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2018 Budgetary Policy Report

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SUMMARY

For the fourth year the Budgetary Policy Report examines the contents of the budget package, set in the Budget Bill and the other accompanying measures. The Report, which follows the Budgetary Planning Report published in the spring in conjunction with the presentation of the Economic and Financial Document (EFD), develops, extends and supplements with ad hoc analysis the testimony given at the hearings before the Budget Committees of the Chamber of Deputies and the Senate of 3 October and 7 November.

The Report is organised into three chapters: the first assesses the macroeconomic environment, recent economic developments and the outlook for the coming years; the second provides an overview of the budget package and its contents, the potential risks to achieving the public finance objectives and the consistency of the policy scenario with the EU fiscal rules concerning the structural balance, expenditure and the debt; and the third examines the most significant measures in the budget package.

The main economic indicators signal the continuation of the recovery at the international level and of the Italian economy. The Government confirms the forecast for real GDP growth of 1.5 per cent in 2017 and 2018. The update of the forecast of the Parliamentary Budget Office (PBO) that takes account of recent domestic and international economic developments and the composition of the budget package set out in the Budget Bill and Decree Law 148/2017 strengthens the forecast for real GDP growth in 2018 (to 1.3-1.4 per cent, compared with the projection of 1.3 per cent formulated in September). For the two subsequent years, the PBO's September forecasts are essentially unchanged (with GDP growth of 1.4 per cent and about 1 per cent in 2019 and 2020 respectively). The analysis of the macroeconomic scenario is completed with an assessment, conducted on the basis of the econometric model used by the PBO, of the impact of the budget measures on GDP growth. In the PBO's projection, the package would add 0.2 per cent of growth compared with the trend scenario in both 2018 and 2019. In 2020, the contribution of the measures would be just under one-tenth of a point.

The public finance package for 2018-2020 (Decree Law 148/2017 and the 2018 Budget Bill) contains a series of expansionary measures that decline in size over the planning horizon, going from 1.6 per cent of GDP in 2018 to 1.3 per cent in 2019, before dropping more sharply in 2020 (0.8 per cent). Net of the sterilisation of the safeguard clauses for VAT and excise taxes (worth €15.7 billion in a total budget package of €28 billion in 2018, of which 70 per cent financed with an increase in the deficit), the above values decrease to 0.7-0.9 per cent of GDP. The resources to cover the measures are equal to 1 per cent of GDP in 2018 and 0.6 per cent in the two following years.

Comparing the public finance forecasts in the DBP with those published by the European Commission on 9 November, significant differences emerge. While actual net borrowing is very similar, the level of structural net borrowing estimated by the European Commission is much less favourable than that forecast in the DBP. If we shift our attention from levels to changes in the structural balance – which are less affected by the different estimates of the output gap adopted by the Government and the Commission – in 2018 the improvement expected by the European Commission is only one-tenth of a point of GDP, smaller than the three-tenths forecast by the Government. Examining the components, we find that – as the expected improvement in interest expenditure in 2018 is the same for both the Government and the Commission at two-tenths of a point – this difference is a consequence of the disparity in the forecasts for the structural primary balance, which is expected to improve in the DBP (by a tenth of a point) and deteriorate in the European Commission's forecast (by a tenth of a point), The difference expected for 2019 is even greater: different forecasts for the cyclically adjusted primary balance prompt the Commission to project a deterioration of four-tenths of a point in the balance with respect to 2018, compared with a forecast for an improvement of four-tenths of a point in the DBP. This primarily reflects the Commission's decision to exclude the VAT and excise tax increases provided for under the safeguard clauses from its assessments as similar current-legislation increases have repeatedly been cancelled in the recent past.

Assessed over a longer-term horizon, the public finance scenario incorporating the effects of the budget package features a number of elements that have also characterised the recent past. Essentially, in the first planning year, the impact of the safeguard clause is sterilised, avoiding an increase in tax rates, thanks in part to an increase in the deficit, as part of the dialogue with EU institutions concerning a more flexible interpretation of the Stability and Growth Pact rules. In the subsequent two years, a sharper reduction in the nominal deficit and the "substantial" achievement of structural balance – albeit more gradually than indicated in the EFD last April – still depend on the activation of significant safeguard clause resources: 0.7 per cent of GDP in 2019 and 1 per cent in 2020. Without the clauses, the policy deficit in 2019 would remain at virtually the same level forecast for 2018 (1.6 per cent del GDP) and in 2020 would decline by a few tenths of a point (1.2 per cent of GDP), in line with developments in the recent past. This is attributable to the fact that, net of the clause, the budget package contains revenue measures whose overall impact is temporary (declining from about €6.4 billion in 2018 to €1.7 billion and €1.6 billion in 2019 and 2020) combined with others that increase expenditure (about €1.6 billion in 2018, €6.9 billion in 2019 and €4.2 billion in 2020). Without considering the deactivated clauses, the budget measures presented in Parliament improve the deficit only in 2018, by 0.3 per cent of GDP, and worsen it in the two subsequent years, by 0.3 per cent and 0.1 per cent respectively.

The policy measures in the budget documents appear characterised by "short-termism". In the medium term, the provisions remain affected by uncertainty about the composition and scale of the measures that will actually be implemented, since fiscal policy is currently based on an increase in VAT whose deactivation in 2019 is less than that indicated in the Update of the EFD, even if the DBP promises progress on alternative policies that are essential to avoid the activation of the rate increases (the spending review, measures to counter tax evasion and avoidance for 2019-2020). In the short term, for 2018, the postponement of the introduction of IRI (proportional taxation for sole proprietorships and partnerships) changes expectations about the characteristics and level of taxation of business. There is also no specific information about the privatisation programme. These factors threaten to undermine the credibility of the public accounts, the predictability of the macroeconomic framework and, above all, engender uncertainty in expectations and, therefore, in the decisions and behaviour of economic agents.

The assessment of the fiscal rules reveals considerable problems for both 2017 and 2018. For 2017, the estimates presented in the DBP imply a risk of significant deviation both for the structural balance rule and the expenditure benchmark. These risks are also underscored by the recent opinion of the European Commission on the DBP. If these developments should be confirmed by outturn data, the budget balance correction procedures envisaged in national legislation on budget balance and, at the EU level, by the Stability and Growth Pact could be activated. For 2018, the structural adjustment envisaged by the Government in the DBP (0.3 percentage points) could be sufficient to ensure compliance with the fiscal rules considering that the Commission has acknowledged the need to avoid hindering the still uncertain recovery in Italy with an excessively restrictive fiscal stance. Nevertheless, that adjustment must be considered a minimum objective and, according to current Commission forecasts, there is a gap of 0.2 percentage points. Finally, the public debt rule is not complied with in 2017-2018 under any of the established criteria. For subsequent years, the sharper reduction in the debt/GDP ratio in the DBP is based on a highly uncertain current legislation scenario, partly due to the fact that VAT rate increases have been cancelled on multiple occasions in recent years. In its opinion on the DBP, the Commission asked the Government for clarifications on its strategy and the actual steps it intends to take to reduce the debt/GDP ratio and ensure compliance with the associated rule.

Excluding the usual measures for the total and partial sterilisation of the impact of the VAT and excise tax safeguard clauses in the first and second year, the Budget is characterised by a number of measures of significant importance from a financial standpoint and the general design of economic policy and by a large number of small sectoral measures.

Relatively substantial resources are appropriated for public employees, with the renewal of contracts and the targeted hiring of personnel in specific segments of government. Other provisions include measures to support employment (mainly through social contribution relief measures), help families and fight poverty, support businesses (including an extension of so-called hyper-and super-depreciation), and support public investment. The main contribution to funding these measures comes from the postponement of the introduction of the new tax on entrepreneurial income (IRI) to 2018 and measures to counter tax evasion and strengthen tax collection.

Permanent social contribution relief for hiring young people would meet the dual need to encourage the employment of a population segment with the highest rates of unemployment and greater career uncertainty and, at the same time, gradually phase out the two temporary contribution relief mechanisms adopted in 2015 and 2016, which will terminate in 2018 and had achieved significant results for young people as well.

This measure has the virtue of being permanent, which on the one hand interrupts the series of temporary measures and fosters the normalisation of the labour market and, on the other, plays a role in the gradual reduction in the tax wedge on labour. The mechanism also ensures more accurate targeting of both workers (young people and students) and employers (firms that have not cut their workforces either before or after obtaining the benefit).

With regard to the Inclusion Income, the Budget Bill gradually expands the pool of potential beneficiaries and increases the maximum amount of the benefit. The elimination of the category-based eligibility requirements makes the measures a universal programme, even if means testing remains and beneficiaries must participate in a customised job search and social inclusion programme. Additional limitations are the temporary nature of the scheme even if the beneficiary remains in a state of need and the fact that the benefit is restricted by the resources appropriated for the programme (€1.7 billion in 2018 and about €2.2 billion as from 2019).

The impact of the new Inclusion Income seems significant in relation to the scale of absolute poverty in Italy, although it is still insufficient to eliminate the problem. Beneficiary households account for about 44 per cent of households in a state of absolute poverty and the households whose poverty is most alleviated by the programme include those resident in southern Italy and the Centre, those that do not own their home, and those whose household head is an Italian citizen, unemployed and aged up to 40 years old.

Assuming that the Inclusion Income targets only households in a state of absolute poverty, the poverty gap (average difference between the income of the poor and the benchmark threshold) would narrow from 20.7 to 11.2 per cent, but the measure would not have an impact on the poverty head count ratio (the number of the poor as a proportion of the total population), as the benchmark income of the Inclusion Income programme, which is equal to the resources a household would have after having received the benefit, generally appears lower than Istat’s absolute poverty line. In terms of the impact on overall inequality in the distribution of disposable income, the introduction of the Inclusion Income would reduce the Gini coefficient by 0.4 points.

Finally, one of the most significant measures to combat tax evasion is the introduction of mandatory electronic invoicing, an important step in the digitisation of systems for taxpayer compliance and tax authority controls. It represents an additional improvement in the tools available to reduce tax evasion without collusion (i.e. where there is no agreement to evade between buyer and seller) in business-to-business transactions.

However, the risk remains that this measure could encourage VAT number holders to seek out opportunities for collusive tax evasion more aggressively and expand evasion in business-to-consumer transactions. Exposing costs through mandatory electronic invoicing could be accompanied by a loss of revenue that, however, could be countered with appropriate controls of firms' margins. With regard to the final stage of the chain of commercial transactions, it would appear essential to extend the requirement for electronic invoicing and the notification of revenue to include taxpayers that are not required to issue invoices (retailers, restaurants, etc.). Combining electronic invoicing with more stringent limits on the use of cash than are currently in place could make a significant contribution to combatting collusive tax evasion.

1 THE MACROECONOMIC ENVIRONMENT

1.1 *Recent economic developments*

1.1.1 *The international economy*

Signs of a robust and widespread recovery in the main economies have been confirmed at the international level. As a result of the improved economic environment, the International Monetary Fund (IMF), the European Commission and the OECD revised their most recent projections on the expansion of the global economy upwards for this year and the next. The new global GDP forecasts (+3.6 per cent in 2017 and +3.7 per cent in 2018 for the IMF and the OECD, +3.5 per cent in 2017 and +3.7 per cent in 2018 for the European Commission) are broadly consistent with those set out for that two-year period in the Update to the EFD, subsequently incorporated in the DBP.

In the United States, second and third quarter growth was robust (respectively +3.1 and +3.3 per cent on an annualised basis). This growth was accompanied by a decrease in unemployment. The labour participation rate is, however, still below its pre-crisis level, indicating labour force underutilisation that suppresses wage and inflation growth. The IMF and the OECD have marginally raised their growth rate forecasts for the US economy, compared with their previous assessments, for both 2017 and 2018 (to 2.2 and 2 per cent for the IMF and to 2.2 and 2.5 per cent for the OECD), while the European Commission has confirmed its projections. China is also proving to be more dynamic than expected, prompting the three institutions to revise their growth forecasts for this year and 2018 upwards by 0.1-0.2 percentage points. Brazil and Russia, among the few economies to have experienced a contraction in 2016, surprised observers with the speed of their recovery, convincing the IMF, European Commission and OECD to significantly revise their growth forecasts for 2017-2018.

In the euro area, the third quarter featured more robust expansion (+0.6 per cent, after +0.7 per cent in the preceding three months), marking the 18th consecutive quarterly increase in GDP. The rate of growth in economic activity was particularly strong in Germany and Spain (+0.8 per cent), and more restrained in France and Italy (+0.5 and +0.4 per cent, respectively). In addition to favourable international conditions, monetary policy, which is expected to remain accommodative into next year as well, contributed heavily to the expansion. The IMF raised its euro-area growth forecasts for 2017 and 2018 by 0.2 percentage points for each year (to 2.1 and 1.9 per cent, respectively). The European Commission and OECD made more substantial revisions. The European Commission made an upward correction of 0.5 percentage points for 2017 (when the growth rate is expected to be 2.2 per cent) and 0.3 points for 2018 (with growth of 2.1 per cent). The OECD revised its forecasts for the euro area by 0.6 percentage points for this year (bringing the growth rate to 2.2 per cent) and 0.3 points for 2018 (2.5 per cent).

After briefly stalling in the winter months, world trade began to expand again at a good pace, driven mainly by demand from emerging markets and, to a more limited extent, from the advanced countries. According to Central Planning Bureau data, world trade in goods increased from January to September by 4.4 per cent compared with the same period of 2016. The improved performance was incorporated in the recent projections of the IMF, European Commission and OECD, which revised upwards their respective projections for world demand in 2017-2018 (Table 1.1). Compared with the Government's September forecast of +4.7 per cent in the EFD Update/DBP, the European Commission and the IMF scenarios for 2017 are not as strong (+4.3 and +4.2 per cent, respectively), while that of the OECD is basically the same (+4.8 per cent). For 2018, the three institutions expect the growth rate to be slightly higher than that projected by the Government (+4.1 per cent for the IMF and OECD and +4 per cent for the European Commission, compared with +3.9 per cent in the EFD Update /DBP).

As another consequence of the strengthening international recovery, the price of crude oil has risen over the last month (the Brent has risen above $60 per barrel since the end of October, reaching $63 in late November). Furthermore, on 30 November the oil producing countries (OPEC and non-OPEC) decided to extend until the end of next year the production cuts agreed in mid-July that were scheduled to end in March 2018. These developments were reflected in the forward market where prices were higher than those taken as a reference for the forecasts in the EFD Update. Taking account of the historical performance and the forward prices for the month of December, the price of oil is around $54.5 per barrel in 2017 ($51.4 under the assumptions of the EFD Update/DBP). For 2018, the forward price of crude oil is around $62.5 in 2018 ($52.2 under the assumptions of the EFD Update/DBP); according to these market assessments, the price of oil could fall again in 2019 and 2020 (Table 1.2).

In the foreign exchange market, after the strong appreciation that occurred between March and September, the value of the euro fell again through early November before recovering in the final weeks of that month to the same levels as at the end of September (with the dollar/euro exchange rate at 1.19). Looking forward, the technical assumption about the euro exchange rate incorporated in the EFD Update (an average rate of 1.13 dollars per euro in 2017 and 1.19 in 2018) does not appear to be very different from the latest indications from the forward market (with a forward exchange rate for 2018 of around 1.20 dollars/euro). For the years 2019-2020 the forward markets instead indicate that the euro will appreciate (compared with the assumption in the EFD Update that it will remain stationary) to 1.24 and 1.27 dollars/euro, respectively, for the two years (Table 1.3).

Table 1.1 – World trade

	Percentage growth rates				Differences in percentage points with previous forecasts			
	2017	2018	2019	2020	2017	2018	2019	2020
Update/DBP (23 September)	4.7	3.9	4.0	3.7	1.3	0.4	0.1	0.0
European Commission (9 November)	4.3	4.1	4.0	-	0.9	0.3	-	-
International Monetary Fund (10 October)	4.2	4.0	3.9	3.8	0.4	0.1	-0.1	-0.2
OECD (28 November)	4.8	4.1	4.0	-	0.2	0.3	-	-

Sources: MEF, European Commission, IMF, OECD.

Table 1.2 – Oil prices (1)
($/barrel)

	2017	2018	2019	2020
Update/DBP (23 September)	51.4	52.2	52.8	53.6
European Commission (9 November)	53.6	55.7	54.7	-
International Monetary Fund (10 October)	50.3	50.2	-	-
OECD (28 November)	-	60.0	60.0	-
Forward markets	54.5	62.5	59.6	57.7

Sources: MEF, European Commission, IMF, OECD.
(1) Forward market prices refer to the average for the last ten days of November.

Table 1.3 – Dollar/euro exchange rate (1)

	2017	2018	2019	2020
Update/DBP (23 September)	1.13	1.19	1.19	1.19
European Commission (9 November)	1.13	1.18	1.18	-
International Monetary Fund (10 October)	1.13	1.18	-	-
OECD (28 November)	1.13	1.16	1.16	-
Forward markets	1.13	1.21	1.24	1.27

Sources: MEF, European Commission, IMF, OECD.
(1) Forward market prices refer to the average for the last ten days of November.

Overall, recent international developments suggest that world growth will be stronger in 2018 (with a slightly higher growth rate and a less intense deceleration than in 2017) and oil prices will rise more rapidly than assumed in the EFD Update/DBP scenario.

1.1.2 The Italian economy

During the year the Italian economy consolidated the recovery begun in early 2013. The increases registered in the first two quarters were followed by further average GDP growth from July to September (+0.4 per cent quarter-on-quarter), although around 0.1 percentage points lower than the preliminary estimate released in mid-November. For the third quarter, national accounts data indicate increases in value added for industry and (marginally) for services, compared with a decline for agriculture. As to the components of demand, the rise in GDP was fuelled by a significant contribution from final domestic demand (0.7 percentage points), along with the positive contribution of net exports (0.2 percentage points); by contrast, inventories subtracted 0.5 percentage points from growth.

Household consumption continued to post moderate growth from July to September as well (+0.3 per cent, a slight acceleration on the spring months). The most recent data from consumer surveys are positive: on average in October and November, confidence (overall and in the various general/personal and current/future sub-components) has risen compared with the third quarter average, despite the drop reported in the last month. The improved confidence is accompanied by developments in the labour market that, despite some softening, is still favourable as a whole. Overall, these factors suggest that the growth in private consumption will continue in the final part of the year.

The recovery in investment observed in the second quarter strengthened over the summer months, posting a 3 per cent jump on average for April through June (when the quarter-on-quarter increase was 1.1 per cent). The findings of more recent economic surveys suggest that capital accumulation continued in the final months of 2017. More specifically, Istat surveys show levels of domestic orders for capital equipment and capacity utilisation close to pre-crisis highs, while the Bank of Italy's survey on inflation and growth expectations points to expansion expanding across the various sectors in the final part of 2017, driven mainly by more optimistic demand expectations. After a slight decline at the start of the year, indicators of business profitability improved in the second quarter before stabilising in the third. The very limited growth in unit production costs is expected to continue to foster the recovery of profit margins.

The continued growth in national domestic expenditure has occurred against the background of credit conditions marked by conflicting signs, as revealed in particular by the findings of surveys of sector firms and operators. The latest Istat surveys on manufacturing (June and September) point to a partial reversal of the decline, observed in previous months, in the share of firms that have experienced rationing (that is, those that state that they did not receive the credit for which they applied). Looking forward, the results of the most recent Bank of Italy survey show, expectations for credit demand to continue to rise in the final quarter of the year both among households, mainly for home mortgage loans, and firms, driven by increased spending on investment. On the supply side, banks appear to expect an improvement in credit availability for households, compared with a more prudent view they are taking in respect of their risk exposure to firms, tied to the continuing outlook of low profitability and the need for capital strengthening. This development appears to be confirmed by banking system statistics. In September, the stock of credit to firms (excluding securitisations) was down slightly compared with a year earlier and the ratio of non-performing positions to total loans had declined markedly compared with the previous.

Despite the progressive appreciation of the euro in 2017, exports accelerated in the third quarter (+1.6 per cent) after coming to a standstill in the second. Surveys in

November show optimism concerning international orders and turnover generated abroad, pointing to continued growth in foreign sales in the final months of 2017. It would therefore appear that the gradual recovery in Italy's share of global merchandise exports, under way since 2010, is continuing. The positive trend in exports has been accompanied by a sharp increase in imports, fuelled by stronger domestic demand and the growth in exports themselves (which absorb a large proportion of foreign goods and services). In the third quarter, imports grew more slowly (+1.2 per cent) than exports, allowing net foreign demand to make a positive contribution to GDP growth. The latest data suggest that imports will continue to rise in the fourth quarter, especially of energy products.

On the production side, the most recent economic indicators remain positive: the expansion in the volume of industrial production on average from April to June was followed by further acceleration in the third quarter, despite a downturn in September. Qualitative indicators also point to economic growth in the short term: the Purchasing Managers' Index (PMI) for manufacturing rose by an average of more than 2 points in October-November compared with the July-September average, reaching (in November) its highest level since early 2011. At the same time, Istat's confidence index for manufacturing firms progressively improved, albeit discontinuously, during the year, returning close to its pre-crisis level in November. According to the PBO's forecasts, industrial activity will continue to expand in the fourth quarter, although at a slower pace than in the third.

In construction, value added rose in the third quarter in volume terms, although it remained at the historically low levels seen in 2015-2016. Confidence, which rose in November after falling the month before, progressively gained strength in 2017. There were also positive signs from the survey conducted by the national observatory on the real estate market, which pointed to a further increase in the average number of sales in July-September, although the market has slowed since the second quarter.

The results of the housing market survey conducted by the Revenue Agency, the Bank of Italy and Tecnoborsa in September-October, also show an improvement in operators' expectations for sales prices (up) and in the discount of prices offered (down), forecasting a strengthening in the final part of the year of the turnaround in housing prices first seen in the second quarter.

Continuing along the path of recovery that began in spring of 2014, value added in volume terms in the services sector expanded slightly again in the third quarter, reaching levels last seen in the second quarter of 2011. Qualitative indicators also provide moderately positive signs for the final part of the year, with an increase in October-November in the confidence level for the third quarter. There was also an improvement in the average level of confidence in October-November in the retail sector despite the decline registered in November.

Finally, there were also encouraging signals from the cyclical indices prepared by various institutions. Both the Bank of Italy's ITA-coin coincident indicator, which accelerated in November for the fifth consecutive month, and Istat's leading indicator, which posted a marked increase in the same month, suggest that the economy will continue to expand at a good pace.

The favourable signs emerging from the economic data suggest that the recovery will remain buoyant in the final part of the year, albeit proceeding at a slower pace than in the third quarter. In particular, based on the forecasts developed using the PBO's short-term models, GDP is expected to rise by 0.3 per cent quarter-on-quarter in the fourth quarter of 2017. The slight slowdown compared with the previous three months reflects a moderation in domestic demand and a softening in exports owing to the appreciation of the euro in recent months. Given developments over the first three quarters, the PBO estimates for October-December would put annual growth at 1.5 per cent for 2017, adjusted for seasonal and calendar effects. Taking account of the smaller number of working days (two fewer than 2016), the unadjusted increase in GDP would be 1.4-1.5 per cent.

In the labour market, developments in employment remained positive in the third quarter, followed by stagnation in October. On an annual basis, the decline in self-employed workers was more than offset by the increase in the number of payroll employees, represented almost entirely by the fixed-term component, confirming the trend observed in the final months of 2016. In October, the unemployment rate was 11.1 per cent, basically unchanged from September.

There are also signs of an increase in employment levels in the employment survey conducted by INPS (the national social security institution), which shows a larger increase in the net positive balance of new hires over terminations in the first nine months of the year than in the same period of 2016. The survey also indicates that the increase in jobs reflected the rise in fixed-term contracts and apprenticeships; by contrast, hiring on open-ended contracts declined owing entirely to the drop in part-time employment. In the same period, about 130,000 positions benefited from tax incentives, around one-third of which through the "Youth Guarantee" programme and the rest from the "southern Italy Employment" measure (see Chapter 3).

Despite the improvement in economic conditions, inflation has yet to rebound, reflecting the modest pressure from production costs. The harmonised index of consumer prices rose by 1.1 per cent in November year-on-year, the same pace as that observed in the preceding month (in September, the increase was 1.3 per cent). According to the NIC index, inflation appeared to have subsided further (+0.9 per cent in November, compared with 1 per cent a month earlier). The upward push from unregulated energy products (+5.0 per cent year-on-year, in acceleration from +4.3 per cent in October) were offset by the decline in the prices of unprocessed food products (+3.2 per cent from +3.8 per cent in October) and of recreational, cultural and personal care services (-1.4 per cent quarter-on-quarter and 0.9 per cent year-on-year, down from the 1.4 per cent registered in October). There was also a slowdown in core inflation (inflation net of energy and unprocessed food products), which mostly reflects domestic price pressures, having lost another 0.1 percentage points compared with October to stand at 0.4 per cent in November (+0.5 per cent in October).

The modest price pressures have been accompanied by a slightly rise in the inflation expectations of households and firms. Specifically, Istat's consumer survey for November shows an increase (-1.5 from -2.6 in October) in net responses indicating expectations that prices will rise in the future. Firms also expect inflation to rise after dropping over the summer, owing mainly to the increase in energy prices. The Istat survey net balance was 6.9 in November (up from 6 in October), thanks to the increase in expectations of rising prices.

1.2 The macroeconomic forecasts

1.2.1 The Government scenario

The DBP's macroeconomic scenario differs only marginally from the policy scenario published in September in the EFD Update: real GDP is projected to grow 1.5 per cent this year and in 2018.

The growth forecast in the DBP for 2017 was prepared in October, drawing on national accounts data through the second quarter. It implied that GDP will grow by an average of around 0.4 per cent in the final two quarters of the year. As the economic data explained in the preceding paragraph show, Istat's preliminary GDP figure for the third quarter (+0.4 per cent) and growth forecasts for the fourth (0.3 per cent in the PBO estimates) seem to essentially confirm these assumptions, so that the average expansion in economic activity for 2017 should be in line with the Government's forecast. In the DBP scenario, GDP for 2017 is driven by the increase in consumption and investment (with a total contribution to final domestic demand of 1.5 percentage points), as well from the slightly positive contribution (0.1 percentage points) from inventory building. This development in national expenditure stands in contrast to a marginally negative contribution from net foreign demand (0.1 percentage points) as a result of imports exceeding exports. As for inflation, the estimate of the GDP deflator (+0.6 per cent) incorporates the weak performance that marked the first half of the year. The changes in real GDP and the GDP deflator mean nominal GDP growth of just over 2 per cent. Overall these forecasts appear to be broadly consistent with the information available on developments during the year in components of economic growth and inflation.

With regard to 2018, taking account of the GDP growth forecast under the trend scenario in the EFD Update (+1.2 per cent), the DBP scenario confirms the assessment that the budget measures will have a positive impact of 0.3 percentage points, essentially reflecting a strengthening of the components of final domestic demand. More specifically, in 2018 household spending will benefit, compared with the trend scenario, from the improvement in real disposable income thanks to lower inflation (a decrease of 0.6 percentage points compared with the trend forecast in the EFD Update) resulting from the deactivation of the VAT safeguard clause. At the same time, the greater increase in expenditure on investment reflects measures to help firms and the improvement in the general outlook for the economy. The DBP forecast for the GDP deflator, while below that assumed in the trend scenario, which incorporates a VAT increase, nevertheless registers an acceleration (+1.6 per cent) compared with the weak performance of 2017. Nominal GDP growth for 2018 in the DBP and in the policy scenario in the EFD Update is expected to be 3.1 per cent.

The DBP provides a forecast for real and nominal GDP growth for 2019-2020, confirming the forecasts prepared in September for the policy scenario in the EFD Update for this period as well. Real GDP is expected to increase by 1.5 per cent in 2019 (0.3 percentage points higher than in the EFD Update's trend scenario) and 1.3 per cent in 2020 (in line with the trend scenario). Nominal GDP should increase by 3.4 per cent in both years (0.4 percentage points more than under the trend scenario for both 2019 and 2020). According to the breakdown provided in the policy scenario contained in the EFD Update, in 2019 economic growth will still be driven by an expansion in final domestic demand; in 2020, as national expenditure weakens, the contribution of net foreign demand will strengthen. The GDP deflator is expected to accelerate in the two years to 2 per cent, reflecting, for 2020 in particular, the activation of the VAT safeguard clause.

1.2.2 The endorsement exercise and the effects of the budget measures

On 15 September the PBO endorsed the macroeconomic trend scenario for 2017-2018, which was then published in the EFD Update on 23 September. Subsequently, on 3 October the PBO endorsed the policy projections for 2017 and 2018 published in the same document. As already mentioned, the policy forecasts in the EFD Update were maintained by the Government, apart from very marginal changes, after the approval on 16 October of the 2018 Budget Bill by the Council of Ministers and were incorporated in the DBP sent to the European Commission.

The endorsement exercise for the EFD Update was performed on the basis of a comprehensive analysis of the MEF's macroeconomic scenarios using: 1) the PBO forecasts for short-term developments in GDP and the components of demand; 2) the annual forecasts obtained by the PBO using Istat's forecasting model in accordance with the PBO-Istat framework agreement; 3) the annual forecasts specifically produced by independent forecasters (CER, Prometeia and REF.Ricerche) that make up the PBO forecasting panel; 4) monitoring of the most recent projections available from other national and international institutions. In order to perform a like-for-like comparison with the MEF's projections, the forecasts of the PBO panel members (including the PBO projections made using the Istat model) were formulated on the basis of the same assumptions for exogenous international variables adopted by the MEF. In addition, for the policy scenario, the PBO panel based their estimates on the hypothetical 2018-2020 budget package developed by the PBO taking account of the EFD Update and information received from MEF on the public finance assumptions used to produce the policy scenario from the trend scenario.

We briefly summarise the results of the endorsement exercise conducted in September on the policy scenario contained in the EFD Update. Based on the comprehensive assessment of the Government's scenario, the PBO endorsed the policy forecast in the EFD Update, while pointing out a risk of downward revisions connected with the 2018 growth estimate (1.5 per cent), which exceeds the upper bound of the PBO panel's projections (1.3 per cent; Figure 1.1). Overall, the PBO found that this risk factor was offset by the consistency of the EFD Update's assumptions with the PBO panel's upper-bound projections for the size of the impact (0.3 percentage points) of the budget measures and the increase in nominal GDP (3.1 per cent; Figure 1.2), the variable most directly relevant for the evolution of the public finances.

Figure 1.1 – Government (EFD Update) and PBO panel forecasts for real GDP

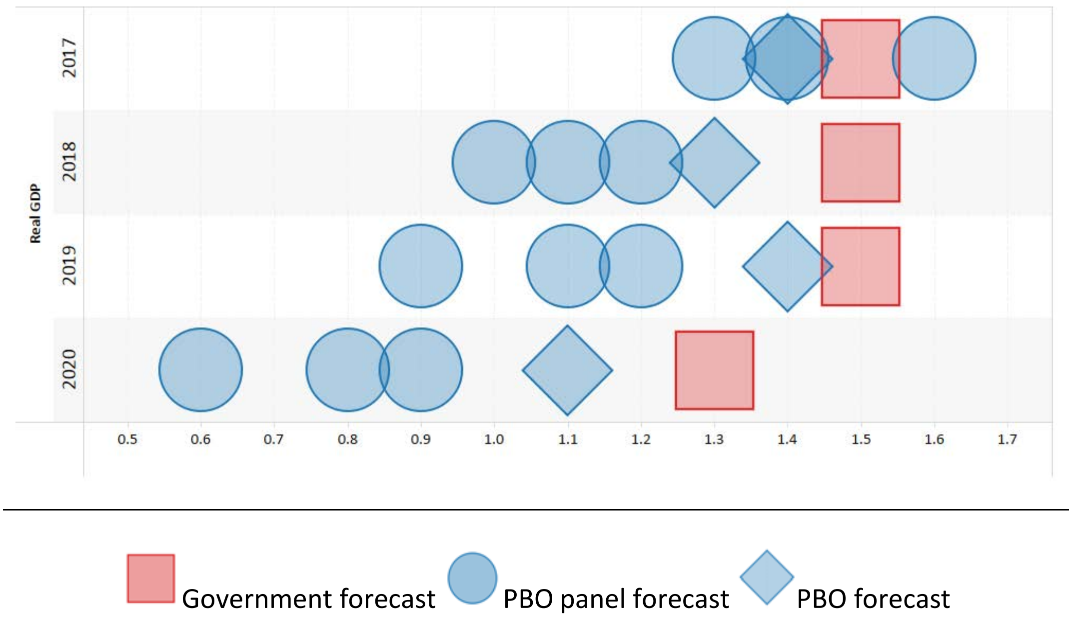
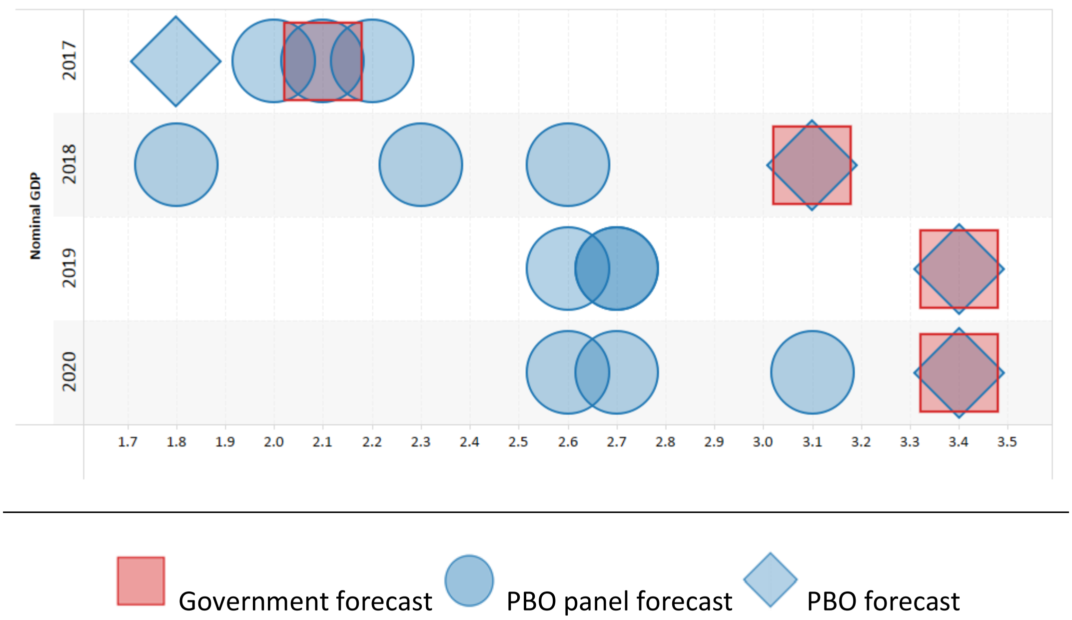


Figure 1.2 – Government (EFD Update) and PBO panel forecasts for nominal GDP



In the September scenarios, the coincidence of the nominal GDP projections, despite the deviation in the real GDP forecasts, reflects the fact that the GDP deflator in the Government forecast was below the upper bound of the PBO panel forecasts. The assessment for 2018 also took account of the uncertainty concerning the strength of the recovery in the second half of 2017 and thus the scale of the carry-over effect on the next year. In assessing the Government's policy forecast, the PBO also indicated that the risk factors threatening the 2018 growth scenario are considerably amplified in 2019-2020, a period that lies beyond the endorsement horizon.

It has to be recalled that, in the September endorsement exercise, the PBO's forecast represented the upper bound of the PBO panel forecasts for the change in real GDP, the GDP deflator and, as a result, nominal GDP growth.[1] Taking account of the marginally stronger carry-over effect compared with the assumption in September that developments in the second half of 2017 would generate for 2018, as well as the latest data on exogenous international variables (with world trade slightly stronger and oil prices higher in 2018 than assumed in September) and the actual composition of the budget measures as indicated in the Stability Bill, an update of the PBO forecast strengthens the projection for 2018 GDP growth (1.3-1.4 per cent, compared with 1.3 per cent expected in September), alongside a slight reduction in the evolution of the GDP deflator and a rate of nominal GDP growth essentially in line with the September projection. The consolidation of the 2018 growth forecast basically reflects a slightly more positive contribution of final domestic demand, especially the investment component. The slowdown in the change in the GDP deflator reflects higher oil prices and, therefore, a smaller improvement in the terms of trade than assumed in September. Based on more recent information, the update of the forecast for the next period (2019-2020) essentially confirms the forecasts made in September in the PBO policy scenario (with an increase in GDP of 1.4 per cent in 2019 and around 1 per cent in 2020). Accordingly, compared with this exercise it would be confirmed the divergent nature, indicated in September, of the Government's growth projections for 2019-2020.

Finally, to complete the analysis of the macroeconomic scenario, the PBO assessed the effects of the budget measures on GDP growth using Istat's annual econometric model. The quantification of the impact is measured on the basis of a trend scenario with no budget measures. Alongside the measures contained in the 2018 Budget Bill, those considered include the provisions of the Tax Decree (Decree Law 148/2017). The latter, which entered force in mid-October 2017, has very limited macroeconomic effects, for the most part occurring next year. To facilitate understanding, all of the measures have been placed into one of three larger categories: expansionary measures, measures to restructure indirect taxation and funding measures (Table 1.4).

Expansionary measures basically comprise policies to encourage investment by firms and to support employment, particularly of young persons, through contribution relief measures. Other spending-side measures aim to support the income of the poorest households. The expansionary measures also include appropriations for the renewal of public employment bargaining agreements. Overall these measures increase GDP

[1] As regards the scale of the impact of the budget measures (measured as the difference between GDP under the policy scenario and GDP under the trend scenario), in the endorsement exercise for the Update of last September the upper bound was represented by a different PBO panel forecaster.

compared with the trend scenario by an estimated 0.2 percentage points in both 2018 and 2019, and around 0.5 percentage points in 2020.

The budget measures also include provisions to restructure indirect taxation. As for 2018, the tax increases previously envisaged with the safeguard clauses are neutralised. The expansionary effect of their deactivation on GDP in 2018 (+0.2 percentage points) is consolidated the following year (when GDP growth benefits from an analogous stimulus), despite the only partial elimination of the clause in that year. Instead, it is estimated that the impact will be recessionary for 2020 (-0.1 percentage points), owing to the increase in indirect taxation connected with the full activation of the clauses.

The set of funding measures includes, on the one hand, structural cuts to public expenditure (on current and capital account) and, on the other, to a larger extent, measures to increase revenue. The effect of these measures is reflected in a reduction of GDP growth of 0.2 percentage points in 2018, 0.1 percentage points in 2019 and 0.5 percentage points in 2020.

Overall, these assessments quantify the boost given to GDP growth by the budget measures with respect to the trend scenario at around 0.2 percentage points in both 2018 and 2019. In 2020, the measures as a whole cause GDP to contract slightly (just under -0.1 percentage points). Taken together, these forecasts show the budget measures adding around 0.4 percentage points to GDP growth over the 2018-2020 period.

Table 1.4 – Impact on GDP of the budget measures envisaged by the 2018 Budget Bill
(difference in percentage points compared with the trend scenario)

	2018	2019	2020
Expansionary measures	0.198	0.172	0.046
Safeguard clauses	0.159	0.208	-0.065
Funding measures	-0.169	-0.134	-0.049
Overall impact of the budget package	**0.188**	**0.246**	**-0.068**

Box 1.1 – Revision of output gap estimate

In the DBP the Government makes a number of significant revisions to the output gap estimate for the years 2015-2020 compared with the values reported in the April EFD. It is revised to -4.2 per cent in 2015 (from -3.8 per cent in the EFD), -3.2 per cent in 2016 (from -2.7 per cent), -2.1 per cent in 2017 (from -1.8 per cent), -1.2 per cent in 2018 (from -1.1 per cent), -0.4 per cent in 2019 (from -0.5 per cent) and 0.2 per cent in 2020 (from 0 per cent). These forecasts would therefore indicate a more adverse cyclical position compared with previous forecasts in 2015-2017 (the output gap is 0.3/0.5 percentage points larger). The difference shrinks, but persists, in 2018 (the output gap is 0.1 points more negative), narrows further in 2019 and improves marginally in 2020 (when the gap moves from nil to positive).

The factors that appear to affect the revision of the output gap by comparison with the EFD are: a) the more favourable macroeconomic scenario forecast for the current and subsequent years; b) the modifications made by the MEF to some of the technical elements (initial parameters) that led to an increase in the estimate of the change in the potential output of the Italian economy; and c) Istat revisions of the 2015 national accounts, with GDP growth rising from 0.8 to 1 per cent.

The PBO's assessment (Table R1.1.1)[2] indicates that, while for past years (2015-2016) half of the difference between the DBP and EFD in the estimated output gap is attributable to the revisions in the parameters, for the current year the difference is instead due solely to the choice of parameters, while for the forecast years (2018-2020), the effects of the changes to the macroscenario and the parameters work in the opposite direction. The DBP macroeconomic scenario, characterised by a stronger recovery than forecast in the EFD, could cause the output gap to narrow more quickly, closing it sooner (probably as early as 2019) compared with the forecast in April. This is more than offset by the countervailing effect connected with the adoption of new parameters, giving more weight to the cyclical component, which restores a negative gap and brings it closer to the profile estimated in the EFD.

More specifically, the DBP uses assumptions that differ from those of the spring concerning the initialisation of certain parameters connected with the estimate of total factor productivity (TFP). Calibration of these parameters is a crucial step in that it determines both the degree of the smoothing of the series and the intercept or the possibility of shifts in the smoothed series occurring. The EU practice is that the Member States act only on the parameters for stochastic processes that govern shocks to these processes (usually performed by the MEF for the non-accelerating wage rate of unemployment, or NAWRU). In the DBP, the MEF decided to modify another element in the estimate of TFP, which determines the amplitude of the cycle.

To present a statistical assessment of the change made, Figure R1.1.1 shows the distributions (prior and posterior) of the parameter that governs the amplitude of the cycle (parameter A) in the DBP and EFD forecasts. The figure demonstrates that the posterior distributions of this parameter used in the DBP appear to have greater dispersion and to be more centred (on the horizontal axis) around a higher value than the analogous distribution in the EFD forecasts. This indicates that, from a statistical standpoint, the change made causes a deterioration in the degree of matching of the model with the data, which is also confirmed by the fact that the difference in the plausibility of the two models favours the parameterisation used in the EFD.[3]

[2] The results presented in the table were obtained using counterfactual simulations in which the estimate is obtained alternatively the old data in the EFD with the new parameters, or the old parameters in the EFD with the new parameters in the Update/DBP. The sum of the effects shown in the table is in some cases slightly different from the total difference owing to the non-linearity of the estimation model.

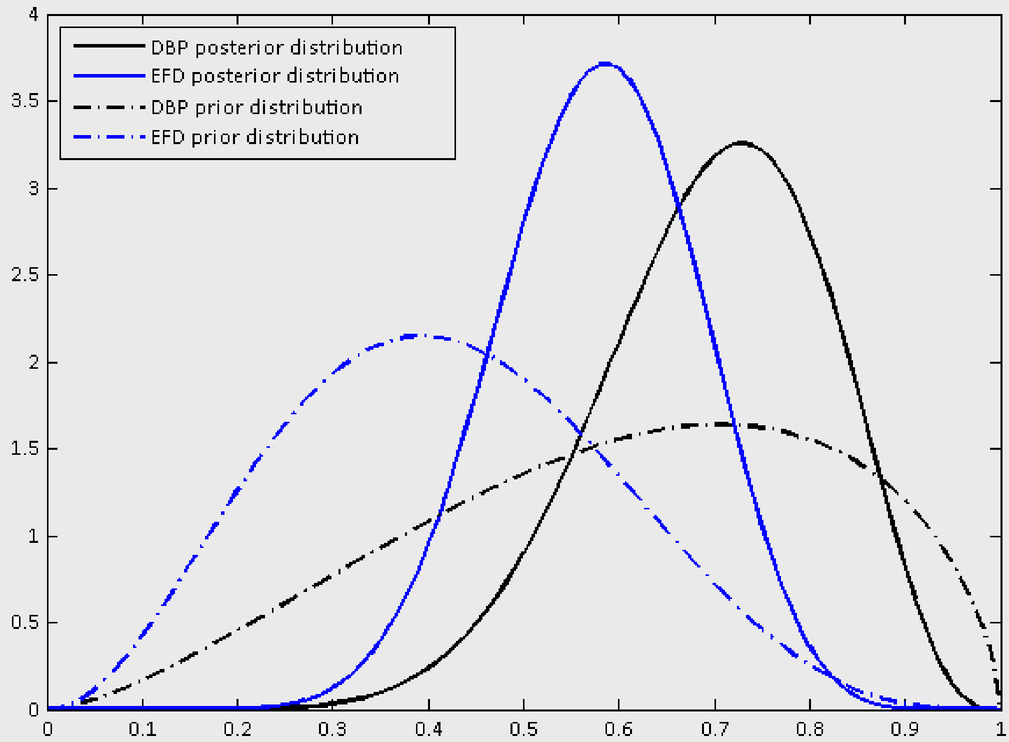
[3] This is based on the criterion indicated by Kass, R.E. and Raftery, A.E. (1995), "Bayes factor", *Journal of the American Statistical Association*, vol. 90, no. 430.

Table R1.1.1 – Impact effects of various differences between the EFD and DBP forecasts

	DBP-EFD differences		QM effect		Parameter effects	
	Output gap	Potential GDP	Output gap	Potential GDP	Output gap	Potential GDP
2015	-0.4	0.0	-0.2	0.1	-0.3	-0.1
2016	-0.5	0.1	-0.2	0.1	-0.3	0.0
2017	-0.4	0.3	0.0	0.2	-0.4	0.1
2018	-0.1	0.2	0.3	0.1	-0.4	0.0
2019	0.1	0.3	0.6	0.2	-0.4	0.1
2020	0.2	0.1	0.7	0.1	-0.4	0.0

Source: based on MEF data.

Figure R1.1.1 – Priors and posteriors of parameter A for the amplitude of the cycle in the TFP model



Basically, the new parameters adopted by the MEF increased the part of the observed change in TFP that can be attributed to the cyclical component, producing a more stable and flatter productivity trend (and, ultimately, less pro-cyclical). The consequence is that, while in the EFD forecasts the TFP trend component registers consistently negative changes from 2004 to 2018, the estimate obtained in the DBP is less negative and covers a relatively shorter period (from 2007 to 2016), turning positive in the years forecast. This results in an improved performance of potential output and a larger output gap estimate.

While causing deterioration from a statistical standpoint, the MEF's choice makes sense from an economic standpoint in that it is difficult to justify such a long negative change in the TFP trend: this means assuming the destruction of innovation/technical progress for an extended period of time. It should be observed that the new MEF estimate would reduce, but not eliminate, the extended technical regression (it would last 9 years instead of 14).

The MEF's new estimates for the output gap levels differ significantly from those of the European Commission.[4] As reported in Table R1.1.2, in its Autumn 2017 forecast, the European Commission estimates a larger negative output gap historically (-3 per cent in 2015, -1.9 per cent in 2016) and for the current year (-0.6 per cent), with the gap closing in 2018 (+0.3 per cent) to then become much more positive in 2019 (+0.8 per cent).

In addition to the usual reasons that the MEF forecasts differ from those of the European Commission (differences in the macroeconomic scenario, in the length of the forecasting horizon and in the assumptions about the NAWRU initialisation parameters), there is also the change made by the MEF to the initialisation parameters for the TFP estimation model. In general, it appears that the differences between the Government's forecasts and those of the European Commission are due mainly to the differences in the parameters (relating to TFP and NAWRU) and in the underlying macroeconomic scenario, while the effect of the length of the forecasting horizon is more limited.

Finally, alongside the previous observations, it should be noted that a further factor for uncertainty emerges from the assessment of the plausibility of the European Commission's output gap estimates. Recently, following pressures for a revision of the current approach to estimating potential output, which according to various Member States does not appear to correctly distinguish the cyclical component from the trend component of the economic growth of a country, the European Commission developed a tool for assessing the plausibility of its output gap forecasts: the Plausibility Tool.[5] According to the most recent assessments, conducted in conjunction with the Autumn Forecast and referring to 2017, this monitoring tool indicates an inconsistency in the Commission's output gap forecasts, while the Italian Government's forecasts fall within the plausibility range. It should also be noted that the use of this tool to assess the plausibility of the European Commission's forecasts does not eliminate uncertainty since the methodology used is not entirely consistent with the official approach agreed for estimating potential output.[6]

As a general rule, the nature of and methods for assessing the output gap make this metric uncertain. In this round of programming many factors appear to overlap in such a way as to considerably expand the range of uncertainty surrounding the estimation of this key variable for economic policy decisions.

Table R1.1.2 – Estimate of potential output and the output gap by the MEF and the European Commission

	MEF				European Commission			
	DEF 2017		DBP 2017		Spring 2017		Autumn 2017	
	Output gap	Potential GDP	Output gap	Potential GDP	Output gap	Potential GDP	Output gap	Potential GDP
2015	-3.8	-0.1	-4.2	-0.1	-2.8	-0.2	-3.0	-0.2
2016	-2.7	-0.2	-3.2	-0.1	-1.7	-0.3	-1.9	-0.3
2017	-1.8	0.1	-2.2	0.4	-0.8	0.0	-0.6	0.2
2018	-1.1	0.3	-1.2	0.5	0.0	0.3	0.3	0.4
2019	-0.5	0.4	-0.4	0.7			0.8	0.5

Sources: MEF and the European Commission.

4 Under the approach agreed by the EU Member States, the output gap is estimated using the production function method. Since potential output is an unobservable variable, specific techniques are used to estimate the function components. Specifically, the labour and total factor productivity (TFP) trend components. Many factors influence these estimates, including the length of the forecasting interval and some of the estimation initialisation parameters, in addition to the underlying data.

5 Hristov, A. Raciborski, R. and Vandermeulen, V. (2017) "Assessment of the Plausibility of the Output Gap Estimates", *European Economy – Economic Brief*, no. 23, April.

6 See also Frale, C. and De Nardis, S. (2017) "Which gap? Alternative estimations of potential output and the output gap in the Italian economy", PBO – *Working Paper* no. 2, July.

2 PUBLIC FINANCE POLICY SCENARIO AND COMPLIANCE WITH THE FISCAL RULES

2.1 The public finances in 2017-2020 and the budget measures for 2018

2.1.1 2017 and subsequent years

The year 2017 registered the third consecutive improvement in net borrowing as a proportion of GDP compared with the previous year, the first not attributable solely to the reduction in interest expenditure.

For 2017, the Government expects net borrowing to amount to 2.1 per cent of GDP, down from 2.5 per cent in 2016. The forecast improvement would derive both from lower interest spending (falling from 4 to 3.8 per cent of GDP) and from an increase in the primary surplus (rising from 1.5 to 1.7 per cent of GDP). This increase is attributable to a reduction of one-tenth of a point in the ratio of primary expenditure to GDP (to 45.3 per cent) - attributable to current expenditure - and a similar increase in the ratio of total revenue to GDP (to 47.0 per cent), despite a decrease of one tenth of a percentage point in the fiscal burden (to 42.0 per cent).

On the expenditure side, current primary spending should fall from 41.9 to 41.7 per cent of GDP thanks to the slight reduction in the share of compensation of employees and social benefits. By contrast, the expected share of GDP of total intermediate consumption remains constant, with monitoring during the year showing that the operating expenditure of government departments was greater than previously forecast. With regard to capital expenditure, the slight growth projected in the Update of the EFD in investment spending compared with 2016 would be possible only in the event of a significant acceleration in the second half of 2017 to offset the reduction in the first half of the year revealed in currently available data. Conversely, other capital expenditure is expected to increase substantially, due to greater refundable tax credits in respect of deferred tax assets (DTAs) and expenditure by the National Resolution Fund. The developments in capital spending also reflect the quantification of the effects of the sale of frequency use rights (€2 billion) provided for in the 2017 Budget Act and effectively implemented during the year in the amount of €1.9 billion. These effects appear to have been accounted for differently in the various official documents. Initially, the Technical Note to the 2017-2019 Budget Act classified the impact of the sale as a reduction in investment grants in 2017. Subsequently, the EFD published last April shifted the effect of the sale from investments grants (which therefore increased) to other capital expenditure (which thereby declined). Finally, using new accounting policies, the Update of the EFD from last September changed the accounting yet again. Under the new criteria, the sale of licenses is not recognised in the year of sale but is deferred over the years in which the licenses become available for use. In addition, the proceeds are no longer recognised as a reduction in capital expenditure but rather as an increase in current revenues.

On the revenue side, direct taxes reflected developments of the opposite sign. Increases were mainly attributable to the measures in Decree Law 50/2017 to counter unwarranted offsetting of tax receivables and liabilities and the redetermination of the reference base for the calculation of the allowance for corporate equity (ACE). Measures reducing direct taxation mainly reflected measures to support firms, notably the measure provided for in the 2016 Stability Act reducing the IRES (corporate income tax) rate from 27.5 per cent to 24 per cent as from 2017, as well as the measures set out in the 2017 Budget Act exempting productivity bonuses from taxation. For individuals, relief measures concerned the extension of the no-tax area for pensioners under the age of 75. The increase in indirect taxation reflects a variety of measures, in particular measures concerning VAT, including the provisions of Decree Law 50/2017 relating to the extension of the split payment mechanism, as well as the greater-than-expected revenue generated by the programme for the facilitated settlement of tax arrears provided for in Decree Law 193/2016. Developments in social contributions were affected by the effects of the various contribution relief measures, partly offset by the increase in total wages and salaries, thanks to the greater-than-forecast increase in employment, as well as by the impact of revenue connected with the facilitated settlement of tax disputes. Capital taxes reflected the revenue from the voluntary disclosure programme, which decreased between 2016 and 2017.

With regard to the 2018-2020 policy scenario, based on assessments of current economic developments the Government envisages a more gradual adjustment of the public finances compared with that indicated in last April's EFD (for an analysis of the fiscal stance, see section 2.2). Net borrowing falls from the 2.1 per cent of GDP forecast for 2017 to 1 per cent in 2018 (1.3 per cent in the EFD), 0.3 per cent in 2019 (0.6 in the EFD) and 0.1 per cent in 2020 (0.5 in the EFD). The structural adjustments set out in the EFD, which were concentrated in 2018-2019, have been attenuated and distributed over the 2018-2020 period. Consequently, in the EFD Update as in the DBP, structural budget balance is substantially achieved (-0.2 per cent of GDP) in 2020, one year later than the EFD forecast (in which a structural surplus of 0.1 per cent of GDP was achieved in 2019). After a deterioration of 0.4 percentage points of GDP in the 2017 structural balance, an improvement of 0.3 percentage points is forecast for 2018 (compared with 0.8 points in the EFD), rising slightly in 2019 to 0.4 points (instead of the 0.8 points in the EFD) and the same in 2020 (with an improvement of 0.4 percentage points, compared with the deterioration of 0.1 points forecast in April) (Table 2.1, line g').

For the fourth consecutive year, therefore, a deviation from the path towards the MTO is planned, invoking the flexibility and discretionary criteria provided for in the most recent interpretation of the EU fiscal rules (see section 2.3).

The planned structural improvement is attributable – totally in 2018 but only partially in 2019 – to the reduction in interest expenditure as a proportion of GDP. The structural primary surplus does not change between 2017 and 2018, and improves by three-tenths of a point in 2019. By contrast, the improvement in structural borrowing of four-tenths of a point in 2020 is the result of a corresponding increase in the structural primary surplus (Table 2.1). Note that the improvement in the structural primary balance in 2019-2020 is above all a consequence of the planned increases in indirect tax rates provided for in the safeguard clauses. In recent years, however, these increases have been cancelled in the budget bills for the following year.

Table 2.1 – Public finance indicators: comparison between the 2017 EFD and the 2018 DBP (1)
(percentage of GDP)

	EFD 2017					DBP 2018			
	2016	2017	2018	2019	2020	2017	2018	2019	2020
Trend net borrowing (a)	**-2,4**	**-2,3**	**-1,3**	**-0,6**	**-0,5**	**-2,1**	**-1,0**	**-0,3**	**-0,1**
Change (a')	*0,3*	*0,1*	*1,0*	*0,7*	*0,1*	*0,4*	*1,1*	*0,7*	*0,2*
Trend one-off measures	0,2	0,3	0,1	0,0	0,0	0,4	0,0	-0,1	-0,1
New measures (b)			**0,1**	**0,4**	**0,5**		**-0,6**	**-0,6**	**-0,1**
Planned net borrowing (c=a+b)	**-2,4**	**-2,1**	**-1,2**	**-0,2**	**0,0**	**-2,1**	**-1,6**	**-0,9**	**-0,2**
Change (c')	*0,3*	*0,3*	*0,9*	*1,0*	*0,2*	*0,4*	*0,5*	*0,7*	*0,7*
Cyclical component of policy budget balance (d)	-1,5	-1,0	-0,6	-0,3	0,0	-1,2	-0,6	-0,2	0,1
Planned net borrowing adjusted for cycle (e=c-d)	-0,9	-1,1	-0,6	0,1	0,0	-1,0	-1,0	-0,7	-0,3
Planned one-off measures (f)	0,2	0,3	0,1	0,0	0,0	0,3	0,0	-0,1	-0,1
Planned structural balance (g=e-f)	**-1,2**	**-1,5**	**-0,7**	**0,1**	**0,0**	**-1,3**	**-1,0**	**-0,6**	**-0,2**
Change (g')	*-0,7*	*-0,3*	*0,8*	*0,8*	*-0,1*	*-0,4*	*0,3*	*0,4*	*0,4*
Interest expenditure (h)	**4,0**	**3,9**	**3,7**	**3,7**	**3,8**	**3,8**	**3,6**	**3,5**	**3,5**
Change (h')		*-0,1*	*-0,2*	*0,0*	*0,1*	*-0,2*	*-0,2*	*-0,1*	*0,0*
Planned structural primary surplus (i)	**2,8**	**2,4**	**3,0**	**3,8**	**3,8**	**2,6**	**2,6**	**2,9**	**3,3**
Change (i')		*-0,4*	*0,6*	*0,8*	*0,0*	*-0,4*	*0,0*	*0,3*	*0,4*
Public debt (l)	**132,6**	**132,5**	**131,0**	**128,2**	**125,7**	**131,6**	**130,0**	**127,1**	**123,9**
Change (l')		*-0,1*	*-1,5*	*-2,8*	*-2,5*	*-0,4*	*-1,6*	*-2,9*	*-3,2*

Source: 2017 EFD and 2018 DBP.
(1) Totals may not match due to rounding of decimals.

Box 2.1 – Comparison of forecasts in the DBP with those of the European Commission

It is useful to conduct a summary comparison of the public forecasts in the DBP and those in the Autumn Forecast 2017 published by the European Commission on 9 November. The results are presented in Table R2.1.1.

For this year, the projections for net borrowing coincide. For the subsequent two years, the Commission expects larger deficits than those forecast in the DBP. For 2018, the larger deficit (1.8 per cent of GDP compared with 1.6 per cent in the DBP) is essentially attributable to slower nominal GDP growth and faster growth in expenditure. For 2019 the European Commission forecasts a substantially larger deficit than that set out in the DBP (2.0 per cent of GDP, compared with 0.9 per cent in the DBP), mainly because it does not consider the approximately €12.5 billion (0.7 per cent of GDP) in higher indirect taxes that would be generated by the activation of the safeguard clauses. This decision was prompted by the fact that in recent years, planned increases in VAT rates have systematically been suspended by the Government.

In 2017-2018, despite very similar figures for actual net borrowing, the structural deficit estimated by the European Commission is much higher than that in the DBP. This is due to the different estimates of the output gap used by the Government and the European Commission to determine the cyclical component of the deficit (for more on this issue, see Box 1.1). Since the output gap used in the DBP is more negative than that of the Commission (which forecasts a positive output gap as soon as 2018), the cyclical component to be eliminated from actual net borrowing to obtain the structural component is larger (the Commission's forecasts of a positive output gap in 2018 causes the structural deficit to be worse than the actual deficit).

If we shift our attention from levels to changes in the structural balance – which are more comparable as they are less affected by different estimates of the output gap – in 2018 the improvement expected by the European Commission is only one-tenth of a point of GDP, smaller than the three-tenths forecast by the Government (see also section 2.3). Examining the components, we find that – as the expected improvement in interest expenditure in 2018 is the same for both the Government and the Commission at two-tenths of a point – this difference is a consequence of the disparity in the forecasts for the structural primary balance, which is expected to improve in the DBP (by a tenth of a point) and deteriorate in the European Commission's forecast (by a tenth of a point), owing to a cyclically adjusted increase in primary expenditure.

Table R2.1.1 – Public finance objectives in the DBP and European Commission forecasts (1)
(percentage of GDP)

	2017		2018		2019	
	DBP	COM	DBP	COM	DBP	COM
Actual net borrowing	-2.1	-2.1	-1.6	-1.8	-0.9	-2.0
Structural net borrowing	-1.3	-2.1	-1.0	-2.0	-0.6	-2.4
Change in structural net borrowing (a=c-b)			0.3	0.1	0.4	-0.4
of which: change in interest expenditure (b)			*-0.2*	*-0.2*	*-0.1*	*-0.1*
change in primary structural balance (c=e-d)			*0.1*	*-0.1*	*0.4*	*-0.6*
of which: one-off changes (d)			*-0.3*	*-0.3*	*-0.2*	*0.0*
change in cyclically-adjusted primary balance (e=f-g)			*-0.2*	*-0.4*	*0.2*	*-0.6*
of which: change in cyclically-adjusted revenue (f)			*-0.6*	*-0.3*		*-0.6*
change in cyclically-adjusted primary expenditure (g)			*-0.4*	*0.1*		*-0.1*

Source: based on 2018 DBP data and European Commission (Autumn Forecast, November 2017).
(1) Totals may not match due to rounding of decimals.

For 2019, the Commission forecasts a deterioration of four-tenths of a point in the balance compared with 2018, while the DBP envisages an improvement of four-tenths of a point. This essentially reflects the different projections for the cyclically-adjusted primary balance, for which the European Commission forecasts a deterioration of six-tenths of a point, compared with an improvement of two-tenths in the DBP. The deterioration expected by the European Commission is largely attributable to cyclically adjusted revenue, which is forecast to decline by six-tenths of a point of GDP compared with 2018, owing primarily to the Commission's decision to exclude the VAT increases provided for under the safeguard clauses from its assessments.

2.1.2 Developments in the debt/GDP ratio

The DBP policy scenario retains the larger decrease in the debt indicated in the recent Update than that set out in the EFD last April. More specifically, in 2017 the debt/GDP ratio declines by four-tenths of a point (rather than two-tenths compared with the EFD forecast). In subsequent years, the debt/GDP ratio is expected to decline at a progressively faster pace, reaching 123.9 per cent in 2020.

The policy scenario reflects the impact of a projected improvement in the state sector and public sector borrowing requirement of €6 billion in 2018 and €3 billion in 2019, the result of the extension of the Single Treasury system until 31 December 2021 provided for in the Budget Bill (in the trend scenario in the EFD Update the system was scheduled to terminate on 31 December 2017). The policy forecasts in the EFD Update and the DBP reflect the impact of recent measures in support of the banking system, classified as financial items, of about 0.6 per cent of GDP[7] (see Box 2.2). In addition, the forecasts also reflect a reduction in the liquidity holdings of the MEF of about 0.7 per cent of GDP in 2017 and about 0.1 per cent of GDP in 2018 and 2019.

In the 2017-2020 forecasting period, the cumulative decrease in the debt/GDP ratio is put at about 8 percentage points. Among the determinants of the change in that ratio, this result is almost entirely attributable to the planned primary surpluses, which would reduce the debt/GDP ratio by more than 9 percentage points. Nevertheless, it should be recalled that in 2019-2020 those surpluses are supported by the effects of the safeguard clauses[8] on indirect taxes, changes that have repeatedly been suspended in the recent past, implying uncertainty in the direction of fiscal policy.

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[7] In particular, €5.4 billion for the precautionary recapitalisation of Banca Monte dei Paschi di Siena and €4.8 billion for the liquidation of the Veneto banks (Banca Popolare di Vicenza and Veneto Banca). For the latter, the estimate does not include an additional €5.4 billion in guarantees, equal to 0.3 per cent of GDP, covering the difference between assets and liabilities in the sale (the debt of the liquidator to Banca Intesa). In its Autumn forecasts, the European Commission includes that additional amount among the measures to support the banking system (for a total of 0.9 percentage points of GDP), specifying that the valuation of the overall impact of the two interventions is currently being verified by Eurostat and Istat.

[8] See section 2.1.3.

Box 2.2 – State guarantees to the banking sector

With regard to the State's exposure to the risk that its guarantees might be enforced, the DBP does not update the scenario presented in the 2017 EFD. Referring to 2015 and 2016, that document emphasised that compared with other EU countries Italy had made less use of guarantees to manage the banking crisis.

At 31 December 2016, the total stock of State guarantees amounted to about €39.7 billion (2.4 points of GDP), of which €6.4 billion in respect of the banking industry (0.4 points). The increase registered in 2016 compared with the previous year (€3.7 billion, or 9.3 per cent) was entirely attributable to the guaranteed loans of small and medium-sized firms and households to buy primary residences.

Nevertheless, in 2017 a number of measures to support the banking system were implemented, including grants of aid as well as guarantees for specific operations. In particular, support measures for struggling banks were deployed for Monte dei Paschi di Siena (MPS) and the Veneto banks (Banca Popolare di Vicenza and Veneto Banca), which were liquidated and purchased in part by Banca Intesa.

These banks benefitted first from an injection of €10.2 billion in liquidity (of which €4.8 billion to Banca Intesa for the acquisition of the Veneto banks and €5.4 billion to MPS), with an impact on the public debt of 0.6 per cent of GDP. In addition, the State granted those institutions guarantees of a maximum of €15.6 billion, of which €9 billion already committed. More specifically:

– €3.2 billion guaranteeing the MPS operation with regard to the securitisation of its own NPLs (GACS);

– €5.8 billion guaranteeing the loans purchased by Banca Intesa in the acquisition of the two Veneto banks. In detail, €5.4 billion are securing Banca Intesa's claim on the liquidator in respect of the difference between the assets and liabilities acquired – more of the latter (deposits) than the former (performing loans) – and €0.4 billion are securing payment of the performing loans acquired by Banca Intesa. The State guarantees to that bank can be increased to €12.4 billion following due diligence and subsequent verification of the solvency of the performing loans acquired.

The Update of the 2017 EFD specified that the guarantees did not impact the public finance balances or the debt,[9] while the potential impact on the debt in the event of actual enforcement of the guarantees was estimated at a total of €1.1 billion (of which €700 million in respect of MPS and €400 million in respect of the two Veneto banks). It noted that that amount fell within the limits established by Decree Law 237/2016, which in authorising the bank support measures set a ceiling on the impact on the debt of €20 billion, of which €4 billion concerning the impact of the guarantees.

The Government estimate of the impact of the operations on the deficit and the debt was nevertheless subject to a confirming assessment by Istat and Eurostat. While those statistical institutions have not yet published the findings of their assessment, the estimate of the Italian public debt produced by the European Commission in its recent opinion on the 2018 Draft Budgetary Plan is €7.6 billion higher than the Government's estimate.[10] Of the total difference, €5.4 billion[11] is attributable to the impact of the guarantees referred to earlier, which would be included in the general government debt if the liquidator were included in that aggregate. As regards the impact on the deficit, the risks already noted persist, as the statistical institutions have not yet confirmed the neutrality of the overall operation. If it is confirmed, the impact on the deficit would in any case be a one-off factor.

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[9] Note the risks identified in the hearing of the Parliamentary Budget Office concerning the Update of the 2017 EFD. In particular, see attachment 2.3 of the hearing of 3 October 2017 (in Italian).

[10] In its opinion on the DBP of 22 November 2017, the European Commission calculated the Italian public debt at €2,266.4 billion (equal to 132.1 per cent of GDP), compared with the €2,258.8 billion (or 131.6 per cent of GDP) indicated in the 2018 DBP.

[11] The remainder appears attributable to smaller-than-expected privatisation receipts.

The snow ball effect, connected with the difference between interest expenditure and the contribution of nominal GDP growth, is unfavourable but declines in 2017, becomes favourable in 2018 and, over the entire period under consideration, helps reduce debt by about 1 percentage point of GDP. The policy scenario forecasts a decline in interest expense to 3.8 per cent of GDP in 2017, 3.6 per cent in 2018, and 3.5 per cent in 2019 and 2020.[12] The stock-flow adjustment has an adverse impact of more than 2 percentage points of GDP over the four-year forecasting period, an improvement compared with the projection in the EFD (Table 2.2).

Among the other components, the stock-flow adjustment also includes the effect of financial derivatives. This includes net flows generated by derivatives contracts outstanding or expiring, and any reclassification as debt of transactions that do not give rise to monetary changes (exercise of swaptions[13] with the establishment of unmatched swaps, derivatives restructuring transactions). In recent years, derivatives have had a substantial adverse impact on developments in the debt. According to the Notification on general government net borrowing of 23 October 2017 by Istat, in 2013-2016 the average annual increase in the debt due to derivatives amounted to about €6 billion (about €8.3 billion in 2016).

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

	2015	2016	2017	2018	2019	2020
Debt/GDP ratio	131.5	132.0	131.6	130.0	127.1	123.9
Change in debt/GDP ratio	**-0.3**	**0.5**	**-0.4**	**-1.6**	**-2.9**	**-3.2**
Primary surplus (accruals basis)	**-1.5**	**-1.5**	**-1.7**	**-2.0**	**-2.6**	**-3.3**
Snow-ball effect, (2) of which:	**1.7**	**1.7**	**1.1**	**-0.4**	**-0.8**	**-0.7**
Interest expenditure/nominal GDP	*4.1*	*4.0*	*3.8*	*3.6*	*3.5*	*3.5*
Contribution to growth of nominal GDP	*-2.4*	*-2.2*	*-2.8*	*-4.0*	*-4.3*	*-4.2*
memo item: average cost of debt	*3.2*	*3.1*	*3.0*	*2.8*	*2.8*	*2.9*
Stock-flow adjustment	**-0.4**	**0.2**	**0.3**	**0.8**	**0.4**	**0.8**
Cash-accruals difference			*0.2*	*0.7*	*0.4*	*0.3*
Net accumulation of financial assets, of which:			*0.8*	*0.1*	*-0.1*	*0.0*
privatisation receipts			*-0.2*	*-0.3*	*-0.3*	*-0.3*
Debt valuation effects			*0.1*	*0.2*	*0.2*	*0.4*
Other (3)			*-0.8*	*-0.2*	*-0.1*	*0.0*

Source: based on data from 2018 DBP and 2017 EFD Update.
(1) Totals may not match due to rounding of decimals. – (2) The snowball effect is calculated as the sum of interest as a proportion of nominal GDP and the contribution of growth in nominal GDP, given by $(d_{t-1}/GDP_{t-1})*(-g_t/(1+g_t))$, where d_{t-1} is the debt at time t-1 and g_t is the nominal rate of growth of GDP at time t. – (3) Includes changes in liquid assets of the MEF, Eurostat reclassifications and statistical discrepancies.

[12] At its meeting of 26 October 2017, the Governing Council of the ECB decided to maintain its expansionary monetary policy measures. More specifically, the asset purchase programme was extended for another nine months, from January to September 2018, albeit with purchases proceeding at a slower pace (from €60 billion to €30 billion a month); principal repayments from maturing securities purchased under the APP will be reinvested; policy rates were held unchanged and the Governing Council expects them to remain at their present level for an extended period of time, and well past the horizon of the net asset purchases.
[13] Options that allow the buyer to enter into a swap contract with specified characteristics. Under ESA 2010 rules, at the time the private counterparty exercises the option, if the market value of the swap established as a result of the exercise of the option is negative, it must be classified as a loan and therefore included in the debt.

For 2016, the guidelines for managing the public debt limited operations in derivatives to transactions to improve the overall structure of the existing portfolio, depending on current market conditions. Consistent with this objective, the Treasury mainly intervened to manage swaptions expiring during the year, in order to reduce the accounting impact on the debt due to the generation of the underlying swaps – whose market value would be negative (off-market swaps[14]). According to the "2016 Report on the Public Debt", the Treasury's restructuring of a number of derivatives during the year reduced their impact on the debt by about €800 million.

As already discussed in the PBO's "2017 Budgetary Planning Report", the 2017 EFD provided forecasts for the interest expenditure generated by financial derivatives.[15] More specifically, the interest expenditure on swaps was projected to be about €4.6 billion in 2017[16] (down from €5.2 billion in 2016, including about €1 billion associated with the early closure of an interest rate swap), before rising to about €5 billion in 2018 (of which about €1.6 billion due to the likely early closure of a number of derivatives positions). Such expenditure would then decline in the final two years of the forecasting horizon, to €3.2 billion and €2.3 billion in 2019 and 2020 respectively, probably explained in part by the expected increase in interest rates.

For 2017, the DBP confirms the updated targets for privatisation receipts given in the EFD Update, which decrease from 0.3 to 0.2 percentage points of GDP compared with the figures given in the 2017 EFD, while those for 2018-2020 set out in the 2017 EFD are confirmed at 0.3 per cent of GDP. Note that both the DBP and the EFD Update do not provide sufficient information to determine if the privatisation programme is feasible, thereby posing a risk to achievement of the policy scenario.[17]

Statements by the chief executive officer of ENAV indicate that the sale of part of the MEF's stake in the company to Cassa depositi e prestiti (CDP) is being evaluated. The MEF currently holds 53.28[18] per cent of ENAV, which at current market prices is worth about €1.2 billion.

In order to achieve the target of 0.2 per cent of GDP in privatisation receipts by the end of the year, the sale of part of the MEF's interest in ENI to CDP[19] is also being assessed, in addition to the ENAV operation. That interest is currently equal to 4.34 per cent, which at current market prices is worth about €2.2 billion.

The EFD Update does not specify either the timing or the procedure to be adopted (i.e. a market offering or sale to CDP) for the sale of an additional part of the MEF's holding in Poste Italiane. The MEF still holds 29.3 per cent of the Poste Group (worth about €2.3 billion at current market prices), following the market placement of 35.7 per cent in 2015 and the transfer to CDP of 35 per cent in 2016 (as part of the CDP capital increase reserved to the MEF, which meant that the transaction did not generate receipts to lower the debt).

[14] Swaps on non-market conditions, for which a premium is paid.

[15] In accordance with Law 196/2009, Art. 10, paragraph 3, letter f), as amended by Art. 1, paragraph 6, letter d) of Law 163 of 4 August 2016.

[16] Until the second quarter of this year, data reported in the Bank of Italy's Financial Accounts show payment flows in respect of derivatives of about €2.2 billion.

[17] The European Commission, in its opinion on the DBP, also notes the risks posed to the implementation of the privatisation programme. In its debt forecasts, privatisation receipts are lower than the Government's targets: for 2017 the Commission does not include any receipts in view of the risk associated with accomplishing sales within one month, while for 2018 it reduces them to 0.15 per cent of GDP.

[18] On 30 October 2017, the sale was completed with the award of bonus shares. As a result of the bonus share grant (equal to about 0.10 per cent) by the seller, i.e. the MEF, the float increased and is now equal to 46.72 per cent of ENAV's share capital.

[19] CDP already holds 25.76 per cent of ENI. The MEF currently exercises de facto control over ENI through its direct holding and the interest held by CDP.

Finally, Article 49 of Decree Law 50/17 provides for the integration of ANAS into the Ferrovie dello Stato Group.[20] The consequent removal of ANAS from the general government aggregate could reduce the public debt by the amount of ANAS' debt (€412 million at 31 December 2016).

2.1.3 The budget package: Decree Law 148/2017 and the 2018 Budget Bill

The budget measures

The public finance package contained in Decree Law 148/2017 and the 2018 Budget Bill increases general government net borrowing from its current legislation baseline by 0.6 percentage points of GDP in 2018 and 2019, and by 0.1 points in 2020 (Tables 2.1, 2.3 and 2.5). The impact of the provisions of the budget measures is unchanged from the balances indicated in the Update of the 2017 EFD.

In the budget measures submitted to Parliament, the expansionary measures ("uses" in Table 2.3) decline over the planning horizon, falling from 1.6 per cent of GDP in 2018 to 1.3 per cent in 2019 and then even more sharply to 0.8 per cent in 2020. Net of the deactivation of the safeguard clauses, these values decrease and stabilise at 0.7-0.9 per cent of GDP. The resources to fund the measures amount to 1 per cent of GDP in 2018 and 0.6 per cent in the two subsequent years.

Table 2.3 – 2018-2020 budget measures and impact of Decree Law 148/2017 on 2017 *(millions of euros and percentage of GDP)*

	2017	2018	2019	2020
USES	**1,251.1**	**27,861.4**	**22,988.7**	**14,751.0**
As a % of GDP	*0.1*	*1.6*	*1.3*	*0.8*
Increases in expenditure	1,090.0	6,795.8	8,757.1	7,983.5
Current	*340.0*	*5,707.7*	*6,616.0*	*5,218.6*
Capital	*750.0*	*1,088.1*	*2,141.2*	*2,764.9*
Decreases in revenue	161.1	21,065.6	14,231.6	6,767.5
Deactivation of safeguard clauses		*-15,742.5*	*-6,415.1*	
As a % of GDP		*-0.9*	*-0.4*	
Uses net of deactivation of safeguard clauses	*1,251.1*	*12,118.9*	*16,573.6*	*14,751.0*
As a % of GDP	*0.1*	*0.7*	*0.9*	*0.8*
RESOURCES	**1,261.1**	**16,925.2**	**11,408.9**	**12,129.1**
As a % of GDP	*0.1*	*1.0*	*0.6*	*0.6*
Increases in revenue	126.1	11,713.5	9,550.9	8,347.3
Decreases in expenditure	1,135.0	5,211.7	1,857.9	3,781.9
Current	*1,020.6*	*2,267.4*	*1,510.4*	*1,564.8*
Capital	*114.4*	*2,944.3*	*347.5*	*2,217.0*
NET REVENUE	**-35.0**	**-9,352.2**	**-4,680.7**	**1,579.8**
NET REVENUE net of safeguard clauses	**-35.0**	**6,390.3**	**1,734.4**	**1,579.8**
NET EXPENDITURE	**-45.0**	**1,584.1**	**6,899.2**	**4,201.6**
Current	*-680.6*	*3,440.3*	*5,105.6*	*3,653.8*
Capital	*635.6*	*-1,856.3*	*1,793.6*	*547.9*
NET BORROWING	**10.0**	**-10,936.2**	**-11,579.9**	**-2,621.9**
As a % of GDP	*0.0*	*-0.6*	*-0.6*	*-0.1*

Source: based on data from the summary schedules detailing the financial effects of Decree Law 148/2017 and the 2018 Budget Bill.

[20] See section 3.7.3.

For 2018, the budget in absolute terms contains measures involving uses of about €28 billion, for which Decree Law 148/2017 and the Budget Bill recover resources of about €17 billion, with a consequent deterioration in the deficit of about €11 billion (Table 2.3). On the uses side, for the third year in a row, the largest measure regards the elimination of the safeguard clauses providing for increase in VAT and excise taxes. After the partial suspension provided for in Decree Law 50/2017 in April, the current measure provides for the elimination of the increases in VAT and excise taxes envisaged in current legislation, which were expected to generate revenue of €15.7 billion, financing 70 per cent of the shortfall with borrowing. The other main measures essentially regard the renewal of public employment contracts, contribution relief to boost youth employment, support for public and private investment and measures to combat poverty. In addition, international missions and the cultural spending allowance for eighteen-year-olds are refinanced.

On the funding side, the largest part is attributable to revenue increases, which represent about 70 per cent of the resources (nearly 84 per cent in 2019). The largest revenue increases come from the postponement of revenue cuts provided for in previous measures and measures to counter tax and contribution evasion, only some of which have increasing and structural effects. As regards expenditure containment measures, the most significant provisions concern a substantial replanning of transfers to the State Railways and cuts decided by the individual ministries (Tables 2.4 and 2.5).

For 2019-2020, the partial deactivation of the safeguard clause for 2019 alone and the greater effects of a number of expansionary measures already envisaged for 2018 – notably those concerning the revival of investment, contribution relief, combatting poverty and social exclusion – are joined by new measures in favour of firms that extend and expand tax incentives connected with depreciation and the entry into force of the new tax on entrepreneurial income (IRI). On the funding side, revenue measures continue to predominate: in 2019, the divergence between the components expands, with an increase in the share of new revenue, which as noted above rises to about 84 per cent, mainly due the effects of mandatory electronic invoicing (Tables 2.4 and 2.5).

Examining the nature of the funding, some of the revenue provisions are one-off measures and some of the expenditure cuts have variable effects over time: in the former case, these regard the revenue generated by the readmission of previously ineligible taxpayers to the mechanism for the facilitated settlement of tax arrears and the extension of the facilitated settlement mechanism and the revenue from the tax on the revaluation of equity investments not traded on regulated markets and land. The expenditure cuts with variable effects concern the planning of transfers to the State Railways, with significant cuts in 2018 and 2020.

Table 2.4 – Impact of the main measures in Decree Law 148/2017 and the 2018 Budget Bill on the general government accounts
(millions of euros)

		2018	2019	2020
	NET REVENUE	**-9,352**	**-4,681**	**1,580**
Safeguard clauses		-15,743	-6,415	0
	NET REVENUE NET OF SAFEGUARD CLAUSES	**6,390**	**1,734**	**1,580**
Measures for firms	Deferral of entry into force of IRI system	1,986	-750	23
	Payment of insurance tax	480	0	480
	Revaluation of equity investments not traded on regulated markets and land	333	175	175
	Extension of super depreciation on high-tech capital goods and extension of super amortisation of software	0	-487	-952
	Hyper depreciation at 130% tangible assets excluding vehicles	0	-416	-760
	Uniform taxation of income from qualified equity investments by physical persons outside entrepreneurial activity - tax in settlement	253	10	-11
	Group total	3,178	-1,396	-973
Personal income tax credits	Energy upgrading, building renovations and natural landscaping projects for homes	36	-588	-898
	Group total	20	-724	-990
Measures to fight tax evasion	Mandatory electronic invoicing	202	1,690	2,351
	Countering fraud in mineral oils sector - VAT	271	434	387
	Limits on automatic offsetting (reduction to €2,500)	239	239	239
	Reduction in government payments threshold to €5,000	145	175	175
	Group total	1,004	2,685	3,304
Measures for employment	Social contribution relief for open-ended hiring of young people	-382	-1,038	-1,507
	Group total	-358	-1,035	-1,509
Other tax measures	Extension of facilitated settlement of tax arrears for assessments delivered by 30/09/2017 (DL 148/2017)	484	131	-18
	Admission of previously ineligible taxpayers to facilitated settlement of tax arrears (DL	452	0	0
	Reduced flat-rate taxation for rent-controlled accommodation	-126	-133	-7
	Group total	694	169	61
Gaming	Extension of concessions for instant lotteries, betting and Bingo (DL 148/2017 and 2018 Budget Bill)	120	151	151
Other		317	465	390
Contribution charges borne by employers		1,018	1,081	1,128
Refunding and defunding - second section				
	Tax revenue/current	*397*	*340*	*19*
	NET EXPENDITURE	**1,584**	**6,899**	**4,202**
Public employment	Fund for government employment contract renewals	1,650	1,650	1,650
	Group total	2,134	2,262	2,320
Urgent interventions	Increase in fund for urgent interventions	250	330	330
Measures for firms	Increase in fund for SME guarantees (DL 148/2017)	200	0	0
	Measures for southern Italy - tax credit for purchases of capital equipment	200	100	0
	Tax credit for training expenditure	0	250	0
	Group total	495	435	94
Measures for families and fighting poverty	Increase in fund for fighting poverty and social exclusion	300	700	900
	Sterilisation of impact of contract renewals on €80 tax credit	211	211	211
	Fund for family policies	100	100	100
	Community welfare		100	100
	Group total	611	1,111	1,311
Public investment	Fund to be allocated for revival of investment and development of country	170	1,140	1,370
	Use of restricted surplus for investment as part of national pact - local authorities	70	122	351
	Group total	157	1,324	1,875
Regions and other local authorities	Reduction of contribution to public finances of ordinary statute regions and special autonomous entities	254	60	60
	Grant to provinces, metropolitan areas, small municipalities and merger of municipalities	412	160	160
	Grant to municipalities for public works to secure buildings and territory	11	62	154
	Group total	644	210	210
Other measures	Beautiful schools (community service work)	192	96	0
	Special fund - current expenditure	70	200	200
	Special fund - capital expenditure	10	100	100
	Fund for intangible capital, competitiveness and productivity and for foundations	5	150	250
	Group total	-81	604	900
Defunding - second section		-2,470	-1,294	-1,303
	of which: *cuts at ministries*	*-1,009*	*-1,013*	*-1,015*
	Fund for urgent interventions	*-600*	*0*	*0*
	Transfers to State Railways	*-420*	*0*	*0*
Replanning - second section		-1,850	100	-1,950
	of which: transfers to State Railways	*-1,000*	*950*	*-1,150*
Refunding - second section		1,695	1,817	416
	of which: international missions	*900*	*900*	*0*
	Cultural spending allowance for eighteen-year-olds	*290*	*290*	*0*
	Fund for hiring in central government departments	*15*	*80*	*100*
	Calabria Forest Rangers	*130*	*130*	*0*
	Promotion of "Made in Italy"	*130*	*50*	*50*
	NET BORROWING	**-10,936**	**-11,580**	**-2,622**

Source: based on data from the financial schedules attached to the 2018 Budget Bill and Decree Law 148/2017 and the Technical Note attached to Senate Act 2960.

The main budget measures

We now turn to look more specifically at the components of the budget package as submitted to Parliament and the various areas covered by the main measures (see Table 2.4 for a summary view and Table 2.5 for a more detailed breakdown).

First, uses include, on the one hand, the total and partial deactivation of the *safeguard clauses* providing for VAT and excise tax increases and, on the other, numerous smaller measures covering a large group of sectors (internationalisation, security, culture, sports, justice system, agriculture, the environment and territory, education and universities).

Much of the resources are devoted to *public employment*, comprising appropriations for the renewal of contracts and for the recruitment of staff and salary adjustments in certain sectors, including personnel in law enforcement, the judicial system and the attorney general's office, the educational system and universities. In addition, a fund for recruitment in central government departments had been established in the second section of the Budget Bill (section 3.6).

Employment measures include contribution relief for open-ended hiring of persons under the age of 35 (section 3.1). The social fund for employment and training has also been increased.

Resources have been appropriated for *measures directed at families and the fight against poverty*. The main measures comprise: an increase in the fund to combat poverty and social exclusion, including strengthening the inclusion income system (section 3.3); the sterilisation of the effects of the renewal of public employment contracts on the 80-euro tax credit for low-income earners; the establishment of a family fund; a tax credit for foundations implementing programmes aimed at promoting community welfare (against poverty, social vulnerability, the hardship of families with minors, etc.). The cultural spending allowance for eighteen-year-olds has also been extended for 2018-2019.

Personal income tax credits for spending on energy upgrading and building renovations have been retained, albeit partly reduced, and new credits have been introduced for natural landscaping projects concerning the external areas of residential buildings. A credit for public transport passes has been reintroduced after having been eliminated some years previously.

With regard to *measures for businesses*, the legislation on so-called hyper and super-depreciation/amortisation has been extended (section 3.5). The guarantee fund for SMEs has been increased and a tax credit has been established for company training activities. Other measures focus on firms in the south of Italy, with a tax credit for the acquisition of capital goods. The second section of the Budget Bill appropriates resources for the promotion of products "made in Italy".

Other measures regard the revival of *public investment*, with additional financing of the fund established in the 2017 Budget Act and measures to facilitate investment by local authorities (section 3.7).

A number of other measures concern the finances of the *regions and local authorities*, such as the reduction of the contribution of ordinary statute regions to the public finances and transfers to provinces, metropolitan cities and municipalities (section3.8). Certain provisions regard the *healthcare sector* (section 3.9).

Turning to the resources funding these measures (see Table 2.4 for a summary view and Table 2.5 for a more detailed breakdown), the main provisions concern the fight against tax evasion, other fiscal measures and the containment of expenditure, mainly in the second section of the budget, both through spending cuts by the ministries, especially current expenditure, and through the replanning of capital expenditure, which will reduce outlays in 2018 and 2020.

As regards the *fight against tax evasion*, the main measures concern the introduction of mandatory electronic invoicing in private-sector transactions, the fight against VAT fraud in the mineral oil sector, preventive controls on the unwarranted offsetting of credit positions in tax returns, the extension of the verification of tax and other payment compliance by the recipients of government payments to include all transfers of at least €5,000 (section 3.4).

The *measures for businesses* include the deferral until 2018 of the introduction of the new entrepreneurial income tax (IRI), a new application of the tax on the redetermination of the value of equity investments not traded on regulated markets and land and increases in the payment on account of the tax on insurance policies (section 3.5).

Additional resources will be generated by *other tax measures*, including the readmission of previously ineligible taxpayers to the mechanism for the facilitated settlement of tax arrears and the extension of the facilitated settlement mechanism.

Finally, a number of *measures concerning gaming*, consisting in the renewal against consideration of concessions for instant lotteries, betting and bingo.

And as regards *expenditure savings*, the largest part will be generated by the provisions in the second section of the Budget Bill. These comprise the reduction in appropriations for ministries and the fund for urgent interventions, which however is increased in the text of the provision, with a net restrictive effect for 2018 only. Other measures regard the replanning of transfers to the State Railways, which for years has been conducted on a stop-and-go basis.

Table 2.5 – Effects of Decree Law 148/2017 and the 2018 Budget Bill on the general government revenue and expenditure account
(millions of euros)

	2017	2018	2019	2020
USES (1)	**1,251**	**27,861**	**22,989**	**14,751**
percentage of GDP	*0.1*	*1.6*	*1.3*	*0.8*
Increased expenditure	**1,090**	**6,796**	**8,757**	**7,983**
Increased current expenditure	***340***	***5,708***	***6,616***	***5,219***
Fund for government employment contract renewals		1,650	1,650	1,650
Sterilisation of impact of contract renewals on €80 tax credit		211	211	211
Refunding of social fund for employment and training (DL 148/2017)	200	138	189	181
Increase in fund for the fight against poverty and social exclusion		300	700	900
Reduction of contribution to public finances of ordinary statute regions and special autonomous entities		254	60	60
Employment centres and ANPAL		239	239	239
Grant to provinces, metropolitan areas, small municipalities and merger of municipalities		412	160	160
Fund for family policies		100	100	100
Community welfare			100	100
Beautiful schools (community service work)		192	96	
Tax credit for training expenditure			250	
Increase in fund for urgent interventions		250	330	330
Special fund - current expenditure		70	200	200
Refunding - second section		1,408	1,610	334
International missions		*900*	*900*	*0*
Cultural spending allowance for eighteen-year-olds		*290*	*290*	*0*
Fund for hiring in central government departments		*15*	*80*	*100*
Other		*203*	*340*	*234*
Other measures		484	722	754
Increased capital expenditure	***750***	***1,088***	***2,141***	***2,765***
Fund to be allocated for revival of investment and development of country		170	1,140	1,370
Increase in fund for SME guarantees (DL 148/2017)	300	200	0	0
Use of restricted surplus for investment as part of national pact - local authorities		70	122	351
Grant to municipalities for public works to secure buildings and territory		11	62	154
Measures for southern Italy - tax credit for purchases of capital equipment		200	100	
Fund for intangible capital, competitiveness and productivity and for foundations		5	150	250
RFI loans (DL 148/2017)	420			
Special fund - capital expenditure		10	100	100
Refunding and replanning - second section		287	307	82
Calabria Forest Rangers		*130*	*130*	*0*
Promotion of "Made in Italy"		*130*	*50*	*50*
Other		*27*	*127*	*32*
Other measures	30	135	160	458
Decreased revenue	**-161**	**-21,066**	**-14,232**	**-6,767**
Sterilisation of VAT clauses (2018 Budget Bill and DL 148/2017)		-15,743	-6,065	0
Sterilisation petroleum product excise tax rate increase (2018 Budget Bill and DL 148/2017)		0	-350	0
Uniform taxation of income from qualified equity investments by physical persons outside entrepreneurial activity - IRPEF		-956	-1,406	-1,436
Deferral of entry into force of IRI system		-3,345	-2,219	0
Social contribution relief for open-ended hiring of young people		-382	-1,195	-1,931
Extension of super depreciation (250%) on high-tech capital goods and extension of super amortisation (140%) of software		0	-487	-952
Hyper depreciation at 130% tangible assets excluding vehicles		0	-416	-760
Energy upgrading, building renovations and natural landscaping projects for homes		-121	-1,291	-603
Reduced flat-rate taxation for rent-controlled accommodation		-126	-133	-7
Increase in fund for reduction of tax burden in accordance with Art. 1, paragraph 431, of Law 14	0	0	-370	-370
Other measures	-140	-511	-414	-396
Tax effects:	0	0	-12	-313
Energy upgrading, building renovations and natural landscaping projects for homes		*0*	*0*	*-299*
Other		*0*	*-12*	*-14*
Contribution charges borne by employers	-21	-7.3	-7.3	-7.3
NET REVENUE	**-35**	**-9,352**	**-4,681**	**1,580**
NET EXPENDITURE	**-45**	**1,584**	**6,899**	**4,202**
current	*-681*	*3,440*	*5,106*	*3,654*
capital	*636*	*-1,856*	*1,794*	*548*
NET BORROWING	**10**	**-10,936**	**-11,580**	**-2,622**
percentage of GDP	*0.0*	*-0.6*	*-0.6*	*-0.1*

Table 2.5 – *(cont.)* Effects of Decree Law 148/2017 and the 2018 Budget Bill on the general government revenue and expenditure account
(millions of euros)

	2017	2018	2019	2020
SOURCES	**1,261**	**16,925**	**11,409**	**12,129**
percentage of GDP	*0.1*	*1.0*	*0.6*	*0.6*
Increased revenue	**126**	**11,713**	**9,551**	**8,347**
Deferral of entry into force of IRI system		5,332	1,469	23
Mandatory electronic invoicing		202	1,587	1,587
Uniform taxation of income from qualified equity investments by physical persons outside entrepreneurial activity - tax in settlement		1,209	1,416	1,424
Extension of facilitated settlement of tax arrears for assessments delivered by 30/09/2017 (DL 148/2017)		484	131	0
Admission of previously ineligible taxpayers to facilitated settlement of tax arrears (DL 148/2017)		452	0	0
Payment of insurance tax: increase in payment on account from 40% to 55% for 2018 and 2019 and to 70% as from 2020		480	0	480
Countering fraud in mineral oils sector - VAT		271	296	296
Revaluation of equity investments not traded on regulated markets and land		333	175	175
Limits on automatic offsetting (reduction to €2,500)		239	239	239
Reduction in government payments threshold to €5,000		145	175	175
Gaming (DL 148/2017 and 2018 Budget Bill)		120	151	151
Revenue from measures to combat tax evasion			370	370
Reduction in fund for the reduction of the tax burden referred to in Art. 1, paragraph 431, Law 147/2013		378	378	508
Other measures	80	550	638	511
Tax effects:		160	1,105	1,289
Mandatory electronic invoicing		*0*	*103*	*764*
Countering fraud in mineral oils sector - direct taxes		*0*	*138*	*91*
Energy upgrading, building renovations and natural landscaping projects for homes		*158*	*704*	*4*
Social contribution relief for open-ended hiring of young people		*0*	*157*	*424*
Other		*2*	*3*	*5*
Contribution charges borne by employers	46	1359	1421	1119
Decreased expenditure	**-1,135**	**-5,212**	**-1,858**	**-3,782**
Decreased current expenditure	***-1,021***	***-2,267***	***-1,510***	***-1,565***
Reduction in appropriations for ministries (DL 148/2017)	-870	0	0	0
Defunding - second section		-1,789	-1,060	-1,049
Cuts at ministries		*-878*	*-839*	*-836*
Fund for urgent interventions		*-600*	*0*	*0*
Other measures	-151	-478	-451	-516
Decreased capital expenditure	***-114***	***-2,944***	***-348***	***-2,217***
Reduction in appropriations for ministries (DL 148/2017)	-54	-89	0	0
Replanning - second section		-1,850	0	-1,950
Transfers to State Railways		*-1,000*	*950*	*-1,150*
Defunding - second section		-681	-234	-254
Cuts at ministries		*-131*	*-174*	*-179*
Transfers to State Railways		*-420*		
Other measures	-60	-325	-113	-13

Source: based on data from the financial schedules attached to the 2018 Budget Bill and Decree Law 148/2017 and the Technical Note attached to Senate Act 2960.
(1) Totals may not match due to rounding of decimals.

An overview and the risks of the budget measures

Looking at the public finance scenario reflecting the budget measures over the forecasting horizon, a number of key elements that have also characterised the recent past emerge.

In the first policy year, the safeguard clause is deactivated and tax rates are not increased thanks in part to a larger deficit than that previously envisaged, in the context of the discussions with the EU institutions concerning a more flexible interpretation of the rules of the Stability and Growth Pact (see section 3.1 of the PBO hearing on the occasion of the EFD Update). In the next two years, a sharper reduction in the nominal deficit and the "substantial" achievement of structural balance – albeit more gradual than envisaged in the EFD in April – still depend on a significant contribution from the safeguard clauses, equal to 0.7 per cent of GDP in 2019 and 1 per cent in 2020 (Tables 2.6 and 2.7).

Moreover, for 2018 the budget measures postpone the reduction in revenue associated with the entry into force of the IRI system established with last year's Budget Act, contributing further to the unpredictability of the Italian tax system, and, on the other hand, contain no provisions for the reorganisation and reduction of tax expenditures, which according to the National Reform Programme published last April and to the more recent EFD Update, had been expected for 2017-2018. On the contrary, a number of existing tax relief measures were extended and new measures introduced.

For 2019, the partial deactivation of the safeguard clauses in the budget package is smaller than indicated in the supplement to the EFD Update presented to Parliament on 2 October 2017. That document with more details on the possible areas of budget intervention showed a reduction in VAT revenue of about €11.4 billion, or 0.6 per cent of GDP, whereas the provisions of Decree Law 148/2017 and the Budget Bill establish a smaller cut of €6.4 billion or 0.4 per cent of GDP.

Without those clauses, the policy deficit in 2019 would remain at broadly the same level as that forecast for 2018, before falling by a few tenths of a point in 2020, similar to developments in the recent past. This reflects the fact that, net of the clauses, the budget includes measures whose impact on revenue is not permanent and others with an increasing impact on expenditure (Table 2.3).

The budget package commits resources for permanent measures, in some cases with increasing expenditure, using the expected improvement in balances compared with April.

The trend deficit in the DBP was three-tenths of a point smaller than that forecast in the EFD both in 2018 and 2019 and four-tenths smaller in 2020. That revision was essentially due to the improvement in macroeconomic conditions and the reduction in interest expenditure expected as a result of the recent decline in market expectations for yields on government securities in the coming years, which is associated with the ECB's decision to only gradually taper its quantitative easing.

This is occurring at a time when there appears to be room for flexibility/discretion with respect to the fiscal rules on the part of the European Commission, based on the appropriateness of the fiscal stance of the euro area, for 2018 only.

The credibility of the actual activation of the safeguard clauses has been weakened by the repeated sterilisation or postponement of those clauses. In order to understand the real developments in the public finances, we propose a simple exercise showing the evolution of trend and policy balances net of the safeguard clauses (Table 2.7).

Table 2.6 – Decree Law 148/2017 and the 2018 Budget Bill: previous, partially deactivated and to be activated safeguard clauses
(millions of euros)

Measure	2018	2019	2020
Safeguard clauses active post DL 50/2017			
Increase in VAT rate from 10% to'11.5% as from 2018 (Art. 9, paragraph 1, letter a))	3,479	3,479	3,479
Increase in VAT rate from 11.5% to 12% as from 2019 (Art. 9, paragraph 1, letter a))		1,160	1,160
Increase in VAT rate from 12% to 13% as from 2020 (Art. 9, paragraph 1, letter a))			2,319
Increase in VAT rate from 22% to 25% as from 2018 (Art. 9, paragraph 1, letter b))	12,264	12,264	12,264
Increase in VAT rate from 25% to 25.4% as from 2019 (Art. 9, paragraph 1, letter b))		1,635	1,635
Reduction in VAT rate from 25.4% to 24.9% as from 2020 (Art. 9, paragraph 1, letter b))			-2,044
Increase in excise tax on fuels as from 2019 (Art. 9, paragraph 1, letter c))		350	350
Total increase in revenue expected post DL 50/2017	**15,743**	**18,887**	**19,162**
Deactivation of clauses provided for in DL 148/2017 and 2018 Budget Bill			
Reduction in VAT rate from 11.5% to 10% in 2018 (Art. 5, DL 148; Art. 2, paragraph 1, 2018 Budget Bill)	-3,479		
Reduction in VAT rate from 12% to 11.5% in 2019 (Art. 2, paragraph 1, 2018 Budget Bill)		-1,160	
VAT rate remains at 13% as from 2020 (Art. 2, paragraph 1, 2018 Budget Bill)			0
Reduction in VAT rate from 25% to 22% in 2018 (Art. 2, paragraph 1, 2018 Budget Bill)	-12,264		
Reduction in VAT rate from 25.4% to 24.2% in 2019 (Art. 2, paragraph 1, 2018 Budget Bill)		-4,906	
VAT rate remains at 24.9% in 2020 (Art. 2, paragraph 1, 2018 Budget Bill)			0
Sterilisation of increase in excise tax on fuels for 2019 (Art. 5, DL 148; Art. 2, paragraph 1, 2018 Budget Bill)		-350	
Total reduction in revenue provided for in DL 148/2017 and 2018 Budget Bill	**-15,743**	**-6,415**	**0**
Safeguard clauses active post DL 148/2017 and 2018 Budget Bill			
Increase in VAT rate from 10% to 11.5% as from 2019 (Art. 2, paragraph 1, 2018 Budget Bill)		3,479	3,479
Increase in VAT rate from 11.5% to 12% as from 2020 (Art. 2, paragraph 1, 2018 Budget Bill)			1,160
Increase in VAT rate from 12% to 13% as from 2020 (Art. 2, paragraph 1, 2018 Budget Bill)			2,319
Increase in VAT rate from 22% to 24.2% as from 2019 (Art. 2, paragraph 1, 2018 Budget Bill)		8,994	8,994
Increase in VAT rate from 24.2% to 24.9% as from 2020 (Art. 2, paragraph 1, 2018 Budget Bill))			2,862
Increase in excise tax on fuels as from 2020 (Art. 2, paragraph 1, 2018 Budget Bill)			350
Total increase in revenue expected if no alternative measures are found	**0**	**12,472**	**19,162**

Source: based on data from the texts and technical reports of Decree Law 148/2017 and the 2018 Budget Bill.

Table 2.7 – A hypothetical exercise (1)
(millions of euros and percentage of GDP)

	2017	2018	2019	2020
Trend deficit with total safeguard clauses (a)	-36.439	-17.364	-4.869	-1.140
Percentage of GDP (a')	*-2,1*	*-1,0*	*-0,3*	*-0,1*
Trend deficit net of total safeguard clauses (b=a-h)	**-36.439**	**-33.107**	**-23.756**	**-20.302**
Percentage of GDP (b')	*-2,1*	*-1,9*	*-1,3*	*-1,1*
Budget package net of deactivated safeguard clauses:				
Impact on deficit *(+ = improvement in balance) (c=d-e)*		**4.806**	**-5.165**	**-2.622**
Percentage of GDP (c')		*0,3*	*-0,3*	*-0,1*
Net revenue net of deactivated safeguard clauses (d)		*6.390*	*1.734*	*1.580*
Net expenditure (e)		*1.584*	*6.899*	*4.202*
Planned deficit in DBP (f)	-36.439	-28.300	-16.449	-3.762
Percentage of GDP (f')	*-2,1*	*-1,6*	*-0,9*	*-0,2*
Planned deficit net of total safeguard clauses (g=b+c)	**-36.439**	**-28.300**	**-28.921**	**-22.924**
Percentage of GDP (g')	*-2,1*	*-1,6*	*-1,6*	*-1,2*
Memorandum item:				
total safeguard clauses (h)		15.743	18.887	19.162
Percentage of GDP (h')		*0,9*	*1,0*	*1,0*
Safeguard clauses deactivated in budget package (i)		-15.743	-6.415	0
Percentage of GDP (i')		*-0,9*	*-0,4*	*0,0*
Remaining safeguard clauses (l)		0	12.472	19.162
Percentage of GDP (l')		*0,0*	*0,7*	*1,0*

(1) Totals may not match due to rounding of decimals.

Bear in mind that this is a hypothetical exercise, one in which mechanical operations are performed without conducting a simulation that also considers the macroeconomic framework and that therefore takes account of the feedback effects of the assumption of no activation of the clauses. Nevertheless, these effects should not significantly alter the underlying trends identified by the exercise.

First, it should be emphasised that the trend deficit net of the clauses would obviously be less favourable, with a reduction of one percentage point of GDP between 2017 and 2020, rather than twice that size taking account of the clauses (Table 2.7, lines a ', b and b').

Another aspect to consider is that the budget package currently under discussion in Parliament, without taking account of the deactivated clauses, would produce an improvement in the deficit only in 2018, equal to 0.3 per cent of GDP, causing a deterioration in the following two years of 0.3 and 0.1 per cent, respectively (Table 2.7, line c ').

This is a consequence of a budget package that, without considering the total deactivation of the clauses in 2018 and the partial suspension in 2019, essentially increases revenue in the first year more than it does in the next two (Table 2.7, line d) and has the opposite effect on expenditure, which increases relatively little in 2018 and then grows more in the subsequent two years, especially in 2019 (Table 2.7, line e).

The end result is that the reduction in the planned deficit net of the clauses found in the exercise is much more gradual with respect to that set out in the official policy documents (Table 2.7, lines g' and f’), remaining at its 2018 level in 2019 as well, as noted earlier.

In conclusion, the policy measures in the budget documents contain elements of indeterminacy that give the measures a “short-termist” cast. In the medium term, for 2019-2020, the provisions remain characterised - as has happened in recent years – by uncertainty about the composition and scale of the measures that will actually be implemented, since fiscal policy is currently based on an increase in VAT, even if the DBP promises progress on alternative policies that are essential to avoid the activation of the rate increases (the spending review, measures to counter tax evasion and avoidance). In the short term, for 2018, the postponement of the introduction of IRI changes expectations about the characteristics and level of taxation of business. Even in the very short term, in the period between the publication of the EFD Update and the presentation of the Budget Bill, the composition of the budget package has changed, with a significant reduction in the scale of the deactivation of the safeguard clause for VAT in 2019. And as work on the measures continues, there is still no information on privatisations, even for the current year.

These factors weaken the framework for the implementation of the public finances and, consequently, also make the macroeconomic framework less predictable. Above all, however, they create uncertainty about expectations and, therefore, about the decisions and behaviour of economic operators.

Additional risk factors also affect a number of expenditure items and the macroeconomic and financial framework, with an impact on revenue and interest expenditure. The budget measures will in fact take effect in a period of public employment contract renewals, including at the local level, for which no additional resources appear to be appropriated. Moreover, Government intends to reverse the decline in public investment with appropriations that increase the available resources and which - with the gradual elimination of the problems associated with the new legislation governing public procurement - could be implemented more rapidly. Even if this is desirable, it is important to note that in the last few years achievement of planned balances and containment of the deficit have been made possible precisely by the failure to implement planned investments. Finally, the budget package is based on a macroeconomic and financial scenario that, on the one hand, does not exhibit large downside risks compared with the GDP growth expected by other forecasters but, on the other, does not reflect the possibility of significant increases in interest rates on the government securities market.

2.2 Analysis of the fiscal stance

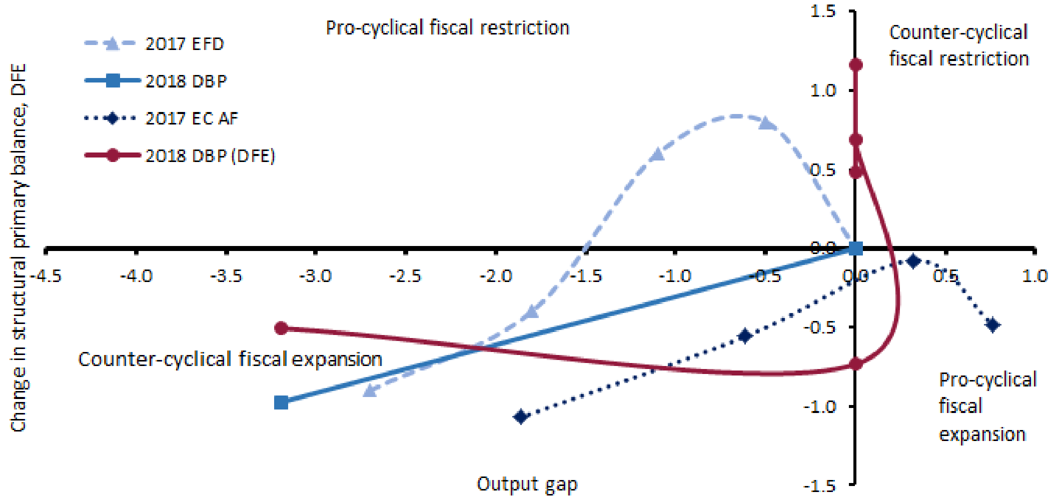
The analysis of the fiscal stance consists in an assessment of the orientation of fiscal policy in relation to the cyclical position of the economy. The latter is generally determined using the output gap (the gap between actual and potential GDP, expressed as a ratio with the latter), while an indicator of the type of impulse (expansionary or restrictive) provided by fiscal policy and its intensity is given by the change in the structural primary balance (which is equal to the primary balance corrected for the cyclical component and net of temporary measures). An expansionary budget package (i.e. a deterioration in the structural primary balance) is counter-cyclical if it is implemented at a point in the cycle with a negative output gap and pro-cyclical if it is implemented at a positive point in the cycle. The opposite holds in the case of a restrictive budget (an improvement in the structural balance).

The public finance scenario in the 2018 DBP reflects a very gradual transition from a moderately expansionary fiscal policy adopted for counter-cyclical purposes in 2016-2017 to a neutral stance in 2018, although the cyclical position is still negative (with an output gap of about -1), and a restrictive stance in the final two years of the forecasting horizon, when the output gap is around zero (Figure 2.1).

By significantly reducing the target for structural adjustment compared with the EFD, the fiscal stance reflected in the DBP postpones the pro-cyclical tightening that should have characterised the next two years. This is primarily achieved by deactivating (totally in 2018 and partially in 2019)[21] the safeguard clauses, only partly offset by other measures, with a view to fostering a more rapid elimination of the output gap (with a cumulative improvement of 1.7 points in 2018-2019 in the DBP, compared with 1.3 points in the EFD). Note that the estimates of the size of the output gap were revised negatively in the DBP compared with the EFD (see chapter 1). This could have influenced the decision to make the path of adjustment towards the MTO less restrictive, with achievement of the objective now postponed until 2020.

[21] The policy scenario in the 2017 EFD still included the safeguard clauses, but took account of the partial sterilisation of the clauses (in the amount of about 0.3 points of GDP as from 2018) with the measures set out in Decree Law 50/2017, which was enacted at the end of April. Following those measures, the scenario still included clauses with an impact of €15.7 billion in 2018, €18.9 billion in 2019 and €19.2 billion in 2020.

Figure 2.1 – Changes in the structural primary balance, DFE and the output gap
(percentage of GDP)



Source: based on data from the MEF (2017 EFD and 2018 DBP) and the European Commission (Autumn Forecast 2017).

This assessment of the fiscal stance is only partly confirmed by the analysis of another indicator of the intensity of the fiscal policy impulse: the discretionary fiscal effort (DFE).[22] The DFE is calculated as the difference between the estimate of the discretionary revenue and expenditure measures adopted as ratio of nominal GDP (Y_t). more formally, the DFE is defined as:

$$DFE_t = \frac{N_t^R}{Y_t} - \frac{(\Delta E_t - y^p \cdot E_{t-1})}{Y_t}$$

where N_t^R is the estimated sum of the individual discretionary revenue measures, excluding temporary measures. The numerator of the second term indicates the difference between the actual change ΔE_t in an expenditure aggregate (total expenditure net of interest spending and estimated expenditure on cyclical unemployment, as well as temporary spending measures) and the theoretical change that should have be registered if that aggregate had grown in line with the 10-year average (from *t-5 to t+4*) of the growth rate for potential GDP y^p[23] expressed in nominal terms using the GDP deflator.

Using the forecasts in the DBP, the DFE shows fiscal impulses that are broadly similar to those calculated on the basis of the changes in the structural primary balance for 2017 and 2019 (Figure 2.1). However, the two indicators diverge in the other two years considered: for 2016, the DFE signals a less expansionary stance (of about half a point of GDP) for fiscal policy compared with that obtained using the change in the structural

[22] See Carnot, N. and de Castro, F. (2015), "The Discretionary Fiscal Effort: an Assessment of Fiscal Policy and its Output Effect", in *European Economy*, *Economic Papers* (543).
[23] The use of such a broad interval to calculate the average rate of change in potential GDP is intended to reduce the uncertainty involved in estimating and forecasting that rate in real time.

primary balance; the stance appears more restrictive in 2018 and 2020, by 0.7 and 0.8 points, then returning to the same pro-cyclical restriction forecast in the EFD for 2018 and significantly tightening the counter-cyclical correction currently envisaged for 2020.

Although methodological differences in the construction of the two indicators do not permit detailed comparisons of the breakdown of the budget measures into revenue and expenditure, the neutral stance indicated by the change in the structural primary surplus for 2018 seems to be the result of offsetting lower revenue (about 0.4 points of GDP) with a corresponding decrease in expenditure, while in the calculation of the DFE a reduction of about 0.3 points in expenditure is accompanied by an increase in revenue of nearly 0.4 points of GDP. For 2020, the sharply restrictive impulse indicated by the DFE (+1.2 points of GDP) is distributed fairly equally between expenditure cuts and greater revenue (with a slight prevalence of the latter), while the change in the structural primary surplus (+0.4 per cent) is mainly generated by expenditure reductions (of about 0.7 points of GDP), partly offset by reductions in revenue.

Using the most recent projections of the European Commission (Autumn Forecast 2017), a rather different scenario emerges (Figure 2.1): in 2016-2017 the fiscal stance is more expansionary, with output gaps that are still negative but considerably smaller than those indicated in the 2018 DBP. In the two following years, the gap between actual and potential output is in fact of the opposite sign, giving rise in 2019 to a pro-cyclical expansionary fiscal impulse of half a point of GDP. The most significant difference between the change in the structural primary balance forecast by the European Commission and that in the DBP regards 2019, the year in which what really diverges are the assessments of developments in the actual primary balance compared with the previous year, mainly because the Commission's projections do not consider the VAT increases provide for in current legislation.

In general, these comparisons suggest that it may be misleading to base an analysis of the fiscal stance on only one indicator, especially when this (as in the case of the structural primary balance) is highly influenced by uncertainty in the estimation of the key variables and by the assumptions underlying the forecasts.

2.3 *Assessment of compliance with the fiscal rules*

The public finance policy scenario presented by the Government in the 2018 DBP contains a risk of significant deviations from the European and national fiscal rules.

More specifically, the structural balance rule is at risk of a significant deviation in 2017 on both a one-year and two-year basis. For 2018, confirming a required adjustment (0.3) of half that indicated in the matrix as reported by the European Commission in its opinion on the DBP (see below), the rule would be complied with in one-year terms but would be close to the risk of a significant deviation in two-year terms according to the estimates contained in the DBP.

Under national legislation (Law 243/2012), if a significant deviation from the structural balance rule actually occurs, an automatic correction mechanism is activated, i.e. Government policy documents must specify measures that would ensure compliance with the rule no later than the fiscal year following that in which the deviation was ascertained.

In 2017 the expenditure benchmark would be at risk of a significant deviation from both the one-year and two-year perspectives. This assessment is less favourable than the view indicated by the estimates published by the Government in the EFD in April. This is due both to faster-than-expected growth in overall spending and a weaker estimated impact of the discretionary revenue measures (DRMs) excluding one-off provisions. From a preliminary assessment, the higher-than-expected expenditure appears partly attributable to the increase in the deferred tax assets (DTA) of the banking system being transformed into refundable tax credits. The weaker impact of the DRMs seems to reflect the adoption of estimation criteria based on preliminary data that were not available in April. Nevertheless, the information made available by the Government is insufficient to determine precisely the causes of the weaker effect. For 2018, again assuming that the structural adjustment of 0.3 points is confirmed (rather than the 0.6 indicated in the matrix), the expenditure growth rule would be complied with in one-year terms according to the forecasts given in the DBP. However, it would still be a risk of a significant deviation from the two-year perspective.

Note that at the EU level, if outturn data show significant deviations from the numerical rules for the structural balance or expenditure, the European Commission will conduct an overall assessment to ascertain compliance with the preventive arm of the Stability and Growth Pact (SGP). In the event of non-compliance, a significant deviation procedure could be initiated.

On 22 November 2017, the European Commission published its opinion on the DBP, accompanied by a letter to the Minster for the Economy and Finance. On the basis of its autumn forecasts, the Commission underscored the risk of a significant deviation in 2017 and 2018. More specifically, the Commission noted, again on the basis of its autumn forecasts, that the structural correction for 2018 would be equal to just one-tenth of a point of GDP, less that the three-tenths of a point forecast by the Government in the DBP, which the Commission said it would be willing to accept as the adjustment for 2018 after an assessment of the sustainability of the public finances and economic conditions in Italy.

Finally, the debt criterion is also not respected in 2017-2018 on either a forward looking or backward looking basis, or in cyclically adjusted terms. In the past, the European Commission has decided not to open an excessive deficit procedure for non-compliance with the debt criterion in consideration of a number of relevant factors, include ex ante compliance with the preventive arm of the SGP. Nevertheless, in its recent opinion on the DBP the Commission, after noting non-compliance with the debt rule, decided to reassess the situation in the spring on the basis of the outturn data for 2017 and the final version of the Budget Act.

2.3.1 Exchange of letters between the European Commission and the MEF on the 2018 DBP

Following the publication of the DBP in mid-October, the European Commission and the Italian Government exchanged letters with a view to clarifying the relationship between the budget strategy set out in the DBP and the EU rules. The most recent Commission letter of 22 November underscored the risk of non-compliance with the provisions of the preventive arm of the SGP in 2017. For 2018, the Commission emphasised the need for strict implementation of the Budget Act in order to deliver a structural effort of at least 0.3 percentage points of GDP. Finally, the Commission postponed its assessment of compliance with the debt criterion until the spring of 2018, based on outturn data for 2017 and the final version of the Budget Act.

On 27 October 2017 the European Commission sent a letter to the Minister for the Economy and Finance requesting clarification of the consistency of the planned fiscal effort set out in the 2018 DBP with the requirements of the preventive arm of the Stability and Growth Pact.

The letter of the European Commission points to the risk in 2017 of a significant deviation from the required structural adjustment of at least 0.6 percentage points. In addition, real growth in net primary expenditure would exceed the reduction required under the expenditure rule. Even taking account of the flexibility under the exceptional events clause invoked by Italy for 2017 (equal to 0.34 points of GDP), the requirements of the preventive arm would not be met.

For 2017, the European Commission had formulated a preliminary estimate of eligible expenditure under the exceptional events clause equal to 0.34 percentage points of GDP, broken down as follows: 0.18 per cent for the costs associated with seismic vents and 0.16 per cent for the refugee crisis (equal to the 0.25 per cent requested by the Government less 0.09 per cent already granted by the Commission to Italy for costs incurring in managing migrant flows in previous years). As usual, the Commission will conduct a final assessment in the spring of 2018 on the basis of data provided by the Government. In the DBP, the Government does not make any request for further flexibility, although it does confirm that the burden of managing the refugee crisis in 2017 amounted to 0.25 percentage points of GDP and emphasises that pending the establishment of a common European policy for managing the Union's external border, Italy will continue to incur expenditure of "more than 0.25 per cent of GDP" in the coming years.

It should be noted that in assessing the 2017 EFD/Stability Programme, and based on its own spring forecasts, the European Commission believed that, taking account of the exceptional events, there was a risk of a deviation from the expenditure criterion in 2017, albeit not a significant one.[24] However, between the EFD and the DBP, the aggregates underlying the expenditure rule changed in an unfavourable direction (section 2.3.3 and Box 2.3).

For 2018, the letter notes that the DBP envisages a structural effort of 0.3 percentage points, which, recalculated by the European Commission, would instead be only 0.2 percentage points. Secondly, the letter notes that the planned adjustment is less than the adjustment of 0.6 percentage points required under the adjustment matrix for the path towards the MTO.[25] The nominal rate of growth in net primary expenditure would also exceed the recommended reduction under the preventive arm (at least 0.2 points of GDP) by 0.1 points.

The text of the country-specific recommendations for Italy approved last July by the European Council called for a "substantial", albeit unquantified, fiscal effort in 2018, in line with the requirements of the preventive arm of the SGP, "taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Italy's public finances". Only in the recitals to the actual recommendations is there any reference to the matrix, which requires an adjustment of 0.6 per cent in the light of cyclical conditions. In a letter of 30 May to the European Commission, Minister Padoan had stated the Government's intention of implementing a structural adjustment for 2018 of 0.3 percentage points of GDP. In its reply of 12 July, the Commission acknowledged the Italian position.

For 2018, the European Commission underscores the risk of a significant deviation from the two-year perspective. The letter also notes that the Commission's subsequent assessment of fiscal policies will take account of the objective of maintaining a fiscal stance that contributes to supporting the recovery and ensuring fiscal sustainability.

In short, as notified to the European Council in recent months,[26] for 2018 the European Commission intends to exercise its degree of discretion in using the matrix that governs the path towards achievement of the MTO in relation to cyclical conditions in the countries – such as Italy, Belgium, France and Slovenia – required to make a substantial fiscal effort (0.5 percentage points of GDP or more) under the preventive arm, with a significant impact on growth and employment.

Finally, after observing that a preliminary assessment of the 2018 DBP had indicated that the debt reduction criterion would not be respected in 2018, the European

[24] European Commission (2017), "Assessment of the 2017 stability programme for Italy", page 17.
[25] European Commission (2015), "Making the best use of the flexibility within the existing rules of the stability and growth pact", COM (2015) 12 final.
[26] European Commission (2017), "2017 European Semester: Country-specific recommendations", COM (2017) 500 final.

Commission noted that compliance with the rules of the preventive arm of the SGP is a relevant factor in assessing compliance with the debt criterion under Article 126(3) of the Treaty.

In his reply of 30 October to the Commission, the Minister attributed the difference of 0.1 per cent between the fiscal effort to correct the structural deficit indicated in the DBP (0.3 per cent) and that indicated in the letter of the European Commission (0.2 per cent) to differences in the application of the method for calculating the output gap, noting that in assessing the cyclical position of the Member States in 2018 the Commission will not only use the estimated output gap but also other indicators of a slack economy, having acknowledged the problems with the methodology commonly agreed at the European level.

More specifically, with regard to the difference in the fiscal effort to correct the structural deficit, the Minister's letter refers to a simplified procedure for calculating the output gap used by the European Commission in assessing the estimates of the Member States, using a reduced subset of information. In the Minister's view, that procedure has in the past produced different results from the complete official methodology. The technical assessment of the Commission, while not ruling out the influence of using the simplified procedure, attributes past differences not so much to the procedure as to the use by Italian budget authorities of a longer time horizon than that permitted by official programmes. It should be borne in mind that as the simplified procedure is available for use within the Commission only, it is not possible to assess the factors underlying those differences.

As regard the risk of a significant deviation in 2017 and in 2017-2018 combined, the letter of reply argues that the Government acted fully in line with the recommendations of the European Commission, with the adoption last April of additional structural measures amounting to 0.2 per cent in 2017.

In its report last February under Article 126(3) of the Treaty, the European Commission, in consideration of the non-compliance with the debt criterion, had asked for the adoption of additional structural measures of at least 0.2 percentage points of GDP in order to ensure compliance with the requirements of the preventive arm in 2017. As noted earlier, thanks in part to the measures implemented by the Italian Government, last May the Commission found that the path of adjustment was consistent in 2017 and in 2016-2017 taken together with the requirements of the SGP, once the exceptional events clause was taken into consideration.[27] However, the figures in the recently published DBP show a deterioration in the aggregates underlying the expenditure rule compared with the EFD/Stability Programme (section 2.3.3 and Box 2.3).

In the letter of 30 October, the Minister emphasises that the fiscal targets planned in the DBP are in line with the SGP requirements and reflect the Government's strategy of deficit and debt reduction while supporting the ongoing recovery, in line with the July recommendations of the Council of the EU.

On 22 November, the European Commission accompanied the publication of its opinion on the 2018 DBP with a new letter to the Minister, emphasising the risk of non-compliance with the requirements of the preventive arm of the SGP in 2017. Specifically,

[27] European Commission (2017), "Assessment of the 2017 stability programme for Italy", page 24.

the Commission notes that the deterioration in structural net borrowing in 2017 has increased from the 0.2 percentage points of GDP projected in the Commission's Spring Forecast to 0.4 percentage points according to the Autumn Forecast, implying a risk of a significant deviation.

The European Commission urges that the Budget Bill being discussed in Parliament be approved without watering down its key provisions and that it be strictly implemented in order to deliver a structural correction of at least 0.3 percentage points of GDP. However, in its opinion on the DBP the Commission notes, again based on its Autumn Forecast, that the structural effort for 2018 would be only one-tenth of a point of GDP.

It is important to note that the explicit reference to three-tenths of a point as the size of the correction, rather than the six-tenths of a point indicated in the matrix for normal economic times, confirms that the European Commission applied its "degree of discretion" and granted the request made by the Minister in that regard (the letter of 30 May 2017), as confirmed by the text of the Commission's opinion on Italy's DBP.[28]

On the occasion of the publication of the opinions on the 2018 DBPs of the Member States, the European Commission specified in greater detail how its degree of discretion will be applied for 2018 only. In cases in which short-term sustainability challenges are identified, or the recovery appears sufficiently robust, no discretion is warranted. Where the economic recovery appears too fragile or could be jeopardised by too large a tightening, an adjustment of at least half of the requirement from the matrix could be considered reasonable. Nevertheless, full compliance with this reduced adjustment is required, especially for Member States that do not comply with the debt criterion.[29] In the opinion on the Italian DBP, the Commission states that Italy does not face such short-term sustainability challenges although the recovery is fragile: real GDP and investment remain below their pre-crisis levels and the unemployment rate is still above its pre-crisis level, while the estimated output gap is subject to uncertainty, as flagged by the plausibility tool. Accordingly, the conditions for reducing the adjustment required by the matrix appear to be met.

Finally, the European Commission has postponed its assessment of compliance with the debt criterion until the spring of 2018 based on 2017 outturn date and the final version of the Budget Act, which will be approved by Parliament in the coming weeks. The Minister is then asked to provide a clarification of the reasons for the greater deterioration in the structural balance in recent months and of the Government's strategy for reducing the debt/GDP ratio in the medium term. At the same time, the Commission also warns the Government of the risks of backtracking on key reforms, notably as regards pensions, which underpin the long-term sustainability of the debt.

[28] European Commission (2017*), "*Commission opinion of 22.11.2017 on the Draft Budgetary Plan of Italy"*,* SWD (2017) 519 final, page 5.

[29] European Commission (2017), "Communication from the Commission, 2018 Draft Budgetary Plans: Overall Assessment", COM (2017) 800 final.

2.3.2 *The structural balance rule*

The assessment of compliance with the fiscal rules in the autumn consists of an in-year analysis for 2017 and an ex ante analysis for 2018. The European Commission's assessment is based on the 2018 DBP.

The ex post analysis for 2016 concluded with the assessments of the Stability Programmes by the EU institutions in the first half of 2017.

It is important to bear in mind that, as noted in the hearings on the EFD in April and the Update of the EFD in September, as well as in the letters of the European Commission of 27 October and 22 November to the Minister for the Economy, the adjustment path was already at risk of a significant deviation in 2017 from both a one-year and two-year perspective (Table 2.8). In the scenario set out in the DBP, for which the estimates of the output gap were more unfavourable than those in the Commission's Spring Forecast 2017 and Autumn Forecast 2017 and therefore the fiscal effort required for 2016 and 2017 was relatively smaller,[30] the risk of a deviation on a one-year basis was equal to -0.5 percentage points, and therefore close to significance. In any event the risk of a significant deviation on a two-year basis remained.

Table 2.8 – Deviations and compliance with the structural balance rule for 2017 (1)
(percentage of potential GDP)

		2016 adjustment achieved - Commission Spring 2017 (-0.7)	2016 adjustment achieved recalculated - DBP 2018 (-0.8)
Adjustment required in 2016 and 2017 - Commission Spring 2017 (-0.33 in 2016 and 0.26 in 2017)	One-year	-0.6	-0.6
	Two-year	-0.50	-0.52
Adjustment required in 2016 and 2017 - DBP 2018 (-0.58 in 2016 and 0.16 in 2017)	One-year	-0.5	-0.5
	Two-year	-0.45	-0.35

Compliance | Deviation not significant | Deviation close to significant | Significant deviation

Source: based on data in the 2017 EFD Update and the Spring Forecast 2017.
(1) Compliance is achieved if the deviation of the structural adjustment from the required effort is nil or positive. If the one-year deviation is negative and between 0 and -0.5 (0 and -0.25 for the deviation over two years taken together), then the deviation is not significant. If the one-year deviation is negative and less than -0.5 (-0.25 for the deviation over two years taken together), then the deviation is significant.

[30] As noted in the *Staff Working Document* of the European Commission accompanying the opinion on the DBP, a more unfavourable output gap for 2017 is also confirmed using the so-called "constrained judgement approach" (see below), under which Italy could be considered to be experiencing bad economic times rather than normal times as used in the Commission forecasts. However, owing to the "unfreezing" principle, this would not change the fiscal effort required for 2017. As discussed in Box 1.6 on page 37 in European Commission, (2017), "Vademecum on the Stability and Growth Pact 2017 Edition", the required adjustment for a given year is revised only if the estimated output gap puts the economy in very bad times or exceptionally bad times, not in bad times, as in 2017. For 2016, however, the constrained judgement approach adopted the 2017 DBP 2017 in November 2016 as a basis, with a very similar outcome to that for this year, for which the assessment of that year was not changed.

For 2018, Table 2.9 presents and assessment of compliance with the structural balance rule by required structural adjustment, showing the risk of deviations. For that year, the assessment is less unfavourable than for 2017, especially in the event of a required effort of 0.3 percentage points, i.e. half that indicated in the matrix, consistent with the statement in the letter of the Minister for the Economy of 30 May 2017 and confirmed in the letter and the opinion on the DBP of 22 November 2017 of the European Commission. Nevertheless, the opinion itself emphasises that 0.3 points is the minimum required adjustment: in other words, no deviation for the year taken alone will be tolerated. Note, however, that even in this more favourable scenario, the risk of a deviation over two years taken together would be close to significant.

For 2019-2020, the policy scenario presented in the DBP contains a structural adjustment of 0.4 percentage points each year, achieving the MTO in 2020. As the required adjustment under the matrix is 0.6 percentage points each year, there is a risk of a one-year deviation of -0.2 percentage points in both years, which is not significant.

In the *Staff Working Document* accompanying the opinion on Italy's 2018 DBP,[31] based on the Autumn Forecast 2017, the European Commission estimates a structural deterioration in 2017 of 0.4 points of GDP (rather than the 0.3 estimated in the DBP; see also Box 2.3) and a structural improvement in 2018 of 0.1 percentage points (rather than the 0.3 estimated in the DBP). The differences arise from the slower nominal GDP growth estimated in the Autumn Forecast 2017, faster growth in expenditure, and differences in the method for estimating the rate of growth in potential GDP and the output gap.

Table 2.9 – Deviations and compliance with the structural adjustment rule for 2018 (1)
(percentage of potential GDP)

		Adjustment required in 2018 - Commission Spring 2017 (0.6)	Adjustment required in 2018 - Letter Minister for the Economy (0.3)
Adjustment required in 2017 - Commission Spring 2017 (0.26)	One-year	-0.3	0.0
	Two-year	-0.44	-0.29
Adjustment required in 2017 - DBP 2018 (0.16)	One-year	-0.3	0.0
	Two-year	-0.39	-0.24

Compliance | Deviation not significant | Deviation close to significant | Significant deviation

Source: based on data from the 2017 EFD Update and the Spring Forecast 2017.
(1) Compliance is achieved if the deviation of the structural adjustment from the required effort is nil or positive. If the one-year deviation is negative and between 0 and -0.5 (0 and -0.25 for the deviation over two years taken together), then the deviation is not significant. If the one-year deviation is negative and less than -0.5 (-0.25 for the deviation over two years taken together), then the deviation is significant.

[31] European Commission, (2017), "Staff Working Document – Analysis of the draft budgetary plan of Italy, Accompanying the document Commission Opinion on the draft budgetary plan of Italy".

The European Commission's forecasts indicate a risk of a significant deviation in 2017 as well, even after easing the required adjustment under the exceptional events clauses. For 2018, the Commission's opinion confirms that the required fiscal effort could be halved (0.3 instead of the 0.6 provided for under the matrix). However, as noted earlier, the Commission also emphasised that the adjustment of 0.3 percentage points is to be considered a minimum, i.e. "without any additional margin of deviation over one year". This means that the improvement of 0.1 percentage points projected in the Commission's Autumn Forecast 2017 would not be sufficient to ensure compliance with the rule.

As regards the long-standing debate over the methodology for estimating the rate of growth in potential GDP and the output gap, in April 2016 ECOFIN decided, in addition to revising the estimation method, to use a "constrained judgement" approach for countries whose output gap estimated using the commonly agreed methodology was inconsistent with certain key cyclical indicators, adopting a "plausibility tool"[32]. The constrained judgement approach was used in assessing the 2017 DBP and the 2017 Stability Programme.

For Italy, the European Commission, using the plausibility tool, concluded that the output gap for 2017 as estimated in the Autumn Forecast 2017 using the commonly agreed methodology was not consistent with a number of cyclical indicators and obtained a new estimate of -1.7 points. Even considering the new estimate produced using the plausibility tool, the required adjustment under the matrix has not changed owing to the application of the "unfreezing" principle (see note 30).

2.3.3 The expenditure benchmark

The expenditure rule is also at risk (Table 2.10) of a significant deviation from the path towards the MTO in 2017 on both a one-year and two-year basis. The risk of deviation is slightly lower, but still significant, if economic conditions (measured on the basis of the output gap) were assessed as more unfavourable as in the 2018 DBP, with a smaller required adjustment for the structural balance (and consequently a recalculated expenditure benchmark) in 2016 and 2017.[33]

[32] As discussed in Box 1.1, the plausibility tool is used to assess when a given estimate of the output gap is to be considered plausible on the basis of a series of cyclical indicators.
[33] However, the discussion in note 30 holds here too.

Table 2.10 – Deviations and compliance with the expenditure benchmark for 2017 (1)
(percentage of GDP)

		2016 deviation in expenditure - Commission Spring 2017	2016 deviation in expenditure recalculated - DBP 2018
Required structural balance adjustment 2016 and 2017 - Commission Spring 2017 (-0.33 in 2016 and 0.26 in 2017)	One-year	-0.9	-0.9
	Two-year	-0.39	-0.48
Required structural balance adjustment 2016 and 2017 - DBP 2018 (-0.58 in 2016 and 0.16 in 2017)	One-year	-0.8	-0.8
	Two-year	-0.34	-0.30

Compliance | Deviation not significant | Deviation close to significant | Significant deviation

Source: based on data from the 2017 EFD Update, 2018 DBP and the Spring Forecast 2017.
(1) The growth in the expenditure aggregate is calculated net of discretionary revenue measures and net of one-off items. Compliance is achieved if the deviation of the benchmark from actual expenditure growth is nil or positive. If the one-year deviation is negative and between 0 and -0.5 (0 and -0.25 for the deviation over two years taken together), then the deviation is not significant. If the one-year deviation is negative and less than -0.5 (-0.25 for the deviation over two years taken together), then the deviation is significant.

This assessment of the expenditure benchmark is much less favourable than can be inferred from the forecasts contained in the EFD from last April. The deterioration in the assessment of the expenditure rule is mainly due to a higher estimate for the rate of growth in total expenditure in the DBP than in the EFD (1.6 per cent, compared with the earlier 1.2 per cent; for more details, see Box 2.3) and the weaker estimated impact of the discretionary revenue measures net of one-offs (a negative impact of €3.5 billion in the DBP, compared with no impact in the EFD). Capital expenditure increases significantly (+€5.3 billion in the EFD Update/DBP compared with the EFD). This rise is primarily attributable to an increase in deferred tax assets (DTAs) recognised by some banks and transformed into refundable tax credits. Under ESA 2010 accounting rules, these are recognised under other capital transfers.

The DTAs represent the balance-sheet manifestation of income taxes that may be recoverable in future periods. According to international accounting standards (IAS 12), such assets arise in respect of: i) deductible temporary differences; ii) the carryforward of unused tax losses; and iii) the carryforward of unused tax credits. Deductible temporary differences emerge from temporary mismatching between accounting profit and taxable profit, often created by differences in the rules for recognising the value of assets: if the former is less than the latter, the reporting entity can recognise an asset in the amount of the greater prepaid taxes, which can be deducted from future taxable income. Accordingly, the deductibility of such "tax" assets is connected with the probability that, within a certain number of future financial years, the company will generate sufficient income to generate a tax liability against which the assets can be deducted. In consideration of this element of uncertainty, the Basel III rules establish that over a certain threshold, such assets do not form part of regulatory capital, penalising entities that have recognised substantial deferred tax assets.[34]

[34] This is the case of Italian banks, which due to a number of regulatory factors – for example, the impossibility of fully deducting loan losses in the year in which they were recognised – saw the value of their DTAs rise very rapidly during the economic and financial crisis.

A number of legislative changes introduced in 2010 and 2011 sought to reduce this penalty, providing for the automatic conversion – under certain conditions – of DTAs in respect of undeducted loan losses into tax credits, thereby increasing the value and liquidity of those assets. These regulatory changes also impact the recording of DTAs in the national accounts: Eurostat[35] has specified that the conversion of DTAs into tax credits requires that they be recorded under capital transfers at the time in which they are converted, in the entire amount of the credit; conversely, unconverted DTAs are recorded as a reduction in tax revenue in the years in which they are reversed. Following the issue of this Eurostat guidance in 2014, the tax rules limiting the deductibility of loan writedowns, contributing to the emergence of DTAs, were amended. The value of the latter should therefore decline over time as the stock of previous writedowns deductible over a long period of time (until 2023) is wound down.

The stock of DTAs recognised by entities, mainly in the banking sector, against undeducted loan losses can be transformed into tax credits if a loss is recorded by the entity in proportion to the impact of that loss on the value of assets. This is what occurred in 2016 in respect of the substantial loan losses recognised by a number of banks, generating sizable losses for the year, with the consequent need for recapitalisation. The substantial impact of those losses on bank balance sheets permitted the transformation of a significant share of DTAs into tax credits. The transformation of the DTAs into refundable tax credits (which helped the banks to reduce the different between the valuation of assets for reporting purposes and their valuation for supervisory purposes) impacts the public finances, in accordance with the rules established by Eurostat, by increasing other capital transfers.

In addition, the same item also reflects the updating, with the EFD Update/DBP, of the criteria for recording receipts from the sale of licenses: as noted in previous PBO documents[36] and in section 2.1, in the EFD they were recognised as a reduction in capital transfers, in contrast with the guidelines issued by Eurostat in March 2017, which recommended that such resources be accounted for on an annual basis under other current revenue.

For 2018, the DBP shows compliance with the rule on a one-year basis, considering a required structural adjustment of 0.3 (Table 2.11), equal to a maximum benchmark for expenditure growth of 0.5 per cent, which is consistent with the letter of the Minister for the Economy of 30 May 2017 and confirmed in the letter and opinion of 22 November 2017 of the European Commission. However, with a required structural adjustment of 0.6, which would be consistent with the matrix and the estimates of the cyclical position contained in the Commission's Spring Forecast 2017 and Autumn Forecast 2017**,** there would be a risk, albeit not significant, of a deviation on a one-year basis. On a two-year basis, the risk of a significant deviation is confirmed in all scenarios, although it would be smaller if the lower required structural adjustment were confirmed for 2017 or 2018.

[35] Eurostat (2014), "Treatment of deferred tax assets (DTAs) and recording of tax credits related to DTAs in ESA2010", Eurostat Guidance Note, 24 August.
[36] See Ufficio parlamentare di bilancio (2017), "2017 Budgetary Planning Report", note to Table 2.2a, page 53.

Table 2.11 – Deviations and compliance with the expenditure benchmark for 2018 (1)
(percentage of GDP)

		Required structural balance adjustment 2018 - Commission Spring 2017 (0.6)	Required structural balance adjustment 2018 - Letter Minister for the Economy (0.3)
Required structural balance adjustment 2017 - Commission Spring 2017 (0.26)	One-year	-0.1	0.2
	Two-year	-0.50	-0.35
Required structural balance adjustment 2017 - DBP 2018 (0.16)	One-year	-0.1	0.2
	Two-year	-0.45	-0.30

Compliance   Deviation not significant   Deviation close to significant
Significant deviation

Source: based on data from the 2017 EFD Update, 2018 DBP and the Spring Forecast 2017.
(1) The growth in the expenditure aggregate is calculated net of discretionary revenue measures and net of one-off items. Compliance is achieved if the deviation of the benchmark from actual expenditure growth is nil or positive. If the one-year deviation is negative and between 0 and -0.5 (0 and -0.25 for the deviation over two years taken together), then the deviation is not significant. If the one-year deviation is negative and less than -0.5 (-0.25 for the deviation over two years taken together), then the deviation is significant.

Note that, considering the deviations from the structural balance rule and the expenditure growth benchmark, it is possible that the European Commission could conduct an ex post assessment to establish if the preventive arm of the Stability and Growth Pact had been respected.

In its opinion on Italy's 2018 DBP, the European Commission asserts that the growth in net government expenditure is at risk of a significant deviation in 2017, even considering the exceptional events clause. The expenditure benchmark also points to a larger risk of a deviation for 2018 than that estimated in the DBP. The faster-than-forecast growth in net expenditure for 2018 in the Autumn Forecast 2017 compared with the projection in the 2018 DBP is mainly attributable to spending cuts planned by the MEF that the European Commission considers too ambitious.

Box 2.3 – Differences in estimates of the structural adjustment and expenditure growth

With regard to the assessment of compliance with the structural balance and expenditure growth rules for 2017, it is instructive to compare the estimates for those aggregates by the Government in the EFD last April with the more recent forecasts in the DBP published last October. In addition, at least for the structural balance, it is possible also possible to perform a comparison with the estimate in the Autumn Forecast 2017 (AF) of the European Commission.[37]

Differences in the estimated adjustment of the structural balance

Table R2.3.1 presents the differences between the DBP and the EFD, and between the DBP and the AF, in the estimates of the adjustment of the structural balance and its components for 2017.

As the left-hand side of the table shows, the difference in the estimates of the structural adjustment is relatively small between the EFD and the DBP. The estimated deterioration in the structural balance is only slightly less marked in the DBP than in the EFD. This reflects the fact that the estimation of a larger increase in the primary balance in the DBP is entirely explained by the estimation of a larger rise in the cyclical component, which is associated in turn with faster real GDP growth in the DBP than in the EFD. The slightly more favourable cyclical adjustment in the DBP than in the EFD is therefore almost entirely connected with a smaller estimated change in one-off measures.

The European Commission's Autumn Forecast 2017 shows a larger deterioration in the structural balance compared with both the DBP and the EFD. As the right-hand side of Table R2.3.1 shows, that difference is mainly attributable to a larger estimated cyclical component (about 0.1 percentage points of GDP greater) than in the DBP, due to the forecast of a larger improvement in the output gap (section 2.3.2).

Differences in the estimated growth in adjusted net expenditure

Table R2.3.2 presents the differences between the DBP and the EFD in the calculation of the change in adjusted net expenditure and its components.

Table R2.3.1 – Adjustment of the structural balance and its components for 2017 (1)
(percentage of GDP)

	EFD	DBP	Difference	AF	DBP	Difference
Change in structural balance (a= b-c-d-e)	**-0,34**	**-0,32**	**0,02**	**-0,43**	**-0,32**	**0,11**
Change in primary balance (b)	0,18	0,24	**0,06**	0,23	0,24	**0,01**
Change in cyclical component of balance (c)	0,51	0,57	**0,06**	0,68	0,57	**-0,11**
One-off change(d)	0,16	0,12	**-0,03**	0,12	0,12	**0,01**
Change in interest expenditure (e)[(2)]	-0,11	-0,12	**-0,01**	-0,13	-0,12	**0,01**

Source: based on data from the 2017 EFD, the 2017 EFD Update, the 2018 DBP and the Autumn Forecast 2017.
(1) Totals may not match due to rounding of decimals. – (2) The change in interest expenditure as a percentage of GDP is calculated as the difference in the ratio of interest spending to GDP at time t minus the same ratio at time t-1. This differs from that calculated in Table R2.3.2, which is equal to the difference between interest expenditure at time t and at time t-1 divided by GDP at time t.

[37] Currently available information is not sufficient to estimate all of the components of the growth in adjusted net expenditure consistent with the Autumn Forecast 2017 of the European Commission as all the data needed for the calculation are not published.

Table R2.3.2 – Change in adjusted net expenditure and its components for 2017(1)
(percentage of GDP)

	EFD	DBP	Difference
Change in nominal net expenditure corrected for one-off items (a = b-c-d-e+f-g-h-i)	**0.52**	**1.04**	**0.52**
Change in total expenditure (b)	0.60	0.78	**0.19**
Change in interest expenditure (c)(2)	-0.02	-0.04	**-0.02**
Change in expenditure financed with EU funds (d)	0.12	0.12	**0.00**
Change in net investment financed domestically (e)	-0.04	-0.09	**-0.05**
Four-year average change in net investment financed domestically (f)	-0.02	-0.02	**-0.01**
Change in cyclical unemployment expenditure (g)	-0.02	-0.03	**-0.01**
One-off change in expenditure (h)	0.02	-0.04	**-0.06**
Discretionary revenue measures net of one-offs (i)	0.00	-0.20	**-0.21**

Source: based on data from the 2017 EFD, the 2017 EFD Update and the 2018 DBP.
(1) Totals may not match due to rounding of decimals. – (2) The change in interest expenditure as a percentage of GDP is calculated as the difference between interest expenditure at time t and at time t-1 divided by GDP at time t. This differs from that calculated in Table R2.3.1, which is calculated as the difference in the ratio of interest spending to GDP at time t minus the same ratio at time t-1.

In this case, the differences between the estimates in the DBP and the EFD are larger. The estimated increase in adjusted net expenditure is about 0.5 percentage points of GDP larger in the DBP than it is in the EFD. The increase in spending is mainly attributable to an increase of just under 0.2 percentage points of GDP in total government expenditure in the DBP, accompanied by a decrease of about the same amount in the estimate of discretionary revenue measures net of one-off items. In addition, another factor is the admittedly more limited impact of other items, including a reduction of 0.05 points of GDP in the estimated change in investments financed with national funds (which are excluded from the total expenditure aggregate and replaced by the average for the previous four years) and a reduction of 0.06 points of GDP in the estimated change in one-off measures (which are also eliminated from the total expenditure aggregate). The other differences are marginal.

Currently available information is not sufficient to estimate all of the components of the growth in adjusted net expenditure consistent with the AF. Nevertheless, the estimated growth in adjusted net expenditure is lower for European Commission than in the DBP. This is mainly due to the estimate for the DRMs: according to the AF, the DRMs net of one-off measures in 2017 are estimated at 0.04 percentage points of GDP, compared with the estimate of -0.20 points of GDP published in the DBP. In addition, according to the AF projections, total government expenditure is expected to increase by 0.73 percentage points of GDP, less than the increase of 0.78 percentage points estimated in the DBP. The change in cyclical unemployment expenditure and the change in net investment financed domestically, both of which are eliminated from the spending aggregate used in the expenditure benchmark, are both greater in the AF than in the DBP. Finally, the change in interest expenditure is very similar, while that for one-off spending measures are virtually identical.

These differences (considerable in some cases) in the various components of the aggregates used for the fiscal rules in the different documents produced by the Government and the EU institutions make it difficult to assess the rules themselves. This underscores the importance that official documents should publish not only a detailed list of the components used to calculate the aggregates but also a more comprehensive explanation of the sources and methodological assumptions used for their estimation.

2.3.4 *The debt reduction rule*

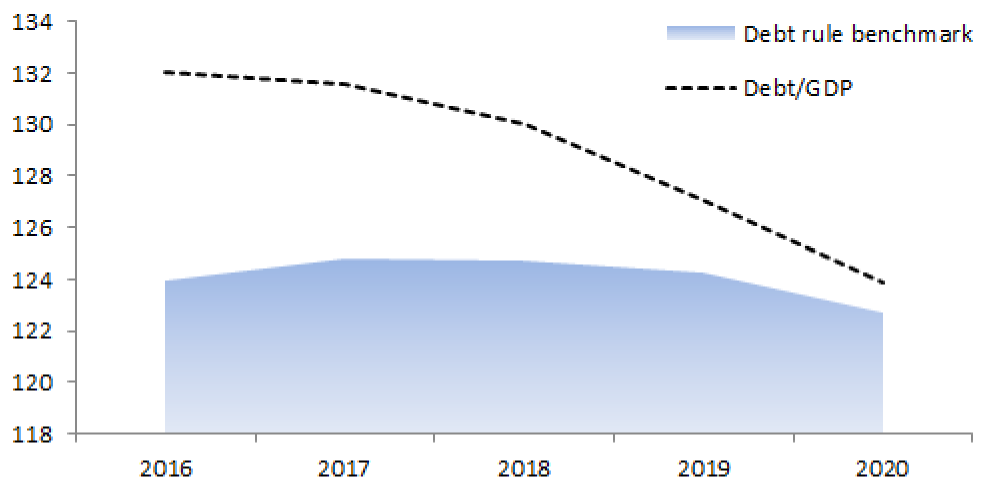
The developments in the planned debt/GDP ratio set out in the DBP show that after a slight increase in 2016 (to 132 per cent of GDP from 131.5 per cent in 2015), the ratio falls in 2017 (to 131.6 per cent) and 2018 (to 130 per cent), before declining more rapidly (to 127.1 per cent in 2019 and 123.9 per cent in 2020). Despite the decrease in the debt, the debt reduction rule is not complied with in the period covered by the DBP, either with the backward-looking criterion until 2020, or the forward-looking criterion until 2018, nor with the cyclically adjusted criterion (Figure 2.2).

As noted in previous Reports, compliance with the rule using the forward-looking method in a given year is the equivalent of complying with the rule using the backward-looking approach two years after the reference year. For example, complying with the rule using the backward-looking approach in 2020 implies compliance with the rule in 2018 using the forward-looking criterion. This also means that given the current state of information it is not possible to assess compliance with the rule using the forward-looking approach for 2019-2020, because that would require projections for the debt/GDP ratio for 2021-2022.

In its opinion on Italy's 2018 DBP, based on the Autumn Forecast 2017, the European Commission projects an increase in the debt/GDP ratio in 2017 (rather than the reduction forecast in the DBP) to 132.1 per cent, and a reduction to 130.8 per cent in 2018, less than that presented in the DBP. So the Commission's forecasts also point to non-compliance with the debt reduction rule in both 2017 and 2018.

In its statement of 4 December, the Eurogroup noted that Italy, like France and Belgium, was not in compliance with the debt reduction benchmark. The Eurogroup ministers therefore invited those countries to "consider" in a timely manner the necessary additional measures to address the risks identified by the Commission and to ensure that their 2018 budget will be compliant with SGP provisions.

Figure 2.2 – Compliance with the public debt/GDP reduction rule
(percentage of GDP)



Source: based on data from the 2018 DBP.

2.4 *Medium-term sustainability of the public debt*

The analysis of medium-term sustainability consists of two parts: 1) a deterministic analysis with the formulation of a baseline scenario in which the policy developments in the debt/GDP ratio presented in the DBP are extended until 2026 using ad hoc assumptions and subjected to sensitivity analysis; 2) a stochastic analysis in which the variables that affect developments in the debt/GDP ratio are exposed to temporary and permanent shocks in order to obtain a large number of scenarios for the ratio over the coming decade and determine their probability intervals.

The ad hoc assumptions to extend the policy trajectory for the debt/GDP ratio in the DBP from 2021 to 2026 include: 1) the gradual convergence of real growth towards 1 per cent, the rate of inflation to 2 per cent and short and long-term interest rates to 3 and 4.5 per cent respectively; 2) a primary budget balance sufficient to achieve a structural position close to balance; and 3) a zero stock-flow adjustment. The extrapolation was conducted using a method similar to that adopted by the European Commission for the analysis of the sustainability of the public debt.[38]

With these assumptions, in the baseline scenario the debt/GDP ratio continues to decline after 2020. Nevertheless, at the end of the forecasting period in 2026, the ratio is still above 100 per cent, at just over 102 per cent (Figure 2.3, panel a)).

These developments are compared with those in the debt/GDP ratio consistent with the PBO's projections for real GDP growth and the GDP deflator.

After 2020 the same assumptions used in the baseline scenario for developments in the real GDP growth rate and the inflation rate are retained. By contrast, for the entire 2017-2026 period, the ratio between the primary surplus and GDP is calculated by applying an elasticity for the ratio of 0.539,[39] to be applied to the difference in real growth between the PBO scenario and the DBP scenario. In addition, we assume that the change in prices is partially reflected in interest rates. The stock-flow adjustment is unchanged from that in the DBP policy scenario.

In both scenarios, the debt/GDP ratio declines by the end of the DBP forecasting horizon and continues to do so in the subsequent years. However, in the PBO macroeconomic scenario, the decline is shallower, causing the two trajectories to diverge by about 1 percentage point of GDP in 2020, and by more than 3 points in 2026.

The exercise also analyses the impact on the debt/GDP ratio of a structural primary balance unchanged from its 2017 value, a scenario that would produce a further slowdown in the path of adjustment towards the MTO (Figure 2.3, panel b)). The assumptions imply a lower structural primary balance than the baseline figure from 2019 onwards. In this scenario, the debt/GDP ratio[40] is still declining but less steeply that that presented in the DBP, reaching about 107 per cent of GDP at the end of the

[38] See also Ufficio parlamentare di bilancio (2016), "2017 Budgetary Policy Report", Appendix 3.3.
[39] In line with that estimated by the OECD and the European Commission.
[40] This sensitivity analysis used the dynamic fiscal multipliers of the Istat-PBO macroeconometric model, which were calculated by assuming a permanent change of one point of GDP in the budget balance. They are equal to about 0.23 in the first year, about 0.43 in the second, before gradually rising to about 0.55 in the fifth. These simulations assume that that value is unchanged in the subsequent years.

forecasting period, with a difference of about 5 percentage points compared with the baseline scenario.

In order to assess the impact of a rapid increase in rates (caused by a change in monetary policy stance or an increase in credit risk) on the sustainability of the debt, the exercise simulated a 100-basis point shock on the yield curve for each of the years in the forecasting period of the DBP (Figure 2.3, panel c)). From 2021, the assumptions used in the DBP scenario are replicated (convergence of short-term rate to 3 per cent and the long-term rate to 4.5 per cent). Once again, the debt/GDP ratio trajectory, while remaining above that in the DBP scenario, begins to decline in 2018. The divergence between the two scenarios remains below 3 percentage points of GDP over the forecasting horizon (2.5 percentage points in 2020 and about 2 percentage points in 2026).

As discussed in section 2.1, the public finance policy scenario presented in the 2018 DBP is exposed to risks associated with its actual implementation, first and foremost the low probability that the increases in indirect taxes provided for in current legislation will be adopted. It is therefore of interest to simulate developments in the debt/GDP ratio assuming the deactivation of the remaining safeguard clauses for indirect taxes in 2019-2020 without offsetting budgetary measures. This assumption would produce a deterioration in the structural primary balance of about 0.7 per cent of GDP in 2019 and 1 per cent from 2020 until the end of the period of extrapolation beyond the baseline.

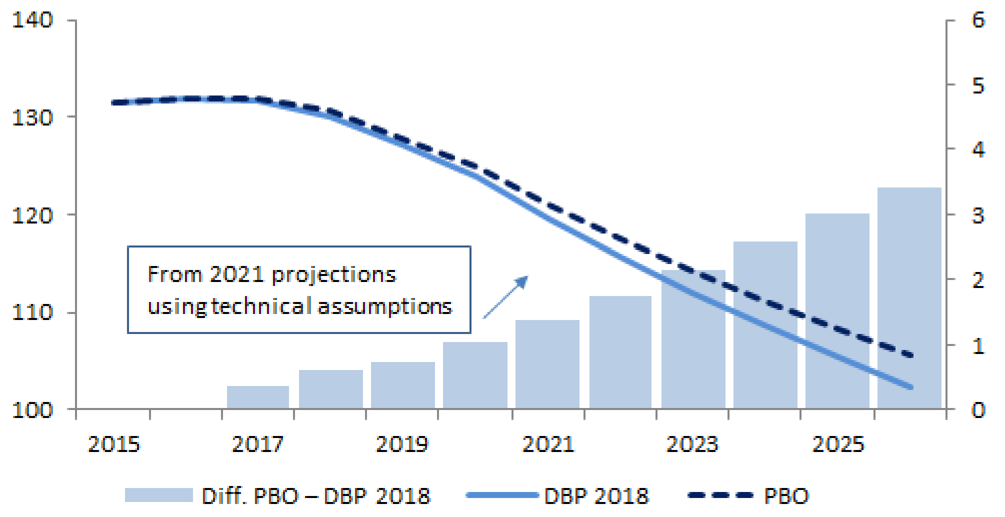
In this scenario, the debt/GDP ratio still falls, but more slowly than in the DBP, reaching around 109.5 per cent at the end of the period of extrapolation, a difference of about 7.2 percentage points compared with the baseline scenario (Figure 2.3, panel d)). Bear in mind that this difference could be a minimum considering the fact that this simple exercise assumed that the rate of change in the GDP deflator is identical to that in the DBP, whereas the absence of an increase in VAT rates should have a negative impact on inflation.

Finally, we consider a scenario in which in addition to the deactivation of the safeguard clauses without offsetting budgetary measures we also assume no privatisation receipts from 2018 to 2020, totalling 0.9 percentage points of GDP (about €16 billion). In this case, the debt/GDP ratio would fall even more slowly, about 8 percentage points of GDP less in 2026 compared with the baseline scenario (Figure 2.3, panel e)).

The backward-looking debt rule would be complied with in 2021 in both the DBP and PBO scenarios. However, in the scenario assuming a structural primary balance unchanged on that in 2017 and in that with higher interest rates, compliance would be achieved the following year. In the 2018 DBP scenario without VAT safeguard clauses and in the 2018 DBP scenario without clauses or privatisation receipts, there would be no compliance with the backward-looking debt rule over the entire medium-term forecasting period.

Figure 2.3 – Developments in the debt/GDP ratio in selected macroeconomic scenarios *(percentage points)*

a) DBP and PBO forecasts



b) DBP with unchanged structural primary balance

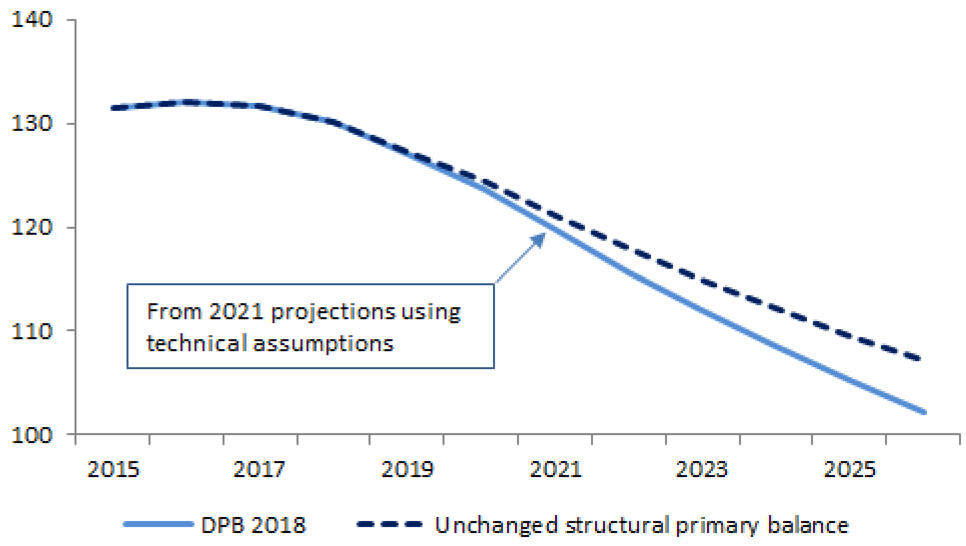
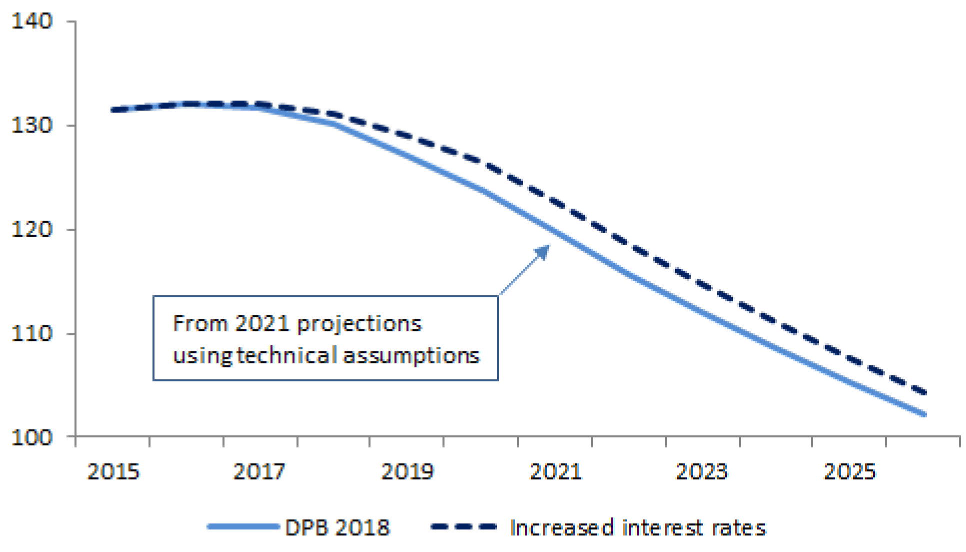


Figure 2.3 – *(cont.)* Developments in the debt/GDP ratio in selected macroeconomic scenarios
(percentage points)

c) DBP with 100-basis-point shock to yield curve



d) DBP with full deactivation of VAT clauses (2019-2020)

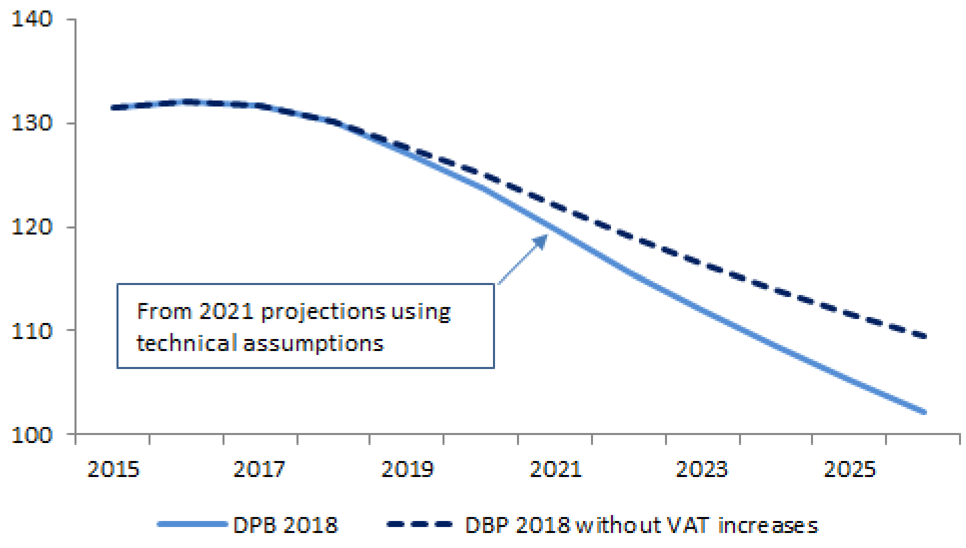
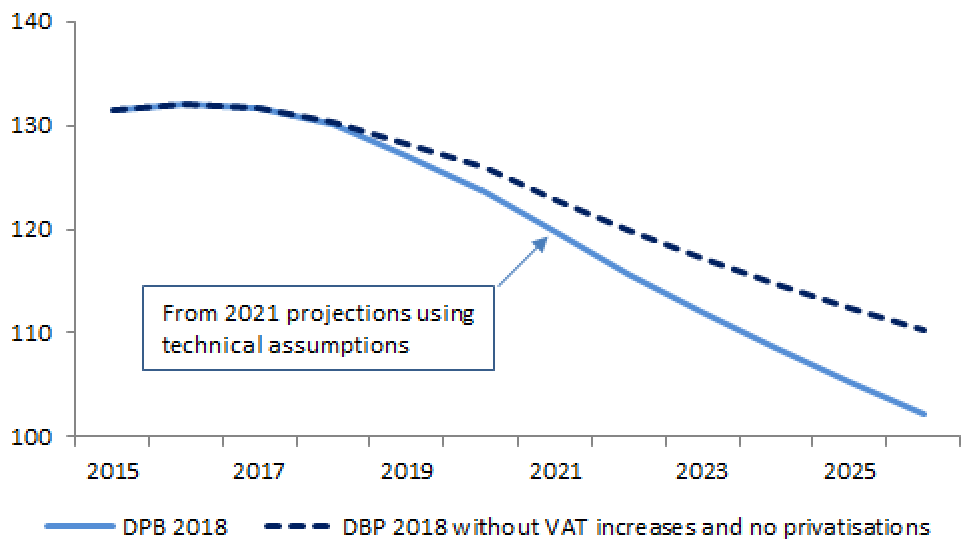


Figure 2.3 – *(cont.)* Developments in the debt/GDP ratio in selected macroeconomic scenarios
(percentage points)

e) DBP with full deactivation of VAT clauses (2019-2020) and no privatisations



Source: based on data from the 2018 DBP.

Finally, in order to take account of the uncertainty in the estimates, the DBP's policy scenario is compared with probability intervals obtained using statistical techniques consistent with those used by the European Commission and the International Monetary Fund.[41] More specifically, we have estimated 5,000 possible trajectories for the debt/GDP ratio, considering developments in the ratio that are consistent with the PBO macroeconomic forecasts discussed in the previous section. This enabled the construction of a probability fan chart under an assumption of temporary and permanent shocks to the variables that affect the behaviour of the debt (Figure 2.4).

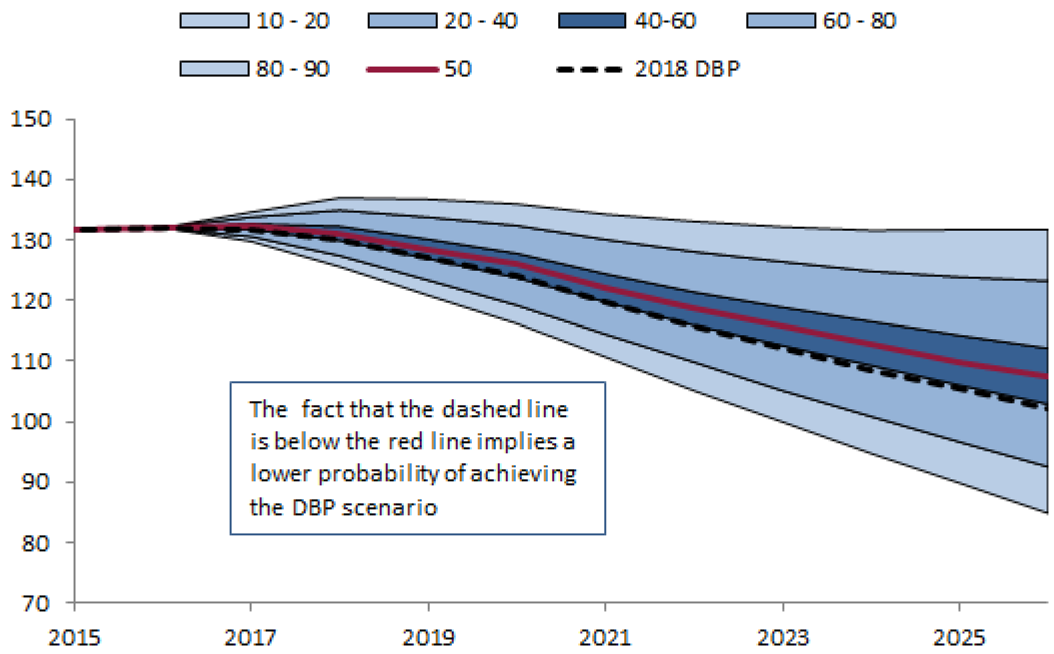
Using the equation describing debt dynamics, alternative debt/GDP ratio scenarios are obtained by shocking the variables that characterise the equation itself: the real GDP growth rate, the GDP deflator growth rate, the short-term interest rate and spreads between short- and long-term interest rates.[42]

Given the PBO's macroeconomic forecasts, the distribution obtained in the case of temporary shocks puts the DBP policy debt/GDP ratio near the 40th percentile: This means that 60 per cent of the scenarios generated show the debt/GDP ratio at higher levels than that projected in the DBP scenario.

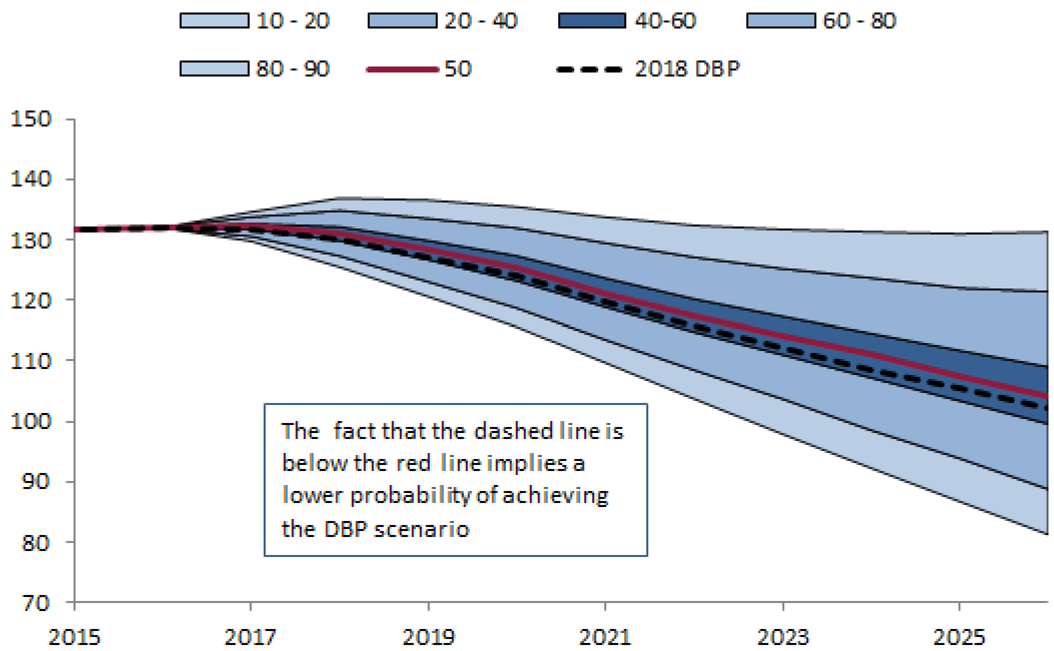
[41] See Berti, K. (2013), "*Stochastic public debt projections using the historical variance-covariance matrix approach for EU countries*", European Commission, *Economic Papers* 480, April.
[42] The assumption of temporary shocks provides for changes in the variables that determine developments in the debt/GDP ratio whose effects are limited to the year of the shock. The assumption of permanent shocks provides for persistent shocks over time with regard to interest rates.

Figure 2.4 – Stochastic analysis of temporary shocks and permanent: DBP policy scenario compared with PBO scenario
(percentage points)

a) Temporary shocks



b) Permanent shocks



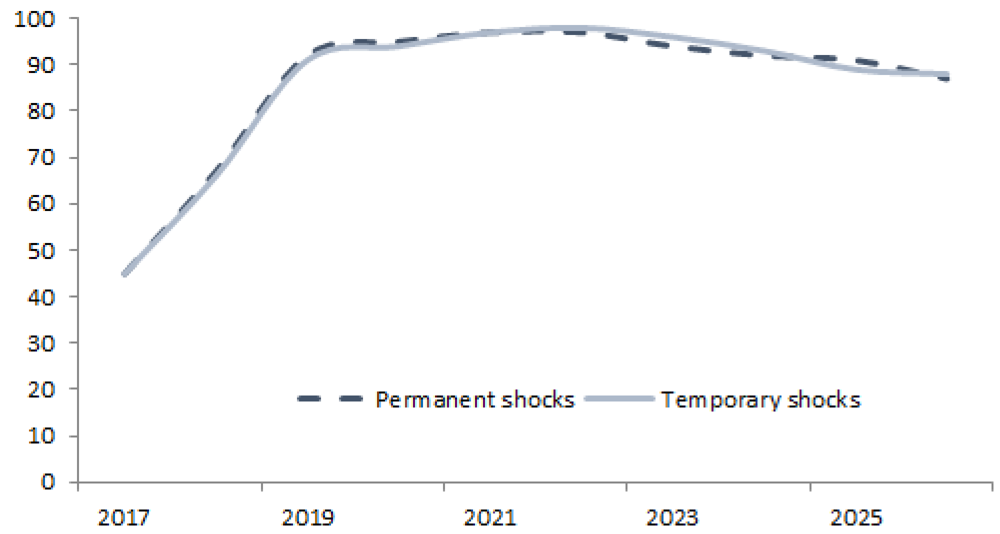
Source: based on date from the 2018 DBP.

Under the assumption of permanent shocks, the distribution of values for the debt/GDP ratio is slightly broader. In particular, while the values in the ninth decile of the distribution are similar to those obtained with temporary shocks, all of the lower deciles (including the median) are shifted lower. Accordingly, the extrapolated scenario for the DBP policy debt/GDP ratio is assigned a slightly higher probability of achievement, as it is relatively closer to the median of the distribution. This reflects the fact that the interest rate shocks are cumulative, as their baseline value is the short-term interest rate in the first forecasting year (which is currently very low).

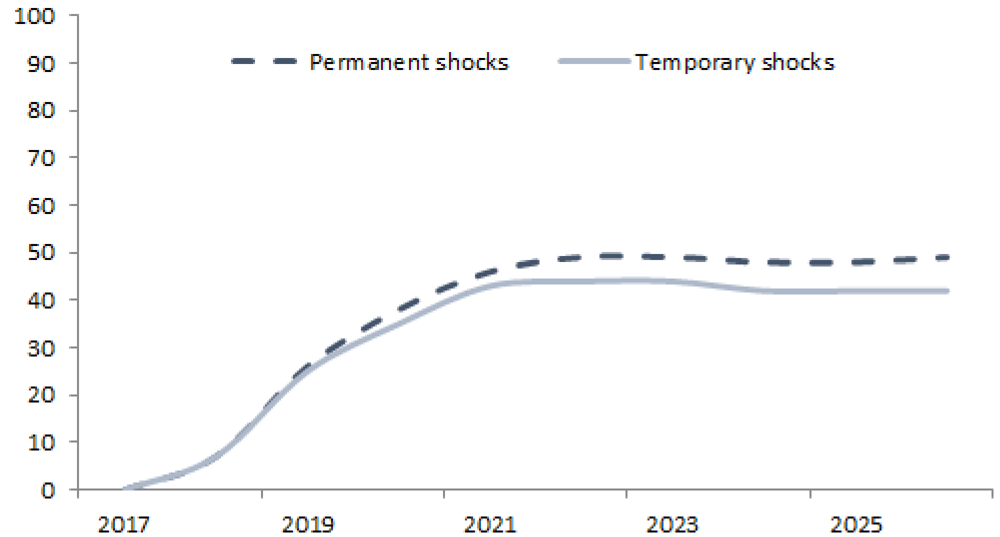
Figure 2.5 reports the probability of a decline in the debt compared with the previous year (panel a)) and of compliance with the debt rule using the backward-looking criterion (panel b)) in the presence of temporary and permanent shocks.

Figure 2.5 – Stochastic analysis of temporary and permanent shocks: implicit probabilities
(percentage points)

a) Debt declining compared with previous year



b) Compliance with the debt rule



Source: based on data from the 2018 DBP.

The analysis finds that the probability of a decrease in the debt/GDP ratio compared with the previous year is similar over the entire simulation horizon for both temporary and permanent shocks. It is about 45 per cent in 2017 and rises in subsequent years, stabilising above 90 per cent from 2019 onwards.

As regards the backward-looking debt rule, the findings show a probability of around 35 per cent in 2020, the final year in the DBP horizon. In subsequent years, that probability increases in both scenarios, but remains below 45 per cent in the case of temporary shocks and around 50 per cent in the case of permanent shocks.

3 MAIN MEASURES OF THE 2018 BUDGET BILL

The budget package contains the usual measures for the total and partial sterilisation of the safeguard clauses increasing the rates of VAT and excise taxes in the first and second years of the policy horizon, a number of measures of significant importance from a financial standpoint and with regard to the general design of economic policy and by a large number of small sectoral measures.

This chapter examines the most important of these provisions: the permanent three-year social contribution relief for hiring of young people and students who have never held a job before (section 3.1), measures in favour of the employees of companies in difficulty (section 3.2), anti-poverty measures, including the strengthening of the Inclusion Income (section 3.3), and measures combatting tax evasion (section 3.4), in favour of firms (section 3.5), measures concerning public employees (section 3.6), measures for direct public investment (section 3.7), provisions for local government finance (section 3.8) and healthcare (section 3.9) and the reorganisation of financial relations between the State and INPS (section 3.10).

For each of these issues, the analysis generally regards the provisions in the Budget Bill as presented to Parliament for examination. Where necessary, account is also taken of amendments made in the Senate to the legislation during the approval process.[43]

3.1 *Contribution relief for young people*

The Budget Bill continues efforts to sustain open-ended employment with the introduction of a structural incentive for young people under the age of 30 and a specific incentive, for 2018 only, for professional farmers and smallholders under the age of 40. In addition, the foundations for the extension of the relief introduced for 2017 in southern Italy are established. These measures come at a time when the effects of previous social contribution relief mechanisms are waning: the full three-year contribution relief scheme of 2015, the reduced two-year scheme of 2016, the exemption for southern Italy and that connected with the "Youth Guarantee" programme of 2017.

The first measure introduced with the Budget Bill establishes that as from 2018 for each new hire on an open-ended contract and for each transformation of a fixed-term contract into a permanent position,[44] private-sector employers will benefit for the first 36 months of the contract from an exemption of 50 per cent of social contributions charged to the employer (excluding those paid to INAIL), up to a maximum of €3,000 per year. The contributions will be entirely financed out of general taxation with no impact on benefits granted to workers. The

[43] The Senate amendments also introduced pension and welfare measures, the web tax and a number of changes to "super" co-payments on prescriptions, which will be the focus of upcoming Flash Papers prepared by the PBO.

[44] Excludes management positions.

relief does not apply to domestic workers or apprentices and cannot be combined with other reductions (partial or total) in contribution rates.

Once fully in place, the benefit will apply to under 30s who have never held an open-ended job,[45] but in the first year (2018) eligible beneficiaries will also include persons under 35 years of age. The benefit is portable, so a worker who gets a new open-ended job with another employer will continue to benefit from the residual part of the relief (regardless of the age at which the change occurs). Certain conditions also apply to employers, who in order to qualify for the benefit must not have fired other workers in the same production unit for justified cause or as part of a collective procedure and, in order to avoid having to return the benefits received, must not fire for justified cause either the worker hired under the relief mechanism or other employees in the same production unit at the same career level.[46]

Another version of contribution relief applies for apprenticeship contracts that, following 31 December 2017, are transformed into open-ended positions. In this case, the employee must be under 30 years of age and the portability of the benefit and the constraints on the employer restricting past and future terminations do not apply.[47]

Specific rules also apply in the case of employers who hire young people within six months of their having obtained an educational qualification who had worked with the employer under a work experience programme or advanced training scheme.[48] In this case, the relief is increased from 50 to 100 per cent without prejudice to the age limits and the maximum benefit (€3,000 per year).

Another measure in the Budget Bill establishes a contribution relief mechanism for under-40s who enrol in an agricultural pension scheme in 2018 as professional farmers or smallholders. The mechanism creates a total exemption on contributions for disability, old-age and survivors pensions for an initial maximum of 36 months, 66 per cent relief for an additional 12 months and 50 per cent relief for a maximum additional period of 12 months. The benefit calculation rate remains unchanged. The benefit may not be combined with other total or partial reductions in contribution rates and is subject to EU “de minimis” rules. According to the technical report, the measure is expected to reduce contribution revenue by €7.4 million in 2018 and something on the order of €20 million in each year of the 2019-2021 period, before falling to zero until 2025. The mechanism is the same as the sectoral relief begun in 2017 and can be considered as an extension of more selective employment stimulus measures, together with the new incentives for young people.

Finally, the Budget Bill also envisages the possibility – which must be activated by the competent ministries and by ANPAL (the Active Labour Policy Agency) – of dedicating national programmes co-financed with European resources to encourage permanent hiring in southern Italy of young people under 35 years of age or older persons if they have not had a regular paid job in at least six months. The incentives can also take the form of total contribution relief (excluding INAIL contributions) up to an annual maximum of €8,060 per new employee or transformation into a permanent job. As was the case the previous year, the Budget Bill prepares the way for specific measures for southern Italy that could be implemented during the year, taking account of developments in local economies and in available funds. The decision to delegate actual activation of the measures and

[45] Employees who had apprenticeships with other employers that were not transformed into permanent positions are also eligible.

[46] In the event of a violation of these requirements, the benefits already received must be returned, but another employer who hires the worker on an open-ended contract could still be eligible for the remaining benefits.

[47] During the first year following the transformation of the contract into an open-ended position the contribution relief previously established for apprenticeships shall continue to apply. The new relief mechanism shall apply as from the first month of the second year (Art. 47, paragraph 7, Legislative Decree 81/2015).

[48] The measure replaces the contribution relief in favour of the dual system introduced with the 2017 Budget Act (Art. 1, paragraphs 308-310). The programmes include training apprenticeships, vocational diplomas, secondary school diplomas, advanced technical specialisation certificates and advanced training programmes.

the details of their design to ANPAL (the technical institution created for this purpose) is consistent with the objective of improving the targeting of the measure.

This section offers an analysis of the permanent contribution relief mechanism for young people and its impact on labour costs, with an overview of the main results of previous relief measures.

On the basis of the estimates in the technical report, the structural contribution relief mechanism will result in new jobs/transformations into permanent contracts for about 424,000 individuals in 2018, 734,000 in 2019 and more than 1 million a year as from 2020. Gross of tax effects, the reduction in contribution revenue is forecast at about €380 million in 2018, €1.2 billion in 2019, €1.9 billion in 2020 and about €2.4 billion a year as from 2021.[49]

About 87 per cent of the reduction in gross revenue and 89 per cent of the subsidised contracts assumed in the technical report are attributable to persons outside the agriculture sector and not in apprenticeships or work-experience programmes. For this category, the technical report forecasts 350,000 new hires in 2018 (when the pool of eligible beneficiaries includes individuals under the age of 35), 290,000 in 2019 and 300,000 as from 2020 onwards (when the eligible beneficiaries must be under 30 years of age). Given these flows and considering the three-year duration of the benefit, the stock of facilitated contracts for this group of beneficiaries will number 900,000.

On the expenditure side, the technical report assumes average relief of €2,315 in 2018 and about €2,300 in subsequent years. This would correspond to annual gross earnings of about €15,000.

Both of the estimates in the technical report (for the pool of potential beneficiaries and total spending) appear relatively optimistic in view of INPS data for 2015 and 2016.

More specifically, as regards the pool of beneficiaries, in 2015 – the year the three-year full contribution exemption was introduced – the number of contract activations regarding persons under the age of 30 was just under 298,000 (27.6 per cent of new hires under subsidised open-ended contracts) and in 2016 – when relief mechanism provided for a two-year 40 per cent exemption – the corresponding new contracts numbered just under 130,000 (31.3 per cent) (Table 3.1). Moreover, in 2015 and 2016 there was no first-job condition for eligibility for contribution relief.[50] Nevertheless, the possible overestimation in the technical report would avoid the risk of having insufficient funding to support a stronger reaction by the labour market in an improved macroeconomic environment compared with 2015 and 2016.

[49] Corrected for tax effects, the reduction in contribution revenue is forecast to be €381 million in 2018, just over €1 billion in 2019, €1.5 billion in 2020 and about €1.8 billion a year as from 2021.

[50] Accordingly, the observed flows were presumable larger than those that could be generated in 2018. The same conclusion is also suggested by the fact that, unlike the previous two contribution relief measures, the measure is now permanent (the first three years of every open-ended employment contract) and it is therefore unlikely that hires planned for subsequent years will be anticipated to 2018, as was instead the case in 2015 and 2016 (see below).

Table 3.1 – New hires and transformations to open-ended contracts with contribution relief in 2015 and 2016

(number of beneficiaries and percentage distribution by age group)

	New open-ended jobs with contribution relief				Transformations to open-ended jobs with contribution relief			
	2015	2016	2015 (1)	2016 (1)	2015	2016	2015 (1)	2016 (1)
Males								
Up to 24	72,643	34,693	60.8%	59.3%	17,540	13,564	63.2%	62.3%
From 25 to 29	99,849	39,626	56.1%	56.0%	33,521	20,187	55.0%	54.6%
From 30 to 39	193,032	72,130	58.2%	58.4%	71,057	38,531	59.1%	59.7%
From 40 to 49	158,700	58,348	60.0%	60.6%	60,065	31,637	61.9%	62.1%
50 and over	123,652	43,887	66.7%	68.0%	39,094	19,374	67.7%	67.8%
Total	**647,876**	**248,684**	**60.0%**	**60.1%**	**221,277**	**123,293**	**60.8%**	**60.8%**
Females								
Up to 24	46,867	23,827	39.2%	40.7%	10,212	8,217	36.8%	37.7%
From 25 to 29	78,291	31,165	43.9%	44.0%	27,411	16,795	45.0%	45.4%
From 30 to 39	138,537	51,301	41.8%	41.6%	49,158	25,960	40.9%	40.3%
From 40 to 49	105,814	37,992	40.0%	39.4%	36,933	19,341	38.1%	37.9%
50 and over	61,685	20,662	33.3%	32.0%	18,665	9,205	32.3%	32.2%
Total	**431,194**	**164,947**	**40.0%**	**39.9%**	**142,379**	**79,518**	**39.2%**	**39.2%**
Overall								
Up to 24	119,510	58,520	11.1%	14.1%	27,752	21,781	7.6%	10.7%
From 25 to 29	178,140	70,791	16.5%	17.1%	60,932	36,982	16.8%	18.2%
From 30 to 39	331,569	123,431	30.7%	29.8%	120,215	64,491	33.1%	31.8%
From 40 to 49	264,514	96,340	24.5%	23.3%	96,998	50,978	26.7%	25.1%
50 and over	185,337	64,549	17.2%	15.6%	57,759	28,579	15.9%	14.1%
Total	**1,079,070**	**413,631**	**100.0%**	**100.0%**	**363,656**	**202,811**	**100.0%**	**100.0%**

Source: based on data from the INPS Osservatorio sul precariato (private-sector payroll employees excluding domestic workers and farmhands; includes employees of public economic entities). The figures are drawn from the update released in October 2017, which includes data for the first eight months of 2017.
(1) For these breakdowns, the percentages regard the size of each item as a proportion of the corresponding total item. For the aggregate, the percentages represent the size of each item as a proportion of the annual total.

As regards the estimated expenditure connected with the measure, the gross earnings of €15,000, which are derived implicitly from the amount of the average contribution relief considered, seems relatively low both compared with starting wages on full-time open-ended contracts and compared with average gross earnings of about €23,000 in 2014, €22,700 in 2015 and €23,600 in 2016 observed by INPS with regard to total new open-ended jobs (including those receiving contribution relief and those not benefitting)[51]. It is however possible that it has been assumed that a not-insignificant portion of the new jobs would be part-time positions.[52]

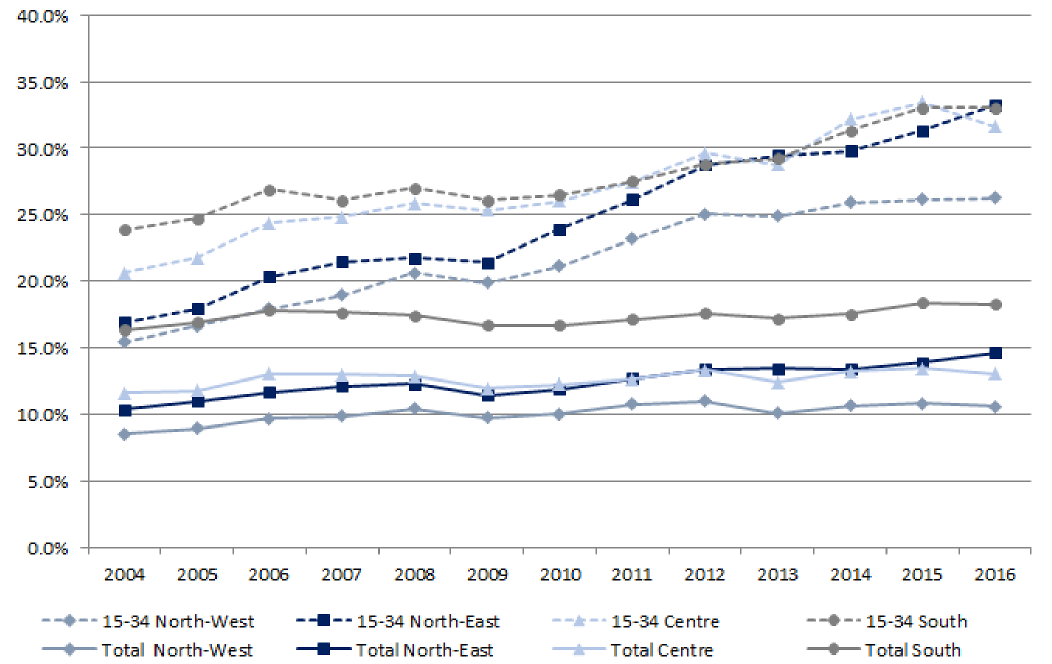
[51] According to Eurostat data (*Structure of earnings survey: annual earnings*), for under 30s, annual gross earnings on full-time employment contracts (not necessarily open ended and not necessarily new hires) averaged €25,000 in 2014 (the most recent data available). The same data put average gross earnings at just over €27,000 for workers (of all ages) with less than one year of seniority with their current employer (only employers with at least 10 payroll employees).

[52] In 2014-2016 and in the first eight months of 2017, more than 40 per cent of new open-ended contracts were part-time positions. The figure is also confirmed if we go from the data on contract activations from the INPS Osservatorio sul precariato (published on the INPS website) to those on beneficiaries: part-time positions accounted for 40 per cent of the stock of beneficiaries of the three-year contribution relief mechanism at December 2015 and 43 per cent of beneficiaries of the two-year relief mechanism at December 2016.

The measures appear to be motivated by the need: i) to take action for a segment of the population characterised by relatively high unemployment rates[53] and rates of precarious work that has already proved to be responsive to hiring incentives and ii) to attenuate the effect of the expiry of the previous incentive mechanisms.

With regard to the former aspect, INPS data show that in 2015 and 2016, the response of the under-30 segment to the contribution relief measures was substantial. In 2015, nearly 28 per cent of new hires and 25 per cent of transformations into permanent contracts regarded individuals under 30 years of age. In 2016 the corresponding proportions were more than 31 per cent and nearly 29 per cent respectively. In the transition from the full contribution relief in force in 2015 to the reduced relief available in 2016, the proportion of new open-ended contracts involving under 30s increased by about 5 percentage points. Nevertheless, this did not prevent an increase in both 2015 and 2016 in the share of fixed-term contracts, continuing the trend under way since the start of the crisis, especially in the Centre-North of the country (Figure 3.1).

Figure 3.1 – Employees on fixed-term contracts as a ratio to total payroll employees *(15-34 age group and all ages)*



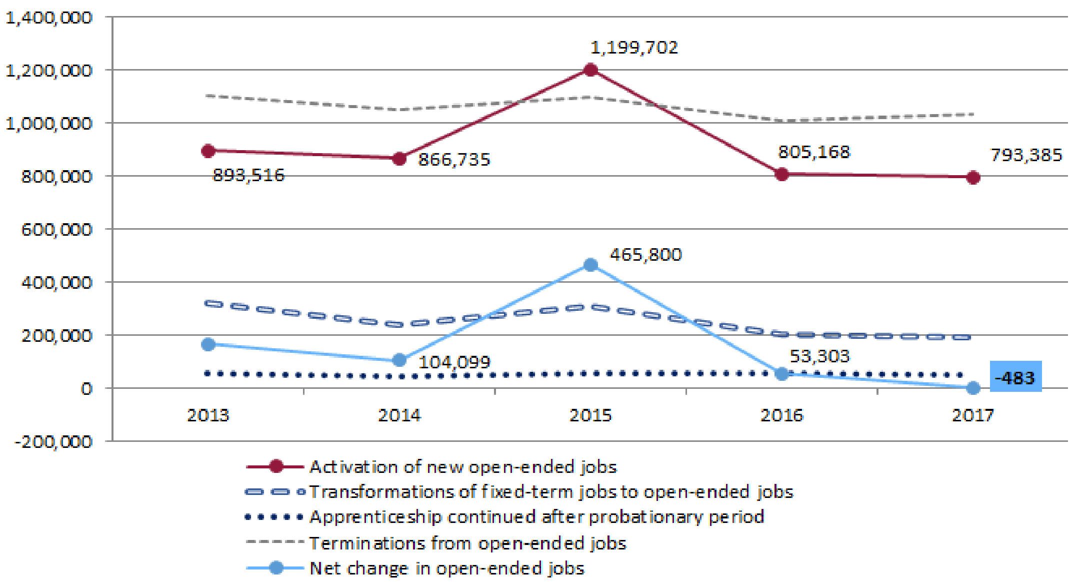
Source: based on Istat data (online database).

[53] According to Istat figures, in the second quarter of 2017, the unemployment rate for under 30s was 17.9 per cent in the North-West, 13.6 per cent in the North-East, 23 per cent in the Centre and 42.1 in southern Italy, compared with overall unemployment rates of 7.3, 6.1, 8.7 and 15.5 per cent respectively. In addition, in the second quarter of 2017, the fixed-term positions accounted for 29 per cent of total payroll positions in the North-West, 36.5 per cent in the North-East, 35.8 per cent in the Centre and 35.2 per cent in the South, with a constant rising trend over at least the past ten years. For all age groups, the proportion of fixed-term contracts was 11.7 per cent in the North-West, 16.4 per cent in the North-East, 15.4 per cent in the Centre and 19.3 per cent in the South.

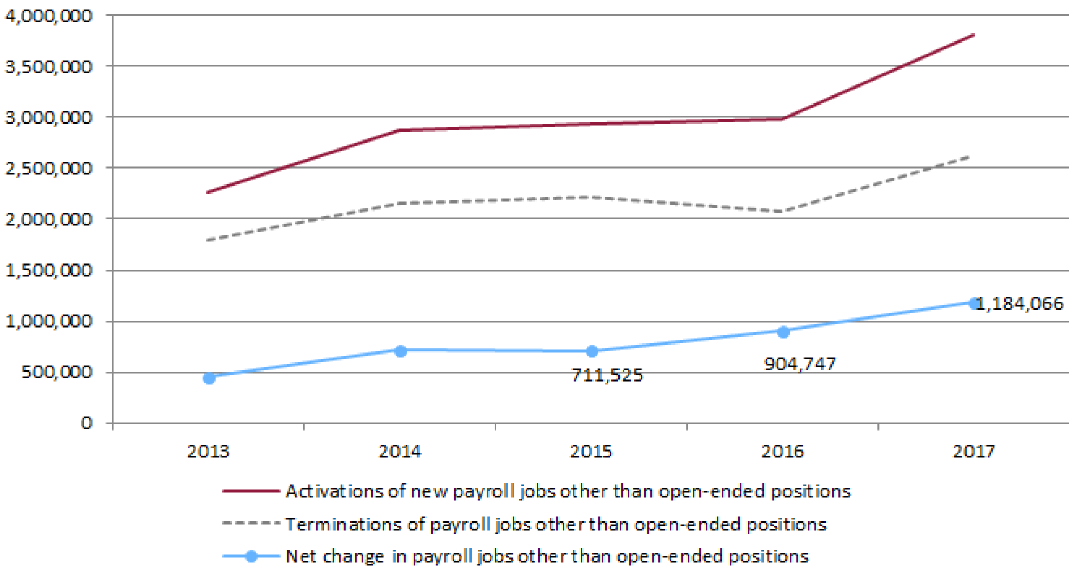
With regard to the desire to attenuate the impact of the expiry of previous relief measures, despite the improvement in macroeconomic conditions, INPS data for the first eight months of 2017 show that compared with the corresponding period in the two previous year the number of net new open-ended positions declined, while the number of fixed-term jobs increased significantly (Figure 3.2).

Figure 3.2 – New hires, transformations and terminations of payroll employees in the first eight months of the year

Open ended



Fixed term

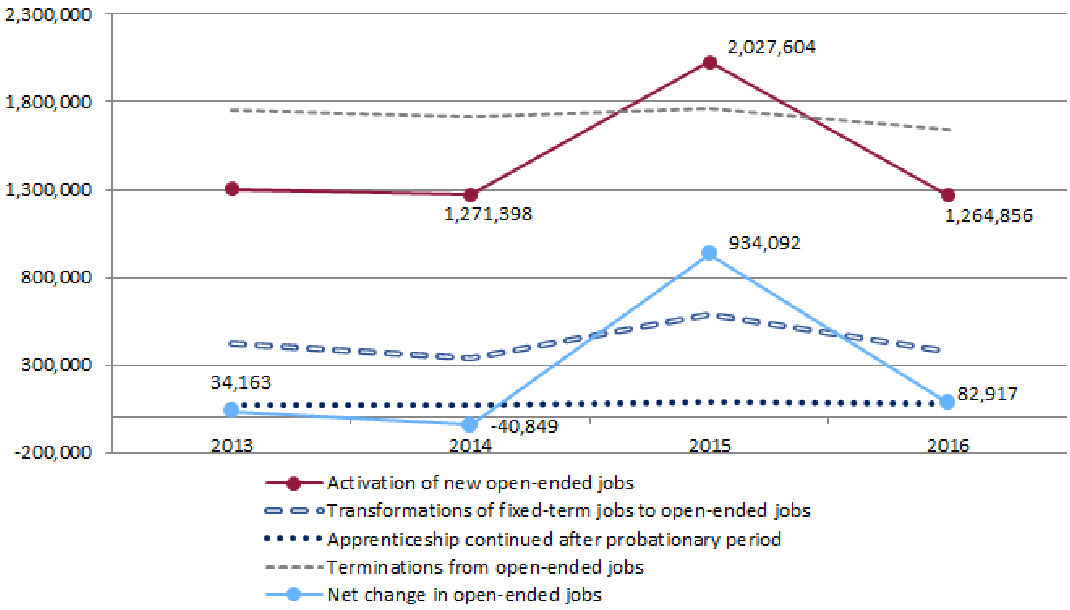


Source: based on data from the INPS Osservatorio sul precariato (private-sector payroll employees excluding domestic workers and farmhands; includes employees of public economic entities). The figures are drawn from the update released in October 2017, which includes data for the first eight months of 2017. The updates of the INPS Osservatorio sul precariato are given in sequence, enabling the reconstruction of developments in the first eight months of the year over the 2013-2017 period.

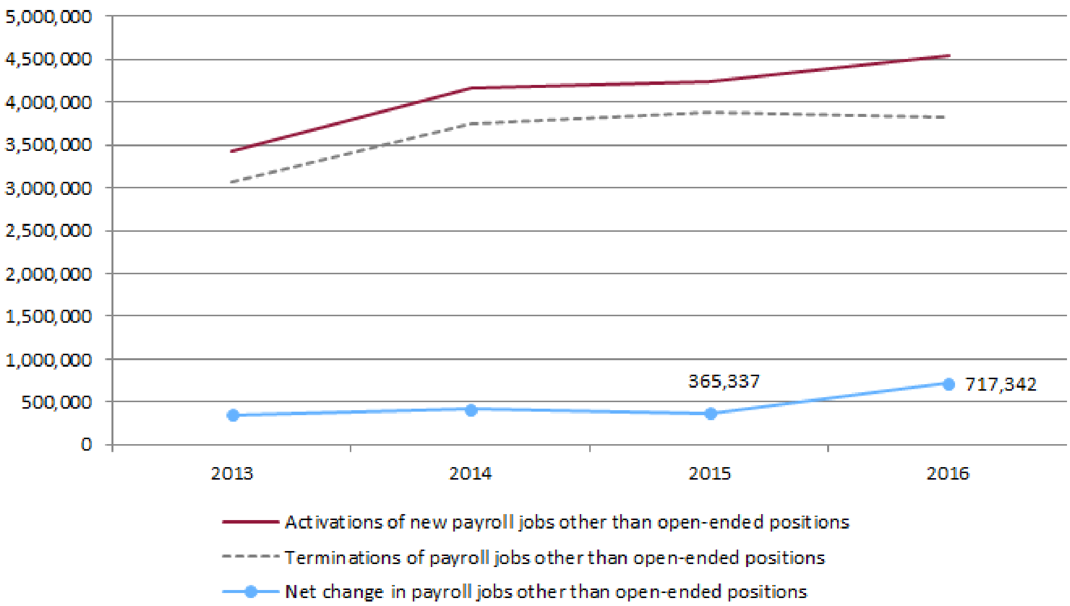
It is possible that after the peak in incentivised hirings in 2015 (see below), saturation effects or even a rebalancing towards contracts not open ended are beginning to emerge (Figure 3.3). The new measure would accompany the winding down of the contribution relief measures of 2015 and 2016, whose effects will expire in 2018.

Figure 3.3 – New hires, transformations and terminations of payroll employees

Open ended



Fixed term



Source: based on data from the INPS Osservatorio sul precariato (private-sector payroll employees excluding domestic workers and farmhands; includes employees of public economic entities). The figures are drawn from the update released in October 2017, which includes data for the first eight months of 2017.

The new measure is better designed than the previous two, with more accurate targeting (which helps reduce the deadweight loss[54]) of both workers (young people and students) and employers (firms that have not cut their workforces). Another interesting feature is the structural nature of the relief, which on the one hand interrupts the series of temporary measures and fosters the normalisation of the labour market and, on the other, remains consistent with a gradual reduction in the tax wedge on labour.

Impact on labour cost. – The measures will have a not negligible impact on the overall tax burden of labour. In order to estimate this effect, we use the so-called tax wedge as an indicator, i.e. the difference between the cost of labour for employers and the corresponding net earnings of workers. This difference is calculated as the ratio between the fiscal burden on labour (income taxes paid by workers, net of State transfers,[55] and social contributions charged to employers and workers) and the cost of labour incurred by firms (the sum of gross earnings and social contributions paid by employers).

It is instructive to assess the extent to which the measures provided for in the Budget Bill reduce the tax wedge for a number of employee categories and different levels of gross earnings. For example, consider single employees with no dependents hired as blue collar or office positions by industrial firms of different sizes (up to 15 employees, more than 15 and up to 50 employees and more than 50 employees). We also assume three levels of gross earnings: the national accounts average gross earnings expected for 2018 (about €30,300) and 67 and 50 per cent of this amount (€20,300 and €15,100 respectively), to approximate what appears to be assumed in the technical report to the measure (about €15,000).[56] Considering different levels of gross earning is necessary in order to understand, given the ceiling to the maximum contribution relief available, the potential reduction in the cost of labour produced by the various contribution relief mechanisms.

With regard to the 50 per cent social contribution relief measure, considering a single employee on an open-ended contract with no dependents with gross earnings equal to the average forecast for 2018 (estimated at just under €30,300), the tax wedge for the employer would decrease by between 6.2 and 6.5 percentage points of the cost of labour, depending on the professional qualification of the employee (blue collar worker or office employee) and firm size (Table 3.2).[57] That decrease become even larger, at between 9.6 and 10.1 percentage points, if we consider gross earnings of 67 per cent of the average forecast for 2018 (just under €20,300). The decline in the tax wedge for employers with regard to employees with gross earnings equal to 50 per cent of the average expected for 2018 (just over €15,100, as plausibly assumed in the technical report) would amount to

[54] Ufficio parlamentare di bilancio (2015), "2015 Budgetary Policy Report 2015", pages 73-75.
[55] More specifically, family allowances, which are paid by INPS but are advanced by employers to employees.
[56] The INPS data for total activations of open-ended positions show (as noted previously) that average gross earnings amounted to about €23,000 in 2014, €22,700 in 2015 and €23,600 in 2016.
[57] The regional and municipal surtax rates are assumed to be equal to the national average rates for those taxes.

between 10.1 and 10.7 percentage points. In the latter case, the annual ceiling on the contribution relief (€3,000) would not be binding.

With regard to the total social contribution relief measure, current legislation already establishes, albeit with a slightly higher ceiling (€3,250), 36 months of full contribution relief for employers who hire up to 31 December 2018, within six months of their obtaining an educational qualification, young people who had worked with those employers in a work-experience programme or in a training or advanced-training apprenticeship.[58] For 2018-2021, the repeal of the existing measure and its replacement with that envisaged in the Budget Bill (without the repeal, new employees hired up to 31 December 2018 would be eligible for relief for 36 months) will increase the tax wedge for employers, as a result of the lowering of the ceiling on the permissible relief, by 1.4 percentage points of the labour cost for the lowest gross earnings category, by about 1 point for earnings equal to 67 per cent of the average forecast for 2018 and 0.6 points for gross earnings equal to the estimated national average (Table 3.3).

Table 3.2 – Impact of partial contribution relief on overall tax wedge (1)
(percentage of labour cost; single employees without dependants)

	Trend			Policy			Difference		
	Total tax wedge	Employer tax wedge	Employee tax wedge (2)	Total tax wedge	Employer tax wedge	Employee tax wedge (2)	Total tax wedge	Employer tax wedge	Employee tax wedge (2)
50% contribution relief - Gross earnings equal to 100% of average earnings (about €30,300)									
Blue collar worker									
Up to 15 employees	46.7	23.7	23.0	42.3	17.4	24.9	**-4.4**	**-6.3**	**1.9**
More than 15 and up to 50 employees	47.1	24.0	23.1	42.8	17.8	25.0	**-4.3**	**-6.2**	**1.9**
More than 50 employees	47.2	24.2	23.0	42.9	18.0	24.9	**-4.3**	**-6.2**	**1.9**
Office employee									
Up to 15 employees	45.8	22.3	23.4	41.3	15.9	25.4	**-4.5**	**-6.5**	**2.0**
More than 15 and up to 50 employees	46.2	22.7	23.5	41.7	16.3	25.4	**-4.5**	**-6.4**	**1.9**
More than 50 employees	46.3	22.9	23.4	41.9	16.5	25.4	**-4.4**	**-6.4**	**1.9**
50% contribution relief - Gross earnings equal to 67% of average earnings (about €20,300)									
Blue collar worker									
Up to 15 employees	39.5	23.7	15.9	31.8	13.9	17.9	**-7.7**	**-9.7**	**2.0**
More than 15 and up to 50 employees	40.0	24.0	16.0	32.4	14.4	18.0	**-7.6**	**-9.6**	**2.0**
More than 50 employees	40.1	24.2	15.9	32.5	14.6	18.0	**-7.6**	**-9.6**	**2.0**
Office employee									
Up to 15 employees	38.5	22.3	16.2	30.5	12.3	18.3	**-8.0**	**-10.1**	**2.1**
More than 15 and up to 50 employees	38.9	22.7	16.2	31.1	12.7	18.3	**-7.9**	**-10.0**	**2.1**
More than 50 employees	39.1	22.9	16.2	31.2	12.9	18.3	**-7.8**	**-9.9**	**2.1**
50% contribution relief - Gross earnings equal to 50% of average earnings (about €15,100)									
Blue collar worker									
Up to 15 employees	34.9	23.7	11.3	26.0	13.1	12.8	**-9.0**	**-10.5**	**1.6**
More than 15 and up to 50 employees	35.4	24.0	11.4	26.3	13.3	13.0	**-9.1**	**-10.7**	**1.6**
More than 50 employees	35.5	24.2	11.4	26.4	13.4	13.0	**-9.1**	**-10.7**	**1.6**
Office employee									
Up to 15 employees	33.8	22.3	11.5	25.2	12.3	13.0	**-8.6**	**-10.1**	**1.5**
More than 15 and up to 50 employees	34.3	22.7	11.6	25.6	12.5	13.1	**-8.7**	**-10.2**	**1.5**
More than 50 employees	34.4	22.9	11.6	25.7	12.6	13.1	**-8.7**	**-10.3**	**1.5**

(1) For simplicity, account is not taken of other existing relief mechanisms for employers who hire disabled workers on open-ended contracts or who transform fixed-term contracts into open-ended positions for such workers (Art. 13 of Law 68/1999, Legislative Decree 151/2015, INPS Circular no. 99/2016 and ANPAL order no. 41/454 of 23 January 2017). – (2) The employee tax wedge changes solely as a result of the decrease in the denominator.

[58] The measure introduced with the Budget Bill replaces social contribution relief with the dual system introduced in the 2017 Budget Act (Art. 1, paragraphs 308-310) for new hiring by 31 December 2018.

Tab. 3.3 – Impact of total contribution relief on overall tax wedge (1)
(percentage of labour cost; single employees without dependants)

	Trend			Policy			Difference		
	Total tax wedge	Employer tax wedge	Employee tax wedge (2)	Total tax wedge	Employer tax wedge	Employee tax wedge (2)	Total tax wedge	Employer tax wedge	Employee tax wedge (2)
100% contribution relief - Gross earnings equal to 100% of average earnings (about €30,300)									
Up to 15 employees	40.8	15.3	25.6	41.3	15.9	25.4	**0.4**	**0.6**	**-0.2**
More than 15 and up to 50 employees	41.3	15.7	25.6	41.7	16.3	25.4	**0.4**	**0.6**	**-0.2**
More than 50 employees	41.5	15.9	25.5	41.9	16.5	25.4	**0.4**	**0.6**	**-0.2**
100% contribution relief - Gross earnings equal to 67% of average earnings (about €20,300)									
Up to 15 employees	29.8	11.3	18.5	30.5	12.3	18.3	**0.8**	**1.0**	**-0.2**
More than 15 and up to 50 employees	30.3	11.8	18.5	31.1	12.7	18.3	**0.8**	**0.9**	**-0.2**
More than 50 employees	30.5	12.0	18.5	31.2	12.9	18.3	**0.7**	**0.9**	**-0.2**
100% contribution relief - Gross earnings equal to 50% of average earnings (about €15,100)									
Up to 15 employees	20.6	6.8	13.8	21.8	8.2	13.6	**1.2**	**1.4**	**-0.2**
More than 15 and up to 50 employees	21.2	7.3	13.9	22.4	8.7	13.7	**1.2**	**1.4**	**-0.2**
More than 50 employees	21.4	7.6	13.9	22.6	9.0	13.6	**1.2**	**1.4**	**-0.2**

(1) Only office employees are considered given that hirings are subject to obtaining educational qualification. For simplicity, account is not taken of other existing relief mechanisms for employers who hire disabled workers on open-ended contracts or who transform fixed-term contracts into open-ended positions for such workers (Art. 13 of Law 68/1999, Legislative Decree 151/2015, INPS Circular no. 99/2016 and ANPAL order no. 41/454 of 23 January 2017). – (2) The employee tax wedge changes solely as a result of the decrease in the denominator.

Nevertheless, the new measure does have a number of positive aspects: 1) the Budget Bill replaces a temporary social contribution relief measure with a permanent mechanism; 2) while the maximum annual relief available is lowered to €3,000, the ceiling on the reduction in annual contribution revenue provided for under current mechanism is eliminated; 3) standardising the maximum annual relief for the different relief measures increases their internal consistency.

3.1.1 The results of previous social contribution relief measures

Recent years have seen numerous overlapping employment enhancing measures aimed at boosting specific types of work or categories of beneficiary.[59] The INPS Observatory on Insecure Employment has undertaken specific studies for only four of the most recent measures: the three-year full contribution relief of 2015, the two-year partial relief of 2016, the annual contribution relief for southern Italy of 2017 and that connected with the "Youth Guarantee" programme of 2017. As the final and preliminary data show, these are the most significant measures by pool of potential beneficiary and loss of revenue. An overview of the salient features of the programmes and the main data offer an idea of the effect that could be generated by the new employment incentives in the light of developments in employment produced by the incentives for new hiring implemented in 2015-2016.

Three-year full social contribution relief measure of 2015 (Law 190/2014, Art. 1, paragraphs 118-124). – New hires and transformation of contracts to open-ended

[59] For a complete and updated list, see "Guida agli incentivi all'assunzione e alla creazione d'impresa" published by ANPAL on a regular basis.

positions in the private sector[60] in 2015 benefitted from full social contribution relief for employers (excluding INAIL contributions): overall, the relief regarded about 31 per cent of gross earnings with an annual ceiling of €8,060, prorated in the case of part-time jobs. The benefit, which was available only once for each employee, lasted three years, with the final year of relief coming in 2018 (when the last contract activated in 2015 will receive its thirty-sixth month of contribution relief).[61] The relief was entirely financed out of general taxation, with no reduction in pension benefits for workers.

The technical report to the 2015 Stability Act estimated that about 1 million contracts were eligible for the relief mechanism,[62] of which about 790,000 with full relief and about 210,000 with a relief limited by the maximum of €8,060 a year. The reduction in contribution revenue[63] was forecast to amount to €1.9 billion in 2015, €4.9 billion in 2016, €5.0 billion 2017, €2.9 billion in 2018 and €0.4 billion in 2019. Corrected for tax effects, the revenue shortfall would amount to €1.9 billion in 2015, €3.7 billion in 2016, €3.9 billion in 2017, €2.1 billion in 2018 and €0.1 billion in 2019.

In conjunction with the introduction of the social contribution relief measure, as from 2015 the permanent incentives for open-ended hiring introduced with Law 407 of 29 December 1990 were repealed. The latter consisted in a 50 per cent temporary reduction (36 months) in social contributions paid by private-sector employers for each new employees hired on open-ended contracts (including part-time positions) among unemployed workers or those receiving benefits under the Special Wage Supplementation mechanism (Cassa integrazione guadagni straordinaria – CIGS) at zero hours for at least 24 months, on the condition that the newly hired employee did not replace suspended employees, employees terminated for justified cause or terminated as part of a personnel reduction programme by the employer applying for the contribution relief.[64] Compared with that introduced in 2015, this measure was structural with no predetermined limit on spending per beneficiary, but was also targeted at a highly circumscribed pool of beneficiaries composed of workers in an especially disadvantaged position. On the basis of the data in the technical report to the 2015 Stability Act, the reduction in contribution revenue from this measure amounted to €1.1 billion a year (in 2012 and 2013). The beneficiaries numbered about 287,000 in 2014 and just over 300,000 on average in 2010-2014.[65]

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[60] Beneficiaries of the programme also included public economic entities, while apprenticeships and domestic work were excluded.

[61] The worker could not have been employed on an open-ended contract by any employer in the six months preceding the subsidised hiring and, in the three months prior to the entry into force of the 2015 Stability Act, could not have been employed on an open-ended contract by the same employer applying for the subsidy (or entities controlled or connected with that employer, including through an interposed person). Special rules applied to the agricultural sector, including a ceiling on the cost (once the ceiling was reached, additional relief could no longer be granted). The benefits could not be combined with other contribution exemptions or reductions in contribution rates.

[62] The calculation was based on the data for new hires on open-ended contracts in 2013, equal to 636,000 net of those regarding workers who were already hired on open-ended contracts in the previous six months, which was increased by about 50 per cent to take account first and foremost of the replacement of fixed-term contracts with permanent contracts.

[63] This was calculated on the basis of data (from INPS) on the distribution by wage level of the new open-ended contracts and those transformed into open-ended contracts.

[64] Hirings on an open-ended basis in southern Italy or by craft firms received full contribution relief, with the other characteristics and duration of the benefits unchanged. The relief could be claimed for the same worker if hired by another employer.

[65] Open Data INPS, "*Politiche occupazionali attive. Numero medio dei beneficiari distinti per misura e sesso. Anni 2010-2014 (valori assoluti e percentuali*)".

The final data from the INPS Osservatorio sul precariato updated to August 2017 show that new hires in 2015 numbered 1,079,070 and transformations numbered 363,656, for a total of 1,442,726 (Figure 3.4).[66] The better-than-expected results presumably reflect the shifting to 2015 of permanent hiring that would otherwise have occurred either in the final couple of months of 2014 or the early months of 2016.

Consequently, the cost of the social contribution relief measure was higher than expected: according to INPS data it amounted to €2.2 billion in 2015 and €6.4 billion in 2016.[67]

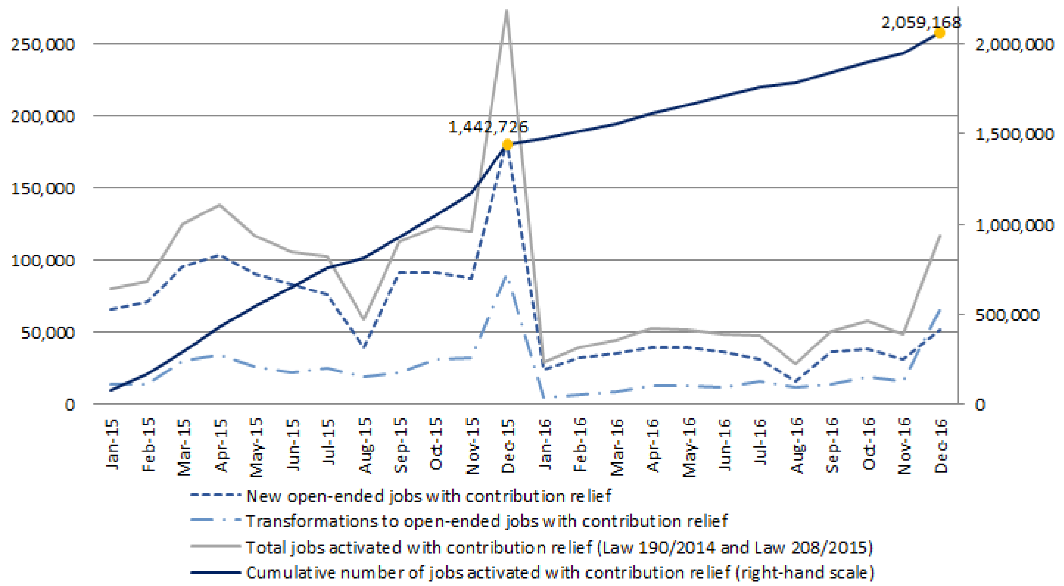
The predominance of new hiring over transformations, together with an analysis of the microdata drawn from the mandatory employer reports, prompted INPS to declare in its 2016 Annual Report that the contribution relief specifically benefitted workers looking for their first permanent jobs and above all long-term unemployed trying to re-enter into the labour force. The same microdata show that in 2015 nearly 80 per cent of new hirings that benefitted from the relief mechanisms came in conjunction with an increase in the size of the firm, thereby indicating that the relief may have made a contribution to the net creation of new jobs, at least in 2015.[68]

[66] More recent administrative data from INPS (not published in the Osservatorio sul precariato) quantify the number of workers benefitting from the relief at 1,366,796 at the end of 2015, a difference of about 80,000 compared with the total number of contract activations benefitting from the relief (the latter also include employment relationships that were later terminated as a result of resignation, firing, job changes, deaths, as well as jobs for which the relief may have been revoked following administrative enquiries). One year later, at the end of December 2016, that number had fallen to 1,115,793 workers (-18.4 per cent), while at the end of June 2017 only 989,161 remained (-27.6 per cent with respect to December 2015 and -9.3 per cent with respect to December 2016).

[67] INPS noted that the calculation of the overall net cost to the budget was more complex and uncertain, as other factors need to be considered: many employment relationships do not last the entire three years, in some cases new contract activations replace contracts that were already benefitting from another subsidy mechanism (such as the beneficiaries of the programme under Article 8 of Law 407/1990 or apprenticeships), ex post checks may find an appreciable number of contracts for which relief was granted unduly, etc.. For example, in the last year in which the employment incentives granted under Law 407/1990 were in force (2014), the associated revenue loss was more than €1 billion. However, since at least part of the two beneficiary pools (that for the three-year relief of 2015 and that for benefits granted under Law 407/1990) overlapped, it is reasonable to assume that part of the revenue loss for the three-year relief mechanism replaced (rather than added to) the repealed benefits.

[68] This aspect was prudentially not considered in the technical report to the 2015 Stability Act. The data of the Ministry of Labour ("Annual Report on Mandatory Reporting") show that on average, considering all types of payroll employment rather than just permanent positions, about 28.5 per cent of employment relationships are terminated within 12 months (29.6 per cent in 2014, 27.5 per cent in 2015 and 28.5 per cent in 2016). In the light of these figures, it would seem that new hiring with the three-year contribution relief, while making a contribution to net new job creation, did not improve the stability of employment.

Figure 3.4 – New contracts/transformations with social contribution relief in 2015 and 2016



Source: based on data from the INPS Osservatorio sul precariato (private-sector payroll employees excluding domestic workers and farmhands; includes employees of public economic entities). The figures are drawn from the update released in October 2017, which includes data for the first eight months of 2017.

Two-year partial social contribution relief measure of 2016 (Law 208/3015, Art. 1, paragraphs 178-180). – New hiring and contract transformations for open-ended positions in the private sector in 2016 benefitted from a social contribution relief that was identical to the previous year's system except for the scale of the benefits and their duration: the measure no longer provided full relief from social contributions (INAIL excluded) charged to employers, but rather only 40 per cent with an annual ceiling of €3,250, and the benefit no longer lasted for 36 months but rather for 24 months.[69] The relief could only be claimed once for any given employee and employees who benefitted from the 2015 relief mechanism were not eligible.

In the technical report to the 2016 Stability Act, the number of contracts that could be activated with the social contribution relief benefit was put at about 1 million, taking account of the number of subsidised contracts in 2015 adjusted to take account of the more favourable economic conditions, the less generous terms of the scheme and the shifting of planned hiring from 2016 to 2015 and from 2017 to 2016 to take advantage of the relief mechanisms. The forecast reduction in contribution revenue amounted to €0.8 billion in 2016, €2.1 billion in 2017, €1.3 billion in 2018 and €0.1 billion in 2019. Adjusted for tax effects, these figures become €0.8 billion in 2016, €1.5 billion in 2017 and €1.0 billion in 2018.

[69] Another difference compared with 2015 is the provision that an employer who takes over the supply of services in a tender arrangement and who hires, even if under a previous obligation, a worker for which the departing employer had claimed the contribution relief retains the entitlement to the relief to the extent of the residual duration and amount.

Outturn data from the INPS Osservatorio sul precariato reveal a reality the diverges significantly from the forecasts. In 2016, new hiring with the contribution relief totalled 413,631 (38.3 per cent of that in 2015) and transformations came to 202,811 (55.8 per cent of that in 2015), for a total of 616,442 (42.7 per cent of the 2015; Figure 3.4).[70]

As regards the cost of the relief, in 2016 INPS registered a decline of €354 million in contribution revenue. While the forecasts for the contribution relief mechanism for 2015 were significantly exceeded by actual results, in 2016 the opposite occurred, with actual results only about half the expected level.

The lower effectiveness of the relief in 2016 is confirmed even if, using the INPS data, we look at: 1) the proportion of new hires with relief[71] compared with total open-ended hiring and 2) the proportion of new hires with relief compared with total hiring with any form of payroll employment contract. In 2015, the two proportions were equal to 54.2 and 20.5 per cent, which then fell in 2016 to 35.4 and 9.8 per cent. Among other things, the shifting of planned hiring, which was proportionately greater in 2015 than in 2016, does not appear to have had much of an impact. December 2015 registered 18.9 per cent of all new hires and transformations with open-ended contracts benefitting from the relief, compared with percentages in other months that ranged from 4.1 per cent in August to 9.6 per cent in April, with an average of 7.4 per cent. In 2016 the percentage were not much different, with 19 per cent in December and the other months ranging from 4.6 per cent in August to 9.3 per cent in October, with an average of 7.4 per cent. The relief measure for 2016 was less effective because it was less generous in terms of scale and duration and because it was the second in a closely spaced series of major employment incentive programmes.[72]

In both 2015 and 2016, new hires with the relief were greater than transformations with relief, but while in 2015 they were three times greater, in 2016 they were only twice as numerous. More than 70 per cent of new open-ended positions with relief and slightly less than 65 per cent of contracts transformed into open-ended positions came in 2015. Compared with total new hires and transformations of all types, in 2015 new hires with contribution relief amounted to 15.7 per cent of the total and transformations with contribution relief amounted to 5.3 per cent of the total, percentages that fell to 6.6 and 3.3 per cent in 2016.

The overall impact of the 2015 and 2016 social contribution relief measure. – Summing up, following the introduction of the social contribution relief measures in 2015 and

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[70] More recent administrative data from INPS (not published in the Osservatorio sul precariato) quantify the number of workers benefitting from the relief at 540,137 at the end of 2016, a difference of about 76,000 compared with the total number of contract activations benefitting from the relief (the latter also include employment relationships that were later terminated as a result of resignation, firing, job changes, deaths, as well as jobs for which the relief may have been revoked following administrative enquiries). At the end of June 2017 only 478,684 remained (-11.4 per cent).

[71] Including transformations.

[72] See Croce G. (2017), "Il *Jobs Act* due anni dopo: obiettivi, fatti e prospettive", in *Economia&Lavoro*, May-August 2017, no. 2.

2016, net new open-ended contracts peaked at about 934,000 in 2015 (the year in which full, three-year relief was available), while the corresponding figure in 2016 was about 83,000 (when the relief was reduced to 40 per cent and lasted for two years), well below that registered the previous year albeit higher than the result posted in 2014 (a contraction of about 41,000, probably due to the shifting of hiring to the following year) and 2013 (about 34,000) (Figure 3.3). These results reflected virtually flat developments in terminations of open-ended contracts, which in fact contracted in 2016 compared with 2015. Looking at new hires and terminations for payroll positions other than open-ended jobs, between 2013 and 2015 they essentially changed in parallel, leaving the balance (net new hires) unchanged. Only in 2016 do the series diverge, with net new hiring almost doubling from 365,337 to 717,342.

It therefore appears that the 2015 employment incentive measure, combined with the reduced version of 2016, generated a peak in net new open-ended positions in 2015 with no apparent offsetting reductions in other types of contract. On the contrary, there was also a substantial increase in net new contracts other than open-ended employment in 2016. It will be necessary to await developments in the coming months to see whether the latter development reflected a need to rebalance the composition of contract types after hoarding of open-ended positions or rather a strategy of anticipating possible future incentive programmes for transformations to open-ended status (which is in fact happening with the Budget Bill), or perhaps other reasons that could become clearer as time goes on. The first hypothesis (working off the hoarding of open-ended positions) would be compatible with open-ended hiring approaching a "saturation" threshold, at least for hiring which can be stimulated by contribution relief alone in a given macroeconomic environment. Important evidence (to understand what has been happening) will be provided by the data on the ability of contracts activated with relief in 2015 and 2016 to continue beyond the expiry of the contribution relief, i.e. beyond 2018.

The above considerations are confirmed by the data for the first eight months of each year. Following the peak in net new hiring on open-ended contracts in 2015 (about 466,000 in the first eight months), in 2016 the aggregate declined significantly (to about one-tenth of the level in 2015 and less than half of the equivalent figures in 2013 and 2014), before continuing to decline in 2017, when net new hiring on open-ended contracts turned negative for the first time, with a contraction of more than 480 (Figure 3.2). The latter was accompanied in the first eight months of 2017 by an increase in net activations of contracts other than open-ended positions, posting a rise of nearly 31 per cent on the equivalent figure for 2016 (from about 905,000 to just under 1.2 million).

In short, this is the framework in which the new employment incentives contained in the Budget Bill will be incorporated: while the drive towards open-ended hiring appears to have wound down, the figures for 2017 suggest the possible start of a reversal of course (towards fixed-term contracts), which for now is occurring against the background of growth in overall employment.

The social contribution relief measures of 2017.[73] – Two social contribution relief measures are in place in 2017 to foster youth employment, one reserved for southern Italy, the other covering the entire country.

The former regards new hires and transformations into open-ended contracts – including part-time positions, temp agency positions (so called "Lavoro somministrato") and vocational qualification apprenticeships (including seasonal positions if envisaged in the national collective bargaining agreement) – in 2017 by private-sector employers located in southern Italy. It is directed at unemployed young people aged 16 to 24 and over 24s who have been without a regular job for at least six months.[74] The benefit lasts 12 months and involves full social contribution relief (with the exception of INAIL contributions) for employers: overall, about 31 per cent of gross earnings with an annual maximum of €8,060 euro, prorated for part-time jobs or when the training period provided for in the apprenticeship contract is shorter than one year.[75] The relief mechanism is financed out of general taxation, so worker benefits are not reduced, and it is subject to European "de minimis" rules, with exceptions for situations in which the subsidised hiring generates an increase in net employment at single firm level. Access to the scheme is determined in chronological order of submission of applications up to the budgeted expenditure ceiling of €500 million for the less developed regions (Basilicata, Calabria, Campania, Puglia, Sicily) and €30 million for the transition regions (Abruzzo, Molise, Sardinia).

The second benefit scheme regards jobs activated in 2017 by private-sector employers for young people aged 16 to 29 enrolled in the "Youth Guarantee" programme.[76] The benefit applies to hiring on open-ended contracts (including temp agency positions), vocational training apprenticeships (including seasonal workers if provided for in the national collective bargaining agreement) of at least one year and fixed-term positions (including temp agency jobs) with a term of at least six months. The benefit, which applies for 12 months, is structured in a similar manner to that for southern Italy. In particular, it provides for full contribution relief for the employer (financed out of general taxation for the purpose of pension benefits) up to annual maximum of €8,060, prorated in the case of positions other than full-time open-ended jobs.[77] Access to the scheme is determined in chronological order of submission of applications up to the budgeted expenditure ceiling of €200 million.

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[73] Director's Decree of the Ministry of Labour and Social Policy no. 367 of 16 November 2016 as amended and Director's Decree of the Ministry of Labour and Social Policy no. 394 of 2 December 2016.

[74] Excludes domestic worker contracts, apprenticeships without vocational qualification aspect and on-call contracts. Also excluded are hirings to comply with legal obligation, with the exception of contracts executed to implement the associative connection with a labour cooperative.

[75] The benefit may not be combined with other contribution- or non-contribution-based employment incentive measures. Workers may not have had an employment relationship with the same employer in the previous six months.

[76] More detailed requirements are in place for young people aged 25 to 29 (for example, they may not have held paid employment for at least the previous six months).

[77] In the case of a fixed-term contract, the relief is equal to 50 per cent of contributions up to an annual ceiling of €4,030.

Data from the INPS Osservatorio sul precariato show that in the first eight months of 2017 the “Southern Italy” benefit mechanism was drawn on for 60,129 open-ended contracts and for 15,828 transformations of other employment relationships into open-ended contracts. The INPS data also indicates that over the same period the “Youth Guarantee” incentive was drawn on for 24,343 open-ended contracts and 11,893 fixed-term contracts. Comparisons with previous socialcontribution relief mechanisms are not straightforward, not only due to differences in the pools of beneficiaries and certain constraints on access to the schemes, but also and above all due to the ceiling on the funding available in 2017. At the end of the programmes, it will be interesting to assess whether the two appropriations were used in full, as this information – in addition to the other data on the effectiveness of the measure, with a breakdown by region – would be helpful to ANPAL in designing the new incentive mechanisms for southern Italy (provided for in the Budget Bill).

3.2 *Measures for employees of firms in economic difficulty*

The Budget Bill contains three measures to support the employees of firms in economic difficulty with a limited impact on the government budget. The first, a structural measure, completes the operation of the outplacement allowance (Assegno di ricollocazione – ASR) and seeks to strengthen links between the supplementary benefits paid through the Special Wage Supplementation Fund (CIGS) and active labour market policies. The other two measures are temporary and represent exceptions to the rules governing social shock absorbers in place following the Jobs Act, justified by the uncertainty and weakness still affecting the labour market.

The first measure is targeted at supporting the outplacement of employees who, as they are already in the Special Wage Supplementation mechanism (CIGS), are at risk of losing their jobs. It provides economic incentives for workers and any new employer that might hire them. In essence, it represents a renewed version, adapted to the case of early access to the ASR,[78] of the scheme already in place since 1993 to encourage the re-employment on full-time open-ended contracts of workers in the CIGS mechanism.[79]

When the agreements underlying activation of the CIGS mechanism identify types of job and professional qualifications that are unlikely to be retained following a crisis and are therefore at risk of termination, workers are allowed to apply to ANPAL for the early disbursement of the ASR benefit, which can be spent immediately, while maintaining their wage supplementation benefits, in order to obtain job search assistance from a public or private employment agency.

Workers who apply for early disbursement of the ASR do not have to accept the first appropriate job offer, as ordinary recipients of the allowance normally have to do. In addition, if these workers accept an employment contract from another employer (unconnected with their current employer), any amounts received as part of a termination package from their old job are exempt from income tax. The exemption applies to a maximum of nine months' of the wages taken as the reference aggregate used in calculating termination benefits. The worker also receive 50 per cent of the wage supplementation benefits they would have received if they had not found a new job.

The programme also offers incentives to employers who hire such workers: they are exempt from paying 50 per cent of social contributions (excluding INAIL contributions), up to an annual maximum of €4,030 (adjusted for inflation[80]). The employer's exemption lasts 18 months if the worker is hired on an open-ended contract and 12 months for a fixed-term contract. If the fixed-

[78] The ASR is a voucher that recipients of "new social insurance for employment" benefits (NASPI) who have been unemployed for more than four months can spend at a public or private employment services agency to obtain customised outplacement support, for which a worker will sign an intensive service programme agreement. The value of the ASR is not fixed as it depends on the risk profile of the beneficiary and, above all, on the final outcome of the retraining and job search services. The risk profile, which varies from '0' for workers who can easily find another job to '1' for the most challenging cases, is updated every three months. The value of the allowance can vary from €250 to €5,000, with the maximum being paid to especially vulnerable workers living in undeveloped areas, whose outplacement process is completed with a new open-ended position.

[79] Nevertheless, access to the benefits available since 1993 is governed by different and more stringent requirements. For example, workers must have drawn on the CIGS mechanism for at least 3 months (not necessarily consecutively) and must be employees of firms in the CIGS mechanism for at least 6 months. In addition, while the incentives introduced in 1993 go entirely to employers, the current system directs a part to workers. See Ufficio parlamentare di bilancio (2017), "2017 Budgetary Planning Report", page 130 et seq..

[80] Since the measure is permanent, the expenditure ceiling is adjusted for inflation.

term contract is transformed into a permanent contract, the contribution relief is extended for another 6 months.

At the same time, the "penalty" that an employer within the scope of the CIGS mechanism must pay for any termination made as part of a collective redundancy procedure increases significantly (it rises from 50 to 85 per cent of the initial monthly NASPI benefit[81] for each 12 months of seniority with the company in the previous three years).

The rationale for the measure seem clear: when there is an effective risk of being made redundant, the earlier (even while receiving CIGS benefits) workers activate outplacement services to find a new job, the more likely they are to find one and, if they are rehired rapidly, the lower the cost associated with unemployment benefits and, above all, the greater the preservation of human capital and productivity.

The technical report estimates that the measures included in Article 20 will have a positive impact, net of tax effects, of about €20 million in 2018 (associated with the increase in the redundancy "penalty"), followed by a net cost of about €6.4 million in 2019, €11 million in 2020, €6.6 million in 2021, before steadily rising from about €7 million in 2022 to about €8 million in 2027.

The second measure extends the duration of the CIGS benefits (normally 12 or 24 months depending on the specific cause of difficulty) for 2018-2019 in two specific cases applicable to large companies (employing more than 100 labour units) of strategic national or regional interest.[82] In the first case, the benefits may be extended by a maximum of 12 months if the company reorganisation plan (an essential requirement for activation of the CIGS mechanism) is sufficiently complex – in terms of the investment involved and/or the management of human capital and the retraining/outplacement of personnel – that it would not be possible to compete the process in the standard 24 months. In the second case, the benefits can be extended by a maximum of 6 months if the company reorganisation plan provides for complex corrective measures for company operations that cannot be implemented in the standard 12 months. The estimated expenditure amounts to €100 million both in 2018 and in 2019.

Note that following the "Fornero reform" (2012) and the Jobs Act (2014), the rules governing the CIGS mechanism were overhauled. More specifically, prior to the reforms the system had been "deformed" by extensions and exceptions that had essentially extended its reach into areas normally covered by other measures in the event of redundancies following by unemployment (creating confusion between social shock absorbers for workers still in a job and those for workers who lost their jobs). The reforms implemented in recent years have unequivocally redefined the pool of potential CIGS beneficiaries, the mandatory categories for which the

[81] The NASPI is directed at payroll employees who have involuntarily lost their jobs, excluding public employees with open-ended contracts, agricultural workers and non-EU seasonal workers (in addition to direct recipients of pensions).

[82] The provisions also make permanent the indemnity (already in place last year) for periods in which activity is suspended (for a maximum of 40 days a year) for employees of companies engaged in maritime fishing (including working members of small-scale fishing cooperatives).

mechanism can be activated and, above all, the duration of the benefits associated with each such category.[83]

The exceptions introduced with the Budget Bill, which are limited to 2018-2019, may find a justification in the desire to accompany the full implementation of the new rules of the Jobs Act at a juncture in which the labour market remains uncertain and weak. While this rationale is reasonable, it would still be advisable to avoid the re-emergence of frequent changes to the rules governing the shock absorbers or the introduction of exceptions.

Finally, the third measure provides for the use in 2018 of resources previously appropriated for 2016 and 2017 but not entirely used (those referred to in paragraph 11-bis of Article 44 of Legislative Decree 148 of 14 September 2015) in order to continue to fund the exceptional operation of the CIGS mechanism (CIGS in deroga) and the "mobility" unemployment scheme.

The measure allows regional governments to use resources that have already been appropriated but not completely used to fund new initiatives against unemployment as an exception to applicable legislation. The original purpose of the appropriations was to extend for a maximum of 12 months the operation of the CIGS mechanism in situation of complex corporate difficulties, initially for 2016 only and then 2017 as well. It is now possible to use the residual resources in 2018 to fund the exceptional operation of the CIGS mechanism and the "mobility" unemployment scheme in order to address complex difficulties at firms.

The underlying purpose has not changed, and it makes sense to use those resources to continue to provide unemployment protection. However, the exceptional extension of the social shock absorber mechanisms (CIGS in deroga) has already been made superfluous by the Jobs Act, which created a sharp distinction between mechanisms that can be activated while workers still have a job (CIG and CIGS) and those activated to protect workers who have lost their job (including the "mobility" unemployment scheme before it was abolished for reasons of efficiency and equity[84]). The exception created here to complete the use of resources that have already been appropriated should not encourage the trend towards the exceptional application of welfare programmes in the labour market, in order to avoid undermining the rationale of their reorganisation under the Jobs Act.

[83] Article 20 of Legislative Decree 148/2015 sets out a list of eleven types of firms to which the CIGS provisions apply. Following the passage of the Jobs Act, the admissible causes for activating the scheme return the CIGS mechanism to its original scope of application: a social shock absorber against serious adverse events of prolonged duration that can nevertheless be remedied by a clear company programme to restore, within a reasonable period of time, normal and independent operations. A PBO Focus Paper that discusses developments in social shock absorbers in recent years is current being prepared.

[84] More generous than the ordinary unemployment benefit scheme in terms of amount and duration, the "mobility" system gradually acquired a more important role in supporting industrial policy, helping to attenuate the social repercussions of large-scale redundancies. This explains the variants of this tool, which has been used on multiple occasions with ad hoc measures targeted at a specific industry, geographical area or even individual company. Following the Fornero reform and the Jobs Act, all the unemployment benefit schemes were replaced by the NASPI.

3.3 Measures concerning the Inclusion Income

One of the key measures to support income and counter social exclusion provided for in the Budget Bill expands the pool of beneficiaries of the Inclusion Income mechanism and increases the maximum amount of the benefit.

The Inclusion Income was introduced with Legislative Decree 147/2017, in implementation of the anti-poverty enabling law (Law 33/2017, as provided for by Law 208/2015), which defined it as a single national measure to fight poverty and social exclusion. As is usually the case with such programmes,[85] in addition to financial support it also envisages the delivery of customised services for social inclusion and labour market participation.

The resources appropriated for the Poverty Fund in the Budget Bill amount to €300 million for 2018, €700 million for 2019, €665 million for 2020 and €637 million as from 2021, as well as an additional €235 million in 2020 and €263 million in 2021 for objectives to be identified in the National Plan for the Fight against Poverty and Social Exclusion (section 3.3.3).[86]

The changes made by the Budget Bill in the category requirements for access to the Inclusion Income make it a universal measure, albeit subject to means testing and participation in a customised labour market participation and social inclusion programme. One limitation of the system is the temporary nature of the benefits even if the recipient remains in a situation of need (section 3.3.1.1). In addition, the amount of the benefit is tied to the resources available (section 3.3.1).

The analyses below, some conducted using the PBO's microsimulation model, produced the following main results.

The impact of the Inclusion Income seems significant in relation to the scale of absolute poverty in Italy, which in 2016 afflicted about 6.3 per cent of households,[87] although it is still insufficient to eliminate the problem. Beneficiary households account for about 44 per cent of households in a state of absolute poverty. Households whose poverty is most alleviated by the programme include the following: those resident in southern Italy and the Centre; those that do not own their home; those whose household head is an Italian citizen; those whose household head is unemployed; and those whose household head is young (up to 40 years old) (section 3.3.2).

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[85] See, among other: Granaglia, E. and Bolzoni, M. (2016), "Il reddito di base", Ediesse, Roma; European Commission (2016), "Minimum income schemes in Europe - A study of national policies", Frazer, H. and Marlier, E. (eds.), January; European Parliament (2017), "Minimum income policies in EU Member States", Directorate general for internal policies, Policy department A: Economic and scientific policy, Study for the EMPL Committee.

[86] The National Plan can be used to revise and update many of the characteristics of the Inclusion Income, within the scope of the available resources (additional compared with those already appropriated or if the Anti-Poverty Fund has certified and structural resources to fund the changes) in order to expand the pool of beneficiaries and increase benefits.

[87] Istat (2017): "La povertà in Italia – anno 2016"; Statistiche Report, July.

Assuming that the Inclusion Income targets only households in a state of absolute poverty, the poverty gap (average difference between the income of the poor and the benchmark threshold) would narrow by about 9.5 points (from 20.7 to 11.2 per cent), but the measure would not have an impact on the poverty head count ratio (the number of the poor as a proportion of the total population), as the benchmark income of the Inclusion Income, which is equal to the resources a household would have after having received the benefit, generally appears lower than Istat's absolute poverty line (section 3.3.2).

In terms of the impact on overall inequality in the distribution of disposable income, the introduction of the Inclusion Income would reduce the Gini coefficient[88] by 0.4 points (section 3.3.2).

A comparison of the Inclusion Income with the Support for Active Inclusion programme (SIA) in place in 2017 shows that, all other requirements being equal, the change in the economic eligibility criteria does not have a significant impact on the pool of beneficiaries. The new thresholds mainly enable homeowners who had previously been excluded to qualify for the benefit (section 3.3.1.1).

3.3.1 The features of the Inclusion Income

The following is a description of the main features of the Inclusion Income programme, detailing eligibility requirements and the benefits. The table in Appendix 3.1 provides a comparison between the Inclusion Income and previous income support measures adopted in Italy, while Box 3.1 summarises recent legislation, with specific regard to the transition from the SIA to the Inclusion Income and the more complex efforts to reorganise and coordinate the actions and social services connected with the introduction of a single national anti-poverty programme.

3.3.1.1 Beneficiaries

Various household economic requirements for access to the Inclusion Income have been established:

- an ISEE (equivalent economic status indicator) of no more than €6,000;
- an ISEE income component[89] divided by equivalence scale (ISRE) of no more than €3,000;

[88] The Gini concentration coefficient is a statistical indicator that measures the distribution of resources within a population. It can vary between 0, in the case of equal distribution among all population members, and 1, in the case of maximum concentration.

[89] This is disposable income net of rent payments of up to €7,000 (increased by €500 for each cohabiting child after the second) and 20 per cent of income from payroll employment up to €3,000 or 20 per cent of income from a pension or post-employment, assistance or indemnity benefits up to €1,000, as well as other

- real estate other than the primary residence with a value of no more than €20,000;
- movable property with a value of no more than €6,000, increased by €2,000 for each member of the household beyond the first up to a maximum of €10,000.

Households with members receiving benefits under the NASPI scheme or other social shock absorbers for involuntary unemployment are not eligible for the Inclusion Income scheme. In addition, the programme establishes certain conditions concerning living standards: household members may not own (or in any case have full use of) new automobiles or motorcycles (registered in the previous two years) – unless they are for the disabled – or pleasure craft. Finally, beneficiaries must have been resident in Italy for at least two years (continuously) in order to be eligible.

The main changes introduced with the Budget Bill consist in the elimination of certain conditions that restricted the pool of Inclusion Income beneficiaries. More specifically, beginning in January 2018, the requirement for at least one member of the household to be aged over 55 and unemployed will no longer apply and as from the second half of 2018 all the other conditions will be repealed.[90]

The requirements provided for in the decree introducing the Inclusion Income (Legislative Decree 147/2017) included the requirement for at least one household member to have specified social and/or age characteristics: minors, children (including adults) with disabilities, women in an advanced stage of pregnancy; workers aged 55 and over who are 1) unemployed following termination, resignation for cause or consensual termination as provided for under Law 604/66, Art. 7, who have not received full unemployment benefits for at least three months; 2) unemployed for at least three months without entitlement to unemployment benefits; or 3) with income from payroll employment or self-employment below or equal to the personal income tax exemption threshold.

This makes the Inclusion Income more consistent with the definition, given in Legislative Decree 147/2017, of universal income support measure, even if subject to means testing and participation in a customised labour market participation and social inclusion programme.

The customised social and labour market participation programme is developed following a multidimensional assessment of need and agreed with the beneficiaries. The programme must set objectives, timelines and expected results, identify the support to be provided by networked service providers (social and socio-healthcare services and employment agencies, with the involvement of the third sector, the social partners and "the entire community"[91] (included private social service operators) and establish a series of commitments for the household in the areas of job search,

deductions pursuant to Decree Law 159/2013. For the purpose of determining eligibility for the Inclusion Income, account is not taken of local anti-poverty measures adopted by the autonomous provinces of Trento and Bolzano.

[90] The Budget Bill eliminates, as superfluous, the previous priorities established for the future expansion of the scope of the measure to include households whose members include persons aged 55 and over and, more generally, all references to subsequent expansion of the pool of beneficiaries based on household characteristics and any use of need assessment rankings.

[91] Ministero del Lavoro e delle politiche sociali (2017), "Il reddito di inclusione", August 29th agosto, available at http://www.lavoro.gov.it/stampa-e-media/Comunicati/Documents/Reddito-di-inclusione-PPT-29082017.pdf.

education and health. The support comprises the services offered by social services in the various areas and the outplacement allowance (provided for under Legislative Decree 150/2015, Art. 23). These commitments include: active job search and availability to accept job offers (in accordance with Legislative Decree 150/2015 and with a reference to the service agreement or intensive job search programme envisaged therein); contacts with the offices in charge of the programme; school attendance; and health-conscious behaviour.

The universal nature of the system is still undermined by the fact that the Inclusion Income is of limited duration even if the beneficiaries continue to meet the requirements of the programme and their need remains. Any renewal of benefits must follow a period of suspension. While it has been established that the Inclusion Income is intended to provide an essential level of benefits pursuant to Article 117 of the Italian Constitution, that level of benefits is also constrained by the level of available funds.[92] If there is a shortfall in resources, the amount of the benefit will be adjusted on the basis of available funds for the remainder of the period (section 3.3.3).

Inclusion Income benefits can only be disbursed for a period of 18 months, even if the beneficiaries continue to meet the requirements for access to the scheme and their need remains. Any renewal must be preceded by a period in which benefits are suspended of at least 6 months and will have a duration of one year. Even if the possibility of renewal is expanded in the future, the maximum duration of 18 months and the period of suspension will be retained.

Beneficiaries may hold jobs while receiving Inclusion Income benefits and a number of measures have been established to counter any disincentives to work and avoid the poverty and unemployment traps that can emerge when earned income triggers the suspension or reduction of benefits. First and foremost the implicit mechanism in the calculation of the income component of the ISEE (the ISR) will come into play. It provides for a deduction from income from payroll employment (see note 88). As regards the specific rules governing the Inclusion Income, if a household member benefitting from the scheme finds a job and, therefore, is likely to see his or her income change, the household has 30 days to notify the new expected annual income, which will be used to produce an updated ISEE. This will form the basis of an assessment of the financial condition of the family for the purposes of determining its continued eligibility (a similar notification must be made if a beneficiary has income from employment that is not reflected in the ISEE, which regards a previous period). If the beneficiaries continue to meet the eligibility requirements, the amount of the benefit for households that are already receiving the Inclusion Income will not be reduced (in addition, for the first six months of 2018, when the unemployment requirements are still in force, workers over the age of 55 whose income is insufficient to incur an income tax liability after calculating the tax credit for payroll employment will be treated as unemployed).

According to the estimates in the technical report accompanying the Budget Bill and that for Decree Law 147/2017, calculated on the basis of the ISEE returns collected in

[92] Note that services to provide information and access to the Inclusion Income, the multidimensional assessment, the customised programme and the associated support, and the integrated offer of initiatives and services, as defined in coordination with regional and provision governments, represent essential benefits but their supply is limited by the amount of resources available under current legislation.

the ISEE information system (DSU),[93] about 700,000 households (1.8 million individuals) will be eligible for the Inclusion Income, of which about 200,000 as a result of the expansion of the pool of beneficiaries introduced with the Budget Bill.

The ISEE returns[94] can be used to compare the size of the potential pool of beneficiaries of the new programme with that of the SIA, with specific regard to the impact of the redefinition of the parameters that specify the economic requirements for Inclusion Income eligibility.

In the transition from the old to the new programme, the access threshold based on the ISEE is increased (€6,000 rather than €3,000) (Appendix 3.1) and additional requirements for the income and property components are introduced. The expansion of the pool of beneficiaries connected with the increase in the ISEE income threshold affects only 5 per cent of DSUs with an ISEE of up to €6,000. More than one third of households with an ISEE of up to €6,000 remain ineligible for the programme as a result of the constraint on the equivalent income component.

All other aspects held unchanged, the higher ISEE threshold makes it possible to increase the real estate component, mainly with regard to the primary residence, which is not affected by the new restrictions introduced with the Inclusion Income (an additional €22,500, above the deductibles, in the cadastral value for local property tax purposes for each household member equivalent). For owners of other real estate, the scope for using the increased property capacity of the patrimonial restriction is reduced by the limit imposed on the value of homes that are not the beneficiary’s primary residence. Finally, the potential beneficiaries of the SIA programme with movable assets whose value exceeds the deductibles are currently ineligible.

In essence, the pool of potential Inclusion Income beneficiaries largely overlaps that of the SIA programme, the categorical requirements being equal[95].

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[93] The estimates in the technical reports accompanying Decree Law 147/2017 and the Budget Bill are based on simulations conducted using a sample of ISEE returns (DSUs) submitted in 2016, which were prepared by INPS for the Ministry of Labour pursuant to Art. 12, paragraph 4, of Legislative Decree 159/2013. As noted in the technical reports, the use of the returns submitted in the past (DSU) could theoretically lead to an underestimation of costs when one simulates the effects of an expansion of the pool of beneficiaries of an existing subsidy programme. However, with regard to the pool of households with children, the broad overlap of eligible beneficiaries for both the Inclusion Income and the SIA programme, and the adoption of a degree of prudence in counting potential beneficiaries, seems sufficient to mitigate the risk of underestimating the cost. Greater uncertainty is found with regard to the impact of the extension of the programme to segments of the population not covered by the SIA, as provided for in the Budget Bill. The technical report for the Budget Bill addresses these risks by incorporating a margin of 15 per cent in additional costs compared with the estimate performed using the sample of 2016 DSUs. Moreover, the restrictive effect of certain constraints (such as possession of a vehicle and citizenship requirements) was not incorporated in the estimation.

[94] The information base, consistent with that used to prepare the technical reports, was made available to the PBO by INPS.

[95] For the categories eligible for SIA benefits, the technical report accompanying Decree Law 147/2017 estimates that the overlap of the categories eligible for the SIA with the corresponding pool of potential Inclusion Income beneficiaries would be more than 94 per cent.

Box 3.1 – From the 2016 Stability Act to the Inclusion Income

The 2016 Stability Act (Law 208/2015) laid the foundations for the launch of the Inclusion Income: it introduced the National Plan for the Fight against Poverty and Social Exclusion,[96] to be financed with the Fund for the Fight Against Poverty and Social Exclusion (the Anti-Poverty Fund). It established a number of temporary measures for 2016, essentially intended to strengthen trials of the so-called Purchase Card introducing the SIA. It also established that as from 2017 funding should be directed at introducing a new national anti-poverty programme, with benefits linked to the difference between beneficiaries' income and the absolute poverty line, with the resulting reorganisation intended to rationalise legislation governing welfare programmes and measures subject to means testing and eligibility criteria.

The Anti-Poverty Fund was funded by Law 208/2015 with an appropriation of €600 million for 2016 (of which €220 million to finance the Unemployment Allowance (ASDI)), €1,030 million for 2017 €1,054 million as from 2018,[97] in addition to resources not used for previous versions of the Purchase Card (€55 million for 2018 and €141 million for 2019, net of €65 million and €32 million in those two years respectively, to continue funding the ASDI). The 2017 Budget Act refinanced the fund with €650 million.[98]

In 2016, the SIA was launched with the contribution of European funds (Decree of the Minister of Labour in concert with the MEF of 26 May 2016). The 2017 Budget Act established that for that year, pending the introduction of the new anti-poverty programme, the eligibility criteria for the SIA should be revised, with an expansion of the pool of beneficiaries (and the time limits for the experimentation of the ASDI should be specified, using part of the resources of the Anti-Poverty Fund if necessary). This was implemented with the Decree of the Minister of Labour of 16 March 2017 and with that of the Minister of Labour in concert with the MEF of 26 July 2017, directed at the areas affected by the earthquakes (see the table in Appendix 3.1 for a comparison of the characteristics of the various forms of the SIA and the Inclusion Income programme).

The provisions of the 2016 Stability Act were implemented with the approval of the anti-poverty enabling legislation in March 2017 (Law 33/2017). The implementation of the enabling law required the adoption of a number of legislative decrees to:

1. introduce the Inclusion Income, the national programme to combat poverty (with poverty defined as a lack of the resources necessary to live a dignified life) and social exclusion, representing an essential level of benefits. The new mechanism was to be implemented using the resources of the Anti-Poverty Fund and would incorporate the experience of the experimental Purchase Card (SIA).

2. reorganise anti-poverty benefit schemes, excluding those for non-working-age persons, those in support of parenthood and those for the disabled. The first two exceptions were introduced in Parliament.[99] A Government amendment ruled out the rationalisation of "other benefit schemes, including contributory provisions, subject to means testing",[100] thereby eliminating the possibility of cutting benefits, in particular survivors' pensions and allowances to raise pension amounts to the level of the minimum pension.

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[96] The three-year National Plan, to be adopted in agreement with the Unified Conference, was to establish the gradual transition to achievement of essential benefit levels in the fight against poverty.

[97] Resources amounting to €30 million in 2017 and €54 million in 2018 were to come from the Employment Fund (with the concomitant elimination of the benefit scheme provided for under Law 92/2012 for certain "para subordinate"workers experiencing periods of unemployment).

[98] Funded directly through Section II in the amount of €500 million in 2018 and 2019 and through Section I in the amount of €150 million as from 2017 (defunding the ASDI scheme by the same amount. ASDI will remain in effect in 2018 only for people who have used all their benefits under the NASPI and are still unemployed).

[99] Which also eliminated a reference to benefits obtained by beneficiaries resident abroad.

[100] Press release of the Ministry of Labour of 26 April 2016, http://www.lavoro.gov.it/stampa-e-media/Comunicati/Pagine/Ministero-del-Lavoro-emendamento-del-Governo-al-DDL-delega-poverta.aspx.

3. strengthen the coordination of initiatives in the social services field in order to ensure that the essential level of benefits is being provided. The Government's enabling bill presented to Parliament did not refer to coordination but rather to the reorganisation of legislation governing the social services system.

The enabling law established that the reorganisation and coordination measures for the welfare and social services system shall not generate new or greater costs for the public finances.

The main characteristics of the Inclusion Income are specified in the principles and guiding criteria of the enabling legislation, which were detailed more clearly during the parliamentary discussion of the measure. These include: the requirement for a single national universal programme, albeit one subject to means testing on the basis of the ISEE while also considering disposable income and indicators of spending capacity; making the benefits conditional on a period of residence in Italy; giving priority to certain categories of household; ensuring the benefits were commensurate with the relationship between the household's economic condition and the poverty line; requiring participation in a customised labour market participation and social inclusion programme.

The principles and guiding criteria of the enabling legislation on the reorganisation of welfare programmes include the replacement of various anti-poverty programmes with the Inclusion Income (once the categories covered by previous measures are covered by the new system),[101] specifying that the ordinary Purchase Card should be replaced entirely when the beneficiaries of that programme are covered by the Inclusion Income mechanism. As for the third object of the enabling legislation the enabling law dwelt on the role and tasks of the Ministry of Labour, local governments, INPS, the social partners and representatives of third-sector organisations.

The enabling law was implemented with Legislative Decree 147/2017, which introduced the Inclusion Income.

3.3.1.2 Benefit payments

The amount of the benefit payment is first determined in respect of the difference between the disposable income of the household as calculated for the ISEE (ISR) and the theoretical threshold of €3,000 for a single member household (the same threshold used as the eligibility condition), initially reduced by 25 per cent. The level of the threshold varies on the basis of the number of members of the household in accordance with the ISEE equivalence scale, net of the increases granted for ISEE purposes[102] (accordingly, households who benefit from those increases, who are favoured by the mechanism of the ISEE with regard to the eligibility requirements to obtain the Inclusion

[101] Provision was also made for the inclusion of any savings produced by the reorganisation of the Anti-Poverty Fund and any uncommitted resources in the funds available for the subsequent year, in compliance with the expenditure limits for each year.

[102] The increases, which can be added together, are as follows: 0.2 for households with 3 children, 0.35 for four children, 0.5 for at least five children; 0.2 for households with minor children (0.3 if at least one of the children is less than 3 years old) if the parents worked as employees or in self-employment for at least six months in the reference year or if the household is composed of a single non-working parent and minor children (bearing in mind that for that purpose in many cases the non co-habiting parent not married to the other parent is also considered a member of the household if he has recognised the children). The scale of equivalence is increased by 1 for single-member households that receive continuous assistance in residential services or are residing with others at the same address without being considered a separate household.

Income, do not enjoy corresponding advantages with regard to the amount of the benefit).

Any welfare benefits subject to means testing are deducted from the amount of the benefit,[103] with the exception of: arrears; internship payments (Agreement in State-Regions Conference of 22 January 2015); any additional benefits provided as part of the customised programme funded by the municipality or the social association of municipalities; any exemptions granted for co-payments for services and payment of taxes; amounts received in lieu of services; and the so-called "baby bonus" of €80 a month for three years (except for the possible increase of 100 per cent envisaged for households with an ISEE of €7,000 or less).[104] For this purpose, the welfare benefits declared in the ISR are replaced, in calculating taxable income, with those received at the time the benefit is received, with the consequent loss of the advantage provided for under ISEE rules (deduction of 20 per cent up to €1,000).

The amount of the Inclusion Income benefit is given by the result, if positive, of the following formula:

$$\text{Monthly Inclusion Income} = \min\{[3{,}000 \times 0.75 \times \text{equivalence scale} - (\text{ISR} - \text{TA}) - \text{TA}_{\text{mt}}]; 534\}$$

where ISR is the income component of the ISEE, TA and TA_{mt} are total welfare benefits (which are subtracted from the ISR) and those subject to means testing (which are subtracted from the amount of the Inclusion Income).

The maximum Inclusion Income payment, which is granted if a beneficiary has an ISR adjusted for welfare benefits equal to zero, is given by the threshold amount less 25 per cent (€2,250) multiplied by the scale of equivalence. There is in any event a maximum benefit of about €534, equal to the social allowance (a sort of social pension) increased by the Budget Bill by 10 per cent.

Given the ISEE equivalence scale and the maximum benefit, the maximum payment would be €187.5 for a single member household, €294.38 for a two-member household, €382.5 for three members, €461.25 for four members and €534 for five or more members (Table 3.4).

Increasing the ceiling from its level set in Legislative Decree 147/2017, the bill eases the pressure on large households, mainly households with many children. Note that such households also receive benefits which are not means-tested established for births and the presence of children (such as the tax credit for a fourth child,[105] transformed into a refundable tax credit for those with insufficient income, or the birth bonus).

[103] Benefits not subject to means testing that are not deducted primarily include the attendance allowance.
[104] With an amendment approved by the Senate during the consideration of the Budget Bill, the "baby bonus" (in effect until 2017) was made permanent and will be paid until the child turns 1 year old. The amount will be reduced by half as from 2019, however.
[105] In the amount of €1,200, granted for households with at least four children present for at least part of the year.

Table 3.4 – Maximum benefit by number of household members
(euros)

Number of household members	Equivalence scale	Maximum monthly Inclusion Income payment (ISR=0)(1)	ISR threshold (Inclusion Income=0) (2)
1	1.00	187.50	2,250
2	1.57	294.38	3,533
3	2.04	382.50	4,590
4	2.46	461.25	5,535
5	2.85	533,95 (3)	6,413

(1) The Inclusion Income is maximum for an ISR of zero. – (2) For an ISR equal to or greater than the threshold, the Inclusion Income is zero. – (3) That amount, equal to the social allowance calculated over 12 months increased by 10 per cent, is based on the value of the allowance in force in 2017.

The calculation procedure thus differs from that used for the SIA, which provides for a constant per capita amount (€80) for all eligible beneficiaries. The Inclusion Income is higher than the SIA for households with the lowest incomes, and is therefore more effective at reducing inequality. An analysis conducted with the PBO microsimulation model shows that a transfer paid using the mechanism envisaged in the Inclusion Income scheme reduces overall inequality by 0.1 points more than a transfer made in accordance with the SIA procedures.[106]

The differences in the calculation mechanism mean that for certain types of household (those closest to the reference threshold for calculating the benefit) the benefit under the Inclusion Income is less than that they would receive under the SIA. In addition, the application of a reference threshold of €2,250 (75 per cent of €3,000) can reduce the Inclusion Income benefit to zero for households with an ISR between €2,250 and €3,000, at which level they would potentially still be eligible for the SIA. Overall, households who could receive the benefit, but with an Inclusion Income of zero, number about 194,000, 21 per cent of eligible households.[107]

3.3.2 The impact of the Inclusion Income on household financial conditions

Law 208/2015, which originated the Inclusion Income, sought to link financial support to the difference between the income of the beneficiaries and the absolute poverty line (see Box 3.1). We can therefore assess the effectiveness of the measure by comparing

[106] The exercise consists in measuring the change in inequality as a function of the benefit payment mechanism only for the same pool of beneficiaries (those in the Inclusion Income scheme).
[107] Consider also that given the procedure for calculating the Inclusion Income, some households receiving a positive benefit whose ISR was close to the threshold would receive very small amounts, probably representing an insufficient incentive to participate in the labour market participation programmes. This could limit the take up of the mechanism.

the pool of households potentially eligible for the Inclusion Income with the total population of households in a state of absolute poverty as estimated by Istat.

The extent of absolute poverty is estimated by Istat using a statistical criterion based on household consumption and represents the percentage of households that, on the base of the consumption survey, spend for consumption less than a threshold given by the monetary value at current prices of the basket of essential goods and services.

According to the estimates in the technical report accompanying the Budget Bill, the households beneficiaries of the Inclusion Income will represent 43.8 per cent of those in absolute poverty as registered by Istat in 2016 (Table 3.5). In addition, the thresholds established for the Inclusion Income, compared with those used by Istat for absolute poverty (which differ by type of household and place of residence, excluding housing expenses[108]) fluctuate between, for example, 45.4 per cent of the single-member households in the North and 54.9 per cent of households with a single member and households consisting of a couple with two children in the South.

Assuming that the Inclusion Income is paid exclusively to households considered to be in a state of absolute poverty in accordance with Istat criteria,[109] the poverty gap (intensity of poverty) would decline by about 9.8 points with the Inclusion Income, falling from the current 20.7 to 10.9 per cent. Under the same assumptions, the introduction of the Inclusion Income would not change the poverty head count ratio (extent of poverty), as the reference income for the Inclusion Income benefit, which is equal to the resources available to the household after receiving the benefit, is generally lower than Istat's absolute poverty line.[110]

Looking at this result, we should however keep in mind that this comparision involves two statistically non homogeneous populations, the poors (measured on the basis of household consumption – Istat's absolute poverty line) and the beneficiaries of REI identified by a selection criterion (that must necessarily consider indicators of financial status – income and property) that is not affected by consumption and savings decisions and reflect the equitable objectives of the law.

[108] For the purposes of the comparison, the absolute poverty line was adjusted (using Istat's 2015 survey of household expenditure) for rental payments or imputed rent on property owned by households, which are essentially excluded from the calculation of the income indicator used by the Inclusion Income scheme.

[109] The fact that the Istat criterion is based on consumption while the Inclusion Income refers to income thresholds means that it is not possible to obtain a precise determination of the degree of overlap between the two groups with the information currently available. As emphasised in the case of the two typical households mentioned earlier (and as can be found with the other population segments) the Inclusion Income threshold is significantly lower than the Istat poverty line and, consequently, the pool of potential Inclusion Income beneficiaries should represent a subset of the population of people in absolute poverty, even if we cannot entirely rule out possible areas of no overlap (for example, certain households qualifying as poor because of a low level of income could maintain a level of consumption above the poverty line by disinvesting past savings).

[110] In addition, the income indicator used to calculate the Inclusion Income includes any income tax and so in these cases disposable income would be below the threshold for the benefit. Moreover, for households to which the ceiling applies, i.e. the most numerous, do not even reach the reference threshold.

Table 3.5 – Inclusion Income and absolute poverty

Extent of absolute poverty and Inclusion Income beneficiaries	
Percentage of poor households (2016)	6.3
Percentage of households beneficiaries of Inclusion Income	2.7
Percentage of poor households that are Inclusion Income beneficiaries	43.8
Poverty gap	
Poverty gap 2016	20.7
Change in poverty gap after introduction of Inclusion Income	-9.8

Source: based on Istat data (2017) "*La povertà in Italia, anno 2016*" 13 July.

In any case, the comparison of the poor population as determined in accordance with Istat criteria and the beneficiaries of the Inclusion Income by subgroup of households offers a picture of the distributive impact of the selection criteria adopted. It is therefore be enlightening to compare, for the various population segments (geographical location, demographic and financial profile of households), the percentage of the population living in a state of absolute poverty and the percentage of the population covered by the Inclusion Income programme.[111]

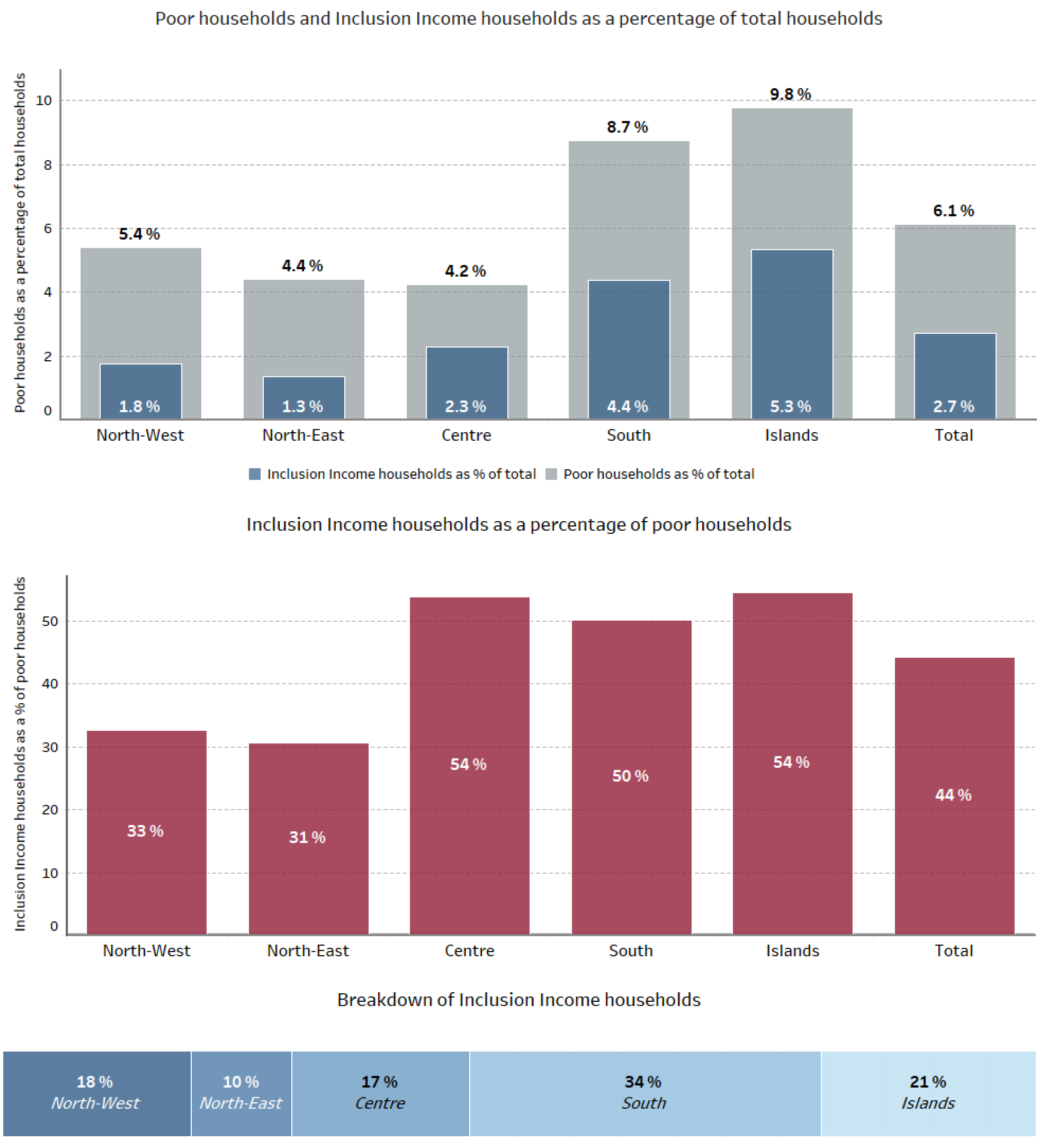
As regards geographical breakdown (Figure 3.5), the high concentration of absolute poverty in the South and Islands is accompanied by greater Inclusion Income coverage in southern Italy and the Centre, where beneficiaries account for more than 50 per cent of the poor. Overall, 55 per cent of Inclusion Income beneficiaries live in southern Italy and 17 per cent in the Centre. This result, which confirms the finding of the comparison of thresholds for typical household, is a consequence of the application of a single threshold for calculating the Inclusion Income across the entire country, while absolute poverty lines are lower in southern Italy as a result of the consideration of territorial differences in the cost of living.

As noted earlier, Istat also considers cost of living differences by the size of municipality. On average, differences by geographical location amount to about one third of the absolute poverty line, while that by size of municipality represent about 10 per cent.[112]

[111] The analyses are based on the 2015 survey of household expenditure, the most recent currently available, which allows a breakdown of the extent of absolute poverty to ensure better comparability of the data with the Inclusion Income estimates.

[112] Average differences for a single-member household. See Istat (2017), *op. cit.*.

Figure 3.5 – Inclusion Income and absolute poverty: geographical distribution



The coverage by the Inclusion Income of the poor households (absolute poverty) that do not own their home is remarkable (Figure 3.6). Among Inclusion Income beneficiaries, non-homeowners represent more than 64 per cent of the corresponding pool of poor householders, while homeowners account for only 13 per cent. This is a consequence of various factors. On the one hand, the pool of Inclusion Income beneficiaries, selected using more stringent criteria that the absolute poverty line, represents a segment that is more disadvantaged overall than the category of persons in absolute poverty. Since the share of non-homeowners is largest among the poorest, it is more likely they would be included among the pool of Inclusion Income beneficiaries. It is also necessary to consider that fact that spending on housing (actual rent for renters and imputed rent for homeowners) is treated differently in the two segments (it is included in determining absolute poverty and only partially considered for the purposes of the Inclusion Income programme[113]) and homeowners are penalised by the share of the value of their residence included in determining the ISEE, even if only above a certain threshold level.[114]

Absolute poverty is much more common among non Italian citizens (27.4 per cent of households with a non-Italian head of household are poor, compared with 4.5 per cent of households headed by an Italian) (Figure 3.7). However, the Inclusion Income programme provides support to nearly half of poor households with an Italian head, compared with about a third of those with a foreign head of household. First, this result could be affected by differences in the take up of the programme, which is presumably greater among Italians.[115] Second, the significant proportion of households in absolute poverty among those with a non-Italian head of household partly depends on the use of consumption as the metric for determining eligibility: very parsimonious consumption habits, partly reflecting the desire to send remittances home to their country of origin, can bring non-citizen households below the threshold even with higher incomes. Overall, more than three-quarters of households benefitting from the Inclusion Income scheme are Italian, even not considering the citizenship and residence requirements established in the rules governing the programme, which would further restrict the pool of eligible foreign citizens.

[113] Up to €7,000 a year in rent payments can be deducted from income, plus €500 for each cohabiting child after the second. The value of a home impacts the ISEE only if it exceeds the exemption threshold and in the amount of about 13 per cent.
[114] An allowance of €52,500 can be deducted from the local property tax (IMU) value of the primary home, plus €2,500 for each cohabiting child after the second, while two-thirds of the remainder is considered in the ISEE calculation.
[115] The estimates for beneficiaries of the Inclusion Income implicitly take account of this phenomenon as they are based on the DSUs actually submitted in 2016.

Figure 3.6 – Inclusion Income and absolute poverty: ownership of home

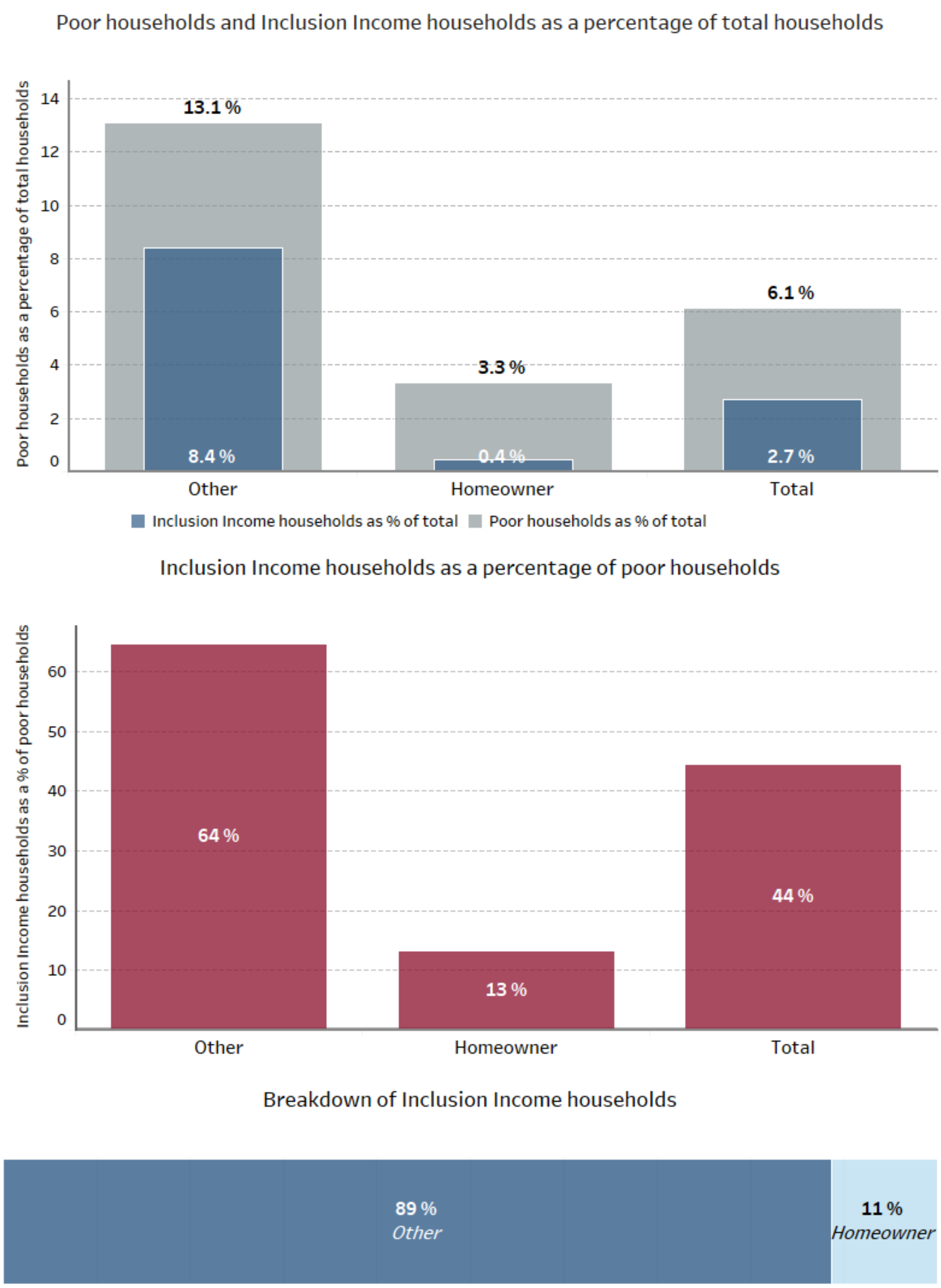
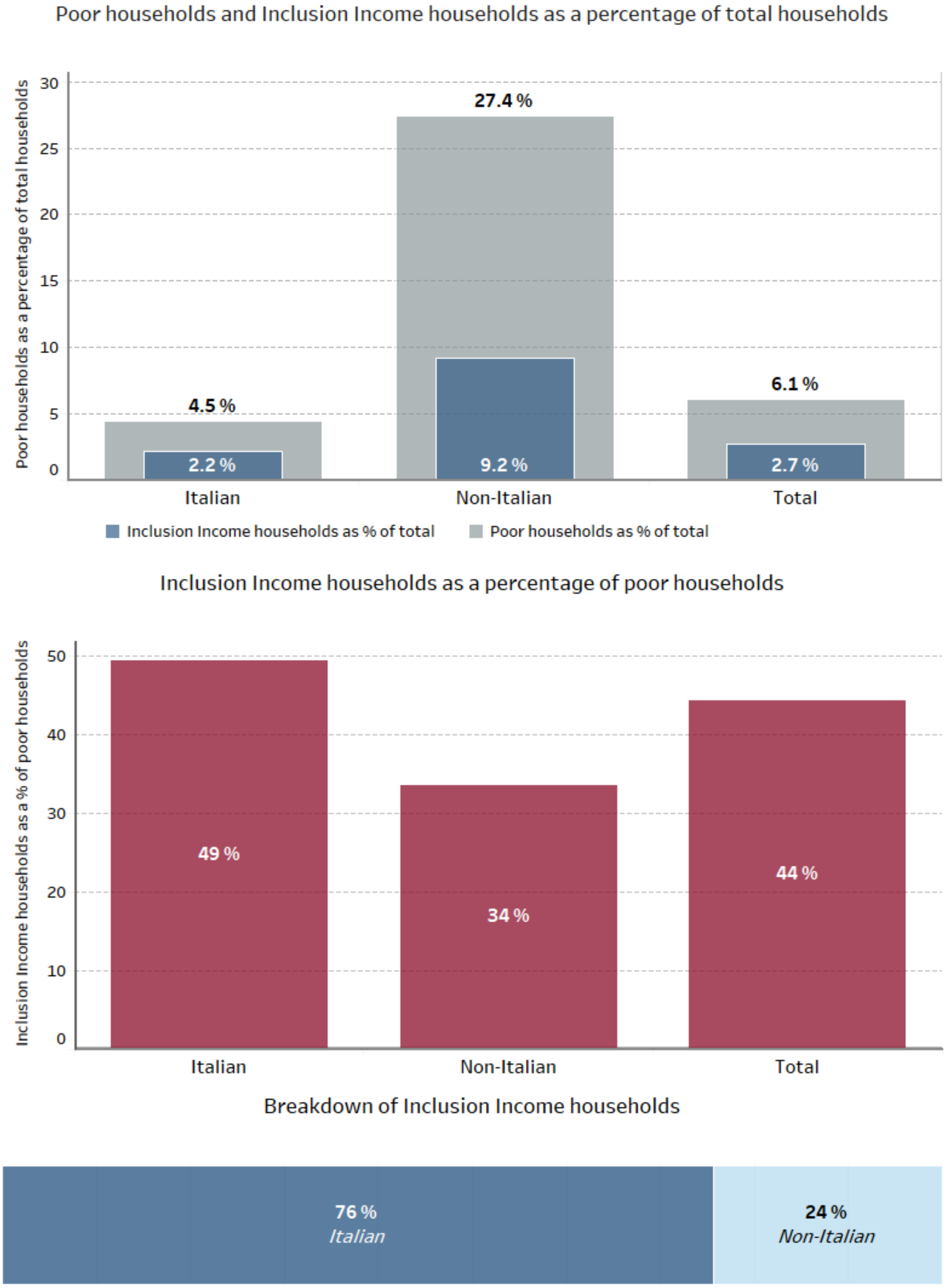


Figure 3.7 – Inclusion Income and absolute poverty: nationality of head of household



The share of poor households among those with an employed head of household (Figure 3.8) is slightly less than that among households with an unemployed head (5.9 per cent, compared with 6.3 per cent),[116] but the number of poor households with an employed head eligible for the Inclusion Income is relatively small: beneficiaries account for about one-fifth of the households in absolute poverty in this category (1.3 per cent compared with 5.9 per cent overall), compared with two-thirds of households with unemployed heads (4.2 per cent compared with 6.3 per cent overall), and less than a quarter of beneficiary households have an employed head of household (21 per cent). It is likely that the characteristics of the Inclusion Income, and in particular the concentration of the programme on groups in a state of extreme poverty, are too restrictive to allow the scheme to cover a significant proportion of the working poor, despite the favourable treatment of income from payroll employment in calculating the ISEE (20 per cent of ISR deductible up to a maximum of €3,000).

According to Istat data, absolute poverty is concentrated among households with younger heads of household (9.2 per cent of households with a head aged up to 40 are in a state of absolute poverty), while among households with a head aged over 65 the share of poor households (4 per cent) is significantly lower than the average (6.1 per cent; Figure 3.9).

The latter category includes households that already receive a pension (whether a contributory pension or a social pension). The Inclusion Income, even in the definitive version set out in the Budget Bill with the elimination of the conditions concerning minor children, will cover more than three-quarters of the pool of poor households with an under-40 head of household, a figure that falls to 45 per cent of those with a head aged between 40 and 64, an age group in which income from employment tends to be higher than that received by households with younger heads. The low level of the ISR threshold for Inclusion Income purposes will disqualify households with an elderly head receiving pensions benefits, which are included as income in the calculation of the eligibility indicator. For example, the social allowance is equal to €485.41 a month, whereas the ISR threshold is €187.5 a month for a single-member household.

As regards the impact of the Inclusion Income on overall inequality in the distribution of disposable income, the introduction of the programme would reduce the Gini coefficient by 0.4 points.[117]

[116] This partly depends on the large share of foreigners among poor households with an employed head of household, who tend to work on the margins of the regular labour market.
[117] Estimation conducted using the PBO microsimulation model. The assessment does not consider the inclusion of the SIA paid in 2017, for which there are no data on actual use.

Figure 3.8 – Inclusion Income and absolute poverty: employment status of head of household

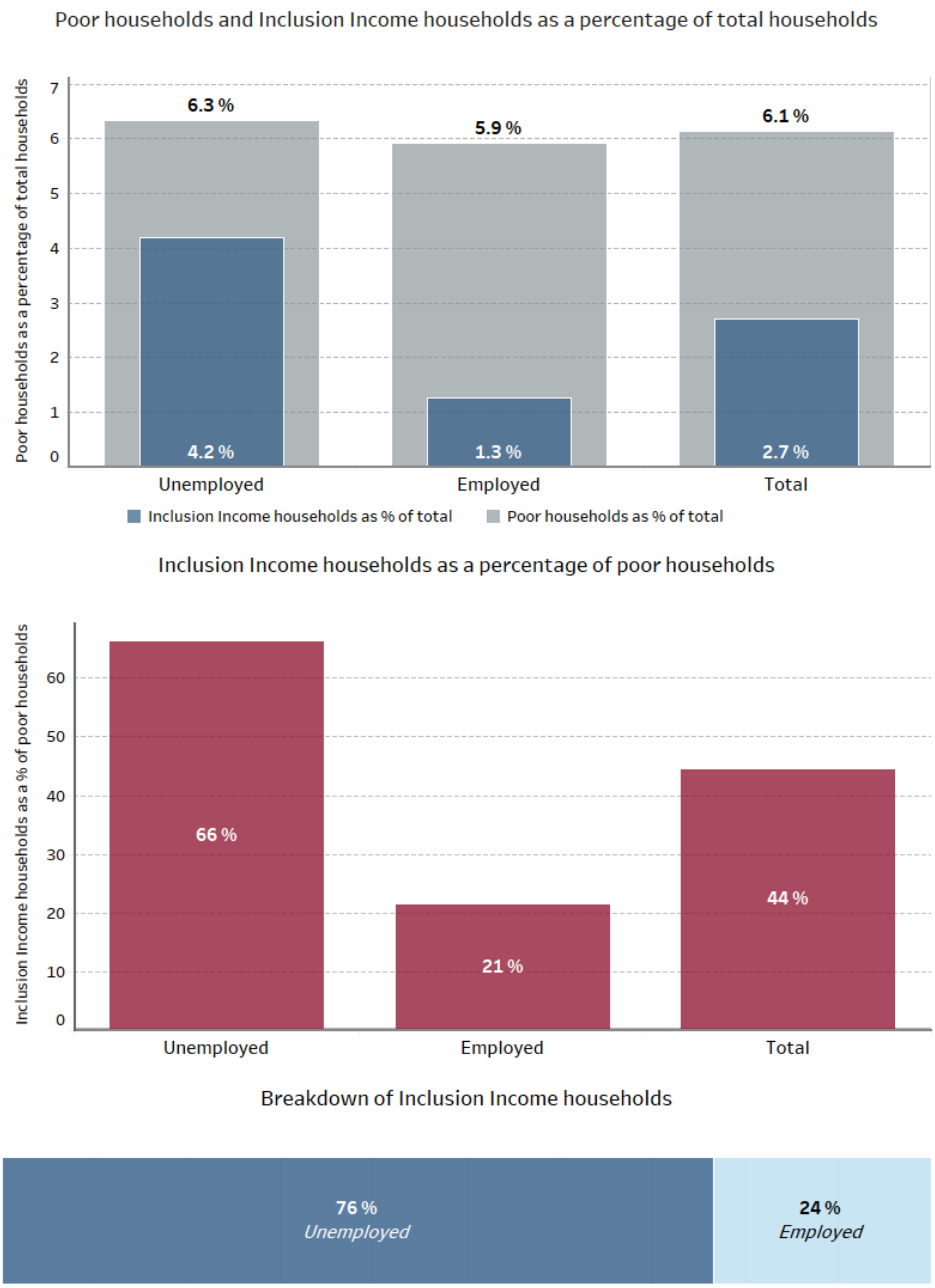
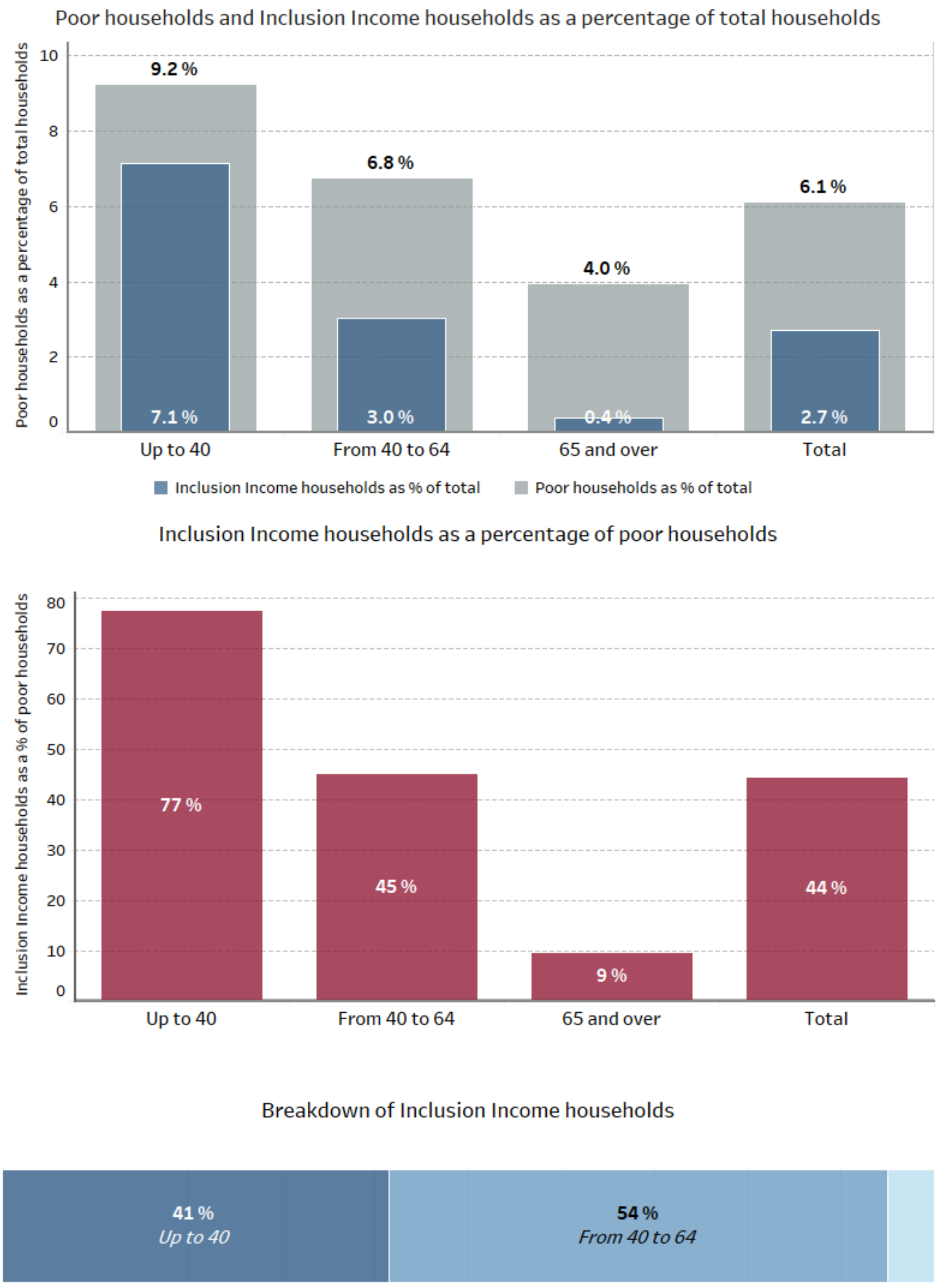


Figure 3.9 – Inclusion Income and absolute poverty: age of head of household



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With regard to the indicators of fair and sustainable well-being (FSWs) incorporated in the budget programming process,[118] it is possible to assess the impact of the Inclusion Income programme on the indicators of financial well-being. These indicators include the poverty head count ratio (the percentage of the poors in the population), the interquintile ratio (an indicator of inequality in disposable income calculated as the ratio between the equivalent income of the richest quintile and that of the poorest quintile), and the average adjusted per-capita disposable income (including services in kind provided by government and non-profit entities). As noted earlier, the income level achieved thanks to Inclusion Income benefits does not appear sufficient to raise beneficiaries out of absolute poverty thresholds and thereby reduce the number of poor households, but it does ease distress by reducing the intensity of poverty, an indicator not included among the FSWs. Similarly, the programme should not have an impact on the interquintile ratio as all the beneficiaries of the Inclusion Income programme should remain in the lowest quintile. Average "adjusted" per-capita disposable income should increase, however, once the Inclusion Income mechanism is fully implemented, by 0.16 per cent, not considering any effects of the opposite sign that might be caused by measures to cover the cost.

3.3.3 The resources for the Inclusion Income programme

Table 3.6 shows the total cost of the Inclusion Income programme, broken down by target (taking account of the changes introduced with the Budget Bill and with the amendments passed by the Senate during the approvals process). These resources include those from other previously existing programmes, such as the Purchase Card[119] (for households with minors that apply for Inclusion Income benefits, the ordinary Purchase Card subsidy is folded into the new programme) and the ASDI, which will remain in 2018 only for people who have finished their NASPI benefits and are still unemployed. The SIA will no longer be supplied as from 2018 (existing beneficiaries will be transferred to the Inclusion Income programme).

Additional resources could be taken from the National Operational Programme (NOP) on Inclusion funds (€1 billion from the European Social Fund 2014-2020).[120] The Budget Bill allocates 15 per cent of the whole Anti-Poverty budget for local social services, which could be reviewed in the future and has already been raised to 20 per cent as from 2020 with the Senate amendment just mentioned. The NOP funds will also be used to finance services and the beneficiary support process (this was already begun for the SIA). A small portion of these resources (€20 million as

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[118] Law 163/2016, which amended the content and structure of the Budget Act, provides for the systematic use of the FSWs in policy documents, integrating them directly into the economic and financial policy cycle and creating the foundation for using them as a tool for assessing economic policy. The 2017 Economic and Financial Document included four FSWs for the first time on an experimental basis. The Decree of the Ministry for the Economy and Finance of 16 October 2017 increased the number of indicators to twelve as from the following year.

[119] For more on the characteristics of the Card, see the Table in Appendix 3.1.

[120] This is the NOP envisaged in the 2014-2020 Partnership Agreement for the use of European Structural and Investment Funds (Ministero del Lavoro e delle politiche sociali (2017), *op. cit.*.).

from 2018) has been allocated to initiatives and services for the extremely poor and the homeless, and another €5 million a year for 2018-2020 have been allocated with a Senate amendment to experimental programmes for adults under the age of 21 living apart from their family under a court order.

Regional governments may supplement the Inclusion Income budget as long as the initiatives are funded with regional resources (which must be channelled into the Anti-Poverty Fund), expanding the pool of beneficiaries or increasing the size of the benefit, using a memorandum of agreement with the Ministry of Labour. For regions other than Trentino Alto Adige (where the anti-poverty programmes of the autonomous provinces do not influence the eligibility requirements for the Inclusion Income), the possibility of supplementing the Inclusion Income seems to represent a major incentive to address resources originally devoted to local programmes into the Inclusion Income scheme.[121]

Note that the total resources allocated to the Inclusion Income programme are consistent with the estimates in the technical report accompanying the Budget Bill and Decree Law 147/2017, which were prepared on the basis of the DSUs submitted in 2016. As noted earlier, this cost estimations may be affected of underestimation. Nevertheless, this issue was taken into account in the technical reports by adding a 15 per cent margin for any additional costs.

Table 3.6 – Resources for fighting poverty (implementation of the Inclusion Income programme)

	2018	2019	2020	2021
Strengthening local social services and initiatives	297	347	470	470
Economic aid	1747	2198	2158	2130
ASDI funding	15			
National Anti-Poverty Plan purposes			117	145
Total	2059	2545	2745	2745

Source: technical report accompanying the Budget Bill. From 2020, the figures reflect the effects of the amendments passed by the Senate during the Budget Bill approval process.

[121] It is not easy to draw a map of local anti-poverty measures, partly owing to the frequency of changes, eliminations and reintroductions of programmes. In addition to efforts by certain municipalities, such as Livorno for example, various regions have or are introducing income support schemes, some of which supplemented the SIA: for example, Valle d’Aosta, Friuli Venezia Giulia, Puglia, Basilicata, Veneto (in some municipalities), Emilia Romagna, Molise, Sardinia and Umbria. In some regions, such as Campania, the experiment has been concluded. In addition, some regions have introduced diversified support programmes, especially during the financial and economic crisis, including voucher schemes (e.g. Lombardy), microcredit initiatives (e.g. Tuscany), integrated public services (e.g. Emilia Romagna), housing policies (e.g. Lazio and Lombardy), heating allowances (Valle d’Aosta), the supply of textbooks (Basilicata), or support for poor families with non-self-sufficient members (Calabria). Various regions also established programmes for the recovery and distribution of surplus food (see Granaglia, E. and Bolzoni, M. (2016), *op. cit.*; Bezze, M. and Geron, D. (2014), “Quando il welfare non è un investimento sociale”, lavoce, 25 July; Napolitano, G. (2017), “Le politiche per la lotta alla povertà in Italia”, mimeo).

INPS will have to monitor the amount of funding needed to provide benefits each year, taking account of the gradual expansion of the pool of potential Inclusion Income beneficiaries. If the funds would run out, the amount of the benefit paid to all beneficiaries (including those already receiving the benefit) will be adjusted with a decree of the Ministry of Labour in agreement with the MEF. Pending adoption of that decree, payment of the benefit and acceptance of new applications will be suspended.

This procedure appears to be designed to safeguard the public finances in respect of a measure whose cost – precisely because of its universal nature – is difficult to quantify ex ante. Nevertheless, reducing the financial benefit would give rise to differential treatment of beneficiaries with the same socio-economic characteristics that ask for the Inclusion Income programme, which represents a level of essential benefits, at different times. It is therefore likely that in the event of a significant divergence from forecasts Parliament would appropriate additional resources or modify the system. The power to redetermine the amount of benefits on the basis of the available resources by administrative fiat does not seem sufficient to ensure the financial soundness of the system in respect of a universal benefit scheme.

3.4 *Measures to fight tax evasion*

The Budget Bill and Decree Law 148/2017 contain measures designed to counter tax evasion and strengthen tax collection totalling €1.9 billion in 2018, €2.8 billion in 2019 and €3.3 billion in 2020 (Table 2.4). The provisions continue the introduction of preventive measures that on the one hand seek to facilitate the acquisition of information necessary for the performance of targeted controls by tax authorities and on the other encourage tax compliance and foster the resolution of disputes. In one case, namely the extension of the time limits and eligible participants in the programme for the facilitated settlement of tax arrears, the budget package is proposing a measure with many of the features of a tax amnesty, which in eliminating sanctions and default interest rewards the least deserving and weakens the incentives for voluntary compliance on the part of taxpayers.

Significant revenue (€0.2 billion in 2018, €1.7 billion in 2019 and €2.4 billion as from 2020) is expected to be generated by the introduction of mandatory electronic invoicing among private-sector taxpayers as from 2019,[122] using the data interchange system (SID). At the same time, the budget measures also eliminate the quarterly reporting of customer and supplier lists and data on invoices and periodic VAT settlements (the so-called VAT transaction report), introduced on an optional basis in 2016 (Legislative Decree 127/2015) and then made mandatory as from 2017 (Law 225/2016).[123]

The measures appears to implement what the Government was asked to do in the resolution approved by the Chamber of Deputies on 18 October 2017 concerning the need to: 1) eliminate the VAT transaction report, 2) minimise mandatory reports, 3) ensure compliance and reduce evasion through simpler, more efficient and more effective methods, and 4) invest in electronic tax assessment and collection systems, ensuring the protection of taxpayer rights and the key principals of personal data protection.

The electronic invoicing was introduced in June 2014 for transactions with government departments and, as from 2017, the SID system can be used on a voluntary basis for transactions between private-sector actors.[124]

The introduction of mandatory electronic invoicing is a major step toward the digitisation of the taxpayer compliance and control systems of the tax authorities. As part of the “Digital Agenda for Europe” of 2010, the European Commission identified the generalised adoption of this tool as a key element of digitisation.

[122] The electronic invoicing requirement has been brought forward to July 2018 for the sale of petrol and diesel fuel and subcontractor services provided to contractors in tenders for services and supplies delivered to government departments.

[123] A system similar to the VAT transaction report had been introduced in 2010 and subsequently weakened because it was considered too great a burden on firms. The requirement for the quarterly submission of invoices introduced with the 2017 Budget Act was expected to generate additional tax revenue of €2.1 billion in 2017, €4 billion in 2018 and €2.8 billion in 2019.

[124] According to Revenue Agency data, private-sector firms already use electronic invoicing account for 30 per cent of the total, much higher than the EU average of 18 per cent.

Various European countries have begun the digitisation process. In the Netherlands, since 2017 firms must transmit electronic invoices through a digital platform, but implementation is gradual. In the same year, Belgium and France, as with Italy, made electronic invoicing mandatory for transactions involving government departments. France also plans to gradually extend the requirement to the private sector, taking due account of firm size and the associated differences in the compliance burden. In Germany, a bill has been introduced to introduce electronic invoicing at the federal level and local authorities are also introducing regulations in this field. In Poland, as from January 2017 firms with fewer than 250 employees and a turnover of more than €2 million must transmit VAT transaction data electronically.

A special case is represented by Portugal, which appears to have increased VAT revenue significantly thanks to the digitisation process initiated in 2013 with a requirement for rapid (within the month following the transaction) electronic reporting of invoice data for transactions carried out by resident firms and self-employed persons, both in business-to-business (B2B) transactions and in business-to-consumer (B2C) transactions. The way in which the system was implemented seems to have played a significant role in its effectiveness. More specifically, using a special web portal, the information transmitted to tax authorities is made available to both those submitting the data and the transaction counterparties in order to enable reciprocal checks of the accuracy of the information. Consumers are eligible for a tax credit of 15 per cent of VAT paid, up to a maximum of €250, for certain categories of services (restaurants, hairdressers and aestheticians, hotels, car and motorcycle repair shops). This is accompanied by a sort of national lottery that awards prizes (for example, cars) to participating consumers. The Portuguese reform is not based on "electronic invoicing", but those subject to VAT requirements can opt to issue paper or electronic invoices. The electronic transmission of the data must nevertheless use a standard format and timeline.[125] More highly structured firms using computerised management systems can therefor use electronic invoicing, while small firms and professionals, who normally do not use computerised systems for their accounts, can manually enter the data contained in invoices on the web portal or upload a data file to the portal. The system offers an incentive to craftsmen and professionals to digitise their invoicing and, at the same time, pushes larger firms to upgrade their administrative systems, with generalised electronic invoicing.

The Budget Bill requires the tax authorities to provide persons who pay VAT and companies using simplified accounting the information they need to prepare the periodic VAT settlement returns, annual VAT returns and income tax returns with the accompanying worksheets summarising the calculations performed, as well as draft payment forms with the amount of tax to pay, offset or request reimbursement.

This represents an additional improvement of the tools to reduce non-consensual tax evasion in B2B transactions. The key element (the Portuguese case is an example) is the possibility of considering only amounts that the tax authorities have registered (through electronic invoicing), in the periodic VAT settlements and VAT returns for the purpose of payment or offsetting of VAT.

A degree of uncertainty remains, however, concerning the possibility that this measure will encourage VAT payers to seek out opportunities for tax evasion with collusion (i.e.

[125] On the technical plane, in 2008 Portugal adopted the Standard Audit File for Tax Purposes (SAF-T), an exportable accounting data format designed for the electronic exchange of accounting information between firms and tax authorities, using OECD guidelines. In recent years, other European countries (for example, Austria, France, Germany, Luxembourg and Poland) have initiated, albeit on a less binding and extensive scale than in Portugal, the adoption of this standard to improve the reliability and speed of audit activities, especially with large companies.

an agreement to evade between buyer and seller) more aggressively and expand evasion in business-to-consumer transactions. Exposing costs through mandatory electronic invoicing could be accompanied by a loss of revenue that, however, could be countered with appropriate controls of the stability and credibility of firms' margins. With regard to the final stage of the chain of commercial transactions, it would appear essential to extend the requirement for electronic invoicing and the notification of revenue to taxpayers not required to issue invoices (retailers, restaurants etc.), even though this would increase the compliance burden for smaller businesses.

This is not the thrust of the measure in the Budget Bill that extends from 2017 to 2018 the electronic transmission of daily revenue data in place of fiscal certification of that revenue for large retailers who opted to do so in 2016. This system was introduced in 2004 (Law 311/2004) and despite its repeal as from 2017 (with Legislative Decree 127/2015) it was extended through 2017 for companies that had exercised the option by 2016 (Legislative Decree 193/2016).

Appropriate limits on the use of cash (more stringent limits than current restrictions) could also make a significant contribution to countering collusive tax evasion.

Another measure designed to expand the tax base through changes in compliance procedures is the extension of the VAT split payment mechanism, assuming the buyer has greater "tax honesty" than the seller. Decree Law 50/2017, which extended the split payment mechanism to all government departments, forecast an increase in revenue of €1 billion in 2017 and about €1.5 billion in 2018 and 2019.

Other measures limit automatic access to payments from government departments and reimbursements from the Revenue Agency, which is expected to generate about €0.4 billion in additional revenue each year.

In general, in recent years the efforts to prevent and combat tax evasion have shifted from an approach based on penalties and repression to one designed to foster and encourage voluntary compliance by taxpayers. The regulatory framework therefore seeks to improve the ex post rationale of audits and penalties (by making them more commensurate with the severity of the tax violation) and adopt a preventive approach ex ante, considering taxpayers as persons to be helped in discharging their tax obligations (moral suasion).

The new approach must meet the need of the tax authorities to operate in a new environment, one where tax assessment and fighting tax evasion must contend with the tax avoidance strategies of large companies and multinationals, as well as the challenges raised by the large number of entrepreneurs and small businesses. This is the rationale behind the measure accelerating the amicable resolution of international tax disputes (MAP), tax rulings for companies with international operations and those associated with the optional preferential tax regime for income from the use of intangible assets.

The quantitative impact of these measures taken together is significant. In recent years, budgets have counted on generating an increasing volume of revenue from tax amnesties and measures to counter tax evasion. While the revenue effects of the former are easier to ascertain, determining the revenue impact of the latter is much more complex and uncertain, both ex ante and e post, which creates substantial uncertainty about the quantification of the budget package as a whole.

3.5 Measures for firms

The main measures targeted at firms include incentives for investment, the postponement of the introduction of the tax on entrepreneurial income (IRI), the exemption of dividends from foreign subsidiaries in the calculation of the gross operating margin, the increase in the tax rate on property income from qualifying equity investments and tax credits granted for the acquisition of capital goods and spending on training. According to official figures, the measures as a whole will reduce net borrowing by €2.7 billion in 2018 and increase it by €1.8 billion in 2019 and €1.1 billion in 2020 (Table 2.4): while most of the incentives will have a financial impact as from 2019, the measures increasing the tax burden are concentrated in 2018 to fund other measures in the Budget Bill.

The investment incentives include tax relief (totalling €0.9 billion in 2019 and €1.7 billion in 2020) – with the extension of increased depreciation for capital goods, software and so-called Industry 4.0 assets – and monetary subsidies (€0.2 billion in 2018 and €0.4 billion in 2019) – with the extension of the new Sabatini mechanism and the tax credit for spending on training and on capital goods with the framework of regional aid schemes. Sectoral incentives include cutting corporate income tax rates (IRES) in half for amateur sports clubs and tax incentives for advertising expenditure (introduce with Decree Law 148/2017).

As regards investment incentives, the Budget Bill reduces the increase in allowable depreciation from 40 to 30 per cent, leaving unchanged those for Industry 4.0 assets (150 per cent) and software (40 per cent). The incentive is extended to investments undertaken or even just ordered with a payment on account in 2018 (even if the assets are delivered in 2019).

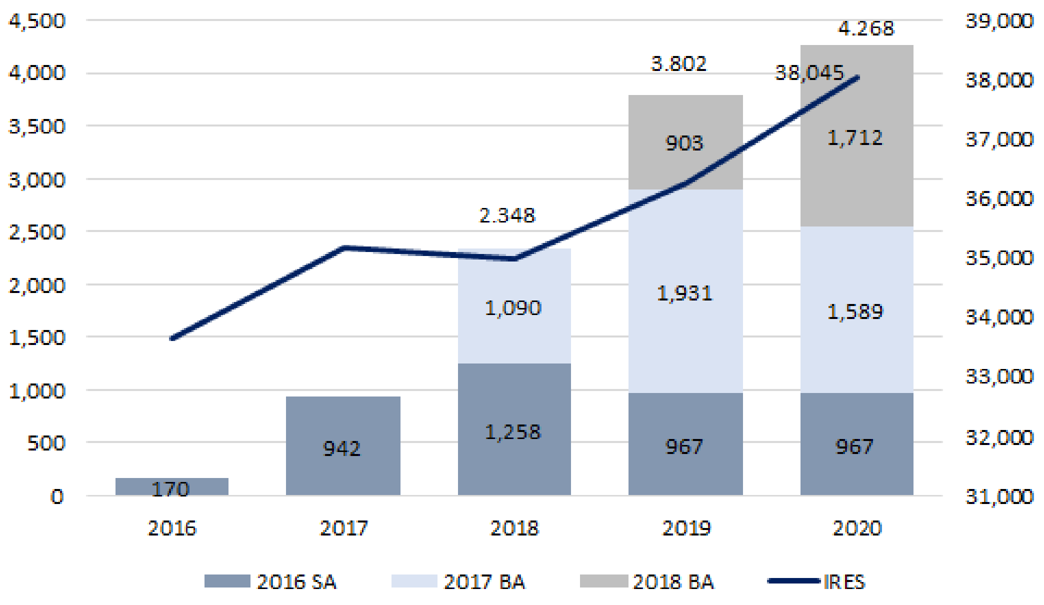
Any assessment of this measure must necessarily analyse the results of other measures in force until 2017. Using the ex ante estimates in the technical reports accompanying the associated legislation (the 2016 Stability Act and the 2017 Budget Act) and considering the long-term effects of the incentives for investments in 2016-2017, the overall impact of the reduction in tax connected with the increased depreciation mechanism amounts to €2.3 billion in 2018 and reaches and then exceeds €4 billion in the two subsequent years (Figure 3.10). Over a three-year horizon (which does not mark the end of the tax relief), the financial support to firms who invest would amount to more than €10 billion.[126] Nevertheless, in the light of data on investments, these quantifications are underestimated.

More specifically, Istat figures for investment by type of good in 2016 (Figure 3.11) show that developments in total investment and investment in the various categories of good appear to confirm and strengthen the slight upturn that began in 2014 and 2015. The data show a high rate of growth in investment in transport equipment, equal to almost 30 per cent between 2015 and 2016. The fastest pace of investment growth is found in agriculture and industry, where the largest increase in investment in plant and machinery

[126] Over the entire time span of the depreciation, between 2016 and 2026 the reduction in taxes due by firms exceeds €20 billion.

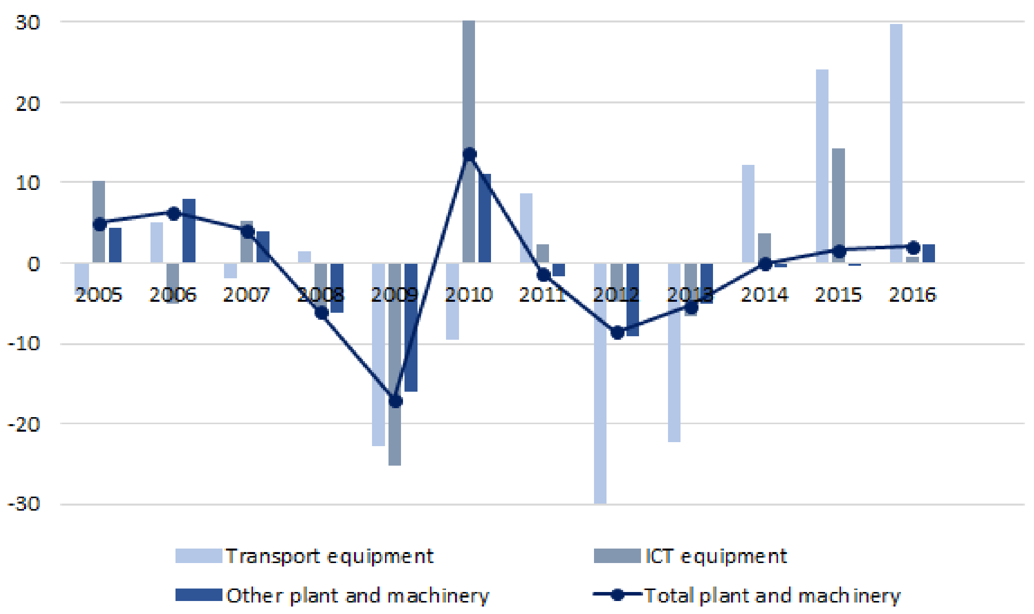
was registered. The eligible investments assumed for 2015 and 2016 in the technical report accompanying the 2016 Stability Act were underestimated by about 15 per cent (Figure 3.12).

Figure 3.10 – Tax revenue loss from the increase in depreciation allowances



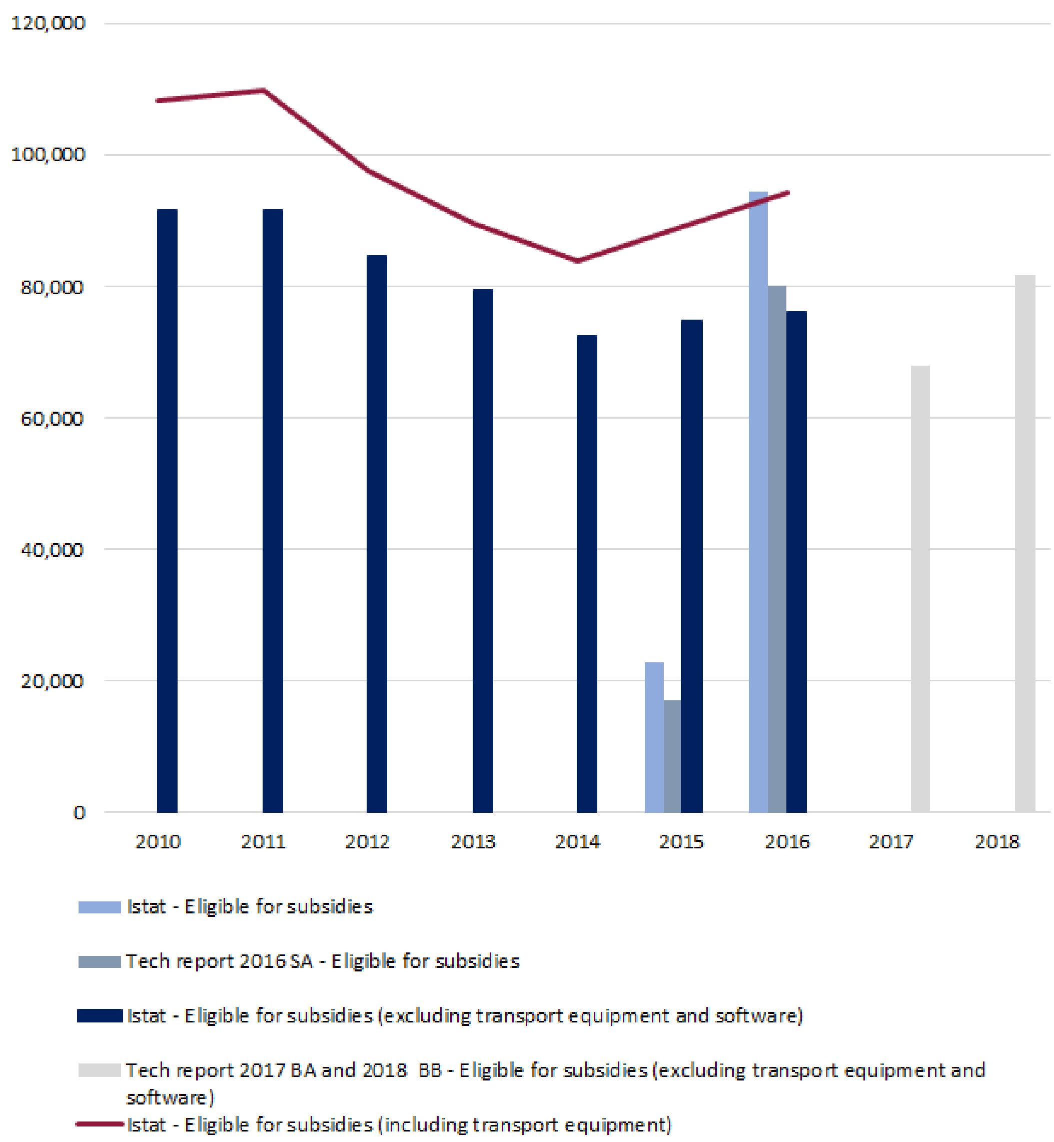
Source: based on data from the technical reports accompanying the 2016 Stability Act, the 2017 Budget Act and the 2018 Budget Bill.

Figure 3.11 – Developments in investment in plant and machinery



Source: based on Istat data.

Figure 3.12 – Potential subsidised investment: ex ante estimate and ex post data



Source: based on Istat data and date from the technical reports accompanying the 2016 Stability Act, the 2017 Budget Act and the 2018 Budget Bill.

For 2017, taking account of the exclusion of transport equipment not used in operations from eligible assets and assuming a level of investment equal to that prior to 2013, the amount of eligible investments reported in the technical report accompanying the 2017 Budget Act could be an underestimate. Investments in Industry 4.0 assets are much more highly incentivised than others, given that firms can reduce the cost of investment (with a subsidy to be deferred over the period of depreciation) by 36 per cent (i.e. 24 per cent of 150 per cent) in the case of taxpayers paying IRES and up to 64.5 per cent (43 per cent of 150 per cent) in the case of those paying personal income tax (IRPEF).[127] On the basis of the data from the technical report accompanying the 2018 Budget Bill, at the indication of the Ministry for Economic Development, investment in such assets was estimated at about €10 billion (just over 13 per cent of total forecast investment in plant and machinery), with an increase of 20 per cent in 2018.

The measures to fund the expenditure include the postponement by one year (from 2017 to 2018) of the entry into force of the IRI system for firms subject to personal income tax (partnership taxation) provided for in the 2017 Budget Act (which increases revenue by €2 billion in 2018 and reduces revenue by €0.8 billion in 2019). The new system applies a proportional tax on the retained earnings of sole proprietorships and partnerships using ordinary accounting rules.[128] The IRI rate is equal to 24 per cent, in line with that levied with IRES on the income of corporations. The measure is intended to eliminate the disparity in the treatment of unincorporated businesses and corporations, making the tax system more neutral with respect to the choice of business status. As shown in Figure 3.13, the difference in taxation between the two types of legal form has widened in recent years, with the IRES rate approaching the minimum rate of personal income tax, after having originally been very close to the maximum IRPEF rate. At the same time, by reducing the taxation of reinvested profits, the measure also seeks to bolster the capitalisation of enterprises with own funds.

The postponement of the entry into force of the new taxation regime could have an impact on the decisions of businesses, increasing uncertainty for the tax system as well.

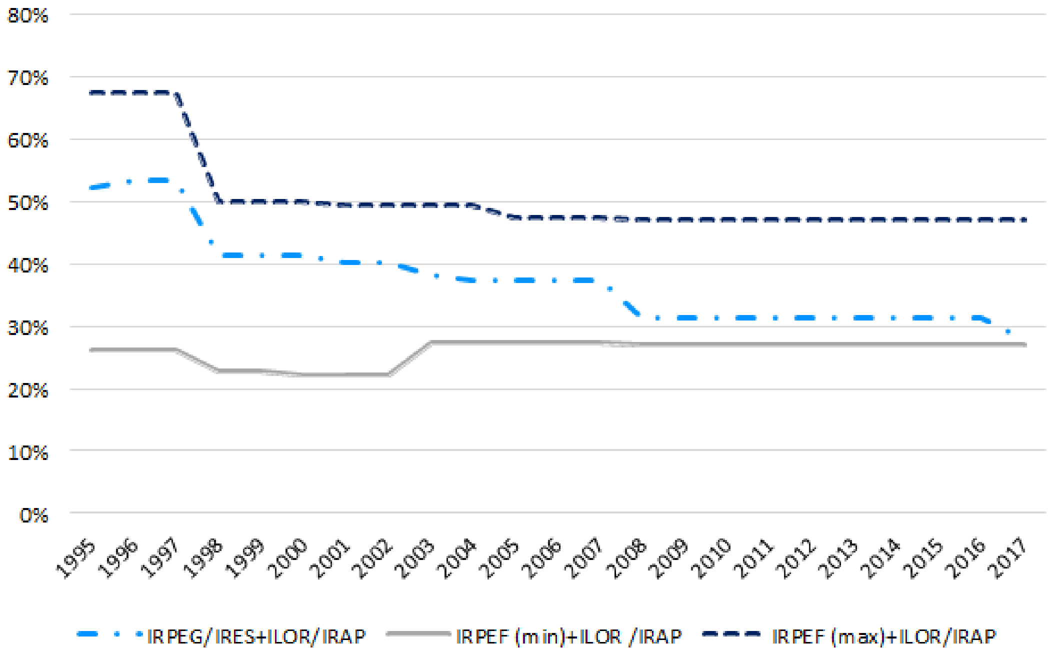
The remaining main measures of the Budget Bill address the very structure of corporate taxation. A uniform tax rate is applied to capital income from equity investment. Under current legislation, only 58.14 per cent of dividends are included in the tax base of IRPEF. In this case the level of taxation depends on the marginal rate of the taxpayer and in any event does not exceed 25 per cent.[129] The measure increase this rate by one percentage point, extending the application of the tax of 26 per cent already levied on all dividends from non-qualifying equity investments to this type of equity investment as well.

[127] For plant and machinery used in operations and software, for which the increase in depreciable amount is equal to 30 and 40 per cent, the subsidy falls to 7.2 and 9.6 per cent for legal persons and 12.9 and 17.2 per cent for natural persons (assuming the maximum marginal tax rate of 43 per cent).

[128] A similar tax system already existed in Italian law. It was introduced with Law 244/2007 (Art.1, paragraphs 40-42), but it did not enter into effective force as the implementing decrees were never issued. The tax enabling law (Law 24/2014) also provided for the introduction of a proportional tax on entrepreneurial income, which should have been extended to the self-employed (arts and professions) but was never implemented.

[129] This mechanism ensures that the total taxation of profits does not exceed the maximum IRPEF rate of 43 per cent. With an IRES rate of 27.5 per cent, the percentage of taxable dividends was 49.72 per cent and the rate on dividends was equal to 21.4 per cent.

Figure 3.13 – Nominal corporate tax rates



A second measure provides for the exclusion of dividends from foreign subsidiaries from the calculation of the gross operating margin, reducing the potential deductibility of interest expense from the IRES tax base. The new rules essentially repeal the provisions introduced in 2014 with Legislative Decree 147/2014.

Although in this case the amounts involved are very small and affect a limited number of companies (the technical report estimates €6 billion in foreign dividends and a gross operating margin of €318 billion in 2015), the reduction of the gross operating margin is a limitation on the deductibility of interest expense (which is deductible in an amount equal to interest income and for the remainder in an amount up to 30 per cent of the gross operating margin), thereby limiting the tax advantages of debt financing. In this regard, it should be noted that Decree Law 50/2017 further weakened the calculation of the allowance for corporate equity (Aiuto per la Crescita Economica – ACE) by reducing the notional rate of ordinary remuneration (from 2.3 to 1.6 per cent in 2017 and from 2.7 to 1.5 per cent thereafter), thereby reducing the attractiveness of financing with own funds.

3.6 Measures for public employees

The Budget Bill contains a number of measures concerning public employment. The most important in terms of resources is the renewal of the contracts of government employees. The overall cost of the agreement between the Government and the trade unions in November 2016 – an average increase in gross monthly salaries of about €85 – will amount to €2.85 billion a year as from 2018, requiring additional resources of €1.65 billion compared with current legislation.[130] In order to ensure that the contract renewal does not lead to the loss of the monthly €80 tax credit for public employees with annual remuneration of less than the €26,000 threshold for the benefit, additional expenditure of €0.2 billion per year is provided for in order to increase the eligibility threshold. The Budget Bill also provides for an adjustment of the fixed component of the remuneration of school heads (about €95 million from 2020) and the acceleration of wage increments for certain groups of university instructors (€80 million in 2020).

The Budget Bill also contains measures designed to permit new hiring in derogation from the restrictions provided for in current legislation for certain government departments. Among the most important, this includes a special hiring programme for security and safety personnel (the Carabinieri, the police, correctional officers, the Finance Police and firefighters) to accelerate the restoration of staffing levels, with about 7,400 new hires between 2018 and 2022. Universities and research institutes will receive an increase in financing (a total of €90 million from 2020) to hire about 1,300 and 300 researchers respectively. The judicial system will receive additional funding of about €80 million a year for personnel, of which more than half to be used to hire an additional 1,400 non-management personnel, with the rest going to pay for more magistrates (the winners of competitive exams already under way) and the expansion of the staffs of the Attorney general's office and the public prosecutors' offices. Other provisions regard the recruitment or stabilisation of non-management personnel, mainly at ministries.[131]

The financial effects of these budget measures will increase expenditure by €2.1 billion in 2018 and €2.3 billion from 2019. However, the impact on net borrowing is nearly halved by the feedback effects (increased tax revenue) of the measures themselves.

In addition, at the start of October the Government issued two Prime Minister's Decrees authorising the hiring of 7,900 personnel on open-ended contracts in 2017-2019, drawing mainly on the savings generated by terminations in the last two years of the period. Most of the new hires envisaged in the Decrees regard security and safety personnel, with 4,774 new hires in law enforcement bodies and 375 in the Fire Service. The remainder regard the ministries and agencies (for a total of about 1,700), INPS

[130] These figures do not reflect feedback effects (the increase in tax and social contribution revenue), which the technical reports quantifies at nearly 50 per cent of the gross outlay.

[131] Another provision regards the increase of 100 (of whom 17 management-level personnel) in the staff of the National Agency for Regional Health Services (AGENAS) provided for in one of the amendments to the bill at first reading in the Senate. The amendment also contains the associated authorisation to hold competitive exams to hire personnel on permanent contracts in 2018-2019.

(730), judges other than those in the ordinary courts and the attorney general's office (about 230). The new positions will largely be filled from the lists of candidates who qualified in previous competitive public exams. For this reason, a large number of candidates (about 5,600) could begin the hiring process as early as 2017. However, the Decrees also authorise some departments to organise new competitive exams over the next three-year period in order to meet the needs set out in the recruitment plan.

These measures mark a reversal of trends over the past decade, in which the budget measures produced a substantial decline in public sector employment through the joint impact of the retirement of large cohorts of employees and severe restrictions on turnover. According to national accounts data provided by Istat, as a result of these policies, in 2016 the number of government employees measured in full-time equivalent (FTE) unit terms[132] was just under 3.4 million, down about 200,000 units from 2009 and 311,000 from 2002.

The most recent series on general government employment (measured in FTE units) published by Istat covers the period 2000-2016. The year 2002 represents peak employment in the interval (3.7 million), while the minimum came in 2015 (3.3 million). A number of standard indicators used at the international level[133] show that public employment as a proportion of total employment fell by about one percentage point between 2009 and 2015, reaching 13 per cent (compared with an OECD average of 18 per cent in 2015). The composition of central government employment by age group is another indicator that clearly demonstrates the impact of the above measures (as well as the various reforms of the pension system, which gradually and significantly lengthened working lives): while in 2010 employees aged at least 55 accounted for about 31 per cent of the total, in 2015 they represented more than 45 per cent (compared with an OECD average of 25 per cent), while employees in the 18-34 age group represented about 2.5 per cent of the total (compared with an OECD average of 18 per cent). This fact deserves particular attention with regard to the effects that the rapid aging of the working population can have on the overall general government efficiency, slowing the natural turnover of skills between successive cohorts and limiting the openness of the public sector to technological and organisational innovation.[134]

Examining the composition of public administration by sub-sector, in 2016 central government employed nearly 58 per cent of the general government labour force, while just over 40 per cent were employed by local government entities (which include the personnel of local health service entities, 20 per cent of the total). Compared with 2009, the distribution of employees by sub-sector shows a shift towards central government departments, which have increased their share by 2 percentage points to the detriment of local government entities other than local health system entities.

The decline in government employees has been accompanied by an equally substantial decline in public outlays for compensation of employees. National accounts data show virtually no change in such spending in nominal terms between 2008 and 2010 (equal to

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[132] Full-time equivalent (FTE) units measure the number of employed persons in terms of equivalent standard full-time positions.

[133] For example, the indicators cited above (ratio of public employment to total employment and composition by age group of central government personnel) are used in *Government at a Glance*, a survey published every two years by the OECD.

[134] For an empirical study of the effects of an aging workforce on productivity, see, for example: Aiyar, S., Ebeke, C. e Shao, X. (2016), "The Impact of Workforce Aging on European Productivity", *IMF Working Paper* WP/16/238, European Department.

about €172 billion), followed by a constant decline until 2015 (€162 billion). In 2016, nominal expenditure returned to its 2007 level (€164 billion).[135] Taking into account price dynamics as measured by the GDP deflator, between 2010 and 2016, compensation of employees diminished in real terms by 10.8 per cent.[136] In per-capita terms of the resident population, real expenditure fell by 12 per cent.[137]

The data in the Annual Accounts of Public Employment provided by the State General Accounting Department can be used to obtain a more detailed analysis of developments in public employment.

As a tool for monitoring the financial costs associated with public employment, mainly used to assess the impact of contract renewals, the registration and dissemination of the data are not strictly tied to cost centres (the department or entity to whom the public employee belongs), but rather to aggregates that can generally be defined as "bargaining sectors",[138] within which the data are generally registered at the level of the individual contractual profiles.[139] In addition, personnel is subdivided on the basis of the type of employment contract (permanent employees, fixed-term workers, persons engaged in community service, temporary workers, trainee contract and others[140]). In comparing this data with the accrual-basis one, it should also be borne in mind that the annual accounts generally report employment relationships existing at the end of each year, with only flexible forms of employment being expressed in FTE units. Furthermore, the public administration perimeter does not exactly coincide to the entities participating to the

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135 In interpreting the data it is necessary to consider the fact that since 2016, the Italian public broadcaster (RAI) has been included in the Istat S13 list of entities belonging to the general government sector. As a result, about half of the increase in expenditure registered in 2016 (about €2 billion) is attributable to that change: the IGOP-RGS survey of RAI put the total number of personnel used at about 23,000, with an associated cost of close to €1 billion.

136 According to Ameco data, in the same period real public expenditure in the main EU countries on compensation of employees rose by 5.1 per cent in Germany and 4 per cent in France; by contrast it fell in Spain and the United Kingdom by 3.7 and 5.1 per cent respectively.

137 Between 2010 and 2016 per-capita real expenditure on public employment rose in Germany and France (by 2.3 and 1.3 per cent, respectively) and fell by 3.5 per cent in Spain and 9.2 per cent in the United Kingdom.

138 Twenty-four aggregates are identified. Some are not in fact bargaining sectors but groups of sectors: for example, this is the case of "Special statute regions and autonomous provinces", which does not correspond to an actual bargaining sector but rather aggregates the various types of contract that each local government has created. In addition, about one-fifth of public employees (judges, diplomats, university professors, prefects, correctional officers, firefighters and armed forces and police personnel) continue to be employed under public law regulations and have no collective bargaining agreement. These categories were grouped together in "notional" bargaining sectors for jobs with broadly uniform professional profiles and careers, as well as the administrative entities for which the employees work. Departments that employ personnel using contracts pertaining to other sectors (or even have no formal contract) are therefore included in various aggregates. Similarly, not all personnel included in the "Ministries" sector necessarily work for a minister, as they may be employed by some other government entity that hires personnel using contracts pertaining to that sector.

139 An exception is represented by "sectors" that group together various (and relatively small) entities with considerable autonomy, such as the independent authorities, entities under Article 60 of Legislative Decree 165/2001 and the other entities on the Istat S13 list, which were surveyed using a simplified procedure that only distinguished between management personnel and others.

140 This residual category includes school and advanced training instructors in art and music on annual fixed-term contracts or contracts for the school year, as well as certain categories of personnel who are not fully covered by the standard definition of "public employee" such as director generals, contract workers, volunteers and cadets in the armed forces and the police. Open-ended positions also include managers on fixed term contracts who hold management positions that cannot be considered to have been created to meet temporary requirements of the public administration.

annual accounts. The former represents 97 per cent of the general government definition provided by Istat in list S13[141], and includes other entities not considered in that list.

Table 3.7 shows developments in public employment registered in the annual accounts for 2009-2015 (the last year for which data are currently available). The 24 bargaining sectors have been reclassified here into nine macro-groups in order to further aggregate personnel into uniform classes in respect of the area of government action to which they pertain.

Bearing in mind the methodological differences, the complexity of the reality we are trying to measure and its absolute size, the numbers are relatively close to those calculated by Istat in the period under consideration. The decline also emerges clearly, with a fall of -5.9 per cent in 2015 compared with 2009 (-6.2 per cent according to Istat data) if we compare a constant domain over time (Table 3.7, "Subtotal"). Looking instead at total employment as registered in each year in the annual accounts ("Overall total"), the contraction is less marked and seems to show a reversal of the trend as early as 2014. The differences are almost entirely explained by the gradual expansion of the survey to other public entities.

Table 3.7 – Personnel of government departments by bargaining sector *(number of personnel)*

	2009	2010	2011	2012	2013	2014	2015	% change 2009-2015
Schools, universities, research entities & art academies	1.224.963	1.188.737	1.160.199	1.155.052	1.168.284	1.178.232	1.221.512	-0,3%
National health service	734.137	728.900	717.628	705.559	702.510	698.023	690.882	-5,9%
Police, armed forces and firefighters	560.939	553.870	553.628	542.236	537.080	536.573	528.203	-5,8%
Regions and other local entities	578.308	569.299	551.289	535.946	527.334	521.739	502.654	-13,1%
Ministries, tax agencies and Presidency Council of Ministers	238.768	232.439	226.187	220.582	218.226	214.114	207.973	-12,9%
Public non-economic entities	56.975	55.361	52.433	51.312	48.985	46.617	43.724	-23,3%
Courts, diplomatic corps, prefects and correctional institutions	13.276	12.939	12.808	12.916	12.968	13.102	12.719	-4,2%
Subtotal	**3.407.367**	**3.341.545**	**3.274.172**	**3.223.603**	**3.215.386**	**3.208.400**	**3.207.667**	**-5,9%**
Special statute regions and autonomous provinces (1)	84.343	84.924	106.982	105.688	105.689	105.795	103.046	22,2%
Entities referred to in Art. 60 para. 3 and 70 para. 4, independent authorities and other entities on S13 list (2)	11.516	11.434	14.218	14.588	14.725	52.188	52.258	353,8%
Overall total	**3.503.225**	**3.437.902**	**3.395.372**	**3.343.879**	**3.335.800**	**3.366.383**	**3.362.971**	**-4,0%**

Source: Annual accounts of the Department of the State Accountant General.
(1) The positive (and anomalous) value of the rate of change in this aggregate in 2009-2015 is attributable to the inclusion of the personnel of the Regional government of Sicily in the survey (about 20,000 employees) in 2011. The rate of change in 2011-2015 was -3.7 per cent. – (2) The positive (and anomalous) value of the rate of change in this aggregate in 2009-2015 is attributable to the inclusion of the personnel of other entities on the Istat S13 list (nearly 38,000 employees) in 2014. The rate of change in 2014-2015 was +1.3 per cent.

[141] Since 2013, all of the entities in the S13 list that were previously not included in the annual accounts are required to participate in the survey. Nevertheless, the entities involved – often small and not always with personnel – have a significant non-participation rate due to the fact that they are not specifically entered in the list, given that the legally binding list published by Istat does not contain a detailed breakdown of individual entities.

Among the larger of these are the employees of the Regional government of Sicily (about 20,000), who were first registered in 2011, while in 2014 we have the first recording of personnel of the other entities on the S13 list (just under 40,000 employees). The two developments just mentioned also explain the anomalous values of the rates of change in the associated aggregates: they were the only two increases seen during the period.

The figures show that the personnel reductions involved nearly all segments, but with differing scales: the largest group ("Education and research") saw employment remain virtually table, with the gains in 2013-2015 offsetting the decline registered between 2009 and 2012. While the university segment recorded a steady decline in personnel (instructors and others)[142], the number of employees at research institutes[143] and the "Schools" segment increased. In particular, as from 2015 the latter benefitted from the measures contained in Law 107/2015, which provided for an increase in personnel, partly through a special intake of about 100,000 teachers, including ordinary positions, support teachers and curriculum enhancement positions, drawing on long-term waiting lists and those from competitive exams for tenured positions. The increase in open-ended positions in that segment (from 887,000 in 2014 to 944,000 in 2015) is therefore attributable to those measures, as was the concomitant decline (about 10,000) in the "Other personnel" segment, as a result of the decline in the demand for substitute teachers. Bear in mind that the "School" sector has always been exempt from the rules restricting turnover in public employment: the decline in staff up through 2012 was due to a reduction in the teacher-to-students ratio provided for under Law 133/2008, the so-called Gelmini reform.

The other significant sectors posted significant declines: from the approximately -6 per cent experienced by the National Health Service and the "Security and safety" aggregate to at least twice that for the main State entities and local government entities. "Ministries" alone experienced a decrease of 14.5 per cent. Consistently with these developments, the data in the annual accounts show that in 2013-2015 the number of terminations each year was systematically larger than the number of new hires in almost every segment (with the exceptions of "Schools" and "Firefighters"). Among the personnel of police forces, the armed forces and the National Health Service, the ratio of terminations to new hires was about 1.5; in the "Ministries" and "University" sectors it was approximately twice that.

As from 2008 (Law 296/2006), open-ended hiring at many public administrations (including autonomous entities, like the police and firefighters) was constrained by stringent financial limitations on new hiring, expressed as a percentage of funds freed up by terminations in the previous year, with a gradual return to full use of those savings: for example, in 2008 hiring was restricted to 20 per cent of personnel terminating their employment. Subsequent regulations further reduced the turnover ratio, delaying the return to full use of resources, and a per capita limit was also introduced (10 per cent of persons who left service the previous year, with Decree Law 112/2008).

[142] From about 119,000 in 2009 to 102,000 in 2015, a fall of more than 16 per cent.
[143] By far the smallest sector in the "Education and research" aggregate, with 24,500 units in 2015 (just under 22,000 in 2009).

Some provisions of Decree Law 90/2014, such as the possibility to cumulate three years of the hiring budget and the gradual return to full replacement of departing staff as from 2018, appear to mark the end of hiring restrictions. Nevertheless subsequent measures have again severely impacted the turnover process in public employment: Art. 1, paragraph 227 of Law 208/2015 set a coefficient of 25 per cent for all non-management personnel until 2018 (retaining the percentages established for management positions at 60 per cent in 2016, 80 per cent in 2017 and 100 per cent as from 2018). This rule applies to State entities, including autonomous organisations, agencies and public non-economic entities (which include INPS, with about 29,000 employees at December 2015), including those referred to in Art. 70, paragraph 4, of Legislative Decree 165/2001.[144].

Setting aside special situations governing smaller segments or entities with special autonomy, the primary exception to the limits on turnover regards the provisions of Law 232/2016, which established a fund in the expenditure budget of the Ministry for the Economy and Finance (with an appropriation of €1.5 billion for 2017 and €1.9 billion as from the following year), to be allocated with a Decree of the Prime Minister. The fund was to be used in part to supplement resources already appropriated for contract renewals, with the remainder to be used to enable the open-ended hiring of personnel, in addition to or in derogation from the hiring authority provided for in current legislation, to cope with urgent service-related needs of State bodies, including police forces and the National Fire Service, agencies and other types of entity.

In the light of the framework created with the regulations limiting recruitment, the measures cited at the start of this section do not seem sufficient to reverse the trend, although they do appear to reflect an effort to counter the adverse effects of that framework, at least in those operational sectors that have been considered priorities in recent years (security, territorial control and emergency response) or in which the increase in average age has been an especially important issue. Other major sectors, such as ministries and the National Health Service, have benefitted only slightly from the hiring programmes mentioned above (mainly for special circumstances). They continue to operate with a significant shortfall between actual staffing levels and theoretical requirements, despite the fact that the latter have often been reduced over the years. These are public administrations with missions of vital importance, as they provide essential services or play a key role in the organisation and coordination of the functions of government as a whole. A number of studies[145] suggest to pay attention to the costs in terms of the reduced effectiveness of public action associated with cutting personnel spending. These costs are often underestimated and over the long term can offset short-term savings.

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[144] Article 70 entities currently include the following: the Space Agency, the National Civil Aviation Authority (ENAC), the National Railway Safety Agency, the National Air Safety Agency, the National Union of Chambers of Commerce, the National Council for the Economy and Labour (CNEL) and the Agency for Digital Italy (AGID).

[145] For example, see OECD (2016), "Engaging Public Employees for a High-Performing Civil Service", in *OECD Public Governance Reviews*; Haque, N. and Sahay, R. (1996), "Do Government Wage Cuts Close Budget Deficits? Costs of Corruption", in *IMF Economic Review*, no. 43.

3.7 Measures for public investment

The 2018 Budget Bill contains measures designed to support public investment in various sectors of government. The aim of the measures is to reverse the downward trend in direct investment by public administrations over the last seven years. Indicators for the current year also point to a decline in 2017 as well. This would continue the decline under way since 2010, which was only temporarily interrupted in 2015.

The causes of this development are associated with the uncertainty over available resources, due in part to the restrictive fiscal policies adopted in past years, and more generally with the planning and implementation difficulties that have long plagued public investment and which have been recently exacerbated by the need to adjust procedures and administrative competencies to comply with the 2016 reform of the Public Contracts Code.

The following sections discuss the main measures provided for in the 2018 Budget Bill involving public infrastructure. We then provide an overview and discuss recent developments in the associated investment and offer a focus on the activity of the National Road Agency (ANAS). The section concludes with an examination of the possible impact of the reform of the Public Contracts Code on recent developments.

3.7.1 Measures in the 2018 Budget Bill

The primary measure to sustain public investment is the refinancing of the Investment Revival Fund established with the 2017 Budget Act. The increase in appropriations in the State budget amounts to €940 million in 2018, €1,940 million in 2019 and €2,550 million in 2020. It is estimated that actual implementation of expenditure programmes will have an impact on the general government accounts of €170 million, €1,140 million and €1,370 million over the three years. Other measures, discussed below, are targeted at local government entities.

Looking at the second section of the 2018 Budget Bill, the amounts associated with the reprogramming and refinancing of direct investment by government bodies are negligible.[146] On an accruals basis, the State budget contains refinancing of €1 billion for healthcare construction in 2020. Examining the financial plan in the Budget Bill, that increase in appropriations does not appear to have an impact on general government net borrowing, probably because the associated investments expenditure will be carried out beyond the three-year planning horizon (section 3.9).

In order to enhance transparency in understanding the financial plan accompanying the second section of the Bill, it would be advisable to publish the detailed data in a way which is consistent

[146] Bear in mind that investment grants to the State Railways, for example, have been reduced by about €1.5 billion in 2018.

with the general government account as well, which would make it possible to see the breakdown between direct public investment and investment grants.

The resources in the fund noted above must be allocated – using Decrees of the Prime Minister – to specific sectors: a) transportation and roads; b) sustainable mobility and road safety; c) infrastructure, including the water supply network and collection, sewage and water treatment infrastructure; d) research; e) land protection, prevention of hydrogeological instability, environmental remediation and reclamation; f) public building, including schools and healthcare infrastructure; g) high technology industrial activity and export support; h) the digitisation of State entities; i) the prevention of seismic risk; l) investments in urban development and safety in outlying urban areas; m) upgrading infrastructures and transport equipment for public order, safety and rescue; and n) elimination of architectural barriers.

The areas of intervention identified last year have been expanded with the addition of sustainable mobility and road safety, upgrading infrastructures and transport equipment for public order, safety and rescue as well as the addition of healthcare infrastructure to the public building initiative.

As regards local government entities, the largest measure involves municipalities, which are supported with two initiatives. Their expected impact (€4 billion) is diluted over ten years (from 2018 to 2027). More specifically:

- the Budget Bill provides transfers to finance works to secure buildings and the territory totalling €850 million (respectively €150, 300 and 400 million in each year of 2018-2020), whose effects in terms of the effective increase in spending are spread over a period of 7 years in the national accounts from 2018 to 2024, of which €11 million in 2018, €62 million in 2019 and €154 million in 2020);

- it also permit the expansion and extension of the fiscal space devoted to investments, already envisaged in the 2017 Budget Act, using flexibility in derogation from the existing fiscal rules. The additional resources amount to €3.2 billion, increasing expenditure over a period of 10 years (2018-2027). For the three-year budget horizon, actual expenditure in terms of net borrowing will amount to €70, 122 and 351 million respectively.

It remains to be seen if the last of these measures will actually increase municipal spending given that, as currently structured,[147] the balanced budget constraint already leaves considerable unused spending capacity (overshooting, i.e. the surplus in excess of the target budget balance, was about €3 billion in 2015 and €6.4 billion in 2016, as discussed in Box 3.2). Accordingly, additional flexibility in that constraint, which is already not stringent, may not be translated into an increase in actual expenditure.

[147] With the exclusion from the balance, for example, of allocations to the provision for doubtful credits.

With regard to the regions, the investment measures provided for in the Budget Bill are less far-reaching and of ambivalent sign. They include incentives (such as the extension of the time allowed to balance the 2014 deficit conditional on an increase in investment spending) and provisions to reduce capital expenditure of modest size (such as the deferral of appropriations for healthcare building in the amount of €94 million in place of cuts to current expenditure of an equal amount provided for in current legislation, and the easing of the requirement for Sicily to reduce current expenditure by €70 million, which under the balanced budget constraint translates into a corresponding reduction in capital expenditure[148]).

3.7.2 Developments in general government investment

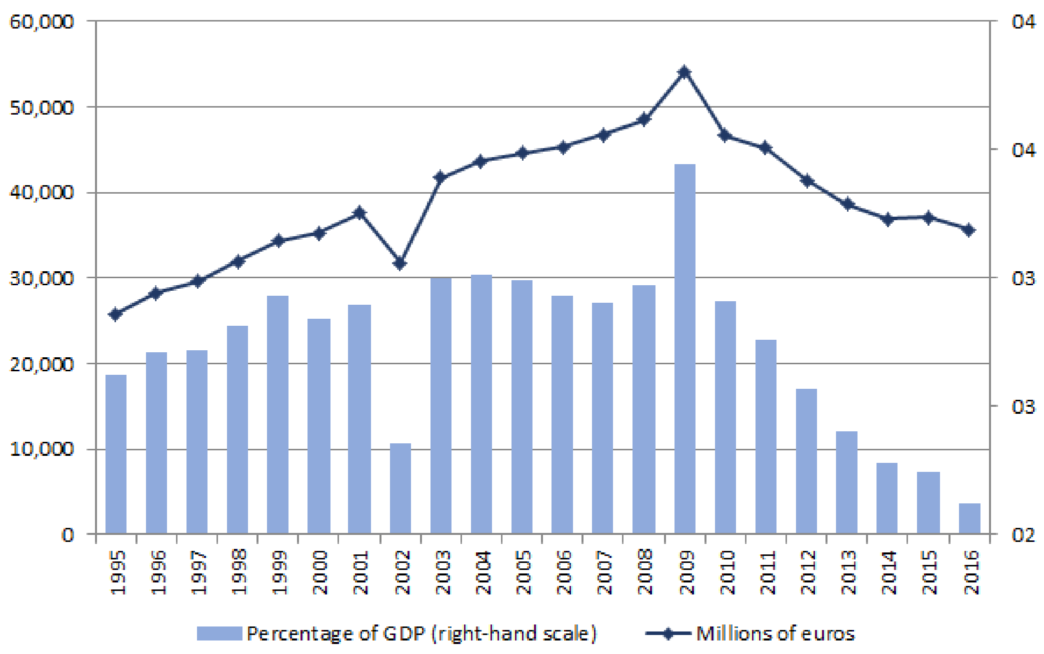
The measures envisaged in the 2018 Budget Bill for public investment come against the background of a broader context in which, after contracting in absolute value up to 2014 (from their peak in 2009), it stabilised in 2015 and began to fall again in 2016 (Figure 3.14), with a further decline likely in 2017. In the first half of the year, Istat figures show public investment decreasing by 4.1 per cent compared with the same period of the previous year. To achieve the Government's forecast of a slight increase in 2017 in the EFD Update (0.4 per cent), expenditure would have to expand by a substantial 4.5 per cent in the second half of the year over the same period of 2016. Information drawn from the BDAP database on the State budget (-2.3 per cent) and from the General Government Payments Information System (SIOPE) for local entities (about -8.5 per cent) confirms the downward trend for the first eight months of the year.

With regard to the Central Government, budget data show that the years from 2011 to 2016 were marked by alternating reductions and increases in appropriations on both an accrual and cash basis: in 2016, the former declined by nearly 9 per cent compared with 2011, while the latter contracted by 25 per cent. The capacity to carry out investments (given by the ratio of commitments to definitive appropriations on an accrual basis) declined from 100 per cent in 2011 to 95 per cent in 2016, while the coefficient of implementation of expenditure (equal to the ratio of total payments to definitive cash appropriations) fell in the same period from about 81 to 72 per cent (with a peak of 86 per cent in 2012).

In 2016, expenditure for public investments[149] reached its lowest point as a percentage of GDP since 1995 (Figure 3.14).[150]

[148] The summary schedule does not indicate the increase in current spending and the corresponding decline in capital expenditure.
[149] Including changes in inventories and gross of property disposals.
[150] The share decline posted in 2002 was attributable to the major impact (about €10 billion) of disposals of public real estate assets, which were also carried out using securitisations. The rise in 2009 reflects substantial investment in arms and the repurchase of real estate left unsold as part of the SCIP2 operation.

Figure 3.14 – Gross fixed investment expenditure and changes in inventories of general government entities
(millions of euros and percentage of GDP)



Source: based on Istat data.

Developments in expenditure differed significantly from sector to sector (Table 3.8). With the exception of "Other local entities" (including, for example, Universities, mountain communities and sundry agencies) and "Social security institutions", whose weight in the total investment aggregate was influenced by property transactions, all sectors registered positive rates of change on average between 1996 and 2008 followed by negative rates between 2009 and 2016.

Table 3.8 – Investment expenditure by sector of government
(millions of euros and average period growth rates)

	1995	1996-2008	2009-2016	1996-2016
General government departments	25,861	5.4	-3.5	2.0
State	8,948	4.8	-1.1	2.6
Municipalities	7,908	4.8	-5.0	1.1
Regions	2,657	5.1	-4.5	1.4
Other central government entities	1,647	7.0	-0.8	4.0
Other local government entities	1,559	6.2	1.2	4.3
Local healthcare authorities	1,308	8.1	-5.5	2.9
Social security institutions (1)	1,075	121.6	2,374.9	980.0
Provinces	759	10.1	-9.9	2.5

Source: based on Istat data.
(1) The growth rate for social security institutions in 2009-2016 reflects the impact on 2009 of the repurchase of real estate that remained unsold in the SCIP2 operation.

Looking at the recent past, in 2015 the constant decline in investment in absolute terms between 2010 and 2014 was interrupted. The slight increase in 2015 was made possible by the recovery in spending by local entities, especially municipalities (+€1.9 billion) and, to a lesser extent, social security institutions (about €0.3 billion). This more than offset the contraction of more than €1.7 billion in investment by the central government. The rise in investments by municipalities in 2015 was essentially due to the increase in the activity of entities in this segment prompted by the end of the 2007-2013 programming cycle for EU funds, as 2015 was the final year those funds could be used before the recipients would forfeit the resources. The increased spending was concentrated among municipalities in southern Italy, owing to the large volume of projects co-financed by the European Union.

The data from the Territorial Public Accounts (RPA), while affected by methodological differences with the national accounts statistics, confirm that 2015 experienced a significant increase in the share of investment carried out by regions in the South compared with the country total (to about 46 per cent from 39 per cent in 2014).[151] The South also had a very high percentage of additional resources in 2015, funded by the European Structural Funds, national co-financing and the Cohesion Action Plan, as well as the national resources of the Development and Cohesion Fund.[152]

As regards 2016, the investment forecasts for general government were gradually reduced in the associated policy documents for that year. Projected growth in September 2015 was 2.4 per cent (2015 Update of the EFD), while it was 2.0 per cent in the 2016 EFD, and just 0.9 per cent in the 2016 EFD Update. Istat then certified a reduction of 4 per cent in the end-of-year figures. This was the result of a decrease in investment by local government entities, as there was an increase in investment by central government entities associated with defence expenditure. More specifically, municipalities continued the reduction in spending registered in the years prior to 2015, partly reflecting the decline in spending associated with additional resources due to the start of the 2014-2020 EU programming cycle, as reflected in the contraction in the types of spending that had characterised the growth in 2015 (non-residential buildings, road works and other civil engineering projects).

Figure 3.15 – based on data from IFEL, the institute for finance and local economies, concerning expenditure commitments for investment broken down by geographical area – shows that the increase in 2015 and the decline in 2016 were almost entirely driven by municipalities in ordinary statute regions in the South, while in the other regions the trend in commitments in the same period were constant or rose slightly.

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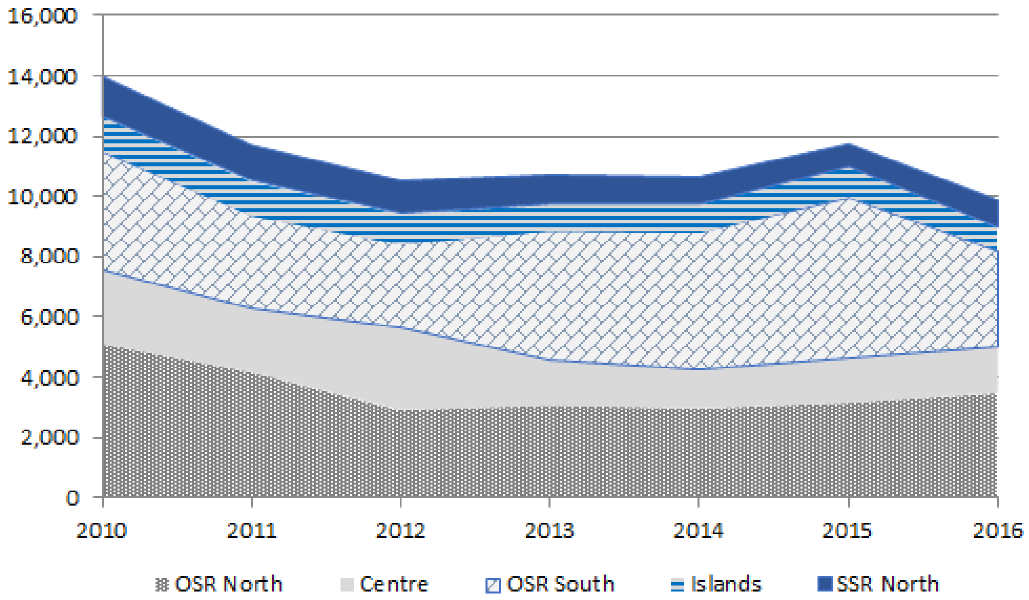
[151] See Agenzia per la coesione territoriale (2017), "*Relazione annuale CPT 2017*, Politiche nazionali e politiche di sviluppo a livello territoriale", Numero 4.

[152] See also the PBO hearing (2017) "Distribuzione territoriale delle risorse pubbliche per aree regionali", 22 November.

Figure 3.15 – Expenditure commitments for municipal investment
(millions of euros)



Source: based on IFEL data.

Any interpretation of the data must take due account of a methodological discontinuity in the accounting policy used for registering expenditure commitments in municipal accounts. Until 2014 this was based on the principle of legal accrual and then from 2015 on a modified commitment/cash basis. The latter is considered a valid proxy for accrual accounting: while in the period until 2015 developments in commitments diverged from those in expenditure on an accruals basis published by Istat, in 2016 the rates were the same (-16 per cent).

The level of investment expenditure commitments is higher than the figure published by Istat, which is measured using a criterion close to cash-based accounting. As indicated in the PBO's spring report,[153] if the modified commitment/cash system played a greater role in constructing the national accounts (in place of pure cash-basis accounting) the level of investment spending by local government entities reported in the general government accounts would be revised for 2016, presumably upwards.

The various factors slowing municipal investment that could have had an impact in 2016 include the following in particular:[154]

– uncertainty about the actual amount of resources available and associated timing issues;
– delays in defining the framework of budget rules applicable in 2016;
– the start-up difficulties of the new European programming cycle following the acceleration in 2015, the final year of the previous cycle;
– the procedural changes in tendering processes (section 3.7.4);

[153] See the analysis of municipal investment in Ufficio parlamentare di bilancio (2017), "2017 Budgetary Planning Report", May, page 111.
[154] For more details, see Ufficio parlamentare di bilancio (2017), *op. cit.*.

- the limits on access to unrestricted surpluses[155] that could be allocated to investment;
- the option of deferring resources not raised through debt to the future using the restricted long-term fund (RLTF), which may have slowed the planning of expenditure;
- a decline in the propensity to borrow, attributable in part to the need for a precise calculation of the resources to be activated, as it is not possible to defer use to the future through the RLTF. Another factor in reducing recourse to debt may have been the desire to contain interest expenditure in cases where debt service burdens were already too heavy as a result of debt accumulated in years of high interest rates.

The reduction in expenditure compared with the stronger performance in 2015 may also have been a reflection of the elimination of vertical flexibility between levels of government, as bonus grants to regions which transferred resources to allow local authorities in their territory to undertake investments were no longer available. These were replaced by a regional flexibility mechanism which permitted agreements for the implementation of investments on the condition of achieving overall budget balance (including the regional government), which however was not used to any great extent as it would require an improvement in local planning capacity and greater capacity for coordination among government entities.

In general, the set of measures that the Government had adopted to accelerate public investment in order to exploit the flexibility granted at the European level under the investment clause was not as effective as hoped in 2016. The Government had adopted a number of measures to prevent delays caused by a shortage of resources and bottlenecks at the regional level: the 2016 Stability Act permitted cash advances to the regions through the Revolving Fund for the implementation of Community policies (as had already been done for central government departments), and allowed those regions to establish entities for the exclusive purpose of managing European programmes under special accounting rules, with special treatment of the balanced budget rules.

Despite the various measures, difficulties already encountered in the past re-emerged, as acknowledged by the Government itself, which in the introduction to the 2016 EFD Update noted: "*The crucial acceleration of public investment does not so much depend on the appropriation of funds through the Budget Act, but rather on the effectiveness of the public administrations that have been urged to revive appropriations, spending, and monitoring procedures, after years of uncertainty and downsizing*".

[155] In other words, not encumbered by numerous provisioning requirements (for example, for uncollectible receivables, losses of investees, restoration of the Advance Fund provided for in Decree Law 35/2013) or other restrictions (for example, repayment of previous loans or deficits, such as those generated by the special reassessment of carryovers or the restitution of amounts used under conditions of financial flexibility in the past).

For 2017, as noted in previous Reports, the Budget Act had allocated resources for the implementation of investments through both a Fund to be allocated using decrees of the Prime Minister and through spending by local authorities to exploit the amendments to Law 243/2012 on budget balance for the purposes of reviving investment.

With regard to the first issue, the initial budget appropriation for Fund referred to above was €1.9 billion for 2017 (€3.15 billion for 2018 and €3.5 billion for 2019), with an impact on general government net borrowing estimated at €629 million (about €2 billion in 2018 and €3.5 billion in 2019).

In order to determine the allocation of the Fund, at the central level the individual ministries submitted requests that exceeded the available funds, prompting the Ministry for the Economy and Finance to revise the requests on the basis of the actual ability to spend the resources, the timetable for the launch of initiatives, the impact on the internal market and planning capacity over a longer time horizon.[156]

In addition, the Fund was allocated with an initial Prime Minister’s Decree for the financing of projects to upgrade suburban areas by municipalities and metropolitan areas (€270 million in 2017 and 2018 and €260 million in 2019). The resources of the Fund were also reduced to transfer €400 million for this year, with Decree Law 50/2017, to ordinary statute regions (which waived their shares; see below and section 3.8.2) and €64 million (€118 million in 2018 and €80 million in 2019) for school building and fire safety initiatives. The remaining resources – about €1.2 billion in 2017 (about €2.8 billion in 2018 and about €3.2 billion in 2019) were then allocated with the Prime Minister’s Decree of 21 July 2017, published on 27 September 2017.

As regards the second issue, the 2017 Budget Act sought to foster an increase in local authority spending permitted by the changes in the rules governing budget balance. More specifically, this involved the inclusion of the RLTF (with an increase of about €0.3 billion in expenditure) and the granting of uncompensated financial flexibility (within the limits established within the framework of national solidarity pacts) associated with the possibility of using surpluses and resources funded by debt (with additional spending estimated at more than €0.4 billion in 2017). In the latter case, the resources were targeted at school building, seismic upgrades of buildings and prevention of hydrogeological instability. A second group of initiatives (totalling €0.2 billion) was directed at the seismic emergency, with the appropriation of resources for public reconstruction (reconstruction, repairs, and restoration of public buildings and cultural heritage assets) in the areas hit by earthquakes in August 2016.

With regard to the regions, Decree Law 50/2017 implemented one of the measures provided for in the State-Regions agreement of last February, allocating those governments the €400 million of financial resources cited above (€132 million in accrual terms). As a result of the agreement, however, these resources were cut, representing the regions’ contribution to the savings provided for 2017 in the 2015 Stability Act. However, the regions agreed to make an additional €132 million in investments from their own budgets (or generate a surplus of the same amount).

[156] See the hearing of Minster Padoan on the Prime Minister’s Decree on the allocation of the Fund of 27 June 2017.

3.7.3 *The role of ANAS S.p.A.*

With regard to investment by central government entities other than the State, after a period of irregular growth in spending, especially between 2003 and 2011, investment turned downwards between 2011 and 2016, contracting by 37 per cent (Figure 3.16 a)). As a percentage of GDP, investment spending by this segment in 2016 returned to the same level (0.17 per cent) registered at the start of the period of observation (1995).

Net of the State segment (which however accounted for an average of 82 per cent of the total between 1995 and 2016), the largest share of investment by central government entities is represented by the investment expenditure of ANAS, the national road agency, although that proportion declined in 2013-2016[157] from 72 to 67 per cent (Figure 3.16 b)). More specifically, in 2015-2016 the reduction in ANAS investment appears to have reflected not only the regulatory and procedural uncertainty that slowed the award of contracts during the approval and implementation of the new Public Contracts Code (section 3.7.4), but also delays in the new 2016-2020 Programme Contract and the consequent impossibility of drawing on the associated financing (€23.4 billion), part of which had already been appropriated.[158]

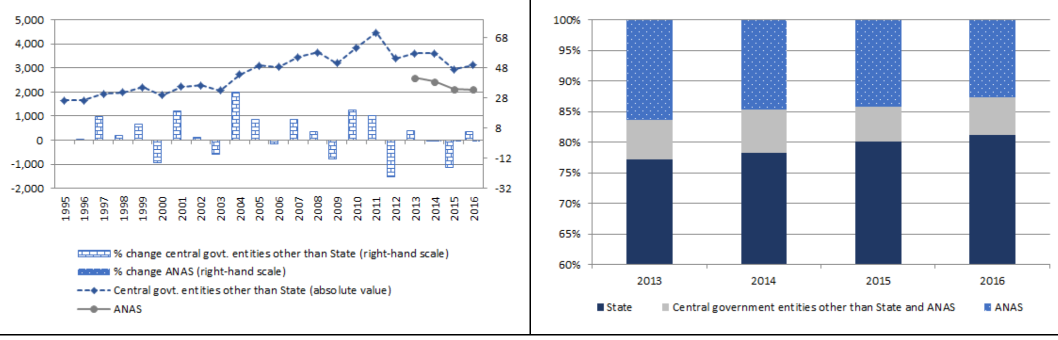
The approval of the new Programme Contract in August 2017 should lend impetus to ANAS investments in the coming years.

The allocation of investments by ANAS to the general government sector or elsewhere will depend on the manner and timing with which ANAS is transferred to the Ferrovie dello Stato Group (State Railways), as provided for in Article 49 of Decree Law 50/2017.

Figure 3.16 – Investment by other central government entities

a) Absolute values (millions of euros) and percentage change

b) Percentage composition of expenditure by segment



Source: based on Istat data.

[157] The data on ANAS investment on an accruals basis in accordance with ESA 2010 for the 2013-2016 period were provided by Istat. The time series published since 1995 regard all central government entities, for which Istat provides a detailed breakdown for the State sector only.

[158] An exception was recently introduced with Decree Law 50/2017, which provides for the allocation of resources to ANAS drawn from a share (20 per cent) of the appropriations for the new 2016-2020 Programme Contract, pending its approval, for the design of new projects and extraordinary road maintenance activities.

More specifically, that article provides for the transfer of ANAS S.p.A. to Ferrovie dello Stato Italiane S.p.A. by way of a capital increase conducted by the latter. The operation is subject to a number of conditions, including the recognition of provisions proportional to the value of outstanding litigation and the absence of an adverse impact on the public finance balances. If the operation should cause the exclusion of ANAS from the general government sector, it would free ANAS from the rules on the containment of government expenditure to which the entities within that segment are subject, which in theory would also facilitate investment.

A number of conditions must hold for the transfer to result in the exclusion of ANAS S.p.A. from the general government sector. The 2016-2020 ANAS Programme Contract provides for the implementation of the principle, as envisaged in the 2015 Stability Act, of determining the fees paid to ANAS as remuneration of it investment activities and the services provided on market terms and conditions on the basis of qualitative and quantitative variables, therefore excluding transfers paid as reimbursement of expenditure. The manner in which the conditions of that remuneration are determined, the governance of issues such as the transfer of risk and the establishment of any restrictions on the trading of the ANAS shares transferred to Ferrovie dello Stato will determine whether the conditions exist for the exclusion of ANAS from the general government sector.

Where such exclusion should be possible, the impact on the public finances will be assessed in any event. While such an assessment would be premature at this juncture, certain methodological aspects can be analysed in advance.

In general, once any exclusion was completed, the impact on the public finances would be broadly neutral, albeit with a different composition of the general government account. The latter would no longer include the items in the ANAS financial statements but would include transfers to that company by the State. As a result, on the one hand there would be a decrease in spending on personnel, intermediate consumption and direct investment and, on the other, an increase in transfers to firms, whether for current spending or for investment grants. If the latter are in line with current State transfers to ANAS – although configured as fees for services rather than as a grant – the effect would essentially be neutral.

Nevertheless, during the transfer of ANAS to Ferrovie dello Stato, temporary but substantial effects could arise. Specifically, it will be important to value existing transactions, including investments under way, pending litigation and ANAS' debt.

The state financing of works under construction could be configured as an ANAS receivable in respect of the State, for which it would be necessary to decide how to account for the corresponding transfer of funds. Alternatively, the latter could be considered an investment grant, with an impact on the income statement at the time it falls due, or it could be included in the transfer value of ANAS, recognising a financial item only. In this second case, the ANAS-Ferrovie dello Stato merger would permit substantial, albeit one-off, savings - presumably excluded from the calculation of the structural balance – in net borrowing, equal to the value of the construction contracts for which ANAS had a receivable in respect of the State.

The exclusion of ANAS could reduce the public debt (€412 million at the end of 2016), unless the State takes it over. The reciprocal commercial relationships between ANAS and the State would have no impact, as the public debt only includes financial debt.

3.7.4 The impact of the introduction of the new Public Contracts Code

The new Code governing public tenders and concession contracts, which came into force in April 2016 (Legislative Decree 50/2016), and was amended with a corrective decree in 2017 (Legislative Decree 56/2017), has probably contributed to the recent decline in investment.

The demand for public works (tenders) decreased in 2016.[159] More specifically, with regard to tenders worth more than €40,000 – under that threshold works can be awarded directly with no special formalities – there was a substantial drop in the number of tenders (-29 per cent) and their value (-15 per cent).

First, the new Code introduced a major paradigm shift, which in the early phase of implementation may have made organising tenders more complex. From a technical point of view, the system was transformed from rigid to flexible and, unlike the previous Code, no regulation for execution and implementation was established. Rather, guidance and general guidelines were issued (soft law), as well as decrees approved by various entities, including in particular the National Anticorruption Authority (ANAC) and the Ministry of Infrastructure and Transport (MIT).[160]

In substance, the new Code is trying to achieve the ambitious goal of improving the operation of the market for public works and for that purpose pursues a far-reaching and innovative transformation on both the demand and the supply side.

On the demand side, the Code seeks to improve the professional skills of entities organising tenders, and indirectly reduce their number, so that they are capable of using the new and broad discretion granted to them by the Code in the most effective manner possible, especially in the selection of the tender procedures for the award of contracts and the award criteria. For this purpose, the Code introduces a qualifying system for contracting entities, managed by ANAC, which modulates the level of operational autonomy in relation to the actual professional capacities those entities demonstrate. The introduction of qualifying requirements and the establishment of qualification limits for smaller entities will effectively reduce the number of contracting entities from the current level of about 32,000.[161]

The Code also envisages about forty tender procedures that can be obtained from the possible combinations of type, object, contractual amounts and reference sector. The standard procedures envisaged in the previous Code (open, restricted, negotiated,

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[159] Peta, A. (2017), "Gli appalti di lavori nel nuovo codice: un'analisi gius-economica delle principali misure", Banca d'Italia, *Questioni di Economia e Finanza*, no. 400/2017.

[160] While the elimination of the execution regulation was largely welcomed, some scholars criticised the new model of regulation both for its complexity and the uncertain nature and legal validity of the guidelines, in particular those issued by ANAC. For example, see Chiti, M.P. (2017), "Le modifiche al Codice dei contratti pubblici: un correttivo scorretto?", *Giornale di diritto amministrativo*, 4/2017.

[161] De Nictolis, R. (2016), "Codice dei contratti pubblici (nuovo)", L'Amministrativista, il portale sugli appalti e i contratti pubblici, Portali tematici Giuffrè.

competitive dialogue) are joined by the partnership-for-innovation model. Parliament has thereby restored a "power of discretionary choice" to contracting entities that the previous public works legislation had always sought to limit.[162]

As regards award criteria, the Code introduces a radical change from the past, giving preference to the criterion of the "most economically advantageous offer" over the "lowest price" criterion, which has become a residual standard permitted only in certain cases specified in the Code. In the public works sector, these residual cases include the simplest orders, with a value of less than €1 million, increased to €2 million with the corrective decree.[163]

On the supply side, the new Code seeks to improve the quality of execution of works, giving weight to the reputation of the contractors with the establishment of a rating system for firms. However, the corrective decree made sweeping changes to the rating system, transforming the ratings from qualifying factor for participation in tenders into a bonus factor to be considered in assessing bids.

The normal uncertainty that arises when the regulatory framework is undergoing profound change, with a consequent need for suppliers to adapt to the new paradigm (as happened previously with the introduction of the Merloni Act in 1994 and the previous Code in 2006), could have therefore played a role in the decline in the number of tenders. Another factor is the fact that only 16 of the implementing instruments have come into force so far, compared with the more than 50 provided for by the Code and the corrective decree from last May.[164] Although the Code establishes that pending approval of the new implementing regulations the rules of the previous implementing regulations shall continue to apply, the regulatory uncertainty may have influenced the behaviour of the contracting entities.

As some have noted,[165] the developments in the demand for works could have also reflected the failure to provide for a transition period in the application of the new rules introduced with the Code. The Code establishes (Article 262) that the rules of the new Code shall apply, with a number of exceptions, for all tender procedures begun after its entry into force. This provision has forced contracting entities to apply the procedures of the reformed Code, including the most complex of them, to new

[162] De Nictolis, R. (2016), "Le procedure di scelta del contraente", www.giustizia-amministrativa.it.
[163] The lowest price criterion could in fact wind up having a much broader application than the marginal role to which it would appear to be relegated by the Code, given that 93 per cent of the market for public works is represented by tenders with a value of less than €1 million (2016 data from the ANAC Annual Report for that year).
[164] Another nine instruments are in preparation, at various stages of drafting and publication. Moreover, in introducing more than 450 amendments to the Code, the corrective decree made it necessary to revise a number of the implementing instruments that had already been issued, including that regarding selection committees. See the periodical "Bollettino di legislazione tecnica" for a detailed update on the issuance of the implementing regulations.
[165] Peta, A. (2017), *op. cit.*.

tenders without the support of the full body of soft law to be produced by ANAC and without consolidated operating practices.

The immediate application of the new rules has in many cases made it necessary to revise procurement processes already under way, causing delays in the publication of tender documentation. The new requirements for greater detail in the design of works and, above all, the general requirements to tender works with detailed engineering, and not just a definitive design,[166] have increased the time need to prepare tenders.

Another major change is the introduction of a general prohibition, with the exception of certain cases specifically indicated in the Code, on integrated tenders (a procedure in which both the design and construction of the works are to be carried out by the contractor).[167] That prohibition has, at least in this initial stage, created operational challenges for many contracting entities, especially local authorities without the technical skills to produce the detailed engineering in house,[168] with the consequent need to tender the detailed engineering separately from the execution of the works, which clearly increases the time necessary to complete projects. While confirming the general rule, the corrective decree expanded the scope of application of integrated tenders, extending them to include works involving a high level of technological or innovative know-how. In addition, the corrective decree established a transitional system with exceptions for integrated tenders for procedures whose definitive designs were approved prior to the entry into force of the Code in 2016, as long as the call for tenders is published within 12 months of the issue of the corrective decree.

However, a number of cases (for example, the recent case of an ANAS tender for road maintenance[169] using a framework agreement, with a tender missing the detailed engineering designs) have demonstrated that some interpretive difficulties and uncertainties remain. The MIT, and subsequently ANAC, found that the ANAS tender did not comply with the Code, as the framework agreement without detailed

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[166] The design process for the execution of public works is structured into three levels: preliminary design, definitive design and detailed engineering.

[167] Tendering only the execution of a project is considered by some to be the best approach to ensure close control of quality, costs and time. However, as noted by Peta, A. (2017), *op. cit.*, the literature does not offer clear evidence in favour of one approach (tendering execution only) or the other (integrated tendering). As remarked by the Council of State in its opinion on the draft legislative decree, "*This is a choice of the legislator concerning political merit. With regard to legitimacy in Community law ... the European directives do not impose limits on the joint award of design and execution to a single contractor* ..." (Consiglio di Stato (2016), "Parere del 21 marzo 2016, Schema di decreto legislativo recante 'Codice degli appalti pubblici e delle concessioni', ai sensi dell'art. 1, comma 3 della L. 11/2016".

[168] On the other hand, even when technical skills were available within the government departments, the elimination of the bonuses granted for design work handled by technical staff employed by a government department, established by the new Code in a divergence from the previous legislation, appears to have acted as a disincentive to technical personnel. In July 2016, ANAC clarified that, after initial uncertainty over the interpretation of Article 113, paragraph 2, of the Code, design work performed by employees of government departments cannot be remunerated with the incentive system provided for in the new Code. Employee incentives are instead focused on the planning, organisation and management of the tender, as well as execution and control of the contract.

[169] A contract for the maintenance of State Highway SS 131 "Carlo Felice" in Sardinia.

engineering violated the prohibition on integrated tenders, even under the provisions of the corrective decree.

Despite these difficulties, the data available so far for 2017 offer some grounds for optimism, showing a slight recovery in the public works market, which closed the first nine months of the year with an increase of 4.4 per cent in the number of tenders and of 1.8 per cent in their value[170] compared with the same period of 2016.

[170] Source: CRESME, cited by Lerbini, A., *il Sole 24 Ore* of 24 October 2017.

3.8 Measures for local government finance

With regard to local finance, the Budget Bill appears to adopt an expansionary stance, aiming primarily:

- for the regions, to attenuate the effects of the current-legislation budget, with the only partial replacement of cuts to transfers with an obligation to post surpluses, in derogation from the balanced budget rule;
- for the provinces and metropolitan areas, to restore part of the transfers eliminated in previous budget packages, allocating resources to these governments or those that inherited the associated functions (for example, the regions in the case of employment centres);
- for municipalities, to grant resources and financial flexibility in derogation from the balanced budget rule in order to encourage investment.

The budget also provides for the extension of the Single Treasury system – aimed at avoiding the adverse impact on the borrowing requirement that the termination of the system would cause (€6 billion in 2018 and €3 billion in 2019) – and the extension for 2018 of the suspension of the validity of increases in local taxes.

The above measures regard all regional and other local governments. Other measures for specific groups of local government entities mainly concern:

- for local authorities:
  - the appropriation of resources, for the sole purpose of the State budget's net borrowing,[171] to restore revenue from the municipal services tax (TASI) on primary residences,[172] which was eliminated when the tax was repealed;
  - the appropriation of resources to support the financial requirements of small towns and the merger of municipalities, as well as local authorities in financial distress or at risk of distress;
  - with regard to the Municipal Solidarity Fund, the reduction for 2018 and 2019 of the equalisation payment to be allocated on the basis of the difference between fiscal capacity and standard requirements, consequently increasing the weight of the component allocated on the basis of historical expenditure patterns;[173]
  - a more gradual implementation of the provision for doubtful credits, with the postponement from 2019 to 2021 of the obligation to fully provision doubtful revenue;

- for ordinary statute regions:
  - the extension from 10 to 20 years of the period for eliminating regional deficits accrued up to 31 December 2014, subject to a rising trend in payments for investments;

- with regard to special statute authorities:

[171] With a corresponding obligation to post surpluses in municipal budgets.
[172] The increase in the basic TASI rate on primary residences by municipalities before the tax was repealed.
[173] See the hearing of the Parliamentary Budget Office before the joint Parliamentary Committee for Fiscal Federalism on 28 September 2017 as part of the examination of the draft ministerial decree concerning the methodological note on the fiscal capacities of municipalities in ordinary statute regions.

– the establishment of a fund of €60 million per year for purposes and beneficiaries to be determined in a decree of the Prime Minister;
– the definitive transition to the balanced budget rules for Friuli-Venezia Giulia, Trentino-Alto Adige and the provinces of Trento and Bolzano;
– the easing of the requirement to reduce current expenditure for the Region of Sicily to the detriment of capital expenditure.

The financial effects of the measures concerning local government entities contained in the initial bill are summarised in Table 3.9, although this does not include measures that only change the composition of the expenditure from capital account to current account.[174] In addition, the amounts do not comprise the indirect impacts, which are mainly borne by the State.[175]

Some of the measures discussed may be a source of problems, both of a general nature involving all local authorities and those of specific relevance for individual segments of the regions and local authorities.

3.8.1 General issues

The budget package, relying on provisions that require the posting of surpluses (€2.5 billion in 2018, of which €2.2 billion for the regions and €0.3 billon for municipalities) or which grant the possibility to run deficits (€3.2 billion for municipalities over a period of six years from 2018 to 2023), appears to turn away from the primary purpose of the balanced budget reform, i.e. to establish a stable public finance rule for local government entities that would enable medium-term planning on the part of local government officials and making them accountable for achieving their objectives.

The presence since 2015 of significant unused budget appropriations (so-called overshooting) with the exception of the provinces (Figure R3.2.1) makes it difficult to assess a priori what the actual impact of the exceptions and of the tightening of the constraints provided for in the budget measures will have on increasing or decreasing expenditure for municipalities and regions. It is therefore necessary to assess the factors underlying the overshooting and consequently modify the incentives driving local authorities to produce such surpluses (a brief examination of this phenomenon is provided in Box 3.2).

