Budgetary Policy Report

June 2023

upB ufficio parlamentare di bilancio

The Report has been published with information updated to 5 June 2023.
The electronic version can be downloaded from: en.upbilancio.it

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PART 1

2022 AND FUTURE PROSPECTS

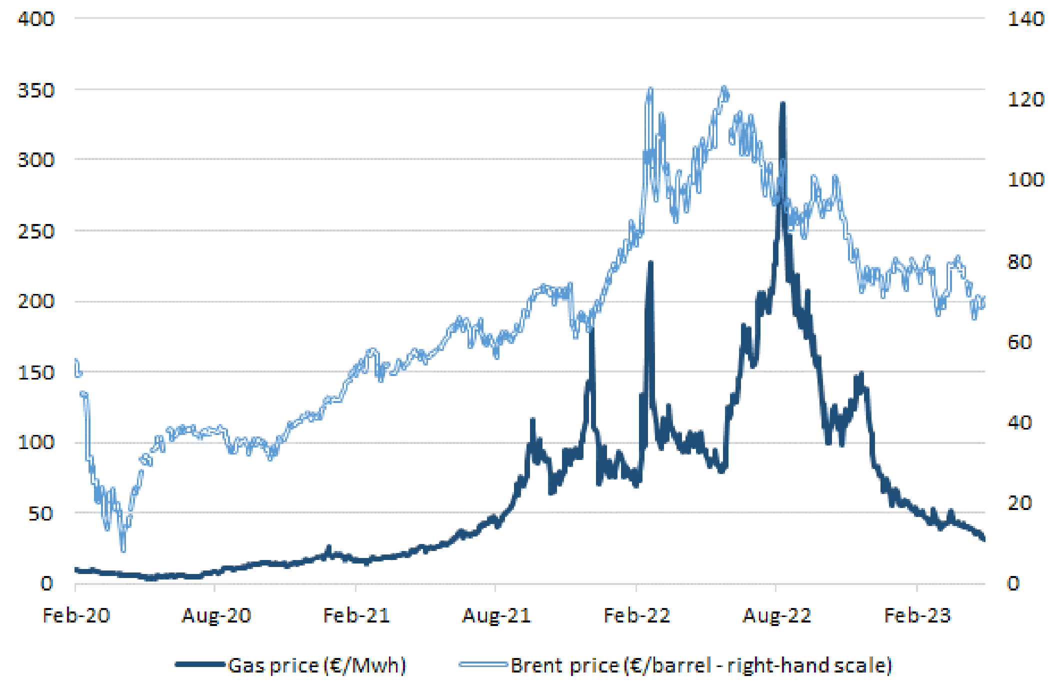
1. MACROECONOMIC FRAMEWORK AND FORECASTS

1.1 The international context

The formulation of international exogenous variables (including oil prices, international trade developments, interest rate and exchange rate expectations) plays a crucial role in the definition of macroeconomic forecasts, especially for an open economy such as the Italian one. Last autumn, the 2022 Update to the Economic and Financial Document (EFD Update) took into account the events occurred in the summer and mainly related to the consequences of the Russian invasion of Ukraine. As early as spring last year, European countries had in fact begun a race to stockpile natural gas, which, together with the fall in demand for Russian energy commodities, had led to sharp increases in the price of both natural gas and oil. Fears over the outcome of the conflict and its economic repercussions, in terms of trade curbs due to sanctions against Russia and tensions on the financial and commodity markets, had already affected the spring forecasts and thus also those of the 2022 Economic and Financial Document (EFD). In the summer, tensions on the gas markets had escalated, partly due to discontinued or substantially reduced gas flows from Russia, resulting in the price of natural gas peaking at EUR 340 per MWh in August (Figure 1.1) from an average value of EUR 15 in 2019. Furthermore, in September, the Nord Stream 2 pipeline was sabotaged, an event that contributed to exacerbating tension in the energy markets. With the arrival of the autumn, these critical issues began to ease due to various factors: the European strategy to diversify supplies was showing its first results; the cold weather season was taking longer to arrive; and a sudden worsening of the European economic cycle was expected between the end of 2022 and the start of 2023, with a consequent reduction in demand for energy goods. Thus, despite peaks in the middle months of the year, oil and gas futures prices at the end of October were again close to those formulated in the 2022 EFD Update. The November 2022 EFD Update (revised and integrated version) projected an oil price of USD 100 per barrel on average in 2022, slightly above USD 80 in 2023 and then a gradual decline to slightly below USD 75 per barrel at the end of the period (2025) (Figure 1.2).

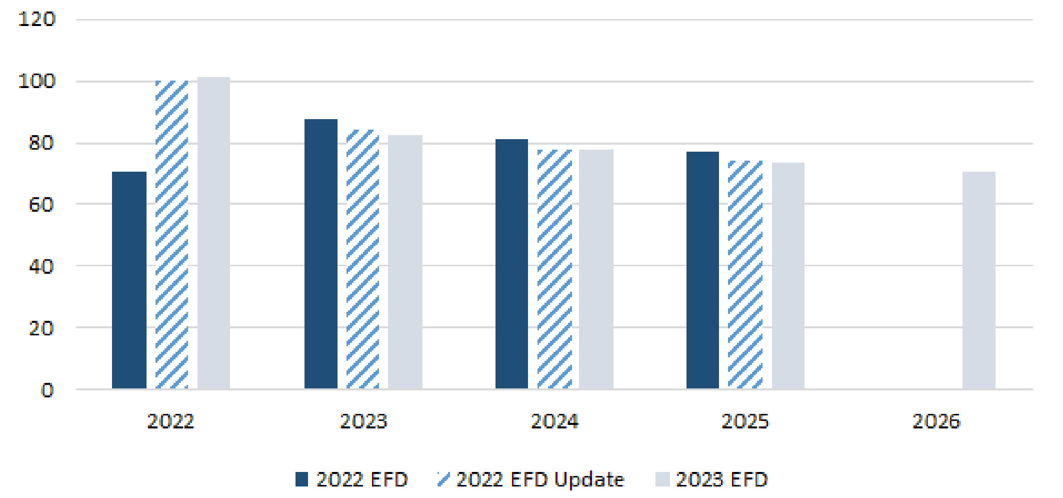
Between the exogenous variables of the last EFD Update and the 2023 EFD, drawn up last spring, the price of natural gas on international markets continued to fall, as a result of the high volume of gas stocks in Europe and a significant reduction in gas consumption, also favoured by the particular weather conditions, while the price of oil showed greater stability, also driven by the decisions of OPEC+ countries to curb supply. The 2023 EFD therefore essentially confirms the oil price profile of the 2022 EFD Update. For 2026, a year not included in previous Economic Planning Documents, the Italian Ministry of Economy and Finance (MEF) foresees a further reduction in the price of Brent, towards USD 70 per barrel.

Figure 1.1 – Oil and gas prices



Source: S&P Global.

Figure 1.2 – Evolution of oil price projections in the policy documents
(dollars per barrel)



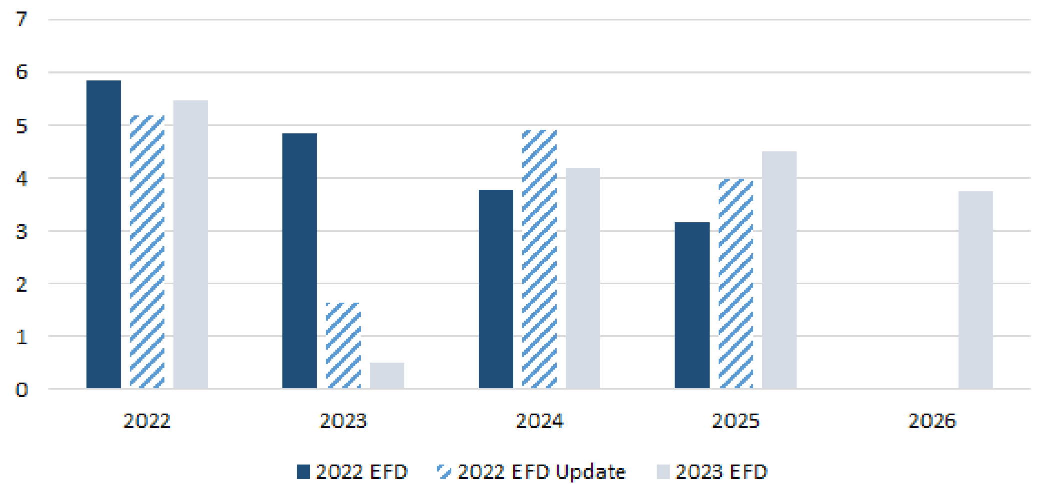
Source: Source: 2022 EFD, revised and integrated version of the 2022 EFD Update, 2023 EFD.

Last year, several forecasters assessed the possible critical effects of Italy's heavy dependence on energy imports in dedicated simulations. For example, in the 2022 EFD Update, the MEF assessed the impact of a further 30 per cent rise in the price of gas caused by a cut in gas flows from Russia (between the end of 2022 and the start of 2023), with a subsequent gradual decline in prices towards those found in the baseline scenario.

These circumstances would have led, according to MEF estimates, to a reduction in GDP growth compared to the baseline scenario equal to 0.2 percentage points in 2022 and 0.5 percentage points in 2023. The Parliamentary Budget Office (UPB) also carried out several simulations of the possible effects of the gas price shock,[1] using a version of the MeMo-It model suitably modified to take account of the importance of the gas market for the Italian economy. Last autumn, it was estimated that if the increase in gas prices that had already occurred in 2022 (which had already taken about one point of GDP away from growth) were extended to 2023-24, this would cumulatively affect GDP levels by a further two percentage points.

Unlike the projections on oil prices, which despite the strong fluctuations recorded in 2022 did not lead to major changes in the forecasts of the various policy documents, the dynamics of international trade have been revised down considerably, particularly for the current year. In fact, last November's EFD Update drastically reduced expectations on international trade growth for 2023 compared to the 2022 EFD, which forecast a growth of just under five per cent. Behind the trade revisions was the continuing frictions in global value chains, heavily influenced by China's zero COVID policy. Instead, the downward revision for 2023 adjusted upwards the trade growth by about one percentage point on average over the next two years. The latest EFD further revised downwards the estimates for the current year (by more than one point) as well as those for 2024 (by more than half a percentage point); in 2026, the last year of the forecast, apparent trade elasticity to global growth is expected to return above unity (Figure 1.3).

Figure 1.3 – Evolution of world trade projections in policy documents
(annual percentage variations)



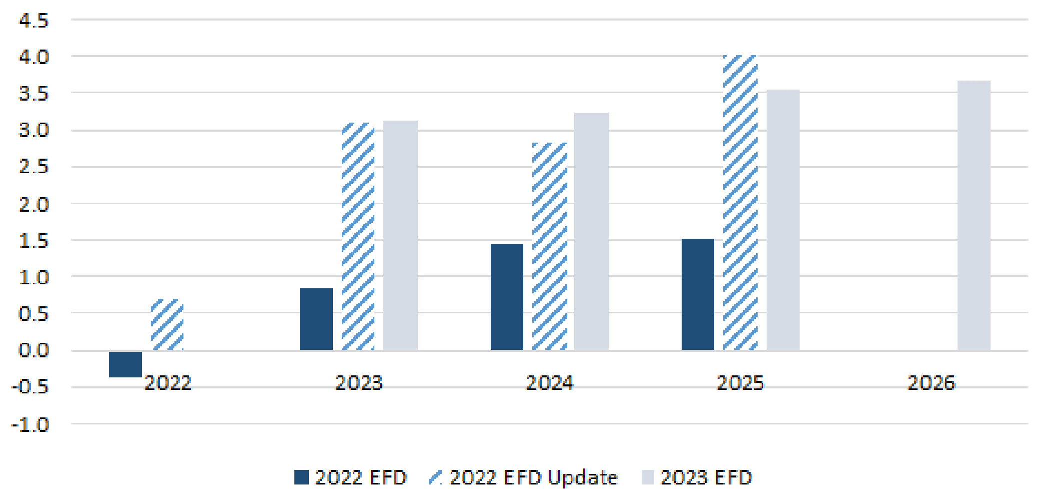
Source: 2022 EFD, revised and integrated version of the 2022 EFD Update, 2023 EFD.

[1] See Parliamentary Budget Office (2022), 'Report on Recent Economic Developments - October 2022', Box 'Gas price shock and macroeconomic impact for Italy'.

Last year was characterised by significant interest rate increases, triggered by central banks to cope with rising inflation. In autumn, price dynamics in the euro area exceeded the double-digit threshold, thus stimulating a stronger response from the European Central Bank (ECB). While on the other side of the Atlantic the Federal Reserve had already started to raise its key interest rates in the spring, in Europe the official interest rates rose with a few months delay; in July and September the ECB issued its first interest rate increases, announcing further increases at future meetings. When the revised and integrated EFD Update was drafted, the restrictions that had taken place or had been announced were taken into account and, as a consequence, the profile of both short-term and long-term interest rates was substantially revised compared to the 2022 EFD. In particular, short-term rates largely returned to positive territory by 2022 and in the remaining three years the yield curve underwent an average upward shift of more than two percentage points. At the same time, long-term rates were also rising to a similar extent. Last April's EFD again changed expectations for short-term rates, making upward revisions for 2024 and downward revisions for 2025 (Figures 1.4 and 1.5).

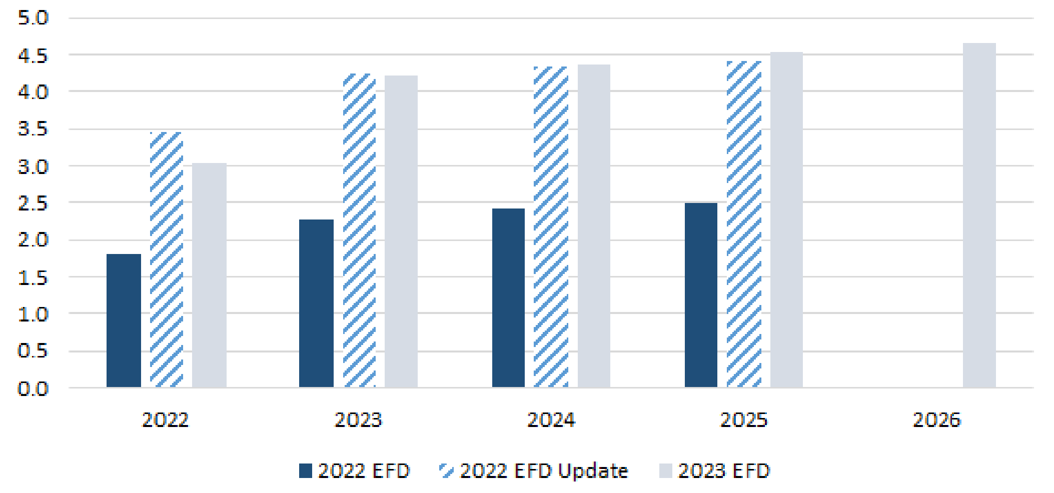
Lastly, as regards the exchange rate, since this variable is projected ahead on the basis of the average quotation of the last 10 working days prior to the definition of the scenario, the revisions made in the various Documents directly reflect historical quotations.

Figure 1.4 – Evolution of short-term interest rate projections in policy documents *(percentage values)*



Source: 2022 EFD, revised and integrated version of the 2022 EFD Update, 2023 EFD.

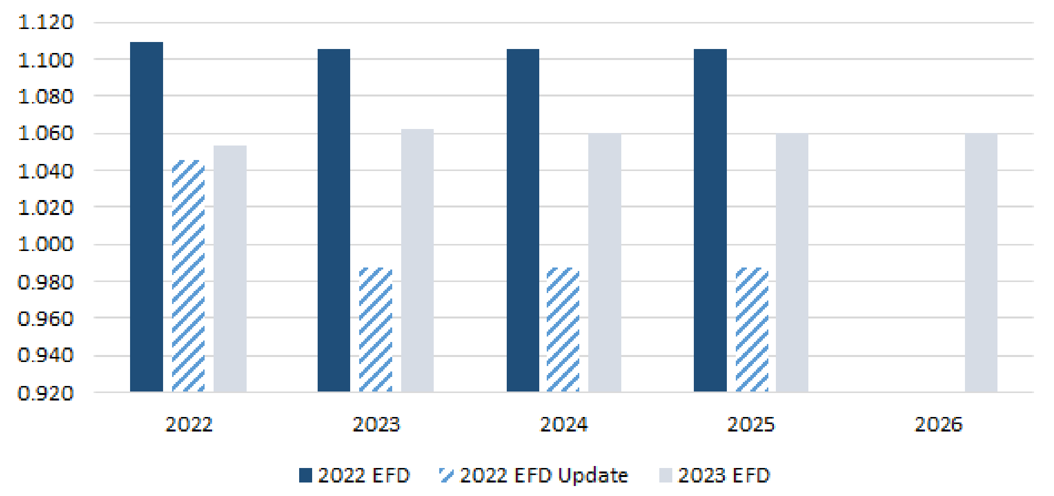
Figure 1.5 – Evolution of long-term interest rate projections in policy documents *(percentage values)*



Source: 2022 EFD, revised and integrated version of the 2022 EFD Update, 2023 EFD.

Given that since mid-September the dollar/euro exchange rate had remained below parity (USD 0.987 per euro was the projection for the three-year period 2023-25), the November EFD Update forecast a 10 per cent downward revision compared to those formulated in the 2022 EFD. The euro's depreciation against the dollar was driven by both the different growth prospects and the policy rate differential, which had reached about two percentage points in the autumn. In October, the euro gradually began to strengthen, driven by reasons opposite to those that had led to its depreciation. This was reflected in last April's EFD definition of exogenous variables, which forecast an appreciation of the euro by about seven percentage points against the dollar (a 1.06 exchange rate in the years 2023-26) (Figure 1.6).

Figure 1.6 – Evolution of dollar/euro exchange rate projections in policy documents *(dollars per euro)*



Source: 2022 EFD, revised and integrated version of the 2022 EFD Update, 2023 EFD.

1.2 Developments in the Italian economy

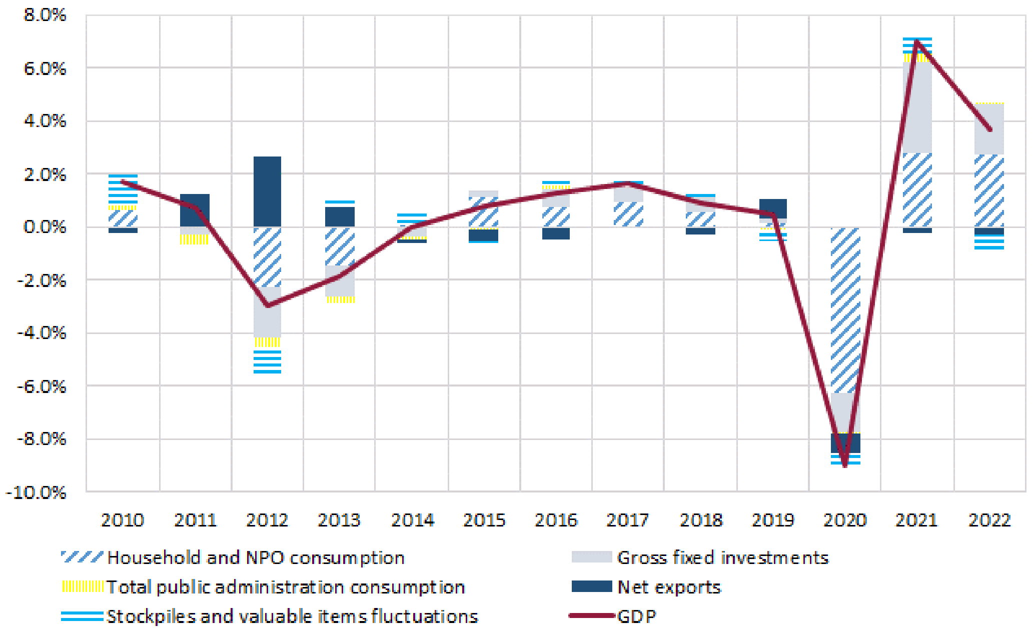
The revised and integrated version of the EFD Update, drawn up between the end of October and the beginning of November last year, arrived after a favourable GDP performance in the second and third quarters of 2022, even though the war in Ukraine had exacerbated the inflationary trends that had already begun in 2021. In the summer, tensions in the gas market had escalated, foreshadowing adverse impacts on growth. In fact, in the fourth quarter of 2022 Italy's GDP was at a standstill (-0.1 per cent quarter on quarter), as was the euro area average, due to the slowdown in consumption driven by price increases. The 2023 EFD was instead drawn up considering economic data for the first months of the year, which supported the expected recovery of GDP growth starting from the first quarter of 2023.

Overall, last year the Italian economy continued the recovery process begun in 2021, after the unprecedented contraction recorded in times of peace in 2020 due to the pandemic. In 2022, Italy's GDP grew by 3.7 per cent (Figure 1.7), more than that of other leading European and non-European economies. Italy's GDP was mainly driven by private domestic demand, that is by household consumption and gross fixed investment, which together contributed almost five percentage points to growth; on the other hand, the contribution of net exports, like that of inventories, was negative, although exports alone contributed strongly to GDP growth (by about three points). On the supply side, value added increased markedly in all sectors and in particular in the tertiary sector (which contributed almost 3.5 percentage points to GDP), driven mainly by services (trade, transport, accommodation and food), as well as by the construction sector (which contributed about half a point to the change in GDP); on the other hand, there was a further decline in agriculture (for the fourth consecutive year) and a substantial stagnation in the industry sector excluding construction.

The 2023 EFD was drawn up between the end of March and the beginning of April, based on still incomplete economic data on the first quarter of the year, which then began to improve. According to the quarterly economic accounts, released by Istat after the 2023 EFD was published, in the first three months of this year Italy's GDP grew by 0.6 per cent in quarterly terms (from the 0.5 per cent forecast in the preliminary estimate). This was the result of positive performances by both the industrial and services sectors, while the primary sector stagnated. Domestic demand made a positive contribution to GDP growth, while net foreign demand made a negative contribution. Italy's robust economic growth in the winter period was similar to that of Spain, while the other major European partners recorded lower or zero growth rates.

With regard to sectoral developments, 2022 was characterised by a weak industry, a trend that continued into the first part of this year. According to economic surveys, the manufacturing sector remained negative for the first part of 2022, only to stabilise (in the case of the Istat surveys) or to recover beyond the threshold marking the expansion and contraction phases (according to the PMI index), forecasting a recovery in the short term. However, the most recent analysis of both surveys, referring to April and May, point to a worsening of the sector's economic performance.

Figure 1.7 – GDP growth and demand components
(percentage changes and growth contributions in percentage points)



Source: based on Istat data.

Construction activity, after having strengthened last year also thanks to the generous tax incentives in force (see Box 1.1 'Analyses on the impact of the incentives for residential construction on the Italian economy'), remained more or less unchanged compared to its level at the end of 2022 in the first three months of the year, while sector confidence continued to increase in the first part of 2023, building on the positive trend that began after the first lockdown in 2020.

The added value of the tertiary sector in 2022 grew by 4.8 per cent, more than GDP. This growth was also driven by the favourable trend in tourism flows, with the surplus in the tourism balance being twice that of the previous year. Also this year, the services sector is expected to continue to benefit from significant tourist inflows, as evidenced by the strong surplus of the tourism balance of payments in January and February. Activity in the services sector picked up briskly again last quarter, after a temporary setback in the final quarter of 2022. Between January and May, the services PMI averaged well above the dividing line between expansion and contraction, while the Istat confidence index averaged about four points above the level recorded last December for the first five months of the year.

Box 1.1 – Analyses on the impact of the incentives for residential construction on the Italian economy

Over the past few months, the PBO has conducted a number of analyses on the macroeconomic effects for Italy of the tax incentives for residential construction, looking at both the impacts on economic activity[2] and on prices.[3]

The measures introduced to support the construction industry during the pandemic, in particular the Superbonus incentive, helped to revive the sector, which grew strongly in the two-year period 2021-22, more than in other major European countries. This also reflected on employment: in fact, in the two-year period 2021-22 there was a cumulative growth of more than ten percentage points in employment in the construction sector (as measured in quarterly national accounts).

In the past two years, construction in Italy was particularly dynamic not only in the residential sector, stimulated by the Superbonus, but also in the non-residential and public works sectors. The recovery of investment in housing, after a drop in 2020 of almost eight percentage points, was very strong in 2021, slowing down markedly in 2022 when the incentive was most heavily resorted to. In September 2021 (the first period for which Enea data[4] on the take-up of the Superbonus *110 per cent* were published), the completed financed investments amounted to approximately EUR 5 billion, reaching a total value close to EUR 60 billion at the end of April 2023.

Regarding the effects of these investments for the construction sector, both the investment that households would have made without the incentives and the crowding out, i.e. the impact of the incentive on the demand for non-facilitated investments, should be assessed. Based on the data released by Enea on the Superbonus, as of 31 December 2022, about EUR 47 billions of completed works had been financed, while national accounts data show that in the period 2021-22 total residential investments (both incentivised and non-incentivised) increased cumulatively by about EUR 43 billion. Assuming the full additionality of incentivised investments would therefore imply that in their absence there would have been a very large reduction in non-incentivised residential investments; this possibility seems unlikely, in part because there was a very strong recession in 2020. However, it should be noted that any investments crowded out in the past two years may be recovered in the coming years. The measure fulfilled its role as a countercyclical stimulus in 2021, but also remained in place in 2022 when economic activity also gained ground in sectors other than construction (Figure B1.1.1).

According to national accounts data, the contribution of investment in residential construction to GDP growth in the past two years amounted to two percentage points. According to analyses carried out using the equations of the macro-econometric model adopted by the PBO (MeMo-It), about half of the contribution (i.e. one percentage point) is estimated to be attributable to the shock generated by the tax incentive, i.e. the additional investment in housing compared to what would have been made in the two-year period in the absence of the tax incentive (so-called counterfactual scenario). This estimate only shows the additional boost to the construction sector and not the effects for the whole economy, so it should not be taken as a multiplier. In order to have an evaluation for the Italian economy as a whole, it is necessary to consider how the initial impulse on housing construction spread to the other sectors. Therefore, to analyse how the shock received by the construction sector propagated to the rest of the Italian economy, it is possible to use input-output tables; according to these, additional expenditure in the construction sector propagates to the rest of the economy, producing overall added value that, in equilibrium, is approximately similar to the initial impulse, i.e. with a multiplier close to unity; indeed, while there is a multiplier effect that might tend to exceed unity, it must be considered that the use of external resources reduces the effects for the national economy as a whole.

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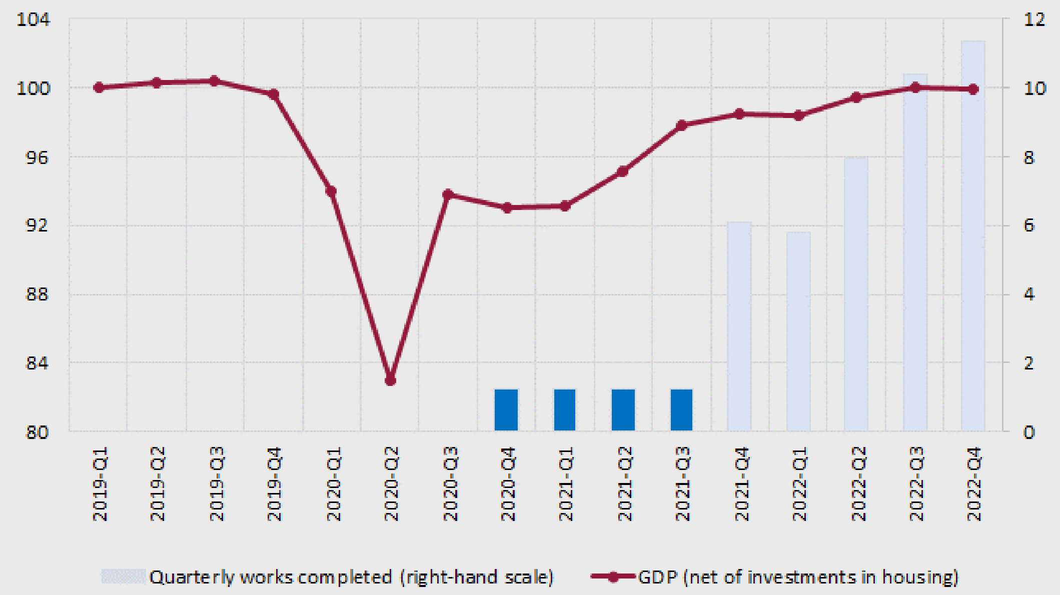
2 Parliamentary Budget Office (2023), 'Hearing of the Chair of the PBO as part of the fact-finding inquiry on the macroeconomic and public finance effects of building tax incentives', 16 March.

3 Parliamentary Budget Office (2023) 'Report on Recent Economic Developments – April 2023'.

4 Data available on the Enea website: https://www.efficienzaenergetica.enea.it/detrazioni-fiscali/superbonus/risultati-superbonus.html.

Figure B1.1.1 – GDP net of investments in housing and works financed with the Superbonus (1)
(index numbers 2019Q1=100 and billion euro)



Source: Enea, Istat.
(1) The blue histograms, referring to the period between the fourth quarter of 2020 and the third quarter of 2021, are obtained by equally distributing over the four periods the figure published by Enea, concerning the cumulative amount of completed investments financed with the Superbonus incentive up to September 2021 (EUR 5.1 billion). The other histograms represent the flow of new concluded investments financed with the incentive in the corresponding period.

Ultimately, even evaluating for the whole economy the purely additional impact of the Superbonus initiative, the effects in the past two years appear to be around one percentage point of GDP.

The issue of additionality and crowding out at the macroeconomic level is crucial in the debate generated on the Superbonus. In a parliamentary hearing held on 23 May, the MEF assumed that about half of the investments facilitated by the Superbonus incentive would have occurred regardless of the incentive. However, the Government estimated that the effect of the tax relief between 2021 and 2022 would have been about two percentage points of real GDP. Such impact is higher than the one identified by the PBO for the same period, as it incorporates the response to the shock also of households that would have made the investment in the absence of the incentive; in the MEF's assessment, it is assumed that these households had already set aside the necessary funds for the interventions, and thus the public contribution is treated as a transfer (considering the differential with respect to the pre-existing incentives) increasing disposable income. Moreover, while the PBO's assessment is based on the overall data on investments in housing, which may have been affected by crowding out effects, the MEF's study is based on the value of investments financed with the Superbonus, and therefore does not consider any crowding-out with respect to other residential investments.

One aspect that has provoked intense public debate is the potential effect of the Superbonus initiative on prices. Despite the caps introduced on eligible expenses, a measure that finances more than 100 per cent of the expenditure could affect final prices due to the lack of conflicting interests between seller and buyer. An analysis of the overall inflation data did not reveal an abnormal trend in the construction sector components covered by the Superbonus, which grew in Italy in line with other euro area countries. Nevertheless, focusing on the detailed items of the Eurostat harmonised consumer price index, in particular in the "Heaters, air conditioners" category, Italy seems to have experienced higher price increases than the euro area as early as the pandemic period. In particular, between the second half of 2019 and that of 2022, the cumulative increase in the prices of this subset of goods was just under forty per cent in Italy, compared to much smaller increases in France, Germany, Spain and the euro area.

In its Report on Recent Economic Developments published last April, the PBO[5] offered an initial analysis of the prices of the above-mentioned goods, conducted with the help of granular data collected online. A time series of the daily prices of around 7,000 individual products on sale on Amazon[6] in different countries (Italy, France, Germany and Spain) and falling under the 'gas boilers and water heaters' and 'air conditioners' product categories[7] was constructed. The final dataset collected a sample of 1,007 goods, on sale between January 2019 and March 2023. The evolution of the Eurostat national indices and that of the corresponding indicators reconstructed from internet prices appears to be strongly correlated for Germany, France and especially Italy. Looking at the evolution in historical series, it was observed that while until mid-2021 in Italy the price dynamics of the goods analysed tended to be lower than in France and Spain, the gap closed and became positive in 2022, in the quarters during which the volume of works financed with the Superbonus increased rapidly.

Based on this evidence, an in-depth study was conducted on the prices of air conditioners, whose information can be isolated in the Amazon data more accurately than that of boilers and water heaters.[8]

Figure B1.1.2 shows the (standardised) year-on-year monthly changes of the series of air conditioner prices in the four reference countries. Starting from mid-2021, when expenditure financed with the Superbonus intensified, a strong trend growth in monthly prices is observed for Italy, on average higher than that of its main European partners. Based on the cumulative monthly data made available by Enea for the Superbonus as from August 2021, the historical series of investments for works completed and admitted to deduction[9] was reconstructed. A comparison of the two historical series shows a strong correlation (0.83) between the monthly investments concluded and the trend change in air conditioner prices that occurred in Italy between January 2021 and last March.

Based on this evidence, a linear regression model of the trend changes in monthly air conditioner prices in relation to monthly investments subsidised by the Superbonus was estimated for Italy (Table B1.1.1). The coefficient estimated for investments financed with the Superbonus is positive and statistically significant, even after controlling for lagged values of the dependent variable, so a relationship between the incentive and prices seems to emerge, albeit weak.

The analysis must be interpreted with caution, due to the small number of monthly data collected during the analysed period; moreover, the partial representativeness of the sample must be considered, since the analysed prices concern a single retailer, albeit a large one. In conclusion, the analysis carried out, although preliminary, does not allow to reject the hypothesis that incentivised investment flows have contributed to exacerbate the price increases of goods affected by the measure.

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5 https://www.upbilancio.it/wp-content/uploads/2023/04/Nota-sulla-congiuntura_04_2023.pdf.

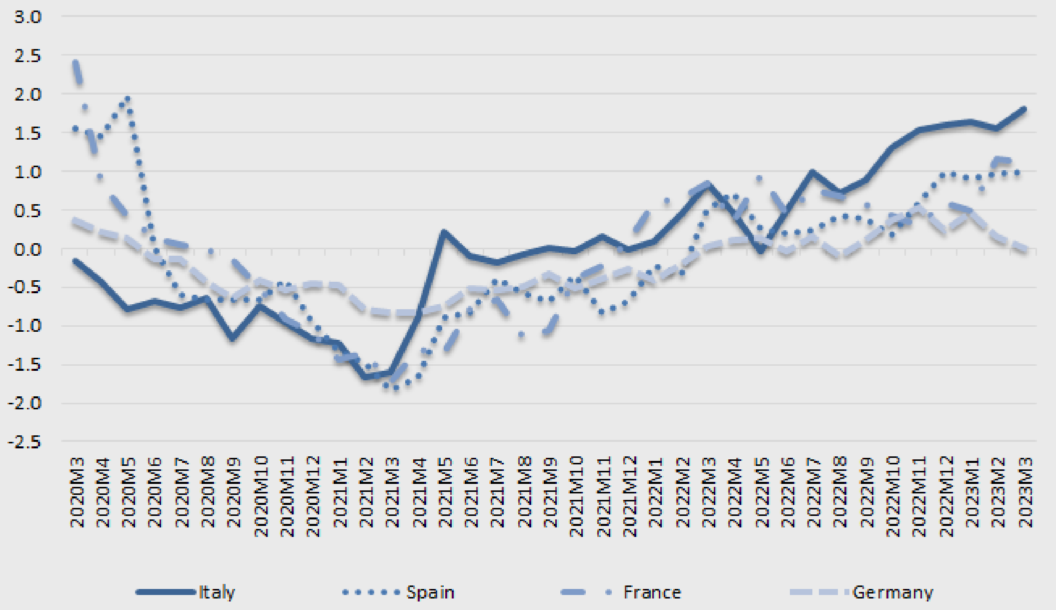
6 Data of prices actually found on Amazon.it were reconstructed. In particular, the analysis focused on product categories 3120120031, 3120121031, 3692885031 on Amazon.it and their equivalent categories on Amazon.de, Amazon.fr and Amazon.es for which 'best sellers' were identified. Time series of prices for the identified goods − as well as other statistical information − were massively acquired for each country using the API provided by the Keepa.com platform.

7 Goods which, based on their characteristics, do not fall into the analyzed categories (e.g. spare parts or ancillary accessories) or those with abnormal prices were removed from the dataset.

8 The products classified as electric water heaters and gas boilers tend to overlap in our dataset, and the exact distinction between the two goods would require further textual investigation that should also take into account the different customs and regulations between the four countries analyzed. On the contrary, the analysis of air conditioning prices allows a consistent international comparison that is more detailed than the index provided by Eurostat.

9 As only the cumulative value of investments is available for the period January to August 2021, a geometric trend was estimated in order to impute the missing monthly flows for the first eight months of the year.

Figure B1.1.2 – Prices of air conditioners in different European countries
(standardised year-on-year changes)



Source: based on Amazon data collected by Keepa.com.

Table B1.1.1 – Linear regression between the year-on-year changes in air conditioner prices and the monthly levels of investment subsidised through the Superbonus (1)

	(1)	(2)	(3)
(Intercept)	-0.02 (p = 0.20)	-0.02 ° (p = 0.06)	-0.02 * (p = 0.04)
Superbonus investments	0.10 *** (p = 0.00)	0.03 ° (p = 0.10)	0.04 * (p = 0.02)
Price trend changes (*lag* 1)		0.09 *** (p = 0.00)	0.12 *** (p = 0.00)
Price trend changes (*lag* 2)			-0.05* (p = 0.04)
N	27	27	27
R2	0.68	0.87	0.89

Source: based on Keepa.com and Enea data, 'Monthly data report'.
*** p < 0.001; ** p < 0.01; * p < 0.05; ° p < 0.1.

Regarding the production sectors as a whole, the composite index of business confidence, obtained as a weighted average of sectoral climates, was characterised in 2022 by a rather erratic performance, remaining at almost unchanged levels compared to the previous year's average. In the first five months of the year, it recorded a marked increase compared to the October-December average, consolidating the recovery phase begun last October. Household and business uncertainty, according to the measure compiled by the PBO, gradually increased last year and then decreased in the first quarter of the current year, the first time since the second half of 2021, reflecting the decline recorded by both the business component and, to a greater extent, the household component.

Last year, consumer inflation reached 8.1 per cent (up from 1.9 per cent in 2021), the highest value since 1985; the initial impulse to price increases came from the energy sector, in the wake of rises in commodity markets, with a strong impact upstream in the distribution chain (producer prices rose by 34.0 per cent) which then spread downstream and among expenditure items. Price increases would have been higher (by about one percentage point compared to the general index at constant taxation in the 2022 average) in the absence of the measures launched by the Italian government to mitigate the adverse impacts of energy price increases. These measures had significant effects, especially in distributional terms in favour of the weaker classes (see section 5.4).

Between the end of 2022 and the beginning of 2023, inflation was on a downward path, temporarily interrupted in April and resumed in May (when it stood at 7.6 per cent). The decline in the first months of this year reflected the continued decline in energy commodity prices and the easing of upstream pressures in the distribution chain. However, pressures are still being observed on the underlying component, especially on the prices of several services and food products, which have a strong impact on the 'shopping basket' and significantly affect the budgets of households with lower incomes. Inflation projections, as measured by Istat 's confidence surveys of businesses and households, have declined significantly in the first months of this year, in line with the rapid decline in energy prices.

On average in 2022, rising prices eroded the increase in nominal incomes, causing purchasing power to fall by more than one percentage point compared to the previous year. This resulted in a marked decline in the propensity to save, which fell from 10.9 per cent of disposable income in the first quarter to 5.3 per cent in October-December, the lowest value for more than a decade. In the same period, the share of profits in value added increased, while in relation to the total resources of the economy it decreased; similarly, the mark-up declined, driven by the unfavourable performance in the services and construction sectors, against a slight increase in the industry sector (excluding construction) (Figure 1.8).

Regarding the labour market, the 2022 EFD Update had reflected a summer quarter characterised by a standstill in employment growth, accompanied by a further decline in the unemployment rate. In the following months, employment strengthened, especially in the case of permanent contracts, although the imbalances between labour supply and demand continued, which also held back production.[10]

In 2022 labour input grew by 4.4 per cent, meaning that the apparent elasticity with respect to output remained above unity. Hours worked declined in the agricultural sector, while they increased in the industry sector excluding construction, to a greater extent than value added; the construction industry showed an increase below that of production activity, while the services sector saw an increase close to that of activity.

[10] Parliamentary Budget Office (2023) 'Report on recent economic developments - April 2023'.

Figure 1.8 – Mark-up: total economy and sectors
(index numbers; 2010=100)

Source: Istat.

The recovery in employment continued in the initial months of the year (0.6 per cent on average in January-April compared to the previous three months) still driven by permanent employment and the self-employed.

On average in 2022, due to wage renewals, contractual wages increased by 1.1 per cent, a very low increase compared to the rate of inflation. In January-April this year, hourly contractual wages increased at 2.2 per cent, especially in the public sector (4.8 per cent), which included the increases set by the 2022 contract renewals. Over the same period, hourly wages in the private sector rose more moderately, as a large part of employees still await renewal (around 75 per cent in private services in April). On average in 2022, the year-on-year increase in hourly labour costs (2.3 per cent) and the decrease in hourly productivity (by about half a percentage point) caused the ULC to rise by almost three percentage points.

1.3 Macroeconomic forecasts

The 2022 EFD

In the final part of 2021, despite the upturn in the number of COVID-19 cases due to the spread of the Omicron variant, GDP increased by almost one percentage point and production levels were just below pre-crisis levels, ahead of Germany but slightly behind France and the euro area. Analysts' expectations leaned towards a strengthening of economic activity, despite the world economy being characterised by high volatility in commodity prices, affected by restrictions in global supply chains and the evolution of the pandemic.

However, expectations worsened abruptly with Russia's invasion of Ukraine on 24 February 2022. Confidence indicators for business and consumers fell rapidly; growth and inflation expectations deteriorated especially for those economies most dependent on Russian energy supplies, such as the euro area.

To cope with the sudden change in the macroeconomic context, the Italian Government adopted specific measures with the 2022 EFD in order to curb the increase in energy and fuel prices for households and businesses, strengthen guarantee instruments for companies' access to credit, and reinforce policies to welcome Ukrainian refugees; resources were also integrated to offset the increase in the cost of public works and to continue supporting the healthcare system's response to the pandemic and the sectors most affected by the health emergency. The EFD was approved by the Council of Ministers on 6 April, with the Parliament's majority resolution updating the public finance targets and the related plan to bring the structural balance towards the medium-term objective (MTO).

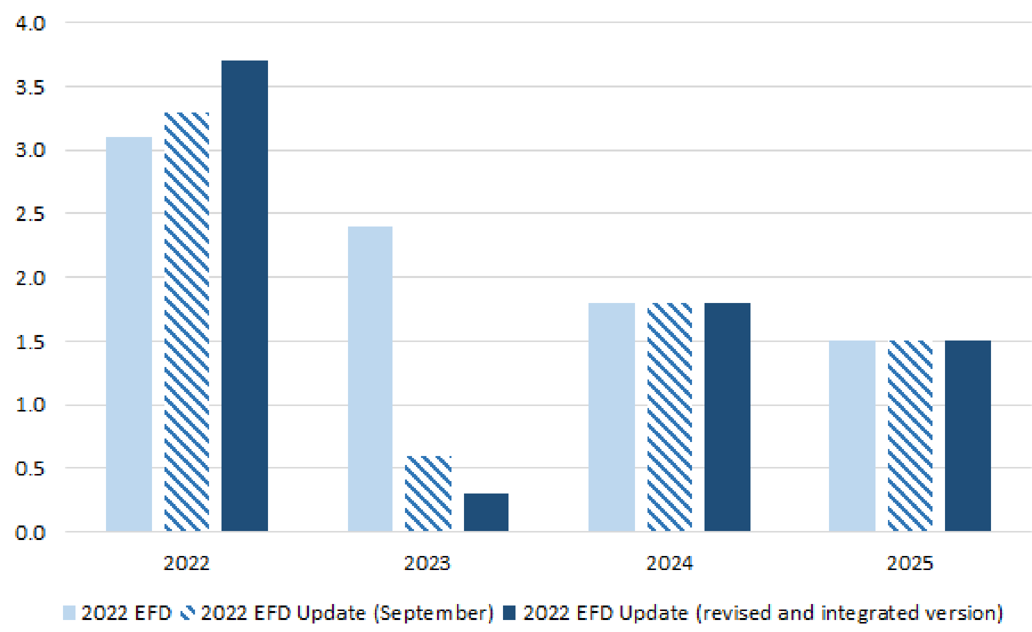
After the rebound in 2021, the trend macroeconomic framework of the 2022 EFD projected GDP performance to normalise to 2.9 per cent in 2022, 2.3 in 2023, 1.8 in 2024 and 1.5 at the end of the period (2025). Compared to the 2021 EFD Update, the trend macroeconomic framework was characterised by a downward revision of growth, sharp in 2022 (-1.8 percentage points) and not insignificant in 2023 (half a percentage point). The significant revision of growth for 2022 was affected by the change in world trade and sanctions against Russia, by increases in energy prices and by new assumptions on interest rates, which also affected the other years of the planning period. With regard to inflation, in the trend macroeconomic framework the rapid increases in energy commodity prices led to a considerable upward revision of prices compared to the EFD Update, with pervasive effects mainly on import and consumption deflators. The change in the GDP deflator for 2022 was estimated at 3.0 per cent (from 1.6 in the EFD Update).

The measures envisaged in the EFD were financed with the fiscal room resulting from the confirmed policy targets and the improved public accounts trend framework; this resulted in a higher-than-expected year-on-year debt, up five-tenths of GDP in 2022, two-tenths in 2023 and one-tenth in both 2024 and the final forecast year. In the EFD's policy macroeconomic framework the expansionary impact of the measures on growth was cumulatively estimated at three-tenths of a percentage point in 2022 and 2023 (with a change in GDP of 3.1 and 2.4 per cent, respectively; Figure 1.9) and nominal GDP was expected to increase by 6.3 per cent in 2022, 4.6 per cent in 2023 and below four per cent in 2024-25 (Figure 1.10).

The growth estimates of the macroeconomic framework over the forecast period incorporated the expansionary effects attributable to the implementation of the National Recovery and Resilience Plan (NRRP) programmes.[11] In estimating the macroeconomic impact, the MEF considered only resources for additional investment plans; in particular, spending was assumed to be of high quality and efficiency, so as to structurally raise productivity and thus growth potential in the long run. Based on the time distribution of these resources, the 2022 EFD estimated that in 2026 Italy's GDP would be 3.2 per cent higher than in the baseline scenario; the impact of the Plan for 2021-22 was estimated at almost one percentage point (0.7 per cent for 2022).

The 2022 EFD macroeconomic policy and trend forecasts for the four-year period 2022-25 were validated by the PBO.[12]

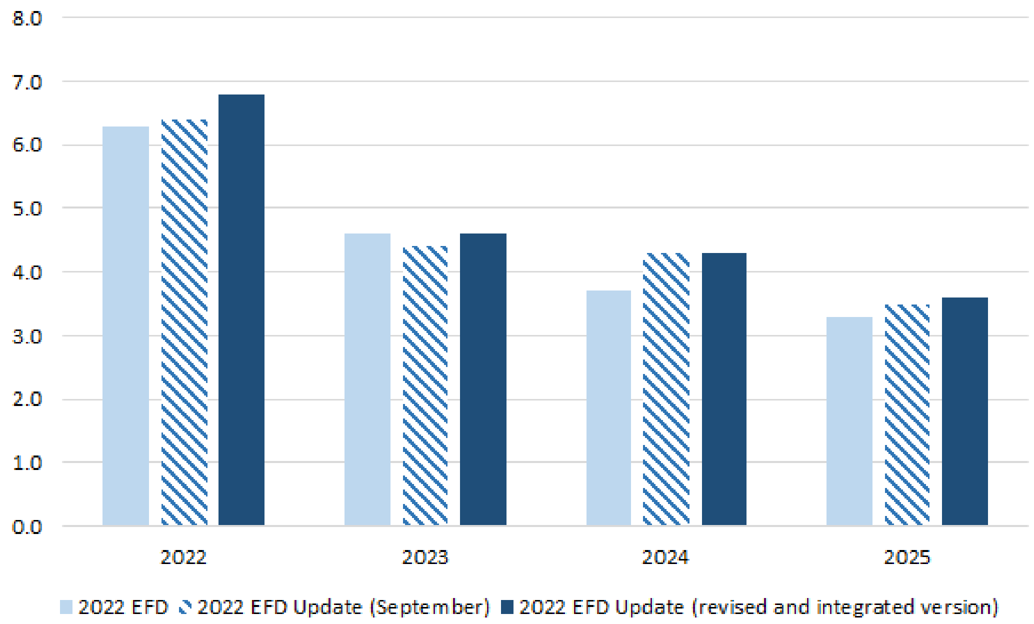
Figure 1.9 – Real GDP, 2022 EFD policy scenario and 2022 EFD Update trend scenario *(percentage changes)*



Source: 2022 EFD, 2022 EFD Update (September) and 2022 EFD Update (revised and integrated version, November).

[11] See the assessments in Appendix I to the 2022 National Reform Programme (NRP).
[12] See endorsement of trend macroeconomic framework and endorsement of policy macroeconomic framework.

Figure 1.10 – Nominal GDP, 2022 EFD policy scenario and 2022 EFD Update trend scenario
(percentage changes)



Source: 2022 EFD, 2022 EFD Update (September) and 2022 EFD Update (revised and integrated version, November).

The methodology adopted for the endorsement process is hereby briefly described. It is based on the overall analysis of the MEF's macroeconomic scenarios through: a) the PBO's estimates of the short-term trends of GDP and of the main demand components; b) the annual estimates obtained by the PBO with Istat's forecasting model, MeMo-It, under the Framework Agreement with the same institute; c) the annual estimates separately and specifically produced for the PBO by the independent forecasting institutes (CER, Oxford Economics, Prometeia, REF.ricerche), which are part of the PBO panel. In addition, the most recent forecasts of other national and international institutions are monitored and an examination of the internal consistency of the MEF's forecasting frameworks is conducted. To ensure a consistent comparison with the MEF's forecasts, the estimates of the PBO panel forecasters (which include those of the PBO) are made on the basis of the same assumptions on international exogenous factors (world trade, oil prices, exchange rates, interest rates) as those adopted by the MEF. The trend estimates of the PBO panel incorporate the investment programmes envisaged in the NRRP. The policy forecasts are based on broad assumptions about the public finance package, drawn up by the PBO based on the indications in the budget documents (EFD, EFD Update) and on dialogue with the MEF.

Overall, the MEF policy forecasts were consistent with those of the panel: the rate of change of real GDP in the macroeconomic framework was at the upper bound of acceptability of the PBO forecasts in 2022 and around the median of the panel's variations in the following years. Nominal GDP dynamics, most relevant for public finance developments, were at the upper end of the panel projections in 2022, close to the median in 2023 and between the median and the upper end of the PBO forecasts in the final two years. The impact of the public finance measures on GDP growth was deemed acceptable, as it was little different from that estimated by the PBO forecasters.

The macroeconomic scenario of the Italian economy was exposed to mainly downside risks, especially of an international nature due to the Russian-Ukrainian conflict, as the baseline scenario of the EFD forecast implicitly assumed a relatively quick resolution of the conflict.

The 2022 EFD Update forecast and context

In the months following the approval of the 2022 EFD Update, the ongoing war in Ukraine increased uncertainty about the outlook for the world economy (see section 1.1). In Europe, gas prices peaked in August and monetary policies were restrictive to anchor expectations. Geopolitical tensions with Russia, in particular over natural gas supplies to Europe, raised fears of a halt of gas supplies in the autumn or winter months, which under certain conditions would have led to the need to ration gas consumption in Italy.

The Italian economy returned to rapid growth in the second quarter, due to the gradual phasing out of restrictions to combat the pandemic, yet a number of adverse factors were gaining strength. Core inflation was also rising and, according to the PBO indicator, household and business uncertainty reached values close to those of the 2012-13 sovereign debt crisis. Overall, the forward-looking economic indicators of the Italian economy pointed to a weakening of the economic cycle in the second half of 2022.

In September, the outgoing executive (with the crisis of the Draghi government on 20 July 2022, new general elections had been scheduled for 25 September) started budget planning. The outgoing government, in office for current affairs, approved (28 September) an initial version of the EFD Update, which included only the trend scenario at existing legislation,[13] while leaving the definition of the measures and policy targets for the three-year period 2023-25 to the new executive.

The trend macroeconomic framework in the September 2022 EFD Update projected a 3.3 per cent GDP growth for the same year, followed by a sharp slowdown for 2023 (0.6 per cent) and a subsequent recovery in the final two years of the forecast (1.7 per cent on average for 2024-25). Compared to the 2022 EFD, the trend macroeconomic framework estimated slightly higher GDP growth for 2022 (Figure 1.9), due to the upward revision of national accounts estimates for the first two quarters but assumed a sharp weakening of the macroeconomic framework between the second half of 2022 and the first quarter of 2023. This deterioration mainly affected the change in GDP for 2023, which compared with the EFD trend macroeconomic framework showed a marked downward revision, largely attributable to revisions in international exogenous factors, in particular energy markets, foreign demand and interest rates. On the other hand, in 2024-25 the growth forecasts of the trend macroeconomic framework in the September EFD Update

[13] A similar situation had arisen in April 2018 with the Gentiloni government, which approved the EFD without policy indications.

confirmed those of the 2022 EFD, for which a recovery of economic activity above potential output rates was anticipated, thanks to the support of the NRRP.

Regarding nominal variables, in 2022 the upward boost to the GDP deflator, driven by the sharp recovery of the private consumption component (6.6 per cent), was largely offset by the net loss of terms of trade, attributable both to increases in imported raw materials and to the depreciation of the euro. In 2023 the contribution of terms of trade was nil and the GDP deflator was rising driven by consumer prices, even though the corresponding dynamics were expected to weaken. The change in the GDP deflator in the EFD Update, estimated at 3.0 per cent in 2022, confirmed the EFD projections, while the estimate at 3.7 per cent in 2023 projected a marked increase (1.5 percentage points). This high trend was more than offset by lower real growth, resulting in a slightly lower change in nominal GDP in 2023 (4.4 per cent) compared to the one in the EFD (Figure 1.10).

The macroeconomic scenario of the September 2022 EFD Update included updated assessments of the impacts of the NRRP[14] based on new projections of the resources of the Recovery and Resilience Facility (RRF) over the Plan period,[15] which reduced the resources related to 2022 by almost EUR 16 billion compared to the EFD. Total RRF resources up to 2023 were thus reduced, while those allocated to the years 2025-26 were increased (over EUR 16 billion). This implied a reduction in the Plan's expansionary impulse for the two-year period 2021-22 (by half a point of GDP compared to the 2022 EFD) and a correspondingly greater effect in the period 2023-25.

The trend macroeconomic framework of the September EFD Update was validated by the PBO on 23 September 2022,[16] as the MEF's trend forecasts for the two-year validation period 2022-23 were within an acceptable range. In particular, the change in real GDP deviated to an acceptable extent from the panel median estimates and in any case did not exceed the upper end of the range; nominal GDP growth exceeded the panel median to an acceptable extent in 2022-23 and in any case did not exceed the upper range in any year of the trend macroeconomic framework. The set of cost and price variables in 2022-23 also appeared broadly acceptable. The change in the GDP deflator projected by the MEF for 2022 barely exceeded the median of the panel. In 2023 the private consumption deflator was at the upper end of the range, so that the expected growth of the GDP deflator was also at the high end of the PBO forecasters' expectations.

In October, the global outlook, particularly the European outlook, continued to deteriorate. Although natural gas prices on the European market were falling, they remained high, and in Italy inflation reached almost 12 per cent. The economic indicators showed, however, that the Italian economy was more resilient than expected; the change

[14] See Table II.1-2 in the 2023 Draft Budgetary Plan (updated version).
[15] See Table I.1 in the September 2022 EFD Update.
[16] The PBO's validation of the macroeconomic framework of the EFD Update covers the minimum time horizon required by European regulations for the Draft Budgetary Plan (DBP), that is, the first two years of the forecast period. For more details see the Memorandum of Understanding between the PBO and the MEF of 13 May 2022.

in GDP in the third quarter, according to Istat 's preliminary estimate of 31 October, amounted to 0.5 per cent in quarterly terms (it was later revised to 0.4 per cent), higher than that of the main euro area countries.

Italy's new government[17] approved a revised and integrated version of the EFD Update on 4 November, updating the forecast trend of the September EFD Update. The trend macroeconomic framework revised upward GDP growth in 2022 compared to the autumn EFD Update (to 3.7 per cent, almost half a percentage point up), but halved the expected change in GDP in 2023 (to 0.3 per cent) and confirmed its performance in 2024-25[18] (Figure 1.9).

The improvement in the forecast for 2022 entirely reflected the unexpected growth in activity in July-September, which the September EFD Update had estimated to decline; the trend scenario of the revised and integrated EFD Update projected a decline in GDP in the final quarter of 2022 and the first quarter of 2023, and thereafter estimated a prudent recovery in economic activity, resulting in a slight increase in output on average for the year. The lower growth in 2023 compared to the September EFD Update was consistent with the weakening of international exogenous variables underlying the forecast, which subtracted 0.3 points from GDP growth, cancelling out the favourable carry-over effect from the second half of 2022.

The forecast on nominal variables in the November EFD Update was revised upwards compared to the EFD, both for the current and following years, in view of the stronger impetus exerted by energy prices. The revision, which had already been made in the September EFD Update, was increased especially for 2023, as inflationary pressures were more persistent. The evolution of the GDP deflator anticipated by the MEF was similar in 2022 to that of the September EFD Update (3.0 per cent), while it was more pronounced in 2023 (at 4.2 per cent), due to the upward push provided by the private consumption deflator. Nominal GDP growth was estimated at 6.8 per cent in 2022 and eased the following year (to 4.6 per cent) (Figure 1.10). Price changes in the final two years converged towards the single monetary policy target and nominal GDP growth averaged around four per cent over the two years.

The policy macroeconomic framework incorporated the effects of the public budget expansion foreseen in the EFD Update. The authorisation to revise the policy targets for net borrowing, requested by the Italian Government and approved by Parliament, entailed the use of the budget room for 2022 (for EUR 9.1 billion) and the availability of additional resources (about EUR 24 billion in 2023-24) to extend and finance additional measures to counter the effects of energy price hikes for households and firms. In the new policy scenario, the net borrowing was higher than the one projected in the EFD in

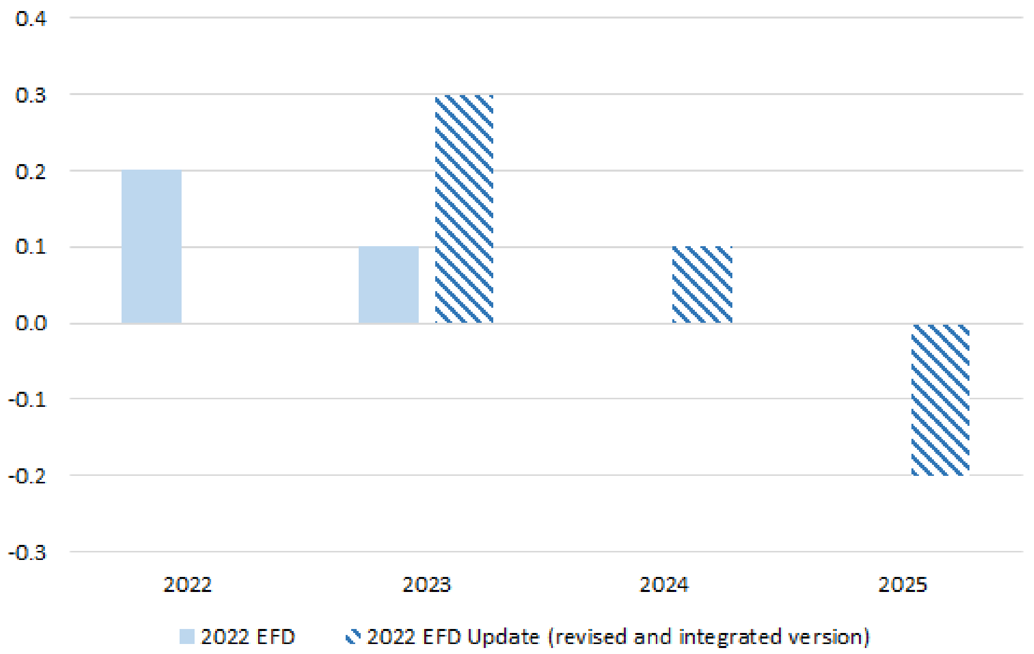
[17] The new Government was sworn in on 22 October 2022 and won the vote of confidence of the Chamber of Deputies on 25 October and of the Senate of the Republic the following day.

[18] Compared to the policy framework of the 2022 EFD, the GDP outlook of the revised and integrated EFD Update seemed better in 2022 (by just over half a percentage point), worse in 2023 by over two percentage points and the same in 2024-25.

2022-24 and increased, with respect to the one under existing legislation, by 0.5 points in 2022, 1.1 points in 2023 and 0.1 points in 2024, while decreasing (by 0.3 points) in the final year. The Government's manoeuvre supported GDP growth, which in the policy framework was projected at 0.6 per cent in 2023 (three tenths above the trend scenario) and 1.9 in 2024 (one tenth above the trend macroeconomic framework); at the end of the period (2025) the impact of the manoeuvre was slightly restrictive (Figure 1.11).

The PBO repeated the validation procedure on the macroeconomic frameworks of the revised and updated EFD Update and validated the trend and policy macroeconomic forecasts of the MEF for 2022-23;[19] the PBO reported that the MEF's estimates for 2024, a year outside the validation period, were optimistic. With specific reference to the Government's policy scenario in the two-year validation period, the forecasts for real GDP growth were close to the median of the PBO panel's range; the increase in nominal GDP was between the median and the upper bound of the range of the PBO forecasters' estimates; the impact of the fiscal package on economic activity in 2023 was similar to that estimated by the PBO panel.

Figure 1.11 – Impact on GDP of the fiscal measures of the 2022 EFD and the revised and integrated version of the 2022 EFD Update
(percentage points)



Source: 2022 EFD and 2022 EFD Update (revised and integrated, November).

[19] See Parliamentary Budget Office (2022), 'Hearing of the Chair of the PBO as part of the preliminary fact-finding activity prior to the examination of the revised version of the Update to the 2022 Economic and Financial Document ' 9 November.

More specifically, the change in real GDP estimated in the policy macroeconomic framework of the most recent EFD Update was close to the median estimates of the PBO forecasters for 2022, which predicted a downturn in the final part of 2022, similarly to the MEF. The expected growth for 2023 was considered acceptable as just below the panel median. The set of cost and price variables was judged plausible, although at the high end of the validation range. The change in the GDP deflator, in line with the upper end of the panel projections in 2022, was far from this limit in 2023, but still above the median of the range. In the following two years (not subject to validation) some risks emerged especially for 2024, as real GDP growth clearly exceeded the upper end of the panel projections. GDP growth exceeding the estimated potential output implied a timely and effective implementation of the projects envisaged in the NRRP.

The PBO noted that the macroeconomic scenario of the Italian economy was exposed to different types of risks, overall downwards-oriented. Among the most relevant, the PBO reported Italy's high energy dependence on a small number of natural gas pucing countries, which exposed the country to negative shocks in the event of a supply disruption. This event was not considered in the baseline scenario of the macroeconomic frameworks, either of the MEF or of the PBO panel, and therefore the risks of gas consumption rationing in the event of adverse conditions, leading to strong negative repercussions on economic activity, were neglected. Compared with the forecasts of other institutional and private forecasters, the MEF's projections appeared decidedly high; for example, the IMF had estimated in October a slight contraction of Italy's GDP for 2023.

The 2023 EFD forecasts and context

At the end of 2022 the international economic cycle weakened and the European economies experienced a rapid decline in the prices of energy commodities, especially natural gas. Consumer price dynamics in the EU started to decline but was still high and therefore not yet sufficient to stop the normalisation of the monetary policies. The European economic cycle was deteriorating, and in Italy GDP came to a standstill, mainly because of inflation.

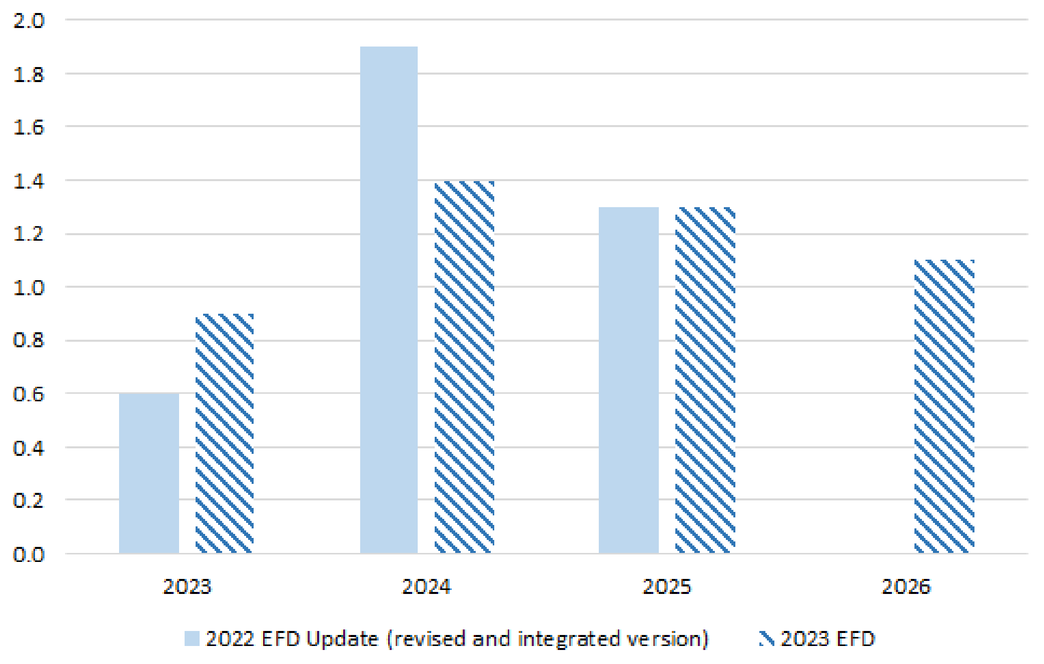
In the last quarter of last year, the economic cycle deteriorated, with output in Italy coming to a halt (-0.1 per cent quarter-on-quarter), mainly because of higher inflation. At the beginning of this year, the framework of available indicators again took on a more favourable tone, despite the persistence of significant exogenous fragility factors, such as the Russian-Ukrainian conflict, high inflation and the appearance of new financial tensions. The improvement in the short-term outlook led to an upward revision of expectations on production activity for the first quarter.

The 2023 EFD, approved by the Italian Council of Ministers on 11 April, assumed in its trend scenario a recovery of GDP growth in January-March, while for the same period the

November EFD Update had forecast a contraction. Compared to the policy framework of the latest EFD Update, for this year the EFD trend macroeconomic framework revised growth upwards (by 0.3 percentage points) to 0.9 per cent (Figure 12), while estimates for next year were revised downwards (by 0.5 points), to 1.4 per cent; the performance for 2025, at 1.3 per cent, already forecast last autumn, was confirmed, while for the last forecast year (2026) a GDP change of 1.1 per cent was provided, a value slightly higher than potential GDP forecasts made by leading analysts. The revisions on 2023-24 reflected the effect of the new international exogenous factors; according to the projections reported in the EFD, the updated international scenario contributed favourably to GDP growth in 2023 (by 0.5 percentage points), mainly due to the reduction in gas prices;[20] on the other hand, the new profile of world trade, interest rates and exchange rates subtracted four tenths from GDP growth in 2024.

With reference to nominal variables, the GDP deflator in the EFD trend macroeconomic framework is expected to rise by 4.8 per cent this year, driven by the strong change in the consumption deflator, before slowing down at the end of the period. The nominal GDP estimate in the trend macroeconomic framework is therefore 5.7 per cent this year and just above 3.0 per cent in the final year. Compared to the 2022 EFD Update, this projection is revised upward by almost one percentage point in 2023 and downward by half a point in 2024; the change in nominal GDP is instead confirmed for 2025 (Figure 1.13).

