Il Ministro
dell'Economia e delle Finanze
P. 2840

Rome, 9 May 2016

Dear Valdis, dear Pierre

In order to allow the Commission to fully consider the views of the Italian Government to comprehensively assess compliance with the deficit and debt criteria, please find hereby attached detailed information on relevant factors influencing recent debt developments in Italy, in accordance with provision of art. 2(3) of Council Regulation n. 1467/97.

Reducing the public debt-to-GDP ratio is one of the key economic policy goals of the Italian government together with the commitment to deficit reduction. Italy's gross public debt-to-GDP ratio already virtually stabilized in 2015, despite adverse global economic conditions. The government expects the debt ratio to start declining in 2016 and continue more sharply in 2017-2019. Moreover, since 2012, thanks to consistent primary surpluses, Italy's budget deficit has always been equal to or below the 3 percent-of-GDP threshold; after reaching 2.6 percent in 2015, it will decline further to 2.3 percent this year and 1.8 percent in 2017. At the same time, as carefully documented in the Stability Programme, the implementation of a comprehensive programme of structural reforms is on track while further, more ambitious measures have been taken, notably in the banking sector and regarding insolvency procedures.

The April 2016 Stability Programme ensures compliance with the preventive arm of the SGP in 2016. As for 2017, the government confirms that the "safeguard clauses", whereby VAT rates will be hiked in January 2017, remain in place, as they can only be repealed by means of new legislation. In the Stability Programme, the government declares its intention to implement an overall fiscal package, the components of which will be illustrated in the Draft Budgetary Plan in October and legislated via the 2017 Budget by end-year. The repeal of the 2017 safeguard clause will be conditional upon implementing deficit reduction measures to comply with the preventive arm of the SGP in 2017.

- Mr. Valdis Dombrovskis

Vice President European Commission

- Mr. Pierre Moscovici

Commissioner for Economic and Financial Affairs
European Commission
Brussels

As already acknowledged by the Commission in its Report prepared in accordance with Article 126 (3) in 2015, particularly low inflation make the respect of the debt rule particularly demanding. As a matter of fact, the current economic environment is even more challenging for debt reduction, as global deflationary pressures have intensified. Against this backdrop, a tighter fiscal policy compared to the 2016 Stability Program would worsen the growth performance of the Italian economy and the evolution of the debt-to-GDP ratio. This argument is particularly relevant at low levels of economic activity, as fiscal multipliers are larger and entail higher risks that fiscal consolidation could prove to be self-defeating. Moreover, the estimation of Italy's structural budget balance is beset by serious empirical issues that have been signaled in several occasions. In our view, the underestimation of Italy's output gap severely affects the assessment of compliance with the Stability and Growth Pact.

In addition, both in 2015 and 2016 Italy incurred extraordinary costs equivalent to 0.2 percent of GDP on an annual basis as it dealt with a large wave of immigrants and asylum seekers. We believe that these additional budgetary efforts, largely related to the costs of border control and immediate relief, should also been considered when assessing deficit and debt developments.

Finally, let me recall that thanks to the reforms already enacted in age-related expenditure, Italy fares the best value of the long-term sustainability indicator (S2) among EU countries; this adds to having one of the most favorable debt-maturity structures among EU countries while, considering overall private and public debt, as well as contingent liabilities, the position of Italy is in line with major EU countries.

I trust that the above elements will be duly taken into account in your report.

Yours sincerely

Pier Carlo Padoan

Attachments:

Note on relevant factors influencing recent debt developments in Italy