

**NATIONAL ACCOUNTS AND EUROPEAN STANDARDS.
ANALYSIS OF THE 2015 ECONOMIC AND FINANCIAL
DOCUMENT ACCORDING TO INNOVATIONS
INTRODUCED BY ESA 2010¹**

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1. Introduction

In the absence of a supranational fiscal jurisdiction, fiscal policies in the Member States are coordinated by the European Union (EU) through the implementation of common rules. These rules establish several boundaries for the budget balance and the public debt dynamics. Therefore, the Euro Area Member States are free to decide their fiscal policies within this rules framework.

Because of the Greek sovereign debt crisis that led to the European debt crisis, European policy-makers have decided to guarantee a greater coordination of fiscal policies among the Members States of Economic and Monetary Union (EMU) over the last few years, strengthening surveillance policies on deficit and public debt. Thus, almost all the Member States (except for the United Kingdom and the Czech Republic) implemented the “Treaty on stability, coordination and governance”, the so-called *Fiscal Compact*. It establishes the balanced structural budget and a greater decrease of the debt-to-GDP (Gross domestic product) ratio in the medium term.

Nevertheless, because of enduring financial and economic crisis in several EU Member States in the 2007-2013 period, the obligations of the Stability and Growth Pact (SGP) and the later regulations (such as the Fiscal Compact) have been more and more under discussion among policy-makers, especially with reference to austerity measures. As a result, the economic and financial crisis has led the Member States more in trouble (especially, Southern European countries, including Italy) to ask greater flexibility margins in the implementation of the European standards (ISTAT 2014a).

It should be noted that the European standards have been recently implemented according to the new system of national and regional account ESA 2010. As a

¹ Vincenzo Marinello wrote the Introduction, the Paragraph 3 and the Conclusions; Mariano Cavataio wrote the Paragraph 1 and the Paragraph 2. In any case, this essay is the result of a common commitment by the two Authors.

consequence, the EFD 2015 is the first economic and financial document that makes reference to the estimates in ESA 2010.

After describing the main differences between the previous system of national and regional accounts (ESA 95) and the new system of national and regional accounts (ESA 2010) implemented by the EU countries members and after analyzing the main documents of public finance, the objective of this essay is to examine the last Economic and Financial Document (EFD 2015) in terms of the policy scenario (*programmatic framework*) and the scenario based on unchanged legislation (*tendency framework*), also highlighting the changes introduced by ESA 2010.

2. 1. Differences and peculiarities between ESA 95 and ESA 2010

National accounts are the main tool for measuring the overall economic situation of a country. Thus, they are an essential tool for evaluating, analyzing and forecasting economic phenomena. They are used by public authorities, economic and social operators to find in them important information for their decisions. Moreover, some crucial measurements for the governance of the EU and each Member State (such as the deficit-to-GDP ratio and the debt-to-GDP ratio) are estimated making reference to national accounts.

Within this framework, ESA is the European tool for the measurement of the economic and financial activities of an economic system, its components and the relations between them in a given period of time.

It should be noted that global changes have impacted economies over the last twenty years. As a result, the macro-economic statistics have needed an adaptation to new situation. The most important adaptation has been the updating of the United Nations System of National Accounts (SNA) which sets guidelines national accounts worldwide. Therefore, all the countries have passed from the SNA 1993 version to the current SNA 2008 throughout the last few years. Likewise, the same has been happened for the new ESA 2010 which is consistent with the SNA 2008 guidelines, although with several adaptations concerning the data presentation and with a higher level of precision in defining several concepts, especially those used for specific purposes by the EU.

In September 2014, ISTAT published the results of the revision of national accounts in accordance with the new ESA. Therefore, the switch to a new version of accounting standards (from ESA 95 to ESA 2010) led to a large revision of methodologies and information sources in order to better estimate the main aggregates of National Accounting (see Eurostat 2013). Within this revision process, the fiscal year 2011 was defined as *benchmark* year. Thus, the values of

all items included in the accounts were redefined for 2011. Starting from the new levels of the aggregates, a diachronic reconstruction of the time series revised back to 1995 onwards was carried out.

