2020 Budgetary Planning Report

Summary

The 2020 Budgetary Planning Report comes out in the midst of an exceptional economic and financial environment, one never before experienced in peacetime since the great crisis of the 1930s. The Report, which in previous editions focused on the Economic and Financial Document (EFD) and on the parliamentary hearing that followed, this year expands its perspective to examine the effects that the COVID-19 pandemic has had on the international and national economic system, the broad set of measures taken between March and today by European institutions and the Italian government to counter the dramatic economic and social consequences of the crisis, and the impact that these measures are having on the public finances now and looking forward.

In particular, since March the Government has implemented a series of very substantial financial measures that overall will cause general government net borrowing to deteriorate by 4.5 per cent of GDP in 2020 and 1.5 per cent in 2021.

Most of the measures have been of an emergency nature, offering temporary support to almost all economic actors (workers, households and firms). A wide range of instruments is being deployed, such as the establishment of new funds, outright grants, tax credits, tax relief and tax deferrals with temporary effects on the liquidity of firms. Only some of the most recent measures have incorporated some degree of selectivity, limiting access and differentiating benefits depending on the extent to which the crisis has impacted the beneficiaries. In addition, the latest legislative provisions also include some measures that focus on recovery, such as those designed to strengthen the capitalisation of firms, to support technological innovation and research or to sustain specific sectors.

The measures adopted require numerous implementing decrees and, in some cases, also need a prior declaration of compatibility with EU legislation from the European Commission. In general, the effectiveness of the measures depends critically on compliance with timetables, rapid mechanisms for allocating resources, efficient electronic administrative procedures and the implementation of the procedural simplifications envisaged in the legislative provisions.

Nevertheless, looking ahead to the gradual exit from the most acute phase of the health and economic crisis, the measures will necessarily have to be reconsidered within a more comprehensive vision of fiscal policy. It will be necessary to make strategic choices about the sectors to which greater or fewer resources should be allocated, about the future of the tax system and about the resumption of capital expenditure.

At the end of the emergency, Italian budgetary policy will have to come to terms with public accounts burdened by the cost of the extraordinary measures and with a

contraction of revenue due to the economic crisis, in a future no longer clouded by the presence of the safeguard clauses providing for indirect tax increases, which have been eliminated. Budgetary action in this deteriorated but more transparent environment will have to make priority choices in a context where it will be necessary to ensure the gradual reconstitution of a primary surplus enabling the reduction of public debt over time, albeit in a context of economic stabilisation.

The macroeconomic environment

The PBO endorsed the trend macroeconomic scenario in the 2020 EFD, while emphasising the extraordinarily high degree of uncertainty about the short-term outlook and the extreme variability surrounding the macroeconomic forecasts. The divergences between the projections formulated by the various participants in the PBO panel of forecasters are much wider this year than in the past. In the two months following the publication of the EFD, macroeconomic forecasts continued to deteriorate, as some of the risks noted by the PBO during the endorsement exercise materialised.

The spread of the coronavirus pandemic (COVID-19), first in China and then in the rest of the world, has radically changed the international economy, which had appeared to be recovering at the beginning of 2020, causing a collapse of economic activity and a deterioration in the outlook of a severity that has not been seen since the Great Depression. Despite the time lag in the spread of the pandemic, the stock markets reacted swiftly and simultaneously. The pandemic has had a major impact on the oil market, exerting downwards pressure on prices since as early as the beginning of February. International trade, which in early 2020 looked poised to benefit from an easing of the trade tensions between the United States and China, was also heavily affected. The disruption of the global value chains generated bottlenecks in the production of domestic goods that make significant use of imported intermediate inputs. Economies that rely on exports, such as Germany and Italy, are suffering significantly. Economic policy-makers responded promptly, with governments introducing fiscal stimulus measures and central banks easing their monetary policy stances.

Cyclical conditions in the Italian economy, which were already deteriorating in the final quarter of 2019, worsened with the spread of the epidemic at a pace and intensity unprecedented in times of peace. The industrial sector experienced a steep drop in output due to the lockdown of non-essential economic activities, while the consequences of the health emergency for the services sector were even more severe, having already emerged early in the year as a result of the decline in the flow of international tourists. The progressive tightening of social distancing measures culminated with the shutdown of a range of activities, including those related to restaurants, trade fairs and conferences and air and rail transport, with an adverse impact on the logistics sector. The most recent qualitative indicators confirm the

exceptional intensity of the slowdown. In addition to a deterioration in confidence, uncertainty has also increased, with the PBO uncertainty indicator rising markedly in the first part of this year, both for households and for firms. Inflation, which in early 2020 continued to display the weakness already observed last year as a result of moderate internal demand and limited pressure from upstream prices, declined further during the health emergency and eventually turned negative. The labour market, which had shown signs of weakening even before the outbreak of the health emergency, also appears affected by the measures introduced to contain the pandemic. Restrictions on movement have strongly discouraged active job searches, leading to a jump in the inactive population, and the restriction of demand has produced a sharp reduction in new fixed-term positions. After falling steeply in April, the more timely high-frequency quantitative indicators began to recover in May, albeit very gradually. Despite the lifting of most restrictions on economic activity, the second quarter suffered both the extraordinarily low level of activity in April and the extremely adverse statistical carryover effect from March. The available economic indicators points to a continuation of the exceptional crisis in the Italian economy in that quarter as well.

