PBO hearing on the Budget Bill for 2025

Press release

Rome, 5 November 2024 | Today, the **President of the Parliamentary Budget Office Lilia Cavallari** presented the PBO’s assessment of the **2025 budget manoeuvre** in a hearing before the Joint Budget Committees of the Chamber of Deputies and the Senate of the Italian Republic. The memorandum contains an analysis that, starting from the macroeconomic scenario and the financial impact of the manoeuvre, develops in-depth studies on the main measures, in particular on the tax, health, pensions, birth rate and territorial authorities chapters. Below is a summary of the contents of the memorandum.

- ***Manoeuvre in line with deficit targets and MTFSP net expenditure path***
- ***Downward risks on GDP, the international scenario and the NRRP weigh in***
- ***An organic design for the Country’s productivity growth is needed***
- ***Main beneficiaries of the manoeuvre are employees with low to middle incomes***
- ***Measures on tax wedge and rates become structural, while for businesses measures are fragmented***
- ***Increased Irpef progressivity[?]but with greater complexity and disparities among taxpayers***
- ***Healthcare funding grows less than expenditure with risk of regional deficits***
- ***Contribution of local authorities has to be consistent with the protection of core functions and essential levels of performance (ELPs)***

The macroeconomic scenario and the future risks

The **international context** in which the 2025 manoeuvre takes place is fragile and uncertain, especially due to geopolitical tensions; ongoing wars have already tangible impacts on international trade, whose prospects may be affected by new tariffs, and on raw material prices. The international economy is fragmented and the actions of Governments and central banks are becoming more uncertain, particularly in Europe, where Germany’s weak business situation is weighing heavily.

Italy is slowing down and sees the long wave of the “post-pandemic rebound” of the three-year period 2021-2023 come to an end; growth returns in line with previous values. Italian GDP stagnated in the third quarter; the PBO’s short-term models see a moderate recovery in the last three months of the year.

Last month, at the hearing on the 2025-29 Structural Budgetary Plan (MTFSP), the PBO endorsed the **macroeconomic forecasts** of the Draft Budgetary Plan (Documento programmatico di bilancio, DBP) as being acceptable, but exposed to several downside risks. In the DBP, GDP growth strengthens next year to 1.2 per cent (from 1.0 per cent in 2024), while it slows to 1.1 per cent in 2026 and to 0.8 per cent in 2027. The most recent quarterly national account data worsened expectations on 2024 by at least a couple of tenths of a percentage point but, net of this revision, the official forecasts are close to the range of the most recent estimates of other external forecasters.

The fiscal stimulus remains moderate throughout the five-year horizon of the Plan. In the macroeconomic scenario of the DBP, the manoeuvre has an expansionary effect of 0.3 GDP points in 2025 (mainly attributable to the stimulus to domestic demand from the tax measures for low-income earners), no effect in 2026 and a barely positive impact in 2027. According to simulations carried out with the MeMo-It econometric model used by the PBO, the GDP impacts of the manoeuvre would be similar over the whole period to those indicated by the Government, albeit with a slightly different distribution over time (marginally lower in 2025 and slightly stronger in 2027).

The **GDP growth target** of 2025 hinges on the assumption that **foreign demand** will strengthen as a result of the strengthening of world trade, which is however exposed to several critical issues; the quick implementation of reforms and projects related to the **NRRP** will also be crucial. The dynamics of Italian economic activity would be driven mainly by **domestic demand** (recovery of consumption, sustained dynamics of public and private investments).

With the depletion of the NRRP funds and the unfavourable demographic trend (decline in the working population), after 2027 the **growth of potential output** can remain positive **only due to a structural increase in productivity**.

Besides **external risks** on international trade, energy and commodity prices and market volatility, there is an increasing need to take account of other relevant negative factors. As the recent tragic events in Spain warn, **environmental and climate change** could divert resources away from development in the coming years.

The financial impact of the 2025 manoeuvre

The budget manoeuvre is part of the new framework of fiscal rules adopted by the EU last April. The targets embedded in Italy's MTFSP, submitted to the European Commission on 15 October, envisage a debt reduction through budgetary consolidation over seven years; **the targets seem consistent** with the net expenditure path of the new EU governance scenario. The Budget Bill initiates this **ambitious multi-year path of public accounts consolidation, which will have to be sustained over time**.

