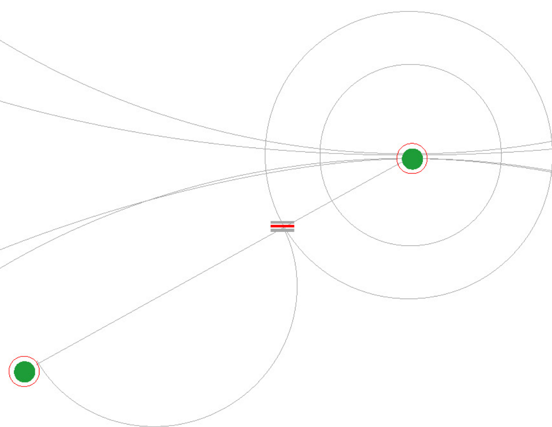
Ministero dell'Economia e delle Finanze

ITALY'S DRAFT BUDGETARY PLAN 2014



MINISTERO DELL'ECONOMIA E DELLE FINANZE

ITALY'S DRAFT BUDGETARY PLAN 2014

Submitted by Minister of the Economy and Finance
Fabrizio Saccomanni

INDEX

I. INTRODUCTION **1**

II. TABLES **5**

III. METHODOLOGICAL APPENDIX **17**

I.2 Short description related to models 17

THE ITALIAN TREASURY ECONOMETRIC MODEL 17

IGEM – Italian General Equilibrium Model 17

QUEST III - Italy 18

I.3 Methodological Note on the criteria for the formulation of macroeconomic and budgetary projections 18

APPENDIX A : APPENDIX **19**

A.1 SUSTAINABILITY ANALYSIS **20**

A.1.1 Debt projection and its components. 20

A.1.2 Stochastic public debt projections 22

A.1.3 Medium-term scenarios and sensitivity analysis 23

A.1.4 Sustainability indicators and long-term scenarios 25

INDEX OF THE TABLE

Table I.1-1 Basic Assumptions (0.i) 5
Table I.1-2 Macroeconomic prospects (1.a) 6
Table I.1-3 Price developments (1.b) 7
Table I.1-4 Labour market developments (1.c) 7
Table I.1-5 Sectoral balances (1.d) 7
Table I.1-6 General government budgetary targets broken down by subsector (2.a) 8
Table I.1-7 General government debt developments (2.b)* 9
Table I.1-8 General government expenditure and revenue projections at unchanged policies broken down by main components (3) 10
Table I.1-9 General government expenditure and revenue targets, broken down by main components (4.a) 10
Table I.1-10 Amounts to be excluded from the expenditure benchmark (4.b) 11
Table I.1-11 General government expenditure by function (4.c.) 11
Table I.1-12 Discretionary measures taken by General Government (5.a) 12
Table I.1-13 Discretionary measures taken by Central Government (5.B) 13
Table I.1-14 Country Specific Recommendations (6.a) 14
Table I.1-15 Targets set by the Union's Strategy for growth and jobs (6.b) 15
Table I.1-16 Divergence from latest SP (7) 16
Table A.1-2 Sustainability indicators 26
Table A.1-3 Contribution to changes in Public Debt 27

INDEX OF THE FIGURE

Figure A.1-1 Contributions to changes In Public Debt 21
Figure A.1-2 Stochastic debt projections (temporary shock) in % of GDP 22
Figure A.1-3 Stochastic debt projections (permanent shock) in % of GDP 22
Figure A.1-4 Medium term debt projections in percentage of GDP (central scenario) 24
Figure A.1-5 Medium term debt projections in percentage of GDP (alternative scenario) 25
Figure A.1-6 Public Debt Sensitivity with respect to primary balance (In percentage of Gdp) 27

I. INTRODUCTION

A COMPREHENSIVE ECONOMIC POLICY FOR GROWTH

Italy has taken unprecedented measures to exit the crisis. The exit from the EU Excessive Deficit Procedure is one of the most visible accomplishments but the overall reform effort is bringing Italy back onto a stable growth path. Italy is now running sound fiscal policies with the second primary surplus in the EU.

The Italian Government is now putting forwards a comprehensive and multiannual strategy in line with the specific recommendations addressed to Italy in June 2013 to restore Italy's competitiveness and ensure strong, sustainable and job-rich growth.

The economic policy of the Italian Government is based on three pillars: the 2014 budget law, carrying measures to ensure deficit and debt reduction coupled with a consistent cut of the tax wedge on labour, a package of measures aimed at increasing competitiveness and an asset privatisation process.

The first pillar, the Budget Law for 2014, contains measures to combine continuing fiscal consolidation, action to improve the business environment and access to credit as well as a significant cut in the tax wedge on labour, both for employers and employees. The government is committed to step-up the proposed tax reduction plan in 2015 and 2016. The draft budget law also includes measures to improve access to credit for business via incentives to increase firm capitalisation (Allowance for Corporate Equity) and the extension of the loan guarantee program for SMEs. The draft budget law for 2014 also includes measures to fight poverty and social exclusion and step up infrastructure investments.

In 2014, Italy will run a deep process of spending review giving large powers to a Commissioner with a three-year mandate and dedicated personnel to proceed to targeted and structural cuts in expenditure incurred by the public sector at large, including state-owned enterprises.

The second pillar of our growth strategy is aimed at cutting red tape and improving the business environment. In particular, it refers to the plan 'Destinazione Italia', adopted at the end of September to promote and attract foreign direct investments. It provides a comprehensive framework of regulatory reforms almost cost-free but with a strong growth potential. The Plan is structured along three main building blocks. First, a better environment through all the investment lifecycle; second, enhancing value of Italy's assets, including tourism and cultural heritage; third, the attraction of human capital. "Destinazione Italia" provides regulatory certainty, time certainty, and tax rate certainty to business through 50 measures introducing nationwide standard procedures, speeding up procedures, improving civil justice and allowing ex ante tax agreements.

The third pillar of the Italian Government's growth strategy consists in a privatisation process in order to properly and incrementally sell State-owned assets. The privatisation process will serve the dual purpose of reducing public debt and improving the overall efficiency of the Italian economy.

Pursuing growth and job-creation requires at least the same determination we have put in adjusting our public finances. This is our clear commitment for 2014 and the coming years.

A BUDGET FOR GROWTH

In line with the new requirements of the *Two Pack*[1], in the current budget session Italy presents for the first time the Draft Budgetary Plan (DPB) to update the macroeconomic and public finance projections indicated in Italy's Stability Programme published in April and give details on the adjustment measures.

The current document follows the Update of 2013 Economic and Financial Document adopted by the Cabinet of Ministers on the 20th of September and endorsed by Parliament on the 9th of October. The scenario herewith presented is based on unchanged legislation and takes into account the revisions of data released by ISTAT with the Excessive Deficit Procedure notification of the 1st of October. The policy scenario for next year is complemented by the impact of measures aimed at securing the public accounts 3.0 per cent target in 2013, as well as those for 2014-2016.

GDP is forecast to contract by 1.8 per cent in 2013. It is projected to reach 1.1 per cent in 2014, also thanks to the effects of the mentioned budget measures aimed at supporting economic activity.

In order to address the specific requirement of the *Two Pack* on independent macroeconomic forecasts, trend growth forecasts are compared with those of consensus and national and international forecasters in the Update of 2013 Economic and Financial Document[2]. From next year onwards, forecasts will be endorsed by the newly created Parliamentary Budget Office (PBO), which will become operational as of January 2014.

In 2013, the net borrowing requirement based on the policy scenario is estimated at 3.0 per cent of GDP, thanks to timely initiatives to bring the deficit within the threshold set at European level[3].

