ISSN:2229- 6247

COVID-19 Crisis and the Public Debt Issue: The Case of Italy

Daniele Schilirò

Department of Economics
University of Messina

Abstract

The COVID-19 pandemic has left the global economy with severe health damage, losses of life and a sharp recession. In addition, it has resulted in a rise of public debts, heightening the tension between meeting major policy goals, growth, employment, health system, environment and containing debt vulnerabilities. This paper examines the literature regarding the debt–growth nexus and the issue of debt sustainability. In particular, it highlights the evidence of some empirical literature showing that high public debt hampers growth, and that countries with high public debt are vulnerable to adverse shocks. In addition, the paper focuses on the case of Italy, a country characterized by a high public debt, low growth and other economic weaknesses, with the purpose to claim a strategy and indicate policy measures.

Keywords: COVID-19, crisis, public debt, growth, debt sustainability, Italian economy.

JEL Classification: H6, E6, F01, O40, O50.

INTRODUCTION

The COVID-19 pandemic has created serious public health and death-toll concerns. The pandemic is the typical "black swan," an unforeseen event with serious economic and social consequences. The coronavirus pandemic has affected the global economy through a complex interaction between supply and demand shocks. As a consequence, the global economy has experienced the combination of a breakdown in global trade, depressed global commodity prices, rapid deterioration of both public and private balance-sheets, and a synchronous economic downturn.

For the first time since the Great Depression, both advanced and emerging market economies will be in recession in 2020. Today, there is a common awareness that the scale of this crisis, with related economic paralysis, high unemployment and rising debt, appears much wider and deeper than the global financial crisis of 2008–2009.

The International Monetary Fund (IMF, 2020) predicts that as a result of the pandemic, the global economy is projected to contract sharply, by –4.4% in 2020, with more than 170 countries with falling per capita gross domestic product (GDP). In 2021 global growth is projected to be 5.1%. Following the contraction in 2020 and recovery in 2021, the level of global GDP in 2021 is expected to be a modest 0.6 percent above that of 2019. In addition, the COVID-19 pandemic will reverse the progress made since the 1990s in reducing global poverty and will increase inequality.

Countries have announced around $11 trillion in new fiscal measures to mitigate the impact of the COVID-19 crisis, so deficits and public debts are rising. Governments in major advanced economies have found they can raise finances in domestic capital markets without adverse impact on inflation or on the cost of capital. The situation is more unpredictable for emerging and developing economies, especially those with thin domestic financial markets, where most additional financing comes from abroad. In both cases, the high debt issue remains on the forefront.

This paper analyzes the economic problems caused by the COVID-19 pandemic. In particular, in the first section, by focusing on the increase in debt occurring in most countries, it reviews the literature regarding the debt–growth nexus and the issue of debt sustainability. In the next section, the paper explores the issue of debt sustainability and the extraordinary actions taken in the Eurozone by the European Commission and the European Central Bank (ECB) to counter the crisis. Then, it discusses the case of Italy, since a high public debt and low growth characterize the country, with the purpose to highlight the critical aspects and suggesting the need of a long-term strategy and several policy measures. Discussion and conclusions end the paper.

PUBLIC DEBT, GROWTH & DEBT SUSTAINABILITY: THE ECONOMIC LITERATURE

Reinhart and Rogoff (2010) supported the thesis that debt accumulation has a causal and damaging effect on GDP growth. In particular, by examining a large panel of countries, they found non-linearities in the relationship between public debt and growth and identified a critical threshold of 90% of the debt-to-GDP ratio, beyond which debt is harmful to growth. Other empirical studies confirmed the negative

impact of high public debt on growth (Chudik, Mohaddes, Pesaran and Raissi, 2017; Gómez-Puig and Sosvilla-Rivero, 2017; Pescatori, Sandri and Simon, 2014; Teles and Mussolini, 2014). Most of these studies also highlighted a "spending composition effect," in favor of interest payments on debt, that leaves a smaller fiscal space for fighting unemployment and improving the economy. However, the search for the debt threshold above which growth is jeopardized by public debt, as suggested by Reinhart and Rogoff (2010), produced non-conclusive results in the subsequent literature. Panizza and Presbitero (2014), Eberhardt and Presbitero (2015), and, more recently, Tamborini and Tomaselli (2020) stressed the relevance of country-specific characteristics, contingencies and events that play a prominent role and significantly affect the debt–growth relationship and its determinants. Tamborini and Tomaselli (2020), in particular, argued that no meaningful assessment of debt and its effect on growth at any point in time is possible without reference to the entire debt trajectory and the specific state of the economy along the trajectory. Thus, according to them, it is impossible to devise a single general law that explains the relation between debt and growth and identifies a critical threshold.

