002238/EU XXV.GP
Eingelangt am 15/11/13

Brussels, 15.11.2013
C(2013) 8005 final

COMMISSION OPINION

of 15.11.2013

on the Draft Budgetary Plan of ITALY

{SWD(2013) 606 final}

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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 2014 submitted on 15 October by Italy, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. Italy is subject to the preventive arm of the SGP and should ensure sufficient progress towards its medium term objective. As the debt ratio was exceeding the 60% of GDP reference value (at 127%) in 2012 (the year in which Italy corrected its excessive deficit), 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 criterion. In this period it should ensure sufficient progress towards compliance.

5. The real GDP recovery projected for 2014 in the April stability programme has been revised slightly down in Italy's Draft Budgetary Plan. Projected growth remains mainly driven by accelerating external demand, while both private consumption and investment growth have been revised down. The Commission Autumn 2013 Forecast projects a lower real GDP growth in 2014 than Italy's Draft Budgetary Plan (0.7% vs. 1.1%), with a broadly similar composition but more moderate increases in private consumption and exports and somewhat more dynamic investment. The Draft Budgetary Plan's macroeconomic projections for 2014 thus appear relatively optimistic. Clear downward risks stem from the external side (e.g. a smaller expansion of export markets and stronger exchange rate appreciation), as well as from persistently tight credit conditions.

6. Regulation 473/2013 requires that the draft budget be based on independently endorsed or produced macroeconomic forecasts. The Draft Budgetary Plan macroeconomic and budgetary projections have been prepared by the government, without involvement of other institutions. The Draft Budgetary Plan states that from next year onwards, forecasts will be endorsed by the newly created independent Parliamentary Budget Office, which will be tasked in particular with assessing macroeconomic and budgetary forecasts, monitoring compliance with fiscal rules (and the trigger of correction mechanisms) and reporting on long-term fiscal sustainability.

7. Italy's Draft Budgetary Plan projects the government deficit to decline to 2.5% of GDP in 2014 from 3% in both 2012 and 2013, i.e. 0.7 pp. higher than in the stability programme. Part of the difference (around ½ pp. of GDP) is explained by a worse economic outlook over 2013-14. A further ¼ pp. of GDP is accounted for by higher investment expenditure projected in the Draft Budgetary Plan, which is related to the government's application for the so-called "investment clause". Total revenues are projected to decline in 2014, slightly more than planned in April, due to expiring one-offs and also to new measures in the Draft Budgetary Plan. On the expenditure side, a smaller contraction in the ratio of primary expenditure to GDP is projected than in the stability programme, partly due to new measures (e.g. additional investments) and partly to a lower GDP. Finally, interest expenditure is projected to stabilise as a share of GDP in 2014, also thanks to the assumption of falling spreads. In structural terms (i.e. the cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology), the government projections imply an overall improvement of 0.5 pp. of GDP in 2013 and 0.2 pp. in 2014 (after 2¼ pps. in 2012), with a structural position still in deficit in 2014 (-0.7% of GDP).

8. In the Commission Forecast, the 2014 deficit is expected to be at 2.7% of GDP (after 3.0% in 2013), i.e. 0.2% of GDP higher than in the Draft Budgetary Plan. This is essentially explained by the lower economic growth, so that the structural balance is in line with the recalculated structural balance in the Draft Budgetary Plan. Downside risks to the budgetary projections are associated to the lack of full implementation of measures already enshrined in legislation and a weakening of the Draft Budgetary Plan in Parliament.

9. In the Draft Budgetary Plan the general government gross debt is projected to peak at around 133% of GDP in 2013 and then stabilise in 2014. Over 2013-14, the on-going settlement of trade debt arrears adds around 3 pps. of GDP to the EDP definition of debt, while the support to other euro-area Member States adds another 1 pp. of GDP. By contrast, the government privatisation plans reduce the debt ratio by 0.5% of GDP in both 2013 and 2014. In the Commission Forecast, the debt ratio still increases in 2014 mainly owing to a less positive economic outlook and lower inflation (GDP deflator). In addition, privatisation proceeds are not incorporated as the government plans are not sufficiently detailed.

