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COMMISSION OPINION

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING ITALY

3. On the basis of the Draft Budgetary Plan for 2015 submitted on 16 October 2014 by Italy, and taking into account also the additional measures publicly announced by Italy on 27 October 2014, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013

4. Italy is currently subject to the preventive arm of the Stability and Growth Pact (SGP). As its debt-to-GDP ratio was 122% in 2012 (the year in which Italy corrected its excessive deficit), exceeding the 60% reference value, during the three years following the correction of the excessive deficit Italy is also subject to the transitional arrangements as regards compliance with the debt rule until the end of 2015. In this period it should ensure sufficient progress towards compliance with the debt reduction benchmark. On 8 July 2014, the Council recommended Italy to reinforce the budgetary measures for 2014 in the light of the emerging gap relative to the SGP requirements, namely the debt reduction rule, and ensure progress towards its medium-term budgetary objective (MTO) of a balanced budgetary position in structural terms. The Council also recommended to significantly strengthen the budgetary strategy in 2015 so as to ensure compliance with the debt reduction requirement and reach the MTO.

5. The Draft Budgetary Plan significantly revised downward real GDP growth to -0.3% in 2014 (from 0.8% in the Stability Programme) and 0.6% in 2015 (from 1.3% in the Stability Programme). The downward revision is mainly due to lower export growth, given the slowdown in global trade, and lower investment, also on the back of persistently tight financing conditions. The Commission forecast expects a slightly worse outcome in 2014 (-0.4%) and the same real GDP growth (0.6%) in 2015. The Commission forecast, however, expects final domestic demand to contribute less to the 2015 real GDP growth. This is compensated by a higher contribution of exports.

6. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the Parliamentary Budget Office (PBO), Italy's newly-established independent fiscal monitoring institution, which has assessed the forecast as within an acceptable interval given the

information currently available. The PBO has confirmed the validity of the programme scenario underlying the DBP, also after the inclusion of the measures announced on 27 October 2014. As also recommended by the Council in July 2014, the PBO has become fully operational, and it has been given a broad-based mandate to monitor public finances and its functional autonomy is formally guaranteed by law.

7. Italy's Draft Budgetary Plan projects the general government deficit to increase to 3.0% in 2014, from 2.8% of GDP in 2013 (ESA 2010), whereas the 2014 deficit planned in the April 2014 Stability Programme was 2.6% of GDP, down from 3.0% of GDP in 2013 (ESA95). For 2015, the updated Draft Budgetary Plan (i.e. incorporating the additional measures announced on 27 October) targets the government deficit to decline to 2.6% of GDP. The new deficit target is substantially above the 1.8% of GDP in the Stability Programme. The higher deficit, in spite of the lower projected interest expenditure, is explained by the worse 2014 starting position, lower real GDP growth, and new deficit-increasing measures aimed to foster growth and jobs. In structural terms, the updated Draft Budgetary Plan implies a 0.3 pp. of GDP deterioration of the (recalculated) balance in 2014 and a 0.3 pp. of GDP improvement in 2015, with a structural position still in deficit in 2015. The Draft Budgetary Plan thus postpones the achievement of the MTO of a balanced budget in structural terms to 2017.

8. In the Commission 2014 autumn forecast, after incorporating the measures in the updated Draft Budgetary Plan, the headline deficit is expected to be at 2.7% of GDP for 2015, i.e. slightly higher than the government projections. The forecast structural improvement amounts to 0.1 pp. in 2015, following a structural deterioration of 0.1 pp. in 2014. Downside risks to the budgetary projections and/or to the quality of the planned budgetary execution might stem from worse-than-expected macroeconomic outcomes, persistently low inflation, and only partial implementation of the planned budgetary measures.

9. In the updated Draft Budgetary Plan, the government debt-to-GDP ratio is expected to be at 131.6% in 2014, with an increase of 3.7 pps. relative to 2013 compared to 2.3 pps. in the Stability Programme, mainly due to lower nominal GDP growth. In 2015, the debt-to-GDP ratio is planned to peak at 133.1%. The Stability Programme projected instead a 1.6 pps. decrease in the 2015 debt-to-GDP ratio, thanks to a significantly higher primary surplus and higher nominal growth, while interest expenditure was less benign for debt developments. In the Commission forecast, debt developments are broadly in line with those in the updated Draft Budgetary Plan.

