EUROPEAN
COMMISSION

Brussels, 2.6.2021
COM(2021) 512 final

Recommendation for a

COUNCIL RECOMMENDATION

delivering a Council opinion on the 2021 Stability Programme of Italy

{SWD(2021) 501 final}

Recommendation for a

COUNCIL RECOMMENDATION

delivering a Council opinion on the 2021 Stability Programme of Italy

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to the Recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause[2] of the Stability and Growth Pact.[3] In its Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The general escape clause has granted Member States budgetary flexibility to deal with the crisis. It has facilitated the coordination of budgetary policies in times of severe economic downturn. Its activation allows for a temporary departure from the adjustment path towards the medium-term budgetary objective of each Member State, provided this does not endanger fiscal sustainability in the medium term. On 17 September 2020, in its Annual Sustainable Growth Strategy, the Commission announced that the general escape clause would remain active in 2021.[4]

(2) On 20 July 2020, the Council recommended Italy[5] to take all necessary measures, in line with the general escape clause, to effectively address the pandemic, sustain the economy and support the ensuing recovery. It also recommended Italy to pursue, when

---

1 OJ L 209, 2.8.1997, p. 1.

2 The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

3 Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

4 Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

5 Council Recommendation of 20 July 2020 on the National Reform Programme of Italy and delivering a Council opinion on the 2020 Stability Programme of Italy, OJ C 282, 26.8.2020, p. 74.

economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

(3) The Council Recommendation on the economic policy of the euro area indicates that fiscal policies remain supportive in all euro area Member States throughout 2021 and that policy measures should be tailored to country-specific circumstances and be timely, temporary and targeted.[6] When the epidemiological and economic conditions allow, emergency measures should be phased out, while combatting the social and labour-market impact of the crisis. Fiscal policies should be pursued that are aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment. Member States should pursue reforms that strengthen the coverage, adequacy, and sustainability of health and social protection systems for all.

(4) On 18 November 2020, the Commission adopted its Opinions on the 2021 Draft Budgetary Plans of the euro area Member States, which were based on a qualitative assessment of the fiscal measures. The Commission was of the opinion that the Draft Budgetary Plan of Italy was overall in line with the fiscal policy recommendations adopted by the Council on 20 July 2020, and that most of the measures included in the plans supported economic activity against the background of considerable uncertainty. However, some measures did not appear to be temporary or matched by offsetting measures.

(5) Next Generation EU, including the Recovery and Resilience Facility, will ensure a sustainable, inclusive and fair recovery. Regulation (EU) 2021/241 establishing the Recovery and Resilience Facility[7] came into force on 19 February 2021. This Facility will provide financial support for the implementation of reforms and investment, entailing a fiscal impulse financed by the EU. It will contribute to the economic recovery, to the implementation of sustainable and growth-enhancing reforms and investment, notably to promote the green and digital transitions, and it will strengthen the economies' resilience and potential growth. In turn, it will also help public finances to return to more favourable positions in the near term and will contribute to strengthening sustainable public finances, growth and job creation in the medium and long term.

(6) On 3 March 2021, the Commission adopted a Communication providing further policy orientations to facilitate the coordination of fiscal policies and the preparation of Member States' Stability and Convergence Programmes.[8] The overall fiscal stance, taking into account national budgets and the Recovery and Resilience Facility, should remain supportive in 2021 and 2022. At the same time, given the expectation of economic activity gradually normalising in the second half of 2021, Member States' fiscal policies should become more differentiated in 2022. Member States' fiscal policies should take into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. In view of the need to support a sustainable recovery for the EU, Member States with low sustainability risks should gear their budgets towards maintaining a supportive fiscal policy in 2022, taking into account the impact of the Recovery and Resilience Facility. Member States with high debt levels should pursue prudent fiscal policies, while preserving

[6] Pending final adoption by the Council, after endorsement by the European Council. The text agreed by the Eurogroup on 16 December 2020 is available at: https://data.consilium.europa.eu/doc/document/ST-14356-2020-INIT/en/pdf

[7] OJ L57, 18.2.2021, p.17.