Associated with this figure is a structural deficit at 0.5 per cent of GDP in 2013. The structural improvements in 2013 and in the 2012-2013 average (0.7 and 1.5 percentage points of GDP respectively) are well above those required of the countries still far from the Medium Term Objective (0.5 percentage points of GDP per year). Finally, payments of past-due debt of the public administration for capital expenditure, as agreed with the European Union, will account for approximately 0.5 percentage points of GDP in 2013 and are included in this year's aggregate.

In 2014, the budget deficit is projected at 2.5 per cent of GDP, which also takes into account some expenditure items not included in the 'current legislation' aggregate but that are 'likely to be paid'; in structural terms, the structural balance is expected to improve by approximately 0.3 percentage points compared with the previous year.

The Italian Government herewith applies for the activation of so-called investment clause envisaged by the preventive arm of the Stability and Growth Pact to fund some investment projects co-financed by the European Union for 2014. Net of the expected extra leeway (about 0.3 percentage points), the 2014 structural

[1] EU Regulation No. 473/2013.

[2] For more details see the focus on 'Validation of macroeconomic forecasts, as provided by the Two Pack', Chapter II of the Update of 2013 Economic and Financial Document.

[3] Decree Law endorsed by Cabinet on 9th October 2013, referring to 'Urgent measures in public finance rebalancing and in the field of immigration flows'

outcome would be in line with Italy’s commitment to balance the budget already in 2014, i.e. in line with Italy’s MTO.

Measures outlined in the Budget for 2014-2016 are designed to benefit economic growth, especially by reducing the tax wedge on labour, increasing investment and reviewing public expenditure to support competitiveness of the Country and the needs of the more vulnerable groups of society. Budget law includes also measures to achieve fiscal targets over 2015-2017 period. Moreover, this strategy is a first step that will lead to an important reduction in the overall tax burden over time.

The debt-to-GDP ratio (inclusive of the financial aid to other Member States of the Euro Area and the settlement of payments in arrears of the public administration) is projected to increase from 127.0 per cent in 2012 to 132.9 per cent in 2013 and then decline to 132.7 per cent in 2014 (with a minor downward revision versus the Update of 2013 Economic and Financial Document), following the revised data in ISTAT’s notification. According to Government’s projections, this path ensures the compliance with the new debt rule introduced by the European Union (as translated into the Minimum Linear Structural Adjustment).

This document also includes information on how measures included in the Stability Law address the Country-Specific Recommendations (CSR) and contribute to the targets and national commitments established within the framework of the Union’s Strategy for Growth and Jobs.

II. TABLES

TABLE I.1-1 BASIC ASSUMPTIONS (0.I)			
	2012	2013	2014
Short-term interest rate[1] (annual average)	0,81	0,52	0,87
Long-term interest rate (annual average)	5,65	4,47	4,45
USD/€ exchange rate (annual average)	1,29	1,32	1,32
Nominal effective exchange rate	-7,2	7,6	0,5
World excluding EU, GDP growth	3,9	3,7	4,4
EU GDP growth	-0,2	0,3	1,3
Growth of relevant foreign markets	1,6	2,2	4,7
World import volumes, excluding EU	4,1	4,5	6,4
Oil prices (Brent, USD/barrel)	111,6	109,9	113,6

[1] If necessary, purely technical assumptions.

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

	ESA Code	2012	2012	2013	2014
1. Real GDP	B1*g	1.389.043	-2,5	-1,8	1,1
Of which					
1.1. Attributable to the estimated impact of aggregated budgetary measures on economic growth				0,0	0,1
2. Potential GDP (1)		1.439.591	-0,6	-0,3	0,1
contributions:					
- labour			-0,5	-0,2	0,1
- capital			0,0	-0,1	0,0
- total factor productivity			-0,1	0,0	0,1
3. Nominal GDP	B1*g	1.567.010	-0,8	-0,6	3,0
Components of real GDP					
4. Private final consumption expenditure	P.3	817.524	-4,2	-2,4	0,6
5. Government final consumption expenditure	P.3	291.052	-2,6	-0,4	0,1
6. Gross fixed capital formation	P.51	242.728	-8,3	-5,5	2,4
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53		-0,7	-0,2	0,1
8. Exports of goods and services	P.6	413.975	2,0	0,2	4,1
9. Imports of goods and services	P.7	373.515	-7,4	-3,1	4,1
Contributions to real GDP growth					
10. Final domestic demand			-4,7	-2,5	0,8
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		-0,7	-0,2	0,1
12. External balance of goods and services	B.11		2,8	0,9	0,1

(1) Based on the production function methodology agreed at European level, more allowances for the co-financing of EU investment projects, limited to 2014 and for 0.3 per cent of GDP, brings, ceteris paribus, an increase in the potential growth rate of 0.03 percentage points over the 2014-2017 period. The contribution of capital to potential output growth increases by 0.1 percentage points during the same period. In case the investment rule is applied also in 2015, co-financed investment may increase by 0.1 percentage points and cumulatively reach an amount of 0.4 per cent of GDP. In this case, potential growth would increase by 0.03 percentage points in 2013, 0.08 in 2014 and 0.07 per cent over the period 2015-2017. These estimates are somehow conservative because the impact coming from the EU investment that would be activated by the co-financing has not been considered. By including also such an impact, the increase in potential growth would doubleSimulations carried out through the QUEST model show that the impact of a temporary shock on public investment results in a deviation of GDP with respect to the baseline equal to 0.22 percentage points in 2014, 0.05 in 2015, 0.04 in 2024 and 0.03 percentage points in 2035. To complement the above estimates, further simulations obtained through the QUEST model show the impact of a permanent increase of expenditures cofinanced by the Italian authorities. In modeling the shock it was assumed that cofinancing expenditures would activate an increasing share of public investments as well as a larger amount of tax credit to the private investments both in tangibles and intangibles. Results show a 1.6 percentage points increase in output in the long run, out of which 0.71 percentage points due to TFP increase.

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

	ESA Code	2012	2012	2013	2014
		Level	rate of change	rate of change	rate of change
1. GDP deflator		112,8	1,7	1,3	1,9
2. Private consumption deflator		115,8	2,8	1,5	2,0
3. HICP		117,5	3,3	1,5	2,0
4. Public consumption deflator		116,5	0,5	-1,3	-0,4
5. Investment deflator		115,6	1,6	0,9	2,6
6. Export price deflator (goods and services)		114,4	1,9	0,1	1,5
7. Import price deflator (goods and services)		122,0	3,1	-1,3	1,1

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

	ESA Code	2012	2012	2013	2014
		Level	rate of change	rate of change	rate of change
1. Employment, persons[1]		24.661	-0,3	-1,7	0,0
2. Employment, hours worked[2]		43.212.145	-1,4	-1,8	0,0
3. Unemployment rate (%)[3]			10,7	12,2	12,4
4. Labour productivity, persons[4]		58.496	-1,5	0,0	1,1
5. Labour productivity, hours worked		32	-1,1	0,0	1,0
6. Compensation of employees	D.1	668.917	-0,2	-0,4	0,8
7. Compensation per employee		39.271	1,0	1,4	0,9

[1] Occupied population, domestic concept national accounts definition.
[2] National accounts definition.
[3] Harmonised definition, Eurostat; levels.
[4] Real GDP per person employed.
[5] Real GDP per hour worked.

