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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 2016 submitted on 15 October 2015 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 Stability and Growth Pact and should achieve a fiscal adjustment of at least 0.25% of GDP towards the medium-term budgetary objective (MTO) in 2015 and of 0.1% of GDP in 2016, taking into account the allowed deviation for the implementation of major structural reforms. As the debt-to-GDP ratio was 123.2% 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 debt rule.

5. Compared to the 2015 Stability programme, Italy's 2016 Draft Budgetary Plan revised real GDP growth for 2015 upward (to 0.9%), with private domestic demand and exports set to be its main drivers, and the GDP deflator growth significantly downward (to 0.3%). The Commission forecast is broadly in line with these projections (real GDP growth at 0.9% and GDP deflator at 0.4%). For 2016, the Draft Budgetary Plan also projects higher real GDP growth (at 1.6%) and somewhat lower GDP deflator (at 1%) compared to the 2015 Stability Programme, broadly in line with the Commission forecast (growth at 1.5% and GDP deflator increasing by 1%) despite a slightly different growth composition. Both the Draft Budgetary Plan and the Commission expect unemployment to decline further albeit remaining at high levels. Overall, the macroeconomic projections outlined in Italy's 2016 Draft Budgetary Plan appear plausible. Downside risks to these projections are related to a further loss of momentum in the external demand.

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 Parliamentary Budget Office, Italy's independent fiscal monitoring institution as being "within an acceptable interval given the information currently available". The Parliamentary Budget Office assessed the government growth projections for 2016 as being close to the upper bound of its forecast range, therefore subject to downside risks.

7. Italy's 2016 Draft Budgetary Plan projects the general government deficit to decrease to 2.6% in 2015, down from 3.0% of GDP in 2014, in line with the Stability Programme. For 2016, the Draft Budgetary Plan projects the government deficit to decline to 2.2% of GDP, well above the 2015 Stability Programme target of 1.8% of GDP. The difference results mainly from deficit increasing measures worth 0.9% of GDP, envisaged in the Draft Budgetary Plan. The planned (recalculated) improvement in the structural balance is slightly smaller for 2015 (0.2% of GDP) compared to the Stability Programme. For 2016, the structural balance is set to deteriorate by around 0.5% of GDP compared to a zero structural adjustment in the Stability Programme.

   The fall in interest expenditure since the peak reached in 2012 has decisively contributed to maintain the structural balance broadly stable between 2012 and 2015 (around 0.3% over the three years) despite some deterioration in the structural primary balance (around -0.6% over the three years) in a context of low inflation and (up to 2014) economic contraction. In 2016, an additional reduction of interest expenditure by 0.1% of GDP is anticipated in the Draft Budgetary Plan.

8. The Draft Budgetary Plan indicates that the budgetary impact of the refugee crisis is significant and should be considered as an unusual event outside the control of the government, as defined in article 5.1 and article 6.3 of Regulation (EC) No 1466/97. In relation to this, Italy requested for additional flexibility amounting to 0.2% of GDP, i.e. the total annual amount of the migration-related outlays foreseen for 2016. If the unusual event circumstances are recognised, the Draft Budgetary Plan envisages an increase in the headline deficit by this amount and consequently a further structural deterioration. The government currently estimates the additional costs in 2015 with respect to 2014 at below 0.1% of GDP. At this stage, no additional costs are estimated for 2016 with respect to 2015. The Commission will make a final assessment of the fulfilment of the conditions and the eligible amounts on the basis of observed data as provided by the Italian authorities.

9. The Commission forecast expects the headline deficit to be at 2.3% of GDP in 2016, down from 2.6% in 2015. The higher headline and structural deficit forecast by the Commission in 2016 is due to a more cautious assessment of revenue developments and of some measures enshrined in the Draft Budgetary Plan, namely additional revenues from gaming, only partly compensated by lower interest expenditure. The projected structural adjustment amounts to 0.1% in 2015, followed by a deterioration of 0.5% in 2016. The lower structural adjustment forecast by the Commission in 2015, despite the same headline deficit as in the Draft Budgetary Plan, is also due to the fact that the latter treats the additional outlays related to the migration inflow compared to a 2011-2013 average as one-offs. Overall, downside risks to both the Commission and the government budgetary projections are related to possibly worse-than-expected macroeconomic outcomes, including persistently low inflation, as well as to partial or inadequate implementation of the measures in the Draft Budgetary Plan.

10. The Draft Budgetary Plan projects the debt-to-GDP ratio to peak at 132.8% in 2015 and to decline to 131.4% of GDP in 2016. The Commission forecast expects a similar debt-to-GDP ratio in 2015 followed by a smaller debt reduction in 2016, due to a lower primary surplus, a marginally higher snow-ball effect, and a more prudent assessment of planned privatisation proceeds. Risks to the debt projections for 2016 are mainly related to a worse-than-anticipated growth outlook, lower privatisation intake, as well as lower inflation.

11. The measures underpinning Italy's Draft Budgetary Plan have a net negative impact on the 2016 headline deficit of 0.9% of GDP. Deficit increasing measures, worth overall 1.7% of GDP, include, among others, the repeal of a previously legislated VAT hike, the abolition of recurrent taxation on first residences, agricultural real estate, and immovable machinery for productive use, as well as measures to further reduce the tax wedge, for instance acting on employers' social contributions, and to incentivise public and private investment. Deficit reducing measures, worth overall 0.8% of GDP, include, among others, additional expenditure savings by all levels of government through the rationalisation of central government expenditure, lower transfers to Provinces and Regions, as well as more centralised public procurement, one-off capital taxes related to the extended voluntary disclosure of assets held abroad and other permanent revenue proceeds from gaming. A further increase of the VAT rate, which may be replaced by other measures having an equivalent budgetary impact, is also envisaged in the Draft Budgetary Plan to safeguard the planned budgetary targets as of 2017.

12. Until 2015 Italy is in a transition period for the assessment of compliance with the debt rule. In 2015, under the projected unfavourable economic conditions, the required minimum linear structural adjustment based on the Draft Budgetary Plan would be 1.3% of GDP, well above the 0.1% of GDP adjustment recommended by the Council and Italy's planned structural effort of 0.2%. Based on the Commission forecast, the minimum linear structural adjustment would amount to 2% of GDP in 2015, well above the forecast structural adjustment of 0.1% of GDP. For 2016, the Draft Budgetary Plan projects to comply with the debt rule in its forward-looking formulation, also due to planned privatisation proceeds. This is not corroborated by the Commission forecast.

13. On 27 February 2015, the Commission issued a report under Article 126(3) of the TFEU, as Italy was not expected to make sufficient progress towards compliance with the debt rule in 2014-2015. The analysis concluded that the debt criterion should be considered as complied with at that time.

14. In 2015, Italy has to achieve a structural adjustment of 0.25% of GDP towards its MTO. The planned (recalculated) structural effort of 0.2% of GDP, points to some deviation. The expenditure benchmark also points to some deviation. Overall, Italy plans some deviation from the required adjustment towards the MTO in 2015. This conclusion is confirmed based on the Commission 2015 autumn forecast, even if the Commission does not consider the refugee-related expenditure as a one-off.

15. For 2016, Italy's Draft Budgetary Plan was accompanied by a formal request to avail itself of 0.4% of GDP additional flexibility under the preventive arm, on top of the 0.4% of GDP already granted by the Council in July under the structural reform clause. This request includes an additional 0.1% of GDP deviation under the structural reform clause and 0.3% of GDP under the investment clause. The Commission notes that granting at this stage the additional flexibility requested would take place outside the normal European Semester cycle and depart from the process envisaged in its Communication on the flexibility within the SGP. At the same time, it appears that the eligibility criteria for the investment clause appear to be met on the basis of the Commission forecast. As regards the request for additional flexibility under the structural reform clause, the Commission recalls the substantial flexibility granted in recognition of the ongoing structural reform effort. In assessing the request for further flexibility next spring, the Commission will consider progress

made with the structural reform agenda, taking into account the Council recommendations.

The Draft Budgetary Plan envisages a (recalculated) structural deterioration of 0.5% of GDP in 2016 which compared to the improvement of 0.1% of GDP required in the country-specific recommendation, points to a risk of significant deviation from the adjustment path towards the MTO. This is also confirmed by the expenditure benchmark. The Commission forecast envisages a structural deterioration of the same magnitude, which points to a risk of a significant deviation from the required adjustment towards the MTO, while the expenditure benchmark points instead to a risk of some deviation. The discrepancy between the two indicators is mainly due to revenue shortfalls resulting from the protracted low inflation and subdued wage increases, which are not reflected in the expenditure benchmark. These shortfalls were foreseeable and cannot be considered as temporary. Therefore, the structural balance seems to be a better indicator of the government's fiscal stance at the current juncture. An overall assessment thus points to a risk of a significant deviation from the adjustment path towards the MTO in 2016. An exclusion from the assessment of the budgetary impact of the exceptional inflow of refugees would not change this conclusion.

16. Italy has taken some steps to reduce the labour tax wedge and to reform the taxation system at large. As regards the former, Italy’s 2016 Draft Budgetary Plan foresees a temporary exemption for social contributions paid to new permanent employees hired in 2016. However, the enabling law to make the system of taxation more efficient and equitable has been only partially implemented and the recommended reform of cadastral values and all-encompassing revision of tax expenditures, as well as the rationalisation of environmental taxation, have not been implemented. In addition, recent decisions on housing taxation do not appear in line with achieving a more efficient tax structure by shifting the tax burden away from productive factors onto other revenue bases. As regards the spending review, more effort is needed to make it an integral part of the budgetary process across all levels of government.

17. Overall, the Commission is of the opinion that the 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 provisions of the Stability and Growth Pact. In particular, according the Commission 2015 autumn forecast there is a risk of significant deviation from the required adjustment path towards the MTO in 2016. The Commission will continue to closely monitor Italy's compliance with the obligations under the SGP, notably in connection with the assessment of the next Stability Programme. In the context of the 'overall assessment' of a possible deviation from the adjustment path towards the MTO, the Commission will take into account the above considerations on Italy's possible eligibility for flexibility under the SGP. Particular attention will be paid to whether a deviation from the adjustment path is being effectively used for the purposes of increasing investments; to the existence of credible plans for the resumption of the adjustment path towards the MTO; and to progress with the structural reform agenda, taking into account the Council recommendations. The Commission therefore invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the SGP.

The Commission is also of the opinion that Italy has made some progress with regard to the country-specific recommendations issued by the Council in the context of the 2015 European Semester relating to fiscal governance and thus invites the authorities to make further progress. A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the Country Specific Recommendations adopted by the Commission in May.

Done at Brussels, 16.11.2015

For the Commission
Pierre MOSCOVICI
Member of the Commission

CERTIFIED COPY
For the Secretary-General,

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Director of the Registry
EUROPEAN COMMISSION