MINISTERO DELL'ECONOMIA E DELLE FINANZE

# ITALY'S DRAFT BUDGETARY PLAN 2016

Ministero dell'Economia e delle Finanze

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Submitted by Minister of Economy and Finance
Pier Carlo Padoan

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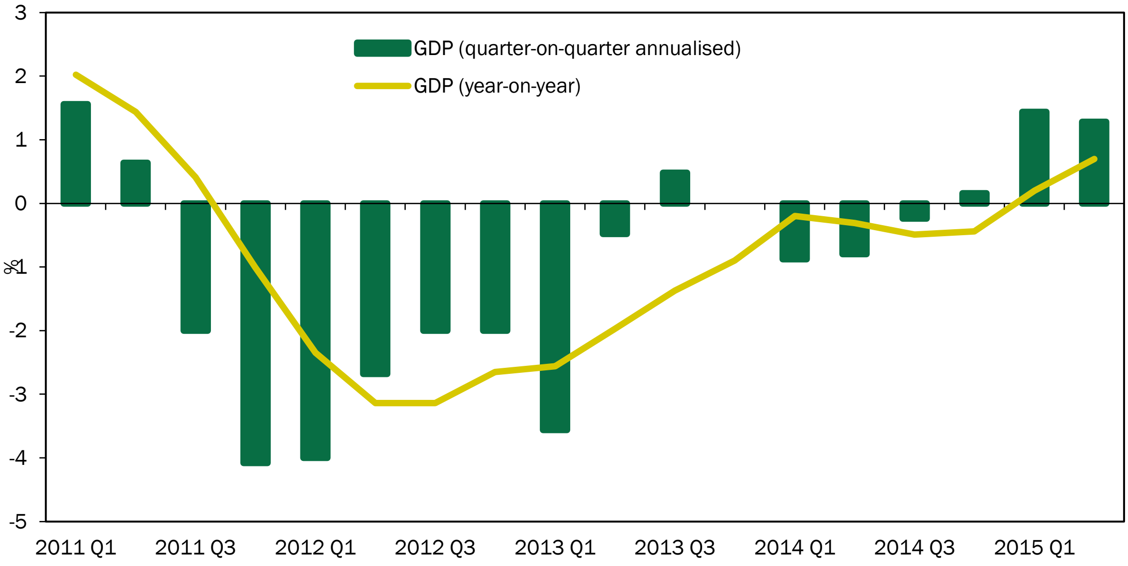
# I. MACROECONOMIC OUTLOOK AND FISCAL POLICY

## The Italian economy is recovering, firms and consumers more upbeat

The Italian economy is recovering. In the first half of the year real GDP grew at an annualised rate of 1.4 percent over the fourth quarter of 2014. A continuation of this positive tendency is expected for the remainder of the year and the medium term despite a global economic environment that appears more challenging than in April, at the time of the 2015 Stability Program.

In the recent Update of the 2015 Stability Program (*Nota di Aggiornamento del Documento di Economia e Finanza*), the government raised the official real GDP growth forecast for 2015 from 0.7 to 0.9 percent and the one for 2016 from 1.4 to 1.6 percent. Projections for subsequent years were also increased while sticking to a prudent assessment.

**Figure I.1-1 Real GDP growth**



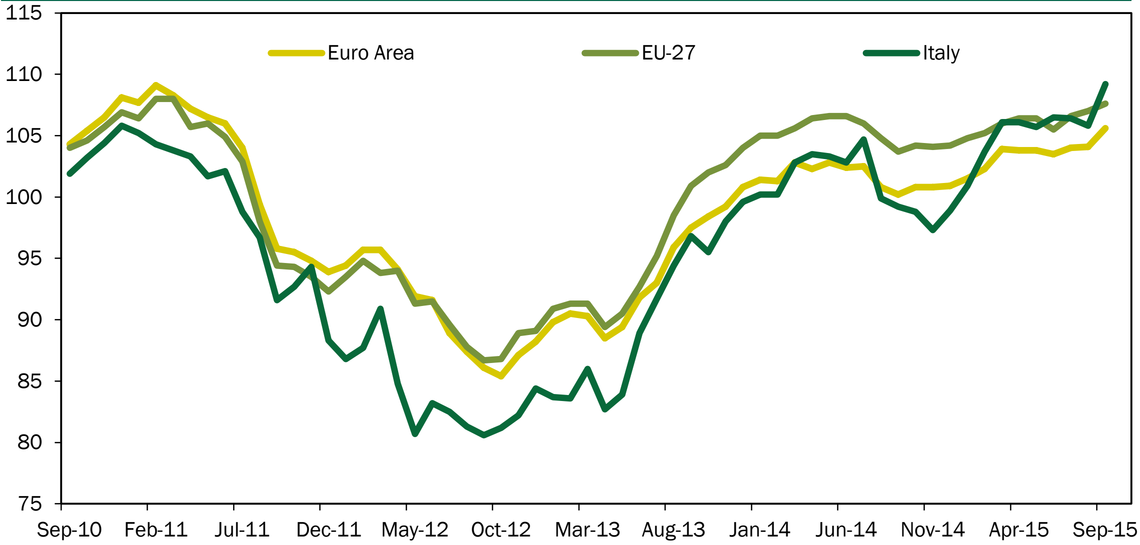

Source: ISTAT.

The upward revision in the growth forecasts is based on two main factors. First, the recent performance of the economy has been more favourable than previously expected, both on the domestic and the export side.

A number of indicators suggest that the Italian economy performed well in the third quarter, particularly the service sector. Employment is growing, reflecting both cyclical factors and increased labour market flexibility. Business and consumer confidence in September rose to a new post-crisis level.

Italy's Economic Sentiment Index is now among the highest in Europe. Improving 'hard data' and confidence indicators not only imply a more favourable starting point for the forecast, but also suggest that structural reforms and the improvement in monetary and financial conditions are gaining traction.

**Figure I.1-2 Economic sentiment indicator**

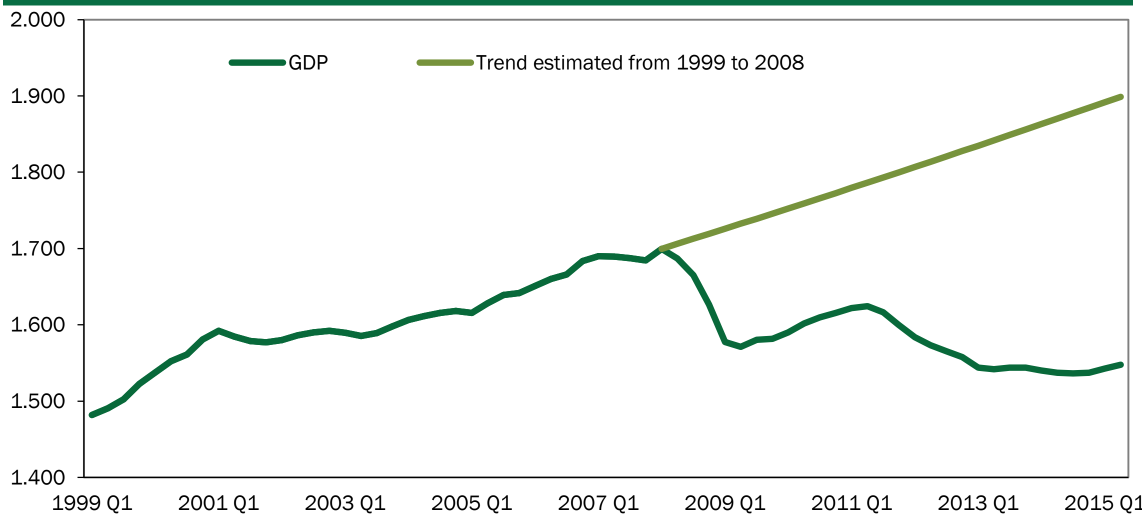



Source: European Commission.

The second factor underlying the forecast is the adoption of a more growth-friendly budgetary policy. Italy's priority is to reverse the rise in general government debt as a share of GDP and to achieve a marked reduction in the debt ratio over the forecast horizon. The realisation of this goal, however, rests not only on budgetary discipline but also on a return to sustained GDP growth.

In fact, while recent trends are quite encouraging, the Italian economy is still at an early stage of economic recovery. The degree of slack in resource utilisation is unprecedented. Although the unemployment rate has declined significantly in recent months, it is still close to 12 percent. Real GDP is twenty percentage points below its pre-crisis trend. Still-weak domestic demand compounds the structural problems which led to low economic growth rates even before 2008.

**Figure I.1-3 Real GDP 1999-2015 and trend 1999 Q1-2008 Q1 (in € billion)**




Note: Chained quarterly data, seasonally adjusted, annualized and adjusted for calendar effects (2010).

Source: MEF calculation based on ISTAT data.

In order to enhance the growth potential of the economy, the government aims to significantly reduce the tax burden on companies and households and to stimulate private investment. To this end, it wishes to make full use of the flexibility available within the Stability and Growth Pact (SGP).

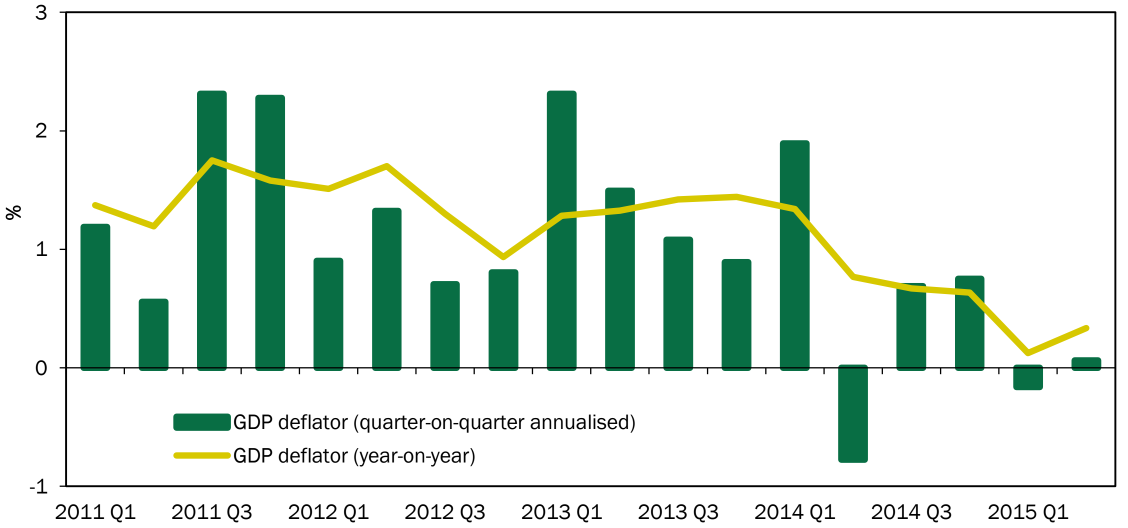
## Challenging external environment, deflationary forces still at work

The recent wave of immigration from Africa and the Middle East not only raises humanitarian concerns, but also has substantial economic repercussions for Italy, given its geographical proximity and exposure to the influx of migrants and refugees from Northern Africa and the Middle East.

Meanwhile, the world’s largest emerging economies are slowing down and even contracting in some cases, which creates downward pressures not only on commodity and energy prices, but also on finished goods’ prices.

Partially reflecting these global trends, Italian inflation is running below the rates predicted in the 2015 Stability Program. Despite higher real output growth, the virtual stability of the GDP deflator in the first half of the year and signs that deflationary pressures remain strong have led us to revise down our inflation and nominal GDP growth projections.

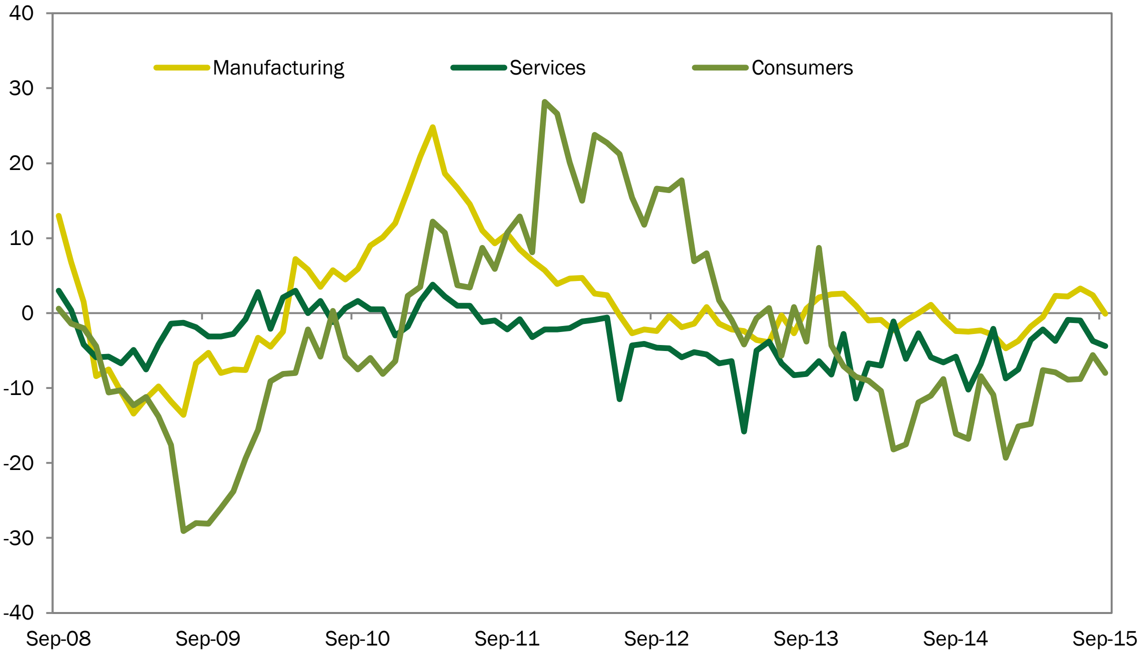
**Figure I.1-4 GDP deflator**




Source: ISTAT.

Near-deflation conditions in the presence of unprecedented monetary policy stimulus and returning output growth is a clear sign that the economy is in exceptional circumstances.

**Figure I.1-5 Prices expectations**




Note: Monthly data, seasonally adjusted.
Source: European Commission.

## A growth-friendly budgetary strategy underpinned by structural reforms

This Draft Budgetary Plan builds on the recent Update of the 2015 Stability Program, which was approved by the Council of Ministers on 18 September and by Parliament on 8 October. The Update was presented along with a report required by national law which updates progress towards the Medium Term Objective (MTO) of a balanced structural budget.[1]

Compared to April's Stability Program, the updated plan targets a more gradual improvement in the general government fiscal balance. As mentioned above, the government wishes to make greater use of the flexibility within the SGP and is invoking both the European regulation concerning structural reforms[2] and the public investment clause. The government will also seek additional budgetay margins to reflect the budgetary impact of the influx of refugees and migrants.

In the 2015 Stability Program, Italy applied for a 0.4 percentage point deviation from the convergence path towards the MTO in 2016 to reflect its substantial plan of structural reforms.

The government has now decided to utilize the additional 0.1 percentage point allowable within the SGP[3] on the basis of structural reforms. Chapter II of this document reviews recent progress on structural reforms ranging from the constitutional framework and the electoral law, to the labor market and the opening up of the service sector. It also discusses in detail the changes in bankruptcy law and

[1] Law No. 243/2012, Article 6.
[2] European Regulation No. 1466/97, Article 5.
[3] European Regulation No. 1466/97, Article 5, par. 5 and Law No. 243/2012, Article 3, par. 4.

in the tax treatment of banks' nonperforming loans that were implemented with Law No. 132, 6 August 2015. Such changes aim to enhance banks' ability to offload nonperforming loans and to extend new credit to the economy. The measures will enhance the growth potential especially in the medium-term. As such, they are fully in line with the rationale for the flexibility granted within the SGP preventive arm.

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**The macroeconomic effects of some measures of the decree n. 83 of June 27, 2015**

Among the reforms of the second half of 2015 not included in the previous reforms assessment of Italy's National Reform Plan and yet eligible for the application of the structural reform clause, there are the interventions on bankruptcy law to accelerate the judicial procedures for debt recovery. In what follows an evaluation of these measures is provided.

The decree n. 83 of June 27, 2015 (converted with modifications into law n. 132 of August 6, 2015) deals with bankruptcy, civil and civil procedure legislation and with the functioning of the judicial system. It introduces important provisions to increase the speed and efficiency of the insolvency and liquidation procedures. Moreover, it features new provisions for the tax treatment of losses on loans for banks and insurance companies, with the possibility for them to immediately deduct losses from taxable income in one year only rather than in five years as under the previous regime.

The reduction in foreclosure times and in the length of the insolvency and liquidation procedures should pave the way for a contraction of nonperforming loans (NPL) in the bank balance sheets. Their high incidence in the Italian banking system compared to many other countries reflect, apart from the adverse cyclical conditions, the slow pace of legal procedures for debt recovery which inevitably causes the nonperforming loans to be stuck in the banks' account for a relatively long time span.

The measures recently adopted should allow banks to recover the nonperforming loans more easily with an ensuing parallel increase in the value of these assets. The removal of nonperforming loans from bank balance sheets can be fostered by a higher reliance on transactions where these types of loans are disposed to investors through their sale or securitization. In particular, the large amount of time required to foreclose have contributed thus far to a sizeable gap between book values of nonperforming loans on bank balance sheets and the corresponding prices that investors are willing to pay for them (pricing gap). This of course has discouraged credit disposal and the new rules are expected to act in the direction of reducing this gap, although gradually.

With regard to the provisions pertaining to the tax treatment of losses on credit, the possibility of immediately deduct losses from taxable income in one year rather than in five years and the parallel gradual removal from the bank balance sheets of Deferred Tax Assets (DTA) avoids tax payments to be made in advance which so far has absorbed liquidity from the banking system; moreover it attenuates the pro-cyclical nature of the tax treatment of losses on credit. Also these tax provisions contribute to increase the incentives for banks to write down (or write off) nonperforming loans, although a transitory regime on these tax issues will in fact postpone to the year 2018 the financial benefits that banks may obtain from the new tax regime for losses on loans.

A quantitative assessment of the macroeconomic impact of these measures is rather complex as a number of other factors influence the evolution of the stock of nonperforming loans and the pace of their reduction in the bank balance sheets: among them, the business cycle conditions, the changes of the procedures for banks' prudential supervision after the banking union, or other interventions in the Italian credit sector, such as the reform of cooperative banks. In order to figure out the effects of a more extensive removal of nonperforming loans from bank balance sheets, several channels should be considered. On the one hand, at first the need to meet capital requirement might require banks to tackle the realized losses on nonperforming loans through a parallel reduction of assets, with possible negative effects on credit supply. This channel is more relevant in the case in which banks' actual capital ratios lie in the proximity of the required threshold. Afterwards, since nonperforming loans typically feature high weights when riskweighted assets are calculated for prudential supervision, their removal from the bank balance sheets would free up capital and encourage the supply of new credit. Moreover, the disposal of nonperforming loans through their sale or securitization would generate a cash flow for banks improving their financial conditions in terms of liquidity.

At the end of 2014, the stock of nonperforming loans was 197 billion, their coverage rate equal to about 60 per cent (58,7 at the end of 2014) and the stock of nonperforming loans sold or securitized amounted to 4 billion in 2014. Hence, the share of nonperforming loans (at net values) which have been sold or securitized in that year was about 5 per cent. The disposal of nonperforming loans typically takes place at a price that reflects the gap between book values on bank balance sheets and the price investors are willing to pay. In the simulation exercise with the ITEM model we assumed that the reforms aimed at reducing foreclosure times and increasing efficiency of the liquidation procedures induce an increased incidence of disposed nonperforming loans and a parallel gradual reduction of the discount that investors require for purchasing the nonperforming loans. [4]

The impact on credit supply reflects the channels previously illustrated. According to our estimates, while a possible reduction of credit might be obtained in the first year of simulation (2016) with respect to the baseline scenario, a gradual increase of it is envisaged in the subsequent years. The underlying assumption is that in the first year a negative effect on loans is induced by the reduction of total assets required as a result of the realized losses associated with a larger number of disposals of nonperforming loans. In the subsequent years, on the contrary, the expansionary effects on credit supply would prevail. At the macroeconomic level, the impact on GDP would be slightly negative in the first year, with a 0.1 per cent reduction with respect to the baseline scenario, close to zero in the subsequent year and slightly positive in the years 2018 and 2019 (see Tab. below).

**Table I.1-1 The macroeconomic impact of some measures of the Decree n. 83 of June 27, 2015 (percentage deviation from the baseline scenario)**

| | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|
| GDP | -0.1 | 0.0 | 0.1 | 0.1 |
| Investment | -0.4 | 0.0 | 0.4 | 0.3 |

[4] We assumed that the amount of disposed loans as a fraction of the stock of nonperforming loans (in net value) might increase by 10 percentage points, reaching a share of about 15 per cent. Moreover we assumed that the pricing gap might shrink by more than one third and in the simulation exercise this is implemented through a gradual reduction of the discount rate applied to the net value of nonperforming loans so as to reach a rate of 30 per cent.

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### Fiscal multipliers

The purpose of this box is to provide a brief review of the recent empirical literature on fiscal multipliers, namely, the impact on GDP associated with an exogenous change in public expenditure or taxation. The interest of the empirical literature on the subject began developing after 2000, and intensified following the 2008-2009 economic/financial crisis. Indeed, some of the world's leading economies implemented countercyclical expansionist policies in an effort to end the recession. At the same time, the sovereign debt crisis in the Euro Area required the adoption of severe fiscal-consolidation polices in many Euro Area countries.

The initial research about the question of fiscal multipliers mainly resorted to historical series, including structural VAR, as estimated using data on the US economy. A review of this literature (Table I.1-2) shows that the estimates of the multipliers are highly variable depending on a large number of factors, including: the method used, the identification strategy, and the estimation period.

**Table I.1-2 Estimates of fiscal multipliers**

| | Country | Period | Expenditure | | Taxes | |
|---|---|---|---|---|---|---|
| | | | Impact | Medium Term | Impact | Medium Term |
| Blanchard and Perotti (2002)[5] (a) | USA | 1960-1997 | 0.90 | 0.66 (c) | -0.70 | -1.29 (c) |
| De Castro (2006)[6] | SPAIN | 1980-2001 | 1.14 (b) | -0.83 (c) | 0.09 (b) | -0.52 (c) |
| Galì et al. (2007)[7] | USA | 1948-2003 | 0.41 | 0.68 (d) | -- | -- |
| Favero and Giavazzi (2007)[8] | USA | 1980-2006 | 0.16 (b) | 1.43 (c) | 0.00 (b) | 0.27 (c) |
| Giordano et al. (2007)[9] | ITALY | 1982-2004 | 0.60 (f) | 0.00 (d) | -- | -- |
| De Castro and Hernandez de Cos (2008)[10] | SPAIN | 1980-2004 | 1.31 (b) | 0.26 (c) | -- | -- |
| Hall (2009)[11] | USA | 1948-2008 | 0.47 | - | -- | -- |
| Mountford and Uhlig (2009)[12] | USA | 1955-2000 | 0.65 | -2.24 (c) (e) | -0.28 | -2.59 |
| Barro and Redlick (2011)[13] | USA | 1950-2006 | 0.68 | -- | -1.06 | -- |
| Burriel et al. (2010)[14] | EURO | 1981-2007 | 0.75 | 0.02 (c) | -0.79 | -0.74 (c) |
| Romer and Romer (2010)[15] | USA | 1950-2007 | -- | -- | - | -3.08 (g) |
| Ramey (2011)[16] | USA | 1947-2008 | -- | 0.60 (c) | -- | -- |

(a) VAR with stochastic trend. (b) Impact after 4 quarters. (c) Impact after 20 quarters. (d) Impact after 8 quarters. (e) Not significantly different from zero. (f) Impact after 3 quarters. (g) Impact after 10 quarters.

[5] Blanchard, O., Perotti, R. (2002), 'An Empirical Characterization of the Dynamic Effects of Changes in Government Spending and Taxes on Output', *The Quarterly Journal of Economics*, vol. 117(4), pages 1329-1368.

[6] De Castro, F. (2006), 'The Macroeconomic Impact of Fiscal Policy in Spain', *Applied Economics*, vol. 38(8), pages 913-924.

[7] Galì, J., Lopez-Salido, J.D., Valles, J., 'Understanding the Effects of Government Spending on Consumption', *Journal of the European Economic Association*, vol. 5(1), pages 227-270.

[8] Favero, C., Giavazzi, F. (2007), 'Debt and the Effects of Fiscal Policy', *Federal Reserve Bank of Boston*, Working Paper No. 07-4.

[9] Giordano, R., Momigliano, S., Neri, S., Perotti, R. (2007). 'The Effects of Fiscal Policy in Italy: Evidence from a VAR Model' , *European Journal of Political Economy*, vol. 23(3), pages 707-734.

[10] De Castro, F., Hernandez de Cos, P. (2008), 'The Economic Effects of Fiscal Policy: The Case of Spain', *Journal of Macroeconomics*, vol. 30(3), pages 1005-1028.

[11] Hall, R.E. (2009), "By How Much Does GDP Rise if the Government Buys More Output?", Brookings Papers on Economic Activity, vol. 2, pages 183-231.

[12] Mountford, A., Uhlig, H. (2009), 'What are the Effects of Fiscal Policy Shocks?', *Journal of Applied Econometrics*, vol. 24(6), pages 960-992.

