognition of doubtful accounts, leaving unchanged the amount of the expected savings. More specifically, it made it possible to exclude allocations to the provision for doubtful accounts from the DSP, while tightening the targets of the objectives of the DSP for each entity in compensation. The compression of spending is equivalent in the two cases and is included in the trend balance.

The balanced budget principle is accompanied by a regional flexibility mechanism covering a three-year timeframe for investment expenditure.<sup>75</sup>

The mechanism envisages the reciprocal transfer of expenditure capacity among entities in the same region, with offsetting effects both within the region in the same year, and for the individual government over the three-year period. This flexibility is aimed at adapting the balanced budget principle to the need to enable individual local governments to make public investments (using debt or funds saved over time), especially small entities. The so-called incentivised vertical flexibility is lost, as incentive grants are not paid to the regions that transfer capacity to allow local bodies in their territory to make investments.

In this regard, the three-year time horizon may be excessively short, restricting flexibility to smaller investments. Furthermore, the entire mechanism depends on the willingness of counterparties to transfer the expenditure capacity. Accordingly, the entire mechanism requires a considerable improvement in planning capacity at the local level, both by those who supply and those who request resources.

The provisions in the Stability Bill concerning the balanced budget requirement for local governments must be read in conjunction with Law 243/2012 ("*Provisions for the implementation of the balanced budget principle*"), which, according to recent Government statements,<sup>76</sup> is set to take effect for 2017 budgets, i.e. one year after the entry into force of the provisions now under review.

Law 243/2012 establishes the balanced budget targets that the local authorities must meet, structured as a range of constraints: between final revenue and expenditure; between current revenue and expenditure; in the budget and the final accounts; in terms of accrual and cash accounting. It also calls for the establishment of a territorial offsetting mechanism for investment expenditure.

The measures under review could therefore be viewed as a partial implementation of Law 243/2012, leaving the other measures suspended. In addition to the territorial flexibility mechanism, the provisions introduce a requirement for a non-negative balance between revenue and final expenditure, both *ex ante* and *ex post*. Owing to the introduction of the reinforced accrual-based accounting principles, recognition on an accruals and cash basis is increasingly similar, thereby narrowing the difference between the two balances.

If all the revenue and expenditures due were collected and paid on time, the cash scenarios would correspond to the accrual scenarios. The reinforced accrual-based accounting principle, envisaged in Legislative Decree 118/2011, in seeking to achieve this objective, requires that

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<sup>75</sup> Article 35, paragraphs 16-18.

<sup>76</sup> See the testimony of Deputy Minister Morando before the Senate Budget Committee, in which he asserted that "*as to (...) the question of the entry into force of the new system, I believe that there is no reason for concern since the 2016 fiscal year is simply a period of transition during which the old rules are applied while the new ones are rolled out*". The Committee, in its opinion on the text of the 2016 Stability Bill, commented that "*as regards Article 35, paragraph 3, concerning the Domestic Stability Pact, we find that the provision is valid for 2016 only, otherwise it could conflict with Article 9 of Law 243/2012, which governs the balances of the same entities differently*" (hearing of 28 and 29 October 2015).

revenue and expenditure be recognized in the budget on the basis of the amounts that the entity believes can actually be collected or paid in each year considered. We can thereby avoid the accumulation of outstanding amounts associated with the management of long-term expenditures, although it will still be possible to accumulate outstanding amounts arising from mere delays in collections or payments on a cash basis.

The implementation framework for this law within the context of the budget rules for local governments remains incomplete, however, regardless of the year it formally enters force. Specifically, two features appear to be missing from the rules set out in the Stability Bill. Unlike Law 243/2012, there is no requirement for balance in current revenue and expenditure and no Fund for the economic cycle is activated. As regards the former issue, the provisions of the Stability Bill function as an ex-post constraint on the management of entities' budget (replacing the DSP), beyond the requirements of existing accounting regulations, which already contain a requirement (for the purposes of the preparation of the budget) for *ex ante* balance on (largely) current account. With regard to latter issue, as discussed in the hearing on the outlook for the reform of budget instruments and procedures,<sup>77</sup> the objective of concentrating the cyclical stabilisation functions at the central government level, i.e. the stabilisation of the revenue of local governments during the various phases of the economic cycle, is already in part accomplished using ordinary financing mechanisms for these authorities. The assessment of the expected benefits and any disadvantages of these two aspects could therefore be developed pending the entry into force of the framework connected with Law 243/2012.

### **3.3.2 The healthcare system**

Following the budget measures, the funding of the National Health Service (NHS) in 2016 is set at €111 billion, slightly higher than in 2015, compared with the €113.097 billion that remained after subtracting from the amount indicated in the 2015 Stability Act (consistent with the Healthcare Pact for 2014-16) the correction asked of the regions by another paragraph of that law, to the extent applied to healthcare expenditure.<sup>78</sup> However, as mentioned above, the impact on net borrowing is limited to €1.783 billion, as the impact on the special statute regions is sterilized. The additional effort requested of the regions for the years after 2016 will be allocated between expenditure areas and divided among the regions in an agreement to be finalized in the State-Regions Conference by the end of January each year. The Stability Bill reaffirms that the "provision of essential levels of care" should not be jeopardized by the cuts. If no agreement is reached, the Government, with a decree of the President of the Council of

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<sup>77</sup> See the hearing of the Chairman of the PBO, Giuseppe Pisauro, before the joint Budget Committees of the Italian Chamber of Deputies and the Senate as part of the fact-finding inquiry into the outlook for the reform of budget instruments and procedures, 14 July 2015.

<sup>78</sup> The part of the correction assigned to the healthcare system was set at €2.352 billion in the agreements reached in the State-Regions Conference of 2 July 2015 and with Law 125/2015 (which ratified with amendments Decree Law 78/2015).

Ministers, will determine the allocation of the reductions among the areas of regional spending (explicitly including the healthcare sector) and the division among the regions (with population and GDP among the criteria to be adopted).<sup>79</sup> Uncertainty remains about the distribution of the earlier cuts, already established through 2018 (Decree Law 66/2014 and the 2015 Stability Act) and confirmed for 2019 in the Stability Bill: the portion that was not attributed to the healthcare sector with Decree Law 78/2015 will be allocated and distributed for 2016 through an agreement among the regions or otherwise by Prime Minister's Decree (consistent with Decree Law 66/2014), and for the following years with the above procedures for the new effort requested: it is possible that healthcare will be subject to additional cuts, as these procedures appear to differ from those applicable in the first year mainly because the possibility of adjusting healthcare funding has been made explicit. Assessing the impact of measures implemented on the services rendered remains a challenge in a sector that agrees, on an annual basis, the allocation of long-term or permanent cuts. Moreover, given the composition of the budgets of the regions, it seems inevitable that an increasing proportion of the correction would impact the National Health Service. Considering the forecast for developments in healthcare expenditure on a current legislation basis contained in the Update to the 2015 EFD, which projects a decrease in relation to GDP from 6.8 to 6.5 percentage points between 2015 and 2019, the overall reduction at period-end could be about half a point of GDP in the policy scenario.

In addition, a portion of the funding for the NHS, amounting to €0.8 billion, is subject in 2016 to the adoption of the new essential care standards.<sup>80</sup>

A draft Prime Minister's Decree containing the new essential care standards<sup>81</sup> was circulated last February, with an estimated cost of €414 million, but the Technical Report attached to the Stability Bill includes the revision of the national nomenclature of services<sup>82</sup> in the essential care level operation. The Bill also provides for the establishment of a new National Commission for updating the essential care standards and the promotion of the appropriateness of the National Health Service (appointed and chaired by the Minister of Health), which each year will submit proposed updates and systematically evaluate the services included in the essential care standards and their appropriateness, possible innovations to introduce – performing a health technology assessment – and their associated costs, as well as applications for authorization to provide innovative services submitted by individual units of the NHS.

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<sup>79</sup> Separate agreements will have to be reached with the special statute regions.

<sup>80</sup> The essential care standards should be introduced with a Prime Minister's Decree on the basis of a proposal from the Minister of Health, in agreement with the Minister for the Economy and Finance and with the State-Regions Conference (the opinion of the competent parliamentary committees is no longer required). They will be updated with the same procedure, unless the changes only involve modifications of the list of deliverable services or measures to improve their appropriateness, with no increase in costs, in which case a ministerial decree will be sufficient, having obtained the opinion of the State-Regions Conference.

<sup>81</sup> The previous essential care standards date back to 2001, when they were introduced with the Prime Minister's Decree of 29 November 2001.

<sup>82</sup> The Stability Bill eliminates the priorities indicated in Decree Law 158/2012 for the purposes of revising the essential care standards, namely the reformulation of the list of chronic and rare diseases and the treatment of problems associated with gambling addiction.

