EUROPEAN COMMISSION

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Recommendation for a

COUNCIL OPINION

on the updated stability programme of Italy, 2009-2012

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The 2005 reform of the Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Stability and Growth Pact, stipulates that each Member State has to submit, to the Council and the Commission, a stability or convergence programme and annual updates thereof. Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes.

In accordance with the Regulation, the Council delivered an opinion on the first stability programme of Italy on 8 February 1999 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. As regards updated stability and convergence programmes, the Regulation foresees that these are assessed by the Commission and examined by the Committee mentioned above and, following the same procedure as set out above, the updated programmes may be examined by the Council.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the stability programme of Italy, submitted on 28 January 2010, and has adopted a recommendation for a Council Opinion on it.

In order to set the scene against which the budgetary strategy in the updated stability programme is assessed, the following paragraphs summarise:

(1) the Commission Communication of 26 November 2008 ("A European Economic Recovery Plan");

(2) the conclusions of the Economic and Financial Affairs Council of 20 October 2009 on the "Exit strategy";

(3) the country's position under the corrective arm of the Stability and Growth Pact (excessive deficit procedure);

(4) the most recent assessment of the country's position under the preventive arm of the Stability and Growth Pact (summary of the Council Opinion on the previous update of the stability programme).

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[1] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text are available at: http://ec.europa.eu/economy_finance/sgp/index_en.htm.

2.1. The Commission Communication of 26 November 2008 ("A European Economic Recovery Plan")

In view of the unprecedented scale of the global crisis that hit financial markets and the world economy in 2008-2009, the European Commission called for a European Economic Recovery Plan (EERP)[2]. The plan proposed a co-ordinated counter-cyclical macro-economic response to the crisis in the form of an ambitious set of actions to support the economy consisting of (i) an immediate budgetary impulse amounting to € 200 bn. (1.5% of EU GDP), made up of a budgetary expansion by Member States of € 170 bn. (around 1.2% of EU GDP) and EU funding in support of immediate actions of the order of € 30 bn. (around 0.3 % of EU GDP); and (ii) a number of priority actions grounded in the Lisbon Strategy and designed to adapt our economies to long-term challenges, continuing to implement structural reforms aimed at raising potential growth. The plan called for the fiscal stimulus to be differentiated across Member States in accordance with their positions in terms of sustainability (or room for manoeuvre) of government finances and competitive positions. In particular, for Member States with significant external and internal imbalances, budgetary policy should essentially aim at correcting such imbalances. The plan was agreed by the European Council on 11 December 2008.

2.2. The conclusions of the Economic and Financial Affairs Council of 20 October 2009 on the "Exit strategy"

Following the halt of the sharp decline in economic activity and first signs of a recovery from the crisis, the stabilisation of financial markets and the improvement in confidence, the Council concluded on 20 October 2009 that, while in view of the fragility of the recovery it was not yet time to withdraw the support governments provided to the economy and the financial sector, preparing a coordinated strategy for exiting from the broad-based policies of stimulus was needed. Such a strategy should strike a balance between stabilisation and sustainability concerns, take into account the interaction between the different policy instruments, as well as the discussion at global level. Early design and communication of such a strategy would contribute to underpinning confidence in medium-term policies and anchor expectations. Beyond the withdrawal of the stimulus measures of the European Economic Recovery Plan, substantial fiscal consolidation was required in order to halt and eventually reverse the increase in debt and restore sound fiscal positions. Increasing the efficiency and effectiveness of public finances and the intensification of structural reform were desirable even in the short term as they would contribute to fostering potential output growth and debt reductions.

The Council agreed on the following principles of the fiscal exit strategy: (i) the strategy should be coordinated across countries in the framework of a consistent implementation of the Stability and Growth Pact; (ii) taking country-specific circumstances into account, timely withdrawal of fiscal stimulus was needed; provided that the Commission forecasts continued to indicate that the recovery was strengthening and becoming self-sustaining, fiscal consolidation in all EU Member States should start in 2011 at the latest; (iii) in view of the challenges, the pace of consolidation should be ambitious, in most countries going well beyond the benchmark of 0.5% of GDP per annum in structural terms; and (iv) important flanking policies to the fiscal exit would include strengthened national budgetary frameworks for underpinning the credibility of consolidation strategies and measures to support long-term

[2] Communication from the Commission to the European Council of 26 November 2008.

fiscal sustainability; in addition, structural reform efforts should be strengthened to enhance productivity and to support long-term investment. The Council agreed that these elements should be reflected in the stability and convergence programmes, to be transmitted by Member States to the Commission by the end of January 2010.

