THE ITALIAN GOVERNMENT'S BALANCED BUDGET POSTPONEMENT

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Abstract

The debate on European economic governance is witnessing a conflict between the hardliners of austerity and the advocates of flexibility. The Italian request for a postponement of the balanced budget allows us to reflect on how much room for flexibility is effectively provided by current European economic governance and to identify issues that remain. This report aims to highlight the fact that, though it is not necessary to reform the current juridical framework, the problems are due to the way that regulations are put into practice. Such rules suffer from the method in which investment for growth, structural reforms and the choice for a definitive way to calculate the budgetary deficit are identified. These are aspects that require a solution based on a common view about parameters and criteria, currently absent or still under construction in Italy and France. The examination of the Italian case highlighted not only technical issues, but also political ones: there is a mutual distrust that is shaping the debate on the flexibility of current economic governance, and it reflects two diametrically opposed views between North-European countries and South-European countries.

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1. Introduction

This Article analyses the postponement of the balanced budget implemented by the Italian government. The purpose is to understand the reasons behind the decision to postpone the balanced budget, and whether there is evidence of an inability to meet targets that are too strict, or whether European countries are still autonomous towards their own budget policies[1].

The Italian Parliament, by absolute majority, authorized the government to postpone the balanced budget to 2016 – according to the provisions of Art. 81, second paragraph of the Constitution and Art. 6 of Law 243 of 24 December 2012. This happened two years after the balanced budget amendment had been introduced in the Italian constitution. Following a new European economic regulation, member countries of the EU are required to comply with new parameters – incorporated into the Italian body of law according to Law 243/2012.

A deficit/GDP ratio of 3% was set, along with a public debt/GDP ratio of 60%; medium-term objective budgeting, equal to 0, was redefined. A new public debt regulation, which implies a yearly reduction of debt equal to 0.6 percentage points of GDP, will be fully phased in for Italy from 2015[2].

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[1] The Italian case can be interpreted as another manifestation of an unfinished process towards the realization of a so-called "magic triangle", which is a balance between monetary base, government spending and the rate of exchange with other currencies, notably the dollar. See F. Merusi, *Il sogno di Diocleziano. Il diritto delle crisi economiche* (2013) 3; more recently, *ex multis*, see M. Ruffert, *The European debt crisis and European Union Law*, in Common Market Law Review 1777 ff. (2011); P. Craig, *The Stability, Coordination and Governance Treaty: principle, politics and pragmatism,* in European Law Review 231 ff. (2012); F. Donati, *Crisi dell'euro, governance economica e democrazia nell'Unione europea,* in Dir. Un. Eu. 337 ff. (2012); G. della Cananea, *L'Unione economica e monetaria venti anni dopo: crisi e opportunità*, in Costituzionalismo.it (2011).

[2] See Art. 2, Reg. Ue 1467/97; Artt. 2 *bis* and 3 Reg. Ue 1466/97; Artt. 3, 5, 6 and 10, par. 3, lett. *b*) Reg. Ue 1466/97.

Further budget regulations have been introduced. Countries, which fail to meet their MTO, will have to reduce their structural budget balance by at least 0.5% every year. The Italian Government has outlined an economic and financial plan that involves a deviation from the rule of expenditure, the MTO and the public debt regulation.

The government has requested a derogation from MTO, asking for a reduction of the structural deficit of 0.2% of GDP instead of 0.5% of GDP, which will lead to postponement of the balanced budget to 2016. The postponement, drawing along with the recession, will have an impact on the path towards a reduction of the public debt/GDP ratio that will be evaluated in 2016.

This paper will mainly focus on the deviation from the second and third points – MTO and public debt regulation. Whilst not complying with the benchmarks established by the Commission, the public expenditure trend does not significantly affect the structural balance and the public debt.

The report begins with the reasons behind the Italian Government's decision to introduce the principle of a balanced budget in the Constitution. Procedures and substantial aspects of the whole process will be analysed in sections 1 and 2. The soundness of such a request by the Italian Government will be carefully weighed in sections 4 and 4.1.

This investigation will shed light on some problematic issues concerning European budgetary discipline (sections 5 and 6). It will also determine the open questions and soundness of current European budgetary discipline (sections 7 and 7.1).

The inquiry uses the Italian case as a gateway to highlight the nodal points of the present debate concerning the possibility of channelling European economic governance not only towards austerity but also towards flexibility (section 8).

2. The balanced budget reform in the Italian Constitution: a reform politically opportune but not judicially necessary

The Italian Senate approved on 18 April 2012, with 235 votes in favour, constitutional reforms of Articles 81, 97, 117 and 119. The principle of a public balanced budget was introduced in the Constitution. A set of exceptions was also introduced in order to draw upon money borrowing under extraordinary circumstances.

Such a vast majority from the chambers and quickness to deliver this constitutional reform were essential due to pressure from the financial markets. This action was seen as a concrete answer to the indications included in the ECB memorandum of understanding, sent to the Italian government in August 2011[3].

In Italy's case it is not uncommon for economic and financial regulations to originate from external requests, such as from the ECB memorandum. A letter of intent was sent by the Italian Government to the IMF in March 1977. In this letter, Italy bound itself to commit to the rebalancing of public finance in order to respect the obligations that were the result of the credit it obtained to deal with the rise of the deficit/GDP ratio to 22%.

Before long, in August 1978, financial Law 468 was approved, a law that delivered an oversight on public finance planning. It is not possible to detail every single step that led from the financial law to the current stability law, although it is crucial to realize how the changes that occur within national financial regulations often originate from a supranational context, even before any internal debate.

The last Italian constitutional reform was a result of supranational political and economic pressures – despite there not being anything in the EU regulations to enforce a member state to modify its constitution. Neither the Europlus Pact nor the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed in Brussels in March 2012, made any such obligation. This treaty, the so called fiscal compact, provides that the budgetary rules shall take effect in the national law of contracting parties "through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary process" (Art. 3, paragraph 2 of TSCG).

In this perspective is the sentence of 9 August 2012 issued by *Conseil Constitutionnel* declaring that a *loi organique* needed to

[3] The EU memorandum of understanding sent on 5 August 2011 was later published by the newspaper Il Corriere della Sera on 29 September 2011; about the extraordinary quickness of the reform, see R. Perez, *Il pareggio di bilancio in Costituzione*, in Giorn. dir. amm. 929 and ff (2012); about the need of an urgent reply to the financial markets, see M. Luciani, *Costituzione, bilancio, diritti e doveri dei cittadini*, in Astridonline.it (2013).

be preferred over a constitutional reform, something formerly started and after abandoned[4]. It is for these reasons that a constitutional reform happened to be politically appropriate, but, at the same time, not judicially necessary. In fact, budgetary discipline originates from regulations that are immediately effective and the fiscal compact in large part confirms the regulatory framework[5]. In this perspective, it is possible to argue that the Italian constitution was reformed not to keep public finance in order but to make economic targets, tools and procedures more explicit. Juridical boundaries were set to recover credibility from both markets and international institutions.[6] For these reasons, the introduction of the principle of a balanced budget in the constitution is politically appropriate because it represents a warranty of trustworthiness necessary to cope with financial markets that is decisive to maintain a sustainable public debt[7].

3. The balanced budget in Art. 81 of the Italian Constitution and in the law implemented

For the reasons outlined so far, it is clear why the constitutional law approved on 20 April 2012 (Art. 1, "Introduction of the principle of a balanced budget in the constitution") was ratified after a parliamentary process that lasted less than seven months and without a significant public debate around it[8].

