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| From: | Secretary-General of the European Commission,<br>signed by Mr Jordi AYET PUIGARNAU, Director |
| date of receipt: | 15 November 2013 |
| To: | Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union |
| No. Cion doc.: | SWD(2013) 606 final |
| Subject: | COMMISSION STAFF WORKING DOCUMENT Analysis of the draft budgetary plan of ITALY Accompanying the document COMMISSION OPINION on the draft budgetary plan of ITALY |

Delegations will find attached document SWD(2013) 606 final.

This document is aimed for discussion in the **Eurogroup.**

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EUROPEAN
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Brussels, 15.11.2013
SWD(2013) 606 final

**COMMISSION STAFF WORKING DOCUMENT**

**Analysis of the draft budgetary plan of ITALY**

*Accompanying the document*

**COMMISSION OPINION**

**on the draft budgetary plan of ITALY**

{C(2013) 8005 final}

**COMMISSION STAFF WORKING DOCUMENT**

**Analysis of the draft budgetary plan of ITALY**

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**COMMISSION OPINION**

**on the draft budgetary plan of ITALY**

## 1. INTRODUCTION

Italy submitted its Draft Budgetary Plan for 2014 on 15 October 2013 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Italy is subject to the preventive arm of the Stability and Growth Pact (SGP) and should ensure sufficient progress towards its medium-term objective (MTO).

As the debt ratio was 127% of GDP in 2012 (the year in which Italy corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit Italy is subject to the transitional arrangements as regards compliance with the debt criterion. In this period it should ensure sufficient progress towards compliance.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission Autumn 2013 Forecast. The section that follows presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission Forecast. In particular, it also includes an assessment of the measures underpinning the draft budgetary plans. Section 4 assesses the recent and planned fiscal developments in 2013-2014 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 summarises the main conclusions of the present document.

## 2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

In both Italy's Draft Budgetary Plan and the Commission Forecast, economic activity is projected to contract by 1.8% in 2013, after the -2.5% recorded in 2012. The downward revision to the real GDP outlook compared to -1.3% expected in spring is mainly explained by significantly lower investment, a less dynamic external environment and a stronger exchange rate appreciation. The Draft Budgetary Plan projects economic activity to recover in 2014, although slightly less rapidly than expected in the April Stability Programme (see Table 1). The recovery is mainly driven by external demand, with exports expanding by more than 4%. Domestic demand turns positive, even though growth of both private consumption and investment has been revised down significantly from the stability programme. The expanding

demand also leads to positive import dynamics, after the negative reading recorded over 2012-13. The balance with the rest of the world is anticipated to remain in surplus at around ¾% of GDP over 2013-14.

The Commission Forecast projects 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 slightly more dynamic investment.

The macroeconomic projections in the Draft Budgetary Plan for 2014 thus appear rather optimistic. Clear downward risks come notably from the external side (e.g. smaller expansion of export markets and stronger exchange rate appreciation), as well as from credit conditions, which may turn out tighter than assumed for 2014.

**Box 1: The macro economic forecast underpinning the budget in Italy**

The Draft Budgetary Plan macroeconomic and budgetary projections have been prepared by the government, without involvement of other institutions. According to the government "*In order to address the specific requirement of the Two Pack on independent macroeconomic forecasts, trend growth forecasts are compared with those of consensus and national and international forecasters in the Update of 2013 Economic and Financial Document. From next year onwards, forecasts will be endorsed by the newly created Parliamentary Budget Office (PBO), which will become operational as of January 2014*". The Parliamentary Budget Office, to be hosted by the Parliament but operationally independent, 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.

**Table 1. Comparison of macroeconomic developments and forecasts**

| | 2012 | 2013 | | | 2014 | | |
|---|---|---|---|---|---|---|---|
| | COM | SP | DBP | COM | SP | DBP | COM |
| Real GDP (% change) | -2.5 | -1.3 | -1.8 | -1.8 | 1.3 | 1.1 | 0.7 |
| Private consumption (% change) | -4.1 | -1.7 | -2.4 | -2.3 | 1.4 | 0.6 | 0.3 |
| Gross fixed capital formation (% change) | -8.3 | -2.6 | -5.5 | -5.2 | 4.1 | 2.4 | 2.7 |
| Exports of goods and services (% change) | 2.0 | 2.2 | 0.2 | 0.1 | 3.3 | 4.1 | 3.6 |
| Imports of goods and services (% change) | -7.4 | -0.3 | -3.1 | -3.5 | 4.7 | 4.1 | 3.6 |
| *Contributions to real GDP growth:* | | | | | | | |
| - Final domestic demand | -4.6 | -1.9 | -2.5 | -2.6 | 1.4 | 0.8 | 0.5 |
| - Change in inventories | -0.7 | -0.1 | -0.2 | -0.3 | 0.1 | 0.1 | 0.1 |
| - Net exports | 2.8 | 0.7 | 0.9 | 1.1 | -0.2 | 0.1 | 0.1 |
| Output gap[1] | -3.2 | -4.2 | -4.5 | -4.5 | -3.1 | -3.4 | -3.7 |
| Employment (% change) | -0.3 | -0.4 | -1.7 | -1.7 | 0.4 | 0.0 | 0.0 |
| Unemployment rate (%) | 10.7 | 11.6 | 12.2 | 12.2 | 11.8 | 12.4 | 12.4 |
| Labour productivity (% change) | -1.5 | -1.0 | 0.0 | -0.2 | 0.7 | 1.1 | 0.5 |
| HICP inflation (%) | 3.3 | 2.0 | 1.5 | 1.5 | 2.0 | 2.0 | 1.6 |
| GDP deflator (% change) | 1.7 | 1.8 | 1.3 | 1.3 | 1.9 | 1.9 | 1.4 |
| Comp. of employees (per head, % change) | 1.0 | 1.0 | 1.4 | 1.3 | 1.2 | 0.9 | 1.2 |
| Net lending/borrowing vis-à-vis the rest of the world (% of GDP) | -0.3 | 0.2 | 0.7 | 1.1 | -0.2 | 0.8 | 1.2 |

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

*Source*:

*Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.*

## 3. RECENT AND PLANNED FISCAL DEVELOPMENTS

### 3.1. Deficit developments

In 2013, Italy's Draft Budgetary Plan projects the general government deficit to remain at 3.0% of GDP, from the 2.9% planned in the April Stability Programme. The slightly worse estimated outturn is mainly explained by the deeper recession, while the government adopted measures with negative impact on the structural balance, namely as the halving of the recurrent property tax on primary residences for 2013 was financed with some one-offs. The Commission Forecast also projects the 2013 deficit at 3.0% of GDP, including the full budgetary execution of the consolidation measures enshrined in legislation.

The Draft Budgetary Plan projects the government deficit to decline to 2.5% of GDP in 2014, from 3% in both 2012 and 2013. The new 2014 deficit target is higher than in April (1.8% of GDP). 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".

On the revenue side, after increasing by 0.6 pp. as a share of GDP in 2013, total revenues are projected to decline slightly in 2014. The impact of expiring one-offs largely offsets the expected increase in current taxes, also owing to measures in the Draft Budgetary Plan (see below section 3.3). On the expenditure side, the positive growth outlook for 2014 supports the

decline in the ratio of primary expenditure to GDP, after the increase expected in 2013. In addition, compensation of employees continues to fall thanks to the wage freeze and new hiring restrictions, while intermediate consumption dynamics remain moderate owing to the spending review conducted in 2012 and additional measures in the Draft Budgetary Plan. After the increase recorded in 2013 driven by significantly higher unemployment benefits, social transfers are projected to stabilise as a share of GDP in 2014 also thanks to the new de-indexation of higher pensions in the Draft Budgetary Plan. Capital expenditure is projected to decline in 2014, despite the additional investment expenditure projected in the Draft Budgetary Plan, due to diminishing expenditure related to the settlement of trade debt arrears. Finally, in 2014 interest expenditure is projected to stabilise as a share of GDP also thanks to the assumption of spreads between 10-year yields on Italian and German government bonds falling by 50 bps (to 200 bps).

In the Commission Forecast, the 2014 deficit is expected to be at 2.7% of GDP after incorporating the expansionary measures in the Draft Budgetary Plan. Lower economic growth explains the 0.2% of GDP higher deficit relative to the government projections.