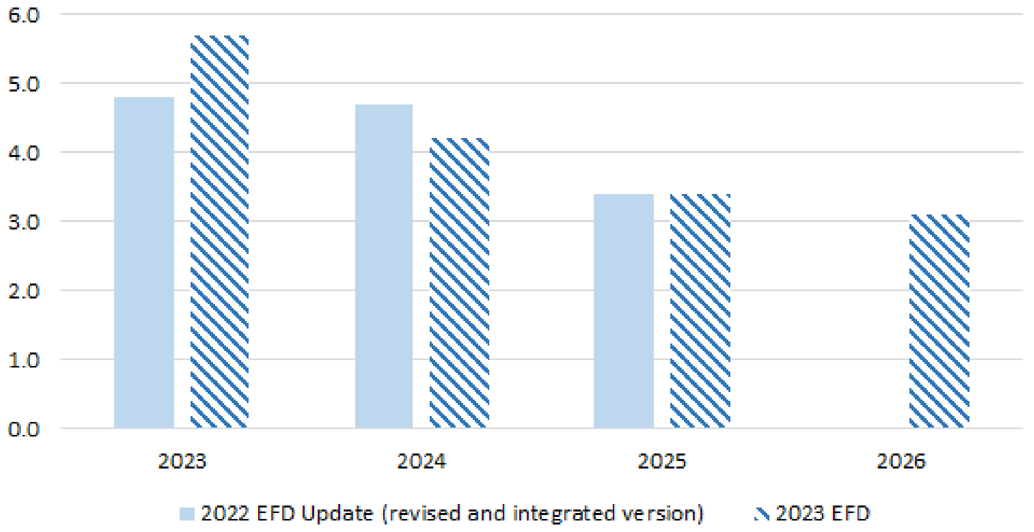
Figure 1.12 – Real GDP, 2022 EFD Update policy scenario and 2023 EFD trend scenario *(percentage changes)*



Source: 2022 EFD Update (revised and integrated version, November) and 2023 EFD.

[20] In the 2023 EFD trend macroeconomic framework, this positive impact was only partly taken into account for prudential reasons, due to the high uncertainty in the international scenario at the beginning of 2023.

Figure 1.13 – Nominal GDP, 2022 EFD Update policy scenario and 2023 EFD trend scenario
(percentage changes)



Source: 2022 EFD Update (revised and integrated version, November) and 2023 EFD.

The MEF trend macroeconomic framework incorporated public investment expectations benefiting from the strong boost provided by the NRRP. The 2023 National Reform Programme (NRP) provides an updated estimate of the macroeconomic impact of the Plan, which considers the final information, available in April, on actual expenditure in 2020-22 and technical assumptions on the distribution of expenditure over the remaining years. According to this assessment, GDP in 2026 is projected to be 3.4 per cent higher than in the baseline scenario, 0.2 percentage points higher than estimated in the autumn. The distribution of resources assumed in the EFD resulted in lower financial resources in the initial phase of the Plan and higher resources thereafter; in detail, the impacts attributable to the NRRP in 2021-22, amounting cumulatively to 0.2 percentage points, are slightly lower than those in the 2023 Draft Budgetary Plan (DBP) and are instead higher starting from this year (2.5 points in the 2023-25 period, up from 2.4 in the updated version of the 2023 DBP). The PBO's analysis (see Box 1.2 'Update on the macroeconomic impact assessment of the NRRP') also showed that a significant part of the growth effects is expected to occur over the EFD planning horizon. The Government is currently assessing a revision of the Plan, which will lead to a revision of the above-mentioned macroeconomic estimates.

The measures envisaged in the EFD result from the confirmation of the 2022 EFD Update policy deficit targets, against slightly lower balances (by 0.1 and 0.2 GDP points in 2023 and 2024 respectively) expected under existing legislation. The 2023 EFD policy macroeconomic framework, incorporating the new measures,[21] projects output growth

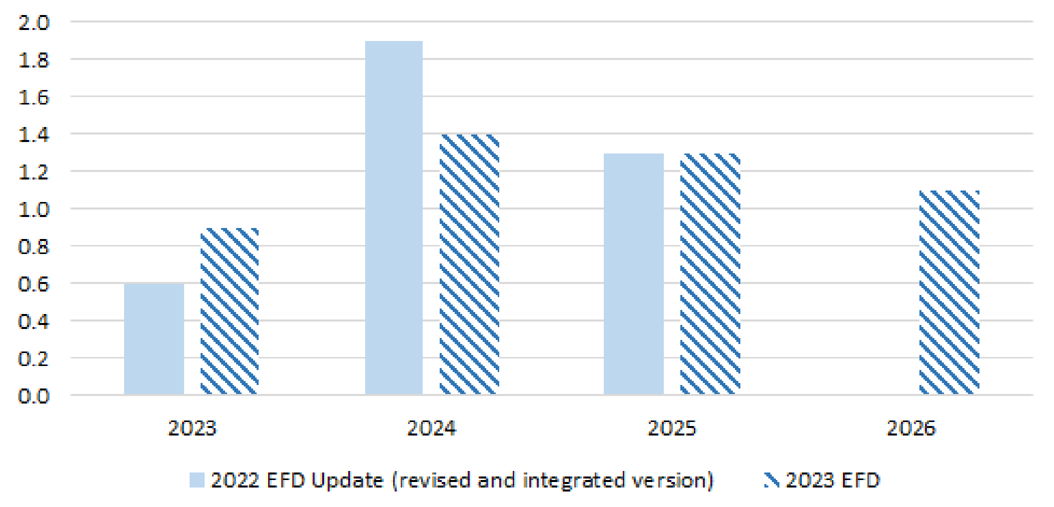
[21] As a result, the deficit remains projected at 4.5 per cent of GDP in 2023, 3.7 per cent in 2024, and 3.0 per cent in 2025, falling to 2.5 in the final forecast year. The difference between policy and trend balances in 2023-24 is earmarked to finance in 2023 a cut in the tax wedge on low and medium wage earners (by more than 3 billion) and to increase in 2024 the Tax Relief Fund (by more than 4 billion).

at 1.0 per cent this year and 1.5 per cent in 2024. As a result, the impact on the growth of the Italian economy estimated in the EFD amounts to one-tenth of a percentage point in 2023 and 2024, and to zero thereafter (Figure 1.14). The change in the GDP deflator does not differ from that of the trend macroeconomic framework over the entire forecast interval. The differences on nominal GDP therefore only reflect those on volume output.[22]

The EFD macroeconomic forecasts for 2023-26 were validated by the PBO.[23] The MEF policy projections are found to be broadly consistent with those of the PBO panel, although close to the upper end of the validation range for the entire forecast period. The MEF's macroeconomic framework was validated as the rate of change in real GDP does not exceed the upper end of the PBO panel forecasts, except marginally in 2024, and deviates acceptably from the panel median; nominal GDP performance is below the median of the panel projections, except in 2026, when it deviates acceptably; the impact of the fiscal package on GDP growth is broadly in line with that of the PBO forecasters (Figure 1.15).

With regard to nominal variables on the other hand, the projections made in the EFD for the GDP deflator are below the panel median in the first three years of the validation interval and close to it in 2026. This forecast more than balances the EFD GDP performance in terms of volume, which is close to the upper end of the PBO forecasters' expectations, so that the policy profile of nominal GDP falls within the panel's range.

Figure 1.14 – Impact on GDP of the measures in the revised and integrated 2022 EFD Update and 2023 EFD
(percentage points)



Source: 2022 EFD Update (revised and integrated version, November) and 2023 EFD.

[22] In 2025-26 there are no deviations between the changes in nominal GDP in the policy framework and in the trend framework. In the Government's policy scenario, nominal GDP increases by 5.8 per cent this year, slows to 4.3 per cent in 2024 and then reaches a level just above 3 per cent in 2026.
[23] See Endorsement of trend macroeconomic framework and Endorsement of policy macroeconomic framework.

Box 1.2 – Update on the macroeconomic impact assessment of the NRRP

In the 2023 EFD the MEF published estimates of the macroeconomic impact of the NRRP – which includes the NGEU resources up to 2026 and those of the National Complementary Plan up to 2030 – based on the information available in April on expenditure measures, past (over 2020-22) and within the Plan's implementation period.[24] The NRRP is currently being revised by the Government, and therefore an assessment of the macroeconomic impacts of its current version is needed as a reference point for the definition of the new Plan.

The PBO updated the simulation exercise on the macroeconomic effects of the NRRP, which had already been carried out in 2021 and 2022 on the occasion of a parliamentary hearing[25] and the 2022 Budgetary Planning Report.[26] The exercise includes resources for additional interventions and measures to support capital accumulation over the Plan's policy period.[27] Overall, the boost to the economy included in the simulation amounts to EUR 207 billion, allocated between 2021 and 2030, including about EUR 22 billion in resources for substitutive interventions (additional to the resources considered in the MEF simulations, as there is a lack of detailed information to distinguish between additional and substitutive measures for each type of intervention).

The projections of public expenditure enabled by the NRRP with the resources of the RRF, already revised in last September's EFD Update (which reduced the resources for 2020-24 and increased the expenditure projections for the following two years), have been further updated by the 2023 NRP. According to the PBO estimates, the resources earmarked for the financing of investment projects amount to about 53 per cent in 2021-24, 81 per cent in 2025-26, and substantially cover the entire Plan in 2027-30. With regard to the allocation of funds, 66 per cent of the resources are earmarked for financing public investments, 21 per cent are for incentives for private business investments, and 11 per cent for current expenditure.

The first simulation exercise is performed using the MeMo-It macroeconomic model, which is regularly used by the PBO for its institutional activities, including for validating the Government's macroeconomic forecasts.[28] The MeMo-It model is based on a neo-Keynesian approach, whereby the short-term effects triggered by aggregate demand stimuli are prevalent; in the long term, actual output returns to its pre-shock balance level, as the nominal variables of the model react to the deviations between actual and potential output, allowing the rebalancing between aggregate supply and demand. In the model, NRRP investment affects the production function, via capital, but does not improve productivity in the long run.

Based on the PBO simulation, carried out taking into account the new time distribution of available funds, assuming the complete and timely implementation of investment projects, the expansive impacts attributable to the NRRP are estimated at 0.6 percentage points in 2021-22, about 0.9 points in 2023 and almost 1.5 points in the subsequent three-year period (Table B1.2.1). Compared to the previous assessment made by the PBO (May 2022), the effects in the past two years are lower by almost half a percentage point, while they appear higher for this year (two-tenths higher) and for the final years of the Plan (by half a percentage point). Overall, at the end of the period (2026), the level of GDP is expected to be about three percentage points higher than in the baseline scenario, with an average fiscal multiplier close to unity.

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[24] See https://www.governo.it/sites/governo.it/files/PNRR.pdf.

[25] See Parliamentary Budget Office (2021), 'Hearing of PBO Advisor Chiara Goretti, as part of the examination of the proposed National Recovery and Resilience Plan (Doc. XXVII, no. 18)', 8 February.

[26] See Parliamentary Budget Office (2022), 2022 Budgetary Planning Report, May.

[27] The additional resources of the RRF facility amount to EUR 124.5 billion, the funds of the ReactEU programme amount to EUR 14.4 billion, the resources made available by the Development and Cohesion Fund amount to EUR 15.6 billion, and those allocated through the Supplementary Fund (up to 2030) amount to EUR 30.6 billion.

[28] See The PBO's macroeconomic forecasting tools.

Table B1.2.1 – Macroeconomic impacts of the NRRP estimated with the MeMo-It model *(percentage changes with respect to the baseline scenario)*

	2021	2022	2023	2024	2025	2026
GDP	0.2	0.6	1.5	2.2	2.7	2.9
Private consumption	0.1	0.1	0.4	0.8	1.3	1.6
Gross fixed investment	0.8	2.6	4.8	8.9	11.3	11.9
Impact on annual growth	0.2	0.4	0.9	0.7	0.5	0.2

The PBO's impact assessment is lower than the most updated MEF estimate (reported in the 2023 NRP), according to which, Italy's GDP in 2026 is projected to be 3.4 per cent higher than in the baseline scenario. Compared with official estimates, the results of the PBO's simulation appear to be stronger in the first three years of the simulation period (by half a percentage point), while in the following three years the expansionary effects tend to be decidedly weaker (by one percentage point). Both PBO and MEF simulations, however, concur that a significant part of the expansionary impacts attributable to the NRRP should be felt in the 2023 EFD planning horizon. Deviations can be attributed to the different econometric tool used by the PBO and the MEF to perform the analyses.

In fact, in order to perform its impact assessments, the MEF used a dynamic general equilibrium (DGE) model developed by the European Commission (QUEST III R&D)[29] and partly modified by the MEF; the QUEST model is able to represent, in addition to the impact on expenditure, the medium-term effects on production conditions and the effects of endogenous monetary policy. In particular, in the macroeconomic assessment of the NRRP carried out by the MEF with the QUEST model, it was assumed that: a) public investments would be highly efficient; b) Public Administrations would become more efficient, compared to historical standards, in the implementation of the Plan over the policy period; c) borrowing costs for funds disbursed through loans would be lower than those applied to Italian government bonds; d) that all subsidies to other EU countries would be used for public investments with average efficiency. The basis of the exercise assumes a high complementarity between public and private capital in the production function of businesses, resulting in public capital generating a persistent improvement in the growth potential of the economy. The official estimate of the impact of the NRRP on the Italian economy is thus based on the assumption that spending is of high quality and efficiency, so as to structurally raise productivity and hence growth potential in the long run.

The PBO then carried out a further exercise to assess the impact of the measures of the NRRP using a tool similar to that used for the MEF estimates[30] and the same assumptions underlying the simulations conducted with the MeMo-It model in terms of fund distribution across the different years and the different measures.

Under these assumptions, GDP is projected to be increasingly higher than in the baseline scenario starting in 2022 (Table B.1.2.2). In the last year of the simulation (2026), it is estimated to be 2.8 percentage points higher than in the baseline scenario. This is the result of a 0.5 percentage point impact on private consumption and an 8.9 percentage point impact on gross fixed capital formation.

The results of the simulations presented in this section differ from those reported in the 2023 NRP, and in particular the impacts on GDP at the end of the period are more than half a percentage point higher in the MEF simulations. The main difference with respect to the PBO assessment

[29] See Roeger W., J. Varga and J. in 't Veld (2008) , "Structural reforms in the EU: a simulation-based analysis using the QUEST model with endogenous growth", European Economy Economic Paper 351 and D'Auria F., A. Pagano, M. Ratto and J. Varga (2009), "A comparison of structural reform scenarios across the EU member states: Simulation-based analysis using the QUEST model with endogenous growth", European Economy Economic Paper 392.

[30] QUEST III R&D model (2020 version) is slightly modified in line with the assumptions used by the MEF, which however uses the 2018 version. The 2020 version is the latest version of the model made available by the European Commission and is calibrated on data updated to 2019 and thus more recent than in the 2018 version. In the 2020 version, the levels of private and public investment and public spending are higher, so their increase has a smaller impact on GDP, compared to the 2018 version.

carried out with QUEST model lies in the capital accumulation, which is higher in the NRP (12.4 percentage points in 2026) and, to some extent, in the consumption profile, which is also higher in the NRP (1 percentage point in 2026). One of the main reasons for these differences is the use of two different versions of the QUEST model, as the 2018 version used by the MEF produces larger impacts than the more recent version (2020) used by the PBO.

Note that the results reported in the NRP and Table B1.2.2 were obtained by assuming a high efficiency of public investment, meaning a higher elasticity of output to public capital. This assumption is based on the fact that investments in basic infrastructure, such as transport infrastructure, usually have a higher efficiency than other public investments. However, simulations assuming other levels of efficiency, both medium and low, for public investment compared to that assumed in the NRP can be conducted. As shown in Table B1.2.3, the difference in impact in the various scenarios is modest in the early years of the simulation but stronger in the later years, as public capital accumulates gradually, producing an increasing deviation over time in the impact of the interventions envisaged in the NRRP.

Table B1.2.2 – Macroeconomic impacts of the NRRP estimated with the QUEST III R&D model
(percentage changes compared with the baseline scenario)

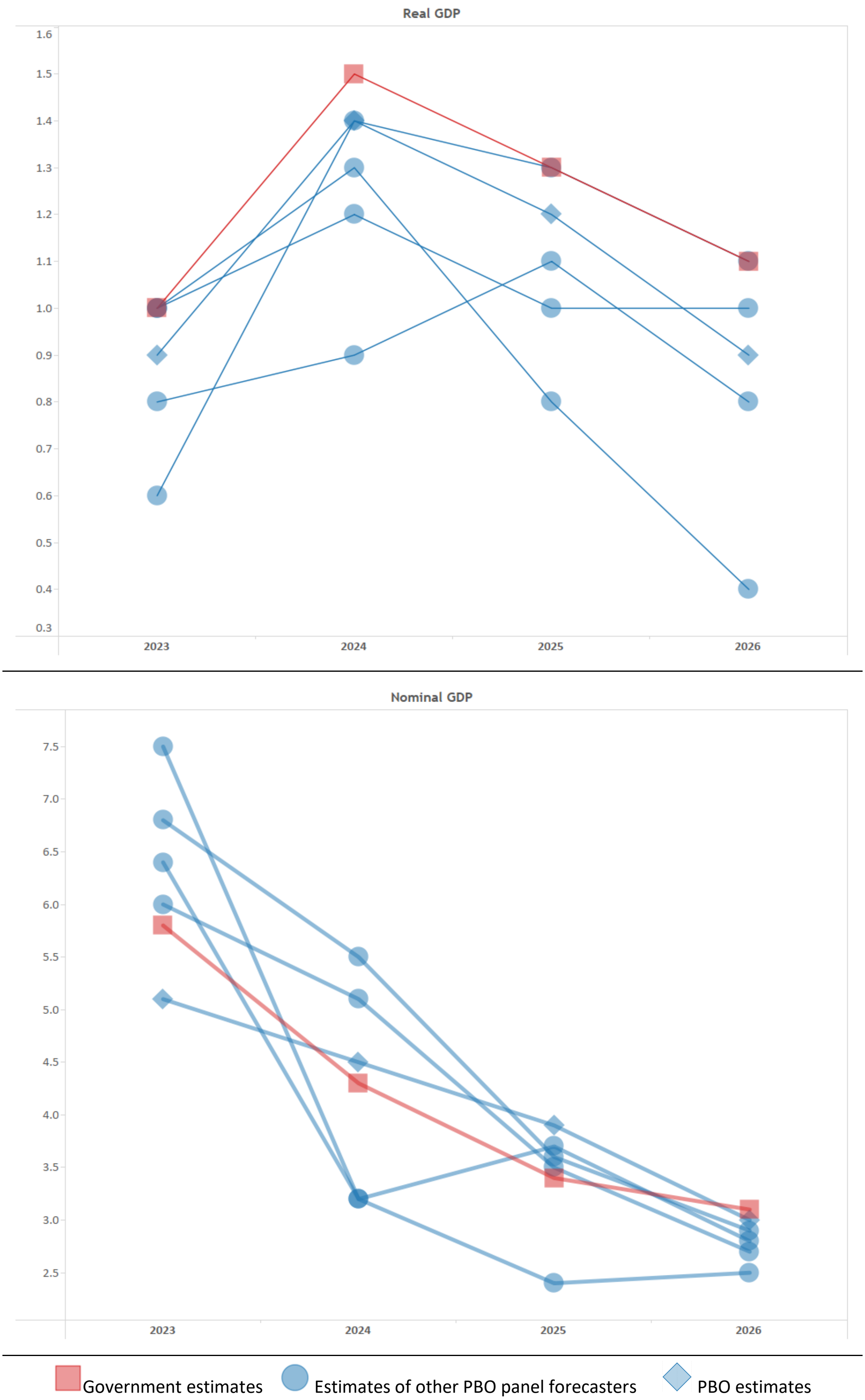
	2021	2022	2023	2024	2025	2026
GDP	0.0	0.1	0.7	1.5	2.4	2.8
Private consumption	-0.3	-0.5	-0.6	-0.5	-0.1	0.5
Gross fixed investment	0.7	2.2	4.9	8.5	10.2	8.9
Impact on annual growth	0.0	0.2	0.6	0.8	0.9	0.5

Table B1.2.3 – NRRP impacts on GDP for different levels of efficiency of public investment in the QUEST III R&D model
(percentage changes compared with the baseline scenario)

	2021	2022	2023	2024	2025	2026
High efficiency	0.0	0.1	0.7	1.5	2.4	2.8
Medium efficiency	-0.1	0.1	0.6	1.3	1.9	2.2
Low efficiency	-0.1	0.1	0.5	1.1	1.5	1.5

The PBO reported in April balanced short-term risks for the macroeconomic scenario of the Italian economy. Italy's GDP growth in the first quarter (0.6 per cent in quarterly terms) was then more favourable than both the MEF and the PBO panel had expected, thus currently indicating upside risks to this year's GDP estimates. On the other hand, the risk factors on Italy's macroeconomic outlook for the coming years (especially for 2024) remain tilted to the downside, as do expectations on global economy. The projections in the EFD macroeconomic framework for 2024 are confirmed to be at the upper end of even the most recent estimates of other institutions and private analysts.

Figure 1.15 – Real and nominal GDP, policy scenario



1.4 Ex post *assessment of the recent official macroeconomic forecasts*

The PBO has been carrying out retrospective assessments of the accuracy of macroeconomic projections since last year, as agreed in the memorandum of understanding on forecasts with the MEF.[31] In January 2022, a first analysis was published on the Government's forecasts since 2014, year in which the PBO started conducting its validation exercises, comparing them with the estimates made by the PBO and the European Commission.[32] An analysis of the differences between the official forecasts before and after 2014 (excluding 2020 in order not to reflect the COVID-induced recession) revealed that (Figure 16): (i) the Government's estimates of GDP, both real and nominal, until 2014 were on average optimistic (based on the average error diagnostics); (ii) after 2014 the forecasts became more balanced, especially regarding real GDP; iii) a positive distortion (optimism) continued to affect nominal GDP, becoming more pronounced as the forecast horizons increased, though partly attributable to the assumptions made on the public accounts' safeguard clauses; iv) the accuracy of the Government's forecasts (measured by the mean squared error) also improved after 2014.

In last year's Budgetary Planning Report the PBO presented similar data with regard to the last four years (2018-2021), the minimum period prescribed by European legislation.[33] The analysis carried out by the PBO showed that: i) the MEF's forecasts for the current year (year t) are slightly pessimistic regarding real GDP and substantially balanced for nominal GDP; ii) the estimates for subsequent years (t+n) are characterised by a very high positive bias, especially for the horizon (t+1).

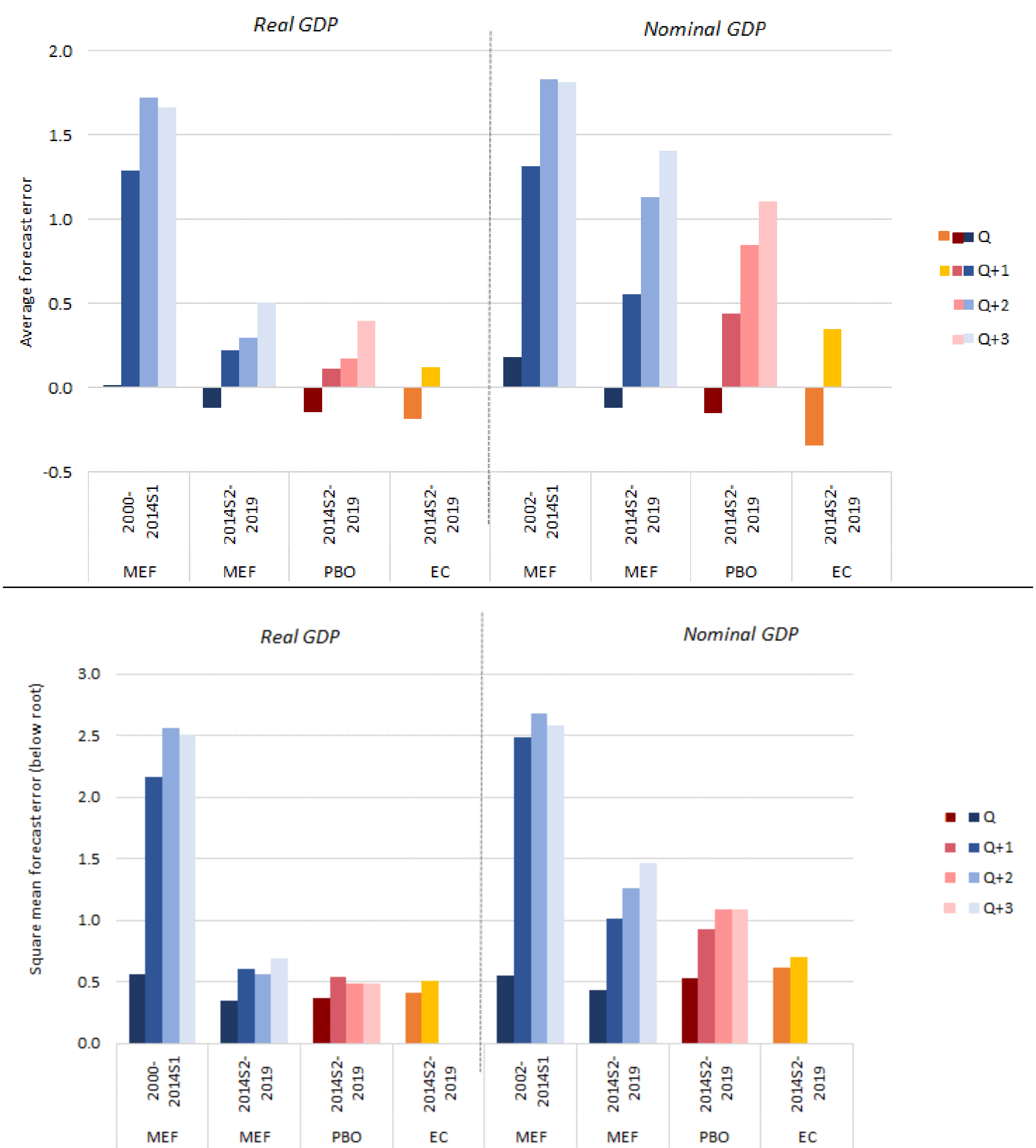
This section provides an updated error analysis of the official macroeconomic forecasts, including the latest available national accounts data (2022), for the period 2018-2022. The findings observed a year ago are substantially confirmed with the most recent data: (i) the forecasts made by the MEF, the PBO and the European Commission on real GDP are slightly pessimistic for the current year, while they appear optimistic for the wider horizons, especially for the following year and in particular in the case of the MEF; (ii) also in the case of nominal GDP, a high bias is observed on the year (t+1), which decreases for the more distant horizons; (iii) the orders of magnitude of the error are similar across the institutions and the error increases with the time horizon, as expected by the theory.

31 See 'Memorandum of Understanding between the Parliamentary Budget Office and the Ministry of the Economy and Finance'.

32 See Parliamentary Budget Office (2022), 'A retrospective assessment of the macroeconomic forecasts of the MEF and the PBO', Focus Paper no. 1, 20 January.

33 See Council Directive 2011/85/EU of the Council of the European Union of 8 November 2011 on requirements for budgetary frameworks of the Member States.

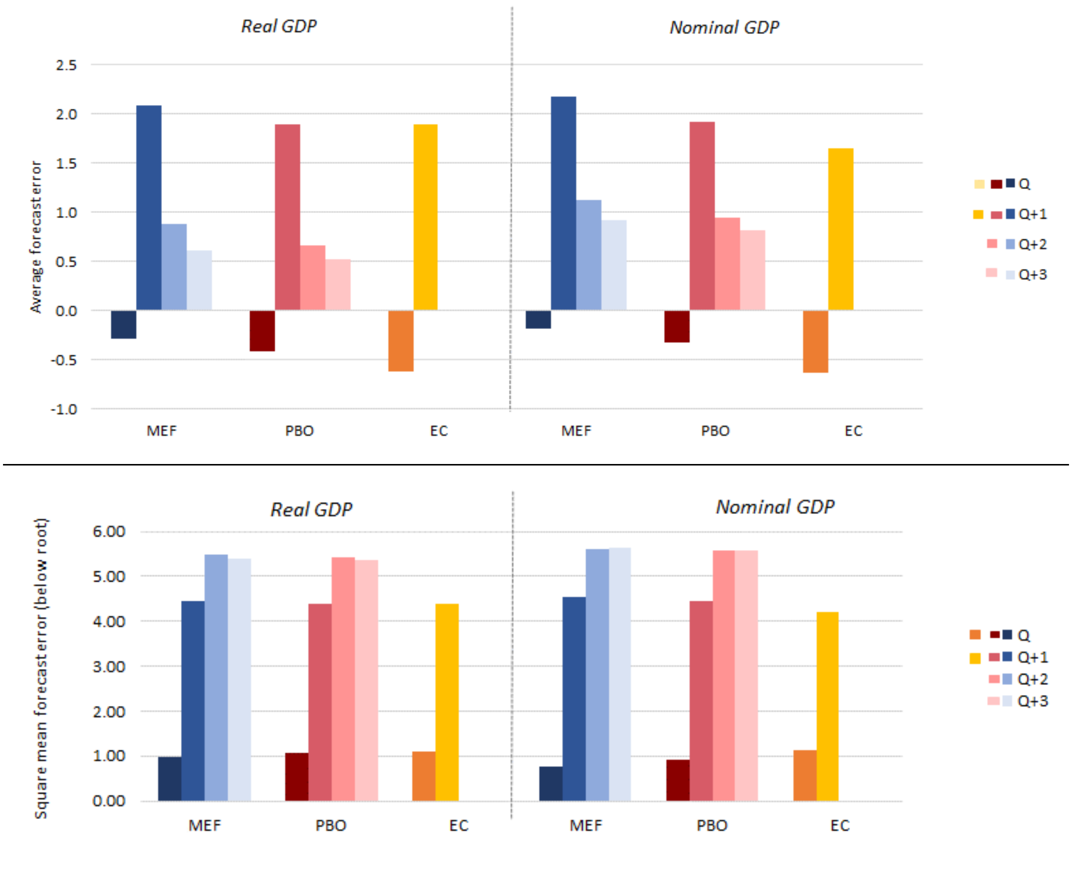
Figure 1.16 – Italy's GDP forecast error measures (1)



Source: based on forecasts by MEF, PBO and the European Commission.
(1) 2014S1 refers to the first half of 2014 and thus includes the 2014 EFD, while the 2014 EFD Update (first policy document validated by the PBO) falls in the following interval (2014S2-2019). The analysis period prior to 2014 excludes 2008 and 2012 as they were the first years of the crisis, which is consistent with the exclusion of the pandemic year 2020.

More in detail, for the current year (t) the forecast distortion on real GDP, measured by the average error, is similar among the three institutions considered (Figure 1.17 top panel), all being slightly pessimistic; the estimates for subsequent years are instead decidedly optimistic for all forecasters, especially with reference to the year immediately following the year of the forecast (t+1).

Figure 1.17 – Italy's GDP forecast error measures (2018-2022)



Source: based on forecasts by MEF, PBO and the European Commission.

Compared to last year, optimism for the horizons other than the current one (t) has largely decreased,but remained very high for the year (t+1); for this time horizon, forecasts were on average biased upwards by about two percentage points. The errors for years beyond the current one, for which the information from short-term forecasting models (nowcasting) is not available, depend heavily on exogenous assumptions, in particular those regarding the international environment; in this regard, an in-depth analysis of the assumptions on foreign demand, which is one of the most important exogenous variables in the forecast, is presented below.

With reference to nominal GDP, data over the last five years is similar to that reported for real GDP; a high distortion is observed over the year (t+1), which is somewhat more pronounced for the MEF and less marked for the European Commission, and which becomes smaller over the more distant horizons (t+2 and t+3) but remains in the order of one percentage point. Note that in the case of nominal GDP, the distortion on price trends for the years 2018 and 2019 could also be attributable to the VAT safeguard clauses, passed into law and then systematically removed, which the European Commission's forecasts did not consider.

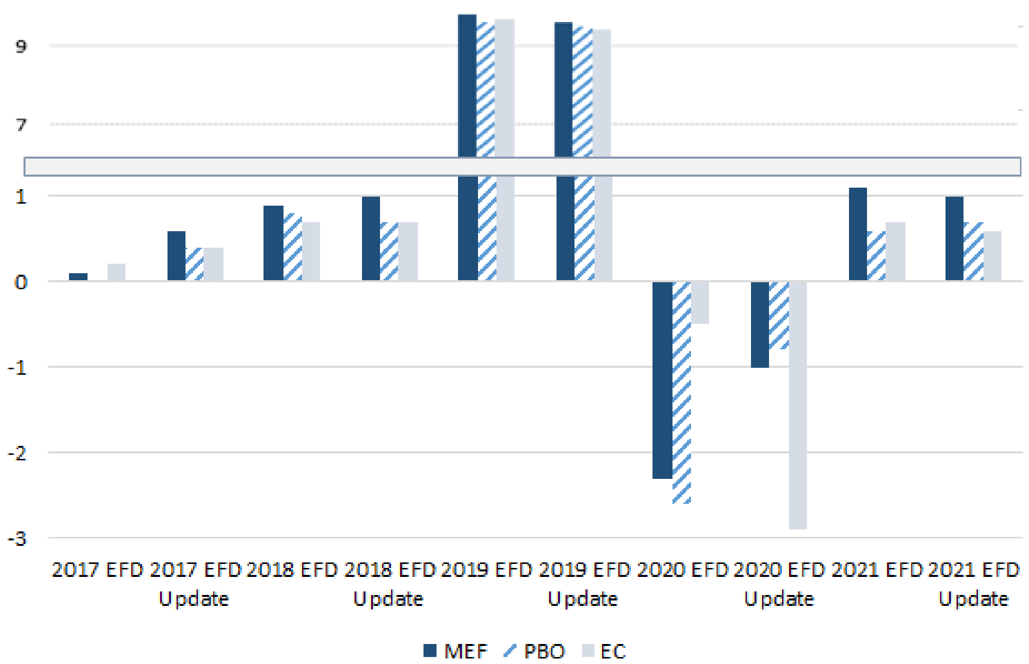
As regards the order of magnitude of the errors (measured by the mean squared error), the trends are similar among the three institutions (Figure 1.17 bottom panel); the errors tend to increase as the time horizon increases, as expected in the forecast literature, for both real and nominal GDP.

The distortion of estimates one year ahead (t+1) is of particular interest when assessing fiscal policy for at least two reasons. Firstly, public finance forecasts rely heavily on macroeconomic forecasts for future years, while for the year (t) they rather rely on timely indicators, such as monitoring (on revenues, expenditures and debt) available during the year; furthermore, the fiscal package is prepared in the preceding year, in the autumn, so that the Government's macroeconomic forecasts for the horizon (t+1) have a non-negligible impact on the margins for budgetary manoeuvre.

The error committed by the MEF in its one-year ahead forecasts of real GDP (Figure 1.18) has been similar to that of other forecasters over the last five years, although slightly larger except in two cases: in the 2021 EFD when the PBO's error was slightly larger and in the 2021 EFD Update, when the European Commission's error was much more pronounced.

However, the above analyses are very much affected by the shock caused by the COVID-19 pandemic: the collapse of economic activity in 2020, the strongest in peacetime, could not have been anticipated, and thus the growth rates of the recovery phase (in 2021 and 2022) could also be hardly predicted. Net of the anomalous data, the distortion of forecasting errors is much smaller, but still not negligible, for all forecasters, especially for the MEF.

Figure 1.18 – Year t+1 forecast errors in real GDP (1)



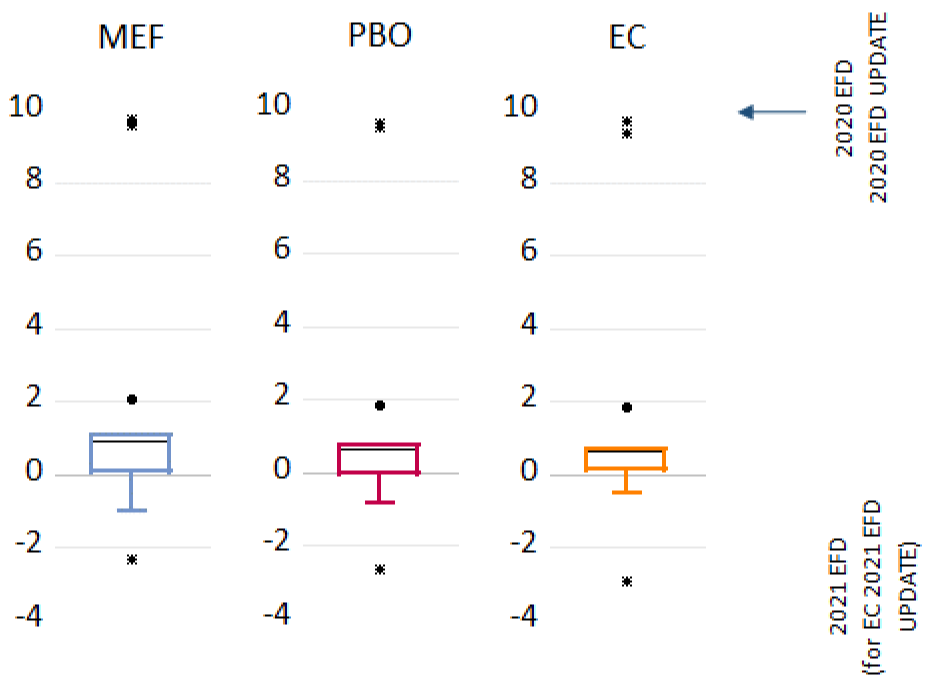
(1) The y-axis has been cut to better show the graph, the 2020 values being of much higher magnitude than the rest of the data.

One way to remove outliers is to analyse the distribution of errors using the box-plot, a graph of the distribution of observations in which the outliers are isolated outside the range of variation of the most frequent data (represented by the rectangle in the middle).

The box-plot (Figure 1.19) shows that net of the 2020 and 2021 outliers, the error in the forecast of real GDP one year ahead (t+1) appears much smaller, although not negligible. However, all the estimates are characterised by a positive bias (indicating optimism), slightly more pronounced in the case of the MEF errors, which are also slightly more dispersed.

Although the analysis presented so far focused on the last five years, in order to assess the most recent forecasts it is possible to focus on the estimates provided in the official forecast documents (EFD and EFD Update) referring to the last available year, i.e., 2022.[34] Real GDP forecasts for 2022 (Figure 1.20) were pessimistic before the pandemic and optimistic after 2020, only to converge last autumn to the achieved value (3.7 per cent).

Figure 1.19 – Box-plot of forecast errors on real GDP for year t+1 (1)

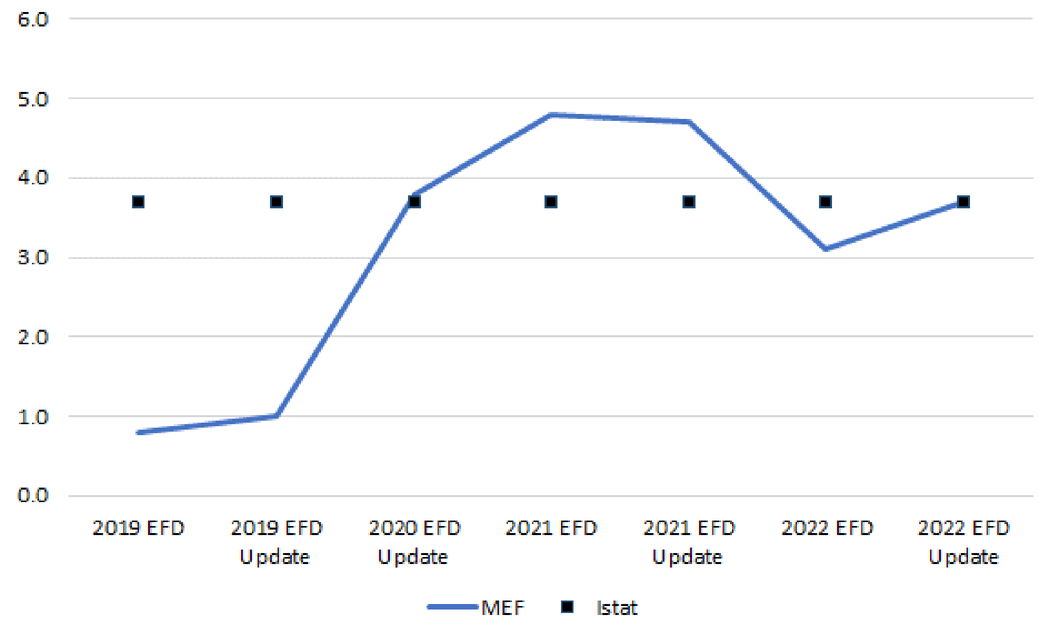


Source: based on forecasts by the MEF, PBO and European Commission.
(1) The box-plot provides a summary statistical representation of a data distribution. The central (black) line in the box represents the median of the data. If the data are symmetric, the median is in the middle of the box. If, on the other hand, the data are asymmetric, the median will be closer to the top or the bottom of the box; differences between median and mean define the asymmetry of the distribution; the dot (black) represents the mean; the bottom and top of the box correspond to the 25th and 75th percentile; the vertical lines (tails), which extend from the top and bottom of the box indicate the maximum and minimum of the data excluding outliers; data falling more than 1.5 times the deviation between 75th and 25th percentile, both in the upper and lower part of the box, are indicated with asterisks and are considered as outliers.

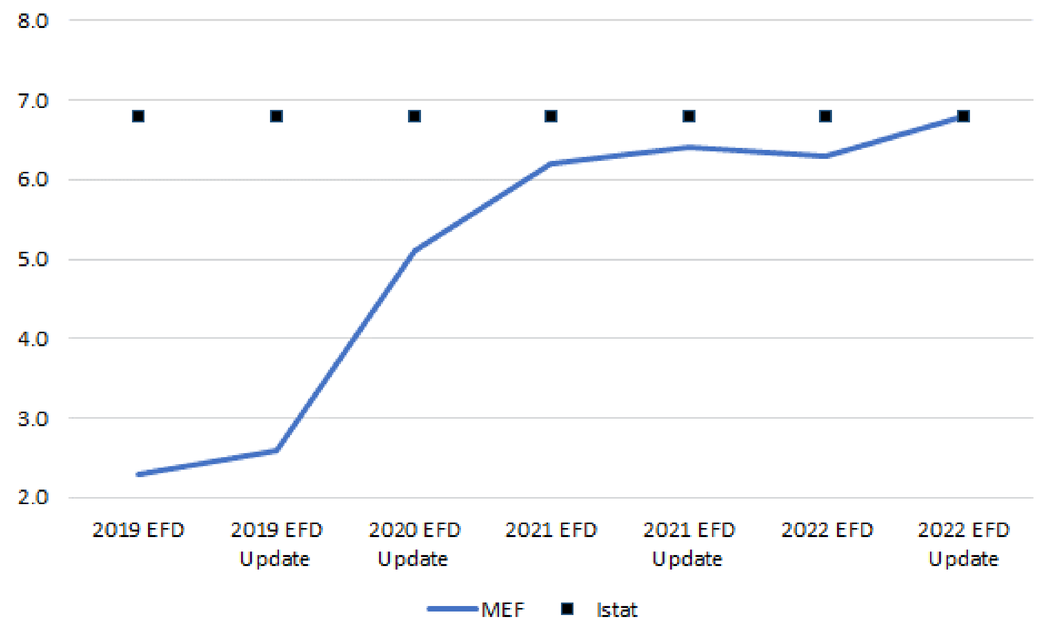
[34] Similarly, in last year's PBO Report, the same reconstruction was carried out with reference to 2021.

Figure 1.20 – GDP forecasts for the year 2022 in the official policy documents (1)
(annual percentage changes)

Real GDP



Nominal GDP



Considering that official forecasts have a four-year horizon (up to t+3) the first document with a forecast for 2022 is the 2019 EFD, which is therefore the first to appear on the x-axis of Figure 1.20. Prior to the pandemic, growth in 2022 was estimated by the MEF at around one per cent, a value close to historical averages; with the outbreak of the health emergency the forecast improved as a recovery in growth rates was anticipated to compensate for the drop in 2020 (-9.0 per cent); expectations of a recovery gradually strengthened, until the 2021 EFD forecast a slightly below five per cent growth. In the spring of 2022, shortly after the outbreak of the war in Ukraine, the estimates were sharply reduced to around three per cent; at the end of last year, with timely economic information available, the forecasts became more accurate. In the autumn of 2022, the forecast of real GDP was accurate, although when making a historical comparison it should be kept in mind that the forecast was produced later than the usual timetable for official planning documents; the new Government in fact published a revised and supplemented EFD Update in early November, thus including the GDP figure for the third quarter of the year, which is generally not available when drawing up the EFD.

The nominal growth forecasts for 2022 were relatively less volatile than those for real GDP. They rebounded after the pandemic and gradually increased, but unlike those for real growth, they always remained below the actual value, as the inflationary wave, which peaked precisely in 2022, was generally underestimated.

With regard to 2023, for which no annual data are yet available, the forecasts by the various organisations can only be reconstructed. Last autumn, when the last EFD Update was prepared, several forecasters were predicting a recessionary phase between the end of 2022 and the beginning of 2023, as a result of fears concerning gas availability, as well as a surge in gas prices. However, in the early months of this year, the outlook has already improved, also due to the fall in the price of gas, attributable in no small measure to favourable weather conditions. As a result, GDP estimates for 2023 have been revised upwards, approaching one per cent in recent months (Table 1.1). By contrast, forecasts for 2024 have gradually deteriorated; part of the growth was reassigned to 2023, but downside risks prevail for the coming years.

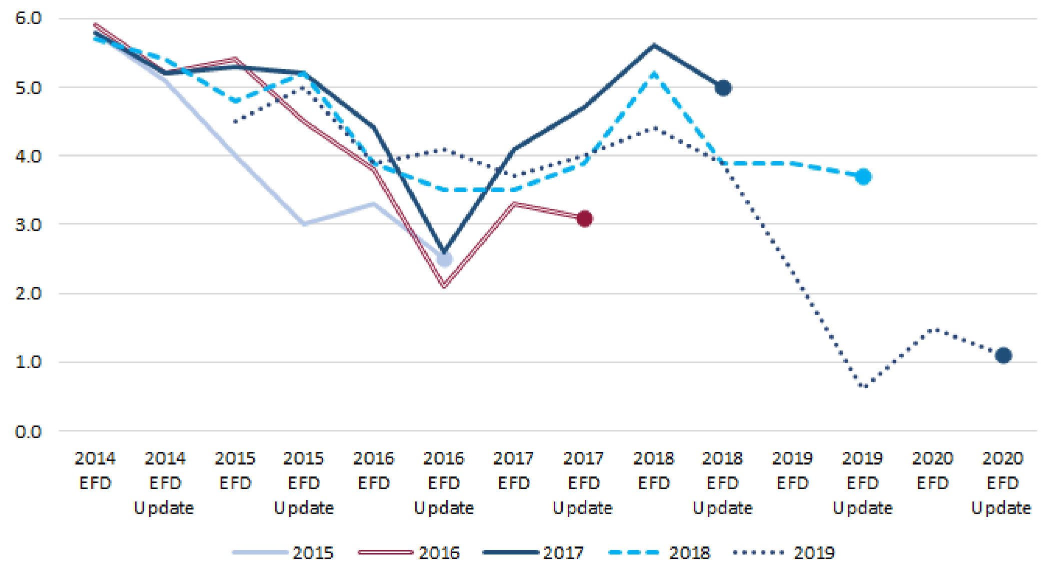
Table 1.1 − Italian real GDP forecasts of different institutes (1)

	2023			2024		
	Sept-Oct 2022	Jan-Feb 2023	Mar-Apr 2023	Sept-Oct 2022	Jan-Feb 2023	Mar-Apr 2023
Oxford Economics (2)	-0.3	0.0	1.1 (4)	1.4	1.0	0.9 (4)
Consensus Economics (2)	-0.1	0.0	0.8 (4)	1.3	1.1	0.9 (4)
European Commission	0.3 (3)	0.8	1.2 (4)	1.1 (3)	1.0	1.1 (4)
Prometeia (2)	0.1	-	1.0 (4)	1.0	-	1.0 (4)
OECD	0.2 (3)	-	0.6	1.0 (3)	-	1.1
Confindustria Study Centre	0.0	-	0.4	-	-	1.2
Bank of Italy (2)	0.3	0.6	-	1.4	1.2	-
International Monetary Fund	-0.2	0.6	0.7	-	0.9	0.8
MEF	0.6		1.0	1.9		1.5

(1) Institutes are displayed in the table in descending order according to the most recently published forecast. − (2) Working-day adjusted figure − (3) Forecast published in November 2022 − (4) Forecast published in May 2023, thus including the Istat GDP figure for Q1 2023.

GDP forecast revisions are often largely the result of changes in the international outlook; in this regard, note that in recent years assumptions on the evolution of global dynamics have been widely revised by international institutions, mostly downwards. For example, in the five years prior to COVID, the MEF systematically downgraded its estimates for foreign demand from markets relevant to Italy. Figure 1.21 shows the evolution of expectations on foreign demand as assumed in the various policy documents; the prevailing negative slope in the various broken lines indicates that the historical figure, identified in the last figure of each line, was almost always lower than that assumed in the policy documents.

Figure 1.21 – Revisions in the assumptions on foreign demand for Italy in the official policy documents (1)
(percentage changes)



Source: MEF, policy documents from 2014 to 2020.
(1) The single line represents various forecasts for the percentage change in foreign markets relevant to Italy (indicated on the y-axis) for the year reported in the legend; since the same year has been forecast more than once over time, the evolution of the forecasts in the various policy documents is shown on the x-axis. The first point to the left of each line therefore identifies the first forecast, while the last point to the right (highlighted with a dot) indicates the final forecast, which is assumed to be the historical figure.

2. PUBLIC FINANCE IN 2022 AND IN 2023-26

2.1 Public finance in 2022: results compared with initial forecasts and targets

General government deficit and debt in 2022: main results

General government deficit in 2022 amounted to 8 per cent of GDP, down from the previous year − when it stood at 9 per cent − but still high for the third consecutive year. After the pandemic-related deficits that characterised 2020-21, last year was particularly affected by both the repeated interventions aimed at tackling the effects of the energy crisis and the new accounting reclassification of certain building bonuses (so-called Superbonus and Façade Bonus), which were introduced mainly to counteract the negative impact of the pandemic on economic growth, but whose effect was in fact delayed. These developments were partly offset by a good revenue trend also linked to inflation and a lower than expected use of the measures to counter the previously mentioned effects of the energy crisis.

Also contributing to the higher deficit was interest expenditure, which was around EUR 20 billion higher than in the previous year. This increase resulted both from the rise in yields on fixed-income securities due to the implementation of a restrictive monetary policy by the ECB and, above all, from the marked increase in the price of inflation-indexed securities. As a result, after eight years of consecutive reductions until 2020 and an increase of more than 10 per cent in 2021, debt service payments again rose significantly in 2022, by more than 30 per cent.

Net of the new accounting rules for construction bonuses (considered by the statistical authorities as payable credits and thus recorded on an accrual basis instead of the former cash basis), the decline in the deficit would have been larger in 2022: the deficit would have amounted to 5.7 per cent of GDP (see Box 2.1 'The deficit net of the new classification of building bonuses (Superbonus and Façade Bonus)'), just above the 5.6 per cent target set in the EFD Update of September 2021 and maintained until the DBP of November 2022.

The public debt-to-GDP ratio, which was not affected by the accounting reclassification of the Superbonus and Façade Bonus, stood at 144.4 per cent at the end of 2022, down 5.5 percentage points from 149.9 per cent in the previous year, as a result of the favourable effects of both the so-called snow-ball effect component, i.e. the differential between the contribution of nominal GDP and interest expenditure (by 5,2 percentage points), and of the stock-flow adjustment-to-GDP component (by 3.9 percentage points), including the impact of the accounting reclassification of tax credits related to the Superbonus and Façade Bonus (a consequence of the cash and accruals classification difference mentioned earlier), against the unfavourable impact of the primary deficit-to-GDP ratio (by 3.6 percentage points of GDP) (see also Box 2.2 'Characteristics of the public debt stock at the end of 2022').

Box 2.1 – The deficit net of the new classification of building bonuses (Superbonus and Façade Bonus)

Based on the contents of Eurostat's 2022 Manual on Deficit and Debt,[35] the benefits related to the Superbonus and Façade Bonus – the only building bonuses for which the accounting reclassification was carried out –, given the certainty of the amount and their full or almost full availability over time due to the possibility of being transferred to third parties,[36] have been classified as payable credits.[37] As a result, they were recorded for the full amount accrued as an increase in expenditure in the general government account in the year in which the obligation arises, i.e. the year in which the subsidised expenditure is incurred (accrual basis). The impact on the government accounts was thus brought forward from previous forecasts and concentrated mainly in 2020-22 as higher investment subsidies. Prior to these revisions, the impact of the measures was recorded as a reduction in tax revenues in the years of actual use of the relief (cash basis).

In particular, the investment subsidies for 2020 and 2021 were revised upwards by EUR 2.4 billion and EUR 36.5 billion, respectively, while for 2022 the revision amounted to EUR 50 billion. In addition, there was an upward revision of revenues (so-called 'grossing-up'), as with the new accounting approach, the annual revenue is not reduced by the tax offsets associated with these bonuses. Given that the tax bonuses are distributed over several years, this change is of a much smaller magnitude than the increased expenditure revision. In 2022, the increase in direct taxes attributable to this is quantified by the Government at around EUR 5.5 billion; this effect is much smaller in 2021 and nil in 2020 since the tax offsets can be made from the year after the expenditure is made. At the same time, again in order to comply with the accounting conventions established at EU level, the other current and capital revenues have also been revised in relation to the different amounts of subsidies related to the NGEU programme, since some of the related projects provide for the financing of part of these measures.[38]

Therefore, in order to assess the deficit net of the effects of these new accounting rules, it is necessary to carry out a number of operations on individual items in the general government account. First of all, investment subsidies to households must be decreased by about 50 billion; secondly, direct taxes (specifically, IRPEF) must be decreased by about 5.5 billion and, at the same time, other current revenues (specifically, international aid) must be increased by the same amount, to take into account the previous accounting of EU subsidies allocated to this operation by the NRRP; finally, other capital revenue (specifically, other capital transfers from the Rest of the World) has to be decreased by about EUR 7 billion, to remove the new accounting of the effect of EU grants linked to outbound investment grants. After these adjustments, net borrowing would amount to 5.7 per cent of GDP, just above the Government's previous estimate (5.6 per cent).

Starting in July 2022, in order to counter inflationary pressures in the euro area, the Governing Council of the ECB started to tighten monetary policy, first by terminating the net purchases of financial assets under the Asset Purchase Programme (APP) as of 1 July and then by progressively raising the key policy interest rates, with four interventions that increased the policy rates by a total of 2.5 percentage points in 2022.

[35] The Manual was published by Eurostat on 1 February.

[36] Eligibility is no longer linked to the tax capacity of a single party (the original beneficiary) but of several parties (original beneficiary and assignee of the credit). Moreover, the transfer of the credit assumes that the assignee has made an initial assessment of its ability to offset the amounts taken up against its overall tax liability.

[37] For the accounting processing of the building bonuses and the consequences on public accounts, see Parliamentary Budget Office (2023), 'Hearing of the Chair of the Parliamentary Budget Office as part of the fact-finding inquiry on the macroeconomic and public finance effects of building tax incentives', 16 March.

[38] Note that these subsidies have no impact on the deficit as the expenditure financed with these funds is covered by incoming transfers from the EU.

In 2022, the Eurosystem's purchases of financial assets on the secondary market were thus significantly reduced compared to 2021. As far as Italian government bonds are concerned, a total of around 42 billion securities were purchased in the secondary market (of which 14 billion under the APP programme and an estimated 28 billion under the PEPP), down by more than 100 billion compared to the previous year.

Due to the end of the Eurosystem's net purchases of government bonds, the private sector as a whole returned, after a number of years, to absorb an additional amount of government debt, albeit of a still modest size in 2022 (estimated at around EUR 2 billion; see Box 2.5 'The impact of Eurosystem programmes on the Italian Government bond market' in Section 2.2).

General government deficit and debt in 2022: estimates and initial targets

An initial overview. – After an initial revision, the net borrowing-to-GDP targets for 2022 were confirmed following the presentation of subsequent official documents, albeit with different trend estimates, updated over time (Table 2.1). In particular, the 2021 EFD Update projected a net borrowing of 5.9 per cent of GDP for 2022. From the 2021 EFD Update onwards, the Government reduced the deficit target to 5.6 per cent. As described above, net of the new accounting classification of the Superbonus and Façade Bonus, the deficit target was only marginally exceeded (5.7 per cent). The revision of the debt-to-GDP target in the following official documents was more marked: from 156.3 per cent in the 2021 EFD to 145.7 per cent in the 2023 DBP. As shown above, at the end of the year the debt stood at 144.4 per cent of GDP (see Box 2.2 'Characteristics of the stock of public debt at the end of 2022'), thus below the target set in the 2021 EFD and the targets later revised.

With regard to budgetary measures, the evolution of public accounts in 2022 was marked, in particular, by the impacts of the measures to counter the energy emergency. After the measures introduced in 2021, those contained in the Budget Law for 2022, and those enacted in the first part of last year (the latter with financial coverage), four requests for deviation from the adjustment path toward the medium-term objective (MTO) were made through the Reports to Parliament drawn up pursuant to Article 6 of Italian Law No. 243 of 2012[39] (Table 2.2), followed by nine implementing Decree Laws (Table 2.3) and provisions contained in seven inter-ministerial decrees.

[39] The Report to Parliament, envisaged by Law 243/2012, must be used by the Government to request parliamentary authorization to deviate from the MTO or from the adjustment path towards the MTO with respect to what was previously authorized. Article 6, paragraph 3 of Law 243/2012 defines the conditions and the procedure to be followed in the case of an exceptional event, in compliance with Article 81 of the Constitution. If, in order to cope with an exceptional event, it is deemed indispensable to temporarily deviate from the MTO, the Government, having consulted the European Commission, shall submit to Parliament a report updating the public finance targets, as well as a specific request for authorization indicating the extent and duration of the deviation, establishing how the resources available as a result of the deviation are to be used, and defining the adjustment path to meet the MTO, adjusting its duration to the severity of the events. The adjustment path shall be implemented with effect from the financial year following those

Table 2.1 – Official documents: Estimates, targets and results for general government and GDP – Year 2022
(EUR billion and percentage changes)

	Trend estimates							Targets						
					GDP							GDP		
	Net borrowing	Primary balance	Interest expenditure	Public debt	Real growth	Nominal growth	Current prices	Net borrowing	Primary balance	Interest expenditure	Public debt	Real growth	Nominal growth	Current prices
2021 EFD (April 2021)	-100.0	-45.2	54.7		4.3	5.6	1,835.8					4.8	6.2	1,851.6
(as % of GDP)	*-5.4*	*-2.5*	*3.0*	*154.7*				*-5.9*	*-3.0*	*3.0*	*156.3*			
2021 EFD Update (September 2021)	-82.9	-27.6	55.3		4.2	5.8	1,883.4					4.7	6.4	1,892.5
(as % of GDP)	*-4.4*	*-1.5*	*2.9*	*148.8*				*-5.6*	*-2.7*	*2.9*	*149.4*			
2022 DPB and NTI (November 2021 and January 2022)	-81.7	-26.4	55.3		4.2	5.8	1,883.4	-105.0	-49.7	55.3		4.7	6.4	1,892.5
(as % of GDP)	*-4.3*	*-1.4*	*2.9*					*-5.6*	*-2.6*	*2.9*	*149.4*			
2022 EFD (April 2022)	-95.2	-29.2	65.9		2.9	6.0	1,882.7					3.1	6.3	1,887.0
GDP)	*-5.1*	*-1.6*	*3.5*	*146.8*				*-5.6*	*-2.1*	*3.5*	*147.0*			
2022 EFD Update and 2023 DPB (September and October 2022)	-96.8	-21.6	75.2									3.3	6.4	1,896.2
(as % of GDP)	*-5.1*	*-1.1*	*4.0*	*145.4*										
2022 EFD Update Revised and integrated version 2022)	-97.6	-20.3	77.2		3.7	6.8	1,903.3					3.7	6.8	1,903.3
GDP)	*-5.1*	*-1.1*	*4.1*	*145.2*				*-5.6*	*-1.5*	*4.1*	*145.7*			
2023 DBP and NTI (November 2022 and January 2023)	-97.6	-20.3	77.2		3.7	6.8	1,903.3	-106.6	-29.4	77.2		3.7	6.8	1,903.3
(as % of GDP)	*-5.1*	*-1.1*	*4.1*					*-5.6*	*-1.5*	*4.1*	*145.7*			
								Results						
Istat (1 March 2023)								-153.4	-70.2	83.2		3.7	6.8	1,909.2
(as % of GDP)								*-8.0*	*-3.7*	*4.4*				
Istat and Bank of Italy (5 April and 7 April 2023)								-151.9	-68.7	83.2		3.7	6.8	1,909.2
(as % of GDP)								*-8.0*	*-3.6*	*4.4*	*144.4*			

Source: Italian Ministry of Economy and Finance, Istat and Bank of Italy.

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for which the deviation is authorized, taking into account the evolution of the economic cycle. The resolution by which each Chamber authorizes the deviation and approves the recovery plan is to be adopted by an absolute majority of its members. According to Paragraph 5, the adjustment path may be updated in the same manner as described above in case of further exceptional events or should the Government wish to make changes to it based on the economic cycle.

Through the latter decrees, the MEF prepared price mitigation measures using the higher-than-expected revenues resulting from the effects of the oil price increase on VAT.[40] Also to be considered are the measures introduced on the occasion of the budget adjustment law.

The decree-laws approved in total in 2022 are: Decree Laws No. 4, No. 17, No. 21 (incorporating DL 38), No. 50 (incorporating DL 80), No. 115, No. 144 (incorporating DL 153), and No. 176 (incorporating DL 179) of 2022; those adopted in March, April, June, July, August, September and October 2022 are the inter-ministerial decrees.

Table 2.2 – Deviations requested via Reports to Parliament: effects on general government net borrowing
(EUR billion)

	Year 2022
Report of 6 April	-10.5
Report of 26 July	-14.3
Report of 8 September	-6.2
Report of 4 November	-9.1
Total deviations requested	**-40.1**

Source: Reports to Parliament pursuant to Article 6 of Italian Law No. 243/2012.

Table 2.3 – Decrees implementing the Reports to Parliament: effects on general government net borrowing
(EUR billion)

	Year 2022
DL 21/2022, 21 March (with DL 38/2022, 2 May)	-2.1
DL 50/2022 (Aiuti), 17 May (with DL 80/2022, 30 June)	-8.4
DL 115/2022 (Aiuti *bis*), 9 August	-14.3
DL 144/2022 (Aiuti *ter*), 23 September (with DL 153/2022, 20 October)	-6.2
DL 176/2022 (Aiuti *quater*), 18 November (with DL 179/2022, 23 November)	-9.0
Total decrees effects	**-39.9**

Source: Summary tables of the financial effects attached to the Decree Laws.

[40] According to the provisions of Article 1, paragraph 290 of Italian Law 244/2007: 'From the date of entry into force of this law, for the purposes of protecting the citizen-consumer, by decree of the Italian Minister for the Economy and Finance, in agreement with the Italian Minister for Economic Development, the rates of excise duties on energy products used as fuels or as heating fuels for civil uses, established by the Consolidated Text of Legislative Provisions on Taxes on Production and Consumption and related criminal and administrative sanctions, referred to in Italian Legislative Decree No. 504 of 26 October 1995, and subsequent amendments, are decreased in order to offset the higher value added tax revenues deriving from variations in the international price, expressed in euros, of crude oil'.

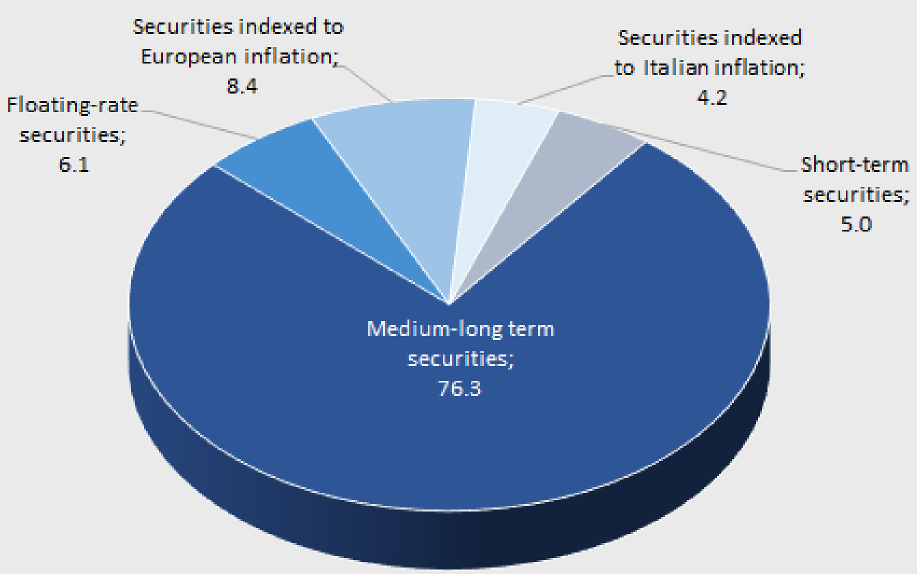
Box 2.2 – Characteristics of the stock of public debt at the end of 2022

As at 31 December 2022, the nominal level of public debt amounted to EUR 2,757 billion (or 144.4 per cent of GDP), an increase of approximately EUR 77 billion compared to the end of 2021. With reference to the financial instruments comprising public debt, negotiable securities of the State, other central governments and local authorities accounted for 82.7 per cent of the consolidated stock, loans and other non-negotiable liabilities for 9.4 per cent, and coins and deposits for 7.9 per cent. Included in the share of loans are liabilities related to EU programmes, of which EUR 27.4 billion related to the SURE (Support to Mitigate Unemployment Risks in an Emergency) programme and EUR 37.9 billion related to the NGEU programme.

With regard to the aggregate of government securities, 97.9 per cent of the stock consisted of domestic securities and the remaining 2.1 per cent of securities issued on international markets (both in euro and in foreign currency). Specifically, the stock of domestic government securities consisted of medium-long term fixed-rate securities (76.3 per cent), inflation-indexed securities (12.6 per cent, of which 8.4 per cent indexed to European inflation and 4.2 per cent to Italian inflation), floating-rate securities (indexed to the 6-month Euribor rate) (6.1 per cent) and short-term securities (5 per cent) (Figure B2.2.1).

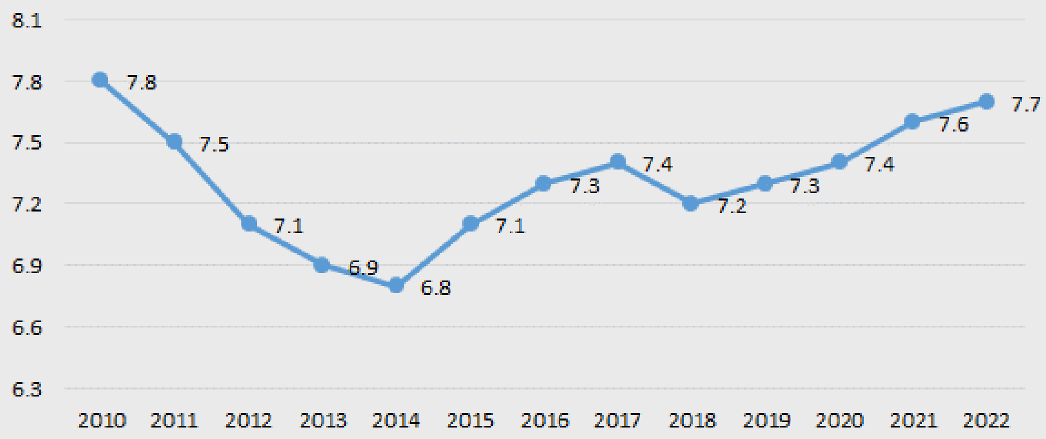
The average maturity of the stock of government bonds amounted to 7.04 years at the end of 2022, slightly shorter than the previous year (7.11 years). A different conclusion is reached when considering the total debt of general government; in fact, although the share represented by EU loans – around 2.5 per cent – is small, their high duration has allowed the average maturity of the stock of general government bonds to lengthen. It was slightly longer in 2022 than in the previous year, standing at 7.7 years, and continuing to rise, for the fourth consecutive year, from the value of 7.2 recorded at the end of 2018 (Figure B2.2.2).

Figure B2.2.1 – Domestic government bond breakdown at the end of 2022
(percentages)



Source: based on MEF data.

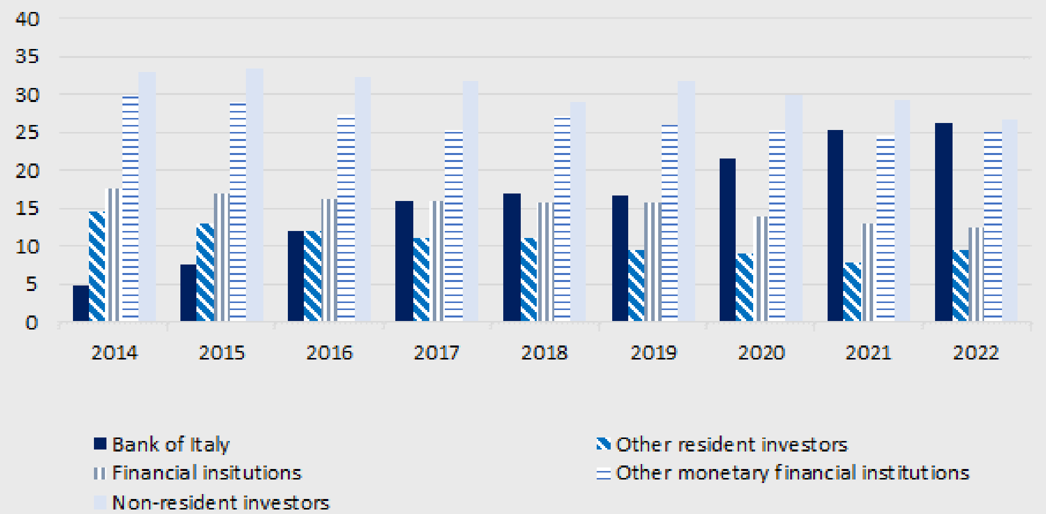
Figure B2.2.2 – Average residual maturity of general government debt
(years)



Source: Bank of Italy.

With regard to the breakdown by debt holders (Figure B2.2.3), at the end of 2022, there was a reduction of about 2.4 percentage points compared to the end of 2021 in the share of debt held by non-residents, which stood at 26.8 per cent,[41] compared to an increase of 1.6 percentage points in the share of debt held by other resident investors (i.e. mainly households and businesses), which stood at 9.5 per cent, and an increase of 0.9 percentage points in the share held by the Bank of Italy, which stood at 26.2 per cent. The shares of the other debt-holding sectors, namely of financial institutions (i.e. mainly mutual funds) and other monetary financial institutions (i.e. mainly banks) remained substantially stable compared to 2021, at 12.5 per cent and 25 per cent respectively.[42]

Figure B2.2.3 – General government gross debt: breakdown by holder sectors
(as a percentage)



Source: based on Bank of Italy data.

[41] The lowest share held by non-resident investors in the last twenty years.

[42] The 'Other monetary financial institutions' are resident banks and other monetary financial institutions; 'financial institutions' are financial intermediaries (SIMs, SICAVs and mutual funds), financial auxiliaries, insurance companies and pension funds. The 'Other resident investors' aggregate includes households and non-profit institutions serving households, and non-financial corporations. The 'Non-residents' aggregate includes, inter alia, securities acquired by the Eurosystem, except those held by the Bank of Italy, as part of its secondary market purchase programmes for government bonds.

In 2022 overall, the *ex ante* estimated gross burdens of the measures taken to mitigate the effects of the energy crisis amounted to EUR 70 billion, or 3.7 per cent of GDP (Table 2.4). The actual *ex post* results, as mentioned, were lower than expected, particularly with regard to tax credits. Moreover, these costs were partly offset by lower expenditure in other areas or higher revenues. However, a major source of coverage, namely the extraordinary contribution on extra profits of companies operating in the electricity, gas and oil sectors, provided less resources than initially expected.

The measures to counter the effects of the energy crisis fall into four types (Table 2.5) (for measures benefiting households, see Chapter 5). First, general energy price containment measures affecting taxes or regulated price components were introduced. These are, in particular, the compensation of general system charges for both electricity and gas, the lowering of excise duties on fuels, and the reduction to 5 per cent of VAT on gas for civil and industrial use.

In addition to these price interventions, measures have been enacted to support households with different forms of money transfers, in order to alleviate the pressure of inflation on family budgets. This includes interventions specifically aimed at families in economic hardship and physical distress, such as the increase in energy bonuses, and other interventions of a more general nature aimed at a wider group of recipients, such as one-off allowances distributed according to individual income, the exemption from social security and welfare contributions for employees with a certain monthly salary and having no effect on the rate at which benefits are calculated, the anticipation of the adjustment for the equalising calculation of pensions in 2021, and the 2 per cent revaluation of pensions paid in the months of October to December 2022.

Table 2.4 − Inflation mitigation measures: breakdown by measure − Effects on general government net borrowing
(billions of euro)

	Year 2022
2022 BL	4.0
DL 4/2022 (Sostegni *ter*), 27 January	1.7
DL 17/2022 (Sostegni *quater*), 1 March	6.0
MD 18/03/2022	0.3
DL 21/2022, 21 March (with DL 38/2022, 2 May)	5.4
MD 06/04/2022	0.3
DL 50/2022 (Aiuti), 17 May (with DL 80/2022, 30 June)	14.9
MD 24/06/2022	0.9
MD 19/07/2022	0.7
DL 115/2022 (Aiuti *bis*), 9 August	13.3
MD 31/08/2022	0.5
MD 13/09/2022	0.4
DL 144/2022 (Aiuti *ter*), 23 September (with DL 153/2022, 20 October)	14.7
MD 19/10/2022	0.1
DL 176/2022 (Aiuti *quater*), 18 November (with DL 179/2022, 23 November)	5.7
State Budget Adjustment	1.0
Total effects	**70.0**
As a percentage of GDP	*3.7*

Source: Summary tables of financial effects annexed to the decrees.

Table 2.5 – Inflation mitigation measures: breakdown by type (1)
(billion euros)

	Year 2022
Total	**70.0**
As a percentage of GDP	*3.7*
1) System charges	12.4
Energy	*9.0*
Gas	*3.4*
2) Lowering of excise duties on gasoline, diesel and LPG and lowering of VAT on gas for road transport	9.2
3) Lowering of VAT for civil and industrial use	2.5
4) Social bonuses (energy and gas)	3.2
5) One-off allowances (2)	9.9
6) Exemption from social security and pension measures	2.6
7) Tax credits	20.3
Energy	*11.9*
Gas	*8.3*
8) Additional measures	9.9
Local authorities	*1.6*
National Health Service	*1.7*
Investments	*3.9*
Other	*2.7*

Source: Summary tables of financial effects annexed to the decrees cited in Table 2.4.
(1) Totals may not match due to rounding of decimals. – (2) In favour of workers and pensioners, NASPI, DIS-COLL and Minimum Income Scheme (*Reddito di cittadinanza, RdC*) recipients.

A third type of intervention involved tax credits provided for different categories of companies (energy- and gas-intensive e non-intensive companies) in order to offset the higher costs, caused by price increases above certain thresholds, actually incurred for energy consumption; these tax credits can be used as offsets or transferred (in full) to other entities.

The fourth and final type included measures of a different nature with resources largely destined to local authorities, the National Health Service, and to the realisation of public investments, again with the aim of countering the impact of price increases; these were flanked by other minor provisions, such as, for example, the transport bonus and measures related to corporate welfare.

During the course of the year, the deficit estimate was therefore revised in the various official documents, taking into account not only developments in the macroeconomic scenario, but also the results of the public accounts monitoring activity and the effects of the measures gradually adopted.

Below is a more detailed analysis of budgetary policy developments for 2022.

The 2021 EFD, the 2021 EFD Update, the 2022 Budget Law and the 2022 DBP. – The April 2021 EFD, against a trend forecast of net borrowing for 2022 at 5.4 per cent of GDP, projected a target of 5.9 per cent for the same year and a public debt-to-GDP ratio of 156.3 per cent (Table 2.1). The deterioration with respect to the trend at unchanged legislation was mainly due to: i) the refinancing of unchanged policies; ii) the need to adopt additional support and recovery measures; iii) the revision of the NRRP and the establishment of an investment fund complementary to the NRRP − with a ten-year duration − fed only by national resources and intended to finance projects deemed strategic, but which could not be financed using resources from the NGEU programme.

Note that the EFD estimated a trend deficit of 9.5 per cent of GDP for 2021; the forecast deficit was set at 11.8 per cent of GDP as it included the EUR 40 billion deterioration (2.3 per cent of GDP) resulting from the deviation requested via the Report to Parliament pursuant to Article 6 of Law 243/2012, which had not yet been converted into legislative measures. Subsequently, Italian Decree Laws 59/2021 and 73/2021 used the resources made available by the deviation. The very high level of deficit expected for 2021 was mainly due to the fall in GDP caused by the pandemic and the temporary measures introduced to counter its effects.

The following September, with the 2021 EFD Update, the trend forecasts were updated by taking into account, on the one hand, the improvement in the macroeconomic scenario[43] and the more favourable trend in interest rates and, on the other hand, the financial effects of the legislative measures approved after the publication of the EFD (namely, Decree Laws No. 59/2021 and No. 73/2021) as well as the use of the resources provided for in the NGEU programme according to a new version compared to the one considered in the EFD, with a slightly lower impact on public expenditure.

According to the new estimates, instead of increasing to the 11.8 per cent estimated in April, the deficit in 2021 was expected to be lower, at 9.4 per cent due to higher revenues resulting from more favourable economic growth and lower expenditure following a lower take-up of the measures adopted than initially estimated.[44]

Therefore, starting from a lower deficit-to-GDP estimate for 2021 than the previous one, in 2022 the ratio was projected to stand at 4.4 per cent of GDP, one point of GDP lower than projected in the EFD (Table 2.1). The update of public finance forecasts at unchanged legislation thus created room in the budget for expansionary measures beyond what had already been planned in the 2021 EFD. These measures, in addition to confirming unchanged policies, were expected to concern mainly action in favour of SMEs, the strengthening of the healthcare system, the reform of social safety nets and the implementation of the Universal child allowance as well as the first phase of tax reform.

The budget package planned for 2022 was expected to increase the deficit by 1.2 percentage points of GDP compared to the trend scenario, bringing it to 5.6 per cent.

[43] Compared to the EFD policy scenario, real GDP growth forecast for 2021 has been revised upward to 6.0 per cent from 4.5 per cent. In 2022, real growth was expected at 4.2 per cent trend in the EFD Update compared to the previous EFD policy scenario of 4.8 per cent (Table 2.1). However, the new 2022 estimate was higher than the previous one in both real and nominal terms.

[44] For an analysis of the causes behind the deficit improvement in 2021 see Parliamentary Budget Office (2021), 'Hearing of the Chair of the PBO as part of the preliminary examination of the Update to the 2021 Economic and Financial Document'.

The public debt-to-GDP ratio would have been lower than the 156.3 per cent projected in the EFD (149.4 per cent).

The budget package, enacted through Decree Law 146/2021 and the 2022 Budget Law, was estimated to increase the deficit by EUR 23.2 billion (equal to 1.2 per cent of GDP), reflecting a net revenue decrease of EUR 15.2 billion and a net expenditure increase of EUR 8 billion.[45]

The Budget Law redefined the structure of the IRPEF tax levy, with a reduction in the tax burden achieved through changes in rates, tax brackets, deductions and the tax wedge bonus. In addition, individuals engaged in commercial activities and professions were exempted from paying the IRAP tax. Revenue-reducing measures to curb price increases in the electricity and gas sector for the first quarter of 2022 were arranged. An exemption was also granted, for 2022 only, on the portion of social security contributions for disability, old age and survivors payable by employees with low to medium incomes, excluding workers in household services.

Compared to the scenario under unchanged legislation, current expenditure was increased, allocating it in particular to the health sector, to the reorganisation of social safety nets, to measures concerning the family and social policies − including those for refinancing the minimum income scheme and pension schemes −, and to provisions for local authorities. As regards the interventions involving capital expenditure, a large part has been earmarked to support businesses by refinancing the guarantees for SMEs and the so-called 'New Sabatini', the financing of the RFI programme contract, and the infrastructures of local authorities.

As for the resources to finance the above measures, half of the additional revenue came from the changes in the regulations on the revaluation of tangible assets of enterprises, another half from the extension of the contribution of extraordinary wage subsidies for categories currently excluded, and another part from the automatic increase in revenues (*oneri riflessi*) related to higher personnel expenses incurred by the general government. The reduction in expenditure was due to the discontinuation of the cashback programme and to the abolition of the Fund for the reform of social shock absorbers provided for by Italian Decree Law No. 73/2021; in addition, there were also the cuts in capital expenditure made in Section II of the Budget Law, essentially involving cuts in funding for the State Railways, the Development and Cohesion Fund and for Defence programmes.

On the occasion of the release of the 2022 DBP, the public finance trend scenario at unchanged legislation indicated in the EFD Update was updated to reflect the financial effects of Italian Decree Law No. 130/2021 (the so-called *'Decreto bollette'*) and on the basis of the most up-to-date monitoring information. The measures of the decree did

[45] For a detailed analysis of the package see Parliamentary Budget Office (2022), 'The 2022 budget package: an analysis of the version approved by Parliament', Focus Paper no. 2, 17 February.

not affect the level of the deficit, since their financial impact resulted in an equal reduction in revenue and expenditure. On the contrary, the monitoring of public finance measures enacted in 2021 revealed elements that allowed for an improvement in trend estimates of revenues by more than one billion in 2022 due to carry-over effects from the previous year, resulting in a deficit reduction of one-tenth of a point of GDP. In particular, in addition to more favourable projections than in the EFD Update estimates for social contributions, higher revenues were identified from the monitoring of payments via tax return form F24 for the entire month of September 2021, including those related to taxes self-assessed by ISA taxpayers (i.e. those who have adjusted to the synthetic indicators of tax reliability). The target for 2022 remained fixed at 5.6 per cent of GDP (although it improved in the second decimal place). At 1.4 per cent of GDP, the primary deficit was one-tenth of a point lower than in the EFD Update, while interest expenditure remained at 2.9 per cent of GDP. The target for the public debt-to-GDP ratio also remained stable, at 149.4 per cent.

The 'Sostegni ter', 'Energia' and 'Ucraina' Decree Laws. – In the first months of 2022, the *'Sostegni ter'* and *'Energia'* Decree Laws were issued (respectively Decree Law No. 4/2022 of 27 January and Decree Law No. 17/2022 of 1 March), which, in addition to still containing support measures in favour of companies and territorial entities to fight the COVID emergency, essentially supplement and extend to the second quarter of 2022 the subsidies to counteract the impact of high energy prices already provided for by the Budget Law for the first quarter. These initiatives are covered within the same measures. In the case of DL *'Sostegni ter'*, the interventions are financed mainly through a portion of the proceeds of the auctions of $C0_2$ emission allowances, paid by *Gestore dei Servizi Energetici* (GSE) to the State Treasury and to be reimbursed to *Cassa per i Servizi Energetici e Ambientali* (CSEA), as well as through the reduction of the allocations for non-repayable subsidies provided for by DL 73/2021. In the case of DL *'Energia'*, financing was ensured mainly through the reduction of appropriations for Ministries, the proceeds of the substitute tax for the revaluation of land and equity investments not traded on regulated markets, and the deferral of the deductibility of write-downs and losses on receivables.

During the second half of March, measures to counter the economic and humanitarian effects of the Ukrainian crisis, as well as additional support measures to counter the energy emergency, were introduced with DL *'Ucraina'* (DL 21/2022), the financing of which was mainly entrusted to an extraordinary contribution on the extra profits of companies operating in the electricity, gas and oil sectors.

The 2022 EFD and the April Report to Parliament, Decree Law 38/2022 and the 'Aiuti' Decree Law. – The 2022 EFD was submitted at the beginning of April, accompanied by a Report to Parliament pursuant to Law 243/2012 to request authorisation to update the recovery plan to bring the structural balance towards the MTO from what was previously allowed.

Given the adverse evolution of inflation and interest rates, as well as the deterioration of household and business confidence, exacerbated by the uncertain international geopolitical situation, the economy's growth prospects appeared weaker and more uncertain. This translated into a downsizing of real GDP growth, which was set at 2.9 per cent in the 2022 EFD trend forecast compared to the 4.7 per cent projected in the 2021 EFD Update.

Despite the downward revision of growth, the deficit estimate − including the effects of the measures enacted up to the end of March − was lowered to 5.1 per cent of GDP from the 5.6 per cent projected in the 2021 EFD Update, despite an increase in interest expenditure from 2.9 per cent to 3.5 per cent of GDP due mainly to the effects of higher inflation on consumer price-indexed securities. A lower primary deficit of 1.6 per cent of GDP was thus expected, 1.1 percentage points of GDP lower than the EFD Update policy scenario (and one point lower than the 2022 DBP).

This projected improvement, which was also supported by the positive data on government cash borrowing requirements in the first quarter of 2022, was influenced by several elements. First of all, the better-than-expected forecast was due to the carry-over effects on 2022 of the significantly lower-than-expected 2021 deficit balance (amounting to 7.2 per cent of GDP, instead of the estimated 9.4 per cent forecast in the Explanatory Technical Note to the 2022-2024 Budget Law[46]), thanks to lower current expenditure − also due to lower impacts than expected of the measures to counter the economic effects of the health emergency − and higher tax revenues, particularly related to VAT. Moreover, a favourable trend in overall revenue over the year more than offset the upward revision of expenditure compared to the EFD Update.

The deficit remained projected at 5.6 per cent of GDP and, given the more favourable conditions under existing legislation revealed by the updated forecasts, room was found for funding new measures, estimated at EUR 10.5 billion (including interest expenditure), equal to 0.5 per cent of GDP, in the Report to Parliament of 6 July. Thanks to these interventions, forecast growth was revised upward by two tenths, to 3.1 per cent, with respect to the trend estimate. Debt was projected to fall from previous estimates, reaching 147 per cent of output.

The report was followed by the approval of two decree laws: DL 38/2023 of 2 May (which will later be converted into DL 21/2023) and DL *'Aiuti'* (DL 50/2023) of 17 May. The measures enact the provisions set out in the 2022 EFD, which pointed out the areas requiring urgent action. In particular, DL 38/2022 − which increases the deficit by 2.1 billion − mainly contains measures on excise duties and VAT on fuels, with the provision of reduced rates in favour of final consumers and of the road hauling sector in the period from 3 May to 8 July 2022. The *'Aiuti'* DL deteriorated the 2022 deficit by EUR 8.4 billion. The most relevant part of the measures consisted in the payment of a one-off allowance

[46] Which also reflected the effects of DL 146/2021 with respect to the 2022 DBP.

(for 2022) to a wide range of subjects (employees, pensioners, NASPI, DIS-COLL and *RdC* recipients, self-employed workers and professionals) in possession of specific requirements, such as certain financial conditions, belonging to particular categories, previous acquisition of certain benefits.

Measures were also provided: to cope with higher costs in the public works sector as well as to ensure the implementation of projects financed in whole or in part through the resources of the NRRP or the National Supplementary Fund established by Decree Law No. 59/2021; to partially restore the expenditure of Ministries that had been reduced by Decree Law No. 17/2022 due to the need to cover the financial impact of the measures contained therein; to mitigate the effects of fuel, energy and gas price increases, including by increasing funds for the National Health Service and local authorities; to strengthen the assistance measures introduced by Decree Laws No. 14/2022 and 21/2022, with the integration − for 2022 only − of the resources earmarked for the widespread reception of refugees, for subsistence contributions, for health care provided for by the Regions, for social services provided for by municipal administrations, and for detention and reception centres managed by the Ministry of the Interior; to support the liquidity of businesses through an increase in funds for credit guarantees.

Partial financing resources were mainly derived from an increase in the extraordinary contribution required for 2022 from companies operating in the electricity, gas and oil sectors (which, also considering the provisions of Decree Law No. 21/2022, amounted to a total of approximately EUR 10.5 billion) and from a reduction in the financing of the Development and Cohesion Fund for the 2014-2020 programming period.

Note that the *'Aiuti'* Decree Law was converted into DL 80/2022, which provided − with zero impact on the deficit − for measures to contain the cost of electricity and natural gas for the third quarter of 2022, which were totally covered by reductions in Ministry appropriations, made possible by the use of more than 80 per cent of the partial recovery of expenditure previously provided for by the same *'Aiuti'* Decree Law.

Lastly, note that in the first half of the year, the three inter-ministerial decrees, already mentioned above, were issued for interventions totalling EUR 1.5 billion.

The July Report to Parliament and the 'Aiuti bis' Decree Law. − On 26 July a new Report to Parliament submitted an update of the public finance trend scenario based solely on the monitoring of revenues and expenditures as of 30 June. Based on this update, the Government estimated that the deficit figure could be revised down by 0.8 percentage points of GDP compared to what had been forecast in the EFD (5.6 per cent). This showed a possible improvement of about EUR 14.3 billion for the whole year compared to previous estimates, entirely due to higher revenues. In fact, the upward revision in the estimate of interest expenditure was offset by a downward estimate of current primary and capital expenditure.

In particular, the better-than-expected revenue forecast was largely attributable to the tax component (especially self-assessment taxes and VAT), for which the MEF's monitoring at the end of June showed an upward revision of about EUR 11.1 billion with respect to previous estimates, together with a further revision of about EUR 3.2 billion for the extra-tax component. These developments were also due to inflation that, since the publication of the 2022 EFD, had continued to rise with increasing intensity, driven by the imported component affected by tensions in energy markets, bottlenecks in global value chains and the consequences of the Russian-Ukrainian conflict.

The Government therefore asked Parliament to approve the use of the margins of improvement in the policy budget balances to finance an urgent measure to counter the effects on individuals, households, businesses and public entities of exceptional events related to the increase in the prices of energy products and more generally to inflation, to the continuing spread of COVID-19, and to the repercussions of the prolonged period of drought.

The *'Aiuti bis'* Decree Law (DL 115/2022) of 9 August provided for measures that used the budget room created. First of all, the new decree provided for: the extension to the fourth quarter of the year of the measures concerning electricity, natural gas, and energy products used as fuels (social bonuses for electricity and gas, general system charges, and reduced VAT); the reintroduction of certain tax credits implemented by Italian Decree Laws No. 4, 17, 21 and 50 of 2022 to counter the increase in electricity and gas costs for businesses (originally operating in relation to costs incurred in the first and second quarters of 2022) with the aim of extending them also to costs incurred in the third quarter of 2022; the reduction of excise duties on fuels from 22 August to 20 September 2022.

Transitional pension indexation measures were also introduced, bringing forward to 1 November 2022 (from 1 January 2023) the effective date of the adjustment (amounting to two-tenths of a percentage point) for the calculation of the indexation for 2021, as well as a provisional increase (up to a maximum of two percentage points, provided that the total pension benefits of the individual did not exceed a certain amount), applied only to the months of October, November and December 2022 and to the thirteenth payment.

The exemption on the portion of social security contributions owed by public and private employees with low to medium incomes for the second half of the year, already set at 0.8 per cent for the first quarter by the Budget Law for 2022, was increased by 1.2 percentage points to 2 per cent. Measures in favour of local authorities were extended, the Fund for the revision of public works prices was increased, and actions in support of farms that had suffered damage caused by the exceptional water shortage that had occurred in Italy since May were arranged. Partial reinstatement of the reductions in the Ministries' appropriations made by Decree-Law No. 50/2022 was again envisaged.

Among the main coverage measures was a reduction in the allocation for the Universal child allowance *(Assegno unico e universale per i figli a carico).*

The September Report to Parliament, the 'Aiuti ter' Decree Law, the 2022 EFD Update, and the October 2023 DBP. – On 8 September, a third Report to Parliament, based on the monitoring of the first eight months of the year, showed a further 6.2 billion (0.3 per cent of GDP) improvement in the deficit compared to previous estimates due to better revenue performance than previously estimated. This improvement concerned direct taxes (IRPEF and IRES) for about EUR 4 billion, with the remainder resulting from more favourable social security contributions.

Furthermore, as happened in July for the first half of the year, based on the year-end projection of expenditures according to the monitoring as of the end of August, a higher-than-expected interest expenditure was estimated (due to the unfavourable evolution of inflation and the forward rate curve), which was offset by the downward revision of the estimate of primary current expenditure and capital expenditure. According to the Government, the improvement in the balances could have been even greater if there had not been higher-than-expected effects for certain measures, such as those related to building bonuses.

In order to counter the continuing negative effects resulting in particular from the international geopolitical situation, the Government therefore asked Parliament for authorisation to use the budget room to promptly finance further measures, especially in favour of households, businesses and local authorities, as well as to extend the reduction of excise duties on fuels.

After being authorised by Parliament, the Government approved Decree Law *'Aiuti ter'* (DL 144/2022 of 23 September) which reintroduced a number of tax credits in favour of companies to counter the increase in electricity and gas costs already provided for by the various previous decrees, with the aim of extending them also to the costs incurred in October and November 2022 and increasing the size of the concessions. In addition, a monthly reduction of the excise duty rates on petrol, diesel, liquefied petroleum gas and natural gas used as fuels was introduced.

Again with the aim of countering the high cost of energy, in addition to reintroducing measures for the NHS and local authorities, subsidies were provided for various sectors: sport, voluntary work, culture, transport, state-recognized private schools, and charitable institutions. An additional one-off allowance (EUR 150) was also granted to employees, pensioners, workers providing household services, *RdC* beneficiaries, self-employed workers and professionals provided they met certain financial conditions.

Partial financing resources were derived from a series of measures including: the acquisition to the Treasury, with payments by GSE, of the proceeds from the compensation mechanism on the price of electricity produced from renewable sources;

a new reduction in the appropriations of Ministries; a cap on the reallocation in expenditure of the proceeds from the administrative sanctions imposed by the Competition and Market Authority (*Autorità garante della concorrenza e del mercato*, AGCM); and a reduction in the Fund for the re-regisration of residual expenditure carryovers (*Fondo per la reiscrizione dei residui passivi perenti*).

The 2022 EFD Update of September and the 2023 DBP of October reported only the scenario under unchanged legislation presented by the outgoing Government.

The updated trend forecasts, in addition to the revisions made by Istat to the final 2021 national accounts data, incorporated: the change in the macroeconomic scenario, in particular the upward revisions of expected growth in 2022 and the more unfavourable than expected trend in interest rates; the financial impact of legislative measures following the EFD, mainly containing measures to support households and businesses in the face of rising energy prices; the results of the in-year monitoring of public accounts; and the use of the resources envisaged by the NGEU programme according to a new timeframe, with a lower impact on public expenditure than assumed in the 2022 EFD.

Based on the above elements, the deficit-to-GDP ratio was expected to fall to 5.1 per cent in 2022 (from 7.2 per cent in 2021), less than estimated in the 2022 EFD (5.6 per cent of GDP, as mentioned above). The estimate of the public debt-to-GDP ratio continued to be revised downwards to 145.4 per cent of GDP.

The November Report to Parliament, the revised and integrated 2022 EFD Update, the revised 2023 DBP, the 'Aiuti quater' Decree Law. – The Report to Parliament of 4 November, prepared by the new Government, showed a slowdown in the most recent estimates of GDP growth for the third quarter of 2022 compared to the trends of the first half of the year, resulting in significant downside risks to economic activity for the final part of the year, due to inflationary tensions and the weakening of the international business cycle. In view of these developments, the economy's growth prospects for the near future appeared weaker and more uncertain. Against this backdrop, the energy crisis was expected to continue to have a negative impact on businesses and households and to act as a brake on economic activity, especially in energy-intensive sectors.

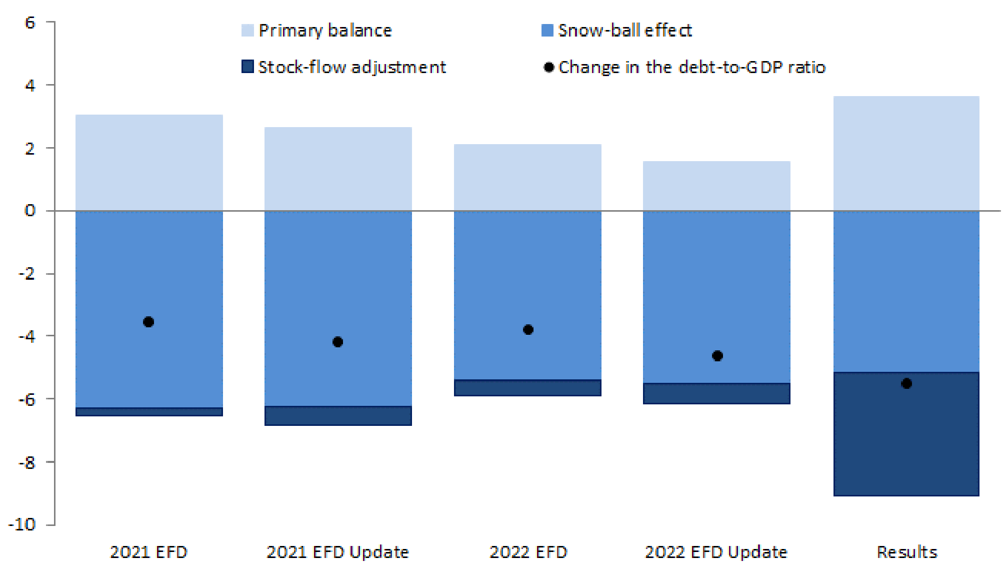
Given these premises, and the risk of an economic slowdown, it was deemed necessary to foresee a more gradual deficit reduction. Therefore, the Parliament was asked to authorise the Government to resort to borrowing in the year 2022 in order to use EUR 9.1 billion to finance measures to counter the increase in energy prices on households, companies and local authorities. This was to increase the deficit from 5.1 per cent of GDP in the trend scenario to 5.6 per cent as the policy target.

With the revised and integrated 2022 EFD Update and the revised November 2023 DBP, both the trend deficit of the previous Government's EFD Update (at 5.1 per cent of GDP) and the target set since the September 2021 EFD Update and always confirmed in subsequent official documents (at 5.6 per cent of GDP) were confirmed.

Over time, compared to September 2021, the same deficit target changed composition, with an improving primary deficit, which fell to 1.5 per cent of planned GDP in the revised and integrated 2022 EFD Update, and an increasing interest expenditure estimate, at 4.1 per cent (see Box 2.3 'Evolution of the yield curve of Italian government securities in 2022').

Moreover, due mainly to a higher level of nominal GDP, there has been a continued reduction in the target for the public debt-to-GDP ratio, set at 145.7 per cent, with a downward trend in line with that of the previous year and amounting to approximately 4.6 percentage points, confirming a budgetary policy approach geared towards reducing this ratio, at a time when the Government nevertheless prioritises limiting as much as possible the negative impact on the budgets of households and businesses of the sharp rise in prices (Figure 2.1).

Figure 2.1 – Contributions to the change in the debt-to-GDP ratio: targets and results for 2022
(as a percentage of GDP)



Source: MEF, Bank of Italy and Istat.

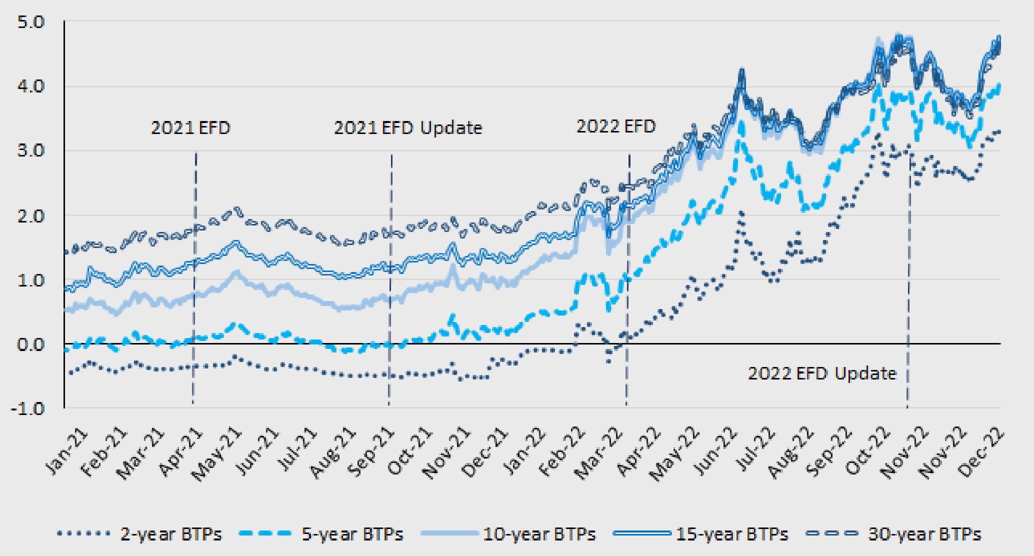
Box 2.3 – Evolution of the yield curve of Italian government securities in 2022

This box briefly describes the development of interest rates on Italian government bonds over the two-year period 2021-22 and how this may have influenced the related expected yield curve for 2022 used for the interest expenditure forecasts described in the main text.

During 2021, the evolution of Italian government bond yields was influenced by the outlook for growth (also related to developments resulting from the pandemic) and inflation, as well as by expectations regarding the ECB's monetary policy stance. Italian government bond yields have remained relatively stable at very modest levels, thanks mainly to the ECB's policies; for example, the yield on the 10-year bond stood at around 0.7 per cent in the period when both the March 2021 EFD and the September 2021 EFD Update were being prepared (Figure B2.3.1). In the last months of 2021, however, a gradual rise in yields was observed, which continued more markedly during 2022, firstly due to expectations of a faster-than-expected reduction in monetary accommodation, against a background of strong inflationary pressures, and then, in the second half of the year, due to the ECB beginning to raise its key official rates. The yield on the 10-year maturity increased to 1.7 per cent in March 2022 (coincidental with the 2022 EFD drafting period) and to 4.5 per cent at the end of October 2022 (in the revised and updated 2022 EFD Update drafting period).

These market developments also influenced the implied yield curve expected for 2022 on an annual average basis. In fact, the curve was very low in March 2021 and still marginally lower on the short/medium-term part of the curve in September 2021 (Figure B2.3.2). Then, in March 2022 and even more markedly in October 2022, the yield curve was expected to be much higher across all maturities. For example, while the yield on the 10-year bond maturity expected for 2022 averaged around 1 per cent in both the 2021 EFD and 2021 EFD Update drafting period, it was expected to rise to 1.8 per cent in the 2022 EFD drafting period and to 3.2 per cent in the 2022 EFD Update drafting period;[47] at the end of the year, the yield actually recorded on average for 2022 on the secondary market amounted to 3.1 per cent.

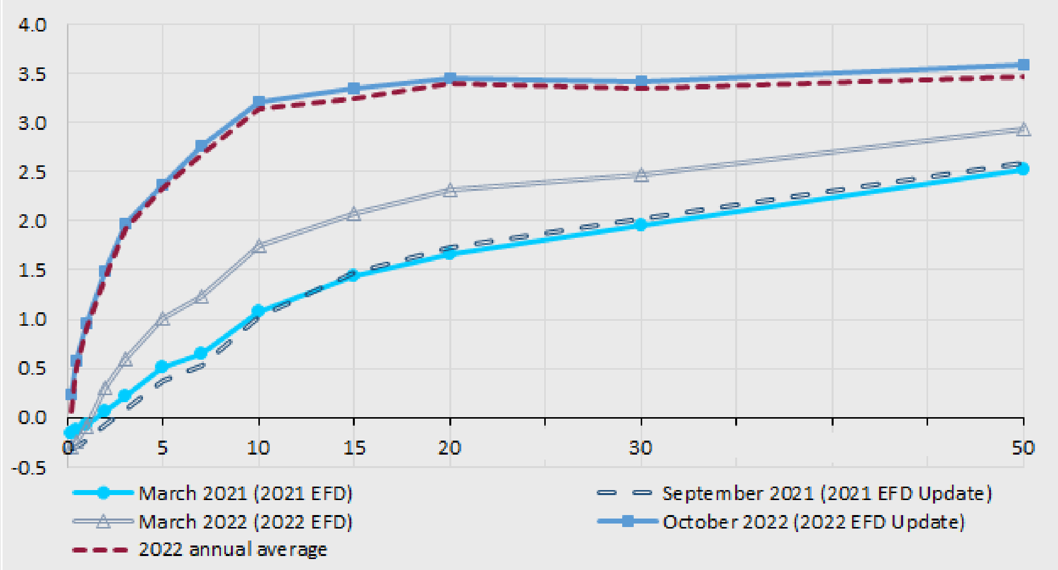
Figure B2.3.1 – Government bond yields (2-, 5-, 10-, 15- and 30-year BTPs)
(percentage points)



Source: Refinitiv.

[47] Note that the value for March 2022 (2022 EFD forecast) is an average between the interest rates recorded on the market between January and March and the forward rates for the remaining months of the year while the value for October 2022 (2022 EFD Update forecast) is an average between the interest rates recorded on the market between January and October and the forward rates for the remaining months of the year.

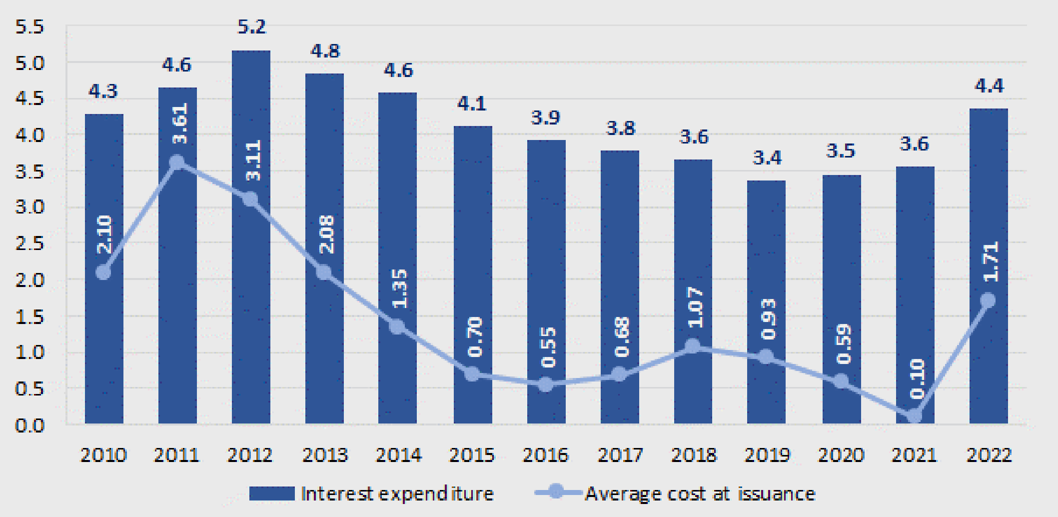
Figure B2.3.2 – Italian government bond yield curve for the year 2022 (1)
(percentage points)



Source: based on Refinitiv data.
(1)) The 'March 2021 (2021 EFD)' curve represents the expected implicit rates in the Italian yield curve (forward rates) recorded in the 2022 EFD drafting period; the 'September 2021 (2021 EFD Update)' curve represents the forward rates recorded in the 2022 EFD Update drafting period; the 'March 2022 (2022 EFD Update)' curve is an average between the interest rates recorded on the market between January and March and the forward rates for the remaining months of the year; the 'October 2022 (2022 EFD Update)' curve is an average between the interest rates recorded on the market between January and October and the forward rates for the remaining months of the year. Lastly, the '2022 annual average' curve represents the average effective yields recorded during the year.

In this context, the weighted average cost of new Italian government bond issues reversed in 2022 after three years of gradual reduction, rising from 0.1 per cent in 2021 (when the lowest level was recorded) to 1.7 per cent (Figure B2.3.3). The incidence on GDP of interest expenditure amounted to 4.4 per cent in 2022, a marked increase over the previous year's 3.6 per cent, due both to the rise in yields (Figure R2.3.1), influenced by the ECB implementing a restrictive monetary stance to contain inflationary pressures, and to the impact of the marked increase in inflation on index-linked securities.

Figure B2.3.3 – Interest expenditure-to-GDP ratio and weighted average cost at issuance
(percentage points)



Source: Istat and MEF.

On 18 November, the *'Aiuti quater'* Decree Law (DL 176/2022,[48] incorporating DL 179/2022 upon conversion) was enacted, reintroducing and extending regulations already laid down in previous decrees, as occurred repeatedly during the course of the year. Thus, tax credits against high energy prices were granted; excise duties on fuels for the final part of the year were reduced; the extraordinary contribution to guarantee the continuity of local government services was increased; and social bonuses for electricity and gas were strengthened; with regard to company welfare measures, the value of goods and services that do not contribute to forming employee income was extended, including among the fringe benefits the sums disbursed or reimbursed to employees for the payment of utilities; the fund set up to support local and regional public passenger transport services was increased; compensation was provided for the higher costs incurred by ANAS for public street lighting.

New significant measures were also introduced: the deadline by which GSE was required to sell natural gas purchased for storage purposes was postponed to 31 March 2023;[49] the resources allocated for the year to the State Railways were increased.

Part of the funding resources derived from various measures, including the reduction of appropriations of the expenditure Missions and Programmes of the Ministries, as well as of various funds: the fund for the minimum income scheme, the fund to encourage the early retirement of employees of small and medium-sized enterprises in crisis, and the fund for the protection of jobs, which had been introduced during the COVID-19 crisis.

Lastly, in the second half of the year, four inter-ministerial decrees were issued to provide the price mitigation measures described above, with an overall impact of EUR 1.7 billion.

The 2022 results. − After the numerous interventions during the course of the year, 2022 closed − as mentioned above − with a general government net borrowing, according to Istat's figures issued on 5 April, equal to 8 per cent of GDP, down from 9 per cent in 2021, but well above the 5.6 per cent expected in last October's DBP estimates due to the already mentioned effects of the new accounting treatment of building bonuses. Net of these effects, the deficit would in fact have been 5.7 per cent of GDP, close to the 5.6 per cent policy target.

[48] Which repealed DL 179/2022 upon conversion, without prejudice to its effects.

[49] The sale of gas purchased by GSE in 2022 was postponed from 2022 to 2023. According to a previous regulation (DL 50/2022), the purchase and then subsequent resale of gas should have taken place in 2022 at the same time, with no effect on the deficit; with the postponement to 2023 provided for by DL 176/2022, the accumulation of gas stocks (considered as an increase in general government capital expenditure) in 2022 amounting to EUR 4 billion will be followed, in 2023, by a reduction in gas stocks (with a reduction in general government capital expenditure), again amounting to EUR 4 billion.

Compared with the latest official assessments reported in the Explanatory Technical Note (*Nota tecnico-illustrativa*, NTI)[50] to the 2023-2025 Budget Law, revenues were higher by EUR 0.5 billion (including the effects of the new accounting rules for building bonuses mentioned above in terms of higher direct taxes and higher revenues for EU subsidies), while expenditures were higher by EUR 45.8 billion (also taking into account higher investment subsidies due to the new accounting rules for building bonuses) (Table 2.6).

Table 2.6 − General government account: differences between Istat final figures and the Explanatory Technical Note (NTI) – Year 2022
(millions of euro)

	NTI	Istat	Differences
EXPENDITURE			
Wages and salaries	188,208	186,916	-1,292
Intermediate consumption	167,564	166,014	-1,550
Social security transfers	408,167	406,921	-1,246
Pensions	*297,350*	*296,647*	*-703*
Other social security transfers	*110,817*	*110,274*	*-543*
Other current expenditure	109,609	95,562	-14,047
TOTAL PRIMARY CURRENT EXPENDITURE	**873,548**	**855,413**	**-18,135**
Interest expenditure	77,234	83,206	5,972
TOTAL CURRENT EXPENDITURE	**950,782**	**938,619**	**-12,163**
Gross fixed capital formation	49,120	51,465	2,345
Investment subsidies	23,628	76,870	53,242
Other capital expenditure	14,043	16,376	2,333
TOTAL CAPITAL EXPENDITURE	**86,791**	**144,711**	**57,920**
TOTAL PRIMARY EXPENDITURE	**960,339**	**1,000,124**	**39,785**
TOTAL EXPENDITURE	**1,037,573**	**1,083,330**	**45,757**
REVENUES			
Total tax revenues	567,231	565,516	-1,715
Direct taxes	*284,231*	*290,397*	*6,166*
Indirect taxes	*278,167*	*276,543*	*-1,624*
Capital account taxes	*4,833*	*1,709*	*-3,124*
Social security contributions	264,368	261,004	-3,364
Actual social security contributions	*259,588*	*256,932*	*-2,656*
Imputed social security contributions	*4,781*	*4,072*	*-709*
Other current revenues	89,654	85,869	-3,785
TOTAL CURRENT REVENUES	**916,420**	**913,813**	**-2,607**
Non-tax capital account revenues	9,717	15,908	6,191
TOTAL CAPITAL ACCOUNT REVENUES	**14,550**	**17,617**	**3,067**
TOTAL REVENUES	**930,970**	**931,430**	**460**
Tax burden	*43.7*	*43.5*	*-0.2*
PRIMARY NET BORROWING (-) / LENDING (+)	**-29,369**	**-68,694**	**-39,325**
CURRENT BALANCE	**-34,362**	**-24,806**	**9,556**
NET BORROWING (-) / LENDING (+)	**-106,603**	**-151,900**	**-45,297**
Nominal GDP	*1,903,331*	*1,909,154*	*5,823*

Source: NTI and Istat.

[50] The comparison refers to what is reported in the tables of the general government policy income statement in the Explanatory Technical Note to the 2023-2025 Budget Law.

In particular, with regard to expenditure, current expenditure net of interest was lower than expected by EUR 18.1 billion, partly offset by higher interest expenditure amounting to EUR 6 billion and capital expenditure amounting to EUR 7.4 billion (net of approximately EUR 50 billion of higher investment subsidies due to the new accounting rules of building bonuses).

All items contributed to different degrees to the lower primary current expenditure: to a limited extent (in the order of EUR 1.2-1.6 billion per component) contributed public wages and salaries (mainly due to the slowdown in hiring procedures), intermediate consumption (due to higher revenues from pay-backs that reduced healthcare spending) and social security benefits (essentially due to lower-than-expected spending related to measures to counter the energy emergency); other current expenditure fell more substantially than expected (- EUR 14 billion), mainly due to the lower-than-expected use of tax credits in favour of businesses provided for by the various decrees issued during the year to counter high energy prices. In particular, compared with the initial estimates of around EUR 20 billion (Table 2.5), the actual use amounted to around EUR 7 billion.

So with regard to revenues, changes were observed with respect to expectations, resulting in lower revenues for taxes and contributions (also related to the lower output components that form part of the tax bases) as well as for other current revenues and, conversely, higher other capital revenues due to higher EU subsidies related to the Superbonus.

Compared with the previous year, given an increase in interest expenditure from 3.6 to 4.4 per cent of GDP − attributable to the increase in interest rates and, above all, to the effects of inflation on index-linked securities − the improvement in the deficit stemmed from a substantial reduction in the primary deficit, which fell from 5.5 to 3.6 per cent of GDP (Table 2.7). This was achieved thanks to a 0.5 percentage point increase in the revenue-to-GDP ratio (from 48.3 to 48.8 per cent) − due to direct taxes and non-tax capital revenues − and, above all, thanks to a 1.4 percentage-point decrease in primary expenditure (from 53.8 to 52.4 per cent). Contributing to the latter was a drop in both current primary expenditure (down by 0.8 percentage points of GDP, from 45.6 to 44.8 per cent of GDP), particularly for social security transfers, and capital spending (down by 0.6 points, from 8.2 to 7.6 per cent of GDP), as a result of reductions in gross fixed capital formation and, above all, in other capital expenditures only partially offset by increases in investment subsidies.

Looking at percentage changes, primary expenditure increased by 4.1 per cent over 2021, reflecting a 5 per cent growth in current primary expenditure and a 1.3 per cent reduction in capital expenditure. As regards revenues, which increased overall by 7.9 per cent from 2021, all the main components showed sustained growth and, in particular, non-tax capital revenues (91 per cent).

Table 2.7 – General government account: final figures – Years 2021 and 2022

	Million euro		Values in % of GDP		Growth rates
	2021	2022	2021	2022	2022
EXPENDITURE					
Wages and salaries	176,752	186,916	9.9	9.8	5.8
Intermediate consumption	158,083	166,014	8.8	8.7	5.0
Social security transfers, of which:	397,876	406,921	22.3	21.3	2.3
Pensions	*286,271*	*296,998*	*16.0*	*15.6*	*3.7*
Other social security transfers	*111,605*	*109,923*	*6.2*	*5.8*	*-1.5*
Other current expenditure	81,644	95,562	4.6	5.0	17.0
TOTAL PRIMARY CURRENT EXPENDITURE	**814,355**	**855,413**	**45.6**	**44.8**	**5.0**
Interest expenditure	63,693	83,206	3.6	4.4	30.6
TOTAL CURRENT EXPENDITURE	**878,048**	**938,619**	**49.1**	**49.2**	**6.9**
Gross fixed capital formation	52,057	51,465	2.9	2.7	-1.1
Investment subsidies	58,461	76,870	3.3	4.0	*31.5*
Other capital expenditure	36,044	16,376	2.0	0.9	-54.6
TOTAL CAPITAL EXPENDITURE	**146,562**	**144,711**	**8.2**	**7.6**	**-1.3**
TOTAL PRIMARY EXPENDITURE	**960,917**	**1,000,124**	**53.8**	**52.4**	**4.1**
TOTAL EXPENDITURE	**1,024,610**	**1,083,330**	**57.3**	**56.7**	**5.7**
REVENUES					
Total tax revenues	529,411	568,649	29.6	29.8	7.4
Direct taxes	*267,698*	*290,397*	*15.0*	*15.2*	*8.5*
Indirect taxes	*260,115*	*276,543*	*14.6*	*14.5*	*6.3*
Capital account taxes	*1,598*	*1,709*	*0.1*	*0.1*	*6.9*
Social security contributions	246,062	261,004	13.8	13.7	6.1
Actual social security contributions	*241,495*	*256,932*	*13.5*	*13.5*	*6.4*
Imputed social security contributions	*4,567*	*4,072*	*0.3*	*0.2*	*-10.8*
Other current revenues	79,599	85,869	4.5	4.5	7.9
TOTAL CURRENT REVENUES	**853,474**	**913,813**	**47.7**	**47.9**	**7.1**
Non-tax capital account revenues	8,328	15,908	0.5	0.8	91.0
TOTAL CAPITAL ACCOUNT REVENUES	**9,926**	**17,617**	**0.6**	**0.9**	**77.5**
TOTAL REVENUES	**863,400**	**931,430**	**48.3**	**48.8**	**7.9**
Tax burden	*43.4*	*43.5*			
PRIMARY NET BORROWING (-) / LENDING (+)	**-97,517**	**-68,694**	**-5.5**	**-3.6**	
CURRENT BALANCE	**-24,574**	**-24,806**	**-1.4**	**-1.3**	
NET BORROWING (-) / LENDING (+)	**-161,210**	**-151,900**	**-9.0**	**-8.0**	
Nominal GDP	***1,903,331***	***1,909,154***			

Source: Istat.

Within current primary expenditure and looking at the largest components, the strongest growth regarded wages and salaries (5.8 per cent), mainly attributable to the renewal of most public sector employment contracts for the three-year period 2019-2021, which also included the payment of arrears, and, to a lesser extent, to growth in public employment, especially for central government.

Also significant was the increase in intermediate consumption (5 per cent), to which contributed both social security benefits in kind purchased directly on the market (6.2 per cent) and, albeit to a lesser extent, intermediate consumption in the strict sense (4.5 per cent). The former, and in particular those of a welfare nature provided for by the State, were affected by the payment of social bonuses – recognised to economically disadvantaged persons or persons having severe health conditions and aimed at countering increases in electricity and gas prices − provided for on several occasions, from the Budget Law for 2022 to Decree Law No 115/2022 (the so-called *'Aiuti bis'* Decree Law).

Social security transfers increased (2.3 per cent) due to the growth in pension expenditure (3.7 per cent) only partly offset by the reduction in other transfers (-1.5 per cent). With reference to the latter, the increase due to the introduction of the Universal child allowance from March 2022 was more than offset by the discontinuation of the COVID-linked salary integration allowances and by lower expenditure related to the '100 euro bonus'.[51] Pension transfers have been affected − in addition to the balance between new pensions and those cancelled due to the death of the beneficiaries and the usual indexation − by the transitional rules laid down in Decree Law No. 115/2022 aimed at supporting the purchasing power of pensioners in the face of rising inflation. In particular, the decree provided for − as already mentioned − both the bringing forward from 1 January 2023 to 1 November 2022 of the starting date of the adjustment (equal to 0.2 per cent) concerning the calculation of the automatic equalisation for 2021, and a provisional increase (of 2 per cent) for October-December 2022 in monthly pensions equal to or less than EUR 2,692.

Lastly, there was a sharp increase in other current expenditure (17 per cent), within which only production subsidies grew, including extraordinary subsidies − in the form of tax credits − against the high cost of energy for businesses, which were, however, as already mentioned, lower than budgeted. In addition, also within production subsidies, the accounting of the selective contribution relief provided for by the Budget Law for 2021 for the hiring of young people, women and in the South of Italy continued.

With regard to capital expenditure, while there was an increase in investment subsidies (31.5 per cent, due to higher allocations compared to the previous year for building bonuses), a reduction was recorded in both investments (-1.1 per cent) and, above all, in other capital expenditure (-54.6 per cent). The latter decreased significantly due to the discontinuation of non-repayable subsidies granted to support businesses and VAT holders in 2020-21 during the acute phase of the pandemic. On the other hand, both transfers to the *Monte dei Paschi di Siena* bank and expenditure related to the purchase of natural gas stocks for storage purposes by GSE and Società nazionale metanodotti (SNAM) contributed to the increase.

With regard to revenues, direct taxes recorded a high growth rate (8.5 per cent) for two main reasons. The first reason is the already mentioned upward revision made by Istat following the new rules for the accounting of building bonuses. In addition, the high growth was influenced by the favourable performance of the self-assessment system due to the balance-advance payment mechanism, whereby the balance paid in 2022 was high (especially for the IRES tax) to compensate for the previous year's advance payments, which had been particularly low as they were calculated on the basis of the 2020 results.

[51] Note that the Budget Law for 2022 transformed part of the bonus into tax deductions.

Moreover, in addition to the increase in withholding taxes on the profits distributed by companies, revenue was affected by the extraordinary contribution (amounting to approximately EUR 2.8 billion, significantly lower than the EUR 10.5 billion expected during the year) to be paid by entities producing electricity, methane gas or extracting natural gas, introduced by Italian Decree Law No. 21/2022 and reinforced by Italian Decree Law No. 50/2022 (the '*Aiuti*' Decree Law).

The growth rate of indirect taxes (6.3 per cent) reflected the sustained increases in: IRAP (regional tax on production activities), due to the same balance-advance payment-mechanism effect already reported for the self-assessment component of direct taxes; VAT, both for domestic trade, driven by the increase in consumer prices, and for imports, driven by the increase in the cost of energy products; and the tax on lotteries. Conversely, the tax on electricity and system charges and the tax on mineral oils and derivatives fell sharply as a result of the measures to counter the impact of high energy prices.

Social security contributions grew by 6.1 per cent in line with the tax base, which was also affected by the impact of the renewal of contracts for the civil service sectors for 2019-2021; a significant increase in contributions paid by self-employed workers was also recorded.

Other current revenues also experienced a significant increase (7.9 per cent) due to a favourable trend in both saleable output, also resulting from price increases, and other revenues, which include current transfers from the EU related to the NRRP. Subsidies from the EU − specifically capital subsidies related to the granting of building bonuses − also drove the growth of capital revenues (77.5 per cent), particularly the non-tax component (91 per cent).

2.2 Public finance in 2023 and 2024-26

The targets for the three-year period 2023-25 set in the 2022 EFD and the revised and integrated 2022 EFD Update. – The 2022 EFD set a deficit target of 3.9 per cent for 2023 against a trend of 3.7 per cent of GDP. For subsequent years, the deficit targets stood at 3.3 per cent in 2024 (3.2 for trend scenario) and 2.8 in 2025 (2.7 for the trend scenario).

When the revised and integrated 2022 EFD Update and related Report to Parliament were issued on 4 November, the new Government decided to set new policy targets for the following three-year period, setting the target for 2023 at 4.5 per cent of GDP, an increase of 0.6 percentage points of GDP compared to what was planned in the 2022 EFD.

In spite of still significant growth in 2022, the Government deemed it necessary – as already mentioned – to forecast a more gradual deficit reduction, taking into account the risk of an economic slowdown in the following months and the possibility that the energy crisis could continue to have a negative impact on businesses and households and act as a brake on economic activity, especially in energy-intensive sectors.

Compared to the scenario at unchanged legislation, the new target made available resources amounting to approximately EUR 21 billion, to be allocated through the 2023 budget package to measures aimed at further countering the impact of high energy prices for households and firms.

The policy scenario envisaged a deficit that, after 4.5 per cent of GDP in 2023 (3.4 in the trend), would fall to 3.7 per cent in 2024 (3.6 in the trend) and 3 per cent in 2025 (down from 3.3 in the trend). The debt-to-GDP ratio was also set at 145.7 per cent for the year 2022, and projected to fall continuously to 144.6 per cent in 2023, 142.3 per cent in 2024 and 141.2 per cent in 2025.

Thus, an approach of budgetary policy geared to reducing the public debt-to-GDP ratio was confirmed, in a context in which the Government nevertheless considered it a priority to limit as much as possible the negative impact of the sharp increase in prices on the budgets of households and businesses. This was in line with previous policy planning.

Decree Law 176/2022 and the Budget Law for 2023. – In line with these objectives, a package of measures was introduced – through DL 176/2022[52] concerning urgent support measures in the energy and public finance sectors (with effects mainly on 2022) and the Budget Law for 2023 – which implied a worsening of general government net borrowing, compared to the trend scenario under unchanged legislation, equal to 0.5 percentage points of GDP in 2022 (EUR 9.1 billion) as already mentioned in the previous paragraphs,

[52] DL 176/2022 provided for significant expansionary measures for 2022, largely concerning urgent measures to tackle high energy prices in the final part of the year, but marginally affects the net effects of the budget package in 2023 – merely improving the deficit by 0.3 billion – and has a negligible net impact on the following two years, since its planned uses are in fact offset by corresponding funding resources.

to one percentage point in 2023 (EUR 20.8 billion), and to 0.1 points in 2024 (EUR 2.1 billion); on the other hand, the interventions in 2025 resulted in a deficit improvement of 0.2 percentage points of GDP (4.9 billion).[53]

In 2023, the measures had the greatest impact on households, although 'general' measures, meaning those aimed simultaneously at multiple subjects, and measures aimed at businesses and the self-employed were also significant, and all essentially aimed at mitigating the high energy prices for the first quarter of the year. In the case of households, the main measures concerned: the extension for 2023 of the partial exemption on the employee's share of social security contributions for disability, old age and survivors provided for by the 2022 Budget Law, as well as the increase of the exemption by a further percentage point, bringing it to a total of 3 per cent, for employees with a certain monthly income; and a series of measures regarding healthcare and social protection, for the purchase of basic necessities for people with an ISEE (Equivalent economic status indicator) not exceeding EUR 15,000, the increase in below-minimum pensions, early retirement, the Universal child allowance and the purchase of a first home.

Among the measures aimed at improving the balance, only those targeted at households will provide an overall positive contribution in both 2024 and 2025, while the 'general' measures will only improve it in 2025. With regard to households, the main measures include those determining: less favourable rules for the pension indexation mechanism; savings from the simultaneous repeal of the so-called "*Reddito di cittadinanza*" (Citizenship income, a Minimum Income Scheme) and the establishment of the Fund to support poverty and active inclusion *(Fondo per il sostegno alla povertà e alla inclusione attiva)*; the increase in the excise tax on tobacco products; and the reduction from 110 per cent to 90 per cent of the deduction for renovation expenses on apartment buildings incurred in 2023. In 2025, the most significant 'general' funding measures are those included in Section II of the Budget Law and concerning, in particular, reductions in capital expenditure, measures to rationalise Ministries' spending (spending review) and lower allocations for IRPEF returns.

On the contrary, in 2024-25, businesses and the self-employed continue to benefit from various interventions, in particular: the funds for the revision of the prices of materials, contribution exemptions for the hiring of particular subjects, the change of the facilitated tax regime consisting in the increase of the revenue threshold for the flat-rate regime, the so-called incremental flat tax. Reducing the deficit are the cuts in financing in Section II of the Budget Law concerning capital expenditure.

In 2023-25, there are also net interventions, albeit of a smaller magnitude, in favour of public employees, thanks to the financial improvements of state employees (for 2023

[53] See Parliamentary Budget Office (2023), 'The 2023 budget package: an analysis of the version approved by Parliament', Focus Paper No.1, 9 March.

only), the strengthening of the financial administration with the hiring of permanent staff, and, as of 2024, an allowance envisaged for emergency room personnel.

Il DL 34/2023. − DL 34/2023 was issued on 30 March. The decree was financed using the funds available thanks to the lower cost of approximately EUR 5 billion compared to the estimates in the Budget Law for financing measures to counter the impact of high energy prices in favour of businesses, and provided for new measures to support households and businesses in the purchase of electricity and natural gas, as well as in the area of health care. In particular, the following measures were provided for the second quarter of the year: a reduction to 5 per cent of the VAT rate on methane gas and tax credits; a contribution for heating in the fourth quarter in favour of resident domestic customers other than social bonus holders (to be disbursed only in the event of an increase in gas prices above a certain threshold); an increase in the fund for the provision of state contributions to cover expenditure exceeding the spending ceiling (payback) for medical devices; and measures for healthcare, emergency and first aid services and emergency room personnel.

The 2023 EFD: trend developments. − The path of budget balances at unchanged legislation outlined in the 2023 EFD reflects the updating of the macroeconomic scenario compared to the November 2022 EFD Update (with higher growth in the current year but lower growth in 2024), the financial impact of the measures contained in the Budget Law for 2023 and in subsequent decree laws passed up to last March and a new time profile of the measures financed with the resources provided for by the NRRP, whose details are not given in the 2023 EFD, as the outcome of the ongoing talks with European institutions on the revision and reshaping of some of the measures envisaged by the NRRP and the related milestones and targets is still pending (see Box 2.4 'Use of Next Generation EU resources in policy documents').

The trend net borrowing of general government is only slightly more favourable in 2023-24 than that projected in last autumn's revised and integrated 2022 EFD Update. The forecasts for the following years show a continuously declining general government deficit, again at or below 3 per cent of GDP from 2025. In addition, after four years, a return to a positive primary balance, i.e. net of interest expenditure, is expected from 2024 onwards. The current balance is also expected to turn positive from next year (Figure 2.2).

In particular, in the absence of further measures, public deficit is expected to fall significantly in the current year, from 8.0 to 4.4 per cent of GDP − also due to the significant downsizing of the effects of building bonuses and the substantial decline in measures to counter the impact of high energy prices − and then to fall to 3.5 per cent in 2024, 3 in 2025 and 2.5 in 2026.

Box 2.4 – Use of Next Generation EU resources in policy documents

Table B2.4.1a compares the information disclosed in the 2021 EFD, 2022 EFD and 2022 EFD Update on the annual profile of EU-funded expenditure under the Next Generation EU (NGEU) programme. The table allows an assessment of how the assumptions on the allocation of NGEU resources have changed over time. Note that the most up-to-date information was published last September in the 2022 EFD Update; the 2023 EFD does not include an update of the expenditure profile, presumably pending the reformulation of the NRRP.

The table shows changes in the use of resources, largely due to lower expenditure incurred in 2020-21 and estimated for 2022; in particular, in the 2022 EFD Update they are on the whole lower than envisaged in the 2022 EFD.

More in detail, again comparing the 2022 EFD Update with the 2022 EFD, while there was a slight increase in the figures for 2020-21 (by EUR 1.2 billion), the amounts for the three-year period 2022-24 were revised downwards (by EUR 14.4 billion in 2022, EUR 2.4 billion in 2023, and EUR 0.8 billion in 2024), with a simultaneous postponement of expenditure to 2025 (by EUR 6.1 billion) and 2026 (by EUR 10.5 billion) (Table B2.4.1a, row (f)). Looking at the components, the expenditure profile of the ReactEU programme remained unchanged while, as regards the Recovery and Resilience Facility (RRF), it was slightly revised downwards for 2023-24 and significantly revised upwards for 2025-26. However, note that, given the downward revision of the estimate for 2022, the change in expenditure in 2023 compared to the previous year is much larger than projected in the 2022 EFD (+12 billion).

Table B2.4.1a – Use of NGEU resources (1)
(million euro)

	2020-21	2022	2023	2024	2025	2026	Total
2022 EFD Update							
RRF subsidies (a)	1.5	9.0	21.7	16.2	14.8	5.7	68.9
RRF loans (b)	4.0	6.0	19.3	30.2	32.9	30.2	122.6
Total RRF (c)=(a)+(b), of which:	5.5	15.0	40.9	46.5	47.7	35.9	191.5
Additional (c.1)	*1.3*	*8.2*	*27.6*	*31.0*	*32.4*	*24.0*	124.5
Substitutive (c.2)	*4.2*	*6.8*	*13.3*	*15.5*	*15.3*	*11.9*	*67.0*
ReactEU *subsidies (d)*	*0.0*	*4.2*	*10.2*				*14.4*
TOTAL (e)=(c)+(d), of which:	**5.5**	**19.2**	**51.1**	**46.5**	**47.7**	**35.9**	**205.9**
Additional total (subsidies and loans) (e.1)=(c.1)+(d)	*1.3*	*12.4*	*37.8*	*31.0*	*32.4*	*24.0*	*138.9*
Total difference 2022 EFD Update-2022 EFD (f)=(e)-(e')	**1.2**	**-14.4**	**-2.4**	**-0.8**	**6.1**	**10.5**	**0.0**
Additional difference (subsidies and loans) (g)= (e.1)-(e'.1)	*0.2*	*-9.8*	*-1.5*	*0.2*	*4.3*	*6.6*	*0.0*
2022 EFD							
RRF subsdies (a')	1.5	14.1	22.5	15.6	10.9	4.2	68.9
RRF loans (b')	2.8	15.3	20.8	31.7	30.7	21.2	122.6
Total RRF (c')=(a')+(b'), of which:	4.3	29.4	43.3	47.3	41.6	25.4	191.5
Additional (c'.1)	*1.1*	*18.0*	*29.1*	*30.8*	*28.1*	*17.4*	124.5
Substitutive (c'.2)	*3.2*	*11.3*	*14.2*	*16.6*	*13.6*	*8.1*	*67.0*
ReactEU *subsidies (d')*	*0.0*	*4.2*	*10.2*				*14.4*
TOTAL (e')=(c')+(d'), of which:	**4.3**	**33.6**	**53.5**	**47.3**	**41.6**	**25.4**	**205.9**
Additional total (subsidies and loans) (e'.1)=(c'.1)+(d')	*1.1*	*22.2*	*39.3*	*30.8*	*28.1*	*17.4*	*138.9*
Total difference 2022 EFD-2021 EFD (f')=(e')-(e'')	**-18.2**	**0.6**	**9.6**	**6.3**	**7.4**	**-5.0**	**0.9**
2021 EFD	*2021*						
RRF subsidies (a'')	10.5	16.7	26.7	10.1	4.1	0.8	68.9
RRF loans (b''), of which:	8.0	12.0	12.0	30.9	30.1	29.6	122.6
Additional (b''.1)				*12.9*	*13.5*	*13.6*	*40.0*
Substitutive (b''.2)	*8.0*	*12.0*	*12.0*	*18.0*	*16.6*	*16.0*	*82.6*
Total RRF (c'')=(a'')+(b'')	18.5	28.7	38.7	41.0	34.2	30.4	191.5
ReactEU subsidies (d'')	*4.0*	*4.25*	*5.25*				*13.5*
TOTAL (e'')=(c'')+(d'')	**22.5**	**32.95**	**43.95**	**41.0**	**34.2**	**30.4**	**205.0**

Source: based on data from the 2022 EFD Update, the 2022 EFD and the 2021 EFD.
(1) Totals may not match due to rounding of decimals.

Tables B2.4.1b and B2.4.1c show that, according to the 2022 EFD Update, investment amounting to 0.1 per cent of GDP, capital transfers amounting to 0.2 per cent of GDP and reductions in tax revenues also amounting to 0.2 per cent of GDP were to be financed in 2022 through subsidies (thus with a worsening impact on public finance balances), as well as additional public investment also amounting to 0.2 per cent of GDP through loans (thus with a worsening impact on public finance balances).[54]

Table B2.4.1b – Use of RRF resources broken down by economic category – Subsidies
(as a percentage of GDP)

		2021	2022	2023	2024	2025	2026
Revenues from RRF subsidies							
RRF subsidies included in revenue forecasts	2022 EFD Update	0.1	0.5	1.1	0.8	0.7	n.d.
	2022 EFD	0.1	0.7	1.1	0.8	0.5	n.d.
	2021 EFD Update	0.3	0.7	1.0	0.7	n.d.	n.d.
	2021 EFD	0.6	0.9	1.4	0.5	0.2	0.0
Expenditure financed by RRF subsidies							
Total current expenditure	2022 EFD Update	0.0	0.0	0.2	0.2	0.2	n.d.
	2022 EFD	0.0	0.1	0.2	0.2	0.1	n.d.
	2021 EFD Update	0.1	0.2	0.2	0.1	n.d.	n.d.
	2021 EFD	0.1	0.1	0.2	0.1	0.0	0.0
Gross fixed capital formation	2022 EFD Update	0.0	0.1	0.2	0.4	0.3	n.d.
	2022 EFD	0.0	0.2	0.3	0.3	0.3	n.d.
	2021 EFD Update	0.1	0.2	0.3	0.3	n.d.	n.d.
	2021 EFD	0.4	0.5	0.8	0.2	0.1	0.0
Capital transfers	2022 EFD Update	0.1	0.2	0.5	0.1	0.1	n.d.
	2022 EFD	0.1	0.3	0.5	0.1	0.0	n.d.
	2021 EFD Update	0.1	0.3	0.3	0.2	n.d.	n.d.
	2021 EFD	0.1	0.3	0.3	0.2	0.0	0.0
Other costs financed by RRF subsidies							
Reduction in tax revenue	2022 EFD Update	0.0	0.2	0.2	0.2	0.2	n.d.
	2022 EFD	0.0	0.1	0.2	0.3	0.1	n.d.
	2021 EFD Update	0.0	0.1	0.2	0.2	n.d.	n.d.
	2021 EFD	0.0	0.0	0.1	0.1	0.1	0.1

Source: based on data from the 2022 EFD Update, the 2022 EFD and the 2021 EFD.

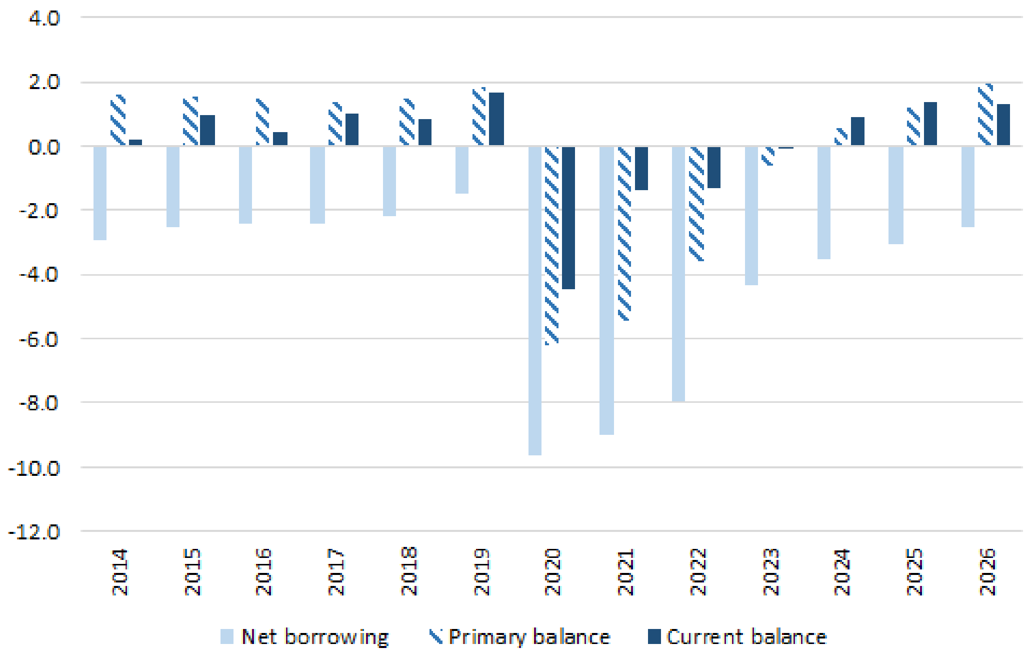
Table B2.4.1c – Use of RRF resources broken down by economic category – Loans
(as a percentage of GDP)

		2021	2022	2023	2024	2025	2026
Expenditure financed by RRF loans							
Total current expenditure	2022 EFD Update	0.0	0.0	0.1	0.1	0.1	n.d.
	2022 EFD	0.0	0.1	0.1	0.1	0.1	n.d.
	2021 EFD Update	0.0	0.0	0.0	0.1	n.d.	n.d.
	2021 EFD	0.2	0.2	0.0	0.1	0.1	0.1
Gross fixed capital formation	2022 EFD Update	0.1	0.2	0.9	1.3	1.4	n.d.
	2022 EFD	0.1	0.7	0.9	1.4	1.4	n.d.
	2021 EFD Update	0.3	0.6	0.8	1.4	n.d.	n.d.
	2021 EFD	0.5	0.5	0.5	1.0	0.9	0.8
Capital transfers	2022 EFD Update	0.0	0.0	0.0	0.0	0.0	n.d.
	2022 EFD	0.0	0.0	0.0	0.0	0.0	n.d.
	2021 EFD Update	0.1	0.0	0.0	0.0	n.d.	n.d.
	2021 EFD	0.1	0.2	0.2	0.2	0.2	0.1

Source: based on data from the 2022 EFD Update, the 2022 EFD and the 2021 EFD.

[54] As was the case in the other policy documents, transfers related to the Rural Development programme, the Just Transition Fund (JTF) and other programmes have not been taken into account for reasons of prudence and given the relatively small amounts involved. According to the ESA 2010 accounting rules, these transfers from the EU and the related expenditure offset each other with zero impact on the deficit.

Figure 2.2 – General government budget balances – Years 2014-2026
(as a percentage of GDP; trend developments from 2023)

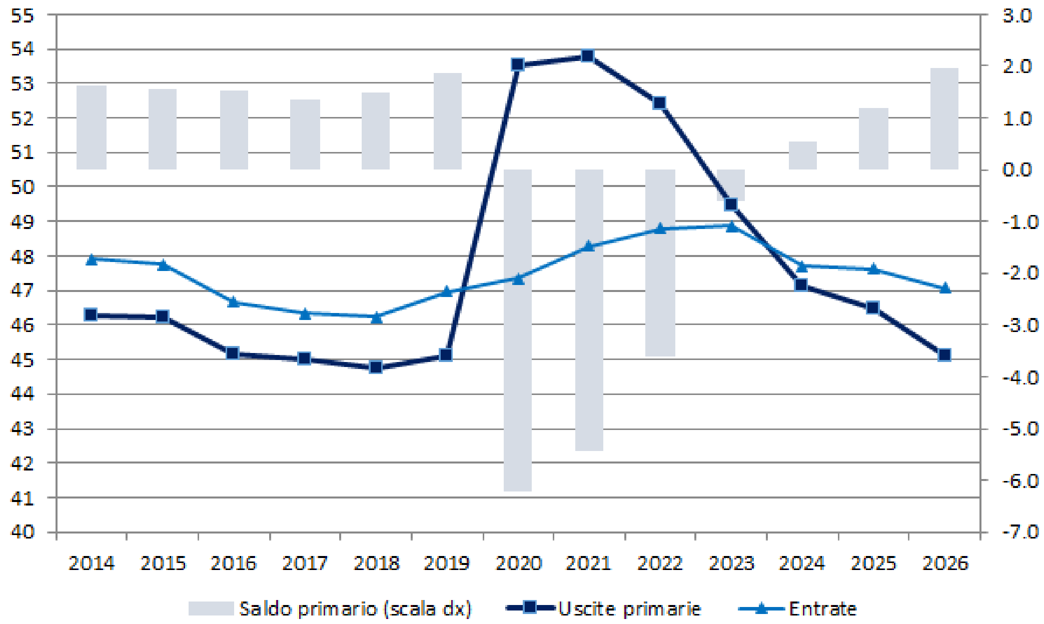


Source: based on data from Istat and the 2023 EFD.

These trends assume, on the one hand, a slightly declining revenue profile with respect to GDP from 2024 and, on the other hand, given the unchanged legislation nature of the forecast, a more pronounced downward trajectory of primary expenditure as a percentage of GDP (Figure 2.3 and Tables 2.8a and 2.8b); on the contrary, interest expenditure on GDP is expected to grow from 2024, reflecting the effects of the expected increase in both short-term and long-term rates.

Primary balance is still expected to remain in deficit in 2023 (0.6 per cent of GDP), albeit with a marked improvement over 2022, and to turn positive and increase from the following year, reaching 0.5 per cent in 2024, 1.2 per cent in 2025 and 2 per cent in 2026. Interest expenditure is projected to fall to 3.7 per cent of GDP in the current year due to the strong decline in prices, but then to gradually increase to 4.1 in 2024, 4.2 in 2025 and 4.5 in 2026 due, as already mentioned, to higher expected rates. Such expenditure is expected to reach a level of 100 billion in 2026, more than forty billion higher than the relative minimum reached in 2020. Primary expenditure is expected to fall in terms of GDP (by 7.3 percentage points, from 52.4 per cent in 2022 to 45.1 in 2026) much more than revenues (which are projected to fall by 1.7 percentage points, from 48.8 per cent in 2022 to 47.1 in 2026).

Figure 2.3 – General government primary balance, revenue and primary expenditure – Years 2014-2026
(as a percentage of GDP; trend developments from 2023)



Source: based on data from Istat and the 2023 EFD.

Compared to GDP, current primary expenditure is expected to decrease significantly – given the trend nature of the projections (which, for example, do not include expenditure for contractual renewals subsequent to those of the 2019-2021 three-year reference period) and due to the gradual discontinuation of measures to counter the impact of high energy prices (Table 2.9) – as is, to a lesser extent, capital expenditure. Despite the measures introduced by the NRRP, the latter also declines in absolute terms with respect to 2022, when expenditure was very high due to the new classification of the Superbonus and Façade Bonus. Over the four-year forecast period of the EFD, investment spending is projected to average 3.5 per cent of GDP, higher than in the years following the financial crisis due to the impact of additional measures related to the NRRP. In the 2024-25 period, public investment as a percentage of GDP (3.8 and 3.7 per cent) is projected to be in line with the peak recorded in 2009. The financial impact of the RRF resources, after amounting to 0.2 per cent of GDP in 2022, is expected to peak at 1.8 per cent in 2025, financing slightly less than half of the investments forecast in the trend scenario for that year.

Looking more closely at the main components of the general government account (Figure 2.4), wages and salaries show a profile that reflects an increase in employment and, in 2023, the contractual renewals for public management (relating to the 2019-2021 period) – which follow those for other sectors signed in 2022 – as well as the allowance that is paid to workers for the following years, pending subsequent renewals.

Table 2.8a – General government account: trend forecasts *(millions of euro)*

	2023 EFD					
	2021	2022	2023	2024	2025	2026
Wages and salaries	176,752	186,916	189,237	186,230	187,347	187,747
Intermediate consumption	158,083	166,014	173,202	166,632	168,291	172,077
Social security transfers	397,876	406,921	424,730	449,060	460,270	472,460
Pensions	*286,271*	*296,998*	*317,990*	*340,700*	*350,950*	*361,890*
Other social security transfers	*111,605*	*109,923*	*106,740*	*108,360*	*109,320*	*110,570*
Other current expenditure	81,644	95,562	99,107	84,439	83,984	81,975
TOTAL PRIMARY CURRENT EXPENDITURE	**814,355**	**855,413**	**886,275**	**886,361**	**899,892**	**914,259**
Interest expenditure	63,693	83,206	75,643	85,188	91,609	100,604
TOTAL CURRENT EXPENDITURE	**878,048**	**938,619**	**961,918**	**971,549**	**991,500**	**1,014,863**
of which: *Health expenditure*	*127,451*	*131,103*	*136,043*	*132,737*	*135,034*	*138,399*
Gross fixed capital formation	52,057	51,465	66,558	78,959	80,804	75,225
Investment subsidies	58,461	76,870	40,945	24,392	24,732	17,303
Other capital expenditure	36,044	16,376	4,594	1,912	4,416	4,536
TOTAL CAPITAL EXPENDITURE	**146,562**	**144,711**	**112,097**	**105,263**	**109,952**	**97,064**
TOTAL PRIMARY EXPENDITURE	**960,917**	**1,000,124**	**998,372**	**991,624**	**1,009,844**	**1,011,323**
TOTAL EXPENDITURE	**1,024,610**	**1,083,330**	**1,074,015**	**1,076,812**	**1,101,452**	**1,111,927**
Total tax revenues	529,411	568,649	600,213	615,411	635,585	651,659
Direct taxes	*267,698*	*290,397*	*295,160*	*299,175*	*309,725*	*318,214*
Indirect taxes	*260,115*	*276,543*	*303,145*	*314,651*	*324,263*	*331,837*
Capital account taxes	*1,598*	*1,709*	*1,908*	*1,585*	*1,597*	*1,608*
Social security contributions	246,062	261,004	273,919	288,383	297,134	305,168
Actual social security contributions	*241,495*	*256,932*	*269,672*	*284,039*	*292,695*	*300,640*
Imputed social security contributions	*4,567*	*4,072*	*4,247*	*4,344*	*4,439*	*4,528*
Other current revenues	79,599	85,869	88,062	88,050	90,006	88,475
TOTAL CURRENT REVENUES	**853,474**	**913,813**	**960,286**	**990,259**	**1,021,128**	**1,043,694**
Other capital revenues	8,328	15,908	23,997	11,039	12,660	9,738
TOTAL CAPITAL ACCOUNT REVENUES	**9,926**	**17,617**	**25,905**	**12,624**	**14,257**	**11,346**
TOTAL REVENUES	**863,400**	**931,430**	**986,191**	**1,002,883**	**1,035,385**	**1,055,040**
Tax burden	*43.4*	*43.5*	*43.3*	*43.0*	*42.9*	*42.7*
NET PRIMARY BORROWING (-) / LENDING (+)	**-97,517**	**-68,694**	**-12,181**	**11,259**	**25,543**	**43,718**
as a % of GDP	*-5.5*	*-3.6*	*-0.6*	*0.5*	*1.2*	*2.0*
NET BORROWING (-) / LENDING (+)	**-161,210**	**-151,900**	**-87,824**	**-73,929**	**-66,066**	**-56,887**
as a % of GDP	*-9.0*	*-8.0*	*-4.4*	*-3.5*	*-3.0*	*-2.5*
Nominal GDP	*1,787,675*	*1,909,154*	*2,018,045*	*2,102,844*	*2,173,320*	*2,241,161*

Source: base on data from the 2023 EFD, Table II.2-2 and from Istat.

Intermediate consumption reflects, in addition to the impact of the NRRP measures, the effects on 2023 expenditure of the renewal of agreements for general practitioners and internal outpatient specialists (including arrears) and of the amount allocated by Decree Law No. 34/2023 to offset the breach of the expenditure ceiling for medical devices. The intermediate consumption expenditure of central government in 2023 and local government in 2024-25 has been revised significantly upward compared to the latest NTI estimates. In the case of local government, which includes National Health Authorities, it can be assumed that part of the upward revisions concern, in particular, healthcare intermediate consumption whose amounts, as for the rest of trend current healthcare expenditure, may have been increased so as to keep expenditure as a percentage of GDP between 6.7 per cent of GDP at the beginning of the planning period and 6.2 per cent at the end (percentages substantially unchanged from those planned in the 2022 EFD for 2023-25).

Table 2.8b − General government account: trend forecasts
(as a percentage of GDP)

			2023 EFD			
	2021	2022	2023	2024	2025	2026
Wages and salaries	9.9	9.8	9.4	8.9	8.6	8.4
Intermediate consumption	8.8	8.7	8.6	7.9	7.7	7.7
Social security transfers	22.3	21.3	21.0	21.4	21.2	21.1
Pensions	*16.0*	*15.6*	*15.8*	*16.2*	*16.1*	*16.1*
Other social security transfers	*6.2*	*5.8*	*5.3*	*5.2*	*5.0*	*4.9*
Other current expenditure	4.6	5.0	4.9	4.0	3.9	3.7
TOTAL PRIMARY CURRENT EXPENDITURE	**45.6**	**44.8**	**43.9**	**42.2**	**41.4**	**40.8**
Interest expenditure	3.6	4.4	3.7	4.1	4.2	4.5
TOTAL CURRENT EXPENDITURE	**49.1**	**49.2**	**47.7**	**46.2**	**45.6**	**45.3**
of which: *Health expenditure*	*7.1*	*6.9*	*6.7*	*6.3*	*6.2*	*6.2*
Gross fixed capital formation	2.9	2.7	3.3	3.8	3.7	3.4
Investment subsidies	3.3	4.0	2.0	1.2	1.1	0.8
Other capital expenditure	2.0	0.9	0.2	0.1	0.2	0.2
TOTAL CAPITAL EXPENDITURE	**8.2**	**7.6**	**5.6**	**5.0**	**5.1**	**4.3**
TOTAL PRIMARY EXPENDITURE	**53.8**	**52.4**	**49.5**	**47.2**	**46.5**	**45.1**
TOTAL EXPENDITURE	**57.3**	**56.7**	**53.2**	**51.2**	**50.7**	**49.6**
Total tax revenues	29.6	29.8	29.7	29.3	29.2	29.1
Direct taxes	*15.0*	*15.2*	*14.6*	*14.2*	*14.3*	*14.2*
Indirect taxes	*14.6*	*14.5*	*15.0*	*15.0*	*14.9*	*14.8*
Capital account taxes	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*
Social security contributions	13.8	13.7	13.6	13.7	13.7	13.6
Actual social security contributions	*13.5*	*13.5*	*13.4*	*13.5*	*13.5*	*13.4*
Imputed social security contributions	*0.3*	*0.2*	*0.2*	*0.2*	*0.2*	*0.2*
Other current revenues	4.5	4.5	4.4	4.2	4.1	3.9
TOTAL CURRENT REVENUES	**47.7**	**47.9**	**47.6**	**47.1**	**47.0**	**46.6**
Other capital revenues	0.5	0.8	1.2	0.5	0.6	0.4
TOTAL CAPITAL ACCOUNT REVENUES	**0.6**	**0.9**	**1.3**	**0.6**	**0.7**	**0.5**
TOTAL REVENUES	**48.3**	**48.8**	**48.9**	**47.7**	**47.6**	**47.1**
NET PRIMARY BORROWING (-) / LENDING (+)	**-5.5**	**-3.6**	**-0.6**	**0.5**	**1.2**	**2.0**
NET BORROWING (-) / LENDING (+)	**-9.0**	**-8.0**	**-4.4**	**-3.5**	**-3.0**	**-2.5**
Nominal GDP	*1,787,675*	*1,909,154*	*2,018,045*	*2,102,844*	*2,173,320*	*2,241,161*

Source: based on data from the 2023 EFD, Table II.2-2 and from Istat.

The dynamic of social benefits is largely affected by the effects of the increase in inflation on pensions (with a one-year lag) − albeit mitigated by the change in the indexation mechanism for 2023-24 provided for in the 2023 Budget Law − and by the measures on early access to retirement; with regard to non-pension benefits, the dynamic is affected by the regulations for the Citizenship Income (limited in 2023 and being reformed from 2024), the measures to increase the Single and Universal child allowance and the extension of the so-called social APE.

Table 2.8c – General government account: trend forecasts
(growth rates)

			2023 EFD		
	2022	2023	2024	2025	2026
Wages and salaries	5.8	1.2	-1.6	0.6	0.2
Intermediate consumption	5.0	4.3	-3.8	1.0	2.2
Social security transfers	2.3	4.4	5.7	2.5	2.6
Pensions	*3.7*	*7.1*	*7.1*	*3.0*	*3.1*
Other social security transfers	*-1.5*	*-2.9*	*1.5*	*0.9*	*1.1*
Other current expenditure	17.0	3.7	-14.8	-0.5	-2.4
TOTAL PRIMARY CURRENT EXPENDITURE	**5.0**	**3.6**	**0.0**	**1.5**	**1.6**
Interest expenditure	30.6	-9.1	12.6	7.5	9.8
TOTAL CURRENT EXPENDITURE	**6.9**	**2.5**	**1.0**	**2.1**	**2.4**
of which: *Health expenditure*	*2.9*	*3.8*	*-2.4*	*1.7*	*2.5*
Gross fixed capital formation	-1.1	29.3	18.6	2.3	-6.9
Investment subsidies	31.5	-46.7	-40.4	1.4	-30.0
Other capital expenditure	-54.6	-71.9	-58.4	131.0	2.7
TOTAL CAPITAL EXPENDITURE	**-1.3**	**-22.5**	**-6.1**	**4.5**	**-11.7**
TOTAL PRIMARY EXPENDITURE	**4.1**	**-0.2**	**-0.7**	**1.8**	**0.1**
TOTAL EXPENDITURE	**5.7**	**-0.9**	**0.3**	**2.3**	**1.0**
Total tax revenues	7.4	5.6	2.5	3.3	2.5
Direct taxes	*8.5*	*1.6*	*1.4*	*3.5*	*2.7*
Indirect taxes	*6.3*	*9.6*	*3.8*	*3.1*	*2.3*
Capital account taxes	*6.9*	*11.6*	*-16.9*	*0.8*	*0.7*
Social security contributions	6.1	4.9	5.3	3.0	2.7
Actual social security contributions	*6.4*	*5.0*	*5.3*	*3.0*	*2.7*
Imputed social security contributions	*-10.8*	*4.3*	*2.3*	*2.2*	*2.0*
Other current revenues	7.9	2.6	0.0	2.2	-1.7
TOTAL CURRENT REVENUES	**7.1**	**5.1**	**3.1**	**3.1**	**2.2**
Other capital revenues	91.0	50.8	-54.0	14.7	-23.1
TOTAL CAPITAL ACCOUNT REVENUES	**77.5**	**47.0**	**-51.3**	**12.9**	**-20.4**
TOTAL REVENUES	**7.9**	**5.9**	**1.7**	**3.2**	**1.9**

Source: based on data from the 2023 EFD, Table II.2-2 and from Istat.

The path of other current expenditures – significantly revised downward with respect to the latest NTI estimates – essentially reflects the impact on production subsidies of tax credits for the energy emergency on 2023 alone, as well as the impact of the targeted contribution relief aimed at encouraging the hiring of young people, women and workers in southern regions.

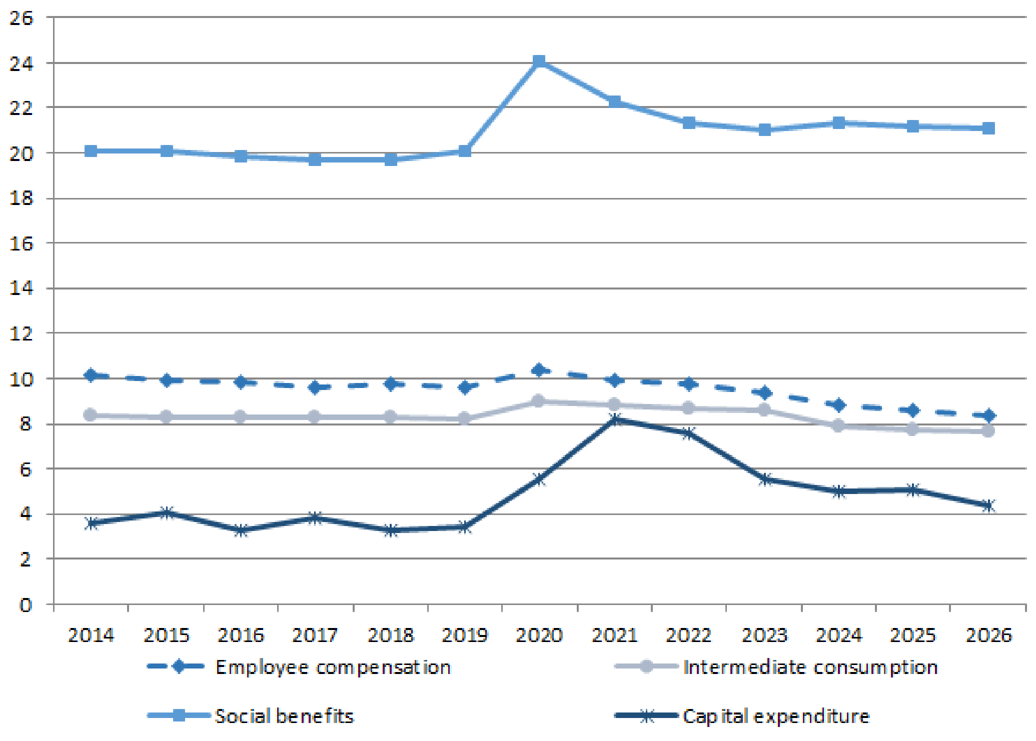
The components of capital expenditure show differing trends. The profile of investment expenditure and of investment grants substantially reflects the implementation coefficients of the Supplementary Fund envisaged in Decree Law No. 59/2021 and the assumptions on the implementation of the NRRP programmes, which have been partly modified by rescheduling expenditure forward with respect to what was indicated in the EFD Update. Investments are expected to grow strongly in 2023-24 (with 29.3 per cent increases in 2023 and 18.6 per cent in 2024), and to grow slightly again in 2025 (by 2.3 per cent) and decrease in 2026 (by 6.9 per cent) (Table 2.8c).

Table 2.9 – Inflation mitigation measures: breakdown by type
(billions of euro)

	2021	2022	2023	2024	2025	Total
Total	**5.6**	**70.0**	**35.1**	**4.7**	**3.5**	**118.9**
As a percentage of GDP	*0.3*	*3.7*	*1.7*	*0.2*	*0.2*	
1) System charges	4.5	12.4	6.5	0.5	0.5	24.5
Energy	*4.0*	*9.0*	*1.0*	*0.0*	*0.0*	*14.0*
Gas	*0.5*	*3.4*	*5.0*	*0.0*	*0.0*	*9.0*
2) Lowering of excise duties on gasoline, diesel and LPG and lowering of VAT on gas for road transport	0.0	9.2	-0.6	0.3	0.0	8.9
3) Lowering of VAT for civil and industrial use	0.6	2.5	1.6	0.0	0.0	4.7
4) Social bonuses (energy and gas)	0.5	3.2	2.5	0.0	0.0	6.2
5) One-off allowances (1)	0.0	9.9	0.3	0.0	0.0	10.2
6) Exemption from social security and pension measures	0.0	2.6	8.2	0.9	0.0	11.7
7) Tax credits	0.0	20.3	6.3	0.0	0.0	26.5
Energy	*0.0*	*11.9*	*3.6*	*0.0*	*0.0*	*15.5*
Gas	*0.0*	*8.3*	*2.7*	*0.0*	*0.0*	*11.0*
8) Additional measures	0.1	9.9	10.2	3.0	3.0	26.2
Local authorities	*0.0*	*1.6*	*0.5*	*0.1*	*0.0*	*2.2*
National Health Service	*0.0*	*1.7*	*1.4*	*0.0*	*0.0*	*3.1*
Investments	*0.1*	*3.9*	*3.9*	*3.0*	*3.0*	*13.9*
Other	*0.0*	*2.7*	*4.4*	*-0.2*	*0.0*	*7.0*

Source: Summary tables of the financial effects annexed to the measures mentioned in Table 2.4 and to Decree Laws 34/2023 and 48/2023.
(1) For workers and pensioners benefiting from NASPI, DIS-COLL and RdC.

Figure 2.4 – General government's main expenditure items – Years 2014-2026
(as a percentage of GDP; trend developments from 2023)



Source: based on data from Istat and the 2023 EFD.

Investment grants are particularly affected by the recognition in the accounts of the effects of building bonuses up to 2025, albeit limited by the measures provided for in DL 11/2023. The EFD reports that new guidance on building bonuses is expected from the statistical authorities, which could lead to the impact of the bonuses being reclassified on a cash basis in light of the provisions of DL 11/2023. This would occur in the event that the subsidies are considered 'non-payable' (since the possibility of applying an invoice discount and transferring the credit to third parties, with certain exceptions, would no longer exist). As a result, they would be classified as reducing tax revenues in the various years based on their actual use, with a different impact on the deficit (which would improve in the first three years and worsen in the following years) than what is currently envisaged.

Other capital expenditures decrease after the various extraordinary interventions of recent years; in 2024, they reflect the reduction in natural gas stocks following the sale of what was stored in 2022-23. This item is also affected, on the one hand, by the reduction in reserves for standardised guarantees granted by the SMEs Guarantee Fund and the guarantee fund for first homes and, on the other hand, conversely, by the liquidation calls related to other guarantee measures due to the expiry of the pre-amortisation period.

Finally, interest expenditure is projected to fall to 3.7 per cent of GDP[55] in 2023, in line with the progressive decline in the Italian and euro area inflation rate, which reduces the revaluation of inflation-indexed securities; in the following three-year period, instead, interest expenditure is expected to rise again to 4.1 per cent of GDP in 2024, 4.2 per cent in 2025 and 4.5 per cent in 2026. This is mainly due to the upward shift in the yield curve on government bonds throughout the planning period − which implies an increasing burden over time considering that the effects of higher-cost issues add up over the years − and to the still relatively high level of the inflation rate, which in the EFD is assumed to reach values close to 2 per cent only starting from 2025 in the case of Italy and from 2026 in the case of Europe.

The expected reduction in revenues on GDP, down by 1.7 percentage points in 2026 compared to 2022, is to be attributed to a reduction in the tax burden from 43.5 to 42.7 per cent and, in particular, to the direct tax component (Figure 2.5 and Table 2.8b). The incidence of indirect taxes on GDP returns to higher levels as from 2023 due to the gradual reduction of the effects of interventions to counter the impact of high energy prices, and remains such for the following three years, while the incidence of social contributions and capital taxes remains stable. The reduction in the incidence on GDP of other current revenues (from 2023) and of other capital revenues (from 2024) is essentially due to the inclusion in the accounts of subsidies from the EU aimed at financing NRRP measures.

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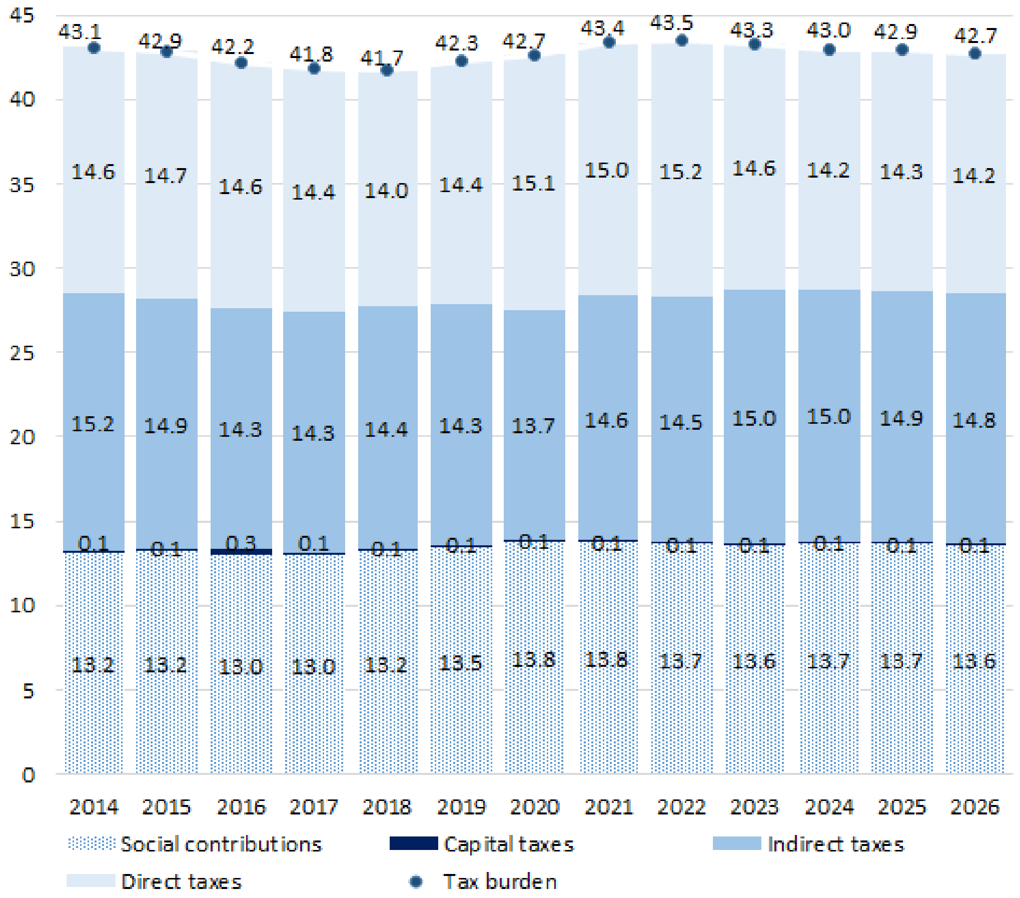
[55] Compared to the 2022 EFD Update, the 0.4 percentage points of GDP reduction in interest expenditure forecast in 2023 is mainly due to a reduction in yields on inflation-indexed bonds amounting to almost EUR 9 billion compared to previous assumptions.

Figure 2.5 – Tax burden and its components – Years 2014-2026
(trend developments from 2023)



Source: based on data from Istat and the 2023 EFD.

Direct taxes as a percentage of GDP are negatively impacted by the changes to personal taxation introduced by the 2022 Budget Law, the extension of the flat-tax regime for the self-employed, the revision of the pension indexation mechanism for 2023-24 and the discontinuation as from 2024 of the extraordinary levy on companies operating in the energy sector provided for by DL 21/2022. On the contrary, they are positively impacted by the abolition of the deductions for dependent children up to the age of 21 years, coinciding with the introduction of the Universal child allowance.

Indirect taxation is affected by a VAT trend that also reflects the effects on the level of nominal consumption of the gradual easing of inflationary pressures and, only for 2023, by price containment measures in the electricity and gas sectors; in addition, the trend of indirect taxation is influenced by the restoration of ordinary excise rates on energy products and by the collection of revenue from general system charges.

Social security contributions evolve in line with the whole economy's wage bill but are affected in 2023 by the provisions contained in the Budget Law extending the partial exemption (2 percentage points) on the share of social security contributions to be paid by employees and increasing it by a further percentage point (for a total of 3 percentage points) for employees with a monthly income of EUR 1,538.

The 2023 EFD and the April Report to Parliament: the policy targets. – The 2023 EFD policy scenario for 2023-25 confirms the deficit-to-GDP targets set in the 2022 EFD Update and the 2023 DBP of last November, against slightly more favourable expected budget balances under unchanged legislation in 2023 and 2024. The deficit targets thus remain set at 4.5 per cent of GDP in 2023, 3.7 per cent in 2024 and 3 per cent in 2025; a target at 2.5 per cent of GDP is then set for 2026 (Table 2.10).

The difference between policy and trend balances in 2023-24 was destined with DL 48/2023 to finance a cut in the tax wedge on low and medium wage earners in 2023 and to increase the Tax Relief Fund in 2024. The Government deemed these measures necessary to support private demand and counter the decline in the purchasing power of low and medium wage earners caused by inflation.

Despite the confirmed nominal targets, the plan for adjusting the structural balances towards the MTO was revised downward with respect to the 2022 EFD Update, particularly the structural balance for 2023; for this reason, on 11 April the Government submitted a Report to Parliament, pursuant to Article 6 of Law 243/2012, to request authorisation for such revision.

The Report also included the increased amounts of net borrowing compared to the scenario under existing legislation, including interest expense contributing to the worsening of the adjustment path towards the MTO (Table 2.11). In particular, these amounts amounted to EUR 3.4 billion in 2023 and EUR 4.5 billion in 2024. Starting in 2025, the amounts only concerned interest expenditure.

Table 2.10 – Trend forecasts and deficit targets in the 2023 EFD (1)
(as a percentage of GDP)

	2023	2024	2025	2026
Trend net borrowing (a)	**-4.4**	**-3.5**	**-3.0**	**-2.5**
Net manoeuvre (b)	-0.2	-0.2	0.0	0.0
Policy net borrowing (c=a+b)	**-4.5**	**-3.7**	**-3.0**	**-2.5**

Source: based on data from the 2023 EFD.
(1) Totals may not match due to rounding of decimals.

Table 2.11 – Borrowing authorisation request – Impact on general government net borrowing – Years 2023-2033
(million euro)

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
General gov. net borrowing	3,400	4,500	314	335	370	390	415	440	460	485	520

Source: Government report to Parliament (under Article 6, Law 243/2012) of April 2023.

The EFD also indicated that − in order to provide for the refinancing of the so-called unchanged policies as from 2024 and to continue reducing the tax burden in the two-year period 2025-26, as well as, in general, to finance the new measures to be adopted by the Government as part of the end-of-year budget package − funding would be found within the public budget, including through a strengthening of the spending review aimed at identifying savings increasing over time, and through greater cooperation between the tax authorities and taxpayers.

Unchanged policy measures − as is well known − comprise a series of recurrent expenditures that are usually financed annually through the budget law. These generally include the costs of future contract renewals for general government employees, international missions and a number of capital expenditures. In the 2023 EFD no distinction was made between the various expenditure components and instead a single figure for additional resources needed to finance unchanged policies was reported; these amounted to EUR 7 billion (0.3 per cent of GDP) in 2024, EUR 7.5 billion (0.3 per cent of GDP) in 2025 and EUR 8 billion (0.4 per cent of GDP) in 2026.[56]

Furthermore, the EFD reported that the central government administrations were to contribute to financing these needs through increasing expenditure savings amounting to EUR 300 million in 2024, EUR 500 million in 2025 and EUR 700 million in 2026, to be distributed among Ministries and areas of intervention as provided for by a Prime Minister's Decree before next May 31, as envisaged by the procedure set out in Article 22-bis of Law No. 196/2009.

As regards the public debt-to-GDP ratio, the EFD policy scenario projects a continued decline in all the years of the forecast horizon (Table 2.12). In particular, in the current year debt is expected to fall to 142.1 per cent of GDP, 2.3 percentage points lower than in 2022.

Again in 2023, given the planned trend in public accounts and considering the impact of Eurosystem programmes on the Italian securities market, it can be estimated, under certain assumptions, that the amount of net flows of public securities to be absorbed by private investors will be higher than in 2022 (see Box 2.5 'The impact of Eurosystem programmes on the Italian government bond market').

In the following three-year period, the debt-to-GDP ratio is expected to decline less sharply, falling by 0.6 percentage points on average per year; it is expected to fall to 141.4 per cent in 2024, 140.9 per cent in 2025 and 140.4 per cent in 2026; thus, over the EFD forecast period (from 2023 to 2026), the expected decline amounts to about 4 percentage points of GDP overall.

[56] See page 24, Section II of the EFD. The Document pointed out that 'the indication of additional resources at unchanged policies is purely indicative and is independent from any economic policy consideration. The identification of the measures that the Government will deem necessary to implement, both in terms of size and in the economic and social sectors deemed worthy of attention, shall in fact be subject to a specific assessment, also for the purpose of verifying compliance with the public finance targets'.

Table 2.12 – Determinants of the change in the debt-to-GDP ratio (1)
(as a percentage of GDP and rates of change; policy targets from 2023)

	2021	2022	2023	2024	2025	2026
Debt-to-GDP ratio	149.9	144.4	142.1	141.4	140.9	140.4
Change in the debt-to-GDP ratiO	-5.0	-5.5	-2.3	-0.7	-0.5	-0.5
Primary surplus (2) (accrual basis)	**5.5**	**3.6**	**0.8**	**-0.3**	**-1.2**	**-2.0**
***Snow-ball effect* (3), of which:**	**-7.4**	**-5.2**	**-4.2**	**-1.7**	**-0.4**	**0.2**
Interest expenditure/Nominal GDP	*3.6*	*4.4*	*3.7*	*4.1*	*4.2*	*4.5*
Contribution of nominal GDP growth	*-11.0*	*-9.5*	*-7.9*	*-5.8*	*-4.6*	*-4.3*
p.m. : Debt average cost	*2.5*	*3.1*	*2.7*	*3.0*	*3.1*	*3.3*
p.m. : Net borrowing	*-9.0*	*-8.0*	*-4.5*	*-3.7*	*-3.0*	*-2.5*
Stock-flow adjustment, of which:	**-3.1**	**-3.9**	**1.1**	**1.4**	**1.1**	**1.3**
Cash-accrual component		*-4.1*	*0.5*	*0.8*	*0.5*	*0.4*
Net accumulation of financial assets, of which:		*0.1*	*0.5*	*0.3*	*0.4*	*0.6*
Privatisation revenues		*0.00*	*0.00*	*-0.01*	*-0.09*	*-0.04*
Debt valuation effects		*0.2*	*0.3*	*0.4*	*0.3*	*0.2*
Other		*-0.1*	*-0.3*	*-0.1*	*-0.2*	*0.0*

Source: base on data from the 2023 EFD.
(1) Totals may not match due to rounding of decimals. – (2) The item "primary surplus" with a positive sign indicates a deficit and therefore contributes to a positive change in the debt-to-GDP ratio. – (3) The snow-ball effect is measured as the sum of interest expenditure on nominal GDP and the contribution of nominal GDP growth, equal to (dt-1/GDPt-1)x(-gt/(1+gt)), where dt-1 is the debt at time t-1, and gt is the nominal GDP growth rate at time t.

This is a less intense decline than that projected in the 2022 EFD Update. However, given the better-than-expected outcome in 2022, the ratio is expected to be slightly lower in 2025 than previously projected (140.9 per cent, compared to the previous 141.2 per cent). In addition, at the end of the forecast period the ratio is projected to be about 15 percentage points lower than the peak in 2020 (154.9 per cent) but over 6 percentage points higher than the pre-pandemic level of 2019, when debt was 134.1 per cent of output. In order to reach this level by the end of the decade − the target set in previous policy documents − further reductions in the ratio over the four-year period 2027-2030 would have to be achieved, averaging about 1.6 percentage points of GDP per year, which is higher than the reductions currently planned for the three-year period 2024-26.

These trends reflect the policy macroeconomic scenario of the 2023 EFD and could obviously be affected by different, overall less favourable assumptions (see Box 2.6 'The sensitivity of the debt-to-GDP ratio to macroeconomic assumptions').

The dynamics of the debt-to-GDP ratio is affected in different ways by the various determinants (Table 2.12 and Figure 2.6). The primary balance makes an unfavourable contribution only in 2023, amounting to 0.8 percentage points, while in the subsequent three-year period 2024-26 it is expected to contribute to the reduction of the ratio, with increasing impacts over time, amounting in total to 3.5 percentage points of GDP.

Box 2.5 – The impact of Eurosystem programmes on the Italian government bond market

As already mentioned in section 2.1, to counter inflationary pressures in the euro area, the Governing Council of the European Central Bank (ECB) introduced a phase of restrictive monetary policy beginning last July, first by putting an end to net purchases of financial assets under the Asset Purchase Programme (APP) effective 1 July, and then by progressively raising the key policy interest rates, with four interventions[57] that raised official rates by a total of 2.5 percentage points in 2022.

In the course of 2023, during its February and March meetings, the Governing Council of the ECB raised key interest rates again by 0.5 percentage points and by a further 0.25 percentage points at its May meeting, bringing the reference rate on banks' deposits with the Eurosystem to 3.25 per cent; thus, the total increase from July 2022 amounted to 3.75 percentage points. At the same time, the APP portfolio was reduced at an average rate of EUR 15 billion per month starting last March and continuing until June, due to the partial reinvestment of the principal repaid on maturing securities. As of July 2023, the Governing Council plans to end reinvestments under the APP programme. On the other hand, with regard to the Pandemic Emergency Purchase Programme (PEPP), i.e. the programme for the purchase of public and private securities for the pandemic emergency, the full reinvestment of the principal repaid on maturing securities was confirmed at least until the end of 2024; moreover, the Council confirmed that such reinvestments would continue to be carried out in a flexible manner to avoid any fragmentation of financial markets.[58]

In 2022, the Eurosystem's purchases of financial assets on the secondary market were thus significantly reduced compared to 2021. With regard to Italian government bonds, a total of around EUR 42 billion of securities were purchased in the secondary market (of which EUR 14 billion under the APP programme and an estimated EUR 28 billion under the PEPP), down by more than EUR 100 billion year-on-year.

As regards the stock of securities held by the Eurosystem for monetary policy purposes, they totalled EUR 4,907 billion at the end of March 2023, of which EUR 3,231 billion under the APP programme and EUR 1,676 billion under the PEPP programme. The equivalent value of the Italian government bonds purchased by the Eurosystem amounted to EUR 732 billion, of which EUR 442 billion under the APP and EUR 290 billion under the PEPP.

Based on a number of assumptions, the impact of the Eurosystem's programmes on the Italian government bond market for 2023 can be estimated, and consequently the amount of the net flows of remaining bonds to be absorbed by private investors can be estimated.

Gross issues of government securities are estimated at EUR 474 billion in 2023, higher than in 2022, due both to an increase in the cash balance[59] and to higher levels of securities to be redeemed in the year (Table B2.5.1). This value derives from a projected coverage of the state sector's needs of EUR 113 billion, compared with EUR 67 billion in 2022, and from the volume of maturing securities estimated at EUR 390 billion (net of the reduction in the Treasury's account at the Bank of Italuùy (*Conto disponiblità*) of about EUR 6 billion and RRF loans estimated at about EUR 23 billion[60]) compared with EUR 369 billion in 2022.

As highlighted above, in 2023 the Eurosystem's purchases of Italian government bonds in the secondary market should only concern the reinvestment of part of the principal repaid on maturing bonds.

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[57] In particular, the first 50 basis point increase in the key interest rates was decided at the July meeting, the second one by 75 basis points at the September meeting, the third by 75 basis points at the October meeting and the fourth by a further 50 basis points at the December meeting.

[58] See ECB press release– 'Monetary policy decisions' of 4 May 2023.

[59] In the 2023 EFD policy scenario, State sector cash borrowing requirements are projected to increase to 5.6 per cent of GDP in 2023 from 3.5 per cent of GDP in 2022.

[60] This year, the time distribution of the RRF loan instalments already approved is maintained; however, note that discussions are underway between the Government and the European institutions for the revision and redefinition of some of the interventions envisaged in the NRRP and the related milestones and targets, to which the RRF loan instalment payments are conditional.

Table B2.5.1 – Gross issues of Italian government bonds net of Eurosystem purchase programmes

	2020	2021	2022	2023
State sector's cash borrowing requirements (a)	159	106	67	113
Maturing government bonds (b)	376	387	369	390
Change of Treasury's account at the Bank of Italy (c)	10	5	-4	-6
EU loans: *SURE* (d)	17	11	0	0
EU loans: RRF (e)	0	16	22	23
Government bonds gross issues in the primary market (f)=(a)+(b)+(c)-(d)-(e)	**528**	**471**	**410**	**474**
Government bonds purchases in the secondary market of the APP and PEPP programmes (g)	175	151	42	0
Reinvestment in the secondary market upon maturity of APP and PEPP programmes (h)	34	42	52	42
Total government bond purchases in the secondary market of APP and PEPP programmes (i)=(g)+(h)	**209**	**193**	**94**	**42**
Gross issues of government bonds in the primary market net of APP and PEPP programmes (l)=(f)-(i)	**320**	**279**	**316**	**432**

Source: based on data from the 2023 EFD, ECB, Bank of Italy and MEF.

Therefore, the Eurosystem's purchases of Italian government bonds in the secondary market are estimated at around EUR 42 billion, or 9 per cent of Italy's total planned gross issues in the primary market. To estimate the amount of capital repaid on maturing securities, Italy's capital key is applied to the aggregate figure published by the ECB on the total maturities of APP government securities, adding an estimate of the PEPP maturities according to certain assumptions developed from the published information on the stock and average life of the securities in the portfolio.

Under these assumptions, gross issues of government bonds net of Eurosystem secondary market purchases are projected at EUR 432 billion, some EUR 116 billion higher than in 2022. Estimated government bond net issuance net of Eurosystem secondary market purchases is expected to be positive by 112 billion, a marked increase from the estimated 2 billion for 2022 (Table B2.5.2). Thus, the end of the Eurosystem's government bond purchase programme starting in 2022, the partial reinvestment of the principal repaid on maturing securities from March 2023 to June 2023, and the subsequent non-renewal of securities from July 2023 under the APP programme will lead to an increase in the supply of Italian securities on the secondary market and a consequent rebalancing of the portfolios of private investors, who will have to absorb a significant amount of Italian government securities in comparison with past years.

Finally, at the end of 2022, the share of total general government debt held by the Bank of Italy stood at 26.2 per cent (up from 25.3 at the end of 2021). Moreover, given the total amount of net purchases under the APP and PEPP programmes by the ECB, it is estimated that at the end of 2022 the Bank held about 2.6 per cent of Italian general government debt.

Thus, the total share of Italian general government debt held by the Eurosystem can be estimated at 28.8 per cent at the end of 2022; in 2023, this share is expected to fall to 26.7 per cent, as a result of both the end of the net asset purchase programmes (APP and PEPP) and the subsequent reduction of the securities portfolio under the APP described above.

Table B2.5.2 – Net issues of Italian government securities net of Eurosystem purchase programmes

	2020	2021	2022	2023
State sector's cash borrowing requirements (a)	159	106	67	113
Change of Treasury's account at the Bank of Italy (b)	10	5	-4	-6
EU loans: *SURE* (c)	17	11	0	0
EU loans: RRF (d)	0	16	22	23
Government bonds net issues (e)=(a)+(b)-(c)-(d)	152	84	41	84
Government bonds purchases in the secondary market of the APP and PEPP programmes (f)	175	151	42	0
Maturities of non-reinvested APP government bonds (g)	0	0	0	28
SMP government bonds maturities (h)	9	15	3	0
Net purchases of government bonds in the secondary market of APP, PEPP and SMP programmes (i) = (f)-(g)-(h)	**166**	**135**	**39**	**-28**
Net issues of government bonds net of APP, PEPP and SMP programmes (l) = (e) - (i)	**-14**	**-51**	**2**	**112**

Source: based on data from the 2023 EFD, ECB, Bank of Italy and MEF.

Box 2.6 – The sensitivity of the debt-to-GDP ratio to macroeconomic assumptions

This box examines the sensitivity of the policy path of the debt-to-GDP ratio for 2023-26 presented in the 2023 EFD with respect to alternative assumptions on the growth rate of real GDP and, to reflect the impact of inflation, with respect to alternative assumptions on the growth rate of the GDP deflator and the consumption deflator.

The baseline scenario for the analysis is the policy evolution of the debt-to-GDP ratio for the period 2023-26 ('EFD scenario'). The alternative scenario ('the PBO scenario'), on the other hand, is based on the growth forecasts of real GDP, the GDP deflator and the consumption deflator produced by the PBO for the same period during the endorsement procedure.

In the PBO scenario, the primary balance-to-GDP ratio is recalculated every single year of the forecast horizon based on the Government's forecast figure, by adding to the latter the result of three components. The first component is equal to the differential between the values of the real GDP growth forecast of the PBO scenario and the values of the EFD scenario multiplied by the elasticity of the budget balance to changes in the economic cycle. According to European Commission estimates,[61] this parameter stands at 0.544 for Italy. The second and third components are obtained, respectively, by multiplying the differential of the GDP deflator growth rate and the differential of the consumption deflator growth rate resulting from the two scenarios by specific elasticities obtained by assuming a different reaction of government revenues and expenditures to changes in prices.

More in detail, on the revenue side, VAT revenues were assumed to react in the same year to changes in the consumption deflator growth rate while the remaining revenues to move in line with concurrent changes in the GDP deflator growth rate. Regarding the assumptions adopted for expenditure, in line with the legislation on the indexation of social security benefits to inflation, pension expenditure is expected to react one year later to shocks to the consumption deflator. With regard to the remaining expenditure items, in order to take into account the way the appropriations are typically updated, they were assumed to respond with a one-year lag to positive GDP deflator growth rate shocks while remaining unchanged in the case of negative shocks reflecting downward rigidity of the appropriations themselves.

In addition, in the PBO scenario the differential in consumer price growth with the EFD scenario is assumed to transfer entirely to short-term interest rates and partially, with a coefficient of 0.5, to long-term interest rates on debt maturing during the year. Finally, the impact of this differential on interest expenditure on securities indexed to both Italian and European inflation is considered.[62]

Over the entire forecast horizon, the PBO macroeconomic scenario, presented in paragraph 1.3, forecasts lower real GDP growth rates than the Government policy scenario. More in detail, in the three-year period 2023-25, real GDP growth in the PBO scenario is about 0.1 percentage points below the corresponding EFD values, while in 2026 the PBO forecast is 0.2 percentage points lower.

Conversely, only in 2023 does the GDP deflator dynamics appear less robust in the PBO scenario than in the Government's forecast, being 0.6 percentage points below the policy figure. In 2024-25 the GDP deflator growth rate projected in the PBO scenario is respectively 4 tenths and 6 tenths of a point above the EFD figures, while in 2026 the figure is broadly the same. Similarly, the 2023 rate of change in nominal GDP in the PBO scenario is about 0.7 percentage points lower than the value forecast by the Government, while in 2024 and 2025 nominal GDP is expected to grow by 0.3 and 0.5 percentage points respectively above the corresponding EFD values; in 2026 nominal GDP growth is forecast at 3 per cent, 0.1 points below the value expected by the EFD. Finally, as regards the consumption deflator, the PBO scenario envisages a rate in 2023 that is about 0.8 points lower than the Government's projection, while for the remaining years the figure is broadly in line, being

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[61] Mourre et al. (2019), "The Semi-Elasticities Underlying the Cyclically-Adjusted Budget Balance: An Update & Further Analysis", *European Economy Discussion Paper*, no. 098, European Commission.

[62] For details on the PBO framework for public debt sustainability analysis, see Parliamentary Budget Office (2021), "Assessing Italy's public debt dynamics in the medium term with the PBO framework: Illustrative scenario analysis for the post-Covid period", Working Paper No. 2, by C. Gabbriellini, G. Nocella and F. Padrini.

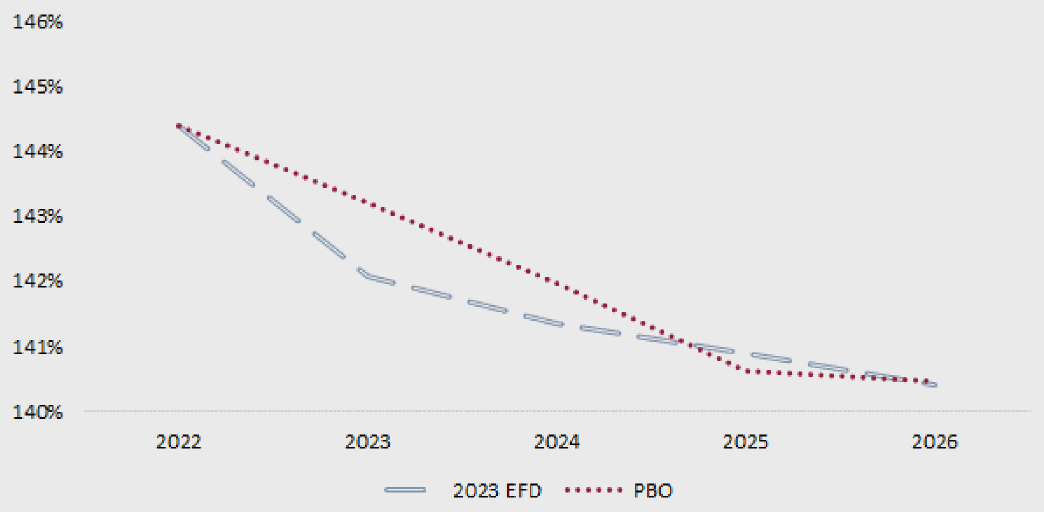
0.1 percentage points above the EFD forecast in 2024 and 0.2 in 2025, before aligning with the latter in 2026.

The simulation assumptions of the PBO scenario imply, for 2023 and 2024, a debt-to-GDP ratio path that, although decreasing, is always above the one projected by the government. More specifically, the deviation from the EFD values is expected to amount to 1.1 percentage points in 2023 and 0.6 percentage points of GDP in 2024. In 2025, the debt-to-GDP ratio would continue to decline up to 140.6 per cent, 0.3 percentage points below the corresponding value of the EFD scenario. Finally, in 2026, the debt-to-GDP ratio of the PBO scenario would be in line with the EFD figure, standing at 140.5 per cent, essentially interrupting its downward trend (Figure B2.6.1).

The higher level of the debt-to-GDP ratio projected in the PBO scenario in 2023 and 2024 and the slowdown in its downward trend expected in 2026 are mainly attributable to lower real GDP growth. The latter, in addition to affecting the level of nominal GDP, expected to be lower over the simulation period than the values projected by the Government, also impacts the primary balance for 2023, resulting in higher deficit which, in turn, contributes to slowing down the reduction of the debt-to-GDP ratio compared to the path planned by the Government.

To account for uncertainty in forecasts, stochastic simulations were also conducted, that is, simulations where the macroeconomic variables that influence the dynamics of the debt-to-GDP ratio (real GDP growth rate, GDP deflator growth rate, short-term interest rate and the differential between short-term and long-term interest rates) are subjected to temporary shocks, based on their historical variability and correlation, in order to obtain a large number of scenarios over the EFD forecast horizon and determine probability ranges.[63]

Figure B2.6.1 – Sensitivity of the debt-to-GDP ratio to growth and inflation assumptions *(percentage points)*



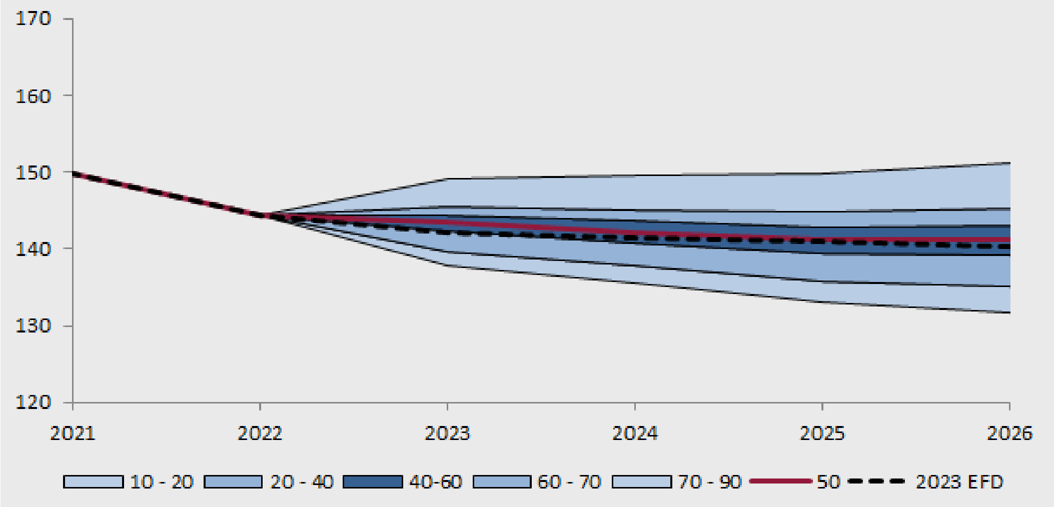
Source: based on data from the 2023 EFD.

[63] In particular, 5,000 possible trajectories of the debt-to-GDP ratio are estimated by taking as a baseline scenario the evolution of the ratio consistent with the macroeconomic forecasts developed in the PBO scenario. For more details on the methodology used, see Berti, K. (2013), “Stochastic public debt projections using the historical variance-covariance matrix approach for EU countries”, *European Commission, Economic Papers* 480. With respect to the stochastic analysis by the PBO, the approach used for the development of the various scenarios is simplified compared to the set of assumptions used for the setting of the PBO scenario in Figure B2.6.1. In particular, at present, the methodology for stochastic simulations still does not use consumption deflator shocks. Moreover, the debt structure data still do not distinguish between bonds indexed to Italian or euro area inflation. The extension of the PBO deterministic framework to the stochastic one to account for consumer inflation (in addition to the growth rate of the GDP deflator) is currently being defined.

Given these assumptions, this procedure allows the construction of a probability fan chart of the debt-to-GDP ratio (Figure B2.6.2). The distribution obtained puts the ratio in the EFD policy scenario at values close to the 40th percentile in 2023 and 2024 and slightly above it in 2025 and 2026. This implies that more than half of the stochastically generated scenarios envisage debt-to-GDP ratio to evolve above the levels estimated in the EFD. The analysis therefore shows that the evolution of the debt-to-GDP ratio is highly likely to be less favourable than expected in the Government's policy scenario.

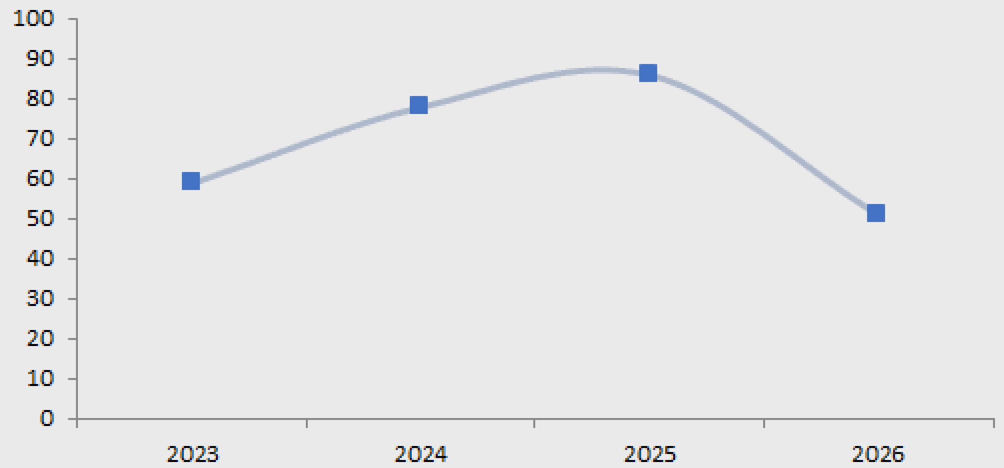
From these stochastic simulations it is also possible to infer the probability of a reduction in the debt-to-GDP ratio compared with the previous year[64] (Figure B2.6.3). In particular, this probability is around 60 per cent in 2023, increases to around 80 per cent in 2024-25, before falling markedly to just around 50 per cent in 2026. These results thus confirm the possibility that the debt-to-GDP downward path may lose momentum or come to a halt in the final year of the EFD programme.

Figure B2.6.2 – Stochastic analysis of the debt-to-GDP evolution
(percentage points)



Source: based on data from the 2023 EFD.

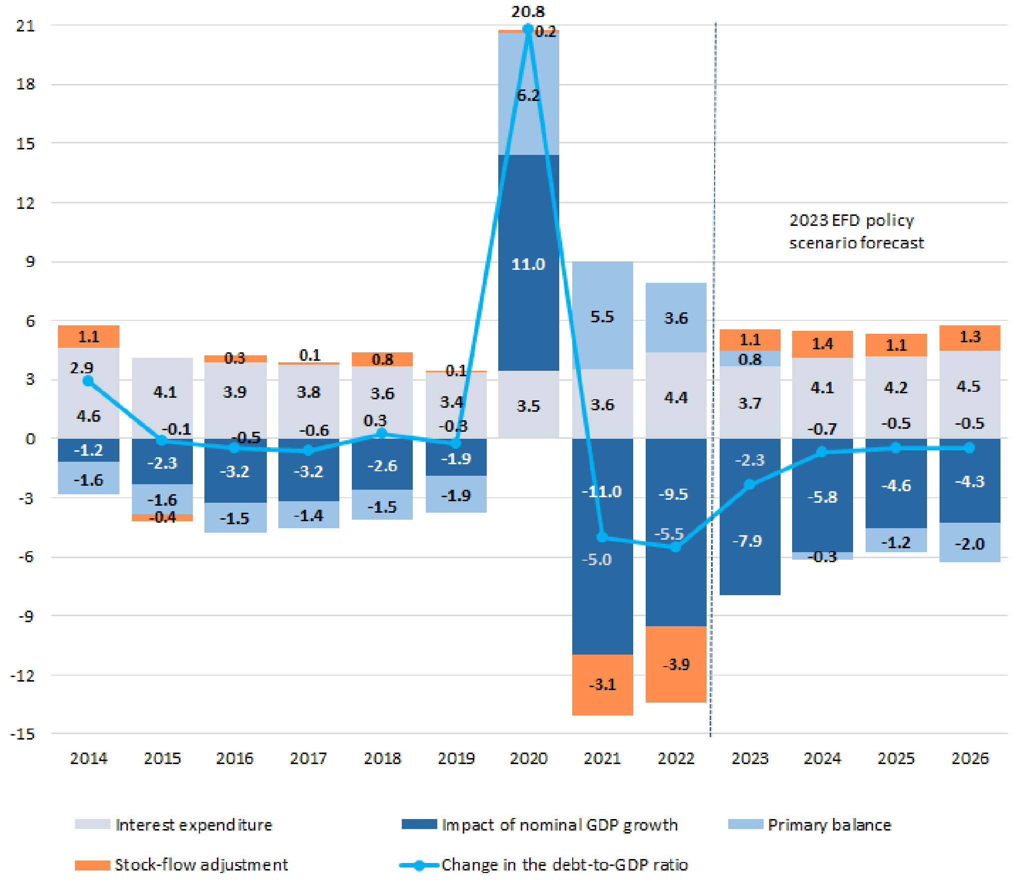
Figure B2.6.3 – Implicit probability of a reduction in the debt-to-GDP ratio from the previous year
(percentage points)



Source: based on data from the 2023 EFD.

[64] For each year of the analysis period, the number of simulations where the debt-to-GDP ratio declines compared to the previous year is observed and this number is compared to the total number of simulations carried out.

Figure 2.6 – Breakdown of the change in the debt-to-GDP ratio – Years 2014-2026
(as a percentage of GDP; policy targets from 2023)



Source: based on data from the Bank of Italy, Istat and the 2023 EFD.

The snow-ball component, which is linked to the differential between the contribution of nominal GDP and interest expenditure, is expected to reduce the debt-to-GDP ratio over the forecast horizon by approximately 6.1 percentage points, as a result of the 22.6 percentage points due to nominal GDP growth partially offset by 16.5 percentage points related to interest expenditure. However, the impact of this component would diminish over time, and in 2026, the final year of the forecast, it would return to have an unfavourable effect, contributing 0.2 percentage points to the increase in debt, due to the increase in interest expenditure to 4.5 per cent of GDP above the contribution of nominal GDP growth (slowing over the forecast horizon). In 2023, the average cost of debt is expected to fall to 2.7 per cent, from 3.1 per cent in 2022, and to start rising again from 2024 to reach 3.3 per cent in the final year of the forecast. This trend reflects the unfavourable dynamics of interest rates, although the high residual average maturity of debt tends to spread the impact of higher rates gradually over time.

The stock-flow adjustment, which also includes the impact of the accounting reclassification of tax credits related to the Superbonus and Façade Bonus (within the cash-compensation component) and of the operations of the so-called 'Patrimonio destinato', is expected to contribute a total of 4.9 percentage points of GDP over the four-year period. Within this component, in the three-year period 2023-25, the Treasury's cash holdings are expected to decrease by a total of 0.7 percentage points of GDP, from 43.5 billion recorded at the end of 2022 to approximately 30 billion in 2025. Compared to the 2022 EFD Update, a greater reduction by approximately 0.4 percentage points of GDP in Treasury liquidity is thus assumed for the same period. Finally, policy estimates take into account proceeds from privatisations totalling about 0.14 per cent of GDP (about EUR 3 billion) in the three-year period 2024-26.

Decree Law 48/2023. – At the beginning of May, DL 48/2023 implemented what was envisaged in the April Report and in the EFD with regard to a cut in the tax wedge on medium-low wage earners in 2023 and an increase in the Fund for reducing the tax burden in 2024, and introduced measures for social inclusion and access to employment.

In particular, an increase in the exemption percentage on the share of social security contributions due by public and private employees is provided for the second half of 2023 compared to what was established by the 2023 Budget Law.[65] In addition, the endowment of the Fund for reducing the tax burden established by the 2023 Budget Law is increased and fed by the higher revenues from the taxation of income from capital gains on crypto-assets transactions.

As for the other main measures, it is planned to establish from 2024 the Inclusion Allowance *(Assegno di inclusione)* and the Support for Training and Employment *(Supporto per la formazione e il lavoro)*.[66] The expenses related to the two new supports are covered by a corresponding reduction in the Fund to Support Poverty and Active Inclusion *(Fondo per il sostegno alla povertà e per l'inclusione attiva),* which was provided for in the last Budget Law in order to provide resources to finance instruments replacing the Citizenship income, which is scheduled to be discontinued as of 2024 (see Chapter 4).

The European Commission's recommendations. – At the end of May, the European Commission presented its country-specific recommendations for Italy, which focus on specific points (see Box 2.7 'The European Commission's May 2023 Recommendations to Italy'). For the current year, it is recommended that, in the absence of any further possible increases in energy prices, support measures for households and businesses be

[65] The percentage was increased from 2 to 6 per cent, if the taxable salary does not exceed the monthly amount of EUR 2,692, and from 3 to 7 per cent if the same salary does not exceed the monthly amount of EUR 1,923, with no further effect on the accrual of the thirteenth month's salary. It should be recalled that the exemption was introduced by the Budget Law for 2022 in the amount of 0.8 per cent on the share of social security contributions for disability, old age and survivors owed by public and private employees, with the exception of employees providing household services, for the whole of 2022 (including the 13th month's salary). The percentage was then increased to 2 points for the period July-December 2022 by DL 115/2022 and, subsequently, the Budget Law for 2023 also extended this percentage to the whole of 2023, if the taxable salary does not exceed a monthly amount of EUR 2,692, and raised it to 3 per cent if the taxable salary does not exceed a monthly amount of EUR 1,923.

[66] These are institutions subject to specific income conditions. The Inclusion Allowance is intended for households having at least one member with a disability or who is a minor or at least sixty years of age; the Support for training and employment consists of an allowance granted in favor of individuals between 18 and 59 years of age who participate in active labor policy projects or projects useful to the community, whose economic conditions meet certain requirements and who do not qualify for the Inclusion Allowance.

discontinued. For 2024, Italy is asked to conduct a prudent fiscal policy − consisting in a cap on the nominal increase in domestically financed net primary expenditure of no more than 1.3 percent over the previous year − while preserving domestically financed public investment as well as using RRF grants and other European funds. For the medium term, it is recommended to continue to pursue a gradual and sustainable fiscal consolidation strategy, to be combined with investments and reforms that foster economic growth. On the tax front, Italy is asked to further reduce taxes on labour and increase the efficiency of the tax system by implementing the enabling act currently in Parliament that preserves the progressivity of the tax system and improves its fairness, particularly by rationalizing and decreasing tax breaks while reducing the complexity of tax legislation. As for the NRRP, an effective governance and improved administrative capacity, particularly at the subnational level, are recommended, as well as a rapid definition of the REPowerEU component[67] with a view to its rapid implementation along with the implementation of cohesion policy programs. Finally, recommendations are provided for the energy field, particularly regarding reducing dependence on fossil fuels, accelerating renewable energy production, increasing energy efficiency in the residential and business sectors, and promoting sustainable mobility.

General considerations on the Government's policy scenario. The public finance policy scenario presented in the 2023 EFD thus confirms the deficit targets of the previous policy document, as was the case in the recent past. In particular, the achievement of the deficit at 3 per cent of GDP in 2025 was confirmed and the strategy of gradually reducing the public debt-to-GDP ratio was reaffirmed.

The objective of continuing to reduce the high public debt is in line with the spirit of the proposed reform of the EU fiscal rules framework and supports the decision to maintain the gradual fiscal adjustment path planned in the EFD Update and the DBP, being aware that a too abrupt consolidation could have a negative impact on growth. According to the EFD, this would be consistent with the European Commission's Communication on 'Fiscal Policy Guidance for 2024', which calls on Member States to present a fiscal plan in the transition phase to the new European governance rules that would put public debt on a downward path and keep it at prudent levels in the medium term while ensuring that general government net borrowing is below 3 per cent of GDP within this forecast horizon (see paragraph 3.1).

These choices are heading towards affirming a more stable planning in the medium term that is useful for an effective reduction in the debt-to-GDP ratio. However, in 2024, the year in which the general safeguard clause will be removed, the deficit is still expected to exceed 3 per cent of GDP, and the debt-to-GDP ratio is projected to fall in the three-year period 2024-26 by an average of about 0.6 percentage points, lower than previously projected.

[67] REPowerEU is the EU's programme aimed at reducing energy dependence and accelerating the green transition.

Box 2.7 – The European Commission's May 2023 Recommendations to Italy

On 24 May, as part of the European Semester for Economic Policy Coordination, the European Commission published its country-specific recommendations for Italy, together with the results of the In-depth Review on macroeconomic imbalances and the Country-specific Report.[68]

Following the In-depth Review, the European Commission confirmed the presence of excessive macroeconomic imbalances, in particular the persistence, although there have been some improvements, of vulnerabilities related to high public debt and weak productivity growth, in a context of labour market fragility and a number of financial market weaknesses.

According to the European Commission, although having further declined in 2022, the debt-to-GDP ratio remains high and constitutes a substantial challenge for fiscal sustainability. The ratio is projected to decline further by 2024 but increase in the medium term in the absence of consolidation measures. Therefore, there is good reason to put the high public debt on a firm downward path, especially given the context of increasing debt service costs and rising ageing-related costs. This requires a multilateral approach based on prudent fiscal policies with adequate primary surpluses as well as growth-enhancing investments and reforms. According to the European Commission, given the challenges Italy is facing, the country would benefit not only from the implementation of the NRRP, but also from further reform measures, in particular regarding taxation and pension systems, as well as demographics, the labour market and energy.

In its country-specific report on Italy, the European Commission analysed the implementation of the NRRP and identified some shortcomings. First of all, an increasing risk of delays is detected, making it essential to take action to identify implementation problems and take timely measures to address them. Considering that a rapid conclusion of the negotiation on the revision of the Plan and its swift implementation are crucial elements given the temporary nature of the RRF, the European Commission believes that it is crucial to ensure an effective and fully operational governance framework for the NRRP and to strengthen general government administrative capacity, particularly at the sub-national level, to enable a continuous, rapid and sustained implementation of the Plan.

At the same time, it is recommended − in order to finance further reforms and investments in support of Italy's strategic objectives in the field of energy and green transition − to rapidly complete the REPowerEU chapter, in order to proceed with its implementation, and also to proceed with the rapid implementation of cohesion policy programmes, working in close complementarity and synergy with the NRRP, to increase economic and social resilience and achieve balanced territorial development.

The European Commission also recommended that the energy support measures be terminated by the end of 2023, in order to allow for the reduction of the public deficit. Should new energy price increases require measures to mitigate their impact, it is necessary to also ensure that such measures are aimed at protecting vulnerable households and businesses, that they are sustainable from an overall public finance point of view and that they preserve incentives for energy savings. In this regard, it is observed that in 2023 most of the measures, while correctly targeting the most vulnerable households or businesses, have not been directed at fully maintaining the price signal to reduce energy demand and increase energy efficiency.

[68] Together with the recommendations, the European Commission published the Report required by Art 126(3) of the TFEU for non-compliance with the deficit and debt criterion in 2022. The aim of the Report is to analyse the relevant factors that could contribute to deciding whether or not to propose to the Council of the EU the opening of an Excessive Deficit Procedure (EDP). The Report focused on Italy and 15 other countries (including Germany, France and Spain). In the case of Italy, the Report was produced due to non-compliance with both criteria. As already announced in its Communication on the fiscal guidance for 2024 of March 2023, the European Commission decided to avoid opening an EDP for all countries due to the still high uncertainty in the macroeconomic and public finance frameworks. The Report also confirms that the decision to propose the opening of an EDP could be taken in spring 2024 on the basis of the 2023 deficit and debt outcomes.

According to the European Commission, there is a general need to ensure prudent fiscal policy, in particular by limiting the nominal increase in domestically financed net primary expenditure to no more than 1.3 per cent in 2024. According to the latest forecasts under unchanged policy by the European Commission, nationally financed net primary expenditure is estimated to grow by 0.8 per cent in 2024, below the recommended growth rate. In addition, the European Commission noted that, in light of the devastating floods that hit Italy in May 2023, the direct cost of support measures aimed at coping with the related emergency will be taken into account in subsequent compliance assessments and that such measures should, in principle, be considered of a one-off and temporary nature.

An increase of no more than 1.3 per cent in the indicator for net primary expenditure financed from domestic resources would ensure a reduction in the structural balance of 0.7 per cent of GDP by 2024, an improvement that the European Commission deems appropriate taking into account budgetary sustainability considerations and the need to reduce the deficit below the 3 per cent of GDP reference value. Member States with public debt exceeding 60 per cent of GDP or with more pronounced debt sustainability risks are required by European regulations to have an annual improvement in the structural budget balance towards the medium-term objective above the reference value of 0.5 per cent of GDP.

The recommendation to preserve domestically financed public investment and to ensure effective absorption of RRF grants and other EU funds, in particular to promote green and digital transitions, is reiterated. This is also with a view to continue pursuing a gradual and sustainable fiscal consolidation strategy after 2024, combined with investments and reforms that foster higher productivity and sustainable growth, to achieve a prudent medium-term fiscal position.

There are also recommendations regarding the Italian tax system as a whole. In this regard, it is recommended to further reduce labour taxes and increase the efficiency of the tax system by properly adopting and implementing the enabling act on tax reform. The progressivity of the tax system should be preserved and its fairness improved, in particular by rationalising and reducing tax benefits, including those related to VAT and environmentally harmful subsidies, while reducing the complexity of tax regulations. It is also recommended to align cadastral values with market values.

With regard to taxation, the European Commission document presents a number of specific considerations. First, it points out that the tax wedge on labour in Italy has remained high for all income levels compared to other EU Member States, despite the personal income tax reduction implemented in 2022. Second, the extension of the flat-rate scheme for the self-employed raises concerns about the fairness and efficiency of the overall system, and the introduction of a new flat-rate scheme on increased earnings for 2023 has increased its complexity. More generally, in implementing the tax reform, the European Commission believes that it is crucial, in addition to preserving the progressivity of the system and reducing its complexity, to increase work incentives, strengthen compliance and ensure budget neutrality. In this regard, the document mentions the possibility of increasing revenue from other, less growth-damaging sources, such as property taxes, VAT and taxes on the authorisation for the use of state-owned coastal assets, in order to reduce the tax burden on labour in a budget-neutral manner. Reference is also made to possible room for improvement of the environmental tax system, which, despite relatively high taxes, is not able to sufficiently promote the transition to cleaner technologies, also due to the extensive use of environmentally harmful subsidies.

Lastly, with regard to the energy sector, the European Commission emphasises the need to reduce dependence on fossil fuels and accelerate the production of renewable energy, to increase internal gas transport capacity in order to diversify energy imports and strengthen security of supply, and to promote sustainable mobility. It is recommended to increase energy efficiency in the residential and business sector, including through more targeted incentive schemes, especially aimed at the most vulnerable households and the least energy-efficient buildings.

This budgetary approach is adopted in a context of high uncertainty both with regard to the macroeconomic scenario and the public finance outlook. Regarding the former, as extensively documented in Section 1.3, downside risks on growth and upside risks on inflation seem to prevail in the medium term, stemming not only from the conflict in Ukraine, but also from the implementation timeframe of the NRRP, global financial tensions as well as the persistence of inflation itself and climate and environmental issues. As for public accounts, besides the risks associated with less favourable than expected revenue developments due to lower growth and further increases in interest and pension expenditure, there are several aspects to be taken into account. In fact, while on the one hand a 'normalisation' of public finance is envisaged thanks to the gradual phasing out of measures aimed at mitigating the effects of the pandemic and energy crisis, on the other hand fiscal policy appears to be conditioned by some critical issues still present in the current scenario.

First of all, a significant source of uncertainty lies in the implementation of the NRRP,[69] which is also evident from the absence in the 2023 EFD of information indicating the assumptions on the expected annual expenditure profile. However, for the purposes of constructing both trend and policy forecasts, the NRRP is assumed to be fully implemented and the related expenditure to be realised by 2026. So far, as is well known, delays have occurred with respect to the initial assumptions, with expenditure being rescheduled forward in the various planning documents; it appears necessary to significantly accelerate the implementation of the programme during the remainder of the Plan in order to avoid some of the projects not being implementable by 2026.

An assessment of the Plan's feasibility and possible reformulation is underway. According to the Government, this process will require the implementation of an overall assessment; this should take into account, in addition to the identification of the problems related to the individual interventions of the NRRP, a postponement of the most delayed projects within the programming period of the Structural Funds for 2021-27 (whose resources can be spent until 2029) and the replacement of some projects with others having faster implementation times that could be included in the REPowerEU plan on energy efficiency, which should become a new chapter of the reformulated NRRP.

These assessments are likely to affect the time profiles of public spending; hence the EFD is seen as a 'bridge document' pending greater clarity that must necessarily emerge by autumn at the latest, when the next EFD Update will be published and the 2024 Budget Law will be defined.

While waiting for more information on these important aspects, a number of critical aspects in the currently available indications about the approach of the year-end budget package are highlighted. First, the EFD contains generic information regarding the total amount of resources to be devoted to unchanged policies and the need to identify financing within the public budget. These will be supported by a spending review that –

[69] Some difficulties also emerge with reference to monitoring the status of implementation.

as intended by the Government − will produce increasing savings over time without jeopardizing the delivery of public services and the implementation of social policies. For now, only relatively limited amounts for strengthening the spending review of Ministries are explicitly reported.

In general, the most significant component within unchanged policies concerns the renewal of civil service contracts; a number of aspects should be emphasized in this regard. First, it should be noted that next year is the last year of the three-year negotiation period yet to begin and there is a risk of significant increases due to cumulative inflation. In addition, the resources that are allocated in the Budget Law for the purpose of contract renewals affect only central government. Similar resources must be found for the renewal of local administrations, which are most likely unable to find them within their own budgets. Looking ahead, however, these elements will be of particular relevance considering that the EFD time frame includes both the 2022-24 economic three-year negotiation period of all public sectors and two-thirds of the following one (2025-27).

With regard to the possibility of a reduction in the tax burden over the course of the legislature, the EFD mentions increased cooperation between tax authorities and taxpayers as one of the possible hedges. Interventions aimed at increasing compliance are desirable but their financial effects are difficult to quantify ex ante and may emerge only gradually over time; based on the principle of prudence, it is therefore desirable that they are not used to finance structural interventions to reduce the tax burden. The idea of finding resources through measures aimed at reorganizing and reducing tax expenditures seems appropriate, although it should be remembered that the latter have often been the subject of analysis and policy commitments, which, however, have not been applied in practice, probably mainly in relation to the redistributive and sectoral effects that their adoption would entail. Moreover, it is unclear how the reduction in the tax wedge for lower and middle incomes reported as temporary fits in with the structural interventions envisaged by the enabling act for tax reform.[70]

With regard to healthcare spending, although more realistic assumptions than previous estimates regarding the effective need for future funding may have been adopted in the EFD trend forecasts, it should be noted that expenditure in Italy is lower than the European average − with unfavourable consequences on the quality of services offered − resulting in the strong possibility that refinancing of the National Health Service will be necessary.

Also to be considered is the significant number of measures linked to the budget package listed in the EFD, including some − such as the one on pension regulations − that may require additional resources, for which adequate funding must be identified.

[70] A.C. 1038, assigned to the Finance Committee of the Chamber of Deputies; in this regard, see the Memorandum of the Chair of the Parliamentary Budget Office on Draft Law C. 1038 and the accompanying Bill C. 75 Marattin titled 'Delegation to Government for Tax Reform,' dated May 25, 2023.

Overall, it would thus seem that substantial resources would be needed for financing resources, which, after the period of consolidation in the recent past, seems difficult to find without affecting service delivery and the implementation of social policies.

Lastly, with regard to the possibility for any fiscal room to emerge, as has been the case in recent years, from more favourable than expected trends in public finance aggregates, it should be noted that such improvements are often derived from overestimates − of a prudential nature − of the interventions put in place to cope with crisis situations, and which hopefully will not be faced in the future.

Finally, it is possible that in light of the recent measures aimed at suspending the transferability of building bonuses, the statistical authorities will decide that they should again be classified as non-payable credits on the basis of the actual use profile of the tax deductions.[71] This would result in lower budget deficits in the three-year period 2023-25 but in higher budget deficits in subsequent years. Any use of these margins would necessarily imply an increase in public debt.

71 These assessments should be carried out by Eurostat by next 30 June.

PART 2

INSIGHTS

3. The European Commission's legislative proposals to reform the EU budgetary policy framework

3.1 The European Commission's legislative proposals: a description of the main innovations

On 9 November, the European Commission published the 'Communication on orientations for the reform of the EU governance framework'[72] presenting the broad outlines of the reform of the Stability and Growth Pact and the procedure for correcting macroeconomic imbalances. Following the long debate that took place in the following months in the various institutional fora, Member States agreed on some elements of the reform orientations, as stated in the conclusions adopted by the Council of the EU on 14 March and the Eurogroup statement on 23 March.[73]

Member States agreed that the reference thresholds of 3 per cent of GDP for the general government deficit and 60 per cent for the related debt should remain unchanged. Moreover, Member States are also agreeing on other elements, including the need for: (i) medium-term planning in order to ensure debt-to-GDP reduction; (ii) ensuring greater incentives for public investment and structural reforms; (iii) more effective enforcement of penalties in the case of excessive deficits, providing for lower financial penalties while reinforcing reputational implications in the event of failure to comply with fiscal rules; (iv) strengthening of debt-based excessive deficit procedures; and (v) appropriate differentiation of fiscal consolidation efforts according to each country's macroeconomic and public finance conditions.

With these elements in mind, the European Commission presented its legislative proposals for reforming the Stability and Growth Pact and the Macroeconomic Imbalance Procedure on 26 April.

The proposals include the following legislative acts:[74]

i. a proposal to replace Council Regulation No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (i.e. the preventive part of the Stability and Growth Pact, which includes, *inter alia*, the rules on the structural balance and the net

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[72] See European Commission 'Communication on orientations for the reform of the EU *governance* framework'[questo dovrebbe puntare alla versione in inglese: https://economy-finance.ec.europa.eu/document/download/43105168-be28-463e-81e7-8242c59f0cd2_en?filename=com_2022_583_1_en.pdf].

[73] See Economic governance framework: Council agrees its orientations for a reform and Eurogroup statement on the fiscal guidance for 2024.[I due link non funzionano più: forse non sono stati riportati correttamente?]

[74] European Commission (2023), '*Proposal for Regulation: New economic governance rules fit for the future*', April.

expenditure benchmark) with a new Council and European Parliament Regulation;

ii. a proposal to amend Council Regulation No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (i.e. the corrective part of the Pact that includes, *inter alia*, procedures for budgetary correction in the event of non-compliance with the deficit and debt rule);

iii. a proposal to amend Council Directive 2011/85/EU on requirements for the budgetary framework of the Member States (which was part of the so-called 'Six-pack' aimed at changing some elements of national budgetary procedures to improve the coordination of economic policies of EU countries).

The new legislative proposals confirm the basic approach of the framework outlined in last November's Communication, which the PBO has already reported on in two parliamentary hearings.[75]

However, compared to the wording of the Orientations, the legislative proposals show some developments that are, on the one hand, designed to strengthen the objective of sustainability and debt reduction by introducing common safeguards for all countries and, on the other hand, to ensure national ownership of the new governance framework by providing, *inter alia*, for a broader involvement of independent fiscal institutions (IFIs), such as the PBO.

Specifically, the legislative proposals, like the previous general orientations, confirm that the reference values of 3 per cent of GDP for the general government deficit and 60 per cent for the related debt laid down in the Treaty on the Functioning of the European Union (TFEU) shall remain in force.

Conversely, with regard to the preventive part of the Stability and Growth Pact, the proposal for a regulation designed to replace Council Regulation No 1466/97 repeals the criterion of convergence of the structural budget balance towards the MTO while, with regard to the corrective part of the Pact, the amendments to Regulation No 1467/97 repeal the current numerical parameter (equal to 1/20) of annual reduction of debt-to-GDP ratio for the portion exceeding the 60 per cent threshold.

In order to increase national ownership of the European framework, these rules are replaced by national medium-term Structural Fiscal Plans (SFPs) to be submitted by Member States. The frameworks will last a minimum of four years, extendable to seven if the country commits to structural reforms and investments to support potential growth

[75] See Parliamentary Budget Office (2023), 'Hearing of the Chair of the PBO in the context of the examination of the European Commission's "Communication on guidelines for a reform of the EU economic *governance* framework"', 1 March and Parliamentary Budget Office (2023), 'Hearing of the Chair of the PBO in the context of the examination of the Economic and Financial Document 2023', 20 April.

and improve the sustainability of public finances. For countries with a debt higher than 60 per cent of GDP or a deficit higher than 3 per cent of GDP, these rules will provide for a public accounts adjustment programme such as to ensure adequate and credible country-specific debt-to-GDP reduction paths over the 10 years following the end of the adjustment plan and under the assumption of unchanged policies, i.e. assuming no further action after those already provided for in the adjustment programme. At the same time, the adjustment programme will have to ensure compliance with the obligation to keep the deficit below 3 per cent of GDP in the ten years following the completion of the adjustment programme and assuming unchanged policies. Before submitting the SFPs, preliminary consultations with the European Commission will be held at the start of the procedure, also according to 'technical trajectories' developed by the Commission itself through debt sustainability analysis (DSA) methodologies. Within a framework common to all EU countries, whose details are described in a special appendix to Regulation 1466/97, the SFPs will also contain a programme for reforms and investments that would turn into real commitments in the case of the seven-year plans.

Finally, the European Commission and the Council shall approve the frameworks submitted by the countries and assess their compliance *ex post.* By considerably simplifying the current system of budgetary rules of the Stability and Growth Pact, compliance with the objectives set in this medium-term consolidation path are going to be monitored through a single indicator of net primary expenditure financed from domestic resources, defined as total government expenditure net of interest expenditure, cyclical expenditure on unemployment benefits, expenditure financed by EU subsidies, and taking due account of the financial impact of discretionary measures on the revenues.

More specifically, the procedure under the proposed new governance framework consists of three stages: a preliminary steering stage, defined by the European Commission; in the second stage, each Member State shall develop its own SFPs; the third stage shall be dedicated to monitoring and evaluation.

In the first stage, the European Commission, in guiding Member States to draft their SFPs, proposes to countries with budget deficits above the 3 per cent of GDP threshold or with a debt-to-GDP ratio greater than 60 per cent to adopt a ‘technical trajectory’ lasting at least four years, up to a maximum of seven years, including a specific net primary expenditure path. The path is determined by estimating the minimum fiscal adjustment that would bring the Member State's debt to a feasible downward trend or keep it at a prudent level in the 10 years following the end of the adjustment period assuming unchanged policies, i.e. without new measures being introduced. The budget adjustment shall allow the budget deficit as a share of GDP to be kept below the 3 per cent threshold in the ten years following the end of the plan assuming unchanged policies. Moreover, these technical trajectories should ensure that the government debt-to-GDP ratio at the end of the adjustment period is below the level of the year prior to the start of the adjustment plan.

For all other countries, at this first stage, the European Commission will only provide technical information of the structural primary balance needed to ensure that the deficit remains below 3 per cent of GDP at unchanged policies in the ten years following the end of the SFP.

Unlike the previous Communication published in November 2022, when drawing up the technical trajectories, the European Commission will not classify the Member States according to the three profiles identified through the methodology presented in the *Debt Sustainability Monitor*,[76] i.e. by distinguishing between countries with a substantial, moderate and low debt challenge, but by considering only the level of the debt-to-GDP ratio in relation to the 60 per cent threshold or the deficit in relation to the 3 per cent threshold.

Another difference in the legislative proposals compared to the wording of last November's Orientations concerns the presence of common safeguards for all countries to ensure and reinforce debt sustainability.

According to the technical trajectories developed by the European Commission, the resulting debt-to-GDP ratio at the end of the multi-year consolidation period will have to be below the level of the year prior to the start of the trajectory. Moreover, as long as the deficit remains above 3 per cent of GDP, the trajectories will have to provide for a minimum annual fiscal adjustment of 0.5 per cent of GDP as a benchmark. In addition, trajectories with an extended fiscal adjustment period of up to seven years will have to assume that most of the adjustment takes place during the first four years covered by the plan. Finally, trajectories will have to be such that the growth rate of the indicator of net primary expenditure financed from domestic resources remains below the medium-term GDP growth rate on average and over the trajectory time span.

In line with the methodology of the European Commission's Debt Sustainability Monitor, the feasibility of the debt reduction path will be assessed through a series of *'stress tests'*, i.e. an evaluation of the sensitivity of the results using worst-case scenarios on interest rates, real GDP growth and the primary budget balance, as well as a stochastic analysis, i.e. a probabilistic analysis that takes into account the uncertainty in the forecasts of the variables (nominal GDP growth, primary balance, interest rates) influencing debt dynamics.

The European Commission will update the technical trajectories and quantitative guidelines at least once every four years in time for the presentation of the next round of medium-term structural budget plans.

At the second stage and after technical consultations with the European Commission, Member States will be required to submit their SFPs with a minimum duration of four years. However, the planning period may be extended up to a maximum of seven years

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76 European Commission, (2022), '*2022 Debt Sustainability Monitor*', Institutional Paper 199.

by providing for a more gradual budgetary adjustment and reduction of the debt-to-GDP ratio. This possibility is granted on condition that countries commit to a set of verifiable and time-bound reforms and investments to be implemented within pre-defined and agreed deadlines.

Specifically, reforms and investments should be such as to foster potential economic growth, improve fiscal sustainability, address common EU priorities and respond to the country-specific recommendations addressed to the Member State under the European Semester. Moreover, in the case of investment, interventions will need to address country-specific priorities while avoiding cuts in domestically financed public investment during the adjustment period.

At the third stage, the SFP is submitted to the European Commission for assessment. The assessment mainly focuses on the plausibility of the macroeconomic and budgetary assumptions, to the extent that they depart from those underlying the reference technical trajectory. Indeed, the debt projections at unchanged policies included in the framework should be consistent and comparable with the European Commission's projections. Should Member States use assumptions in their SFPs that differ from the European Commission's medium-term debt projection framework, they should explain and duly justify the differences in a transparent manner and based upon sound economic arguments.

Once the European Commission's assessment has been passed, the Council will have to endorse the SFP, which will eventually become binding on the country. Conversely, if the Member State and the European Commission fail to agree on the submitted SFP, the Council would adopt the technical reference path defined by the European Commission.

During the period of effectiveness of the SFP, it may not be amended, except in extraordinary and objective circumstances preventing its implementation or if a new government requests a revision. In such cases, the European Commission will publish a new technical trajectory prior to the revision of the SFP. Bearing in mind any previous adjustments, the new technical trajectory proposed by the European Commission shall neither allow the backloading of the initial objectives nor a weaker adjustment effort than the previous one.

In the case of an adjustment period extending beyond four years, the European Commission will also be required to periodically assess whether the requirements for the implementation of the previously agreed reforms and investments remain in force and, if not, reschedule the budgetary adjustment over a shorter period.

Under the new procedures defined in the proposal to replace Regulation 1466/97, the SFPs would thus merge the current Stability Programmes (or Convergence Programmes) with the National Reform Programmes. In addition, each year Member States will be required to publish an annual progress report on the implementation of their national plans, reporting both on the implementation of the multi-year budget plans and on the measures undertaken to follow up on the country-specific recommendations and on the progress of the planned structural reforms.

As regards the annual budgetary surveillance by the European Commission and the Council of the EU in the context of the European Semester, it will be based on monitoring the path of the single indicator of nationally financed net primary expenditure, which will have to remain below the multi-year path agreed in the early stages of the procedure. In order to avoid that small deviations over time from the agreed multi-year path of net primary expenditure end up cumulating in large deviations, the European Commission will resort to notional control accounts for each Member State where annual deviations (both upward and downward) will be cumulated.

Moreover, the new governance framework provides for the activation of a general escape clause in case of a severe economic downturn in the euro area or the EU as a whole; a specific clause shall also activate for exceptional circumstances outside the control of governments with a major impact on the public finances of an individual Member State. The activation and extension of the general and country-specific clauses will require the Council's approval and will allow for temporary deviations from the endorsed medium-term budgetary path.

In a framework where greater *ex ante* national ownership allows Member States more room for manoeuvre in defining adjustment paths, *ex post* control by the EU of compliance with the rules would be stricter than in the past.

As a matter of fact, while the proposed amendments to Regulation 1467/97 on the corrective part of the Stability and Growth Pact stipulate that, in the event of non-compliance with the 3 per cent deficit-to-GDP threshold, the deficit-based Excessive Deficit Procedure (EDP) would be kept essentially unchanged,[77] the EDP based on non-compliance with the debt criterion would be strengthened and focused on deviations from the endorsed net primary expenditure path.

As already provided for in the current procedures, where the European Commission verifies a situation of excessive deficit for a country due to breaches of the numerical deficit or debt criterion, it will issue a Report pursuant to Article 126.3 of the TFEU in which it will also analyse any relevant factors in the steps leading to the decision on the opening of an EDP. Such relevant factors will only be considered in the case of non-compliance with the numerical deficit criterion if the deficit has remained close to the 3 per cent threshold and the excess above this reference value is expected to be temporary.

[77] The EDP for breaches of the 3 per cent of GDP deficit criterion would remain unchanged unless some amendments are proposed to ensure consistency with EDPs based on non-compliance with the debt criterion; the proposed amendments are designed to empower the role of the IFIs in assessing the measures taken by governments to correct the situation of excessive deficits and to clarify the cases of recession at individual country and EU level which would or would not trigger the EDP.

Unlike the current procedures, under the amendments to Regulation 1467/97, the European Commission, when deciding whether to open an EDP for breach of the debt criterion, is required to consider the degree of debt risk as a relevant factor. Specifically, in the case of Member States with a substantial public debt challenge, identified according to the European Commission's classification presented in the most recent Debt Sustainability Monitor Report, deviations of the net primary expenditure indicator from the agreed path would result, by default, in the opening of an EDP.

The Report of the European Commission will also consider further elements. First, the information contained in the notional monitoring account should form the basis for the enforcement of the EDP, i.e. the requests for adjustments to correct deviations from the agreed path. Likewise, the degree of ambition of the path of the net primary expenditure indicator in the SFP should be considered when deciding on the opening of an EDP for breach of the debt criterion. More specifically, the decision should consider whether the trajectory of the Member State's net primary expenditure endorsed by the Council is more ambitious than that proposed by the European Commission and whether the deviation from the trajectory is not significant when measured against the latter.

Other relevant factors that the European Commission should take into account when assessing the existence of excessive deficits are: the structure of public debt; medium-term developments in the economy with reference to the business cycle and inflation trends compared to the assumptions underpinning the net primary expenditure profiles agreed in the SFP; the implementation of reforms and investments and the adoption of fit-for-purpose measures in the context of the excessive macroeconomic imbalance procedure; policies put in place to foster common EU strategies, including interventions financed through the *NextGenerationEU* programme.

Furthermore, countries may provide the European Commission with additional factors deemed relevant for assessing the conditions for opening the EDP. When providing such relevant factors, Member States will also include the opinion of their respective IFIs.

Where a breach is found, the Council, upon a Recommendation from the European Commission, has four months to issue a Recommendation to the Member State setting out not only the new correction path for the net primary expenditure indicator but also the deadline for correcting the excessive deficit.

In setting the corrective path for net primary expenditure under the EDP, the Council should also ensure no backloading of the required fiscal adjustment. The corrective path of net primary expenditure under the EDP should be brought back to the one originally set by the Council under the preventive part procedures. Should the original path be no longer feasible due to objective circumstances, the Council will set a different path under the EDP.

As a rule, the country subject to EDP has six months, reduced to three in the case of particularly large deviations, to submit to the European Commission and the Council a Report on the corrective measures to be taken (*effective action*) in response to the Council Recommendation. According to the legislative revision proposal, this Report should contain the Government's policy objectives outlined in terms of revenues and expenditures as well as the amount of discretionary revenues and expenditures consistent with the new trajectory of correction of the net primary expenditure indicator recommended by the Council. The Report should be public and incorporate the opinion of the IFIs on the appropriateness of the measures adopted and planned by the Government to achieve the new budgetary targets. The Report will eventually have to be assessed by the European Commission and the Council and taken as a reference for future decisions.

As outlined above, the proposed new regulation introduces a common safeguard mechanism. This stipulates that in all years in which the budget deficit of an individual Member State exceeds the threshold of 3 percent of GDP, the profile of the net primary expenditure indicator must be consistent with a minimum budgetary adjustment of 0.5 GDP points. Should the measures adopted be considered appropriate or exceptional circumstances beyond the control of the government arise, with a significant impact on public finances or, alternatively, should the Council assess the existence of a severe economic downturn for the euro area or the EU, the Council, following a Recommendation from the European Commission, may decide to extend the deadline for closing the excessive deficit procedure. The deadline can typically be extended up to one year.

Conversely, where the country in breach fails to take adequate measures to correct the excessive deficit, the Council may, within two months, notify the country to implement the required measures to ensure the correction of the excessive deficit within the specified deadlines. At this stage, the Council may require the country subject to EDP to adopt a new corrective trajectory of the net primary expenditure indicator to bring the deficit below the 3 per cent of GDP threshold within the set deadline or to make the debt plausibly decline in the medium term. Should the country in breach continue to fail to implement the necessary measures to correct the excessive deficit situation, the Council may impose financial penalties amounting, as a rule, to a minimum of 0.05 per cent of GDP per six-month period up to, cumulatively, a maximum of 0.5 per cent of GDP. The resources accumulated as financial penalties will be allocated in the EU budget until appropriate measures to correct the excessive deficit situation are successfully implemented.

The European Commission's legislative proposals relating to the corrective part of the Pact also provide for a stronger dialogue between the European Commission and various institutions of the country subject to the procedure, including the IFIs. Indeed, the European Commission may, at any time, schedule fact-finding missions to assess the economic conditions of the country and the risks or difficulties found in attempting to correct the excessive deficit. The European Commission would also activate specific missions if the country subject to EDP failed to take appropriate measures to correct the excessive deficit situation.

The excessive deficit procedure shall be held in abeyance if the Member State concerned acts in compliance with Council recommendations and shall be repealed only where the European Commission forecasts suggest that the deficit has been kept below the 3 per cent of GDP reference value for an extended period of time and, in case the EDP has been initiated on the basis of the debt criterion, where the Member State concerned has complied with the corrective path for net primary expenditure set by the Council in the previous two years and is expected to continue to do so in the current year.

The legislative proposals also provide guidance on the excessive macroeconomic imbalance procedure by providing for both an increased focus on the spillovers of imbalances on other EU countries and a stronger dialogue between the European Commission and Member States. This dialogue should allow for a better understanding of the specific problems of the national economy as well as the policies needed to address them, leading to a commitment by the Member States to incorporate the reforms and investments needed to prevent or correct these imbalances into their SFPs.

Should new macroeconomic imbalances be identified while a SFP is already in place, further dialogue will be initiated with Member States to reach a consensus on the measures needed to address them. However, the plan already approved will normally not be reconsidered.

Finally, the proposed amendments to Directive 2011/85/EU provide for a significant strengthening of the consistency of national budgetary procedures with the new EU rules proposed in the regulations, including with the aim of ensuring greater national ownership. In particular, the amendments to the Directive require the Member States to promote a medium-term orientation in their national legislation, introducing a credible and effective budgetary framework with a planning period of at least four years.

As for the objective of improving the quality of public finances, the amendments to the Directive require countries to strengthen the system of public accounts by adjusting it to the accrual basis and to provide more information on extra-budgetary entities still included in the scope of general government. In this specific case, the proposed amendment to the Directive requires publication of the impact of the operations of these entities on general government balances and debts, also in terms of expected future assets and liabilities.

In addition, Member States will be required to publish detailed information on the impact of tax benefits on revenues foreseen in the national budgetary targets. More information is also requested on contingent liabilities likely to heavily impact public budgets, such as costs related to ageing populations, public guarantees, non-performing loans and liabilities stemming from the activity of public corporations, contingent expenditures, and obligations stemming from decisions or judgments in court cases. Information shall also be provided on contingent liabilities related to disasters and climate events, requiring quantification of the increased public expenditures to cope with disasters and climate shocks, as well as the cost of interventions needed to mitigate these phenomena. More details are also requested on government shareholdings in the capital of private and public companies.

Finally, the role of IFIs, such as the PBO, will also be significantly strengthened. Indeed, the European Commission acknowledges that IFIs have contributed to promoting budgetary discipline and strengthening the credibility of Member States' public finances. According to the European Commission proposals, in order to improve national ownership of the new governance system, the role of the IFIs, which is typically based on monitoring compliance with the framework of national fiscal rules, should be extended to monitoring the overall EU economic governance framework.

To this end, Article 8 of the proposed amendment of Directive 2011/85/EU stipulates that IFIs will be required to perform the following tasks:

(i) draft annual and multi-year macroeconomic and public finance forecasts underpinning the government's medium-term planning or endorse those drafted by national authorities;

(ii) prepare debt sustainability assessments underpinning governments' medium-term planning or endorse those provided by the government;

iii) produce official assessments of the impact of policies on public finance sustainability and sustainable and inclusive growth or endorse those provided by the government;

iv) monitor compliance with the country's national budgetary rules;

v) in the context of the legislative proposal to replace Regulation 1466/97, provide an assessment of the conformity of the actual outcome of net primary expenditure reported in the Annual Progress Report on SFP with the initially agreed path of the indicator, and, where applicable, also analyse the factors underpinning the deviation from the endorsed path of net primary expenditure evolution, such as the occurrence of exceptional circumstances;

vi) monitor compliance with the EU fiscal rules framework in accordance with Regulation 1467/97, which in the European Commission's revision proposal requires IFIs to provide an assessment of the appropriateness of measures taken by governments to correct the excessive deficit and an opinion on the existence of relevant factors influencing the assessment on the possible opening of an EDP;

(vii) carry out regular analyses of the national budgetary framework in order to assess its overall consistency and effectiveness, including the mechanisms and rules governing budgetary relations between public authorities in the sub-sectors of public administration;

viii) participate in regular hearings and debates in the national parliament.

Member State governments will be required to comply with the assessments or opinions of the IFIs or publicly justify their decision not to comply with such assessments or opinions ('*comply or explain*').

As for the timeframe for implementing the legislative proposals, European Commission suggest such timeframe to be approved by the Council of the EU and the European Parliament by the end of 2023, thus becoming effective as of the first quarter of 2024.

3.2 Medium-term public finance projections for Italy in the context of the proposals for the new framework for fiscal rules

As already detailed in the previous paragraph, the European Commission's legislative proposals on the new EU governance framework provides that, prior to the submission of SFPs, the European Commission shall submit to countries with debt exceeding 60 per cent of GDP or with deficits above the 3 per cent of GDP threshold a 'technical trajectory' for the evolution of the debt-to-GDP ratio based on a multi-year adjustment plan with a duration of at least four years (extendable to seven years), expressed in terms of net primary expenditure financed from national resources.

The fiscal consolidation path underpinning this technical trajectory will be strictly connected to debt sustainability while, also through some mechanisms common to all Member States, ensuring that, in the ten years following the budget adjustment period and assuming unchanged policies, the debt-to-GDP ratio remains on a plausible reduction path[78] with the budget deficit standing below the 3 per cent of GDP threshold.

With these assumptions in mind, this paragraph aims to introduce the evolution of the debt-to-GDP ratio and of the main public finance variables for some medium-term scenarios that, based on the methodology developed by the PBO, are considered broadly consistent with the technical trajectories outlined in the legislative proposals on the new EU governance. This analysis also allows a preliminary assessment of the degree of consistency of the government's planning forecasts contained in the 2023 Economic and Financial Document (*Documento di Economia e Finanza* – DEF) with these technical trajectories. To this end, in line with the new framework, the forecast horizon of the analysis presented in this paragraph, which in previous analysis[79] conducted by PBO extended up to ten years after the last year of the final balance, is further extended up to 2040.

[78] To define the baseline adjustment path for the debt-to-GDP ratio, the European Commission will use the methodology developed in the context of its debt sustainability analysis *(*DSA), specifically adjusted to the new framework. The European Commission's DSA methodology is detailed in the volumes *2022 Debt Sustainability Monitor* and *Fiscal Sustainability Report 2021* as well as in previous publications. At present, not all assumptions required for building these multi-year adjustment paths described in the European Commission's legislative proposals can be accurately reconstructed. For a critical analysis of the assumptions necessary for the European Commission's preparation of the technical trajectories, see the 'Hearing of the Chair of the Parliamentary Budget Office on the Orientations for a Reform of the EU economic Governance Framework' of 1 March. As regards the methodology underpinning the European Commission's DSA, see: European Commission, (2022), "2022 Debt Sustainability Monitor", Institutional Paper 199; European Commission (2022), "Fiscal Sustainability Report 2021", Institutional Paper 171, 25 April; and European Commission (2021), "Debt Sustainability Monitor 2020", Institutional Paper 143, 5 February.

[79] By way of example, see Parliamentary Budget Office (2022), 'Hearing of the PBO Chair in the context of the preliminary enquiry to the examination of the Update to the Economic and Financial Document 2022 and its Supplement', 9 November. For a description of the PBO framework for assessing debt dynamics in the medium term, see Gabbriellini C., Nocella G. and Padrini F. (2021), '*Assessing Italy's public debt dynamics in the medium term with the PBO framework: Illustrative scenario analysis for the post-Covid period*', PBO Working Paper No. 2/2021.

First, it is worth noting to that the technical assumptions used to outline these scenarios may differ from those adopted by the Government and the European Commission either due to a lack of information or due to different methodological choices.

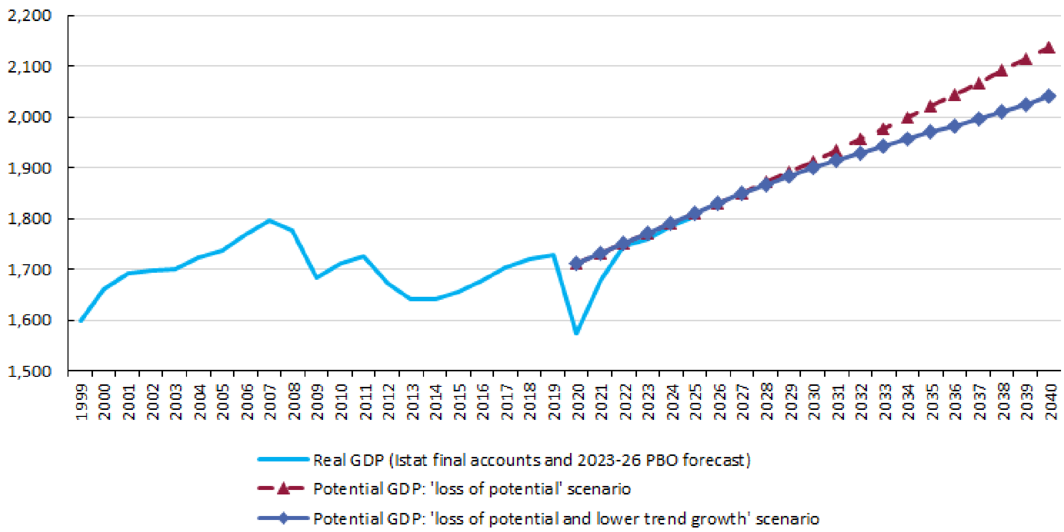
Based on the macroeconomic forecasts and public finance sensitivity analyses for the 2023-2026 period prepared by the PBO when conducting the assessment of the 2023 EFD (see Box 2.6 'The sensitivity of the debt-to-GDP ratio to macroeconomic assumptions'), the medium-term projections are first presented with an unchanged policy public finance assumption from 2024: from that year, and until the end of the forecast horizon, no discretionary fiscal adjustments are made compared to the 2023 public finance framework. Therefore, in this counterfactual scenario, starting in 2024, the structural primary balance would remain at the 2023 level. It is worth noting that the lack of fiscal consolidation measures compared to 2023 leads, through dynamic multipliers estimated with the MeMo-It macroeconomic forecasting model used by the PBO, to an increase in the real GDP growth rate in the 2024-26 three-year period, compared to the PBO forecast used to validate the base scenario of the EFD and thus to a favourable impact on the cyclical component of budget balances.

The debt sustainability analysis also requires assumptions on the macro-financial variables influencing its dynamics in the medium term. As regards GDP development, the working hypothesis assumes the potential GDP to follow a trend-based trajectory. As a matter of fact, the estimate of potential output, calculated through the various statistical procedures available, is expected to be strongly volatile and unstable, especially in the current phase, characterised by the possibility of a reversal of the cycle or by 'anomalous' dynamics of actual GDP caused by extraordinary events (such as, in a pessimistic direction, the uncertainty about the structural impact caused by the pandemic crisis and the energy crisis and, in an optimistic direction, the impact of the investment and reform programmes provided for in the NRrP).

Therefore, when assessing the medium-term GDP trend, a trend-based development under two alternative scenarios is considered (Figure 3.1):

1) a 'loss of potential' scenario, where potential GDP develops over the entire forecast period on a path determined by the average growth recorded in the 2014-2019 period, i.e. in the expansion phase prior to the pandemic, amounting to 1.1 per cent. However, under the prudent assumption that the measures adopted by the government during the pandemic only partially contributed to avoiding the structural deterioration of the economy, the level of potential GDP is also assumed to be permanently around 2.4 per cent below the trend value recorded in the 2014-2019 period. This value roughly corresponds to the average annual loss in Italy's potential GDP recorded after the crisis of the 2008-2013 period.

Figure 3.1 – Development of the level of potential GDP in alternative scenarios *(billion euros)*



Source: based on data from 2023 EFD and Istat.

2) the 'loss of potential and lower trend growth' scenario, assuming the same level of potential GDP until 2026 as that of the 'loss of potential' scenario, after which, from 2027, its growth rate steers toward a lower trend value of 0.7 per cent in six years. This value is consistent with the current Consensus Forecast medium-term growth estimate for Italy.

The evolution of the level of real GDP from 2027 to 2032 in each scenario is calculated by considering the additional assumption of a gradual and constant closure of the output gap estimated for 2026 in six years. In the following years, real GDP is expected to grow in line with the potential value.

For the other non-fiscal drivers of the debt-to-GDP ratio developments, the forecast assumptions for 2027-2040 period are as follows: (i) the gradual alignment (over six years) of inflation to 2 per cent, a value that will remain unchanged from 2032 until 2040; (ii) the gradual alignment (over six years) of weighted average interest rates to 1.6 per cent for short-term government bonds (i.e. with maturity of one year or less) and to 3.5 per cent for long-term ones, values equal to the respective medians of the 1999-2022 period; these values will remain stable from 2032 to 2040; iii) a value of stock-flow adjustments as a percentage of GDP in each year covered by the forecast equal to the median value recorded between 1999 and 2022 (0.3 per cent).

Finally, as regards the determination of the primary balance, in the unchanged policy scenario from 2024, the base case assumption provides for its structural component, as mentioned above, to remain constant in line with the 2023 level throughout the forecast horizon. As for the determination of the nominal primary balance, the impact of the cyclical component of the budget balance and that of age-related expenditures (excluding taxation on pensions and property income) as reported in the Ageing *Report 2021*[80] drafted by the European Commission in collaboration with the Ageing Working Group are added to the structural level. Finally, the cyclical component is calculated from the product between the budgetary flexibility to economic growth estimated by the European Commission, a parameter that for Italy stands at 0.54, and the output gap.

Starting from the unchanged policy scenario, in line with the available indications on the new framework of fiscal rules presented by the European Commission in its legislative proposals, a number of scenarios were then developed for the evolution of the debt-to-GDP ratio and of the main public finance aggregates over the medium term, which assume a multi-year budgetary adjustment in line with the new framework of rules over a four-year period, i.e. until 2027, and over a seven-year period, i.e. until 2030, from 2024 onwards.

The four- to seven-year multi-year budgetary adjustment assumed in these scenarios should be such as to allow, in the decade following the end of the fiscal consolidation plan and assuming unchanged policies, a plausible and constant reduction in debt-to-GDP ratio and a deficit level permanently below the 3 per cent of GDP threshold.

The four- or seven-year budget adjustment scenarios developed by the PBO also incorporate the assumptions related to the clauses introduced in the European Commission's legislative proposals and which are detailed in Section 3.1. Specifically, in the case of a deficit above 3 per cent of GDP, the minimum adjustment compared to the previous year is expected to be at least 0.5 per cent of GDP.

Even in the scenarios with a four- or seven-year budget adjustment, the use of the dynamic multipliers estimated for the Italian economy with the MeMo-It macroeconomic forecasting model supplied to the PBO allows the dynamics of the GDP growth rate to be redetermined, specifically forecasting that the multi-year consolidation measures have a contractionary effect on real GDP growth compared to that of the unchanged policy scenario, with unfavourable effects on the cyclical component of the budget balances.[81]

Based on the above assumptions, the paths of the debt-to-GDP ratio resulting from the four- and seven-year multi-year adjustment shown in Figure 3.2 are compared with the trajectory occurring under the assumption of unchanged policies from 2024[82] in both the 'loss of potential' scenario and the alternative 'loss of potential and lower trend growth' scenario.

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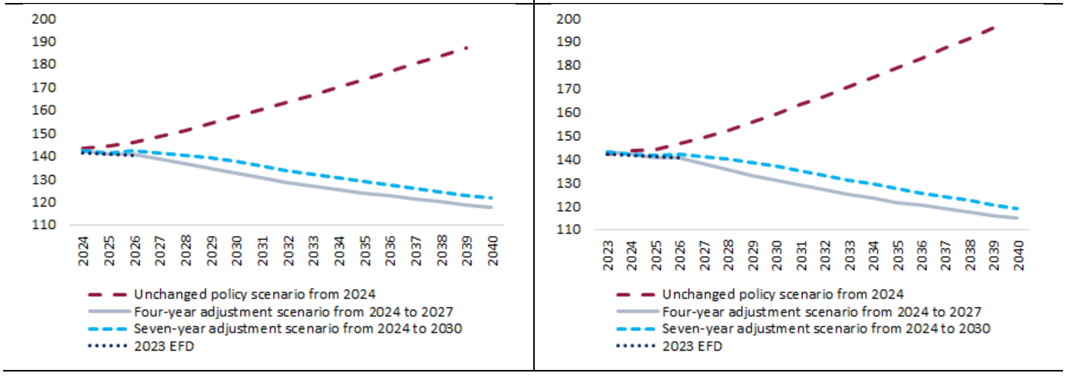
[80] European Commission (2021), *The 2021 Ageing Report*, Institutional Paper No. 148.

[81] In line with the European Commission's assumptions, the output gap is assumed to close in the years following the budgetary adjustment. The PBO projections expect the gap to be nil in the six years following the last year of the consolidation period.

[82] In the unchanged policy scenario, age-related expenditures are assumed to have an impact on the structural balance from 2028 onwards; this in order to allow better comparing the adjustment scenarios where age-related expenditures are assumed to have an impact on the structural primary balance only after the adjustment period.

Figure 3.2 – Public debt development
(as a percentage of GDP)

Loss of potential scenario	*Loss of potential and lower trend growth scenario*



Source: based on data from 2023 EFD, Bank of Italy and Istat.

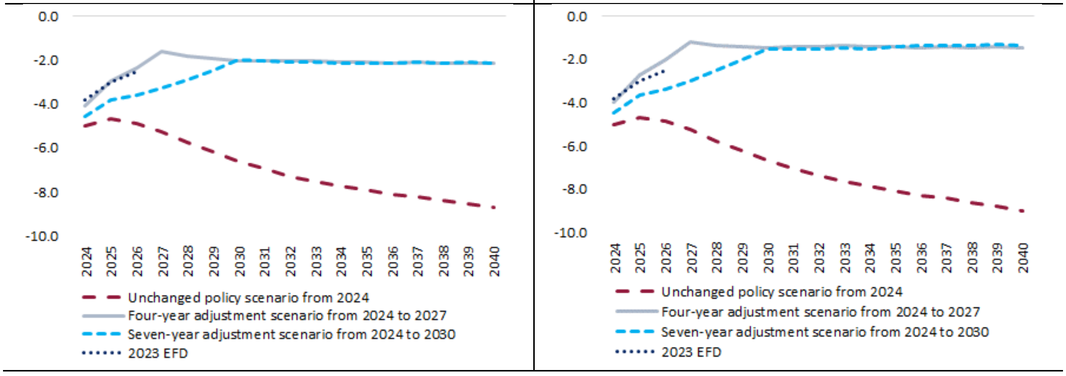
Under the assumption of unchanged policies from 2024, the debt-to-GDP ratio would promptly grow. This would be specifically due to the technical assumption of no fiscal adjustment and, in the medium term, to the progressive growth of age-related expenditures. In the 'loss of potential' scenario, debt would reach just below 184 per cent of GDP in 2040, about 40 percentage points above the 2023 baseline. In the less optimistic 'loss of potential and lower trend growth' scenario, the debt-to-GDP ratio under unchanged policies would immediately show a more pronounced upward trend compared to the 'loss of potential' scenario. In 2040, the debt would stand at just over 191.5 per cent of GDP, more than 48 percentage points above the starting figure of 2023.

Conversely, following multi-year budgetary consolidation adjustments, the debt-to-GDP ratio would be on a constant declining trend. The four-year adjustment would lead to a steeper decline in the debt-to-GDP ratio than a seven-year adjustment, mainly due to the faster decline in interest expenditure as a share of GDP. In the 'loss of potential' scenario, at the end of the forecast period (2040), the debt-to-GDP level would fall to around 117.5 per cent, while the case of a seven-year adjustment period it would be just below 122 per cent, with reductions ranging, respectively, between 26 and 22 percentage points compared to the 2023 baseline. In the 'loss of potential and lower trend growth' scenario, with an adjustment in four years the debt-to-GDP ratio would align to 114.7 per cent in 2040, while it would stand just above 119 per cent with an adjustment period of seven years.

In the context of this debt-to-GDP dynamic, Figures 3.3 and 3.4 below show the corresponding evolution of net borrowing-to-GDP ratio and the primary balance as a ratio of GDP in scenarios involving a multi-year budgetary adjustment in four or seven years compared with the evolution resulting from the unchanged policy scenario.

Figure 3.3 – Net borrowing development
(as a percentage of GDP)

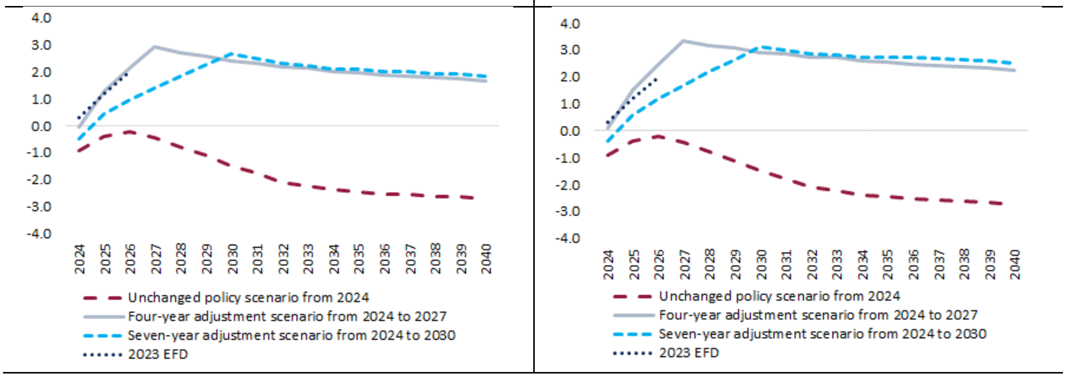
Loss of potential scenario | *Loss of potential and lower trend growth scenario*



Source: based on data from 2023 EFD, Bank of Italy and Istat.

Figure 3.4 – Primary balance development
(as a percentage of GDP)

Loss of potential scenario | *Loss of potential and lower trend growth scenario*



Source: based on data from 2023 EFD, Bank of Italy and Istat.

In the 'loss of potential' scenario, the net borrowing-to-GDP ratio, under the assumption of unchanged policies, would begin to increase until reaching 8.7 per cent of GDP in 2040 after remaining broadly stable until 2026. By contrast, in the four-year adjustment scenario, the budget deficit would fall below the 3 per cent of GDP threshold starting in 2025, reaching 1.6 per cent in 2027, at the end of the consolidation plan. In the following years, the deficit would increase slightly due to rising age-related costs, while remaining around or just above 2 per cent of GDP. Under the seven-year adjustment scenario, the deficit-to-GDP would fall below the 3 per cent threshold in 2028, reaching 2.0 per cent at the end of the consolidation plan (2030) and remaining broadly stable over the following ten years.

Similar dynamics are suggested by the less optimistic assumptions of the 'loss of potential and lower trend growth' scenario. In this case, the debt under unchanged policies would approach 9.0 per cent of GDP in 2040. Under the four-year adjustment scenario, net borrowing would reach 1.2 per cent of GDP in 2027, i.e. at the end of the adjustment period, while it would stand at around 1.4 per cent of GDP in the following years. Finally, in the case of a seven-year adjustment, the deficit would fall to 1.5 per cent in 2030, the final year of the consolidation period, and thereafter would stabilize around 1.4 per cent of GDP.

Figure 3.3 also shows the 2023 EFD net borrowing targets for the 2024-26 three-year period, suggesting that the policy deficit evolution would be in line with the indications of the proposed reform of the EU's economic governance system as prepared by the PBO. However, in the less optimistic 'loss of potential and lower trend growth' scenario, the EFD policy targets would only be consistent with the indications in the case of a seven-year fiscal adjustment.

Figure 3.4 shows the primary balance-to-GDP ratio development in the various trajectories with and without budgetary adjustment. Under the assumptions of unchanged policies, in both the 'loss of potential' and the 'loss of potential and lower trend growth' scenarios, the primary balance, after a slight improvement up to 2026, would show significantly deteriorate in the following years.

By contrast, with a four-year budgetary adjustment, in the 'loss of potential' scenario, the primary balance would reach a surplus of 2.9 per cent of GDP in 2027 and then gradually decline by more than 1 percentage points over the following twelve years as a result of the increase in age-related expenditures. In the case of a seven-year adjustment period, the consolidation path would be more gradual, and the primary surplus would reach 2.7 per cent in 2030, before declining towards 2 per cent in 2040.

In the case of the 'loss of potential' scenario, the EFD primary balance targets in the three-year period 2024-26 turn out to be very similar to those provided for in the four-year adjustment scenario. However, it is worth clarifying that in order to ensure a plausible reduction in the debt-to-GDP ratio, the government, in addition to not deviating from the targets outlined in the policy, will be required to continue to pursue the consolidation also in 2027 to reach a primary balance just below 3 per cent of GDP and keep it thereafter except to take into account higher age-related expenditures.

Compared to the results presented above, in the alternative 'loss of potential and lower trend growth' scenario, the adjustment on the primary balance will have to be even larger. Fiscal consolidation would bring the primary balance to 3.3 per cent of GDP in 2027 in the four-year adjustment scenario and to 3.1 per cent of GDP in 2030 in the seven-year adjustment scenario. In this scenario, according to the framework developed by the PBO, the government's policy balances, if achieved, would only be in line with the indications of the proposed reform of the EU framework in the case of a seven-year adjustment.

To achieve the primary balances needed to ensure the debt-to-GDP ratio reduction paths outlined above, stress tests consistent with the Debt Sustainability Monitor 2022[83] were prepared, while verifying that, even under these adverse scenarios, the debt-to-GDP ratio would continue to decline. These stress tests take into account three alternative deterministic scenarios and an analysis based on stochastic simulations of the debt-to-GDP ratio.

More specifically, the following three deterministic scenarios were outlined:

1. The permanent increase of about 1 per cent in the so-called snowball effect, i.e. the difference between the average cost of debt and the GDP growth rate. This assumption is simulated by assuming, from the first year following the adjustment period, a permanent reduction in GDP growth (real and potential) of 0.5 per cent compared to the unchanged policy scenario and a permanent increase in market interest rates of 0.5 per cent.

2. The temporary increase, limited to the first year following the end of the consolidation plan, of market interest rates by 100 basis points plus a risk premium,[84] triggered only for countries with debt exceeding 90 per cent of GDP. In the case of Italy, these assumptions would bring temporary increase in market rates of around 4 per cent for the year following the adjustment period only.

3. The permanent deterioration of the structural primary balance by a total of 0.5 per cent in the two years following the consolidation period (i.e. 0.25 per cent each year).[85] In the following years, the structural primary balance would remain constant and only changes as age-related expenditures varies.

Figures 3.5 and 3.6 show that in both the 'loss of potential' and the 'loss of potential and lower trend growth' scenarios, the four-year or seven-year adjustment helps ensure that the dynamics of the debt-to-GDP ratio remain on a downward or stable trend even after shocks to market rates, GDP growth and the structural primary balance. In all projections, the temporary increase in interest rates by about 4 per cent would lead to a temporary higher trajectory of the ratio, while in the scenario with a 1 per cent increase in the difference between interest rates and the GDP growth rate, the debt trend stabilises in the medium term around 130 per cent of GDP.

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83 European Commission, (2022), '2022 Debt Sustainability Monitor', Institutional Paper 199

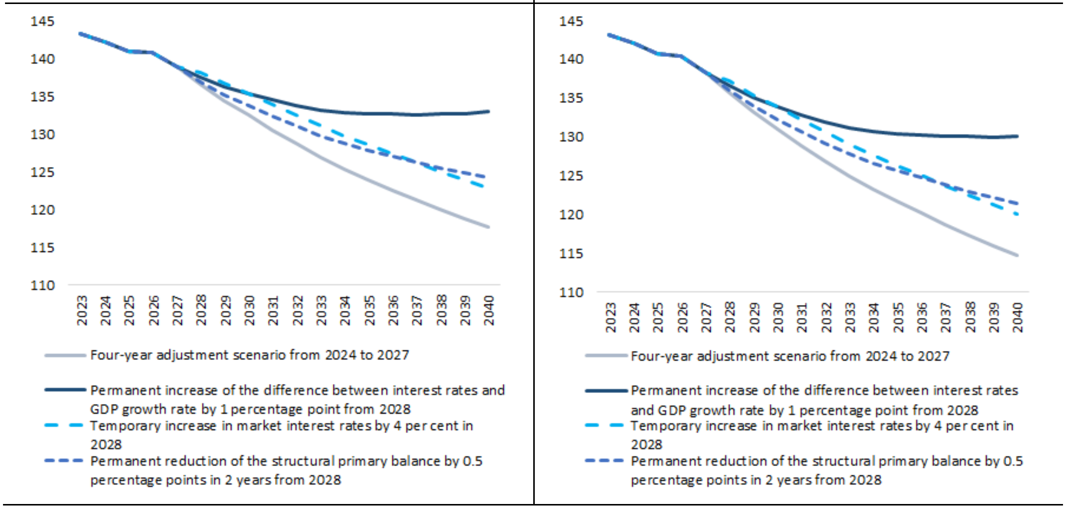
84 The risk premium is calculated by multiplying the differential between the 2028 debt-to-GDP ratio and the 90 per cent level by a parameter of 0.06. For more details, see Paumies S., Carnot N. and A. Patarau, (2021), "Do fundamentals explain differences between Euro Area sovereign interest rates", European Economy, Discussion paper 141.

85 Furthermore, the scenario adopts a conservative assumption under which this fiscal loosening will not have an expansive effect on GDP.

Figure 3.5 – Evolution of public debt with stress test on scenario with a four-year adjustment

(as a percentage of GDP)

Loss of potential scenario	*Loss of potential and lower trend growth scenario*

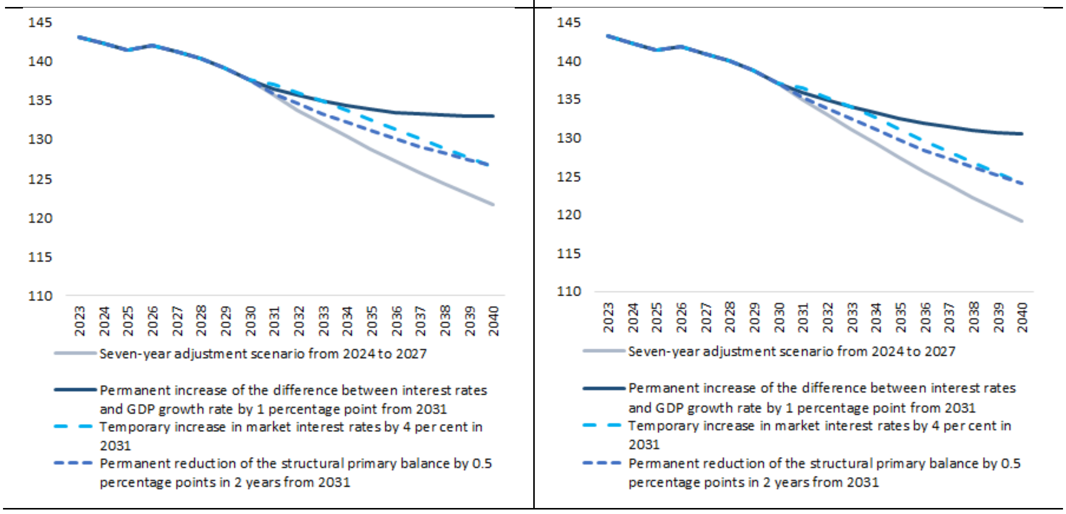


Source: based on data from 2023 EFD, Bank of Italy and Istat.

Figure 3.6 – Evolution of public debt with stress test on a seven-year adjustment scenario

(as a percentage of GDP)

Loss of potential scenario	*Loss of potential and lower trend growth scenario*

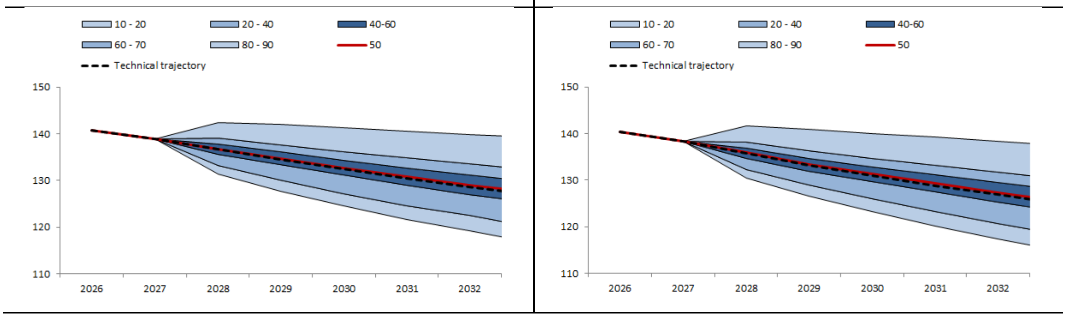


Source: based on data from 2023 EFD, Bank of Italy and Istat.

Finally, the plausibility of the debt-to-GDP ratio decrease as a result of the multi-year budget adjustment assumptions is also assessed through stochastic simulations. This procedure allows assessing whether the probability of the debt being on a downward path is sufficiently high (figs. 3.7 and 3.8). These figures reveal that, in all the scenarios presented, the debt-to-GDP ratio is very likely to show a downward trend after the adjustment period. Specifically, at the fifth year after the end of the fiscal consolidation plan, i.e. in 2032 for the four-year adjustment scenario and in 2035 for the seven-year adjustment scenario, the probability that the debt-to-GDP ratio stands below the level of the last year of adjustment (i.e. 2027 or 2030) is above 70 per cent, in line with the indications of the proposed reform of EU economic governance.

Figure 3.7 – Probabilistic analysis of debt-to-GDP ratio in the four-year adjustment scenario
(as a percentage of GDP)

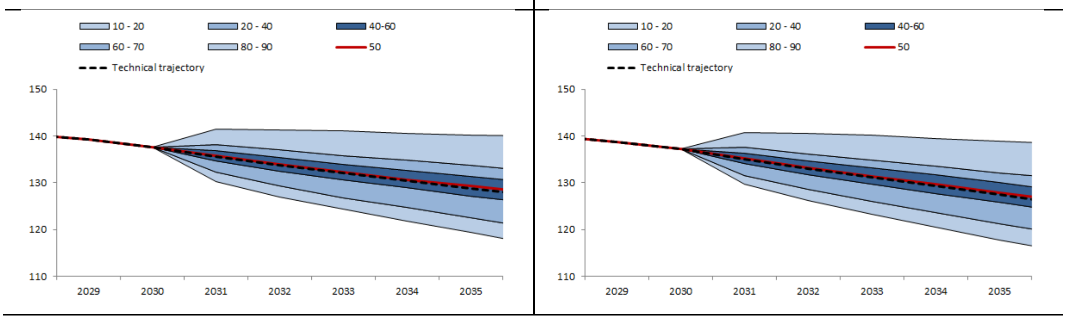
Loss of potential scenario	*Loss of potential and lower trend growth scenario*



Source: based on data from 2023 EFD, Bank of Italy and Istat.

Figure 3.8 – Probabilistic analysis of debt to GDP in the seven-year adjustment scenario
(as a percentage of GDP)

Loss of potential scenario	*Loss of potential and lower trend growth scenario*



Source: based on 2023 EFD, Bank of Italy and Istat.

As mentioned in the previous paragraph, the path of net primary expenditure financed from national resources consistent with this adjustment plan is established once the technical trajectory is defined with the multi-year budget adjustment plan. This aggregate will be the single indicator used for subsequent monitoring.

Based on the scenarios outlined above, a preliminary assessment of the components that make up the net primary expenditure indicator allows defining an estimate of the upper bound and its growth rate based upon the adjustment plans outlined above.[86]

In the unchanged policy scenario, the net primary expenditure grows on average by 3.6 per cent in both scenarios in the 2024-27 period, at the same level as nominal potential GDP growth in the medium term (Table 3.1).

By contrast, with a four-year adjustment, the upper limit on net primary expenditure growth would decrease to 1.2 per cent on average over the 2024-2027 period in the 'loss of potential' scenario and to 0.8 per cent in the 'loss of potential and lower trend growth' scenario. In the case of a seven-year adjustment, the upper limit on net primary expenditure growth would average 2.2 per cent and 1.9 per cent over the 2024-2030 period, respectively. As Table 3.1 shows, these upper limits on net primary expenditure growth would be compatible with the safeguard contained in the proposed regulation, which requires that, over the adjustment period, net primary expenditure grows on average at rates below those of medium-term potential GDP.[87]

Table 3.1 – Upper limit of growth of net primary expenditure aggregate financed from national resources and nominal potential GDP growth in the medium term (1)
(annual averages over the adjustment period, percentage points)

		Upper limit to the growth of net expenditure aggregate	Medium term nominal potential GDP growth
Loss of potential scenario	Unchanged policies scenario from 2024	3.6	3.6
	Four-year adjustment scenario from 2024 to 2027	1.2	3.6
	Seven - year adjustment scenario from 2024 to 2030	2.2	3.4
Loss of potential and lower trend growth	Unchanged policies scenario from 2024	3.6	3.6
	Four-year adjustment scenario from 2024 to 2027	0.8	3.6
	Seven - year adjustment scenario from 2024 to 2030	1.9	3.3

Source: based on data from 2023 EFD, Bank of Italy and Istat.
(1) The average is calculated from 2024 to 2027 for the unchanged policy scenario and the four-year adjustment scenario and from 2024 to 2030 for the seven-year adjustment scenario. Medium-term potential GDP growth for year *t* is calculated as the average of potential GDP growth from *t-6* to *t+3*. The GDP deflator for year *t* is then applied to obtain the nominal value.

[86] The upper limit of the growth rate of net primary expenditure is calculated by using the method described in the *Fiscal Statistical Tables* adopted by the European Commission for the assessment of the 2023 Stability and Convergence Programmes, but without any correction for one-off measures as this is not included in the legislative proposals.
[87] The nominal potential GDP growth in the medium term of the seven-year adjustment scenarios is lower than that of the other scenarios due to the assumptions on GDP deflator growth, which declines from 2026 onwards on the assumption of a convergence towards 2 per cent over six years.

It is worth noting again that the expenditure aggregate that has to comply with the upper limits on growth presented in Table 3.1 is calculated by subtracting from total government expenditure the items not directly under the control of governments, i.e. interest expenditure and expenditure items affected by the business cycle (cyclical unemployment benefit expenditure). Moreover, the net expenditure aggregate is also calculated by subtracting the impact of discretionary revenue measures. As a result, higher overall primary expenditure will be allowed as long as it is offset by new discretionary measures on the revenue side. On the other hand, a reduction in primary expenditure will be required in the case of discretionary revenue measures reducing the tax burden (such as, for example, a tax reform with a burden on public finance).

3.3 Considerations on the European Commission's reform proposals

The legislative proposals to reform the Stability and Growth Pact and the Macroeconomic Imbalance Procedure presented by the European Commission enshrines different positive elements.

First, an important new feature of the new policy framework is the strengthening of 'ownership' by the Member States, i.e. their participation and responsibility in defining their own fiscal adjustment path, as called for by the PBO in its hearings on the reform of EU economic governance held last March and last year.[88]

The broader involvement of Member States in the definition of the adjustment path, in partnership with the EU to harmonise national and European interests, enhances its credibility with potential positive effects on financial markets and interest rates. In this regard, it would be desirable for Member States to be able to discuss, at an early stage, with the European Commission the assumptions underpinning the technical trajectories that the European Commission will publicly disclose as the procedure begins, and to have transparent access to all available information even before the preparation of the SFPs. It is also crucial for final preparation of the SFPs by governments in partnership with the European Commission to represent an opportunity to attach greater importance to the specific characteristics of each country, although in compliance with EU objectives and priorities, when defining budgetary and reform priorities.

As pointed out in paragraph 3.1, compared to the wording contained in last November's Communication, the European Commission's legislative proposals include some clauses that reintroduce numerical rules common to all countries, such as, for example, the requirement in the European Commission's technical trajectories for a minimum budgetary adjustment of 0.5 per cent of GDP where the deficit is above the 3 per cent of GDP threshold, or the rule that the net primary expenditure indicator over the adjustment period must grow below the medium-term GDP growth rate, on average. This would again reduce national ownership of SFPs. Moreover, the introduction of numerical rules independent from the macroeconomic conditions prevailing over the plan horizon could require adjustments well beyond the objective of ensuring a 'plausible' decrease in debt-to-GDP ratio over the medium term, with negative effects on the business cycle.

Conversely, it would be desirable to ensure enough flexibility in relation to the technical trajectories when submitting the SFPs to take due account of country-specific characteristics, thus allowing the adjustment paths to better consider the required balance between the equally important objectives of public finance sustainability,

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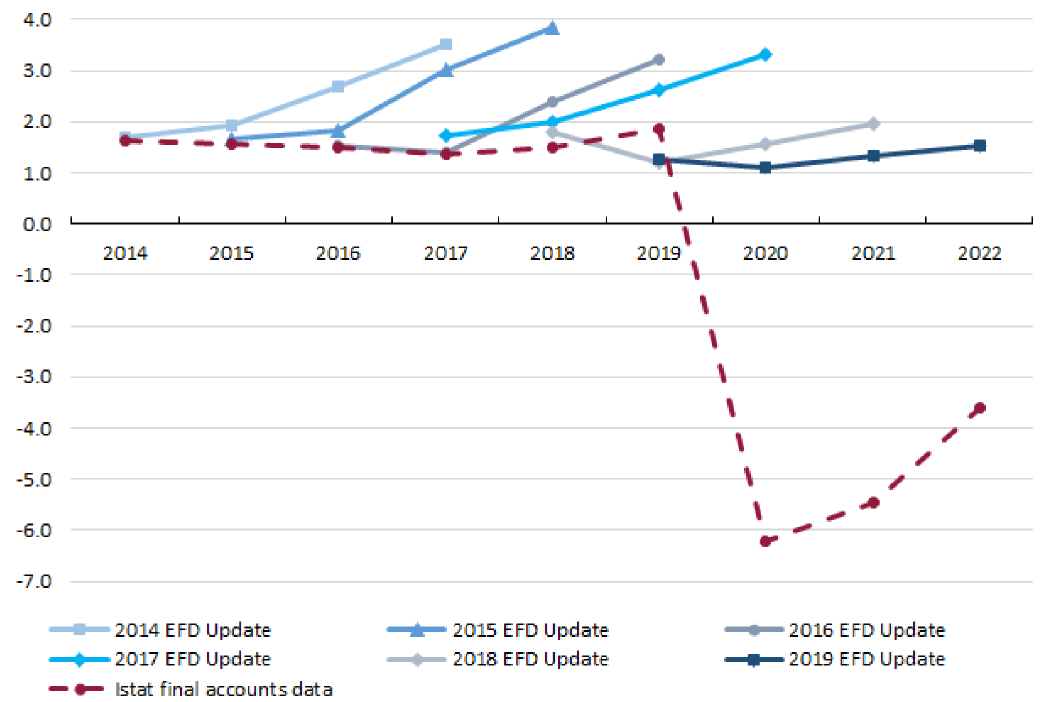
[88] See Parliamentary Budget Office (2023): 'Hearing of the Chair of the Parliamentary Budget Office on the Orientations for a Reform of the EU Governance Framework', 1 March 2023 and Parliamentary Budget Office (2022): "Hearing of the Chair of the Parliamentary Budget Office in the context of the review of the Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions - The EU Economy after COVID-19: implications for economic governance (COM(2021)662 *final*)", 16 March 2022.

business cycle stability and GDP growth. A flexible strategy could also foster greater consistency between the fiscal stance at the national and euro area level if adjustment paths were applied symmetrically in countries below and above the thresholds of 3 per cent of debt-to-GDP ratio and 60 per cent of debt-to-GDP ratio.

Another positive element of the European Commission's proposals is their ability to provide a strong push for multiannual budget planning at national level, as also confirmed by the proposals to amend Directive 2011/85/EU, and as called for in many contributions by the PBO and the EU IFI Network.[89] A medium-term planning horizon fosters stability and predictability of budgetary targets and of public intervention, which facilitates the planning and the implementation of wide-ranging measures. This is particularly important for countries such as Italy where, despite considerable progress from a legislative standpoint, fiscal management is conducted on an annual basis as shown, for example, in the roughly systematic revision of primary budget balances in the programming documents (Figure 3.9).

Figure 3.9 – Policy primary balance targets
(as a percentage of GDP)



Source: based on EFD Update data in different years and Istat.

[89] See: Network of EU *IFIs* (2021), "*EU fiscal and economic governance review: A contribution from the Independent EU Fiscal Institutions*"; *Network of EU IFIs* (2021), "*How to strengthen fiscal surveillance towards a medium-term focus?*", *Contribution to the EFB Annual Conference*, 26 February; Parliamentary Budget Office (2019): "Hearing of PBO Advisor, Chiara Goretti, in the context of the fact-finding activity concerning the results of the first implementation of Art. 22-bis of Law 196/2009 on financial programming and agreements between ministries', 13 March; *Network of EU IFIs* (2018), '*Medium-Term Budgetary Frameworks, A contribution to definitions and identification of good practices*', 4 May.

In a context characterised by more stable budgetary targets proposed by the new framework, it is important to bear in mind that changing multi-year expenditure commitments in a specific area will necessarily entail discretionary interventions to secure higher revenues or lower expenditure in other areas; thus, both a thorough *ex-ante* discussion and assessment of policy priorities and a careful *ex-post* monitoring of the effectiveness of the interventions designed to achieve the targets will be essential.

A further aspect to be positively, yet prudently, assessed is the proposal to incorporate population ageing risks in the framework. As a matter of fact, the required adjustments will also have to take due account of the need to finance the expected impact on public accounts of population ageing, i.e. a non-negligible element of risk for the resilience of future budgets not only in Italy. Due attention to these risks appears justified in the light of the significant impact of demographic transition on public accounts in the coming decades.[90]

At the same time, it is worth considering that the estimates of these costs are considerably uncertain, and some flexibility might be needed when revising adjustment plans. This uncertainty is mainly ascribable to the volatility of demographic scenarios resulting, for example, from forecasts on migration flows that are frequently revised.

Focusing on a single annual policy target, especially on the indicator of net primary expenditure financed from national resources, entails some advantages. Firstly, there is no longer a need to base fiscal policy on multiple indicators, which often provide uneven information, thus casting some doubts on the assessment of whether governments' plans are appropriate to cope with policy priorities, in particular the need to reduce debt-to-GDP ratio.

Moreover, choosing net primary expenditure as a policy indicator should reduce the pro-cyclicality of fiscal policy in relation to the current numerical debt-to-GDP reduction rule and the 3 per cent deficit-to-GDP threshold rule. Indeed, given a better GDP growth than initially expected, the net primary expenditure path will have to remain consistent with the provisions under the adjustment plan. Therefore, net primary expenditure-to-GDP ratio will tend to decrease in periods of higher-than-expected GDP growth while it will increase in periods of lower-than-expected GDP growth.

It is also crucial to stress that the proposed indicator will not affect the overall size and composition of Member States' budgets. Indeed, primary expenditure will be calculated net of the impact of discretionary revenue measures. Therefore, governments will be able to decide on overall primary expenditure increases as long as these are financed by corresponding discretionary revenue-increasing measures. Moreover, it will still be possible to finance expenditure increases in one area with corresponding expenditure

[90] Cavallari L., Padrini F., Salerno N. and Toffoli L. (2023): " *Ageing and the sustainability of public finance*", Economia Italiana 2022/3.

reductions in other areas. Hence, no discontinuity emerges in terms of coverage under Italian national budget procedures.

Likewise, limiting the monitoring of revenues to those stemming from discretionary measures has a remarkable advantage: unlike the existing rule on the structural balance, it would avoid expenditure reductions in the case of temporarily lower-than-expected revenues (*revenue shortfall*), thereby improving budgetary planning. Furthermore, it would also avoid (unjustified) expenditure increases in the case of higher-than-expected revenues that may turn out to be temporary (*revenue windfall*). On the other hand, it will be necessary to monitor that such anomalous revenue trends do not stem from permanent factors such as, for example, a structural change in tax evasion. In such cases, the initially determined net primary expenditure path should be revised.

However, one should bear in mind that the proposed indicator will be calculated by excluding the cyclical component of unemployment expenditure and that this varies considerably across countries (Figure 3.10); thus, in the event of an unfavourable cycle, in the new framework this may favour countries where social safety nets are more developed. Moreover, in many countries there are institutions that are not included in the unemployment benefit expenditure aggregate while remaining vulnerable to cyclical conditions. It could therefore be advisable to include expenditures not strictly included in the unemployment benefit expenditure aggregate into cyclical expenditures.

Finally, using the indicator of net primary expenditure financed from national resources for the multilateral surveillance of the new governance rules seems the right choice as this indicator includes expenditure items under the control of governments, although some of them require the use of estimates.

The importance of the sustainability of public finances in the medium term enshrined in the European Commission's legislative proposals can encourage the strengthening of the quality of fiscal policy at the national level, especially by preserving the components of the budget with greater impact on growth, such as public investment.

As outlined in the March 2022 PBO hearing,[91] budgetary adjustments that preserve public investment lead to a faster decline in debt-to-GDP ratio, especially when considering investments, such as those in the green transition, characterised by relatively high multipliers.

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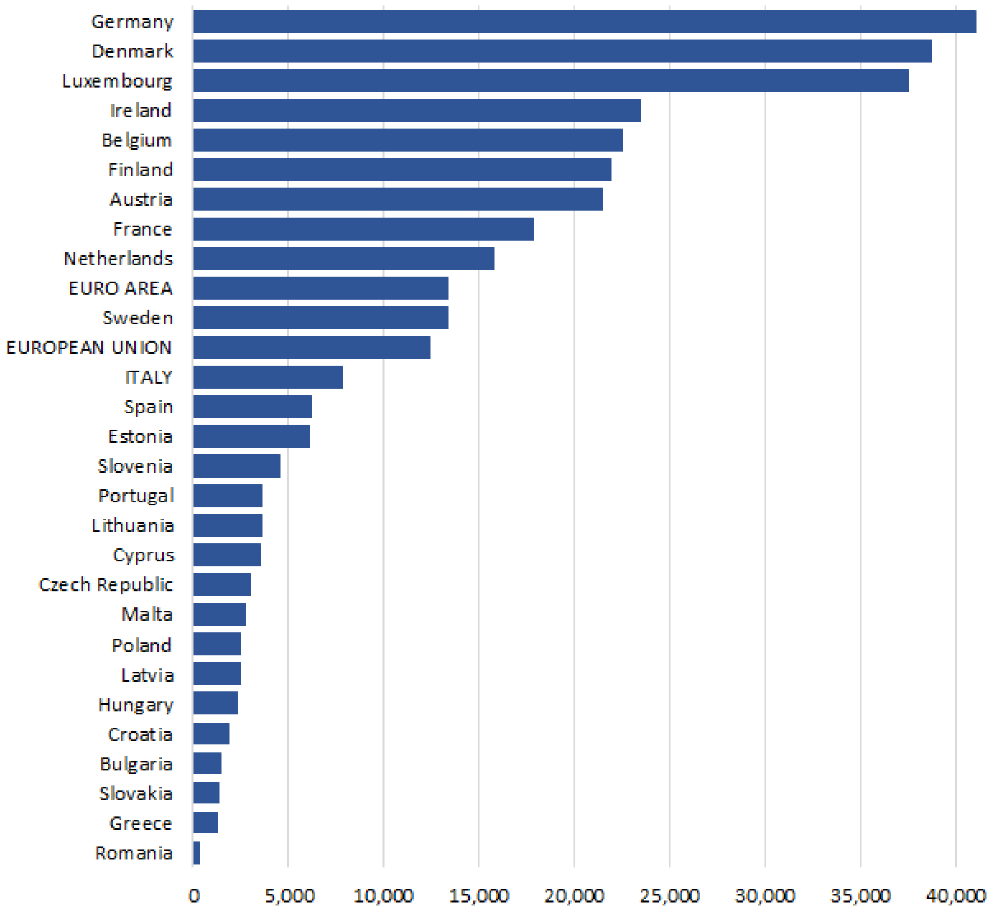
[91] Parliamentary Budget Office (2022): 'Hearing of the Chair of the Parliamentary Budget Office in the context of the examination of the Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions - The EU Economy after COVID-19: Implications for Economic Governance (COM(2021)662 *final*)', 16 March.

Figure 3. 10 – Unemployment benefit expenditure in European Union countries - Year 2019 (1)
(euro per unemployed person)



Source: based on Eurostat data.
(1) The analysis considers the last year with data available for all EU Member States published on Eurostat before the COVID-19 pandemic, thus excluding 2020 and 2021 as they were characterised by the adoption of extraordinary measures to cope with the economic crisis.

The incentive to improve the quality of the public budget is also strengthened by the fact that the SFP incorporates commitments not only in terms of public finance, but also in terms of reform and investment. Fulfilment of the reform and investment commitments in the plan is one of the conditions for extending the adjustment period from four to seven years. As a result, even without the possibility to exclude investment spending from the calculation of the net primary expenditure indicator, the extension beyond the four-year horizon of the SFPs represents an incentive for governments to increase such spending. In this regard, it is likely and desirable that the fiscal space created by the extension of the adjustment path from four to seven years is fully used to increase public investment.

One aspect of the new framework that should become more flexible concerns the scope for modifying the SFP where the preliminary assumptions turn out to be unrealistic over time. Cyclical developments, for example, might turn out to be significantly different from the preliminary forecast, thus requiring the adoption of discretionary deficit measures for stabilisation purposes. Such a circumstance appears relevant especially for countries, such as Italy, where the importance of social safety nets is relatively limited.

By the same token, inflation may turn out to be higher and more persistent than expected, and in such a circumstance a fiscal adjustment of 0.5 per cent of GDP for countries with debt above 3 per cent may require a reduction in net primary expenditure in nominal terms, which may be difficult to implement especially if high inflation is due to adverse supply-related shocks.

On the other hand, as regards business cycle and inflation, the legislative proposals provide that, should their evolution be significantly different from the assumptions underpinning the initially endorsed net primary expenditure path, the relevant factors likely to hinder the opening of an excessive deficit procedure should be assessed. However, in addition to the foregoing, the country-specific exceptional events clause should be activated not only for natural disasters but also in cases of developments in macroeconomic variables significantly different from those originally assumed due to unexpected shocks.

From a more technical perspective with important implications for the transparency and predictability of fiscal policy, although the new framework proposed by the European Commission appears in many respects simpler than the current one, it will still rely on relatively complex methodologies for preparing the sustainability analysis, for determining the multi-year adjustment path and for the annual monitoring of compliance with the net primary expenditure profile. Specifically, the role of unobservable variables such as potential GDP, the output gap and structural balances is significantly reduced but not eliminated. For instance, the use of medium- to long-term GDP projections, essential in the new framework, requires the estimate or assumption of the evolution of potential output. Moreover, an estimate of the structural balance, and hence of the output gap, at the beginning of the projections is crucial in order to determine both the unchanged policy and the adjustment scenario. Therefore, some of the problems found with the old rules, e.g. a lack of transparency or excessive adjustment demands due to an underestimation of the output gap in periods of sluggish growth, may also emerge again in the new framework.

More generally, debt-to-GDP projections over the medium term depend crucially on assumptions about interest rates and GDP growth; it would be appropriate for these assumptions to be addressed in broad public discussion, although their final determination will still be up to governments and EU institutions. This will require full transparency on the assumptions and methods used by both governments and the European Commission, as called for in several contributions of the EU IFI Network.[92]

[92] See: *Network of EU IFIs* (2021), '*EU fiscal and economic governance review: A contribution from the Independent EU Fiscal Institutions*'.

In addition, in 2024, when the first SFPs are expected to be prepared, the impact on economic growth of reforms and investments, including those provided for in the NRP, might only be considered by the European Commission up to 2026. Conversely, it would be desirable that as soon as the technical trajectories are drafted, the models underpinning the DSA can take into account the impact of higher investment and structural reforms in GDP growth projections also over a medium-term horizon.

In any event, the sensitivity of debt projections to macro-financial assumptions will encourage the determination of the adjustment path under prudent assumptions. To reduce the possibility of unexpected increases in the debt-to-GDP ratio, the adjustment path should therefore be determined by assuming scenarios that, although realistic, remain prudential. Likewise, based on what has happened in the banking sector, due attention should be paid when preparing the assumptions and the communication of the results of adverse scenarios (stress tests), as these could negatively impact the stability of financial markets.

Moreover, while the indicator of net primary expenditure financed by domestic resources represents a viable choice, it requires the estimation of some components that are not directly observable and therefore requires the availability of adequate information. In particular, the estimation of the financial impact of discretionary measures on revenues, and in general the financial impact of budgetary measures depends, both *ex ante* and *ex post*, on the working assumptions used. In the new EU regulatory framework, it will be even more important to ensure the principle of prudence when assessing financial impacts as well as transparency in the assumptions and methodologies adopted. Moreover, primary expenditure must also be calculated excluding the cyclical component of unemployment benefit expenditure and requires the estimation of the unemployment gap, another unobservable variable. Finally, more transparency and *ex ante* predictability on the timing and use of EU structural funds would be desirable.

In light of the foregoing, it would be appropriate for the European Commission to publicly disclose as soon as possible, and before the approval of legislative proposals, both baseline and stress-tested debt projections and their policy implications as well as all assumptions and details underpinning the results.

In conclusion, it is worth stressing an important aspect overlooked in the European Commission's legislative proposals: the failure to consider the appropriate budgetary stance for the euro area as a whole. Indeed, the proposed framework risks leading to overly restrictive policy orientation for the euro area and the EU in the near future, albeit to a lesser extent than the Stability and Growth Pact. This is triggered by the fact that the requests for budgetary adjustment will presumably be addressed to all EU countries (among others, probably Italy, France and Spain) that have a general government deficit above the 3 per cent threshold when the new regulation enters into force. As noted above, the legislative proposals require these countries to achieve a budgetary adjustment of at least 0.5 GDP points, regardless of the prevailing cyclical conditions.

Generalised adjustments of this relevance could entail an overly restrictive policy for the EU.

One option to consider the overall dimension of the euro area is for the new framework to provide symmetric indications for the budgetary stance between countries with debt or net borrowing-to-GDP levels both above and below the TFEU thresholds. Conversely, in the current proposal, given the multi-year budgetary consolidation by countries with debt or deficits above the Treaty thresholds, there seems to be no provision for countries below these thresholds to use the fiscal space for expansive policies.

One of the objectives of the legislative proposals is to foster greater integration between the fiscal policy framework and the macroeconomic imbalances procedure. To this end, a share of SFP reforms and investments is expected to be aimed at reducing macroeconomic imbalances. Greater interaction between the two procedures could help ensure the coordination of macroeconomic and fiscal policies. In this regard, it would be desirable for countries with excessive current account surpluses and meeting the deficit and debt parameters to be required to use the available fiscal space for expansionary policies.

However, the best solution should be more ambitious: to achieve more effective economic governance in the euro area, taking steps to build up a euro area budgetary capacity shall remain a priority. Such an instrument should be used to finance investments related to the strengthening of European public goods (e.g. the green and energy transition) and to develop cyclical stabilisation policies for the euro area as a whole, especially in the event of extreme shocks and events.

Once the new framework of EU governance rules is approved, progress will hopefully be achieved in the definition of a common budgetary capacity in the euro area.

The European Commission's hopes for the legislative proposals to be approved by the Council and the European Parliament by the end of 2023, thus entering fully into force as of the first quarter of 2024. However, aside from the deadline for the approval of the Regulations and the technical deadline for the full transposition at national level of the new provisions of Directive 2011/85/EU on requirements for the budgetary framework of the Member States, it may take long time for Member States to adjust their national budgetary procedures to the new EU governance framework, due to the significant amendments proposed. In this context, it would be desirable to provide for a transition period of one to two years for the introduction of the new framework*,* as was already the case with the Six Pack.

4. THE REFORM OF ANTI-POVERTY MEASURES

4.1 Introduction

The 2023 Budget Law[93] introduced measures on the Citizenship Income (*Reddito di Cittadinanza* – RdC) and Pension (*Pensione di Cittadinanza* – PdC) scheme[94] restricting the criteria for their disbursement in 2023 and establishing – pending a comprehensive reform of poverty-reduction support and active inclusion measures – their repeal from 1 January 2024.[95]

The so-called Employment Law-Decree (*DL Lavoro*)[96] completes the reform by introducing the Support Allowance (*Assegno di Inclusione* – AdI). The decree broadly confirms the provisions of the Budget Law with reference to the restriction of the use of the RdC in 2023, focusing anti-poverty measures on persons who, due to age or disability, are unable to actively participate in the labour market. The new allowance is intended exclusively for the financial support of households with disabled people, over-60s[97] and minors (protected individuals). Some of the working-age persons benefiting from the AdI are required to take an active role in the job market and accept job offers.

The other households, subject to a reduction in the duration of the RdC as provided for in the budget law, may not benefit from the new measure. For this category of individuals, the Support for Training and Employment (*Supporto per la Formazione e il Lavoro*) was introduced, i.e. a time-limited financial support conditional on participation in training, job guidance and job-support projects.

The basic criteria underpinning the AdI – while largely tracing the structure of the RdC as amended by the 2023 Budget Law – redefine the number of beneficiaries compared to the RdC and change the amounts of the benefit. Some households with protected persons who were previously beneficiaries of the RdC may be excluded from the new allowance, while the redefinition of the residence requirements, now less restrictive, may allow the extension of support to previously excluded persons.

This chapter briefly examines the evolution of the use of the RdC from 2019 to April 2023 (par. 4.2), then delves into the characteristics of the AdI (par. 4.3) and its activation paths (par. 4.5) and evaluates its distribution implications in relation to the pre-existing situation (par. 4.4). This analysis also takes into account the resources distributed with the Universal child allowance *(Assegno unico e universale per i figli a carico)*, whose access is

93 Law 197/2022, Art. 1, par. 318.
94 Introduced by LD 4/2019, converted, with amendments, by Law 26/2019.
95 For more details, see the Hearing of the PBO Chair, Lilia Cavallari, in the context of the preliminary fact-finding activity prior to the examination of the draft law on the State budget for the financial year 2023 and the multi-year budget for the 2023-2025 three-year period at the Joint Budget Committees of the Chamber of Deputies and the Senate of the Republic on 5 December 2022.
96 LD 48/2023.
97 Over 60s, although still in working age, are protected as they are considered difficult to employ.

redefined by the reform. Indeed, the Universal child allowance will be fully paid to the beneficiaries of the AI, while the beneficiaries of the RdC received only a share of it. The last paragraph contains some general considerations.

4.2 *The Citizenship Income*

The RdC is an income-support measure introduced as part of other measures to promote labour market and social inclusion of beneficiaries. The disbursement of the benefit is subject to economic and citizenship-related requirements.

As for the first requirement: 1) the Equivalent Economic Status Indicator (*Indicatore della situazione economica equivalente* – ISEE) must be less than EUR 9,360 per year; 2) the household income (appropriately multiplied by the equivalence scale[98]) must be less than specific thresholds determined on the basis of age and home ownership; 3) property assets (other than the home) and movable assets cannot exceed, respectively, EUR 30,000 and EUR 6,000 respectively;[99] 4) the household members may not own motor vehicles or motorbikes (with specific characteristics), ships or pleasure boats.

As for the second requirement, the RdC is intended for Italian or EU citizens, their family members with right of residence and, as regards non-EU citizens, holders of long-term residence permits. Residence in Italy for at least 10 years, of which the last two continuous years, is also required.

The economic benefit is differentiated according to the age of the household members and whether or not they own their home. The benefit is granted for 18 months and may be renewed after one month's suspension.[100]

With the introduction of the RdC, Italy has joined the majority of European countries providing universal anti-poverty instruments. Moreover, unlike the AI, the RdC has been recognised in national law as an essential service level (ESL).

Over the past twenty-five years, different anti-poverty measures have been proposed, the first among them being the experimentation of the Minimum Support Income in 39 Italian municipalities. This was followed by a series of tests and other measures (among them, the *Reddito di Ultima Istanza* – Income of Last Resort, the *Carta Acquisti* – Purchase Card, the *Sostegno per l'Inclusione attiva* – Active Inclusion Support) ending up in the introduction of the Support Income (*Reddito di Inclusione* – ReI) in 2018. The greater resources allocated to the RdC compared to the Support Income (about EUR 7.3 billion when fully active, against EUR 2.1 billion) allowed for a significant increase in both the number of beneficiaries and the amount of the benefit.

The remainder of this section provides some fact-finding analysis on the evolution over the years of the number of RdC beneficiaries and related expenditure, the local distribution of the benefit and some results on the implementation of active policies.

98 The equivalence scale, which differs from that used for other welfare measures, assigns a score of 1 to the applicant, 0.4 to each other adult family member and 0.2 to each minor family member, with a cap of 2.1 (raised to 2.2 in the presence of members with serious disabilities or non-self-sufficient members).

99 The threshold for movable assets is increased by EUR 2,000 for each family member beyond the first member up to a maximum of EUR 10,000, increased by a further EUR 1,000 for each child after the second; an additional EUR 5,000 shall be added for each disabled person.

100 For a more detailed description of the RdC see: the Informal Hearing of the Parliamentary Budget Office on draft law no. 1637 of 6 March 2019 and Parliamentary Budget Office (2021), "2022 Budgetary Policy Report", December.

4.2.1 The evolution of beneficiaries and expenditure

The expenditure incurred until April 2023 for the disbursement of the RdC and the PdC was EUR 30.3 billion. In 2019, year in which the measure was introduced, expenditure was EUR 3.9 billion. In 2020, due to the pandemic crisis, it stood at EUR 7.1 billion, a value lower than the one estimated when the measure was approved and equal to more than three times the amount allocated for Support Income. In 2021, as the crisis continued, the number of beneficiaries increased as it did expenditure, which reached EUR 8.8 billion. In 2022, as the macroeconomic framework improved, expenditure decreased to about EUR 8 billion. In the first four months of 2023, disbursements decreased further: compared to the same period of the previous year, expenditure fell by a further 16 per cent (or just under EUR 0.5 billion).

During the pandemic period, additional economic support measures were activated, such as the Emergency Income (*Reddito di Emergenza – RE*), conceived and built as a simplified and reduced RdC, with less stringent access requirements and released from obligations related to active policies.[101]

As from April 2019, the number of households benefiting from the RdC and the PdC (initially amounting to 570,000) grew steadily, with the exception of the initial months and October 2020 (compulsory suspension after eighteen months of use), until they reached 1.4 million in July 2021; in the following months, a gradual decrease began, which continued in the first months of 2023 (Figure 4.1).

While the decrease in the number of beneficiary households was a nationwide phenomenon, it was greater in the northern and central regions and lower – being almost constantly below the national average – in the South.

A joint analysis of the trend in the number of households benefiting from the RdC with the employment rate[102] suggests that recourse to the measure increased in the most severe phases of the pandemic, thus gradually decreasing in the period of economic recovery. The utilization of the RdC thus appears to be influenced by the economic cycle rather than being a form of social assistance.

In January 2020,[103] with an employment rate standing at 59.1 per cent, there were just under one million beneficiary households; in the following months, as the pandemic crisis worsened and employment declined sharply, the number of households increased steadily until the first half of 2021, when, also as a result of the reduction of restrictions imposed to cope with the COVID-19 pandemic, employment began to significantly recover. As of July 2021 – with the employment rate still below the January 2020 level (58.7 per cent) – the number of applications for the RdC began to steadily decrease. Finally, in April 2023 (latest available data), with employment rate standing at 61 per cent, the number of beneficiary households (around 850,000) was lower than in January 2020 (Figure 4.2).

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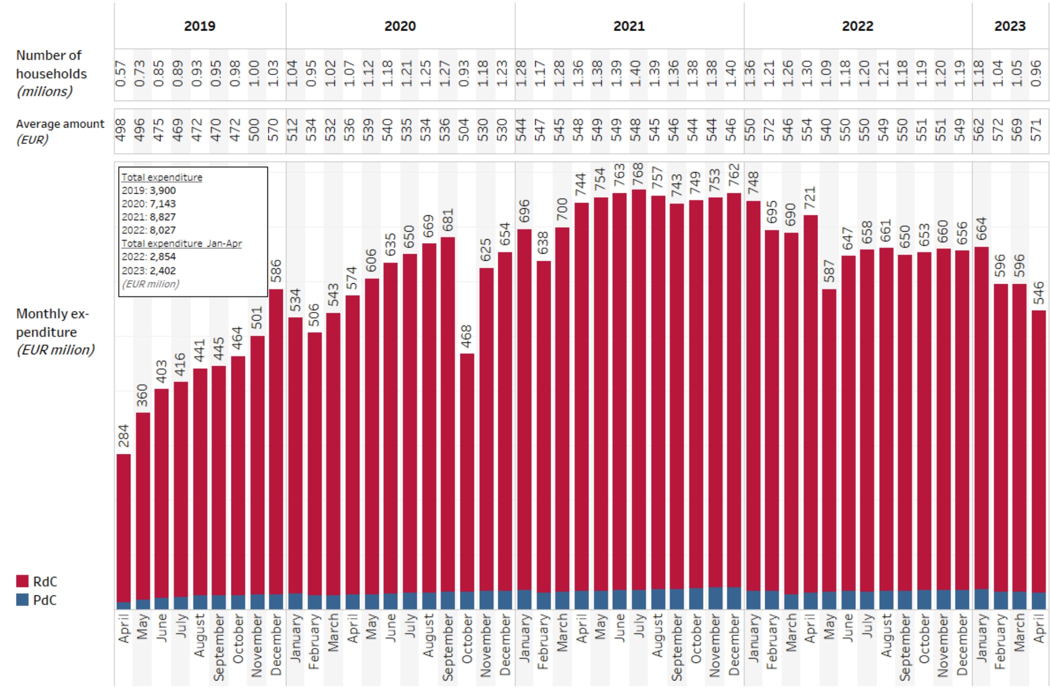
[101] See Parliamentary Budget Office (2021), "The Emergency Income one year after its introduction"; Flash No. 2, June.

[102] Istat, Employment and unemployment (provisional data) – April 2023.

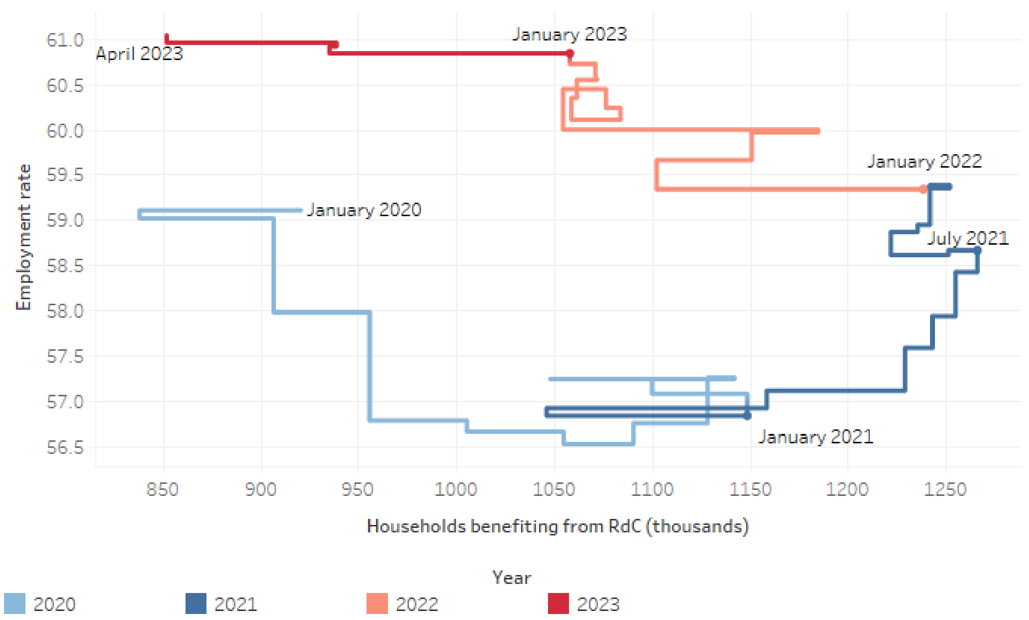
[103] 2019 is excluded from the analysis as the RdC was introduced during the year and with some initial difficulties.

Figure 4.1 – Expenditure, beneficiaries and average amount of RdC and PdC



Source: based on INPS (2023), “Osservatorio Statistico Reddito/Pensione di cittadinanza”, May.

Figure 4.2 – Households benefiting from RdC and employment rate (January 2020 - April 2023)

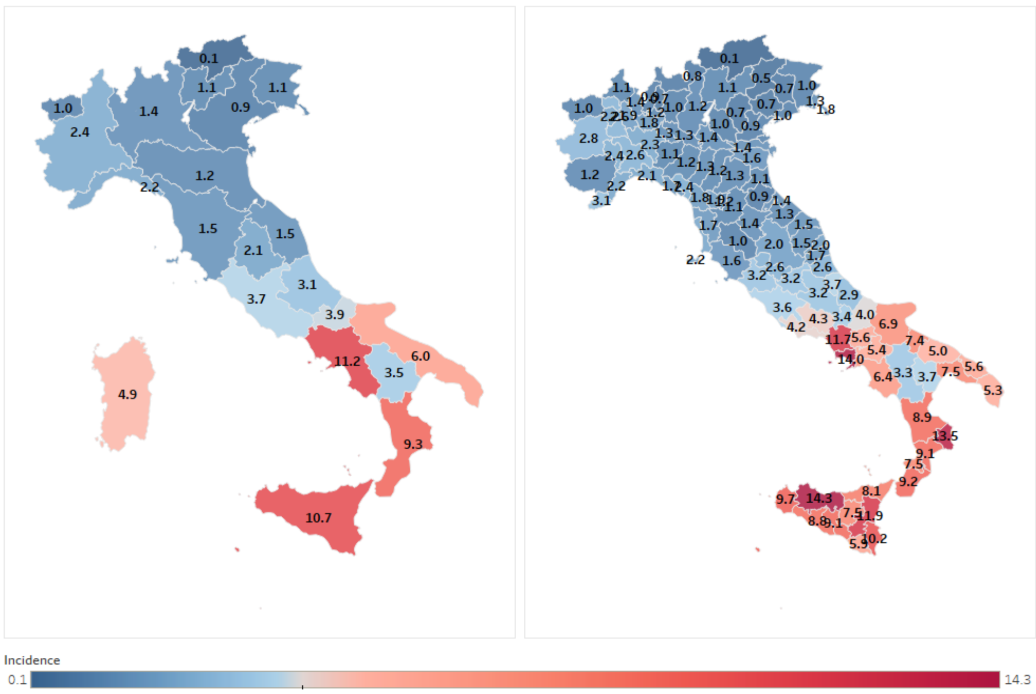


Source: based on INPS (2023), “Osservatorio Statistico Reddito/Pensione di cittadinanza”, and Istat.

Entitlement to RdC predominates in some regions of southern Italy. Specifically, by looking at the incidence of beneficiaries on the resident population, values significantly higher than the national average (4.1 per cent) are recorded in Campania (11.2 per cent), Sicily (10.7 per cent) and Calabria (9.3 per cent). A closer look at regional scenarios reveals strong discrepancies also within regions. For instance, Campania, specifically the provinces of Naples and Caserta, show values among the highest in Italy (14 and 11.7 per cent, respectively), while in the neighbouring provinces of the same region, the incidence is almost halved. Similar trends are also visible in Sicily, where the province of Palermo shows the highest value in Italy (14.3 per cent; Figure 4.3).

Part of these discrepancies can be explained by the different regional economic distress. However, the correspondence between the beneficiaries of the RdC and individuals in absolute poverty varies considerably between the different geographical areas: the percentage of beneficiaries is close to that of individuals in absolute poverty in the South (8.6 per cent of beneficiaries compared with an incidence of absolute poverty of 11.4 per cent) and significantly lower in the Centre and the North (1 per cent in the North-East and 2.6 per cent in the Centre, compared with incidences of absolute poverty of 6.5 and 6.6 per cent respectively; Figure 4.4).

Figure 4.3 – Incidence of RdC beneficiaries by region and province on resident population in 2022

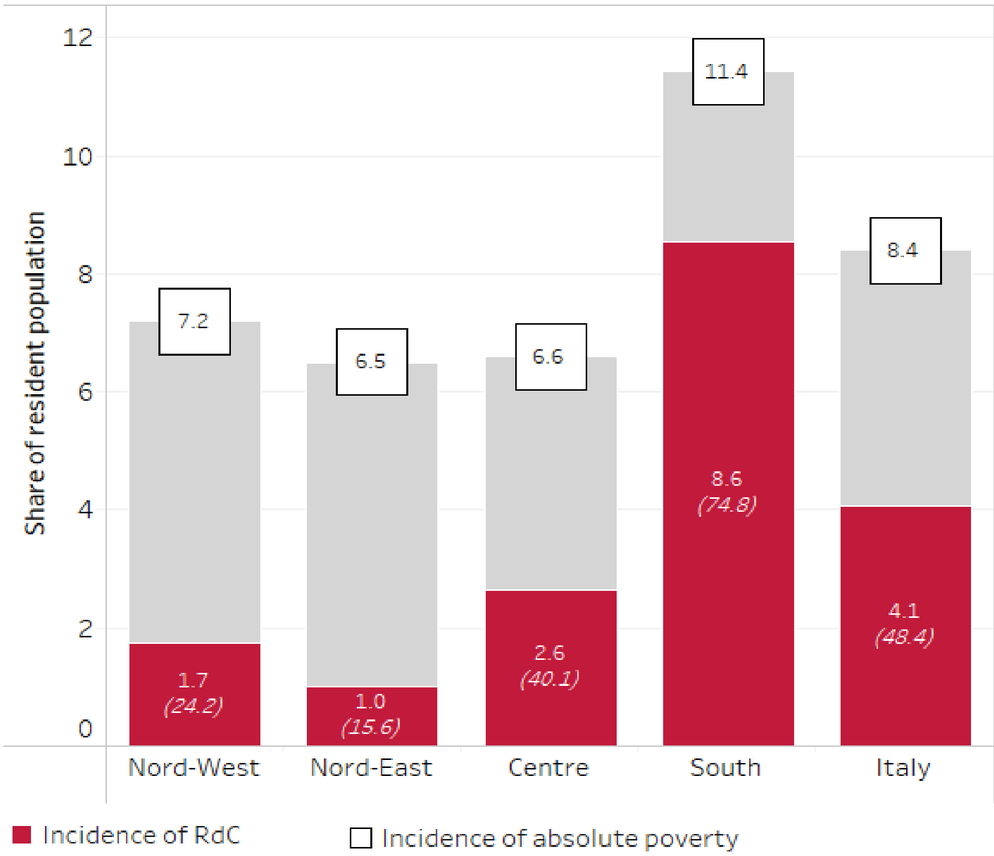


Source: based on INPS (2023), "Osservatorio Statistico Reddito/Pensione di cittadinanza", and Istat.

On the one hand, the harmonised disbursement of the benefit over the national territory in the face of the considerable local heterogeneity of the poverty thresholds[104] and, on the other hand, the exclusion of a part of the foreign population that contributes to reducing the disbursement of the RdC in the North, where their presence is greater, are all factors contributing to the results presented above.

The greater access to the RdC in the South (64.2 per cent) is therefore determined by the regional distribution of Italian beneficiaries, while foreign beneficiaries are equally distributed (Figure 4.5).

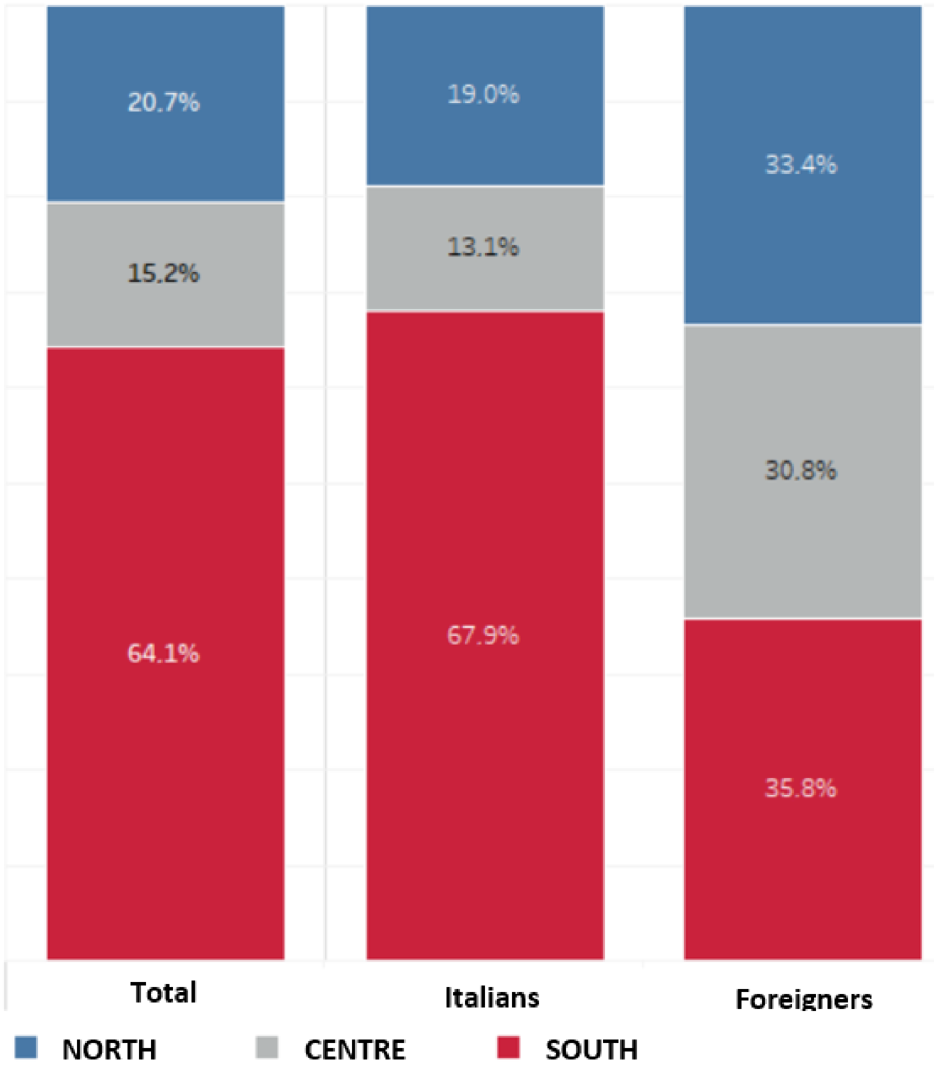
Figure 4.4 – RdC in 2022 and absolute poverty by geographical area (1)



Source: based on INPS (2023), "Osservatorio Statistico Reddito/Pensione di cittadinanza", and Istat.
(1) For a comparison filtering the potential effects of the RdC on poverty measurement, reference is made to individuals in absolute poverty in 2018. The incidence of RdC beneficiaries compared to individuals in absolute poverty is shown in brackets.

[104] See Cutillo, A., Raitano, M. and Siciliani, I. (2022), "Income-Based and Consumption-Based Measurement of Absolute Poverty: Insights from Italy", in Social Indicators Research: An International and Interdisciplinary Journal for Quality-of-Life Measurement, Springer, vol. 161(2), pp. 689-710, June. The absolute poverty line calculated by Istat represents the monetary value, at current prices, of the basket of goods and services considered essential for each household, defined according to the age of the members, the geographical distribution and the type of municipality of residence. Moreover, it is worth noting that while absolute poverty is measured on the basis of household consumption, the beneficiaries of the RdC depend on a selection criterion that refers to indicators of economic condition (based on income and assets), not influenced by consumption and savings choices and such as to reflect the legislator's equity objectives.

Figure 4.5 – RdC beneficiaries by geographical area and citizenship in 2022



Source: based on INPS (2023), "Osservatorio Statistico Reddito/Pensione di cittadinanza", and Istat.

4.2.2 Active policies

Among the critical issues that have influenced the implementation of the RdC, the most significant ones affect individuals unable to enter the labour market.

Analyses conducted over the period of disbursement of the RdC revealed structural gaps linked both to the difficulties of the administrative system (Employment Centres and municipal social services) and to the low professional qualifications of the beneficiaries of the support policies who were to be included in the labour market.

Please note that the regulation of the RdC provides that households are divided into two groups, depending on the degree of employability[105] of their members. Households without employable members receive the economic subsidy without being subject to the obligations provided by the employment programmes. For other households (the "employable" ones), integration policies provide for a series of measures, along with obligations and requirements. According to specific characteristics,[106] "employable" households are distributed in two channels: the Employment Centres, to stipulate the Employment Pact (EP), or the Municipality, for the Social Inclusion Pact (SIP).

As of 31 December 2022,[107] the beneficiaries subject to the Employment Pact[108] were just under one million; of these, approximately 116,000 were exempted from requirement obligations or referred to social services[109] , 157,000 were already employed (not required to enter into the EP) in low-skilled jobs and only the remaining 725,000 ("employable") entered into the EP.

The vast majority of the "employable" persons are Italian citizens, slightly more than half are under 39 years of age (52.7 per cent), are mainly women (57.1 per cent), reside predominantly in the South (76.1 per cent) and mostly have a low level of education, suggesting low professional qualifications (71 per cent have at most a lower secondary school qualification).

In Anpal's analyses, EP subscribers were divided into two groups according to the time that had passed since their last job (proximity to the labour market). The first group, "Close to the labour market", included persons who had had at least one work experience (as an employee or para-subordinate worker) in the previous three years. The second group, "Far from the labour market", is made up of persons who have had no work experience in the last three years. About three out of four beneficiaries (74 per cent) belong to the "Far from the labour market" group and about 80 per cent reside in the South of Italy. However, among the persons in the "Close to the labour market" group (26 per cent), there are potential cases of exclusions: 23 per cent had their last experience in the previous two years and for 21 per cent three years have passed since their last experience.

The time comparison with the same period of the previous year (31 December 2021)[110] shows that the number of EP subscribers decreased overall by 14 per cent (or 118,000)

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105 The main selection criterion identifies adult household members who are neither employed nor in regular education or training. Secondly, persons having care responsibilities for household members under three years of age or with severe disabilities or non-self-sufficient may be exempt.

106 Employment centres call beneficiaries in whose household there is at least one member subject to "conditions" and holding at least one of the following requirements: 1) no employment for no more than two years; 2) beneficiary of the NASpI (unemployment compensation) or other social safety nets for involuntary unemployment or who has had no longer access to it for no more than one year; 3) subscription, in the last two years, of an Employment Pact, still valid, at the Employment Centres; 4) not having signed a customized project pursuant to Legislative Decree 147/2017, art. 6.

107 Anpal (2023), "Reddito di Cittadinanza", Note no. 10, March.

108 Under the penalty of exclusion from the benefit when specific conditions arise, beneficiaries of the RdC are required to enter into an EP to access job placement programmes characterised by training, job guidance and job support measures.

109 For an analysis of the local implementation of the process for accepting RdC beneficiaries referred to social services, see Ministry of Labour and Social Policies and World Bank Group (2023), "The Pact for Social Inclusion of the Minimum Income Scheme: an evaluation of the acceptance procedure", June.

110 Anpal (2022), "Reddito di Cittadinanza", Note no. 8, April.

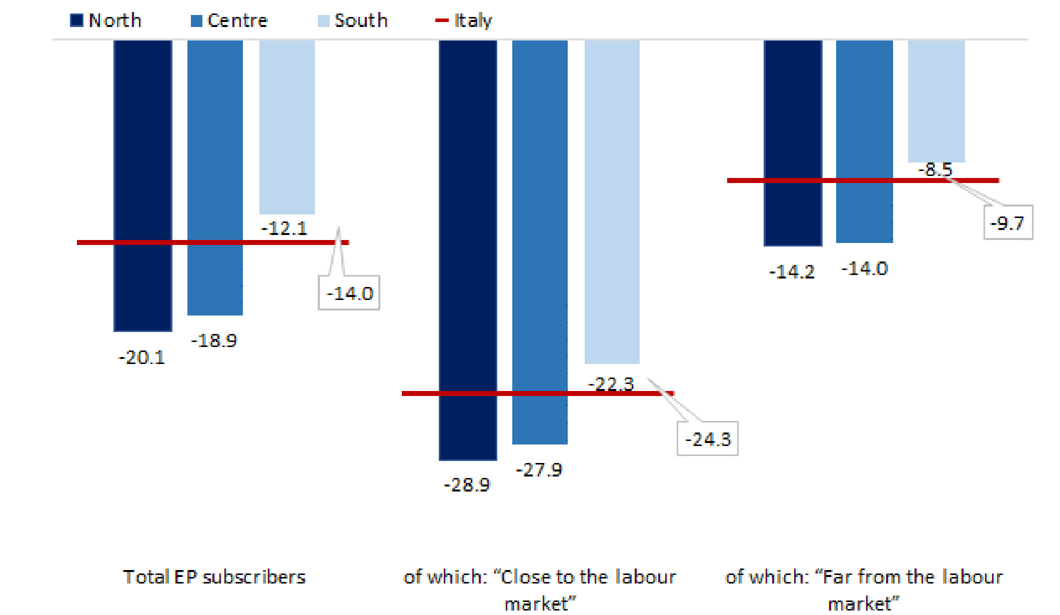
with higher changes in the North and in the Centre (-20.1 per cent and -18.9 per cent, respectively), i.e. areas where the labour market is more dynamic. The reduction in the number of persons "Close to the labour marked" was stronger than that of persons "Far from the labour market" (-24.3 per cent, against -9.7) (Figure 4.6).

In addition to critical issues linked to the professional profile of the "employable" individuals, there are the difficulties experienced by the administrative system in managing them. Compared to the total number of EP subscribers (725,000), only 46.2 per cent (335,000 individuals) were actually taken on by the Employment Services, with higher incidence in the Centre and North than in the South. Of these, 134,000 signed the Service Pact as defined in the *Programma Garanzia occupabilità dei Lavoratori – GOL* (Guaranteed Employability of Workers Programme).

Please note that the GOL programme is a reform provided for in the NRRP (Mission 5, Component 1) with the aim of facilitating, with customised programmes, access or reintegration into the labour market.

As part of the services provided under the GOL programme, a profiling index of subscribers was calculated to measures the probability of being unemployed after twelve months[111]. These calculations reveal that only 4.3 per cent of the population is easily employable, while just over 60 per cent have a high risk of unemployment, a figure that rises to 74 per cent for women.

Figure 4.6 – Percentage variations of RdC beneficiaries subject to the Employment Pact by proximity to the labour market and by macro area
(December 2022 vs. December 2021; percentage variations)



Source: based on Anpal and Istat data.

[111] See ANPAL (2023), "Strumenti per l'attuazione dell'assessment", Anpal Focus Series no. 146. The profiling index is a synthetic index ranging between 0 and 1.

4.3 The Support Allowance

In line with the original scheme of the Support Income (*Reddito di Inclusione – REI*), the Support Allowance (*Assegno di Inclusione – AI*), unlike the RdC, is intended for households with members who are unable to work or difficult to employ, such as the disabled, minors and the elderly, including individuals over 59 years of age. Some of the working-age individuals benefiting from the AdI are required to actively seek employment or accept job offers (see paragraph 4.5). The remaining households made up of working-age individuals[112] are not granted the financial support for the protection against the risk of poverty (RdC), regardless of their actual employability. These households experiencing economic hardship (identified on the basis of access criteria that are stricter than those of the AI) are instead granted the Support for Training and Employment.

In addition to the AI, Decree-Law No. 48/2023 introduced the training and employment support as of 1 September 2023, an allowance of a maximum of EUR 350 per month intended for individuals participating in active labour policy projects and living in households experiencing economic hardship. The allowance is paid for the whole period of participation in these projects and, in any case, for no more than twelve months.

The allowance is granted, subject to participation in the activities, to working-age members of households with an Equivalent Economic Status Indicator (ISEE) not exceeding EUR 6,000 and a family income and immovable and movable assets value within the limits set for access to the AdI (see below). Eligibility is also extended to members of households who, while complying with the above requirements, do not qualify for AdI as they are not made up of people unable to work (disabled, over 60 or minors) or who, while being part of AdI beneficiary households, are not considered for the purposes of determining the benefit.

Training and employment support may be requested electronically through the Information System for Social and Labour Inclusion, by signing the declaration certifying immediate availability for work (without prejudice to the obligation to fulfil the right to education and training or the related exoneration) and authorising the transmission of data to the Employment Centres/Agencies and to the bodies authorised to act as intermediaries, as well as to the entities accredited to the employment services.

Households with members unable to work are granted less restrictive requirements on the length of stay in Italy for foreigners holding a long-term residence permit, thus decreasing from 10 years (for RdC eligibility purposes) to 5 years. The requirements for AdI eligibility are largely the same as those established for the RdC in terms of ISEE threshold (EUR 9,360) and in terms of the limits of movable and immovable assets.[113] However, an additional constrain is now introduced compared to the RdC: the IMU (Municipal Property Tax) value of the dwelling house, which must not exceed EUR 150,000.

[112] People over 60 and not retired are not considered to be of working age.

[113] The movable assets as defined for ISEE purposes may not exceed a threshold of EUR 6,000, increased by EUR 2,000 for each member of the household following the first, up to a maximum of EUR 10,000, increased by a further EUR 1,000 for each minor following the second. Immovable assets (for IMU purposes) other than the dwelling house may not exceed EUR 30,000. Restrictions also applies in relation to the ownership of durable goods such as cars, boats, etc.

The amount of the benefit is defined as the difference between a basic allowance, set according to the household members and their characteristics, and the household income.

Household income, determined according to ISEE (Article 4, par. 2, of Prime Minister's Decree 159/2013), includes total income for Irpef purposes, income subject to substitute or withholding tax and any other tax-exempt income component. However, incomes related to social security measures are updated, compared to those included in the ISEE, so that only those currently being enjoyed shall be considered when calculating the allowance.[114] Non-means-tested social security benefits, such as the attendance allowance and the amount received as RdC and AI, are excluded from the income calculation. Unlike the RdC, anti-poverty measures granted at a local level are not considered in the household income for AI purposes, which can therefore be added to the national measure without being reduced.

Should the beneficiary begin to work during the period in which they receive the allowance, the household income will be recalculated, and the higher income from employment shall not contribute to the determination of the financial benefit when not exceeding EUR 3,000 gross per year. The excess earned income shall entail a reduction of the financial benefit as from the month following the month of employment. In the case of a self-employed activity, the income shall be determined according to the cash principle as the difference between the revenues and remuneration received and the expenses incurred in the performance of the activity and shall contribute to the redefinition of the benefit for the portion exceeding EUR 3,000 gross per year. In the case of allowances or participation in active policies, the related remuneration may cumulate with the benefit within the maximum annual limit of EUR 3,000 gross.

The annual basic allowance for the household remains that of the RdC/PdC, respectively equal to EUR 6,000 and EUR 7,560, equal in all regions. Conversely, the additional amounts determined according to the number and type of household members (equivalence scale) change compared to the RdC. In the case of households with more than one member, the basic allowance increases by EUR 3,000 for each disabled person (+0.5 equivalence scale points), by EUR 2,400 for each elderly person or caretaking adult[115] (+0.4 points) and by EUR 900 for each minor (+0.15 points), which decreases to EUR 600

[114] Following the Council of State rulings Nos. 838, 841 and 842 of 2016, welfare, social security and indemnity measures received from public administrations due to disability were excluded from ISEE income, which are instead considered in household income for RdC purposes. As far as the AdI is concerned, the wording of the law referring to the inclusion in the household income of only income considered for ISEE purposes seems to exclude disability measures from the calculation. This might lead to a significant increase in disabled AdI beneficiaries compared to the RdC. This possibility appears to have been overlooked in the assessments under the technical report of the DL Employment.

[115] According to Article 6, par. 5 of Decree-Law 48/2023, caretaking adults are assessed under the requirement of the presence of children under three years of age, three or more underage children, or household members with disabilities or who are not self-sufficient.

for minors after the second (+0.1).[116] Therefore, the presence of members of working age shall affect the overall allowance only if they are employed in care work.

Unlike the RdC, which provided an additional EUR 2,400 for each additional adult and EUR 1,200 for each minor, the AdI is therefore more abundant for the disabled (EUR +600 in the case of disabled adults and EUR +1,800 for disabled minors), while reducing the benefit for minors (respectively EUR -300 for the first two children and EUR -600 for the following ones), for adult children (EUR -2,400) and for non-caretaking adults (EUR -2,400 for each adult after the first one). However, AdI beneficiaries are granted the full amount of the Universal child allowance (AU), instead of a reduced one as in the case of RdC beneficiaries (AU supplementation). The maximum monthly benefit increases by EUR 600 compared to the RdC, from 12,600 to 13,200 euro for households without disabled people and from 13,200 to 13,800 euro for households with disabled people.

For households living in rented dwellings, a rent contribution is granted to supplement the AdI, the maximum amount of which varies between households with only people over 67 and the others (respectively 1,800 and 3,360 euro, the same amounts granted in the case of the PdC and RdC). Unlike the previous legislation, the income limit to access the benefit is not increased by these amounts compared to the one valid for households not living in rented dwellings. This entails the exclusion from the benefit of some households living in rented dwellings with incomes close to the threshold that were previously potential beneficiaries of the RdC.

In order to better understand the implications of the redefinition of the minimum amount and the connections with the AU, the analysis compares the levels of the RdC and AdI for some typical households, also considering the amount received as Universal child allowance in the case of households with children (Figure 4.7).

In the case of a household with a child under the age of three (left box), the "second" adult is entitled to the amount of EUR 2,400 for the recognition of the care burden (due to the presence of a child under the age of three). The AdI benefit granted to adults is therefore equal to the RdC benefit. For the child, the AdI benefit of EUR 900 and the full AU benefit are due. As the sum of RdC for minors and AU supplementation was the same as the full AU amount, the benefit granted to minors after the reform is EUR 900 higher than the past.

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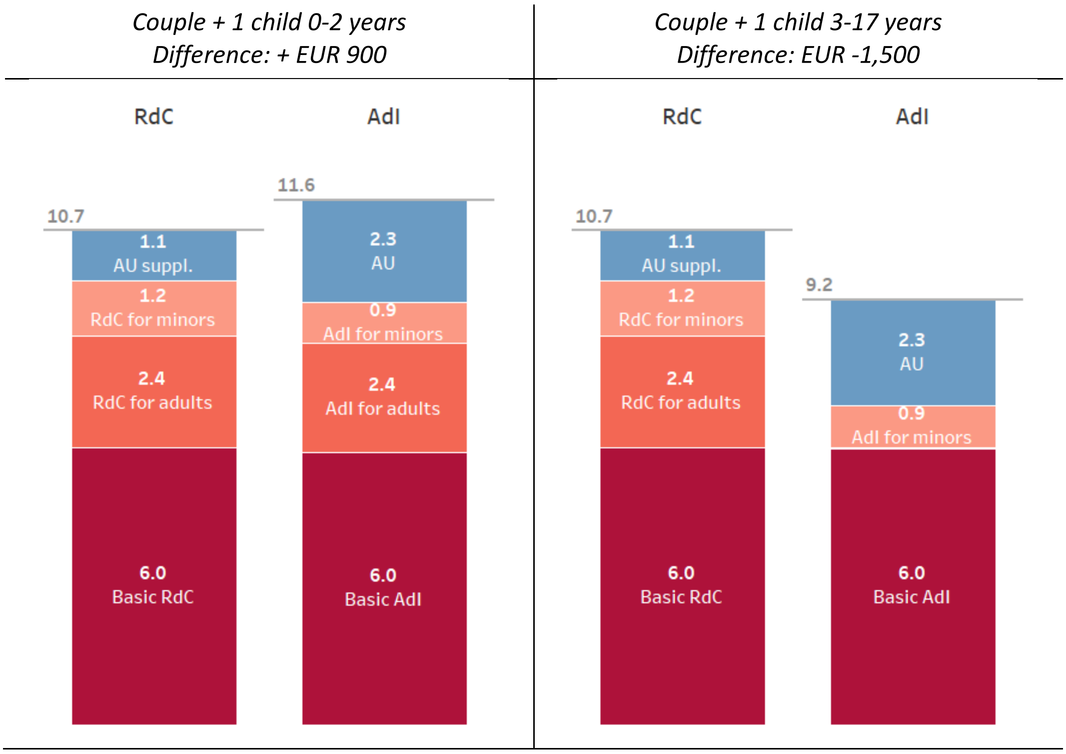
[116] The number of applicable increments is always lower by one unit than the number of household members, as the minimum benefit of EUR 6,000 (or EUR 7,560) refers to one of the members. The presence of different types of individuals to which different increments are associated may lead to an arbitrary choice of the member to which the initial benefit refers. The simulation took as a reference the most convenient calculation for the household. Where one or more care burdens exist, EUR 2,400 shall be granted to one of the adults.

Figure 4.7 – RdC, AdI and AU amounts for households with one dependent child
(annual household income: 0 euro; thousands of euro)



If the child is older than three years, the adult AdI share is not due as no care burden is recognised. The advantage of the increased benefit for the child is more than compensated for by the loss of the adult share. In this case, the change to AdI entails a reduction in the benefit of EUR 1,500.

It is worth noting that the scenario assumed above refers to discrepancies in the amount of RdC and AdI due to households with zero income. Generally, such discrepancies persist notwithstanding a positive household income. This circumstance does not occur exclusively for households with children benefiting from the RdC supplementation as AU, which rises as household income increases.[117]

Appendix 4.1 provides a wide selection of case studies of typical households, allowing for a detailed analysis of the combination of the different effects of the changes in economic requirements and in the calculation of the allowance.

[117] Consider the case of the household with a minor dependent child shown in Figure 4.7: with a zero household income, the supplementation to the RdC as AU was EUR 1,070, i.e. the difference between the amount of the AU (EUR 2,270) and the share of the RdC ascribable to the minor (EUR 1,200), so as to grant the minor an overall benefit (RdC + AU supplementation) at least equal to the AU. Due to the formula used to calculate the supplementation, households with positive income were entitled to a supplementation of more than EUR 1,070. For instance, for EUR 3,000 household income, the supplementation is EUR 1,445 and, for EUR 6,000 household income the amount rises to EUR 1,820. This circumstance increases the gap between the AdI and RdC as income increases for households with children.

4.4 *Analysis of the distributive impacts in the transition from RdC to AdI*

The PBO microsimulation model fed by a sample of administrative data on ISEE declarations and actual payment of the RdC in the 2020-22 three-year period, allows outlining a scenario of the impacts of the regulatory changes introduced by Decree-Law 48/2023 on the regulation of measures against the risk of poverty.

It is therefore possible to identify which of the previous beneficiaries of the RdC will be entitled to benefit from the AdI and to what extent, emphasising the distributive effects of the reform, also considering the changes introduced in the AU discipline. The simulation focused on RdC beneficiaries in December 2022,[118] including an estimate of the effects of the extension of the benefits to foreign nationals previously excluded from the RdC.[119]

Table 4.1 shows, in terms of households and individuals, the distribution of AdI beneficiaries according to household type (presence of protected individuals: disabled, over 60s and minors) and the characteristics of individuals (in working age with and without caretaking responsibilities and protected).

Out of the nearly 1.2 million households benefiting from the RdC, about 400,000 (33.6 per cent) are not eligible for the AdI as there are no protected persons within them. Out of the remaining 790,000 households with protected persons, about 97,000 (12.1 per cent) are not eligible for the AdI due to economic constraints. Overall, households benefiting from the AdI appear to be slightly more than 690,000, i.e. about 58 per cent of the current beneficiaries of the RdC.

In terms of individuals, the non-beneficiaries of the AdI are estimated to be about 823,000 (about one third of the beneficiaries of the RdC), of which 553,000 belong to households without protected persons and 270,000 belong to households with protected persons but excluded due to economic constraints.

Overall, around 88 per cent of disabled, over 60s and underage beneficiaries of the RdC could continue to benefit from AdI, a circumstance revealed for less than half of working-age persons.

The extension of benefits to foreign citizens residing in Italy for more than five years and less than ten is estimated to involve about 50,000 households, i.e. about 148,000 individuals, benefiting from the AdI due to the presence of minor children in the household.

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118 Last month covered by available data.

119 The characteristics of the new measure, as noted above, are in line with the RdC in a generally restrictive sense, and it is therefore possible to identify, as a first approximation, the AdI beneficiaries as a subset of the RdC beneficiaries. Conversely, the impact of the change in the residency constraint for foreign citizens is analysed in a separate estimate. The simulation did not take into account the possible new entries stemming from the increase in the income threshold for households with disabled people, nor the possible different definition of AdI household income (with respect to the RdC) in relation to disability benefits.

Table 4.1 – Households and individuals benefiting from AdI in relation to household and individual member characteristics
(analysis over RdC beneficiaries as of December 2022)

		Aggregate total	Excluding protected cat.	Including protected cat.	Only protected cat.
			Households		
	Total households	**1,186,675**	399,508	481,953	305,215
	AdI non-beneficiaries	**496,354**	399,508	59,424	37,422
	AdI beneficiaries	**690,322**		422,529	267,793
			Individuals		
Total	Total individuals	**2,590,922**	553,056	1,667,909	369,957
	Working-age, among whom:	**1,396,908**	553,056	843,853	0
	With burdens of care	***206,753***	*0*	*206,753*	*0*
	Protected categories	**1,194,014**	0	824,057	369,957
AdI non-beneficiaries	Total individuals	**823,141**	553,056	228,241	41,844
	Working-age, among whom:	**682,456**	553,056	129,400	0
	With burdens of care	***16,935***	*0*	*16,935*	*0*
	Protected categories	**140,685**	0	98,840	41,844
AdI beneficiaries	Total individuals	**1,767,782**		1,439,669	328,113
	Working-age, among whom:	**714,453**		714,453	0
	With burdens of care	***189,818***		*189,818*	*0*
	Protected categories	**1,053,329**		725,216	328,113

Source: based on PBO microsimulation model.

In terms of overall benefits, the abolition of the RdC and the introduction of the AdI entail a sharp reduction of about 2.5 billion per year for households previously entitled to the RdC, mainly due to the exclusion of households with no disabled persons, minors and over 60s (table 4.2). The benefits for protected households excluded from the AdI due to economic constraints drop by about 216 million. For this category, the RdC loss is partially compensated by the increase in the amount of the AU, which was previously only partially disbursed.

Table 4.2 – Variation in total resources distributed in the AdI and RdC schemes
(analysis over RdC beneficiaries as of December 2022; millions)

		Total	Excluding protected cat.	Including protected cat.	Only protected cat.
Total	RdC+AU	**8,912**	2,590	4,826	1,496
	AdI+AU	**6,383**	33	4,868	1,482
	Balance	**-2,529**	-2,557	43	-15
AdI non-beneficiaries	RdC+AU	**2,966**	2,590	343	33
	AdI+AU	**250**	33	215	1
	Balance	**-2,716**	-2,557	-128	-32
AdI beneficiaries	RdC+AU	**5,946**		4,483	1,463
	AdI+AU	**6,134**		4,653	1,480
	Balance	**188**		171	17

Source: based on PBO microsimulation model.

Overall, the resources allocated for households entitled to the AdI amount to about 6.1 billion (considering AdI and AU) and are roughly equal to the benefits received under the previous scheme, with a positive balance of about 188 million.

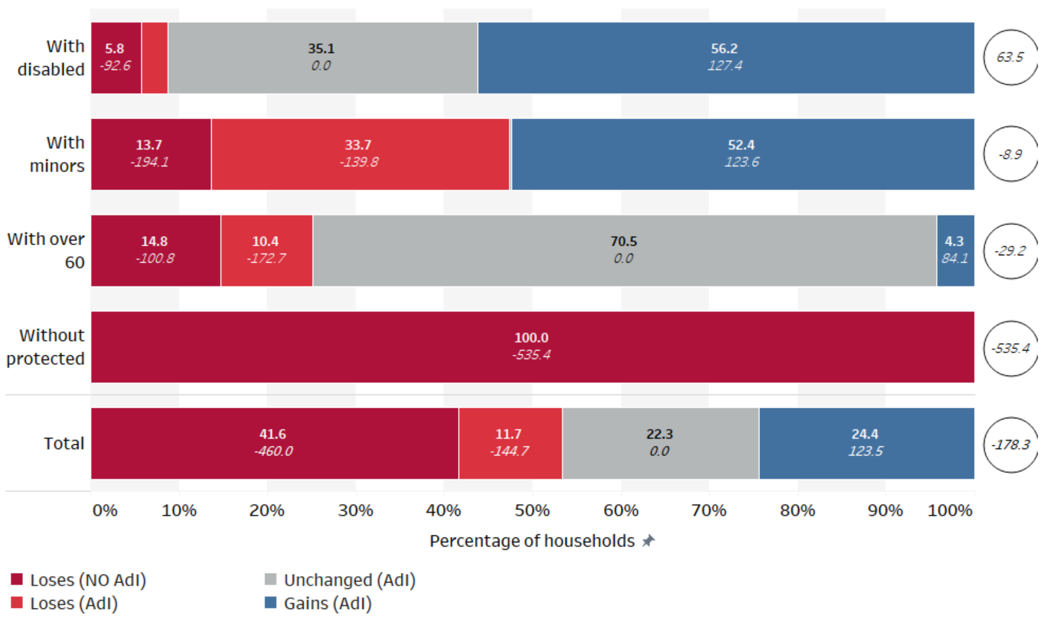
The extension of the target group to individuals who have been resident for at least five years (instead of ten) leads to a total expenditure of EUR 360 million per year.

Figure 4.8 shows an estimate of the distribution of households, distinguished by the presence of protected persons, according to the change in total benefit. The bars show the distribution of the share of households in four different groups: non AdI beneficiaries and AdI beneficiaries with total benefit (sum of AdI and AU) lower than, equal to or higher than the sum of RdC and AU supplementation. The number in italics in the bars shows the average change in benefits for the individual groups, while the circle to the right of the figure shows the average monthly change for the entire group.

Overall, as reported above, households not entitled to the AdI are about 42 per cent, with an average monthly loss of about EUR 460. Households with no protected persons, not entitled to the AdI, lose on average about EUR 535 per month.

Households with disabled persons benefit the most from the reform: more than 56 per cent of them get higher benefits of about EUR 127 per month and only 9 per cent lose benefits, mainly because of ineligibility for AdI. The households losing benefits used to be granted very low benefits (about EUR 93 per month on average).

Figure 4.8 – Variation of benefits by household type
(analysis over RdC beneficiaries as of December 2022; percentage composition and average amounts in euro)



Source: based on PBO microsimulation model.

Finally, about 35 per cent of the households with disabled persons suffer no impacts whatsoever compared to the previous framework.[120] On average, considering all households with disabled people, the benefit increases by about EUR 64 per month.

Households with minors (not disabled), as shown, are those most affected by the change in the calculation of the basic amount of the AdI. For slightly more than half of the cases their overall benefit increases (by EUR +124 per month on average) and the remainder are granted lower allowances (33.7 per cent, losing about EUR 140) or no benefits at all (13.7 per cent of households, losing about EUR 194 per month). On average, considering all the households with minors, the benefit is substantially stable (EUR -9 per month on average).

On the other hand, households with elderly people over 60 (without disabled people and minors) are those whose benefits are less impacted by the reform. About 71 per cent of previous RdC/PdC beneficiaries are expected not to suffer any impact from the reform. However, this category also includes some households that have their allowance reduced (10 per cent, by EUR 173 per month) or totally denied (14.8 per cent, losing EUR 101 per month). Only a little more than 4 per cent of households with elderly persons finally have their allowances increased. Considering all households with elderly persons, benefits are reduced by about EUR 29 per month on average.

Figure 4.9, in which the distributive analysis takes as a reference the household size, shows that no single-person households benefit more when moving to the AdI[121]. 38.6 per cent of these households retain their previous benefits with AdI, while 60.7 per cent (made up of working-age persons) are no longer entitled to the benefit.

As household size increases, the share of households losing the benefit decreases, from 31.9 per cent of households with two members to 17.6 per cent of households with five or more members. The latter also have the highest share of advantaged persons (54.5 per cent). Overall, only households with five members or more show a positive average benefit (EUR 5), compared with an average gain of EUR 178 for advantaged households and about EUR 200 loss for disadvantaged ones.

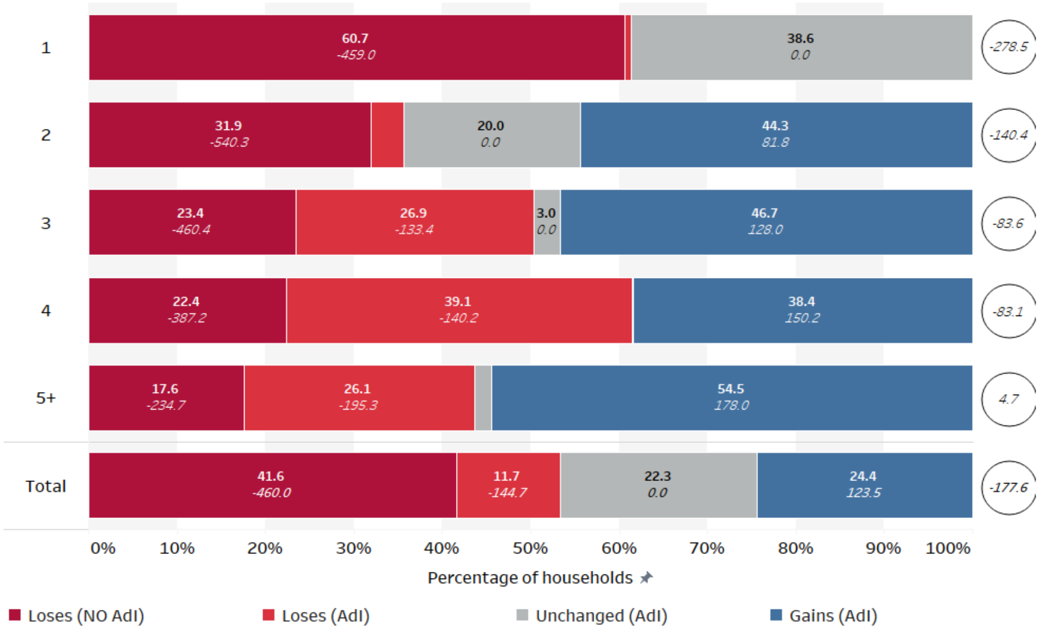
As regards regional distribution, the impact of the reform is estimated to be substantially homogeneous across the country. However, in the North and in the Centre the analysis shows a slightly higher share of households previously entitled to the RdC and excluded from the AdI (the highest share in the Centre, 46.1 per cent, against a national average of 41.6 per cent), a higher share of households whose situation has not changed (30.8 per cent in the Northeast, against a national average of 22.3 per cent) and a lower share of advantaged households (18.8 per cent in the Northeast, against a national average of 24.4 per cent). In the South, the largest shares of households benefiting from the AdI are

[120] This is the case of households made up of a single disabled individual, who is entitled to a basic allowance of EUR 6,000 if under 67 years of age and EUR 7,560 if older. In the case of single-person households, the increases conditional on specific types of individuals shall not apply.

[121] As already noted in the analysis of typical households, increases in the basic amount of the AdI are only due for the presence of members additional to the first one.

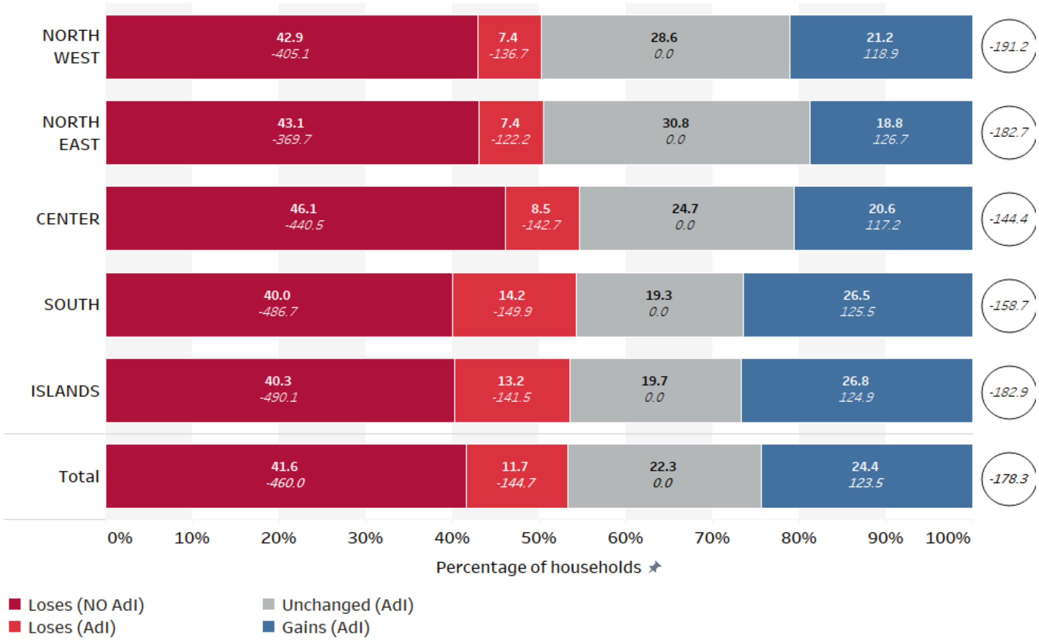
estimated to be granted lower benefits than those allowed by the previous legislation (Figure 4.10).

Figure 4.9 – Benefit variation by number of members in the household
(analysis over RdC beneficiaries as of December 2022; percentage composition and average amounts in euro)



Source: based on PBO microsimulation model.

Figure 4.10 – Variation in benefits by geographical breakdown
(analysis over RdC beneficiaries as of December 2022; percentage composition and average amounts in euro)



Source: based on PBO microsimulation model.

Therefore, the reform appears to have a slight inclination to concentrate more beneficiaries and resources in the South (table 4.3) compared to the distribution found with the RdC. The share of beneficiary households in the South would rise from 41.4 to 42.6 per cent (with an increase from 43.6 to 44 per cent of the resources distributed) and that in the Islands from 22.7 to 23.3 (from 23.8 to 24 per cent of the resources). However, it is worth noting that the extension of benefits to foreign citizens, relatively more concentrated in the North than the total number of beneficiaries, is expected to substantially counterbalance the trend outlined. By including these new beneficiaries, the regional distribution would be substantially unchanged compared to the pre-reform situation.

Finally, an estimate of the distributive impacts on AdI beneficiaries alone is conducted to better understand the role of the changes in the economic requirements to benefit from the anti-poverty measures.

Table 4.3 − Regional distribution of beneficiary households and total benefits before and after the reform
(analysis over RdC beneficiaries as of December 2022)

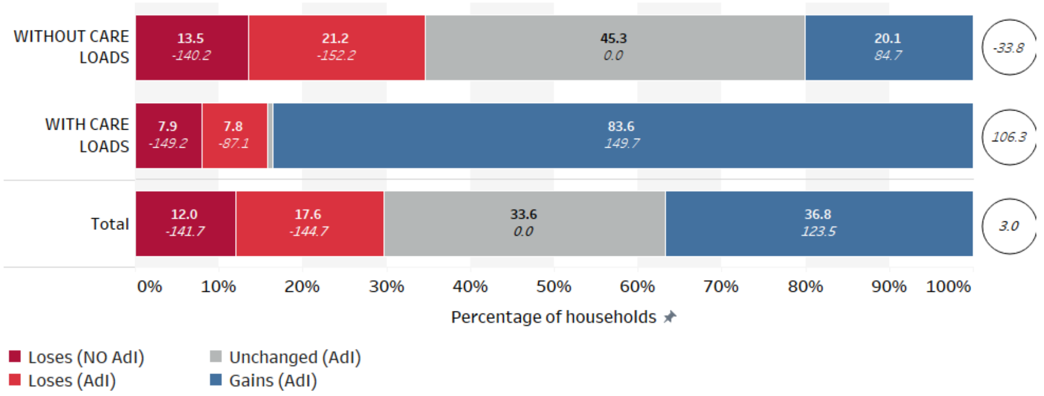
		Households percentage		Benefits percentage	
		RdC + AU	AdI + AU	RdC + AU	AdI + AU
North-West	Lombardy	7.2	7.0	6.6	6.8
	Piedmont	5.4	5.3	5.1	5.1
	Liguria	1.7	1.7	1.5	1.5
	Valle d'Aosta	0.1	0.1	0.1	0.1
	Total	**14.5**	**14.2**	**13.3**	**13.5**
North-East	Emilia-Romagna	2.7	2.6	2.3	2.3
	Veneto	2.3	2.4	2.1	2.2
	Friuli-Venezia Giulia	0.8	0.8	0.6	0.5
	Trentino-Alto Adige	0.3	0.3	0.3	0.3
	Total	**6.2**	**6.0**	**5.3**	**5.4**
Centre	Lazio	10.2	9.2	9.7	8.9
	Tuscany	2.9	2.7	2.5	2.3
	Marche	1.1	1.1	1.0	1.0
	Umbria	0.9	0.9	0.8	0.8
	Total	**15.2**	**14.0**	**14.0**	**13.1**
South	Campania	21.7	22.8	24.1	24.7
	Apulia	9.4	9.6	9.4	9.4
	Calabria	6.9	6.9	6.9	6.8
	Abruzzo	1.9	2.0	1.9	1.9
	Basilicata	0.9	0.9	0.8	0.7
	Molise	0.5	0.5	0.5	0.5
	Total	**41.4**	**42.6**	**43.6**	**44.0**
Islands	Sicily	19.0	19.6	20.5	20.8
	Sardinia	3.8	3.7	3.4	3.2
	Total	**22.7**	**23.3**	**23.8**	**24.0**
Total Italy	**Total**	**100.0**	**100.0**	**100.0**	**100.0**

Source: based on PBO microsimulation model.

Figures 4.11 to 4.13 show the distributive impacts for households with protected individuals, hence not excluded from the AdI. The analysis of this subgroup of households thus allows isolating the effects due to the change in the economic criteria for determining the benefit.

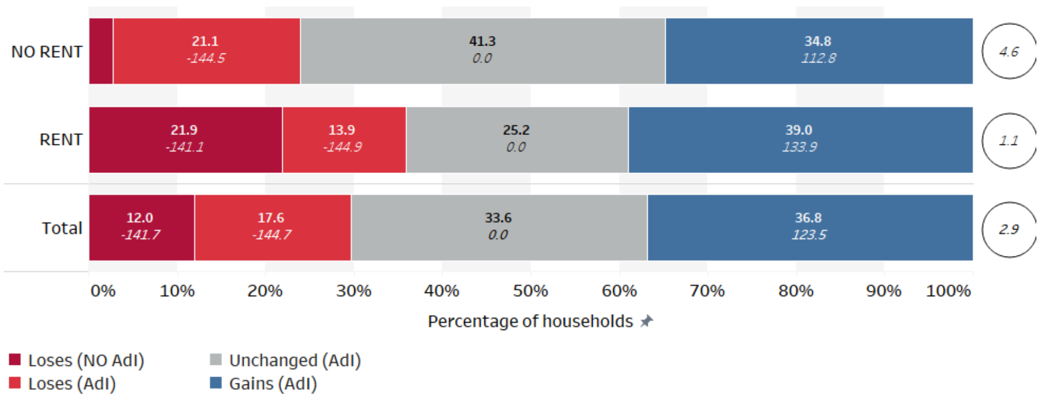
Figure 4.11 highlights the decisive role of the presence of a care burden on the distributive impacts when shifting to the AdI. Almost 84 per cent of these households benefit from the reform, compared to about 37 per cent on average. As already highlighted above and in Appendix 4.1, the presence of an adult with caretaking responsibilities leads to the increase in the basic allowance by EUR 2,400 (the amount allocated in the RdC for each adult after the first) and allows benefiting from the increase in child benefits determined by the full allocation of the Universal child allowance.

Figure 4.11 – Distributive effects for households with protected individuals with and without care burdens
(analysis over RdC beneficiaries as of December 2022; percentage composition and average amounts in euro)



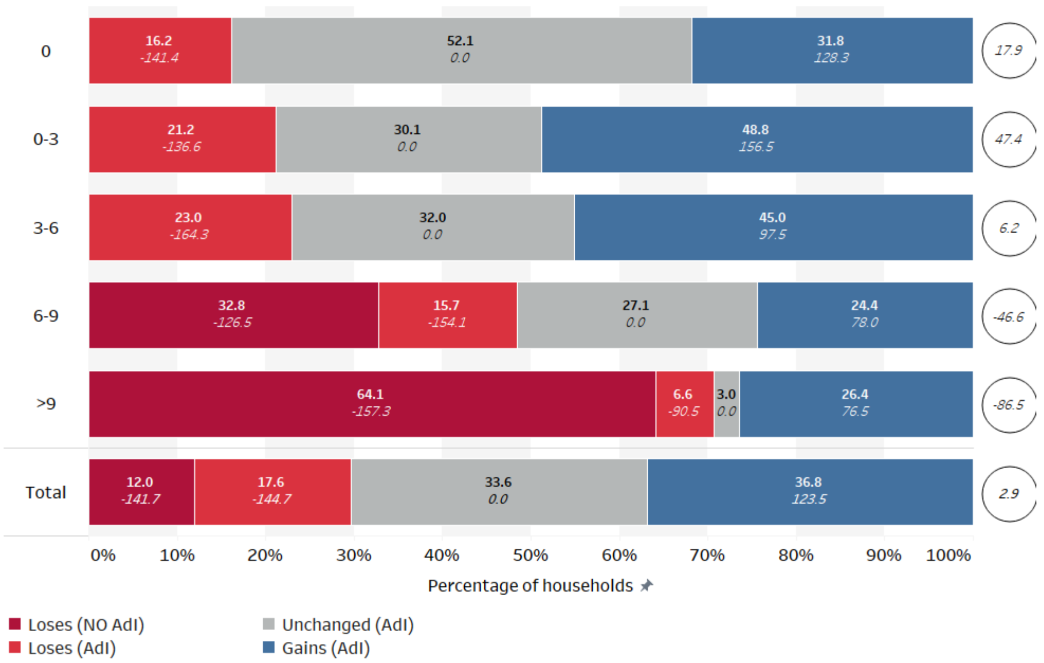
Source: based on PBO microsimulation model.

Figure 4.12 – Distributive effects for households with protected individuals by type of dwelling
(analysis over RdC beneficiaries as of December 2022)



Source: based on PBO microsimulation model.

Figure 4.13 – Distributive effects for households with protected individuals by household income level
(analysis over RdC beneficiaries as of December 2022; percentage composition and average amounts in euros; income categories expressed in thousands of euros)



Source: based on PBO microsimulation model.

Figure 4.12 shows the penalising effect on households of the change in the income threshold compared to the RdC. The households that, while benefiting from the RdC, would not be entitled to the AdI (among those with protected subjects), are in fact made up almost entirely of households living in rented dwellings.

Finally, Figure 4.13 shows that the tightening of economic requirements penalizes primarily households with higher household income and, therefore, with persons who are employed or receive other forms of benefits. Households that, while benefiting from the RdC, would not be entitled to the AdI (among those with protected individuals) include almost entirely households with more than EUR 6,000 of household income. More than 40 per cent of these (protected) households are not eligible to the AdI as a result of tighter economic constraints compared to RdC.

4.5 Requirements for entitlement to the Inclusion Allowance and resources for inclusion policies

AdI beneficiary households are required to join customised social or labour inclusion programmes that provide for obligations and conditionalities for working-age individuals that can be activated for a job and not exempt from obligations.[122] Figure 4.14 summarises the administrative process provided for AdI application and granting purposes. The application shall be electronically submitted to the Inps, which, once verified the existence of the eligibility requirements (citizenship, residence, economic-financial situation, standard of living and penalties), shall inform the applicant of the obligation to register with the Information System for Social and Labour Inclusion (*Sistema informativo per l'inclusione sociale e lavorativa* – SIISL)[123] set up at the Ministry of Labour and implemented by the Inps.

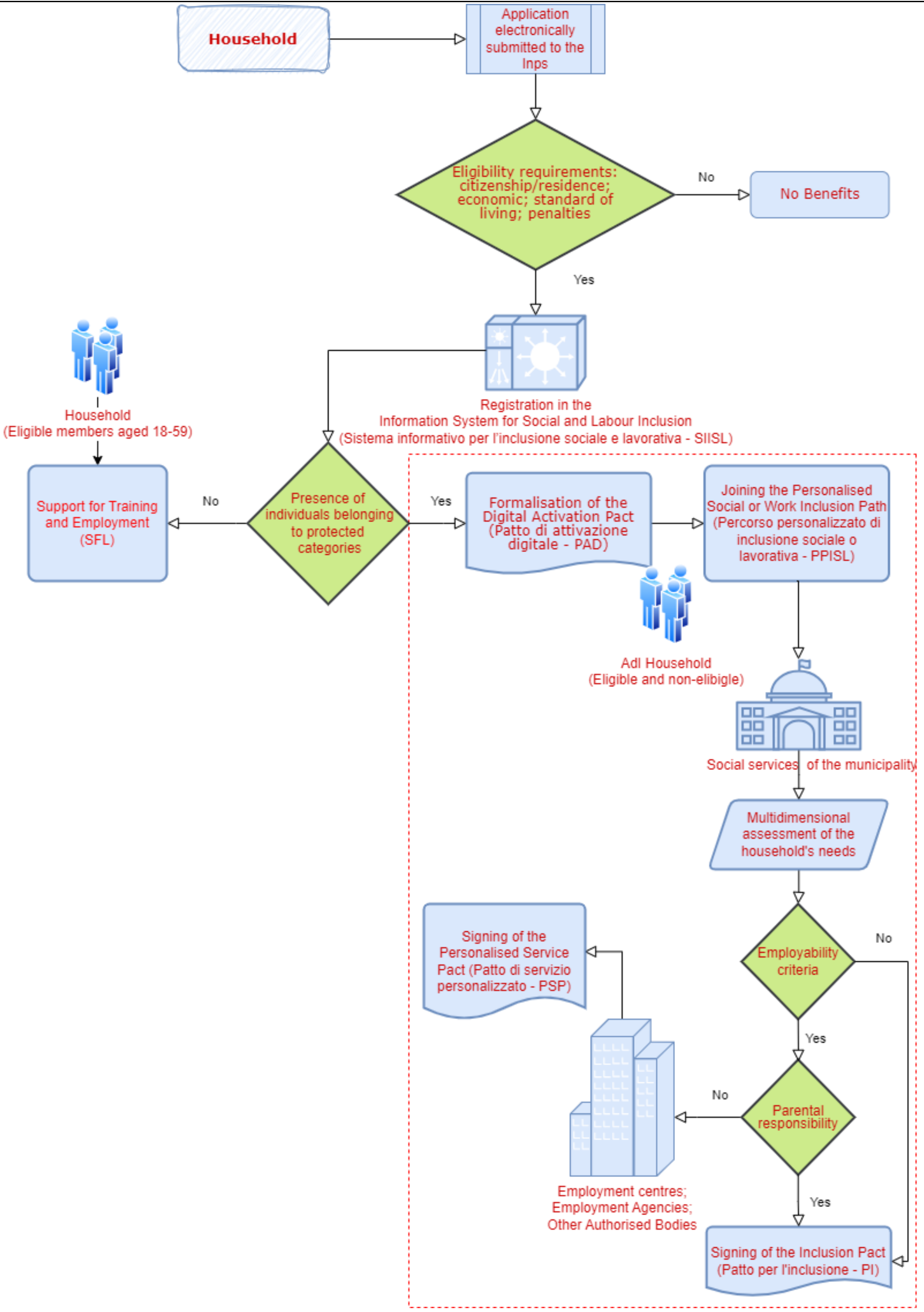
After registration with the SIISL, households applying for AdI are required to formalise the Digital Activation Pact (*Patto di attivazione digitale* – PAD)[124] and turn up at the Social Services of the municipality of residence within 120 days. After the first appointment, the beneficiaries, with the exception of individuals found to be eligible for work, are required to update their position every 90 days. Failure to comply with these obligations shall lead to suspension of the benefit.

The Social Services shall carry out the multidimensional assessment of the household's needs, defining the Personalised Social or Work Inclusion Path (*Percorso personalizzato di inclusione sociale o lavorativa* – PPISL), which will lead to the adoption of differentiated actions (taking charge of complex needs; provision of supports; definition of inclusion projects) for individual members, as well as the signing of the Inclusion Pact (*Patto per l'inclusione* – PI).

As part of the assessment path, household members aged between 18 and 59 (with the exception of pension holders, disabled persons, cancer patients and members with care responsibilities[125]) will be sent to the employment centres to sign the Personalised Service Pact (*Patto di servizio personalizzato* – PSP).[126] The submission to the CPI is not permanent and can be amended according to specific needs (inclusion, training, access to work). The PSP must be signed within 60 days; failure to do so shall result in the suspension of the benefit. Thereafter, beneficiaries must update their position every 90 days.

[122] In addition to protected persons, persons with care responsibilities and without parental responsibility, already employed or students, and cancer patients are exempted from the obligations.
[123] The SIISL has different purposes: activation of personalised paths; promotion of autonomous job-search paths; strengthening of the beneficiaries' skills; analysis, monitoring, evaluation and control of the AdI. Moreover, the SIISL is considered an integral part of the unitary information system of labour policies.
[124] AdI is paid starting from the month following that of registration with the PAD.
[125] Presence of disabled persons, children under three years of age or three or more minor children.
[126] Legislative Decree 150/2015 details the obligations and conditionalities required in the PSP.

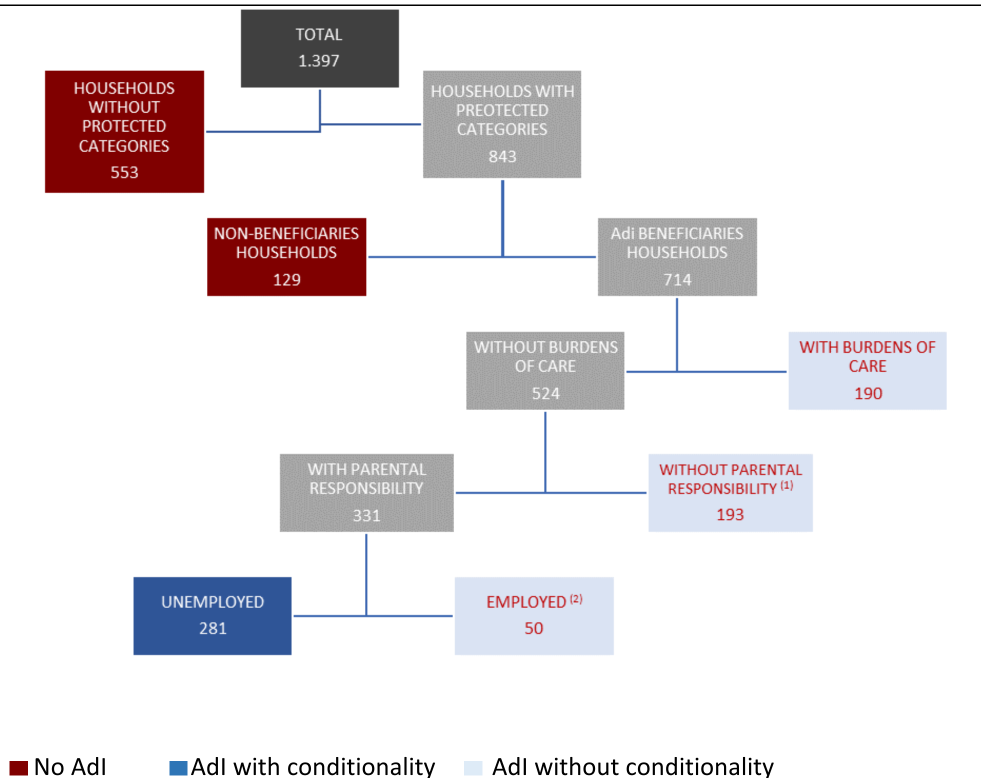
Figure 4.14 – Administrative process for AdI application



Decrees of the Minister of Labour and Social Policies will define the specific procedures concerning the application for the measure, the signing of the PAD, PPI and PSP, the social secretariat activities, the operational tools for the multidimensional assessment and the definition of and adherence to the PPISL through the SIISL, as well as the methods for confirming the household's condition.

The available information allow separating working-age individuals (18-59 years), previous RdC beneficiaries (1.397 million individuals), according to the obligations and activation path provided for by LD 48/2023. 553,000 of the previous RdC beneficiaries belong to households without protected persons and therefore will not be eligible for the AdI. In addition, 129,000 individuals, who, although belonging to households with protected persons, will not be eligible for the AdI due to economic requirements. Out of the 714,000 remaining adults in households eligible for the AdI, 190,000 have care responsibilities and 193,000 have no parental responsibility and are therefore not subject to any educational or work obligations. Of those with parental responsibility (331,000), 281,000 are subject to work or training obligations as they are not employed (Figure 4.15).

Figure 4.15 – Working-age individuals benefiting from the RdC by type of category in AdI
(thousands)



(1) Do not contribute to the determination of the benefit. – (2) Estimated value based on employed RdC beneficiaries.

4.5.1 *Funds for Social Inclusion purposes*

LD 48/2023 confirms the extension of the main social inclusion measures granted to households benefiting from the RdC to those found to be eligible for the AdI.

The interventions of the Social Services for taking charge, the multidimensional assessment of the household's needs and the definition of customised inclusion paths qualify as essential service levels (ESL) (art. 6, par. 8, LD 48/2023). The municipalities and Municipal social associations involved will be required to fulfil the related obligations with the human and financial resources available under current legislation. Such resources are available in the Fund for Combating Poverty and Social Exclusion (Art. 6, par. 9, LD 48/2023), amounting to EUR 439 million in 2023, net of the resources to be allocated for different needs, referred to in Article 4, par. 13 of LD 4/2019 (Table 4.4).

The interventions also include the strengthening of social measures and services to combat poverty, which will also involve AdI beneficiaries, to an extent yet to be defined by decree of the Minister of Labour and Social Policies, and in any case within the limits of the residual portion of the Fund (Art. 6, par. 9, DL 48/2023). In this regard, it is worth reminding that the reduction in the number of beneficiaries with the transition from the RdC to the AdI may not simultaneously reduce local assistance needs, taking also into account the planned strengthening.

As the Fund for Combating Poverty and Social Exclusion, before the enforcement of the AdI, was partially apportioned according to the relevance of RdC beneficiaries, the LD delegates to a decree of the Minister of Labour and Social Policies, in agreement with the Minister of the Economy and Finance, upon agreement at the State-Cities and Local Autonomies Conference, the definition of the criteria for apportioning the residual share and the procedures for reporting and monitoring the allocated resources.

Table 4.4 – Resources of the Fund to fight poverty and social exclusion for the 2021-23 three-year period
(million euro)

Objectives	2021	2022	2023
Financing of the essential service levels (ESL) (a), of which:	594.0	527.0	414
Social first aid	*20.0*	*20.0*	*20.0*
Financing in favour of homeless people (b), of which:	20.0	20.0	20.0
Housing first	*5.0*	*5.0*	*5.0*
Post and virtual residence services	*2.5*	*2.5*	*2.5*
Social first aid	*2.5*	*2.5*	*2.5*
Interventions in favour of persons separated from their families by a court order (c)	5.0	5.0	5.0
Total (a + b + c)	**619.0**	**552.0**	**439.0**

Source: Decree allocating the 2021-2023 Poverty Fund and approving the Plan for social interventions and services to combat poverty (Inter-ministerial Decree of 30 December 2021, registered by the Court of Auditors on 24 January 2022).

4.6 General remarks

LD Employment completes the redefinition of the measures to combat poverty launched with the 2023 Budget Law, by introducing a new instrument, the AdI, to replace the RdC. Unlike the latter, the new allowance focuses the fight against poverty only on individuals who, due to age limits or disability reasons, may not actively participate in the labour market. The only exceptions concern adults over 60, who are considered difficult to employ, and persons who bear caring burdens due to the presence in the household of a child under three years of age, three or more children under the age of three, or a member with a severe disability or not self-sufficient. Individuals between 18 and 59 years of age who are not disabled and not engaged in care work are not eligible for the allowance unless they are cohabiting with individuals unable to work. Nevertheless, they are generally not considered for the purposes of determining the level of the allowance and are in any case subject to the work engagement obligation, under penalty of spending the benefit for the whole household. With these changes, about 400,000 adult-only households previously protected by the RdC (about 34 per cent) are excluded from the measure regardless of their economic conditions.

The new allowance seems to be conceived to decisively counteract the disincentives to labour market participation typically associated with universal anti-poverty measures, trying to reduce the number of eligible persons, thus including only individuals who struggle to find employment due to objective conditions, easily verifiable. Lacking such objectives hindrances, state support to people living in poverty (the Training and Employment Support) will be exclusively aimed at encouraging re-employment through training and job guidance programmes and will be granted for no more than twelve months.

At the international level, the coordination between social protection and active labour market policies has been for at least two decades a cornerstone of the reform agenda, increasingly inspired by the so-called *workfare*, with an increasing focus on the link between conditionality and activation mechanisms with the aim of counteracting misuse and providing beneficiaries with a route out of social and labour exclusion. To this end, the recent EU Council Recommendations[127] emphasise the necessity of labour engagement of beneficiaries, ensuring that activation requirements provide sufficient incentives to re-enter the labour market, while making sure that the support network can reach all individuals lacking sufficient resources.

In Italy, the integration between benefits and active policies has become crucial following the introduction of the RdC, as the previous anti-poverty measures had remained at an almost embryonic stage: after years of tests, the ReI – the measure replaced by the RdC in 2019 – was granted to less than half a million households in 2018, about 30 per cent of those experiencing absolute poverty, for an expenditure of about EUR 1.8 billion. The RdC

[127] EU Council Recommendation of 30 January 2023 on an adequate minimum income guaranteeing active inclusion (2023/C 41/01).

covered about 1.7 million households (beneficiaries of at least one monthly payment) in 2022 for a total expenditure of EUR 8 billion. The attempt to combine the guarantee of a minimum income with labour market engagement was tackled through conditionalities and obligations that required the activation of many administrative procedures. The outcomes were influenced by the slow and difficult start-up of organisational procedures, also due to the pandemic crisis. The activities of the Employment Centres were generally insufficient to achieve the expected results, although some monitoring activities have shown that the adoption of the RdC did not discourage people from seeking employment. Anpal data[128] show that more than 30 per cent of the total number of beneficiaries managed by the Employment Centres entered into an employment contract while benefiting from the measure. This has contributed, as labour market conditions have improved, to the reduction in the number of RdC beneficiaries, which have decreased by more than 25 per cent since the end of the pandemic.

The AdI largely reduces the need for conditionality, with the exclusion from the benefit of people lacking objective conditions that hinder labour market participation. Conditionality is a requirement only in the cases of unemployed adults, with parental responsibilities and no care burdens: the obligations would concern about 281,000 individuals against approximately 900,000 beneficiaries of the RdC referred to Employment Centres.[129]

Upon signing the digital Activation Pact, AdI applicants are involved in professional activation paths which entail, after the multidimensional needs assessment, the definition of the customised Social or Labour Inclusion Path, which will develop as a differentiated actions for the individual members, as well as the signing of the Inclusion Pact. Within the assessment pathway, household members aged between 18 and 59 subject to the obligations and employable will be referred to the Employment Centres to sign the Personalised Service Pact.

The interventions of the Social Services for taking charge, the multidimensional assessment of the household's needs and the definition of customised inclusion paths qualify as ESL. Municipalities and Municipal social associations involved will be required to provide for the related fulfilments within the limits of the human and financial resources available in the Fund for combating poverty and social exclusion equal to EUR 439 million in 2023, net of the resources allocated for needs other than ESL. The reduction in the number of beneficiaries when shifting from the RdC to the AdI may not simultaneously reduce local assistance needs, also in view of the strengthening of services provided for in the Employment Decree. In this regard, it is worth considering that the generalised exclusion from long-term poverty risk coverage of all adults in households

[128] See Anpal (2021), "Reddito di cittadinanza: Condizione occupazionale dei beneficiari di RdC", Note no. 7, December. Data as of 30 September 2021. An update of the analysis was presented at the INPS Conference "La povertà in Italia, le misure di contrasto", Rome, 20 October 2022.
[129] See Anpal (2023), "Reddito di cittadinanza", Note no. 10, March. Data as of 31 December 2022.

with no members with disability, minors or elderly people could also involve individuals unable to work, characterised by severe hardship of various kinds, such as the homeless.

In prospect, the monitoring and evaluation activities under the Employment Decree to promote participatory programming and monitoring (Art. 11) will allow verifying the needs and results of both the AdI and the other anti-poverty measures.

According to an estimate conducted with the PBO's microsimulation model on administrative data, the number of households benefiting from the AdI would be about 740,000, of which about 690,000 already entitled to the RdC and about 50,000 new foreign beneficiaries, due to the required period of residence changing from 10 to 5 years (a change responding to the findings of the European Commission outlined in the infringement procedure against Italy of 15 February 2023). Overall, also in light of the greater resources stemming from the full compatibility between AdI and the Universal child allowance, households previously benefiting from the RdC that will be granted the AdI will enjoy an overall increase of about EUR 190 million, while the households previously benefiting from RdC excluded from the AdI would lose EUR 2.7 billion.

Although the calculation criteria of the new allowance are generally in line with those of the RdC, they entail a redefinition of the amounts, which are generally higher than the current ones for households with disabled people and for those with children up to three years of age. Moreover, the possibility for AdI beneficiaries to enjoy the full amount of the Universal child allowance, unlike RdC beneficiaries, entails a greater benefit for households with minor children. The latter, however, could experience an overall reduction in benefits as a result of the exclusion, in the calculation of the allowance, of other adults in the household who are not engaged in caring duties. The reduction of the income threshold for households living in rented dwellings may also cause households with relatively higher incomes to lose the benefit.

Appendix 4.1

A comparison between AdI and RdC broken down by type of household

To better understand the implications of the repeal of the RdC and the simultaneous introduction of the AdI, the levels of the two benefits are compared for some typical households, also considering the amount granted as Universal child allowance in the case of households with children. The wide selection of cases allows a detailed analysis of the combined effects of the changes introduced in the economic requirements and in the calculation of allowances.[130]

Tables 1 to 20 in Figure A4.1.1 show the amounts due to households with zero income, and the types considered vary according to the number and age of children[131] and the presence of elderly and disabled persons.[132].

Tables 21 to 24 show the amounts payable to households with the same members but with different household incomes. Households with children are considered to benefit from the RdC supplementation as Universal child allowance, which increases as household income increases.

List of households:

Couples with 1 child:

1. *Couple, 1 child 0-2*
2. *Couple, 1 child 3-17*
3. *Couple, 1 child 18-20*
4. *Couple, 1 child 21+*

Couples with 2 children:

5. *Couple, 1 child 0-2, 1 child 3-17*
6. *Couple, 2 children 3-17*
7. *Couple, 2 children 18-20*
8. *Couple, 2 children 21+*

Couples with three children:

9. *Couple, 1 child 0-2, 2 children 3-17*
10. *Couple, 3 children 3-17*

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[130] The number of applicable increments is always lower by one unit than the number of household members, since the basic benefit of EUR 6,000 (or EUR 7,560) always refers to one of the household members. The presence of different types of individuals to which different increments are associated could cause arbitrary selection of the members to which the initial benefit refers. The simulation took as a reference the most convenient calculation for the household. In the presence of one or more care burdens, an adult is granted EUR 2,400.

[131] The Universal child allowance surcharge for children under one year old is not considered.

[132] All disabled people are considered non-self-sufficient.

11. *Couple, 1 child 3-17, 2 children 18-20*
12. *Couple, 2 children 18-20, 1 child 21+*

Households with members with disabilities:

13. *Couple, 1 child 0-17 disabled*
14. *Couple, 1 child 18-20 disabled*
15. *Couple, 1 child 21+ disabled*
16. *Couple (of which 1 disabled), 1 child 3-17*

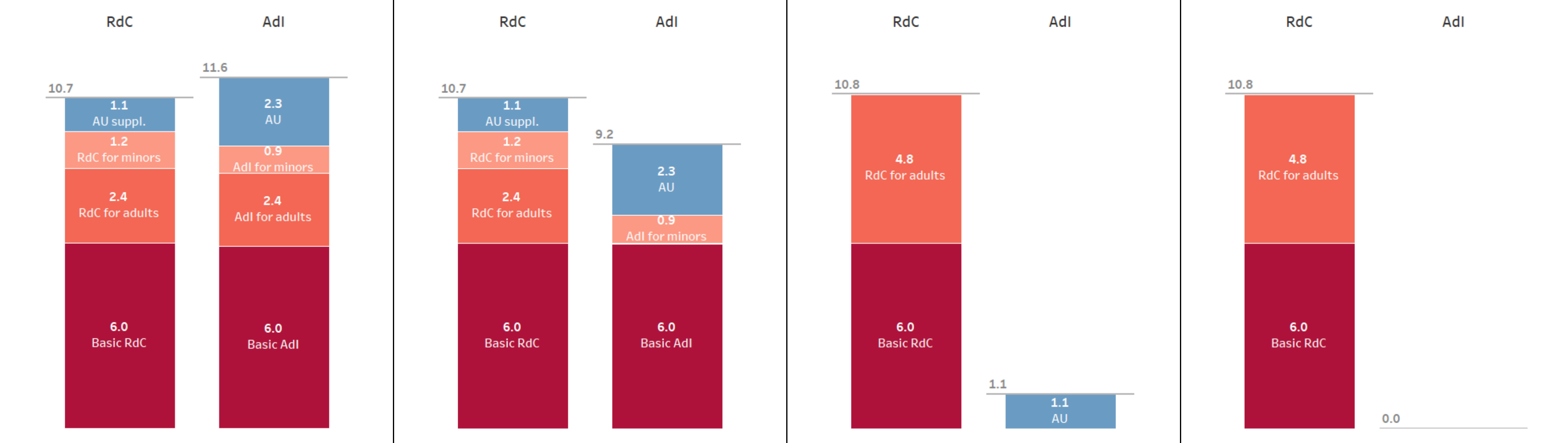
Families with elderly people:

17. *3 elderly people 67+*
18. *Couple 67+, 1 elderly 67+ disabled*
19. *Couple 67+, 1 child 21-59*
20. *Couple 67+, 1 child 21-59 disabled*

Couples with children and variable income:

21. *Couple, 3 children 3-17 – Annual household income EUR 0*
22. *Couple, 3 children 3-17 – Annual household income EUR 9,000*
23. *Couple, 3 children 3-17, 2 children 21-59 – Annual household income EUR 0*
24. *Couple, 3 children 3-17, 2 children 21-59 – Annual household income EUR 9,000*

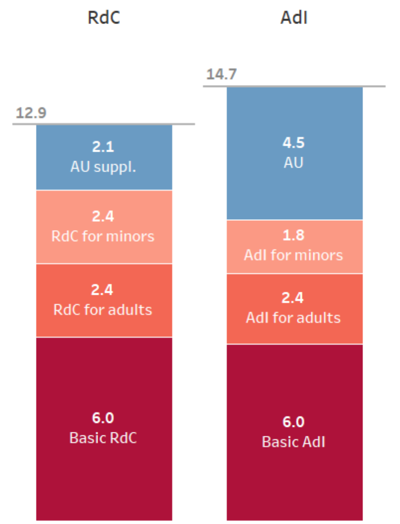
Figure A4.1.1 – Amounts of RdC, AdI and AU for typical households
(annual household income EUR 0; thousands of euro)



(1) Couple, 1 child 0-2 years old *Difference: +EUR 900*	*(2) Couple, 1 child 3-17 years old* *Difference: -EUR 1,500*	*(3) Couple, 1 child 18-20 years old* *Difference: -EUR 9,697*	*(4) Couple, 1 child 21+ years old* *Difference: -EUR 10,800*
The second adult is granted EUR 2,400 for the recognition of the care burden (child under 3 years old). The AdI is therefore equal to the RdC as far as the adult-related benefit is concerned. The minor is granted EUR 900 and the AU. Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, as far as the benefit related to minors is concerned, AdI + AU is EUR 900 higher than RdC + AU supplementation.	The second adult is not entitled to any benefit as children over 2 years old are not recognised as care duties. The AdI is therefore EUR 2,400 less than the RdC for the adult-related benefit. The minor is granted EUR 900 and the AU. Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, as far as the benefit related to minors is concerned, AdI + AU is EUR 900 higher than RdC + AU supplementation.	The AdI is not granted as no disabled, minor or elderly members live in the household. There is a loss equal to the entire value of the RdC corresponding to EUR 10,800. The adult child is granted the full amount under the AU allocated to children aged between 18 and 21 (EUR 1,103). On the contrary, the RdC due for the presence of an adult child is higher than the theoretical amount of the AU and the AU supplementation is null. The AU benefit under the new legislation is therefore EUR 1,103 higher.	The AdI is not granted as no disabled, minor or elderly members live in the household. There is a loss equal to the entire value of the RdC corresponding to EUR 10,800. The AU is not granted for a child aged 21 or over.

Figure A4.1.2 – *(cont'd)* Amounts of RdC, AdI and AU for typical households
(annual household income EUR 0; thousands of euro)

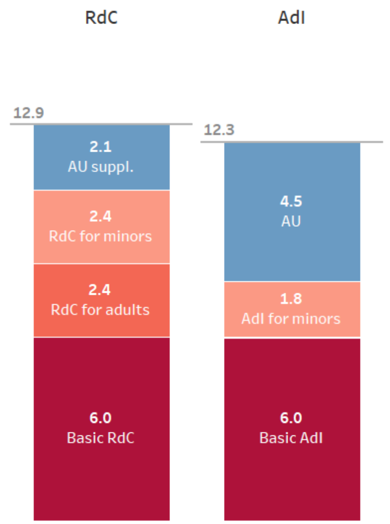
(5) Couple, 1 child 0-2 years old, 1 child 3-17 years old
Difference: +EUR 1,800



The second adult is granted EUR 2,400 for the recognition of the care burden (child under 3 years old). The AdI is therefore equal to the RdC as far as the adult-related benefit is concerned.

The two minors are granted EUR 1,800 as RdC and the AU. Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, the benefit for minors consisting of AdI + AU is EUR 1,800 higher than RdC + AU supplementation.

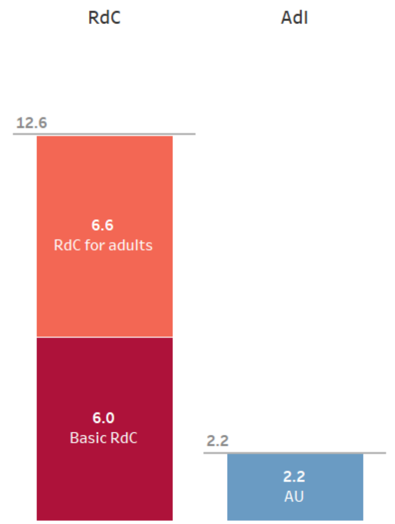
(6) Couple, 2 children 3-17 years old
Difference: -EUR 600



The second adult is not entitled to any benefit as children over 2 years old are not recognised as care duties. The AdI is therefore EUR 2,400 less than the RdC for the adult-related benefit.

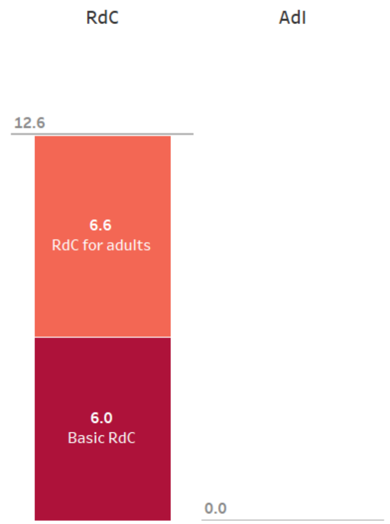
The two minors are granted EUR 1,800 as RdC and the AU. Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, the benefit for minors consisting of AdI + AU is EUR 1,800 higher than RdC + AU supplementation.

(7) Couple, 2 children 18-20 years old
Difference: -EUR 10,394



The AdI is not granted as no disabled, minor or elderly members live in the household. There is a loss equal to the entire value of the RdC corresponding to EUR 12,600. Children aged 18 to 21 are granted the full amount under the AU (EUR 1,103 each). On the contrary, the RdC due for the presence of an adult child is higher than the theoretical amount of the AU and the AU supplement is null. The AU benefit under the new legislation is therefore EUR 2,206 higher.

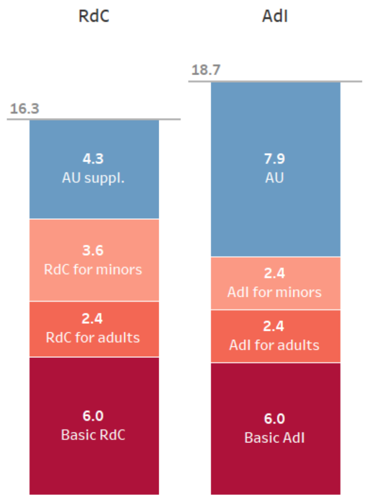
(8) Couple, 2 children 21+ years old
Difference: -EUR 12,600



The AdI is not granted as no disabled, minor or elderly members live in the household. There is a loss equal to the entire value of the RdC corresponding to EUR 12,600. The AU is not granted for a child aged 21 or over.

Figure A4.1.3 – *(cont'd)* Amounts of RdC, AdI and AU for typical households
(annual household income EUR 0; thousands of euro)

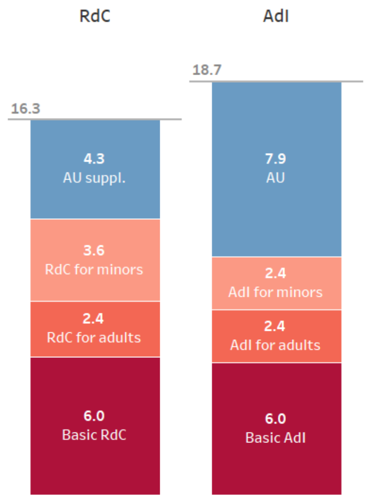
(9) Couple, 1 child 0-2 years, 2 children 3-17 years old
Difference: +EUR 2,400 euro



The second adult is granted EUR 2,400 for the recognition of the care burden (which would be due both for the presence of 1 child under 3 and for the presence of 3 minor children). The AdI is therefore equal to the RdC as far as the adult-related benefit is concerned.

The three minors are granted the EUR 2,400 as RdC and AU. Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, the benefit for minors consisting of AdI + AU is EUR EUR 2,400 higher than RdC + AU supplementation

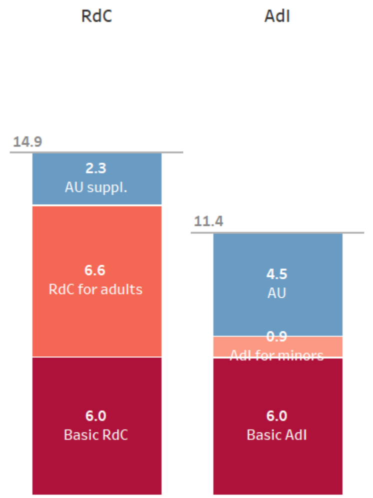
(10) Couple, 3 children 3-17 years old
Difference: +EUR 2,400 euro



The second adult is granted EUR 2,400 for the recognition of the care burden (presence of 3 minor children). The AdI is therefore equal to the RdC as far as the adult-related benefit is concerned.

The three minors are granted the EUR 2,400 as RdC and AU. Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, the benefit for minors consisting of AdI + AU is EUR EUR 2,400 higher than RdC + AU supplementation

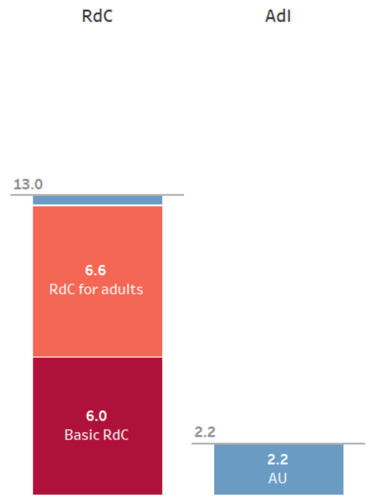
(11) Couple, 1 child 3-17 years old, 2 children 18-20 years old
Difference: -EUR 3,494 euro



The second adult and the two children between 18 and 21 years old are not entitled to any benefit as no care burden is recognised. The AdI is therefore EUR 6,600 less than the RdC for the adult-related benefit. The two children between 18 and 21 are granted the AU share equal to EUR 1,103 each. However, they are not granted the AU supplementation to the RdC as the RdC share due is higher than the theoretical amount of the AU. For adults AdI + AU is EUR 4,394 less than RdC + AU supplementation.

The minor child is granted the EUR 900 AdI and the EUR 2,270 AU. As for the RdC, the minor child does not contribute to the equivalence scale (already reaching the 2.1 limit) and is granted the full EUR 2,270 AU. For minors, AdI + AU is EUR 900 higher than RdC + AU supplementation.

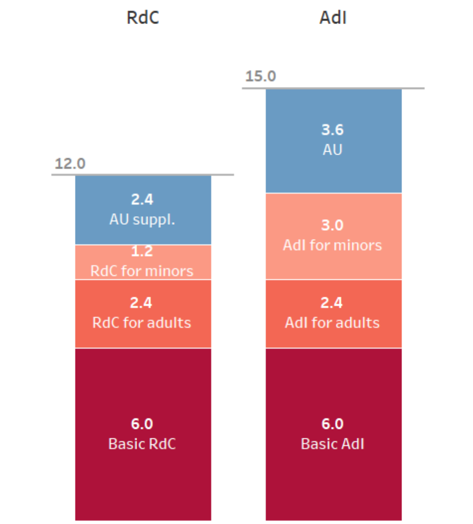
(12) Couple, 2 children 18-20 years, 1 child 21+ years
Difference: -EUR 10,800 euro



The AdI is not granted as no disabled, minor or elderly members live in the household. There is a loss equal to the entire value of the RdC corresponding to EUR 12,600. Children aged 18 to 21 are granted the amount under the AU (EUR 1,103 each). However, they are granted a EUR 406 AU supplement to the RdC as the share of RdC due is higher than the theoretical amount of AU. The AU benefit under the new legislation is therefore EUR 1,800 higher.

Figure A4.1.4 – *(cont'd)* Amounts of RdC, AdI and AU for typical households
(annual household income EUR 0; thousands of euro)

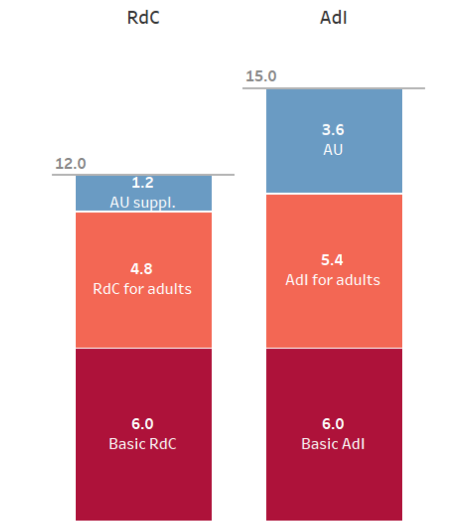
(13) Couple, 1 disabled child 0-17 years old
Difference: +EUR 3,000



The second adult is granted EUR 2,400 for the recognition of the care burden (presence of a disabled person). The AdI is thus equal to the RdC as far as the adult-related benefit is concerned.

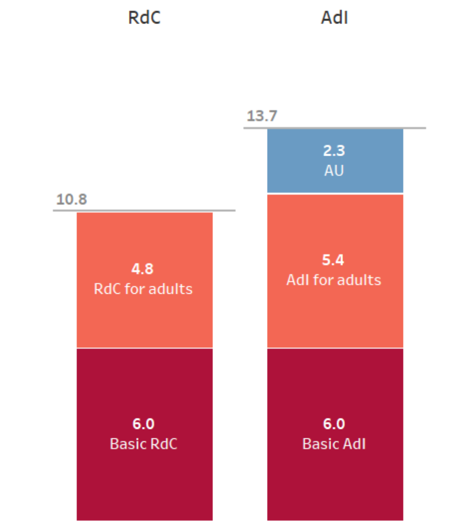
The child is granted EUR 3,000 as a disabled person and the AU for disabled persons (with a surcharge for disabled persons under 21 years of age). Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, the benefit for minors consisting of AdI + AU is EUR EUR 3,000 higher than RdC + AU supplementation.

(14) Couple, 1 disabled child 18-20 years old
Difference: +EUR 3,000



The second adult is granted EUR 2,400 for the recognition of the care burden (presence of a disabled person). The adult child aged between 18 and 21 is granted EUR 3,000 as disabled. In the case of RdC, adults are granted without distinction EUR 2,400. The AdI is therefore EUR 600 higher than the RdC as far as the adult-related benefit is concerned. An adult child is entitled to the full AU for disabled children with a surcharge for disabled children under 21 (EUR 3,632). The AU supplementation is instead EUR 1,232 (3,632-2,400). The AU benefit under the new legislation is therefore EUR 2,400 higher

(15) Couple, 1 disabled child 21+ years old
Difference: +EUR 2,870 euro



The second adult is granted EUR 2,400 for the recognition of the care burden (presence of a disabled person). The adult child aged between 18 and 21 is granted EUR 3,000 as disabled. In the case of RdC, adults are granted without distinction EUR 2,400. The AdI is therefore EUR 600 higher than the RdC as far as the adult-related benefit is concerned. An adult child is entitled to the full AU for disabled children (+EUR 2,270). On the contrary, the share of the RdC due for the presence of an adult child is higher than the theoretical AU and the AU supplementation is null

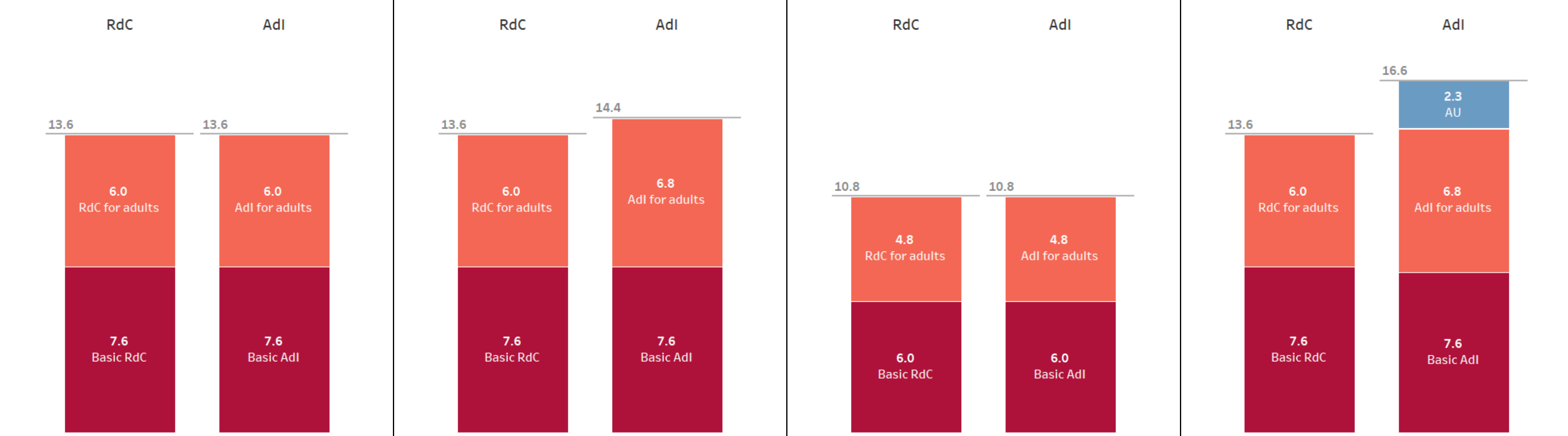
(16) Couple (of which 1 disabled), 1 child 3-17 years old
Difference: +EUR 1,500

The second adult is grangted EUR 3,000 as a disabled person. The AdI is therefore EUR 600 higher than the RdC as far as the adult-related benefit is concerned.

The minor is granted EUR 900 and the AU. Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, the benefit for minors consisting of AdI + AU is EUR EUR 900 higher than RdC + AU supplementation.

Figure A4.1.5 – *(cont'd)* Amounts of RdC, AdI and AU for typical households
(annual household income EUR 0; thousands of euro)

(17) 3 elderly 67+ years old *Difference: EUR 0*	*(18) Couple 67+ years old, 1 disabled elderly 67+ years old* *Difference: +EUR 756*	*(19) Couple 67+ years old, 1 child 21-59 years old* *Difference: EUR 0*	*(20) Couple 67+ years old, 1 disabled child 21-59 years old* *Difference: +EUR 3,026*



(17)	(18)	(19)	(20)
Household consisting of persons all aged 67 and over and other members all with disabilities. The base value is EUR 7,560. The second and third adults are each granted EUR 3,024 as an elderly person (aged 60 and over). AdI is therefore equal to RdC/PdC.	Household consisting of persons all aged 67 and over and other members all with disabilities. The base value is EUR 7,560. The second adult is granted EUR 3,024 as an elderly person (aged 60 and over). The third adult is granted EUR 3,780 as a disabled person. AdI is therefore EUR 800 higher than RdC/PdC.	Assuming the most convenient calculation for the household, the second and third adults are granted EUR 2,400 as elderly persons (aged 60 and over). AdI is therefore equal to RdC/PdC	Household consisting of persons all aged 67 and over and other family members all with disabilities. The base value is EUR 7,560. The second adult is granted EUR 3,024 as an elderly person (aged 60 and over). The third adult is granted EUR 3,780 as a disabled person. AdI is therefore EUR 756 higher than RdC/PdC. The adult child is granted the full AU for disabled children (+ EUR 2,270). On the contrary, the RdC due for the presence of an adult child is higher than the theoretical AU amount and the AU is null.

Figure A4.1.6 – *(cont'd)* Amounts of RdC, AdI and AU for typical households
(annual household income EUR 0; thousands of euro)

(21) Couple, 3 children 3-17 years old

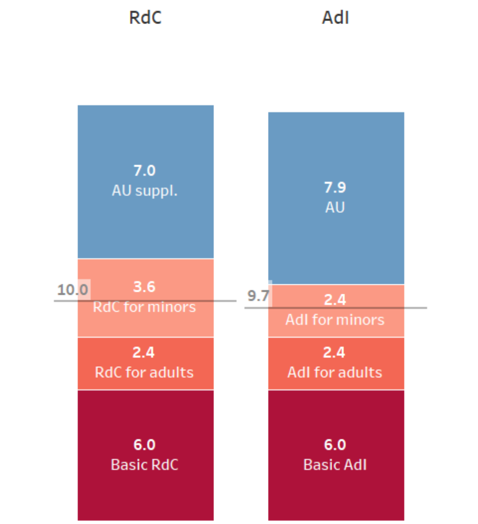
Difference: +EUR 2,400

The second adult is granted EUR 2,400 for the recognition of the care burden (presence of 3 minor childern). The AdI is thus equal to the RdC as far as the adult-related benefit is concerned.

The three minors are granted the EUR 2,400 as RdC and AU. Since the sum of the minor-related RdC and AU supplementation equates the amount of the AU itself, the benefit for minors consisting of AdI + AU is EUR EUR 2,400 higher than RdC + AU supplementation.

(22) Couple, 3 children 3-17 years old

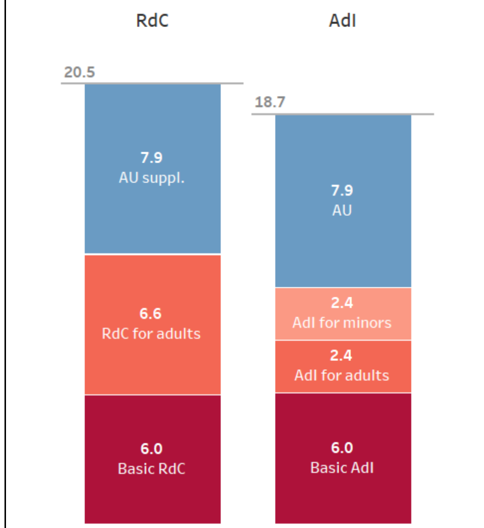
Difference: -EUR 300



As income increases, the actual share of minor-related RdC decreases. Since the sum of minor-related RdC and AU supplementation is equal to the AU amount itself, when the effective share of minor-related RdC tends to 0 the AU supplementation tends to equate the full AU value. A positive balance of EUR 2,400 for EUR 0 household incomes is offset by a negative balance of - EUR 300 for household incomes of EUR 9,000. The EUR 2,700 difference between the balances corresponds exactly to the increase in the AU supplementation to the RdC.

(23) Couple, 3 children 3-17 years old, 2 children 21-59 years old

Difference: -EUR 1,800

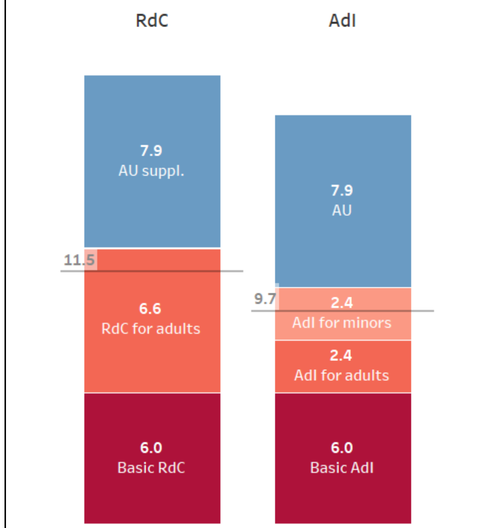


The second adult is granted EUR 2,400 for the recognition of the care burden (presence of 3 minor childern). On the contrary, for the two adult children, the share is null. The AdI is therefore EUR 4,200 less than RdC with regard to the adult-related benefit.

The three minors are granted the EUR 2,400 benefit and the AU. Since the share for the three minors in the RdC is zero, the AU supplementation to the equates the theoretical AU benefit. The the minor-related AdI + AU supplementation is + EUR 2,400 higher than RdC + AU supplementation.

(24) Couple, 3 children 3-17 years old, 2 children 21-59 years old

Difference: -EUR 1,800



Since the RdC share for the three minors is zero for any income level, the AU supplementation for the RdC is always equal to the full value of the AU. A positive balance of -EUR 1,800 for EUR 0 household incomes is offset by the same negative balance of - EUR 1,800 for EUR 9,000 household incomes.

5. DISTRIBUTIVE IMPACT OF INFLATION ON HOUSEHOLDS

5.1 Introduction

In line with other EU countries, Italy is facing one of the most serious and long-lasting inflation. In particular, 2022 was characterised by record price increases not observed for about forty years: inflation measured by the NIC index reached 8.1 per cent (up from 1.9 per cent in 2021), the highest value since 1985, when it exceeded 9 per cent.

The persistence of high and volatile inflation rates can have important distributive impacts on consumption. These impacts are linked to the simultaneous action of several transmission channels. Among these, a first factor relates to the different composition of the household consumption basket and the impact of goods affected by the highest price increases on total expenditure. A second factor relates to the different distribution of inflation mitigation policies, whether tariff-based or provided in the form of money transfers.

Using the PBO's microsimulation model on a representative sample of Italian households and with reference to the 2022-23 two-year period, the analysis aims at assessing the combined effect on the household budget of the increase in expenditure associated with the increase in prices for all consumption items and of the different types of mitigation measures implemented by the current and previous Governments through both the reduction of the tariff components of energy goods and the granting of specific transfers and allowances. For the remainder of 2023, the analysis is based on a prospective scenario of price trends consistent with the forecasting framework prepared by the PBO.

Paragraph 2 shows inflation trends and its components recorded from the second half of 2021 to the present; paragraph 3 and, more specifically, Appendix 5.1 describe the complex set of measures aimed at supporting households and its evolution over time by comparing it to price trends; paragraph 4 describes the main results of the distributive analysis covering both 2022 and 2023; the last paragraph provides some general remarks.

5.2 Consumer goods inflation by expenditure aggregates

The upward pressure on prices, which started up the production chain as early as spring 2021 as a result of commodity price increases, has then spread to consumer goods, until considerably impacting on food shopping.

In the autumn of 2022, a decline in gas and energy goods prices led to a reduction in consumer price inflation in the first months of 2023; however, as this phenomenon also embraces the less volatile components of the consumption goods and services, price trends are now gradually and unevenly stabilising. Core inflation, which excludes energy goods and fresh foodstuffs, had remained low until last summer, but then the transmission process along the production chain and between expenditure items caused it to reach over 8% in December 2022. In the following months, as the energy price shock was brought under control and pressures on producer and import prices eased, core inflation began to slowly lessen as well, while still standing at 6 per cent. Along with core inflation, there was a considerable increase in food prices, which reflected the increases up the production chain with a certain lag. Specifically, non-fresh food prices are decreasing very slowly, still 13% higher than in 2022.

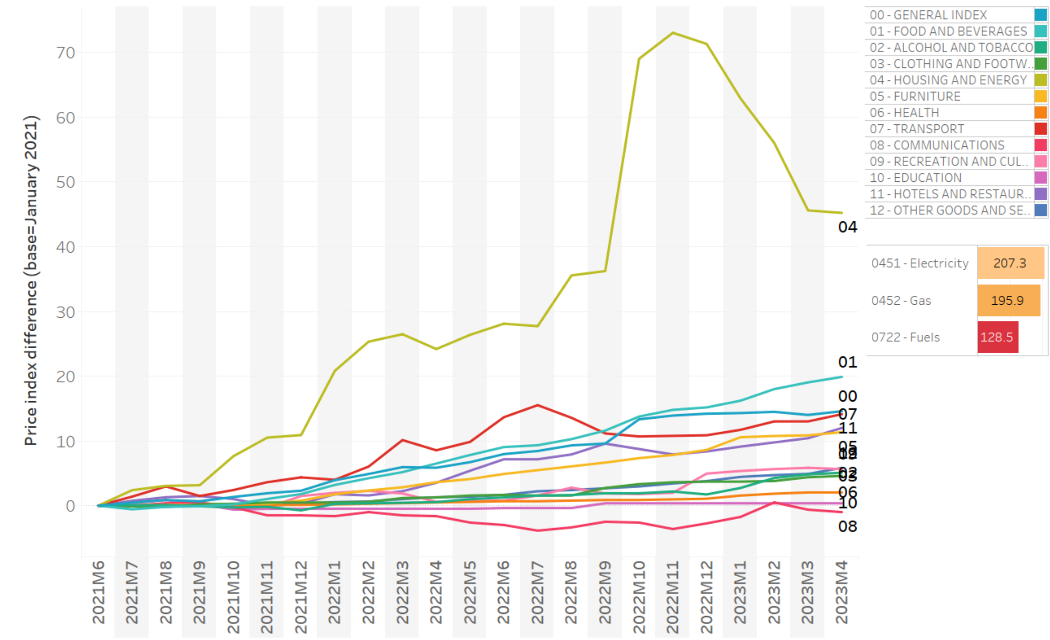
The outlook for 2023 suggests a gradual decrease in prices, with a quick decline of energy component prices thanks to the easing of tensions in commodity markets but slower for both food and core items, which generally have a more pronounced persistence. Inflation estimates for 2023, prepared by the PBO and used in this analysis, at around 6 per cent, incorporate a rapid decline in energy prices over the year and their return to pre-crisis levels, and a slower decline in food and other commodity prices.

Figure 5.1 shows the developments of the consumer price indices for the whole nation separated by expenditure items according to the two-digit COICOP classification.[133] From 2021 (the year in which energy price increase began to be tangible and the first support measures were adopted) to April 2023, the general consumer price index[134] for all expenditure items increased by 15.6 points, corresponding to a trend inflation of 8.2 per cent in 2022, and by a further 8.7 trend in the first four months of 2023. It is worth noting that these trends reflect both market price dynamics and changes in the tax (excise duty and VAT) and tariff (system charges) components of energy goods introduced by the governments in office over time to minimise the impact of increases on households.

Price developments are highly differentiated according to the category of goods considered and the period surveyed.

[133] COICOP (*Classification of* individual *consumption by purpose*) is an international standard for the classification of individual consumption used for preparing consumer price indices.
[134] The general index is calculated as the average of the indices per expenditure item weighted with the components of the specific basket used in the calculation of the Istat-NIC price indices.

Figure 5.1 – Price changes by consumption item (1)
(index numbers, base January 2021 = 100)



Source: Istat, price indices for the whole nation (NIC).
(1) Provisional data for April 2023.

The index for the aggregate of household expenses, which includes gas and electricity utilities, showed the highest growth compared to the other categories of goods. After having increased as early as the third quarter of 2021, it accelerated two further times during 2022: in January-February and especially between the end of September and November 2022. Since December 2022, a sharp correction of the index can be noted, which in April 2023 is more than 47 per cent higher than in January 2021. However, the increase drops to 17 per cent compared to the April 2022 due to the decrease in the first months of the year. Within this category, electricity and gas prices increased by 207 per cent and 196 per cent from January 2021, respectively. The trend in the electricity and gas price indices reflects the change in both the market prices of energy goods and the components of the final price on the free and protected market on which mitigation policies (which concerned excise duties, VAT, system charges and the variable component of the price in the protected market) impacted.

The aggregate of transport expenditure also changed significantly (+18.3 per cent compared to the level at the beginning of the period surveyed) driven by the trend of fuel prices on international markets and by the final price mitigation policies (excise change). Figure 5.1 shows that the index first accelerated in March 2022, when the first fuel excise reduction measures were introduced, leading to a sudden fall in prices. A second significant increase occurred in July 2022. From August, the transport price index started to fall, reaching a level at the end of 2022 that almost completely amortised the increases experienced during the year. The slight growth recorded in the first months of 2023 is partly due to the elimination of the excise discounts as inflation reduced, and partly to a physiological increase in prices. Within the transport sector, fuels accumulated a price increase of 128 per cent.

Food prices, on the other hand, only started to rise from November 2021 at a roughly constant monthly rate, accumulating an increase of about 20.3 points overall by the end of the period.

The price developments for the other expenditure items were noticeably more contained: the aggregate for accommodation and food services and the aggregate for furniture and household goods alone rose by about 12 and 15 per cent, respectively, over the period surveyed. It is worth considering that the price indices of the other categories of goods, especially foodstuffs and expenditure on furnishings, reacted with considerable lag to the inflationary spike and did not fluctuate sharply up and down as did expenditure on housing and transport between 2022 and early 2023 and, therefore, were not subject to specific mitigation measures.

5.3 *Price mitigation measures in favor of households*

To mitigate the impact of the generalised increase in the prices of consumer goods and, in particular, of energy goods, in line with other EU countries,[135] the governments in office have adopted various measures starting in the second half of 2021, which were confirmed and, in some cases, strengthened during 2022 to cope with continuous price increase. The composition and extent of the mitigation policies then changed in 2023 with the partial easing of the reduction applied to tariffs and the elimination of the fuel excise discount, in line with the fall in energy prices. Overall, EUR 119 billion were allocated to mitigate inflationary impacts, of which EUR 5.6 billion in 2021, EUR 70 billion in 2022 and EUR 35 billion in 2023 (see Table 2.9 in paragraph 2.2).

As for household-friendly measures, whose effects this chapter analyses, they appear to be similar to the measures taken since April 2021, although they have become increasingly selective, in line with the EU Council Recommendations of July 2022.

In fact, the measures started in 2021 with DL 73/2021 and continued in the same year with DLs 99 and 130 of 2021. Further measures were then adopted for 2022, initially with the Budget Law for 2022 and then with DLs 4, 17, 21, 38, 50, 80, 115 and 144 of 2022 and the inter-ministerial decrees of the Ministry of Economy and Finance and the Ministry of Ecological Transition of March, April, June, July, August and September 2022. Finally, some measures were also extended for the current year by the Budget Law for 2023 and DLs 34 and 48 of 2023 (see Appendix 5.1 for a brief description of the measures and their development).

Table 5.1 shows the main measures to mitigate the effects of inflation in favour of households or households and businesses, where difficult to distinguish, for 2021, 2022 and 2023 with the relevant legislative reference.[136]

Household-friendly price mitigation measures can be distinguished into different types (OECD, 2022).[137] A first classification separates tariff-based measures from income support measures. The former measures include interventions aimed at containing the final prices of energy goods paid by households, acting on taxes or regulated price components, i.e. involving caps on energy prices or social tariffs. Income support policies entail money transfers to energy-consuming households and firms to relieve their energy costs, but also, for example, financial support to poorer households in order to provide generic support to cope with lower purchasing power.

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135 See Parliamentary Budget Office (2022), 'An overview of the budgetary strategies in the 2022 Stability and Convergence Programmes of EU countries', Thematic Focus No. 5.

136 The table does not include measures exclusively intended for businesses, which mainly consist of tax credits.

137 See OECD (2022), 'Why governments should target support amidst high energy prices', Tackling Policy Challenges, June.

Tab. 5.1 – Household-friendly measures by month of application and reference legislation: financial effects on 2021, 2022 and 2023 *(amounts net of tax effects in billion euros)*

<table>
<tr><th colspan="3" rowspan="2">Measures</th><th colspan="7">2021</th><th colspan="12">2022</th><th colspan="12">2023</th><th rowspan="2">Total</th></tr>
<tr><th>Jun</th><th>Jul</th><th>Aug</th><th>Sept</th><th>Oct</th><th>Nov</th><th>Dec</th><th>Jan</th><th>Feb</th><th>Mar</th><th>Apr</th><th>May</th><th>Jun</th><th>Jul</th><th>Aug</th><th>Sept</th><th>Oct</th><th>Nov</th><th>Dec</th><th>Jan</th><th>Feb</th><th>Mar</th><th>Apr</th><th>May</th><th>Jun</th><th>Jul</th><th>Aug</th><th>Sept</th><th>Oct</th><th>Nov</th><th>Dec</th></tr>
<tr><td rowspan="6">TARIFF MEASURES (households and businesses)</td><td rowspan="2">Electricity [1]</td><td>Reduction of system charges</td><td></td><td colspan="3">1.2 DL 73/21</td><td colspan="3"></td><td colspan="12"></td><td colspan="3">0.5 [7] BL 2023</td><td colspan="9"></td><td>1.7</td></tr>
<tr><td>Cancellation of system charges</td><td colspan="4"></td><td colspan="3">2.0 DL 130/21</td><td colspan="3">1.8 BL 2022</td><td colspan="3">1.8 DL 17/22</td><td colspan="3">0.7 DL 50/22</td><td colspan="3">0.5 DL 115/22</td><td colspan="3">1.0 BL 2023</td><td colspan="9"></td><td>7.8</td></tr>
<tr><td rowspan="2">Gas [1]</td><td>Reduction of system charges and heating contribution</td><td colspan="4"></td><td colspan="3">0.5 DL 130/21</td><td colspan="3">0.5 BL 2022</td><td colspan="3">0.3 DL 17/22</td><td colspan="3">0.5 DL 50/22</td><td colspan="3">2.2 DL 115/22 DL 179/22</td><td colspan="3">4.0 [8] BL 2023</td><td>0.3 DL 34 [9]</td><td colspan="5"></td><td colspan="3">1.0 DL 34/23</td><td>9.3</td></tr>
<tr><td>VAT reduction</td><td colspan="4"></td><td colspan="3">0.6 DL 130/21</td><td colspan="3">0.6 BL 2022</td><td colspan="3">0.6 DL 17/22</td><td colspan="3">0.5 DL 50/22</td><td colspan="3">0.8 DL 115/22</td><td colspan="3">0.8 BL 2023</td><td colspan="3">0.5 DL 34/23</td><td colspan="6"></td><td>4.4</td></tr>
<tr><td>Fuels [1]</td><td>Excise tax reduction</td><td colspan="7"></td><td colspan="2"></td><td colspan="10">9.1 Various DLs and MDs</td><td colspan="12">-0.6 BL 2023</td><td>8.5</td></tr>
<tr><td colspan="2">Total (households and businesses)</td><td colspan="7"></td><td colspan="12"></td><td colspan="12"></td><td>31.7</td></tr>
<tr><td rowspan="6">TRANSFERS AND COMPENSATIONS (Households)</td><td rowspan="2">Energy bonuses for economic hardship</td><td>Integration amount</td><td colspan="4"></td><td colspan="3">0.5 DL 130/21</td><td colspan="3">0.9 BL 2022</td><td colspan="3">0.4 DL 17/2022</td><td colspan="3">DL 50/22 [6]</td><td colspan="3">1.7 DL 115/22 DL 176/22</td><td colspan="6">2.4 BL 2023 and DL 34/23</td><td colspan="6"></td><td>5.9</td></tr>
<tr><td>Increase threshold ISEE [2]</td><td colspan="7"></td><td colspan="12">0.2 DL 21/22 and DL 50/22</td><td colspan="12">0.1 BL 2023</td><td>0.3</td></tr>
<tr><td colspan="2">One-off bonus (EUR 200 and 150) [3]</td><td colspan="7"></td><td colspan="6"></td><td>6.8 DL 50</td><td></td><td>0.2 DL 115</td><td></td><td>2.9 DL 144</td><td></td><td colspan="12">0.3 DL 144/22</td><td>10.2</td></tr>
<tr><td colspan="2">Exemption from contribution [4]</td><td colspan="7"></td><td colspan="12">2.7 BL 2022 and DL 115/22</td><td colspan="12">8.2 BL 2023 and DL 48/23</td><td>10.9</td></tr>
<tr><td colspan="2">Pension revaluation and minimum pension increase</td><td colspan="7"></td><td colspan="9"></td><td colspan="3">1.0 DL 115/22</td><td colspan="12">0.5 BL 2023</td><td>1.5</td></tr>
<tr><td colspan="2">Total households [5]</td><td colspan="7"></td><td colspan="12"></td><td colspan="12"></td><td>28.8</td></tr>
<tr><td></td><td colspan="2">Total</td><td colspan="7"></td><td colspan="12"></td><td colspan="12"></td><td>60.5</td></tr>
</table>

Source: based on data from the financial statements of the above-mentioned legislative measures.
(1) Measured intended for both households and businesses. It excludes the effects of measures intended for non-household users and above certain powers, which are considered to benefit businesses. - (2) The quantification also includes the automatic granting of the bonuses to eligible beneficiaries as from January 2022 provided for by DL 80/2022, which was converted into DL 50/2022. - (3) The EUR 200 one-off *bonus* was paid in July 2022; the EUR 150 bonus in November 2022. - (4) The 0.8 per cent exemption from contribution from January 2022 introduced by the Budget Law for 2022 was then increased to 2 and 3 per cent (depending on income) from July to December 2022 by DL 115/2022 and extended to 2023 and enhanced by a further 4 points by the Budget Law for 2023 and DL 48/2023. - (5) This amount does not include the effects of other measures benefiting households such as: the exclusion of fuel bonuses from the employee income, up to the limit of EUR 200 per worker, provided for by DL 21/2022; the vouchers for the purchase of transport season tickets provided for by DLs 50 and 115 of 2022; the enhancement of corporate welfare measures such as the increase to EUR 600 in the value of assets not contributing to forming employee income, including among the so-called *fringe benefits* also the amounts disbursed or reimbursed to employees for payment of utilities, provided for by DL 115/2022 and extended by DL 48/2023 up to the limit of EUR 3.000; the amounts for a contribution for the purchase of basic necessities for persons with ISEE lower than EUR 15,000. - (6) The bonuses are redetermined within the limit of the available resources of the Fund for Energy and Environmental Services for 2022. - (7) This refers to the taxability of the general system charges improper for implementing goal M1C2-7 of the NRP. - (8) Includes SNAM's Default Service Fund to be used to mitigate the consequences for end users of the impact of charges relating to services of last resort. - (9) Includes the adjustment of the negative rates of the UG2C tariff component applied to consumption bands of up to 5,000 cubic metres per year for April 2023 only.

A second classification separates measures granted to general beneficiaries and measures subject to conditionalities (proof of means or other characteristics of the beneficiaries, such as age or state of health, or both).[138]

Firstly, measures to contain the increase in energy prices acting on taxes or regulated price components were implemented as part of the price mitigation measures. These include the reduction of excise duties on fuels, the reduction of VAT on gas for civil and industrial use to 5 per cent, and the compensation of general system charges for both electricity and gas. These measures are among those intended for general beneficiaries, in some cases consisting of both households and businesses,[139] or granted without conditionality.

The compensation of system charges for the electricity and the gas sectors was introduced as of Q3 2021 and confirmed and enhanced by writing off charges until the end of Q1 2023 (for gas until April). VAT on gas was also reduced as from the Q3 2021.

The reduction of excise duty rates on fuels (by 30.5 cents for petrol and diesel and 5.7 cents for LPG before VAT) was adopted close to the price peak in March 2022. The discount was reduced by DL 179/2022 for December 2022 only by 10 cents for petrol and diesel and 3 cents for LPG. Since January 2023, excise duties have bounced back to the pre-crisis level.

In addition to energy tariff interventions, measures aimed at supporting households through various forms of money transfers were adopted to relieve the pressure of inflation on their budgets. In this context, one can separate income support measures subject to means-testing intended for a target group of beneficiaries having specific characteristics and other general measures intended for a broad target group.

As for the first type, some measures are aimed at mitigating the impact of the increase in energy tariffs specifically on poorer households consuming electricity and gas. These measures include the strengthening of social energy bonuses implemented both by increasing the amounts of the bonuses and extending the number of beneficiaries. The amounts have been increased starting from the fourth quarter of 2021 and throughout 2022. The increase was reconfirmed also for 2023 but with a *decalage*, provided for by the Budget Law for 2023, so as to ensure greater savings for households with fewer than four children and for lower ISEE levels. As for the target group of beneficiaries, households with fewer than four children had their benefit extended in 2022 (as ISEE threshold increased from EUR 8,265 to EUR 12,000 per year) and further in 2023 (from EUR 12,000

[138] For an international comparison of tariff and financial support see Varga, J., Kasdorp, R., Johannesson Lindén, A., Döhring, B., Cima, A., and Bethuyne, G. (2022), 'Targeted income support is the most social and climate-friendly measure for mitigating the impact of high energy prices', VoxEU, June.

[139] For these measures it was impossible to clearly separate from the technical reports attached to the legislative measures how much has benefited one category and how much has benefited the other.

to EUR 15,000); households with at least four children had their benefit extended as from 2023 (from EUR 20,000 to EUR 30,000).

As for general financial compensation measures, specific and transitional measures were provided for in 2022, such as the advance on the calculation of the final balance for pensions in 2021 and the 2 per cent adjustment of pensions paid in the months from October to December 2022. Furthermore, the payment of the one-off allowances of EUR 200 and EUR 150 and the introduction (0.8 per cent) and enhancement (2 per cent from the second half of the year) of the exemption from social security contribution were arranged in 2022. In 2023, in addition to the 1.5 per cent adjustment[140] of minimum/below-the-minimum pensions, the exemption from social security contribution was extended and enhanced. Specifically, for the first half of 2023 the exemption for workers with monthly incomes up to, respectively, EUR 2,692 and EUR 1,932 was confirmed at 2 per cent and increased to 3 per cent, and for the second half of the year it was raised by 4 per cent, to 6 and 7 per cent depending on the income threshold. It is worth noting – as the analysis below did - that the ordinary adjustment of pensions, which, for minimum/below-the-minimum pensions was equal to the entire expected increase in the consumer price index (7.3 per cent), although restricted for the 2023-24 two-year period by the Budget Law for 2023, contributed to mitigating the burden of inflation on household budgets.

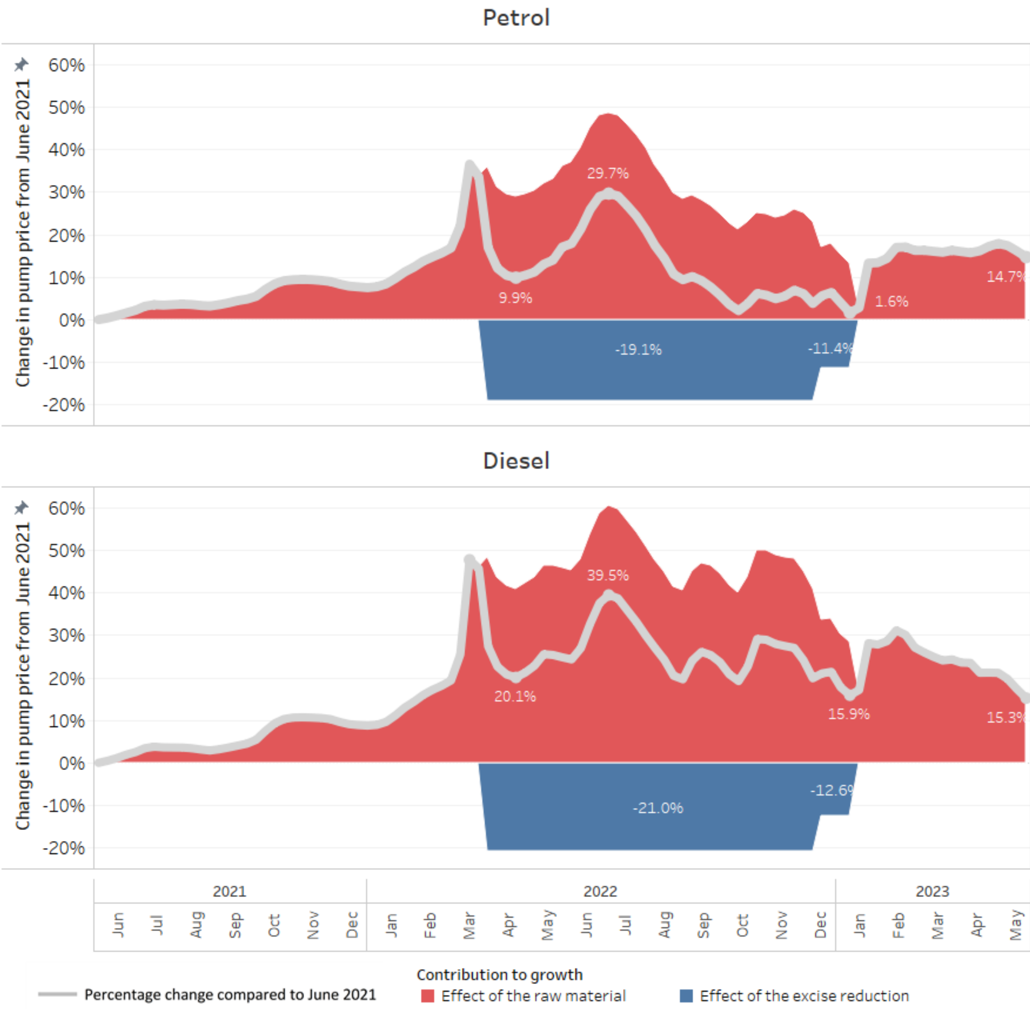
These categories do not include all the types of household-friendly measures adopted from the second half of 2021 onwards, which will be renewed and, in some cases, extended in 2022 and 2023. Indeed, these measures go hand in hand with other minor provisions, such as, for example, the transport bonus and corporate welfare measures.

All the above leads to a complex set of interventions implemented to cope with the increase in expenditure due to inflation, which, moreover, has varied between 2022 and 2023, also due to different inflation developments. In fact, the possibility of gradually reducing the mitigation measures has been strongly influenced by the decrease in price pressure, as shown, for example, by the intervention provided for in DL 179/2022 on motor fuels, which provided for a reduction in the excise discount as from December 2022.

Figure 5.2 shows the interaction between petrol and diesel prices and the change in the corresponding excise duty. A similar price development for both fuels can be noted until August 2022, both in the pump price net of the excise discount (grey line) and in the gross price (red area). We can also note the timeliness of the mitigation measures: introduced almost upon the first major price increase between February and March 2022, then reduced as from December 2022 onwards as prices begin to fall, before being permanently cancelled from 2023.

140 By 2.7 per cent in 2024.

Figure 5.2 – Percentage change in pump price of motor fuels compared to June 2021 and related contributions to growth



Source: Ministry of Ecological Transition - Directorate-General for Infrastructure and Security, weekly survey of fuel prices.

The price effect of the excise reduction for both petrol and diesel was steady from March to November 2022 with a slightly lower weight for petrol due to the price differences between the two fuels in the pre-crisis period. When considering excise duty reduction, the de-escalation of price tensions recorded since the second half of 2022 has brought the price of petrol back to levels close to pre-crisis levels since October 2022, thus setting the conditions for a gradual reduction of the discount, which caused the pump price of petrol in December 2022 to settle at end-2021 levels. From 2023 onwards, petrol prices recovered, until settling at around 15 per cent above the pre-crisis level in April 2023, even considering that the elimination of the excise discount from the beginning of the year did not coincide with a price increase of the amount of the discount itself.

Conversely, the sale price of diesel increased more and then declined more moderately during 2022 until reaching, in December 2022, values almost 16 per cent higher than in

June 2021 and higher than those recorded for petrol during the same period. Finally, given a constant and negative contribution to growth due to the reduction in excise duties, the different magnitude of the increases leads the sales price of diesel to be higher than that of petrol in December 2022 compared to June 2021, when excluding the measures adopted. The price of diesel also rose in the first two months of 2023 and then started to fall again, settling at a level 15 per cent higher than at the beginning of the period and just below the level reached in December 2022, net of the excise reduction.

5.4 *The distributive effects of price increases and household-friendly measures*

The impact of price changes may vary between households due to the different composition of their expenditure: households consuming more of the goods subject to a higher price increase will see their purchasing power fall more sharply. The scenario surveyed suggests that households with a higher share of expenditure on housing, food and transport would suffer the most the reduction in their purchasing power.

To analyse this phenomenon, the annual change in expenditure for 2022 and 2023 due to price developments and mitigation policies was estimated on a representative sample of Italian households.[141] The analysis was conducted using the PBO microsimulation model fed by the Istat household budget survey (HBS) supplemented with administrative data on taxes, social security contribution and welfare information (pensions and ISEE).[142] As mentioned, the analysis for 2023 is based on the construction of a benchmark forecast scenario that incorporates domestic estimates of inflation for different categories of goods (energy, food and other types).

The detailed overview provided by the sample survey of expenditures allows to fully capture the influence of different consumption behaviour. The survey was conducted by applying the NIC price indices at a high level of disaggregation (4-digit COICOP, 112 expenditure items) to the consumption behaviours of individual households. For energy goods (fuel, gas and electricity[143]) a fit-for-purpose methodology was adopted, based on the application of the tariff schemes to an estimate of household consumption expressed in terms of quantity (litres of fuel, kWh of electricity and cubic metres of gas). For fuels, the number of litres of petrol, diesel and LPG consumed was determined from the expenditure made and the average prices;[144] for electricity and gas, the quantities were assumed from the expenditure made by the households in the sample and the pricing structures in force in the quarter surveyed.[145] The evolution of expenditure on energy goods over the last two years was determined by keeping constant the quantities consumed calculated on the basis of the sample survey and by reconstructing, for each sample household, the cost of gas and electricity bills by varying only the pricing structures and, for fuels, by varying the prices applied at the pump. The effect of the interventions on tariff components (system charges, VAT

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141 In previous simulations, still using the PBO microsimulation model, the impact of price changes on expenditure was calculated as the difference between the expenditure incurred over a specific time period (12, 16 or 18 months depending on the update of the estimates, starting in June 2021), considering the monthly evolution of market prices, compared to a benchmark scenario with constant prices (prices at the beginning of the period, i.e., June 2021). During the simulations the quantities were kept unchanged over the period surveyed. The impact of energy price developments and the simultaneous action of mitigation policies through tariff reductions and money transfers were estimated. For estimates of the distributive effects up to May, October and December 2022, see respectively: the Hearing of the Chair of the Parliamentary Budget Office in the context of the examination of DDL C. 3614, converting into law DL no. 50 of 2022, Parliamentary Budget Office (2022), 'The distributive effects of price increases and household support measures', Flash no. 2, and the Hearing of the Chair of the Parliamentary Budget Office as part of the fact-finding activity prior to the examination of the draft law on the State budget for the financial year 2023 and the multi-year budget for the 2023-2025 three-year period.

142 The model is fed by the Istat household expenditure survey for 2017, the last year for which administrative information associated with the sample data was available.

143 In relation to both electricity and gas, the estimate from tariffs was limited to users in the protected market. For users in the free market, the price change was calculated by applying the specific Istat price index.

144 Fuel price data are available on the Unem website.

145 Information on the electricity pricing structure for the 2005-2023 period is available on the ARERA website. The tariffs of the highly protected market were used for the estimate of the quantities consumed.

and excise duties) and money transfers was estimated, for each month of application, by comparing the expenditure including these measures with the expenditure actually borne by the households. The estimate of expenditure following the increase in prices for the same basket allows assessing the impact of both inflation and the price mitigation measures on the spending capacity of households.

The use of inflation forecasts allows an assessment of the overall and distributive effects for 2023, assuming a decrease in prices during the year and taking into account a different composition and extent of household support policies between the first and second half of the year. The fall in the prices of energy products and, to some extent, fuels in the first months of the year, visible in the trends shown in Figures 5.1 and 5.2, suggest an improvement in the overall scenario and a decrease in inflationary pressure on household budgets. Table 5.1 shows that following the reduction of the inflationary pressure on energy goods, mitigation policies have been downsized, both in terms of tariffs and money transfers, adjusting the structure of household supports to cope with the effects of lower price growth. However, tensions persist both on the prices of non-fuel energy products, although gradually easing, and on other major expenditure items, such as food. Inflationary pressure on Italian household budgets therefore remains significantly high, particularly affecting households with lower spending capacity.

In particular, the forecasts used in the simulation assume a rapid decline in the prices of energy goods in 2023, which are expected to bounce back to the levels recorded in the pre-crisis period. A slower decline is expected for food and other categories of goods. The forecast scenario used in the analysis therefore assumes a partial downward correction of inflation in 2022 (8.1 per cent), to around 6 per cent.

This analysis has dealt with the tariff mitigation and money transfer measures involving households in 2022 and those so far planned for 2023 shown in Table 5.1[146] and their inter-annual variation.[147]

The benefits corresponding to monetary compensation were estimated for each household in the sample on the basis of information on economic conditions (employment status, income and ISEE) derived from administrative sources.

Price increases have differential effects on household expenditure for two reasons. First, households with different spending capacity show structural discrepancies in the shares of the different consumption items. Second, for energy (electricity and gas) and fuels, tariffs and taxes affect, respectively, the bill and expenditure differently for households

[146] The analysis does not include - as difficult to assess given the uncertainty of the measure - the resources allocated by DL 34/2023 for the disbursement of a contribution, for the fourth quarter of 2023, to partially offset heating costs where the price of natural gas exceeds the EUR 45/MWh threshold. Consistent with the content of the table, other measures benefiting households are also not included - as negligible or difficult to assess - such as: the exclusion of fuel bonuses from the formation of employee income, vouchers for the purchase of transport season tickets, and the strengthening of corporate welfare measures.

[147] The overall assessment of the distributive effects, with regard to the electricity and gas bonuses, only considers the inter-annual change in the amounts allocated for existing beneficiaries (with ISEE below EUR 8,265) and the entire amount for new beneficiaries entitled to the bonus thanks to the extensions of the target group resulting from the increases in the ISEE threshold.

consuming little and for households consuming more, as the weight of the different tariff components (energy, transport, system charges, taxes) is not homogeneous on the quantities consumed.

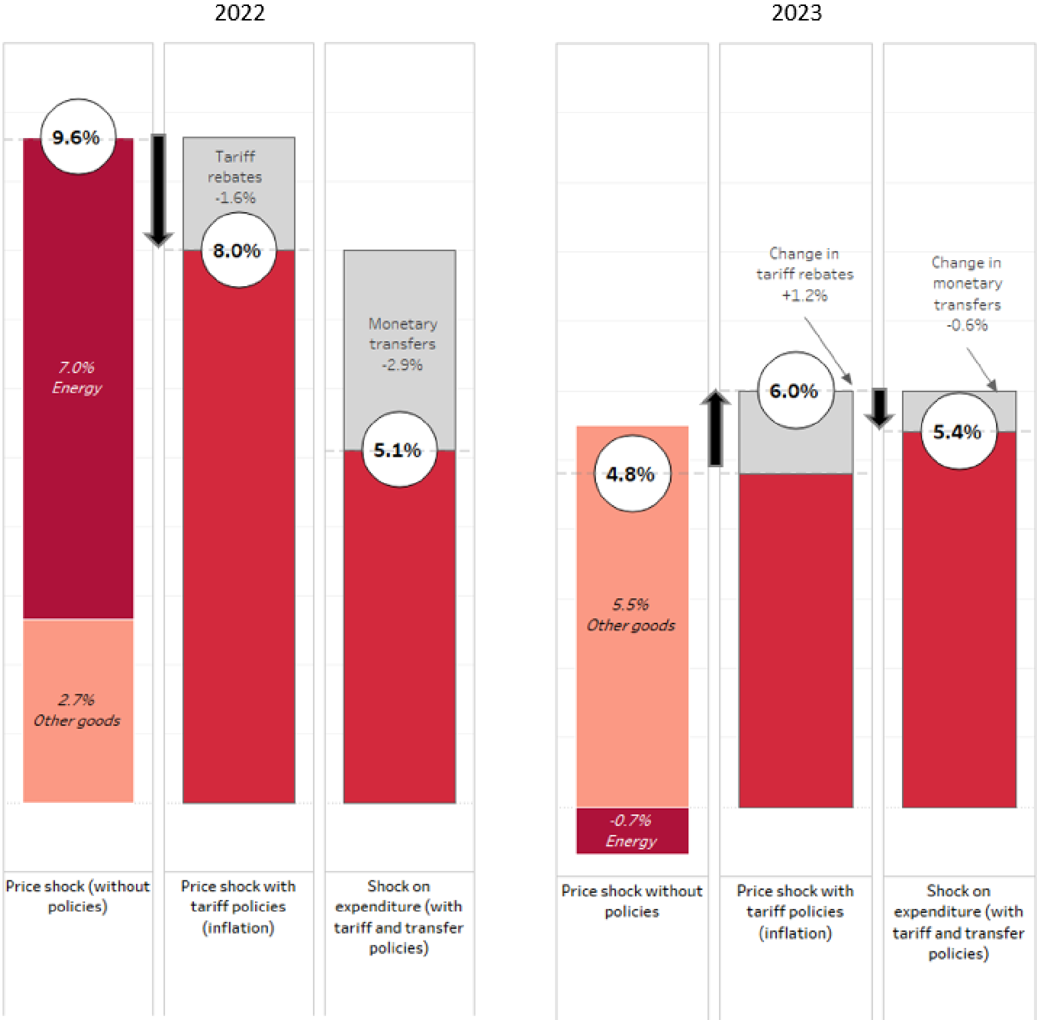
The analysis focuses on the effects of price changes on expenditure assuming constant quantities. The reconstruction of expenditure from consumption and tariff structure allowed considering the different impact of energy good prices according to the level of consumption. By the same token, the reconstruction of the tariff components allows analysing the distributive impact of mitigation policies in reducing some of these components.

Figure 5.3 shows the change in household expenditure due to price developments before tariff and compensatory mitigation measures in 2022 and 2023 - which allows for capturing the contributions to growth related to price developments only - and the effect after these measures. The figure also shows the effects on household spending in light of the changed scenario stemming from the different price trend and the different mitigation policies in 2023 compared to 2022, taking into account only the measures envisaged so far and, from May until the end of the year, a slowdown in inflationary pressure in line with the forecasts used in the analysis.

A 5.1 per cent net impact on household expenditure is estimated for 2022. The support policies helped to relieve by about 4.5 per cent the burden on household spending related to price increases, which would otherwise have been about 9.6 per cent (including about 7 per cent for price increase in energy goods and 2.7 for inflation in other goods). Considering only tariff rebate policies (-1.6 per cent), the effect of inflation on spending would have been 8 per cent. When considering the effect of money transfers as well, the burden on expenditure drops by 2.9 per cent, reaching a net impact of 5.1 per cent.

Assuming the same composition in the consumption basket, the net effect on household expenditure in 2023 is estimated at 5.4 per cent, up 0.3 per cent with respect to 2022. The increase in the prices of other categories of goods due to the spread of inflation leads to an increase in expenditure before mitigation policies of 5.5 per cent. At the same time, the sudden drop in energy prices projected for the whole of 2023 contributes to a decrease of 0.7 per cent, bringing the total gross increase to 4.8 per cent. In line with the measures on fuels, the expected reduction on inflationary pressures on energy goods went hand in hand with a gradual adjustment of tariff support policies, which, however, had a greater impact on expenditure than the reduction in energy prices (1.2 per cent increase for the former, against 0.7 per cent decrease for the latter): energy expenditure therefore contributes 0.5 per cent to an increase in total expenditure in 2023. Overall, the effect of both energy and non-energy inflation in 2023 is 6 per cent once considering the change in tariff rebates. Finally, the change in money transfers leads to a further reduction in expenditure of 0.6 points, resulting in a net effect of 5.4 per cent.

Figure 5.3 – Change in expenditure due to price developments in 2022 and 2023 before and after support measures (1)



Source: simulations using the PBO microsimulation model.
(1) Any missing balancing is due to the rounding of decimal places.

An overall assessment of the impact of inflation and of the mitigation measures shows that over the two years surveyed, the latter managed to stabilise the impact of inflation by mitigating it in 2022 and increasing it in 2023: the net increase in household expenditure appears almost constant over the two years (5.1 per cent and 5.4 per cent). Regarding 2023, an unexpected improvement in the development of energy and, above all, other goods inflation in the remainder year is expected to allow a gradual elimination of the support measures in the second half of the year.

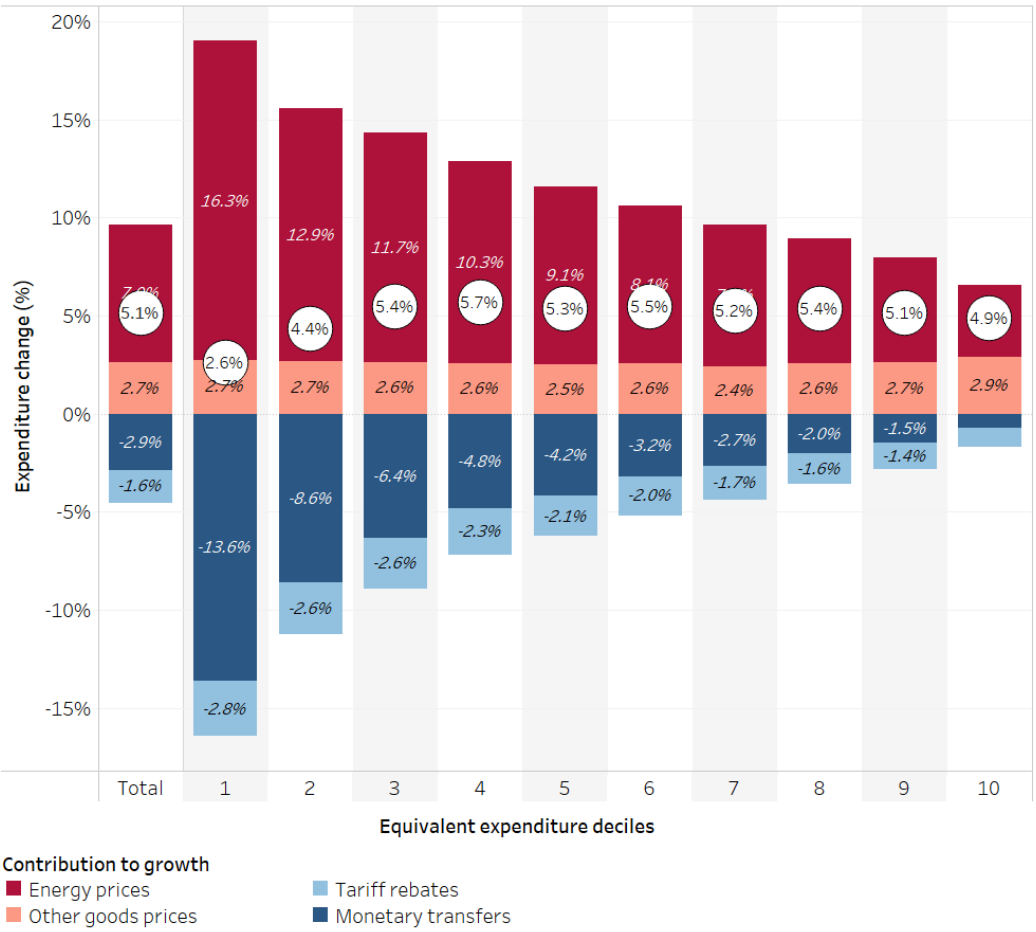
In order to assess the distributive effect of inflation and mitigation policies, Figures 5.4 and 5.5 show the impact on expenditure per decile of average equivalent expenditure.[148]

Figure 5.4 shows that, in 2022, price growth had a retrogressive impact, being it significantly greater on the lowest equivalent expenditure deciles (poor households based

[148] Household expenditure (net of imputed rent) related to the ISEE equivalence scale.

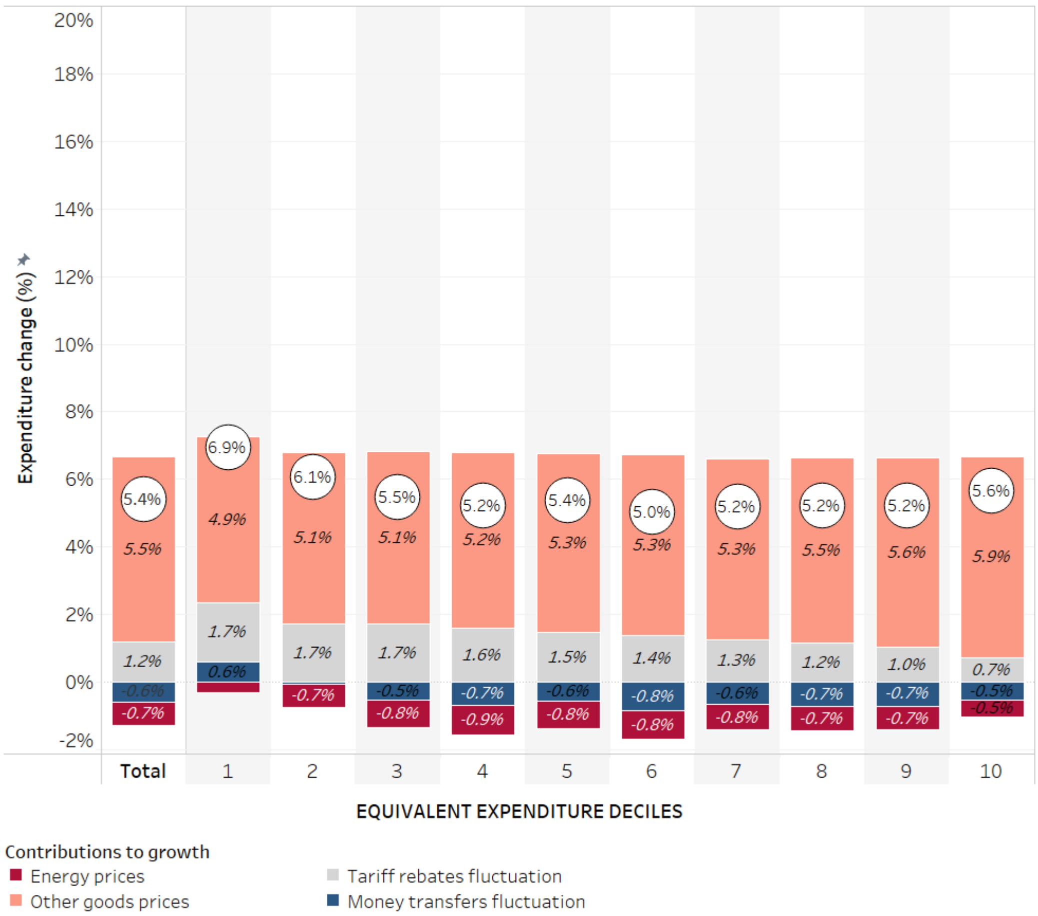
on their consumption) than on the remainder of the population. This is related to the decreasing impact, as expenditure deciles change, of the increase in energy prices (+16.3 per cent for the first decile and +3.7 for the tenth decile; red bars). By contrast, the impact of the increase in non-energy prices was broadly homogeneous across deciles and underpins the 2.7 per cent growth found in the first decile and at most 2.9 per cent growth in the tenth decile (orange bars). For the first decile, the increase in price without supportive policies would have led to an increase in expenditure of about 19 per cent (16.3 per cent due to the increase in the prices of energy products and 2.7 per cent due to the increase in the prices of other types of goods), 9.3 points higher than the national average and almost three times the impact on the tenth decile. This result stems from the greater weight that expenditure items with the highest increase (electricity, gas and food) have on the consumption basket of the relatively poorer households. Therefore, energy tariff mitigation measures (reduction of excise duties, system charges and VAT) and money transfers have a progressive impact (blue bars). The latter contribute to reducing expenditure by 13.6 per cent in the first decile and about 0.7 per cent in the last.

Figure 5.4 – Change in expenditure due to price developments between 2021 and 2022 per decile of equivalent expenditure before and after support measures



Source: simulations using the PBO microsimulation model.

Figure 5.5 – Change in expenditure due to price developments between 2022 and 2023 per decile of equivalent expenditure before and after support measures



Source: simulations using the PBO microsimulation model.

With reference to the first decile, money transfers almost entirely offset the specific negative effect of energy commodity price increase. Considering only money compensation, household expenditure in this decile would have increased by 5.4 per cent, compared to 5.9 in the tenth decile. Support measures granted as money transfers have a stronger impact on households with lower consumption patterns as well, both because they are granted to households with lower disposable income (measured by ISEE for social bonuses and by income for one-off allowances, social security contribution relief measures and measures on pensions), and because, being partly paid in fixed amounts, they are naturally progressive as expenditure increases. The combined action of measures on tariffs, social bonuses, one-off allowances, social contribution reliefs and measures on pensions, leads to a progressive distributive pattern: the net effect of price increases and mitigation measures is significantly lower for the first two deciles of expenditure than for the highest deciles (2.6 per cent and 4.4 per cent, respectively, compared to the average 5.1 per cent).

Figure 5.5 shows the results in terms of the distributive impact for 2023 in light of the trends already seen in inflation and those expected for the remainder of the year, and the mitigation measures planned to date, which differ from those planned for 2022 in terms of composition and size. The redistributive effect of mitigation policies recorded in 2022 ceases to exist. The net increase in expenditure in 2023 is expected to be greater for the first two deciles than for the last decile (6.9 per cent and 6.1 per cent, respectively, vs 5.6 per cent). The regressive trend is favoured by: the increase in energy expenditure determined by the downsizing of tariff rebates, which is greater for the lowest deciles; the weaker impact of energy price reduction, which less impactful on the poorest deciles as it involves the contraction of variable components only, with weaker effects on particularly low expenditure profiles; the lack of the protection secured by money transfers in the form of one-off allowances (particularly relevant for the lowest deciles) which is not offset by the new greater benefits stemming from the measures considered in 2023 on the same segment of the population (increased social security contribution relief measures and pension adjustment).

The results presented above assess the mitigation effects resulting from public policies alone. On the other hand, the potential effects following changes in individual behaviour such as, for example, the early liquidation of wealth or the shift in consumption towards goods with less dynamic prices or following macroeconomic factors such as favourable labour market and employment trends, have not been included. The potential significance of these effects is presented through a preliminary calculation of the reduction in energy consumption following the price increases analysed, using an approximate estimation of the historical data separated by quartiles of household expenditure (Figure 5.6).

The estimation of residential energy demand elasticities is based on a methodology developed by Bardazzi and Pazienza (2017 and 2020).[149] Data from the Household Budget Survey (HBS) are used to set up a pseudo-panel dataset containing annual data, for the period 1997-2019, on households grouped into cohorts on the basis of time-invariant characteristics[150] combined with information on energy prices and related tax components. A Partial Adjustment Model (PAM) is then used to estimate a dynamic demand model for electricity and gas[151] and elasticities for the different energy goods, cohorts and expenditure quartiles. The simulation used elasticities considering the tariff structure for customers in the protected market. Specifically, they were applied to the variable component of the bill only, with a consequently smaller effect for the lower expenditure quartiles on which the weight of the variable component is lower than on the fixed component. For free market customers, elasticities were applied to the relevant Istat price index.

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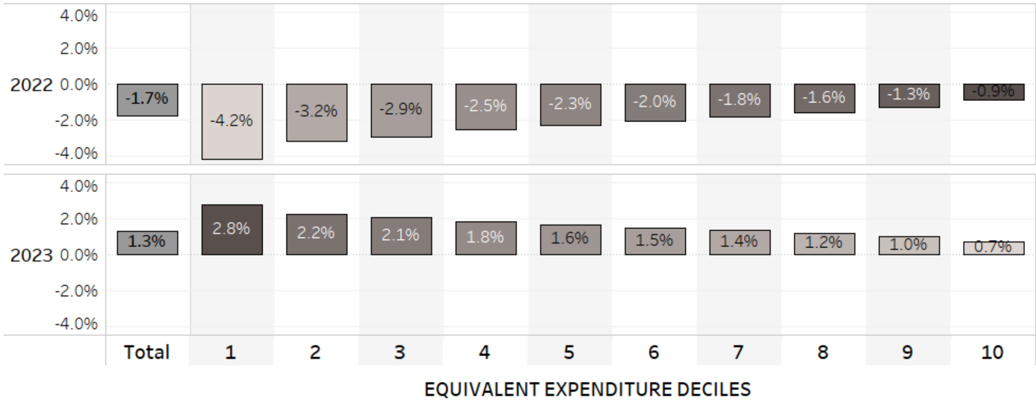
149 See Bardazzi, R. and Pazienza, M.G. (2017), 'Switch off the light, please! Energy use, aging population and consumption habits', Energy Economics, vol. 65, pp. 161-171 and Bardazzi, R. and Pazienza, M.G. (2020), 'When I was your age: generational effects on long-run residential energy consumption in Italy', Energy Research & Social Science, no. 70, 101611.

150 The main assumption underpinning the construction of a pseudo-panel is that units sharing the same time-invariant characteristics such as year of birth - and thus grouped in the same cohort - have similar behaviour and can therefore be treated as a single unit. This specific simulation used the quartile of total equivalent expenditure (as an approximation of income) as an additional characteristic. See Deaton, A. (1985), 'Panel Data from Time Series of Cross Sections', Journal of Econometrics, No. 30, pp. 109-126.

151 The WFP assumes an adjustment by consumers of their stocks of energy-using goods to increase energy efficiency.

Figure 5.6 – Estimated impact on total expenditure of the change in energy consumption in 2022 and 2023 by equivalent expenditure deciles



Source: simulations using the PBO microsimulation model.

The estimated elasticities appear to be higher than the average elasticities shown in the empirical literature but, as pointed out by Alberini and Miller (2016),[152] the estimated values are clearly influenced by the data used, with estimates on micro data tending to be higher than those with aggregate series as their basis. Moreover, most of the empirical literature is based on the US case, which is characterised by a general inelasticity of demand. Based on this evidence, it was considered appropriate to set a homogeneous upper limit on the value of elasticities across all deciles and all market types at 25 per cent. In assessing the role that elasticities may play in steering consumer behaviour in this economic phase, it is important to emphasise that the empirical literature has verified that the ordinary values of elasticities are altered in periods of strong price fluctuations.[153]

In 2022, as the shocks occurred, the reduction in consumption determined by applying historical elasticities could have contributed, on average, for 1.7 per cent to the decrease in expenditure. The potential impact of a consumption reaction to prices seems to be higher for households in the lowest deciles, even considering the strong relevance of the fixed charge on the bills of households consuming less. Marked changes for households already potentially rationed reveal the risk that, despite mitigation measures, the shock may significantly contribute to energy poverty.

In 2023, assuming energy inflation reduction, we might observe a partial recovery of energy consumption of accounting for 1.3 per cent of total expenditure, still applying historical elasticities. Again, the reactions are more pronounced in the lowest deciles due to the greater relevance of this type of expenditure in their basket.

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[152] Miller, M. and Alberini, A. (2016), 'Sensitivity of price elasticity of demand to aggregation, unobserved heterogeneity, price trends, and price endogeneity: Evidence from US Data', Energy Policy, no. 97, pp. 235-249.
[153] In this regard, Miller and Alberini (2016) note that households can be particularly more responsive to price changes if these are particularly high, implying a causal relationship between price levels and response to their changes. More recently, Peersman and Wauters (2022), on the basis of Belgian consumer survey data, point out that elasticity is asymmetrical during periods of rising and falling prices, with higher elasticity in periods of rising prices higher compared to periods of falling prices. In addition, Peersman and Wauters note that elasticity crucially depends on the significance of the price change and decreases greatly during large increases. For instance, households have an elasticity of -0.38 when the monthly constant consumption bill increases by EUR 20 and of -0.19 when the bill increases by EUR 100. See Peersman, G. and Wauters, J. (2022), 'Heterogeneous Household Responses to Energy Price Shocks', CESifo Working Paper No. 10157.

5.5 General remarks

The microsimulation model developed by the PBO to assess the effect of inflation on household expenditure allows for several considerations on the effectiveness of the compensatory policies introduced so far and the prospect of their gradual elimination. As 2022 was characterised by strong pressures on the prices of energy goods, both tariff policies and money transfers have allowed for an important gradual reduction in the impact on household expenditure, mitigating the cost of consumption, especially energy consumption and for the lowest deciles. It is worth noting that money transfers are more effective than tariff reductions in curbing expenditure growth for poorer households, which have experienced the largest increases. In 2023, the increase in the prices of non-energy goods and the rebalancing policy mix are generating quite weakly regressive effects on expenditure. Overall, for the 2022-23 two-year period, the mitigating measures had both a redistributive impact and a stabilising effect on the inflation shock: the change in expenditure, excluding the measures, was quite constant over the two years (5.1 per cent in 2022 and 5.4 per cent in 2023).

The assessment of the measures implemented to safeguard households' purchasing power in 2023 compared to the measures implemented for 2022 will necessarily be influenced by price developments until the end of the year, with regard to both energy goods and the other categories of goods affected by the initial inflationary spike. In particular, it will be crucial to assess the degree of inflation persistence and thus the time needed before a further decrease in energy prices and a restoration of price developments to more physiological values observed in pre-crisis periods.

As energy inflation eases and price increases spread to other asset classes during 2023, the review of mitigation policies will have to take several factors into account. First, the impact of lower energy prices on expenditure may not compensate for the growth induced by the gradual loosening of tariff measures. Second, inflation may be more persistent, thus requiring the reintroduction of some of the measures in the second half of 2023 to mitigate the effects of non-energy inflation. As a matter of fact, should the expected fall in the prices of energy goods stop or fail to reach levels close to those achieved before the inflationary crisis, it could become necessary to extend the tariff policies, currently financed only for the gas sector until April 2023 (extending VAT reductions to the entire second quarter of 2023), and/or to adjust the support policies. As for support policies, only social bonuses - for which the number of beneficiaries has also been increased - and social security contribution relief measures for employees within specific income levels are financed for the whole of 2023. Pensioners will be protected by the indexation mechanism, whose redistributive profile has been increased, establishing, *inter alia*, equalisation mechanisms by value groupings rather than by brackets. The possibility of gradually reducing price mitigation policies is thus influenced by the actual decrease in inflationary pressure, as shown by the reduction of the excise discount on fuels.

In light of these elements, should further compensatory measures be necessary during the remainder of the year, that they should be more decisively concentrated on the neediest households in order to emphasize their redistributive nature, be designed in such a way as to provide the necessary incentives to achieve more ambitious energy-saving objectives, also through market prices, and be supported by adequate financial coverage so as not to jeopardise public finances.

Appendix 5.1

Description of price increase mitigation measures

Below is a brief description of the policies implemented from the second half of 2021 onwards to compensate households for the increased expenditure triggered by the rise in the general level of prices, especially of energy goods.

The compensation of system charges for electricity used for domestic purposes and for low-voltage users and for gas was partially introduced for the first time in 2021 with DL 73/2021 with reference to the third quarter of 2021 mainly through money transfers to the *Cassa per i Servizi Energetici e Ambientali* (CSEA). The compensation became then total and was extended for the fourth quarter of 2021 by DL 130/2021, for the whole of 2022 by the Budget Law for 2022 and DLs 17, 50 and 115 of 2022 and, finally, for the whole of the first quarter of 2023 by the 2023 Budget Law for. Decree-Law 34/2023 also extended, for the gas sector only, the elimination of general system charges for the entire second quarter of 2023 and extended to April the elimination of the negative rates of the UG2C tariff component for natural gas consumption brackets up to 5,000 cubic metres/year. Finally, the same decree provided for the payment of a contribution for the fourth quarter of 2023, to partially offset heating costs should the wholesale price of natural gas exceed the threshold of EUR 45/MWh on a monthly basis and regardless of the heating mode.[154] The total outlay for this type of measure from 2021 to 2023 amounts to EUR 18.8 billion.

The reduction of VAT on gas for civil and industrial use to 5 per cent was provided for by DL 130/2021 and re-proposed for 2022 by the 2022 Budget Law and DLs 17, 50 and 115 of 2022. The measure was then extended to the first quarter of 2023 by the 2023 Budget Law and to the second quarter by DL 34/2023. The total estimated outlay from 2021 to 2023 is EUR 4.4 billion.

The reduction of excise rates on fuels was granted between 22 March and 31 December 2022[155] by inter-ministerial decrees of the Ministry of Economy and Finance and the Ministry of Ecological Transition[156] and by DLs 21, 38, 115 and 144 of 2022. The excise tax reduction is 25 cents on petrol and diesel, which corresponds to a discount of 30.5 cents before VAT, and 4.7 cents on LPG, which corresponds to a gross VAT discount of 5.7 cents. For the month of December 2022 only, DL 179/2022 provided for the reduction of the excise discount by 10 cents for petrol and diesel and 3 cents for LPG. It is worth noting that the reduction of excise duties on fuels is the only measure of tariff compensation not

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[154] The subsidy is in fact recognised by using the electricity utility that identifies the house of residence, regardless of a specific mode or fuel used for heating.
[155] The provision does not only apply in the period from 1 to 4 November 2022, for which, on examination of the measures concerned, no provision has been made.
[156] Decrees of 18 March, 6 April, 24 June, 19 July, 31 August, 13 September and 19 October 2022.

renewed for 2023. The Technical Reports estimate a total gross cost (on households and businesses) of EUR 8.5 billion in 2022 and 2023.

The social energy bonus can be of two types: for physical discomfort and for economic hardship. Both are allocated directly as a discount in the electricity, gas and water bill to reduce their cost. Their value is determined and updated by ARERA at the beginning of the year. The bonus for physical discomfort, which is compatible with the bonus for economic hardship, is granted without ISEE limits to households with a member suffering from serious diseases as established by the Ministry of Health Decree of 13 January 2011 and is granted upon submission of an application to the CAF (Tax Advice Centre) or the municipality of residence. The bonus for economic hardship is a discount on the energy bill and varies according to the composition of the household and is granted to: households with an ISEE not exceeding EUR 8,265 with fewer than four children or an ISEE not exceeding EUR 20,000 with at least four children or beneficiaries of a citizenship income (Reddito di Cittadinanza - RdC or Pensione di Cittadinanza – PdC) who hold an electricity and/or natural gas and/or water supply contract with a household tariff. Each household is entitled to only one bonus (water, electricity or gas) per year as per the DSU (Single Self-Declaration) (so-called 'unique constraint'). Introduced by Law 266/2005 (the 2006 Finance Act) and implemented by the Decree of the Ministry of Economic Development (MISE) of 28 December 2007, the social energy bonus has been often amended in terms of percentage of the expenditure discount (initially 20 per cent, then 15 per cent and finally 30 per cent), in terms of ISEE thresholds for entitlement to the benefit, and in terms of extension to gas and water expenses. The MISE decree of 29 December 2016 reformed the energy bonuses for economic hardship by providing for a compensation value of 30 per cent and tasking ARERA with updating the ISEE reference value every three years, based on the average national FOI index (consumer price index for blue and white-collar worker households). Finally, DL 124/2019 established that social energy bonuses shall be automatically granted to eligible households as from 2021.

Decree Law 130/2021 adjusted the energy bonuses for households with an ISEE of less than EUR 8,265 per year, large households (with at least four children and an ISEE of less than EUR 20,000 per year), RdC or PdC beneficiaries, and users of electro-medical equipment in precarious health conditions in order to offset the increase in energy prices. Tariff relief measures continued to be improved in 2022 with the 2022 Budget Law and DLs 17, 115 and 176 of 2022. Decree Law 21/2022 raised the ISEE threshold for the first type of households (with less than four children) to EUR 12,000, and DL 80/2022 (converted into DL 50/2022) granted the energy bonus for economic hardship, retroactively from January 2022, also to those households that had submitted an ISEE certificate in 2022 that entitled them to receive the social energy bonus. The 2023 Budget Law, in addition to extending the bonus, further extended the number of beneficiaries, including households with an ISEE threshold within EUR 15,000, and introduced a *decalage* for the energy bonus based on the ISEE value for households with less than four children so as to ensure the greatest savings for households with lower ISEE levels[157]. Finally, DL 34/2023 extended the social energy bonuses based upon the disbursement mechanism amended by the 2023 Budget Law and raised the ISEE threshold for entitlement to the payment of social energy bonuses for households with at least four children to EUR 30,000 from the second quarter of 2023. Overall, the measures to strengthen the energy social bonuses imply a total outlay of EUR 6.2 billion from 2021 to 2023.

By way of exception, DL 115/2022 provided that a portion of the 2% pension adjustment, was to be granted, as a transitional measure, in the last quarter of 2022, for a total net outlay of EUR 1 billion in 2022[158]. In addition, it was provided that the equalisation adjustment for 2021 pensions was to be brought forward to 1 November 2022 to the extent of 0.2 per cent, entailing a net additional outlay of EUR 0.6 billion in 2022 and a reduction in the outlay for 2023. For 2023, a 1.5 per cent adjustment is expected for pensions at or below the minimum threshold. The total outlay for the pension adjustment measures is EUR 1.5 billion in the 2022-23 period.

Both one-off benefits, i.e. the EUR 200 benefit introduced by DL 50/2022 and the EUR 150 benefit provided by DL 144/2022, were aimed at supplementing the income of a large number of workers and pensioners, selected through a criterion based on individual income[159]. As regard the first one-off benefit, in order to be eligible, the monthly taxable income had to be lower than EUR 2,692, corresponding to EUR 35,000 per year, or about 1.7 times the average income of the individuals concerned[160]. According to the Technical Report, more than 13 million employees and the same number of pensioners were to benefit from the above measure, in addition to about EUR 2.8 million NASPI/DIS-COLL beneficiaries, holders of coordinated and continuous collaboration contracts, domestic, seasonal, entertainment and occasional workers. Similar benefits were paid to RdC beneficiaries (0.9 million individuals). Decree Law 115/2022 extended the number of beneficiaries of the allowance also to: workers with an employment relationship in place as of July 2022 who had not benefited from the exemption from socials security contribution established by Law No 234/2021; pensioners whose pension effective date was 1 July 2022; PhD students and assignees; and sports collaborators who had already

157 In this regard, it is worth noting that the Explanatory Report of DL 34/2023 suggests that, in implementation of the provisions of Article 1, paragraph 18 of the 2023 Budget Law, a reduced bonus is granted to beneficiaries with an ISEE value between € 12,000 and € 15,000. In particular, it is specified that ARERA has provided that for this ISEE band the *bonus* is equal to 80 per cent of the value recognised to beneficiaries with ISEE values below EUR 12,000. ARERA Resolution 13/2023 provides that the ISEE threshold above which a reduced bonus shall be granted is EUR 9,350.

158 The increase is granted for pensions of EUR 2,692 or less.

159 For the support of the purchasing power of self-employed workers and professionals, DL 50/2022 set up a fund with a maximum budget of EUR 500 million, increased to 600 million by DL 115/2022.

160 Eligible employees are those who have benefited from the social security contribution exemption referred to in Article 1, paragraph 121 of the 2022 Budget Law, i.e. those for whom the taxable salary, based on a monthly basis for thirteen months, does not exceed the monthly amount of EUR 2,692, increased, for the month of December, by the accrual of the 13th month payment. For pensioners, including social allowance, civil invalidity pension and attendance allowance beneficiaries, the income threshold shall refer to 'total personal income' for tax purposes.

benefited from the relief granted to cope with the COVID emergency. The additional EUR 150 one-off allowance introduced by DL 144/2022 was granted to the same types of beneficiaries as the EUR 200 one-off allowance. However, the income criterion for entitlement to the allowance limited the number of beneficiaries to workers and pensioners with a monthly taxable income not exceeding EUR 1,538, corresponding to EUR 20,000 of total annual income. The total outlay of these measures was estimated at EUR 10.2 billion for 2022-23.

By way of exception, the 2022 Budget Law introduced a reduction of 0.8 per cent in social security and welfare contributions for 2022, intended for workers with a monthly salary of EUR 2,692 (EUR 35,000 per year), with no effect on the benefit calculation rate. DL 115/2022 increased the social security contribution relief rate to 2 per cent for the second half of 2022. The 2023 Budget Law extended the social security contribution relief also to 2023, at the rate of 2 per cent for monthly incomes up to EUR 2,692 and 3 per cent for incomes below EUR 1,932. Decree-Law 48/2023 raised the social security contribution exemption by a further 4 per cent, to 6 and 7 per cent respectively, from 1 July to 31 December 2023. The outlay for the measures was estimated at a total of EUR 10.9 billion for the 2022-23 two-year period.