[174] Such as, for example, the measure providing for a reduction in appropriations for healthcare building (€94.1 million in 2018) in place of equivalent cuts in current transfers, as well as that easing the requirement to reduce current expenditure for the Region of Sicily to the detriment of capital expenditure (€70 million in 2018).
[175] The table reports the effects of the measures as set out in the original text. More information on the financial effects of the amendments introduced in Parliament will be provided in a PBO Focus Paper on the 2018 Budget Act scheduled for publication in January 2019.

Table 3.9 – The 2018 budget package: impact of the main measures on local government entities
(millions of euros; a negative sign signifies a reduction of the deficit)

	2018	2019	2020
MEASURES IMPACTING NET BORROWING AND THE BORROWING REQUIREMENT	**880**	**643**	**964**
A. Regions	**399**	**299**	**299**
Reduction in contribution of OSRs to the public finances	100		
Fund for special statute authorities	60	60	60
Hiring and stabilisation of personnel of employment centres and ANPAL, of which:	239	239	239
- hiring of employment centre personnel	*220*	*220*	*220*
- hiring of fixed-term personnel of employment centres	*16*	*16*	*16*
- stabilisation of ANPAL personnel	*3*	*3*	*3*
B. Provinces and metropolitan areas	**370**	**140**	**140**
Grant to provinces in OSRs	270	110	110
Grant to metropolitan areas in OSRs	82		
Elimination of grant to metropolitan areas of OSRs for the exercise of essential functions referred to in Art. 20, paragraph 1-bis, DL 50/2017	-12		
Grant to provinces in financial distress or at risk of financial distress	30	30	30
C. Municipalities	**111**	**204**	**525**
Use of restricted advance for investment within the scope of the incentivised national pact - local authorities	70	122	351
Grant to municipalities for public works to secure buildings and the territory	11	62	154
Increase in resources for small municipalities	10	10	10
Increase in resources for liquidation operations at small municipalities in financial distress	10		
Special grant to merged municipalities - increase from 50% to 60% in tax revenue transfers as from 2018	10	10	10
Reduction in grant referred to in Art. 1, paragraph 24 of Law 208/2015 - recovery of amounts in respect of fixed plant and equipment	-10	-10	-10
MEASURES IMPACTING BORROWING REQUIREMENT ONLY	**-6.000**	**-3.000**	
Extension to 31.12.2021 of suspension of mixed Single Treasury mechanism	-6.000	-3.000	
MEASURES IMPACTING STATE BUDGET'S NET BORROWING ONLY	**2.500**		
OSR contribution to public finances through State contribution to debt reduction	2.200		
Reimbursement of municipalities for decrease in revenue following replacement of local property tax (IMU) on primary residence with municipal services tax (TASI) on all buildings	300		

Source: summary schedule of the financial effects of the Budget Bill. It does not report the effects of amendments approved by the Senate in the course of passing the Budget Bill.

A more generally useful analysis would be to examine the joint action of the dual constraints represented on the one hand by the accounting rules for local authorities (Legislative Decree 118/2011) and, on the other, by the balanced budget rule (Law 243/2012). They alternate as the more restrictive regulation, enhancing the overall containment of the expenditure capacity of local governments. The provisions of the 2018 Budget Bill, which grant financial flexibility to authorities running surpluses or holding cash, seek to attenuate the restrictive effect if the more stringent rule is the balanced budget rule.

For example, in the case of a local authorities with a history of uncollectible revenue or a large debt burden, with large allocations to the provision for doubtful credits and a large debt service outflow – expenditures that have an impact on the accounts but are not relevant for the purpose of assessing compliance with the balanced budget rule – the latter restriction would be less stringent. The budget would have a degree of financial flexibility that could potentially be used for investment spending financed with operating surpluses or borrowing. If, however, the local authority does not have access to such self-financing (since its debt is already too large), the financial flexibility allowed by the balanced budget rule could not effectively be exploited, with consequent overshooting (Box 3.2).

Conversely, for a local authority without large allocations to the provision for doubtful credits (i.e. with a historically high ratio between revenue collections and assessments) and low debt servicing payments, as well as an operating surplus, it would be the accounting rule from Legislative Decree 118/2011 that would be less stringent. It would allow the authority to use the surplus to finance new investments, a possibility ruled out by the balanced budget rule.

It would also be necessary to assess the relationship between the balance reported by local authorities subject to the balanced budget rule (as defined in Law 243/2012) and the corresponding impact in terms of net borrowing. Istat data shows that the net surplus of local authorities in 2015-2016 is smaller than the overshooting referred to earlier.

Another critical issue concerns the extension for 2018 of the suspension of the increases in local taxes. That measure, while not having financial effects, impacts the financial independence of local authorities as it limits their scope for self-financing through taxation.

With regard to the measure extending the Single Treasury mechanism for local authorities, it seems unwarranted to include a savings on interest expenditure in the summary schedule of financial effects. While that measure will have a significant positive impact on the borrowing requirement (€6 billion in 2018 and €3 billion in 2019), it is included with other provisions that overall will produce a deterioration in the borrowing requirement (€6.1 billion in 2018, €8.2 billion in 2019 and €5.4 billion in 2020). The savings associated with the measure improving the borrowing requirement merely offset part of the increase in interest expenditure produced by the budget package as a whole. Note that while the savings in interest spending generated by the individual measures concerning the Single Treasury are quantified, the adverse impact on interest spending of the expansionary measures in the budget are not reported in the budget: trend interest expenditure is equal to planned spending.

3.8.2 Issues of primary relevance for the regions

The requirement for large surpluses, especially for regions, creates a series of problems, first and foremost with regard to the accumulation of surpluses that will very likely create pressures for their use. These issues emerge primarily when they result in unused cash holdings. If instead the surpluses are merely accounting items, the future pressure on expenditure could be less significant. In any event, the build-up of surpluses in regional accounts (such as those generated by the Domestic Stability Pact prior to the introduction of policies cutting transfers) does not seem sustainable in the medium term, presumably making the future resolution of such an accounting imbalance inevitable.

This issue takes on even greater importance in the light of recent rulings by the Constitutional Court, which on the one hand have underscored the necessity of ensuring the full availability of the surplus once it has been certified in the accounts for the previous year and, on the other, allow that availability to be subject to reaching regional or national agreements.[176]

It would also be necessary for the regions to conduct a broad assessment of previous budget packages, ending the practice of deferrals and reprogramming from year to year, and to transparently determine the financial requirements of the sector in relation to the financial compatibility and sustainability of the public accounts. This would facilitate the transition to a system in which the balanced budget rule was always applied to the budgets of local authorities.

The practice of implementing previous budgets through their reprogramming from year to year – thereby significantly reducing, at times with accounting stratagems, planned funding cuts by replacing them with a requirement to post surpluses – clouds the transparency of financial relations between the State and the regions.

Excessively technical accounting practices, which can limit the clarity of budget policy, is one of the issues addressed in the Constitutional Court rulings.

Summing the effect of previous budget packages that still had to be implemented, the regions would see resources cut by about €2.7 billion a year in 2018-2020. The way these cuts are implemented, repeated year after year, is normally as follows: the Budget Act appropriates additional transfers to the regions for the following year (often on capital account and sometimes with effects only in terms of the State budget's net borrowing). Subsequently, within the framework of State-Regions negotiations, those transfers are cut in order to implement the measures of previous budgets. When the reduced transfers only have an impact on the State budget's net borrowing, the regions undertake to post corresponding surpluses, in order to generate savings for the purposes of general government net borrowing and the borrowing requirement. Thus, the actual purpose of the additional resources assigned to the regions in the budget is to create an accounting item to be used to reduce the burden of previous budgets on the regions, thereby diverging from the purpose determined ex ante during the budget session (healthcare building, investment supports, reducing the debt, etc.). In the case of the February 2017 accord, the timetable was even turned on its head: the agreement provided for the issue of a subsequent measure to assign to the regions part of the Investment Fund created with the 2017 Budget Act, while at the same time declining the

[176] The Constitutional Court ruling nos. 247 and 252 of 2017 will be examined in an upcoming PBO Flash Paper.

additional transfer. The subsequent Decree Law 50/2017 then assigned the regions amounts that had already been cut.

The budget package currently passing through Parliament gives the regions €2.2 billion for 2018 for the sole purpose of the State budget's net borrowing, which can be used to reduce the debt. However, the same amounts are revoked in the next paragraph to implement part of the cuts envisaged in previous budget packages. For the purposes of general government net borrowing and the borrowing requirement, the regions are expected to achieve savings of €2.2 billion by posting surpluses. An additional €100 million in cuts provided for under current legislation are cancelled (for the purpose of all balances). Accordingly, with an expected cut in resources for 2018 amounting to €2.7 billion, the actual reduction amounts to just €0.4 billion, of which €0.1 from funding for residential building and €0.3 billion to be decided with a State-Regions agreement by 30 April 2018.

In addition to obscuring the implementation of budget measures impacting the regions, this accounting practice could limit the medium-term planning capacity of regional officials. The latter find themselves in the position each year of managing uncertainty about the availability of resources in the medium term, engendered by the procedures used to implement or neutralise the major cuts provided for in earlier budget packages.

The actual cuts, however small they may be, arrive with a lag during the year, making the amount of revenue due to the regions uncertain. That revenue is in fact often only specified close to the end of the year, effectively making it impossible to spend the resources and thereby increasing the overshooting noted earlier (Box 3.2). Moreover, since the allocation of the effective cut across the various transfer chapters is accomplished within the framework of State-Regions negotiations, it eludes public and parliamentary scrutiny and debate over the allocation of resources, whose proper arena is the parliamentary examination of the budget package.

For 2018, the regions proposed an across-the-board cut of 32 per cent in transfers to them in accordance with the scheme set out in Table 3.10.

Table 3.10 – Proposed reduction in transfers formulated by the regions for 2018
(millions of euros)

Transfer	Current legislation appropriation	Reduced appropriation	Reduction	Percentage reduction	Composition of overall cut
Non-self-sufficiency fund	450	308	142	32%	47%
Social policies fund	308	211	97	32%	32%
Textbooks	103	70	33	32%	11%
Defaulting tenants fund	45	31	14	32%	5%
Livestock and agriculture	23	15	7	32%	2%
School building fund	20	14	6	32%	2%
Total	**949**	**649**	**300**	**32%**	**100%**

Source: Hearing of the Conference of Regions and Autonomous Provinces of 7 November 2017 before a joint session of the Budget Committees.

It would therefore be advisable to assess the scale of the reduction in funding provided for by previous budgets to be borne by the regions and, once specified, to divide that amount over a sustainable longer-term period, avoiding the year-to-year postponement of the reprogramming. It would also be appropriate, as noted earlier, to adopt procedures for implementing the budget package that are consistent with the balanced budget rule.

3.8.3 Issues of primary relevance for municipalities

For municipalities, with regard to the general issues noted above concerning exceptions from the budget balance rule provided for in the budget package[177] and the advisability of assessing the joint effects of the dual budget constraints, another issue regards the concerns expressed in section 3.7 about the effectiveness of granting flexibility for deficit spending for investments in the light of the considerable overshooting with which these governments spontaneously comply with the balanced budget constraint (Figure R3.2.1).

In the light of this overshooting and the slow growth in investment spending, it would be helpful to assess the operation of the balanced budget constraint – as currently configured in Law 243/2012 – and its interactions with the parallel accounting constraint set out in Legislative Decree 118/2011. It would be necessary to verify whether the dual operation of multiple accounting constraints, whose differences in formulation ease the balanced budget constraint on current expenditure[178] in order to free up resources for investment, actually achieves this goal (Box 3.2).

[177] The sign of the impact for municipalities is ambivalent, as the package contains measures requiring surpluses (such as Article 71, paragraph 15, concerning the TASI provision and measures that permit deficits (such as Article 72, paragraph 1, letter a), concerning the €3.2 billion for investment over six years.
[178] The balanced budget rule does not consider the provision for doubtful credits.

Box 3.2 – Overshooting of local authority budget targets

This box presents an assessment of developments in the overshooting of budget targets achieved by authorities subject to monitoring under the Domestic Stability Pact in 2003-2014[179] and the balanced budget rule[180] for 2015-2016. The upper part of the chart reports the excess compliance in absolute value by sector of local government (right-hand scale), while the lower part of the chart reports the percentage of non-compliant authorities by sector (left-hand scale).

The overshooting, which was considerable until 2006, underscores the laxity of the Domestic Stability Pact in its early years. It decreased with the tightening of the constraint from 2007 to 2014, before growing again in 2015-2016, when the constraint was progressively eased in the transition to the balanced budget rule.

Non-compliance, initially small, increased in 2006-2009, in parallel with the overshooting decrease. Subsequently, the introduction of horizontal and vertical flexibility mechanisms facilitated compliance with the constraint on the part of individual local authorities, even though the constraint was more stringent overall. In 2014-2016, the difficulty of complying with the constraint only becomes evident for the provinces following large cuts in the resources flowing to that sector, while the other sectors were almost entirely compliant.

In 2015-2016,[181] in parallel with the introduction and implementation of the balanced budget rule, overshooting reached an average of 7.7 per cent of total municipal spending and 7 per cent of regional spending (excluding healthcare) after having averaged 1.5 and 1 per cent in 2011-2014.[182]

In 2015, much of the phenomenon can be explained by temporary factors such as:

- considerable exceptions to the balanced budget constraint[183] (not necessarily to be used entirely) aimed at encouraging the full use of expiring Community resources[184] and permitting the drawdown of cash holdings and surpluses accumulated under the Domestic Stability Pact,[185] in view of the transition to the balanced budget system;
- the assessment of unexpected revenue by a number of regions (Campania, Lazio, Liguria, Lombardy, Marche and Puglia), associated with the extraordinary restructuring of debt.

  This operation, undertaken in December 2015, involved obtaining loans from the MEF, the buy-back of outstanding regional bonds and the concomitant closure of the associated derivatives positions. The mark-up of the extinguished derivatives,[186] recognised as a revenue item, helped increase the extent of those regions' overshooting in that year.

A more complex challenge is presented by the analysis of the factors underlying the overshooting registered in 2016, the year of full implementation of the balanced budget rule.

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[179] Local authorities subject to monitoring increased from 200 in 2003 to more than 5,600 in 2014.

[180] The balanced budget rule entered force for all ordinary statute regions in 2016, but most of its substantive effects were brought forward to 2015.

[181] For a summary analysis of the phenomenon for the previous period, please see the hearing of the Chairman of the Parliamentary Budget Office of 26 May 2016 on the reform of the Budget Act and the budget rules for local authorities.

[182] A safety margin was retained for prudential purposes in order to avoid penalties in the event of unexpected expenditures or revenue shortfalls.

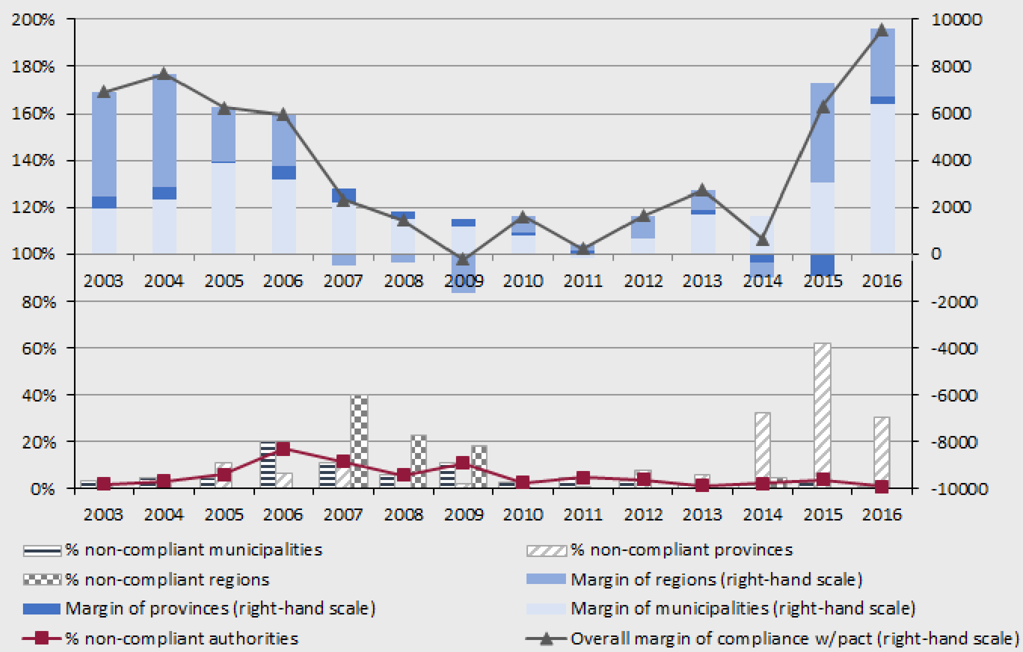
[183] In addition to the easing of the constraint provided for in the 2015 Stability Act, during the year a measure was passed that allowed the exclusion of investment spending by regions and allocations to the provision for doubtful credits from the balanced budget rule, with a corresponding increase in the budget balance target.

[184] For the 2007-2013 programming cycle.

[185] In recent years, this constraint called for the posting of surpluses.

[186] The structure of the bullet-amortising derivatives connected with the issue of regional with bullet repayment schedules (i.e. repayment in a single instalment) tended to naturally give them a positive value for the public entities, since under those contracts the entity undertook to pay a periodic amount and the bank to pay an overall amount at maturity, which the regional government would use to redeem the securities. The closure of those contracts allowed the regions to collect their positive market value.

Figure R3.2.1 – Margin of compliance with the Domestic Stability Pact constraint and the balanced budget rule and percentage of non-compliance among local authorities *(millions of euros and percentages)*



Source: based on data from monitoring of Domestic Stability Pact drawn from reports of the Court of Auditors (2003-2014 for the regions and 2003-2010 for other local authorities) and the Department of the State Accountant General (2015-2016 for the regions and 2011-16 for other local authorities).

In addition to temporary factors that caused a partly unexpected slowdown in investment expenditure (difficulties associated with the application of the new Public Contracts Code, the start of the new programming cycle for EU resources, the delays in stabilising the regulatory framework with the inclusion of the restricted long-term fund in the balanced budget rule), the difficulties in that year also appear to reflect structural factors of an administrative and legislative nature.

The former include the delays in the allocation of transfers to the various authorities, with a cascade effect (from the State to the regions, and then from the latter to the other local authorities).

The uncertainty of the associated amount makes it difficult to size appropriations in the accounts of the local authorities, which should adopt conservative criteria and avoid recognising transfers of unknown amount under their revenue, thereby restricting their expenditure capacity. Delayed receipt of greater revenue does not generate an equivalent increase in spending capacity, given that the ability to commit the amounts received is subject to their actual assessment. Part of the transfers received near the close of the year was therefore transformed into overshooting for the purpose of the balanced budget rule (Law 243/2012) and into surpluses for the purposes of accounting rules (Legislative Decree 118/2011).

The legislative factors included differences in the structure of the items considered for the purposes of the balanced budget rule compared with those considered by the accounting rules. The existence of this dual system means that, depending on the circumstances, one may be more stringent than the other (see above). In cases in which the accounting restriction is more stringent, overshooting for the purpose of the balanced budget rule may occur.

The possibility for part of the budget flexibility to be transferred – under regional or national agreements – to authorities for which the more stringent constraint was the balanced budget rule reduces this phenomenon only marginally. The measure in the 2018 Budget Bill concerning the granting of financial flexibility to authorities with surpluses and cash holdings also reduced the need for horizontal transfers.

Without a change in the above administrative practices or the redefinition of the items included or excluded from the calculation of budget balance, it is likely that significant overshooting will also occur in the future. Part of this margin merely appears to be indicative of the fact that the balanced budget constraint is less stringent – for some local authorities – than the accounting constraint.

3.9 Measures for healthcare

The 2018 Budget Bill does not specify the funding for the National Health Service (NHS). The previous year's Budget Act had set it at €113,000 million for 2017, €114,000 million for 2018 and €115,000 million for 2019. These figures should be reduced by €423 million in 2017 and €604 million from 2018 onwards to offset special statute regions' failure to contribute to consolidating the public finances as required in the 2016 Stability Act, as they did not sign the associated agreement. Funding is therefore equal to €112,577 million for 2017, €113,396 million for 2018 and €114,596 million for 2019. The figures for 2020 are not determined.

The Budget also specifies that the funding of costs for contracts in 2016-2018 and for the renewal of general practitioner agreements shall continue to be charged to the NHS budget. It is likely that the regions had difficulty in provisioning all the funds they need for contractual increases and general practitioner agreements, due in part to: 1) cuts in funding; 2) the costs associated with the introduction of the new essential care standards (the so called LEP); 3) restrictions imposed for some pharmaceutical spending;[187] 4) the need to hire new staff to ensure orderly turnover of personnel, addressing the problem of non-permanent employees and ensuring compliance with European directives on the working hours of physicians;[188] and 5) reimbursements of ceilings overruns on pharmaceutical spending at firms expense (the pay-back mechanism) which remained only partial and deferred. The need to find funds on a current legislation basis for contract renewals introduces an element of risk in the level of healthcare services and the soundness of the sector's accounts.

In the Update of the EFD the expenditure forecasts were kept unchanged in absolute value from those in the 2017 EFD, and this implies, given the new projections for nominal GDP growth, a decline of 0.1 per cent in the share of healthcare spending each year, from 6.7 per cent in 2016 to 6.3 per cent in 2020. The underlying allocative choice appears to be to reduce the effort made in the public health system, investing resources in lightening the tax burden for occupational[189] and "community" welfare (in which the bank foundations have been involved).

The Budget Bill offers a tax credit of 65 per cent (non-refundable) for donations to projects promoted by bank foundations – in the pursuit of their official purposes for the

[187] With the funds for innovative pharmaceuticals and innovative oncological pharmaceuticals and those to finance the vaccine plan, for a total of €1,127 million in 2018 and €1,186 million in 2019.

[188] The 2017 Budget Act introduced another targeted fund of €150 million a year for 2018 and 2019. For more information on personnel expenditure, see the section on public employment (section 3.6).

[189] For more on measures in favour of occupational welfare, see UPB (2016), "2017 Budgetary Policy Report", November. A Senate amendment of the Budget Bill permitted the provinces of Trento and Bolzano, in the presence of national supplementary NHS funds, to allow the participation in another fund with geographical or company-level agreements, as long as service levels were not inferior to the other programmes.

promotion of community welfare[190] – at the request of local authorities, aimed at the delivery of healthcare and social services and third sector services (in the latter case, by way of a public selection process). The applicant authorities must use those resources for non-commercial initiatives. The cost of the measure is set at €100 million per year for the 2019-2021 period. The tax credit will be granted as long as the appropriated funds last. The programme represents an additional extension of the tax relief granted recently to the foundations for activities that in any event form part of their institutional purpose.

The 2018 Budget Bill seeks to definitively resolve the pharmaceutical pay-back issue, which has engendered considerable litigation both for 2016 and for 2013-2015, offering legal coverage to settlement agreements between the Italian Medicines Agency (AIFA) and pharmaceutical companies that will generate certain revenue, albeit less than previously expected.[191]

For 2016, AIFA has been asked to issue a decision for reimbursement within 30 days of the entry into force of the Budget Act, with the pharmaceutical companies to pay within a further 30 days.

As regards amounts pertaining to previous years, AIFA has been given 120 days to complete the settlement agreements concerning payments for 2013-2015 (provided for by Decree Law 113/2016), in respect of litigation still pending at the end of 2017. The operation is limited to only those pharmaceutical companies that made regular payments for 2016 in order to discourage additional litigation in respect of 2016.

The explanatory report accompanying the Budget Bill emphasises that the Attorney General's Office had found that the "outlook for the litigation was decidedly unfavourable", justifying the decision to opt for settlements that involve the termination of the suits and thus avoid the risk of having to return amounts already received.

The technical report does not attribute any impact on the budget to these measures, but notes that the total pay-back amount for 2013-2015, as recalculated on the basis of the settlement agreements, could be equal to about €930 million, about €560 million less than the €1,486 million previously indicated by AIFA. As clarified in the 2017 EFD, in 2015 €735 million were recognised as revenue in the accounts of the healthcare authorities, reducing the intermediate consumption expenditure of general government departments (in the national accounts), while for 2016 the expenditure of the latter was reduced by Istat by €147 million, i.e. the difference between the effective revenue from the pay-back mechanism (€882 million) and the amount registered the previous year. An

[190] For measures to fight poverty and hardship in families with minor children as well as to strengthen home care services. The list was expanded with a Senate amendment of the Budget Bill, which accompanied the goal of fighting poverty with the fight against social vulnerabilities and hardship among young people, and included protection of childhood and the provision of treatment and assistance of the elderly and the disabled, social and labour market inclusion and integration of immigrants, as well as specifying the goal of enhancing healthcare equipment levels.
[191] For more on the pharmaceutical pay-back mechanism see UPB (2017), "Governing pharmaceutical spending through ceilings and the payback mechanism", Focus Paper no. 5, 21 June (text in Italian).

additional small amount of reimbursements would remain to be recognised, presumably in 2018. The fact remains that owing to administrative difficulties in implementing the mechanism, the healthcare system has foregone part of the reimbursements that should have been received by the NHS for past years (2013-2015) and is permitting long delays in payments for 2016 and 2017. It is therefore to be hoped that the information on the outcome of the settlements with the individual companies is as extensive and transparent as possible.

In addition, the effectiveness of the measures introduced with the previous year's Budget Act and with Decree Law 50/2017 seems decisive. They were intended to simplify the calculation of the pay-back amount (by aggregating all direct purchases of pharmaceuticals under one category) and enhance AIFA's analytical capacity (by improving the traceability of the data through the use of the figures drawn from electronic invoicing). If those measures will prove to be insufficient, it would no longer be possible to count on the full amount of the reimbursements, which for 2016 should be equal to half of the overshoot in spending on hospital pharmaceuticals, previously estimated by AIFA at nearly €1,600 million (expenditure through convention with chemist's shops was about €200 million under its ceiling). As for subsequent years, according to forecasts from the OSFAR pharmaceuticals observatory,[192] the overruns of the pharmaceutical spending ceiling for direct purchases, 50% of which should be reimbursed by pharmaceutical companies, will be equal to €1,813 million in 2017 and €2,536 million in 2018 (in the same period, spending through convention with chemist's shops would not exceed the ceiling). According to other estimates,[193] in 2017 the overruns would be just €1,500 million.

In the pharmaceutical field, the Budget Bill also provides for three years of experimental monitoring of the effect of the use of innovative pharmaceuticals and innovative oncological pharmaceuticals on the overall cost of treatment, using the Standing Committee for the Monitoring of Delivery of Essential Care Standards,[194] on the basis of data drawn from clinical practice. The exercise would also serve to support any reallocation of resources and, in particular, the assessment of the adequacy of the two funds for innovative drugs. This approach, which has been promoted by the pharmaceutical industry on occasion, seeks to identify possible savings in expenditure connected with the use of pharmaceuticals. Any such monitoring programme should be entrusted to entities with extensive technical and scientific capacities and skills. The strength of its findings with regard to the efficiency of the use of resources will depend on the reliability and completeness of the data used, taking due account in allocative decisions of the need to balance the introduction of new technologies with that of ensuring the effective operation of basic services.

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[192] OSFAR – Osservatorio Farmaci (2017), Report n. 37, Report annuale per il 2016, Cergas, Università Bocconi.

[193] See Martini, N. (2017), "Una mappa di proposte per la nuova *governance* farmaceutica", Sanità24, *il Sole 24 ore*, 10 November.

[194] Composed of representatives of the Ministry of Health, the Ministry for the Economy and Finance, the Department for Regional Affairs of the Presidency of the Council of Ministers and the regions.

Finally, a Senate amendment introduced during the approval of the Budget Bill again extended (until the end of 2018) the deadline for a review of the remuneration system for the pharmaceuticals distribution system, a reform that has been pending for some time. In the meantime, however, an amendment of Decree Law 148/2017 updated as from 2018 the turnover limits for entitlement to a reduction in the discount withheld by the NHS (which ranges from 3.75 to 19 per cent depending on the price of the drug), from €387,343 (750 million lire) to €450,000 for rural pharmacies (discount of 1.5 per cent) and from €258,228 (500 million lire) to €300,000 for low turnover pharmacies (a 60 per cent reduction of the discount). This will increase costs for the public finances by about €9 million.

Another group of measures regards the digitisation of procurement of goods and services: documentation concerning the ordering and execution of purchases should be managed electronically (this is true for all government departments). Specifically, the bodies of the NHS will have to transmit that documentation through the management system implemented by the MEF-RGS (the operation will be part of the National Health Card system), which will be supplemented by other databases (the national public contracts database, SIOPE and the electronic invoice interchange system).

In addition, the Budget Bill and Decree Law 148/2017 provide financing to specific entities: the Mediterranean Institute for Transplants and Advanced Treatment in Palermo (ISMETT); a number of other entities, including private-sector organisations, that will be identified in a ministerial decree but which in fact have very specific characteristics and should therefore involve only a very few cases (€9 million).

With regard to capital expenditure, the Parliamentary resolution approving the EFD Update made specific reference to the Government's commitment to increase capital resources for investment in the healthcare sector. With regard to healthcare building, the situation is difficult to read. On the one hand, resources in 2018 are reduced, but on the other substantial refunding is planned for 2020.

As part of regional participation in consolidating the public finances in 2018 (Decree Law 66/2014 and Law 208/2015), the Budget Bill cuts €94.1 million in funding for healthcare building, postponing until 2019 the regions' assessment of the amounts under programme agreements signed in 2017 and granted funding in 2018 for building renovations and technological modernisation in the healthcare field, with the concomitant extension of the time limit for terminating the programme agreements (an amendment approved by the Senate during the passage of the Budget Bill redetermined and extended those deadlines).[195] The postponement is permitted as an exception to the rules governing the revenue recognition,[196] which require the regions to assess and

[195] The assessment of amounts eligible for funding in 2017 in respect of programme agreements signed in 2016 had already been postponed until 2018 with Decree Law 50/2017 in the amount of €100 million following the State-Regions agreement of 23 February 2017.
[196] Legislative Decree 118/2011 on the harmonisation of accounting systems and financial statements.

commit, during the year, an amount equal to that indicated in the decree authorising funding of the Ministry of Health.

Law 67/1988 authorised a long-term programme of building renovations and technological modernisation of healthcare assets and the construction of residential facilities for the elderly and the non-self-sufficient, in a total amount of 30,000 billion lire, subsequently increased (with Law 388/2000, Law 296/2006 and Law 191/2009) to €24 billion, of which 95 per cent to be financed by loans to the regions (with repayment charged to the State). The subscription of programme agreements with the regions and the allocation to other healthcare entities remained subject to the limit determined each year on the basis of actual budget resources. Law 502/1992, as amended by Legislative Decree 229/1999, permitted programme agreements between the regions and other healthcare entities and the Ministry of Health, in concert with the Ministry of the Treasury, Budget and Economic Planning and in agreement with the State Regions Conference, as part of regional programmes for the implementation of these projects.[197] If the programmes were not activated by the specified deadlines, the financing would be reprogrammed and allocated to other regions and healthcare entities, having obtained the opinion of the State-Regions Conference, taking account of expenditure capacity and ability to make immediate use of the resources. In addition, the legislation also established deadlines for termination of the agreements in the case of failure to submit an application for funding, inadmissibility of the application or failure to tender the works (for the part of the agreements concerning projects affected by such deficiencies).

According to data from the New Healthcare Information System (NSIS) published by the Court of Auditors,[198] at the end of 2016 the regions had reached 79 programme agreements, for a total of €10.9 billion, out of the €15.3 billion available[199] (just over 70 per cent), while the resources approved for funding under the agreements totalled €10.2 billion (about 94 per cent). In addition, of the €886.4 million reserved for Institutes for science-based care and research (IRCCS), experimental veterinary Institutes (IZS) and directly-operated university-affiliated hospitals, €862.4 million were used in the agreements and of this €764.3 million were approved for funding.

Section II of the Budget Bill contains a number of "horizontal" offsets (between different years) that, in most cases, shift healthcare building funds from 2018-2019 to 2020 and later (Table 3.11).

These involve: 1) compensatory reprogramming of discretionary earmarked expenditure and adjustment of the payment scheduling in respect of the support for the regions for healthcare building projects (the reprogramming involves public healthcare building while the scheduling adjustments[200] concern amounts quantified with the extraordinary reassessment of expenditure carryovers conducted under the provisions of Decree Law 66/2014) (Table 3.11, line a); 2) refunding and defunding (the latter implemented as part of the cuts in the Ministry of Health budget) of the appropriations provided for on a current legislation basis for public healthcare building (Table 3.11, line b)).

[197] Some regions also reached framework programme agreements within the scope of institutional programme agreements (Law 662/1996).
[198] Court of Auditors (2017), "Rapporto 2017 sul coordinamento della finanza pubblica", April.
[199] This regards the second phase of the extraordinary investment programme begun in 1988. Including additional resources, in the second phase a total of more than €18 billion was allocated. The first phase ended with an allocation of €4.9 billion in 2006. Another billion was allocated with the 2010 Finance Act.
[200] These adjustments were prompted by the need to reschedule expenditure, not decisions to alter the planning of the expenditure itself (reprogramming).

Table 3.11 – Funding of healthcare building programmes

	2018	2019	2020
Draft budget on current legislation basis	1,140.0	1,000.2	431.0
a) Reprogramming and adjustment of scheduling	-740.0	-350.2	1,090.2
of which:			
Reprogramming: public healthcare building	*-600.0*	*-369.0*	*969.0*
Adjustments of scheduling: repayment of debts in respect of regions	*-140.0*	*18.8*	*121.2*
b) Refunding, defunding and replanning	0.0	-25.0	975.0
of which:			
Cuts at ministries		*-25.0*	*-25.0*
Refunding			*1,000.0*
Budget Bill - section I	-94.1		
Budget Bill - overall	305.9	625.0	2,496.2

Source: based on the Budget Bill, sections I and II.

Box 3.3 – Investment in healthcare building projects

The financing of healthcare building projects provided for in the 2018 Budget Bill – about €306 million in Table 3.11 – is lower than definitive cash appropriations and the payments from the State budget posted and recognised, respectively, since 2011 (Table R3.3.1).

An analysis of the State budget shows that the appropriations on an accruals basis for healthcare building in 2011-14 were limited by the large carryovers accumulated previously (Table R3.3.2). Beginning with 2015, as most of those carryovers had lapsed, appropriations on an accruals basis were generally larger in the final years of the three-year policy horizon. However, the following budget cycles postponed spending of the resources, which is especially evident with regard to the 2018 Budget Bill.

The downward trend in investment in healthcare infrastructure, only part of which reflects a reduction in funding from the State budget, is also revealed in other data, notably those from the payments registered in the SIOPE database concerning healthcare facilities[201] and the regional healthcare system (Table R3.3.3). For the former, investment in buildings has contracted by 54.3 per cent in the last five years, going from €1.3 billion in 2011 to €604 million in 2016. Investment in hospitals and healthcare facilities operated by the regions decreased from €104 million in 2012 to €33 million in 2016, a drop of 68.3 per cent.

SIOPE data can be used to perform an analysis by macro-area of the distribution of payments within the country. Table R3.3.4 reports payments associated with investment – on a per capita basis – for healthcare facilities and regional healthcare systems, grouping together expenditure on buildings and that for hospitals and other healthcare facilities.

Table R3.3.1 – Investment in healthcare building (1)
(millions of euros)

	2011	2012	2013	2014	2015	2016	2017
Definitive appropriations on accruals basis	722	1,181	57	0	508	601	250
Definitive appropriations on cash basis	584	1,181	764	606	565	601	530
Definitive carryovers	3,249	2,838	1,888	1,224	57	193	433
Amounts committed	722	1,181	57	0	508	601	
Payments on accruals basis (a)	4	6	0	0	316	168	
Payments under carryover account (b)	576	868	519	439	0	193	
Total payments (a+b)	580	874	519	439	316	361	

Source: for 2011-16, Final Statement of Account; for 2017 Budget Adjustment Act.
(1) The figures for 2017 only include changes approved definitively by the date of presentation of the 2017 budget adjustment legislation (Law 157/2017).

Table R3.3.2 – State budget: Initial appropriations for healthcare building on accruals basis (Chapter 7464)
(millions of euros)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2011 SA	236.0	532.3	0.0							
2012 SA		328.8	0.0	0.0						
2013 SA			56.8	0.0	0.0					
2014 SA				0.0	100.0	500.0				
2015 SA					810.0	1,410.0	1,721.2			
2016 SA						810.0	821.2	700.0		
2017 BA							250.0	1,140.0	1,000.2	
2018 BB								305.9	625.0	2,496.2

Source: 2011-2016 Stability Acts, 2017 Budget Act and 2018 Budget Bill.

[201] The healthcare system bodies included in the SIOPE database comprise: regional healthcare agencies, local health authorities, hospitals, Institutes for science-based care and research, experimental veterinary Institutes and university-affiliated hospitals.

Table R3.3.3 – Healthcare facilities and regional healthcare systems: payments registered in SIOPE
(millions of euros)

	2011	2012	2013	2014	2015	2016
Buildings (healthcare facilities)	1,321	1,185	1,170	801	715	604
Hospitals and healthcare facilities (regions)		104	66	54	56	33
Total	**1,321**	**1,288**	**1,236**	**856**	**770**	**636**

Source: SIOPE, 2011-2016.

The data show that all geographical areas experienced substantial cuts in 2011-2016: the largest fall in investment expenditure was seen in the Centre (-65.6 per cent), followed by the North (-56.5 per cent) and the South (-29.1 per cent). These developments shifted per capita investment flows, which at the end of the period were more similar across the macro-areas, although investment in the North remained greater than elsewhere. This stands to reason, as the regions in the North were the most active in committing resources in the programme agreements they had signed – as part of regional programmes for the implementation of initiatives – and which were most effective in applying for and obtaining funding.

As regards healthcare investment in general, Istat's national accounts data for local healthcare bodies (LHBs) for 2011-2016 show a downward trend only as from 2013, with a smaller decline. After the approximately €3.2 billion registered in 2012, investment contracted to just over €2 billion, a decrease of 35.8 per cent (Table R3.3.5). Nevertheless, in 2016 alone, investment by LHBs (which in 2015 had represented about 55 per cent of investment in the healthcare field) contracted by 18.1 per cent on the previous year (compared with a reduction of 4 per cent in total general government investment).

The decline over the years appears to reflect the joint impact of the reduction in appropriations on an accruals and cash basis in the State budget, and the provisions of the budget packages at the regional level as agreed in the State-Regions Conference, as well as difficulties in implementing projects at the regional level, especially in the regions in the South. The renewed creation of expenditure carryovers in the last year for which data are available seems to reflect the implementation difficulties in the sector.

Table R3.3.4 – Healthcare facilities and regional healthcare systems: payments registered in: SIOPE
(euros per capita)

	2011	2012	2013	2014	2015	2016
Buildings, hospitals and other healthcare facilities						
North	26.8	27.1	25.0	15.5	13.4	11.7
Centre	26.8	17.3	15.0	10.5	10.8	9.2
South	13.7	16.6	17.2	14.3	12.9	9.7

Source: based on SIOPE and Istat data.

Table R3.3.5 – Local healthcare bodies: total investment
(millions of euros)

	2011	2012	2013	2014	2015	2016
Total investment	2,798	3,191	2,980	2,772	2,501	2,048

Source: Istat.

3.10 *The reorganisation of financial relations between the State and INPS*

The Budget Bill contains measures to reorganise financial relations between the State and INPS in order to restore an accurate representation of the financial situation of the social security institution, which currently has a large liability towards the State, accompanied by a large credit exposure.

More specifically, at the end of 2015 INPS had a liability in respect of the State of €88.9 billion, corresponding to the sum of advances received over the years from the State budget. At the same time, INPS had receivables in respect of the State for transfers not disbursed in the amount of €38.7 billion. In addition, the INPS position vis-à-vis the Treasury included liabilities for cash advances disbursed in the past, amounting to €32.2 billion, and cash holdings with the Treasury of €37.7 billion.

INPS' liability in respect of the State was largely generated by the mechanism for financing pension expenditure, which is only partly based on contributions from beneficiaries, with the remainder financed with State resources. The representation of the latter as advances rather than transfers generates an increasing liability for INPS in respect of the State. Another factor increasing this liability is the practice of using advances to finance welfare benefits in the event of insufficient budget appropriations for the corresponding transfers or, in the case of accounting delays by INPS, benefit payments. In the case of welfare benefits, the INPS liability for advances received gives rise to a corresponding creditor position for transfers to be received for the benefits disbursed.

The PBO recently addressed the anomalous nature of the reciprocal financial relations between the State and INPS.[202] With regard to the stock of advances that had accumulated, a proposal was advanced to sterilise the INPS' debtor position with the State by offsetting the reciprocal debtor and creditor positions and settlement of the remaining advances. In order to prevent INPS from re-accumulating a debt with the State, it was also proposed to finance the various accounts – both welfare benefits and the portion of pensions not covered by contributions – with more adequate appropriations in the associated chapters in the State budget, restricting the use of advances to covering temporary mismatches in financial transactions between the State and INPS. The scale of those mismatches could also be further limited by accelerating the time needed to complete reporting for the welfare accounts in order to ensure the associated appropriations in the State Budget do not expire.

The Budget Bill establishes that advances recognised as liabilities in respect of the State in the 2015 accounts of INPS, totalling €88.9 billion, shall be offset against the receivables due from the State as reported in the same accounts up to the amount of €29.4 billion. For the remainder, the advances shall be considered non-repayable, for which no demand for reimbursement or offsetting against other receivables shall be made. The implementing measures will determine which chapters of the INPS accounts

[202] Ufficio parlamentare del Bilancio (2017), "Rapporti finanziari tra bilancio dell'INPS e bilancio dello Stato", Flash n. 6 of 3 August 2017.

will be used for the offsetting as well as the criteria and pension accounts to which the definitive transfers shall be attributed.

This measure seems appropriate to settling previous transactions but may not be sufficient to prevent the problem from re-emerging in the future.

With regard to the welfare accounts, part of which are financed from the State budget, the issue would require a more accurate determination of the appropriations in the chapters of the State budget with respect to the benefits paid.

In the case of the pension accounts, a remaining issue concerns deciding how to reconcile the principle of financial balance,[203] which would prohibit State financing of deficits in the pension system, with the actual situation of a lasting imbalance between the balances of pension accounts with surpluses and those with deficits, in which the latter are predominant. If the past practice of financing the imbalance with advances should continue, it is likely that INPS will again generate a liability in respect of the State that is simply representative of the imbalance between the entitlements of the beneficiaries and the contribution requirements set by law.

[203] Article 41 of Law 88/1989.

Appendix 3.1 – Comparison of the Inclusion Income and income support mechanisms adopted in Italy in the past

	Ordinary Purchase Card	Experimental Purchase Card (SIA card)	SIA 2016	SIA 2017	Inclusion Income (Legislative Decree 147/2017; provisions amended subsequently with 2018 Budget Bill indicated in red)
Year introduced	2008	2012	2016	2017	as from 2018
Citizenship and residency	Since 2014: EC citizens and family members not a citizen of a Member State with temporary or permanent residency permit, foreigners with EU residency permit for long-term residents; political refugees or persons eligible for subsidiary protection	Italian or EU citizens and family members not a citizen of a Member State with temporary or permanent residency permit, foreigners with EC residency permit for long-term residents, political refugees or persons eligible for subsidiary protection. Resident in one of 12 major cities with more than 250,000 inhabitants in which the measure has been activated (Bari, Bologna, Catania, Florence, Genoa, Milan, Naples, Palermo, Rome, Turin, Venice, Verona)	Italian or EU citizens and non-EU citizen family members with temporary or permanent residency permit, foreigners with EC residency permit for long-term residents. Resident for at least two years.	Italian or EU citizens and non-EU citizen family members with temporary or permanent residency permit, foreigners with EC residency permit for long-term residents. Resident for at least two years.	Italian or EU citizens and non-EU citizen family members with temporary or permanent residency permit, foreigners with EC residency permit for long-term residence. Continuous resident for at least two years (persons eligible for international protection are treated as Italian citizens under applicable law),
Income eligibility thresholds	ISEE: €6,788.61; personal income and any benefits received: €6,788.61; €9,051.48 if age >= 70; movable property: €15,000 (2016)	ISEE: €3,000; value of primary residence: €30,000; movable property: €8,000; ISEE wealth indicator: €8,000; public monetary benefits: €600 a month	ISEE: €3,000 (if the household has minors with a different ISEE, the lowest is considered); public monetary benefits:€600 a month	ISEE: €3,000 (if the household has minors with a different ISEE, the lowest is considered); public monetary benefits: €600 a month	ISEE: €6,000; ISRE: €3,000; real estate other than primary residence <= €20,000; movable property <= €6,000, + €2,000 for each member of the household beyond the first up to a maximum of €10,000
Subsidies and other support not considered in determining eligibility			Any tax relief, reductions in co-payments or rates, service coupons or vouchers in lieu of services, allowances, prizes or subsidies for studies or vocational training and support provided for in customised programme	Any tax relief, reductions in co-payments or rates, service coupons or vouchers in lieu of services, allowances, prizes or subsidies for studies or vocational training and support provided for in customised programme, local anti-poverty measures in the autonomous provinces of Trento and Bolzano	Local anti-poverty measures in the autonomous provinces of Trento and Bolzano
Conditions on other benefits	Any other benefits received must fall within income threshold	Total value of pension, disability and social benefits received by the household of less than €600 a month; must forfeit ordinary Purchase Card; other benefits received must not exceed the €600 a month limit	Total value of pension, disability and social benefits received by the household of less than €600 a month; may not receive NASPI or ASDI or any other benefits for involuntary unemployment or experimental Purchase Card	Total value of pension, disability and social benefits received by the household of less than €600 a month, or €900 if the household has non-self-sufficient member (as indicated in DSU); may not receive NASPI or ASDI or any other benefits for involuntary unemployment or experimental Purchase Card	May not receive NASPI or any other benefits for involuntary unemployment
Characteristics of household or householder	Adults aged >= 65 or children aged <= 3; not living in long-term treatment facility or in a correctional institution	One member who is aged < 18 and no members in employment and at least one member who stopped working in the 36 previous months, or is an employee or works under a flexible employment contract and income from employment of the household in the previous 6 months is <= €4.,00; municipalities may introduce additional requirements	One member who is aged < 18 or child with disability or pregnant women (benefit can be applied for as from the sixth month of pregnancy)	One member who is aged < 18 or child with disability or pregnant women (benefit can be applied for as from the sixth month of pregnancy)	One member who is aged < 18 or child with disability or pregnant women (benefit can be applied for as from the sixth month of pregnancy) or unemployed following termination, resignation for cause or consensual termination aged 55 or over, who have not received full unemployment benefits for at least three months, or unemployed for at least three months without entitlement to unemployment benefits, or with income from payroll employment or self-employment below or equal to the personal income tax exemption threshold, who are treated as equivalent to unemployed

Appendix 3.1 – (cont.) Comparison of the Inclusion Income and income support mechanisms adopted in Italy in the past

	Ordinary Purchase Card	Experimental Purchase Card (SIA card)	SIA 2016	SIA 2017	Inclusion Income (Legislative Decree 147/2017; provisions amended subsequently with 2018 Budget Bill indicated in red)
Year introduced	**2008**	**2012**	**2016**	**2017**	**as from 2018**
Possession of durable assets and real estate	The holder (with the person exercising parental authority or the foster parent), alone or with spouse, may not have registered in his or her name: more than one electrical utility contract (domestic or otherwise), more than 2 gas utility contracts, more than two vehicles; may not own >= 25 per cent of a residential building or >= 10 per cent of a building not used for residential purposes or in category C7	No member of the household may possess a new vehicle (registered in the previous year) or with a displacement of more than 1,300 cc or a new (3 years) motorcycle of more than 250 cc	No member of the household may possess a new vehicle (registered in the previous year) or with a displacement of more than 1,300 cc or a new (3 years) motorcycle of more than 250 cc	No member of the household may possess a new vehicle (registered in the previous year) or with a displacement of more than 1,300 cc or a new (3 years) motorcycle of more than 250 cc, with the exception of vehicles for the disabled (for which they are receiving the associated tax relief)	No member of the household may possess a new vehicle or motorcycle (registered in the previous two years), with the exception of vehicles for the disabled (for which they are receiving the associated tax relief), or boats or pleasure craft
Multidimensional assessment of need		Formation of a ranking; priority given to households: experiencing hardship in their housing conditions; single-family with minor children; with 3 or more minor children or expecting a third; with disabled minor children. Other qualifications for priority status: number of children (high) and age of youngest (low)	Score >= 45. Scale: dependents up to 65 points; financial condition up to 25 points; employment status 10 points (all working-age members unemployed)	Score >= 25. Scale: dependents up to 65 points; financial condition up to 25 points; employment status 10 points (all working-age members unemployed, with the exception of the non-self-sufficient, the unfit for work and students)	There is no scale of assessment of need for eligibility; the Anti-Poverty Plan may introduce a scale (based on financial status, dependents and persons in care and employment status) if the pool of beneficiaries is expanded in order to restrict the expansion and ensure its consistency with additional resources
Benefit	€40 a month	2 members: €231 a month; 3 members: €281; 4 members: €331; 5 or more members: €404	€80 a month for each household member up to a maximum of €400	€80 a month for each household member up to a maximum of €400, plus €80 in the case of a single-parent household with minor children	The amount of the benefit is based on the difference between household disposable income as determined for ISR purposes (with the substitution of welfare benefits reported in the ISEE with those received at the time the benefit is disbursed) and the threshold. The threshold is equal to €3,000 for a single-member household and varies depending on the number of household members in accordance with the ISEE equivalence scale net of increases and reduced by 25 per cent at the outset. The amount of the benefit may not exceed the value of the social allowance for pensioners; more specifically, the maximum benefit is equal to €187.5 a month for 1 member, €294.38 for 2 members, €382.5 for 3 members, €461.25 for 4 members and €485.41 for 5 or more members
Duration of benefits	1 year, renewable	1 year, renewable	Maximum of 12 months	Maximum of 12 months; interruption of 6 months before any new application	18 months followed by an interruption of at least 6 months and possible renewable for an additional year

Appendice 3.1 – *(cont.)* Comparison of the Inclusion Income and income support mechanisms adopted in Italy in the past

	Ordinary Purchase Card	Experimental Purchase Card (SIA card)	SIA 2016	SIA 2017	Inclusion Income (Legislative Decree 147/2017; provisions amended subsequently with 2018 Budget Bill indicated in red)
Year introduced	**2008**	**2012**	**2016**	**2017**	**as from 2018**
Reduction of benefits			The value of the benefit is reduced by: the amount of the ordinary Purchase Card for minors, the increase (from €80 to €160 a month) in the allowance for children up to 3 years of age in the case of an ISEE of less than €7,000; the allowance for households with at least 3 minor children	The value of the benefit is reduced by: the amount of the ordinary Purchase Card for minors, the increase (from €80 to €160 a month) in the allowance for children up to 3 years of age in the case of an ISEE of less than €7,000; the allowance for households with at least 3 minor children	Welfare benefits subject to means testing, with the exception of: internship payments (Agreement in State-Regions Conference of 22 January 2015); any additional benefits provided as part of the customised programme funded by the municipality or the social association of municipalities; any exemptions granted for co-payments for services and payment of taxes; amounts or vouchers received in lieu of services; and the so-called "baby bonus" of €80 a month for three years (except for the possible increase of 100 per cent envisaged for households with an ISEE of €7,000 or less, in force until 2017
Compatibility with employment	Targeted at non-working-age persons	Not permitted	Permitted to the extent compatible with economic status restrictions (taking account of the tax credit for payroll employment for ISEE purposes). If some member of the household already receiving the benefits is able to enter the labour market and is expected his or her income to change, the new expected annual income must be notified within 30 days. This will form the basis of an assessment of the financial condition of the family for the purposes of determining its continued eligibility (a similar notification must be made if a beneficiary has income from employment that is not reflected in the ISEE return). If the beneficiaries continue to meet the eligibility requirements, the amount of the benefit is not reduced	Permitted to the extent compatible with economic status restrictions (taking account of the tax credit for payroll employment for ISEE purposes). If some member of the household already receiving the benefits is able to enter the labour market and is expected his or her income to change, the new expected annual income must be notified within 30 days. This will form the basis of an assessment of the financial condition of the family for the purposes of determining its continued eligibility (a similar notification must be made if a beneficiary has income from employment that is not reflected in the ISEE return). If the beneficiaries continue to meet the eligibility requirements, the amount of the benefit is not reduced	Permitted to the extent compatible with economic status restrictions (taking account of the tax credit for payroll employment for ISEE purposes). If some member of the household already receiving the benefits is able to enter the labour market and is expected his or her income to change, the new expected annual income must be notified within 30 days. This will form the basis of an assessment of the financial condition of the family for the purposes of determining its continued eligibility (a similar notification must be made if a beneficiary has income from employment that is not reflected in the ISEE return). If the beneficiaries continue to meet the eligibility requirements, the amount of the benefit is not reduced
Safeguard clause on financing	Yes	Yes	Yes	Yes	Yes
Beneficiary support		Customised projects for poverty alleviation, labour market participation and social inclusion for at least half of beneficiary households, selected at random. Failure to sign up for the project will result in termination of benefits	Customised project (with reference to customised service agreement provided for in the Jobs Act), initially for at least 50 per cent of beneficiary households. Failure to sign up for the project will result in termination of benefits. Commitments for household members: frequency of contacts with the offices responsible for the project; active job search; involvement in labour market participation and training initiatives; acceptance of appropriate job offers; school attendance; health-conscious behaviour	Customised project (with reference to customised service agreement provided for in the Jobs Act). Failure to sign up for the project will result in termination of benefits. Commitments for household members: frequency of contacts with the offices responsible for the project; active job search; involvement in labour market participation and training initiatives; acceptance of appropriate job offers; school attendance; health-conscious behaviour	Customised social and labour market participation project developed following a multidimensional assessment of need (possibly based on the service agreement with employment centres provided for in the Jobs Act). Signing up for the project is a condition for disbursement of the Inclusion Income (except during a transitional phase). Commitments for household members: frequency of contacts with the offices responsible for the project; active job search and willingness to be involved in labour market participation and training initiatives, as well as acceptance of appropriate job offers (with a reference to the service agreement or intensive job search programme envisaged in the Jobs Act); school attendance; and health-conscious behaviour

Source: information drawn from the legislation introducing the mechanisms and from the INPS website.

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