As part of the spending review, the Stability Bill envisages a number of measures to improve the productivity and efficiency of the institutions of the NHS, which are not directly connected with the funding cuts and do not produce financial effects measured by the Technical Report. These mainly include: 1) the introduction of financial recovery and redevelopment plans for NHS units; and 2) new rules on the centralization of purchases of goods and services, but also health technology assessments.

- 1) With regard to the first point, the regions<sup>83</sup> are to identify, by 30 June each year (31 March for 2016), the hospitals, including university-affiliated hospitals, research hospitals and other public entities providing hospitalization and treatment services – except for local health authorities (ASL) and any units they operate directly, at least for 2016<sup>84</sup> - in one or both of the following conditions to an extent that would require the definition of a financial recovery plan: a) financial imbalance, specifically costs – as reported in the income statement<sup>85</sup> – exceeding revenue<sup>86</sup> by more than 10 per cent of those revenue, or €10 million in absolute terms; b) deficiencies in compliance with a number of new parameters for the volume, quality and outcome of care. Institutions that do not meet the two conditions must submit a three-year recovery plan to the Region within ninety days, setting out measures designed to restore financial balance and improve the quality and range of services.

This plan is evaluated from a number of perspectives, including with regard to regional planning (or the regional recovery plan) and any guidelines indicated, and approved by the regional government or the ad hoc commissioner within thirty days. The measures set out in the recovery plan are binding and may involve changes to administrative programming and planning measures. The regions subject to recovery plans provide an indication in the operational implementation programme of any plans in place within the entities of their regional health service and their objectives.

A decree of the Minister of Health, issued in agreement with the Minister for the Economy and Finance, in consultation with the State-Regions Conference, will indicate the methodology to assess deficits for the purpose of ascertaining compliance with the first condition, and to identify areas of assistance and the reference parameters for volumes, quality and outcomes of care with regard to the second condition, taking account of the recent ministerial decree on hospital standards (Decree no. 70 of 2 April 2015), and to define the guidelines for the preparation of the recovery plans.

Regions with health service entities that do not meet the two conditions shall establish, if they have not already done so, the centralized health service management unit,<sup>87</sup> so that the latter can recognize a portion of the Regional Health Fund equal to the deficits

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<sup>83</sup> With a measure of the regional government or an ad hoc commissioner.

<sup>84</sup> In 2016, the criteria and methods used to identify the local health authorities, the units they manage directly and other public entities, identified in regional laws, that provide hospitalisation and treatment services to are to be subject to a recovery plan will be specified and the procedures for determining the costs of directly-managed hospital units will be updated in order to assess operating performance on the basis of rate and non-rate remuneration.

<sup>85</sup> For 2016, the income statement will be that for the fourth quarter of 2015.

<sup>86</sup> Determined as the remuneration of the activity, pursuant to the provisions of Decree Law 502/1992.

<sup>87</sup> The centralized health service management unit is responsible for the direct management in the region of a share of the funding of the regional health service.

recorded by health service entities subject to recovery plans. These stages will be checked by the technical working groups to verify compliance and delivery of essential care standards, which will be notified, within five days, of the approval of recovery plans for the entities of the regional health service and the size of the divergences.

The region (or the ad hoc commissioner) shall audit the implementation of the plan on a quarterly basis: if the results are positive, it may disburse part of the available resources in the budget; otherwise, it shall adopt the plan measures that have not been implemented. At the end of each year, the financial performance achieved by individual entities in relation to the objectives shall be published. The contracts (including existing contracts) of the directors of the local health authorities and research hospitals shall provide for the automatic termination of the latter in the case of non-approval of the plan or a failed annual audit.

In addition, all entities of the NHS, in addition to complying with transparency requirements in their accounts,<sup>88</sup> must implement a system to monitor the delivery of services and their quality, integrated with that already required for the regions by Decree Law 158/2012, and, like the latter, is connected with the national outcomes evaluation programme.<sup>89</sup> Any breach of these requirements would represent a disciplinary offense and could entail administrative liability for the director general and the head of transparency and prevention of corruption.

According to data published by Agenas on net revenue and the operating results of the hospitals (and research hospitals) for 2014,<sup>90</sup> the first condition was not met by three out of six organizations in Piedmont, two out of three in Veneto, the two in Liguria, three out of four in Tuscany, the nine in Lazio, two out of five in Calabria and the three in Sardinia. It was mainly the €10 million constraint that had the largest impact, but in Lazio, Calabria and Sardinia the threshold of 10 per cent of revenue was also a factor. The overall deficit in the Lazio region exceeded €660 million. The definition of benchmarks for the evaluation of quality/quantity/outcomes will require considerable care to ensure that improvement efforts, especially in the presence of major deficits that have to be eliminated, are not focused solely on aspects covered by the monitoring programme at the expense of others.

The Stability Bill also provides that, in order to enhance synergies and generate savings, the regions and autonomous provinces without recovery plans that the

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<sup>88</sup> All entities must publish their financial statements on their website. In addition, the schedules attached to Legislative Decree 118/2011 are also due to be revised.

<sup>89</sup> This programme produces metrics and indicators to support clinical and organizational auditing and the improvement of effectiveness and equity (see the Agenas website: <http://95.110.213.190/PNEed14/index.php>).

<sup>90</sup> See Agenas (2015), "*Dati Aziende ospedaliere (AO, AOU) e IRCCS pubblici (CE 2014)*", available at <http://www.agenas.it/>.

last two years have reorganized, or begun to reorganize, the regional health service with the aggregation of healthcare units, may establish unified healthcare organizations that incorporate university-affiliated hospitals in the local health authorities, by way of agreements with the universities. Unification operations of this type might not necessarily meet the operational efficiency criteria of the regional health service, owing to, among other factors, the large size of such organizations, which may create governance difficulties, and to the regulatory peculiarities and complexity of universities.

- 2) The intervention to increase the efficiency of healthcare spending essentially involves further centralization of procedures for the purchasing of goods and services and the technology assessment system.

For the product categories in the health sector,<sup>91</sup> regardless of any contract amount thresholds, the institutions of the NHS must channel procurement through Consip SpA or regional central purchasing bodies (and, if the latter are not available or operational, the central purchasing bodies entered in the list of aggregators, which are in any event identified by the regional bodies). Existing contracts may only be extended until the date of activation of the contract awarded by the central purchasing body (further extensions would be void), with violations subject to disciplinary action and liability for loss of government revenue.

For health technology assessments, the regions are asked to take steps to ensure that no new technology assessment units are created by NHS entities and that existing ones are phased out, with assessments being conducted exclusively by the regional or national units. The control room established last March in implementation of the Healthcare Pact will be responsible for guidance, promotion of activities, coordination, validation of methodologies, dissemination of findings and fostering the use of the information in technology procurement decisions.

The reduction in resources from the levels agreed in the 2014-16 Healthcare Pact may not be consistent with the commitment to adopt the new essential care standards and new nomenclatures, with the introduction of expensive innovative drugs,<sup>92</sup> with the start of collective bargaining for employees (and perhaps the staff of entities operating under contracts with the NHS), with the introduction of new service quality/quality standards, or with the possible adoption of the new vaccine plan.<sup>93</sup> The reduction benefits from the savings under the spending review and the possible implementation of new pay-back mechanism for pharmaceuticals.<sup>94</sup>

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<sup>91</sup> The categories are specified with a Prime Minister's Decree as envisaged in Decree Law 66/2014, based on the analysis of the Panel of Aggregating Entities.

<sup>92</sup> The Government has appropriated €100 million for innovative drugs in 2015, while the other resources in the earmarked fund of €500 million for 2015 and 2016 were used in funding the specific objectives of the National Health Plan.

<sup>93</sup> The discussion of the Vaccine Plan was adjourned at the State-Regions Conference, with a request from the Ministry for the Economy and Finance to extend the analysis of the text of the measure, application of which would appear to cost an additional €300 million.

<sup>94</sup> The pay-back system in the pharmaceutical field (coverage of overruns of spending ceilings charged to the pharmaceutical industry) is being reassessed, but a solution to the complex issue has yet to emerge. Decree Law 179/2015 made it possible to ascertain and appropriate – in the 2015 budget of the regions in



### 3.3.3 Ministries

The measures affecting government ministries is divided into specific initiatives and other more general actions, which also involve central government departments. The latter initiatives, in particular, consist mainly of savings achieved through price reductions to be obtained through further development of the centralized procurement of goods and services for government. Other interventions include broadly linear cuts in the discretionary expenditures of ministry missions – the effects of which are shown in a list attached to the Stability Bill – and, in part, reductions in the budgets of other government entities or in resources channelled to the economy.

Overall savings amount to €2.2 billion in 2016, €1.9 billion in 2017 and €2.1 billion in 2018. They consist of specific measures indicated in the Stability Bill on the basis of a proposal from the ministries and of a series of across-the-board reductions defined as a percentage cut in available funds on a cash and accruals basis. The scope of the cuts, which largely affects funds still to be allocated and assigned, is given only for missions and programmes of the ministries and, for this year, appears not to have taken account of "protected" programmes excluded from the cuts. The most significant savings regard the Ministry of Education, Universities and Research and the Ministry for the Economy and Finance.

With regard to specific measures, in addition to the savings that the Prime Minister's Office and social security institutions identify independently, the reductions in appropriations defined for individual ministries largely concern external institutions, such as tax assistance centres, citizens assistance agencies, political parties, international organizations, or companies such as those operating in the maritime transport sector. In some cases, moreover, rather than spending reductions, the measures involve sales of real estate holdings or increases in fees. In yet other situations, the savings are achieved through efficiency measures, which in one case involve the reduction of a fund set up a year earlier for the purpose of improving efficiency.

Another significant expenditure containment effort regards the content of the tables attached to the Stability Bill and largely derives from reductions or readjustments of capital expenditure, especially in the areas of rail transport and National Health Service building projects.

As for measures impacting prices, the effects of spending restraint have been parameterized, demanding a greater effort of those ministries that made less recourse to centralized procurement in 2014.

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order to cover the deficits in the previous two years – 90 per cent of the reimbursements already identified by the pharmaceutical agency – AIFA (€367 million for excess local and hospital expenditure in 2013 and €472 million hospital overruns in 2014), net of any amounts already recognized (without prejudice to any subsequent corrections in the event of differences with the final outcome of the definitive recovery procedures, through account adjustments).

The rules include new procedural and control mechanisms, strengthening the process initiated with Decree Law 66/2014. Common rules, which also apply to the ministries, establish new opportunities and obligations for government departments, which can conduct purchasing for specific categories of recurrent-use goods and services outside the centralized system on the condition that they obtain prices that are at least 10 per cent lower than the best prices obtainable through the central and regional purchasing centres. The associated contracts must still be transmitted to the ANAC (the national anti-corruption authority). All government departments are required to carry out planning on a two-year basis for purchases of goods and services worth more than €1 million. The use of centralized procurement mechanisms for maintenance activities is also permitted. The governance of autonomous purchasing by government departments has also been tightened, with the definition of "essential characteristics" for procured goods to be specified with a decree of the MEF (having obtained the opinion of the ANAC), in order to ensure that smaller differences do not allow evasion of obligations for adoption of/compliance with benchmarks.

A significant contribution to the budget measures is provided by the use of the Fund for the reduction of the tax burden (€0.8 billion in 2016 and €0.4 billion in each of the subsequent two years), which is drawn down in order to cover the reduction in revenue in the budget. In addition to the savings of the ministries, the Fund is also financed with the resources generated by the fight against tax evasion, although the Technical Report and in the attachments to the budget do not specify the funding sources for the appropriation on a current legislation basis.

Many of the cuts involve expenditure flows directed outside government, and therefore do not require the internal reorganization of government departments. The range of entities required to use centralized purchasing is extended. The inclusion of maintenance activities among those that are required to use centralized procurement mechanisms was also implemented in response to specific needs expressed by various departments, including the schools. The assessment of "essential characteristics" and the associated prices, on the basis of the aspects with the greatest impact on price, with publication on the MEF website, is a step in the direction of further suppressing what remains widespread avoidance.

The price reduction effects of centralized tools adopted in the past are partly documented by the MEF-Istat survey of unit prices for government purchases of goods and services, conducted with a sample of some 1,400 institutions and included in the National Statistical Programme.

It would nevertheless be appropriate for Istat to publish the data series for government intermediate consumption on both a volume and price basis in order to be able to conduct an aggregate assessment at the general government level of the possible price-volume effects produced by the various corrective measures implemented over time.

A possibly important development in the rationalisation of procurement may be the transfer of most tenders currently held by 32,000 contracting authorities to the 34 recently designated aggregators, including, in addition to Consip and 21 regional purchasing centres, other entities representing nine metropolitan areas, two provinces and a consortium.

### **3.4 Income support measures and initiatives to combat social exclusion**

The measures in the Stability Bill include some are essentially assistance initiatives, designed to support the income of certain categories of individuals and to combat poverty and social exclusion. These include the changes in tax credits for pension income, the safeguarding of a further group of former workers no longer eligible for a pension following pension reform, funding of social safety nets and a number of mechanisms to support individuals living in poverty.

*Tax credit for pension income.* – As from 2017, the tax credit for personal income tax purposes is increased for poorer pensioners (those with incomes of up to €15,000). More specifically, the amount of the credit itself and the amount of income qualifying for the credit are increased.

*"Safeguarding" of former workers without pensions.* – Relief has been granted to an additional 26,300 former workers who are no longer eligible for a pension following the "Fornero reform".

More specifically, without prejudice to the six "safeguard" initiatives introduced previously, the pension requirements before the "Fornero reform" will also apply to: 1) workers laid off or enrolled in the special construction industry unemployment programme as a result of agreements reached by 31 December 2011, on the condition that the pre-reform pension requirements are met by the end of the period for which the beneficiaries receive the associated unemployment benefits; 2) workers who lost their jobs by 31 December 2014 as a result of bankruptcy proceedings, on the condition that the pre-reform pension requirements are met by the end of the period for which the beneficiaries receive the associated unemployment benefits;<sup>95</sup> 3) workers already authorized to continue voluntary contributions before 4 December 2011, on the condition that the pre-reform pension requirements are met within the sixty-sixth month following the entry into force of the reform; 4) workers whose employment was terminated by 31 December 2012 or, in the case of unilateral termination, in the period between 1 January 2007 and 31 December 2011, on the condition that the pre-reform pension requirements are met within the sixty-sixth month following the entry into force of the reform; 5) workers who in 2011 workers were on leave to assist children with severe disabilities, on the condition that the pre-reform pension requirements are met within the sixty-sixth month following the entry into force of the reform; 6) workers with fixed-term contracts in sectors other than agriculture, whose employment was terminated between 1 January 2007 and 31 December 2011 and were no longer re-employed on a permanent basis, on the condition that the pre-reform pension requirements are met within the sixty-sixth month following the entry into force of the reform. INPS will accept applications for protection in chronological order

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<sup>95</sup> Those terminated by 31 December 2012 can also meet the pre-reform requirements by making voluntary pension contributions.

up to the limits on the number of beneficiaries and the available funds, the latter being set at €0.2 billion in 2016 and €0.4 billion in 2017 and 2018, gradually decreasing thereafter.

The system of safeguards essentially remains that set out in the previous Stability Act, with an extension of the access criteria that continues the expansion of the range of beneficiaries under way since 2013. Taking account of the potential beneficiaries of the seventh safeguard measure, official estimates indicate that beneficiaries would total 172,466, at a cost of about €11.4 billion over ten years (2013-2023), eroding the savings generated by the Fornero reform, quantified at about 20 percentage points of GDP between 2012 and 2060.<sup>96</sup>

*Extended social safety net.* – For 2016, €250 million have been appropriated to refinance the extended social safety net, pending the start of the new system provided for in the Jobs Act. The measure establishes that next year the extended wage supplementation benefits cannot be granted or extended for a period exceeding three months and that extended unemployment benefits cannot be granted for more than four months with no further extensions (six months for workers in southern Italy).<sup>97</sup> New grants must comply with the restriction that the total duration of benefits (including past periods) shall not exceed three years and four months.

*Measures to combat social hardship.* – The Stability Bill establishes a new fund whose resources, amounting to €0.6 billion in 2016 and €1 billion as from 2017, will fund a national plan to combat poverty and social exclusion, to be adopted every three years with a decree of the Prime Minister in agreement with the Joint Conference. The plan will outline the steps to gradually approach (as the effort is limited by available resources) the essential level of welfare services to be delivered nationwide to combat poverty.<sup>98</sup> In addition to the three-year plan, a number of measures are also designed to reorganize legislation governing various forms of welfare support (or other support obtained through means testing<sup>99</sup>) and the eligibility criteria for access to social benefits, with the aim of establishing a single national anti-poverty programme.

While the first rationalization measures will have to wait until at least 2017, the Stability Bill already specifies the plan's 2016 priorities, to which the appropriated resources will be allocated. More specifically, €380 million will be used to finance the expansion of the trial of the new prepaid "purchase card" (see below for a brief analysis of the different versions of this tool and its application). Pending the issue of the plan, the features of

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<sup>96</sup> See Ragioneria Generale dello Stato (2015), *“Le tendenze di medio-lungo periodo del sistema pensionistico e socio-sanitario”*, Rapporto n. 16.

<sup>97</sup> Extended unemployment benefits cannot be granted to those who have already such benefits for at least three years, even if not consecutively. In 2016, the regions and autonomous provinces may grant wage supplementation and unemployment benefits, including in extended form, in an amount that may not exceed 5 per cent of the resources allocated to them. Any excess must be fully funded with regional resources.

<sup>98</sup> Recall that the essential service levels in this field have not yet been defined, despite the fact that they were to have been one of the pillars of the system of fiscal federalism envisaged in enabling law no. 42 of 2009.