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

	ESA Code	2012	2013	2014
	B.9	% GDP	% GDP	% GDP
1. Net lending/net borrowing vis-à-vis the rest of the world		-0,5	0,7	0,8
of which:				
- Balance on goods and services		1,1	2,5	2,7
- Balance of primary incomes and transfers		-1,8	-1,9	-2,0
- Capital account		0,1	0,1	0,1
2. Net lending/net borrowing of the private sector	B.9	2,5	3,7	3,3
3. Net lending/net borrowing of general government	B.9	-2,9	nd	nd
3. Net lending/net borrowing of general government	EDP.9	-3,0	-3,0	-2,5
4. Statistical discrepancy				

Decimals may not add, due to rounding to the first decimal place .

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

	ESA Code	2013	2014
		% GDP	% GDP
Net lending (+) / net borrowing (-) (B.9) by sub-sector			
1. General government	S.13	-3,0	-2,5
2. Central government	S.1311	-2,6	-2,4
3. State government			
4. Local government	S.1213	-0,6	-0,3
5. Social security funds	S.1314	0,2	0,2
6. Interest expenditure	D.41	5,4	5,4
7. Primary balance		2,4	2,9
8. One-off and other temporary measures		0,3	0,0
9. Real GDP growth (%) (=1 in Table 1.a)		-1,8	1,1
10. Potential GDP growth (%) (=2 in Table 1.a)[1]		-0,3	0,1
contributions :			
- labour		*-0,2*	*0,1*
- capital		*-0,1*	*0,0*
- total factor productivity		*0,0*	*0,1*
11. Output gap (% of potential GDP)		-5,0	-4,1
12. Cyclical budgetary component (% of potential GDP)		-2,7	-2,2
13. Cyclical-adjusted balance (1 - 12) (% of potential GDP)		-0,3	-0,3
14. Cyclical-adjusted primary balance (13 + 6) (% of potential GDP)		5,1	5,1
15. Structural balance (13 - 8) (% of potential GDP)		-0,5	-0,3

[1] Based on the production function methodology agreed at European level, more allowances for the co-financing of EU investment projects, limited to 2014 and for 0.3 per cent of GDP, brings, ceteris paribus, an increase in the potential growth rate of 0.03 percentage points over the 2014-2017 period. The contribution of capital to potential output growth increases by 0.1 percentage points during the same period. In case the investment rule is applied also in 2015, co-financed investment may increase by 0.1 percentage points and cumulatively reach an amount of 0.4 per cent of GDP. In this case, potential growth would increase by 0.03 percentage points in 2013, 0.08 in 2014 and 0.07 per cent over the period 2015-2017. These estimates are somehow conservative because the impact coming from the EU investment that would be activated by the co-financing has not been considered. By including also such an impact, the increase in potential growth would doubleSimulations carried out through the QUEST model show that the impact of a temporary shock on public investment results in a deviation of GDP with respect to the baseline equal to 0.22 percentage points in 2014, 0.05 in 2015, 0.04 in 2024 and 0.03 percentage points in 2035. To complement the above estimates, further simulations obtained through the QUEST model show the impact of a permanent increase of expenditures cofinanced by the Italian authorities. In modeling the shock it was assumed that cofinancing expenditures would activate an increasing share of public investments as well as a larger amount of tax credit to the private investments both in tangibles and intangibles. Results show a 1.6 percentage points increase in output in the long run, out of which 0.71 percentage points due to TFP increase.

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

	ESA Code	2013	2014
		% GDP	% GDP
1. Gross debt[1]		132,9	132,7
2. Change in gross debt ratio		5,9	-0,1
Contributions to changes in gross debt			
3. Primary balance (= item 10 in Table 2.a.i)		2,4	2,9
4. Interest expenditure (= item 9 in Table 2.a.i)	D.41	5,4	5,4
5. Stock-flow adjustment		2,2	1,2
of which:			
- Differences between cash and accruals[2]		1,5	0,8
- Net accumulation of financial assets[3]		0,3	-0,1
of which:			
- *privatisation proceeds*		*-0,5*	*-0,5*
- Valuation effects and other[4]		*0,3*	*0,5*
p.m.: Implicit interest rate on debt[5]		*4,2*	*4,2*
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] The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.
[3] Liquid assets (currency), government securities, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.
[4] Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.
[5] Proxied by interest expenditure divided by the debt level of the previous year.
[6] Liquid assets are here defined as AF.1, AF.2, AF.3 (consolidated for general government, i.e. netting out financial positions between government entities), A.F511, AF.52 (only if quoted in stock exchange).

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

General government (S13)	ESA Code	2013	2014
		% GDP	% GDP
1. Total revenue at unchanged policies	TR	48,3	47,9
Of which			
1.1. Taxes on production and imports	D.2	15,1	15,4
1.2. Current taxes on income, wealth, etc	D.5	15,0	15,0
1.3. Capital taxes	D.91	0,2	0,1
1.4. Social contributions	D.61	14,0	13,8
1.5. Property income	D.4	0,6	0,6
1.6. Other[1]		3,3	3,1
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[2]		44,3	44,2
2. Total expenditure at unchanged policies	TE[3]	51,3	50,2
Of which			
2.1. Compensation of employees	D.1	10,5	10,1
2.2. Intermediate consumption	P.2	5,5	5,3
2.3. Social payments	D.62[1], D.632	23,4	23,3
of which Unemployment benefits[4]		*1,0*	*1,0*
2.4. Interest expenditure	D.41	*5,4*	*5,4*
2.5. Subsidies	D.3	*1,0*	*1,0*
2.6. Gross fixed capital formation	P.51	*1,8*	*1,8*
2.7. Capital transfers	D.9	1,4	1,0
2.8. Other[5]		2,4	2,3

[1] Under ESA95: D6311_D63121_D63131pay; in ESA2010 D632pay

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

General government (S13)	ESA Code	2013	2014
		% GDP	% GDP
1. Total revenue target	TR	48,3	47,9
Of which			
1.1. Taxes on production and imports	D.2	15,1	15,3
1.2. Current taxes on income, wealth, etc	D.5	15,0	15,1
1.3. Capital taxes	D.91	0,2	0,1
1.4. Social contributions	D.61	14,0	13,7
1.5. Property income	D.4	0,6	0,6
1.6. Other[1]		3,3	3,1
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[2]		44,3	44,2
2. Total expenditure target	TE[3]	51,3	50,4
Of which			
2.1. Compensation of employees	D.1	10,5	10,1
2.2. Intermediate consumption	P.2	5,5	5,3
2.3. Social payments	D.62[6], D.632	23,4	23,3
of which Unemployment benefits[4]		*1,0*	*1,0*
2.4. = Table 2.a.9. Interest expenditure	D.41	5,4	5,4
2.5. Subsidies	D.3	1,0	1,0
2.6. Gross fixed capital formation	P.51	1,8	1,9
2.7. Capital transfers	D.9	1,4	1,1
2.8. Other[5]		2,4	2,3

[1] 11+P.12+P.131+D.39rec+D.7rec+D.9rec (other than D.91rec)
[2] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions D.995), if appropriate.
[3] TR-TE = B.9.
[4] Includes cash benefits (D.621 and D.624) and in kind benefits (D.631, under ESA2010 D.632) related to unemployment benefits.
[5] D.29pay + D.4pay (other than D.41pay) +D.5pay +D.7pay +P.52+P.53+K.2+D.8.
[6] Under ESA95: D6311_D63121_D63131pay; in ESA2010 D632pay.

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

	ESA Code	2012	2012	2013	2014
		Level	% GDP	% GDP	% GDP
1. Expenditure on EU programmes fully matched by EU funds revenue		3.900	0,2	0,3	0,3
2. Cyclical unemployment benefit expenditure[1]		1.503	0,1	0,2	0,1
3. Effect of discretionary revenue measures		20.380	1,3	-0,1	0,2
4. Revenue increases mandated by law		0	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 I.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 0.4 p.p. of GDP from 2010 (4.0%)to 2015 (3.6%).
Health[1]	Healthcare expenditure is forecasted to decrease from 7,3 % of GDP in 2010 to 6,9% in 2015.
Employment[2]	Data are available until 2011. The employment expenditure to GDP ratio decreased from 0,41% in 2007 to 0,34% in 2011. By now, there is no evidence to foresee an employment expenditure different from 0,3% of GDP over the 2012-2014 period.

[1] MEF analyses developed using the long-term forecast model of the General State Accounting Office based on Eurostat data.
Source: MEF (2013), Economic and Financial Document 2013- Section I Italy's Stability Programme. See Table V.1.
[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

TABLE I.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				
						2013 % GDP	2014 % GDP	2015 % GDP	2016 % GDP	2017 % GDP
Increase of tax detractions for wages and salaries from regular employment	Increase of tax detractions for the following salary brackets: from 8.000 to 15.000 euro and from 15.000 to 55.000 euro.	D.5	ESA 95	immediate effectiveness			-0,10%	-0,01%	0,00%	0,00%
Deductibility of devaluation and losses on credits for IRES and IRAP for banks, insurance companies and other financial intermediaries	Banks, insurance companies and other financial intermediaries can deduct negative adjustments and losses on credits from their taxable base over a 5 year period as concerns IRES and IRAP (business taxes). In current legislation, as concerns IRES, these items are deductible over an 18 year period (except for a share of 0.3% in the year of reference) and, as concerns IRAP, they are not deductible.	D.5	ESA 95	immediate effectiveness			0,14%	-0,18%	-0,06%	-0,06%
Modification of tax rate and reduction of benefits and detractions	By Decree of the President of the Council of Ministers to be adopted by January 15, 2015, modifications of current tax rates and reduction of benefits and tax detractions will be enforced. These measures will ensure an estimated 3 billion euro additional revenue in 2015, 7 billion euro in 2016 and 10 billion euro in 2017. These measures may be limited in case of an increase of revenue foreseen by further legislation and/or greater savings coming from the rationalization and revision of expenditures, both to be enacted by January 1, 2015.	D.5	ESA 95	needs implementation measures			0,00%	0,19%	0,23%	0,17%
Reduction of automatic re-evaluation rates for retirement benefits (2014-2016 period)	For the years 2014-2016, the automatic re-evaluation of retirement benefits is applied at the rate of 100% for pensions up to three times the minimum treatment (6,440 euro per year equal to 495.4 euros per month), at the rate of 90% for pensions between three and four times greater than the minimum treatment, at a rate of 75% for pensions between four and five times the minimum treatment and at a rate of 50% for all other treatments. The automatic re-evaluation for pensions exceeding 6 times the minimum treatment is blocked for 2014. It is a temporary measure and by 2017 the current regime comes back into force.	D.62	ESA 95	immediate effectiveness			-0,04%	-0,05%	-0,05%	0,00%

TABLE I.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				
						2013 % GDP	2014 % GDP	2015 % GDP	2016 % GDP	2017 % GDP
Increase of tax detractions for wages and salaries from regular employment	Increase of tax detractions for the following salary brackets: from 8.000 to 15.000 euro and from 15.000 to 55.000 euro.	D.5	ESA 95	immediate effectiveness			-0,10%	-0,01%	0,00%	0,00%
Deductibility of devaluation and losses on credits for IRES and IRAP for banks, insurance companies and other financial intermediaries	Banks, insurance companies and other financial intermediaries can deduct negative adjustments and losses on credits from their taxable base over a 5 year period as concerns IRES and IRAP (business taxes). In current legislation, as concerns IRES, these items are deductible over an 18 year period (except for a share of 0.3% in the year of reference) and, as concerns IRAP, they are not deductible.	D.5	ESA 95	immediate effectiveness			0,14%	-0,18%	-0,06%	-0,06%
Modification of tax rate and reduction of benefits and detractions	By Decree of the President of the Council of Ministers to be adopted by January 15, 2015, modifications of current tax rates and reduction of benefits and tax detractions will be enforced. These measures will ensure an estimated 3 billion euro additional revenue in 2015, 7 billion euro in 2016 and 10 billion euro in 2017. These measures may be limited in case of an increase of revenue foreseen by further legislation and/or greater savings coming from the rationalization and revision of expenditures, both to be enacted by January 1, 2015.	D.5	ESA 95	needs implementation measures			0,00%	0,19%	0,23%	0,17%

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

CSR number	List of measures	Description of direct relevance
CSR no. 1 - Debt reduction	Reduction of public administrations expenditure (art.10)	Improvement of the efficiency and quality of public expenditure.
	Spending Review Commissioner and safeguard clauses to guarantee financial coverage of the legislation enacted in accordance with EU fiscal framework (art.10)	Implementation of the in depth spending review at all levels of governments, safeguard clauses to guarantee the compliance with the EU fiscal framework.
	Reduction of public sector employment expenditure (art.11)	Containment of the current public expenditure related to wages of civil servants, including the public health sector until 2014.
	Reduction of pension expenditure (art.12)	Measures aiming at reducing the benifits provided by the pension system such as a revision of the indexation to the cost of living for pensions higher than three times the minimum state pension (with respect to "Fornero Reform")
	Internal Stability Pact – Regions (art. 13)	Financial contribution of Regions in pursuing public finance targets. Revenue coming from the application of Law Decrees n. 138/2011 and 201/2011 will be earmarked by the State.
	Internal Stability Pact – Local Authorities (art. 14)	Financial contribution of Local Authorities in pursuing public finance targets.
	Internal Stability pact local public companies (art.15)	Measures aimed at improving the monitoring and surveillance of the local public companies as they contribute to the fiscal consolidations efforts.
	Payments in arrears by the public administrations (decree law 15 October 2013, n. 120)	Growth-friendly fiscal consolidation by accelerating the payments of commercial debts in arrears.
	Cuts to State Budget (with the exception of MIBAC and MIUR, as decree law 15 October 2013, n. 120)	Relevant expenditure containment in order to achieve public finance targets.
	Integration of municipal solidarity fund for 2013 (decree law 15 October 2013, n. 120)	Providing municipalities with the resources expected by the municipal real estate taxes (IMU) revenue, and other provisions on the solidarity fund.
	Fiscal system (art.17)	Revision of several tax credits and tax deductions.
	Sale of State-owned assets (art.10)	Fiscal consolidation.
CSR no. 2 - Efficiency and quality of Public Administration	Monitoring of P.As past debts (art.14)	Ensuring control over the payments due by local entities and enforcing the accountability of local administrators.
	Recruitment of magistrates and extension of ordinary judges (art.9)	Reduction of the pending civil and penal court proceedings.
	Streamline of legislation for companies operating in the cultural heritage sector (art.10)	Simplification of the administrative framework for the companies operating in the cultural heritage sector.
	National co-financing of EU programs (art.8)	Improve the management of EU funds.
	Public administrations benefiting from EU funds must rely on the Consip for their purchasing of goods and services (art.8)	Improve the management and efficiency of EU funds.
	Increase of the Social Cohesion Fund for 2014-2020 (art.3)	Improvement of the management of EU funds in the southern regions by finetuning of eligibility criteria.
	On line payment of fiscal and other duties (art.18)	Efficiency of public administration.
	Elusion from the Internal Stability Pact for local entities of the commercial debts in arrears (art.14)	Accelerate payments of commercial debts in arrears.
CSR no. 3 - Financial system	Writing off of banking devaluation and losses on loans (art.6)	Reviewed the legislation regarding the non-performing loans on banks' balance sheets.
CSR no. 4 - Labour market	Reduction in tax wedge for companies and workers (art.6)	Employment increase. Positive impact on disposable income.
	Increase of protected workers (salvaguardati) (art.7)	Measures to enlarge the number of employees close to retirement or in distress, allowed to retire.
	Refinancing of social card and Fund for non self-sufficient people (art.7)	Extended the number of people entitled to social benefits, with positive impact on a greater number of low-income families.
	University Funds (art. 9 and 10)	Strengthening of higher education through new or increased funding to universities.
	Refinancing of ordinary wage supplementation scheme (Cassa Integrazione Guadagni) (art.7)	Prosecution of wage support for workers.
CSR n. 5 - Fiscal system	Revision of local taxes (Municipal services, waste management, indivisible services, IMU) (art. 19, 20, 21, 22, 23)	Overcoming problems of previous waste taxation systems. Rationalization of local taxes. Definition of taxable persons in relation to some local taxes.
	Revision of tax expenditures (art.10)	Reviewing the scope of tax exemptions and reduced rates.
	Revision of cadastral system (art.9)	First step for the implementation of the reform envisaged by the Delega Fiscale (Delegated Tax Law).
	Revenue provisions (art.18)	Fight against tax evasion, tax compliance and contrast of unwarranted refunds.

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

CSR n. 6 - Competition	Financing for Transport and infrastructures (railways, maritime and road transport) (art.4)	Maintenance of the road network and of adequate capacity in the maritime sector, strengthening of rail and local public transport, completion of major infrastructures (MOSE).
	Incentives for road transport (art.4)	Support for the road transport sector to improve intermodality.
	Interventions for water infrastructures (art.5)	Protection and management of water resources in order to strengthen the capacity of waste water treatment plants.
	Development of broadband and ultrabroadband infrastructures (art.4)	Completion of the National Broadband Plan, approved by the European Commission.

TABLE I.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%]	Reduction in tax wedge for companies and workers (regional taxes and social contributions) (art.6)	Increase of permanent work contracts and employment rate in general.
2 - R&D expenditure [1,53%]		
3 - Greenhouse gas emissions [-13%]*		
4 - Renewable energy sources [17%]		
5 - Energy efficiency [20 Mtoe/year]**	Extension of tax credits for energy efficiency of buildings (art.6)	Improved energy efficiency in housing
6 - Early school leavers [16%]		
7 - University education attainments [26-27%]	Funding for University (art. 9 and 10)	Strengthening of Universities and upper secondary education
8 - Fight against poverty	Fund for the accommodation of foreign unaccompanied minors (decree law 15 October 2013, n. 120)	Sustaining minors and immigrants
	Institution of fund to address the exceptional influx of foreigners in Italy (decree law 15 October 2013, n. 120)	Aid to migrants
	Additional financing of social works (art.7)	Providing jobs for disadvantaged people
	Refinancing of social card and Fund for non self- sufficient people (art.7)	Sustain to at-risk of poverty and social exclusion households
	Reduction in tax wedge for workers (art.6)	Sustain to income
	Refinancing of ordinary wage supplementation scheme (Cassa Integrazione Guadagni) (art.7)	Ensuring income to individuals experiencing temporarily unemployment

*The target of 13% reduction refers to non ETS sectors

** The energy efficiency target is computed as saving on final use as foreseen by the EU Directive.

TABLE I.1-16 DIVERGENCE FROM LATEST SP (7)

	ESA Code	2012 %GDP	2013 % GDP	2014 % GDP
Target General Government net lending/borrowing				
Stability Programme		-3,0	-2,9	-1,8
Draft Budgetary Plan		-3,0	-3,0	-2,5
Difference		0	0,1	0,7
General Government net lending projection at unchanged policies				
Stability Programme		-3,0	-2,9	-1,8
Draft Budgetary Plan		-3,0	-3,0	-2,3
Difference		0	0,1	0,5

III. METHODOLOGICAL APPENDIX

With regard to information required by Table 8 and relative to methodological aspects and estimation techniques used in DPB, two notes are provided:

1. a note with a short description related to models[4] developed and used in the DBP for macroeconomic estimates and impact on growth of structural reforms;
2. the Methodological Note is an official document generally attached to the Economic and Financial Document released in April and describes methodology, process and models used for economic and public finance projections in greater detail[5].

I.2 SHORT DESCRIPTION RELATED TO MODELS

THE ITALIAN TREASURY ECONOMETRIC MODEL

The model ITEM is the econometric model developed and utilized at the Department of Treasury of the Italian Ministry of the Economy and Finance. Being designed for the needs of a Treasury Department, ITEM has a public finance section developed in great detail, on both the expenditure and revenue side. In general, the model has a quarterly frequency and includes 371 variables (247 of which are endogenous). The model structure features 36 behavioral equations and 211 identities, referring to accounting definitions and institutional relationships among variables. As a medium-size econometric model, ITEM is suitable to track and explain the behavior of a considerable number of macroeconomic aggregates of the Italian economy. With regard to the general structure, ITEM belongs to the class of macroeconomic models that assign a prominent role to the supply side of the economy. Indeed, one of its key features is the joint and explicit representation of the economic environment on both the demand and the supply side.

IGEM – Italian General Equilibrium Model

IGEM is a medium scale Dynamic General Equilibrium (DGE) model for the Italian economy. The model, which is based on explicit microeconomic foundations, has been designed to study the impact and the propagation mechanism of temporary shocks and to evaluate alternative reform scenarios, single policy interventions and fiscal consolidation packages. IGEM is a New Keynesian (NK) model that features a large assortment of nominal and real frictions. Contrary to most NK- DGE models, IGEM features a detailed labour market in which different contract types coexist, so to better describe the Italian economy, whose labour market is heterogeneous. This heterogeneity in the labour market, coupled with a high degree of real and nominal rigidities, reveals to be essential in explaining the transmission mechanisms and the

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

[5] See chapters I- III.

effects on employment and income of the business cycle and of different policy interventions. Despite its complexity, IGEM has a highly flexible structure which allows the model to be adapted easily to the nature of the issue under investigation. All these features, together with the richness of policy instruments, make of IGEM a useful simulation tool of analysis.

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 analyze the effects of structural reforms and the response of the economy to a variety of shocks. The QUEST III model belongs to the class of large-scale DSGE models. In particular, the version of model used at the Department of Treasury is an extension of the DSGE model for quantitative policy analysis developed at the DG ECFIN. In our simulation exercises we use the version of the model calibrated for Italy, already employed by the Commission in multi-country analyses of structural reforms by the European Commission. The endogenous growth version of QUEST III is particularly well-suited to analyze the impact of structural economic reforms enhancing growth in the context of the Lisbon Strategy. By including several nominal and real frictions, modeling markets as imperfectly competitive, the model can be used to study the effects of competition-enhancing policy e reforms aimed at increasing the rate of knowledge creation.

I.3 METHODOLOGICAL NOTE ON THE CRITERIA FOR THE FORMULATION OF MACROECONOMIC AND BUDGETARY PROJECTIONS

The document is attached to this Appendix and is provided in Italian only.

MINISTERO DELL'ECONOMIA E DELLE FINANZE

DRAFT BUDGETARY PLAN 2014

Appendix A: APPENDIX

A.1 SUSTAINABILITY ANALYSIS

This Annex is aimed at assessing the sustainability of public debt in the short, medium and long term, in the light of the macroeconomic forecasts and public finance targets contained in the Draft Budgetary Plan (DBP) and in the Update of the 2013 EFD.

To this end, the Annex is divided into three sections. The first one presents a 'short term' analysis, which describes the dynamics of the debt ratio and its com-ponents along the forecast horizon of the Update EFD, that is the period 2013-2017. This section is further enriched through a stochastic simulation, that allows projecting the probability distribution for the debt ratio in the case of both temporary and permanent shocks. The second section provides a medium term analysis for the period 2013-2025, in which the debt projections rely on the growth scenario obtained according to the convergence hypotheses agreed within the *Output Gap Working Group* (OGWG). The baseline scenario is then complemented by sensitivity analyzes regarding the growth assumptions, the level of the yield curve and the dynamics of the primary balance. The third section is devoted to analyze the ''long run' projections for public debt (2018-2060) assuming the growth methodology developed by *the Ageing Working Group* (AWG) and the dynamic of the age related expenditures (public pensions, health care, education, unemployment benefits and long-term care).

A.1.1 Debt projection and its components.

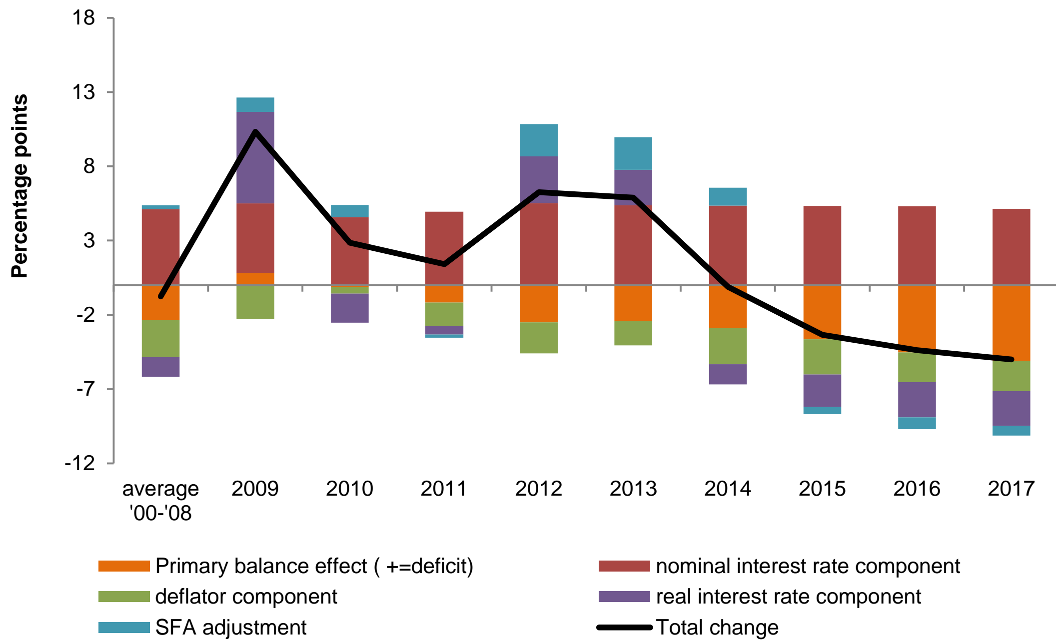
According to the so-called debt dynamics equation, the annual change in the debt ratio can be split down into three main components: i) the differential between the nominal interest rate and the nominal growth rate (snowball effect) ii) the primary balance, and iii) the stock-flow adjustments.[6]

The snowball effect can be further disaggregated to identify the impact on the change in the debt ratio, respectively, of the average cost of debt (positive), the change in the GDP deflator (negative) and the real growth rate (negative) (Table 2). On the basis of the outlook of the Draft Budgetary Plan (DBP) and of the EFD Update , Figure 1 shows the various components that affect the change in the debt ratio for the years 2009-2017, reporting the average for the years 2000-2008.

Figure 1 confirms that the ratio decreases as of 2014 , with an average reduction of about 3,0 percentage points along 2014-2017. The contribution of the primary surplus appears to be crucial for the containment of the public debt ratio, even in the presence of a positive differential between the growth rate and the average interest rate.

[6] The principal components of this item are: the difference between cash and accrual basis, the net accu-mulation of financial assets, public debt evaluation effects (which include also possible variations of debt stocks caused by changes in the exchange rates and in inflation).

Figure A.1-1 **Contributions to changes In Public Debt**



Note: the negative sign in front of components means a reduction effect on public debt ratio.
Source: MEF elaborations

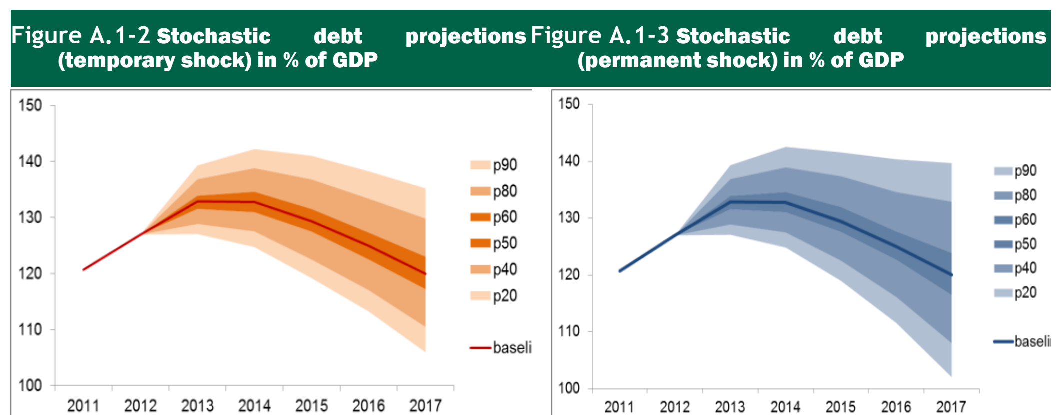
A.1.2 Stochastic public debt projections

In order to take into account the uncertainty of macroeconomic conditions (interest rates and growth rates), the deterministic projection of the debt/GDP ratio are integrated with some stochastic projections based on historical volatility of interest rates, short and long term, and nominal growth rates[7].

The simulations are conducted using a Monte Carlo methodology, applying to a central scenario (DBP and Update of the 2013 EFD) some shocks on interest rates and growth rate. These shocks are obtained by performing at least 2,000 draws from a normal distribution with zero mean and the observed variance-covariance matrix in the period 1990-2012. More specifically, it is assumed that the shocks on interest rates can be characterized as being either temporary or permanent. In addition, it is assumed that temporary shocks on the nominal growth unfold their effects even in the cyclical component of the primary balance. Therefore, for each year of projection and for each shock is possible to identify a distribution of the debt/GDP ratio, represented in probabilistic terms by means of a fan chart (Figure 2).

Figure A.1-2 **Stochastic debt projections (temporary shock) in % of GDP**

Figure A.1-3 **Stochastic debt projections (permanent shock) in % of GDP**



Note: The fan chart report the 10th, 20th, 40th, 50th, 60th, 80th and 90th distribution percentiles. The debt path under the deterministic projection is represented in the charts as a bold line.

Source: MEF elaborations

In the case of a temporary shock, the debt/GDP ratio shows a tendency to decline from 2014 onward, even in cases of stressful events such as those between the sixth and the eighth decile. In the case of the most severe shocks, which lie above the eighth decile, the debt/GDP ratio still shows a tendency to stabilize after peaking slightly above 140 percent.