In the main, several innovations have been introduced by the new ESA, starting from the improvement of the timeliness of data transmission to the Statistical Office of the European Commission (Eurostat) and the timeliness of national dissemination (see Eurostat 2014).

Moreover, ESA 2010 changes the way in which research and development (R&D) expenditure and weapon systems expenditure are recorded. They are no longer considered as intermediate consumption expenditure, but as expenditure for investments (in terms of gross fixed capital formation).

In addition, the new ESA changes significantly the estimate of flows of goods and services in international trade, albeit with an almost null net effect on the trade balance (and consequently on GDP).

Contrary to ESA 95, the new ESA establishes the inclusion of illegal activities estimates in national accounts (and therefore in GDP). The illegal activities considered by ESA 2010 are trade in narcotic drugs, prostitution and smuggling (alcohol and tobacco). This methodological innovation is consistent with Eurostat guidelines.

Furthermore, the list of corporations belonging to General Government is revised in order to improve their recording in national accounts. This innovation has an impact, although limited, on public consumption expenditure and on General Government net borrowing.

Finally, it should be also noted that the treatment of super dividends paid by public corporations is clarified better in order to improve the measurement of the elements that affect public debt. Moreover, the treatment of public-private partnerships is defined for the first time and this innovation has several implications on government account with reference to deficit and debt.

On the whole, ESA 2010 has introduced several innovations and improvements in national accounts. These changes have implied an impact on the estimate on macroeconomic variables.

As regards the new national accounts estimates for the benchmark year 2011, GDP has been revaluated for a value of EUR 58.9 billion (with a corresponding revaluation to 3.7%) compared to the ESA 95 estimates (Tab. 1).

In other words, the revision of economic aggregates for 2011 can be decomposed in three main components.

First, a contribute to the revaluation of the nominal GDP for 1.5 percentage points (equal to EUR 24.3 billion) has been due to the defining modifications introduced by ESA 2010 at the methodological level. Within this revaluation, the main share is attributable to the capitalization of R&D expenditure.

Second, another part of revision is due, for further 0.8 percentage points (equal to EUR 12.6 billion) to the changes related to the overcoming of European reservations on the implementation of ESA 95. These changes also include some illegal activities (narcotics, prostitution and smuggling).

Table 1 – *GDP and expenditure components for fiscal year 2011: revisions by typology between ESA 2010 estimates and ESA 95 ones (data in percentage of GDP)*

Typology	Revaluation compared to ESA 95 estimates	Defining modificatio ns	Of which Overcoming of European reservations	Other (sources/ methods)
Imports of goods and services	-2.0	-2.5	0.2	0.3
Final national consumptions expenditure	3.1	-0.1	1.2	2.0
Gross capital formation	7.2	8.5	-0.6	-0.7
Exports of goods and services	-2.9	-2.8	0.0	-0.1
GDP at market prices	3.7	1.5	0.8	1.4

Source: Our elaboration of data from ISTAT (2014b)

Third, the remaining share of the revaluation, corresponding to 1.4 percentage points (equal to EUR 22 billion), comes from the combination of several effects related to innovations in information sources and methodologies. Within this revaluation, there is the inclusion of the new estimate of the underground economy which in 2011 accounts for 11.5% of GDP (corresponding to EUR 187 billion). The overall amount of this component and of the illegal activities one leads to the wider definition of non-observed economy (NOE) that is equal to 12.4% of GDP in 2011 (ISTAT 2014b).

However, the inclusion of illegal economy in national accounts estimates has involved a strong debate among economists with reference to ESA 2010.

According to its supporters, the new ESA has the merit of providing macroeconomic statistics that are more updated and more consistent with the new economic and financial context. On the contrary, its detractors claim that ESA 2010 improves significantly the deficit-to-GDP ratio and the debt-to-GDP ratio, being successful where economy fails (Centorrino, David and Gangemi 2014).

