DIPARTIMENTO DEL

TESORO

Italy’s Fiscal Framework

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Lorenzo Codogno

Italian Ministry of Economy and Finance, Treasury Department

MINISTERO DELL'ECONOMIA E DELLE FINANZE

Italy’s strengthened framework

- April 2012: a **constitutional amendment** introduced a **balanced budget rule**: it will enter into force in FY 2014.
- July 2012: Parliament **ratified the Treaty** on Stability Coordination and Governance (Fiscal Compact).
- Dec 2012: Parliament approved Law 243/2012 which implements April’s Constitutional amendment by detailing **balanced budget** provisions and establishing a **fiscal council** (in line with the requirements of the renewed Stability and Growth Pact, Directive 85/2011 and Fiscal Compact provisions).

New rules to help reducing the debt-to-GDP ratio

- **The balanced budget rule** (effective 2014) applies to the whole government sector and takes into account economic cyclical fluctuations and exceptional circumstances.
- **The spending rule** (effective 2013) limits planned growth rates of public expenditure to the benchmark set at European level.
- **The debt rule** (to be applied in 2016) requires an annual reduction in the debt/GDP ratio of least 1/20th of the difference versus the target of 60% of GDP calculated over the previous three years.

Numerical fiscal rules at a glance

The newly-legislated fiscal rules add to the existing ones:

- **The Domestic Stability Pact**, in force since 1999.
- **The Health Care Pact**, in force since 2001**.**
- **The Pharmaceutical spending ceilings,** in force since 2001.
- **The ceilings on State Budget spending**, introduced by Law 196/2009 and still to be implemented.
- **The ex ante appropriation rule on extra revenues**, introduced by Law 39/2011 and effective since 2011.

Medium-term budgetary framework: other recent changes

- Law 196/2009 on public finance and accounting, as amended by Law 39/2012, brought forward in April the starting of the budget cycle by aligning planning documents with the **European semester**.
- The law anticipated some of the requirements of Directive 85/2011 (contained in the Six pack), such as the **harmonisation of balance sheets** in the public administration and the strengthening of **multi-year planning.**

Balanced budget rule – Basic principles

- Dec 2012 (L.243/2012): the enabling law **details the principle of balanced budget** set in Constitution and introduces in the Italian legislation many **provisions of the EU Stability and Growth Pact and Fiscal Compact**.
- Some basic principles: the general government balance is in equilibrium when at its MTO (medium-term objective in structural terms) which for Italy is currently a **zero structural balance**.
- Government deficit/surplus in nominal terms are allowed depending on the position in the cycle (output gap).

Balanced budget rule – Cyclical adjustment and intervals

- For cyclical developments, it applies the EU production function methodology: fully comparable with other MS but **subject to large ex ante and ex post revisions**.
- **Tolerance intervals**: ex post and ex ante significant deviations from MTO (more than 0.5pp) to be corrected asap.
- **Temporary deviation** from MTO in exceptional circumstances (large recessions, catastrophes, financial crisis) must be approved by Parliament.
- Return to MTO asap, taking into account cyclical developments.

Balance budget rule – Open issues

- Major **structural reforms** are crucial in defining the adjustment path to the MTO.
- Need to embody the **projected impact of the reforms** on economic growth over time.
- Need to refine models to better estimate both their **macro impact and their effects on structural fiscal budget**.

Debt rule – Basic principles

- Debt/GDP should be reduced yearly at a pace of at least **1/20th of the difference versus the 60% target** calculated over the previous three years.
- **Assessment of compliance**: impact of the cycle and impact of no policy change debt developments.
- Role of ‘**other relevant factors**’.

Debt rule – Open issues

- **Financial contributions to EFSF/ESM** are included in the gross debt aggregate, and therefore relevant in assessing compliance with the debt rule.
- Funds used by each country for financial support programmes should be clearly included in the definition of the **'other relevant factors'** against compliance with debt rule at EU level.
- Need for **clearer definitions and quantification** of these items at the EU level.

Expenditure rule – Basic principles

- New **expenditure aggregate** (net of interest expenditures, government expenditure on EU programmes, smoothed gross fixed capital formation, non-discretionary unemployment benefits) and net of discretionary revenue measures.
- If at MTO, expenditure aggregate should grow in real terms in line with **10y potential average growth** (over t-4 – t+5 period).
- If not at MTO, expenditure aggregate should grow in real terms in line with a **reduced 10y potential average growth** (over t-4 – t+5 period), so that the structural deficit decreases by at least 0.5pp per year.

Expenditure rule - Open issues

- Only measures that have been specified and committed to by governments will be taken into account in the **definition of ‘discretionary revenue measures’**.
- Art. 81 of the Constitution: new or increased expenditure/lower revenues need to be fully financed; no possibility to include announced tax reform in a fiscal programme, i.e. difficulties in defining what ‘discretionary revenue measures’ mean.
- Problems with the definition of a **‘no-policy change scenario’.**
- Reliance on a ‘**current legislation scenario**’.

Other provisions

- **Sub-national level** of government in equilibrium (in nominal terms).
- Creation of a fund to finance **social expenditures** which moves in line with cyclical developments.
- Creation of a **fiscal council**.

Fiscal council - Mandate

- The special law adopted in December 2012 established the **Parliamentary Budget Office (PBO)** within Parliament.
- PBO is responsible for **monitoring public finances** and **compliance with numerical fiscal rules**.
- It is also mandated to assess the **underlying assumptions** of fiscal projections, including macroeconomic projections, as well as macroeconomic effects of **major legislative packages** and **public finance sustainability**.

Fiscal council - Composition

- The **PBO governing body** is a three-member board appointed by the Presidents of the two Houses of Parliament.
- Members of the board shall be selected among **qualified persons** of recognised independence.
- A **6-year non-renewable mandate** for Board Members.
- **Staff recruitment** based on open competition and selection procedures (up to 30 staff units as of 2016, 40 later).

Fiscal council – Main features

- Full access to economic and public finance **databases** managed by other administrations.
- All public administrations must provide **information** on public finance developments as required.
- Adequate multi-year public **PBO funding**.
- **PBO annual programme**, reports and analysis are to be public and published on the web site.

Fiscal council – Comply or explain

- In case PBO assessments are significantly different from those of government, upon request of at least one third of Members of the Parliamentary Budget Commissions the government shall **explain to the Parliament** the reasons why it intends to confirm its own assessments.
- Otherwise it shall **align with those of PBO**.

Adequate transposition already in place in Italy

- The **informal assessment** of the **transposition process** will start soon. The Commission has launched an **informal dialogue** with Member States on the basis of a questionnaire. Members States are invited to provide replies by mid-April.
- The **formal assessment** of the transposition of the Fiscal Compact, in accordance with article 8 of the TSCG, will occur later.