Compared with mid-April, when the macroeconomic scenario of the Ministry for the Economy and Finance (MEF) was finalised, the macroeconomic forecasts for 2020 continued to slide for all the major countries, excluding China. For Italy, the fall in expectations in March was followed by a further drop in April and a slight weakening in recent weeks. In the light of this instability, the PBO is issuing an update of the macroeconomic scenario. Compared with that produced on the occasion of the endorsement exercise for the MEF forecasts, a further deterioration in short-term expectations has been factored in, as have the expansionary effects of the "Revival Decree". The PBO's short-term forecasting models point to a substantial additional contraction in GDP in the second quarter, equal to about ten percentage points, broadly in line with that already expected in April. However, the process of normalising economic activity and spending behaviour is such as to induce further uncertainty in the timing and strength of the recovery, which is now projected to be less robust than forecast in April.

Compared with the PBO's macroeconomic scenario produced at the time of the endorsement of the MEF forecasts, taking account of the more recent information on the economic situation and incorporating the effects of the Revival Decree, the forecast for GDP growth this year is revised downwards by over a percentage point. By contrast, the forecasts for the consumption and GDP deflators have not changed.

These projections are clouded by historically unprecedented uncertainty, attributable not only to the usual economic factors, but also to social and health variables. The risks are mainly on the downside and include health factors, the global environment and the possible resurgence of financial tensions. There is also a risk that the accuracy of the preliminary national accounts estimates of the countries most affected by COVID-19 may be impacted by the difficulties in acquiring and seasonally adjusting data in real time. A

more firmly based assessment of the current cyclical position can only be performed retrospectively, in the coming quarters, when the national statistical institutes will have had the opportunity to supplement the missing data and the seasonal-adjustment models will have sufficient information to treat statistically the outliers.

The public finances

In its response to the emergency, the Government has twice asked Parliament to authorise a deviation from the previously approved path towards the medium-term objective. The first authorisation enabled the subsequent approval of Decree Law 18/2020 (the "Cure Italy Decree"), while the second enabled enactment of Decree Law 34/2020 (the "Revival Decree").

The emergency therefore halted the downward trend in the deficit, which in 2019 was markedly smaller than the previous year. Last year, in fact, general government net borrowing decreased compared with 2018 from 2.2 to 1.6 per cent of GDP. The trend forecasts in the EFD are limited to the 2020-2021 period and reflect the effects of the Cure Italy Decree and Decree Law 23/2020 (the "Liquidity Decree") but not the Revival Decree. The forecasts show a rapid increase in the public deficit for this year (7.1 per cent of GDP), followed by a reduction in 2021 (to 4.2 per cent of GDP), due to the extraordinary nature of the measures taken to counter the impact of COVID-19 and the presence of the safeguard clauses providing for increases in VAT and excise duties on mineral oils.

The EFD does not contain a policy scenario, but it does offer information on a public finance framework with new policies which also incorporates the effects of the Revival Decree on the public finance balances (but which prudentially does not consider the feedback effects of the legislative provision on the macroeconomic framework). The financial impact of the decree would raise general government net borrowing to 10.4 per cent of GDP in 2020 and 5.7 per cent in 2021 compared to the trend. Public debt would rise to 155.7 per cent of GDP this year, before declining to 152.7 per cent next year.

The various measures launched by the Government to address the COVID-19 emergency since March have had a significant impact on public finance balances. Overall, the provisions adopted increase general government net borrowing by 4.5 per cent of GDP in 2020 and 1.5 per cent in 2021, in line with the projections indicated in the EFD.

The increase in net expenditure dominates in the first year (with an impact of €69.4 billion, compared with €5.5 billion in 2021 and €6.5 billion in 2022), while from 2021 the net reduction in revenue (equal to €6 billion in 2020, €20.6 billion in 2021 and €28.2 billion in 2022) accounts for about 80 per cent of the deterioration in the balance. Examining the areas of intervention, in 2020 the resources have been mainly targeted at supporting workers and firms, allocating €27 billion and €22.7 billion to those categories

respectively. About €8.3 billion has been allocated for the healthcare system and the safety sector. Between €6 and €7 billion concern various sectoral measures and financing local authorities. Tax measures absorb €4.1 billion in financial resources, while programmes with an impact of less than €1 billion are directed to other purposes.