<sup>99</sup> Including that for beneficiaries residing abroad.

this instrument (including selection criteria, the amount of the benefit, the customised labour force integration and social inclusion projects and the associated procedures) will be redefined with a decree of the Minister of Labour and Social Policy, in agreement with the Minister for the Economy and Finance, but the Stability Bill already prioritises interventions targeted at families with minor children. The resources already appropriated for previous versions of the purchase card and not used (including €287 million in respect of those for the new version), as well as additional €54 million from the Employment Fund,<sup>100</sup> will also be channelled into the new programme. Ultimately, funding should exceed €700 million in 2016.<sup>101</sup>

The remainder of the Fund to combat poverty and social exclusion for 2016, i.e. €220 million, will increase the Fund for financing the ASDI,<sup>102</sup> the new unemployment benefit scheme provided for in Legislative Decree 22/2015 implementing the Jobs Act (Law 183/2014). It is intended to provide income support for workers who have used up their entire eligibility for benefits under the New Social Insurance for Employment system (NASpi), are still unemployed and are in a condition of financial need. This tool, which is still in the trial stage, is aimed primarily at those living in households with minors and, secondarily, those close to retirement. The benefits will be disbursed until depletion of the special fund in an amount equal to the lower of 75 per cent of the last NASpi benefit received and the minimum pension (increased for any dependents). Compensation of employees can be partly combined with the ASDI in order to encourage the search for new employment. The grant is conditional on participation in a customised project that includes a commitment to actively seek work and to accept appropriate job offers, as well participation in orientation and training programmes.

In addition, the Government intends to make changes to other social funds and establish new ones. Among the latter, the experimental Fund for the fight against educational poverty will be funded for 2016-18 with contributions from the bank foundations as part of their institutional activities. These payments will benefit from a tax credit of 75 per cent (with a maximum appropriation of €100 million), which can be used to offset a tax liability or be transferred to banks, financial institutions and insurance companies.<sup>103</sup> The procedures for managing the fund and interventions to combat educational poverty, evaluation systems, and the selection and monitoring of projects (including independent evaluators) will be established with a memorandum of understanding between the foundations, the Prime Minister's Office, the Ministry for the Economy and Finance and the Ministry of Labour and Social Policy.

Other initiatives include: 1) a fund in support of persons with severe disabilities, particularly the indigent with no immediate family (the so-called "After Us" fund), funded with €90 million a year,

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<sup>100</sup> At the same time, the benefit provided for in Law 92/2012 for certain term-contract workers who experienced periods of unemployment will be abolished.

<sup>101</sup> After 2016, these amounts will remain in the new fund to combat poverty and social exclusion.

<sup>102</sup> Previously financed with €200 million for 2015, €380 million for 2016, €270 million for 2017, €170 million for 2018 and €200 million after 2018.

<sup>103</sup> The credit is not subject to existing overall limits on use.

the procedures for which will be specified in a non-regulatory decree that will require an agreement in the State-Regions Conference; and 2) a fund for international adoptions, with €15 million in funding a year, recovered from the fund for family policies. Finally, the fund for the non-self-sufficient is increased by €150 million (which may also be used for the support of people with ALS), thus maintaining the level of 2015, while interventions for early childhood and for the distribution of food (€112 million) have been defunded.

The level and the growth of poverty among families with at least one minor, along with the need to protect those inherently more vulnerable and dependent, explain the decision to target these households with interventions to fight social hardship. In order to cope with the various conditions of poverty, however, would require a less segmented and broader intervention than that planned for 2016. The Italian experience has always been marked by a focus of specific categories of beneficiary and, more recently, the multiplication and fragmentation of programmes. For now, as we have seen, a reorganization and rationalization of social policy instruments in this area has been postponed to 2017, and the funds appropriated are limited.

According to the latest Istat data,<sup>104</sup> the extent of absolute poverty among individuals has more than doubled during the crisis years, now involving more than 4 million people, while the rate among households increased from 3.5 per cent to 6.3 per cent between 2007 and 2013, before declining to 5.7 per cent in 2014 (Table 3.12). In the South, the percentage of poor households exceeded 10 per cent in 2013 and was a somewhat lower (8.6 per cent) in the last available year of observation. In addition, the proportion of absolute poverty has increased very considerably among families with at least one minor child, from 2.4 per cent to 8.4 per cent,<sup>105</sup> while among households with seniors it has remained relatively stable at much lower levels (4.7 per cent in 2014). However, other hardship situations are widespread, regardless of the presence of minors, especially for families with a head of household seeking employment (the proportion of which has doubled in the observation period, reaching 15.7 per cent in 2014) or households with a head of household in a blue-collar or equivalent position, for which the proportion of poor families exploded during the crisis and also increased in 2014, now standing at nearly 10 per cent.

*Purchase card.* – The purchase card or social card<sup>106</sup> was introduced many years after the abandonment of the trial of the minimum labour force integration income, despite the fact that the assessment of the research institutes charged with evaluating that programme was not negative, and of the proposed income of last resort, for non-compliance with regional jurisdiction. The programme was frequently revised and amended on the fly for a variety of reasons, including changes in the Government in power between the time the proposal was made and the implementation stage. The succession and overlapping of mechanisms for combating poverty and social exclusion is such that a brief review of the path followed by the different national-level policies would be useful.<sup>107</sup>

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<sup>104</sup> Since 2015, Istat has calculated absolute poverty on the basis of the survey of household expenditure, which replaced the previous consumption survey. See Istat (2015), *La povertà in Italia - Anno 2014*, 15 July.

<sup>105</sup> The proportion increases as the number of minors and, in general, the number of members increases above two.

<sup>106</sup> Both terms are used as equivalents here.

<sup>107</sup> For a more extensive discussion of the critical comparative assessment of the various instruments, please see: Lusignoli, L. (2014), *Come cambiano gli interventi di contrasto alla povertà: social card a*

**Table 3.12 – Individuals and households in poverty in absolute and percentage terms (1)**

| Individuals |        |             |        | Households |        |       |                          |                             |                        |                  |                               |     |
|-------------|--------|-------------|--------|------------|--------|-------|--------------------------|-----------------------------|------------------------|------------------|-------------------------------|-----|
| ITALY       |        | ITALY       |        | North      | Centre | South | At least one minor child | At least one elderly member | Seeking employment (2) | Other status (2) | Blue collar or equivalent (2) |     |
| (thousands) | % rate | (thousands) | % rate | % rate     |        |       |                          |                             |                        |                  |                               |     |
| 2007        | 1,789  | 3.1         | 823    | 3.5        | 3.1    | 2.8   | 4.6                      | 2.4                         | 4.6                    | 7.0              | 7.3                           | 1.7 |
| 2008        | 2,113  | 3.6         | 937    | 4.0        | 2.9    | 2.7   | 6.2                      | 3.2                         | 4.6                    | 9.6              | 8.9                           | 4.5 |
| 2009        | 2,318  | 3.9         | 969    | 4.0        | 3.0    | 2.3   | 6.6                      | 3.6                         | 4.6                    | 10.6             | 8.3                           | 4.0 |
| 2010        | 2,472  | 4.2         | 980    | 4.0        | 3.4    | 3.6   | 5.1                      | 3.5                         | 4.5                    | 10.3             | 6.7                           | 6.6 |
| 2011        | 2,652  | 4.4         | 1,081  | 4.3        | 3.2    | 3.6   | 6.4                      | 4.1                         | 5.0                    | 9.7              | 7.4                           | 6.1 |
| 2012        | 3,552  | 5.9         | 1,398  | 5.6        | 4.8    | 4.6   | 7.6                      | 5.5                         | 5.2                    | 15.6             | 10.7                          | 7.4 |
| 2013        | 4,420  | 7.3         | 1,614  | 6.3        | 4.4    | 4.9   | 10.1                     | 8.6                         | 5.2                    | 21.1             | 9.9                           | 9.3 |
| 2014        | 4,102  | 6.8         | 1,470  | 5.7        | 4.2    | 4.8   | 8.6                      | 8.4                         | 4.7                    | 15.7             | 7.7                           | 9.6 |

Source: Istat (2015), "La povertà in Italia, Anno 2014".

(1) Series reconstructed for years prior to 2014. Provisional data. - (2) The professional status is that of the head of household. The definition of person seeking employment is based on self-reported status.

The original "social card", or ordinary purchase card, was introduced with Decree Law 118/2008. It consists of limited monetary assistance (€40 per month) and is targeted at households with children under three years of age and/or seniors over 64.<sup>108</sup> Beneficiaries are subject to means testing, based on an ISEE threshold,<sup>109</sup> the level of benefits received and certain wealth requirements, as well as consumption levels.

The card, which is requested through the post office, can be used to buy food and pharmaceutical products and to pay electricity (possibly subsidized) and gas bills, and may also entitle holders to discounts in shops. The absence of services to support social, educational and labour market integration, the limited number of beneficiaries and the small size of the benefit, as well as the significant administrative costs, represent some of the limitations of this programme.