[8] Communication from the Commission to the Council on one year since the outbreak of COVID-19: fiscal policy response, Brussels, 3.3.2021, COM(2021) 105 final.

nationally-financed investment and making use of grants under the Recovery and Resilience Facility to fund additional high-quality investment projects and structural reforms. For the period beyond 2022, fiscal policies should continue to take into account the strength of the recovery, the degree of economic uncertainty and fiscal sustainability considerations. A refocusing of fiscal policies towards achieving prudent medium-term fiscal positions, including by phasing out support measures in due course, will contribute to ensuring fiscal sustainability in the medium term.

(7) The Communication of 3 March 2021 also announced the Commission's view that the decision on the deactivation or continued application of the general escape clause should be taken as an overall assessment of the state of the economy, with the level of economic activity in the EU or euro area compared to pre-crisis levels (end-2019) as key quantitative criterion. On the basis of the Commission's 2021 spring forecast, on 2 June the Commission considered that the conditions to continue to apply the general escape clause in 2022 and to deactivate it as of 2023 were met. Country-specific situations will continue to be taken into account after the deactivation of the general escape clause.[9]

(8) On 30 April 2021, Italy submitted its 2021 Stability Programme, in line with Article 4 of Regulation (EC) No 1466/97.

(9) In 2020, based on data validated by Eurostat, Italy's general government deficit was 9.5% of GDP, while general government debt increased to 155.8% of GDP. The annual change in the primary budget balance amounted to 8.0% of GDP, including discretionary budgetary measures in support of the economy and the operation of automatic stabilisers. Italy also provided liquidity support to companies and households (such as guarantees and tax deferrals, which do not have a direct and immediate budgetary impact) estimated at 24.8% of GDP.

On 2 June 2021, the Commission issued a report under Article 126(3) TFEU. This report discusses the budgetary situation of Italy, as its general government deficit in 2020 exceeded the 3% of GDP Treaty reference value, while its general government debt exceeded the 60% of GDP Treaty reference value and did not diminish at a satisfactory pace. The report concluded that the deficit criterion was not fulfilled and the debt criterion was not complied with.

(10) The macroeconomic scenario underpinning the budgetary projections of the authorities is realistic in 2021 and 2022. The 2021 Stability Programme projects real GDP to grow by 4.5% in 2021 and 4.8% in 2022. By comparison, the Commission's 2021 spring forecast projects a moderately lower real GDP growth of 4.2% in 2021 and 4.4% in 2022, mainly due to the lower expected use of Recovery and Resilience Facility grants in 2021 and 2022 based on the more recent indications provided in the National Recovery and Resilience Plan.

(11) In its 2021 Stability Programme, the government plans an increase of the general government deficit from 9.5% of GDP in 2020 to 11.8% of GDP in 2021, while the debt ratio is planned to increase to 159.8% of GDP in 2021. According to the programme, the change in the primary budget balance in 2021 compared with the pre-crisis level (2019) is set to amount to 10.4% of GDP, reflecting the discretionary budgetary measures in support of the economy and the operation of automatic stabilisers. These projections are in line with the Commission's 2021 spring forecast.

---

[9] Communication from the Commission on Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, Brussels, 2.6.2021, COM(2021)500 final.

(12) In response to the COVID-19 pandemic and related economic downturn, Italy has adopted budgetary measures to strengthen the capacity of its health system, contain the pandemic and provide relief to those individuals and sectors that have been particularly affected. This forceful policy response has cushioned the contraction in GDP, which, in turn, curtailed the increase in government deficit and public debt. Fiscal measures should maximise support to the recovery without pre-empting future fiscal trajectories. Therefore, measures should avoid creating a permanent burden on public finances. When Member States introduce permanent measures, they should properly fund them to ensure budgetary neutrality in the medium term. The measures taken by Italy in 2020 and 2021 have been in line with the Council Recommendation of 20 July 2020. Some of the discretionary measures adopted by the government in 2020 and 2021 do not appear to be temporary or matched by offsetting measures. Beyond the horizon of the Commission's forecast, in 2023, the remaining impact of those non-temporary measures is preliminarily estimated at around 1% of GDP, mainly consisting of a reduction of social security contributions in poorer regions, the extension of the tax credit on employment income and the introduction of a family allowance. Those non-temporary measures also include investment of approximately ⅓% of GDP, which is expected to support medium-term potential growth, and thus sustainability.