As expected, the permanent shock produces a broader distribution of values of the debt/GDP ratio around the central scenario, but the dynamics of the debt will not be explosive as well.

[7] Berti K., (2013), "*Stochastic public debt projections using the historical variance-covariance matrix approach for EU countries*", *Economic Papers 480*.

A.1.3 Medium-term scenarios and sensitivity analysis

In this section, the projections of the debt/GDP ratio are extended in a de-terministic way until 2025. The exercise consider the following scenarios[8]:

a) a central scenario assuming as a starting point for the years 2013-2017 the macroeconomic framework of the DPB and the Update of 2013 EFD. This scenario is extended to 2025 by applying the convergence hypotheses agreed within the OGWG[9]. Under these assumptions, in the period 2013-2025 the average GDP growth is projected to hover around 1.1 percent, while the growth rate in the GDP deflator is expected to converge to 2.0 per cent starting from 2020. The structural primary surplus as a percentage of GDP, planned for 2017 in the Update of the EFD, is kept constant until 2025. In order to assess the realism of the assumptions on the primary surplus, a variant of the central scenario is presented. From 2014 onwards, the primary surplus is held constant at the historical average, calculated over the period 1995-2008, which is 3,2 per cent of GDP;
b) an alternative scenario in which, from 2014 onwards, an upward shift of the yield curve of 100 basis points, gradually declining after 2017, is as-sumed. In addition, the projections include a reduction in real GDP growth of 0,5 percentage points per year between 2013 and 2017 with respect to the central scenario. For subsequent years, we maintain the assumption of a gradual convergence to structural values identified according to the hypotheses agreed by the OGWG. Accordingly, the average GDP growth rate for the period 2013-2025 is around 0,9 percent, thus 0,2 percentage points lower than that projected in the central scenario. The lower growth is assumed to have a negative impact on the primary surplus, that is revised downwards by 0,2 percentage points on average. To assess the realism of the assumptions on the primary surplus, a variant of this scenario is also presented. As of 2014 and due to the impact of the higher yield curve, primary surplus is kept constant at a level which is 0,5 percentage points of GDP lower than the historical average considered in the central scenario.

[8] In all the simulated scenarios the resulting dynamics of the debt/GDP ratio is obtained by re-estimating the implicit interest rates which, in turn, are in line with the underlying assumptions on yield curves and the primary surplus.

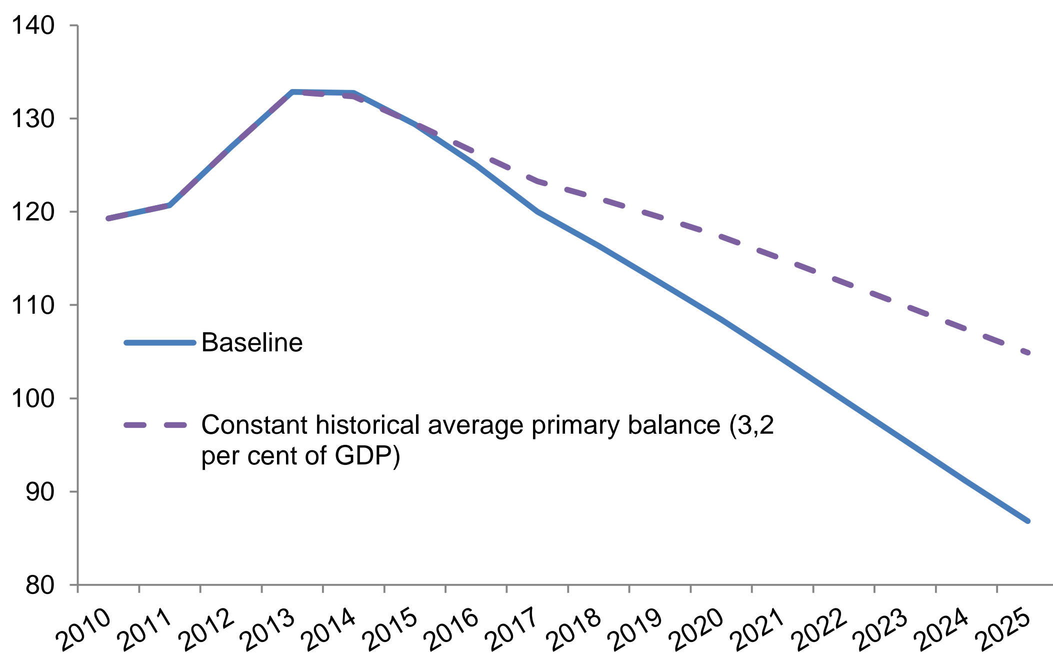
[9] In particular, we consider the closure of the output gap in 2020, that is in the next three years following the last year of the projection horizon of the Update of the EDF, plus some rules of gradual convergence over the medium term to the estimated level of the structural unemployment rate and the investment/Potential GDP ratio. In addition, in the calculation of the component relating to labor participation rates, trends are in line with the predictions of the Cohort Simulation Model (AWG), which incorporates the effects of pension reforms. For the alternative scenarios the same rules of convergence to 2025 are applied but the levels of the medium-term structural unemployment rate and the of investment/Potential GDP ratio are endogenously re-determined.

On the basis of the underlying macroeconomic and public finance assumptions of the central scenario, Figure 3 shows that the debt/GDP ratio keeps declining over the medium term. After reaching a peak above 130 percent, the debt is expected to fall below 90 percent of GDP at the end of the projection horizon. In the event that the primary balance deteriorates, reaching historical levels, the decline of the debt would still be confirmed, but at a more gradual pace (dotted line).

In the case of the pessimistic scenario, which assumes lower growth and an increase of the yield curve by 100 basis points, the debt/GDP ratio would continue to shrink in the coming years, but at a slower pace than in the central scenario. At the end of the period, the debt level would amount to above 95 percent of GDP, about 10 percentage points more than in the reference scenario.

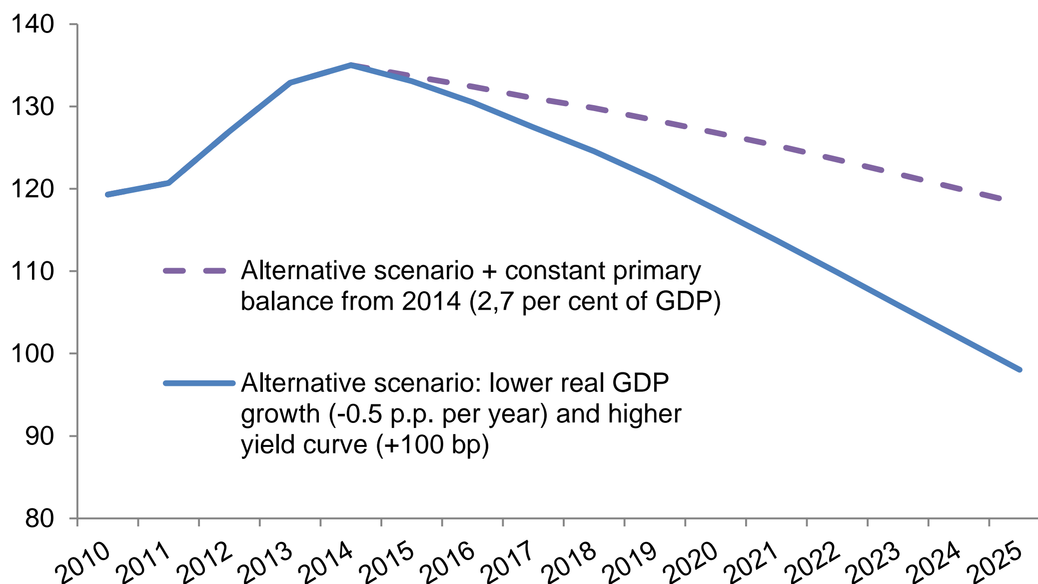
In the event that the deterioration in macroeconomic conditions and rising interest rates would also be reflected on the primary surplus, permanently reducing it by 0,5 per cent of GDP with respect to the historical average, the debt would still continue to decrease but more slowly. At the end of the period, the debt/GDP ratio would be around 120 percent (Figure 4).

