Dipartimento del Tesoro

Italy’s macrofiscal framework and budget formulation within the EU Semester

Seminar on Medium term budgetary framework
Rome, Ministry of Economy and Finance
February 9, 2017

Overview

- A bird's eye on the current framework
- Role of the Stability Programme in setting a stable medium-term budgetary plan
- Issues related to the Autumn session
- The role of the PBO
- Medium-term Budget horizon, use of safeguard clauses and quality of budgetary measures

A bird's eye on the current framework

Main changes introduced in 2009-2015

- Brought forward to April the starting of the budget cycle
- Transposed minimum requirements required by Directive 85/2011
- Introduced the budget equilibrium provision and issued Law 243/2012
- Introduced new fiscal rules
- Established the Parliamentary Budget Office and signed a MoU setting procedures for forecasts assessment
- Postponed the presentation of the Update of the EFD
- Abolished the Stability Law to include the changes needed to achieve fiscal targets in the first part of the Budget Law and postponed the presentation of the draft Budget Law

Italy's planning documents and budget cycle

Economic and Financial Document	Update of the EFD	Draft Budgetary Plan	Draft Budget Law
Stability Programme			
by 10 April	by 27 September	by 15 October	by 20 October

Entities involved: the government, the Parliament and the PBO

Planning cycle aligned with the European Semester

	The European Semester	Italy's planning cycle
November year t-1	Annual Growth Survey, Alert Mechanism Report Opinion on draft budgetary plans by European Commission	
February/March	Endorsement by European Council of economic priorities and publication by European Commission of Single Analytical Document for MSs	Economic and Financial Document (EFD) i) Stability programme (national medium-term budget plan); ii) Public finance analysis and trends; iii) National Reform Programme by 10 April
April	SP and NRP to European Commisson by end of April	
May	Assessment on NRPs and SP by European Commission	
July	The European Council endorses country-specific recommendations	
September		Update to the EFD by 27 September
October	The EC consults the MSs whose DBP is at risck of non-compliance with SGP obligations	Draft Budgetary Plan by 15 October Draft Budget Law (first section = Stability Law) by 20 October
November	Annual Growth Survey, Alert Mechanism Report Opinion on draft budgetary plans by European Commission	
December		Approval of the Budget Law by 31 December

Level of details in planning documents: macroeconomic scenario

- Full alignment with the contents required by the Code of Conduct
- Hypothesis on exogenous variables coherent with EC latest projections
- Use of last updated data released by ISTAT (notification of final data and quarterly estimates for the ongoing year)
- Impact of planned budget measures on the macroeconomic scenario (trend vs policy scenario forecasts)

Level of details in planning documents: fiscal targets

- Targets based on ESA accounting referring to the general government
- Breakdown for sub-sectors: central government, local government and social security funds
- Projections for expenditure and revenues at current legislation
- Net borrowing requirement and balance to be financed: the objective set for the forthcoming year shall be taken as fixed parameters for budget preparation
- Assessment of ex ante compliance with fiscal rules
- Public debt sustainability analysis
- Information on contingent liabilities

The existing fiscal rule based framework (1)

- **Balanced budget rule:** maintain the MTO (balanced structural balance for Italy) or, if not at the MTO, complying with the fiscal effort required by the SGP
- **Expenditure rule:** the planned real growth rate of public expenditure aggregate cannot exceed the specific benchmark rate set at European level
- **Debt rule:** reducing the debt to GDP ratio at a yearly pace of at least one twentieth of the discrepancy with the target of 60% of GDP calculated over the previous three-year period

The existing fiscal rule based framework (2)

- **Nominal balanced budget:** regions and local governments should ensure nominal surplus or balanced budget on an accrual basis
- **Indebtedness allowed only to finance investments:** the balance of sub-national government bodies, net of investments, should be balanced in surplus
- **Healthcare Pact:** regions should ensure the equilibrium of the healthcare sector
- **Expenditure ceilings on pharmaceutical expenditure nominal growth rate** (at regional and hospital level)

Ensuring independence of macroeconomic forecasts (1)

- Since September 2014, official forecasts are elaborated by the government and validated/endorsed by the PBO
- The macroeconomic scenario has been splitted into two scenarios: the trend scenario, including the effect of current legislation, and the policy scenario, including the impact of planned budgetary measures to achieve fiscal targets
- The main reason behind the choice was avoiding the Ministry of Economy and Finance to send the PBO the information on the Budget before the document was approved by the Council of Ministers
- The procedure ensured greater transparency on the way official macroeconomic forecasts are made and measures considered

Ensuring independence of macroeconomic forecasts (2)

- Before the CoM: exchange of relevant information on macroeconomic variables; continuous dialogue with the PBO for the validation of trend projections
- After the CoM and before the approval by the Parliament:
- i) exchange of information on planned budget measures;
- ii) the PBO and the Minister are audited by the Parliament;
- iii) the comply-or-explain procedure can be activated in the event the Office assessment differs from that of the government;
- iv) validation of policy-scenario forecasts;
- v) as a final step the Parliament approves the document

Steps for macroeconomic forecasts validation

Data release by ISTAT

Provisional trend macroeconomic projections from MoF to PBO

Feedback from PBO

Final trend macroeconomic projections from MoF to PBO

Validation by PBO

CoM approval and presentation to Parliament

Macroeconomic projections based on policy scenario from MoF to PBO

Feedback from UPB

Comply or explain/ Auditions

Possible revision of macroeconomic projections by Mof

Validation by PBO

Parliament approval

Ex ante independent assessment on public finance

- The PBO provides its assessment in the Audition to the Parliament and then in ad hoc reports, which are generally released by fifteen days after the approval of the document on:
- i) the compliance with fiscal rules (MTO, expenditure and debt rule);
- ii) the macroeconomic impact of budgetary measures;
- iii) the respect of budgetary targets established according to the MTBF in the draft budget (in the Autumn session).
- Comply-or-explain procedure
- The PBO assessment affects the Parliament vote on current document and public opinion and provides guidelines to the government for future planning

Steps for independent assessment on public finance

Data release by ISTAT

Assumptions underlying trend projections of main budgetary items from MoF to PBO

Feedback from PBO

CoM approval and presentation to Parliament

Details on the Budget from MoF to PBO

Comply or explain/ Auditions

Parliament approval

Budgetary Planning Report issued on the PBO website (Budgetary Policy Report for the Autumn session)

Role of the Stability Programme in setting a stable medium-term budgetary plan

Anticipating to April but possible revisions in September...

- In 2009 the EFPD was initially renamed Financial and Economic Decision and its presentation postponed from end June to Sept, 15
- Aim: get closer macroeconomic forecasts updating and the setting of fiscal targets to the presentation of the Budget, better assess budgetary measures
- Following the ES, in 2011 the SP becomes the first section of the EFD
- The Update to the EFD allows to potentially revise fiscal targets:
- i) due to the updating of macroeconomic forecasts;
- ii) to modify the planned breakdown of fiscal targets among sub-central governments;
- iii) to implement the CSRs endorsed by the European Council.

...and due to unexpected events or deviations by presenting ad hoc Report to the Parliament)

- The 2009 reform also allowed the government to revise budgetary targets due to unexpected events or because of significant deviations from planned trends calling for corrective measures (L 196/2009, Art 10-bis, p. 6 now abolished)
- In 2012 a new procedure to revise the path towards the Medium Term Objective (MTO) is set to implement the requirements of the Fiscal Compact in the national framework

Procedure to revise the path towards the MTO (1)

- Set by Law 243/ 2012, Art 6
- Aim: anchor medium-term fiscal planning to the MTO, while allowing temporary deviations from the adjustment path:
- i) due to exceptional circumstances (SGP definition: severe economic downturns, exceptional events such as natural catastrophes)
- ii) to take into account the implementation of major structural reforms with positive long term impact on growth and fiscal sustainability (or the financing of public investments co-funded with EU structural funds, which have been considered equivalent by the Commission to structural reforms in boosting long term growth)

Procedure to revise the path towards the MTO (2)

- If a temporary deviation from the adjustment path towards the MTO is needed due to exceptional conditions, the government, after having informed the Commission, should ask the Parliament an authorisation
- The government has to present an ad hoc Report containing the revised path towards the MTO to be approved with absolute majority of the members of Chambers
- Any further update of the path due to aggravating exceptional circumstances should be authorised by following this procedure

