

## **Work Plan of the Parliamentary Budget Office**

**Year 2016**

**(as required by Law 243 of 24 December 2012, Article 18, paragraph 4)**

The objective of the Parliamentary Budget Office (PBO) is to contribute to the sustainability of Italy's public finances, ensuring that the public accounts are transparent at the service of Parliament and the general public. As specified in the law establishing the PBO (Law 243/2012, pursuant to the new Article 81 of the Constitution), the PBO assesses macroeconomic and public finance forecasts; quantifies the macroeconomic effects and the impact on the public finances of the most important legislative measures; analyses public finance trends, including by sub-sector, and verifies the long-term sustainability of the public finances; assesses compliance with fiscal rules and monitors the activation and use of a number of mechanisms envisaged in the new European framework of rules (specifically, the corrective mechanism and authorisation in the case of exceptional circumstances). Finally, the PBO prepares analyses and reports at the request of the parliamentary committees responsible for public finance matters.

Established in May 2014 and operational as from the following September, the PBO is beginning its second year of activity. The PBO's activities in 2016 will follow a number of closely related main lines of action:

1. completion of the tools needed to assess forecasts of macroeconomic conditions, the public finances and the impacts of the most important legislation on the public accounts and the distribution of resources, assuming that the various government institutions involved (Ministry for the Economy and Finance, Ministry of Labour, Ministry of Health, etc.) make the associated databases available;
2. strengthening the role of the PBO to foster greater transparency in the public accounts by providing increasingly systematic analyses and expanding the instruments available for communicating with Parliament and the general public;
3. completing development of the PBO's organisational structure by gradually filling all staffing needs and placing all its units in operation.

## Activities performed in 2015

In 2015 the PBO continued and refined its work to validate the official macroeconomic forecasts (trend and policy) in accordance with the memorandum of understanding between the MEF and the PBO signed in September 2014 (<http://en.upbilancio.it/wp-content/uploads/2015/03/MEF-PBO-Memorandum-of-Understanding.pdf>). The results of this activity and the assessments of the public finances were provided to the Budget Committees of the Senate and the Chamber of Deputies on the occasion of the hearings during the parliamentary consideration of the Government's planning documents and were then incorporated in two Reports: in April, the 2015 Budgetary Planning Report and in November the 2016 Budgetary Policy Report. The PBO's Reports are published in time for the European Commission's review of the documents submitted by the Italian Government.

In addition to the Reports, the PBO publishes documents that provide an in-depth examination of specific issues, chosen independently by the PBO as part of the duties assigned to it under the law establishing it or prepared in response to requests from the parliamentary committees. More specifically, a number of hearings were held on issues of concern to the public finances, and nine *Focus Papers* and one *Working Paper* were published. The issues addressed included: estimating the output gap and potential output; the European Commission's guidance on flexibility under the Stability and Growth Pact; the 2015 Stability Act; derivatives contracts entered into by government entities; the revaluation of pensions after Decree Law 65/2015 implementing the ruling of the Constitutional Court; the Investment Plan for Europe; the redistributive effects and the impact on the public finances of the cancellation of the municipal services tax on primary residences; the accounting treatment and public finance issues of the advances paid to the regions to settle commercial payables; the review of the public finance objectives in the light of the "security package"; and the problems and outlook for healthcare expenditure.

Finally, during the year we began publication of a new periodical publication, the *Report on recent economic developments*. It analyses developments in the Italian and international economies on a quarterly basis, focusing specific attention on developments (divergences or otherwise) in the main macroeconomic variables compared with the government forecasting scenario. The document contains short-term forecasts (up to two quarters) on changes in GDP on the previous period and year-on-year over the course of the year and offers qualitative assessments of the main components of demand, inflation and the labour market.

This has been made possible by the strengthening of the analytical tools available to us. First and foremost, in the field of macroeconomic analysis, the PBO directly manages the Istat MeMo-It econometric model. This has made it possible to improve the use of the tool for the timely production of forecasts during the validation exercise and to estimate the macroeconomic impact of budget measures on the revenue and expenditure sides. The publication of the Report on recent economic developments also led to the implementation of short-term forecasting tools, which are necessary for monitoring developments in the economy during the year.