(13) The 2021 Stability Programme assumes investment and reforms financed by grants under the Recovery and Resilience Facility amounting to 0.6% of GDP in 2021, 0.9% in 2022, 1.4% in 2023, 0.5% in 2024 and 0.2% in 2025. The programme also assumes investment and reforms financed by loans under the Recovery and Resilience Facility amounting to 0.3% of GDP in 2020, 0.8% of GDP in 2021, 0.9% in 2022, 0.7% in 2023, 1.3% in 2024, 1.2% in 2025 and 1.0% in 2026. The Commission's spring forecast does not fully include these grants in its budgetary projections, in line with the more recent indications provided in the National Recovery and Resilience Plan, which was finalised after the Stability Programme. Instead, the Commission forecast assumes that investments and reforms financed by the Recovery and Resilience Facility grants will amount to 0.3% of GDP in 2021 and 0.7% of GDP in 2022.

(14) The established indicators of fiscal adjustment set out in Regulation (EC) No 1466/97 need to be considered in the context of the current circumstances. First, there is significant uncertainty surrounding output gap estimates. Second, there is a need for fiscal policy to stand ready to rapidly adapt to the evolution of the pandemic, shifting from emergency relief to more targeted measures once health risks diminish. Third, the current context is characterised by a significant policy response to support economic activity. In the presence of sizeable transfers from the EU budget (such as those from the Recovery and Resilience Facility), the established indicators do not capture the full impulse provided by fiscal policies to the economy. Against this background, the structural balance does not appear adequate in the current circumstances. The expenditure benchmark, in turn, needs to be adapted[10] and complemented with additional information in order to fully gauge the fiscal policy orientation.

First, similarly to the approach pursed in the assessment of the 2021 Draft Budgetary Plans, temporary emergency measures have been excluded from the expenditure aggregate. These crisis-related temporary emergency measures support health systems and compensate workers and firms for the losses in income due to lockdowns and

[10] In particular, the 4-year smoothing of investment used in the expenditure benchmark does not allow assessing properly the fiscal support to the recovery provided by nationally financed investments.

supply chain disruptions; their reversal by the public authorities is contingent on the return of the public health and economic situation to normality.

Second, to assess the overall fiscal stance at the current juncture, the sizeable transfers from the EU budget (such as those from the Recovery and Resilience Facility) should be included in the relevant expenditure aggregate.

Therefore, the fiscal stance is then measured by the change in primary expenditure (net of discretionary revenue measures and excluding crisis-related temporary emergency measures) including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds.

Going beyond the overall fiscal stance, the analysis also aims at assessing whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions. For that reason, particular attention is paid to the evolution of nationally financed primary current expenditure and investment.

(15) In its 2021 Stability Programme, Italy's general government deficit is planned to decrease to 5.9% of GDP in 2022, mainly due to a discontinuation of the temporary support measures adopted in 2020 and 2021 and the lower support from the automatic stabilisers. The general government debt ratio is planned to decrease to 156.3% of GDP in 2022. These projections are in line with the Commission's 2021 spring forecast.

Based on the Commission's forecast, the overall fiscal stance as defined above – also including the impact on aggregate demand in 2022 from investment financed by both the national and the EU budgets, notably the Recovery and Resilience Facility – is estimated at -2.2% of GDP.[11] The positive contribution of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to increase by 0.4 percentage points of GDP. Nationally financed investment is projected to provide an expansionary contribution of 0.3 percentage points of GDP.[12] Nationally financed primary current expenditure (net of discretionary revenue measures) is projected to provide an expansionary contribution of 1.3 percentage points of GDP.

(16) The quality of Member States' budgetary measures appears particularly important. Fiscal structural reforms aimed at improving the composition of national budgets can support potential growth, create much-needed fiscal space and help ensuring fiscal sustainability over the longer term, including in view of climate change and health challenges. On the revenue side, the COVID-19 crisis has reinforced the importance of reforms for more efficient and fairer public revenue systems. On the expenditure side, it has made even more crucial to increase the level and quality of sustainable and growth-enhancing investments, consistent with serving the objectives of enhancing growth potential, economic and social resilience and the green and digital twin transition. The Recovery and Resilience Plans will allow to improve the composition of national budgets.

(17) According to the programme's medium-term budgetary plans, the general government deficit is planned to decrease from 4.3% in 2023, to 3.4% of GDP in 2024. The

[11] A negative sign of the indicator corresponds to an excess of the primary expenditure growth compared with medium-term economic growth, which indicates an expansionary fiscal policy.

[12] Other nationally financed capital expenditure is projected to provide an expansionary contribution of 0.2 percentage points of GDP.

general government deficit is therefore not planned to return below 3% of GDP over the programme horizon.

Based on the programme, the overall fiscal stance – also including the impact on aggregate demand from investment financed by both the national and the EU budgets, notably the Recovery and Resilience Facility, is estimated at 0.4% of GDP in 2023 and 2024 on average.[13] The positive contribution of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to decrease by 0.4 percentage points of GDP. Nationally financed investment is projected to provide an expansionary contribution of 0.2 percentage points of GDP.[14] Nationally financed primary current expenditure (net of discretionary revenue measures) is projected to provide a neutral contribution.

The current estimate of the 10-year average nominal potential growth is 2%.[15] However, this estimate does not include the impact of the reforms that are part of the Recovery and Resilience Plan and can boost Italy's potential growth.

(18) The general government debt ratio is planned to decrease from 155% of GDP in 2023 to 152.7% of GDP in 2024. In light of the high debt ratio, which is projected to only gradually fall over time, Italy is considered to face high fiscal sustainability risks over the medium term, as per the latest debt sustainability analysis.[16]

(19) In view of the currently still exceptionally high degree of uncertainty, the fiscal policy guidance should remain predominantly qualitative. More precise quantified guidance for the later years should be provided in 2022, if the degree of uncertainty has sufficiently declined by then.

The Council has assessed the 2021 Stability Programme and the follow-up by Italy to the Council Recommendation of 20 July 2020.

HEREBY RECOMMENDS ITALY TO:

1. In 2022, use the Recovery and Resilience Facility to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Preserve nationally financed investment. Limit the growth of nationally financed current expenditure.

2. When economic conditions allow, pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, enhance investment to boost growth potential.

3. Pay particular attention to the composition of public finances, both on the revenue and expenditure sides of the budget, and to the quality of budgetary measures, to ensure a sustainable and inclusive recovery. Prioritise sustainable and growth-enhancing investment, notably supporting the green and digital transition. Give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including

---

[13] The estimates presented in this paragraph are based on the detailed budgetary projections transmitted by Italy with the 2021 Stability Programme. Except for the overall figures for government deficit and debt, the projections transmitted by Italy do not take into account the fiscal package announced for May 2021. This package, adopted on 20 May 2021, included additional emergency support in 2021 as well as more resources for nationally-financed investment projects in the coming years.

[14] Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0.2 percentage points of GDP.

[15] Estimated by the Commission, following the commonly agreed methodology.

[16] See Commission Staff Working Document – Statistical Annex providing background data relevant for the assessment of the 2021 Stability and Convergence Programmes.

by strengthening the coverage, adequacy, and sustainability of health and social protection systems for all.

Done at Brussels, 2.6.2021

For the Council
The President