2.3. The excessive deficit procedure for Italy

On 2 December 2009 the Council adopted a decision stating that Italy had an excessive deficit in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU). At the same time, the Council addressed a recommendation under 126(7) TFEU specifying that the excessive deficit had to be corrected by 2012.

In particular, Italy was recommended to bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the Italian authorities should implement the budgetary measures in 2010 as planned in the three-year fiscal package for 2009-2011 approved in summer 2008 and confirmed in the Economic and Financial Planning Document for 2010-2013 updated in September 2009. They should also ensure an average annual fiscal effort of at least 0.5 percentage point of GDP over the period 2010-2012. This should also contribute to bringing the government gross debt ratio back on a declining path that approaches the 60% of GDP reference value at a satisfactory pace by restoring an adequate level of the primary surplus. Furthermore, the Italian authorities should specify the measures that are necessary to achieve the correction of the excessive deficit by 2012, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected. In addition, the Italian authorities should seize any opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio towards the 60% of GDP reference value. The Council established the deadline of 2 June 2010 for the Italian government to take effective action to implement the fiscal measures in 2010 as planned and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

The Italian authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes prepared between 2010 and 2012.

2.4. The assessment in the Council Opinion on the previous update

In its opinion of 10 March 2009, the Council summarised its assessment of the previous update of the stability programme, covering the period 2008-2011, as follows. The Council considers "that fiscal policy and the economic recovery package for 2009 are in line with the European Economic Recovery Plan (EERP) and can be regarded as adequate in view of the very high debt ratio. Reflecting the strong economic downturn associated with the financial crisis, the headline deficit is expected to increase significantly in 2009 to above the 3% of GDP reference value. In 2010 and 2011, the programme foresees an expenditure-based adjustment, which would bring the deficit just below 3% of GDP in 2011. However, the achievement of the deficit targets throughout the programme period might be hampered as economic growth could be even lower than planned. In addition, possible slippages in the implementation of the planned restraint in primary expenditure may materialise, even though the improved fiscal framework enhances the conditions for fiscal discipline and spending

efficiency. The debt ratio is set to increase from 104.1% of GDP in 2007 to over 111% of GDP by the end of programme period. The gross debt ratio might increase further also as a result of possible capital injections into the banking sector. Finally, important structural weaknesses still hamper sustained productivity growth in Italy and weigh on its external competitive position, while the current composition of social spending is not supportive of adjustment in the labour market." In view of this assessment, the Council invited Italy to: "(i) implement the planned fiscal policy for 2009 and carry out with determination the adjustment path planned over the programme period in order to set the very high debt ratio on a steadily declining path and ensure the long-term sustainability of public finances; (ii) continue the progress made to improve fiscal governance and the work on a new framework for fiscal federalism that ensures the accountability of local governments and underpins fiscal discipline; (iii) pursue efforts to improve the quality of public finances by focussing on spending efficiency and composition, also by reallocating social expenditure so as to create room for a more comprehensive and uniform unemployment benefit system that ensures appropriate work incentives and effective activation policies, without compromising the fiscal consolidation process."

COUNCIL OPINION

of [22 April 2010]

on the updated stability programme of Italy, 2009-2012

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[3], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [22 April 2010] the Council examined the updated stability programme of Italy, which covers the period 2009 to 2012.

