



OPINION OF THE EUROPEAN CENTRAL BANK

of 21 February 2008

at the request of the Italian Ministry of Economic Affairs and Finance

on some provisions of the Law on the State annual and pluriannual budget (2008 Budget Law)

(CON/2008/10)

Introduction and legal basis

On 20 December 2007 the European Central Bank (ECB) received a request from the Italian Ministry of Economic Affairs and Finance (MEF) for an opinion on some provisions of the draft law on the composition of the State annual and pluriannual budget (hereinafter the '2008 Budget Law').

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the third indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions¹, as the law relates to the Banca d'Italia. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

The Italian Council of Ministers approved the draft law on 15 November 2007 and the national Parliament adopted it on 24 December 2007 as Law No 244². The subject of this opinion is the draft version of the law that the consulting authority sent to the ECB with its consultation request (*Atto Camera* 3256 – A), which was agreed by the Parliament only shortly before its adoption and corresponds fully to the final text that was adopted. This opinion relates only to the specific provisions identified by the consulting authority as relevant for the ECB.

1. Purpose of the relevant provisions of the 2008 Budget Law

The specific provisions on which the MEF has consulted the ECB affect the role of the Banca d'Italia as a national central bank (NCB) of the Eurosystem and cover two different fields. On the one hand, Article 2(39) of the 2008 Budget Law implements a structural reform to the government account held at the Banca d'Italia by amending the Law on consolidation of legislative provisions and regulations on public debt (hereinafter the '2003 Consolidated Law'), which regulates the single Treasury account³. On the other hand, Article 3(44) to (49) of the 2008 Budget Law relates to the overall financial treatment of the Banca d'Italia. According to Article 3(45), the regulation of the financing modalities, expenditure control and remuneration of the Banca d'Italia will be delegated to a future law reforming the

¹ OJ L 189, 3.7.1998, p. 42.

² *Gazzetta Ufficiale* No 300, 28.12.2007, *Supplemento ordinario* No 285.

³ Presidential Decree No 398 of 30 December 2003 (*Gazzetta Ufficiale* No 57, 9.3.2007, *Supplemento ordinario*).

independent authorities in Italy, including the Banca d'Italia. In this regard, it may be noted that the ECB has already opined earlier last year on a draft law reforming the independent authorities (*Atto Senato* 1366)⁴.

2. General observations

The ECB received the consultation request in the same week in which the law was adopted. The ECB understands that on 31 December 2007, shortly after adoption of the law, Decree-Law No 248 on the extension of deadlines set by legislative provisions and urgent provisions on financial matters (hereinafter the 'Decree-Law') was adopted⁵. According to Article 42(1) of the Decree-Law, Article 2(39) of the 2008 Budget Law only enters into force following the adoption of the relevant ECB opinion, while Article 42(2) of the Decree-Law adds to Article 3(45) of the 2008 Budget Law the words 'in compliance with the requirements provided for by Community law' after the words 'on the expenditure'. In view of these provisions of the Decree-Law and the late stage in the legislative process at which the ECB was consulted, the ECB would like to draw attention to Article 4 of Council Decision 98/415/EC, which requires Member States to ensure that the ECB is consulted at an appropriate point in time to allow the consulting authority to take its opinion into consideration before deciding on the substance of the draft legislative provisions. In the present matter, the ECB was consulted more than one month after approval of the draft Law by the Government and two working days before its final adoption by Parliament. On the other hand, the ECB appreciates that the consulting authority will take appropriate additional measures to reflect the ECB's opinion to the extent appropriate. In addition, the ECB expects that for future amendments or implementing measures to the law, the obligation to consult the ECB is respected. More generally, internal administrative procedures should be in place to ensure that timely consultation of the ECB is foreseen whenever such consultation is mandatory.

3. Specific observations

3.1 Publicity and transparency

One aspect of Article 3(44) of the 2008 Budget Law is the application to the Italian public institutions of the general principles of publicity and transparency of the remuneration of public administration servants. These principles promote best practice in public administration and the ECB welcomes the fact that they apply to the Banca d'Italia, in addition to the other Italian independent authorities.

3.2 Central bank independence – Personal independence

3.2.1 Article 3(44) of the 2008 Budget Law also establishes limits to the 'overall level of remuneration' for anyone receiving payment from public finances within the scope of employment or self-employment contracts with the public administration and exempts the Banca d'Italia from the scope of this general rule. However, Article 3(46) of the 2008 Budget Law provides for a specific

⁴ See ECB Opinion CON/2007/17 of 18 June 2007 at the request of the Italian Ministry of Economic Affairs and Finance on a draft law on the regulation and supervision of markets and the functioning of the competent independent authorities.

⁵ Decree-Law No 248 of 31 December 2007 (*Gazzetta Ufficiale* No 302, 31.12.2007, p. 4).

threshold for the overall remuneration of any Banca d'Italia servant, as well as in public administration and the independent authorities, of double the First President of the Supreme Court's remuneration. The ECB understands that this threshold will apply to all Banca d'Italia servants.

3.2.2 The ECB notes that, under the current regime, the Banca d'Italia enjoys statutory autonomy in determining its servants' salaries, including the Directorate. An act of the Board of Directors determines the remuneration of the Banca d'Italia's servants, subject to internal and external controls. In this regard it may also be noted that the ECB defines autonomously its staff's conditions of employment and that this autonomy forms part of the ECB's independence as guaranteed by Article 108 of the Treaty and Article 36 of the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'ESCB Statute'). The new provisions of Article 3(46) of the 2008 Budget Law represent a departure from the current regime in that the determination of remuneration of Banca d'Italia's servants will be subject to the limit referred to in that Article. In order to ensure that Article 3(46) is consistent with the Community requirements for personal independence of the members of NCBs' decision-making bodies, the new legislation introducing a remuneration threshold for the Banca d'Italia should be implemented so as to ensure that it does not affect the terms under which the current members of its decision-making bodies have been appointed. Therefore, the new legislation should only apply to future appointments.

3.3 *Central bank independence – Financial independence*

3.3.1 The concept of financial independence is assessed from the perspective of whether any third party is able to exercise either direct or indirect influence not only on the performance of an NCB's tasks, but also on its ability - both operational in terms of manpower and financial in terms of appropriate financial resources - to fulfil its mandate⁶. The ECB has noted in the past that Member States may not put their NCBs in a position where they risk having insufficient financial resources to carry out such ESCB or Eurosystem-related tasks⁷. In the present case, the ECB is concerned that the Banca d'Italia's ability to carry out its tasks may be affected by future legislation foreseen in the 2008 Budget Law.

3.3.2 Article 3(45) of the 2008 Budget Law subjects the Banca d'Italia to a law to be adopted in the future, reforming the independent authorities, which will regulate their financing modalities, expenditure control and related issues. It has to be ascertained that this envisaged future legislation does not affect the Banca d'Italia's financial independence. In particular, it will need to take into account the Banca d'Italia's status as a member of the Eurosystem and its specific auditing and controlling structure (Article 38 of the Banca d'Italia's Statute), which the ECB welcomed in its opinion on the new Statute⁸. Considering that the future legislation foreseen in Article 3(45) of the 2008 Budget Law is intended to regulate aspects such as, *inter alia*, expenditure control, the ECB

⁶ See ECB Convergence Report 2007, p. 20.

⁷ See ECB Convergence Report 2007, p. 19.

⁸ See ECB Opinion CON/2006/44 of 25 August 2006, paragraph 3.2.

understands that such future legislation will exclude any *ex ante* third party intervention in the Banca d'Italia's expenditure needed for the Banca d'Italia's statutory tasks, including both its ESCB and non-ESCB related tasks, in compliance with the principle of financial independence, and that the scope of any such control will be clearly defined by the legal framework and be without prejudice to the activities of the Banca d'Italia's independent external auditors, as laid down in Article 27.1 of the ESCB Statute⁹. Along the same lines, as explained in paragraph 3.2.2, it is noted that also in this respect the new law would depart from the current regime which leaves regulation of these matters to the statutory autonomy of the Banca d'Italia and would consequently weaken its independence. Finally, Article 3(45) of the 2008 Budget Law departs from Article 17(9) of the draft law on the independent authorities, relating specifically to the organisation of the authorities, according to which the Banca d'Italia is fully exempted by the scope of Article 17 itself. Such an exemption should specifically apply also to Article 3(45) of the 2008 Budget Law.

3.4 *Monetary financing prohibition*

3.4.1 The Law regulating the account held by the Italian Treasury with the Banca d'Italia to manage the Treasury services was adopted prior to European Monetary Union¹⁰. Article 5(5) of the 2003 Consolidated Law, which mirrors the same provision already in force since 1993, provides that the Banca d'Italia attributes, at the beginning of each six months, interest equal to the average of Treasury bills issued in the previous six months to the 'Treasury availability to provide Treasury services' account¹¹. The 2003 Consolidated Law does not contain provisions on the maturity of deposits and, consequently, does not explicitly correlate the remuneration rate of the deposits with their maturity.