The annual reports of INPS can be used to reconstruct the number of beneficiaries of the ordinary purchase card and the amounts disbursed between 2009 and 2014. After the reduction registered between 2009 and 2010 (from 637,000 to 540,000 individuals), the number of beneficiaries remained broadly stable until 2013 and then increased by 14.9 per cent in 2014, to more than 615,000 (Table 3.13). In the six years in question, the beneficiaries of at least one credit transfer to the card appear to be concentrated in two regions, Campania (23.4 per cent of the total) and Sicily (22.9 per cent), followed by Puglia (11 per cent), Lazio (8.5 per cent), Calabria (7 per cent) and Lombardy (6 per cent). In total, these six regions account for almost 78 per cent of beneficiaries.

confronto", in "Le politiche contro la povertà in Italia", Rapporto 2014, Caritas; Baldini, M. and Toso, S. (2013), "Sostegno del reddito e lotta alla povertà: le politiche pubbliche in tempo di crisi", in Zanardi, A. (2013) (eds) "La finanza pubblica italiana", Rapporto 2013.

<sup>108</sup> The 2014 Stability Act expanded the programme to include certain foreign citizens in order to comply with a European directive.

<sup>109</sup> The thresholds for means testing undergo annual monetary revaluation. In 2015, the eligibility requirements for the old purchase card were: 1) an ISEE threshold €6,795.38; 2) maximum public monetary benefits of €6,795.38 for persons aged between 65 and 69 and €9,060.51 for those aged 70 and over; 3) a threshold for non-real-estate wealth for ISEE purposes of €15,000; 4) no ownership of real estate other than the primary residence, unless the share is less than 25 per cent for residential use and 10 per cent in other cases; 5) not a holder of more than one domestic electricity contract and one non-domestic contract, more than two gas contracts, and more than two motor vehicles. The benefits terminate if the holder is admitted to hospital with food paid by the central government or if sentenced to prison.

**Table 3.13** – Beneficiaries with at least one credit transfer to ordinary purchase card (1)

|                       | 2009           | 2010           | 2011           | 2012           | 2013           | 2014           |
|-----------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Piedmont              | 26,049         | 18,794         | 18,068         | 17,879         | 17,990         | 26,069         |
| Valle D'Aosta         | 574            | 414            | 385.00         | 390            | 367            | 515            |
| Liguria               | 10,719         | 8,244          | 7,634          | 7,238          | 7,051          | 8,440          |
| Lombardy              | 44,117         | 30,370         | 29,018         | 27,975         | 27,604         | 45,564         |
| Trentino Alto Adige   | 2,187          | 1,650          | 1,642          | 1,501          | 1,470          | 3,058          |
| Veneto                | 22,950         | 15,892         | 14,901         | 14,097         | 13,565         | 21,506         |
| Friuli-Venezia Giulia | 5,579          | 3,982          | 3,762          | 3,702          | 3,744          | 5,754          |
| Emilia-Romagna        | 17,783         | 12,823         | 11,904         | 11,331         | 11,139         | 20,282         |
| Tuscany               | 18,954         | 14,034         | 13,068         | 12,265         | 12,025         | 17,141         |
| Umbria                | 4,310          | 3,032          | 2,707          | 2,550          | 2,504          | 4,195          |
| Marche                | 8,048          | 5,886          | 5,386          | 5,093          | 4,941          | 7,529          |
| Lazio                 | 58,593         | 45,721         | 45,032         | 44,949         | 45,430         | 50,704         |
| Abruzzo               | 12,183         | 9,149          | 8,754          | 8,452          | 8,585          | 10,043         |
| Molise                | 3,161          | 2,439          | 2,462          | 2,450          | 2,534          | 2,640          |
| Campania              | 134,965        | 125,931        | 130,044        | 132,038        | 133,477        | 137,033        |
| Puglia                | 62,317         | 55,675         | 55,670         | 55,562         | 55,622         | 58,043         |
| Basilicata            | 6,098          | 4,903          | 4,770          | 4,708          | 4,703          | 5,100          |
| Calabria              | 44,507         | 38,973         | 37,334         | 37,602         | 38,119         | 40,645         |
| Sicily                | 134,060        | 125,662        | 126,757        | 127,824        | 128,061        | 133,710        |
| Sardinia              | 19,808         | 16,107         | 16,114         | 16,263         | 16,573         | 17,424         |
| <b>Total</b>          | <b>636,962</b> | <b>539,681</b> | <b>535,412</b> | <b>533,869</b> | <b>535,504</b> | <b>615,395</b> |

Source: based on INPS data. The 2010 data are from Istat (<http://dati.coesione-sociale.it/>).

(1) Compliance with the eligibility requirements for the card are verified every two months; consequently, a recipient may not necessarily receive credits in every two-month period of the year.

As regards expenditure, between 2011 and 2014<sup>110</sup> the funds disbursed through the ordinary purchase card programme exceeded €854 million (Table 3.14). In terms of developments in amounts and geographical concentration, spending reflects the trends observed for the beneficiaries.

The Istat database on social cohesion enables us, for the years 2010-12 only,<sup>111</sup> to observe the distribution of funds disbursed by gender, age and amount used by card beneficiaries. The percentage of female recipients (Fig. 3.15) was broadly unchanged in the three years and significantly exceeded 50 per cent everywhere. In the North-East and North-West, women accounted for 70 per cent of the total. The Centre registered a slightly lower percentage (67-68 per cent), while in the South and the Islands, the level drops to about 60 per cent. The differences are probably explained by the more widespread presence in the South and the islands of women who are unemployed or have low income from employment, but who live in households that are not eligible for the purchase card. By contrast, in the North and Centre there are more women who are employed and the main breadwinner in independent eligible households.

<sup>110</sup> Expenditure data is available in the INPS annual reports only as from 2011. The Istat social cohesion database only reports data on beneficiaries, not expenditure.

<sup>111</sup> The Istat cohesion database provides annual data up to 2012. For 2013, data is only available for part of the year.