However, despite it being difficult to single out a critical threshold and devise a single empirical law, the evidence of the empirical literature generally shows that high public debt tends to hamper growth by increasing uncertainty over future taxation, crowding out private investment and weakening a country's resilience to shocks (Schilirò, 2019). The increase in public debt due to the COVID-19 pandemic is a case in point. Burriel, Checherita-Westphal, Jacquinot, Schön and Stähler (2020), although they justified the contingent debt increase, warned that once the crisis is over and the recovery firmly sets in, keeping debt at high levels over the medium term is a source of vulnerability in itself. They observed that, particularly in the Eurozone, where monetary policy focuses on the area-wide aggregate, countries with high levels of indebtedness are poorly equipped to withstand future asymmetric shocks. Their analysis, based on large-scale DSGE models, suggested that high debt economies can lose more output in a crisis, are more heavily affected by spillover effects, face a crowding out of private debt in the short and long run, and are adversely affected in terms of potential (long-term) output, with a significant impairment in the case of large sovereign risk premia reaction and the use of the most distortionary type of taxation to finance the additional debt burden in the future (Burriel et al., 2020).

Yared (2019) underlined that a long-term trend in debt accumulation seems inconsistent with theories of optimal government debt policies. He focused on specific political factors that can explain the long-run trajectory of government debt. Among these factors, Yared identified an aging population, rising political polarization and rising electoral uncertainty. Persson and Tabellini (2000) had indicated that public spending is used to seek political consensus on behalf of those responsible for managing public affairs, rather than to incentivize the economy to change its structure, improve productivity and foster growth. They show that politicians have as their goals their re-election and the maximization of political power, and these goals make the management of public spending inefficient.

Presbitero and Wiriadinata (2020), in turn, questioned Blanchard's (2019) view of pursuing fiscal expansions in a low interest rate environment and high debts to spur growth. They warned that despite a low-interest-rate environment, the risks of high public debt persist, especially because interest rate–growth differentials are endogenous to the size and dynamics of public debt, as highlighted by Wyplosz (2019). Presbitero and Wiriadinata (2020) underlined that before the COVID-19 pandemic public debt levels were already at historically high levels, and growth rates had stagnated in many countries; therefore, the fiscal expansion adopted in most countries following the crisis caused by COVID-19 entails significant risks. Since risks associated with refinancing are critical when countries borrow from financial markets, a major risk is the potential feedback loop between high public debt and the risk premium, as shown by Alcidi and Gros (2019).[1] Lian, Presbitero and Wiriadinata (2020), in their analysis based on a large sample of 56 advanced economies and emerging markets, showed that a higher level of current public debt is associated with an increase in the likelihood of exceptionally high difference between the rate of interest (*r*) and rate of growth (*g*) in the future. Countries with high public debts are more vulnerable to adverse shocks. Therefore, their conclusion is that high public debt can make the difference *r-g* more likely to rise and turn positive, potentially amplifying the effect of adverse shocks in driving up *r-g*. It follows that a surge in *r-g* leads to sovereign debt distress and is a concern for future debt sustainability, as shown in the work of Mauro and Zhou (2020).

Buiter (2020) views fiscal stimulus, whether financed by debt or by central-bank money creation, with some suspicion, as both leave bills for the future. In particular, a side effect of Quantitative Easing (QE) is that it leaves the central bank unable to raise interest rates without paying interest on the enormous quantity of electronic money that banks have parked with it. The higher the outstanding QE as a share of total government debt, the more the government is exposed to fluctuations in short-term interest rates, and this becomes particularly problematic for countries with a high public debt/GDP ratio. Then, the problem of

[1] Of course, central banks (e.g., Federal Reserve System, ECB) with their QEs are working to avoid these negative effects. However their action does not guarantee absolute immunity from such risks.

monetary policy in a low inflation environment is to overcome the zero lower bound on nominal interest rates (Buiter, 2009; Goodfriend, 2000; Kimball, 2015). A possible solution, according to this view, is to take interest rates negative.