3.4.2 The 2003 Consolidated Law currently in force is constructed so that it does not exclude the possibility of Treasury deposit remuneration rates being higher than the market rates in particular for the remuneration of overnight deposits. Such a remuneration rate would contravene the objectives of the monetary financing prohibition under the Treaty¹². From an economic perspective, the prohibition of monetary financing by central banks of government activities is independent of its form, i.e. loans, or other direct financial means (e.g. the provision of direct, non-reimbursable funding to the public sector). Interest payments above market rates constitute a *de facto* advanced distribution of profits to the government. This, in turn, implies a *de facto* intra-year credit, contrary to the objective of the monetary financing prohibition. Therefore, the remuneration for government deposits should not go beyond the remuneration applied to a similar deposit made by a market counterparty. If the remuneration mechanism for government deposits allows the Government to systematically steer the remuneration by an NCB at a rate above the rate at which a similar deposit

⁹ See ECB Convergence Report May 2007, p. 20.

¹⁰ Law No 483 of 26 November 1993 (*Gazzetta ufficiale* No 282, 1.12.1993).

¹¹ The 2007 calendar for the issue of Treasury bills provides for the issue of six-month and 12 month Treasury bills, while it previously also issued three-month Treasury bills.

¹² According to paragraph 20 of Case 283/81, *Srl CILFIT and Lanificio di Gavardo SpA v Italian Ministry of Health* [1982] ECR 3415 'every provision of Community law must be placed in its context and interpreted in the light of the provisions of Community law as a whole, regard being had to the objectives thereof'.

would be remunerated by a market counterparty, in addition to constituting a breach of the monetary financing prohibition it may have undesired signalling effects.

3.4.3 The ECB notes that the draft 2008 budget law initially submitted to the Parliament aimed at remedying the above described problematic provisions by introducing the following provision in Article 5(5), linking clearly the deposit remuneration rate to the market: ‘The Minister for Economic Affairs and Finance and the Banca d’Italia shall establish by means of agreements, to be agreed within 90 days of entry into force of this Law, the conditions for maintenance and remuneration of the account, which shall be linked to market rates’. However, the amendments introduced by Parliament to Article 5(5) of the 2003 Consolidated Act no longer contain this provision, thus maintaining the incompatibility of Italian law with the prohibition of monetary financing.

3.5 *Monetary policy implementation*

3.5.1 Government deposits held with the Eurosystem reduce the amount of liquidity available to the euro area’s banking sector. Therefore, the deposits have to be forecast when calibrating the ECB’s open market operations. The Banca d’Italia and the other NCBs of the Eurosystem provide these forecasts to the ECB on a daily basis. Since 1999, their precision has to a large extent depended on the procedures for the management of government deposits, which differ widely between the different countries of the euro area. On an aggregate level, errors in the forecast of government deposits have continuously caused a large part of the errors in the forecast of liquidity needs of the euro area banking sector as a whole. Given the particular nature of the procedures for managing government deposits in Italy, the ECB welcomes any effort to make the forecasts of government deposits at the Banca d’Italia more reliable. In that respect, the 2008 Budget Law provides that deposits in excess of a threshold agreed between the MEF and the Banca d’Italia in the context of the exchange of information on cash flows will no longer be remunerated. This can be expected to provide an incentive for the MEF to transfer funds in excess of this threshold to the banking sector.

3.5.2 This measure could indeed reduce forecasting errors in the liquidity management transactions (OPTES) procedures. These procedures were introduced in April 2007 to increase flexibility in the management of Treasury funds and thereby satisfy the MEF’s short-term financial needs and improve the predictability of the available account balance¹³. As mentioned in the statement of reasons, the performance of OPTES with respect to avoiding forecasting errors could greatly improve by introducing transactions transferring surplus balances from the MEF’s account with the Banca d’Italia to the banking system. For these reasons, the change planned for the remuneration regime should be implemented as soon as possible.

3.5.3 The change planned for the remuneration regime is insufficient alone to achieve high precision in government deposit forecasting. However, Article 5(5), as amended by the 2008 Budget Law, provides that ‘To stabilise the balance with the forecast, the liquidity management

¹³ See press release of the MEF and the Banca d’Italia of 13 April 2007, ‘Starting of the liquidity management transactions (OPTES)’.

modalities...shall be established by means of a later decree of the Minister for Economic Affairs and Finance.’ Without knowing these modalities in detail, it is not possible for the ECB to conclusively assess future government deposit management procedures in Italy. They should in any event leave no scope for liquidity management operations to be specified in accordance with interest rates.

3.5.4 The ECB expects that the exact specifications of the future procedures for the management of government deposits in Italy will be compatible with the efficient implementation of monetary policy. This may require further modifications to the law.

This opinion will be published on the ECB’s website.

Done at Frankfurt am Main, 21 February 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET