MINISTERO DELL'ECONOMIA E DELLE FINANZE

ITALY'S DRAFT BUDGETARY PLAN 2015

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Submitted by Minister of the Economy and Finance
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I. INTRODUCTION

A DIFFICULT MACROECONOMIC SCENARIO

The latest macroeconomic developments indicate that the growth of the Euro Area economies, which is already weak, is significantly slowing further. The sluggishness of the economy, the fragility of the recovery, and the prompt setbacks of economic activity are factors to suggest a critical and structural situation that is partly the consequence of the damage caused by the severe, lengthy recession of recent years.
The continuing uncertainty affecting the European economies has changed the behaviour of businesses and households, reducing their propensity to invest and to consume; it has dried up the sources of income and the possibilities for accessing credit, thereby reducing spending capacity. The weak demand in the Euro Area has furthermore limited the normal contribution that exports make to economic recovery.
Even though decisively contributing to the financial stability, the monetary-policy actions taken to date have not been sufficient on their own to relaunch the growth in Europe. The benefits of structural reforms are materialising with increasing delays and less intensity, including due to the continuing weakness of aggregate demand.
More in general, this framework suggests the Euro Area is facing a defining moment. Barring any significant intervention, the European countries risk spiralling into a state of stagnation and deflation, in which high unemployment and flat nominal growth will make the recovery of competitiveness and debt sustainability even more difficult.
Against this backdrop, Italy's government believes it is necessary to contemplate a recovery that is less robust and delayed with respect to the forecasts outlined in the Economic and Financial Document (EFD) published in April 2014. At the same time, inflation remains extremely low and is continuing to fall, thereby precipitating the growing risk of deflation.
The GDP growth estimate is -0.3 per cent for 2014, and is forecast to rise to 0.6 per cent in 2015, until reaching 1.4 per cent in 2018, inclusive of the impact of the reforms already approved and in the process of being approved and implemented.
To change the direction of growth, it will be necessary to use of all economic-policy mechanisms available - namely, monetary policy, structural measures and fiscal policy - in a coordinated and synergetic manner.
Italy's government is determined to continue the reform programme initiated, whose timeframe spans approximately three years. The implementation of the reforms will be assured over this period, thereby fostering positive interaction with fiscal policy, in a single strategy to stimulate and support aggregate demand in the short term and to increase the potential of the economy in line with the European Union's strategy for growth and employment.
Some of the reform measures have an important role within the framework of the Macroeconomic Imbalances Procedure at the European level. Such measures include: the reform of the justice system, which is needed to close an efficiency deficit that has discouraged economic activity in Italy; the measures introduced for the deregulation of credit and the access to the capital markets that will increase financing alternatives for businesses, especially small- and medium-sized firms; the

simplification of the taxation system that, through the implementation of the so-called Delega Fiscale, and the simultaneous permanent reduction of fiscal pressure on households and businesses, will contribute to eliminating obstacles to growth; the reform of the labour market with the Jobs Act that will allow for a more rapid response in adjusting productive activities to cyclical and structural changes, with beneficial effects on investment (including investment from abroad), and the rate of participation in the labour market, and a related reduction in the segmentation of the work force; this reform is closely linked to education reform.

A STABILITY LAW FOR GROWTH

The simultaneous implementation of structural reforms, fiscal policies and measures to support investment will allow for bolstering flexibility, resistance to the crisis, and the capacity to generate growth and employment.

The fiscal policy for 2015 will emphasise growth as a result of the mix of the measures contemplated in the Stability Law for 2015-2017 which provides for expenditure cuts against a significant reduction of the tax wedge on labour, and resources available for the reform process and to facilitate investment in research and innovation.

The tightening of economic conditions during the current year is viewed as an exceptional event. In line with European and Italian laws and regulations that allow for temporarily deviating from the path in converging towards the Medium-Term Objective[1], and taking into account the recessionary effects that would come from further fiscal consolidation measures, Italy's government is revising the budget objectives and the realignment plan presented in the 2014 EFD, deferring the achievement of structural breakeven to 2017. The government intends to make use of the flexibility available for implementing an ambitious package of structural measures aimed at getting economic growth back on a sustainable track.

In 2014, the net borrowing under the policy scenario is set at 3.0 per cent of GDP. Such figure is associated with a structural deficit equal to 0.9 per cent of GDP. For 2015, the net borrowing under the policy scenario is set at 2.9 per cent of GDP, with an upward revision of approximately 0.7 percentage points with respect to the estimate of the trend scenario based on unchanged legislation. The revision reflects the effects of the Stability Law that, in remaining consistent with the actions already taken by the government, will pave the way for a permanent reduction in fiscal pressure on households and businesses.

The resources freed up by the reduction in spending and the increase in net borrowing will make it possible: to finance the measures to increase the quality of the educational system and the number of educational programmes offered, funding projects in the fields of education and research and development; to support the investments through a substantial revision of the Domestic Stability Pact for the regions and local government; to reduce the fiscal burden for businesses, including through further revisions to the regional tax on productive activity (IRAP); to increase, alongside the revision of the rules related to the labour market, the appropriations for social safety nets (Social Insurance for Employment, ASPI), thereby extending the protection guaranteed in the event of the loss of employment, with a particular emphasis on the status of the younger components of the work force; to

[1] Article 5 of EU Regulation No. 1466/97 and Article 6, Paragraph 5 of Law No. 243/2012.

refinance the personal income tax bonus for low and medium income brackets for 2015; and to refinance 2015 expenditure based unchanged policies.

The redefinition of the nominal targets should ensure improvement in the structural budget balance equal to 0.1 percentage points in GDP between 2014 and 2015. The intensity of the structural improvement considers an output gap equal to -3.5 per cent of potential GDP in 2015, above that historically recorded in normal recessions, and the continuation of the current economic recession.

The consistency of the new targets vis-à-vis European rules will also need to be evaluated by considering the future beneficial effects of the structural reforms on the country's economic growth. According to the estimates indicated in the Update to the 2014 EFD, the measures provided by the 2015-2017 Stability Law and the other structural reforms now being implemented should produce increasing improvement of economic growth over the years. Such effect should be equivalent to approximately 0.1 percentage points in 2015. The growth effect of the reforms alone should get to an amount equivalent to around 0.4 percentage points of GDP in 2018.

These estimates support the idea behind the flexibility clause provided by the preventive arm of the Stability and Growth Pact, according to which the implementation of reforms can be considered for the purpose of the temporary deviation from the path in converging toward the Medium-Term Objective, provided there is a positive impact on long-term sustainability and there is a safety margin guaranteed with respect to the deficit limit of 3 per cent of GDP.

In the medium term, Italy's fiscal policy will continue the pursuit of the fiscal consolidation shown in recent years, which has been one of the most significant efforts at a European level. As clarified in the Update to the 2014 EFD, the government is committed to resuming the effort for convergence to the Medium-Term Objective starting in 2015. The budget measures contained in the 2015-2017 Stability Law will ensure improvement of the structural balance equal to 0.5 percentage points of GDP in 2016, when the debt-to-GDP ratio is forecast to start descending.

In line with the requirements of the Two Pack[2], this Draft Budgetary Plan (DBP) contains the update of the macroeconomic and public finance forecasts set out in the Stability Programme, which represents the first section of the Economic and Financial Document presented in April 2014, and the details of the public finance measures. The DBP also includes some information about how the measures outlined in the budget respond to the EU Council's specific recommendations to Italy.

The DBP is a follow-up to the Update to the 2014 EFD, approved by the Council of Ministers on 30 September and by Parliament on 14 October. The Update was presented along with a special report required by national law[3] that updates the process of convergence toward a structural balanced budget (Medium-Term Objective), approved with an absolute majority vote by the Parliament as the same time as the Note.

The policy scenario for public finance and the economy presented herein considers the new methods of the national and regional system of accounts (ESA 2010) adopted at a European level, and is based on the yearly final data issued by ISTAT with its notification on net borrowing and the debt dated 1 October 2014. The scenario does not consider, however, the revisions to the estimates of the quarterly economic

[2] EU Regulation No. 473/2013.

[3] Law No. 243/2012, Article 6.

accounts, published by ISTAT on 15 October, because of the lack of time for their updating. Furthermore, the estimated impact on the macroeconomic framework has been made on the basis of preliminary indications about the components of the budget. Estimates will be therefore revised and updated, if necessary, and made official in a report to the Parliament as required by law.
In order to satisfy the specific requirements of the Two Pack regarding the use of independent macroeconomic forecasts, the growth estimates contained in this DBP have been validated by the Parliamentary Budget Office, the independent entity instituted in 2012, which became operational in the latest months, on 10 October 2014.

FOCUS

Effects of structural reforms on the debt-to-GDP ratio

With the aim of getting the economy back on track on a sustained path for potential growth, the government has planned an ambitious package of structural reforms. In order to finance these measures, the government will make use in 2015 of the flexibility granted by the national legislation (Article 3, paragraph 4 of Law 243/2012) and by the European framework (Article 5 of EC Regulation no. 1455/97) .

In case of implementation of structural reforms with a positive impact on potential growth and fiscal sustainability, the European Commission and the European Council may decide to revise the convergence calendar and to allow a temporary deviation in the path towards the Medium Term Objective (MTO) of single member countries. This temporary deviation is allowed provided that an appropriate safety margin is guaranteed with respect to the 3 per cent deficit-to-GDP ceiling , and that the budgetary position returns to the MTO within the forecast horizon, i.e. by 2018 in the case of the Update to the 2014 EFD (October 2014).

According to the government's assessment, the macroeconomic and fiscal policy scenario of the Update to the 2014 EFD, which provides for achieving the MTO in 2017, is in line with the specific requirements for the implementation of the so-called reforms' clause described above.

However, a simple counterfactual analysis has been carried out in order to assess how the package of structural reforms to be introduced in 2015 according the policy scenario of the Updated EFD will affect the short/medium-term trend of the debt-to-GDP ratio.

Starting from the forecast of the debt-to-GDP ratio based on unchanged legislation, which therefore does not include the effects of the privatisations planned by the government, the net borrowing for 2015 deteriorates by an amount equivalent to 0.7 per cent of GDP (from 2.2% to 2.9%) for the effect of the revenue and spending measures to implement the reforms. As of 2015, the trend of the debt-to-GDP ratio is recalculated by taking into account both the negative impact of the increased deficit and the increased real growth prompted by the introduction of the reforms. In line with the estimates presented in Table II.4 of the Update to the 2014 EFD, the structural reforms considered in this analysis are only those that entail budgetary costs. They include: 1) the refinancing of the personal income tax bonus; 2) the reduction of taxes levied on businesses; 3) other measures of the Stability Law, including those entailing negative effect on GDP in relation to measures to cover expenditures; and 4) the impact due to the Jobs Act in the component identified as "Effect of the reforms" which amounts to 0.1 percentage points on GDP between 2016 and 2018. Overall, the effect on GDP growth of the structural reforms is equal to 0.1 percentage points in 2015, 0.3 percentage points in 2016, 0.2 percentage points in 2017 and 0.1 percentage points in 2018. At the end of the simulation period, the cumulative additional effect on the GDP is equal to 0.7 percentage points and the benefits to the economy are permanent. Considering also the other measures in Table II.4, i.e. also those without budgetary impact which have not been included for precautionary reasons, the effects on GDP increase with time.