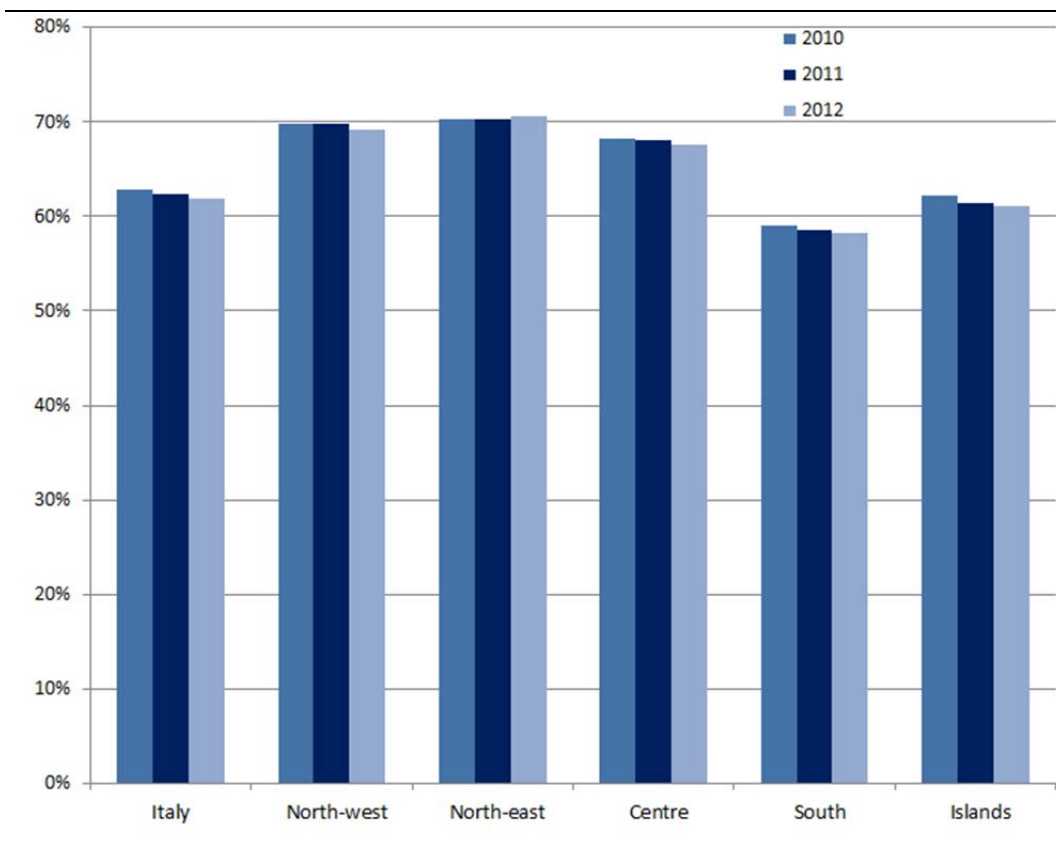


**Table 3.14** - Total amount disbursed with the ordinary purchase card

|                       | 2011               | 2012               | 2013               | 2014               | total 2011-2014    |
|-----------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| Piedmont              | 7,194,612          | 7,138,578          | 7,144,915          | 9,217,230          | 30,695,336         |
| Valle D'Aosta         | 151,440.00         | 150,400.00         | 143,600            | 175,520            | 620,960            |
| Liguria               | 3,138,259          | 3,001,969          | 2,914,555          | 3,215,440          | 12,270,222         |
| Lombardy              | 11,548,146         | 11,260,400         | 11,022,259         | 15,748,968         | 49,579,773         |
| Trentino Alto Adige   | 636,681            | 602,750            | 579,680            | 975,040            | 2,794,151          |
| Veneto                | 6,093,964          | 5,822,218          | 5,538,174          | 7,559,051          | 25,013,407         |
| Friuli-Venezia Giulia | 1,503,967          | 1,486,305          | 1,496,880          | 2,053,360          | 6,540,512          |
| Emilia-Romagna        | 4,679,700          | 4,480,430          | 4,347,760          | 6,792,814          | 20,300,703         |
| Tuscany               | 5,275,975          | 4,988,438          | 4,831,916          | 6,057,840          | 21,154,169         |
| Umbria                | 1,089,490          | 1,034,831          | 1,002,480          | 1,435,280          | 4,562,081          |
| Marche                | 2,152,256          | 2,047,840          | 1,942,640          | 2,581,680          | 8,724,416          |
| Lazio                 | 17,732,518         | 18,033,543         | 18,274,757         | 19,329,547         | 73,370,365         |
| Abruzzo               | 3,464,551          | 3,388,320          | 3,406,960          | 3,740,720          | 14,000,551         |
| Molise                | 972,817            | 970,960            | 986,240            | 1,021,520          | 3,951,537          |
| Campania              | 49,162,242         | 50,695,642         | 51,329,482         | 52,431,152         | 203,618,519        |
| Puglia                | 21,134,669         | 21,239,985         | 21,260,587         | 21,950,381         | 85,585,623         |
| Basilicata            | 1,791,451          | 1,815,760          | 1,817,760          | 1,907,600          | 7,332,571          |
| Calabria              | 14,201,637         | 14,450,871         | 14,592,720         | 15,289,149         | 58,534,377         |
| Sicily                | 49,041,386         | 49,526,138         | 49,839,199         | 51,546,554         | 199,953,277        |
| Sardinia              | 6,134,690          | 6,271,377          | 6,400,960          | 6,684,962          | 25,491,990         |
| <b>Total</b>          | <b>207,100,450</b> | <b>208,406,756</b> | <b>208,875,684</b> | <b>229,713,808</b> | <b>854,096,698</b> |

Source: based on INPS data.

**Figure 3.15** – Female beneficiaries of ordinary purchase cards  
(percentage of total)



Source: based on Istat data.

With regard to age, the presence of a minor of less than three years of age is the most widespread characteristic of households eligible for purchase cards (Table 3.15). In this age group, the number of beneficiaries of the two genders is equivalent, albeit with a slight predominance of males. After age 65, women are much more numerous than men, with the gender difference increasing with age, reaching a maximum among the over 80s.

In terms of amounts used during the year (Table 3.16 and Figure 3.16), beneficiaries are concentrated in the range between €450 and €500, with 60 per cent of cardholders, who received all twelve monthly payments. The other five brackets account for an average of 7-8 per cent of beneficiaries.

**Table 3.15** – Beneficiaries of ordinary purchase cards by age and gender (1)  
(number of individuals)

|                   | 2010           |                |                | 2011           |                |                | 2012           |                |                |
|-------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
|                   | Male           | Female         | Total          | Male           | Female         | Total          | Male           | Female         | Total          |
| Up to 3 years     | 126,002        | 119,395        | 245,397        | 127,283        | 120,012        | 247,295        | 126,376        | 118,974        | 245,350        |
| 65-69 years       | 14,342         | 26,238         | 40,580         | 14,441         | 24,141         | 38,582         | 16,505         | 24,267         | 40,772         |
| 70-74 years       | 22,609         | 63,018         | 85,627         | 21,843         | 59,842         | 81,685         | 21,455         | 57,159         | 78,614         |
| 75-79 years       | 19,575         | 60,139         | 79,714         | 19,330         | 59,479         | 78,809         | 19,502         | 58,985         | 78,487         |
| 80 years and over | 17,782         | 71,110         | 88,892         | 18,638         | 70,919         | 89,557         | 19,309         | 71,556         | 90,865         |
| <b>Total</b>      | <b>200,310</b> | <b>339,900</b> | <b>540,210</b> | <b>201,535</b> | <b>334,393</b> | <b>535,928</b> | <b>203,147</b> | <b>330,941</b> | <b>534,088</b> |
| Up to 3 years     | 62.9%          | 35.1%          | 45.4%          | 63.2%          | 35.9%          | 46.1%          | 62.2%          | 36.0%          | 45.9%          |
| 65-69 years       | 7.2%           | 7.7%           | 7.5%           | 7.2%           | 7.2%           | 7.2%           | 8.1%           | 7.3%           | 7.6%           |
| 70-74 years       | 11.3%          | 18.5%          | 15.9%          | 10.8%          | 17.9%          | 15.2%          | 10.6%          | 17.3%          | 14.7%          |
| 75-79 years       | 9.8%           | 17.7%          | 14.8%          | 9.6%           | 17.8%          | 14.7%          | 9.6%           | 17.8%          | 14.7%          |
| 80 years and over | 8.9%           | 20.9%          | 16.5%          | 9.2%           | 21.2%          | 16.7%          | 9.5%           | 21.6%          | 17.0%          |
| <b>Total</b>      | <b>100.0%</b>  | <b>100.0%</b>  | <b>100.0%</b>  | <b>100.0%</b>  | <b>100.0%</b>  | <b>100.0%</b>  | <b>100.0%</b>  | <b>100.0%</b>  | <b>100.0%</b>  |

Source: based on Istat data.

(1) The figures include beneficiaries not resident in Italy (less than 0.1 per cent). Discrepancies with INPS data are a result of differences in updating.

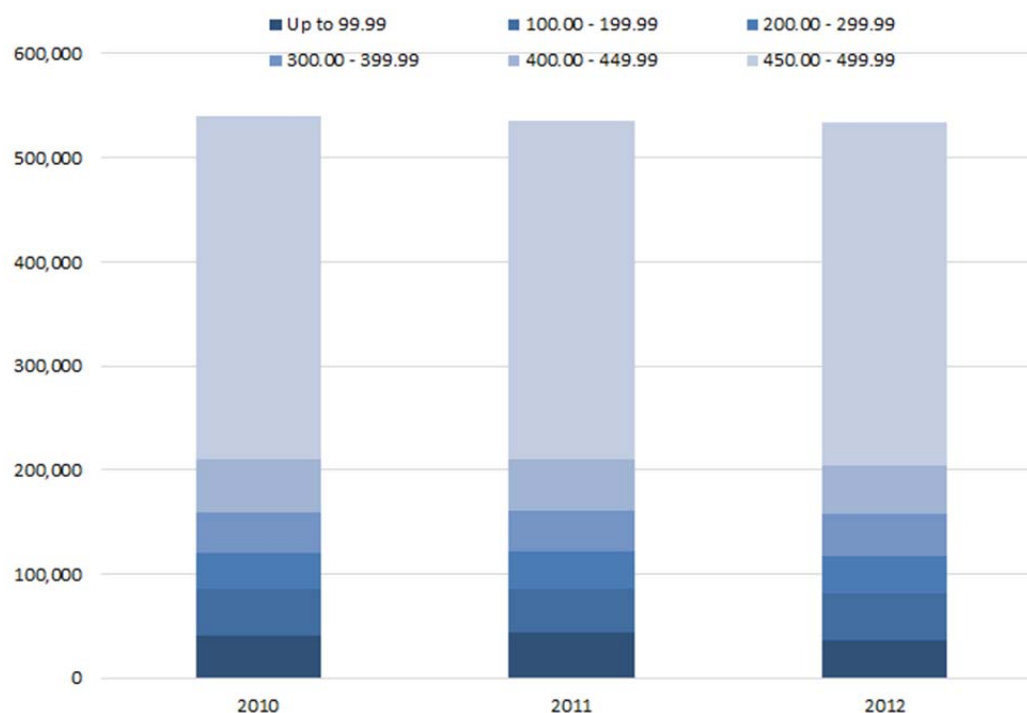
**Table 3.16** – Ordinary purchase card beneficiaries by amount received in the year (1)  
(in euros)

|                 | 2010           | 2011           | 2012           |
|-----------------|----------------|----------------|----------------|
| Up to 99.99     | 40,709         | 43,566         | 36,358         |
| 100.00 - 199.99 | 45,255         | 42,868         | 44,933         |
| 200.00 - 299.99 | 34,893         | 35,157         | 36,666         |
| 300.00 - 399.99 | 38,881         | 39,663         | 39,744         |
| 400.00 - 449.99 | 50,925         | 49,738         | 46,819         |
| 450.00 - 499.99 | 329,547        | 324,936        | 329,568        |
| <b>Total</b>    | <b>540,210</b> | <b>535,928</b> | <b>534,088</b> |

Source: based on Istat data.