The impact of the manoeuvre is **consistent with the programme targets for the gradual reduction of the deficit-to-GDP ratio** set out in the 2025-29 MTFSP and the 2025 DBP (from 3.8 per cent in 2024 to 3.3 in 2025, to 2.8 in 2026, and to 2.6 in the following year), which envisage the return of the deficit to below 3 per cent of GDP by 2026. The gross manoeuvre is 35.3 billion in 2025, 40.2 in 2026 and 49.4 in 2027. Financing is almost stable, amounting to 24.9 billion in 2025, 24.7 in 2026 and 23.1 in 2027.

The **main beneficiaries of the manoeuvre are households**, with a net benefit of **55 billion** over the three-year period (15.2 billion in 2025, 19.4 in 2026 and 20.4 in 2027), mainly due to measures in support of the employees. Also having a positive impact on the household sector are the refinancing of the National Health Service and measures in the social, pension and parenting sectors. On the other hand, **measures aimed at businesses and the self-employed** improve the balance in 2025-26 compared to the current-legislation scenario (by EUR 6.4 billion on average in each year), as a result of measures on both revenue and expenditure.

Over the three-year period 2025-27, **labour revenues are significantly reduced**, mainly due to the stabilisation of the benefits from the reduction of the tax wedge, while **consumption revenues increase**, mainly due to the feedback effects of the indirect tax manoeuvre.

Revenue on the capital factor increases in 2025-26 (due to various measures, including the suspension of DTAs, stamp duty on insurance products, and the revaluation of land and participations) and decreases from 2027 (recovery of deferred tax assets and extension of the increase in deductions on hiring 2025-27).

General considerations on the manoeuvre

The Budget Bill is marked by **prudence and responsibility** in the perspective of medium-term consolidation of public finance. The measures introduced have, however, used up all the available budget space - for both deficit and net expenditure - so that the effects of **any new future** budgetary policy **proposals will have to be covered by revenue increases or structural expenditure reductions**.

From a multi-year planning perspective, it is important to have **made temporary provisions of previous manoeuvres structural**. Moreover, **refinancing and definancing** of expenditure programmes are **geared to a more realistic medium-term trend** in public accounts; expenditure cuts are no longer postponed to the last year of the programme, but savings are decreasing and seem to be aimed at **maintaining investment expenditure** at levels of the previous years, even after the end of the NRRP.

However, **some critical issues** emerge, both of a general and more specific nature:

- In the Budget Bill, the summary tables of the financial effects of the manoeuvre stop at 2027, resulting in a significant lack of information that limits the ability to fully assess the manoeuvre (a shortcoming already found in the 2025-2029 MTFSP).

- The technical reports of the measures do not always allow quantifying their effects, including for the purpose of estimating the net expenditure path.

- The effects of fiscal feedback are included in the quantification of the manoeuvre - for financing purposes - whereas it would have been prudent not to account for them.

- Several measures are in the nature of revenue anticipation, with initially positive impacts that become negative in subsequent years: they therefore do not provide structural resources.

- The amounts of the contractual renewals of the civil service for Authorities other than the central Government administrations are not quantified, since they still have to identify the resources within their budgets, nor is the value of vacant-contract indemnity (*indennità di vacanza contrattuale*, i.e. the indemnity paid when the old contract has expired and the new one is still to be signed) for the three-year period 2025-27, payable from 2025, indirectly inferable for the central Government administrations only.

- The presence of "linear cuts" in expenditure still prevails in the absence of an effort to rationalise expenditure, which should have resulted from the public policy assessment and spending review activities long since initiated by the Ministry of finance.

On the development of public accounts, the aforementioned **uncertainties** on the international scenario and the strong criticalities on the full and timely implementation of the reforms and investments of the NRRP should also be considered.

In conclusion, the budgetary manoeuvre is part of the ambitious path of public finance consolidation in the medium term outlined in the MTFSP and introduces **several elements of strategic planning**. However, it appears **only partially embedded in an overall economic policy vision.** Many interventions do not follow a comprehensive reform design nor appear to adequately support the growth potential in line with the reforms and investments on which the call for an extension of the budgetary adjustment period to seven years is based.

Net expenditure growth and orientation of budgetary policy

Considering the trend scenario and the measures envisaged in the Budget Bill, the **forecast growth of net expenditure** for 2025 is 1.3 per cent, in line with the policy target set in the MTFSP. Expenditure growth before the impact of discretionary revenue measures (DRM) is 2.4 per cent, compared to 2.1 per cent estimated in the unchanged legislation scenario. The impact of DRMs is EUR 11.2 billion (0.5 percentage points of GDP) compared to the EUR 20.5 billion envisaged in current legislation.

However, the DBP **lacks information on the net expenditure growth for 2026 and 2027, which makes it impossible to make assessments** about the consistency of the budgetary manoeuvre with the growth of net expenditure planned in the MTFSP for these two years.

The budgetary policy stance for the three-year period 2025-27 is projected to be **restrictive and counter-cyclical**: in 2025 the overall stance is broadly neutral including expenditure financed by EU transfers; in 2026 the restrictive stance is softened by the increase in expenditure financed by EU transfers, while in 2027 it worsens significantly due to the disappearance of NGEU transfers.

Interventions in the fiscal sphere

The Budget Bill introduces a reform with structural coverage that goes beyond the logic, adopted in recent years, of temporary interventions to reduce the tax wedge. First, **there is a stabilisation of the merging of the personal income tax (Irpef) rates** and the increase of the employee deduction for incomes up to EUR 15,000 provided only for 2024 based on the implementation of the principles of the enabling law on the tax reform. This component of the reform entails a full-year cost of 5.1 billion (net of the effect on local surtaxes). Second, **the temporary contribution relief is replaced by two structural measures**: a bonus for employees with incomes up to EUR 20,000 calculated with differentiated rates on taxable income, and an additional employee deduction of EUR 1,000 for incomes between EUR 20,000 and EUR 32,000, which then gradually decreases to zero at EUR 40,000. The bonus guarantees an average benefit of EUR 490 for about 9 million taxpayers; from the additional deduction comes an average benefit of EUR 870 for another 9 million taxpayers.

The result is a new Irpef structure characterised by a **significant redistributive orientation**, with a focus on supporting low and medium wage earners. At the same time, an articulated system emerges in its structure, which may require **further rationalisation interventions in the future** to optimise its overall functioning.

Overall, the analysis of distributional effects shows a **concentration of benefits on employees**, with differentiated impacts per occupational category. Blue-collar workers receive an average benefit of EUR 692, corresponding to 4.1 per cent of income, while for white-collar workers the benefit is EUR 766, corresponding to 2.4 per cent of income. Executives, pensioners and self-employed receive smaller benefits of EUR 280, 118 and 165 respectively.

The reform **increases the already large differences in tax treatment** for different categories of taxpayers (employees, pensioners and self-employed) which, however, cancel out for incomes above EUR 50,000. The coexistence of three instruments for reducing the tax burden on employees, which interact with each other in an articulated manner, **produces a complex tax architecture that is difficult for its recipients to perceive**.

There is a **higher incidence of benefits on the lowest deciles of household income**, while maintaining a significant impact on the middle deciles, with 40 per cent of total resources flowing to the first five deciles.

The Budget Bill also intervenes on **tax deductions for expenses**, introducing a new capping mechanism for taxpayers with income above EUR 75,000. Once fully operational, when all multi-year expense instalments will be subject to the new restrictions, about 28 per cent of taxpayers with income over EUR 75,000 (about 312,000 individuals) and about 40 per cent of those with income over EUR 100,000 would be affected by the cuts. Overall, approximately 49 per cent of the expenditure would be non-deductible, amounting to EUR 3.1 billion, of which 0.6 billion related to taxpayers in the range between EUR 75,000 and EUR 100,000 (approximately 28 per cent of the expenditure) and 2.5 billion in the upper range (approximately 60 per cent). The **limit on total deductible expenses** does not operate a selective rationalisation, but rather a linear cut of benefits that differ in type and purpose. Although the reform is a step in the direction of containing tax expenditures, a more organic approach to their rationalisation is needed, also to avoid increasing the complexity of the system.

On **income of a financial nature**, the Budget Bill expands the heterogeneity of tax rates either explicitly, by raising the tax rate on gains from crypto-assets to 42 per cent, or implicitly, by making permanent the possibility of revaluing the purchase cost of participations and land by paying a substitute tax of 16 per cent.