The results reported below show that the debt-to-GDP ratio, which includes the higher deficit in 2015 and the effects of reforms on GDP growth, would quickly resume (as early as 2016) the trend indicated by the scenario based unchanged legislation. In 2017, the debt-to-GDP ratio would be equal to 131.7 per cent, i.e. the starting level of 2014.

TABLE I.1-1 EFFECTS OF STRUCTURAL REFORMS ON THE DEBT-TO-GDP RATIO

	2014	2015	2016	2017	2018
Debt-to-GDP - unchanged legislation	**131.7**	**133.7**	**133.7**	**132.1**	**129.9**
Net borrowing - unchanged legislation	-3.0	-2.2	-1.8	-1.2	-0.8
Nominal GDP growth - unchanged legislation	0.5	1.0	2.1	2.7	2.8
Deterioration of net borrowing due to policy scenario	0.0	-0.7	-0.7	-0.7	-0.7
Net borrowing - counterfactual analysis	-3.0	-2.9	-2.5	-1.9	-1.5
Incremental real growth due to structural reforms [1]	0.0	0.1	0.3	0.2	0.1
Debt-to-GDP – counterfactual analysis [2]	**131.7**	**134.3**	**133.6**	**131.7**	**129.5**
Debt-to-GDP - difference versus unchanged legislation	**0.0**	**0.6**	**0.1**	**-0.4**	**-0.3**

1 Updated 2014 EFD - Table II.4 - Impact of the new measures on the rate of growth based on unchanged legislation

2 The Stock-Flow Adjustment is assumed to be equal to zero over the simulation period.

II. TABLES

TABLE II.1-1 BASIC ASSUMPTIONS (0.I)	2013	2014	2015
Short-term interest rate [1] (annual average)	0.2	0.2	0.4
Long-term interest rate (annual average)	4.4	3.0	2.7
USD/€ exchange rate (annual average)	1.3	1.3	1.3
Nominal effective exchange rate	8.2	0.2	-2.3
World excluding EU, GDP growth	3.8	3.8	4.3
EU GDP growth	0.1	1.3	1.7
Growth of relevant foreign markets	0.9	3.3	4.3
World import volumes, excluding EU	4.2	4.4	5.7
Oil prices (Brent, USD/barrel)	108.6	104.7	98.5

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

Long-term interest rates are the average of forecast rates on 10-year government securities issued during the year.

TABLE II.1-2 MACROECONOMIC PROSPECTS (1.A)

	ESA Code	2013	2013	2014	2015	2016	2017	2018
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	1,548,107	-1.9	-0.3	0.6	1.0	1.3	1.4
Of which								
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth					0.1			
2. Potential GDP		1,618,221	-0.5	-0.3	-0.2	0.0	0.2	0.3
contributions:								
- labour			-0.4	-0.2	-0.2			
- capital			-0.3	-0.3	-0.3			
- total factor productivity			0.2	0.2	0.3			
3. Nominal GDP	B1*g	1,618,904	-0.6	0.5	1.2	2.6	3.1	3.3
Components of real GDP								
4. Private final consumption expenditure	P.3	914,689	-2.8	0.1	1.0			
5. Government final consumption expenditure	P.3	314,606	-0.7	0.1	-0.5			
6. Gross fixed capital formation	P.51g	274,861	-5.4	-2.1	1.5			
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53		0.0	-0.1	0.0			
8. Exports of goods and services	P.6	436,060	0.6	1.9	2.8			
9. Imports of goods and services	P.7	392,186	-2.7	1.8	3.4			
Contributions to real GDP growth								
10. Final domestic demand			-2.8	-0.3	0.7			
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		0.0	-0.1	0.0			
12. External balance of goods and services	B.11		0.9	0.1	-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 2014 Update of the Economic and Financial Document fro the period 2014-2018.
They may differ from the figures calculated by the European Commission for a different (longer) time horizon.

TABLE II.1-3 PRICE DEVELOPMENTS (1.B)

	ESA Code	2013	2013	2014	2015	2016	2017	2018
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		104.6	1.4	0.8	0.6	1.6	1.8	1.8
2. Private consumption deflator		107.1	1.2	0.4	0.5			
3. HICP		117.5	1.3	0.4	0.5			
4. Public consumption deflator		100.1	0.4	-1.4	-0.2			
5. Investment deflator		105.0	0.5	0.2	1.0			
6. Export price deflator (goods and services)		106.0	-0.1	-0.5	1.0			
7. Import price deflator (goods and services)		108.5	-1.8	-1.7	0.9			

TABLE II.1-4 LABOUR MARKET DEVELOPMENTS (1.C)

	ESA Code	2013	2013	2014	2015
		Level	rate of change	rate of change	rate of change
1. Employment, persons		24,304	-2.0	-0.4	0.3
2. Employment, hours worked		42,539,881	-2.0	-0.8	0.1
3. Unemployment rate (%)			12.2	12.6	12.5
4. Labour productivity, persons		63,705	0.0	0.1	0.4
5. Labour productivity, hours worked		36.4	0.1	0.5	0.7
6. Compensation of employees	D.1	647,963	-0.5	0.6	1.1
7. Compensation per employee		39,973	1.2	0.8	0.8

TABLE II.1-5 SECTORAL BALANCES (1.D)

	ESA Code	2013	2014	2015
	B.9	% GDP	% GDP	% GDP
1. Net lending/net borrowing vis-à-vis the rest of the world		0.9	1.0	0.8
of which:				
- Balance on goods and services		2.3	2.7	2.6
- Balance of primary incomes and transfers		-1.6	-1.8	-1.9
- Capital account		0.2	0.1	0.1
2. Net lending/net borrowing of the private sector	B.9	3.8	3.7	2.6
3. Net lending/net borrowing of general government	B.9	-2.8	-3.0	-2.9
4. Statistical discrepancy				

The total may differ from the sum of the elements because of rounding effects

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 II.1-6 GENERAL GOVERNMENT BUDGETARY TARGETS BROKEN DOWN BY SUBSECTOR (2.A)

	ESA Code	2014	2015	2016	2017	2018
		% GDP	% GDP	%GDP	%GDP	% GDP
Net lending (+) / net borrowing (-) (B.9) by sub-sector						
1. General government	S.13	-3.0	-2.9	-1.8	-0.8	-0.2
2. Central government	S.1311	-3.1	-2.9			
3. State government	S.1312					
4. Local government	S.1313	0.0	-0.1			
5. Social security funds	S.1314	0.1	0.1			
6. Interest expenditure	D.41	4.7	4.5			
7. Primary balance		1.7	1.6			
8. One-off and other temporary measures [1]		0.3	-0.1	0.1	0.0	0.0
9. Real GDP growth (%) (=1 in Table 1.a)		-0.3	0.6			
10. Potential GDP growth (%) (=2 in Table 1.a) [2]		-0.3	-0.2	0.0	0.2	0.3
contributions :						
- labour		*-0.2*	*-0.2*			
- capital		*-0.3*	*-0.3*			
- total factor productivity		*0.2*	*0.3*			
11. Output gap (% of potential GDP)		-4.3	-3.5	-2.6	-1.4	-0.4
12. Cyclical budgetary component (% of potential GDP)		-2.4	-1.9	-1.4	-0.8	-0.2
13. Cyclically-adjusted balance (1 - 12) (% of potential GDP)		-0.7	-0.9	-0.4	0.0	0.0
14. Cyclically-adjusted primary balance (13 + 6) (% of potential GDP)		4.1	3.6	4.1	4.2	4.1
15. Structural balance (13 - 8) (% of potential GDP)		-0.9	-0.9	-0.4	0.0	0.0

Disparities, if any, are due to rounding. Estimates based on the trend scenario, used for the computation of the debt-rule, are provided in the Statistical annex.

[1] A plus sign means deficit-reducing one-off measures.

[2] The rate of potential growth and the output gaps have been derived on the basis of the EU commonly agreed methodology on the basis of the macroeconomic outlook of the 2014 Update of the Economic and Financial Document for the period 2014-2018. They may differ from the figures calculated by the European Commission for a different (longer) time horizon.

TABLE II.1-7 GENERAL GOVERNMENT DEBT DEVELOPMENTS (2.B)*

	ESA Code	2014	2015	2016	2017	2018
		% GDP	% GDP	% GDP	% GDP	% GDP
1. Gross debt[1]		131.6	133.4	131.9	128.6	124.6
2. Change in gross debt ratio		3.7	1.8			
Contributions to changes in gross debt						
3. Primary balance (= item 10 in Table 2.a.i)		1.7	1.6			
4. Interest expenditure (= item 9 in Table 2.a.i)	D.41	4.7	4.5			
5. Stock-flow adjustment [2]		1.3	0.5	0.1	-0.1	-0.2
of which:						
- Differences between cash and accruals[2]		1.5	0.8			
- Net accumulation of financial assets[3]		0.0	-0.3			
of which:						
- privatization proceeds		*0.3*	*0.7*			
- Valuation effects and other[4]		*-0.2*	*0.0*			
p.m.: Implicit interest rate on debt[5]		*3.7*	*3.5*			
Other relevant variables						
6. Liquid financial assets[6]						
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.
[2] Sum of: Differences between cash and accruals, Net accumulation of financial assets, Valuation effects and other.

