A STRATEGY FOR FISCAL CONSOLIDATION, GROWTH AND SOCIAL FAIRNESS

Today, December 4, the Italian Council of Ministers approved a decree law laying down a series of fiscal consolidation and growth-enhancing measures which will allow Italy to reach a balanced budget by 2013. The decree law thus ensures a timely and enhanced delivery of the objectives set out in Italy's Update of the 2011 Economic and Financial Document presented in September, which had already been welcomed by European Heads of State and Government at the European Council of 26 October.

Fiscal consolidation measures are mainly of a structural nature and balanced between revenue increases and spending cuts. Growth enhancing measures focus on the business environment, infrastructure spending, liberalisation, deregulation and consumers' protection. They represent the first part of a comprehensive agenda that will fully unfold over the coming months.

The Government's overall strategy is based on three key pillars: fiscal consolidation, economic growth and social equity.

Supplementary fiscal package to balance the budget by 2013

Since mid-September, the global economic outlook has deteriorated. Tensions in financial markets have increased, especially in the Euro Area. Italy's 10-year government bond yield spreads versus German benchmarks have recently hovered between 400 and 500 basis points. Taking into account this worsened external environment, **Italy's macroeconomic scenario** has been revised downwards.

The worsened economic backdrop and higher-than-expected interest payments called for further consolidation to maintain nominal targets unchanged. The Italian Government has thus approved additional permanent fiscal measures to confirm the balanced budget target by 2013 as agreed at European level.

On the expenditure side, key measures concern reduction of the **pension expenditure** and **cuts to local government transfers**. As for pensions, the retirement age of women is increased to 62, and both for women and men will converge to 66 in 2018. The system will be fully harmonised and based on contributions. The savings amount to about €8.5 billion by 2014, and are estimated to increase further in the following years. The changes to the pension system include an indexation freeze in 2012 and 2013, except for the lowest pensions, an overall revision of key parameters of the pension system, including early retirement schemes, and higher social contribution rates for the self-employed.

On the **revenue side**, measures focus on the introduction of a Municipal real estate levy based on property values and local services, higher excise taxes on fuels, tax surcharges on luxury items, taxation on financial assets (including a tax on so-called 'tax shielded' assets) and dismissal of state-owned real estate. In addition, a 2 percentage point increase of VAT rates will be introduced starting from September 2012 to substitute the so-called "safeguard clause" included in the last budget law of August 2011. A number of measures aim at strengthening the fight against tax evasion, including by making compulsory the use of electronic means for payments above €1000. Moreover, parts of the proceeds from the sale of CO_2 certificates will be used to reduce public debt.

The Government accelerated the **process** for introducing in the **Constitution** a balanced budget rule and strengthening the fiscal framework. It made steps towards streamlining the institutional structure, including by eliminating one layer of administration, i.e. the provinces.

Growth enhancing measures to the fore

The strategy for growth will be fully deployed over the next few months and will focus on: (1) **improving the business environment**, (2) **strengthening infrastructure investment**, (3) **enhancing consumers' protection through liberalisation and deregulation**, and (4) tax deductions for hiring female and young workers. The decree law already includes a number of measures in this direction.

Among the key initiatives on **business environment**: (1) companies will receive substantial tax benefits for recapitalisations, (2) reduction of the so called tax wedge on labour, through tax deductions from IRAP, notably in the case of employment of women and young workers (3) re-funding of the guarantee fund for SMEs, (4) redesign and extension of tax incentives on building renovations and energy efficiency investments.

Furthermore, measures are introduced to reduce the administrative burden, especially for hotels, foreign workers, and simplification of waste disposal procedures.

Important measures are introduced to open up product and services market to greater **competition and improve competitiveness**, such as: (1) liberalisation of opening hours for retailers, (2) simplification of requirements for selling pharmaceutical products, (3) streamlining of petrol station regulation, (4) enhancing the effectiveness of the Competition Authority, which is empowered to more effectively contest acts in breach of competition rules, (5) liberalisation of transport sector, (6) sectoral regulation and monitoring for the postal and water sectors attributed to the Communication Authority and Energy and Gas Authority, respectively.

On **infrastructure investment**: (1) concrete steps for supporting strategic infrastructures, (2) measures to increase participation of private capital in public investments, (3) reduction in administrative burden for infrastructure projects, (4) special measures for SMEs in the construction sector, and (5) regional programmes co-financed by EU structural funds.

Background

In July, the Italian Government delivered the planned fiscal adjustment set out in the 2011 Economic and Financial Document (DEF). Budget measures amounted to a cumulative correction of €48 billion and allowed the achievement of close-to-balance net borrowing by 2014, as agreed at European level.

In mid-August, following tensions in financial markets and widening in Italy's government bond yield spreads, the Government introduced a supplementary fiscal package, increasing the cumulative fiscal adjustment to €55.4 billion,

frontloading the adjustment to 2012 and 2013 and balancing the **budget already in 2013**, **one year** earlier than previously expected.

At the beginning of September, the Parliament further strengthened the package. **The resulting overall fiscal adjustment amounted to a cumulative €59.8 billion, i.e. 3.5% of GDP.**