(2) While the low indebtedness of the household sector and a relatively solid financial sector have provided some shelter from the global financial crisis, deep-seated structural weaknesses giving rise to unsatisfactory productivity growth had weakened the Italian economy long before the global downturn. After having contracted for five quarters, GDP rebounded in the third quarter of 2009, but declined again slightly in the fourth quarter. The recession has taken its toll on the labour market with a lag: in 2009, its impact materialised more in terms of hours worked than of headcount employment, with many workers, in particular in the hardest hit manufacturing sector, accessing the wage supplementation fund to complement their salary for the fewer hours worked. The government's policy response to the crisis was constrained by Italy's fragile public finances, in particular its very high government debt, in a context of increased risk aversion. Since the last quarter of 2008, the government approved several measures to shore up the stability of the financial sector, restore confidence and offer relief to distressed firms and households. According to the government's estimates, the recovery measures were fully financed by redeploying existing funds and increasing revenues, with no effect on the deficit. Notwithstanding the government's prudent fiscal stance, the impact of the economic downturn on the Italian public finances has been significant. The government deficit ratio doubled between 2008 and 2009, to 5.3% of GDP (confirmed in the statistical office's estimate released on 1 March 2010). This, in conjunction with the very high government debt ratio, led

3 OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/sgp/index_en.htm

to the Council deciding that Italy was in excessive deficit on 2 December 2009, with a deadline for the correction of this situation by 2012. Besides fiscal consolidation, which is a condition to keep public finances on a sustainable path, the key challenge for Italy's economic policy in the coming years will be to foster a swift and durable recovery in productivity growth so as to restore competitiveness and raise the country's low potential GDP growth. Far-reaching structural reforms are key to addressing the productivity challenge. In addition, restoring competitiveness in the short term also requires ensuring that wage developments are aligned with productivity developments.

(3) Although much of the observed decline in actual GDP in the context of the crisis is cyclical, growth in potential output will resume from a lower starting point. In addition, the crisis may also affect potential growth in the medium term through lower investment, constraints in credit availability and increasing structural unemployment. Moreover, the impact of the economic crisis will coincide with the negative effects of demographic ageing on potential output and the sustainability of public finances. Against this background it will be essential to accelerate the pace of structural reforms with the aim of supporting potential growth. In particular, for Italy it is important to undertake reforms in the areas of market competition, business environment, quality of public services and labour market functioning, including the reallocation of social expenditure towards a more comprehensive and uniform unemployment benefit system.

(4) The macroeconomic scenario underlying the programme envisages that real GDP will return to positive growth of 1.1% in 2010, from -4.8% in 2009 (-5% according to the statistical office's estimate released on 1 March 2010), and accelerate to a rate of 2% over the rest of the programme period. Assessed against currently available information[4], this scenario appears to be based on favourable growth assumptions. The programme's projections for inflation appear realistic. The projections for employment growth and the unemployment rate are more favourable than in the Commission services' autumn 2009 forecast, consistent with the programme's higher real GDP growth projections.

(5) The programme estimates the general government deficit in 2009 at 5.3% of GDP. The significant deterioration from a deficit of 2.7% of GDP in 2008 reflects to a large extent the impact of the crisis on government finances. Several recovery packages were adopted in line with the European Economic Recovery Plan (EERP), together amounting to around 0.7% of GDP in 2009 and, according to the authorities, fully financed by redeploying existing funds and additional revenues. According to the programme, fiscal policy is planned to turn mildly restrictive already in 2010, and more significantly so in 2011 and 2012, with a view to correcting the excessive deficit by 2012. This is broadly in line with the exit strategy advocated by the Council, also taking into account the very high government debt ratio.

(6) For 2010 the programme plans a 0.3 pp. of GDP reduction in the general government deficit, to 5.0% of GDP, which taken at face value can be regarded as broadly in line with the Council recommendations under Article 126(7) of 2 December 2009. The revenue-to-GDP ratio is set to fall by 0.5 pp., also because of the expiry of the one-off

[4] The assessment notably takes into account the Commission services' autumn 2009 forecast and February 2010 interim forecast, but also other information that has become available since then.