[4] See, *ex multis*, R. Casella, *Il Consiglio costituzionale francese e il trattato sul Fiscal Compact*, in Forum Quad. Cost. (2012).
[5] See G.L. Tosato, *I vincoli europei sulle politiche di bilancio*, in Il Filangieri, Quaderno 83 ff. (2011); Id., *La riforma costituzionale sull'equilibrio di bilancio alla luce della normativa dell'Unione: l'interazione fra i livelli europeo e interno*, in Riv. dir. int. 5 ff. (2014).
[6] See M. Marè, M. Sarcinelli, *Le regole del bilancio in pareggio: come assicurarla e a quale livello?* Paper presented to Congress on "*Il principio dell'equilibrio di bilancio secondo la riforma costituzionale del 2012*", Corte costituzionale, Rome 22 november 2013.
[7] See T. Groppi, *Editorial, The impact of the financial crisis on the Italian written Constitution*, in 1 It. J. of Publ. Law 6 ff. (2012).
[8] See A. Brancasi, *L'introduzione del principio del c.d. pareggio di bilancio: un esempio di revisione affrettata della Costituzione,* in www.forumcostituzionale.it (2012); R. Perez, *Dal bilancio in pareggio all'equilibrio tra entrate e spese,* in Gior. dir. amm. 929 ff. (2012).

The first comments on the reform underlined the ambiguity between the constitutional law's name (balanced budget) and the subsequent provisions that imply on one hand a balance between revenue and expenditure (Art. 81, first and sixth subparagraph of the constitution) and on the other a budgetary balance (Art. 97, first subparagraph of the constitution)[9].

Art. 81 of the Italian Constitution refers to the concept of balance, something different from the balanced budget indicated in the bill for the constitutional amendment; it does not even coincide with fiscal compact dispositions that refer to "budgetary position (…) balanced or in surplus" (Art. 3 paragraph 1, letter A). The difference between the two concepts is based on the desire to retain a degree of flexibility in the management of the budget that would be eliminated with the introduction of a pure balanced budget that has a static nature, consisting of the accounting par value between revenue and expenditure[10]. In contrast, the concept of balance is dynamic and does not necessarily coincide with the balance between income and expenditure, especially in light of trends in GDP and the public debt[11].

The formulation of the new Art. 81 connects the respect of a balanced budget to the different phases of the economic cycle. Consequently this allows the indirect economic opportunity to exhibit deficits in times of adversity or in case of favourable situations, fiscal surpluses. The provision actualizes what is a required of European legislation, that member states are asked to pursue a medium-term budgetary goal where structural balance is intended as nominal budget balance adjusted for the economic cycle and net of one-off measures.

[9] See F. Bilancia, *Note critiche sul c.d. "pareggio di bilancio"*, in RivistaAic (2012); D. Cabras, *Su alcuni rilievi critici al c.d. "pareggio di bilancio"*, in RivistaAic (2012); R. Bifulco, *Jefferson, Madison e il momento costituzionale dell'Unione. A proposito della riforma costituzionale sull'equilibrio di bilancio,* in RivistaAic (2012).

[10] The dangers from the introduction of a tie in the Constitution are highlighted in a letter that eight major American economists sent in July 2011 to the President and Congress of the United States. The letter, published 28 July 2011, was signed by Kenneth Arrow, Peter Diamond, Eric Maskin, Charles Schultze, William Sharpe, Robert Solow, Alan Blinder and Laura Tyson. Available at http://www.cbpp.org/cms/index.cfm?fa=view&id=3543).

[11] See Servizio Studi del Senato, *Introduzione del principio del pareggio di bilancio nella Carta costituzionale Disegni di legge costituzionale AA.SS. nn. 3047, 2834, 2851, 2881, 2890 e 2965*, Dossier n. 322, 16 (2011).

Since the reform of the Stability and Growth Pact of 2005, the use of the structural budget balance was introduced in order to understand the extent to which the balance is attributable to the fiscal policies of the government, thereby avoiding the adoption of pro-cyclical fiscal policies.[12] To guarantee a balanced budget, the second subparagraph of Art. 81 provides that "borrowing is permitted only for the purpose of considering the effects of the economic cycle and, with the approval of the Chambers adopted by an absolute majority of its members to the occurrence of exceptional events". Introducing a safeguard clause, this provision contrasts adverse economic cycles. Since the absolute majority of the members of each house is required, this tool can be used to tackle exceptional events with the use of debt only when necessary.

An ambiguity concerning the conditions in which indebtedness is allowed (Art. 81 of the Italian Constitution, second subparagraph) was highlighted by some scholars[13]. There are two possible interpretations of this Art.. According to the first, indebtedness was allowed in the event of there being two conditions: "the occurrence of extraordinary economic events" and a proper consideration of "the impact of the economic cycle"; according to the second circumstance, just one of the conditions would have been considered necessary in order to borrow money according to Art. 3, paragraph 3, point b of the fiscal compact. However, this interpretation was not consistent with the first subparagraph Art. 81 of the Constitution, which states that is up to the state to implement counter-cyclical policies in order to grant a balance between revenue and expenditure. Overall, it was not coherent with the European budgetary parameters, which are of a structural nature and imply that the calculation of the budget must be net of the effects of counter-cyclical policies. Therefore, an interpretation of the law that allows the legislator to borrow

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[12] See, *ex multis*, M. Buti, S.C.W. Eijffinger, D. Franco, *The stability pact pains: forward-looking assessment of the reform debate,* CEPR, Discussion Paper (2005); R. Morris, H. Ongena, L. Schuknecht, *The reform and implementation of Stability and Growth Pact,* 47 ECB Occasional Paper (2006); J. De Haan, M. Mink, *Has the Stability and Growth Pact impeded political budget cycles in the European Union?*, 1532 Cesifo Working Paper (2005).

[13] See A. Brancasi, *Il principio del pareggio di bilancio in Costituzione*, in osservatoriosullefonti.it 4 ff. (2012).

money not only during an economic downturn but also in the occurrence of extraordinary economic events has proven to be preferable. This would leave more leeway to politics according to Law 243, subsequently implemented in late 2012.

The first case in which the derogation is allowed confirms that it is possible for a member country to implement counter-cyclical policies, in according with the first paragraph of that same Art. and with the European legislation related to structural balances, net of the effects of economic cycles. In the second case, for exceptional events, borrowing is not limited to offset the negative effects of adverse cycles. This opens room for discretionary interventions by the decision maker, as long as there is a consensus in both houses wider than what is required for a motion of confidence[14].

In order to avoid recurring borrowing, it is left to the implementation of the reform law requirement for parliamentary authorization to indicate a debt limit. This provision, implemented by Art. 6 of Law 243/2012, describes the manner in which it is possible to depart from the balanced budget regulations. Law 243/2012, taking the provisions of EU regulation 1467/1997, paragraph 2, identifies both exceptional events in periods of economic downturn in the Eurozone or even in the entire EU and extraordinary events outside the control of the state, such as financial crises and severe natural disasters (Art. 6, paragraph 2)[15].

In such cases, the third paragraph of this law provides that in order to cope with exceptional events, the government can deviate temporarily from programmatic targets. After consulting the European Commission, a report, which updates the policy targets of public finance, needs to be shown to both houses of

[14] See G. D'Auria, *Sull'ingresso in Costituzione del principio del "pareggio di bilancio"(a proposito di un recente parere delle sezioni riunite della Corte dei conti)*, in V Foro it. 48 (2012).

[15] Law 243 is rather similar to French and Spanish organic laws; see N. Lupo, *La revisione costituzionale della disciplina di bilancio e il sistema delle fonti*, Il Filangieri Quaderno 89 ff. (2011); such laws can be abolished, modified or waived only through a law implemented by an absolute majority in both the Chamber of Deputies and the Senate. It is therefore an atypical ordinary law provided with greater strength than ordinary laws, decree-laws and legislative decrees.

parliament. A further authorization that indicates the extent and duration of the deviation is needed too. Available resources must be allocated according to it, defining the repayment plan and tying its duration to the gravity of the exceptional events. The repayment plan must be implemented with effect from the year following that for which the deviation is authorized, taking into account economic trends.

Each house can authorize the deviation and approve the repayment plan only by an absolute majority of its members. It is self-evident that, in this case, the borrowing is not tied to the cyclical effects of the balance and can also be extended beyond the maximum parameters defined by the EU. The borrowing is entirely within the discretion of the policy-maker. This point is underlined by the absence of an indebtedness cap in Law 243/2012. The establishment of such a cap, therefore, remains within the political debate between the government and parliament to be subsequently formalized by resolution of parliament.

It is expected that the resources needed to cope with exceptional events will have a bond of destination. They must be used only to fulfil the purposes described in the authorization request to the chamber (Art. 6, paragraph 4, Law 243/2012). It is on this basis that the Italian government has asked for the postponement of a balanced budget. It is this postponement, which we shall now analyse.

4. Postponing a balanced budget: procedural aspects

The request for a balanced budget postponement by the Italian government appeared likely since the closure of the EU excessive deficit procedure in May 2013. The procedure was accompanied by six recommendations by the European Commission (and endorsed by the Council): one relative to the maintenance of a deficit/GDP ratio below 3% and the remainders concerning other interventions in various sectors of public administration, all aimed at strengthening the economic and financial stability of the country[16].

Cohering with these recommendations, the current economic and financial planning document outlines a budget plan divided into different areas: efficiency of public administration through spending reviews, intervention in the welfare state and labour market, intervention in inland revenue, encouragement of healthy competition in the market and intervention in the banking system and financial market. These are interventions that take place in a context of economic recession. It is unrealistic to expect these interventions to be feasible without the chance of negotiating greater flexibility in meeting the goals of the Stability and Growth Pact[17].

Hence the request for a balanced budget postponement which consists of a derogation from the adjustment path that will not break even in 2014 but will do so, according to government estimates, in 2016.

Before analysing whether the postponement request is coherent with the overall legal framework, some comments about the profile of the procedure are required. In the context of the European Semester, the stability program, which sets out the budget's targets, was submitted to the Commission and the European Council (EU Regulation 473/2013, Art. 4).

The European Council, on the basis of the Commission's assessment, examines the MTO's reliability in terms of economic outlook and considers whether the adjustment path towards the medium-term objective is appropriate, taking into account the evolution of the debt/GDP ratio. A temporary deviation requires the approval of both the commission and council (EU Regulation 1466/1997, Art. 5).

The request for authorization was made by means of communication from the Italian Government to the European Commission a few days prior to the submission of the request for

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[16] European Commission, Brussels, 20 May 2013, COM (2013) 362 Final recommendation on the 2013 National Reform Programme of Italy, delivering a Council opinion on the 2012–2017 stability program of Italy.

[17] See R. Perez, *La chiusura per disavanzi eccessivi,* in Gior. dir. amm. 882 (2013). It is noted that Spain and France could overcome Stability Pact boundaries on the condition that they take measures in the fields of pensions, the welfare state, liberalization of the markets and in the field of taxation.

postponement of the balanced budget in parliament. The European Commission stated that it would assess the adjustment path towards the MTO in its assessment of the stability programme and the national programme[18]. Therefore, the timing for the approval of the document bearing the economics and finance report to parliament on net borrowing and debt and its application for authorization proved to be incompatible with the acquisition of an opinion from the Commission. Authorizing the postponement of the budget balance showed a full assumption of responsibility by the government and the parliament. It is a decision considered strategic for the economic revival of the country, but it is not without risks relating to the impact on public finance[19].

Financial policy, while being influenced by quantitative and procedural constraints arising from European legislation, remains in line with the principle of subsidiarity (Art. 5 TEU) and the competence and responsibility of the member countries. A thesis that attaches excessive rigidity to the decision by the current budgetary stance of Art. 81 of the Constitution is not grounded. Art. 81 of the Constitution, in fact, emphasizes the accountability of public finance policies, allowing for flexibility only if objectively recognized as such. The large majority required by the second paragraph of Art. 81 of the Constitution not only limits the use of debt but is also functional to the involvement of a larger parliamentary majority.

4.1. The postponement of the balanced budget: significant aspects of the decision

The request for a postponement of the balanced budget must be placed in a broader context of social and political tension in which anti-European sentiments and movements have grown increasingly remarkable. Social tension is determined by a persisting economic crisis, which past governments were inadequate to deal with, except for implementing austerity measures according to EU constraints. There is an increasing

[18] See Senate, XVII legislature, stenographic report of the 17 April 2014 meeting.
[19] Hearing of the Court of Auditors on the Document of Economics and Finance (DEF) 2014; joint budget committees, Chamber of Deputies and the Senate, 15 April 2014.

separation between the main political parties (especially left wing parties such as the Democratic Party) and their traditional electorate. An extra-parliamentary crisis led Italian Prime Minister Enrico Letta to step down less than a year after taking office.

Premier Renzi's government took office on 22 February 2014 with the intention of realising a revolutionary plan of reforms. The government's economic policy hitherto opposed the policy of restraint adopted by past governments, believed to be counterproductive in revamping the economy. In line with this approach, the government asked for a derogation from the adjustment path towards the medium-term budgetary objective (MTO). This dispensation consists of a reduction of the structural deficit of 0.2% instead of 0.5% of GDP as laid down by European and Italian legislation[20]. This way, MTO parameters will be met in 2016. The deviation was only requested for 2014 and was based mainly on two propositions. First, it highlighted the need to tackle the effects of the 2012 and 2013 recession using a "comprehensive strategy".

Speaking from a legal point of view, the reason for this postponement can be assessed by considering consistency with European legislation. The current EU Regulation 1466/1997, Art. 2, paragraph 2, provides that the Commission and the Council "can exceptionally consider an exceeding over the reference value resulting from a severe economic recession, if the excess is due to a negative growth rate of the annual GDP or to an accumulated loss of output during a protracted period of very low growth of the annual volume of GDP relative to potential growth".

In the Italian case, there was a contraction in GDP of -2.4% of GDP in 2012 and -1.9% of GDP in 2013. That determined a difference between the actual and potential GDP equal to 3.6%, far below the value that the European Commission considers feasible

[20] The goal of deficit/GDP ratio of 3% has been fully met. In this sense, the risk of incompatibility underlined by some economists would seem ungrounded. See B. De Witte, *European Stability Mechanism and Treaty on stability, coordination and governance: role of the EU institution and consistency with EU legal order*, in European Parliament (ed), *Challenges of Multi-tier governance in the Eu* (2012) 14 and ff.

in recessionary conditions of a normal cycle[21]. Therefore, the above assumptions appear viable to facilitate Italy's request for a temporary deviation from the path of achieving MTO.

A second motivation behind the Italian request for the balanced budget postponement is the need to improve economic growth and the sustainability of public finances. This appears to be consistent with European law. The Council and the Commission, "in defining the adjustment path to MTO, as well as in allowing a temporary deviation to the States that have achieved it, take into account (...) implementation of major structural reforms that are adequate to generate long-term financial benefits, including the raising of potential sustainable growth" (EU Regulation 1466/1997, Art. 5, paragraph 1, letter c).

The Italian Government aims to boost growth through structural reforms along two lines. The first shows new measures of intervention divided among ten areas: containment of public spending, federalism, administrative efficiency, market and competition, jobs and pensions, innovation and human capital, business support, support for the financial system, energy and environment, infrastructures and development[22].

The government aims primarily at reducing the tax burden and public spending, expecting to obtain a public debt reduction by 2.6% of GDP. In doing so, the margin of safety in respect of the "reference value of the deficit," accounting for 3% of GDP, is guaranteed[23]. The second line of action contains the updates of the measures taken in previous years to pay off public administration debts for a total of over 13 billion Euros, in addition to the 47 billion already allocated as a result of previous interventions[24].

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[21] See Ministry of Economy and Finance, *Economic and Financial Document* (2014-2018), 26; European Commission, *Report on public finances*, 4 European Economy 97 (2013).