(1) The figures include beneficiaries not resident in Italy (less than 0.1 per cent).

**Figure 3.16** – Ordinary purchase card beneficiaries by amount received in the year



Source: based on Istat data.

The new social card, or experimental purchase card – as part of the trial of a project to support active inclusion (SAI) – provided for in Decree Law 5/2012, was launched in twelve municipalities with more than 250,000 inhabitants, with €50 million in funding. The initial approach, which essentially envisaged entrusting the programme to charities, was later completely overhauled, giving a significant role to the municipalities (to which applications are submitted directly). The target population is households with children, and the municipalities can use preferential criteria to focus on families experiencing hardship in their housing conditions, single parent households, and households with a large number of minor or disabled children (EU immigrant families or those with long-term residence permits are also eligible). The amount of money available through the new purchase card is higher than under the old programme and depends on household composition (from €231 per month for two-member families to €404 in the case of five or more members), but the means testing is more stringent.<sup>112</sup>

<sup>112</sup> The ISEE threshold is lower (€3,000 euro), the value of the primary residence may not exceed €30,000 euro, financial wealth and the ISEE wealth indicator must both not exceed €8,000 euro, other public monetary benefits must be less than €600 a month, beneficiaries may not possess recent vehicles, with additional limits on engine size. In addition, new requirements are added to these: all the members of a household must be unemployed at the time of the application or at least one must have been terminated in the last 36 months or, in any case, if at least one member is a permanent or temporary employee, the earnings of the household in the previous six months may not exceed €4,000. Other requirements have also been introduced directly by the municipalities, in agreement with the Ministry of Labour and Social Policy and the Ministry for the Economy and Finance.

The main difference with the old purchase card is the delivery of customised services, managed by municipalities and comprising employment, health and educational services. The original plans for the new social card programme also envisaged assessment and evaluation measures, including comparisons with groups not involved in the trial. The launch of this measure has been very challenging, as the limited resources prompted the establishment of very strict criteria (including *ex ante* controls), to the point that many municipalities were not able to use all the funds available (applications were plentiful, but many did not meet the requirements). The standard for employment hardship is especially restrictive.<sup>113</sup>

Decree Law 76/2013 sought to extend the trial of the new purchase card to the regions of the South, with funding of €167 million for 2014 and 2015, supplemented by additional resources amounting to €300 million for 2014 and 2015 (thanks to the reprogramming and reallocation of European funds). On this occasion, the new purchase card was renamed the social inclusion card (SIC). Later, with the 2014 Stability Act (Law 147/2013), the new purchase card was extended to the Centre-North, thanks to funding of €40 million per year for 2014-16.

Finally, a broader approach to what would become SAI was prepared by the working group on the minimum income at the Ministry of Labour and Social Policy in the summer of 2013. The proposal was for a universal programme, based on the reformed ISEE economic situation indicator<sup>114</sup> and on social inclusion support services, which was to raise income to the subsistence level, but would be implemented gradually to cover 6-7 per cent of the population, i.e. those living in absolute poverty. Initial plans provided for an investment of about €1.5 billion, beginning to replace the various social cards and to address the worst poverty. Once fully operational, the programme would cost about €7-8 billion.

The INPS 2014 Annual Report enables an initial analysis of the data on the experimental purchase card (the SAI), which began in the spring of 2014. The trial is still under way in twelve cities: Bari, Bologna, Catania, Florence, Genoa, Milan, Naples, Palermo, Rome, Turin, Venice and Verona. *“The trial is part of a more general process to develop a programme to combat absolute poverty, providing an essential level of support throughout the entire country, incorporating the strategic orientation of the European Commission Recommendation on active inclusion (2008/867/EC) which in addition to income support envisages other two pillars: inclusive labour markets and access to quality services”*.<sup>115</sup>

Table 3.17 shows the data for the first year of operation of the new card. A total of 6,565 beneficiaries received at least one credit transfer to the experimental card. The beneficiaries are concentrated in Palermo (23 per cent) and Naples (20.7 per cent), followed by Turin (14.5 per cent), Milan (11.7 per cent), Catania (9.3 per cent), Bari (6.2

<sup>113</sup> See Guerra, M.C. and Tangorra, R. (2014), *“La nuova social card al banco di prova”*, in *lavoce.info*, 8 August.

<sup>114</sup> The new ISEE, provided for in Decree Law DL 201/2011, entered force at the start of 2015.

<sup>115</sup> INPS (2015), *“Rapporto annuale 2014”*, p. 192.

per cent) and Genoa (5.7 per cent). Bologna, Florence, Verona and Venice recorded lower numbers.

Disbursements using the new card totalled about €16.7 million in 2014. Naples (over €3.8 million), Palermo (over €3.5 million), Turin (about €2.2 million) and Milan (about €2 million) are the cities with the largest amounts drawn. They are followed by Catania (almost €1.5 million), Bari (over €1.1 million), Genoa (€0.9 million) and Bologna (€0.6 million).

**Table 3.17** – Beneficiaries of the experimental purchase card with at least one credit transfer and amounts disbursed in 2014 (1)

|              | Total amount disbursed<br>(euros) | %              | Beneficiaries with at<br>least one transfer | %              |
|--------------|-----------------------------------|----------------|---|----------------|
| Milan        | 2,071,574                         | 12.42%         | 769   | 11.71%         |
| Naples       | 3,847,766                         | 23.07%         | 1360  | 20.72%         |
| Turin        | 2,213,778                         | 13.27%         | 952   | 14.50%         |
| Palermo      | 3,569,766                         | 21.40%         | 1,511                                       | 23.02%         |
| Genoa        | 860,452                           | 5.16%          | 378   | 5.76%          |
| Bologna      | 567,372                           | 3.40%          | 221   | 3.37%          |
| Florence     | 288,198                           | 1.73%          | 112   | 1.71%          |
| Bari         | 1,127,800                         | 6.76%          | 408   | 6.21%          |
| Catania      | 1,456,448                         | 8.73%          | 609   | 9.28%          |
| Venice       | 290,288                           | 1.74%          | 101   | 1.54%          |
| Verona       | 383,816                           | 2.30%          | 144   | 2.19%          |
| <b>Total</b> | <b>16,677,258</b>                 | <b>100.00%</b> | <b>6,565</b>                                | <b>100.00%</b> |

Source: data from INPS.

(1) Compliance with the requirements is reassessed every two months. Consequently, a recipient may not receive credits transfers for all the two-month periods in the year. The City of Rome was accepting applications at the time the data was being collected.

### 3.5 Other major measures

*Contribution relief for permanent hiring.* – The Stability Bill extends the contribution relief granted to employers for new hires to 2016, while reducing the amount and duration of the benefit. In particular, for new permanent contracts entered into between 1 January and 31 December 2016, employers are exempt from payment of 40 per cent (instead of 100 per cent) of social security contributions for a maximum of two years (instead of three) from the date the contract is activated. The maximum relief for individual new employees is set at €3,250 (about 40 per cent of the €8,060 under last year's rules) and cannot be combined with other exemptions or reductions in financing provided for under existing legislation. New apprenticeship and domestic worker contracts do not qualify for the relief.

Specific measures have been established for the agricultural sector. In particular, specified expenditure ceilings have been set for 2016-19, broken down by workers

classified as office employees and managers and all other categories. The limitations means that the relief is granted in the chronological order applications are received, until the resources appropriated are depleted.

INAIL insurance contributions remain payable by employers. The calculation rate for pension purposes remains unchanged on last year, thanks to full figurative compensation.

The relief does not apply to 1) workers who the previous six months were employed on permanent contracts, 2) workers who in the three months preceding the entry into force of the Stability Act have been employed on permanent contracts at the same employer or at formal or de facto subsidiaries or associates, and 3) workers who have already benefited, in a previous job, from contribution relief (including that provided for under the 2015 Stability Act).

Within the agricultural sector, the relief does not apply to new employees with apprenticeship contracts and workers who in 2015 were already employed on permanent contracts or fixed-term contracts for at least 250 days.

The cost of this measure for the public finances is officially estimated at €0.8 billion in 2016, €2.1 billion in 2017 and €1.3 billion in 2018 (respectively, €0.8 billion, €1.5 billion and €1.0 billion net of tax effects).

Based on the mandatory reports of the Ministry of Labour and Social Policy, a total of 1.1 million permanent contracts were activated in the first two quarters of 2015 (an increase of almost 30 per cent over the same period last year). The most recent INPS data suggest that if the pace of growth observed in the first eight months is maintained, total contracts benefitting from contribution relief activated in 2015 will reach 1.2 million (200,000 contracts more than expected in official estimates).

Except for a number of details related to the agricultural sector (for which, as noted, limits have been set on expenditure), the intended beneficiaries of the relief have not changed compared with last year. The only amendments of the mechanism regard the amount and maximum absolute value per worker, both of which have been reduced to 40 per cent of their values in 2015. With no change in the number of new hires or wages compared with 2015, contribution revenue would be expected to decline by around 40 per cent of the amount attributable to the measure adopted in 2015. As the Technical Report, based on the INPS data for 2015 noted earlier, assumes a million new permanent jobs in 2016, compared with the estimated 1.2 million in 2015, adjusting for the reduction in new hires, the decrease in contribution revenue could amount to 33 per cent of that associated with the measure adopted in 2015.

The assumption of a smaller number of new permanent jobs appears realistic. As noted during analysis of the 2015 Stability Act, the total contribution relief introduced this year may have prompted companies to postpone hiring decisions already planned for 2014, amplifying the impact of the measure on 2015. This should lead to a downward revision of the forecast for 2016. However, we must bear in mind that two factors are working in the opposite direction: the slight economic recovery expected for the coming year, which could induce firms to hire more, and a front-loading effect at the end of 2016 as

permanent hires that would have otherwise occurred in 2017 (when there is no contribution relief) are brought forward.

*Taxation of productivity bonuses.* – The Stability Bill includes measures to increase productivity and strengthen the participation of employees in the activity of firms and to support workers and their families. First, the bill revives tax relief for productivity bonuses, already applied in 2014 and previously, changing the ceiling and the income threshold. More specifically, for 2016 the portion of remuneration linked to measurable and verifiable productivity gains, and amounts paid in profit-sharing arrangements, will be subject to a 10 per cent tax in place of personal income tax and the associated regional and municipal surtaxes. The maximum gross amount eligible for the relief is set at €2,000 if in the previous year the employee had income from employment of no more than €50,000.<sup>116</sup> Despite the measure having been adopted in the past, future decrees are necessary to specify the technical methods for defining and measuring productivity. The measure is expected to have a cost of about €0.5 billion a year.

*Corporate welfare.* – The Stability Bill also excludes monetary or in-kind benefits granted to employees or their families from income taxable for personal income tax purposes. Examples include funds, facilities or services provided to workers and/or their families for education, recreation, entertainment, social assistance and healthcare, including benefits provided to the elderly and the non-self-sufficient, and religious worship. The cost of this measure is negligible (about €4 million a year).

*Pension package.* – The pension package in the Stability Bill contains two measures: the amendment of the so-called "female worker option" and pre-retirement part-time work.

The former measure changes the eligibility criteria for the "female worker option", introduced in 2004 and retained in 2011.<sup>117</sup> Under the latter, until 31 December 2015 women who are employees or are self-employed who have paid pension contributions for at least 35 years and are, respectively, 57 or 58 years old are eligible for a seniority pension, provided that they opt to receive benefits as calculated under the defined-contribution system. The Stability Bill includes among possible beneficiaries women who meet the age and contribution requirements by December 31, even if payment of the pension (payment of the first cheque) commences after 31 December 2015.<sup>118</sup> Under current legislation only workers for whom pension payments (disbursement of the first cheque) begin by 31 December 2015.

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<sup>116</sup> In 2014, the last year of application of an equivalent measure, the ceiling on the amount eligible for relief and the income threshold were €3,000 and €40,000 respectively. In short, the system provided a larger benefit to a smaller pool of beneficiaries.

<sup>117</sup> The option was introduced with Law 243 of 23 August (Art. 1, par. 9) and subsequently retained with Law 214 of 22 December 2011, known as the "Fornero reform".

<sup>118</sup> Actual payment of the first pension cheque occurs at 57 years and 3 months for female employees and 58 years and 3 months for self-employed women and those enrolled in the separate INPS pension fund.

Retirement under the "female worker option" continues to be governed by the rules for deferral of the start of pension payments valid prior to the Fornero reform, i.e. twelve months for employees and eighteen months for the self-employed or term-contract workers.

According to official estimates, based on historical developments in retirements and a sample of contribution histories, this measure will generate greater outlays in the first six years (from €0.2 billion in 2016 to €0.7 billion in 2018, before falling to €0.1 billion in 2021), while in the medium to long term the savings from calculating pensions entirely on a defined-contribution basis will predominate.

The higher costs are fully funded by: a) reductions in the expenditure authorizations relating to the safeguards for workers not subject to the pension requirements introduced with the Fornero reform; b) the extension until 2018 of the inflation-adjustment rules for pensions introduced in 2013 with reference to 2014-16,<sup>119</sup> which are based on five brackets: a 100 per cent adjustment for pensions up to three times the minimum, 90 per cent for those between three and four times the minimum, 75 per cent for those between four and five times the minimum, 50 per cent for those between five and six times the minimum, 40 per cent in 2014 and 45 per cent in 2015 and in 2016 for those more than six times the minimum. In the absence of the extension, from 2017 the more attractive (for pensioners) indexation mechanism based on three bands would return in force: 100 per cent for pensions up to three times the minimum, 90 per cent for those between three and five times the minimum and 75 per cent for those more than five times the minimum.<sup>120</sup>

Unlike the situation from 2004 to 2011 (the year of the Fornero reform),<sup>121</sup> more recently the "female worker option" has seen an increase in participation, as demonstrated by the monthly data on new pensions (the most recent figures are for September 2015). If, in conjunction with this increase in the number exercising the option, which is partly attributable to the tightening of requirements due to take effect as from 1 January 2016, we consider the fact that the Stability Bill expands the pool of eligible women, the number of new pensions granted under the female worker option could exceed the level that historical data would suggest.

The other measure, known as pre-retirement part-time work, would allow employees in the private sector on permanent full-time contracts who will qualify for an old-age pension by 31 December 2018 to reduce their working hours, in agreement with their employer, by between 40 and 60 per cent for a period not exceeding the period that separates them from retirement (at most 3 years). It is not clear whether the worker

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<sup>119</sup> Law 147 of 27 December 2013, Art.1, par. 483.

<sup>120</sup> Law 388 of 23 December 2000, Art. 69, par. 1. For a descriptive summary of the rules governing the inflation adjustment of pensions, please see Focus Paper no. 4 published on the website of the PBO on 16 June 2015.

<sup>121</sup> Following its introduction in 2004, the female worker option was not very successful for two reasons: first, until the Fornero reform, there were no significant changes in the age and contribution requirements for pension eligibility (and in fact, a significant increase is expected as from January 2016); and second, the full calculation of pensions on a defined-contribution basis will involve substantial decreases in pensions for most beneficiaries (the Technical Report estimates that the recalculation will reduce pensions by 27.5 per cent for self-employed women and 36 per cent for employees).



must have already met the contribution requirements for the old age pension (20 years of contributions) at the time of the agreement on the transformation of the contract.

The contractual agreement establishes that the employer shall pay to the worker, rather than to INPS, the pension contributions that would be charged to the employer on the part of the worker's pay corresponding to the work not performed. These contributions, once they become an integral part of the workers pay, are exempt from income tax and social security contributions due from the employee. The contributions not paid on the part of the foregone remuneration (both those charged to the employer and those borne by the worker) are borne in full by the state, so that nothing changes for the employee, both in the calculation of pension benefits and for other social security benefits. At the time of actual retirement, the pension may not exceed what it would have been if no change had occurred in the employment relationship.

It can be shown that, given the choice of reducing working hours by between 40 and 60 per cent, the savings for the employer are between 30 and 45 per cent of gross wages, while those for the employee amount to between 13 and 20 per cent.

The maximum expenditure for the measure is set at about €0.1 billion in each year of the 2016-18 period, to be financed through an increase in the supplementary contribution due for compulsory insurance against involuntary unemployment (0.3 per cent of wages affected). The measure establishes that once the spending limit is reached, no further applications for pre-retirement part-time work will be accepted.

In its current guise, the incentive for part-time work appears to be intended to operate as a mechanism for early retirement and reducing payrolls, rather than open opportunities for active aging. At the international level and in the policy guidelines of the OECD and the IMF, active aging is used to refer to contractual arrangements and pension rules that encourage people to continue working beyond the minimum retirement age, including provisions that increase pensions depending on the age of actual retirement. In the measure proposed in the Stability Bill, however, the term appears to be construed differently: the provisions are intended to facilitate and subsidise a reduction in work in order to make the achievement of minimum pension requirements less burdensome.

This interpretation is supported by three other elements: the full transfer of social security contributions (not only pensions) to the state on the part of remuneration not paid; the total exemption from tax and social security contribution of the worker's wages represented by the pension contributions that the employer would have paid to INPS on the portion of remuneration no longer paid; and the non-structural nature of the measure (the option is limited in time and restricted to a limited pool of beneficiaries).

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