Ultimately, the new ESA leads to a revaluation of GDP. Nevertheless, ISTAT (2014b) highlighted that over the period between 1995-2013 the annual rates of change concerning GDP at market prices have deviated only 3 tenth of a point compared to the previous series. Thus, the annual average rate of change remains unchanged compared to the previous estimates (+2.8%). Furthermore, over the period between 1995 and 2013 the annual average growth of GDP expressed in volume values has resulted unchanged compared to previous estimates (+0.5%).

Likewise, the annual rates of change have undergone revisions much more limited than those related to GDP, with a restricted deviation of 0.2 percentage points.

Table 2 – *Revision of estimates concerning the main aggregates of the General Government for fiscal year 2011: ESA 2010 vs. ESA 95 (data in billion Euro at current prices and in percentage of GDP)*

Aggregates	ESA 2010 estimates (September 2014)*	ESA 95 estimates (March 2014)	Revisions
Current balance	-5.8	-21.1	15.3
Capital account balance	-51.0	-38.0	-13.0
Primary balance	19.6	19.3	0.3
Primary balance/GDP (%)	1.2	1.2	0.0
Fiscal burden (%)	41.6	42.5	-0.9
Net borrowing	-56.8	-59.1	2.3
Net borrowing/GDP (%)	-3.5	-3.7	0.2

Note: * Preliminary data

Source: Our elaboration of data from ISTAT (2014c)

On the whole, the reconstruction of the time series revised back to 1995 onwards does not show strong differences concerning GDP and its components. After all, considering the *benchmark* of ESA 2010, that is year 2011, the revision of the deficit-to-GDP ratio has been limited, with a restricted impact of EUR 2.3 billion (Tab. 2).

3. EFD and other public finance documents

The EFD is the first economic and financial document based on the estimates in ESA 2010 instead of ESA 95. It contains the objectives of economic policy for the subsequent triennium.

According to Law No. 39/2011, the EFD is submitted by the Cabinet to Parliament by 10 April of every year. It is composed of three sections and some attachments. Two of the sections– the Stability Program and the National Reform Program (NRP) – are transmitted to the Council of the European Union and the European Commission by the end of April of every year.

Another planning document is the “Updated Note of the EFD”. It is submitted to Parliament by 20 September of every year in order to update the economic and public finance forecasts on the basis of more stable information available on the performance of the macroeconomic situation (for which data are available on the first two quarters of the year) and public finance compared to estimates used in the EFD. Furthermore, the Updated Note contains the revision of economic policy targets and economic and public finance forecasts according to recommendations

adopted by the Council of the European Union concerning to the Stability Program and the NRP. In turn, the “Report to revise the Updated Note of the EFD” updates the programmatic objectives of public finance detailed in the Updated Note.

An additional tool of public finance is the “Draft Budgetary Plan” (DBP) in accordance with the EU Regulation No. 473/2013. It is submitted by the Member States to the European Commission and the Eurogroup by 15 October of every year. The DBP contains an update of the estimates indicated in the previous Stability Program. It illustrates to European Institutions a summarized and standardized version of draft budget for the following year.

On the whole, the EFD, the Update Note of the EFD, the Report to revise the Updated Note of the EFD and the DBP are the main public finance documents.

In the main, the public finance documents contain the economic and financial policies defined by the Cabinet. The elaboration of these policies and forecasts implies a long process which involves all the departments of the Ministry of the Economy and Finance. After all, over the last ten years planning documents have played more and more a key role in providing detailed information on the economic policy action taken by the Cabinet and in ensuring its transparency. They set out the Cabinet’s objectives and the tools used to achieve them. Moreover, as a result of the ongoing European integration process and the serious financial crisis that has hit Europe in the last few years, national economic and fiscal policies are now more coordinated. This has significantly changed the structure of the public finance documents as well as the deadlines for submitting them. Nevertheless, these programmatic documents have been criticized in recent years. According to several experts, they would tend to point out excessively optimistic estimates (e.g. those concerning GDP growth forecasts and unemployment rate forecasts), risking to generate later disillusion as happened in the fiscal year 2014.