[22] Ministry of Economy and Finance, *Economic and Financial Document*, cit., specifically 24.

[23] In particular, the measures to reduce the tax burden on labour, IRAP, auditing of financial income, spending review, liberalization and simplification, as well as measures related to the labour market, are expected to reduce the public debt/GDP ratio to 0.8 of GDP in 2015 to 1.3% of GDP in 2016 to 2.1% in 2017 and to 3.5% in 2018. Cfr. Ministry of Economy and Finance, *Economic and Financial Document*, cit., 33, Table III.8.

[24] This is Decree Law 35/2013 and Decree Law 102/2013, which placed, respectively, payments for 40 billion euros in the period from 2013 to 2014 and

The government has estimated that, since 2012, domestic demand has been depressed by both the credit crunch and the impact of the measures of fiscal consolidation[25]. Tax revenues have been lower than planned, leading to an output gap "significant and coincident with the liquidity conditions of enterprises far from normal levels"[26]. These factors, together with an unstable market situation, led the Italian Government to carefully assess the risks associated with adopting more restrictive measures of public finances, jeopardizing an already fragile recovery.

From this perspective, the payment of public administration debts becomes a key point in order to stimulate domestic demand[27]. Through the payment of these debts, the government aims to alleviate a serious situation that has become even more severe due to the financial and economic crisis and, paradoxically, in an attempt to cope with the principle of a balanced budget.

In fact, the postponement of payments by public authorities has been strategically used by both central and lower level governments in order to meet the Stability and Growth Pact parameters. This postponement was basically an accounting expedient imposed, in most cases, according to the rules of the Internal Stability Pact, which were not based on a long-term vision

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for more than 7 billion euros in 2013. Specifically, the Decree 35 of 8 April 2013, converted into Law 64/2013, marked a turning point in fighting the delays in payments by the government. See the comment made by M. Gnes, *Il pagamento dei debiti della pubblica amministrazione,* in Gior. Dir. Amm. 687 ff. (2013).

[25] The amount of public administration debt for 2012 was estimated by the Bank of Italy at 90 billion euros; see Bank of Italy, *Annual report submitted to the Ordinary of the participants*, 31 May 2013, 155 ff. available at bancaditalia.it; On 28 March 2014, according to data from the Italian government, payments were made by entities subject debtors to creditors amounting to 23.5 billion.

[26] See Ministry of Economy and Finance, *Economic and Financial Document*, cit., 28.

[27] Government intervention is not limited to the payment of existing debts but is aimed at shortening the time of payment in line with European rules, resulting in positive effects for the reduction of entry barriers, as required by the European Commission in a recent document, *Assessing product-market Reforms in Italy, Greece, Spain, Portugal. European Commission: note for the attention of line working group (*2014). Cfr. Decree 35/2013 and Decree 64/2013 24 April 2014; See M. Gnes *La nuova disciplina sui ritardi per i pagamenti*, cit., 115.

of economic and financial planning and which had a negative impact on both financial and economic situations[28].

The paradox is even more evident when we consider that the European legislation had been fighting the delays in payment since Directive 2000/35. Europe encouraged the government to pay its obligations because the issue of non-payment hinders the proper functioning of the internal market, twisting competition[29].

The delay of payments by the government, used to meet the parameters of the Stability and Growth Pact, produced the dual effect of slowing the domestic economy and threatening to upset the European market.

It should be noted that European legislation, as already mentioned, leaves wide discretion to national governments on how to achieve a balanced budget. On the other hand, the legislation is peremptory in terms of the payment of public administration. This has resulted in the need to continue with the turnaround that has already been adopted by Decree/Law 35/2012 and that continues through the operation announced by the Document of Economics and Finance. The delay of payments is a central problem that can produce long-term adverse effects in the face of false positive effects in the short-term.

However, it should be noted that the payment of public administration debt that should have already been implemented according to European regulations, does not exactly allow public expenses in order to create growth and development. It is more precisely related to liquidity in the system and aimed at creating the conditions for economic recovery that the same strict policies followed so far have helped to slow down[30].

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[28] See F. Merusi, *Il sogno di Diocleziano. Il diritto delle crisi economiche,* cit., 3; Banca d'Italia, Audizione preliminare all'esame del Documento di economia e finanza 2014, Commissioni riunite V della Camera dei Deputati (Bilancio, Tesoro e Programmazione) e 5a del Senato della Repubblica (Bilancio) Camera dei Deputati Roma, 15 aprile 2014.

[29] See Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on fighting delayed payments in commercial transactions. Guideline 2011/7/ of the EU Parliament and Council of 16 February 2011. See M. Gnes, *La disciplina Europea sui ritardi dei pagamenti*, in Gior. Dir. Amm. 821 (2011).

[30] See, *ex multis*, D. Schizer, *Fiscal policy in an era of austerity,* 408 http://ssrn.com/abstract=a948692; R. Boyer, *The four fallacies of contemporary austerity policies: the lost Keynesian legacy*, Cambridge Journal of Economics 36

5. The Council's recommendation: the rule of debt and other relevant elements

On 26 June 2014, the EU Council approved the recommendations for each member state's economic and budgetary policies[31]. As regards the request for a postponement of the balanced budget, the first of the eight recommendations addressed to Italy does not contain an explicit denial to it, but stresses the importance of strengthening the budgetary measures for 2014 in the light of the emerging gap relative to the Stability and Growth Pact requirements, namely the debt reduction rule, based on the Commission's forecast of spring 2014[32].

In 2015 a strengthening of the budgetary strategy to ensure compliance with the debt reduction requirement is required. In particular, the Council recommends to ensure that general government debt is on a sufficiently downward path to also carry out an ambitious privatization plan. The Council's recommendations allow flexibility in the pace of public debt reduction that is subject to two conditions: the carrying out of structural reforms and the carrying out of other relevant elements.

Many of the reforms recommended by the EU Council are already outlined in the Italian draft budgetary plan. For these reasons, the main issue now is not which reforms to implement but the need to carry them out as soon as possible. It is, therefore, a question of taking advantage of the flexibility allowed in current budgetary discipline.

Art. 2 of CE regulation 1467/1997 provides that member states with debt in excess of 60% of GDP must reduce the amount by which their debt exceeds the threshold by at least 1/20th per year over three years. This requirement is considered to have been fulfilled only when there is a decline in the debt differential in excess of 60% according to the EU forecast over a three-year period starting from the last year for which there are available data. To assess compliance with this regulation, the general

(2012); Y. Kitromilides, *Deficit reduction, the age of austerity and the paradox of insolvency*, Journal Post Keynesian Economics 33 (2011).

31 See European Commission, *Recommendation for a Council recommendation on Italy's 2014 national reform programme and delivering a Council opinion on Italy's 2014 stability programme*, COM (2014) 413 final, 2 June 2014.

32 See European Commission, *Vademecum on the Stability and Growth Pact, European Economy,* 151 Occasional Papers (2013).

economic trend will also be taken into account. If none of these conditions are met, the debt rule is considered unfulfilled. Member states in breach of this obligation will be the subject of an official report by the EU Commission according to Art. 126.3 of the Treaty on the Functioning of the European Union (TFEU).

For countries such as Italy that, in November of 2011, were subject to an excessive deficit procedure, this rule will come up to speed after a transition period of three years from the closing of the excessive deficit procedure[33]. During this transition period, the debt rule is considered met if the state gets a minimum annual reduction of the structural deficit (minimum linear structural adjustment, MLSA) established by the Commission for each country.

Italy, which came out of the excessive deficit procedure in 2013, is now required to record a reduction in structural deficit of at least 1.32% of GDP in the 2014–2015 period in order to comply with the MLSA established by the European Commission.