revenue-increasing measures impacting on 2009. The expenditure-to-GDP ratio is planned to fall more significantly, by 0.8 pp. of GDP, mainly thanks to the expenditure restraint adopted with the fiscal package for 2009-2011 approved in summer 2008. This is visible in the slowing of primary expenditure growth, which is set to increase by just 0.6% in 2010, also through the fall in public investment after the acceleration in 2009. The 2010 budget itself contains few substantial measures beyond those planned in the fiscal package for 2009-2011 approved in 2008, and, according to the authorities, has a neutral impact on the budgetary position. It contains some new expansionary measures, amounting to around 0.4% of GDP, directed at supporting low-income workers and ensuring the funding of additional health and social expenditure, as well as of military missions abroad. The main source of financing is represented by the one-off revenues from the extraordinary tax on illegally expatriated assets – scudo fiscale – recorded in 2009 (0.35% of GDP) as its positive outturn gave rise to the decision, made in the budget for 2010, to postpone from 2009 to 2010 the collection of some income taxes estimated at 0.25% of GDP. The additional expansionary measures imply some deviation from the recommendations for 2010, although it has to be recognised that these are of a small amount and, according to the authorities' estimate, fully financed thanks to the reshuffling of the one-off proceeds of the scudo fiscale. After worsening by ¼ pp. of GDP in 2009, the structural balance, i.e. the cyclically-adjusted balance net of one-off and other temporary measures, according to the commonly agreed methodology is set to improve by ½ pp. of GDP in 2010 mainly thanks to expenditure restraint.

(7) The main aim of the programme's medium-term budgetary strategy is to reduce the deficit below the 3% of GDP deficit reference value by 2012, the deadline for the correction of the excessive deficit set by the Council, with deficit targets set at 3.9% of GDP in 2011 and 2.7% of GDP in 2012. To reach the targets, the government envisages an additional consolidation effort, beyond that already adopted with the fiscal package for 2009-2011, amounting to 0.4 pp. of GDP in 2011 and a further 0.8 pp. in 2012. No information is provided on the broad measures behind this additional consolidation, which hampers the assessment of the overall composition of the planned adjustment. The primary balance is planned at 1.3% of GDP in 2011, and 2.7% in 2012. The planned annual consolidation amounts to ½ pp. of GDP in 2011 and ¾ pp. in 2012 in structural terms. The budgetary adjustment over the programme period thus appears to be back-loaded. The programme confirms the commitment to the medium-term objective (MTO), which is a balanced budgetary position in structural terms[5]. In view of the new methodology and given the most recent projections and debt level, the MTO reflects the objectives of the Pact; however, the programme does not envisage achieving it within the programme period.

(8) Overall, the budgetary outcomes could be worse than targeted in the programme. This possibility increases in the outer years of the programme period. First, real GDP growth could be lower than assumed in the programme for the whole period 2010-2012. In this context, the sensitivity analysis carried out in the programme indicates

[5] The country-specific MTOs should take into account three components: i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure.

that a 0.5% lower annual GDP growth over the programme horizon would imply a 0.7 pp. of GDP higher headline deficit by 2012 (3.4% of GDP vs. the 2.7% target) and, due to the implications for potential growth, a ½ pp. smaller overall structural adjustment over the period 2010-2012. Second, in 2010 the above-mentioned tax postponement from 2009 may yield less than the budgeted 0.25% of GDP. The measure was in fact adopted just before the tax payment deadline, implying that several taxpayers might have already paid the due amount. Third, the budgetary targets for 2011 and 2012 rely on the specification and implementation of further consolidation efforts but the programme does not spell out the broad measures behind this planned additional adjustment relative to the trend scenario based on unchanged legislation presented in the programme. The latter, moreover, tends to understate actual expenditure trends and thus the size of the consolidation measures needed to achieve the budgetary targets. Fourth, even before considering the required additional consolidation efforts, achieving the trend projections, which incorporate the summer 2008 fiscal package for the period 2009-2011, will be very challenging because they already envisage a very significant degree of expenditure restraint. In this context, the track record indicates that expenditure overruns at the central and local level cannot be ruled out, particularly in current primary expenditure, which increased by around 4.5% on average over the last decade. Respecting the tight expenditure targets that were set in the summer 2008 fiscal package will require an intensification of efforts to cut spending, increase efficiency and improve service quality.

(9) The general government gross debt-to-GDP ratio is well above the Treaty reference value and is projected to be on an increasing trend until 2010. After rising in 2008, the debt ratio is estimated in the programme to have increased by 9.3 pps, to 115.1% of GDP in 2009 (115.8% in the statistical office's estimate released on 1 March 2010), mainly due to the high interest burden and sharp contraction in real GDP, only partially offset by the still sizeable GDP deflator effect. A negative primary balance for the first time since 1991 also increased the debt, as did the stock flow adjustment, mainly because of the Treasury's precautionary accumulation of liquid assets. For 2010 the programme projects an additional 1.8 pps rise in the debt ratio as the debt-increasing effect of the interest burden is only partly offset by the assumed positive growth of real GDP and the GDP deflator. The debt ratio is then projected to follow a declining path in 2011 and 2012, to 114.6% of GDP, mainly thanks to the planned positive primary balances and the assumed acceleration in real GDP growth. The evolution of the debt ratio is likely to be less favourable than projected in the programme, especially after 2010, in view of the risks identified for budgetary consolidation compounded by the possibility of less favourable real GDP growth than assumed in the programme.

(10) The long-term budgetary impact of ageing is clearly lower than the EU average, with pension expenditure showing a more limited increase than on average in the EU through the full implementation of the adopted reforms. Yet, pension expenditure as a share of GDP remains among the highest in the EU. The budgetary position in 2009 as estimated in the programme would not be sufficient to stabilise the current debt ratio. Achieving high primary surpluses would therefore contribute to limiting the risks to the long-term sustainability of public finances which were assessed in the Commission

2009 Sustainability Report[6] as medium. Medium-term debt projections that assume GDP growth rates to only gradually recover to the values projected before the crisis and tax ratios to return to pre-crisis levels show that the budgetary strategy envisaged in the programme for the period until 2012, taken at face value, would be enough to stabilise the debt-to-GDP ratio by 2020.

(11) Fiscal governance in Italy has considerably improved since joining the euro area, prompted by the budgetary constraints imposed by the Treaty and the Stability and Growth Pact. However, there remains scope for improvement in several dimensions of its fiscal framework. A number of initiatives have been taken recently to improve fiscal governance in Italy, but mostly on an ad hoc basis, i.e. without modifying the legal setting. First, to address the traditional short-term orientation of the budgetary plans, in summer 2008 the government adopted a three-year package spelling out not only yearly targets for single expenditure and revenue items, but also the broad measures needed to achieve them. This experience was not repeated with the budget for 2010. However, the framework law on the reform of the budgetary process adopted in 2009 has enshrined in legislation the three-year budget horizon. A second improvement was the simplification of the structure of the State budget, allowing for a simpler and more policy-oriented allocation of resources. Third, some steps have been taken to improve monitoring of expenditure through detailed spending review exercises at the level of ministries. Also the two latter improvements were taken up in the framework law to become a permanent feature of the budgetary process. It remains to be seen whether the practical implementation of this reform, which will take some years, will deliver the planned results in terms of better expenditure control and fiscal governance. Going forward, a major challenge for fiscal governance is to specify and implement the new framework for fiscal federalism so as to ensure the accountability of local governments and foster efficiency.

(12) Although the implementation of pension reforms and the gradual increase of the retirement age for female civil servants introduced in 2009 are positive developments, the composition of social expenditure remains biased towards high pension spending. This takes its toll on other social spending and more productive expenditure aimed at supporting research and innovation, and in turn may have negative effects on growth potential. In addition, given that the consolidation strategy over the programme period relies on an expenditure-based adjustment, significant efficiency gains are needed to avoid compromising the level and quality of services provided. Recent efforts to improve the efficiency and cost-effectiveness of the public administration and to reform the organisation of upper-secondary school curricula could potentially deliver positive budgetary outcomes in the medium to long run.

(13) Overall, in 2010 the budgetary strategy set out in the programme is broadly consistent with the Council recommendations under Article 126(7). However, from 2011 on, taking into account the risks to the deficit targets, the budgetary strategy may not be consistent with the Council recommendations. In particular, the deficit targets for

[6] In the Council conclusions from 10 November 2009 on sustainability of public finances "the Council calls on Member States to focus attention to sustainability-oriented strategies in their upcoming stability and convergence programmes" and further "invites the Commission, together with the Economic Policy Committee and the Economic and Financial Committee, to further develop methodologies for assessing the long-term sustainability of public finances in time for the next Sustainability report", which is foreseen in 2012.