The decision to eliminate the indirect tax increases provided for in the safeguard clauses is consistent with remarks made several times by the Parliamentary Budget Office during the hearings before Parliament and in published documents. An approach that does not incorporate higher future revenue appears more transparent and credible than one that includes the clauses but is accompanied by a political commitment to eliminate them. In this context, it should be stressed that the deactivation of the safeguard clauses on the deficit does not represent the creation of fiscal space for new policies but does make clear the impact of policies adopted in the past on public accounts.

The main measures introduced with the decree laws

The Government has intervened with the decree laws adopted since March to introduce measures intended to counter the effects of the various actions taken to restrict economic activity on the labour market, on the income of employees and self-employed workers and, more generally, on the financial condition of households. These were initially accompanied by measures to sustain the liquidity of firms, mainly in the form of loan guarantees issued by the State and other institutions and, subsequently, by measures to foster the capitalisation of firms. Among other provisions, measures were also introduced to support the activities of local governments involved in dealing with the effects of the crisis, to strengthen the healthcare system and to support specific sectors. The Report analyses these different categories of measure separately.

Income support measures for workers and households. – In order to alleviate the effects of an unprecedented crisis, income support measures for payroll employees and self-employed workers and households were introduced between March and June. Among these, COVID-19 was added as an *ad hoc* cause for eligibility for benefits for employees normally not covered by legislation governing wage supplementation mechanisms (Cassa integrazione guadagni) and bilateral solidarity funds (Fondi di solidarietà bilaterali). Other measures include one-off allowances for self-employed workers and certain more marginal categories of employee, lasting a maximum of three months. These two groups of measures were also accompanied by the Emergency Income programme as a safety net of last resort for households most exposed to the crisis and for the working poor not eligible for wage supplementation schemes or allowances.

The PBO microsimulation model was used to conduct a preliminary analysis of the joint impact of these measures, examining one month of benefit use during Phase 2 of the pandemic response. The exercise, which highlights the distribution of benefits across all

Italian households broken down by a number of key socio-economic characteristics, considered the Ordinary Wage Supplementation programme, as governed by pre-crisis legislation, the related extensions of that programme envisaged under Decree Law 18/2020, Decree Law 34/2020 and Decree Law 52/2020, the one-off allowances and the Emergency Income.

Overall, benefits were received by about one-third of Italian households, with the proportion varying depending on the nature and selectivity of the benefits and the status of the members of the household (payroll employees, self-employed or other), and were on average equal to 47 per cent of pre-crisis monthly household disposable income. About 70.6 per cent of the benefits went to employees and 24.8 per cent to the self-employed, while about 4.6 per cent of total resources are allocated to the Emergency Income programme. The distribution of benefits by income decile shows a larger proportion of beneficiary households in the lower deciles, ranging 46.6 per cent in the first decile to 25.1 per cent of the tenth decile. By contrast, the distribution of resources by decile is substantially uniform. Transfers amount to 90.9 per cent of the average pre-crisis monthly family income of beneficiaries in the second decile, compared with about 20 per cent for beneficiaries in the tenth decile. For the first decile, the Emergency Income represents just under 50 per cent of total transfers received.

According to official estimates, compared with the situation under the ordinary rules in place before the pandemic crisis, almost 5.1 million more workers are eligible for wage supplementation under the COVID-19 extension. The associated increase in spending would amount to around €22 billion (of which €8 billion in notional social contributions). These are very substantial amounts that add to the trend developments in expenditure for wage supplementation benefits under the ordinary system. The expenditure on benefits for COVID-19 related wage supplementation is significantly greater than the outlays for wage supplementation benefits in all of 2013, the peak year for this budget item (about €3.8 billion) and well above the annual average from 2008 to date (€2.4 billion).

The one-off allowances were paid to over 5.2 million beneficiaries in March, over 4.9 million in April and around 1.1 million in May. They met the same need to support business continuity in the most acute moments of the crisis. Official estimates show expenditure of about €8 billion in total, in addition to the April allowance for self-employed professionals granted under the Ministerial Decree of 29 May 2020 (with an expenditure ceiling of €370 million) and a portion of the €6.2 billion earmarked to finance the support grant for small and medium-sized enterprises. These too are expenditures of unusual magnitude, considering that in 2019 (the peak year in the time series since 1995) total expenditure on unemployment benefits (the NASPI and DIS-COLL programmes, the agricultural allowance and other allowances expiring after the reform of the Jobs Act) amounted to about €12.6 billion, while average annual expenditure from 2008 to date was just over €10.2 billion.