[13] Barro, R.J., Redlick C.J. (2011), 'Macroeconomic Effects From Government Purchases and Taxes,' *The Quarterly Journal of Economics*, vol. 126(1), pages 51-102.

[14] Burriel, P., de Castro, F., Garrote, D., Gordo, E., Paredes, J., Perez, J.J. (2010), 'Fiscal Policy Shocks in the Euro Area and the US: An Empirical Assessment', *Fiscal Studies*, vol. 31(2), pages 251-285.

[15] Romer, C.D., Romer D.H. (2010), 'The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shock', *American Economic Review*, vol. 100(3), pages 763-801.

[16] Ramey, V.A. (2011), 'Identifying Government Spending Shocks: It's all in the Timing', *The Quarterly Journal of Economics*, vol. 126(1), pages 1-50.

The comparison between the results obtained from the different studies is made difficult by the fact that the time profile of the multipliers is not always reported, and that precise estimates of the multipliers are reported in many cases, without adequate analysis of statistical significance of the same. With reference to literature based on VAR models, the European Commission[17] concludes that public expenditure multipliers are generally between 0.4 and 1.1 in the first year, but the results for the long-term multipliers are not unique. Estimates based on structural VAR are basically confirmed by the narrative approach, based on the identification of episodes of strictly exogenous variation in public expenditure. Along this line of research, Ramey (2011)[18] estimated that the multiplier reaches a maximum value in the range of 0.6/1.2, depending on the method of calculation and the estimation period. Significantly higher values were obtained from cross-section estimates of regional data, which estimate a value of the multiplier effect of public spending at around 1.5[19].

Recently, more and more authors have studied the fiscal multipliers in the context of neo-Keynesian theoretical schemes (such as DSGE) that have been made more realistic - than the standard formulation - by the introduction of prices rigidities and an elastic labour supply. When appropriately calibrated, some of these structural models produce a public expenditure multiplier close to 1.0, thus substantially confirming the empirical evidence based on time series models[20].

The contributions to the 2008-2009 economic/financial crisis have identified, as the main limitation of the previous literature, the assumption of the stability of the multiplier to changing economic conditions and the ups and downs of the economic cycle. Blanchard and Leigh (2013)[21] identify three factors that can have a significant influence on fiscal multipliers. First, if the economy is suffering from a liquidity trap, monetary policy cannot offset the negative effects from fiscal consolidation programs by lowering interest rates, and this increases the multiplier. Second, in periods of malfunctioning financial markets, consumption and investment rely more heavily on income and current profits rather than on expectations about income and future profits, and this increases the multiplier. Third, there is ample empirical evidence of the fact that the existence of unused resources increases the multiplier. With regard to the first of the three aspects, it is observed that the possibilities of estimating the multiplier in "liquidity trap" situations are limited by the fact that such situations are rare; consequently, the literature uses theoretical scenarios. For example, the IMF (2010)[22] (by means of simulations performed with a DSGE model) estimates that the public expenditure multiplier in "liquidity trap" situations is about twice its value in normal conditions, climbing to approximately 1.0 after two years from the increase in expenditure. Similar results are obtained by Roeger and in't Veld (2010)[23], who (in also using a DSGE) estimated an increase in the public expenditure multiplier of 0.8 to 1.2. The most extreme results are obtained from Christiano et al. (2011)[24], who project an increase in the public expenditure multiplier that goes from 0.9 in normal conditions to 3.9 in a liquidity trap. With respect to the functioning of financial markets, Galì et al. (2007), even before the economic/financial crisis, show that the multiplier will increase during a recession due to the increase in the number of consumers subject to liquidity constraints and whose behaviour is

[17] Boussard, J., de Castro, F., Salto M. (2012), 'Fiscal Multipliers and Public Debt Dynamics in Consolidations', *Economic Papers* 460.

[18] Ramey, V.A. (2011), 'Identifying Government Spending Shocks: It's all in the Timing', *The Quarterly Journal of Economics*, vol. 126(1), pages 1-50.

[19] Romer, C.D., D.H. Romer (2010), 'The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks.' *American Economic Review*, vol. 100(3), pages 763-80.

[20] Hall, R.E. (2009), 'By How Much Does GDP Rise if the Government Buys More Output?' *Brooking Papers on Economic Activity*, vol. 40(2), pages 183-249.

[21] Blanchard, O., Leigh, D. (2013), 'Growth Forecast Errors and Fiscal Multipliers', *American Economic Review*, vol. 103(3), pages 117-20.

[22] IMF (2010), 'Will it Hurt? Macroeconomic Effects of Fiscal Consolidation', *World Economic Outlook*, October.

[23] Roeger, W., in 't Veld, J. (2010), 'Fiscal Stimulus and Exit Strategies in the EU: A Model-Based Analysis', *European Commission Economic Papers* 426.

[24] Christiano, L., Eichenbaum, M., Rebelo, S. (2011), 'When is the Government Spending Multiplier Large?', *Journal of Political Economy* 119(1), pp. 78-121.

different from that envisaged by the standards of intertemporal optimization. Finally, Auerbach and Gorodnichenko (2012)[25] are the first to empirically estimate the impact of the intensity of the expansion/recession on the value of the multiplier. Their analysis - based on a STVAR-type model - led them to conclude that the multiplier is included in the 0.0-0.5 range during a cyclical expansion and rises to 1.0-1.5 during a recession. The aforementioned analysis of Blanchard and Leigh (2013) concludes that the public expenditure multiplier was underestimated by policy-makers in the 2009-2010 recession, and that its value would have amounted to about 1.5. The Keynesian result of the countercyclical variability of the magnitude of the multiplier has been confirmed in numerous empirical studies, including those of Dell'Erba et al. (2014)[26], Herbert (2014)[27], as well as the meta-analysis of Gechert et al. (2015)[28].

Therefore, taking into account the lingering effects of the long crisis on aggregate demand and the exceptional circumstances which still characterize the economic environment, the estimates presented in this document assume - in line with the choice made in the DEF 2015 - a realistic and prudent fiscal multiplier value, slightly less than one. This figure refers to a theoretical budget manoeuvre equally distributed between expenditures and revenues.

The impact of fiscal policy on GDP depends on the composition of the intervention, concerning both the measures already adopted and therefore included in the macroeconomic and public finance trend, and those which the Government plans for the coming years, i.e. the measures that make up the policy scenario. Consistently with the above, it can be assumed that the multiplier size will revert to lower values once Italy extricates itself from the fragile macroeconomic environment that has characterized recent years.

## Making use of the 'public investment clause'

Additional room for manoeuvre is being sought by invoking the SGP clause for public investments. According to the European Commission's communication of 13 January 2015, some categories of investments co-financed by the European Union are considered equivalent to relevant structural reforms and could justify a temporary deviation from the MTO or the convergence path towards it.

These investments are related to projects co-financed by the European Union within its Structural and Cohesion Policy (including the program aimed at boosting youth employment), the Trans-European Networks, the Connecting Europe Facility, as well as the national co-financing of projects co-financed by the European Fund for Strategic Investment (EFSI).

According to the EC's communication, the following eligibility conditions must be met in order to activate the investment clause:

1) the Member State is in the preventive arm of the Stability and Growth Pact and an adequate safety margin is maintained from the reference value of 3 percent of GDP for nominal net borrowing as a share of GDP;

[25] Auerbach, A.J., Gorodnichenko, Y. (2012), 'Measuring the Output Responses to Fiscal Policy', *American Economic Journal: Economic Policy*, 4(2), pp. 1-27.

[26] Dell' Erba, S., Koloskova, K., Poplawski-Ribeiro, M. (2014), 'Medium-Term Fiscal Multipliers During Protracted Recessions', IMF Working Paper.

[27] Herbert, S. (2014), 'Econometric Analysis of Regime Switches and of Fiscal Multipliers', Working Paper OFCE 1/2014.

[28] Gechert, S., Hughes Hallet, A., Rannenberg, A. (2015), 'Fiscal Multipliers in Downturns and the Effects of Eurozone Consolidation', CEPR Policy Insight.

2) There exist unfavourable cyclical conditions (GDP growth is negative or the negative output gap is greater than 1.5 percent of GDP);
3) The gross fixed capital formation for the year of the application of the clause should not decrease;
4) The deviation is linked to national expenditure on projects co-funded by the EU under the Structural and cohesion Policy , Trans-European networks and Connecting Europe Facility, and to national co-financing of investment projects also co-financed by the EFSI, which have direct long- term positive and verifiable budgetary effects.

Having assessed the fulfilment of the aforementioned criteria, in 2016 the Italian government intends to use the flexibility allowed for national share of co-financing of European investment projects in accordance with Article 5 paragraph 5 of European Regulation No. 1466/97 (and Article 3, paragraph 4 of national Law n. 243/2012) by requesting a temporary deviation of 0.3 percent of GDP from the convergence path towards the MTO. The Member State will subsequently compensate for the temporary deviation and the MTO must be reached within the four-year horizon of its current Stability Programme.

The next box provides detailed information on national expenditure on projects co-funded by the EU for which the investment it is invoked and estimates of their macroeconomic impact.

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**Verification of the requisites for the application of the investment clause**

The budget flexibility in relation to public investment is provided by Article 5 and Article 9 of the European Regulation No. 1466/97 97 and specified by the January 2015 Communication by the European Commission on “Making the best use of Flexibility within the existing rules of the Stability and Growth Pact”. According to these provisions, under specific conditions (outlined in detail at a technical level by the European Commission), a Member State can temporarily deviate from the MTO or from the convergence path towards it when the deviation is linked to national expenditure on projects co-funded by the EU under Structural and Investment Funds, including YEI, Trans-European Networks and Connecting Europe Facility and to national co-financing of investment projects also co-financed by the European Fund for Strategic Investments, which have direct long-term positive and verifiable budgetary effects.

The government believes that these eligibility conditions will be fulfilled in 2016, and, accordingly, intends to make use of the flexibility related to the national co-financing of European investment projects for an amount equal to 0.3 percent of GDP.

With respect to the safety margin, the European Commission requires that the country invoking the investment clause has a structural deficit of no more than 1.5 percent of GDP during the year of application of the clause. The Update of the 2015 Economic and Financial Document projects that Italy's structural deficit for 2016 will be equal to 0.7 percent of GDP, whereas the Commission's Spring Forecast projects a structural deficit of 0.8 percent of GDP.

As to the existence of unfavourable cyclical conditions, the Commission's definition provides that the applicant country has negative GDP growth or an output gap exceeding -1.5 percent of potential GDP in the reference year. According to government estimates, Italy's output gap in 2016 will be -2.5 percent of potential GDP. The Commission's Spring Forecast projected an output gap of -2.0 percent.

The national co-financing of European Funds and projects should not substitute for nationally financed investments. On the basis of unchanged legislation, total public investments are projected to grow by 4.1 percent between 2015 and 2016 and approximately 2.5 percent in the two following years.

**Information on national expenditure on projects co-funded by the EU**

In line with the provisions of the January 2015 Communication by the European Commission on "*Making the best use of flexibility within the existing rules of the Stability and Growth Pact*" the temporary deviation requested by Italy under the Investment Clause is linked to projects which have direct long-term positive and verifiable budgetary effects, notably to national expenditure on projects co-funded by the EU under the following headings:

i) Structural and Cohesion Policy, implemented in 2014-2020 through the European Structural and Investment Funds, including projects co-financed through the Youth Employment Initiative YEI;
ii) Connecting Europe Facility and investments in Trans-European Networks (TEN/CEF);
iii) Investment projects also co-financed by the European Fund for Strategic Investment (EFSI) to implement the Juncker Investment Plan.

The expenditure on national co-financing of projects funded under these three headings meets the requirements laid down in Regulation 1466/97, Articles 5 and 9 as their thematic objectives is to promote long-term sustainable growth. Investments that raise potential growth in the long-term can be considered equivalent to major structural reforms and may lead to an improvement of the sustainability of public finance. Moreover, projects co-financed by EU structural funds and by the Juncker Plan/EFSI are subject to an objective selection process, fall within thematic priorities identified at EU level, including the objectives of the "Investment Plan for Europe", and are consistent with national investment strategies and with the targets set within the European Semester[29].

These defining features of structural funds– while maintaining full consistency with previous regulations - have been further clarified in current provisions. Expenditure under European Structural and Investment Funds (ESI) is currently regulated by Regulation 1303/2013 that in Articles 4 (General principles) and 9 (Thematic objectives) provides for a strong link with a) the relevant Country Specific Recommendations adopted in accordance with Article 121(2) and 148(4) TFEU, b) National Reforms Programmes; and c) the objectives of the Europe 2020 strategy. Article 9 identifies the thematic objectives that the ESI Funds shall support to contribute to the Union strategy for smart, sustainable and inclusive growth as well as the Fund-specific missions pursuant to their Treaty-based objectives, including economic, social and territorial cohesion.

National expenditure on projects co-financed by the EU considered for the Investment Clause amounts to 5,150 million The table below specifies by each Fund or financing instrument of EU co-financing the main categories of projects broadly corresponding to those thematic objectives. Investment projects are included in specific operational programs approved by the European Commission and are subject to a system- already implemented in the programming cycle 2007 – 2013 of European Structural Funds - of management, monitoring and control that ensures for each project the traceability and transparency on financial, procedural and physical advancements.

[29] See COM(2015) 12, 13.1.2015 and subsequent operational documentation.

**Table I.1-3 National expenditure on projects co-funded by the EU considered for the investment clause categories of expenditure and fund, year 2016 (Mn Euro)**

| Categories of expenditure | All funds | ERDF | ESF | YEI | CEF (1) | EFSI | EAFRD | EMFF | Total co-financed expenditure (includes national and EU Funds) |
|---|---|---|---|---|---|---|---|---|---|
| Energy and energy efficiency | 280 | 100 | | | | | 180 | | 600 |
| Transport and network infrastructures | 1,850 | 150 | | | 1,050 | 650 | | | 3,100 |
| Social infrastructures | 100 | 100 | | | | | | | 350 |
| Research and innovation | 220 | 180 | | | | | 40 | | 650 |
| Competitiveness SMEs | 550 | 200 | | | | | 300 | 50 | 1,300 |
| Digital agenda | 690 | 260 | | | | 400 | 30 | | 1,670 |
| Environment protection and risk prevention | 270 | 150 | | | | | 120 | | 600 |
| Tourism and culture | 150 | 100 | | | | | 50 | | 350 |
| Employability and labour mobility | 530 | | 310 | 200 | | | 20 | | 1,280 |
| Social inclusion | 200 | | 150 | | | | 50 | | 500 |
| Education | 260 | 150 | 100 | | | | 10 | | 750 |
| Enhancing institutional capacity | 50 | 10 | 40 | | | | | | 150 |
| TOTAL | 5,150 | 1,400 | 600 | 200 | 1,050 | 1,050 | 800 | 50 | 11,300 |

1) Includes 300 mn of projects already financed. The remaining resources are earmarked for projects already considered eligible for financing under the CEF (Connecting European Facility) but that were not yet financed due to insufficient EU resources that Italy is intending to re-submit to forthcoming EU calls in 2016

Besides European Regional Development Fund (ERDF), European Social Fund (ESF) and Youth Employment Initiative (YEI) the Table also includes national expenditure on projects co-financed by European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF). Those Funds are included in the 2014-2020 programming cycle under the common heading of European Structural and Investment Funds (ESI)[30] to improve coordination and harmonize implementation of all the Funds providing support under cohesion policy as well as to emphasize the common objectives of supporting growth and competitiveness. As shown in the Table, EAFRD operates in synergy with other financial sources on most categories of projects while the EMFF contributes to supporting the objective of enhancing the competitiveness of SMEs in the specific sector[31].

[30] See Regulation (EU) No. 1303/2013.

[31] The January 2015 Communication Com (2015) 12 refers to Structural and Cohesion policy thus reflecting the organization of the Funds in 2013 when a previous version of the Investment Clause was introduced by the Commission. The current implementation of the Investment Clause should take into account the current provisions regulating European Structural and Investment Funds i.e. Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No. 1083/2006.

The policy areas illustrated in the Table are meant to have a significant impact on potential growth and to tackle persisting imbalances (see next section for more details on the impact on potential output). They are strictly connected with the Country specific recommendations to Italy and the extraordinary reform effort undertaken by the government. The major financial contribution in 2016 is expected on measures to enhance the competitiveness of SMEs also by boosting the digital agenda and strengthening research, technological development and innovation; resources are also earmarked to SMEs operating in the fields of tourism and culture to boost the contribution to growth of sectors bearing a country-specific added value. A further role to improving overall competitiveness and creating favorable conditions for investment is played by projects aimed at promoting sustainable transport and removing bottlenecks in key network infrastructures and by projects aimed at improving energy efficiency, climate change adaptation and risk prevention. Key network infrastructures, notably investment in Trans-European networks are also specifically supported by the Connecting Europe Facility and by significant national co-financing. Specific categories of projects are aimed at human capital in conjunction with the ongoing adjustments in the labour market and the reform of the educational system: measures to support employment and labour mobility, investment in education and training, including lifelong learning, measures to support social inclusion and education and related infrastructures. Finally, a specific category of resources supports enhancing institutional capacity and improving the efficiency of the public administration.

A further leverage to boost potential growth is provided by the projects presented in the strategic sectors of transportation and Digital Agenda to be co-financed by the Juncker Plan with the involvement of public as well as private investment. They correspond to specific Government priorities and once approved they will be the object of specific monitoring, to ensure swift implementation. Projects in the field of transportation, already submitted to the EIB, are aimed at improving road infrastructures and removing bottlenecks in the northern area of the country, characterized by the pressure of intense economic activity. Projects on the broad band, to be implemented on the basis of a public private partnership, are part of a comprehensive strategy aimed at realizing a fundamental infrastructure to bridge the structural gap of the country, following the EU guidelines of the sector.

### Improving effectiveness of expenditure

A high level of national expenditure on co-funded projects is expected in 2016, based on a consistent backlog of ongoing projects and on the continuous improvements in the capacity of managing authorities and administrations. A further boost will be given by new specific provisions included in the 2016 Stability Law with a view to improve effectiveness of implementation of co-financed projects by tackling existing bottlenecks in the financial management of resources at regional level. More specifically:

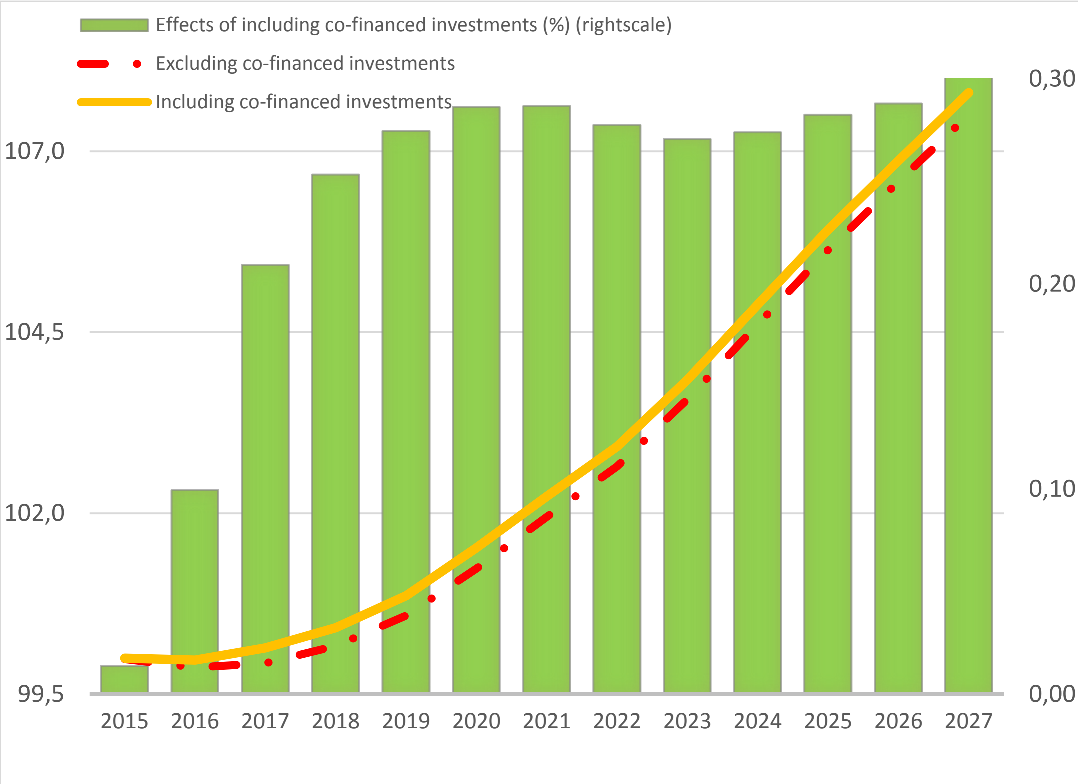
i) Regional administrations will have the possibility of managing EU funds and corresponding national co-financing in specific accounts that have a favourable treatment in the Domestic Stability Pact. This provision overcomes financing constraints on capital expenditure linked to EU funds that had severely affected absorption capacity at local level in the past.

ii) Regional administrations will have the possibility of using advances of funds available in the Revolving Fund for the implementation of EU structural policies (Fondo di rotazione per l'attuazione delle politiche comunitarie), thus ensuring a smooth cash flow for the implementation of projects. This possibility was previously reserved to Central administrations only.

### Impact on potential output

Simulations performed on the Treasury's econometric model (ITEM) and on the model for the estimation of potential GDP agreed at the European level are summarised in the chart below. They show that co-financed investments in 2016 will permanently increase Italy's potential GDP over the medium and long run. Indeed, EU co-financed investments in 2016 amounting to 0.3 percent of GDP would activate an additional and similar share of national investments, resulting in a total amount of almost 0.67 per cent of GDP. Overall, GDP growth in 2016 will increase by 0.5 per cent as consequence of such a shock. Our simulations show that, when considering all these effects, the distance between the level of potential GDP including the national and EU quotas of co-financing investment vis-à-vis that excluding them would likely grow up until 2027 to reach a high of 0.3 per cent. Over a longer horizon (2040) such a gap will further increase to 0.4 per cent. Higher potential output is expected to improve the sustainability of public finances over the medium and long term period. Under a no-policy change assumption for the structural primary surplus[32] , the so called Z indicator, measuring the direct and indirect net gains in debt sustainability over the medium and long term, will increase by 1.7 percentage points in a scenario that includes the national and the EU quota of investments in 2016 vis-à-vis a scenario that would exclude them. It follows that the investments in co-financed projects will improve the sustainability of the public finances in the medium term mostly by raising potential output.

**Figure I.1-6 Potential GDP with and without co-financed investments in 2016**




Finally, to evaluate in more detail the impact that such measures would have at sector level, a further exercise was conducted with the computational model (CGE). The model indicates that without the flexibility for investment Italy would have an impact on national GDP even higher

[32] Both the exercises for simulating the effects on potential output with and without the 2016 investments and for deriving the Z indicators have been carried out assuming as a starting point the trend macroeconomic and fiscal framework of the 2015 Update of EFD extended to 2040. Potential growth has been projected forward to 2027 through the methodology T+10 agreed by the Output Gap Working Group and further extended to 2040 using the Ageing Working Group GDP growth projections. The assumption of no-policy change for the structural primary surplus is equivalent to setting a constant value of this target as of 2019 up to 2040. GDP deflator is assumed to converge to 2.0 per cent in 2022. The Z indicator in the scenario including the effects of investments is equal to 1.4 per cent, that is 1.7 percentage points higher than the corresponding indicator calculated in the scenario which excludes the impact of co-financed investments.

than that obtainable with the ITEM model bringing the loss of growth to 0.7 percent of GDP. The sectors most affected would be those of construction and infrastructure, research and ICT (see Table I.1-4).

**TABLE I.1-4 Sectorial impact of the investment losses whit the CGE model**

| N. | NACE REV.2 | GDP | GDP Var % | WEIGHT | DESCRIPTION |
|---|---|---|---|---|---|
| | | Italy | - 0.7 | | |
| 27 | RF | Constructions and infrastracture works | -4.3 | 46.3 | The negative impact on this sector originate from the reduction in investments on constructions and infrastructures such as railways, residential and non-residential buildings etc. |
| 32 | R50 | Water transport services | -2.0 | 1,0 | The sector "Water transport services" registers a negative performance as a consequence of the reduction in exports which represent the 43% of the total output of this sector. |
| 40 | R62_63 | Computer programming, consultancy and related services; information services | -5.2 | 13.1 | The negative impact in this sector is related to the reduction of investments in research and development services. |
| 48 | R72 | Scientific research and development services | -5.8 | 7.2 | The negative impact in this sector is related to the reduction of investments in research and development services. |
| 54 | R80_82 | Services to buildings and landscape; office administrative, office support and other business support services | -1.8 | 4.2 | The negative impact in this sector is mainly due to the reduction of investments in environmental protection. |

## Fiscal costs of immigration and rescue operations

These fiscal space would be further elevated if the request of the Italian government to recognize the exceptional nature of costs relating to the reception of immigrants and, more generally, the economic and financial impact of this phenomenon, also for the calculation of the structural net borrowing, will be accepted.

