COUNCIL OPINION

of 17 February 2005

on the updated stability programme of Italy, 2004-2008

(2005/C 136/07)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 17 February 2005 the Council examined the updated stability programme of Italy, which covers the period 2004 to 2008. The programme complies partly with the data requirements of the 'code of conduct on the content and format of stability and convergence programmes'. Information on the additional measures foreseen to achieve the budgetary targets for the years 2006 and beyond would have been necessary in order to assess with precision the path and composition of the adjustment. Accordingly, Italy is invited to achieve full compliance with the requirements of the code of conduct.

(2) The macroeconomic scenario underlying the programme reflects the information set available at around mid-year 2004. It envisages real GDP growth to pick up from 1.2 % in 2004 to 2.1 % in 2005 and to average at around 2.3 % over the rest of the programme period. On the basis of currently available information, this scenario seems to reflect somewhat favourable growth assumption because both (i) projected growth in 2005 appears on the high side of the current forecasting range and (ii) the projected evolution of growth in the medium term appears relatively optimistic. The programme's projections of price developments as measured by the GDP deflator appear realistic. ([2])

(3) The programme aims at gradually reducing the nominal budget deficit from an expected outturn of 2.9 % of GDP in 2004, via a deficit target of 2.7 % of GDP in 2005 to 0.9 % of GDP in 2008. Hence, the programme does no longer target a medium term close to balance or in surplus position. In cyclically-adjusted terms the budget balance is projected to improve by 1.1 percentage points over the programme period, as a result of measures of a permanent nature, with the bulk of the adjustment (0.5 percentage point) expected to take place in 2006. Even though no improvement in cyclically-adjusted terms is expected in 2005, a large part of the one-off measures is going to be replaced by permanent ones. Compared to the previous update the nominal deficit figures are more than one percentage point higher and the planned adjustment is back-loaded against a somewhat less favourable macroeconomic scenario. However, since the cyclical conditions, as measured by the output gap, are almost unchanged the largest part of the revision of the deficit can be taken to be structural.

([1]) OJ L 209, 2.8.1997, p. 1.

([2]) The projections for HICP inflation presented in the programme are not forecasts. They rather represent reference values generally intended to be used in the wage bargaining process.

(4) There are risks that the budgetary outcome could be worse than projected in the programme. In particular, concerning 2005, where the margins are narrow, lower than projected economic growth, small deviations from the planned budgetary correction of more than 2 % of GDP, risks linked to some one-off measures as well as the possible re-classification of ANAS, the company in charge of road maintenance, entail a risk of breaching the 3 % of GDP reference value. In the year 2006 and beyond, given past experience, it cannot be excluded that the fiscal adjustment needed to achieve the targets presented in the programme is underestimated. In view of this risk assessment, the budgetary stance in the programme does not seem to provide a sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal macroeconomic fluctuations at least up until 2006. It is also insufficient to ensure that the Stability and Growth Pact's medium-term objective of a budgetary position of close to balance is achieved by the end of the programme period.

(5) The debt ratio is estimated to have reached 106 % of GDP in 2004, only marginally below the level recorded in 2003 and far above the 60 % of GDP Treaty reference value. The programme projects the debt ratio to decline by over 8 percentage points over the programme period mainly on account of an ambitious privatisation plan coupled with an improving primary balance and accelerating economic growth. A more rapid pace of debt reduction is hampered by debt increasing below-the-line operations of more than 2 percentage points of GDP on average per year. The evolution of the debt may be less favourable than projected notably given the risks to the budgetary targets mentioned above and the remaining uncertainties related to stock-flow adjustments.

(6) With regard to the long-term sustainability of public finances, Italy appears to be at some risk. However, the adoption in 2004 of a pension reform is an important step towards addressing the budgetary consequences of ageing population and will contribute to improve the situation of Italy in this respect. Italy could be in a relatively favourable position, provided that the budgetary targets are fully implemented, the expected savings from the pension reform are achieved and any departure from the strategy of running large primary surpluses, effectively leading to rapid debt reduction, is promptly corrected.

(7) The economic policies outlined in the programme are partly consistent with the country-specific Broad Economic Policy Guidelines in the area of public finances. First, the programme does not envisage a medium-term close to balance or in surplus position. Second, the budgetary targets do not ensure an improvement in the cyclically-adjusted budget balance of at least 0.5 percentage point per year although it is recognised that the improvement in the structural budget balance (net of one-offs) reaches in average 0.5 %-points of GDP per year. Third, part of the 2005 tax cut is financed by means of temporary measures. Finally, the programme does not provide sufficient information on how the strengthening of mechanisms for expenditure control would work nor does it outline a clear source of financing regional expenditure.

In view of the above assessment, the Council is of the opinion that Italy should:

(i) do the necessary to ensure the achievement of the 2005 deficit target;

(ii) make the necessary effort in structural terms in 2006 and beyond to achieve a budgetary position of close to balance by the end of the period covered by the programme; and

(iii) ensure that the debt-to-GDP ratio is declining towards the 60 % of GDP Treaty reference value at a more rapid pace, paying particular attention to factors other than net borrowing which contribute to the change in debt levels.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007	2008
Real GDP (% change)	**SP 2004**	**1,2**	**2,1**	**2,2**	**2,3**	**2,3**
	COM Oct 2004	1,3	1,8	1,8	—	—
	SP 2003	*1,9*	*2,2*	*2,5*	*2,6*	
HICP inflation (%)	**SP 2004** (1)	**2,2**	**1,6**	**1,5**	**1,4**	**1,4**
	COM Oct 2004	2,3	2,3	2,0	—	—
	SP 2003	*1,8*	*1,5*	*1,4*	*1,4*	—
General government balance (% of GDP)	**SP 2004**	**-2,9**	**-2,7**	**-2,0**	**-1,4**	**-0,9**
	COM Oct 2004	-3,0	-3,0	-3,6	—	—
	SP 2003	*-2,2*	*-1,5*	*-0,7*	*0,0*	—
Primary balance (% of GDP)	**SP 2004**	**2,4**	**2,4**	**3,3**	**4,0**	**4,7**
	COM Oct 2004	2,0	2,1	1,5	—	—
	SP 2003	*2,9*	*3,5*	*4,4*	*5,1*	—
Cyclically-adjusted balance (% of GDP)	**SP 20042**	**-2,1**	**-2,1**	**-1,6**	**-1,2**	**-1,0**
	COM Oct 2004	-2,4	-2,6	-3,4	—	—
	SP 2003 (2)	*-1,6*	*-1,0*	*-0,4*	*0,1*	—
Government gross debt (% of GDP)	**SP 2004**	**106,0**	**104,1**	**101,9**	**99,2**	**98,0**
	COM Oct 2004	106,0	104,6	104,4	—	—
	SP 2003	*105,0*	*103,0*	*100,9*	*98,6*	—

Note:

(1) Planned inflation from 2005 onwards.

(2) Commission services calculations on the basis of the information in the programme.

Sources:

Stability programme (SP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations