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COMMISSION OPINION

of 20.11.2019

on the Draft Budgetary Plan of Italy

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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, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact 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 16 October 2019, Italy submitted the Draft Budgetary Plan for 2020. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013. By letter of 22 October 2019, the Commission asked Italy for further information. It has taken the reply by Italy of 23 October 2019 into account in its assessment of budgetary developments and risks.
4. Italy is subject to the preventive arm of the Stability and Growth Pact. On 9 July 2019, the Council recommended Italy to ensure a nominal reduction of net primary government expenditure of 0.1 % in 2020, corresponding to an annual structural adjustment of 0.6 % of GDP towards the medium-term budgetary objective of 0.5% of GDP, and to use windfall gains to accelerate the reduction of the general government debt ratio¹. As its public debt, at 134.8% of GDP in 2018, exceeds the 60% of GDP reference value of the Treaty, Italy also needs to comply with the debt reduction benchmark.
5. According to the Commission 2019 autumn forecast, the Italian economy is expected to grow by 0.1 % in 2019 and 0.4 % in 2020. Italy's Draft Budgetary Plan expects real GDP to rise by 0.1 % in 2019 and 0.6 % in 2020, both marginally revised down from, respectively, 0.2 % and 0.8 % in the Stability Programme. In terms of composition of GDP growth, the Commission forecast and Italy's Draft Budgetary Plan are broadly aligned, with a sizeable contribution from net trade and a sharp drop of inventories. The estimate for the unemployment rate in the Draft Budgetary Plan is also in line with the Commission forecast. The projected GDP deflator, estimated at 0.9 % in 2019 and 1.3 % in 2020, is instead higher than the Commission forecast (at 0.5 % and 0.9 %, respectively). Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan appear plausible for 2019 and favourable for 2020, especially as regards nominal growth. In fact, the GDP deflator, in particular

¹ Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Italy and delivering a Council opinion on the 2019 Stability Programme of Italy, OJ C 301, 5.9.2019, p. 69.

for private consumption, appears on the optimistic side, given weak underlying price and wage developments. In addition, the planned policy measures might be less growth supporting than envisaged in the Draft Budgetary Plan. Furthermore, the macroeconomic projections are subject to uncertainty and downside risks, as Italy could be exposed to a further weakening of the global economy, with negative ramifications for exports and investments, and a potential worsening of financing conditions given its high public debt. Italy complies with the requirement of Regulation (EU) No 473/2013, since the draft budget is based on independently endorsed macroeconomic forecasts. The Parliamentary Budget Office, Italy's independent fiscal monitoring institution, endorsed both the trend and the programme scenario underlying the Draft Budgetary Plan, observing that the estimates were inside the acceptable range given the information currently available. However, it also noted that the growth outlook for 2020 was subject to downside risks that might further amplify in the following years.

6. Italy's Draft Budgetary Plan projects that the general government deficit will remain stable at 2.2 % of GDP in 2019, below the target set in the Stability Programme (2.4 % of GDP) but above the objective set with the 2019 mid-year budget (2.0 % of GDP). Among others, lower interest spending projected in the Draft Budgetary Plan compared to the Stability Programme is due to the downward shift in sovereign yields observed as of July 2019. For 2020, the Draft Budgetary Plan also projects that the general government deficit will remain stable at 2.2 % of GDP. Based on the Draft Budgetary Plan, the structural balance² is projected to improve by 0.3 % of GDP in 2019 and to deteriorate by 0.1 % of GDP in 2020.
7. The Commission forecast projects that the general government deficit will remain stable at 2.2 % of GDP in 2019, in line with the Draft Budgetary Plan, before however increasing to 2.3 % in 2020. The difference between the Commission forecast and the Draft Budgetary Plan in 2020 is mainly due to the Commission's more conservative projections both for nominal GDP growth (1.4 % instead of 2.0 %), reflected in lower projected revenues, and for the expected revenues from the planned measures against tax fraud (overall around 0.2% of GDP in the government plans). While those measures appear overall well specified and are expected to support revenues in a structural way, the precise yields of measures against tax fraud are intrinsically uncertain and warrant a prudent approach. Based on an individual assessment of each measure, the Commission forecast considers overall around two thirds of the additional revenues expected by the government from the new measures against tax fraud. At the same time, the Commission forecast assumes the activation of the spending-freezing mechanism included in the 2020 draft budget as a safeguard clause. According to the clause, ministries are allowed to spend part of the funds allocated by the budget (for a total of EUR 1 billion, 0.06% of GDP) only in case the headline deficit target is expected to be met based on a specific mid-year monitoring. In light of the higher deficit expected in 2020, the Commission forecast assumes that the frozen funds will not be spent, with a positive effect on public finances. Based on the Commission forecast, the structural balance is projected to improve by 0.2 % of GDP in 2019 and to deteriorate by 0.3 % of GDP in 2020. The larger structural deterioration projected in the Commission forecast for 2020 is due to a higher headline deficit and a slightly different assessment of one-off measures. Risks to the budgetary projections of both the Draft Budgetary Plan and the Commission include

² Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

worse-than expected macroeconomic developments, lower yields from the planned measures against tax fraud, as well as higher spending for the new minimum income or early retirement schemes. Furthermore, any increase in sovereign risk premia compared to the relatively low level observed as of September 2019 would imply higher interest spending than projected by both the Draft Budgetary Plan and the Commission forecast.

8. Italy's fiscal stance is slightly expansionary in 2020, as reflected by the deterioration of the structural balance projected by the Draft Budgetary Plan. The Commission 2019 autumn forecast projects a more expansionary fiscal stance. In the government projections, the measures included in the Draft Budgetary Plan have an overall deficit-increasing impact of 0.9 % of GDP compared to the projections based on unchanged legislation. This mainly comes from the repeal of the Value Added Tax hike worth 1.3 % of GDP, legislated as a safeguard clause for 2020, net of which the Draft Budgetary Plan has a deficit-reducing impact of 0.4 % of GDP. In addition to the repeal of the Value Added Tax hike, the main deficit-increasing measures for 2020 include the creation of a fund to reduce the tax wedge on labour (0.2 % of GDP); the creation of two funds for public investment at the central and the local level of government; and additional spending for "unchanged policies", including the refinancing of military missions abroad. The main deficit-reducing measures for 2020 include a spending review (0.1 % of GDP), new provisions against tax evasion (0.2 % of GDP), a review of environmentally harmful tax expenditures and several smaller changes in the tax regime.

The Recommendation of 9 July 2019 addressed by the Council to Italy included the recommendations shift taxation away from labour, fight tax evasion, and implement fully past pension reforms to reduce the share of old-age pensions in public spending and create space for other social and growth-enhancing spending. With respect to these recommendations, the Italian authorities have earmarked resources to reduce the tax wedge of labour while marginally reducing tax expenditures, and substantially stepped up the fight against tax evasion. No measures were taken to reduce the share of old-age pensions in public spending.

9. In its Draft Budgetary Plan for 2019, Italy indicated that the budgetary impact of the extraordinary maintenance programme for the road network following the collapse of the Morandi bridge in Genoa as well as of the preventive plan to limit hydrogeological risks following exceptionally adverse weather conditions that occurred in 2018 is significant and should be considered as an unusual event outside the control of the government, for the purposes of Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97. In relation to this, Italy requested a temporary deviation from the adjustment path towards the medium-term budgetary objective of 0.2 % of GDP in 2019. In its Draft Budgetary Plan for 2020, Italy revised this amount to 0.18 % of GDP, indicating that around half of the corresponding funds had been spent as of September 2019. The Commission provisionally assessed Italy to be eligible for an allowance of 0.18 % of GDP in 2019 in relation to costs considered by the Commission to have a clear and direct link to the invoked unusual events. The Commission will make a final assessment, including on the eligible amounts, in spring 2020 based on observed data as provided by the authorities. In its Draft Budgetary Plan for 2020, Italy also indicated that the budgetary impact of the preventive plan to limit hydrogeological risks will be significant also in 2020 and, in relation to that, requested a temporary deviation from the adjustment path towards the medium-term budgetary objective amounting to 0.2 % of GDP in 2020. As

regards costs related to 2020, the Commission will make a final assessment, including on the eligible amounts, in spring 2021, on the basis of observed data as provided by the authorities.