Within the analysis of the public finances, the capacity for forecasting the individual components of the general government accounts has been improved, including the use of specific estimation models for a number of revenue and expenditure items. The consistency between the public finance block and the macroeconomic forecasts of the econometric model has also been refined. Procedures were introduced for medium-term forecasts for the public accounts and the debt. With regard to monitoring compliance with fiscal rules, the method for taking account of the budget flexibility clauses was updated in accordance with the European Commission's interpretation of January 2015.

Finally, more sophisticated analysis was conducted of the impact of specific measures on the public finances, income distribution and the activity of economic agents on the basis of administrative data – in some cases of a fiscal nature – and microdata from corporate financials.

### **The 2016 work plan**

In 2016, the PBO's objective is to continue in the direction undertaken the previous year, completing the development of analytical tools and strengthening the assessment capabilities that it has created. The year's work will focus on developing the tools and organizing the information necessary for forecasting. Without jeopardising this priority, studies will be conducted of specific aspects of the public finances and the interaction of the latter with developments in the economic environment. Our efforts will be focused on: 1) strengthening macroeconomic forecasting capabilities in order to refine the validation process; 2) consolidating the monitoring and assessment of the public finances; 3) enhancing sectoral analysis and the assessment of impacts on the public accounts, income and economic activity in general.

#### Strengthening macroeconomic forecasting capabilities

In order to upgrade forecasting abilities, the tools available for analysis and macroeconomic estimation will be beefed up. The PBO will verify, develop and, where necessary, re-specify the Istat MeMo-It macroeconomic forecasting model. The verification activity will essentially address the stability of the model's behavioural equations. In addition, the structure of the model will be developed, enhancing the parts of greatest relevance to the PBO's activity.

Short-term forecasting tools, which are used to guide the forecasts of the macroeconomic model and the in-year analyses disseminated with the Report on recent economic developments, will also be revised and strengthened. In particular, models for forecasting other variables of essential importance for analysing current economic conditions (industrial production and inflation) will be added to the existing short-term forecasting tools, which regard GDP and the main components of demand.

With regard to enhancing our analysis of the interactions between macroeconomics and the public finances, the PBO will continue to examine the size of the fiscal multipliers. More specifically, with the help of the macroeconomic model, we will determine whether and to what extent the impact of the various budget policy measures on GDP has increased with the crisis (initial findings on this issue were presented in the 2016 *Report on Budgetary Policy*).

Specific attention will also be turned to the issues of potential output and estimating the output gap. This is necessary in order to improve the assessment of the quantification by the European Commission and the Government of variables that are uncertain but of crucial importance for assessing compliance with the fiscal paths determined under European rules. To this end, alternative models for specifying the output gap will be considered and compared.

An issue associated with potential output is hysteresis, i.e. the possibility that the sharp decline in potential output of the Italian economy in recent years was induced by the recessions. In order to test this hypothesis, it will be necessary to develop models that enable us to consider the existence of a correlation between the cycle and trend and that permit identification of the direction of causation between these two components.

In line with the international debate on strengthening the procedure for macroeconomic imbalances, the PBO will conduct a critical review of the main indicators of competitiveness used at the European level to assess convergence between the euro-area economies.

#### Consolidating the monitoring and assessment of the public finances

In 2016, we will strengthen the collection and organization of data for the purpose of monitoring the public finances. Accordingly, the PBO will develop additional agreements with a number of public institutions (Ministry for the Economy and Finance, Ministry of Health, Bank of Italy, Istat) to gain access to the required databases.

The parts of the Istat-Memo.it forecasting model of greatest interest to the public finance monitoring activities of the PBO will be expanded. More specifically, the block of accounts of institutional sectors (firms, households, foreign sector) will be completed and enriched, devoting special attention to interactions with public finance variables.

The sustainability of the debt will be another area on which our efforts will focus in developing analytical tools. The PBO will develop models to produce medium-term projections of the debt, taking due account of the uncertainty inherent in the estimates, and to calculate sustainability indicators in line with the methods used by the European Commission. An additional development in this area is the development of debt forecasts on the basis of the complete universe of government securities and the associated yield curve, exploiting the potential of the forecasting model for interest expenditure.

Connected with the analysis of developments in the debt is analysis of stock-flow adjustments, i.e. the components of the change in the debt that are not captured by net borrowing. More specifically, this requires analysis and monitoring of three aspects: 1) the impact of derivatives entered into by the Italian Republic; 2) the programme of disposals of public-sector enterprises; and 3) the impact of differences between accruals and cash accounting.

With regard to budget rules, the PBO will refine the method used to monitor compliance through the analysis of the interaction between the rule for structural adjustment and the expenditure benchmark. We will also assess the possibility of connecting the public finance rules (structural adjustment, expenditure benchmark, debt rule) and the analysis of debt developments noted earlier to the econometric model as satellite components.

The PBO will also monitor the main structural reforms, tracking their implementation in order to assess their compliance with the flexibility criteria under the European rules.

These activities will result in more comprehensive assessments of the public finances on the occasion of the hearings before Parliament and the publication of the Reports.

In addition, where other priorities do not conflict, specific analyses could also be conducted to compare the budget strategies of the main EU countries and the associated opinions of the European Commission.

### Enhancing sectoral analysis

To support forecasting and analysis, the PBO will complete, subject to the provision of the necessary data by the various institutions involved (MEF, Ministry of Labour, Ministry of Health, etc.), the construction (begun in 2015) of the fiscal microsimulation model for households and the corresponding model for firms, the forecasting model for pension expenditure and spending on other social services, that for spending on compensation of employees and the model for interest expenditure. The completion of these models will provide us with the capacity for on-going analysis of issues of great importance, such as the direction of tax policy, the evolution of expenditure in specific sectors, and the introduction of social measures.

Where monitoring data are available, forecasting models will be used to produce ex-post assessments of specific tax and social policy measures, as well as changes in tax expenditures.

Based on the decision to review of certain key elements of procedures and budget documents, the PBO will prepare documentation, including comparative analyses, to be made available to Parliament on the timetable of the budget session, the structure of the budget documents and the effects of the introduction of a balanced budget requirement for local governments.

Consistent with other priorities, we will deepen our examination of additional issues of special interest to the public finances such as: the composition and evolution of intermediate consumption of government departments; trends in the healthcare and non-healthcare expenditure of the regions in the light of the budget measures; the reform of the public administration and the reorganization of public enterprises; the repercussions of the reform of the operation of the civil justice system for the efficiency of expenditure; the fight against tax evasion and tax erosion; the responsiveness of tax revenues to the business cycle; and developments in financial derivatives.

### **The transparency of the public accounts and communication**

The goal of ensuring the transparency of the public accounts at the service of Parliament and the general public requires that emphasis be placed on how the results of the PBO's analysis are disseminated and communicated. Accordingly, we will enhance our channels of communication with the media and the general public. Wider use will be made of visual data tools and infographics in the presentation of the main results of the analyses we conduct. Workshops open to the public will be organised with guest speakers on key issues in the debate on economic and fiscal policy.

### **The organisational structure**

A PBO Scientific Committee will be created in 2016, composed - as envisaged under the law forming the organisation - of experts of proven experience and expertise in economics and public finance at the national and international level. It will be charged with the task of providing methodological guidance for the PBO's activities.

We will continue to expand our staff, with the goal of gradually reaching our full staffing level (30 employees for the first three years and 40 once fully staffed, as provided for in the law forming the PBO), after having increased staff from 11 to 18 in July 2015. In 2016, the PBO will initiate the recruitment of 8 experts, bringing staff up to a total of 26 employees. We will also launch an internship programme for specific research projects.

One further task is to find premises for the PBO that will provide sufficient space to house the entire staff, overcoming the organisational difficulties arising from the current division of staff between two separate buildings.

## **International activities**

The PBO will continue its international activities: bilateral meetings with the European Commission, the International Monetary Fund, the European Central Bank, the OECD, economic advisors at embassies in Italy and the rating agencies; and participation in multilateral meetings of the network of budget officials of the OECD countries. Of particular importance is the network of national fiscal councils of the European Union. As in Italy, following the implementation of the so-called Two-Pack, every Member State has established independent fiscal institutions that perform the tasks of producing or validating macroeconomic forecasts and assessing the public finances. The institutional arrangements (and the additional duties) of these bodies are highly diverse, and they are gradually consolidating their role in European fiscal governance in relations with national governments and the European Commission. The network, which meets frequently, represents an important vehicle for sharing experience and developing common positions.