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May 24, 2021

**Statement by Mr. Tanaka, Ms. Kashima, and Mr. Nagase on Italy
(Preliminary)
Executive Board Meeting
May 26, 2021**

We thank staff for the informative report, including the useful Boxes, and Mr. Fanizza for the insightful buff statement. Despite the Italian authorities' prompt and decisive policy responses, together with ECB's accommodative monetary policy, the COVID-19 pandemic has inflicted negative impacts on the Italian economy and the scarring effect could be sizable. We agree with staff's assessment that necessary support to firms and households needs to be continued but in a prudent, well-targeted and calibrated manner, while also steadily tackling the country's long-term challenges including fiscal consolidation and structural reforms. On a separate note, we commend Italy's contributions to the PRGT and the Fund's capacity development activities and welcome its leadership as the 2021 Presidency of the G20 and co-host of the UN Climate Change Conference (COP26). As we broadly concur with the thrust of the staff's assessment, we would like to limit our comments as follows.

Economic Developments and Outlook

Italy faces critical challenges of mitigating the harsh negative impact of the current COVID-19 crisis while ensuring post crisis debt sustainability and longer-term economic growth. The pandemic has caused a huge blow on the Italian economy, especially on its contact-intensive service sector and small companies, and we take note of staff's assessment of larger-than-expected scarring from the pandemic as a downside risk for longer-term growth. We encourage staff to continue to closely monitor the development and provide necessary policy recommendations to the authorities, if needed.

Fiscal Policy

Strategic use of fiscal policy and medium-term debt reduction are needed. In order to tackle the pandemic in a timely manner, effective and efficient use of fiscal expenditure is warranted. At the same time, in light of the high level of public debt which has been exacerbated by the pandemic, it is necessary for the authorities to implement a credible medium-term fiscal strategy to anchor public debt reduction. To this end, the authorities should streamline their policy responses and provide targeted demand stimulus measures. On the revenue side, a comprehensive base-broadening tax reform could facilitate sustainable and inclusive growth by tackling tax evasion and generating additional tax revenue. *In this regard, staff's elaboration on the necessary and desirable tax reforms is welcome.*

Financial Sector Policy

We agree with staff that banks and the authorities need to improve their understanding of underlying loan quality to restore financial health of those firms likely to be profitable in the long-term, while facilitating the exit of unviable firms. To this end, a carefully-designed phase-out of moratoria and guarantee schemes is necessary to avoid renewed liquidity pressures and cliff effects, while also incentivizing banks to prudently improve their monitoring of credit risks and to set aside adequate loan loss provisions for any loan quality deterioration. We also concur with staff's analysis of the need to address structural weaknesses in the banking sector such as improving their profitability and modifying their business models with digital technologies.

Structural Policies

While the temporary labor measures have been effective in protecting workers affected by the pandemic, it is critical to restore turnover in the labor market and facilitate reallocation to new sectors to boost productivity. Thanks to measures taken such as short-time work (STW) programs and a ban on layoffs, overall income and employment loss has been contained, but we take note that these measures have provided less protection to the young and to women. We agree with staff that, once the pandemic abates, the authorities should shift their policies' focus from preserving existing employment contracts to those that encourage firms to resize their work force and increase new hiring. We also welcome the authorities' submission of the National Recovery and Resilience Plan (NRRP) and their intention

to efficiently utilize the resources provided from the Next Generation EU (NGEU) Fund to invest in public infrastructure as well as to support firms' digital and environmentally-friendly initiatives. Adequate execution of resources through good governance of the NRRP is crucial for such investments to be effective in revitalizing the economy.