TABLE II.1-8 GENERAL GOVERNMENT EXPENDITURE AND REVENUE PROJECTIONS AT UNCHANGED POLICIES BROKEN DOWN BY MAIN COMPONENTS (3)

General government (S13)	ESA Code	2014	2015
		% GDP	% GDP
1. Total revenue at unchanged policies	TR	47.7	47.9
Of which			
1.1. Taxes on production and imports	D.2	15.2	15.2
1.2. Current taxes on income, wealth, etc	D.5	14.6	14.8
1.3. Capital taxes	D.91	0.1	0.1
1.4. Social contributions	D.61	13.3	13.3
1.5. Property income	D.4	0.6	0.6
1.6. Other		3.8	4.0
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		*43.3*	*43.4*
2. Total expenditure at unchanged policies	TE	50.8	50.1
Of which			
2.1. Compensation of employees	D.1	10.0	9.9
2.2. Intermediate consumption	P.2	5.2	5.1
2.3. Social payments	D.62, D.632	23.1	23.1
of which Unemployment benefits		*1.0*	*0.9*
2.4. Interest expenditure	D.41	4.7	4.5
2.5. Subsidies	D.3	1.7	1.7
2.6. Gross fixed capital formation	P.51	2.2	2.2
2.7. Capital transfers	D.9	1.5	1.3
2.8. Other		2.3	2.4

TABLE II.1-9 GENERAL GOVERNMENT EXPENDITURE AND REVENUE TARGETS, BROKEN DOWN BY MAIN COMPONENTS (4.A)

General government (S13)	ESA Code	2014	2015
		% GDP	% GDP
1. Total revenue target	TR	47.7	47.7
Of which			
1.1. Taxes on production and imports	D.2	15.2	15.1
1.2. Current taxes on income, wealth, etc	D.5	14.6	14.8
1.3. Capital taxes	D.91	0.1	0.1
1.4. Social contributions	D.61	13.3	13.2
1.5. Property income	D.4	0.6	0.6
1.6. Other		3.8	3.9
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		43.3	43.2
2. Total expenditure target	TE	50.8	50.6
Of which			
2.1. Compensation of employees	D.1	10.0	10.0
2.2. Intermediate consumption	P.2	5.2	5.0
2.3. Social payments	D.62, D.632	23.1	23.6
of which Unemployment benefits		*1.0*	*0.9*
2.4. = Table 2.a.9. Interest expenditure	D.41	*4.7*	*4.5*
2.5. Subsidies	D.3	*1.7*	*1.5*
2.6. Gross fixed capital formation	P.51g	*2.2*	*2.3*
2.7. Capital transfers	D.9	1.5	1.2
2.8. Other		2.3	2.5

TABLE II.1-10 AMOUNTS TO BE EXCLUDED FROM THE EXPENDITURE BENCHMARK (4.B)

	ESA Code	2013	2013	2014	2015
		Level	% GDP	% GDP	% GDP
1. Expenditure on EU programmes fully matched by EU funds revenue		4,636	0.3	0.2	0.3
2. Cyclical unemployment benefit expenditure[1]		2,166	0.1	0.1	0.1
3. Effect of discretionary revenue measures		4,253	0.3	0.5	-0.2
4. Revenue increases mandated by law			0	0	0

[1] The cyclical component of unemployment benefit expenditure has been computed using the output gap elasticity as reported in the paper. "The cyclically-adjusted budget balance used in the EU fiscal framework: an update" by Mourre et al., European Economy - Economic papers N.478, March 2013..

TABLE II.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[1]	Education expenditure is estimated to decrease by **0.3** p.p. of GDP from 2010 (**3.9%**)to **2015** (**3.6%**).
Health[1]	Health care expenditure as a percentage of GDP is equal, on average, to 7.0% over the period 2010-2015.
Employment[2]	Data are available until 2012. The employment expenditure to GDP ratio increased from 0.42% in 2008 to 0.37% in 2012. By now, there is no evidence to foresee an employment expenditure to GDP ratio different from 0.3% over the 2013-2015 period. It is foreseen a more efficient use of the expenditure, as required by the Parliamentary Bill on the Labour Market (submitted to the Senate on April 3, 2014).

[1] Source: estimates based on the methodology agreed in the AWG of the Economic Policy Committee of the Ecofin Council. 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] The employment expenditure contains government spending related to active labour market policies including public employment services.

Source: Ministry of Labour and Welfare relative to data from 2007 to 2011.

Source: Ministry of Labour and Social Policy

TABLE II.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				
						2014 % GDP	2015 % GDP	2016 % GDP	2017 % GDP	2018 % GDP
80 euro payroll bonus for employees	Cuts in personal income tax for employees earining less than 25 thousand euro before taxes (which raises by approximately 1 thousand euro additional take-home pay). The provision impacts for about 9.5 billion higher expenses, of which about 2.7 billion have been found through the Special Fund established purposely with Decree Law 66 of 2014, fed by the expenditure savings	D.62p	ESA 2010	immediate effectiveness			0,58	0,00	0,00	0,00
Financing "unchanged policies", such as infrastructure development programs, Truck drivers' fund, Abruzzo earthquake, etc.		Various		immediate effectiveness			0,27	0,06	0,04	0,02
Freeze of the safeguard clause established in the financial law of 2014, automatically reducing tax benefits and detractions (as concerns the share to be activate by end of 2014)	Partial freeze of the clause enacting an automatic reduction of benefits and tax detractions, thanks to the effectiveness of further legislation and/or greater savings coming from the spending review	D.2r	ESA 2010	immediate effectiveness			0,18	0,00	0,00	0,00
Short-term wage supplementing funds		D.62p	ESA 2010	immediate effectiveness			0,09	0,00	0,00	0,00
The "Good school" plan	The establishment of a fund with 1 billion euro endowment in 2015 and 3 billion from 2016 onwards for the implementation of the measures relted to the "good school plan", with priority to a execution of an extraordinary plan of recruitment of teachers and the development of the school-to-work alternation initiatives	D.1	ESA 2010	needs implementation measures			0,06	0,12	0,00	0,00

TABLE II.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				
						2014 % GDP	2015 % GDP	2016 % GDP	2017 % GDP	2018 % GDP
Social security contribution break (employment subsidy) for new employees	Private employers, with the exception of the agricultural sector, benefit from a total exemption from payment ofsocial security contributions for new hirings made by December 31, 2015 (with exclusion of apprenticeship contracts and contracts of housework). The exemption is valid for a maximum period of 36 months and criteria are applied to ensure that the contracts refer to "new" jobs	D.3p	ESA 2010	immediate effectiveness			0,10	0,09	-0,01	-0,11
Reduction of the tax wedge for businesses	In order to ease the tax burden on businesses starting from the year 2015, a totoal deduction of labour costs concerning employees with indefinite-term contracts from the taxable base of the regional tax on businesses (IRAP)	D.2r	ESA 2010	immediate effectiveness			0,16	0,11	-0,04	0,03
Anticipation of maturande employment indemnities in paycheck	On an experimental basis, employees in the private sector can choose to perceive in their paycheck, as part of their salary, quotas comming from maturande employment indemnities (TFR) even in the case of quotas already allocated to forms of supplementary pension provisions. The integrative part of remuneration is subject to ordinary taxation. In order to guarantee the necessary cash, businesses with less than 50 employees may access a guarantee fund established c/o the Social Security Institute (INPS)	D.9		needs implementation measures			0,01	0,01	0,00	0,00
Rationalization of expenditure by Regions	Rationalization expenditure to be implemented by the regions and autonomous provinces, on the basis of their own spending reviews. The breakdown of contributions among regions and identification of areas of expenditure to be reduced shall be carried out by the regions by January 31, 2015. In case of non-agreement, within that period, a Decree of the President of the Council of Ministers will provide for the allocation of contributions taking account of population and GDP, and will determine the corrsponding cuts in state transfers or other modalities.	Various		needs implementation measures			0,24	0,00	0,00	0,04

TABLE II.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				
						2014 % GDP	2015 % GDP	2016 % GDP	2017 % GDP	2018 % GDP
Rationalization of expenditure by Provinces and metropolitan cities	Rationalisation of current expenditure of the provinces and metropolitan cities on the basis of the difference between historical expenditure and standard requirements. In the event of non-payment of the contribution due, sums are automatically fetched by the cnetral govermente from tax liabilities on the insurance of motor vehicles	Various		needs implementation measures			0,06	0,06	0,06	0,03
Rationalization of expenditure by municipalities	Rationalisation of current expenditure of municipalities and contextual reduction of Communal Solidarity Fund			immediate effectiveness			0,07	0,00	0,00	0,03
Rationalization of expenditure by Ministries	Targeted measures to increase expenditure efficiency, duly identified by individual Ministries	Various		immediate effectiveness			0,14	0,01	0,00	0,00
Reducing the fund to confirm the 80 euro bonus for employees	Reducing the special Fund established with Decree Law 66 of 2014, fed by the expenditure savings, to confirm the 80 euros bonus for emplyees			immediate effectiveness			0,16	0,12	-0,03	-0,12
Increase indirect taxes (safeguard clause)	Increasing indirect taxes to guarantee the achievement of planned targets			immediate effectiveness				0,73	0,31	0,20
Other measures (positive effect on the balance)		Various		immediate effectiveness			0,10	0,04	-0,01	-0,05
					TOTAL		**0,67**	**-0,58**	**-0,34**	**-0,20**

TABLE II.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				
						2014 % GDP	2015 % GDP	2016 % GDP	2017 % GDP	2018 % GDP
80 euro payroll bonus for employees	Cuts in personal income tax for employees earining less than 25 thousand euro before taxes (which raises by approximately 1 thousand euro additional take-home pay). The provision impacts for about 9.5 billion higher expenses, of which about 2.7 billion have been found through the Special Fund established purposely with Decree Law 66 of 2014, fed by the expenditure savings	D.62p	ESA 2010	immediate effectiveness			0,58	0,00	0,00	0,00
Financing "unchanged policies", such as infrastructure development programs, Truck drivers' fund, Abruzzo earthquake, etc.		Various		immediate effectiveness			0,18	0,03	0,02	0,03
Freeze of the safeguard clause established in the financial law of 2014, automatically reducing tax benefits and detractions (as concerns the share to be activate by end of 2014)	Partial freeze of the clause enacting an automatic reduction of benefits and tax detractions, thanks to the effectiveness of further legislation and/or greater savings coming from the spending review	D.2r	ESA 2010	immediate effectiveness			0,18	0,00	0,00	0,00
The "Good school" plan	The establishment of a fund with 1 billion euro endowment in 2015 and 3 billion from 2016 onwards for the implementation of the measures relted to the "good school plan", with priority to a execution of an extraordinary plan of recruitment of teachers and the development of the school-to-work alternation initiatives	D.1		needs implementation measures			0,06	0,12	0,00	0,00

TABLE II.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				
						2014 % GDP	2015 % GDP	2016 % GDP	2017 % GDP	2018 % GDP
Anticipation of severance payment	On an experimental basis, employees in the private sector can choose to perceive in their paycheck, as part of their salary, quotas of their severance payment (TFR) even in the case of quotas already allocated to forms of supplementary pension provisions. The integrative part of remuneration is subject to ordinary taxation. In order to guarantee the necessary cash, businesses with less than 50 employees may access a guarantee fund established c/o the Social Security Institute (INPS)	D.9		needs implementation measures			0,01	0,01	0,00	0,00
Rationalization of expenditure by Ministries	Targeted measures to increase expenditure efficiency, duly identified by individual Ministries	Various		immediate effectiveness			0,14	0,01	0,00	0,00
Reducing the fund to confirm the 80 euro bonus for employees	Reducing the special Fund established with Decree Law 66 of 2014, fed by the expenditure savings, to confirm the 80 euros bonus for emplyees			immediate effectiveness			0,16	0,12	-0,03	-0,12
Increase indirect taxes (safeguard clause)	Increasing indirect taxes to guarantee the achievement of planned targets			immediate effectiveness				0,73	0,31	0,20
Other measures (positive effect on the balance)		Various		immediate effectiveness			-0,20	-0,01	0,01	0,05
				Total			**0,47**	**-0,77**	**-0,25**	**0,00**