10. In 2019, for Italy to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 0.1 %, corresponding to an annual structural adjustment of 0.6 % of GDP. Based on the Draft Budgetary Plan, the expenditure benchmark points to a risk of a significant deviation both in 2019 (gap of 0.7 % of GDP) and over 2018 and 2019 taken together (gap of 0.7 % of GDP per year, on average). The structural balance pillar points to a risk of some deviation over one year (gap of 0.3 % of GDP) and to a risk of a significant deviation over 2018 and 2019 taken together (gap of 0.3 % per year, on average). An overall assessment based on the government plans points to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective recommended by the Council for 2019. In case the budgetary impact of the extraordinary maintenance programme for the road network and the prevention plan to secure the national territory against hydrogeological risks were taken into account for 2019, the expenditure benchmark would point to the risk of significant deviation and the structural balance to the risk of some deviation from the adjustment path towards the medium-term budgetary objective in 2019. Based on the Commission forecast, the expenditure benchmark points to a risk of a significant deviation both in 2019 (gap of 0.7 % of GDP) and over 2018 and 2019 taken together (gap of 0.7 % of GDP per year, on average). The structural balance pillar points to a risk of some deviation over one year (gap of 0.4 % of GDP) and to a risk of a significant deviation over 2018 and 2019 taken together (gap of 0.4 % per year, on average). An overall assessment based on the Commission forecast points to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective in 2019. That conclusion would not change even if the budgetary impact of the extraordinary maintenance programme for the road network and the prevention plan to secure the national territory against hydrogeological risks were taken into account for 2019.
11. In 2020, for Italy to comply with the requirements of the preventive arm, the nominal rate of reduction of government expenditure, net of discretionary revenue measures and one-offs, should be at least 0.1 %, corresponding to an annual structural adjustment of 0.6 % of GDP. Based on the Draft Budgetary Plan, the expenditure benchmark points to a risk of a significant deviation both in 2020 (gap of 1.0 % of GDP) and over 2019 and 2020 taken together (gap of 0.8 % of GDP per year, on average), as the growth rate of government expenditure, net of discretionary revenue measures and one-offs, will exceed that recommended by the Council. The structural balance pillar also points to a risk of significant deviation both over one year (gap of 0.7 % of GDP) and over 2019 and 2020 taken together (gap of 0.5 % per year, on average). An overall assessment based on the government plans points to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective in 2020. That conclusion would not change even if the budgetary impact of the extraordinary maintenance programme for the road network and the prevention plan to secure the national territory against hydrogeological risks were taken into account for 2019 and for 2020. Based on the Commission forecast, the expenditure benchmark points to a risk of a significant deviation both in 2020 (gap of 1.0 % of GDP) and over 2019 and 2020 taken together (gap of 0.9 % of GDP per year, on average). The structural balance pillar points to a risk of significant deviation both over one year (gap of 0.9 % of GDP) and over 2019 and 2020 taken together (gap of

0.6 % per year, on average). An overall assessment based on the Commission forecast points to a risk of significant deviation from the adjustment path towards the medium-term budgetary objective recommended in 2020. That conclusion would not change even if the budgetary impact of the extraordinary maintenance programme for the road network and the prevention plan to secure the national territory against hydrogeological risks were taken into account for 2019 and for 2020.

12. The Draft Budgetary Plan indicates that the government debt-to-GDP ratio, after increasing from 134.8 % in 2018 to 135.7 % in 2019, will decrease to 135.2 % in 2020, mainly thanks to sustained nominal GDP growth and declining interest spending. Italy is not projected to comply with the debt reduction benchmark in 2019 and 2020. That conclusion is confirmed based on the Commission 2019 autumn forecast, which expects that Italy's debt-to-GDP ratio will increase from 134.8 % in 2018 to 136.2 % in 2019 and 136.8 % in 2020, resulting in gaps from the debt reduction benchmark of 8.8% and 8.6% of GDP respectively.
13. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Italy is at risk of non-compliance with the provisions of the Stability and Growth Pact. In particular, the Commission projects a risk of significant deviation from the required adjustment towards the medium-term budgetary objective for 2019 and 2020. Moreover, Italy is not projected to comply with the debt reduction benchmark in 2019 and 2020. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2020 budget will be compliant with the Stability and Growth Pact and to use any windfall gains to accelerate the reduction of the government debt-to-GDP ratio.

The Commission is also of the opinion that Italy has made some progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 9 July 2019 in the context of the European Semester and invites the authorities to make further progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2020 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2020.

Done at Brussels, 20.11.2019

For the Commission
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