Revisions of latest years (1)

- Recession, economic uncertainty and new interpretation of flexibility within the SGP induced very frequent revisions of macroeconomic forecasts and fiscal targets
- 2013: EFD + two Reports ex Art 10-bis + Update + Draft Budgetary Plan
- 2014: EFD + Report Art 6 + Update + Draft Budgetary Plan+ Report Art 10-bis
- 2015: EFD + Report Art 6 + Update + Draft Budgetary Plan
- 2016: EFD + Report Art 6 + Update + Draft Budgetary Plan

Revisions made in the latest years (1)

GDP growth rate (vintages and forecasts)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
2011 DEF	-5.2	1.3	1.1	1.3	1.5	1.6					
Update to 2011 DEF	-5.2	1.3	0.7	0.6	0.9	1.2					
Report to Parliament 4 December 2011	-5.1	1.5	0.6	-0.4	0.3	1.0					
2012 DEF			0.4	-1.2	0.5	1					
Update to 2012 DEF		1.8	0.4	-2.4	-0.2	1.1	1.3				
2013 DEF				-2.4	-1.3	1.3	1.5	1.3	1.4		
Update to 2013 DEF				-2.4	-1.7	1.0	1.7	1.8	1.9		
2014 DBP				-2.5	-1.8	1.1					
2014 DEF					-1.9	0.8	1.3	1.6	1.8	1.9	
Update to 2014 DEF/2015 DBP				-2.3	-1.9	-0.3	0.6	1.0	1.3	1.4	
2015 DEF						-0.4	0.7	1.4	1.5	1.4	1.3
Update to 2015 DEF/2016 DBP						-0.4	0.9	1.6	1.6	1.5	1.3
2016 DEF							0.8	1.2	1.4	1.5	1.4
Update to 2016 DEF							0.7	0.8	1.0	1.3	1.2
2017 DBP							0.7	0.8	1.0	1.2	1.2
memo:											
final data	*-5.5*	*1.7*	*0.6*	*-2.8*	*-1.7*	*0.1*					

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Revisions made in the latest years (2)

Structural net borrowing (vintages and targets)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
2011 DEF	-4.1	-3.5	-3.0	-2.2	-1.4	-0.5					
Update to 2011 DEF	-0.4	-3.3	-2.8	-0.6	0.6	0.5					
2012 DEF		-3.6	-3.6	-0.4	0.6	0.6	0.4				
Update to 2012 DEF		-3.6	-3.6	-0.9	0.0	-0.2	-0.4				
2013 DEF			-3.5	-1.2	0.0	0.4	0.0	0.0	0.0		
Update to 2013 DEF			-3.6	-1.3	-0.4	-0.3	0.0	0.0	0.0		
2014 DBP					-0.5	-0.3					
2014 DEF				-1.4	-0.8	-0.6	-0.1	0.0	0.0	0.0	
Update to 2014 DEF+ Report art 6					-0.7	-0.9	-0.9	-0.4	0.0	0.0	
2015 DBP + Report						-0.9	-0.6	-0.4	0.0	0.0	
2015 DEF					-0.7	-0.7	-0.5	-0.4	0.0	0.1	0.2
Update to 2015 DEF+ Report art 6/2016 DBP						-0.7	-0.3	-0.7	-0.3	0.0	0.0
2016 DEF						-0.8	-0.6	-1.2	-1.1	-0.8	-0.2
Update to 2016 DEF + Report art 6						-0.9	-0.7	-1.2	-1.2	-0.7	-0.2
2017 DBP								-1.2	-1.6	-0.7	-0.2
memo:											
current estimates	*-3.0*	*-3.1*	*-3.1*	*-0.9*	*-0.5*	*-0.8*	*-0.6*				
y/y change		*-0.1*	*0.0*	*2.2*	*0.4*	*-0.3*	*0.2*				

Revisions made in the latest years (3)

Net borrowing (vintages and targets)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
2010 Economic and Financial Decision											
2011 DEF	-5.4	-4.6	-3.9	-1.6	-0.1	0.2					
Update to 2011 DEF		-4.6	-3.9	-1.6	-0.1	0.2					
2012 DEF			-3.9	-1.7	-0.5	-0.1	0.0				
Update to 2012 DEF			-3.9	-2.6	-1.6	-1.5	-1.4				
2013 DEF				-3.0	-2.9	-1.8	-1.7	-1.3	-1.0		
Update to 2013 DEF					-3.0	-2.5	-1.6	-0.8	-0.1		
2014 DBP					-3.0	-2.5					
2014 DEF					-3.0	-2.6	-2.0	-1.5	-0.9	-0.3	
Update to 2014 DEF+ Report art 6					-2.8	-3.0	-2.9	-1.8	-0.8	-0.2	
2015 DBP + Report						-3.0	-2.6	-1.8	-0.8	-0.2	
2015 DEF					-2.9	-3.0	-2.6	-1.8	-0.8	0	0.4
Update to 2015 DEF+ Report art 6/2016 DBP						-3.0	-2.6	-2.2	-1.1	-0.2	0.3
2016 DEF						-3.0	-2.6	-2.3	-1.8	-0.9	0.1
Update to 2016 DEF + Report art 6						-3.0	-2.6	-2.4	-2	-1.2	-0.2
2017 DBP								-2.4	-2.3	-1.2	-0.2
memo:											
final data	*-5.3*	*-4.2*	*-3.7*	*-2.9*	*-2.7*	*-3.0*	*-2.6*				

Binding vs flexible nature of planning framework

- Traditionally, most binding frameworks were recommended for their role in enhancing fiscal discipline. The recent crisis has made this requirement more nuanced, calling for balancing most rigid frameworks with some forms of flexibility to accommodate exceptional economic conditions or events outside the control of the government.
- Arising global uncertainty makes underlying forecasts for medium-term (3 years or more) less reliable and this translate into more frequent revisions of fiscal targets.
- How much effective is the Stability Programme in setting a stable medium-term budgetary plan in our country?

Issues related to the Autumn session

Update versus Draft Budgetary Plan

- Two main problems emerged:
- i) the deadline of 20 September originally envisaged for the Update did not allow to consider the more updated final data notified by end September
- ii) the composition of the Budget is hardly defined by end September and subject to further revisions after the Update approval and before the submission of the DBP to European institutions
- The Draft Budgetary Plan actually has similar contents/aim of the Update, as it should update macroeconomic forecasts indicated in the SP on the basis of data notified to Eurostat by end September and provide qualitative details on budgetary measures and their impact on economic growth

The 2015 reform

- The presentation of the Update was postponed from 20 to 27 September and ISTAT anticipated the release of final data of previous year from end to 22 September to allow the use of most updated data
- These changes would have allowed the government to:
- i) elaborate macroeconomic forecasts underlying fiscal projections on the basis of final data notified to Eurostat (thus eliminating potential differences with the DBP)
- ii) have some days more to define the composition of the Budget and estimate the impact of planned budgetary measures on economic growth based on the policy scenario
- Also, the presentation of the draft Budget Law was postponed from 15 to 20 September

Was the 2016 exceptional or are needed further changes?

- Last year, the ISTAT release of 22 September significantly changed GDP data for 2015 and 2014 and also quarterly estimates released on October, 3 implied main consequences on 2016 projection
- The impact of budgetary measures planned in the DBP for 2017 was increased compared to the Update due to exceptional circumstances, and major differences in the composition of the budget occurred
- As a result, the 2016 Update became obsolete in a few weeks after the CoM approval
- The 2017 DBP, sent to European institutions by 15 October, was subsequently amended in 19 October due to further changes introduced in the draft Budget Law that was being presenting to the Parliament

The role of PBO

Independent macroeconomic forecasts

- The endorsement by the PBO has limited political interference and improved the quality of short term forecasts
- In the last Autumn session the comply-or-explain mechanism ensured coherence of economic forecasts with fiscal targets and composition of the Budget
- The validation of economic forecast is however strictly required for year t+1 by the Two Pack and then implemented by the MoU
- The extension to the whole 3 years horizon could help in increasing the stability of medium-term fiscal plans

Independent assessment of public finance

- The assessment on macroeconomic impact of planned budgetary measures was effective as it is strictly linked to the macroeconomic forecasts validation process
- Increasing effectiveness of PBO assessment on public finance:
- i) the assessment on the compliance with fiscal rules, even if provided to the Parliament before the approval of the planning document, has never entailed main consequences on the planned strategy
- ii) reinforcing PBO role in influencing medium-term fiscal policy orientation and budget composition
- Also, the PBO role in monitoring public finance should be strengthened

Independent monitoring and correction mechanism

- According to the Fiscal Compact, independent bodies shall support the credibility of correction mechanism (i.e. the procedure set to correct significant deviations from the MTO or the path towards the objective) by providing public assessments:
- i) over the occurrence of circumstances warranting the activation of the mechanism;
- ii) whether the correction is proceeding in accordance with national rules and plans;
- iii) over the occurrence of circumstances for triggering, extending and exiting escape clauses.
- The MS shall be obliged to comply with, or alternatively explain publicly why it is not following the assessment of the body

The correction mechanism set by Law 243/2012

- The government is the first entity in charge of monitoring the respect of the budgetary objectives established in the MTBF
- If deviations are observed, the government shall inform the Parliament and take corrective actions
- The correction mechanism set in Law 243/2012 requires the government to introduce corrective measures by at least one year after that in which significant deviations from the adjustment path towards the MTO are observed (deviations occurring in year t-1; observed in t; correction starting at least in t+1)

Medium-term Budget horizon, use of safeguard clauses and quality of budgetary measures

A 3 years budget horizon

- The 2009 reform extended the horizon of the ex Stability Law to 3 years, by fully aligning Italy’s framework to minimum requirements set by the Council Directive 85/2011
- Before 2009, the ex Financial law introduced budget adjustments only for the following year
- Aim: avoid incoherency of budgetary measures over the years and ensure stable and credible public finances in the medium-term

The use of the so-called ‘safeguard clauses’

- In the latest years, safeguard clauses have been extensively used in the Budget; they imply future revenues increases (increase in tax rates or cut in tax expenditures) if offsetting measures of the same amount are not introduced
- The planned tax increases have been designed to be almost automatic, even if in some cases the entry into force required the adoption of a ministerial decree
- They have been deactivated on a rolling basis, year after year, by postponing the decision on spending cuts to the future
- At present, it is foreseen an increase of VAT tax rate and excises as for 2018 if spending cut will be not introduced
- They have nothing to do with the clause ensuring financial neutrality

Implications for future planning

- In the past, the Commission was reluctant to include the effects deriving from these clauses in its projections if their activation was not automatic
- At present, there is the risk that the Commission will not to include the impact of current safeguard clauses in its projections because they are not credible even if automatic
- As a result, there will emerge differences between government forecasts and the Commission ones based on no-policy change assumption
- Finally, as the Commission forecasts are the basis for the CSRs, this will imply a different assessment on the fiscal effort required to comply with fiscal rules

How to improve the Budget composition in the future?

- Defining budgetary measures from April to September
- Reinforce the link of deficit-reducing measures with the institutional processes put in place:
- by fully implementing the top-down approach on Ministries spending to project reliable spending savings
- by giving implementation to the guidelines to be provided on a regular basis in the yearly Report on tax expenditures
- by giving a major role to local governments in the definition of the contribution to fiscal consolidation

The new top-down approach for central gov spending

February/ March

Monitoring reports on the achievement of targets for each ministry, to be attached to the EFD (including reasons to justify deviations from targets).

April / May

EFD (10 April) including macroeconomic framework and general government expenditure rule (EU benchmark).

By 31 May, decree of the President of the Council of Ministers setting government priorities and three-year spending targets for each ministry.

Preparation of the Budget Circular.

June / August

Preparation of ministries proposals on how to meet the spending targets through:

- Efficiency increases entailing administrative actions
- Legislative

September (EFD Update)

Coordination of the proposals and check of the overall framework.

Preparation of new three-year agreements or revision of previous agreements.

October/ March

Draft Budget Law containing the legislative proposals to achieve spending targets.
Following the approval of the Budget Law, signature of three-year agreements and implementation timetable (by 1 March, by means of ad hoc interministerial decrees).

By 15 July, Recap of agreements implementation (year t-1) and any updates .
By 1 March, Report on achievement of targets related to the agreements in place in the previous year (t-2).

Monitoring of the three-year agreements.