Faced with these figures, the issue of making benefits conditional on the state of need in which workers or households may temporarily find themselves due to the crisis would deserve more attention. Components of such selectivity could include the amount of wage supplementation benefits and one-off allowances, the compatibility of receiving benefits under more than one income support scheme, and the combination of benefits with other incomes, pensions in particular. Selectivity can become crucial in reconciling the objective of maximising the pool of beneficiaries while keeping expenditure under control, if extraordinary income support should extend into the second half of the year.

The issue of selectivity also plays an important role in the normalisation of the operation of the social safety net and, more generally, its role in a situation of major change. In the optimistic and unlikely scenario of a full and general recovery of work already in the early weeks of the second half of the year, the termination of COVID-19 eligibility for wage supplementation on 31 October may not be a particular issue. A more plausible scenario, however, is a recovery that is slower and, above all, differentiated by industry and geographical area, with some businesses returning immediately to profitability (for which the continuation of COVID-19 eligibility is not necessary), others continuing to operate at a slower pace due to remaining social distancing restrictions (for which continued COVID-19 eligibility may be necessary) and still others that may suffer a permanent reduction in activity and find it a challenge to survive. Along with all this, we have firms in sectors in which the crisis has accelerated changes in the production model that had initially been triggered by developments already under way before the crisis itself and independent of it (for example, retailers that decide to adapt and make more extensive use of online sales technologies). In these scenarios, not only does the gradual termination of COVID-19 eligibility for wage supplementation become relevant, but it is necessary a more general assessment of the social safety net system and its role in the presence of such highly varied situations and structural changes in business activity.

The design of a transition towards elimination of COVID-19 eligibility could involve the progressive application of certain selectivity criteria. The same obviously also applies to other allowances, although the conditions for selective eligibility have already been incorporated in the associated legislation and, if necessary, could serve as a guide for programme renewals beyond May. Furthermore, it could be necessary for the Emergency Income programme – under which benefits only last two months – to transition more gradually to the rules governing the Citizenship Income. For all three instruments it would be appropriate to start considering gradual winding down in order to avoid an abrupt cut-off or an uncertain or overly vague transition phase. It is to be hoped that if there are structural changes that can be inherited from the crisis, these instruments will not be dragged along by inertia but instead explicitly discussed within an overall framework of priorities and resources.

In the coming months it will be necessary to constantly monitor outlays for COVID-19 wage supplementation and the one-off allowances, both to monitor developments in expenditure compared with funding and to obtain information on employment trends in

the various sectors. The data monitoring will also support selective choices, especially in anticipation of what could happen after August when, once the ban on firing workers is removed, expenditure on labour market safety net mechanisms could shift rapidly towards unemployment benefits.

It is possible that the crisis response strategy may have to be reformulated as early as September, moving from the current structure, in which the far most important role is played by wage supplementation mechanisms, towards a structure in which expenditure on unemployment benefits under current programmes could increase above the annual and interim levels experienced recently. One component of the repositioning of the support mix could be the introduction of selectivity for both wage supplementations and allowances. An important role in the redesign could be played by one of the instruments established at the European level in response to the pandemic – the SURE – and by the possibility, envisaged under the European Commission's Temporary Framework for State aid, that local governments (primarily the regions) use budgets to finance aid to employers (including the self-employed if they act as employers) to pay the wages of their employees and avoid layoffs.

Measures for firms. – In the initial phase of the health emergency, the measures adopted to support firms were generally universal to enable all those affected by the lockdown, and therefore facing a potential liquidity crisis, to access credit. In the next phase, the support measures mostly incorporated greater selectivity and were differentiated by size and legal form of the firm. Among the most recent measures, some programmes are aimed at economic recovery, with the introduction of tax incentives for strengthening companies' capitalisation, innovation and research, and relief measures of varying scale in favour of specific industries (construction, tourism, culture and sustainable mobility).

The measures adopted to support liquidity are mainly indirect and channelled through the financial system to ensure both the preservation of existing credit lines (with the extraordinary automatic moratorium for micro firms and SMEs that experience a liquidity squeeze as a result of the emergency), and the operation of the new credit channels to meet any liquidity crises even if a firm's financial situation should deteriorate (State guarantees).

Among other things, Decree Law 23/2020 has significantly expanded and strengthened public guarantees both on new loans and renegotiated positions through the Guarantee Fund for SMEs. In general, the number of companies entitled to guarantees has been expanded, the amount that can be guaranteed has been increased, the cost of borrowing has been reduced and certain eligibility conditions have been simplified or eliminated. The measure significantly increases the size of the public guarantee as a percentage of the exposure, transferring the default risk – which has increased as a result of the health emergency – from the lender to the State. A total of €6 billion has been allocated to the Guarantee Fund for 2020 as provisions for the risk of financial

losses associated with the probability of default. However, the procedure for granting the guarantee, which the decree made less stringent and more streamlined than the ordinary process for needs related to the emergency, could lead to the underestimation of the risk of future default of firms and therefore of the amounts to be allocated to the Fund. This could make it necessary in the future to find additional resources to meet the obligations assumed.

Finally, a crucial element for the effectiveness of the measure is the speed of disbursement of loans. With regard to the Guarantee Fund for SMEs, the early stages of implementation experienced significant delays in the disbursement of funds due to the complexity of certain administrative procedures and a number of uncertainties concerning implementation. It has also to be considered that the regulatory framework has changed significantly in the transition from Decree Law 18/2020 to Decree Law 23/2020, and was further modified with the ratification of the latter into law. The volume of loan applications between 17 March and 29 June – equal to about €43 billion – seems quite small compared with potential demand if all firms sought to borrow the maximum amount allowed under the rules (an estimated €550 billion, of which €46 billion for loans up to €25,000). However, firms may have concluded that it is not worth their while to increase their borrowing beyond a certain level, while it is likely that banks have rejected some loan applications from firms with shaky credit standing. On the other hand, the mechanism for granting guarantees has only begun to operate effectively in the last month, and therefore the volume of loans secured by a public guarantee could grow rapidly in the coming months. Given the potential scale of the loans that could be eligible for a State guarantee and an increase in loan applications in the coming months, the Guarantee Fund could require new funding.

Other liquidity support measures are more direct, using tax relief and outright grants. Decree Law 18/2020 provided for the granting of a refundable tax credit against the assignment of receivables from defaulting debtors. This credit can be used if a firm has deferred tax assets (DTA) for losses carried forward and unused ACE (allowance for corporate equity) deductions. This enables firms to recover unused deductions carried forward and that are unlikely to be used for the year due to the deterioration in profitability. All firms are eligible for the support, even if they are unaffected by the consequences of the health emergency, although by its nature it is more readily used by larger companies and those in the financial sector. Decree Law 34/2020 then introduced a grant and tax incentives to strengthen capital, with the aim of rebalancing the financial structure of firms. These measures are generally characterised by more stringent eligibility requirements and are differentiated by size and legal form of the company involved. A general objective of these measures is to bolster the capitalisation of companies, in order to avoid the risk that the credit support instruments deployed in the emergency will leave firms too heavily burdened with debt, forcing them to allocate cash flows in coming years to debt repayments rather than financing investments.

The measures adopted for medium-sized and larger companies are aimed at strengthening their financial structure by ensuring a better balance between their sources of funding, thus creating more favourable conditions for the investments that will play an essential role in the recovery and the upgrading of production. The incentives for equity capital injections therefore seem to complete the preferential treatment of corporate financing, which had hitherto been primarily focused on debt capital. For the beneficiary companies, which represent less than 5 per cent of corporations, this preferential treatment temporarily accompanies the ACE, considerably increasing the incentive to strengthen capitalisation.

All small firms with a turnover of up to €5 million, with the exception of innovative start-ups and those that invest in research and development in the South, remain ineligible for the incentives to strengthen their capitalisation. Not only may these firms experience a greater deterioration in their financials than their larger brethren, but the difficulties of obtaining additional financing could slow their investment and hinder their growth.

Finally, it should be noted that the incentives for strengthening capital are subject to a total spending limit, which may be insufficient to benefit all the companies eligible for support, while their financial effects will only manifest themselves from 2021.

The measures that provide for actual exemptions from the payment of taxes include the abolition of the balance payment for 2019 and the first payment on account for 2020 of IRAP for most firms. Since this represents a significant generalised tax reduction that also applies to many sectors that have been less affected by the emergency, the measure is less consistent with the aim of channelling public resources to the businesses most affected by the crisis that appears to characterise this new round of interventions. Even in the initial years following its introduction, IRAP was a bone of contention, and the business world has repeatedly called for its elimination. If this measure were to be a first step in this direction, it would be necessary to rethink the overall framework of business taxation and the financing of the healthcare system.

Ecobonus and transferable tax credits. – Decree Law 34/2020 strengthens public incentives for projects to improve the energy efficiency and seismic resilience of buildings undertaken in the second half of 2020 and in 2021: the percentage tax credit has been increased to 110 per cent and the period over which the credit must be applied against taxes has been shortened from 10 to 5 years. For this expenditure and for the other outlays incurred in 2020-2021 that do not benefit from the increase in the tax credit, the tax credit can be transformed into transferable form or be used as a discount on the amount paid for the works.