10. The Draft Budgetary Plan includes several measures aimed at supporting growth and jobs, only partly compensated by financing measures. As a result, the headline budgetary position worsens by around 0.2% of GDP in 2014, to -2.5% from a trend projection of -2.3% based on unchanged legislation. The Commission Forecast incorporates a similar assessment of the impact of the Draft Budgetary Plan for 2014. Measures intended to stimulate growth entail around 0.4% of GDP of additional expenditure, equally split between current and capital spending, and 0.4% of lower revenues, mainly aimed at reducing the labour tax wedge on labour through increased allowances from the tax on personal labour income (targeted at lower incomes) and reduced employers' contributions for worker health and safety. The partial financing is provided by 0.4% of GDP of higher tax proceeds, thanks to the reform of the tax deductibility of loan loss provisions entailing a positive budgetary impact at its inception in 2014 and higher stamp duties on households' financial wealth, and 0.2% of GDP of expenditure savings.

11. In both 2013 and 2014, Italy is in the transition period for the assessment of compliance with the debt criterion. Based on an overall assessment of the draft budgetary plan, Italy is making sufficient progress towards compliance with the debt criterion in 2013; in 2014, however, Italy is not making sufficient progress towards compliance with the debt criterion due to insufficient structural adjustment in the Commission Forecast (0.12 pp. of GDP vs. the required 0.66 pp.).

12. The preventive arm of the SGP requires Member States that are not yet at their MTO to deliver a structural adjustment of at least 0.5 pp. of GDP so as to make sufficient progress towards it. In addition, the July CSR required Italy to achieve the MTO of a balanced budget in structural terms in 2014. The Draft Budgetary Plan instead postpones the achievement of the MTO in 2015, projecting a structural adjustment of only 0.2 pp. of GDP in 2014 due to the higher investment expenditure adopted with the Draft Budgetary Plan on account of the application for the so-called "investment clause". However, according to the Commission Forecast, Italy does not comply with the debt criterion in 2014, leading to non-eligibility to the investment clause. Therefore, Italy should continue to make sufficient progress towards the MTO also in 2014, by ensuring a structural adjustment of at least 0.5 pp. of GDP. Following an overall assessment of Italy's Draft Budgetary Plan, while the analysis of expenditure net of discretionary revenue measures shows growth rates consistent with the required structural adjustment path towards the MTO in 2013-14, the structural balance points to a deviation in 2014 which, if repeated the following year, could be assessed to be significant and could put at risk compliance with the requirements of the preventive arm of the SGP.

13. The small reduction in the tax wedge on labour and the higher tax allowance for new corporate equity in the Draft Budgetary Plan are first steps to implement the country-specific recommendation on tax efficiency that was issued in July under the European Semester. However, the new local services tax that will be introduced in 2014 is planned to yield less revenue than the property tax and waste-collection duties that it is due to replace, thus further narrowing the scope for a more substantial tax shift. Local authorities will have some flexibility to raise additional revenues from the new tax, but an overhaul of the cadastral system remains a priority also to improve its fairness. As to consumption taxation, the 1 pp. increase in the standard VAT rate (to 22%) as of October 2013 does not address the erosion of tax base by the frequent application of reduced rates (at 10% or 4%). The implementation of the recommended effort towards higher efficiency and quality of public spending is delegated to a new special commissioner for the spending review.

14. Overall, based on the autumn 2013 forecast, the Commission is of the opinion that there is a risk that the Draft Budgetary Plan for 2014 does not ensure compliance with the rules of the SGP. In particular, the Commission Forecast points to a risk that the Draft Budgetary Plan will not allow reducing the debt-to-GDP ratio in line with the debt reduction benchmark. The Commission is also of the opinion that Italy has made limited progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the European Semester. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2014 budget will be fully compliant with the SGP and notably to address the risks identified by the Commission in its assessment of the Draft Budgetary Plan. Moreover, it invites the authorities to accelerate progress towards implementation of the fiscal recommendations under the European Semester.

Done at Brussels, 15.11.2013

For the Commission
Olli REHN
Vice-President