Hearing on the 2021 Budget Bill and the Report to Parliament on the budget deviation

Summary

The Chairman of the Parliamentary Budget Office (PBO), Giuseppe Pisauro, spoke today at an informal hearing before the Budget Committees of the Chamber of Deputies and the Senate as part of the examination of the 2021 Budget Bill and the Report to Parliament presented by the Government on 20 November, pursuant to Law 243 of 2012.

In his remarks, Chairman Pisauro analysed the content of the budget measures, focusing his attention on the macroeconomic scenario underpinning the Budget Bill and discussing the PBO's assessment of its overall structure, a number of critical issues that arise, developments in the main public finance aggregates in the light of the proposed interventions and the main measures envisaged.

The Budget Bill has been drafted within the macroeconomic and public finance policy framework for 2021-2023 set out in the Update to the Economic and Financial Document (the Update) and in the Draft Budgetary Plan (DBP) and confirmed in the Report to Parliament that the Government presented on 20 November last. The scenario incorporates the EU funds provided for under the Next Generation EU (NGEU) programme and indicates GDP growth of 6.0 per cent for 2021 (almost 1 point higher than the trend scenario) and a deficit of 7 per cent.

However, since the publication of the Update there has been a resurgence of the COVID-19 pandemic, which required the imposition of new measures restricting mobility and economic activity, although differentiated at the regional level based on the severity of the local health situation. Economic indicators, which had quickly recovered immediately after the end of the lockdown, have begun to deteriorate and, according to our estimates, GDP is expected to decrease by about three percentage points in the fourth quarter. The overall contraction in GDP for 2020 is forecasted at around 9 per cent, in line with the projections of the MEF given in the Update and the DBP, as the negative surprise on the fourth quarter would essentially offset the rebound in the summer. Moreover, the worsening economic situation undermines the outlook for 2021: even in the event of a rapid recovery beginning in the spring, the Government's policy forecast for GDP growth of 6.0 per cent seems difficult to achieve. On the occasion of the endorsement exercise for the macroeconomic scenario in the Update, the PBO forecasted a pace of GDP growth in 2021 similar to that indicated by the Government. However, the slowdown emerging for this quarter will reduce the carry-over impulse into next year - and therefore the outlook for growth - by at least one percentage point.

The global scenario and, consequently, the prospects for Italy remain exposed to predominantly downside risks. The substantial debt accumulated by most sovereign issuers could lead to tensions on the financial markets if fears emerge that the growth potential of some countries would not be sufficient to bear the debt burden and monetary policies are not widely effective. In Europe, the current impasse in the negotiations over the NGEU could delay approval of the budget and therefore delay the disbursement of funds and the effects of the fiscal stimulus. Furthermore, the risks associated with the evolution of the pandemic remain. The main international forecasters are discounting a gradual easing of restrictions over the course of 2021, thanks to the progressive dissemination of vaccines. If, however, distribution should take longer than expected, additional waves of the pandemic could emerge, meaning that new restrictions on economic activity cannot be ruled out.

The public finance package contained in the Budget Bill, which will soon be completed with other legislation fully defining the use of funds relating to the NGEU programme, is thus being enacted within this highly uncertain scenario. The package envisages a deterioration in the budget deficit compared with the trend scenario for 2021-2022 of 1.4 per cent and 0.6 per cent of GDP respectively (€24.6 billion and €12 billion) and an improvement of 0.2 per cent of GDP in 2023 (€3.5 billion).

According to official estimates, net general government borrowing should amount to 7.0 per cent of GDP in 2021 before decreasing to 4.7 per cent in 2022 and then to 3 per cent in 2023, below the 3.3 per cent expected in the trend scenario.

The budget contains expansionary measures of substantially similar size in terms of GDP over the three-year period: 1.8 per cent in 2021, 1.9 per cent in 2022 and 1.7 per cent in 2023. The resources funding these measures, on the other hand, increase over the period, rising from 0.4 per cent of GDP in 2021, 1.2 per cent in 2022 and 1.9 per cent in 2023. However, this profile is largely attributable to the inclusion of the expected increase in tax revenue for 2022-2023 due to the growth created with the expansionary measures, which is estimated by the Government at 0.7 per cent and 1.1 per cent of GDP respectively.