TABLE II.1-14 COUNTRY SPECIFIC RECOMMENDATIONS (6.A)

CSR number	List of measures	Description of direct relevance
1 - Public finance sustainability	Expenditure savings for central and local public administrations (PA); national databank for public contracts; New National Purchasing System; additional powers vested with ANAC to control PA's purchasing of goods and services; cap for annual compensation in case of employment relationships with independent administrative authorities; limits for PA staff turnover; limits on expenditure for consulting, study and research mandates to workers who are already retired; number of board members limited to three for companies subsidiaries or affiliates of the public administration.	Improve the efficiency and the quality of public expenditure.
	2014-2016 Healthcare Pact.	Efficient planning of the NHS, improvement of the quality of services and performance.
	Divestiture of part of the capital of Poste Italiane and ENAV; plan to divest state-owned buildings; programme to improve energy efficiency in public buildings.	Reinforce privatisation process and enhance the value of public property.
	Facilitated the transfer of PA receivables to banks and financial intermediaries; creation of guarantee fund for transfer of the receivables; offsetting of credits claimed from the PA and tax liabilities; exclusion from Domestic Stability Pact of the principal payments made by regions, provinces and municipalities; expansion of number of PAs required to certify debts not extinguished.	Payment of the PA trade debts in arrears.
	Introduction of annual indicator of timeliness for average payment terms; obligation to include an exhibit to financial statements to report payments made after due dates; obligation of electronic invoicing for trade relationships with the PA.	Monitoring of PA trade debts in arrears.
	Appointment of Parliamentary Budget Office (PBO) council; council's approval of regulations for organising and operating PBO; memorandum of understanding with the MEF for transmission of information in order to certificate macroeconomic forecasts.	Full operation of PBO.
2 - Taxation system	Tax credit of €640 for permanent employees earning from €8,160 to €24,000, with the reduction phased out (from €640 to zero) as income rises to €26,000.	Reduce tax wedge. Measure will be made structural in the 2015 Draft Stability Law.
	10 per cent reduction of ordinary IRAP rates for all sectors of economic activity as from the 2014 tax year. New system for IRAP deductions to increase the employment base, as from the 2014 tax year, for new full-time contracts without expiration date. Option to settle taxation on capital gains and capital losses accrued as of 30 June 2014, using tax rates previously in effect.	Reduce the tax burden with respect to productive factors.
	Twenty-three per cent of the earnings of cooperative companies and their consortiums will not be considered as taxable income for direct taxes.	Reduce the tax burden with respect to productive factors.
	The single municipal tax (IUC) went into effect on 1 January 2014.	IUC includes a municipal property tax (IMU), a tax on shared municipal services (TASI) and a tax on waste (TARI) that will finance the costs of waste collection and disposal.
	Tax credit for physical and legal persons who make donations for entertainment- and culture-related projects (the so-called 'Art bonus').	Temporary measure: up to 65 per cent of the donations made in 2014 and in 2015, and up to 50 per cent in 2016.
	Reduced flat tax rate of 10 per cent (versus 15 per cent) for income on so-called agreed rental contracts.	Strenghten spontaneous taxpayer compliance.

TABLE II.1-14 COUNTRY SPECIFIC RECOMMENDATIONS (6.A)

CSR number	List of measures	Description of direct relevance
	Enabling law on taw reform : Legislative decree on fiscal simplifications under review by the Parliament.	Simplify taxation for taxpayers who are physical persons, and further develops spontaneous taxpayer compliance.
	Implementation of enabling law on tax reform - Legislative decree on Cadastral values under review by the Parliament.	The legislative decree redefine powers and functioning of the Cadastral Committees to ensure their functionality in the context of the revision of the cadastral estimate system defining the various types of registers (land, urban land register, land register for buildings).
	Implementation of enabling law on tax reform - Legislative decree on tobacco products under review by the Parliament.	Change to the so-called minimum excise tax and introduction of new categories of tobacco products, with specific rules for electronic cigarettes.
	Draft law for ratification and implementation of an agreement between the Italy and the United States of America, aimed at improving international fiscal compliance and application of the U.S. Foreign Account Tax Compliance Act (FATCA).	Strengthen tax compliance.
	Implementation of the EU Directive no. 2011/16/EU regarding reciprocal assistance between the competent authorities of Member States on the subject of direct taxes and other taxes.	Govern procedures related to the exchange of tax-related information with the fiscal authorities of EU Member States.
	Annual report to Parliament on the design and development of strategies to fight tax evasion.	Indicate the results achieved and those expected, with reference to the recovery of revenues through i) the detection of evasion via tax audits and ii) a greater rate of spontaneous taxpayer compliance.
	Tax compliance plan.	Closer collaboration with the national and international financial administrations, revision of several of the current compliance tools.
	Introduction of measure whereby anyone illegally occupying a building is prohibited from requesting residence and the hook-up of public utility services; anyone illegally occupying public housing is prevented from participating in any proceedings for the assignment of similar housing.	Improve the fight against tax evasion and abuse.
3 - Efficiency of the public administration; justice system; European fund	Institution of metropolitan cities, redefinition of the provincial system, and regulations regarding the union of municipalities.	Specify the responsibilities of all levels of government, and holds down government operating costs.
	First approval by the Parliament of the constitutional reform introducing a bicameral system with different responsibilities, the reduction of the number of members of Parliament, and the revision of Title V of the Constitution.	Specify the responsibilities of all levels of government, and holds down government operating costs.
	Introduction of mandatory electronic invoicing by suppliers to central administrations as of June 2014 and to territorial entities as of 31 March 2015.	Improve invoice and purchasing management for public administrations.
	New rules covering employee transfers; creation of a web site by the administrations for listing of jobs available through transfers; creation of a fund to be used for improving personnel allocation. Changes to Union privileges.	Improve the allocation of PA personnel.
	Public training schools combined into the National Public Administration School.	Streamline the training system for the central administrations and helps curb the related expense.
	Draft of enabling law regarding the reorganisation of the public administrations.	Measures for delivering public services, with reduction in time required; introduces silent consent between administrations; reorders rules for Services Conferences. Reorganises administrations with reference to managerial personnel and the governance of healthcare companies.
	Streamlining of the organisation of independent authorities.	Set rules for incompatibility. Reduces ancillary pay and defines management of logistics services for expenditure savings.
	Reinforcement of the powers vested with the National Anti-corruption Authority (ANAC), which has been charged with the oversight of public contracting (with the abolition of the Authority for Administration of Public Contracts), with additional powers to combat corruption and to settle disputes prior to litigation.	Streamline oversight duties for procedures covering the contracting of public works, and public contracts.
	Mandatory changeover to the online civil trial process for ordinary court proceedings initiated after 30 June 2014, whereas for those initiated before that date, the changeover has been set as of 31 December 2014. The changeover for the appellate courts will be as of 30 June 2015.	Use of information technologies to get the public and participants in the legal process closer to the justice system; provides significant expenditure savings due to reduction in paper use.

TABLE II.1-14 COUNTRY SPECIFIC RECOMMENDATIONS (6.A)

CSR number	List of measures	Description of direct relevance
	Creation of proceedings office to support judges.	Streamline the service of the justice system.
	Decision of pending lawsuits through transfer to arbitration. Assisted negotiation procedure for amicable settlement of disputes.	Reduce the time required for settlements.
	Change to the system for the compensation of court costs and increase in the rate of interest on past-due amounts when lawsuits are pending.	Reduce litigation and the use of the civil justice process as a form of low-cost financing.
	Measures for force expropriation, bankruptcy proceedings and agreements with creditors prior to bankruptcy.	Increase transparency and efficiency, for the benefit of creditors.
	Draft law regarding the civil justice system, and specifically: civil liability of judges; the efficiency of the civil justice process; the reform of the honorary magistrature and the justices of the peace.	Streamline the governance of the magistrature and the civil process so as to achieve greater efficiency and transparency in the service to the public.
	Legislative bills regarding the criminal justice system, and specifically: extradition abroad; the fight against organised crime and illegally accumulated capital; the reform of prescription; the reform of the prison system.	Simplify Italy's system of incoming requests; improves effectiveness of action to combat organised crime; guarantees a reasonable term for proceedings; revises the premises for the use of alternatives to imprisonment.
	Improvement in implementation of operational programmes and related monitoring via the creation of the Agency for Territorial Cohesion; partnership agreement with innovative elements for the 2014-2020 planning period; substitute powers to the Office of the Prime Minister with regard to timing and objectives of EU financed programmes.	Improve management of European funds.
4 - Banking sector, capital market and credit acces	The Bank of Italy has acted with respect to corporate governance of banks, with strict regulations applicable to all banks. Clear distinction of responsibilities and powers of corporate governance bodies; effectiveness of controls and composition of governing bodies consistent with the size and the complexity of the banks.	Improve efficiency in the corporate governance structures of banks.
	Cooperative banks: new provisions aim to allow for representation of different members of the ownership base in the governing bodies and the broader based participation of shareholders in the shareholder meetings.	Adjust corporate governance of cooperative banks with the aim of improving the effectiveness of financial intermediation.
	Banking foundations: reinforcement of procedures for the appointment of board members; greater role of chairman in guaranteeing adequate controls; self-assessments by the entities.	Adjust corporate governance of banking foundations with the aim of improving the effectiveness of financial intermediation.
	Expansion of array of loans that the banks can use as collateral for Eurosystem financing.	Provide incentives for lending to SMEs and households.
	Agreement between EIB, MEF and MISE to start up two initiatives: 1) coverage of risks of initial loss on industrial innovation projects of businesses of any size, through €100 million of the Guarantee Fund for SMEs; 2) master agreement for increasing resources to finance new investments.	Optimise the use of resources in combination with EIB funds.
	Possibility for Italian insurance companies and securitisation firms to grant direct financing to businesses.	Create a new channel for non-bank credit.
	Enhancements to Aid for Economic Growth (AEC) programme, with extension to businesses with negative taxable income, and increase (40%) in aid to companies admitted to quotation on the stock market.	Incent investments in risk capital.
	Reduction of minimum share capital for capital stock companies, from €120,000 to €50,000.	Facilitate market listing and access to risk capital.
	New sizing parameters for SMEs issuing publicly traded shares; change in the rules governing obligatory public purchase offers and consolidation rules. Increase from 2% to 5% in the threshold of material shareholdings to be disclosed. Introduction of shares with increased voting rights.	Simplify SMEs' access to the capital market.