4. Characteristics and peculiarities of the EFD 2015

Despite the enduring financial crisis in Greece, the EFD 2015 takes account of the favorable trend of the macroeconomic scenario (thanks to the ECB’s Quantitative Easing, the steep Euro depreciation and the strong decrease in oil prices), making upward revisions to growth estimates for Italy compared to the previous public finance documents (starting from the Updated Note of the EFD 2014).

The policy scenario contemplated by the EFD 2015 indicates the return to growth after a long period of recession, starting from the current year. It provides for an increase of GDP equal to 0.7% in 2015, followed by increases which may reach over 1% in the subsequent years, although the programmatic growth

forecasts remain below the European average considering the period between 2015 and 2019. However, Renzi's Cabinet evaluates that this gap should reduce in the next years, moving from 0.9 percentage points in 2015 to 0.4 percentage points in 2019 (Tab. 3).

Table 3 – *Differences on the growth forecasts based on policy scenario, 2014-2019. Italy compared to the EU average*

<i>Fiscal year (FY)</i>	<i>GDP EU 28</i>	<i>GDP Italy</i>	<i>Difference</i>
2014	1.3	-0.4	0.9
2015	1.6	0.7	0.9
2016	2.0	1.4	0.6
2017	1.9	1.5	0.4
2018	1.8	1.4	0.4
2019	1.7	1.3	0.4

Source: Our elaboration of data from EFD 2015 (MEF 2015a)

The net borrowing targets indicated in the DBP 2015 for the 2015-2018 period are confirmed, respectively equal to 2.6% of GDP in 2015, 1.8% in 2016 and 0.8% in 2017, reaching zero balance in 2018. A nominal surplus of 0.4% of GDP is expected in 2019. These trends are possible because the Cabinet estimates a progressive increase of the primary surplus in nominal terms which should reach 4% in 2019 (Tab. 4). These forecasts are in line with the trends in the last few years. Indeed, Italy recorded in the 2008-2012 period an accumulated primary surplus equal to around 5.4% of the GDP 2012, against an average deficit of 7.4% in the Euro Area (ISTAT 2014a).

The estimates on the public debt (compared to the GDP) foresee a growth in 2015 (from 132.1% to 132.5%), decreasing significantly in the two years thereafter (130.9% and 127.4%), also thanks to the contribution of the privatizations provided for the Cabinet. On the whole, the debt-to-GDP ratio should decrease from 2016, ensuring in 2018 the full respect of the debt rule provided by national and European regulations.

It should be noted that, according to the programmatic estimates of the Cabinet (that have been criticized by the opposing parties), a decreasing profile of fiscal burden would be envisaged in the next years, net of the accounting classification of the personal income-tax bonus of EUR 80. Nevertheless, according to the General Government account at unchanged legislation, the fiscal burden trend at current legislation is considerably different compared to the programmatic estimates defined by the Cabinet. Therefore, tax burden is projected to remain unchanged at 43.5% in 2015 compared to 2014, and then to rise to 44.1% in 2016 and 2017, before falling back to 43.7% in 2019 (Tab. 4). On the whole, a significant discrepancy is recognized among the programmatic estimates shown in the policy

scenario and the tendency estimates shown in the scenario at unchanged legislation. Compared to the scenario at unchanged legislation, Renzi's Cabinet foresees a higher reduction of fiscal burden, especially in the 2016-2019 period. This divergence of estimates is a typical characteristic that is also observable in the EFD of the previous years, mainly concerning tax burden that is a salient topic for the public opinion.

Table 4 – *Macroeconomic framework based on policy scenario and scenario concerning unchanged legislation, 2014-2019 (data in percentage of GDP)*

<i>Public finance indicators</i>	<i>FY</i>	<i>Policy scenario</i>	<i>Scenario based on unchanged legislation</i>	<i>Difference*</i>
GDP	2014	-0.4	-0.4	0.0
	2015	0.7	0.7	0.0
	2016	1.4	1.3	-0.1
	2017	1.5	1.2	-0.3
	2018	1.4	1.1	-0.3
	2019	1.3	1.1	-0.2
Net borrowing	2014	-3.0	-3.0	0.0
	2015	-2.6	-2.5	-0.1
	2016	-1.8	-1.4	-0.4
	2017	-0.8	-0.2	-0.6
	2018	0.0	0.5	-0.5
	2019	0.4	0.9	-0.5
Primary balance	2014	1.6	1.6	0.0
	2015	1.6	1.7	0.1
	2016	2.4	2.8	0.4
	2017	3.2	3.8	0.6
	2018	3.8	4.3	0.5
	2019	4.0	4.6	0.6
Fiscal burden	2014	43.1	43.5	0.4
	2015	42.9	43.5	0.6
	2016	42.6	44.1	1.5
	2017	42.1	44.1	2.0
	2018	41.9	44.0	2.1
	2019	41.6	43.7	2.1
Public debt	2014	132.1	132.1	0.0
	2015	132.5	132.4	-0.1
	2016	130.9	130.3	-0.6
	2017	127.4	127.2	-0.2
	2018	123.4	123.7	0.3
	2019	120.0	120.2	0.2

Note: * Estimates based on scenario concerning unchanged legislation – Estimates based on policy scenario

Source: Our elaboration of data from EFD 2015 (MEF 2015a)

On the whole, the changeover to the new methods of ESA 2010 has represented an important change in the estimates of the EFD 2015 compared to the EFD 2014,

and has entailed a significant revision in the final figures for economic and public finance aggregates and a carryover effect with respect to later years. Thus, the EFD 2015 implements these changes.

For instance, public investment amounted to 2.2% of GDP in 2014, decreasing by 0.2 percentage points compared with 2013. Nonetheless, according to the EFD 2015, the new estimates point out an increase of 0.6 percentage points over the 2014 EFD forecast, mostly attributable to the reclassification of R&D and armaments expenditure from intermediate consumption to gross fixed investment, as provided by ESA 2010. The trend of the next few years indicates a significant recovery of public investment, with growth of 1.9% in 2015 and 4.5% in 2016. In turn, following the introduction of the new national accounting criteria concerning net lending/borrowing of the General Government, the accounting treatment of interest linked to transactions in financial derivatives instruments – as defined by Excessive Deficit Procedure (EDP) – has been aligned with that of ESA 2010. In addition, after decreasing in 2013, interest expenditure fell further in 2014 (and in 2015), due in part to gradually declining interest rates. However, this decline also reflects the exclusion of the flows originating from transactions in financial instruments for the purpose of the EDP, as provided by the new accounting criteria of ESA 2010. Finally, the national accounting data for GDP, pension expenditure, expenditure on social safety nets and healthcare expenditure have been developed on a basis consistent with ESA 2010. Therefore, for the 2015-2019 period, the values are in line with those underlying the forecast of the public finance framework regarding the EDF 2015 (MEF 2015a).

5. Discussion and conclusions

The EFD 2015 is the first economic and financial document based on the estimates in ESA 2010 instead of ESA 95. As a result, for the EFD 2015, the main reference framework is the revised time series by ISTAT according to new ESA.

This series changes the forecasts for interest expenditure, intermediate consumption expenditure, expenditure for investments and other types of expenditure (MEF 2015a).

Regardless of these methodological innovations, the last EFD revises the growth forecasts of the GDP and the other variables of the Italian macroeconomic framework compared to the Updated Note of the EFD 2014, envisaging a clear direction of change in the economic and financial situation of the country with a positive change for the GDP (+0.7%) after three years of recession, implementing – in turn – an economic policy supporting a more decisive growth in the subsequent three-year period.

According to Renzi's Cabinet, responsible fiscal policy – that is favorable to growth – will ensure the confidence of the markets. In addition, keeping favorable expectations will reinforce growth, and therefore, the long-term sustainability of the public finances.