Overall, against a background of great uncertainty over the evolution of the pandemic and the macroeconomic scenario and considering the complexity of identifying highly effective and feasible growth-oriented measures, the structure of the budget policy emerging from the Budget Bill is partially undefined. The budget package contains a combination of emergency measures, structural interventions and broad guidelines on the use of European funds, the whole being accompanied by a series of detailed micro-sectoral provisions.

The Government has decided to use all the NGEU funds available to Italy, which are estimated to total €209.7 billion. In particular, it has elected to use €121.2 billion of the funds for new measures (to be financed using the full amount of grants available, which total €82.1 billion, and "additional" loans of €39.1 billion) and to use the remaining €88.5 billion for measures already envisaged under current legislation, to be financed with "replacement" loans. In the Budget Bill, the value of measures eligible for European programmes is largely (between 73 and 84 per cent) presented as a lump sum without specification of individual programmes, while the measures for which the Budget Bill already establishes specific authorisation (detailed in the summary table of the financial effects) amount to only €9.5 billion in 2021, €10.4 billion in 2022 and €7.2 billion in 2023.

Accordingly, for most of the European funds, the Budget Bill does not contain sufficient information to identify the scale and timing of the use of EU grants over the 2021-2023 period. Therefore, it is not possible to verify either how expansionary the portion of the overall package attributable to these funds would be or, consequently, the scale of the revenue increase associated with such an expansion. Assuming that the composition and timing of the use of European funds are similar to those that could be inferred from the Update, the estimate of the increase in tax revenue contained in the Budget Bill appears optimistic: from the simulations performed using the models of the PBO panel forecasters with the information available at the time of the Update, the additional revenue is at least a quarter smaller than the values indicated in the Budget Bill.

Given the uncertainty outlined above, the use of the estimated revenue increase due to expansionary measures to cover funding requirements in 2022-2023 represents a risk for the deficit and developments in the debt. This is especially true if, as previously pointed out by the PBO, these estimated amounts are used to finance measures permanently increasing expenditure or reducing revenue, which require structural funding in the long term. In its opinion on the 2021 DBP, the European Commission also noted that some of the measures to support economic activity contained in the document do not appear to be temporary or matched by offsetting measures and, given the level of public debt outstanding before the pandemic, it is important to preserve fiscal sustainability in the medium term.

The budget package is divided into a series of measures part of which follow on those launched previously to support the labour market and firms and part are intended to foster recovery in the coming years. In addition, other measures include interventions to support households, measures for the South, other regarding public employment, combatting tax evasion and incentives for the use of traceable means of payment and measures in the fields of health and education.

The full text of the hearing gives a detailed account of the main sectoral measures and their impact on the stakeholders involved, drawing on specific analyses conducted by the PBO. Here it is sufficient to note that the Budget Bill seeks to mitigate the economic impact of the second wave of the pandemic by extending the package of extraordinary anti-crisis measures for the labour market to the early months of 2021 (section 3.1.1 of the full remarks presented during the hearing) and proposing a number of measures to increase liquidity and encourage the recapitalisation of firms and other sectoral interventions (section 3.1.2). In order to foster the economic recovery in the coming years, it introduces incentives for the hiring and/or transformation of temporary contracts into full-time positions of young people, women and workers in the South (section 3.2.1) and incentives for companies to invest in new capital goods, R&D and training (section 3.2.2).

One notable measure among those to support households is the establishment of a specific fund to finance the announced tax reform, with resources of €8 billion in 2022 and €7 billion starting from 2023. Of these, an annual appropriation of between €5 and 6 billion is specifically allocated to finance the dependent child universal allowance, together with €3 billion for 2021 allocated to the fund for the universal allowance and family services. The additional tax credit for employee income is made permanent, representing an integral part of the so-called €100 bonus (section 3.3).

For the South, incentives for business investment are accompanied by partial contribution relief for employers, which will remain in force, with decreasing percentages, until 2029. The measure regards all workers, not only new hires, and represents a cut in labour costs (section 3.7).

Numerous measures, described in greater detail in the full hearing, concern the healthcare and education sectors (sections 3.5 and 3.6).