The measure, which fully charges the costs of the subsidised projects to the public budget, appears aimed not only at supporting the construction sector, but also at achieving substantial improvements in the energy efficiency classification and the seismic stability of buildings. To this end, the structure of the benefit extends the pool of

potential beneficiaries, mitigating one of the factors giving rise to the highly regressive nature of this type of tax relief (they are more easily used by high-income taxpayers with sufficient liquidity and taxable income) but, obviously, not the second (property ownership is concentrated among taxpayers with higher incomes).

It is also important to bear in mind that the measure could be exploited for tax avoidance or speculative purposes. The amount of the credit significantly reduces the conflict of interest between suppliers and buyers in respect of the cost of the subsidised projects, as both parties benefit from increasing expenditure up to the maximum facilitated amount. For example, in the case of companies that provide both energy upgrading and ordinary renovation works to the same customer, the parties could find it attractive to overestimate the cost of the former, in order to finance the latter under the concessionary regime. The effective use of public resources for the purposes intended by the measure will therefore depend on the effectiveness of any anti-avoidance mechanisms envisaged.

With regard to financial effects, there is a risk of underestimating the costs for the purpose of net borrowing. Official estimates do not consider the possibility of an increase in subsidised expenditure on building renovations for which, while the amount and timing of the preferential regime remain unchanged, it can be expected that the number of potential beneficiaries will increase thanks to the option available to those with insufficient taxable income to transfer the credit to the banking system. Furthermore, if the tax credits transferred and used as set-offs were classified as "payable" (insofar as they can be used regardless of the presence of taxable income in the tax return of the buyer), the associated amount would entirely impact net borrowing in 2021-2022, rather than being distributed over time on the basis of the instalment schedule envisaged for using the credits. This consideration refers both to renovations for which the amount of the benefit has been increased and the time for its use has been reduced, and for the remaining renovation projects in 2020-2021 for which the measure simply allows beneficiaries to opt for the transformation of the credits into transferable form.

Local government finance. – The main measures to support local authorities include the appropriation of extraordinary resources and the grant of cash advances to pay trade payables. In addition, the scope of local government intervention in supporting businesses in their territory has been expanded, in compliance with the Temporary Framework for State Aid envisaged by the European Commission.

The data available on the cash flows of local authorities show a substantial contraction in total receipts in the first five months of 2020, with a drastic reduction in flows in May. The figures do not currently enable any reliable assessment of the adequacy of the resources envisaged under the measure to meet the overall needs that will emerge over the next few months as a result of the health emergency. The amounts appropriated in any case appear significant and their timely allocation will enable governments to cope

with the budget imbalances that begin to appear, while monitoring effective developments will make it possible to assess real requirements.

The grant of cash advances to pay trade payables replicates past measures, demonstrating that the problem of late payments, although gradually improving, has not yet been definitively resolved. However, in the short term this measure represents a useful tool for various purposes: to supply liquidity to businesses that work with government; to forestall the opening of the infringement procedure announced by the European Court of Justice for excessive payment delays; and to limit the application of the penalty mechanism, which starting from 2021 requires local authorities that do not comply with payment times to recognise additional provisions. However, this temporary remedy must not lead to the postponement of processes to improve the efficiency of managing the public accounts that are needed to avoid the use of irregular accounting procedures and commercial practices. In the absence of the adoption of these efficiency enhancing processes, as well as criteria for allocating resources that ensure funding for the fundamental functions of all local government, the temporary remedy represented by cash advances could produce the opposite effect in the medium term, since the need to repay advances will drain liquidity from governments that have had to use those advances, thereby contributing to the risk of creating new payment arrears.

From an accounting standpoint, it seems imprudent to assume that the share of advances that will be used by local governments to pay their trade debts on capital account will have no impact on net borrowing, given that the capital expenditure of territorial governments is recognised on an accruals basis at the time of the cash outlay.

Healthcare measures. – In the healthcare sector, a range of measures has been envisaged to address the pandemic, aimed above all at rapidly increasing the availability of staff and medical equipment and expanding assistance networks, as well as introducing a number of more structural reforms, such improving territorial services and increasing the number of beds in intensive and semi-intensive care wards. It has never been more important for resources to be managed in an informed manner consistent with appropriateness objectives, in order to respond to the substantial demand that could also originate primarily with private-sector service providers/producers.

The funding necessary to implement the measures was partly allocated to the National Emergency Fund (€3.15 billion in 2020 alone) and partly to the special accounts of the extraordinary commissioner (€1.467 billion in 2020 to strengthen intensive care facilities), while in part they represent refinancing of the NHS (€3.203 billion in 2020, €605 million in 2021 and €1.609 billion for 2022). The refinancing is less than the cost, specified at about €1.7 billion in Decree Law 34/2020, of the measures that remain the responsibility of the regional governments for the years after 2020, with an especially large shortfall in 2021. Perhaps reliance is being placed on funding already approved (an increase of €1.5 billion is envisaged in 2021 over 2020) or on additional resources that could be appropriated in the future.

Measures for education. – The many decrees adopted during the health emergency contain a series of measures relating to education. They were initially aimed mainly at managing the various phases of the emergency, while subsequently they have been intended to fund new hiring and provide new financing. Decree Law 34/2020, in particular, expanded the number of places available in competitive exams for secondary school teaching staff (with hiring postponed until the time the places actually become available) and increased hiring of research fellows at universities and research institutes. In addition, new funding was appropriated for schools, universities, art and music academies and research bodies both in response to the emergency and, especially in the case of universities, art and music academies and research entities, to strengthen staffing on a structural level. For schools, the measures also seek to take advantage of the suspension of teaching activities to carry out school building renovations and construction.

In total, the resources allocated to schools, universities, art and music academies and research entities have been increased by about €1.4 billion for 2020 (of which €173 million represent a decrease in net revenue for general government), €1.2 billion in 2021 and €750 million in 2022 (the overall impact of the measures on net borrowing is €1.125 billion in 2021 and €660 million in 2022). Funds for school construction have been increased by €30 million for 2020 alone.

The measures taken by the European Union

The spread of the epidemic prompted European institutions to take measures to counter its recessionary impact. The first significant euro-area response to the financial consequences of the crisis caused by COVID-19 came from the ECB. Beginning with its meeting on 12 March, the Governing Council of the ECB has announced a series of expansionary monetary policy measures intended to preserve the flow of credit to households and businesses, ensure favourable liquidity conditions and support the financial stability of the euro area. More specifically, the ECB first strengthened its asset purchase programme (APP) and then introduced a new public and private securities purchase programme for the pandemic emergency (the Pandemic Emergency Purchase Programme, or PEPP).

The PBO has estimated the possible impact of the ECB's purchase programme on the Italian government securities market on the basis of a number of scenarios concerning the possible scale of the Eurosystem's purchases of Italian government securities. Gross government securities issues in 2020 are projected to be €552 billion. Based on certain working assumptions, purchases of Italian government securities by the ECB are estimated at around €199 billion (of which €37 billion from the reinvestment of principal payments on maturing securities), or 36 per cent of total gross Treasury issues. Gross government securities issues net of ECB purchases on the secondary market would therefore amount

to €353 billion, with a reduction in the total amount of securities that the private sector will have to absorb compared with the previous year (when the corresponding estimated amount was €384 billion). Estimated net government securities issues net of ECB purchases on the secondary market would be around €26 billion.

As regards the framework of European fiscal rules, on 23 March the Council of the Union activated the general escape clause provided for in the Stability and Growth Pact (SGP) for this year, agreeing with the Commission's assessment that the conditions for its application had been met. The application of the general escape clause does not suspend SGP procedures, but allows the Commission and the Council to take the necessary measures for coordinating budgetary policies within the framework of the Pact, while departing from the budgetary obligations that would normally be applicable .

After the endorsement of the European Council of 23 April, on 8 May the Eurogroup approved a new credit line under the European Stability Mechanism (ESM) denominated Pandemic Crisis Support (PCS). Support is available to all euro-area Member States, to reflect the symmetrical nature of the pandemic shock, with standardised terms. The only requirement to access the credit line is a commitment to use the credit - which can be granted in the maximum amount of 2 per cent of 2019 GDP (about €36 billion for Italy and €240 billion for the euro area as a whole) - to finance direct or indirect healthcare, cure and prevention-related costs due to the pandemic.

Among the tools to respond to the economic emergency, in April the Commission proposed the establishment of the SURE initiative (Support mitigating Unemployment Risks in Emergency), a fund of up to €100 billion to finance loans to EU Member States. The rules were approved on 19 May 2020. The goal is to provide Member States with resources complementing national temporary income support mechanisms for employees and self-employed workers.

Other measures at the European level have been introduced through the EIB Group, primarily to counter the impact of COVID-19 on small and medium-sized enterprises. On March 16, the EIB Group proposed a plan to rapidly mobilise up to €40 billion of funding. As part of this programme, on 6 April the European Investment Fund (EIF) approved the initial measure offering €2.2 billion in guarantees to contain the impact of the pandemic by incentivising banks and other lenders to provide €8 billion in financing to SMEs and mid-caps.

Subsequently, with the endorsement of the Eurogroup, on 16 April the Bank's extraordinary Board of Directors meeting approved the creation of the COVID-19 Guarantee Fund, capable of providing support of up to €200 billion to the European economy through various financial instruments, including guarantees for commercial banks and national promotional institutions, counter-guarantees for national guarantee schemes, venture debt to high-growth companies and purchases of asset-backed securities held by banks in order to enable them to grant new loans to SMEs. The

Guarantee Fund will start operation as soon as Member States representing at least 60 per cent of the EIB's capital have made the necessary commitments to grant the guarantee. Italy has already made its commitment under the provisions of Article 36 of the Revival Decree (Decree Law 34/2020).

Finally, on 27 May the European Commission presented a "Recovery Plan for Europe", consisting of a recovery instrument integrated with a reinforced long-term budget of the EU. The Commission proposes to leverage the EU budget to tackle the expected shortfall in investment in the coming years, structuring its proposal around two cornerstones:

1) the Next Generation EU program, the new European recovery instrument, which would be used to increase the budget on a temporary basis by €750 billion with new financing raised on the financial markets and channelled to Member States through EU programmes;

2) the EU's long-term budget, i.e. the Multiannual Financial Framework (MFF), reinforced for the period 2021-2027 with appropriations for expenditure commitments of €1,100 billion over the 7 years of the planning horizon. Some proposals for amendments to existing 2014-2020 MFF were also submitted to make €11.5 billion in additional funding available as early as 2020.

According to the Commission's proposal, Next Generation EU will be a one-off emergency instrument, activated for a limited period exclusively for the purpose of responding to the crisis and for recovery. The funds will be disbursed to the Member States until 31 December 2024 and will be raised on the financial markets taking advantage of the Commission's high credit rating. Of the total €750 billion of resources available through the Next Generation EU instrument, €500 billion will be disbursed in the form of transfers through new EU programmes or reinforced existing initiatives, also accelerating the green and digital transition, and €250 billion in the form of loans granted on almost the same conditions as the original issue.

The Recovery and Resilience Facility, a part of Next Generation EU, is the most important new initiative in the package proposed by the Commission. The package will be offered to all Member States, but in particular to those most affected by the pandemic. It will have €560 billion in funding and is intended to support investments and reforms. Member States will have to submit recovery and resilience plans based on the priorities identified in the context of the European Semester, in line with EU strategies and national plans for energy and climate.

All the Commission's proposals are still being negotiated among the Member States, a process that should be completed by July according to the Commission in order to ensure implementation of new EU Multiannual Financial Framework and Next Generation EU from 1 January 2021.

An initial preliminary analysis found a series of benefits and costs for each of the main instruments deployed by the European institutions, namely the PCS, SURE and RRF. With regard to the *speed with which the programmes can be implemented*, only the PCS is immediately available. For the SURE, it will be necessary to wait for the Member States to make the guarantee available in the coming months, while for the RRF the Member States must reach agreement on its key features, with the possibility that it can be fully operational only starting from January 2021 or, in an unfavourable scenario, even later. In terms of *impact on the public accounts*, the transfers under the RRF should not affect either general government net borrowing or debt, while the use of loans under the PCS, the SURE and the RRF loan component would increase net borrowing and the public debt under the definition used for the Stability and Growth Pact. Any increase in national contributions to the EU budget to repay the debt contracted in 2021-2027 to finance the RRF transfers would only occur starting from 2028.

As to the *maximum amount of aid*, the RRF could represent a significant source of funding for Italy's recovery measures in the coming years, while the PCS and, even more so, the SURE appear to be more limited in scope although potentially important to alleviate the need for the Treasury to raise funds on the markets. As regards *the interest rates charged on the loans*, the three instruments should not involve significant differences and would represent a benefit for Italy considering the high credit standing of the issuers of the securities whose funding would then be transferred to Italy.

Finally, the comparison with regard to *conditionality* appears more differentiated. As far as the SURE is concerned, the conditionality requirements seem relatively light, as the only restriction is on the use of the resources (temporary income support schemes for workers). This constraint also characterises the PCS, since the use of loans is linked to the financing of the direct and indirect costs of the pandemic. Compared to the other ESM instruments, the enhanced surveillance of the Commission will be performed in a simplified manner, as notified by the Commission to the President of the Eurogroup. However, as stated by the Eurogroup itself, the early warning system of the ESM also applies to the PCS, which means assessing a country's ability to repay its debt. In the case of the RRF, although the framework is still being defined, the disbursement of the funds is strictly conditional on the preparation and implementation of reform and investment plans by the beneficiary countries, as assessed and approved by the Commission, that take account not only of the policy preferences of the countries, but also of the priorities determined by the Union. Finally, it should be borne in mind that accessing the instruments will probably be taken into account in the context of the ordinary surveillance of the Stability and Growth Pact with regard to macroeconomic and public finance stability.