Figure A.1-4 **Medium term debt projections in percentage of GDP (central scenario)**



Source: MEF elaborations

Figure A.1-5 **Medium term debt projections in percentage of GDP (alternative scenario)**



Fonte: Elaborazioni MEF

A.1.4 Sustainability indicators and long-term scenarios

This section reports the results of the long-term sustainability analysis through an update of the estimates of medium and long term fiscal indicators, S1 and S2, in line with the multidimensional approach conducted by the European Commission in the 2012 *Fiscal Sustainability Report*[10].

The reference horizon is extended to 2030 and 2060. The growth assumptions used here are in line with the methodologies developed within the *Ageing Working Group of the European Council*. In particular, starting from 2018, the average growth rate in real terms is estimated equal to 1,9 percent until 2030, and to 1,5 percent, if the horizon is extended until 2060. The inflation rate is assumed to be constant and equal to 2,0 percent from 2020, while the real interest rate converges to 3,0 percent. The structural primary surplus is held constant at the 2017 level and then moves with the dynamic of the age-related expenditures, that in the period from 2018 to 2060 increase by 0,1 percent in cumulative terms.

Table 1 shows the results for indicators S1 and S2 and their components, which identify the extent of the fiscal adjustments required to ensure debt sustainability over the long term. Both indicators are negative. As a consequence, the planned fiscal consolidation proves to be sufficient to ensure the sustainability of public finances in the long run. For both indicators this result appears to be confirmed especially by looking at the component of the initial budgetary position, which measures the level of the primary

[10] For further details see Fiscal Sustainability Report 2012, European Economy n.8/2012

balance able to maintain a constant debt-to-GDP ratio to the level of 2017, coeteris paribus.

The so-called cost of delaying adjustment, in the calculation of S1, is almost negligible in the current estimates. Another specific component of S1 is the debt requirement in 2030, which shows the adjustment needed to bring the debt from the initial level down to 60 percent of GDP by 2030. Because of the increased effort due to the anticipation of the achievement of the target to 60 percent of GDP, the component of S1 on the debt requirement entails a positive fiscal adjustment, equal to 4,3 percent of GDP. Finally, the common component to both indicators which measures the additional adjustment needed to cope with the increase of the age-related expenditures, remain close to zero or even negative for Italy.

TABLE A.1-2 SUSTAINABILITY INDICATORS

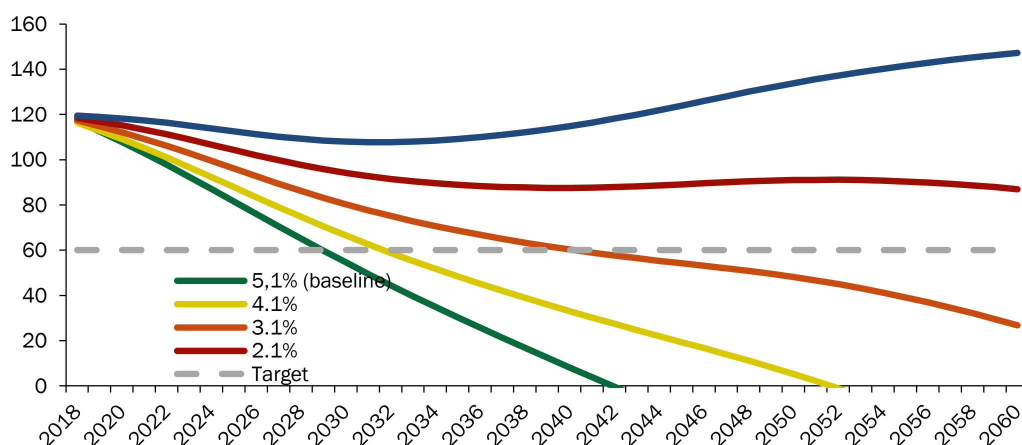
Indicator S1	DPB 2013	PS 2013	2012 Sustainability
Overall index	-0,4	-1,7	0,6
of which:			
Initial budgetary position	-3,9	-4,9	-2,8
Cost of delaying adjustment	0,0	-0,1	0,1
Debt requirement	4,3	4,1	3,7
Ageing costs	-0,8	-0,9	-0,3
Indicator S2			
Overall index	-3,5	-4,5	-2,3
of which:			
Initial budgetary position	-3,4	-4,8	-3,0
Long term component	-0,1	0,3	0,7

Source: MEF elaborations using the long-term forecast model of the General State Accounting Office

Finally, in a long term perspective, the robustness of the results on fiscal sustainability is evaluated against a worsening of the primary balance in 2017. To this aim, the value of the structural primary balance in the baseline scenario, equal to 5,1 percent of GDP in 2017, is decreased by 1,0 percentage point in different scenarios until reaching 1,1 percent of GDP.

The Figure 5, which reports the different paths of the debt-to-GDP according to the assumptions on the primary balance, shows how, for initial values below 4,0 percent the convergence to the 60 per cent target is gradually postponed until beyond 2029. In the case of a primary surplus below the 3,0 percent of GDP, debt firstly tends to stabilize and then to increase for lower levels of the primary surplus. In these cases, debt sustainability would not be guaranteed.

Figure A.1-6 Public Debt Sensitivity with respect to primary balance (In percentage of Gdp)



Source: MEF elaborations using the long-term forecast model of the General State Accounting Office

TABLE A.1-3 CONTRIBUTION TO CHANGES IN PUBLIC DEBT

		final					forecast					
		media '00-'08	2009	2010	2011	2012	2013	2014	2015	2016	2017	cumulative
Gross Debt ratio (*)		105,6	116,4	119,3	120,7	127,0	132,9	132,7	129,4	125,0	120,0	
Changes in the debt ratio		-0,8	10,3	2,9	1,4	6,3	5,9	-0,1	-3,4	-4,4	-5,0	-7,0
1)	Primary balance effect (+=deficit)	-2,3	0,8	-0,1	-1,2	-2,5	-2,4	-2,9	-3,7	-4,5	-5,1	-18,5
2)	Snowball Effect	1,3	8,5	2,2	2,8	6,6	6,1	1,5	0,8	0,9	0,8	10,1
	of which:											
	nominal interest rate component	5,1	4,7	4,6	5,0	5,5	5,4	5,4	5,3	5,3	5,1	26,5
	deflator component	-2,5	-2,3	-0,4	-1,6	-2,1	-1,7	-2,5	-2,4	-2,0	-2,0	-10,5
	real interest rate component	-1,3	6,2	-2,0	-0,6	3,1	2,4	-1,4	-2,2	-2,4	-2,3	-5,9
3)	SFA adjustment	0,3	1,0	0,8	-0,2	2,2	2,2	1,2	-0,5	-0,8	-0,7	1,5

(*) gross of the Italian solidarity contribution to the Euro area stability (GLF, EFSF, and ESM).
Source: MEF elaborations.

The pubblication
ITALY'S DRAFT BUDGETARY PLAN 2014
is available to download on the following websites:
www.mef.gov.it
www.rgs.mef.gov.it