

The contents of this document are preliminary and subject to change.

GRAY/21/1318

May 24, 2021

**Statement by Mr. Palei on Italy
(Preliminary)
Executive Board Meeting
May 26, 2021**

Italy was one of the first countries severely hit by the COVID-19 pandemic. We express our sympathy to the Italian people in their struggle to defeat the virus and to limit the social and economic damage from it. We thank staff and Mr. Fanizza for providing comprehensive information for the Board discussion.

Before the pandemic, two years ago, the economic and financial situation in Italy was featured in the World Economic Outlook as one of the key risks to the euro area and even to the global economy. The economy had not recovered from the Global Financial Crisis and the subsequent euro-area crisis. The Fund's flagship report referred to fiscal policy uncertainty, elevated sovereign spreads, and softening investment in the country. The devastation caused by the pandemic made the situation even worse. Last year the real GDP declined by nearly 9 percent, and the recovery is expected to be protracted and weak. In fact, staff expect the economy to reach its pre-crisis level only in 2023, much later than in most other countries. Staff claimed that the increased investment spending would keep growth well above the previous trend, but we do not see it happening, as the negative effects are likely to be long lasting and the Next Generation EU resources appear to be relatively small and spread over many years. *We would appreciate staff's clarification on the description of growth dynamics in Italy in the following three to five years.*

Moreover, we are concerned that the size of the COVID-19-related shocks in the baseline scenario points to the continuation of worrisome income divergence in the euro area¹. *Could staff provide the chart showing projected income per capita developments for Italy and the euro area economies less damaged by the pandemic?* The divergence between the North and

¹ *Drifting Apart: Income Convergence in the Euro Area*, 2017, by Jeffrey Franks and Hanni Scholermann, <https://blogs.imf.org/2017/09/13/drifting-apart-income-convergence-in-the-euro-area/>

the South may also aggravate institutional challenges in the currency union. *Staff comments would be appreciated.*

In the fiscal area, the 2020 general government deficit was 9.5 percent of GDP, and it is expected to increase almost to 12 percent of GDP this year. Not surprisingly, public debt-to-GDP ratio is likely to jump from about 135 percent to 160 percent. For many years the IMF was preoccupied with the high level of public debt in Italy and consistently called for fiscal consolidation. The current approach seems to be different. We certainly understand and appreciate that the immediate priorities for the authorities should be to protect lives and temporarily maintain the economy, while preserving essential links and providing social protection. At the same time, we believe the Italian authorities are on track to complete the vaccination campaign soon. Hence, their policy dilemma is in the domain of the speed and nature of subsequent adjustment. If we understand the authorities and staff correctly, the strategy is to significantly increase investment spending and resolve the long-standing fiscal issue through more rapid growth.

Higher growth scenario is attractive, but risky. We note that a similar approach was attempted after the euro area crisis, when the authorities in large economies promised through G-20 various packages of structural reforms to support the transition to a higher growth trajectory. For most of them it didn't work well. *What are the reasons for staff and the authorities to believe that this time the implementation of reforms will be different?*

Given this experience and Italy's track record, it would be prudent for the authorities and staff to elaborate on the contingency measures to be introduced in case higher growth expectations do not materialize. *Could staff provide the list of options with their likely yields that could be used to stabilize or even reduce the debt-to-GDP ratio in Italy and offer their understanding of the authorities' views on each of these options?*

The hike in investment spending is overwhelmingly concentrated in infrastructure. At the same time, the report referred to serious gaps in education, digitalization, income distribution, and other areas. *Could staff clarify how the authorities determined their NGEU and other investment spending priorities?*

Finally, *we invite staff to elaborate on the use by the Italian authorities of the Fund's key products, including the Evaluation of Fiscal Transparency, PIMA, two assessments of the SOEs, and others?*