With a view toward facilitating the process of economic recovery, in 2016 the Cabinet intends to make use of Europe's clause for structural reforms to allow for flexibility with respect to public finances. As a result, the path toward improvement of the structural balance would be more gradual, with the achievement of a balanced budget in structural terms in 2017.

On balance, the EFD 2015 provides two series of forecasts: one series based on unchanged legislation (tendency framework) and another series based on the policy scenario (programmatic framework). The latter incorporates the impact of the economic policies outlined in the Stability Program and in the RNP. Fiscal policies are considered as a whole in the forecasts.

Comparing the scenario based on unchanged legislation with the policy scenario, there are not any considerable percentage gaps referring to the main public finance indicators, although the scenario based on unchanged legislation foresees a lesser growth of GDP, a greater reduction of public debt², a higher primary balance and a lower net borrowing in the 2015-2019 period. However, the percentage differences referred to the fiscal burden trend are significant (Tab. 4). As a result, these gaps have caused a strong debate among political parties.

After all, the presentation of the EFD is followed by animated controversies every year. The Cabinet and the governing parties affirm to propose prudent and realistic estimates. On the contrary, the opposing parties charge the Cabinet with presenting excessively optimistic estimates which do not take account of the macroeconomic situation.

Moreover, the problem of forecast mistakes appears important, given that the estimates contained in the EFD have been revealed erroneous in the last few years. Nevertheless, Renzi's Cabinet has been prudent in pointing out the estimates defined in the EFD 2015. Indeed, the targets for 2015 (and the years thereafter) have been revised in the Updated Note of the EFD in September 2015 to reflect a more positive scenario, indicating an increase of GDP equal to 0.9% (instead of 0.7%) in 2015 in terms of both scenario policy and scenario based on unchanged legislation (MEF 2015b). The Cabinet does not exclude that it may be possible to indicate a higher growth rate in the next few months, and that would offer greater margins for the reduction of the tax burden (MEF 2015a).

In the main, during the recessive phases every government – presenting more optimistic estimates – does not intend to affect negatively the economic agents'

² Except for the fiscal years 2018 and 2019.

sentiment. In contrast, during the expansionary phases the cost to be too optimistic becomes higher than the cost to be prudent and conservatives. Therefore, if Renzi's Cabinet expectations will reveal to be exact, it will be possible to assist to several revisions about the forecasts for economic growth in the next few months. Generally, these revisions do not necessarily depend on insufficient economic analyses, but rather on the choices of economic policy authorities which are worried about the public opinion reactions in relation to the incongruity between forecast and realization. An explanation for forecast mistakes may be given by other reasons which have anything to do with economy but rather with searching of consensus (Favero 2015).

Regardless of political controversies and forecast mistakes, the EFD establishes the macroeconomic settings of the Stability Law. These settings give coherence to the public finance decisions.

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SUMMARY

National Accounts and European Standards. An analysis of the 2015 Economic and Financial Document according to innovations introduced by ESA 2010

After describing the main differences between the previous system of national and regional accounts (ESA 95) and the new system of national and regional accounts (ESA 2010) implemented by the EU countries members and after analyzing the main documents of public finance, the aim of this essay is to examine the innovations introduced by the last Economic and Financial Document (EFD 2015) in terms of the policy scenario (*programmatic framework*) and the scenario based on unchanged legislation (*tendency framework*).

On the whole, the EFD 2015 – the first economic and financial document based on the estimates in ESA 2010 instead of ESA 95 – revises the growth forecasts of the GDP and the other variables of the Italian macroeconomic framework compared to the Updated Note of the EFD 2014. The policy scenario indicates the return to growth in 2015 after a lengthy period of recession, implementing an economic policy supporting a more decisive growth in the subsequent three-year period.

However, the presentation of the EFD is followed by strong controversies every year. The Cabinet and the governing parties affirm to propose prudent and realistic estimates. On the contrary, the opposing parties charge the Cabinet with presenting excessively optimistic estimates which do not take account of the macroeconomic trends.