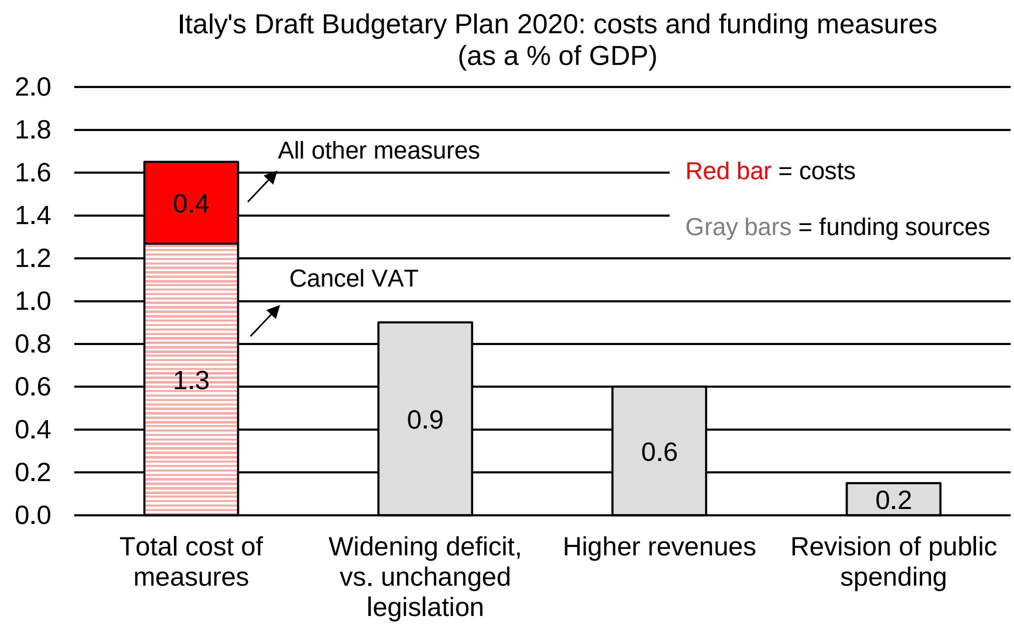
Italy's budget plan: More revenue-raising measures, fewer spending cuts



Source: Italian Ministry of Economy and Finance, UniCredit Research

- Our *Chart of the Week* shows the main features of the Draft Budgetary Plan (DBP) 2020 approved by the Italian government this week and submitted to the European Commission (EC). In its plan, the government confirmed the fiscal targets presented in the Update to the Economic and Financial Document 2019[1], with the budget deficit target in 2020 that has been set at 2.2% of GDP, stable compared to this year. The overall cost of delivering government policy in 2020 has been confirmed at about EUR 30bn or 1.7% of GDP. The greatest loss of anticipated revenue will be due to the repeal of the VAT hike in 2020, EUR 23bn or 1.3% of GDP. This means that EUR 7bn or about 0.4% of GDP will be used next year to start reducing the tax burden, finance public investment and stimulate private investment, and for family policies.

- Half of the funding will come from a higher deficit, resulting in the public deficit widening by EUR 16bn, or 0.9% of GDP, to 2.2% of GDP in 2020, from the deficit target of 1.3% of GDP associated with a scenario in which current legislation does not change (and in which VAT hikes are implemented). The other half of the budget is to be funded by revenue-raising measures in an amount of EUR 11bn or (0.6% of GDP) and by a revision of public spending that is expected to generate about EUR 3bn in savings (0.2%). Among the revenue-raising measures, EUR 3.2bn is expected from combatting fraud and tax evasion. While the government makes an effort in the DBP to detail the expected financial effects of its action, it is clear that the EC is likely to be concerned about the credibility and sustainability of the plan. Revenue-raising measures also include a rationalization of tax expenditure and the revision of tax breaks on environmentally harmful activities (0.1% of GDP), a change in deductibility of deferred tax assets (0.1% of GDP), and additional fiscal revenue in an amount of 0.2% of GDP. The small amount of structural resources coming from the revision of public spending is clearly the weak spot. Viewed optimistically, the lack of spending cuts now could act as a buffer, which can be drawn on should fiscal slippage emerge next spring.

- The EC is expected to provide an opinion on all euro-area countries' DBPs, including Italy, by the end of November (last year, the EC published its opinion on 21 November). However, in the next two weeks, the EC might ask the Italian government for further clarification of the main measures and its decision to target a slight deterioration in the structural budget balance next year. In any case, it is assumed that there will be a constructive dialogue between the Italian government and the EC.

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[1] See "Italy targets 2.2% budget deficit for 2020, paving the way for a constructive dialogue with the EU", *Economics Flash*, 1 October 2019.

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