FOCUS

### Expenditures for the refugee crisis

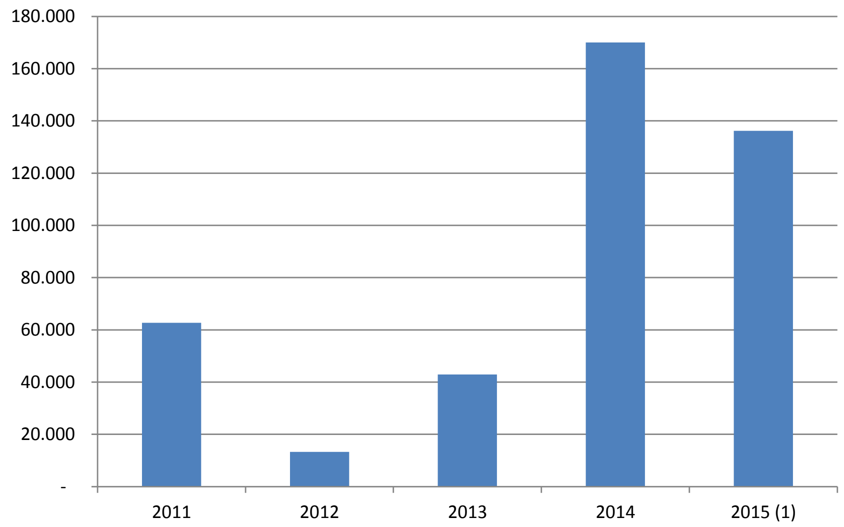
In 2014 around 170 thousand people landed on the Italian coast, more than three times compared to the previous year, surpassing even the values registered in 2011 when the so-called North Africa humanitarian emergency exploded. The peak reached in 2014 also concerns refugee assistance facilities, where attendance doubled compared to 2013. The data recorded up to September 2015 confirm a similar size of the crisis, with over 136 thousand migrants arrived by sea (Figure I.1-7).

This exceptional and not controllable wave of refugees affects the whole of Europe as a result of the upheavals taking place in the countries of origin. According to observers in the next few years it will reach unprecedented levels. Like other countries which are on the southern borders of the European Union (particularly Greece and Spain), Italy found itself at the forefront of this new crisis management, taking on the task of ensuring border control also for countries in the interior and dealing with massive rescue operations.

In September 2015 there were about 77 thousand migrants hosted in government facilities and in over 1800 specially set up temporary structures, almost the double of the attendance recorded at the end of 2014 and over ten times the average figure for the period 2011-2012.

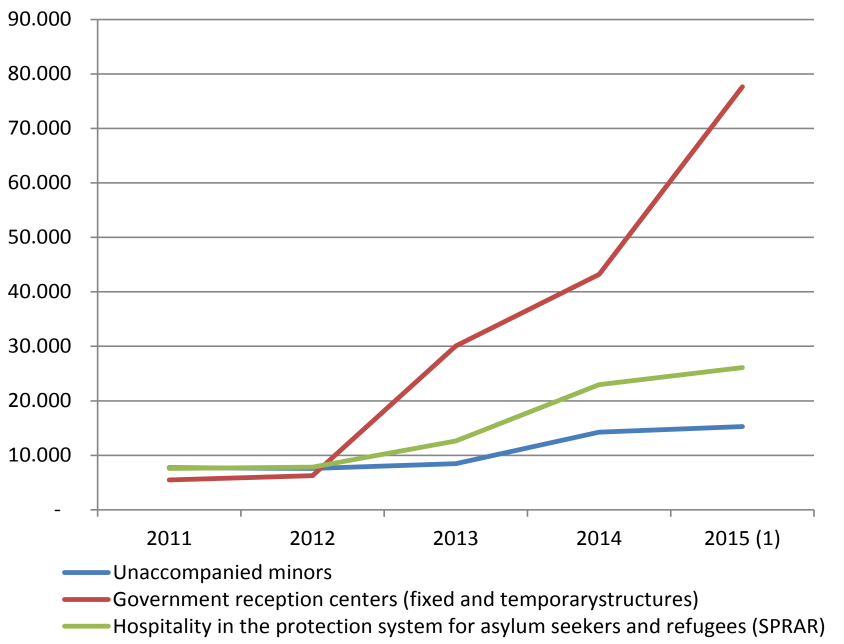
The asylum seeker and refugees protection system covers more than 26 thousand people, with a steady increase over time. Unaccompanied children have exceeded 10 thousand units, causing an enormous challenge in terms of the adequacy of accommodation, supervision and school introduction (Figure I.1-8).

**Figure I.1-7 Arrivals of migrants on the Italian coast. year 2001-2014, 2015 (until September)**




(1) up to September 30
Source: Ministry of the Interior.

**Figure I.1-8 Migrants in refugee assistance facilities and unaccompanied minors. Year 2011-2014, 2015 (until September)**



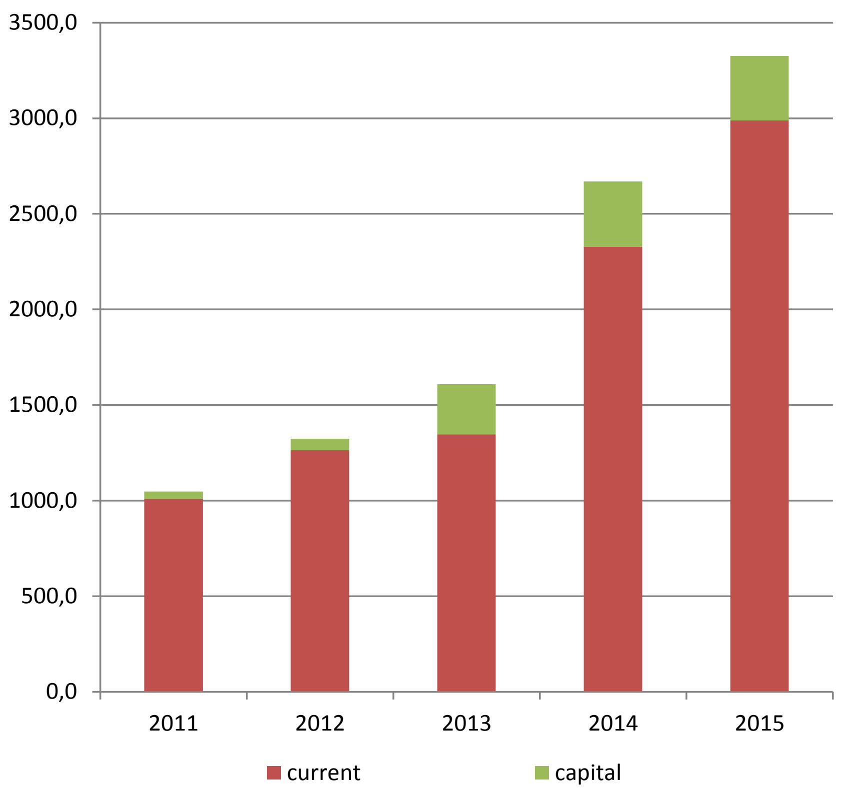

(1) up to September 30
The data on the reception did not consider the emergency North Africa.
Source: Ministry of the Interior.

Shaping an assistance system which timely responds to the very high numbers of refugees arriving simultaneously still requires relevant financial and organizational efforts from all levels of government. The national operational plan to deal with the unexpected flow of non-EU citizens, approved in July 2014 together with regions and local authorities, has provided for the strengthening of the administrative apparatus of the police to speed up the procedures for the identification of migrants and asylum applications, the reinforcement of territorial commissions to accelerate the processing of applications for international protection, the extension of the capacity of hospitality facilities in governmental structures, also in consideration of the need to ensure a smooth transition between immediate relief and secondary assistance.

Enabling and managing the reception system so as to cope with the refugee pressure has resulted in significant budgetary effort. An accurate reconstruction of expenditure for the migrant assistance and aid is complex, given the multiplicity of actors involved. The management of the assistance system is currently headed by the Ministry of the interior, with the Ministry of labour and social affairs dealing with unaccompanied children until 2014. Besides the military, rescue at sea involves men and means of the harbor guards and the Guardia di finanza.

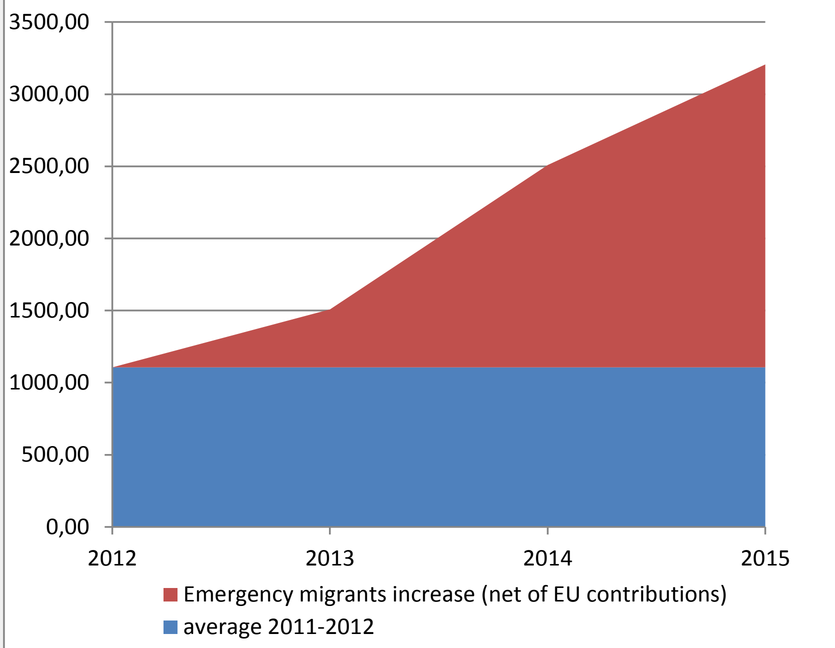
Financial resources required to cope with the extraordinary influx of immigrants on Italian territory are almost entirely dependent on the State budget. In 2015 the estimated costs exceed 3.3 billion euro, of which about 3 billion for current expenditure. Capital expenditure has increased over the years due to the need to expand capacity in assistance facilities and to provide for the maintenance and renewal of means necessary in rescue operations (Figure I.1-9).

**Figure I.1-9 Current and capital expenditures for the migrants crisis. Years 2011-2015**




Source: MEF-RGS.

**Figure I.1-10 Expenditure net of eu contribution: differential between 2011-2012 average and subsequent years**




Source: MEF-RGS.

The most significant share of expenditure relates to reception facilities (generally over 50 per cent of the total) and secondly the rescue at sea (between 25 and 30 per cent). These costs arise in large part because of Italy's geographic position; indeed Italy is considered by migrants mainly a place of transit and not their final destination. These are costs related to the common European border surveillance and immediate relief.

Further costs arising from treatment in the national healthcare system and from education of migrants entering the national school system for the first time should not be neglected (Table I.1-4). Moreover indirect, and incalculable, costs are being faced for the overall integration of immigrants into the economic and social fabric of the country.

**TABLE I.1-5 Estimated expenditure for the migrant crisis. Years 2011-2016.**

| | Average 2011-2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|
| | millions of euro | | | |
| **Total – on constant basis** | **1,326.88** | **2,668.84** | **3,326.53** | **3,302.33** |
| **Total – growth scenario** | | | **3,326.53** | **3,994.29** |
| Of which | % of GDP | | | |
| *Sea rescue* | 25.13 | 30.76 | 26.58 | 24.39 |
| *Hospitality* | 42.97 | 45.94 | 53.58 | 55.62 |
| *Healthcare and education* | 31.90 | 23.29 | 19.84 | 19.99 |
| | millions of euro | | | |
| EU contributions | 86.74 | 160.20 | 120.19 | 112.06 |
| **Total net of EU contribution** | **1,240.14** | **2,508.65** | **3,206.34** | **3,190.27** |

Note: Figures do not include spending on the North Africa emergency, started in 2011.
Source: MEF-RGS

Compared to the average for the period 2011-2013 the expenditure is more than doubled in 2014 and almost tripled in 2015. This trend is confirmed by examining the expenditure net of EU contributions, resulting from the funds for the external borders, for the integration of third-country nationals, for refugees and repatriation (Table I.1-4).

The differential between the expenditure net of EU contributions supported in the years 2011-2012 and in the years in which the humanitarian emergency exploded is, in cumulative terms, about 4 billion euro (Figure 4). The resources available in the budget for the coming years can support a level comparable to that of 2015(constant scenario). In view of the worsening of the crisis, additional funds will be needed. Assuming an increase in the number of migrants to be assisted in the next two years, equal to that recorded between 2014 and 2015 (growth scenario), the cost would amount to just under 4 billion in 2016. The drastic increase in spending on migrants that Italy supported in recent years must be regarded as an unusual event and exceptional circumstance, as defined in article 5.1 and article 6.3 of Regulation (EC) No 1466/97 and in article 3 of the "Fiscal compact".

## Fiscal consolidation set to continue in 2016 and beyond

The official estimate for the 2015 general government net borrowing remains at 2.6 percent of GDP, down from 3.0 percent in 2014. For 2016, the target has been raised from 1.8 percent to 2.2 percent of GDP. Net borrowing should then fall to 1.1 percent of GDP in 2017 and 0.2 percent in 2018. A surplus of 0.3 percent of GDP is projected for 2019.

Consistent with these targets, the structural balance would worsen from -0.4 percent of GDP this year to -0.7 percent in 2016 but then improve to -0.3 percent in 2017 and reach zero, Italy's MTO, in 2018 and 2019.

The debt-to-GDP ratio is projected to decline, for the first time after eight years of an increasing trend, by 1.4 percentage point in 2016 and then fall more sharply in the three following years, to below 120 percent in 2019. The debt rule would be satisfied, on a forward-looking basis, already in 2016. This trend reversal should boost market confidence.

The reduction in the debt ratio will benefit from the privatisation plan, which envisages direct revenues for the central government equal to 0.4 percent of GDP in 2015 and 0.5 in each of the following three years. The 2015 target looks well within reach given that half of the amount has already been achieved and the IPO of *Poste Italiane* should be completed by year-end.

## Highlights of the 2016 Stability Law

The Budgetary policy for 2016 and following years is closely linked to the process of implementation of structural reforms and aims to permanently bring the Italian economy on a path of sustained growth. This policy is based on a gradual, incisive reduction of the tax burden on companies in order to boost employment and investment in physical and human capital.

The 2016 Stability Law includes measures for structurally enhancing the competitiveness of the Italian economy. Moreover, such measures aim at both supporting aggregate demand and changing the expectations of households and firms, thereby putting an end to the vicious circle that has depressed the Italian economy for several years.

The reduction of the tax burden is pursued through the removal of tax increases that should have been in force since the beginning of 2016 (16.8 billion, about 1 percentage point of GDP).

Furthermore, the Stability Law reduces property taxes on primary residential dwellings, affecting the 80 per cent of households, and on farmland and so-called 'bolted' equipment (at a cost equivalent to nearly 0.3 percent of GDP). The first reduction of taxation should contribute to reinforce household confidence, while the other cuts should enhance firms competitiveness.

Because of these measures, the overall tax burden as a percentage of GDP is expected to decrease by 0.6 p.p., moving from – net of the accounting classification of the 80 euros personal income tax bonus – 43.1% in 2015 to 42.5% in 2016 (gross of the 80 euros bonus the tax burden is expected to fall between 2015 and 2016 from 43.7 to 43.1 per cent).

In addition to the tax cuts on primary residential dwellings, the Stability Law confirms the tax relief already provided for renovation of buildings and energy upgrading in order to support the construction sector. Other measures pursue the same goals, allowing municipalities to use the cash surplus for investments and to not comply with the balanced budget rule.

All these interventions together with the action ensuring a faster implementation of the infrastructures and of the projects co-financed by the EU, should facilitate the recovery of construction sector which has experienced a continuing contraction in the last years.

Further incentives to invest will be introduced from 2016 by means of 40 per cent allowance on fiscal amortisations applying to new investment in machinery and equipment realized in 2016. The scheme will allow companies to amortise 140 percent of eligible investments for tax purposes. The aim of such a measure is to contribute to the renewal of the productive capital of the companies, after a long period of investment stagnation. This will contribute to increase productivity and to enhance the potential growth of the economy. Moreover, it will also support the demand for producers of capital goods, which represent a significant portion of the manufacturing sector.

The reduction of the tax burden on companies  will continue in 2017 through the cut of corporate taxation (IRES). The corporate income tax will be reduced from 27.5 to 24 per cent starting from the 1 January 2017. This measure, in addition to the cutting of cost of the labour component of IRAP, aims to reduce taxes on business profits in order to align corporate taxation to European standards.

The budget also includes several measures to reduce the tax burden and to simplify tax procedures for self-employed and small businesses.

Overall, such set of measures  associated with reforms that improve business environment, reduce administrative burdens  and increase efficiency of civil justice will make it possible to improve the competitiveness of all economic sectors.

The emphasis is on competitiveness, investment and productivity since these are the factors that will facilitate jobs creation. Jobs creation will continue benefiting from a lower reduction (at 40 per cent) in social security contributions for new permanent labour contracts. The latter were introduced with the Jobs Act which led to new hires on a permanent basis.

Other measures will be added related to the productivity wage and directed to encourage the second level bargaining which is crucial in order to enhance the differentiation of pay structures in relation to productivity.

Hiring incentives and the productivity wages are part of the labour market reform started in 2015; they contribute , together with the measures of the Jobs Act, to increase employment, to make jobs more stable and the labour market more flexible.

Incentives for hiring and wage productivity are part of the reform of the labor market started in 2015; contribute, together with the various interventions of the Jobs Act, to increase employment, stabilize labor relations, a more flexible market.

The budget also includes important measures for education, research and culture. The aim is to push back the Italian economy to excellence levels. It is meant to reward value and to improve the level of our universities. These actions complement the effort to enhance the creation of human capital realized with the 'Buona Scuola', started in the school year 2015-16. Two measures aim to support to the most vulnerable individuals. A scheme to reduce on a structural basis poverty of the younger members of the population is envisaged, keeping in mind that situations of distress in early life tend to have lingering effects on employment and incomes. Moreover, measures are foreseen to protect unemployed people approaching the retirement age.  In particular, safeguards measures are guaranteed for part of the so called 'esodati'. There are measures to favour the retirement of women having 35 years of contributions against a reduction of their pension ("option woman"). There is also an intervention to enhance the generational turn over through a part time scheme for workers close to retirement. It must be noted that the pension system remains unchanged and that those measures are financed within the pension system itself, also through the extension of the intervention on the indexation of pensions introduced in 2013. It should be noted that the resources are found without increasing the tax burden on families and businesses. The only exception is the increase in the tax burden on the games. An higher level of revenue, approximately equal to 0.13% of GDP in 2015, are expected from the 'voluntary disclosure' related to income and assets held abroad. This measure brings out capital positions, with positive effects on the resources available for domestic investments. Actions are instead taken to curb spending: both in 2016 and 2017 the savings will amount to about 0.4 percent of GDP.

They are due to a significant rationalization of public activity. The measures concern all levels of government. In estimating the scale of the interventions it must be taken into account that in the baseline scenario the growth of current primary expenditure was already very low (increasing from 697 to 706 billion between 2015 and 2016; thanks to the financial measures growth will be reduced to about 3 billion). The budget for 2016 and subsequent years foresees, as already noted, the gradual reduction of the deficit to the extent permitted by the flexibility clauses and, for the first time since the onset of the crisis, the decline in the debt to GDP ratio. The balanced budget, planned for 2018 in structural terms, and the restart of the economy on a growth path, enhanced by the fiscal package, are crucial to determine the rapid decline in the debt burden.

## Statistical data and forecast validation

The policy scenario for public finance and the economy presented herein is based on the annual national accounts published by ISTAT on 23 September and the quarterly public sector accounts released on 1 October. Official macroeconomic projections were formulated on the basis of preliminary indications about the key budget measures. If necessary, forecasts may thus be updated or revised in a report to Parliament as required by Italian law.

In order to satisfy the specific requirements of the Two Pack regarding the use of independent macroeconomic forecasts, macroeconomic forecasts for 2015 and 2016 contained in this document were validated by Italy’s Parliamentary Budget Office.

# II. STRUCTURAL REFORMS

## The reform’s strategy

The National Reform Programme of last April has set out the planning commitments taken by the Government to build its multiannual structural reforms plan bearing in mind the new challenges that the European Commission indicated in the Country Specific Recommendations (CSR) addressed to Italy at the end of the European Semester.

The implementation of these measures is a fundamental part of the medium-term strategy for fiscal consolidation and reduction of public debt. Consistent with European objectives, this strategy is based on structural reforms and support to investment.

From this perspective, the policy-scenario measures - and those recently approved - are directed at structurally impacting the nation's economy, while being essential in the short-term for correcting the macroeconomic imbalances affecting the country. However, in the long term, these actions will serve for guaranteeing sustainable and continuing growth.

## Acting on the State and the Public Administration

The institutional reforms that the government inaugurated when taking office have been partially completed with the approval of the legislative bill for electoral reform. As an integral part of the changes to the institutional framework that the government is striving to make in order to modernise the country, the constitutional reform is to be concluded in 2016, with the confirming referendum. These are two basic steps for running the state in a proper and competent manner, which, in turn, is needed for the effectiveness of public decisions and the efficiency of public spending, both of which are essential for maintaining control over public finance.

The approval of the law to reform the public administration will impact the public at large (by simplifying administrative procedures and ensuring the certainty of the rules and response times), businesses (by supporting productive investment) and public services (by eliminating inefficiencies and waste). The reform of the public administration has prioritised the establishing of efficiency principles and the streamlining of state owned enterprises as well as companies that supply local public services, with the objective of steadily introducing criteria for competition and efficiency coherent with the EU dictates.

## A new taxation system and reduced fiscal pressure

The government's long-term strategy also envisions a significant reform of the taxation system, including for the purpose of reducing fiscal pressure. This has been achieved mainly by completing the implementation of the enabling law for fiscal reform, through which the government has committed to establishing a more equitable, transparent, simplified and growth-oriented system.

In recent months three delegated decrees were approved concerning electronic invoicing, abuse of the law, and international expansion of businesses. Five more decrees have been added through which the Government has completed the implementation of the tax reform. They focus on: reorganization of the fiscal agencies; monitoring of tax evasion and revision of tax expenditures; revision of the sanctions system; revision of the discipline of rulings and tax litigation; simplification and rationalization of tax collection rules.

Provided that it is compatible with public finance objectives, on a gradual and permanent reduction of taxation is envisaged, with the aim of reinforcing citizens and business confidence.

From 2016 the Government will revise the property tax on residential and productive immovable property, with a twofold objective: alleviating the tax burden on households and, indirectly, supporting the recovery of employment in the building sector (which has been very hard hit by the economic crisis). Parallel to the improvement in GDP, the acceleration of the tax cuts will also include a reduction of corporate income tax planned for 2017.

In confirming this approach, the labour market reform flanks to the introduction of new types of contracts a cut of the tax wedge and fiscal relief measures that provide an incentive for businesses to adopt the contracts. Significant efforts undertaken in this regard led to the completion of the implementation of the Jobs Act in mid-2015, and the structural revision of the Italian labour market. The reduction of the taxes on labour (in line with recommendations of all international institutions, and in particular, the European Commission) has made it possible to improve Italy's competitiveness and is part of taxation cuts that are sustainable and consistent with budget measures.

The spending review is an essential part of this action, and in this regard, it is part of the government's effort to achieve continuous improvement in spending from the perspective of (i) greater efficiency and (ii) better allocation of the resources to initiatives consistent with economic policy over the long term. The forthcoming Stability Law will continue in this direction, with measures for the containment of public expenditures.

## Relaunching investments and firms competitiveness

The policies focused on the relaunching of productive investment (especially, investments in innovation), those concentrating on the modernisation of corporate finance, and those directed toward reinforcing the international protection of the productive fabric have turned out to be fundamental drivers of economic growth and the growth of employment.

To reinforce such approach it is essential to delineate a regulatory framework to solve the issue of non-performing loans. This effort will be accompanied by other measures designed to reinforce the Guarantee Fund and to support research and investment. The government has amended the rules for the deductibility (for the purpose of corporate income taxes and regional tax on productive activity) of the write-downs in the values of loans and loan losses for banks, financial institutions and insurance companies. These measures provide an essential incentive to lenders to dispose non-performing credits, and thus to increase the lenders' margins for granting new credit.

Solving the problem of businesses' limited access to credit requires initiatives on various fronts. In this regard, the bankruptcy law addresses the difficulties that businesses experienced in the years of the crisis, facilitating the access to credit in the event of pre-bankruptcy settlements with creditors (*concordato preventivo*), reviewing the agreements for debt restructuring and bankruptcy proceedings. The reform allows for limiting economic losses due to business crises, and where possible, to restore business activity, with benefits at employment level as well.

The new framework for the governance of cooperative banks and banking foundations will be outlined by the end of 2015, as part of an overall reform of the banking sector designed to make investment in Italian banks more attractive, to facilitate business combinations and sector consolidation, and to stimulate efficiency and the competitiveness, with measures that will also affect the competitive environment.

The government has already taken action to support private investment, with the financial and regulatory measures contained in the 'Finance for Growth' initiative. However active participation in the country's development is still necessary by the public sector, both with additional resources and the administrative capacity to complete infrastructure projects and enhance the value thereof. In this regard, financial resources have been recovered and earmarked for specific initiatives to build and develop the network of physical and digital infrastructures that is essential to Italy's future. The Ultra Broad Band operational programme will be a direct beneficiary of these resources, with an appropriation of €2.2 billion that will allow for getting started with implementation immediately.

Within a broader based strategy for the recovery of the Italian economy's competitiveness, the Strategic Plans for Ports and Airports play a fundamental role: measures included in these plans will allow efficiency recovery in the related sectors while actively contributing to the development and cohesion of the Southern Regions.

## Completing the reforms: justice system, Simplification Agenda and privatisations measures

The measures referring to the justice system, the fight against corruption, and administration simplification complete the framework directed to facilitating the business environment. The completion of the reform of the civil and criminal justice system is an essential step in closing the efficiency gap that has adversely impacted both the public at large and businesses. Greater productivity of the judicial system has been pursued through changes in laws and regulations that have led to the gradual reduction of the civil case backlog, and of the tax disputes. Lastly the introduction of the digital civil trial resulted in estimated savings for €48 million per year, and 50 per cent reduction in the timing for issuance of injunctions.

Over the past year, the efforts to reduce administrative charges have gained further momentum. As evidence thereof, as of 31 August 2015, some 90 per cent of the deadlines provided for the Agenda for Simplification and the related detailed plans had been met. From the measures provided by the Agenda, it will be possible to start to concretely implement Italy's Digital Agenda. Noteworthy in this regard is the definition of the measures soon to be adopted with respect to the healthcare file, with the aim of contributing to the improvement of all health care activities.

The government's strategy for fiscal consolidation is also based on an extraordinary plan for the value enhancement and sale of real estate, which, together with the sale of shareholdings, is aimed at securing additional resources for reducing the public debt and financing investment.

| Table II.1-1 Reform timetable | | | | |
|---|---|---|---|---|
| Policy Area | Done | In progress | Impact on GDP | Timetable |
| | | | | |
| Institutions | Electoral Law Chamber of Deputies (L. no. 52/2015). | | - | May 2015 |
| | | Reform of the Constitution | - | 2016 |
| | | | | |
| Labour market and social policies | Enabling Law on market reform (L. 183/2014). | | In 2020: 0.6%; in long term: 1.3% | December 2014 |
| | Enabling legislative decrees on: standard open-ended contract (Lgs. D. 23/2015); new unemployment benefit scheme (Lgs. D. 22/2015). | | | March 2015 |
| | Enabling Legislative Decree on: work-life balance (Lgs. D. 80/2015); Code of labour contracts (Lgs. D. 81/2015). | | | June 2015 |
| | Enabling Legislative Decree on: wage supplementation scheme (D.Lgs. 148/2015); simplification of procedures and equal opportunities (D.Lgs. 151/2015); National Agency for Safety and Health at Work (D.Lgs.149/2015). | | | September 2015 |
| | National Employment Agency and active labour market policies (D.Lgs. 150/2015). | Adoption of the statute for the National Employment Agency and election of its president (October 2015). Definition of the strategy implementing the new active labour market policies and agreements with the regions necessary under the current Constitutional framework (November 2015-Jannuary 2016). Implementation of the active labour market policies strategy according to the regional agreements and issuance of activation vouchers to unemployed individuals within a competitive quasi-market system (February 2016). | | September 2015 (implementation October 2015 - February 2016) |
| | | Agreement on the second level contractual bargaining. | - | By spring 2016 |
| | | | | |
| Justice | Reform of civil justice (D.L. no. 132/2014, cvt. in L. no. 162/2014). | | In 2020: 0.1%; in long term: 0.9% | November 2014 |
| | Reform of criminal justice (D.L. no. 92/2014 cvt. L. no. 117/2014). | | - | August 2014 |
| | | Enabling bill on: strengthening special courts for companies and special courts for human rights and family related issues; rationalisation of civil trial; revision of proceedings stages. | - | March 2016 |
| | | Bill on revision of penal code, penal proceedings, and certainty in the length of proceedings. | - | December 2015 |
| | | Bill against organised crime. | - | March 2016 |

| **Table II.1-1 Reform timetable (continue)** | | | | |
|---|---|---|---|---|
| Policy Area | Done | In Progress | Impact on GDP | Timetable |
| Taxation | Enabling Law on tax reform (L. no. 23/2014). | | - | March 2014 |
| | IVA and taxation on capital gains (D.L. no. 66/2014 cvt. in L. no. 89/2014). | | In 2020: -0.2%; in long term: -0.2% | June 2014 |
| | Permanent reduction of tax wedge (2015 Stability Law – L. no. 190/2014). | | In 2020: 0.4%; in long term: 0.4% | December 2014 |
| | Enabling legislative decrees on: Fiscal simplification (Lgs.D. no. 175/2014). | | (Fiscal simplification, estimates are included in administrative simplification) | November 2014 |
| | Enabling legislative decrees on: Tobacco products (Lgs. D. no. 188/2014); Cadastral committee (Lgs. D. no. 198/2014). | | - | December 2014 |
| | Enabling legislative decrees on: certainty of taxation (Lgs.D. no 128/2015); VAT electronic invoicing (Lgs.D. no 127/2015). | | - | August 2015 |
| | Enabling legislative decree on: simplifying taxation for international businesses (Lgs.D. no. 147/2015) | | - | September 2015 |
| | Enabling legislative decree on: monitoring of tax evasion (Lgs. D. no. 160/2015); sanction system and litigation procedures (Lgs. D. no. 156/2015); collecting system (Lgs. D. no. 159/2015); reorganisation of fiscal agencies (Lgs. D. no. 157/2015). | | - | October 2015 |
| | | Reform of the taxation on properties and local indivisible services (IMU, TASI) | - | 2016 |
| | | Measures to reduce the fiscal burden on businesses and households | - | 2016-2018 |
| | | | | |
| Privatisation | Selling of public shares: Fincantieri (through CDP); CDP Reti; Trans Austria Gasleitung GMbH – Tag; RAIWay. | | - | 2014 |
| | Selling of public shares: ENEL. | Privatisation of Poste Italiane, ENAV, STMicroelectronics Holding, Ferrovie dello Stato (Grandi Stazioni, Cento Stazioni) | Revenues from privatisation for 0.4 p.p. of GDP in 2015, 0.5 p.p. in 2016-2018 period | 2015 - 2018 |
| | | | | |
| Infrastructure | National Strategic Plan for airports. | | - | August 2015 |
| | National Plan for Ports and logistics (D.L. '*Sblocca Italia*' cvt. L. 164/2014) preliminary approval in the Prime Minister Cabinet of 3, July 2015[33]. | | - | September 2015 |
| | | Review of public procurement. (under examination at the VIII Commission of the Chamber of Deputies' – A.C. 3194) | - | December 2015 |
| | | | | |
| Competition | | Strategic ultra-broad band plan | - | 2015 |
| | | Annual law on competition for 2015 | In 2020: 0.4%; in long term: 1.2% | 2015 |
| | | Measures for competition (*) | - | December 2015 |

[33] The Prime Minister Decree of 26th August 2015 was endorsed by the control body no. 2104/2015 of 2nd September 2015.

**Table II.1-1 Reform timetable (continue)**

| Policy Area | Done | In Progress | Impact on GDP | Timetable |
|---|---|---|---|---|
| | | | | |
| Credit | Measure on non-performing loans and bankruptcy (D.L. no. 83/2015 cvt. in L. no. 132/2015). | | - | August 2015 |
| | | Strengthening of Central Guarantee Fund for SMEs (*) | - | October 2015 |
| | | Enhancement of enterprise networks (*) | - | 2015 |
| | Reform of '*Banche Popolari*' (D.L. no. 3/2015 cvt. in L. no. 33/2015). | | - | March 2015 |
| | | Reforms of cooperative banks and Foundations[34] | - | 2015 - 2016 |
| | | | | |
| Education | '*La buona scuola*' reform (L. no. 107/2015). | | In 2020: 0.3%; in long term: 2.4% | July 2015 |
| | | National Plan for Research (*) | - | 2015 |
| | | National Plan for digital education (*) | - | 2015 - 2018 |
| | | | | |
| Public Administration and simplification | Simplification Agenda 2015-2017: simplification for businesses. | | - | December 2014 |
| | Enabling Law on reforming the Public Administration (L. no. 124/2015). | | In 2020: 0.4%; in long term: 1.2% | August 2015 (enabling decrees for Dec. 2015) |
| | | Reform of local public services (*) | - | 2015 |
| | | | | |
| Health | National Healthcare Plan 2014-2016. | | - | July 2014 |
| | | | | |
| Agriculture | Measures for the milk and dairy industry (D.L. no. 51/2015 cvt. L. no. 91/2015). | | - | July 2015 |
| | Implementation of the Common Agricultural Policy. | | - | March 2015 |
| | | | | |
| Environment | | *Green Act* | - | October 2015 |
| | | Environmental taxation (*) | - | 2015 - 2016 |
| | | | | |
| Spending Review and tax expenditures | | Enhancing PA efficiency and revision of the tax expenditures | In 2020: -0.2%; in long term: 0.0% | Structural savings planned until 2019 |
| | | | | |
| **Impact of measures in 2020: 1.8%** | | | | |
| **Impact of measures in 2025: 3.0%** | | | | |
| **Impact of reforms in long term: 7.2%** | | | | |

Note: Reforms are split according to their state of advancement in two categories: i) reforms presented in Parliament for approval (in progress) and ii) reforms who have already completed the process of approval and have been published in the Official Journal (done). The reforms that have not been discussed by the Government are marked with the symbol (*).

[34] For Foundations, Memorandum of Understanding between ACRI and MEF was signed in April 2015.

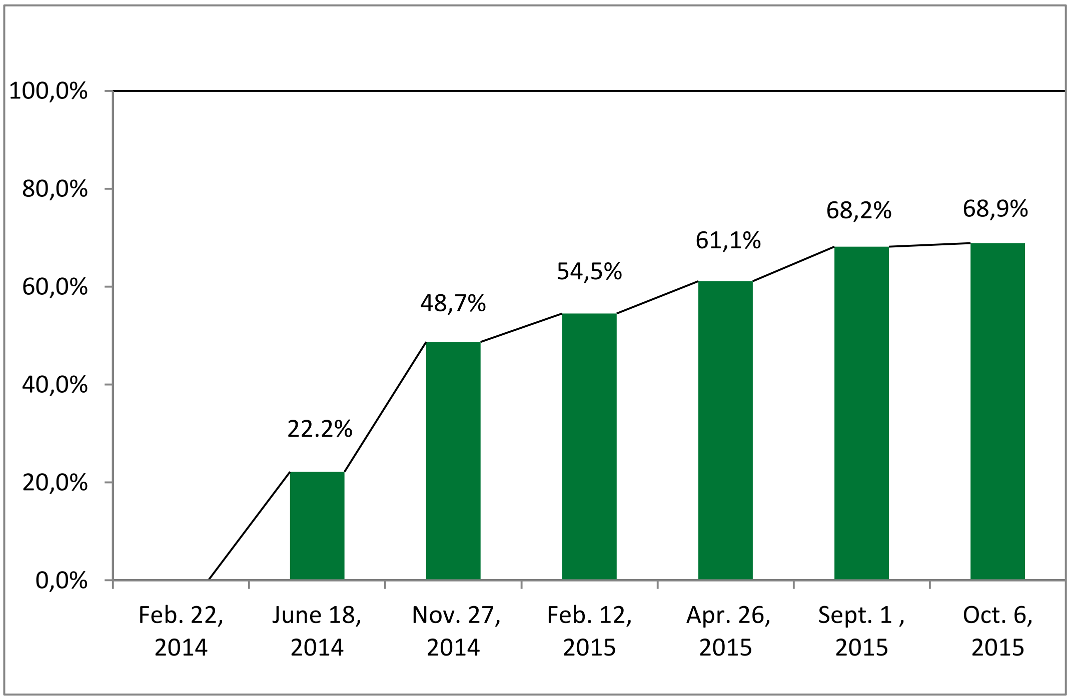
## Reform's implementation and legislative monitoring

The reforms implementation is a priority for the government[35]. For this reason, the monitoring of the legislative implementation has been strengthened both in terms of frequency and extension of the survey, also considering the commitment shown by ministries to enact the measures.

The rate implementation of the reforms of the government in office as of October 6, 2015 reached 68.9 per cent (see Figure II.1)[36].

As of September 14, 2015 the stock of the decrees inherited from previous governments (Letta and Monti), which amounted to 889 measures, fell to 261, with an implementation rate of 74.9 percent.

**Figure II.1-1 Renzi government: implementation rate of reforms**




Note: Implementation rate calculated on the base of the terms set
Source: Prime Minister Cabinet – Ufficio per il programma di Governo.

Concerning the progress in the web based information system for monitoring the implementation of the measures, it should be noted that the system has been put in place in line with the time schedule and after a trial phase, it is now in use by all ministries.

[35] For further information see http://www.programmagoverno.gov.it/

[36] As for the Government in office, since February 22, 2014 to September 14, 2015, the approved laws amount to 219, 40 percent of which are legislative decrees, 43 percent bills and 17 percent decree laws. In the Italian Official Journal 120 legislative acts published so far, 48 percent of which does not require any implementation act, while 52 percent needs 532 implementing acts.

# III. TABLES

**Table III.1-1 Basic Assumptions (0.i)**

| | 2014 | 2015 | 2016 |
|---|---|---|---|
| Short-term interest rate (annual average)[1] | n.a. | 0.0 | 0.3 |
| Long-term interest rate (annual average) | 3.0 | 2.0 | 2.4 |
| USD/€ exchange rate (annual average) | 1.3 | 1.1 | 1.1 |
| Nominal effective exchange rate | 0.1 | -4.6 | -0.3 |
| World excluding EU, GDP growth | 3.6 | 3.7 | 4.2 |
| EU GDP growth | 1.3 | 1.7 | 2.1 |
| Growth of relevant foreign markets | 3.6 | 4.0 | 4.1 |
| World import volumes, excluding EU | 2.5 | 0.5 | 4.6 |
| Oil prices (Brent, USD/barrel) | 99.0 | 53.7 | 54.1 |

[1] 1 Short-term interest rate: the average of the forecast rates on 3-month government securities issued during the year. Long-term interest rate: the average of the forecast rates on 10-year government securities issued during the year.

**Table III.1-2 Macroeconomic prospects (1.a)**

| | ESA Code | 2014 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|
| | | Level | rate of change | rate of change | rate of change | rate of change | rate of change | rate of change |
| 1. Real GDP | B1*g | 1,535,331 | -0.4 | 0.9 | 1.6 | 1.6 | 1.5 | 1.3 |
| Of which | | | | | | | | |
| 1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth | | | | | | | | |
| 2. Potential GDP [1] | | 1,621,594 | -0.4 | 0.0 | 0.0 | 0.3 | 0.4 | 0.6 |
| contributions: | | | | | | | | |
| - labour | | | -0.1 | 0.2 | 0.1 | | | |
| - capital | | | -0.2 | -0.1 | -0.1 | | | |
| - total factor productivity | | | -0.1 | -0.1 | 0.0 | | | |
| 3. Nominal GDP | B1*g | 1,613,859 | 0.4 | 1.3 | 2.6 | 3.3 | 3.4 | 3.1 |
| COMPONENTS OF REAL GDP | | | | | | | | |
| 4. Private consumption | P.3 | 919,647 | 0.4 | 0.8 | 1.5 | | | |
| 5. Government final consumption expenditure | P.3 | 314,364 | -0.7 | -0.2 | 0.8 | | | |
| 6. Gross fixed capital formation | P.51 | 256,520 | -3.5 | 1.2 | 2.7 | | | |
| 7. Changes in inventories and net acquisition of valuables (% of GDP) | P.52 + P.53 | | -0.1 | 0.4 | 0.1 | | | |
| 8. Exports of goods and services | P.6 | 452,140 | 3.1 | 4.3 | 3.8 | | | |
| 9. Imports of goods and services | P.7 | 403,890 | 2.9 | 5.6 | 4.2 | | | |
| Contributions to real GDP growth | | | | | | | | |
| 10. Final domestic demand | | - | -0.5 | 0.7 | 1.5 | | | |
| 11. Changes in inventories and net acquisition of valuables | P.52 + P.53 | - | -0.1 | 0.4 | 0.1 | | | |
| 12. External balance of goods and services | B.11 | - | 0.2 | -0.2 | 0.0 | | | |

[1] The rate of potential growth and the output gaps have been derived on the basis of the commonly agreed methodology on the basis of the macroeconomic outlook of the 2015 Update of the Economic and Financial Document fro the period 2015-2019.

They may differ from the figures calculated by the European Commission for a different (longer) time horizon.

**Table III.1-3 Price developments (1.b)**

| | ESA Code | 2014 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|
| | | Level | rate of change | rate of change | rate of change | rate of change | rate of change | rate of change |
| 1. GDP deflator | | 105.1 | 0.9 | 0.4 | 1.0 | 1.7 | 1.9 | 1.8 |
| 2. Private consumption deflator | | 107.2 | 0.3 | 0.3 | 1.0 | | | |
| 3. HICP | | 119.3 | 0.2 | 0.3 | 1.0 | | | |
| 4. Public consumption deflator | | 100.3 | 0.7 | -0.9 | -0.5 | | | |
| 5. Investment deflator | | 104.5 | 0.1 | 0.2 | 1.7 | | | |
| 6. Export price deflator (goods and services) | | 105.5 | -0.3 | 0.0 | 1.1 | | | |
| 7. Import price deflator (goods and services) | | 106.1 | -2.4 | -0.8 | 1.3 | | | |

**Table III.1-4 Labour market developments (1.c)**

| | ESA Code | 2014 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| | | Level | rate of change | rate of change | rate of change |
| 1. Employment, persons | | 24,340 | 0.1 | 0.7 | 1.0 |
| 2. Employment, hours worked | | 41,881,639 | 0.1 | 1.0 | 1.1 |
| 3. Unemployment rate (%) | | - | 12.7 | 12.2 | 11.7 |
| 4. Labour productivity, persons | | 63,078 | -0.5 | 0.2 | 0.6 |
| 5. Labour productivity, hours worked | | 37 | -0.6 | -0.2 | 0.5 |
| 6. Compensation of employees | D.1 | 643,912 | 0.9 | 1.7 | 2.0 |
| 7. Compensation per employee | | 40,150 | 0.6 | 0.7 | 0.9 |

**Table III.1-5 Sectorial balances (1.d)**

| | ESA Code | 2014 | 2015 | 2016 |
|---|---|---|---|---|
| | B.9 | % GDP | % GDP | % GDP |
| 1. Net lending/net borrowing vis-à-vis the rest of the world | | 2.2 | 1.9 | 1.9 |
| *of which*: | | | | |
| - Balance on goods and services | | 3.0 | 3.0 | 2.9 |
| - Balance of primary incomes and transfers | | -1.1 | -1.3 | -1.3 |
| - Capital account | | 0.2 | 0.2 | 0.2 |
| 2. Net lending/net borrowing of the private sector | B.9 | 5.2 | 4.5 | 4.1 |
| 3. Net lending/net borrowing of general government [1] | B.9 | -3.0 | -2.6 | -2.2 |
| 4. Statistical discrepancy | | | | |

[1] Following the introduction of the new national accounting system, the treatment of interest related to operations in financial derivatives within the EDP, has been aligned with the ESA 2010 definition.

**Table III.1-6 General government budgetary targets broken down by subsector (2.a)**

| | ESA Code | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| | | % GDP | % GDP | %GDP | %GDP | % GDP |
| **Net lending (+) / net borrowing (-) ( B.9) by sub-sector** | | | | | | |
| 1. General government | S.13 | -2.6 | -2.2 | -1.1 | -0.2 | 0.3 |
| 2. Central government | S.1311 | -2.7 | -2.3 | | | |
| 3. State government | S.1312 | | | | | |
| 4. Local government | S.1213 | 0.0 | 0.0 | | | |
| 5. Social security funds | S.1314 | 0.1 | 0.1 | | | |
| 6. Interest expenditure | D.41 | 4.3 | 4.2 | | | |
| 7. Primary balance [2] | | 1.7 | 2.0 | | | |
| 8. One-off and other temporary measures | | -0.1 | -0.1 | 0.0 | -0.1 | 0.0 |
| 9. Real GDP growth (%) (=1 in Table 1.a) | | 0.9 | 1.6 | | | |
| 10. Potential GDP growth (%) (=2 in Table 1.a) | | 0.0 | 0.0 | 0.3 | 0.4 | 0.6 |
| *contributions:* | | | | | | |
| *- labour* | | *0.2* | *0.1* | *0.2* | *0.2* | *0.3* |
| *- capital* | | *-0.1* | *-0.1* | *0.0* | *0.1* | *0.1* |
| *- total factor productivity* | | *-0.1* | *0.0* | *0.1* | *0.1* | *0.1* |
| 11. Output gap (% of potential GDP) | | -4.0 | -2.5 | -1.2 | -0.2 | 0.5 |
| 12. Cyclical budgetary component (% of potential GDP) | | -2.2 | -1.4 | -0.7 | -0.1 | 0.3 |
| 13. Cyclically-adjusted balance (1 - 12) (% of potential GDP) | | -0.4 | -0.9 | -0.4 | -0.1 | 0.0 |
| 14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP) | | 3.8 | 3.4 | 3.7 | 4.0 | 4.0 |
| 15. Structural balance (13 - 8) (% of potential GDP) | | -0.3 | -0.7 | -0.3 | 0.0 | 0.0 |

[1] TR-TE= B.9.
[2] The primary balance is calculated as (B.9, item 8) plus (D.41, item 9).

**Table III.1-7 General government debt developments (2.b)**

| * | ESA Code | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| | | % GDP | % GDP | % GDP | % GDP | % GDP |
| 1. Gross debt[1] | | 132.8 | 131.4 | 127.9 | 123.7 | 119.8 |
| 2. Change in gross debt ratio | | 0.5 | -1.4 | | | |
| Contributions to changes in gross debt | | | | | | |
| 3. Primary balance (= item 7 in Table 2.a.) | | 1.7 | 2,0 | | | |
| 4. Interest expenditure (= item 6 in Table 2.a.) | D.41 | 4.3 | 4.2 | | | |
| 5. Stock-flow adjustment ** | | -0.4 | -0.3 | -0.3 | -0.2 | 0.1 |
| *of which:* | | | | | | |
| - Differences between cash and accruals | | 1,0 | 0,0 | | | |
| - Net accumulation of financial assets | | -0.4 | -0.5 | | | |
| *of which:* | | | | | | |
| - *privatization proceeds* | | *-0.4* | *-0.5* | | | |
| - Valuation effects and other | | *-0.9* | *0.3* | | | |
| p.m.: Implicit interest rate on debt | | 3.3 | 3.3 | | | |
| Other relevant variables | | | | | | |
| 6. Liquid financial assets | | | | | | |
| 7. Net financial debt (7=1-6) | | | | | | |
| 8. Debt amortization (existing bonds) since the end of the previous year | | | | | | |
| 9. Percentage of debt denominated in foreign currency | | | | | | |
| 10. Average maturity | | | | | | |

* Decimals may not add, due to rounding to the first decimal place
[1] As defined in Regulation 479/2009.
** Sum of Differences between cash and accruals, Net accumulation of financial assets and Valuation effects and other

**Table III.1-8 General government expenditure and revenue projections at unchanged policies broken down by main components (3)**

| General government (S13) | ESA Code | 2015 | 2016 |
|---|---|---|---|
| | | % GDP | % GDP |
| **1. Total revenue at unchanged policies** | TR | 48.2 | 48.6 |
| Of which | | | |
| 1.1. Taxes on production and imports | D.2 | 15.0 | 15.7 |
| 1.2. Current taxes on income, wealth, etc | D.5 | 15.3 | 15.2 |
| 1.3. Capital taxes | D.91 | 0.1 | 0.1 |
| 1.4. Social contributions | D.61 | 13.3 | 13.1 |
| 1.5. Property income | D.4 | 0.6 | 0.5 |
| 1.6. Other | | 3.9 | 3.9 |
| p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995) | | 43.7 | 44.2 |
| **2. Total expenditure at unchanged policies** | TE | 50.9 | 50.0 |
| Of which | | | |
| 2.1. Compensation of employees | D.1 | 10.1 | 9.9 |
| 2.2. Intermediate consumption | P.2 | 7.9 | 7.8 |
| 2.3. Social payments | D.62,D.632 | 20.5 | 20.3 |
| Of which Unemployment benefits | | *1.0* | *1.0* |
| 2.4. Interest expenditure | D.41 | 4.3 | 4.2 |
| 2.5. Subsidies | D.3 | 1.7 | 1.6 |
| 2.6. Gross fixed capital formation | P.51g | 2.3 | 2.3 |
| 2.7. Capital transfers | D.9 | 1.6 | 1.4 |
| 2.8. Other | | 2.4 | 2.4 |

**Table III.1-9 General government expenditure and revenue targets, broken down by main components (4.a)**

| General government (S13) | ESA Code | 2015 | 2016 |
|---|---|---|---|
| | | % GDP | % GDP |
| **1. Total revenue target** | TR | 48.2 | 47.6 |
| Of which | | | |
| 1.1. Taxes on production and imports | D.2 | 15.0 | 14.6 |
| 1.2. Current taxes on income, wealth, etc | D.5 | 15.3 | 15.2 |
| 1.3. Capital taxes | D.91 | 0.1 | 0.2 |
| 1.4. Social contributions | D.61 | 13.3 | 13.1 |
| 1.5. Property income | D.4 | 0.6 | 0.5 |
| 1.6. Other | | 3.9 | 3.9 |
| p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995) | | 43.7 | 43,1 |
| **2. Total expenditure target** | TE | 50.8 | 49.8 |
| Of which | | | |
| 2.1. Compensation of employees | D.1 | 10.1 | 9.9 |
| 2.2. Intermediate consumption | P.2 | 7.9 | 7.6 |
| 2.3. Social payments | D.62, D.632 | 20.5 | 20.4 |
| Of which Unemployment benefits | | *1.0* | *1.0* |
| 2.4. = Table 2.a.9. Interest expenditure | D.41 | 4.3 | 4.2 |
| 2.5. Subsidies | D.3 | 1.7 | 1.5 |
| 2.6. Gross fixed capital formation | P.51g | 2.3 | 2.3 |
| 2.7. Capital transfers | D.9 | 1.6 | 1.4 |
| 2.8. Other | | 2.4 | 2.4 |

**Table III.1-10 Amounts to be excluded from the expenditure benchmark (4.b)**

| | ESA Code | 2014 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| | | Level | % GDP | % GDP | % GDP |
| 1. Expenditure on EU programmes fully matched by EU funds revenue | | 5,500 | 0.3 | 0.3 | 0.3 |
| 2. Cyclical unemployment benefit expenditure[1] | | 3,085 | 0.2 | 0.2 | 0.1 |
| 3. Effect of discretionary revenue measures | | 8,118 | 0.5 | -0.2 | -0.9 |
| 4. Revenue increases mandated by law | | 0 | 0.0 | 0.0 | 0.0 |

[1] Computed on the basis of the unemployment gap

**Table III.1-11 General government expenditure by function (4.c)**

4.c.i) General government expenditure on education, healthcare and employment

Table 4.c.i) General government expenditure on education, healthcare and employment

| Expenditure category | Available information |
|---|---|
| Education | Education expenditure[1] averages on 3.7% as a share of GDP in the five year-period 2011-2015 (3.7% in 2016). As for the mid-long term trends, see the latest forects carried out based on the methodology and the long term scenario elaborated at the European level within the Economic Policy Committee - Working Group on Ageing Populations and Sustainability[2] |
| Health | Health care expenditure as percentage of GDP averages on 6.8% in the five-year period 2011-2015 (6.7% in 2016). As for the mid-long term trends, see the latest forects carried out based on the national scenario and that elaborated at the European level within the Economic Policy Committee - Working Group on Ageing Populations and Sustainability[2] |
| Employment[3] | The employment expenditure to GDP ratio decreased from 0,42% in 2008 to 0,35% in 2013 , remaining largely stable between 2012 and 2013 (from 0.37% to 0.35%). At present, elements that could foresee expenditure-to-GDP ratio different from 0.3% between 2013 and 2015 are not available; at the same time, expenditure is expected to be used more effectively during 2015-2016, also taking into consideration the decrees implementing the Jobs Act, which have aimed at rationalising active labour market policies. |

[1] Ageing Working Group definition: the aggregate includes educational levels ISCED 1-6 according to the OECD classification. It does not include Lifelong training and pre-primary level of education.

