COUNCIL OF
THE EUROPEAN UNION

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit in Italy

COUNCIL RECOMMENDATION

of

with a view to bringing an end to the situation of an excessive government deficit in Italy

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof,

Having regard to the recommendation from the Commission, Whereas:

(1) According to Article 104 of the Treaty, Member States are to avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The Ecofin Report to the European Council on "Improving the implementation of the Stability and Growth Pact", endorsed by the latter on 22 March 2005, confirms that the Stability and Growth Pact is an essential part of the macroeconomic framework of the Economic and Monetary Union and presents proposals for strengthening and clarifying its application.

(4) The Council has decided on 28 July 2005, in accordance with Article 104(6) of the Treaty, that an excessive deficit exists in Italy.

(5) Having decided on the existence of an excessive deficit in Italy, the Council, in accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[1] is required to make at the same time recommendations to the Member State concerned with a view to bringing that situation to an end within a given period. The Council recommendation has to establish a deadline for effective action to be taken by Italy to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances. On 20 March 2005, the Council agreed that the determination of the existence of special circumstances should take into account a balanced overall assessment of other relevant factors.

(6) In deciding on the existence of special circumstances, the following elements should be taken into account.

(7) A rapid correction of the excessive deficit in Italy appears essential given the high debt-to-GDP ratio and the high level of the structural deficit (the cyclically-adjusted deficit, excluding one-offs and other temporary measures), and considering that persistent budgetary imbalances weigh on confidence and ultimately affect output growth. The budgetary situation of Italy progressively deteriorated over the recent years. In particular, the primary balance has rapidly declined from 5% of GDP in 1999 to below 2% of GDP in 2004. In view of the high debt, this level, which reflects only to some extent the economic slowdown, calls for a lasting improvement in the public finances. However, in determining the adjustment path, consideration needs also to be given to the current economic situation and the size of the required budgetary correction. While in the case of Italy budgetary consolidation is essential for growth in the medium term, especially if it is of the right composition and it strengthens confidence, too large an effort in too short a period may prove economically costly, in particular considering the current cyclical weakness.

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1 OJ L 209, 2.8.1997, p. 6. Regulation as amended by Regulation (EC) No 1056/2005 (OJ L 174, 7.7.2005, p. 5).

(8) On the basis of recent economic data, according to which GDP fell for two consecutive quarters at the end of 2004 and beginning of 2005, GDP growth in 2005 is now expected to be around zero, down from 1,2% in 2004. This stagnation compares to the 1,2% growth foreseen in the Commission spring forecast for 2005. As a result of the significantly worsened GDP growth prospects, the upward revision to the 2004 deficit, as well as the revision of the contribution from temporary measures to about 0,4% of GDP from the originally planned ¾% of GDP, the 2005 deficit-to-GDP ratio is now expected to be above 4%, compared to 3,6% in the Commission spring forecast. Assuming no additional measures in 2005, and GDP growth recovering to 1,5% in 2006, bringing the deficit below 3% in 2006 would require an adjustment in structural terms, relative to 2005, of more than 1,5% of GDP.

(9) All in all, in view of a balanced overall assessment of all relevant factors, notably the current cyclical weakness in Italy together with the size of the required adjustment to bring the deficit below the 3% of GDP reference value by 2006, the Council takes the view that special circumstances exist and an extension of the deadline for the correction of the excessive deficit to 2007 is warranted.

(10) In general, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy. In the case of Italy, the correction of the excessive deficit needs to be framed within a comprehensive reform strategy aiming at tackling the deep-rooted structural problems that have saddled the economy in the last decade.

(11) A credible adjustment path requires the Italian government to: (i) implement with rigour the 2005 budget; assuming zero GDP growth and a reduction in temporary measures from 1,4% of GDP in 2004 to 0,4% of GDP in 2005, this would imply a nominal deficit in 2005 of at most 4,3% of GDP and a slight reduction in the structural deficit with respect to 2004; and, (ii) take the necessary measures to ensure a cumulative reduction in the structural deficit of at least 1,6% of GDP over 2006-2007 relative to its level in 2005, with at least half of this correction taking place in 2006. Assuming that GDP growth recovers to around 1,5% in 2006 and 2007 and that half of the correction takes place in 2006, the deficit-to-GDP ratio would decrease to clearly below 4% and 3% in 2006 and 2007, respectively.

(12) The high level of government debt and its slow pace of reduction are a cause for concern. In a context of low potential output growth, ensuring that the government gross debt ratio diminishes sufficiently and approaches the reference value at a satisfactory pace requires restoring an adequate level of the primary surplus and permanently addressing factors other than net borrowing that in the past have contributed to the change in debt levels, such as debt-increasing below the line operations.

(13) Statistical revisions for the 2000-2004 period to reported budgetary data highlighted the need to increase transparency, in the collection and processing of general government data in Italian national accounts,

HEREBY RECOMMENDS:

1. The Italian authorities should put an end to the present excessive deficit situation as rapidly as possible and by 2007 at the latest in accordance with Article 3(4) of Council Regulation (EC) No 1467/97. In line with this Regulation the Council establishes the deadline of 12 January 2006 for the Italian government to take effective action to this end.

2. The Italian authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner by 2007. Specifically, to this end, the Italian authorities should:

   (a) implement with rigour the 2005 budget;

   (b) take the necessary measures to ensure a cumulative reduction in the cyclically-adjusted deficit, net of one-off and other temporary measures, of at least 1,6% of GDP over 2006-2007 relative to its level in 2005, with at least half of this correction taking place in 2006.

3. In addition, the Italian authorities should ensure that the government gross debt ratio diminishes sufficiently and approaches the reference value at a satisfactory pace, in line with the correction of the excessive deficit, by restoring in the medium term an adequate level of the primary surplus. Furthermore, the Italian authorities should pay particular attention to factors other than net borrowing, such as below-the-line operations, which contribute to the change in debt levels.

4. In addition, the Council invites the Italian authorities to ensure that budgetary consolidation towards the medium term position of government finances close to balance or in surplus is sustained through a reduction in the cyclically-adjusted deficit, net of one-off and other temporary measures, by at least 0,5% of GDP per year after the excessive deficit has been corrected.

5. The Council urges the Italian authorities to further improve the collection and processing of general government data.

This recommendation is addressed to Italy.

Done at Brussels,

For the Council
The President