European Commission Opinion on the 2019 draft budgetary plan of Italy

The Commission has issued an Opinion on the Italian draft budgetary plan for 2019. It requests that Italy presents a revised draft budgetary plan as soon as possible, and in any event within three weeks of today's decision. This is the first time that the Commission adopts such an Opinion.

What is the Opinion of the Commission on Italy's draft budgetary plan?

The Commission's assessment is that the draft budgetary plan is not in line with the recommendation of the Council addressed to Italy in July 2018. Italy plans a deterioration in the structural balance for 2019 that amounts to 0.8% of GDP, while the Council recommended a structural improvement of 0.6% of GDP.

The Commission is of the opinion that the 2019 draft budgetary plan submitted by Italy for 2019 presents a significant deviation from the recommended adjustment path towards the agreed medium-term budgetary objective. This is because of a large projected deterioration in the structural balance and a growth rate of government expenditure, net of discretionary revenue measures and one-offs, which are well above the reference rate. Moreover, there are significant downside risks to the projections presented in the draft budgetary plan, which could make the situation even worse. Italy's independent fiscal monitoring institution (Ufficio Parlamentare di Bilancio) has not endorsed the macroeconomic forecast underlying the 2019 draft budgetary plan.

The projected fiscal expansion, coupled with the downside risks to nominal GDP growth, endangers the reduction in Italy's still large debt-to-GDP ratio, notably the requirement, agreed by all Member States, to bring the debt down towards the 60% of GDP reference value of the Treaty. High debt remains a major vulnerability for the economy.

The Commission also notes that the draft budgetary plan is not in line with the commitments presented by Italy in its Stability Programme of April 2018. In its Stability Programme, Italy announced that it would target a deficit of 0.8% of GDP in 2019. The 2019 draft budgetary plan expects the government deficit to markedly increase to 2.4% of GDP in 2019 – three times higher than initially planned.

What exactly did the Council recommend to Italy?

Italy is currently subject to the preventive arm of the Stability and Growth Pact. On 13 July 2018, the Council, including Italy, recommended unanimously that Italy should ensure that the nominal growth rate of net primary government expenditure does not exceed 0.1% in 2019, corresponding to an annual structural adjustment of 0.6% of GDP. That recommendation had also been endorsed by the European Council of 28 June 2018.

Why is the macroeconomic scenario problematic?

EU rules set out that macroeconomic forecasts underlying draft budgetary plans have to be prepared or endorsed by an independent body. This is not the case for Italy. The Parliamentary Budget Office, Italy's independent fiscal monitoring institution, did not validate the macroeconomic projections underlying Italy's policy scenario for 2019, "as they lie outside the range of acceptable values on the basis of the information currently available" and are therefore subject to significant downside risks.

Have you taken on board the views of the Italian government?

The Commission consulted Italy via a letter sent on 18 October 2018, asking for further information. The observations from Italy's reply of 22 October 2018 have been taken into account in the Commission Opinion.

Does the Commission expect Italy to change its budgetary priorities?

Italy, like all other Member States, has the right to choose its budgetary priorities: to invest more in infrastructure, to roll out a universal income or to focus on the eradication of poverty. The role of the Commission is to assess whether Italy fulfils the fiscal commitments that it has itself taken before the other Member States: the recommendation addressed to Italy regarding the requirements under the Stability and Growth Pact was, as for all Member States, endorsed unanimously by the European Council of 28 June 2018 and adopted by the Council of the European Union on 13 July 2018, including Italy.

Why is the Italian case different from other countries? Why haven't you asked other countries to revise their plans?

Italy plans a deterioration in the structural balance for 2019 that amounts to 0.8% of GDP, while the Council, including Italy, recommended a structural improvement of 0.6% of GDP.

First, the Council recommendation to Italy calls for a fiscal improvement in 2019: given the size of the Italian debt and the ongoing economic recovery, this is the right time to adjust and rebuild fiscal buffers at national level. The Italian authorities have decided to opt for a draft budgetary plan with a net deficit-increasing impact of around 1.2%. While it has happened in the past that Member States deliver a fiscal adjustment smaller than the one required by the Council, there are no cases of large fiscal expansion when countries were recommended to make a fiscal effort.

Second, according to Italy's own plans, the gap between the planned fiscal deterioration and the adjustment recommended by the Council would amount to 1.4% of GDP. Such a large gap compared to the Council requirement, based on the Member State's own plans, has no precedent since the introduction of the jointly agreed process for assessing draft budgetary plans for euro area Member States back in 2013.

Where does Italy stand regarding government debt?

Italy’s public debt-to-GDP ratio, at 131.2% in 2017, is the second largest in the European Union in relative terms and one of the largest in the world. In 2017, it represented an average burden of €37,000 per inhabitant. The large stock of public debt deprives Italy of the fiscal space it needs to stabilise its economy in case of macroeconomic shocks and represents an inter-generational burden weighing on the standard of living of future Italians. The fact that debt-servicing costs absorb a considerably larger amount of public resources in Italy than in the rest of the euro area also takes a toll on the country’s productive spending. Italy’s interest expenditure stood in 2017 at around €65.5 billion or 3.8% of GDP, which was broadly the same amount of public resources devoted to education.

Moreover, a large public debt, in the absence of prudent fiscal policies, could also amplify the effect of market confidence shocks on sovereign yields, with a proportionally larger negative impact on both the interest bill paid by the country as well as the overall financing cost for the real economy.

What are the economic circumstances relevant for today’s Opinion?

Italy’s economy is characterised by weak growth and productivity dynamics in comparison to the European Union average, with negative employment and social consequences. Boosting potential growth and tackling long-lasting stagnation in productivity require a comprehensive reform strategy. However, the measures included in the 2019 draft budgetary plan also indicate a risk of backtracking on reforms that Italy had adopted in line with past Country-Specific Recommendations, as well as with regard to the structural fiscal aspects of the recommendations addressed to Italy by the Council on 13 July 2018.

How has Italy benefitted from the flexibility within the Stability and Growth Pact?

Italy has been the main beneficiary of the flexibility applied within the Stability and Growth Pact in recent years, for an amount in the order of €30 billion (or 1.8% of GDP) between 2015 and 2018. This was on account of a variety of factors, including bad economic conditions, support for structural reforms and investment, and “unusual events” related to security threats, the refugee crisis and earthquakes.

In what other way has the EU supported Italy?

Italy is the second largest recipient under the Juncker Plan, the Investment Plan for Europe which started at the end of 2014. In that context, the total financing in Italy has reached €8.9 billion, which is expected to generate over €50 billion of new investments. Moreover, Italy is the second largest beneficiary of the European Structural and Investment Funds, with €44.7 billion of Union support over 2014-2020, which represents an average of €735 per person from the Union budget.

What are the next steps?

According to the applicable rules that Member States have jointly agreed on (Article 7(2) of Regulation (EU) No 473/773), the Italian government now has three weeks to present a revised draft budgetary plan. The Commission will assess that plan and publish an Opinion before the end of November.

The Commission intends to publish its Autumn Economic Forecast on 8 November 2018.

For More Information

Press release:

European Commission invites Italy to present a revised draft budgetary plan for 2019

European Semester

Draft budgetary plans 2019

Regulation (EU) No 473/2013

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