Italy
Fiscal stimulus package and Strategies to reduce fiscal deficit

The 3-year budget 2009-2011 adopted in summer 2008

In Italy, the first reaction to the crisis took place in November 2008.

In the previous months, the fiscal measures which had been adopted were unrelated to the crisis and aimed at reducing deficit: the three-year budget approved in August – overall 30 billion euro in the period 2009-2011 - had an impact on net borrowing estimated at 0.6 per cent of GDP in 2009 (1.1 per cent in 2010 and 1.9 in 2011). Compared with a value of 2.5 per cent of GDP in 2008, deficit was expected to be close to balance in 2011 (-0.1 per cent). In the same period debt was expected to decrease from 103 to 95 per cent.

When these decisions were taken, GDP growth projections, though not particularly favourable, were still positive (+0.5% in 2008, +0.9% in 2009 and +1.2% in 2010).

The anti-crisis package

When the crisis exploded in Autumn 2008 and throughout the following year, the Italian Government behaviour was prudent: given the starting position for both deficit and debt, the expansive measures adopted were designed to be neutral on the budget balance.

Therefore the stimulus package introduced in November 2008, which included transfers to low-income households and relief measures for enterprises, was fully financed by revenue increases (mainly by means of the introduction of a voluntary substitute tax on asset re-evaluations) and, to a lesser extent, by means of expenditure cuts.

Following the European Economic Recovery Plan, a second fiscal package was approved in February 2009. It included a car scrapping incentive, financed by closing some tax loopholes.

The additional anti-crisis decree adopted in June 2009 included provisions aimed at strengthening the social safety net and large tax incentives for purchases of machinery in the following 12 months.

While these measures were designed once again to be neutral on the budget balance, the mid-year budget revision in July included temporary boosts to intermediate consumption and public investment, with an impact on public balance of 0.3 per cent of GDP: this was the only deficit-increasing package approved throughout the crisis.

The budget for 2010, approved by the Parliament at the end of December 2009, included expenditure increases financed by an extraordinary tax (the so-called “tax shield”), with an estimated zero effect on the balance.

The effect on the budget balance

<u>Including all actions taken since the summer of 2008</u>, <u>discretionary measures improved the budget balance by 0.3 per cent of GDP in 2009</u> (and by approximately 1.0 per cent in 2010): these data reflect the restrictive measures taken before the crisis exploded, only partly offset by deficit-increasing measures issued in late 2009.

If we take into consideration only the discretionary measures taken since November 2008 to face the crisis, they had an impact on deficit of 0.3 per cent in 2009 (about zero in 2010). Including the retroaction on the budget of their effect on the economy, the result is 0.2 per cent.
At the same time, automatic stabilizers' effects (growth in social payments and contributions and large revenue shortfall) had a larger impact deficit, worsening it by 1.4 per cent of GDP in 2009.

Before considering the macroeconomic impact of the discretionary measures, it must be underlined that the financing side of the Italian stimulus measures was essentially based on two capital taxes, both due on a voluntary basis: a substitute tax on asset revaluations(0.3 per cent of GDP in 2009 and 0,04 per cent in 2010) and a tax on assets held abroad illegally (0.5 per cent of GDP in 2009 and 0.2 per cent in 2010). The recourse to these taxes, compared to more standard revenue increases, limited the negative impact on the consumption and investment, enhancing the overall stimulus of the fiscal package.

The estimated effect on GDP
According to Bank of Italy estimates, the effect on economic activity of discretionary measures was of 0.6 points in 2009 (and broadly zero in 2010). Among them, the car scrapping and the investment incentives were the most effective.
Automatic stabilizers proved to be relatively less effective than discretionary measures, in terms of GDP gain for a given increase in current deficit: given a low value of the fiscal multiplier, the estimated effect on GDP of was 0.3 points.

The 3-year budget 2011-2013 adopted in summer 2010
In summer 2010, as soon as the first signs of economic recovery were clear, Italy adopted a 3-year budget: a deficit correction of 12 billion euro in 2011 (0.8 points of GDP) and almost 25 billion in each of the following two years (1.5 points).
Last official estimates show that deficit passed from 5.4 per cent of GDP in 2009 to 4.6 per cent in 2010. For the current year, the government estimate is 3.9 per cent.
In the following two years, deficit is expected to stabilize at 2.7 per cent of GDP, while for 2014 a further reduction of 0.1 is estimated. Public debt is expected to pass from 119 per cent in 2010 to 116.3 per cent in 2014.

According to the updated Stability Programme that the Italian government should submit to the EU Commission by the 30th of April – after consideration by Parliament – deficit correction measures are to be adopted in order to bring deficit to 1.5 per cent in 2013 and close to balance (-0.2 per cent) in 2014. At the end of the period, debt is expected to be at 112.8 per cent of GDP (112.3 per cent net of aid to Greece and European Financial Stabilization Fund-EFSF up to end of March 2011).

Fiscal trends and budgetary targets
(percentage of GP)

	2008	2009	2010	2011	2012	2013	2014
Trend scenario							
Primary balance	2,5	-0,7	-0,1	0,9	2,4	2,7	2,9
General administration net borrowing	-2,7	-5,4	-4,6	-3,9	-2,7	-2,7	-2,6
Public debt	106,3	116,1	119	120	119,4	118,1	116,3
Programme scenario							
Primary balance	2,5	-0,7	-0,1	0,9	2,4	3,9	5,2
General administration borrowing	-2,7	-5,4	-4,6	-3,9	-2,7	-1,5	-0,2
Public debt	106,3	116,1	119	120	119,4	116,9	112,8

Source: Italian Stability Pact, April 2011

In order not to increase fiscal burden, which is already high (42.6 per cent of GDP in 2010) compared with the other EU countries, the fiscal consolidation (2.3 per cent of GDP in 2013-2014) should concern primary expenditures and, within this aggregate, current expenditures. According to the government, in the following years current expenditures net of interests should reduce their weight on GDP of broadly 4 percentage points. The *expenditure rule* proposed by the EU Committee would therefore be fully implemented. According to the *medium term objective* (MTO), the annual adjustment of the structural balance (budget balance net of cyclical effects and *una tantum* measures) is expected to be 0.5 in 2011 and 0.8 in the following years.

As it results from Parliament hearings, the overall fiscal consolidation path envisaged by the Stability Programme met the consensus of the main Italian Institutions (such as Bank of Italy and *Corte dei conti*), even if a definitive judgment is obviously postponed to the final adoption of the measures. BI also stressed the importance of defining in a short time the above mentioned correction, in order to give a straightforward message to financial markets and avoid further increases in interest rate differentials.

The difficulty of reducing expenditures was also highlighted, given the lack of flexibility of the budget: to this aim, a careful spending review is needed as well as a zero-based budgeting approach.

A reduction of capital expenditures (a bare 2.7 per cent of GDP) should be avoided, while low-cost reforms to enhance productivity could be adopted: a higher potential growth would favour a faster reduction of the debt/GDP ratio and improve the long-term sustainability of public finance.