[2] Source: “Ministero dell'economia e delle finanze (2015), - Le tendenze di medio-lungo periodo del sistema pensionistico e socio-sanitario. Previsioni elaborate con i modelli della Ragioneria Generale dello Stato aggiornati a settembre 2015: Nota di Aggiornamento al rapporto n. 16".

[3] The employment expenditure contains government spending related to active labour market policies including public employment services.

Source: Ministry of Labour and Social Policy

**Table III.1-12 Discretionary measures taken by General Government (5.a)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Rationalisation of expenditure for the purchase of goods and services of Central Government and local government | Motivation: Efficiency of public spending for the purchase of goods and services<br>Contents: measures to ensure the full operation of the new mechanism of centralized procurement for public administrations (already started in decree law 66/2014), including:<br>(1) extension of the obligations and the faculties of centralized procurement and involvement of a wider range of public administrations;<br>(2) extension of the obligations for local governments to purchase through centralized procurement aggregator bodies;<br>(3) a better programming through the preparation of biennial programmes related to the necessities of purchase of goods and services for each administration;<br>(4) the identification of the "essential characteristics" of goods and services, on which comparisons in the application of these called "benchmark price" (which defines the spending threshold for purchases outside the centralized procurement mechanism) | P.2 | ESA 2010 | immediately effective | E | -0.013 | -0.028 | -0.000 | - |
| Rationalization of Central Government spending (Spending review) | Motivation: Rationalization of public expenditure<br>Contents: Specific rationalisation and efficiency measures, duly identified by each Ministries or as a result of spending review activities, also through reallocation between different areas of expenditure | various | | immediately effective | E | -0.202 | 0.075 | -0.007 | -0.004 |
| Regions and autonomous provinces | Motivation: Contribution of the regions and autonomous provinces to the budget<br>Contents: contribution in areas of expenditure and for amounts to be determined in accordance with the essential levels of assistance, within the auto-coordination system and to be deliberated by the Permanent Conference for relations between the State, the regions and the autonomous provinces of Trento and Bolzano, by 31 January of each year. In the absence of an agreement, the amounts will be assigned by decree of the President of the council of Ministers to areas of expenditure and allocated to individual regions and autonomous provinces, taking also into account resident population and GDP. Funding levels and modalities for the acquisition of resources to the national budget are to be redetermined consequently, also including the resources for financing the National Health Service. | P.2 | ESA 2010 | immediately effective | E | -0.106 | -0.099 | -0.084 | - |
| Regions' balanced budget | Achievement of a balanced budget for the Regions | various | ESA 2010 | immediately effective | E | -0.110 | 0.048 | 0.020 | -0.083 |

**Table III.1-12 Discretionary measures taken by General Government (5.a)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Voluntary disclosure and financial administration efficiency | Motivation: Fight against tax evasion<br>Contents: Extension throughout 2016 of deadlines for the submission of instances of "voluntary disclosure" on income and assets held abroad | D.5 | ESA 2010 | immediately effective | R | 0.128 | -0.124 | - | - |
| Games and competitions for the renewal of licences | Motivation: Reordering the gaming industry<br>Contents: increase in the rate of taxation for games with specific machines and new selection procedures for providers acting in the field of 'fixed odds' games and 'totalizers betting' on sporting events and others, in line with Community principles<br>(1) increase the rate of tax levy for games using AWP and VLT machines<br>(2) extension of tax regularization process for unauthorized online betting collection centres<br>(3) new procedures for the public selection of operators acting in the field of fixed odds game and totalizers, betting on sporting events or not, the game of bingo and gambling, in coherence with Community principles | D.2 | ESA 2010 | immediately effective | R | 0.066 | -0.029 | - | - |
| Disabling of the safeguard clauses of the previous Stability Laws | Motivation: Reduction of the tax burden<br>Contents: Freeze of the tax increases on excise duties and VAT that should have been in force since the beginning of 2016 , thanks to the effectiveness of the cost savings measures and to the higher savings due to the rationalization and review of public spending. | D.2 | ESA 2010 | immediately effective | R | -1.002 | 0.330 | 0.094 | - |
| Revision of taxation on primary dwellings (IMU and TASI) | Motivation: Reduction of the tax burden for households<br>Contents: Exemption on property taxes and service taxes on owner-occupied residential dwellings, affecting 80 per cent of households. Exemption of tax on overseas property values for properties used for main dwelling. | D.4 | ESA 2010 | immediately effective | R | -0.214 | -0.000 | 0.000 | - |
| Revision of taxation on agricultural land and industrial facilities | Motivation: Reduction of the tax burden for businesses<br>Contents: Repeal of municipal taxes on agricultural land, plans and machinery (so-called 'imbullonati') | D.4 | ESA 2010 | immediately effective | R | -0.056 | - | - | - |
| Flat-rate scheme for companies and self-employed | Motivation: Reduction of the tax burden for businesses and simplification<br>Contents: Raising the threshold of minimum fees for professionals to access the preferential tax regime | D.5 | ESA 2010 | immediately effective | R | 0.017 | -0.046 | 0.012 | 0.001 |
| Accelerated depre ciation | Motivation: Reduction of the tax burden for businesses<br>Contents: a 40 per cent allowance on fiscal depreciation applying to investment in machinery and equipment realized in 2016. aiming at the renewal of the productive capital of companies. | D.5 | ESA 2010 | immediately effective | R | -0.010 | -0.045 | -0.018 | 0.016 |

**Table III.1-12 Discretionary measures taken by General Government (5.a)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Fight against poverty | Motivation: Fight against poverty Contents: a special fund to combat poverty and social exclusion is set, specifically aimed at supporting measures against poor childhood through interventions directed to: (1) a nationwide measure to combat poverty, based on the extension, strengthening and consolidation of the so-called "Social card"; (2) financing of unemployment benefit (ASDI) (3) legislation on reordering of benefits, allowances, income supplements and welfare grants or other means-tested benefits, also addressed to beneficiaries residing abroad, and the reordering of access to social benefits, aimed at the introduction of a single national measure to combat poverty and the rationalisation of instruments and existing treatments (4) tax credits for banking foundations that contribute to the Fund for the fight against poverty | D.62p | ESA 2010 | immediately effective | E | 0.042 | 0.023 | - | -0.005 |
| Enterprise bargain ing | Motivation: promoting second-level firm bargaining Contents: Tax breaks on productivity premiums by providing a 10 percent taxation threshold for private sector workers who perceived an income not exceeding 50 thousand euro (and with limits on the total amount) | D.5 | ESA 2010 | immediately effective | R | -0.026 | -0.009 | 0.000 | - |
| Provinces and metropolitan cities | Motivation: Intervention in favour of the provinces and metropolitan cities Contents: (1) interventions relating to roads/transport and school maintenance construction functions, to be allocated to each administration by February 28, 2016 (also taking into account the commitments derived from the 3 latest accounts ) (2) contribution for the payment of province staff salaries, while the reorganization process of the functions of the provinces and the reassignment of supernumerary staff to other public administration is completed | various | ESA 2010 | immediately effective | E | 0.024 | - | - | - |
| Municipalities | Possibility granted to municipalities to use a portion of the cash surpluses to invest, derogating from the balanced budget rule | various | ESA 2010 | immediately effective | E | 0.040 | -0.038 | - | -0.001 |
| Support for research | Motivation: A more attractive and competitive University System Contents: Resources for; recruiting first and second-tier University professors by direct call and to encourage the mobility between different universities, for the entry of researchers in Universities, and for medicine specialisation practice | D.1 | ESA 2010 | immediately effective | E | 0.005 | 0.002 | 0.001 | -0.002 |

**Table III.1-12 Discretionary measures taken by General Government (5.a)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Social security contribution exemptions for new permanent labour contracts. | Motivation: Reduction of the tax wedge on labour<br>Contents: the continuation, in reduced amounts, of social security contribution exemptions for new permanent work contracts. For a maximum period of 24 months, the exemption from payment of 40% of social security contributions paid by employers is granted (within the limit of 3,250 euros on an annual basis) with reference to new hires with permanent work contracts made in 2016. The exemption refers to new hires with the exception of those relating to workers that, within the previous six months, were elsewhere employed with a permanent work contract. | D.61 | ESA 2010 | immediately effective | R | -0.050 | -0.041 | 0.031 | 0.053 |
| Construction businesses and energy savings | Motivation: Supporting the construction sector and energy savings<br>Contents: Supporting the construction industry, through an extension till the end of 2016 of the tax relief already provided for renovation of buildings, energy efficiency upgrading, for the purchase of furniture and large electronic appliances, and for the purchase of furniture by young couples buying their first home, as well as measures aimed at promoting energy savings through a reduction from 22 to 10 percent VAT on pellets (fuel derived from sawdust) | various | ESA 2010 | immediately effective | R | -0.003 | -0.031 | -0.059 | -0.043 |
| Protection of persons close to retirement and promotion of generational change | Motivation: Protection of persons close to retirement and promotion of generational change<br>Contents: Protection of unemployed persons close to retirement through safeguards for a residual part of 'esodati'; "no tax area " measure for pensioners by increasing deductions payable to pensioners with a total income up to 15,000 euros; as well as measures to promote generational turn over of workers:<br>(1) the "option woman" to favour the retirement of women with at least 35 years of contributions against a reduction of their pension calculated on the basis of their contributions<br>(2) benefits for workers close to retirement (at least 63 years and 7 months of age) through a part time scheme | various | ESA 2010 | immediately effective | E | 0.022 | 0.046 | 0.063 | 0.051 |
| Corporate Income tax rate reduction (IRES) | Motivation: Reduction of the tax burden for businesses<br>Contents: A 3,5 percent point reduction of the corporate income tax starting from 2017 | D.5 | ESA 2010 | immediately effective | R | - | -0.172 | -0.055 | - |

**Table III.1-12 Discretionary measures taken by General Government (5.a)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Other resources (various) | Contents:<br>(1) reduction of forecasted expenditure on maintenance and construction of healthcare facilities<br>(2) temporary extension (2017 and 2018) of the partial block of indexation of pensions above a certain threshold<br>(3) recovery of residual resources previously set to protect unemployed close to retirement ("esodati")<br>(4) restatement of the value of land and investments and business goods | various | ESA 2010 | immediately effective | | 0.078 | 0.022 | 0.032 | -0.053 |
| Other costs (various) | Contents:<br>(1) financing of unchanged policies<br>(2) economic, social and environmental measures for areas in emergency situation (so-called "terra dei fuochi") and intervention in other emergency areas<br>(3) tax credits and expenditure measures in the field of culture<br>(4) other measures with minor financial impact | various | ESA 2010 | immediately effective | | 0.094 | 0.067 | -0.000 | 0.011 |
| | | | | | TOTAL | -0.870 | -0.265 | 0.167 | 0.124 |

Note: In case of flexibility granted at the European level (2.4% hypothesis) a further reduction of taxes on business profits is foreseen by lowering the income tax rate by 3 percent points in 2016 and additional 0.5 percentage points from 2017 (the rate of corporate income tax would decrease from 27.5 percent to 24.5 percent in 2016 and to 24 percent from 2017) and further resources would be allocated to school maintenance and construction.

**Table III.1-13 Discretionary measures taken by Central Government (5.b)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Rationalization of Central Government spending (Spending review) | Motivation: Rationalization of public expenditure<br>Contents: Specific rationalisation and efficiency measures, duly identified by each Ministries or as a result of spending review activities, also through reallocation between different areas of expenditure | various | | immediately effective | E | -0.202 | 0.075 | -0.007 | -0.004 |
| Voluntary disclosure and financial administration efficiency | Motivation: Fight against tax evasion<br>Contents: Extension throughout 2016 of deadlines for the submission of instances of "voluntary disclosure" on income and assets held abroad | D.5 | ESA 2010 | immediately effective | R | 0.128 | -0.124 | - | - |
| Games and competitions for the renewal of licences | Motivation: Reordering the gaming industry<br>Contents: increase in the rate of taxation for games with specific machines and new selection procedures for providers acting in the field of 'fixed odds' games and 'totalizers betting' on sporting events and others, in line with Community principles<br>(1) increase the rate of tax levy for games using AWP and VLT machines<br>(2) extension of tax regularization process for unauthorized online betting collection centres<br>(3) new procedures for the public selection of operators acting in the field of fixed odds game and totalizers, betting on sporting events or not, the game of bingo and gambling, in coherence with Community principles | D.2 | ESA 2010 | immediately effective | R | 0.066 | -0.029 | - | - |
| Disabling of the safeguard clauses of the previous Stability Laws | Motivation: Reduction of the tax burden<br>Contents: Freeze of the tax increases on excise duties and VAT that should have been in force since the beginning of 2016 , thanks to the effectiveness of the cost savings measures and to the higher savings due to the rationalization and review of public spending. | D.2 | ESA 2010 | immediately effective | R | -1.002 | 0.330 | 0.094 | - |
| Flat-rate scheme for companies and self-employed | Motivation: Reduction of the tax burden for businesses and simplification<br>Contents: Raising the threshold of minimum fees for professionals to access the preferential tax regime | D.5 | ESA 2010 | immediately effective | R | 0.017 | -0.046 | 0.012 | 0.001 |

**Table III.1-13 Discretionary measures taken by Central Government (5.b)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Accelerated depre ciation | Motivation: Reduction of the tax burden for businesses Contents: a 40 per cent allowance on fiscal depreciation applying to investment in machinery and equipment realized in 2016. aiming at the renewal of the productive capital of companies. | D.5 | ESA 2010 | immediately effective | R | -0.010 | -0.045 | -0.018 | 0.016 |
| Fight against poverty | Motivation: Fight against poverty Contents: a special fund to combat poverty and social exclusion is set, specifically aimed at supporting measures against poor childhood through interventions directed to: (1) a nationwide measure to combat poverty, based on the extension, strengthening and consolidation of the so-called "Social card"; (2) financing of unemployment benefit (ASDI) (3) legislation on reordering of benefits, allowances, income supplements and welfare grants or other means-tested benefits, also addressed to beneficiaries residing abroad, and the reordering of access to social benefits, aimed at the introduction of a single national measure to combat poverty and the rationalisation of instruments and existing treatments (4) tax credits for banking foundations that contribute to the Fund for the fight against poverty | D.62p | ESA 2010 | immediately effective | E | 0.042 | 0.023 | - | -0.005 |
| Enterprise bargaini ng | Motivation: promoting second-level firm bargaining Contents: Tax breaks on productivity premiums by providing a 10 percent taxation threshold for private sector workers who perceived an income not exceeding 50 thousand euro (and with limits on the total amount) | D.5 | ESA 2010 | immediately effective | R | -0.026 | -0.009 | 0.000 | - |

**Table III.1-13 Discretionary measures taken by Central Government (5.b)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Support for research | Motivation: A more attractive and competitive University System<br>Contents: Resources for; recruiting first and second-tier University professors by direct call and to encourage the mobility between different universities, for the entry of researchers in Universities, and for medicine specialisation practice | D.1 | ESA 2010 | immediately effective | S | 0.005 | 0.002 | 0.001 | -0.002 |
| Social security contribution exemptions for new permanent labour contracts. | Motivation: Reduction of the tax wedge on labour<br>Contents: the continuation, in reduced amounts, of social security contribution exemptions for new permanent work contracts. For a maximum period of 24 months, the exemption from payment of 40% of social security contributions paid by employers is granted (within the limit of 3,250 euros on an annual basis) with reference to new hires with permanent work contracts made in 2016. The exemption refers to new hires with the exception of those relating to workers that, within the previous six months, were elsewhere employed with a permanent work contract. | D.61 | ESA 2010 | immediately effective | R | -0.050 | -0.041 | 0.031 | 0.053 |
| Construction businesses and energy savings | Motivation: Supporting the construction sector and energy savings<br>Contents: Supporting the construction industry, through an extension till the end of 2016 of the tax relief already provided for renovation of buildings, energy efficiency upgrading, for the purchase of furniture and large electronic appliances, and for the purchase of furniture by young couples buying their first home, as well as measures aimed at promoting energy savings through a reduction from 22 to 10 percent VAT on pellets (fuel derived from sawdust) | various | ESA 2010 | immediately effective | R | -0.003 | -0.031 | -0.059 | -0.043 |

**Table III.1-13 Discretionary measures taken by Central Government (5.b)**

| List of measures | Detailed description | Target (Expenditure / Revenue component) ESA Code | Accounting principle | Adoption Status | Budgetary impact | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Exp/rev | 2016 % GDP | 2017 % GDP | 2018 % GDP | 2019 % GDP |
| Protection of persons close to retirement and promotion of generational change | Motivation: Protection of persons close to retirement and promotion of generational change<br>Contents: Protection of unemployed persons close to retirement through safeguards for a residual part of esodati'; "no tax area " measure for pensioners by increasing deductions payable to pensioners with a total income up to 15,000 euros; as well as measures to promote generational turn over of workers:<br>(1) the "option woman" to favour the retirement of women with at least 35 years of contributions against a reduction of their pension calculated on the basis of their contributions<br>(2) benefits for workers close to retirement (at least 63 years and 7 months of age) through a part time scheme | various | ESA 2010 | immediately effective | E | 0.022 | 0.046 | 0.063 | 0.051 |
| Corporate Income tax rate reduction (IRES) | Motivation: Reduction of the tax burden for businesses<br>Contents: A 3,5 percent point reduction of the corporate income tax starting from 2017 | D.5 | ESA 2010 | immediately effective | R | - | -0.172 | -0.055 | - |

Note: In case of flexibility granted at the European level (2.4% hypothesis) a further redution of taxes on business profits is foreseen by lowering the the income tax rate by 3 percent points in 2016 and additional 0.5 percentage points from 2017 (the rate of corporate income tax would decrease from 27.5 percent to 24.5 percent in 2016 and to 24 percent from 2017) and further resources would be allocated to school maintenance and construction.

**Table III.1-14 Summary of the country Specific Recommendations and the implementation of reforms (6.a)**

| Specific Recommendation | Measures | Relevance |
|---|---|---|
| CSR.1.Achieve a fiscal adjustment of at least 0.25% of GDP towards the medium-term objective in 2015 and of 0.1% of GDP in 2016 by taking the necessary structural measures in both 2015 and 2016, taking into account the allowed deviation for the implementation of major structural reforms. Swiftly and thoroughly implement the privatisation programme and use windfall gains to make further progress towards putting the general government debt ratio on an appropriate downward path. Implement the enabling law for tax reform by September 2015, in particular the revision of tax expenditures and cadastral values and the measures to enhance tax compliance. | The flexibility in 2016 will lead to an estimated structural deficit of 0.7% in 2016 according to the Commission methodology. The structural budget balance is postponed to 2018 and maintained in 2019. The net borrowing is set at 2.6% in 2015, and over the period 2016 - 2018 at 2.2, 1.1 e 0.2% respectively, without considering in 2016 a potential margin of flexibility up to 0.2% to be agreed within the Growth and Stability Pact, accounting for the financial impact of the migration emergency; in 2019 a surplus of 0.3% is foreseen. In the planned scenario the debt-to-GDP ratio is set to 132.8% in 2015, expected to decline significantly in the following three-year period (131.4 in 2016, to reach 119.8% in 2019). | Structural fiscal adjustment |
| | Rationalisation of public spending. Selected subjects authorized aggregators and signed the Convention between CONSIP - MEF. Strengthened the purchasing of goods and services by central purchasing bodies on specific products of frequent use. Centralised public procurement is compulsory at different degrees for central government, social security funds regions, fiscal agencies, local authorities, state owned enterprise, and the NHS. Strengthened the benchmark prices system as defined by Consip. Streamlining the public procurement of goods and services related to ITC through the Agency for Digital Italy. | Public expenditure efficiency |
| | Financial plans and restructuring of bodies belonging to the National Health Service. Maximum data transparency of the budgets and implementation of a monitoring system for the health care activities provided and their quality. Introduction of a three-year plan of financial restructuring, containing measures for the achievement of the economic and financial position, taking into account the improvement of health services provided. Annual update of the basic levels of healthcare. | Health expenditure efficiency |
| | Resources for the payment of debts in arrears of the PA. New features for the digital platform in order to enhance the monitoring of trade payables of the PA. Designed a penalty system and revised administrative responsibilities for the delay. Strengthened the guarantee scheme already provided to lenders. | Payment of the debt in arrears of the PA |
| | Increased the municipal solidarity fund municipal and, as of 2016, increases the share of the Fund to be distributed according to standard requirements and fiscal capabilities criteria. Online publication of financial statements by 31 March. | Public expenditure efficiency in local authorities |
| | Privatisation plans for Enel, FS, Enav, Poste Italiane, STMicroelectronics. Transfer of public real estate to local entities, value enhancement and dismissal of State owned buildings. The targets set by the Government in the DEF2015 are confirmed: expected revenues from privatisation amount to 0.4 p.p. of GDP in 2015 (0.2 already realized), 0.5 p.p. in 2016, 2017 and 2018. | Public debt sustainability |
| | Completed the implementation of the enabling law on reforming the fiscal system. Approved the following measures: legal certainty in the relationship between tax administration and taxpayers; revision of administrative and penal sanctions (entering into force by January, 1 2016); VAT electronic invoicing; simplified measures for international firms; rationalisation of the tax collection system; reorganisation of fiscal agencies; fiscal litigation and certainty in proceedings; monitoring tax evasion and a new framework for revising tax expenditures. | Fiscal system sustainability |

**Table III.1-14 Summary of the country Specific Recommendations and the implementation of reforms (6.a)**

| Specific Recommendation | Measures | Relevance |
|---|---|---|
| | The Stability Law 2015 introduced a cut in the tax wedge through the full deductibility (for businesses and professionals) of the cost of labour hired with an open ended contract from the IRAP taxable base; permanent personal income tax bonus of €80 for employees with an annual income less than €26,000; the total exemption from the payment of social-welfare contributions due on the new full-time open-ended contracts signed before December 31, 2015. The Stability Law 2016 extends to 2016 the fiscal incentives on new open-ended contracts, revising its amount and duration. | Reducing the tax wedge on businesses |
| | Revision of taxation on business income (IRES) with the reduction of the tax rate from 27.5% to 24% in 2 years. | Reducing the tax wedge on businesses |
| | The access to the fiscal benefits for professionals and small businesses has been widened, with increased tax benefits. | Reducing the tax wedge for professionals and small businesses |
| | 40% increase in the cost deduction of instrumental goods purchased between October 2015 and December 2016 by businesses | Investment subsidies in capital goods |
| | Exemption from the tax on property (IMU) for agricultural land. IRAP exemption for agricultural activities and fishing prior subject to a rate of 1.9%. Revised the tax rules applied to the agricultural sector (VAT special regime, registration tax, revaluation of land for agricultural purposes). | Revision taxation on agriculture |
| | TASI and IMU exemption for housing owned or leased intended as principal dwelling. | Reducing the tax burden on households |
| | IMU exemption for the so-called 'bolted' equipment | Reducing the tax wedge on businesses |
| | Tax relief for renovation of buildings and energy upgrading, and for the purchase of furniture | Reducing the tax burden on households |
| | Revision of fiscal rules for gambling. Increase of the rate of the Single tax (Prelievo Erariale Unico). The expiration of concessions for fixed betting on sporting events and totalizer is established on 30 June 2016. | Tax system on games |