2011-2012 need to be backed up by concrete measures and the plans for the entire period sufficiently strengthened to address the risks from possibly less favourable GDP growth and possible slippages on the expenditure side. The same conclusion holds for the structural effort planned in the programme, which may fall short of what was recommended by the Council. Unless these risks are adequately addressed, and the consolidation plans fully implemented, the budgetary strategy may not be sufficient to bring the very high government debt ratio back on a declining path in 2011-2012.

(14) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data[7]. In its recommendations under Article 126(7) of 2 December 2009 with a view to bringing the excessive deficit situation to an end, the Council also invited Italy to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the stability programmes. Italy partly complied with this recommendation, as no information is provided on the broad measures required to achieve the additional consolidation planned in 2011-2012.

The overall conclusion is that the programme projects the deficit to narrow slightly, to 5% of GDP in 2010, from 5.3% in 2009, thanks to the expenditure-based adjustment adopted in summer 2008 and confirmed by the 2010 budget. Thereafter, the deficit ratio is planned to decline to below 3% by 2012, the deadline set by the Council for the correction of the excessive deficit. The strategy is based on (*i*) the further implementation of the expenditure-based adjustment for the period 2009-2011 adopted in summer 2008; and (*ii*) an additional consolidation effort amounting to 0.4 pp. of GDP in 2011 and further 0.8 pp. in 2012, which is however not underpinned by broad measures. The gross debt ratio is set to increase from just above 115% of GDP in 2009 to around 117% of GDP in 2010. Thereafter, it is projected to fall towards 114.6% of GDP in 2012, consistent with the planned budgetary targets and economic growth assumptions. However, the deficit and debt ratios could be higher than targeted. Overall, the programme's macroeconomic assumptions appear favourable. In addition, beyond the lack of broad measures underpinning the planned additional consolidation efforts, achieving the trend projections will be very challenging as they already envisage a very significant degree of expenditure restraint. In this context, the track record indicates that expenditure overruns cannot be ruled out. A major challenge for fiscal governance is the implementation of the budgetary process reform and of rules governing fiscal federalism in such a way to improve the accountability of local governments and ensure fiscal discipline. Besides fiscal consolidation, which is a condition to keep public finances on a sustainable path in view also of the very high debt ratio, a further key challenge for Italy's economic policy in the coming years will be to foster a swift and durable recovery in productivity growth so as to restore competitiveness and raise the country's low potential GDP growth.

In view of the above assessment and also in the light of the recommendation under Article 126(7) TFEU of 2 December 2009, Italy is invited to:

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[7] In particular, the programme does not indicate the broad measures underpinning the additional planned consolidation needed to achieve the budgetary objectives in the medium term. Accordingly, the expenditure and revenue ratios presented in the programme for 2011 and 2012 are not consistent with the budgetary targets. In addition, optional data on general government expenditure by function (Table 3 in Annex 2 of the code of conduct) and on liquid financial asset and net financial debt (Table 4 in Annex 2 of the code of conduct) are not presented.

(i) rigorously implement the planned budgetary adjustment, in particular carry out the fiscal consolidation in 2010 as planned and back up the planned consolidation for 2011 and 2012 with concrete measures while standing ready to adopt further consolidation measures in case risks related to the fact that the macroeconomic scenario of the programme is more favourable than the scenario underpinning the Article 126(7) Recommendation materialise; seize any further opportunities to accelerate the reduction of the gross debt ratio towards the 60% of GDP reference value;

(ii) ensure that the implementation of the reform of the budgetary process improves the conditions for expenditure control and helps sustain the objective of sound public finances and that the rules governing fiscal federalism improve the accountability of local governments and foster efficiency.

Italy is also invited to improve compliance with the data requirements of the code of conduct in view of the indicative nature of revenue and expenditure projections in the outer years and to provide more information on the broad measures underpinning the envisaged consolidation in these years in the EDP chapter of the forthcoming updates of the stability programme.

Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	**SP Jan 2010**	**-1.0**	**-4.8**	**1.1**	**2.0**	**2.0**
	COM Nov 2009	-1.0	-4.7	0.7	1.4	n.a.
	SP Feb 2009	*-0.6*	*-2.0*	*0.3*	*1.0*	*n.a.*
HICP inflation (%)	**SP Jan 2010**	**3.5**	**0.8**	**1.5**	**2.0**	**2.0**
	COM Nov 2009	3.5	0.8	1.8	2.0	n.a.
	SP Feb 2009	*3.5*	*1.2*	*1.7*	*2.0*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Jan 2010**	**1.1**	**-4.0**	**-3.5**	**-2.5**	**-1.6**
	COM Nov 2009[2]	1.3	-3.6	-3.2	-2.5	n.a.
	SP Feb 2009	*0.3*	*-2.3*	*-2.7*	*-2.5*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Jan 2010**	**-2.9**	**-1.8**	**-1.6**	**-1.3**	**-1.3**
	COM Nov 2009	-2.9	-2.3	-2.3	-2.3	n.a.
	SP Feb 2009	*-1.6*	*-1.3*	*-1.1*	*-0.9*	*n.a.*
General government revenue[3] (% of GDP)	**SP Jan 2010**	**46.0**	**46.4**	**45.9**	**45.5**	**45.6**
	COM Nov 2009	46.0	46.3	45.5	45.4	n.a.
	SP Feb 2009	*46.4*	*46.8*	*46.8*	*46.4*	*n.a.*
General government expenditure[3] (% of GDP)	**SP Jan 2010**	**48.8**	**51.7**	**50.9**	**49.9**	**49.5**
	COM Nov 2009	48.8	51.6	50.8	50.5	n.a.
	SP Feb 2009	*49.0*	*50.5*	*50.0*	*49.5*	*n.a.*
General government balance (% of GDP)	**SP Jan 2010**	**-2.7**	**-5.3**	**-5.0**	**-3.9**	**-2.7**
	COM Nov 2009	-2.7	-5.3	-5.3	-5.1	n.a.
	SP Feb 2009	*-2.6*	*-3.7*	*-3.3*	*-2.9*	*n.a.*
Primary balance (% of GDP)	**SP Jan 2010**	**2.4**	**-0.5**	**-0.1**	**1.3**	**2.7**
	COM Nov 2009	2.4	-0.5	-0.6	0.1	n.a.
	SP Feb 2009	*2.5*	*1.3*	*1.9*	*2.6*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**SP Jan 2010**	**-3.3**	**-3.2**	**-3.2**	**-2.7**	**-1.9**
	COM Nov 2009	-3.4	-3.5	-3.7	-3.8	n.a.
	SP Feb 2009	*-2.7*	*-2.6*	*-1.9*	*-1.6*	*n.a.*
Structural balance[4] (% of GDP)	**SP Jan 2010**	**-3.5**	**-3.8**	**-3.3**	**-2.7**	**-1.9**
	COM Nov 2009	-3.6	-3.7	-3.7	-3.7	n.a.
	SP Feb 2009	*-2.9*	*-2.7*	*-2.0*	*-1.7*	*n.a.*
Government gross debt (% of GDP)	**SP Jan 2010**	**105.8**	**115.1**	**116.9**	**116.5**	**114.6**
	COM Nov 2009	105.8	114.6	116.7	117.8	n.a.
	SP Feb 2009	*105.9*	*110.5*	*112.0*	*111.6*	*n.a.*

Notes:

[1] Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2] Based on estimated potential growth of 0.4%, 0.2%, 0.3% and 0.7% respectively in the period 2008-2011.

[3] Revenue and expenditure data provided in the programme are trends based on unchanged legislation. The targeted general government balances incorporate additional measures with a positive impact of 0.4% of GDP in 2011 and further 0.8% in 2012.

[4] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.2% of GDP in 2008, 0.6% in 2009 and 0.1% 2010; all deficit-reducing according to the most recent programme. In the Commission services' autumn 2009 forecast one-off and other temporary measures are 0.2% of GDP in both 2008 and 2009 deficit-reducing; 0% in 2010, and 0.1% of GDP in 2011, deficit-increasing.

Source:

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations.