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COMMISSION OPINION

on the existence of an excessive deficit in Italy

Application of Article 104(5) of the Treaty establishing the European Community

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THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

1. Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future¹, although some of the costs of the government support could be recouped in the future.
2. The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation, and thereby ensuring long-term sustainability of public finances.

LEGAL BACKGROUND

3. Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 “on speeding up and clarifying the implementation of the excessive deficit procedure”², which is part of the Stability and Growth Pact.

¹ See the Eurostat decision of 15 July 2009 on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis, Eurostat News Release No 103/2009.

² OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the “Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes”, endorsed by the ECOFIN Council of 11 October 2005, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm.

4. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).
5. Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to “take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State”.
6. On the basis of the data notified by the Italian authorities in April 2009³ and taking into account the Commission services’ spring 2009 forecast, the Commission adopted a report under Article 104(3) for Italy on 7 October 2009⁴.
7. Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 October 2009.
8. Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. In order to reach a conclusion on whether an excessive deficit exists or may occur, the Commission considers that account should be taken of: (i) the conclusions of its report under Article 104(3) and (ii) the opinion of the Economic and Financial Committee on this report. On the basis of these elements, the Commission has established a number of considerations for Italy.

CONSIDERATIONS CONCERNING ITALY

9. In June 2005 an EDP for Italy was initiated by the Commission with the adoption of a report under Article 104(3), based on a general government deficit of 3.1% of GDP in both 2003 and 2004 and government debt at around 106-107% of GDP, both above the respective reference values of 3% and 60% of GDP⁵. On 28 July 2005, the Council decided, on a recommendation from the Commission, that Italy was in excessive deficit according to Article 104(6). At the same time, and also based on a Commission recommendation, the Council addressed recommendations under Article 104(7) to Italy with a view to bringing the situation of an excessive

³ According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Italy can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables

⁴ All EDP-related documents for Italy can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2

⁵ After successive revisions, the general government deficit is currently reported at 3.5% of GDP in both 2003 and 2004. For the same years, the debt ratio has been revised downwards to around 104% of GDP, essentially due to the revision of nominal GDP levels.

government deficit to an end, by 2007 at the latest. In June 2008, following an overall assessment which showed that the correction of the excessive deficit was completed in 2007, the Council decided, again on a recommendation from the Commission, to abrogate its earlier decision on the existence of an excessive deficit according to Article 104(12).

10. In 2008 Italy's general government deficit increased to 2.7% of GDP, while the debt ratio rose to 105.8%. The budgetary deterioration from 2007 and the worse outturn compared to the official projections and the Commission forecast are partly the consequence of the economic downturn (real GDP contracted by 1% in the whole year) and partly the effect of a moderately expansionary fiscal stance (the structural balance deteriorated by around ½ pp. of GDP from 2007).
11. According to data notified by the Italian authorities in April 2009, the general government deficit in Italy was planned to reach 3.7% of GDP in 2009, thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considered that the planned deficit was not close to the 3% of GDP reference value but that the planned excess over the reference value could be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact, on the basis of the information available at the time of the report. Furthermore, the planned excess over the reference value could not be considered temporary.
12. According to more recent data notified by the Italian authorities in October 2009, the general government deficit in Italy is now planned to reach 5.3% of GDP in 2009, above and not close to the 3% of GDP reference value. Based on the Commission services' autumn 2009 forecast, the planned excess over the reference value still qualifies as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it results from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. The Commission services' autumn 2009 forecast projects real GDP in Italy to contract by 4.7% in 2009, after decreasing by 1% in 2008. A moderate recovery is anticipated for 2010, strengthening in 2011. Furthermore, also on the basis of the Commission services' autumn 2009 forecast, the planned excess over the reference value cannot be considered temporary, since the deficit is projected to remain broadly stable in 2010 and, on a no-policy change basis, to decrease marginally in 2011. The discretionary measures taken with the successive recovery packages to respond to the crisis in line with the EERP (targeted to support low-income groups and key industrial sectors) are not expected to appreciably weigh on the government balance, as they are officially fully financed mainly by reallocating existing funds. The deficit criterion in the Treaty is not fulfilled.
13. According to data notified by the Italian authorities in October 2009 general government gross debt has been well above the 60% of GDP reference value since before the start of stage III of economic and monetary union and is planned to stand at 115.1% of GDP in 2009. The Commission services' autumn 2009 forecast projects the debt ratio to rise further, to 117.8% in 2011. The debt ratio cannot be considered as diminishing sufficiently and approaching the reference value at a satisfactory pace within the meaning of the Treaty and the Stability and Growth Pact. The debt criterion in the Treaty is not fulfilled.

14. In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report “relevant factors”. According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Italy, the double condition is not met. Considered on their own merit, the relevant factors in the current case on balance present a mixed picture.
15. The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

CONCLUSION

16. The monitoring of the budgetary situation in Italy and, in particular, the examination of the compliance with the criteria laid down in Article 104(2) has led the Commission to prepare a report in accordance with Article 104(3) of the Treaty. The Commission, having taken into account its report and the opinion of the Economic and Financial Committee, is of the opinion that an excessive deficit exists in Italy.