In structural terms, the government projections imply an overall improvement of the structural balance[1] of 0.5 pp. of GDP in 2013 and 0.2 pp. in 2014 (after a 2¼ pps. improvement in 2012), with a structural position still in deficit in 2014 (-0.7% of GDP).

Downside risks to the budgetary projections are associated to the lack of full implementation of measures already enshrined in legislation and to parliamentary amendments to the Draft Budgetary Plan.

[1] 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.

**Table 2. Composition of the budgetary adjustment**

| (% of GDP) | 2012 | 2013 | | | 2014 | | | Change: 2012-2014 |
|---|---|---|---|---|---|---|---|---|
| | COM | SP | DBP | COM | SP | DBP | COM | DBP |
| **Revenue** | **47.7** | **48.2** | ***48.3*** | **48.1** | **48.0** | ***47.9*** | **47.8** | **0.2** |
| *of which:* | | | | | | | | |
| - Taxes on production and imports | 14.9 | 15.3 | *15.1* | 14.7 | 15.4 | *15.4* | 14.9 | 0.5 |
| - Current taxes on income, wealth, etc. | 15.2 | 15.0 | *15.0* | 15.3 | 15.0 | *15.1* | 15.2 | -0.1 |
| - Capital taxes | 0.1 | 0.1 | *0.2* | 0.2 | 0.1 | *0.1* | 0.0 | 0.0 |
| - Social contributions | 13.8 | 14.0 | *14.0* | 13.9 | 13.9 | *13.7* | 13.8 | -0.1 |
| - Other (residual) | 3.7 | 3.8 | *4.0* | 3.9 | 3.6 | *3.6* | 3.9 | 0.0 |
| **Expenditure** | **50.7** | **51.1** | **51.3** | **51.2** | **49.8** | **50.4** | **50.5** | **-0.3** |
| *of which:* | | | | | | | | |
| - Primary expenditure | 45.2 | 45.8 | 45.9 | 45.8 | 44.2 | 45.1 | 45.0 | -0.1 |
| *of which:* | | | | | | | | |
| Compensation of employees | 10.6 | 10.4 | 10.5 | 10.5 | 10.0 | 10.1 | 10.2 | -0.5 |
| Intermediate consumption | 5.7 | 5.4 | 5.5 | 5.5 | 5.3 | 5.3 | 5.3 | -0.3 |
| Social payments | 22.6 | 23.1 | 23.4 | 23.3 | 23.0 | 23.3 | 23.4 | 0.7 |
| Subsidies | 1.0 | 1.0 | 1.0 | 1.0 | 0.9 | 0.9 | 1.0 | -0.1 |
| Gross fixed capital formation | 1.9 | 1.8 | 1.8 | 2.0 | 1.7 | 1.9 | 1.8 | 0.0 |
| Other (residual) | 3.4 | 4.1 | 3.7 | 3.5 | 3.3 | 3.6 | 3.3 | 0.1 |
| - Interest expenditure | 5.5 | 5.3 | 5.4 | 5.4 | 5.6 | 5.4 | 5.5 | -0.2 |
| **General government balance (GGB)** | **-3.0** | **-2.9** | **-3.0** | **-3.0** | **-1.8** | **-2.5** | **-2.7** | **0.5** |
| **Primary balance** | **2.5** | **2.4** | **2.4** | **2.3** | **3.8** | **2.9** | **2.8** | **0.3** |
| One-off and other temporary measures | 0.1 | -0.2 | 0.3 | 0.2 | -0.1 | 0.0 | 0.0 | -0.1 |
| **GGB excl. one-offs** | **-3.1** | **-2.7** | **-3.3** | **-3.3** | **-1.7** | **-2.5** | **-2.7** | **0.6** |
| Output gap[1] | -3.2 | -4.2 | -4.5 | -4.5 | -3.1 | -3.4 | -3.7 | -0.3 |
| Cyclically-adjusted balance[1] | -1.3 | -0.6 | -0.6 | -0.6 | -0.1 | -0.6 | -0.7 | 0.6 |
| **Structural balance (SB)[2]** | **-1.4** | **-0.4** | **-0.8** | **-0.8** | **0.0** | **-0.7** | **-0.7** | **0.7** |
| *Change in SB* | *2.3* | *0.9* | *0.5* | *0.6* | *0.4* | *0.2* | *0.1* | - |
| *Two year average change in SB* | *1.2* | *1.6* | *1.4* | *1.4* | *0.7* | *0.3* | *0.3* | - |
| Structural primary balance[2] | 4.2 | 4.9 | 4.6 | 4.5 | 5.6 | 4.7 | 4.8 | 0.6 |
| *Change in structural primary balance* | | *0.7* | *0.4* | *0.4* | *0.7* | *0.1* | *0.3* | - |
| **Expenditure benchmark** | | | | | | | | |
| Applicable reference rate[3] | -0.81 | -0.81 | -0.81 | -0.81 | -1.07 | -1.07 | -1.07 | - |
| Deviation[4] (% GDP) | -0.8 | -2.1 | -0.1 | -0.8 | -2.5 | -0.2 | 0.1 | - |
| Two-year average deviation (% GDP) | -0.6 | -2.1 | -1.1 | -0.8 | -2.3 | -0.2 | -0.3 | - |

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

[3] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t.The reference rates applicable to 2014 onwards have been updated in 2013.

[4] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.

Source:

*Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.*

## 3.2. Debt developments

In the Draft Budgetary Plan, the government debt-to-GDP ratio is projected to peak in 2013 at around 133% and then stabilise in 2014 (see Table 3). The 6 pps. of GDP increase in the debt ratio projected in 2013 (after 6.3 pps. in 2012) is the result of a primary surplus that is still insufficient to offset the significant cost of servicing the debt coupled with economic

contraction (see snow-ball effect in Table 3). In 2014, the planned higher primary surplus together with the projected positive growth help stabilise the debt ratio.

Regarding the stock-flow adjustment, the on-going settlement of trade debt arrears adds around 2.5 pps. of GDP to the EDP definition of debt over 2013-14. The stock-flow adjustment is also affected by the support to other euro-area Member States, in the form of EFSF debt issuances and capital injection to the ESM amounting to around 1% of GDP over 2013-14. Finally, the privatisation planned by the government (amounting to 0.5% of GDP in both 2013 and 2014) reduce the stock-flow adjustment.

In the Commission Forecast, debt developments are very similar to those projected in the Draft Budgetary Plan in 2013; however, in 2014 the debt-to-GDP ratio is still forecast to increase mainly owing to a less positive economic outlook and lower inflation (GDP deflator) than in the government projection. In addition, privatisation proceeds are not incorporated as government's plans are not sufficiently detailed.

**Table 3. Debt developments**

| (% of GDP) | 2012 | 2013 | | | 2014 | | |
|---|---|---|---|---|---|---|---|
| | | SP | DBP | COM | SP | DBP | COM |
| **Gross debt ratio[1]** | **127.0** | **130.4** | **132.9** | **133.0** | **129.0** | **132.7** | **134.0** |
| Change in the ratio | 6.3 | 3.4 | 5.9 | 6.0 | -1.4 | -0.1 | 1.0 |
| *Contributions[2] :* | | | | | | | |
| **1. Primary balance** | **-2.5** | **-2.4** | **-2.4** | **-2.3** | **-3.8** | **-2.9** | **-2.8** |
| **2. "Snow-ball" effect** | **6.5** | **4.6** | **6.1** | **6.0** | **1.6** | **1.6** | **2.7** |
| *Of which:* | | | | | | | |
| Interest expenditure | 5.5 | 5.3 | 5.4 | 5.4 | 5.6 | 5.4 | 5.5 |
| Growth effect | 3.1 | 1.6 | 2.4 | 2.3 | -1.6 | -1.4 | -0.9 |
| Inflation effect | -2.1 | -2.3 | -1.7 | -1.7 | -2.4 | -2.4 | -1.9 |
| **3. Stock-flow adjustment** | **2.2** | **1.2** | **2.2** | **2.3** | **0.8** | **1.2** | **1.1** |
| *Of which:* | | | | | | | |
| Cash/accruals difference | 0.2 | -0.3 | 1.5 | 1.5 | -0.1 | 0.8 | 1.1 |
| Net accumulation of financial assets | 2.0 | -0.2 | 0.3 | 0.8 | -0.6 | -0.1 | 0.0 |
| *of which privatisation proceeds* | -0.5 | -1.0 | -0.5 | -0.1 | -1.0 | -0.5 | 0.0 |
| Valuation effect & residual | 0.0 | 0.3 | 0.3 | 0.0 | 0.3 | 0.5 | 0.0 |

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

*Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.*

### 3.3. Measures underpinning the draft budgetary plan

The Draft Budgetary Plan includes several measures aimed at supporting growth and jobs, only partly compensated by financing measures. Overall, the measures worsen the headline budgetary position by around 0.2% of GDP in 2014, bringing it to the target of -2.5% of GDP, from a trend projection of -2.3% based on unchanged legislation.

Among the expansionary measures there are 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 through increased allowances from the tax on personal labour income (targeted on lower incomes) and a reduction in employers' contributions for worker health and safety.

On the financing side, 0.4% of GDP are to be raised through higher taxation on banks, thanks to the reform of the tax deductibility of loan loss provisions entailing a positive budgetary impact in 2014 and a negative one afterwards, and higher stamp duties on households' financial wealth. Savings on the expenditure side amount to 0.2% of GDP.

The measures in the Draft Budgetary Plan, including the additional investment expenditure related to the "investment clause", have also been incorporated in the Commission Forecast, with an expected budgetary impact that is similar to the one projected in the Draft Budgetary Plan (Table 4 only contains Draft Budgetary Plan measures with larger budgetary impact).

The small reduction in the tax wedge on labour is a first step to implement the country-specific recommendation issued in July under the European Semester to shift the tax burden away from the productive factors onto consumption and property. Furthermore, the Draft Budgetary Plan raises the allowance for new corporate equity (ACE), supporting a more sustainable investment growth. However, the new local services tax that will be introduced in 2014 is planned to yield less revenue than both 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 fairness. As to consumption taxation, the 1 pp. increase in the standard VAT rate (to 22%) as of October 2013 does not address the gap in the tax base, with a broad range of goods still taxed at reduced rates (at 10% or 4%).

On the expenditure side, some further targeted cuts are made to central government expenditure, while regional governments are required to save € 1 bn on non-health-related expenditure. The implementation of the Council recommendation to pursue higher efficiency by making in-depth spending reviews a permanent feature of the budgetary process is delegated to a new special commissioner with the mandate to rationalise spending throughout the public sector and in government-controlled entities. As a result, large unspecified expenditure savings are planned as of 2015 with a safeguard clause that implies lower tax expenditures in case of insufficient savings.

**Table 4. Main discretionary measures reported in the Draft Budgetary Plan**

**A. Discretionary measures taken by General Government - revenue side**

| Components | Budgetary impact (% GDP) | | | |
|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 |
| Taxes on production and imports | | | | |
| Current taxes on income, wealth, etc. | 0.04 | 0.00 | 0.17 | 0.11 |
| Capital taxes | | | | |
| Social contributions | | | | |
| Property income | | | | |
| Other (residual) | | | | |
| Total | 0.04 | 0.00 | 0.17 | 0.11 |

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the Draft Budgetary Plan, i.e. by the national authorities. A positive sign implies that revenues increase as a consequence of this measure.
*Source: Draft Budgetary Plan*

**B. Discretionary measures taken by general Government- expenditure side**

| Components | Budgetary impact (% GDP) | | | |
|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 |
| Compensation of employees | | | | |
| Intermediate consumption | | | | |
| Social payments | -0.04 | -0.05 | -0.05 | 0.00 |
| Subsidies | | | | |
| Gross fixed capital formation | | | | |
| Capital transfers | | | | |
| Other (residual) | | | | |
| Total | -0.04 | -0.05 | -0.05 | 0.00 |

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the Draft Budgetary Plan, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.
*Source: Draft Budgetary Plan*

## 4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

**Box 2. Council recommendations addressed to Italy**

On 9 July, the Council addressed recommendations to Italy in the context of the European Semester. In particular, in the area of public finances the Council recommended to Italy to

1. Ensure that the deficit remains below 3% of GDP in 2013, by fully implementing the adopted measures. Pursue the structural adjustment at an appropriate pace and through growth-friendly fiscal consolidation so as to achieve and maintain the MTO as from 2014. Achieve the planned structural primary surpluses in order to put the very high debt-to-GDP ratio on a steadily declining path. Continue pursuing a durable improvement of the efficiency and quality of public expenditure by fully implementing the measures adopted in 2012 and taking the effort forward through regular in depth spending reviews at all levels of government.

5. Shift the tax burden from labour and capital to consumption, property and the environment in a budgetary neutral manner. To this purpose, review the scope of VAT exemptions and reduced rates and of direct tax expenditures, and reform the cadastral system to align the tax base of recurrent immovable property to market values. Pursue the fight against tax evasion, improve tax compliance and take decisive steps against the shadow economy and undeclared work.

### 4.1. Compliance with the debt criterion

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 as the structural adjustment foreseen by Commission Forecast falls short of the required adjustment by more than ¼% of GDP.

**Table 5. Compliance with the debt criterion**

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| | | COM[1] | COM[1] |
| **Gap to the debt benchmark** [2,3] | n.r. | n.r. | n.r. |
| **Structural adjustment** [4] | n.r. | 0.55 | 0.12 |
| *To be compared to:* | | | |
| Required adjustment [5] | n.r. | 0.62 | 0.66 |

Notes:

[1] Assessment of the consolidation path according to 2013 COM Autumn Forecast and assuming growth follows COM

[2] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[3] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[4] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[5] Defines the remaining annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM budgetary projections for the previous years are achieved.

Source :

*Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.*

### 4.2. Adjustment towards the MTO

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 Council recommendation required Italy to achieve the MTO of a balanced budget in structural terms in 2014. Instead, the Draft Budgetary Plan postpones the achievement of the MTO to 2015, with a projected structural adjustment of only 0.2 pp of GDP due to the higher investment expenditure adopted with the Draft Budgetary Plan on account of the application for the so called "investment clause", which would allow to temporarily deviate from the adjustment path towards the MTO[2]. However, compliance with

[2] The Draft Budgetary Plan projects a structural balance at -0.3% of GDP in 2014 (vs. -0.7% when recalculated) due to a higher estimate of the potential output resulting from the government medium-term growth projections.

both the EDP debt and deficit criteria according to the Commission Forecast (and not government projections) is the pre-requisite to benefit from the "investment clause". As explained in section 4.1, in 2014 Italy does not comply with the debt criterion according to the Commission Forecast, which incorporates the Draft Budgetary Plan (i.e. including the additional investment expenditure related to the "investment clause"). Therefore, Italy is not eligible to the "investment clause" and should instead continue to make sufficient progress towards the MTO also in 2014 by ensuring a structural adjustment of at least 0.5 pp. of GDP.

According to the information provided in the Draft Budgetary Plan, the growth rate of government expenditure, net of discretionary revenue measures, in 2013 is expected to contribute to an annual structural adjustment towards the MTO by 0.5% of GDP. This is because the growth rate of this expenditure is below -0.8%, the lower rate under the expenditure benchmark. For 2014, the growth rate of this expenditure is almost in line with the even lower rate under the expenditure benchmark (-1.1%).

The different conclusions on Italy's budgetary adjustment in 2013-14 reached when looking at the structural balance and the expenditure benchmark criteria mainly depend on the longer-term perspective underlying the latter, which is based on potential growth projections over 10 years and normal revenues' elasticity.

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.

### 4.3. Other considerations

The measures taken in 2013 do not entail 'significant improvements in the quality and efficiency of public expenditure' as requested in the July Council recommendations, while the spending review plan for 2014 is still too vague for an assessment. On tax policy, the recommended shift of the burden from labour and capital onto consumption and property has been taken up only partially through slight reductions in the tax wedge on labour and capital, while further steps to alleviate the tax burden on productive factors and shift it on consumption and/or property are postponed to future legislation.

## 5. SUMMARY

According to the analysis based on the Commission Autumn 2013 Forecast, there is a risk that the Draft Budgetary Plan will not allow reducing the debt-to-GDP ratio in line with the debt reduction benchmark in 2014. This would also exclude Italy from eligibility to the investment clause, implying a deviation from the required structural adjustment path towards the MTO 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.