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This time it may be (and should) be different

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Nobel laureate Samuelson will be turning in his grave to see old economic recipes revived, the same recipes he disproved both logically and practically. One above all: the so-called "pump-priming", i.e. the priming that was used to activate the old water pumps, applied to the fiscal multiplier. According to this logic, the resources that a government puts in place to stimulate growth through public spending and investments can trigger virtuous growth that feeds itself — to the point that the gains in GDP and tax revenue would be sufficient to eliminate the additional debt initially undertaken. Unfortunately, as Samuelson demonstrated, public spending does not have these miraculous effects. There is no way out of high debt through public spending or stimulus to demand, albeit for investments. And yet, we must recognise that today's situation is very peculiar, and different from the past in various respects.

First, the world economy has gone through an unprecedented crisis, marked at its inception by a sudden cardiac arrest that literally required artificial ventilation to avoid premature death, with systemic business failures and skyrocketing unemployment. In such adverse circumstances, the economic literature says that fiscal stimulus is not only necessary but above all, highly effective. The 'multiplier', which quantifies the effect on the overall income of an increase in public spending, is not a constant, but varies and is exceptionally high in the course of deep economic crises. This is a crucial motivation for the immediate fiscal measures introduced by almost all countries and financed by debt. The multiplier also depends on the type of expenditure and is higher for public investments. Even if the Recovery Fund hits the ground when the situation has at least partially normalised compared to today, public investment could still have a more significant impact than in the past, due to a large residual of spare capacity on labour and capital.

Secondly, part of the resources deployed in the European Union will arrive in Italy as subsidies, i.e. they will not weigh on public accounts. These are resources that will only have to be reimbursed in the long run through the EU budget or European taxation — and the share for Italy will be significantly lower than the resources received.

A third element is represented by the borrowing cost for the stimulus financed by national debt. Thanks to the AAA rating of the European Union, a highly accommodative monetary policy and the purchases of financial assets by the European Central Bank, the European package allows the Italian government to finance itself through EU loans at (nominal) rates close to zero. Italy's government bond issues also benefit from tight spreads for very long maturities. But be careful: a low cost does not at all guarantee that public investments have a positive return.

A fourth element is that almost all countries are making policies similar to Italy and the European Union, and this amplifies the stimulus effect for world economies and will probably also push inflation temporarily higher in the future. Here comes the last element, i.e. the declared willingness by central banks to avoid reacting pre-emptively to inflationary tensions. This was recently stated, for instance, by the Federal Reserve, given the recorded long period of low growth and low inflation, and the considerable degree of uncertainty which calls for prudence in any change of course.

All together, the ingredients for an economic recovery that will last at least a few years are all present. In the near-term, such a situation is sustainable in no small part because in itself is global. So, is it enough to justify a boost in public spending? Not exactly.

The principles of sound financial management and the basic rules for maintaining budgetary discipline have hardly changed. For a limited period, however, an opportunity is offered, and for this reason, we should look at the sustainability of public finance with different eyes. Not only because the European Central Bank will continue to buy public debt, and therefore by definition, make it sustainable. But above all, because the current circumstances, never realised in the past and perhaps not repeatable, allow relying on above-par nominal growth for a few years, in the presence of artificially low financing costs. It can generate a virtuous dynamic in the short term. Still, it must translate into a sustainable path in the medium-long term — which is what matters for those who invest in Italian debt, beyond the anaesthetic effect of current monetary policies. So what is necessary?

Public investments should increase the capital stock that brings Italy back on a path of appreciable growth even in the long term — which would also imply higher tax revenues. Italy, therefore, needs projects that raise productivity and give results in a reasonably short time. But Italy cannot achieve its growth goal only with public investments. They must be combined with bold reforms, which facilitate the restructuring and reallocation of resources that Italy needs, now more than ever, after the COVID shock. The temporary boost to growth offers the opportunity to at least partly offset the social costs of a virtuous repositioning of Italy in the global economy — on balance, certainly lower than the social costs that would occur with the continuation of the decline that has been underway for many years.

Only this way will Samuelson be able to sleep in peace. And with him, also many Italians who — alive and well — want to believe, if not in a new Italian miracle, in a future in line with the promises of the past.