The **measures for enterprises** are difficult to place within the scope of the enabling act to reform the tax system. The most significant measures, bringing forward 3.5 and 1.9 billion in revenue in 2025 and 2026 respectively, are related to banks and insurance companies. They basically provide only a different time distribution of the revenue and at most entail a lower cash availability for companies, which can be recovered from 2027, and a cost on the expected return. There is a risk that the Technical Report underestimates the expected revenue shortfall from 2027 when the quotas can be recovered. The Budget Bill also provides for the extension of the employment incentive for only two years, and after the repeal of the ACE (Allowance for Corporate Equity), the new investment incentive envisaged in the enabling law and, more generally, a mechanism to re-establish the tax neutrality of the sources of financing has not yet been outlined. Overall, the measures appear fragmented and mostly oriented towards financing the manoeuvre.

Health, pensions and incentives for childbirth

Despite the fact that the manoeuvre envisages **refinancing of the National Health Service** (NHS) in increasing amounts (from 1.3 billion in 2025 to 8.9 in 2030, including resources for contractual renewals), the growth rate of financing is still lower than the policy nominal GDP. Any changes to increase allocations would require reductions in other expenditure items or discretionary revenue increases. In terms of incidence on GDP, health expenditure would return to 6.4 per cent (pre-pandemic level) in 2026. Considering that the health expenditure is expected to grow at a higher rate than the financing of the NHS, there is a risk of a significant increase in the deficit of Regional Health Services (RHS), even beyond 2027.

Despite the fact that the main problem in the NHS currently lies in **staff shortages**, no new recruits are funded. The financing of the next contractual rounds and the increase of a number of allowances are arranged. Another group of measures is in favour of certain private actors in the health and pharmaceutical sector. In addition, there is an intervention in the **distribution of funding between Regions**, plausibly favouring those with stronger RHS.

For the **pension chapter**, among other interventions, the Budget Bill confirms the main temporary channels to leave early the labour market and introduces a tax incentive for staying at work beyond the attainment of the ordinary retirement requirements, the effectiveness of which will also depend on how workers themselves respond to the incentives. The reconfirmation of tight conditions for access to flexible exit measures foreshadows a limited take-up, especially for the *Opzione Donna* and *Quota 103* options. The tax exemption of contributions received in the payroll makes the measure aimed at extending working life more attractive than the interventions of the last two years. The very close relationship between lower contributions today and lower pensions in the future, which exists in the Italian contributory system, makes the tax exemption introduced for 2025 crucial for evaluating the measure's convenience.

The Budget Bill allocates increasing resources, about one billion a year when fully operational, to the financing of **policies to support the birth rate and early childhood.** The birth bonus is reintroduced and support for the payment of nursery school fees and home care is extended. The measures redesign the profile of economic support for families with children and an ISEE not exceeding EUR 40,000, overlapping the Single Universal Allowance in the case of the birth bonus and merging the ISEE ranges for the daycare bonus. Parental leave is strengthened.

Local and regional Authorities

The manoeuvre affects local Authorities on two levels: measures to ensure **their contribution to public finance balances and compliance with the new EU rules**, and to

reinforce certain types of current expenditure (Municipal solidarity fund or FSC, Child Aid Fund, fundamental functions of municipalities and local public transport).

For current expenditure, the restrictive effects of the contribution to public finance in the planning period are largely offset for municipalities as a whole by the increase in the FSC and completely neutralised for provinces and metropolitan cities by the increase in resources for fundamental functions. On the other hand, the overall net effects on capital expenditure are negative, as the expected utilisation of reserves imposed by the contribution to public finance does not appear sufficient to offset the defunding of investment programmes.

The manoeuvre may also lead to a significant **redistribution of resources within the sector**. A significant portion of the definancing concern resources with quotas reserved for Southern Italy regions and small municipalities, but capital expenditure incurred with any surpluses set aside by local Authorities may not replicate these constraints. The criteria for allocating the contribution to public finance and the additional financing of the FSC should be consistent with the infrastructure needs and the financing requirements of fundamental functions and ELPs. There is a risk that the squeeze on current expenditure will result in the accumulation of earmarked resources in local Authorities budgets or in their inefficient use, with possible benefits for public finance balances but to the detriment of growth opportunities for local communities.

Moreover, in order to avoid jeopardising the **financing of fundamental functions and ELPs**, it is desirable that the distribution of the contribution of equalisation funds based on standard requirements and fiscal capacity be consistent with the criteria governing these funds.