TABLE II.1-14 COUNTRY SPECIFIC RECOMMENDATIONS (6.A)

CSR number	List of measures	Description of direct relevance
	Elimination of source withholding on interest and other income derived from private placements.	Facilitate the issuance of bonds, similar securities and unlisted financial bills of exchange.
	Access to the Central Guarantee Fund for funds management companies that underwrite bonds or similar securities issued by SMEs ('mini bonds').	Facilitate the issuance of bonds, similar securities and unlisted financial bills of exchange.
	Businesses Platform, agreement between *Cassa Depositi e Prestiti* (CDP) and Italian Banking Association to mobilise €5 billion in favour of businesses.	Promote access to non-bank capital markets.
	Expansion of CDP's operations in the areas of research, development and innovation, education, civil protection, real estate, energy, environment.	Improve the effectiveness of financial intermediation.
	Tax credit of 15% for the acquisition of capital goods.	The credit is based on investments made through 30 June 2015, in excess of the average investments made during the previous five tax years. The minimum amount to qualify for the credit is €10,000. The tax credit is split into three annual portions of an equal amount.
	Public contract to grant capital subsidies (for a total of €5 million) to aid micro, small and medium-sized businesses in enhancing the value of industrial models and designs.	Enhance competitiveness on national and international markets.
	Possibility of paying a substitute tax in the event of revaluation of capital assets and shareholdings reported in financial statements as of 31 December 2012.	Capitalisation of businesses.
	Tax credit to favour businesses investing in R&D, for investment up to €600 million over the 2014-2016 period, to be applied to the 2014-2020 planning of structural funds.	Enhance competitiveness on national and international markets.
	The tax treatment of project bonds has permanently been made equal to that for government securities.	Facilitate the issuance of bonds, similar securities and unlisted financial bills of exchange.
	Creation of a private fund to service the capitalisation of businesses	Relaunch Italian businesses that have an operational and business equilibrium, but lack adequate capital funds.
	Zero-rate long-term secured loans granted to farm business owners under the age of 40. A 19 per cent tax deduction granted for the lease of land by young farmers and farm business owners up to the age of 35.	Public instruments to support farm businesses and credit access.
	Institution of a tax credit to accelerate investments ultra-wide broadband.	Tax credit against the payment of corporate income taxes and the regional tax on productive activity, equal to 50 per cent of the cost of incremental investment, in market failure areas, for investments not provided by public sinking-fund subsidies.
	Institution of a tax credit for innovation in the farming sector.	Tax credit of 40 per cent of the investments ~~of~~ up to €400,000 for product/technology innovation and development, and for new business networks for food production. Another tax credit of 40 per cent for investments up to €50,000 for the e-commerce of agro-food products.
	Support to international expansion, relaunching Made-in-Italy merchandise, strengthening the efforts to fight against imitation or counterfeiting of Italian food products abroad.	Further support to international expansion; State guarantee for non-market risks; criteria and procedures for accessing financing and for capitalisation.
5 - Labour market and social exclusion	Changes to rules governing open-ended contracts, apprenticeship contracts and solidarity contracts; streamlining of existing forms of social safety nets; reordering of the regulations for employment services; simplification and streamlining of labour-related procedures and compliance matters.	Reordering of contract forms to improve opportunities for entering thelabour market; to favour opportunities for achieving a proper balance between work and personal life.
	New criteria for supplying exceptional social safety nets and additional measures for involuntary unemployment.	Protections in the event of unemployment
	Youth Guarantee Programme.	Ensure young people up to the age of 29 a qualitatively valid opportunity for work, including through cooperation agreements with large companies.
	Tax credit for the new hiring of highly qualified professionals; projects to facilitate the entry of research doctors into the labour market; incentives to hire young people in the farming, cultural and tourism sectors; simplification of fixed-term and apprenticeship contracts.	Incentives to employment.

TABLE II.1-14 COUNTRY SPECIFIC RECOMMENDATIONS (6.A)

CSR number	List of measures	Description of direct relevance
	Support to active inclusion.	Start-up of pilot programme in 12 cities, and subsequent extension to all of Southern Italy.
	Social card.	Extension to citizens of EU countries and to foreigners holding an EC permit for long-term residence.
	Housing plan.	Support to agreed rental contracts; greater supply of social housing; development of social housing building projects.
6 - Education and training	'*La Buona Scuola*' plan for school reform (under public consultation).	Hiring of approximately 150,000 teachers and initiatives for teacher skills improvement; greater transparency in school; full operation of national school assessment system; mandatory work-school rotation; streamlining of spending on education.
	Permanent apprenticeships (Interministerial Decree no. 473/2014).	On-the-job training assignments (for no less than 30% of class time) for students in the fourth and fifth years of upper secondary school.
	Scuola Bottega' and '*Scuola Impresa*' Programmes.	Professional development programmes in collaboration with groups of craftsman with the opportunity for schools to sell the products.
	Skills certification (Legislative Decree no. 13/2013).	Implementation of a national directory of qualifications for the certification of skills acquired, and definition of a framework of minimum certification standards valid for all central and regional administrations.
	Public financing of schools and universities.	Replanning of the Ordinary Financing Fund for Universities for 2014 with a part of resources allocated on the basis of an assessment of the results achieved; €3-7 million in favour of initiatives for promoting the scientific culture; agreement between MEF and EIB providing, inter alia, measures to facilitate credit to university students.
7 - Simplification, competition and efficiency of public procurements	Healthcare simplifications regarding drug prescriptions and procedures for ascertaining disability.	Simplify the regulatory framework to the advantage of the public at large, and reduces administrative costs.
	Simplifications for the construction sector.	Introduction of a single simplified form for the certified reporting of the start-up of building activity (SCIA) and for building permits. Simplification for non-recurring maintenance works. Simplification of procedures for issuance of landscape permits.
	Simplifications for the farming sector.	Creation of a single controls register; simplifications in the wine sector; extension of the use of injuctions.
	Adoption by the end of October 2014 of the 2015-2017 Agenda for Simplification.	Reduce the time and costs burden for citizens and firms for bureaucratic procedures and ensures certainty with respect to individuals' rights and business activities.
	Simplification of several environmental procedures.	The regional presidents may assume the functions of the special commissioners charged with mitigating hydro-geological instability. Simplified procedures introduced for cleaning up and securing contaminated sites and tracing waste materials. Simplified regulation of land and rock excavations.
	Deregulation of the market for leasing of large non-residential properties (annual rents of more than €150,000).	The parties may independently establish the terms and conditions of the rental contract.
	Changes in civil and fiscal regulations applicable to publicly traded real estate investment companies (SIIQ).	Facilitate the use of the capital market for attracting investment, a mechanism only rarely used to date in the real estate sector.
	Real-time and online acquisition of single insurance contribution payment certificate (DURC).	Shorter time periods for tenders and for the PA's payment, online, real-time verification of regular contributions made to the social security administration (INPS) and the national institute for accidents at work (INAIL).
	Simplification of compliance matters for security in the workplace.	Simplification in the sectors with low risk of occupational illnesses and accidents.
	Adoption, by the end of October 2014, of the Annual Law on Competition.	Remove the remaining impediments and restrictions to competition.
	Quantification of the cost of universal postal service.	Use of net avoided cost method.
	Definition by the insurance regulator (IVASS) of the procedure for direct compensation of damages resulting from road circulation.	Incentives to productive efficiency, cost control and easier identification of fraud.
	Adoption, in July 2014, by the transportation authority of measures to guarantee the respect of passenger rights and outline of the sanctions applicable for non-compliance.	Promote the full application of consumer rights and guarantees, improves the quality and efficiency of railway services.
	Vesting of powers with ANAC for the supervision of the activities involved in the acquisition of goods and services for the public administration.	Define procedures for publication of prices of the main services covered by the CONSIP S.p.A. conventions.

TABLE II.1-14 COUNTRY SPECIFIC RECOMMENDATIONS (6.A)

CSR number	List of measures	Description of direct relevance
	New rules for public procurement in public works, services and goods for municipalities other than provincial capitals	The ANAC will compute the reference prices of goods and services, at the conditions of greatest efficiency, inclusive of goods and service having the greatest impact in terms of cost to the public administration. Publication on web site.
	Procedures to trace payments and to acquire information related to financial payments involved in building strategic infrastructures. Identification of categories of works that require execution by economic agents in possession of specific qualifications.	Strengthen the efficiency of public procurement.
	Cooperation between ANAC and Prefect in relation to criminal acts of corruption. Communication of in-progress changes to public contracts with a value equal to or greater than the EU threshold.	Steps to fight corruption with regard to public procurements.
	Judicial rulings during pre-trial hearings; simplified rulings within 45 days. Pecuniary fines in the event of 'vexatious litigation'.	Accelerate judgements related to public procurements and streamlines litigation.
	Contracting authority may exercise power to allow bidders to supplement the statements filed in the event of fundamental irregularities in the entrustment, against the payment of sanctions.	Simplify formal charges for participation in the proceedings for the award of public contracts.
8 - Infrastructures	Transportation authority active since 15 January 2014. The authority has adopted two regulatory measures (regulations in relation to sanctioning proceedings regarding the protection of passenger rights in railway transport and tariff models for determination of airport fees) and it has initiated three consultation procedures (access to railway infrastructure and related services, exclusive commissioning of local public transport services, and toll highways).	The framework for the independent, economic regulation of public services has been rounded out. The authority's action is based on the common EU transportation framework.
	Refinancing of the so-called 'Infrastructures Fund' (€3.9 billion through 2020), most of which came from the Development and Cohesion Fund.	Clear the way for works already financed, provided that the work sites open within specific deadlines over the 10-month period following the approval of the decree.
	The payments of incomplete works reported by local entities prior to 15 June 2014 are excluded from the Domestic Stability Pact for up to a maximum of €250 million.	Facilitate the process of realising the infrastructural works.
	Concessionaires of toll-highway tracts may propose changes to their concession relationships in respect of EU principles; proposed changes, due by 31 December 2014, to be aimed at optimising operation of the tracts, including through unification of interconnected tracts.	Allow for lengthening concessions to finance investment plans, reducing the burden to the State.
	Introduction of IRES and IRAP tax credit for a maximum of 50 per cent for all public works constructed with the use of project financing.	The investment must exceed €50 million (previous floor of €200 million) and be no greater than €2 billion.
	Acceleration of the planning and realisation of projects to upgrade sewage and purification systems, as well as projects to mitigate hydro-geological risk.	The Government may act on its substitution powers. Starting with the 2015 planning, the presidents of the regions may effect their planning and execution of projects to mitigate hydro-geological risk by making use of the central administrations' in-house resources who have specific technical expertise on the subject. The Minister of the Environment may revoke resources assigned to regions and other entities for such purposes.
	Definition of the categories of infrastructures of strategic importance.	Gas pipelines for the importation of gas from abroad; terminals for the regasification of LNG; storage facilities for natural gas; infrastructures for the national natural gas transport network. Such works will be subject to a simplified authorisation process.
	Introduction of a single concession permit for the research and production of hydrocarbons.	Clear the way for investments (an estimated €15 billion) for the development of hydrocarbon deposits. Limits on the Domestic Stability Pact for the regions involved.
	Draft prepared for the adoption of a National Strategic Plan for Ports and Logistics.	Improve competitiveness of the port system, promotes inter-modal freight transport, and reorganises and merge existing port authorities.

TABLE II.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 to address the target
1 - Employment rate [64-69%]	Changes to rules governing open-ended contracts, apprenticeship contracts and solidarity contracts; streamlining of existing forms of social safety nets; reordering of the regulations for employment services; simplification and streamlining of labour-related procedures and compliance matters.	Reordering of contract forms to improve opportunities for entering the labour market ; to favour opportunities for achieving a proper balance between work and personal life.
	Youth Guarantee Programme.	Ensure young people up to the age of 29 a qualitatively valid opportunity for work, including through cooperation agreements with large companies.
	Tax credit for the new hiring of highly qualified professionals; projects to facilitate the entry of research doctors into the labour market; incentives to hire young people in the farming, cultural and tourism sectors; simplification of fixed-term and apprenticeship contracts.	Incentives to employment.
	Support to active inclusion.	Start-up of pilot programme in 12 cities, and subsequent extension to all of Southern Italy.
	10 per cent reduction of ordinary IRAP rates for all sectors of economic activity as from the 2014 tax year. New system for IRAP deductions to increase the employment base, as from the 2014 tax year, for new full-time contracts without expiration date. Option to settle taxation on capital gains and capital losses accrued as of 30 June 2014, using tax rates previously in effect.	Reduce the tax burden with respect to productive factors.
2 - R&D expenditure [1,53%]	Tax credit to favour businesses investing in R&D, for investment up to €600 million over the 2014-2016 period, to be applied to the 2014-2020 planning of structural funds.	Enhance competitiveness on national and international markets.
	Public contract to grant capital subsidies (for a total of €5 million) to aid micro, small and medium-sized businesses in enhancing the value of industrial models and designs.	Enhance competitiveness on national and international markets.
	Expansion of CDP's operations in the areas of research, development and innovation, education, civil protection, real estate, energy, environment.	Improve the effectiveness of CDP's financial intermediation, including for research.
	Agreement between EIB, MEF and MISE to cover risks of initial loss on industrial innovation projects of businesses of any size, through €100 million of the Guarantee Fund for SMEs, which will tap EIB resources for €500 million.	Optimise the use of resources for R&D in combination with EIB funds.
	Tax credit for the new hiring of highly qualified professionals.	
	Subsidies to small and medium-sized R&D projects in the technological sectors identified in the EU Horizon 2020 programme.	Promote broad-based innovation.
	Institution of a tax credit for innovation in the farming sector.	Tax credit of 40 per cent of the investments ~~of~~ up to €400,000 for product/technology innovation and development, and for new business networks for food production. Another tax credit of 40 per cent for investments ~~of~~ up to €50,000 for the e-commerce of agro-food products.
3 - Greenhouse gas emissions [-13%]*	Subsidies for the purchase of low emissions vehicles and alternative fuel vehicles.	Promote sustainable mobility.
	Measures to transfer auction proceeds to finance emissions reductions (measures now being developed).	
4 - Renewable energy sources [17%]		
5 - Energy efficiency [20 Mtoe/year]**	Energy requalification programme in central administrations' buildings; private	Enhance the value of public owned properties.
	Financing tapped through energy service contracts with consequent energy bill savings.	
	Financing to improve the energy efficiency of public properties used as schools.	

TABLE II.1-15 TARGETS SET BY THE UNION'S STRATEGY FOR GROWTH AND JOBS (6.B)

	Obligation of large companies and energy-intensive businesses to complete periodic energy analyses to identify the most appropriate measures for reducing energy consumption.	
	National Fund for Energy Efficiency.	Facilitate energy requalification measures for public buildings, and reduce energy consumption in the manufacturing and services sectors.
	Public contract to finance integrated investment programmes for businesses in the target convergence regions, aimed at the reduction and streamlining of the use of primary energy in production cycles and/or service delivery carried out within an existing facility.	Effect technologically advanced investments with a low environmental impact with a consequent positive impact on the country's competitiveness and technological development.
	Sinking fund subsidies for projects to improve energy efficiency and/or produce energy for municipal buildings within the target convergence regions, through the purchase and the procurement of goods and services through the Public Administration Electronic Market (MePA).	
6 - Early school leavers [16%]		
7 - University education attainments [26-27%]	More streamlined procedures for national scientific certification (ASN) for access to teaching jobs at universities.	
	Publication of decree law sanctionning the changeover from local competitions to a national competition for admittance to medical schools.	Make admissions uniform at a national level.
8 - Fight against poverty	Support to active inclusion.	Start-up of pilot programme in 12 cities, and subsequent extension to all of Southern Italy.
	Social card.	Extension to citizens of EU countries and to foreigners holding an EC permit for long-term residence.
	Housing plan.	Support to agreed rental contracts; greater supply of social housing; development of social housing building projects.
	Anyone illegally occupying public housing is prevented from participating in any proceedings for the assignment of similar housing.	Expansion of the supply of social housing.
	Tax credit of €640 for permanent employees earning from €8,160 to €24,000, with the reduction phased out (from €640 to zero) as income rises to €26,000	Reduce tax wedge. Measure will be made structural in the 2015 Draft Stability Law.

*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 II.1-16 DIVERGENCE FROM LATEST SP (7)

	ESA Code	2013 %GDP	2014 % GDP	2015 % GDP
Target General Government net lending/borrowing				
Stability Programme		-3.0	-2.6	-1.8
Draft Budgetary Plan		-2.8	-3.0	-2.9
Difference		0.2	-0.4	-1.1
General Government net lending projection at unchanged policies				
Stability Programme		-3.0	-2.6	-2.0
Draft Budgetary Plan		-2.8	-3.0	-2.2
Difference		0.2	-0.4	-0.2

III. METHODOLOGICAL APPENDIX

Two notes are provided with reference to Table 8 regarding 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[4] 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[5].

III.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, which is a medium-sized econometric model, 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. ITEM 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, and to study the response to temporary shocks of a varying nature, including 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

[4] For additional information, see:
http://www.dt.mef.gov.it/it/analisi_programmazione_economico_finanziaria/modellistica/

[5] In particular, see Chapters I-III.

transmission of fiscal policies and the effects thereof on GDP and employment. As a 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.

III.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 same as that used by all EU countries, and is based on a Cobb-Douglas[6] 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[7] provided as an exhibit to the 2014 EFD.

The estimates in this document have been produced on the basis of the macroeconomic scenario contained in the Update to the 2014 EFD for the years of 2014-2018, with a distinction made between the projections based on unchanged legislation and the projections based on the policy scenario. The parameters reported in the following table were used for the computation of the Non Accelerating Wage Rate of Unemployment (NAWRU).

[6] 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)

[7] 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

Table III.2-1 Initialisation parameters for estimation of NAWRU

Unchanged Policies	Value	Policy Scenario	Value
LB Trend innov var	0	LB Trend innov var	0
LB Trend slope var	0.039	LB Trend slope var	0.041
LB Cycle innov var	0.001	LB Cycle innov var	0.001
LB Innovation var 2nd eq.	0	LB Innovation var 2nd eq.	0
UB Trend innov var	0.06	UB Trend innov var	0.06
UB Trend slope var	0.045	UB Trend slope var	0.046
UB Cycle innov var	0.125	UB Cycle innov var	0.19
UB Innovation var 2nd eq.	0.000826688	UB Innovation var 2nd eq.	0.000826688
Exogenous 2nd eq.	0	Exogenous 2nd eq.	0

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

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

III.4 VARIABLES USED FOR THE COMPUTATION OF THE DEBT RULE IN THE TREND SCENARIO OF THE UPDATE OF THE 2014 ECONOMIC AND FINANCIAL DOCUMENT

See the table below.

TABLE III.4-1 VARIABLES USED FOR THE COMPUTATION OF THE DEBT RULE IN THE TREND SCENARIO OF THE UPDATE OF THE 2014 ECONOMIC AND FINANCIAL DOCUMENT

	2013	2014	2015	2016	2017	2018
Real GDP growth (%)	-1.9	-0.3	0.5	0.8	1.1	1.2
GDP deflator (%)	1.4	0.8	0.5	1.3	1.6	1.6
Nominal GDP growth (%)	-0.6	0.5	1.0	2.1	2.7	2.8
Output gap (% of potential GDP)	-3.9	-3.8	-3.1	-2.2	-1.2	-0.3
Net borrowing (% of GDP)	-2.8	-3.0	-2.2	-1.8	-1.2	-0.8
Primary surplus (% of GDP)	2.0	1.7	2.3	2.7	3.1	3.4
Change in the structural balance (p.p. of GDP)	0.7	-0.3	0.7	-0.1	0.1	-0.1
Stock Flow Adjustment (% of GDP)	2.1	1.4	1.1	0.9	0.9	0.5
Public debt (% of GDP)	127.9	131.7	133.7	133.7	132.1	129.9

The estimate of potential GDP and its implications for fiscal policy

Italian GDP grew yearly on average by 1.5 percent during the fifteen years before the current crisis, i.e. 1992-2007. In the same period, according to the model agreed at the EU level, average potential GDP growth rate was 1.4. Both effective and potential GDP growth rates are significantly weak if compared to the other European or OECD countries, due to the relevant structural problems that have been characterizing the Italian economy well ahead of the crisis.

The same model forecasts a decrease of potential GDP growth by 0.2 percent between 2008 and 2015, which implies a cumulated drop of around 2 percent; in the same period effective GDP is supposed to decrease by 1 percent[8]. In other words, the crisis would have reduced not only potential GDP growth rates but also the country's productive capacity.

To which extent is the estimate of potential output reliable? Identifying the cyclical and structural components of the output, a complex task even in normal conditions, becomes particularly puzzling in years characterized by a persistent lack of aggregate demand[9]. It is a crucial issue because the estimate of the potential GDP impacts on structural budget balance, an indicator that plays a fundamental role in shaping the fiscal policy of the Eurozone countries.

On paper, the decrease of potential output can be due to an overestimate in pre-financial crisis years or to its consequences – thus implying a true structural break.

Explaining the drop in GDP potential after the crisis by its overestimate in pre-crisis years looks unlikely in Italy, given the lack of assets bubbles and the high and persistent primary surplus (above 3 percent of GDP on average) before the crisis as well as considering that regulation of goods and labour markets had an evolution in line with other European countries[10].

The other possible explanation is linked to the crisis and seems more realistic: strong shocks in aggregate demand, if not properly counterbalanced, can produce persistent damages to the economy through the so-called hysteresis[11] effects. After a negative shock firms can choose to postpone their investment plans, e.g. in research and innovation, lower the turnover and – possibly – shut down factories and productive sites. Moreover, a prolonged recession frequently implies an increase of long-term unemployed who tend to lose their skills and/or detach from the labour market, deteriorating the match between demand and supply and increasing segmentation. At the aggregate level, these effects can have long lasting impacts on the future productive capacities of an economy hit by a deep and long crisis.