10. Overall, the updated Draft Budgetary Plan incorporates expansionary measures worsening the budgetary position by around 0.4 pp. of GDP in 2015 compared to the Italian authorities' trend scenario based on unchanged legislation, thus leading to a deficit target of 2.6% of GDP. Additional resources are earmarked for a reduction in the tax burden on labour for employers, as well as a permanent tax credit, recorded as a social transfer, to low-wage employees. On the financing side, additional revenues are projected to be raised through the extension of the reverse charge system for the payment of VAT. An increase in VAT rates and excise duties (amounting to 0.8% of GDP in 2016, 1.2% of GDP in 2017, and 1.35% of GDP in 2018) is foreseen to guarantee the achievement of planned fiscal targets as from 2016, unless other measures of equivalent budgetary impact are adopted. A crucial component of the Italian budgetary strategy is a spending review aimed to increase spending efficiency and achieve additional savings. In 2015, around half of these savings is related to

lower transfers to Regions and Provinces, while the rest is to be achieved through the rationalisation of central government expenditure. There is a risk that at least part of the reduced transfers from the central government might entail higher taxes and/or lower capital expenditure at local level.

11. Over 2013-2015, Italy is in the transition period for the assessment of compliance with the debt criterion. Under the expected unfavourable economic conditions (in particular, negative potential growth and low inflation), the required minimum linear structural adjustment (MLSA) calculated on the basis of the updated Draft Budgetary Plan would be 0.9 pp. of GDP for 2014 and 2.2 pps. 2015. Starting from a structural balance of –0.8% of GDP in 2013, this adjustment would have implied reaching a structural surplus of around 1% of GDP in 2015. Based on the Commission 2014 autumn forecast, which projects more subdued nominal growth and lower privatisation proceeds, the MLSA would have been even more stringent, at 1.2 pps. in 2014 and 2.5 pps. in 2015, well above the forecast structural adjustments in these years and implying a needed structural surplus of more than 1.5% of GDP in 2015, i.e. well above Italy's MTO.

12. The preventive arm of the SGP currently requires Member States with a debt ratio above 60% of GDP that are not yet at their MTO but are experiencing economic 'bad times' to deliver a structural adjustment so as to make sufficient progress towards it. Whereas for 2014, exceptionally severe economic conditions (negative growth and a negative output gap larger than 4% of GDP) justified in the Commission's view that Italy is not required to fulfil the requirement of a structural adjustment towards the MTO, for 2015, the Commission forecast points to a significant deviation from the required adjustment towards the MTO over one year and to a possible significant deviation with respect to the expenditure benchmark pillar. Over the two years 2014-2015, the Commission forecast indicates a possible significant deviation as regards the structural balance pillar, and some deviation as regards the expenditure benchmark pillar. An overall assessment, based on the Commission forecast, points to a risk of a significant deviation from the required adjustment path towards the MTO.

13. The updated Draft Budgetary Plan envisages measures to reduce the tax burden on labour, as recommended by the Council. This is done through the deduction of labour costs from the taxable base of the regional tax on businesses (IRAP), the employers' exemption for three years to pay social security contributions for new hires in the private sector in 2015 and by extending and making permanent the one-year tax credit to low-wage employees that was enacted in April 2014.

14. Overall, the Commission is of the opinion that the updated Draft Budgetary Plan of Italy, which is currently under the preventive arm and subject to the transitional debt rule, is at risk of non-compliance with the requirements of the Stability and Growth Pact. The Commission therefore invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2015 budget will be compliant with the Stability and Growth Pact.

    The Commission is also of the opinion that Italy has made some progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the 2014 European Semester and invites the authorities to make further progress. In this context, policies fostering growth prospects, keeping current primary expenditure under strict control while increasing the overall efficiency of public spending, as well as the planned privatisations, would contribute to bring the

debt-to-GDP ratio on a declining path consistent with the debt rule over the coming years.

The Commission will examine in early March 2015 its position vis-à-vis Italy's obligations under the SGP in the light of the finalisation of the budget law and the expected specification of the structural reform programme announced by the authorities.

Done at Brussels, 28.11.2014

For the Commission
Pierre MOSCOVICI
Member of the Commission