In 2014, Italian public debt increased to 134.9% of GDP due to the payments of public administration debts (13 billion) and also due to the slowdown in growth (from 2.9 to 1.7%). The process of reducing the debt/GDP ratio will begin in 2015.

The end of the repayment schedule of trade payables and income resulting from privatizations are estimated to positively affect the reduction of public debt (approximately 0.7% of GDP for each year in the period 2015–2017). It is an ambitious goal considering that in the previous decade the amounts resulting from privatization receipts amounted to around 0.2 % of GDP on average per year[34].

It should be considered that the current value of the shareholdings held by governments in listed companies is estimated to be equal to 1% of GDP. To this must be added that

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[33] See European Commission, Brussels 29 May 2013, COM (2013) 385 Final, Council decision repealing decision 2010/286/EU around the existence of an excessive deficit in Italy. The decision to terminate this procedure has been taken on the basis of the data provided by Eurostat; R. Perez, *La chiusura di infrazione per deficit eccessivi*, cit., 884.

[34] See Banca d'Italia, *Audizione preliminare all'esame del Documento di economia e finanza 2014,* Commissioni riunite V della Camera dei Deputati (Bilancio, Tesoro e Programmazione) e 5a del Senato della Repubblica (Bilancio) Camera dei Deputati Roma, 15 aprile 2014, 7.

the Council of Ministers adopted two decree laws to dispose 40% of *Poste Italiane* and 49% of Enav on 16 May. Moreover, the economic and financial planning document presented the sale of other direct investments relating to Eni, StMicroelectronics and other indirect holdings (held by *Banca Depositi e Prestiti* and *Ferrovie dello Stato*).

It is necessary, in order to comply with the rule of debt, that, in 2016, these privatizations will be pursued, together with the achievement of the MTO. According to Art. 126, TFEU, paragraph 3 and Art. 2 of Regulation EU 1467/97, the Commission must assess compliance with the MLSA parameters by considering the significant factors that have led to the failure to reduce the debt at an appropriate pace (Regulation 1467/97, Art. 2, paragraph 1). In particular the relevant factors are:

a) the economic position including potential growth, the different contributions provided by labour, capital accumulation and total factor productivity, cyclical developments and the private sector net saving position;

b) the budgetary position and the record of adjustment towards the MTO, the level of the primary balance and developments in primary expenditure, both current and capital, and the overall quality of public finances;

c) the debt position, its dynamics and sustainability.

Furthermore, the Commission shall give due consideration to any other factors which, in the opinion of the member state concerned, are relevant in order to comprehensively assess, in qualitative terms, the excess over the reference value and which the member state has put forward to the Commission and to the Council. In that context, special consideration shall be given to budgetary efforts towards increasing or maintaining, at a high level, financial contributions to fostering international solidarity and to achieving European policy goals, notably the unification of Europe if it has a detrimental effect on the growth and fiscal burden of a member state.

In Italy's case, the paper discusses economics and finance-relevant factors, in addition to adverse economic circumstances and the aforesaid payment of trade payables of the public administration and financial support provided to countries in the

Eurozone[35]. This latter point is of particular interest because it highlights a connection between the discipline of public finance and the principle of solidarity, which had previously remained neglected[36].

6. The flexibility of the pact: solidarity and growth

EU regulation 1467/97, Art. 2, paragraph 3, letter c), provides that the Commission pays particular attention to the contributions of international solidarity to achieve the targets of the Union. This, as well as the payment of the debt, will result in financial stabilization. It is a provision that, if properly applied, could mark a revival of European integration focused on the maintenance of financial stability, which would not be incompatible with the values of solidarity.

Thus far, especially after the outbreak of the crisis, financial stability has been excessively emphasized to the detriment of the fundamental value of solidarity. The complementary nature of these two values is confirmed by the provisions of the Treaty on European Union and the Treaty on the Functioning of the Union. In the TEU, the goals of integration, such as peace and well being (Art. 3, paragraph 1), are pursued through the construction of an internal market and EMU, in addition to economic and social cohesion and solidarity among the member countries (Art. 3, paragraph 3).

TFEU contains rules such as the prohibition of excessive deficits (Art. 126), the prohibition of concession overdrafts by the ECB and the national central banks in the ESCB (TFEU Art. 123), the prohibition of privileged access financial institutions (TFEU Art. 124) and the prohibition of bail out (TFEU Art. 125). These regulations were set to preserve financial stability by avoiding the

[35] With regard to the effects of the economic cycle on debt reduction, studies have shown that a reduction in the structural balance equal to 1 or 0% of GDP can generate an economic contraction. This decline may be at least a ½ a percentage point of GDP if the adjustment in the structural balance has been done with an increase in the tax burden and can be equal to ¾ of a percentage point of GDP if the adjustment is done with spending cuts. See O. Blanchard, D. Leigh, *Growth Forecast errors and fiscal multipliers*, 13 IMF Working Paper (2013).

[36] See G. della Cananea, *L'Unione economica e monetaria venti anni dopo: crisi ed opportunità*, cit., 7.

behaviours that could cause moral hazard by member states. Financial stability, however, is pursued in order to achieve the original purpose of the Union, referred to in Art. 3 and the preamble of the treaty. It is, therefore, a means rather than an end. Overemphasis on short-term financial stability has overshadowed the need to pursue concrete actions that encourage investments and stimulate growth in the long term[37].

Emphasis has been placed primarily on a selection of coarse parameters, which are not necessarily indicative of the real wealth of a country[38]. The result of these policies was the contagion of the crisis from the financial to the economic dimension with an increase in unemployment, particularly among young people. This contradicts in full the objectives of solidarity and social inclusion contained in Art. 3 of the TFEU and confirmed as objectives of Europe 2020[39]. Austerity caused a political crisis in some countries, which facilitated the rise of anti-European parties and movements. These elements suggest that we need a change in the interpretation and application of the rules of public finance. It seems necessary to take full advantage of the flexibility of space allowed by the SPG, along with the implementation of measures

[37] The limits of GDP as an economic indicator were highlighted by J. Stglitz, A. Sen, J.P. Fitoussi, *The measurement of economic performance and social progress revisited: reflection and overview,* 16 http://ww.stiglitz-sen-fitoussi.fr/documents/overview-eng.pdf (2009); in other respects, the limits of an approach based on the maintenance of a deficit/GDP ratio within a certain threshold are demonstrated by O. Blanchard, D. Leigh, *Growth Forecast errors and fiscal multipliers*, 13 IMF Working Paper 19 (2013); on the inability of governments to make decisions on a long-term vision, see T.M. Padoa-Schioppa, *La veduta corta* (2009); P. Krugman, *Myths of austerity,* in The NewYork Times, 1 July 2010 Available at nytimes.com/2010/07/02/opinion/02krugman.html; P. De Grauwe, *The governance of a fragile Eurozone*, Working Document 346 (2010).

[38] See *ex multis*, P. De Grauwe, *What kind of governance for the Eurozone*? 214 September Paper, CEPS Policy Brief (2010). It shows that the solution to the crisis lies not within the constraints of the Stability and Growth Pact, but in the reform of private finance: "The root causes of the debt problems in the Eurozone is to be found in the accumulation of unsustainable debt in the private sectors to many Eurozone countries"; in this sense, but more widely, see F. Merusi, *Il sogno di Diocleziano* cit., 4 ff.

[39] See European Commission, *Communication from Commission, Europe 2020. A strategy for smart, sustainable and inclusive growth*, COM (2010)2020 final; to verify the results obtained in Italy and in other countries, see http:// ec.europa.eu/europe2020/reading-thegoals/target/index_it.htm.

of investment and growth on the part of national states from which they can derive both cohesion and solidarity.

The creation of the European Stability Mechanism and the conditionality of the grant of financial assistance to a needy country created additional bulwarks in the defence against opportunistic behaviour on the part of the member states in defence of financial stability[40]. The use of opportunistic increase in public debt by a state is in fact limited by the impossibility for the Governing Council of the ECB to buy government bonds in the absence of specific requirements. The beneficiary country must adhere to a programme of the European Financial Stability Facility (EFSF) or ESM[41].

This could consist of a macroeconomic adjustment program or a precautionary program (enhanced conditions credit line). But, above all, it is required to formalize commitments in a separate memorandum of understanding (MOU)[42].

The complex set of rules introduced following the crisis provides ample reassurance that allows countries to benefit from

[40] For a reconstruction of the last stages of evolution and of the implications for the role of the ECB, see S. Cassese, *La nuova architettura finanziaria europea,* Gior. dir. amm. 79 (2014); G. Napolitano, M. Perassi, *La Banca centrale europea e gli interventi per la stabilizzazione finanziaria: una nuova frontiera della politica monetaria?*, in G. Amato, R. Gualtieri (eds.), *Prove di Europa unita Le istituzioni europee di fronte alla crisi* (2013), 41; S. Antoniazzi., *La Banca centrale europea tra politica monetaria e vigilanza bancaria* (2013), 187.

[41] Regarding the strengthening of the role of the ECB during the crisis and the legal inconsistencies with the provisions of its statutes, see B. Krauskopf, C. Steven, *The institutional framework of the European Central Bank: legal issues in the first ten years of existence ITS,* in Common Market Law Review 144 ff. (2009); T. Beukers, *The new ECB and its relationship with the Eurozone member state: between Central Bank independence and Central Bank intervention,* in Common Market Law Review 1579 (2013); P. De Grauwe, *The European Central Bank: lender of last resort in the government bond markets?*, in F. Allen, E. Carletti, S. Simonelli (eds.), *Governance for the Eurozone: integration or disintegration?* (2012), 17 ff.; F. Capriglione, G. Semeraro, *Il Security Market programme e la crisi dei debiti sovrani. Evoluzione del ruolo della Bce*, in Riv. trim. dir. econ. 264 (2011); G. Napolitano, *La crisi del debito sovrano e il rafforzamento della* governance *economica europea*, in Id. (ed.), *Uscire dalla crisi. Politiche pubbliche e trasformazioni istituzionali* (2012).

[42] See M. Schwarz, *A memorandum of misunderstanding- The dorme road of the European stability mechanism and a possible way out: enhanced cooperation* in Common Market Law Review 389 (2014).

flexibility in the application of fiscal discipline[43]. From this perspective, Italy's situation provides further opportunity for the European institutions to give a signal that it is possible to search for a balance between austerity, growth and solidarity, in accordance with provisions in the preamble of the treaty and before the Schuman Plan.

7. Open questions: the implications of the method of calculation of the MTO

As mentioned above, the EU Council granted Italy with more flexibility for 2015, around two to three billion euros, and the opportunity to reduce public debt more slowly. Such flexibility was granted in exchange for the promise to make substantial public reforms in the fields of labour, public administration and education[44]. The EU Council reaffirmed that budgetary regulations are already flexible enough since they set economic targets that consider economic trends. Budget balance is set in structural terms and is net of one-time measures. Therefore, EU economic boundaries become less restrictive during recessions and more stringent during economic expansions. It is a problem to assess how much of a public deficit is due to cyclical causes and how much is structural. It is a rather arbitrary framework with a certain margin of error.

The European regulation provides that the "Member States may" deviate from the adjustment path towards the MTO with the deviation reflecting the amount of incremental impact of structural reforms on the general government balance" (EU Regulation 1466/1997, Art. 5, paragraph 1, letter c).

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[43] With regard to the impact of the subsequent creation of the ESM European legal framework, B. de Witte, *Treaty games: law as instrument and as constraint policy* in *Governance for the Eurozone. Integration or disintegration?* (2012), 138 ff. observes that "the main game of economic governance will continue to be played within the European Union 'Institutional framework'"; more widely E. Chiti, P.G. Teixeira, *The constitutional implications of the Europeans' responses to the financial crisis and public debt* in Common Market Review 683 (2013).

[44] See T. Boeri, *Ma quella flessibilità è molto rigida,* in Repubblica.it, 30 June 2014.

Analyses conducted by independent research studies show that critical points, relative to the estimates of tax revenue, could be lower for several reasons[45].

First, the estimates of the entry submitted by the government are based on a favourable macroeconomic scenario. These estimates are different from the predictions of independent research institutes that show an overestimation of the yield of about two tenths of a percentage point in the 2014–2015 period and about five tenths of a percentage point in the period 2016–2018.

Secondly, the government anticipates the income from future revenues, amounting to around three billion Euros more revenue estimated for 2013, to lead to a reduction in future revenue in the period 2015–2016. At the same time, it creates a depreciation of receivables from credit and insurance institutions, which will reduce revenue by about two-thirds of the additional revenue provided by the law of stability for 2014[46].

A third factor of uncertainty, concerning the estimates of income, relates to the connection between income growth and the implementation of certain benefits/tax measures that would produce, according to government estimates, a volume of revenue between 26% and 62% in the period 2015–2018. Independent analysis shows an expense net of interest higher than that estimated by the government; interest expenditure is lower in the period 2014–2016 and becomes higher in the period 2016–2018[47]. In consideration of these critical elements that undermine the

[45] See Cer, Prometeia, Ref, *Previsioni per l'economia italiana*, Consensus Report prepared for the CNEL, 9 July 2013; in Italy, Law 243/2012 established the Office of the Parliamentary Budget fiscal council, responsible for verifying the performance of public finance and assessment of compliance with the fiscal rules. This institution has been formed with a delay of about two years and is still not fully operational. P. Chiti, *L'Ufficio parlamentare di bilancio e la nuova* governance *della finanza pubblica*, in Astridonline.it 8 (2014); R. Perez, *L'Ufficio parlamentare di bilancio*, in Gior. dir. amm 197 (2014); R. Hagemann, *Improving performance through fiscal councils*, OECD Economic Department Working Papers 829 (2010); X. Debrun, M.S. Kumar, *Fiscal rules, fiscal councils and all that: commitment devices, signalling tools or smokescreens?*, Paper no. 1 (2007), available at: http://www.bancaditalia. en/studiricerche/seminars/actions/fiscal.pdf.

[46] See Law 147, 27 December 2013, published in OJ 302 of 27 December 2013.

[47] See Cer, Prometeia, *Previsioni per l'economia italiana,* Rapporto di Consenso prepared for the CNEL, 9 July 2013.

reliability of the financial predictions for the Italian government, a positive opinion from the European Commission should not be taken for granted.

These differences in predictions prompted the European Commission to consider Italian public finance as "severely imbalanced," and able to negatively affect the functioning of economic and monetary systems[48].

The issue regarding the differences between the estimates of the government and those of the Commission puts the spotlight on a central point of coordination of fiscal policies in Europe, represented by the methodology used to quantify the MTO[49].

It is the way in which this parameter is constructed that determines the ability of governments to set more or less restrictive budgetary policies. According to EU Regulation 1466/97, as amended by EU Regulation 1175/2011, the medium-term budgetary objectives (MTO) for a specific country are shown in a range between -1% of GDP and the balance or surplus, in cyclically adjusted terms, net of one-off and temporary measures (Art. 2a)[50]. The Treaty on Stability, Coordination and Economic Governance, the so-called fiscal compact, lays down more

[48] See European Commission Communication COM (2014) 150 of 5 March 2014 on the results of the analysis conducted in accordance with EU regulation 1176/2011, prevention and correction of macroeconomic imbalances (procedure for macroeconomic imbalances).

[49] See Decree 54/2014, implementing Directive 85/2011 on requirements for budgetary frameworks of the member states, which imposes an illustration of the differences between the Commission's estimates and those of the government, explaining the most important differences. In the DEF, GDP growth is estimated at 0.8% for 2014 and 1.3% for 2015, while, in 2014, the European Commission winter forecast GDP growth is 0.6% in 2014 and 1.2% in 2015. See the 2014–2018 DEF, 20 where the differences are traced to the various basic data and the different methodologies used by the Commission. The Commission's estimates are based on unchanged policies and legislation. It does not, therefore, consider the effects of the legislation.

[50] In addition to the parameters of the deficit/GDP and debt/GDP ratios, the capacity of a member state to pursue the objectives of the budget in the medium term is also evaluated on the performance of the annual expenditure of public administrations. This is the so-called "rule of expenditure" provided in EU Regulation 1466/1997 and transposed into national law by Article 5 of Law 243/2012. "In particular, in the case of Italy, like the Member with a debt/GDP ratio above 60 percent," the annual expenditure growth should be lower than that of the potential GDP in the medium-term of a measure capable to reduce the structural balance of at least 0.5 % of GDP.

stringent standards, establishing that the balance is met "if the annual structural balance of the public administration coincides with the specific medium-term objective for the country, with the lower limit of a structural deficit of 0.5% of GDP" (Art. 3, paragraph 3, letter b). In the updated version of the Code of Conduct 2012, the MTO is identified with the borrowing of general government, net of the effects of the economic cycle and of one-off and temporary measures.[51] For Italy, the structural balance that is correct for the effects of the economic cycle, net of one-off and temporary measures, has been set equal to zero.

Under the current method of calculating, the measure of the effects of the economic cycle is determined by the result of the multiplication of the output gap for a parameter of semi-elasticity of the economic growth budget balance that, in the case of Italy, is equal to 0.55%. The output gap is the difference between actual and potential output, the latter at the maximum feasible extent, in the absence of inflationary forces and with the full utilization of the factors of production. According to government estimates, the cyclical component of the budget balance is equal to -2% in 2014 and will take on positive values only in 2018, which implies a structural balance of -0.6% in 2014. It may be equal to zero only as of 2016[52].

The calculation method used is common and compulsory for all member states; it has been defined by the European Commission on the basis of what was agreed by the Output Gaps Working Group (OGWG), which meets regularly under the Economic Policy Committee. A first observation is the conventional nature of the calculation methodology used for the output gap. This observation is of particular significance if we consider that the adoption of a balance adjusted for the cycle allows nominal deficits and, therefore, allows borrowing in periods when the output gap is negative; at the same time, when

[51] On 24 January 2012, the document Specifications on the Implementation of the Stability and Growth Pact and Guidelines on the Format and Content of Stability and Convergence Programs was made available. It is a further version of the Code of Conduct on the Implementation of the Stability and Growth Pact, revised compared to that approved by the ECOFIN Council of 7 September 2010.

[52] See the Ministry of Economy and Finance, *Documento di economia e finanza* - DEF, Tav. III. 9 (2014), 38.

the output gap is positive, it is necessary to produce a surplus to repay the debt[53].

Therefore, the use of debt is determined by formulas for the measurement of the output gap – necessary for purification from the effects of the economic cycle and for the assignment of weights to certain variables. In the Italian case, the MTO has been set equal to zero, which, in normal conditions, would exclude the use of debt. Such an exclusion is determined by formulas extremely burdensome for countries with debt above 60% of GDP and that have high costs associated with an aging population. This method has increased the level of the structural deficit for countries with high public debt and high unemployment, such as Italy, Ireland, Greece and Portugal, to an unrealistic and unjustified extent[54].

In order to correct these deficiencies, new methodologies to improve the definition of the structural deficit regarding states with high debt and high unemployment are objects of study. From 2013, as well as the adoption of semi-elasticity of the budget compared to the growth in the calculation of the output gap and parameters related to the structure of revenue, expenses and the individual elements that calculate the output have been updated[55]. This update does not have a direct impact on the calculation of the output gap but allows the production of more realistic data on the calculation of income and expenditure of the member states. It remains clear that, because of the various preliminary hypotheses that can be considered in the calculation of the MTO, there are

[53] See Servizio bilancio del Senato, *Introduzione del principio del pareggio di bilancio nella Carta Costituzionale*, Elementi di documentazione n. 5/2011, specifically 6 and 24-26 ff.

[54] See M. Cacciotti, C. Frale, S. Teobaldo, *A new methodology for a quarterly measure of the output gap,* Ministry of Economy and Finance, Department of Treasury Working Paper no. 6 (2013); P. De Ioanna, L. Landi, *Politica, tecnica democrazia*, Short note n. 3 (2012), available at econpubblica.unibocconi.it, specifically 11–17; European Commission, G. Mourre, G.M. Isbasoiu, D. Paternoster, M. Salto, *The cyclically-adjusted budget balance used in the EU fiscal frame workman update,* 478 Economic Papers (2013); C.E.V. Borio, P. Disyatat, M. Juselius, *Rethinking potential output: embedding information about the financial cycle,* Working Paper n. 404 (2013).

[55] The elasticity of the budget balance measured the impact of growth on the absolute value of the balance; the semi-elasticity measures the change in the budget balance as a percentage of GDP with respect to changes in economic growth; cfr. G. Mourres, G.M. Isbasoiu, D. Paternoster, M. Salto, *The cyclically-adjusted budget balance used in the Eu fiscal frame work: an update*, cit., 480.

elements of discretion that reduce the transparency of the methodology of that calculation and that are likely to induce national governments into decisions, which are inconsistent with the actual economic situation of a country[56].

As far as Italy is concerned, the measurements proposed by the European Commission which identify the persistence in 2014 and expansion in 2015 of the structural deficit should solicit the government to adopt corrective measures whenever an alternative calculation of the structural balance based on OECD data indicates, for the same period, a situation of surplus (equal to 0.4% in 2014 and 0.5% in 2015)[57]. It seems evident that, in this case, technicalities are crucial to the fiscal policy of national governments.

The discretionary component of the national decision maker is influenced by the introduction of automatic stabilization mechanisms as configured by the limits for borrowing. Also, the "if" and "when" of borrowing are ultimately traceable parameters and econometric models. From this perspective, the intergovernmental comparison moves to the definition of the calculation method that is the most appropriate to the needs of a country. What will be the result of mediation at the European level in which the role of bureaucracies is decisive? The non-uniqueness in the methodology strengthens the role of bureaucracies; they will have to determine which method to adopt, and this will have an impact on the transparency and the understanding of decisions[58].

[56] About the functions of the Output Gap Working Group and possible improvements to the methodology used so far, see F. D'Auria, C. Denis, D. Havik, K. McMorrow, C. Planas, R. Raciboski, W. Roger, A. Rossi, *The production function methodology for calculating potential growth rates and output gaps, European Economy*, Economic Paper n. 420 (2010); in 2012, the work done by the Output Gap Working Group has identified certain priorities such as the construction of a database on discretionary interventions of governments and their impact on the elasticity of the budget and the definition of medium-term projection methodologies for the variables in terms of potential output; see most recently, M. Cacciotti, C. Frate, S. Teobaldo, *A new methodology for a quarterly measure or output gap*, cit., 14.

[57] See OECD, *Economic Outlook*, 1 (2014), 107.

[58] See, *ex multis*, C. Lequesne, *La trasparence, vice ou vertu de la démocratie*, in J. Rideau(ed.), *La trasparence dans l'Union européenne* (1999), 11.

7.1. Open questions: the investment clause

In addition to MTO method calculating, there is another question underlined by the Italian government to promote flexibility in order for application of SPG, the investment clause. In this respect, the Italian government argues that removing the cost of strategic investments and structural reforms from the budget deficit is very important. The EU Commission resumed the provisions relative to public investment in line with the Stability and Growth Pact in the 2012 document Blueprint for a Deep and Genuine Economic and Monetary Union. The Commission especially referred to Art. 126.3 of the Treaty of the Functioning of the European Union (TFEU) in which, under the procedure for excessive deficit (EDP) "the report of the Commission shall also take into account whether the government deficit exceeds government investment expenditure".

The blueprint contents were taken forward by the EU Council in June 2012 and March 2013 and it was concluded that there was a need to "balance the productive public investment needs with fiscal discipline objective" [59] . The EU Council's conclusion was transposed in Art. 16.2 of EU Regulation 473/13 (part of the so called two-pack regulation) in which it was envisaged that "the Commission shall report on the possibilities offered by the Union's existing fiscal framework to balance productive public investment needs with fiscal discipline objectives in the preventive arm of SGP, while complying with it fully".

The former president of the EU Commission, during the EU parliament sitting on 3 July 2013, announced that the Commission, when assessing the national budgets for 2014 and 2013 financial statements, might leave room for temporary deviations from the adjustment path towards mid-term financial targets on a case by case basis and in full respect of the Stability and Growth Pact. On the same day, Olli Rehn, the EU Commission Vice-president and Commissioner for Economic and Monetary Affairs, sent a document laying down further specifications of the so called investment clause to ministers of finance of member states and to the EU Parliament.

[59] See Council Conclusions, 13–14 June 2012, 1 and 14, 15 March 2013, 2.

The EU Commission aims to reform Art. 5 of CE Regulation 1466/97 concerning the SGP preventing arm and examines the possibility of deviating temporarily from the medium term budgetary objective (MTO) and from the adjustment pact only when the following conditions are verified:

1) economic growth is negative or well below its potential;
2) the deviation does not lead to a breach of the 3% deficit ceiling and the public debt rule is respected;
3) the deviation from the MTO is linked to national expenditures on projects co-funded by the EU under its structural and cohesion policy, trans-European networks and connecting Europe facility.

It should be noted that adopting an investment clause does not imply that the EU Commission will contemplate the adoption of the so-called golden rule. In fact, the Commission specified that any of these provisions should not be confused with a golden rule that allows the subtraction of all public investments from the budgetary deficit. In this respect, the introduction of a golden rule could represent a threat to the medium and long-term sustainability of public debt.

The golden rule will not be adopted mainly because it is difficult to measure the impact of public investments on economic growth[60].

Being extremely hard to evaluate a single project's rate of return, it is not possible to determine if a project will have an economic comeback sufficient to cover costs or if, on the contrary, it will result in an increase in taxes or in spending cuts at the expense of future generations.[61] Intergenerational equity would require projects with significant rates of return. This would call for parameters that are shared by all the member states, and, in this respect, the debate seems rather untimely[62].

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[60] See S. Micossi, F. Peirce, *Flexibility clauses in the Stability and Growth Pact: no need for revision*, Ceps Policy Brief (2014), 319.

[61] See F. Balassone, D. Franco, *EMU fiscal rules: a new answer to an old question?*, in Banca d'Italia (ed.), *Fiscal rules* (2001).

[62] See, European Commission, *Annual Growth Survey 2013*, COM (2012) 750 final, 28 November 2012.

8. Conclusions

The Italian case drew attention to the opportunity for taking advantage of the flexibility allowed by the current European juridical framework in order to promote growth and development and financial stability. One of the main themes asserted by the Italian government during the meeting of the EU Council on 26 and 27 June was the necessity to generate growth through structural adjustments and investments.

The Italian prime minister, in his first speech on 2 July, talked about a fresh start that must be founded on structural reforms and flexibility, promoting a change in the rigorist politics applied so far. The Italian semester of presidency is focused on growth, structural reforms and on a better use of the flexibility that is already allowed by budgetary boundaries. But there are political and technical difficulties in terms of meeting these targets.

Politically, a major barrier consists of persuading not only rigorist countries but also the European Commissioner for Economic Affairs[63]. It is a difficult challenge, but Italy can count on French support as both countries understand the necessity of tuning the European economy towards growth and employment. Italian and French governments share not only the need for flexibility but also the necessity to get public investments started in order to stimulate private ones. Both governments are persuaded that investments for structural reforms and public investments must be deducted from the deficit calculation. This operation must be carried out depending on the characteristics of each country and not relying on a single method.

However, it is still difficult for the Italian government to get a broader consensus on the issue of flexibility. One of the main obstacles is that past Italian governments did not make the reforms that were promised. Member states are still sceptical towards Italy, and they do not know what kind of structural reforms Italy will eventually make in order to secure flexibility. A general lack of trust characterized the last several EU meetings[64].

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[63] See interview with European Commissioner for Economic Affairs Jyrki Katainen, in Die Welt, 19 July 2014, available at welt.de.

[64] See Interview with Italian finance Minister in A. Baccaro, *Patto Ue sulle riforme,* Corriere della Sera, 6 luglio 2014, 3.

In reality, despite scepticism, Italy's plan for reforms is clear. Italy is not asking for a budgetary discipline reform. Crises must be addressed with the growth of aggregate demand. This can be achieved through structural reforms that will have a positive effect on the economy but not for two or three years. Flexibility is crucial not only for Italy, a single member state, but also for the entire European economic system.

The newly named president of the EU Council, Jean Claude Juncker, has announced a plan of both public and private investments, in addition to granting financial incentives for countries that carry out structural reforms. The measures listed so far represent the initial steps towards a new course for the integration process. In this perspective, the Italian government's request for a balanced budget postponement, along with the need for flexibility and growth, represents a chance to rediscover the values of solidarity that were among the pillars of the EU integration project. However, this change will successfully take place only if both political and *especially* technical obstacles can be overcome.

From the reconstruction of the internal and supranational legal framework, it is evident that the existence of areas of discretion is left to national decision-makers. Such room is conditioned by the respect of adjustment trajectories of finance in order to maintain financial stability. Financial stability is functional and complementary to solidarity, a value protected by the Treaty of Lisbon. The pursuit of stability, growth and solidarity is conditioned by the way in which indexes of public finance are calculated by experts.

The choice of calculation methodology is influenced by national experts who themselves are under pressure from politics. "Politics" is a bit vague in order to identify methodologies, which are more favourable to national public finance[65]. In Italy's case, this can be interpreted as another manifestation of an unfinished process towards the realization of the so-called "magic triangle." The "magic triangle" requires a balance between the monetary

[65] In this sense, the interaction between technology and policy refers to what has already been pointed out by Schmitt about the permeability of technical institutions that have no real but only apparent neutrality; see C. Schmitt, *Der Begriff des Politischen,* trans. and edited by G. Miglio, P. Schiera, *Le categorie del politico* (1972), 182.

base, government spending and the exchange rate with other currencies, notably the dollar[66]. The crisis has highlighted how far away the reaching of the "magic triangle" is not only because the achievement of a balance between these three components is complex, but also because the approach taken so far to address the crisis was focused on a distinct vision of public finance as disjointed from private finance – and that is without taking into account the interrelationships between the two. As previously observed in this essay, using public law to establish a balance between the monetary base, government spending and the exchange rate is extremely complex because the three are not homogeneous. While monetary policy is defined centrally by the ECB, the public spending of individual states remains something non-homogeneous and something, which the rules of the Stability and Growth Pact have failed to stabilize.

The application of the constraints of the Stability and Growth Pact has accentuated the recession, especially for countries with higher public debt such as Italy. The key point is the need to manage public finance as a whole because operating only in the medium-term does not protect from the risk of recession. A balanced budget postponement for Italy, as well as previous postponements requested by Spain and France, is also a symptom of an unfinished process towards a federal-type structure. Strengthening fiscal coordination is destined to produce negative effects, which will occur periodically in the absence of a federal budget. This goal requires a reorganization of powers where there is a "European treasury," the ability to issue European bonds and the recognition of wider powers for the European Parliament, all steps that, although complex, are obligatory and urgent.

[66] See F. Merusi, *Il sogno di Diocleziano. Il diritto delle crisi economiche*, cit., 3-4.