The economic literature agrees on the existence of strong hysteresis effects but the estimates on its impact on GDP growth rates vary in their magnitude. In the model used at the EU level low or negative effective GDP growth rate impacts on potential GDP trough statistical filters; these increase the strength of that link as the crisis continues, because the methodology underestimate the amplitude of the cycle and identify as structural the recent developments. As a consequence, the model produces pro-cyclical estimates of potential GDP which implicitly assume strong hysteresis effects. This methodology showed less downsides in the decades before the crisis – when the correlation between effective and potential GDP was strong – as cyclical fluctuations were shallow; in the current economic environment with a persistent lack of aggregate demand, the model tends to underestimate the potential output.

[8] For the years 2014 and 2015 we have used the programmatic estimates recently reported in the Update of the DEF.

[9] IMF, Structural Balance Targeting and Output Gap Uncertainty, working paper WP/14/107, June 2014.

[10] http://www.oecd.org/els/emp/EPL-timeseries.xlsx; http://www.oecd.org/eco/reform/Database_PMR.xlsx

[11] NBER Macroeconomics Annual 1986, Volume 1, Stanley Fischer, editor, MIT Press, 1986, Hysteresis And The European Unemployment Problem, Olivier J. Blanchard, Lawrence H. Summers, p. 15 – 90.

This issue is confirmed if one considers the pro-cyclicality of the estimates of the structural unemployment rate (Non Accelerating Wage Rate of Unemployment - NAWRU), especially relevant for the methodologies based on the production function, such as the one used at the EU level[12]. Empirical analyses show that in Italy the NAWRU estimated by the model tends to follow the changes in cyclical unemployment. In the current scenario characterized by a prolonged increase of the unemployment rate, the estimate of the NAWRU is therefore higher than that obtained by properly taking into account the impact of cyclical factors; in countries that have experienced a particularly strong cumulative decline of GDP the model offers unlikely results – e.g. in Spain, the equilibrium non-inflationary unemployment rate would be close to 21 percent. The bigger the value of the NAWRU, the lower the potential; as far as fiscal policy is concerned, during prolonged and intense recessions there is the concrete risk that the model overestimates structural deficits.

In order to estimate the NAWRU, the model exploits the relation between the wages and the rate of unemployment dynamics (the Phillips curve); but in an environment of historically low interest rates and weak prices this relation seems to have lost significance, probably reflecting a structural break.

Even assuming significant hysteresis effects, it seems that a reduction from 1.4 to -0.2 per cent in the growth rate of potential GDP – from the period before and after the crisis – is particularly large. For example, assuming as of 2008 a significant decrease in the growth rate of potential GDP, but not as marked as estimated by the model – for example, from 1.4 to 0.4 per cent, rather than -0.2 – the structural budget balance would have basically reached the medium term objective as early as 2012 (see graph 1).

The models used by other forecasters (for ex. the OECD) are not immune from these shortcomings, suffering from the distortions related to the dynamic of the observations at the end of the sample, including those resulting from a revision of the forecasts; on the other hand, it is not surprising that analytical tools designed to cope with "normal" economic circumstances are unable to adequately capture the impact of structural break to macroeconomic variables occurred in 2008.

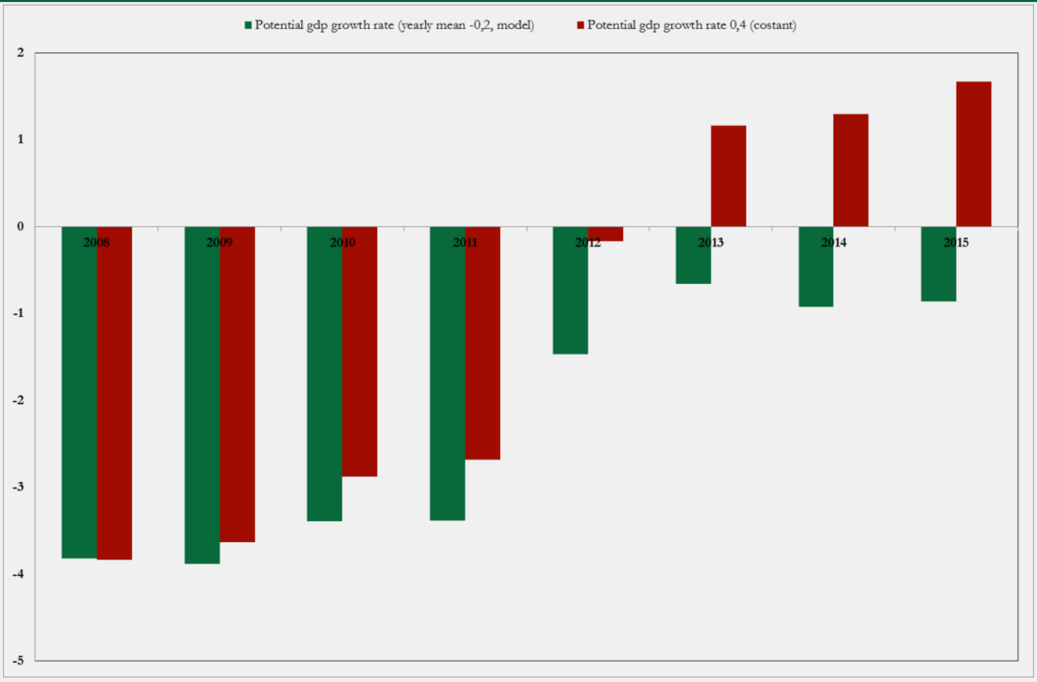
In conclusion, the decline in potential GDP growth rate stemming from the model agreed under the EU is particularly marked in Italy (and other countries), largely because of the working of statistical filters that implicitly assume a very pronounced hysteresis. It is likely that there are significant persistent effects of the long recession; however, in the model estimates they appear excessive. The prediction of the potential output made by the model must therefore be considered with extreme caution.

In the light of the structural break occurred in 2008 and the relevance for the fiscal policy, it is appropriate that national and European policymakers use with extreme caution the potential GDP estimates, which are subject to such an uncertainty. *A fortiori* given the asymmetric risks that make the consequences of a potential underestimation of GDP – and therefore the design of a wrong economic policies mix – potentially far more serious than those related to an overestimation in terms of increased danger of stagnation and deflation.

On the other hand it should be noted that, if the impact of low growth on potential would be as large as implicitly assumed by the model, it would be even more urgent to avoid restrictive macroeconomic policies so as not to damage the long-term prospects. Paradoxically, the model agreed at the European level provides strong arguments to those who embrace a more gradual fiscal consolidation.

[12] See in the Update Note of the DEF, the Focus The estimate of the potential output.

FIGURA I.1-1 Structural budget balance



The impact of structural reforms in italy

The Update to the Document of Economy and Finance (DEF) presented new estimates of the impact of recent reform measures with the help of the quantitative models in use at the Ministry of the Economy and Finance (MEF) (QUEST III, ITEM and IGEM models).

With respect to estimates made in April, the September's revision accounted for the delays occurred in implementing reforms as well as new studies made by the Commission, which investigated several areas of reform and tested their impact on growth.

In carrying out MEF's revisions, two scenarios were considered:

a) The **Trend scenario**, which includes major reform provisions embedded into law and fully enforced. This scenario represents an update of estimates presented in the DEF 2014 back in April as it takes into account implementation delays.
b) The **Policy scenario**, which incorporates both the **Trend scenario** and the effect of measures expected to be introduced by the Government over the near future and that, at present, are not yet law.

The first step of the simulation is a preliminary aggregation of specific measures by policy areas. This step is necessary to prepare the ground for the simulation and clarifies the transmission channels at work. Specific areas of intervention include: i) the Public Administration (PA); ii) Competitiveness; iii) the Labour market and vi) Justice.

It should be noted that for the first two policy areas of interventions, the long-run effects of the Trend scenario are equal to those presented in the DEF 2014, while the medium-run effects have been revised so as to account for some implementation delays of the reforms.[13] As

[13] In the policy area of Competitiveness, the long-run impact in the Trend scenario is slightly smaller than that presented in the DEF 2014 (the effect on GDP is +3.2 per cent in the Trend scenario and +3.4 per cent in the DEF 2014). Some provisions of this policy area, in fact, concerned the personal income taxation (IRPEF), of which the

regards the Policy scenario, the additional provisions examined for these two areas of policy interventions reinforce the short- and the medium-run effects, still confirming the long-run effects observed in the Trend scenario. In the policy areas of labour market and justice, we observe that the effects of the Policy scenario are larger than those of the Trend scenario, both in the short and in the long run. In this case, in fact, the planned reforms bring about a deeper change in the structural parameters of the economy than that generated in the context of the previous legislation.

Public Administration

This area includes reforms that aim to improve the business environment by reducing the regulatory burden, coupled with the elimination of substantial barriers on starting new businesses. The following are the measures associated to each scenario:

a) Trend scenario

- Decree Law no. 5/2012, cvt. into Law 35/2012 – so called 'Semplifica Italia';
- Decree Law no. 90/2014, cvt. into Law 114/2014 – Misure urgenti per la semplificazione e la trasparenza amministrativa e per l'efficienza degli uffici giudiziari.

b) Policy scenario

- Draft Legislative decree on fiscal simplification (under the enabling law on tax reform) submitted to a non-binding opinion of Parliament (art. 13,23,20,16,28);
- Draft enabling law on the reorganisation of the Public Administration (DDL 1577/2014).

Estimation methodology for the policy scenario. Simulations were made by using QUEST III. Reforms in this area are assumed to reduce overhead labour cost. Furthermore, simulations took advantage of elasticities from a recent contribution by the European Commission and then mapped in our model.[14] According to these estimates, the reduction of hurdles to businesses is in the order of 3 per cent. In this scenario, we maintain the assumptions adopted in the NRP 2012 on the size related to the reduction of entry costs and of overhead labour cost. At the same time, we assume that the effects of those measures foreseen by the legislation, but still missing the implementation decrees, are further delayed. In details, the assumptions for the quantification of impact are:

- **Transmission mechanism of the shock**: overhead labour cost;
- **Shock size**: 3 per cent, obtained by modelling in QUEST III the reduction in administrative burdens to get the estimated impact on labour productivity.

TABLE III.4-2 MACRO ECONOMIC IMPACT OF REFORMING THE PUBLIC ADMINISTRATION

(percentage deviations from baseline scenario)

	2015	2016	2017	2018	2019	2020	Long run
TREND SCENARIO							
GDP	0.1	0.2	0.3	0.4	0.4	0.5	2.3
Consumption	1.2	1.2	1.3	1.3	1.4	1.5	2.0
Investment	-0.6	-0.6	-0.7	-0.7	-0.6	-0.6	0.7
Labour	0.1	0.1	0.0	0.0	0.0	-0.1	-0.3
PLANNED SCENARIO							
GDP	0.1	0.3	0.5	0.7	0.8	1.0	2.3
Consumption	1.4	1.4	1.6	1.6	1.7	1.9	2.0
Investment	-0.8	-0.7	-0.8	-0.7	-0.5	-0.4	0.7
Labour	0.2	0.1	0.0	0.0	0.0	-0.1	-0.3

assessment has not been considered in the present analysis of the impact of structural reforms, being the object of a separate analysis on the Stability Law, published in the Update to the Document of Economy and Finance, Tab. II.4.

[14] Lorenzani D., Varga J., 2014, The Economic Impact of Digital Structural Reforms, Economic papers 529, European Commission, pg. 37 table IV.

Estimation results. The two scenarios draw similar results in the short run, while differences amplify in the medium run. This reform area contributes to enhance GDP by 0.5 per cent in the Trend scenario and 1.0 per cent in the Policy one in 2020. The increase in labour productivity linked to the reduction in administrative burdens leads companies to change the production mix by decreasing investment in production capital in the short-medium run. However, in the long run, firms tend to swap labour with capital as a result of a more efficient use of labour.

Competitiveness

Measures included under this heading are related to product market liberalisation. The following are the measures associated to each scenario:

a) Trend scenario

- Decree Law no. 5/2012. cvt. into Law 35/2012 – so-called 'Semplifica Italia';
- Decree Law no. 1/2012 cvt. into Law no. 27/2012 - (so-called 'Cresci Italia');
- Decree Law no. 83/2012 cvt. into Law no. 134/2012 - (so called 'Decreto Crescita');
- Decree Law no. 91/2014 cvt. into Law no.116/2014

b) Policy scenario

- Decree Law no. 133/2014
- Annual Law on Competition[15].

Estimation methodology for the policy scenario. Measures in this area were simulated by QUEST III and includes those aimed at directly fostering market competition (by means of a markup reduction). The assumption is that Decree Law no. 133/2014 and the Annual Law on Competition can magnify the impact of previous measures introduced by the Monti government, by halving the implementation time of reforms.

TABLE III.4-3 MACRO ECONOMIC IMPACT OF MEASURES ENHANCING COMPETITIVENESS

	2015	2016	2017	2018	2019	2020	Long run
TREND SCENARIO							
GDP	0.1	0.1	0.2	0.2	0.3	0.3	3.2
Consumption	-1.0	-1.0	-0.9	-0.8	-0.8	-0.7	0.8
Investment	1.5	1.8	2.2	2.5	2.8	3.1	5.8
Labour	-0.1	0.0	0.0	0.1	0.1	0.1	-0.1
PLANNED SCENARIO							
GDP	0.1	0.1	0.3	0.5	0.8	1.1	3.2
Consumption	-1.1	-1.1	-1.0	-0.7	-0.6	-0.4	0.8
Investment	1.9	2.3	2.9	3.5	3.9	4.3	5.8
Labour	-0.2	-0.1	0.0	0.3	0.4	0.5	-0.1

Estimation results. This area contributes to enhance GDP by 0.3 per cent in the Trend scenario and 1.1 per cent in the Policy scenario in 2020. The simulations show a positive impact on investment, while the impact is negative on consumption. In fact, the mark-up reduction leads consumers to postpone their consumption choices, waiting for a general decrease in prices. This behaviour favours at the same time the accumulation of capital. In the long run simulations show a slightly negative effect on labour as a result of the increased productivity.

Labour market

The measures considered under this area are related to labour market in a broad sense. The following are the measures associated to each scenario:

15 Since 2010, the Antitrust Authority sent to the Government and Parliament an annual monitoring report containing guidelines for the draft law on competition, as required by Law no. 99/2009, art. 47.

a) Trend scenario
   - Law no. 92/2012
   - Decree Law no. 34/2014 cvt. into Law no. 78/2014

b) Policy scenario
   - Draft Enabling Law on Labour Market (DDL n.1428) so called ‘Jobs Act’.

Estimation methodology for the policy scenario. Measures in this area were simulated by IGEM. The provisions under consideration are those contained in the Draft Enabling Law on Labour Market (DDL 1428), in particular the elimination of atypical labour contracts. In particular, it is assumed a shift from atypical workers to permanent workers by 4 percentage points over ten years. The hypotheses adopted in the simulation are consistent with those by Boeri and Garibaldi (2007).[16] According to their findings, it is assumed that a shift of labour demand towards more stable types of contracts results in an average productivity increase.

TABLE III.4-4 MACRO ECONOMIC IMPACT OF THE LABOUR MARKET REFORM

	2015	2016	2017	2018	2019	2020	Long run
TREND SCENARIO							
GDP	0.1	0.2	0.3	0.3	0.4	0.4	1.4
Consumption	0.1	0.2	0.3	0.4	0.5	0.7	1.0
Investment	0.1	0.1	0.1	0.2	0.2	0.2	0.7
Labour	0.2	0.3	0.4	0.5	0.6	0.6	1.2
PLANNED SCENARIO							
GDP	0.1	0.3	0.5	0.6	0.8	0.9	1.6
Consumption	0.1	0.2	0.5	0.7	1.0	1.3	1.2
Investment	0.2	0.2	0.2	0.3	0.3	0.3	0.9
Labour	0.3	0.4	0.5	0.7	0.8	0.8	1.3

Estimation results. This area of reform contributes to enhance GDP by 0.4 per cent in the Trend scenario and 0.9 per cent in the Policy one in 2020. In details, the simulations show a gradual increase in consumption due to the increased share of workers on permanent contracts in the economy. The increased number of permanent workers boosts consumption as a result of ameliorated income prospects connected to permanent workers. The impact on labour tends to gradually increase from the short run to reach 0.6 per cent in 2020.

Justice

Measures are related to improving efficiency of civil and penal justice. The following are the measures associated to each scenario:

a) Trend scenario
   - Legislative Decree no. 155/2012 – Nuova organizzazione dei tribunali ordinari e degli uffici del pubblico ministero as required by the enabling law on the reorganisation of the (Decree Law no.138/2011 cvt into Law no. 148/2011);
   - Decree Law no.69/2013 cvt into Law no.98/2013 – (so-called Decreto del Fare);
   - Decree Law no.90/2014 cvt. into Law no. 114/2014.

b) Policy scenario
   - Decree Law no. 92/2014 cvt. into Law no.117/2014

[16] Boeri, T., Garibaldi,P. 2007. Two Tier Reforms of Employment Protection: a Honeymoon Effect?, Economic Journal, Royal Economic Society, Royal Economic Society, vol. 117(52), tab.5 pg. 377.

- Draft enabling laws on justice (August 2014)
- Draft laws on reforming civil and penal justice.

Estimation methodology for the policy scenario. The measures in this area have been simulated with QUEST III. In the planned scenario, the estimation has benefited from information provided by a recent CE paper[17] showing the impact of improved judicial efficiency on business dynamics and foreign direct investment. The reform considered by the paper are: i) the reduction in the total number of first instance courts by 48 per cent due to the geographical reorganisation of courts and ii) a reduction in litigation rate by 2.9 per cent due to the reform in mediation. According to the authors' estimates on entry rate, we assume a mark-up reduction of 0.15 per cent over three years. In addition, in the long run (namely, since 2020 onward) we assume the activation of FDI investments translating into domestic investments. For this channel we assume a reduction of 5 base points of user costs of capital. In details, the assumptions for the quantification of impact are:

- Transmission mechanism of the shock: a mark-up reduction; user cost of capital reduction
- Size of the shock: 0.15 percentage point reduction in mark-up obtained modelling in QUEST III the increase in productivity linked to a rise in entry rates (as described in the mentioned paper). More specifically, the estimated impact of justice reforms on the entry rate is 2.62 p.p. (i.e. 2.45 p.p. estimated impact due to geographical reorganization of courts + 0.17 p.p. due to the reform in mediation). This amount is equivalent to a change of 39.1 per cent of the entry rate (6.7 per cent reference value). That change is estimated to produce an increase in average productivity by 0.24 per cent (namely using the elasticity estimates of labour productivity of 0.6 per cent). Similarly, the user cost of capital has been modified to reach the FDI increase as in the CE paper.

TABLE III.4-5 MACRO ECONOMIC IMPACT OF THE JUSTICE REFORM

	2015	2016	2017	2018	2019	2020	Long run
TREND SCENARIO							
GDP	0.1	0.1	0.1	0.1	0.2	0.2	0.4
Consumption	0.0	0.0	0.1	0.1	0.1	0.1	0.3
Investment	0.4	0.5	0.5	0.5	0.5	0.5	0.6
Labour	0.1	0.1	0.0	0.0	0.0	0.0	0.1
PLANNED SCENARIO							
GDP	0.1	0.2	0.2	0.2	0.4	0.4	1.0
Consumption	0.0	0.0	0.1	0.1	0.1	0.1	0.8
Investment	0.5	0.8	0.9	0.9	1.4	1.4	2.2
Labour	0.1	0.1	0.1	0.1	0.0	0.0	0.2

Estimation results. This area of reform contributes to enhance GDP by 0.2 per cent in the Trend scenario and 0.4 per cent in the Policy one in 2020. The simulations show a gradual increase in investment, more relevant in the Policy scenario, due to the decrease of litigation rate and the increased certainty of justice. The improved business environment has only marginal effects on consumption and employment.

Overall impact of the four areas of reform

The overall impact of the interventions adopted and planned in the four policy areas (i.e. Public Administration, Competitiveness; Labour market and Justice) were obtained by summing up the results obtained in each single domain of reform.

The considered measures contribute to enhance GDP by 1.4 per cent in 2020 in the Trend scenario and by 3.4 per cent in the Planned one. The reforming action is found to mainly

[17] European Commission, 2014, Market Reforms at work in Italy, Spain, Portugal and Greece, Economic papers 5, Box pg. 50.

stimulate investment (by 3.2 per cent in 2020 in the trend scenario, and 5.6 per cent in the planned scenario). Also the positive impact on consumption is remarkable, hovering around 1.6 per cent in 2020 in the Trend scenario and 2.9 per cent in the Planned scenario. In 2020, the increased efficiency in the economy is estimated to boost employment by 0.6 per cent in the Trend scenario and 1.2 per cent in the Planned scenario.

TABLE III.4-6 MACRO ECONOMIC IMPACT OF THE CONSIDERED STRUCTURAL REFORMS (TOTAL EFFECT)

	2015	2016	2017	2018	2019	2020	Long run
TREND SCENARIO							
GDP	0.4	0.6	0.9	1.0	1.3	1.4	7.3
Consumption	0.3	0.4	0.8	1.0	1.2	1.6	4.1
Investment	1.4	1.8	2.1	2.5	2.9	3.2	7.8
Labour	0.3	0.5	0.4	0.6	0.7	0.6	0.9
PLANNED SCENARIO							
GDP	0.4	0.8	1.5	2.0	2.8	3.4	8.1
Consumption	0.4	0.5	1.2	1.7	2.2	2.9	4.8
Investment	1.8	2.6	3.2	4.0	5.1	5.6	9.6
Labour	0.4	0.5	0.6	1.1	1.2	1.2	1.1

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