**Table III.1-14 Summary of the country Specific Recommendations and the implementation of reforms (6.a)**

| Specific Recommendation | Measures | Relevance |
|---|---|---|
| **CSR.2. Adopt the planned national strategic plan for ports and logistics, particularly to help promote intermodal transport through better connections. Ensure that the Agency for Territorial Cohesion is made fully operational so that the management of EU funds markedly improves.** | Approved the National Strategic Plan for Harbour and Logistics, with the aim of relaunching the competitiveness of the national shipping network; boosting the transportation of goods and passengers, easing the intermodal freight transportation. The Plan includes measures for: simplifying and reducing administrative burdens; boosting competitiveness and transparency; increasing the accessibility of land to sea networks; further integrating the logistic system; improving infrastructures; spurring innovation and sustainability; ameliorating resources management; promoting national coordination by reforming the governance of the sector. | Developing the harbour and logistics system |
| | Increased the coordination between the Customs and Monopolies Agencies for the simplification of the import/export procedures in the port system. With the Italian Coast Guard, simplified the pre-clearing procedures to present custom declarations on a pre-arrival basis in several Italian ports. | Administrative simplification |
| | The enabling law on reforming of Public administration orders the rationalisation of port authorities and their governance. | Rationalisation of port authorities |
| | The National Plan for Airports selected 38 airports of national strategic interest, as they are essential for the exclusive competences of the State. Among them, there are 12 airports of strategic relevance as part of the Trans-European Networks. | Developing the airport sector |
| | The Cohesion Agency is becoming fully operational thanks to the setup of the Board of Directors (in May) and the Board of Auditors (June, 19). | Efficiency in the management of EU Funds |
| | In June 2015, the expenditure certified to the European Commission by Italy in implementing the programs financed by EU funds has reached 79.8% of the total budget. The increase in spending compared to December, 31 2014 was of €3.1 billion (+6.5 p.p. of the total resources programmed). | Monitoring of the EU Funds management |
| | Started in July 2015, the Governance and Institutional Capacity building National Operational Programme 2014-2020. The Programme supported by Italy and the UE Commission, addresses the main problems and challenges arising from specific recommendations for the country regarding the administrative capacity and efficiency, the reform of justice system, the better management of the ESI Funds and the strengthening of the Administration in implementing the public policies of investment. | Improving the EU Funds management |
| | From 2016, Regions can attribute managerial and accounting independence to its own organizational structure designed for the financial management of European interventions. | Efficiency in the EU Funds management |

**Table III.1-14 Summary of the country Specific Recommendations and the implementation of reforms (6.a)**

| Specific Recommendation | Measures | Relevance |
|---|---|---|
| | Finally approved the new electoral law for the Chamber of Deputies. Redrawn also the parliamentary constituencies according to the new electoral system, each of which is represented by more than one Member of Parliament. | Institutional architecture |
| | Approved in August the enabling law reforming the Public administration. Among the main lines of intervention: rationalization of state owned enterprises, reorganization of public management, digitization of administrative services and accounting procedures, rationalization of the prefectures and chambers of commerce. The revision of the state owned enterprises discipline and the reorganization of the local public services is deferred to delegated acts of the government. | Reorganisation of the Public Administration |
| | Approved the law of in the field of corruption, against patronage and vote buying, accounting fraud and money laundering. False accounting becomes punishable for all companies, not only for those listed and the thresholds for punishment exemption are abolished. Penalties for crimes against the public administration are tightened. For those collaborating with the justice system there is a discount of penalty. | Anticorruption and efficiency in Public Administration |
| **CSR.3. Adopt and implement the pending laws aimed at improving the institutional framework and modernising the public administration. Revise the statute of limitations by mid-2015. Ensure that the reforms adopted to improve the efficiency of civil justice help reduce the length of proceedings.** | Completed the assessment on staffing across public administrations. Approved personnel equalization tables, according to the various legal systems of professions existing in the public sector, with the aim of facilitating the internal mobility process. The staff previously working in provinces will be relocated to regions and local authorities (provincial police and employment services personnel). | Efficiency in the Public Administration staffing |
| | In agriculture, measures have been adopted to improve the efficiency of the PA. In particular, it is under way the reorganisation of the companies and agencies under surveillance of the Ministry, the reorientation of the technical assistance in favour of consulting, both in the livestock sector and in that for cultivation. Simplifications in the management of the CAP 2015-2020. | Rationalization of public entities in the agricultural sector |
| | The performance analysis of civil justice shows a steady improvement. In January 2015, the new civil cases registered decreased by 20% compared to the previous year. In December 2013, the civil backlog amounted to 5.2 million cases and, at the end of 2014, the figure fell to 4.9 million (-6.8%). At the end of 2014 the registration of new causes of separation and divorce reduced by 40% with respect to the year before. The tax dispute fell thanks to the introduction of alternative procedures for dispute resolution. | Reducing the length of civil proceedings |
| | To ensure the reasonable length of trials, tools for speeding up the process are made available to the parts, designed as preventive remedies to avoid the abuse in the recourse to justice. | Reasonable length of trials |
| | Invitalia assisted the Ministry of Justice to develop the Telematic Notification System (SNT), finally set up. The system allows the courts to be fully in line with the law and to speed up the internal procedures as well as to reduce the amount of papers required. | Digitalisation of judicial procedures |
| | Regarding the tax courts, at the end of 2014 the pending litigation stood below 600,000 cases (- 9.5% with respect to the previous year). The figures at June, 30 2015 confirm the downward trend of the total pending tax disputes: -2.3% compared to 2014 and -8.1% compared to 30 June 2014. Regarding the new appeals to tax authorities, in 2014 the number of those presented at first instance is -10.1% compared to 2013. | Reducing the length of tax dispute |

**Table III.1-14 Summary of the country Specific Recommendations and the implementation of reforms (6.a)**

| Specific Recommendation | Measures | Relevance |
|---|---|---|
| | The use of PEC in the procedural communications anticipated the full implementation of the digital tax trial, with clear and direct benefits for both the administrative staff working in Tax Commissions and the parties involved in the tax judgment. | Digitalisation of tax trial |
| | Started the first phase of implementation of the digital tax trial. The launch is scheduled for December,1 2015 in the local and regional Tax Commissions of Tuscany and Umbria. | Digital tax trial |
| CSR.4. Introduce binding measures by end-2015 to tackle remaining weaknesses in the corporate governance of banks, particularly the role of foundations, and take measures to accelerate the broad-based reduction of non-performing loans.. | In April 2015 a protocol between ACRI and MEF was signed, in order to reform the regulation of Banking Foundations. It responds to the need that Banking Foundations be the main stakeholder while respecting the autonomy of participated banks, as well as diversify their investment. | Implement the reform of banking foundations |
| | The secondary legislation required to implement the reform of cooperative banks (D.L. no.3/2015) has been adopted. Starting from the day this legislation entered into force, the cooperative banks owning assets higher than €8 billion have 18-month to modify their status into a limited company. | Tackle weaknesses in the corporate governance of banks |
| | Legislative Decree no.72/2015 has been approved. It implements the Directive 2013/36/UE and reforms the regulation on managers and shareholders. Bank of Italy supervisory powers have been enlarged, adding the possibility of removing one or more members of the board and managers of the bank. The administrative sanctions have been totally reviewed, by adopting a system in which the company is sanctioned the first. | Tackle weaknesses in the corporate governance of banks |
| | European Enabling Law 2014 also implements the Directive 2014/59/EU (so called Directive BRRD) which draws a new framework for the recovery and bankruptcy procedure for banks and investment companies. National law will discipline a new resolution mechanism, alternative to the forced administrative liquidation. A bail-in process will be applied, a resolution mechanism to be activated when the capital writing off is not sufficient to cover the losses. Public supporting measures will be strongly limited. In September, the government approved in a preliminary examination two legislative decrees concerning the recovery and resolution of banks and investment company, thus implementing the European Enabling Law. | Tackle weaknesses in the corporate governance of banks |
| | Decree Law no.83/2015 changed the previous system of loss deduction in five annual instalments for the purposes of IRAP and IRES, providing for the total deductibility in the year of allocation of write-downs and credit losses for credit and financial institutions and insurance companies. | Accelerate the reduction of non-performing loans |
| | With the Decree Law no.83/2015, the government intervened to solve the difficulties in accessing credit by firms: a new restructuring agreement has been introduced involving financial creditors (i.e. banks and intermediaries) with the possibility of credit's deferment. | Accelerate the reduction of non-performing loans |

**Table III.1-14 Summary of the country Specific Recommendations and the implementation of reforms (6.a)**

| Specific Recommendation | Measures | Relevance |
|---|---|---|
| CSR.5. Adopt the legislative decrees on the use of wage supplementation schemes, the revision of contractual arrangements, work-life balance and the strengthening of active labour market policies. Establish, in consultation with the social partners and in accordance with national practices, an effective framework for second-level contractual bargaining. As part of efforts to tackle youth unemployment, adopt and implement the planned school reform and expand vocationally-oriented tertiary education. | Progress in the implementation of the enabling law reforming the labour market. Approved the following measures: the standard open-ended contract with increasing protection according to tenure; the universal unemployment benefit scheme associated to stronger active labour market measures; work-life balance measures; simplification of contractual models and administrative procedures; reorganisation of the active labour market policy; simplification of inspection activity and creation of a National Inspectorate. | Flexibility and job protection |
| | Adoption of the enabling law reforming the active labour market policies. Adoption of the statute for the National Employment Agency and election of its president (October 2015). Definition of the strategy implementing the new active labour market policies and agreements with the regions necessary under the current Constitutional framework (November 2015-Jannuary 2016). Implementation of the active labour market policies strategy according to the regional agreements and issuance of activation vouchers to unemployed individuals within a competitive quasi-market system (February 2016). | Active labour market policies |
| | Implementation of Youth Guarantee. Measures to support young self-entrepreneurs. Strengthen the link between school and work. Revision of the apprenticeship discipline. | Support to youth employment |
| | The tax regime of productivity wage premia in the private sector has been revised. They are subject to a facilitated personal income tax regime within fixed limits, which are greater if firms involve workers in the labour organisation. As an alternative to the tax exemptions employee may choose to adhere to forms of corporate welfare. | Favorable taxation on production bonus |
| | Agreements on representativeness signed between CGIL-CISL-UIL and Confindustria and between CGIL-CISL-UIL and Alleanza delle Cooperative Italiane. Agreement on the second level contractual bargaining to be signed by spring 2016. | Strengthen the second-level contractual bargaining |
| | Digitalisation of the social security compliance certificate (DURC). | Simplification of administrative procedures |
| | Approval of the 'La buona scuola' reform: greater autonomy in school governance and planning; increased tenured teaching staff thanks to an extraordinary recruiting plan; developing teachers' competencies through permanent learning; new evaluation system for teachers with careers linked to performances. | Investment in human capital |
| | Realised the first self-evaluation report by schools. Strengthen the National Agency for the Evaluation of the University and Research Systems (ANVUR). | Evaluation of the school system and research |
| | More resources to the school system; fiscal incentives to taxpayers with the 'school bonus'. School building interventions for architectural and technological enhancement and for improving the energy efficiency. | Upgrading school buildings |

**Table III.1-14 Summary of the country Specific Recommendations and the implementation of reforms (6.a)**

| Specific Recommendation | Measures | Relevance |
|---|---|---|
| CSR.6. Implement the simplification agenda for 2015-2017 to ease the administrative and regulatory burden. Adopt competition-enhancing measures in all the sectors covered by the competition law, and take decisive action to remove remaining barriers. Ensure that local public services contracts not complying with the requirements on in-house awards are rectified by no later than end-2015. | Published the second monitoring report on the implementation of the Simplification Agenda. As of August 31 2015, 36 out of 40 deadlines of the Agenda were met (90% of the total), with detailed programming. | Monitoring of Simplification Agenda for 2015-2017 |
| | As of August 31 2015 the implementation of the Simplification Agenda shows the first results: all the ordinary Regions adopted the standardised and simplified models for the construction sector, which are the most used by citizens (namely CIL and CILA); full adoption of the pre-filled tax return for permanent employees and pensioners; activation of a tax tutoring reservation service and strengthening of e-channel for tax assistance. | Implementation of Simplification Agenda for 2015-2017 |
| | The enabling law reforming Public Administration sets simplification measures immediately applicable. | Administrative procedure simplification |
| | In April 2015, the government presented before Parliament the draft of the first annual law on competition. The draft was approved by the Chamber of Deputies and is now before the Senate. The draft law sets provisions of immediate application as well as some enabling acts to government. It intervenes on several sectors: insurance by containing costs and counteract frauds; communications by favouring mobility in the pay-tv market; post, banks, pharmacies, professional services and energy sector so as to further enhance competition. In addition, the draft law pursues the goals of cost reduction related to bureaucracy for citizens and firms, as well as modernisation and ease of investments in the sectors under consideration. | Annual competition law |

**Table III.1-15 Targets set by the Union's Strategy for growth and jobs (6.b)**

| National 2020 headline targets | List of measures | Description of direct relevance |
|---|---|---|
| 1 - Employment rate [64-69%] | Businesses and professionals can completely deduct from the IRAP tax base the cost of permanent employees. Deductions are higher in case of women, under 35 and for workers in Convergence Regions. | Reduction in labour costs for businesses |
| | Three years exemption from social security paid on new employees. The new permanent contracts stipulated from January,1 to December, 31 2015 are exempt from the payment of pension contributions. The limit of the exemption amounts to €8,060 on an annual basis. From the tax exemption are excluded those due to INAIL. | Reduction in labour costs for businesses |
| | Implementation of the Enabling Law on labour market reform: Lgs. D. no. 23/2015 on standard open-end contract with increasing level of protection. In case of dismissal, the compensation is related to tenure with costs defined by law. The new regulation describes various allowances in case of dismissal brought before the court. It also provides for the possibility of an extra judicial conciliation procedure. The new permanent contract applies to people hired from March 2015 in the qualification of clerks, workers or supervisors (*quadro*). | Flexibility in exiting from the labour market |
| | Implementation of the Enabling Law on labour market reform: Lgs. D. no. 150/2015 on the National Agency for active labour market policies. The worker digital curriculum was introduced. The law provides for an activation voucher for those who are unemployed by more than four months and benefit from NASpI. The voucher is to be spent in labour activation initiatives and training provided by authorized employment services centres. | Riorganisation of labour active market policies |
| | Implementation of the Enabling Law on labour market reform: Lgs. D. no. 22/2015 on the new unemployment benefit scheme in case of involuntary dismissal (NASpI), the means tested unemployment assistance after the expiration of NASpI (ASdI) and unemployment benefits for workers with collaboration contracts (DIS-COLL). Strengthened the compliance rules regarding the activation of those who are unemployed. | Unemployment support and activation of worker |
| | Employment bonus within the Youth Guarantee scheme (Directorial Decree no. 1709 of August 2014). The incentive is recognized to assumptions made from May 2014 until June, 2017. The Youth Guarantee employment bonus applies also to the new hiring realized through apprenticeship contract for qualification and professional degree and to temporary contracts. The benefit is diversified according to type of contract, individual profile and territorial characteristics (for €1,500 to €6,000). | Support to youth employment |
| | Implementation of the Enabling Law on labour market reform: Lgs. D. no. 81/2015 introduced changes to the discipline concerning the apprenticeship for the secondary school diploma (namely qualification and professional degree, high school diploma and certificate of advanced technical specialisation) and the apprenticeship on higher education and research. These are the basis for a dual system in which the graduation from the secondary school and the tertiary level qualification can be achieved through the learning on the job. | Strengthening apprenticeship |
| | Specific incentives for apprenticeships and traineeships granted by Regions. Regions provide firms with benefits between €2,000 to €3,000 (according to age) for the activation of apprenticeship contracts related to qualification and professional degree (level I). For the activation of apprenticeship contract related to the higher education and research (level III) the incentive rises to €6,000. In case the internship contract is transformed into a permanent one, a benefit ranging from €1,500 to €6,000 is recognized to the firms by INPS. | Incentives to apprenticeships and traineeships |

**Table III.1-15 Targets set by the Union's Strategy for growth and jobs (6.b)**

| National 2020 headline targets | List of measures | Description of direct relevance |
|---|---|---|
| 2 - R&D expenditure [1,53%] | New regulations governing the tax credit for businesses investing in R&D (Stability Law 2015). Extended the range of beneficiaries to all types of businesses, regardless of their legal form, economic sector or accounting regime adopted. The length of the benefit has been extended to five years (2015-2019). The tax credit is recognized to those firms investing in R&D, up to a maximum of €5 million per year. The credit is proportional to 25 percent of the annual increase in R&D expenditure on the 2012-2014 period. | Fiscal incentives to R&D investment |
| | A new category of innovative SMEs has been defined to benefit from tax incentives (D.L. no. 3/2015): businesses with fewer than 250 workers, with annual turnover less than €50 million based on specific characteristics. Benefits: exemption from the ordinary company discipline; facilities in the settlement of losses; reduction of some administrative burdens; tax incentives for investment in innovative SMEs. | Fiscal incentives to R&D investment |
| | Tax credit for hiring highly qualified personnel. The tax credit is of 35 percent of the cost sustained for hiring of a worker with a permanent contract, with a maximum limit of €200,000 per year for each business. | Fiscal incentives to investments in qualified human capital |
| | Patent Box. The incentive is available to all businesses without limits of turnover, regardless of their legal form, the economic sector in which they operate and the accounting regime adopted. The tax break consists in the reduction of the IRES rate by excluding from the total income 50 percent of income generated by the direct / indirect use of products under intellectual property, patents and trademarks. The 'Investment Compact' decree law expanded its scope to all brands, including commercial brands, drawings and models. Furthermore, it included costs incurred by firms for outsourcing R&D. | Fiscal incentives to intellectual properties, patents and trademarks |
| | Fund for Sustainable Growth: calls for the implementation of the Digital Agenda in the ICT field and on issues relevant to the sustainable industry; incentives to R&D projects of small and medium technologies in areas identified by the Horizon 2020 Programme. | Subsidised loans to enterprises for R&D investment projects |
| | MEF-EIB agreement to sustain R&D projects for both SMEs and Mid-Cap businesses. The initiative entails the use of €100 million from the Central Guarantee Fund for SMEs to cover the risks of initial losses on industrial innovation projects undertaken by SMEs and Mid-Caps. As a result of such funding, the EIB will activate a €500 million loan portfolio. | Subsidised loans to enterprises for R&D investment projects |
| 3 - Greenhouse gas emissions [-13%]* | Strengthened the involvement of local authorities in the energy and environment sustainability through many institutional activities, including the ' Mayors 'Agreement'. | Promote sustainable mobility |
| | Strengthen the supervision and assessment on substances depleting ozone and emissions of fluorinated greenhouse gases. Adjustment to the European Reg. no 517/2014. | Monitoring greenhouse gas emissions |
| | Public call on the analysis of the carbon footprint in the life cycle of consumer products on a large scale, and the public call for the co-financing of projects carried out by public bodies on the use of technologies for energy efficiency and renewable sources. | Promote renewable energy and energy efficiency |
| 4 - Renewable energy sources [17%] | Upgrading of the *Conto termico* for renewable heating (incentive mechanism scheme for energy efficiency measures in the public administration buildings and for installing facilities of thermal energy from renewable sources). | Promote renewable energy and energy efficiency |

**Table III.1-15 Targets set by the Union's Strategy for growth and jobs (6.b)**

| National 2020 headline targets | List of measures | Description of direct relevance |
|---|---|---|
| 5 - Energy efficiency [20 Mtoe/year]** | Program of buildings energy requalification of the central public administration, for the implementation of which € 350 million has been allocated in the period 2014-2020. | Energy requalification of public buildings |
| | National revolving fund for energy efficiency, to provide guarantees and subsidized loans for the realisation of investments on energy requalification of public administration buildings and housing, for improving the efficiency of public lighting and for the construction of district heating networks. | Tax credits for energy requalification |
| | Extension - until 31 December 2016 - of the tax deduction to 65 percent on the energy requalification of buildings. | Promote renewable energy and energy efficiency |
| | New minimum requirements on energy performances for new buildings and for buildings subject to major renovation. | Improving energy efficiency of private buildings |
| | Requalification of public buildings used as schools and universities (Ex - Kyoto Fund). | Promote energy efficiency of school buildings |
| 6 - Early school leavers [16%] | Training planes drafted every three years. The plan is designed to be more closely aligned to the needs of students and their careers. | More efficient school programming |
| | Foreseen at least 400 hours in the last three years of technical and professional institutes and 200 in the high schools (licei) for the work-school rotation, with a budget of €100 million per year. | Work-school rotation |
| | Allocated €93 million to promote the active involvement of students into school life, for the inclusion and integration of students. | Enhancement of the training |
| | Student Card. Encourage the inclusion of secondary school students providing them with means aimed at attesting their status of student and to facilitate access to goods and services of cultural and social interests. | Social inclusion at school |
| | Improved the language skills, enhanced competences on subjects such as Art, Music, Law, Economics, and expanded school sport schemes. | Ensure a comprehensive education |
| 7 - University education attainments [26-27%] | Aligning university courses to the school needs. Started the revision of the different classes of competition in order to adapt the classes of competition to the new university system. In this way, some categories of graduates so far excluded from teaching subjects in line with their curriculum will have access to specific paths enablers. | Tertiary education in line with the schools needs |
| | Ensure adequate training provided by universities until aa 2017/2018, in the universities where the limits to staff turnover are likely to impose a halt to some courses to the detriment of students. A MIUR decree foresees the inclusion of the contract hired professors in the calculation of the minimum number of teachers needed to maintain a degree course. | Ensure funds to University |
| | Increase of the Fund for ordinary financing of State Universities (FFO): 38 mln for 2016 and 75 mln by 2017 for recruiting of first and second tier professors through direct call according to national procedures and in accordance with criteria designed to reward excellence and scientific qualifications of the candidates; 55 mln for 2016 and 60 mln since 2017 for the recruitment of researchers. | Universities financing |
| | Increase of the Fund of medical specilisation for the following amounts: 57 mln for 2016, 86 mln for 2017, 126 mln for 2018, 70mln for 2019 and 90 mln starting from 2020. | Increase of the specilistic training contracts for doctors. |

**Table III.1-15 Targets set by the Union's Strategy for growth and jobs (6.b)**

| National 2020 headline targets | List of measures | Description of direct relevance |
|---|---|---|
| 8 - Fight against poverty | The Fund for non self-sufficient has been increased by €400 million per year. The National Fund for Social Policies has been increased by €300 million annually from 2015. The same Fund is further increased by 150 mln euro per year starting from 2016 for interventions in support of people with amyotrophic lateral sclerosis. Allocated 90 million starting from 2016, for a Fund to finance measures for supporting people with serious disabilities.To sustain international adoptions with €15 million per year from 2016 a specific Fund has been set. Allocated €112 million for 2015 of which: 100 million for the relaunching the plan for the development of the territorial system of socio-educational services for infants and 12 million for the Fund for distribution of food for a people with low income. | Support to families |
| | Annual monitoring on the needs of nursering services. Support to local authorities for the construction of new facilities for childcare and for the increase of places or hours of service. | Support to families |
| | *Bonus bebè*. Monthly allowance for the new born. paid up to the end of the third year of age or the third year of entry in the household in the case of adoption, for ISEE income not exceeding € 25,000 per year. | Support to families with children |
| | Allocated 45 million for 2015 for child support, vouchers for the purchase of goods and services for families with four or more children with an ISEE income not exceeding € 8,500 per year | Support to families with children |
| | *Social card*. The Fund for the priority needs of low-income citizens has been increased of 250 million per year from 2015. The Fund is further increased for 2016 by 380 mln. Starting from 2014 the social card was extended to EU and extra EU citizens and their families, as well as to foreigners having a residence permit for EU long-term residents. | Measures to fight poverty |
| | Engagement of beneficiaries of income support instruments in activities of social interest. Persons receiving income supports can perform a voluntary activity of social utility on behalf of their own communities, in projects carried out jointly by third sector organizations and municipalities or local authorities | Measures to fight poverty |
| | Housing plan.€1,8 billion to support the agreed rental contracts, a greater supply of social housing and the development of social housing building projects. | Social housing |
| | Increased funds for rent by €100 million in the 2014-2015 period and the Fund to cover unintentional rents arrears by €226 million for 2014-2020. Allocated €400 million for a plan of recovery of social housing owned by the ex-Public housing Association (IACP) to promote energy, plant engineering and the static of buildings and €67.9 million for the recovery of additional accommodation ex IACP to be allocated to social disadvantaged categories. The Guarantee Fund for the primary residence has been boosted and the range of beneficiaries for loans granted with the purpose of purchasing, renovating and improving energy efficiency of their first home has been increased. Tax benefits for the 2014-2016 period on behalf of the conductors of social housing used as the main residence. | Social housing |
| | Increases in tax allowances for retired persons with a total income of up to 15,000 euro. | Measures to fight poverty |

**Table III.1-15 Targets set by the Union's Strategy for growth and jobs (6.b)**

| National 2020 headline targets | List of measures | Description of direct relevance |
|---|---|---|
| | National Plan for fighting poverty and social exclusion. Established the Fund for the fight against poverty and social exclusion to which 600 million for 2016 and 1.000 million since 2017 are assigned. A tax allowance of 75% is granted to banking foundations and financial entities investing in project to counter poverty with particular reference to children poverty. Funding for unemployment benefits (ASDI) is increased by 220 mln. | Measures to fight poverty and social exclusion |

* The 13% reduction target refers to non ETS sectors.
** The energy efficiency target is computed as savings on final use as provided by the EU Directive.

**Table III.1-16 Divergence from latest SP (7)**

| | ESA Code | 2014 %GDP | 2015 % GDP | 2016 % GDP |
|---|---|---|---|---|
| Target General Government net lending/borrowing | | | | |
| Stability Programme | | -3.0 | -2.6 | -1.8 |
| Draft Budgetary Plan | | -3.0 | -2.6 | -2.2 |
| Difference | | 0.0 | 0.0 | -0.4 |
| General Government net lending projection at unchanged policies | | | | |
| Stability Programme | | -3.0 | -2.5 | -1.4 |
| Draft Budgetary Plan | | -3.0 | -2.6 | -1.4 |
| Difference | | 0.0 | -0.1 | 0.0 |

# IV. METHODOLOGICAL NOTES

Two notes are provided with reference to the methods and models used for the estimates contained in the DBP:

1) A note containing a brief description of the models used in the DBP[37] for the macroeconomic framework and the impact of structural reforms;
2) A methodological note on the forecasting criteria provided as an exhibit to the 2014 Economic and Financial Document, with detailed information supplied about the methodology, the forecasting process, and the models used for the macroeconomic and public finance forecasts[38].

## IV.1 BRIEF DESCRIPTION OF THE MODELS USED

### The Italian treasury econometric model (ITEM)

The Italian Treasury Econometric Model (ITEM) has been developed and used in the Department of Treasury of the Italian Ministry of the Economy and Finance. ITEM describes the behaviour of key aggregates for the Italian economy at a macroeconomic level. The model includes 371 variables (247 of which are endogenous), and is based on 36 behavioural equations and 211 identities. It is an economic quantitative analysis tool used for both forecasting (it computes medium-term projections conditioned on the international economic framework) and assessing the macroeconomic impact of economic-policy measures or changes in international economic variables. One of ITEM's key features is the joint and explicit representation of the economic environment on both the demand and the supply side. However, the demand conditions influence the responses for the near term, whereas the conditions on the supply side determine the level of equilibrium of the economy in the medium term.

### Italian General Equilibrium Model (IGEM)

IGEM is a medium-scale Dynamic General Equilibrium (DGE) model specifically designed for the Italian economy. The model, which is based on explicit microeconomic foundations, has been used to evaluate alternative economic-policy measures, to study the response to temporary shocks of a varying nature and also for effecting long-term analyses (structural reforms). IGEM has all of the main characteristics of a New Keynesian (NK) model, such as the presence of real and nominal rigidities, but it is extended and adapted to the Italian labour market which incorporates a heterogeneous mix of contracts and professional positions. This heterogeneity is an essential factor in pinpointing some of the key mechanisms for transmission of fiscal policies and the effects thereof on GDP and employment. As a

[37] For additional information, see:
http://www.dt.mef.gov.it/it/analisi_programmazione_economico_finanziaria/modellistica/
[38] In particular, see Chapters I-III.

result of the flexibility with which IGEM was designed, the additional differentiation allows for simulating a vast array of economic-policy measures, including from a demand perspective, and for replicating the main stylised facts in line with current literature.

## QUEST III - Italy

QUEST III with R&D is one of the latest versions of the class of Dynamic Stochastic General Equilibrium (DSGE) models developed by the European Commission. The QUEST model is a simulation tool to analyse the effects of structural reforms and the response of the economy to a variety of shocks or policy measures. In particular, the version of model used at the Department of Treasury is an extension of the DSGE model developed at the DG ECFIN for quantitative policy analysis and modified for endogenous growth. The Department of Treasury's simulation exercises use the version of the model calibrated for Italy, already employed by the European Commission in multi-country analyses of structural reforms. The endogenous growth version of QUEST III is particularly well-suited to analysing the impact of structural, growth-enhancing economic reforms in relation to the Lisbon Strategy. By including several nominal and real rigidities and imperfectly competitive markets, the model can be used, for example, to study the effect of policies to stimulate competition and reforms aimed at upgrading the quality of human capital.

## ORANI-IT & TERMITY - The Enormous Regional Model for Italy

ORANI-IT is a Computable General Equilibrium model (CGE) for the Italian economy. ORANI-IT is a national CGE model, multi-sectoral, with a breakdown to 63 products and 63 branches of production. The model consists of a neoclassical theoretical framework and a database, built on national accounts data, which reproduces the economy and that is imbedded in the theoretical structure of the model by equilibrium conditions. The model is static, designed for comparative static simulations, with a time horizon divided into short and long term, depending on the choice of the endogenous/exogenous variables. Around the core model, ORANI-IT presents a detailed and elaborate tax extension, which enriches the analytical capacity of the model, by modeling the entire spectrum of direct and indirect taxes of the Italian tax system. Each tax is entered into the model based on statutory tax rates and tying the tax bases to the relevant variables in the database. The tax extension includes an economy-wide framework that reproduces the current VAT regime through a detailed system of equations (reduced rates, exemptions, deductions). The model reconstructs the economic accounts of institutional sectors, illustrating, within an integrated approach, resources and uses of households and public administration and transactions with the rest of the world, thus allowing a detailed analysis of the behavior of economic agents and the impact of policy and shock may have on it. By the multi-sectoral interaction between demand and production and the multi-product structure, the model lends itself to simulations of industrial policies. The presence of a breakdown by product, sector and institutional agent can generate results at national and sectoral level. The tax extension makes ORANI-IT a powerful policy analysis instrument, capable of simulating the effect on the economy of alternative proposals for reform of the tax system, both regarding changes in tax rates and in the tax bases. The framework of ORANI-IT is evolving and is part of a vast project structured over a period of several years. The next extension of the model scheduled for 2015 will lead to the definition of a multi-regional dynamic CGE model, ideal for the analysis of regional policies (TERMITY).

## IV.2 ESTIMATION OF POTENTIAL GDP, THE OUTPUT GAP AND STRUCTURAL BALANCES

The method used for estimating Italy's potential GDP and output gap is the one agreed at EU level, and is based on a Cobb-Douglas[39] production function whose specifications are to be discussed and decided by the Output Gap Working Group (OGWG) which is part of the European Council's Economic Policy Committee. For additional details on the model, see Section III.3 of the Methodological Note[40] provided as an exhibit to the 2015 EFD.

The estimates in this document have been produced on the basis of the macroeconomic scenario contained in the Update to the 2015 EFD for the years of 20145-2019[41], with a distinction made between the projections based on trend scenario and those based on the policy scenario. Moreover, estimates have been updated to take into account the recent national account release by Istat that occurred after the publication of the 2015 Update of EFD. The parameters reported in the following table were used for the computation of the Non Accelerating Wage Rate of Unemployment (NAWRU). The initialization priors of the trend-cycle decomposition model for Total Factor Productivity (TFP) have been revised to deal with the introduction of the 2015 capacity utilization observation calculated by the European Commission as an aggregate of the sectoral sentiment indicators published by Istat. By adding the still provisional 2015 figure of the capacity utilisation indicator in the model leads to a very fast and inexplicable closure of the Total Factor Productivity cycle in 2011-2015 coupled with an abnormal lowering of the level of the trend. Vis-à-vis the results of 2015 the Update of the EFD, which was based on the priors underlying the European Commission 2015 Spring Forecasts, the

[39] For additional details, see: D'Auria et al., 2010, 'The production function methodology for calculating potential growth rates and output gaps, European Economy', Economic Papers n. 420)

[40] In this regard, see: http://www.mef.gov.it/doc-finanza-pubblica/def/2014/documenti/Allegato_alla_Sezione_II_del_DEF_-_Nota_metodologica_previsioni_tendenziali_.pdf

[41] For further details on the growth sensitivity analysis, see section III.2 of the EFD 2015 Methodological Note. It has to be noted that the formula:

$$R_A^{ca} = \left(\frac{R^{CA}}{Y_B}\right) * \left(\frac{Y_B}{\bar{\bar{Y}}_A}\right) * \left[1 + \varepsilon_R * \left(\frac{\bar{Y}_A - \bar{Y}_B}{\bar{Y}_B}\right)\right]$$

has been modified as follows :

$$R_A^{ca} = (R_B^{ca}) * \frac{\bar{Y}_A}{\bar{Y}_B} * \left[1 + \varepsilon_R * \left(\frac{\bar{Y}_A - \bar{Y}_B}{\bar{Y}_B}\right)\right]$$

Where $R_B^{ca}$ and $R_A^{ca}$ represent cyclically-adjusted tax receipts in terms of GDP respectively in the baseline and in the alternative scenario; $\bar{Y}_B$ e $\bar{Y}_A$ are the level of potential GDP in the baseline and alternative scenario. Finally, $\varepsilon_R$ represents the semi-elasticity of tax receipts to economic growth.

new initialization parameters have been modified to preserve the amplitude of the cycle of TFP without impacting on the trend[42].

**Table IV.2-1 Initial parameters for the NAWRU estimate**

| Unchanged Policies | | Policy Scenario | |
|---|---|---|---|
| | Value | | Value |
| LB Trend innov var | 0 | LB Trend innov var | 0 |
| LB Trend slope var | 0.025 | LB Trend slope var | 0.03 |
| LB Cycle innov var | 0 | LB Cycle innov var | 0 |
| LB Innovation var 2nd eq. | 0 | LB Innovation var 2nd eq. | 0 |
| UB Trend innov var | 0,08 | UB Trend innov var | 0.085 |
| UB Trend slope var | 0.045 | UB Trend slope var | 0.045 |
| UB Cycle innov var | 0.155 | UB Cycle innov var | 0.15 |
| UB Innovation var 2nd eq. | 0.00081614 | UB Innovation var 2nd eq. | 0.000826688 |
| Exogenous 2nd eq. | 0 | Exogenous 2nd eq. | 0 |

## IV.3 METHODOLOGICAL NOTE ON THE CRITERIA FOR FORMULATING MACROECONOMIC AND BUDGETARY PROJECTIONS

See the document “Nota metodologica sui criteri di formulazione delle previsioni tendenziali” (in Italian only).

[42] More specifically, vis-à-vis the Update of the EFD, the mean and the variance of the innovation process driving the variance of the cycle equation have been increased by almost 4 times with respect to the values of the 2015 Spring Forecasts. In addition, the mean and the variance of the innovation process driving the variance of the capacity utilisation equation have been increased by almost 5 times.

# V. DEBT SUSTAINABILITY ANALYSIS

## V.1 INTRODUCTION

This section provides an update of the debt sustainability analysis included in the 2015 EFD in April 2015, presenting methods and results that allow for an overall evaluation of the short-, medium- and long-term risks to Italy's public finances. The assessment, based on the projections of the 2015 Update of the Economic and Financial Document, is mainly carried out through deterministic projections of the debt-to-GDP ratio, but it is also accompanied by sensitivity analyses and stochastic methods that allow for considering the uncertainty intrinsically inherent to the results.

The analysis presented hereunder shows how the achievement of the policy-scenario objectives in the Update to the 2015 EFD will ensure the sustainability of Italy's public finances with respect to both short-term shocks and medium-/long-term risks, such as those arising from population ageing.

## V.2 SHORT TERM SCENARIOS

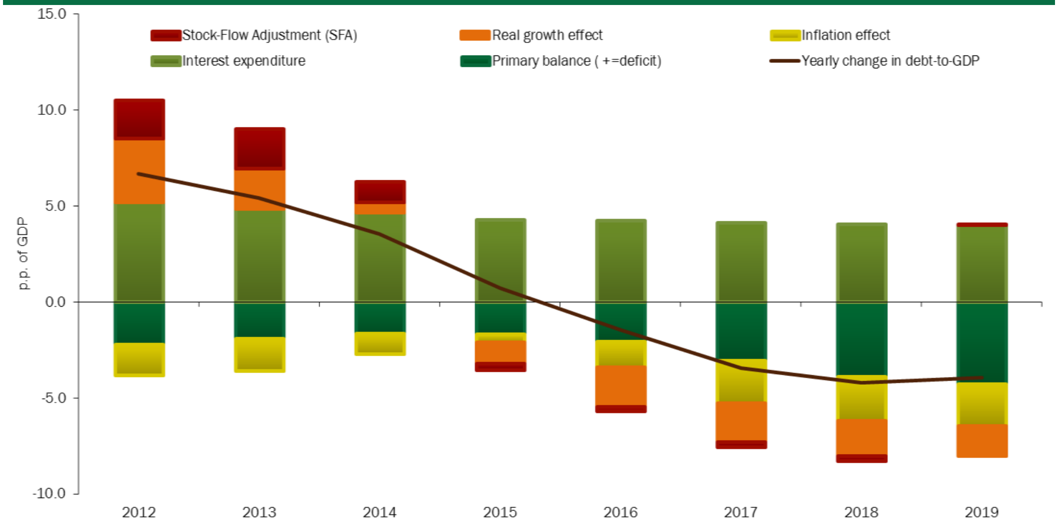
This section has three objectives. First, it is designed to present the trend of the debt-to-GDP ratio under the policy scenario for the 2015-2019 period, also highlighting the pattern of its underlying components. Second, the analysis is integrated by a stochastic projection of the debt-to-GDP ratio for the 2015-2019 period in order to consider the uncertainty linked to the volatility of the underlying macroeconomic variables. Finally, the concept of fiscal risk is expanded to include, through the construction of an ad-hoc indicator, the overall risk of fiscal stress for the public finances in 2016.

### The trend of the debt-to-GDP ratio and its components

From the start of the financial crisis in 2009 to 2014, the ratio of Italy's gross public debt to GDP rose by approximately 20 percentage points, going from 112.5 per cent in 2009 to 132.1 per cent of GDP in 2014. The main determinants of this increase were: interest expenditure; the low rate of real growth; and the level of the Stock Flow Adjustment, which rose in recent years as a result of i) the Italian financial contributions required for supporting the Euro Area (contributions to the Greek Loan Facility , EFSF and ESM) and ii) the payment of the past debts of the public administration. On the other hand, the achievement of sizeable and growing primary surpluses by various governments since 2011 has contributed to slowing the increase in the debt-to-GDP ratio (Figure V.2-1).

During the 2015-2019 period, the government's policy scenario provides that the debt-to-GDP ratio will reach a high of 132.8 per cent in 2015 before gradually falling (in line with the European debt rule) until it reaches 119.8 per cent in 2019. This result is conditioned upon inflation rates (as approximated by the growth rate of the GDP deflator) reaching levels that are closer to the target of 2.0 per cent. In addition, it is assumed that Italy's economy can return to gradually increasing levels of real growth over the next four years. Finally, the debt reduction is to be facilitated by a gradual decrease in the level of the Stock Flow Adjustment attributable, first and foremost, to the disposal of public assets, with the government counting on proceeds therefrom equivalent to approximately 1.5 per cent of GDP in the 2016-2018 period. In any event, Figure V.2-1 illustrates that the reduction of the debt-to-GDP ratio for the next few years is largely to be facilitated by the maintenance of a sizeable primary surplus, averaging around 3.0 per cent of GDP in the 2015-2019 period. Although relatively high, this average level is nonetheless in line with the historical average of the pre-crisis years.

**Figure V.2-1 Public debt determinants (% of GDP)**




## Stochastic simulations of the debt trend

In order to consider the uncertainty related to the macroeconomic forecasts about the yield curve and about economic growth, the deterministic projection of the debt-to-GDP ratio described above is integrated by several stochastic simulations that incorporate both the historical volatility of short- and long-term interest rates and the variability connected with nominal growth data[43]. For each year of the projection and for each individual shock, it is possible to identify a distribution of the debt-to-GDP ratio represented in probabilistic terms through a fan chart (Figures V.2-2 and V.2-3).

[43] Berti K., (2013), "Stochastic public debt projections using the historical variance-covariance matrix approach for EU countries", *Economic Papers 480*. The simulations were carried out with the Monte Carlo method, using historical data for the yield curve and the nominal GDP growth rate, and applying interest-rate and growth shocks to the trend of the debt-to-GDP ratio under the policy scenario. These shocks were obtained by executing 2,000 extractions starting from a normal distribution with a zero average and a variance-covariance matrix observed in the 1990-2014 period. More specifically, it is assumed that the interest-rate shocks may be either temporary or permanent. In addition, it is assumed that the temporary shocks to nominal growth will also wield their effects on the cyclical component of the primary surplus.

As shown by this analysis, under the effect of temporary and simultaneous shocks to growth rates and interest rates (the range of which is calibrated to the past volatility of these variables), the debt, in line with the government's projections, will nonetheless continue to fall until it reaches a median value of approximately 120 per cent of GDP in 2019. However, there is relatively high uncertainty recorded with respect to the 2019 results, as shown by a difference of approximately 29 percentage points between the tenth and ninetieth percentiles of the resulting debt distribution.

**Figure V.2-2 Stochastic projection of the debt to GDP ratio with temporary shocks**

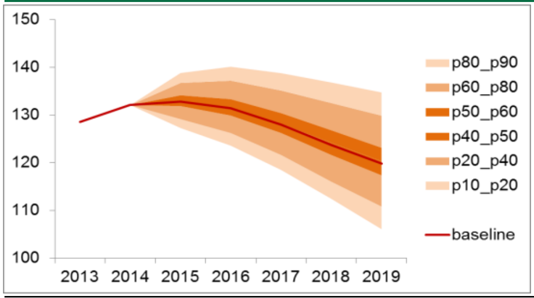
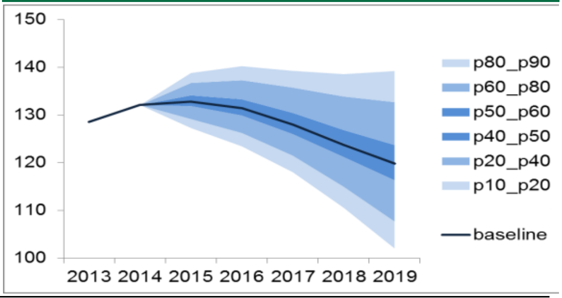



**Figure V.2-3 Stochastic projection of the debt to-GDP ratio with permanent shocks**




Note: The graphs illustrate the tenth, twentieth, fortieth, fiftieth, sixtieth, eightieth and ninetieth percentiles of the distribution of the debt-to-GDP ratio obtained with the stochastic simulation.

Source: MEF own calculations

In the event of a temporary shock, the trend of the debt-to-GDP ratio would show a decrease for the first 40 percentiles as from 2015, between the fiftieth and sixtieth percentiles as from 2016, and above the eightieth percentile as from 2017 only. In any event, even with the more severe shocks (which are found above the eightieth percentile), the debt-to-GDP ratio would tend to stabilise after having reached a peak of just around 140 per cent of GDP.

Instead, in the event of a permanent shock, the distribution of the values of the debt-to-GDP ratio around the baseline scenario would be broader, but with a debt trend that increases starting from the ninetieth percentile only.

## Overall analysis of fiscal risks in the short term

This type of analysis is based on a series of variables, which, according to empirical literature, have had a past role in forecasting risks to fiscal sustainability in the short term. More specifically, 28 variables were considered, and clustered into two sub-groups: fiscal and macro-financial variables. On the basis of the methodology developed by the European Commission[44], the analysis of the fiscal and macro-financial variables allows for determining an indicator known as S0 that measures the probability of the manifestation of a fiscal or financial crisis one year after.

The methodology underlying the calculation of the S0 indicator is linked to the so-called signals-approach and allows for endogenously determining the thresholds, for each of the variables included in the indicator, above which the probability of crisis becomes more concrete. Any values of S0 or of the two sub-indices (fiscal and

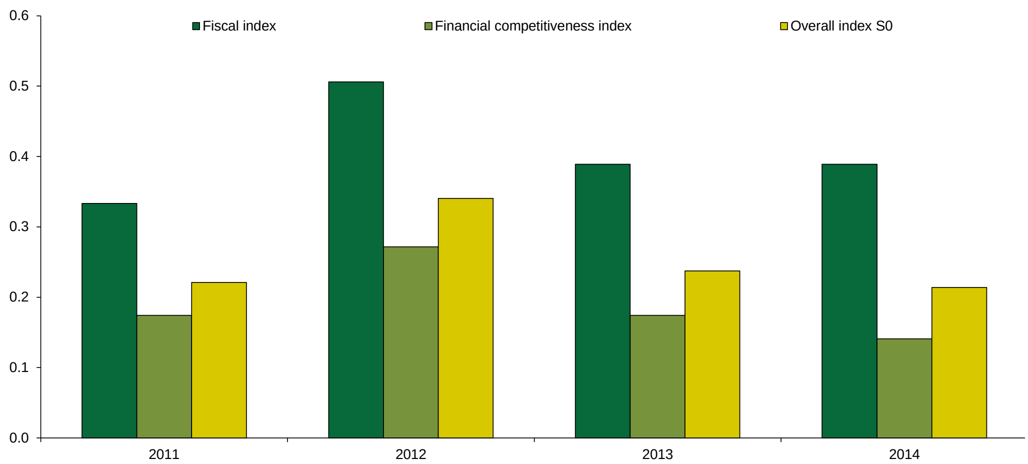
[44] Berti, K., Salto, M. and Lequien, M., (2012), 'An early-detection index of fiscal stress for EU countries', European Economy Economic Papers n. 475.

macro-financial) that might exceed their respective thresholds (0.43, 0.35 and 0.45) are to be interpreted as signs of a growing risk in the short term.

As illustrated by Figure V.2-4, the overall risk in the short term has contracted considerably since the peak in 2012. The improvement starting in 2013 affected both sub-components, but was more pronounced for the fiscal sub-component. The S0 indicator stands around a value of 0.19, which is below the overall threshold (0.43). The results for 2014 point to limited risk of fiscal crisis for the current year. The risk of a fiscal crisis seems to be under control, as illustrated by the respective indicator equal to 0.32, which is below the early warning benchmark (0.35). The probability of a financial crisis is also below the levels that would raise concerns. The indicator stands at 0.14 versus the respective benchmark of 0.45.

However, considering that the optimal thresholds are common to all of the countries examined by the Commission, these values can only represent a preliminary indicator about a country's sustainability in the short term. The punctual analysis with respect to the individual variables that make up the S0 indicator shows that several critical elements linked to the high level of the public debt could emerge in the short term (in this regard, see the heat map presented in Table V.2-1)

**Figure V.2-4 S0 indicator and sub-components**




Note: For the years before 2014, the variables underlying the S0 are expressed in ESA 95.
Source: MEF analyses; AMECO; WEO and EUROSTAT

**Table V.2-1 Heat map on variables underlying S0 for 2014**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Short-term fiscal stress risk from fiscal variables | General Government deficit (%GDP) | Primary balance (%GDP) | Cyclically adjusted balance (%GDP) | Stabilizing primary balance (%GDP) | Gross debt (%GDP) | Change in gross debt (%GDP) | Short term debt gov't (%GDP) |
| | Net debt (%GDP) | Gross financing need (%GDP) | Interest growth rate differential | Change in expediture of gen govt (%GDP) | Change in fin.consumption on expend of gen gov (%GDP) | Old-age dependency ratio 20 years ahead | Avg yearly change (5 years) in projected age-related public expend. (%GDP) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Short-term fiscal stress risk from financial competitivness variables | L1.net international investment position (%GDP) | L1.net savings of households (%GDP) | L1.private sector debt (%GDP) | L1.private sector credit flow (%GDP) | L1.leverage financial corporations | L1.short-term debt non financial corporation (%GDP) | L1.short-term debt households (%GDP) |
| | L1.construction (%value added) | L1.current account (3-year backward MA) (%GDP) | L1.change (3 years) of real eff.exchange rate (based on export deflator) | L1.change nominal unit labour costs | Yield curve | Real GDP growth | GDP per capita in PPP %US level |

Note: The red and green colours respectively indicate the variables above and below the optimal threshold. The asterisks (*) indicate that the 2014 value is calculated as a three-year average (2011-2013) in the absence of updated data.
Source: MEF analyses

## V.3 MEDIUM TERM SCENARIOS

### Alternative scenarios and sensitivity analysis

In this section, the projections of the debt-to-GDP ratio are extended out to 2027. In all of the scenarios, the debt is projected from a starting point that is based on the most recent composition and maturity structure. The projections are carried out accordingly by estimating endogenously the implicit interest rate that, in turn, takes into account all of the assumptions about the trend of the yield curve and the assumptions about the primary surplus. The alternative scenarios allow for several iterations between macroeconomic variables so that, for example, lower growth rates correspond to smaller primary surpluses, and the smaller surpluses are associated with higher borrowing costs.

The medium-term scenarios include:

1. A baseline scenario that incorporates, for the years of 2015-2019, the rates of GDP growth and potential GDP growth in the policy-scenario

macroeconomic framework of the Update of the 2015 EFD. For the years after 2019, the potential GDP growth rate is projected on the basis of a production function model, in line with the methodology approved by the EPC-Output Gap Working Group; such method assumes that the variables related to the individual productive factors are extrapolated with simple statistical techniques or they converge toward structural parameters (Table V.3-1)[45]. The growth rate of the GDP deflator converges to 2.0 per cent as from 2022. As from 2019, the structural primary balance is to be kept constant at the reference level of 4.0 per cent of GDP until the end of the forecast horizon. For the 2015-2019 period, the yield curve is that underlying the Update to the EFD, whereas from January 2020, the yields are kept constant at the values estimated for December 2019.

2. A pessimistic scenario that assumes GDP growth falls during the 2015-2019 period by 0.5 percentage points in each year with respect to the baseline scenario. The potential GDP series for 2015-2019 is obtained by applying the methodology agreed at a European level to the lower growth macroeconomic framework. The output gap is closed as of 2022, while the NAWRU and Total Factor Productivity (TFP) converge in 2027 to the average values for the crisis period (2011-2013). The yield curve is equivalent to that in the baseline scenario with an increase of 100 basis points starting from 2016 and through 2018. The trend in interest rates between late April 2015 and July 2015 suggests that, despite the QE, the worsening of the perception of credit risk may affect the yield curve as well as the spread against German bonds. In 2019, the shock is reduced to 50 basis points, whereas the yields thereafter are assumed to converge toward the value in the baseline scenario.
3. An optimistic scenario that assumes GDP growth rises during the 2015-2018 period by 0.5 percentage points in each year with respect to the baseline scenario. The potential GDP series for 2015-2018 is obtained by applying the methodology agreed at a European level to the higher growth macroeconomic framework. The output gap is closed as of 2022, while the NAWRU and Total Factor Productivity (TFP) converge in 2027 to the pre-crisis averages. The yield curve is equivalent to that in the baseline scenario with a decrease of 50 basis points starting from 2017 to 2019. In the final years of the projection, the yields are assumed to be constant at the level of the baseline scenario.

Table V.3-1 illustrates more specifically the characteristics of the shocks applied to the principal macroeconomic and public-finance variables underlying the trend of the debt-to-GDP ratio. Table V.3-2 reports the values of the main macroeconomic and public-finance variables in the different scenarios for the 2015-2019 period as well as the values of convergence at the end of the medium-term projection horizon.

On the basis of the macroeconomic and public-finance assumptions considered, Figure V.3-1 confirms the declining medium-term trend of the debt-to-GDP ratio in all of the scenarios.

[45] For additional details about the methods for convergence to the structural values, see the Methodological Note of the 2015 EFD in Section III.3.

Though starting at a level above 130 per cent, the debt-to-GDP ratio in the higher growth scenario would fall rapidly to reach 78.5 per cent in 2027, approximately 15 percentage points below the figure for the baseline scenario. Instead, the debt-to-GDP ratio in the lower growth scenario would decline, but would reach a value of 115.6 per cent in 2027, approximately 23 percentage points above the figure for the baseline scenario.

The debt rule calculated based on the forward-looking criterion would be respected in 2016 under both the baseline scenario and the optimistic scenario. When calculated on the basis of the backward-looking criterion, the rule would be respected as from 2018 in the high-growth scenario and as from 2024 in the baseline scenario. Instead, in the case of lower growth, the debt-to-GDP ratio would not fall in accordance with the provisions of the debt rule, and would remain above the benchmark for the entire period of the simulation.

**Table V.3-1 Summary of macro fiscal shocks**

| | Higher Growth Scenario | Baseline Scenario | Lower Growth Scenario |
|---|---|---|---|
| GDP | a) +0.5 p.p. per year vs baseline projections in the 2015-2019 period<br>b) convergence from 2019 to 2027 to pre-crisis averages (1991-2007) for NAWRU (8.9%) and TFP (0.5%) | a) 2015-2019 baseline scenario of the Update of EFD<br>b) convergence to structural parameters such as OGWG T+10 (with NAWRU converging to 9.4%) | a) -0.5 p.p. per year vs baseline projections for the 2015-2019 period<br>b) convergence from 2019 to 2027 to average values for the years of the crisis for NAWRU (10%), and TFP (0.0%) |
| Yield curve | a) 50 bp reduction of yield curve from 2017-2019<br>c) From 2020 return to the baseline scenario | a) 2015-2019 Update of EFD baseline scenario<br>c) From 2020 constant yield curve | a) 100 bps increase in yield curve from 2016 to 2018<br>c) In 2019 shock reduced to 50 bp and from 2020 retrun to baseline scenario |
| Primary surplus | a) redetermination of primary surplus based on elasticity (sensitivity analysis) in 2015-2019 period<br>b) Convergence in 2022 to structural primary surplus of 2019<br>c) structural primary surplus constant from 2023 to 2027 | a) Baseline Update of EFD scenario from 2015 to 2019<br>b) Convergence in 2022 to structural primary surplus of 2019<br>c) structural primary surplus constant from 2023 to 2027 | a) redetermination of primary surplus based on elasticity (sensitivity analysis) in 2015-2019 period<br>b) Convergence in 2022 to structural primary surplus of 2019<br>c) structural primary surplus constant from 2023 to 2027 |
| Inflation | a) deflator increase as per high-growth scenario for 2015-2019<br>b) convergence at 2% between 2019 and 2022<br>c) 2023-2027: constant at 2% | a) baseline scenario for 2015-2019<br>b) convergence at 2% between 2019 and 2022<br>c) 2023-2027: constant at 2% | a) deflator reduction as per low-growth scenario for 2015-2019<br>b) convergence at 2% between 2019 and 2022<br>c) 2023-2027: constant at 2% |

Note: For additional details about the sensitivity scenarios see the Methodological Note of the EFD 2015 in Section III.3

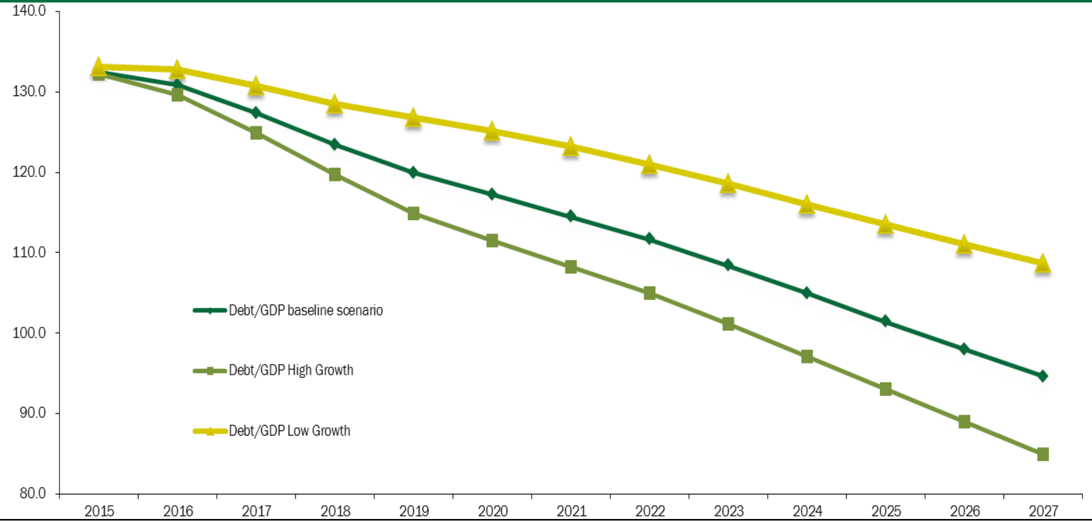
**Table V.3-2 Sensitivity to growth and interest expenditure [1] (percentage values)**

| | | 2015 | 2016 | 2017 | 2018 | 2019 | ... | 2027 |
|---|---|---|---|---|---|---|---|---|
| Nominal GDP growth rate | Higher growth scenario | 1.2 | 3.3 | 3.9 | 4.0 | 3.7 | ... | 3.0 |
| | Baseline scenario | 1.2 | 2.6 | 3.3 | 3.4 | 3.1 | ... | 2.8 |
| | Lower growth scenario | 1.2 | 1.9 | 2.6 | 2.8 | 2.5 | ... | 2.3 |
| Real GDP growth rate | Higher growth scenario | 0.9 | 2.1 | 2.1 | 2.0 | 1.8 | ... | 1.0 |
| | Baseline scenario | 0.9 | 1.6 | 1.6 | 1.5 | 1.3 | ... | 0.8 |
| | Lower growth scenario | 0.9 | 1.1 | 1.1 | 1.0 | 0.8 | ... | 0.3 |
| Potential GDP growth rate | Higher growth scenario | 0.1 | 0.3 | 0.6 | 0.7 | 0.9 | ... | 1.0 |
| | Baseline scenario | 0.0 | 0.0 | 0.3 | 0.4 | 0.6 | ... | 0.8 |
| | Lower growth scenario | -0.1 | -0.2 | 0.0 | 0.1 | 0.3 | ... | 0.3 |
| Net borrowing | Higher growth scenario | -2.6 | -1.6 | 0.0 | 1.3 | 2.1 | ... | 2.0 |
| | Baseline scenario | -2.6 | -2.2 | -1.1 | -0.2 | 0.3 | ... | 0.7 |
| | Lower growth scenario | -2.6 | -2.9 | -2.2 | -1.7 | -1.6 | ... | -1.3 |
| Cyclically adjusted net borrowing | Higher growth scenario | -0.4 | -0.5 | 0.3 | 0.9 | 1.3 | ... | 2.0 |
| | Baseline scenario | -0.4 | -0.9 | -0.4 | -0.1 | 0.0 | ... | 0.7 |
| | Lower growth scenario | -0.4 | -1.3 | -1.1 | -1.0 | -1.3 | ... | -1.3 |
| Primary surplus | Higher growth scenario | 1.7 | 2.6 | 4.0 | 5.2 | 6.0 | ... | 4.8 |
| | Baseline scenario | 1.7 | 2.0 | 3.0 | 3.9 | 4.3 | ... | 4.0 |
| | Lower growth scenario | 1.7 | 1.4 | 2.0 | 2.5 | 2.6 | ... | 2.7 |
| Cyclically adjusted primary surplus | Higher growth scenario | 3.8 | 3.7 | 4.3 | 4.8 | 5.1 | ... | 4.8 |
| | Baseline scenario | 3.8 | 3.4 | 3.7 | 4.0 | 4.0 | ... | 4.0 |
| | Lower growth scenario | 3.8 | 3.0 | 3.1 | 3.1 | 2.9 | ... | 2.7 |
| Implicit interest rate | Higher growth scenario | 3.3 | 3.3 | 3.2 | 3.2 | 3.2 | ... | 3.4 |
| | Baseline scenario | 3.3 | 3.3 | 3.2 | 3.3 | 3.3 | ... | 3.4 |
| | Lower growth scenario | 3.3 | 3.3 | 3.4 | 3.5 | 3.6 | ... | 3.5 |
| Public debt | Higher growth scenario | 132.8 | 130.9 | 125.8 | 119.8 | 114.0 | ... | 78.5 |
| | Baseline scenario | 132.8 | 131.4 | 127.9 | 127.7 | 119.8 | ... | 93.0 |
| | Lower growth scenario | 132.8 | 132.6 | 130.9 | 128.8 | 127.5 | ... | 115.6 |

1)Rounding to the first decimal point may cause the lack of consistency between the variables.

Note: the cyclically adjusted balances for the alternative scenarios were calculated by using the semi-elasticity of revenues (equal to 0.04) and expenditures (equal to -0.5) to economic growth, while the total cyclical component was calculated using the semi-elasticity of the net borrowing to economic growth (equal to 0.54).

**Figure V.3-1 Medium term projection of debt to GDP ratio in the different scenarios**




Source: MEF

## V.4 LONG TERM SCENARIOS

This section presents the results of the medium-/long-term sustainability analysis through the updating of i) the projections of age-related expenditures and ii) the traditional sustainability indicators. The timeframe of reference is extended out to 2060 on the basis of the methodology developed within the Economic Policy Committee's Working Group on Ageing (EPC-AWG).

### The impact of population ageing on fiscal sustainability

Consistent with the methodological indications defined at a European level (EPC-AWG), Italy has traditionally developed medium-/long-term projections for five public expenditure items that are influenced by ageing (age-related expenditure): public expenditure for pensions, healthcare expenditure, expenditure for assistance to the elderly and the permanently disabled (long-term care, or LTC), expenditure for education and expenditure for social safety nets.

Assumptions have been adopted for the 2015-2019 five-year period that are in line with the indications of the short-term macroeconomic framework at unchanged legislation for the Update of the 2015 EFD. For the later years, the structural assumptions of the projection scenarios developed by the EPC-AWG 2015[46] have been reconciled with the short run macroeconomic outlook. The national accounting data for GDP, pension expenditure and expenditure for social safety nets have been developed on a basis consistent with the new European system of national and

[46] The demographic assumptions are those related to the EUROSTAT baseline forecast, with base year of 2013, assumed as an integral part of the EPC-AWG baseline scenario cited above. This scenario provides for the following for Italy: i) net annual flow of immigrants of approximately 306,000 on average, with a growing profile for the first 15 years and a decreasing trend thereafter; ii) a level of life expectancy at 2060 of 85.5 years for men and 89.7 years for women; and iii) a fertility rate of 1.61 as of 2060.

regional accounts (ESA 2010). The projections for the 2015-2019 period are in line with those underlying the public-finance framework of the 2015 Update of the EFD.

The projection of pension expenditure incorporates the effects of Decree-Law No. 65/2015, converted with Law No. 109/2015, and namely, the provision that implements the principles of the Constitutional Court Ruling No. 70/2015 regarding the unconstitutionality of de-indexing payments for pensions exceeding three times the minimum.

Overall, the ratio of age-related expenditure to GDP is stable for the 2015-2060 period, and averages around 27.8 per cent of GDP. However, in the years after 2015, the expenditure falls slightly before starting to rise again as of 2030, and reaching 28.5 per cent of GDP around 2042. The aggregate age-related expenditure falls in the final years of the forecast, amounting to 27 per cent of GDP in 2060.

With reference to the individual components, the ratio of pension expenditure, which rose during the crisis due exclusively to the decrease in level of nominal GDP, is projected to decrease as of 2015, due to the effects of the reform introduced with Law No. 214/2011. Starting from a level of 15.8 per cent of GDP, the pension expenditure declines to 15.3 per cent in 2020. In the later years, with the impact of the retirement of the Baby Boom generation, the ratio starts growing again to reach a high of 15.9 per cent of GDP in 2040. During the final years of the projection horizon, the ratio of pension expenditure to GDP falls rapidly to reach around 13.8 per cent in 2060.

The projection of healthcare expenditure is carried out on the basis of the so-called reference scenario methodology, which incorporates both age-related effects as well as the effects of additional explicative factors capable of significantly influencing the trend of healthcare expenditure. It follows that the projections of the ratio of healthcare expenditure to GDP initially declines for the effect of the cost-containment measures recently legislated, and it then starts to grow as from 2020 to amount to approximately 7.6 per cent in the final 10 years of the forecast period.

The expenditure for assistance to the elderly and permanently disabled is initially stable in relation to GDP. Subsequently it grows constantly reaching 1.6 per cent of GDP in 2060.

The projection expenditure for social safety nets in relation to GDP goes from 1.0 per cent in 2015, and then gradually decreases to around 0.6 per cent as from 2030.

Finally, the projection expenditure for education in relation to GDP presents a gradual reduction for the 2015-2033 period, going from an initial level of 3.7 per cent to 3.3 per cent of GDP. In the later years, expenditure is projected to grow to reach around 3.5 per cent of GDP in 2060.

## Fiscal sustainability indicators

The medium- and long-term indicators (S1 and S2) allow to assess the impact of implicit age-related liabilities on fiscal sustainability over the medium/long term.

The medium-term sustainability indicator (S1) shows the increase in the structural primary balance to be achieved cumulatively in the years 2019 and 2020 so as to ensure, if the increase is maintained constant thereafter, both the achievement of a debt-to-GDP ratio of 60 per cent by 2030 and to offset the age-related costs. The long-term sustainability indicator (S2) shows the fiscal adjustment in terms of structural primary balance which, if immediately realized and maintained, allows for complying with the intertemporal budget constraint from 2019 and over an infinite time horizon.

Both indicators are based on the growth projections and fiscal targets outlined in the policy scenario in the 2015 Update of the EFD, and incorporate the medium-/long-term projections of age-related expenditures. The higher and more positive the values of the S1 and S2 sustainability indicators, the greater will be the need for fiscal adjustment and thus, the greater the sustainability risk will be. Other conditions being equal, higher projected age-related expenditures will make the compliance with the intertemporal budget constraint harder as higher primary surpluses will be required.

Table 4 reports the results for the S1 and S2 indicators and their components. In comparison with previous analyses, the value of S1 stabilises and continues to reflect less-than-excessive risks regarding fiscal sustainability in the medium term. As shown by the breakdown of S1, the value related to the component measuring the effort necessary to stabilise the debt-to-GDP ratio at the 2019 level continues to be negative (equal to -3.1 points of GDP). Instead, the component that negatively impacts the indicator is the one that measures the adjustment needed to reduce the ratio from its initial level to 60 per cent of GDP in 2030. This component contemplates a fiscal adjustment equal to 4.7 per cent of GDP.

With reference to S2, the value related to the component that measures the effort needed to stabilise the debt-to-GDP ratio at the 2019 level, *coeteris paribus*, remains negative (equal to -2.4 points of GDP), thereby indicating the capacity of Italy's public finances, given the planned budgetary targets, to cope with the accumulation of interest expenditure/GDP (snowball effect) expected over the long term. Another component common to both S2 and S1, is the one that measures the additional fiscal adjustment needed to cover the increase in age-related expenditures. In Italy's case, this adjustment remains close to zero or is even negative, and thus indicates that the budgetary impact of age-related expenditures appears to be fully under control over the medium and long term.

It is possible therefore to conclude that the fiscal consolidation planned by the government for the 2015-2019 period can be considered appropriate for ensuring the sustainability of the public finances in the medium and long term.

**Table V.4-1 Sustainability indicators (points of GDP)**

| | NDA2015 | PS 2015 | NDA 2014 | PS 2014 |
|---|---|---|---|---|
| **S1 Indicator** | | | | |
| Total adjustment | 1.7 | 1.9 | 1.7 | 0.3 |
| of which: | | | | |
| Initial budgetary position | -3.1 | -2.8 | -2.6 | -3.6 |
| Cost of delaying adjustment | 0.0 | 0.0 | 0.1 | 0.0 |
| Debt requirements | 4.7 | 4.7 | 4.6 | 4.4 |
| Ageing costs | 0.1 | 0.1 | -0.5 | -0.6 |
| **S2 Indicator** | | | | |
| Total adjustment | -2.4 | -2.2 | -2.1 | -2.7 |
| of which: | | | | |
| Initial budgetary position | -2.4 | -2.2 | -2.1 | -2.9 |
| Long-term component | 0.0 | -0.1 | 0.0 | 0.2 |

Source: MEF calculations

## Sensitivity analysis of the long-term trend of the debt

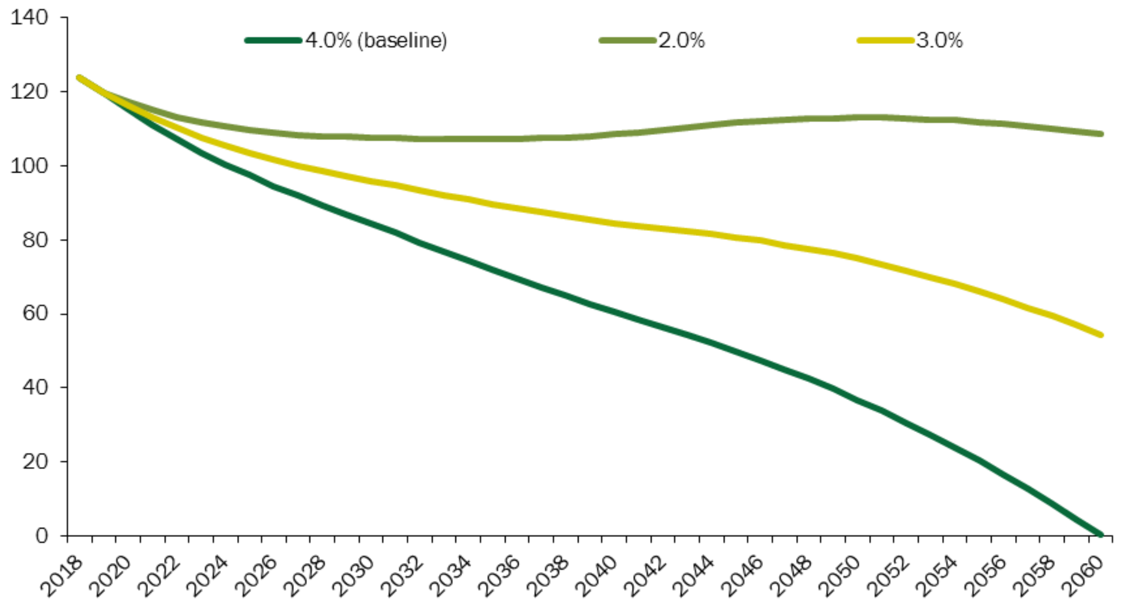
This section contains a comparison between the projection of the debt-to-GDP ratio through 2060 in the baseline scenario vis-à-vis the pattern resulting from a deterioration of the structural primary surplus in 2019. Such projections are obtained in line with the methodological indications developed at a European level by the EPC-AWG (Chapter IV of the 2015 EFD). The main assumption is that the structural primary surplus will evolve in the years after 2019, moving in line with the change in age-related expenditures.

In the baseline scenario, the debt-to-GDP ratio would rapidly decrease, reaching 60 per cent of GDP in 2040.

In addition to the baseline scenario, this section reports the results of two simulations that were aimed at evaluating the robustness of the results of public finance sustainability in the midst of a deterioration of the structural primary surplus in 2019. For this purpose, the value in the baseline scenario (approximately 4.0 per cent of GDP in 2019) is decreased at different stages by 1.0 percentage point, to get it to 3.0 per cent and 2.0 per cent, respectively (Figure V.4-1).

The trend of the public debt is significantly modified following the deterioration of the primary surplus, in particular for levels below 3.0 per cent of GDP. More specifically, structural primary surpluses below 3.0 per cent of GDP would not be sufficient to stabilise the debt-to-GDP ratio at the 60 per cent threshold. In general, the sustainability of the debt requires the maintenance of sizeable primary surpluses.

**Figure V.4-1 Public debt sensitivity to Structural primary surplus (% of GDP)**



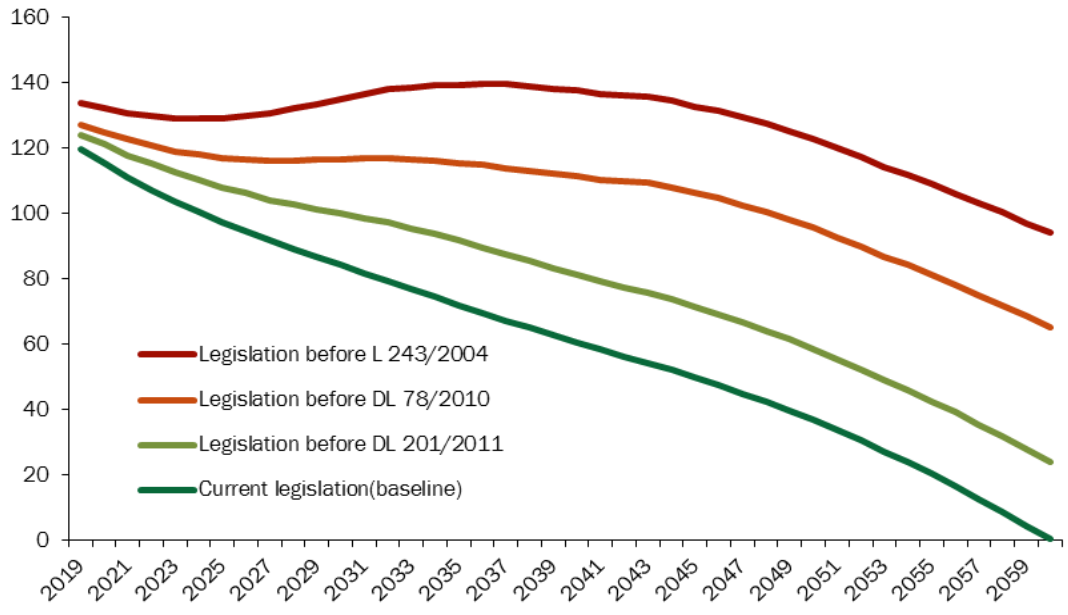

Source: MEF analyses and calculations using the Long-Term Forecast Model of the State General Accounting Department

## Simulations with respect to pension reforms

As shown by the sensitivity tests presented in the preceding section, when based on the government's budget objectives outlined in the Update to 2015 EFD (namely, the achievement of the Medium-Term Objective in 2018 and its maintenance in the years thereafter), the long-term trend of age-related expenditure would not jeopardise the sustainability of the Italy's public debt, even in the presence of particularly adverse macroeconomic, demographic or fiscal conditions. It should nonetheless be pointed out that this conclusion is the by-product of intensive pension reforms that have significantly contributed to reducing age-related expenditure over the past 20 years.

Figure V.4-2 describes the implications for the debt-to-GDP ratio of the various pension reforms adopted from 2004 to 2011, based on a counterfactual analysis that recomputes the initial levels of the debt and the primary surplus under the assumption of the absence of the pension reform considered. All of the reforms considered (from 2004 to the most recent) have entailed structural effects, and have produced an overall reduction of the ratio of pension expenditure to GDP versus the forecasts at unchanged legislation, thereby impacting the present value of the projected expenditure flows.

**Figure V.4-2 Impact of reforms on the debt to GDP ratio (% of GDP)**




**Source:** MEF analyses and calculations using the Long-Term Forecast Model of the State General Accounting Department

As shown by the results, in the scenario without the reforms adopted as from 2004, the debt-to-GDP ratio, after increasing in response to the ongoing retirement of the Baby Boom generation, would not begin to decrease until after 2040, and would be at levels permanently higher than those in the baseline scenario, which instead incorporates the financial effects of all of the reforms subsequently implemented.

The pubblication
ITALY'S DRAFT BUDGETARY PLAN 2016
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www.mef.gov.it
www.rgs.mef.gov.it