In addition, excessive high public debt raises the issue of sustainability. First, to properly assess a country's debt sustainability, it is important to cover all types of debt that pose a risk to a country's public finances (Hakura, 2020). Debrun, Ostry, Willems and Wyplosz (2019) observed that debt sustainability is intimately related to the government's ability to honor all its current and future obligations; it is purely forward-looking, and assessing it amounts to predict an unknowable future. Macroeconomic theory generally equates debt sustainability with public sector solvency. Under normal conditions for growth and interest rates, government solvency imposes public debt to be at equal to the present value of all future primary balances. Equivalently, primary deficits must at some point be fully offset by surpluses. Thus, any public commitment to generate sufficiently high primary surpluses at some point in the future should be considered credible. In other words, solvency is a mere judgment on a government's credibility. The concrete challenge of assessing solvency amounts to predicting future fiscal policy (primary balances) over an infinite horizon. Unfortunately, such prediction is subject to considerable uncertainty surrounding (nominal) economic growth, borrowing costs and the primary balance itself. Moreover, the current environment of ultra-low interest rates and seemingly insatiable demand for safe assets complicates the tradeoff between relevance and the simplicity/transparency of sustainability assessments by the stakeholders, especially those with limited public financial literacy (e.g. taxpayers, voters and small investors) (Debrun, Ostry, Willems and Wyplosz, 2019).

Yet, debt management has an important role for debt sustainability, since it consists of choosing a sustainable future path of expenditures and taxation. Also, as Corsetti, Erce and Uy (2019) specified, lengthening loan maturity and managing debt repayment flows can have substantial effects on sustainability.

DEBT SUSTAINABILITY, THE EUROZONE AND THE COVID CRISIS

The COVID-19 pandemic is resulting in a rise in public debt that will heighten the tension with meeting important policy goals, such as growth, employment, environment, health system, fighting inequality. As Hakura (2020) highlighted, a country's public debt is considered sustainable if the government can meet all its current and future payment obligations without exceptional financial assistance or going into default. In addition, Hakura warned that new borrowing should be consistent with fiscal spending and deficit plans. The new borrowing should be carefully set to keep public debt on a sustainable path. Thus, some debt is good if it is aimed at improving the efficiency of spending, reducing corruption, improving the business environment and strengthening the potential productive capacity of the economy. Chatelain, Tinel, Azizi and Canry (2012) pointed out that the existing debt should be serviced with its own revenue effort, and, as a result, no additional borrowing is required. This requirement is expressed by the so-called no-Ponzi condition; that is, the public debt growth rate has to be lower than the real interest rate. Such a condition ensures solvency since the funding of interest payments are not made from the new debt issuances. Indeed, the persistence of conditions in which interest rates remain below growth rates makes government Ponzi schemes consistent with stable or declining debt ratios. Any illusory attitude of wanting to disregard these relationships between variables regarding the real interest rate and the debt growth rate can lead to insolvency and, therefore, to default. Thus the warning by Lian, Presbitero and Wiriadinata (2020), of the relation between high public debt and an increase in the likelihood of exceptionally high difference r-g in the future, remains valid. In addition, the risk of default for countries with high debt persists. This problem exists, particularly in some countries of the Eurozone. Compliance with the rules of the Stability and Growth Pact (SGP) is meant to safeguard the smooth functioning of the Economic and Monetary Union (EMU) and to contribute to the overall stability of the Eurozone. On March 20, 2020, the European Commission (2020a) suspended for the first time the Stability and Growth Pact[2] to ensure the needed flexibility and to protect the European Union (EU) economies.[3] However, the current suspension of the SGP by the European Commission for 2020 and 2021 does not imply that the budgetary constraints have completely disappeared and must no longer be taken into account. The issue of the SGP will soon re-emerge as a key topic in the policy debate, especially considering the sharp increase in government debt levels.

[2] The Stability and Growth Pact of the EU limits the state budget deficit in EU Member-States by 3% and the state debt by 60% of GDP.

[3] Actually, by exploiting a clause introduced as part of the "Six-Pack" reform of the Stability and Growth Pact in 2011, the European Commission could allow Member States to undertake budgetary measures to deal adequately in times of severe economic downturn for the euro area or the Union as a whole. In this particular situation, Member States may be allowed temporarily to depart from the adjustment path toward the medium-term budgetary objective, provided this does not endanger fiscal sustainability in the medium term.

Most importantly though, on March 18, 2020, the ECB announced its Pandemic Emergency Purchase Program (PEPP), an unprecedented scale of asset purchases that succeeded in smoothing financial markets and lowering the spreads on the bonds of countries with high public debt, following the downturn due to the coronavirus pandemic around the world. In more detail, in March, the ECB started its temporary asset purchase program of private and public sector securities for a total of purchases equal to 750 billion euros. On June 4, 2020, the ECB extended the COVID-19 anti-emergency bond purchase plan by 600 billion euros, bringing the total to 1,350 billion euros, leaving interest rates unchanged. It also widened the PEPP time horizon until the end of June 2021, compared to the previous deadline of December 2020.

In addition, on May 8, 2020, the Eurogroup defined the ESM agreement with a credit line of up to € 540 billion called Pandemic Crisis Support to help euro-area Member States cover COVID-19 healthcare costs. The only requirement is to use the funds for healthcare expenses. There is no other condition; it can be requested by individual countries from June 1, 2020 to December 2022. Most Eurozone countries can finance healthcare costs more economically through the ESM than by borrowing directly from the capital markets. Also, on May 19, 2020, Member States in the Council approved the proposal of the European Commission to adopt the regulation establishing SURE (Support to mitigate Unemployment Risk in an Emergency). Such initiative provides financial assistance up to € 100 billion in the form of loans from the EU to affected Member States to address sudden increases in public expenditure for the preservation of employment. In short, the ESM and SURE funds are respectively European Union aid for countries that are most in difficulty due to the COVID-19 crisis to cover the health and social emergency expenses. These funds are financed through debt securities issued by the EU and lent to countries that require them, at low interest rates.

On top of the previous decisions of fiscal policy, on July 21, 2020, the European Council, formed by 27 European Union governments, following a proposal by the European Commission, reached a major agreement over the new fiscal stimulus, that is a new recovery instrument: Next Generation EU, embedded within a powerful long-term EU budget (European Council, 2020).[4] The European Commission, taking advantage of its strong credit rating, has been tasked with raising € 750 billion on the financial markets. The funds will be distributed among the countries and sectors most impacted by the coronavirus pandemic, and will take the form of grants and loans. Most of this financial support will be for investments and reforms that should include green and digital transitions and the resilience of national economies. The recovery fund will be available from January 2021.

Monetary policy, through asset purchases, has become crucial to face the crisis and stabilize the financial markets, while governments have been pressured to use fiscal policy in order to have a significant role in managing the economic cycle. All this has inevitably led to massive fiscal stimulus programs. Today's low interest rates facilitate the favorable attitude toward this type of fiscal policy intervention, which enables governments to service much higher public debts.

As Bénassy-Quéré and Weder di Mauro (2020) pointed out, the ECB and the EU budget provide a policy response to the pandemic crisis avoiding financial instability and limiting any risk of sovereign default, also supporting the economy. In short, they constitute an ex-post insurance to shocks.

Therefore, as long as the ECB keeps purchasing sovereign debts, even for countries with high debts, their situation is sustainable. However, this favorable condition cannot last forever. Thus, in the long run, for sustainability not to be at risk, nominal growth must remain sufficiently strong to support the (likely) rising cost of borrowing (Codogno and Corsetti, 2020).

LOW GROWTH AND HIGH PUBLIC DEBT IN ITALY BEFORE AND WITH COVID PANDEMIC

Before the COVID-19 pandemic, the Italian economy was already characterized by a considerable amount of public debt and low growth for two decades (Schilirò, 2019). The COVID-19 pandemic is adding severe economic consequences on the country with a collapse in output, GDP and employment, and a huge increase in public debt. After all, already the global financial crisis (2008–2009) had a strong negative impact on the Italian economy. In those years, the country showed a low GDP growth rate, mainly due to structural factors such as low productivity, weak competitiveness, poor innovation in companies, and a labor market with little flexibility that led to high youth unemployment and an unsustainable rate of unemployment in the Southern regions. Investments after the global financial crisis had dropped considerably. The Italian GDP has grown on average by one percentage point less than the euro-area average, and the country had the lowest growth rate in the European Union, with a productivity lower than its European partners, and a public debt that became the third highest in the world (Schilirò, 2010, 2014).

In fact, Italy has been struggling with limited annual budgets and its large public debt for quite some time. Table 1 shows the public debt-to-GDP ratio for various years, starting from 1970, when the value of the ratio was 44%. The table highlights that the debt-to-GDP ratio began to rise in the eighties, so in 1990, it was

[4] However, to become operational, the Next Generation EU plan must be approved by each Parliament of the 27 countries of the European Union.

already 94.6%. In 1992, when Italy joined the Maastricht Treaty, the ratio exceeded 100% and reached 105.2%. So it continued to rise to 108.5% in 2000, when the country had recently adopted the euro. The global financial crisis and the Eurozone debt crisis (2009–2010) further worsened the Italian debt situation. The European policies of budget consolidation and austerity fail to stabilize the debt/GDP ratio, which in 2014 reached 131.8%.

By and large, the table confirms that Italian public finances were not in good health since the nineties, and the debt situation was already fragile before the COVID-19 crisis. In fact, in 2019, Italy had a public debt of 134.8% of GDP, and an interest expense of over € 60 billion per year, despite the drastic reduction in interest rates over the years.

Table 1

DEBT/GDP Ratio Italy (various years)

1970*	44%
1980	56,8%
1990	94,6%
1992	105,2%
2000	108,5%
2009	112,5%
2010	115,3%
2014	131,8%
2019	134,8%

Source: AMECO – European Commission
https://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm
*The source for 1970 is ISTAT

The structural problems of the Italian economy that have contributed to the low growth and high debt included an inefficient public administration that tolerated extensive tax evasion and allowed unproductive public spending and a slow and complex bureaucracy far removed from the needs of businesses (Schilirò, 2019). It is also important to mention an aging population coupled with low birth rates, as well as a process of deindustrialization and a consequent transfer of companies. No less important to understand the economic difficulties and the social hardship of the country is the economic gap between the Northern and Southern regions, where the risk of poverty and social exclusion reached alarming levels. Thus, too much bureaucracy; excessive taxation; excessive tax evasion; a delay on behalf of companies and the public administration to adapt to new technologies, in particular digital innovation; the weakening of the production system; strong territorial disparities; protection guaranteed by politics to one part of Italian society at the expense of the other being unprotected; all these have been important factors contributing to the economic decline of Italy.

Faced with a high and growing debt, Italy presents a worrying situation regarding growth. In the last decade (2009–2019), the average growth rate of the Italian economy was 0.2%. Per capita GDP was € 29,348 in 2019, while it is estimated that in 2020 it will be € 26,481. Regarding the debt, the COVID-19 epidemic has further precipitated the precarious situations. Despite the resilience of incomes, most of the consequences of the crisis have been discharged on public accounts, due to the fall in revenues, and as a result of spending increases, also thanks to the extensive funding of social safety nets. Thus, in May 2020, the debt peaked at € 2,530604 billion (Banca d'Italia, 2020a). Most likely, Italy will have around € 150 billion of new debt by the end of the year. As a result, per capita debt in 2020 will be € 42,000. However, the debt situation in the whole Eurozone is not good at all either. According to the European Commission (2020b), in the Eurozone, the debt-to-GDP ratio is projected to rise substantially, reaching a new peak of approximately 103% in 2020, before decreasing to below 100% in 2021.[5] In Italy, in particular, the debt-to-GDP ratio will increase from 134.8% in 2019 to 158.0% at the end of 2020 and should decrease at the end of 2021 (Banca d'Italia, 2020b).[6] This is because the deficit in Italy should reach 10.8% in 2020, and then reduce to 5.6% in 2021, well above the threshold of 3%, thanks to the suspension of the SGP by the European Commission (2020a). In addition, Italy will receive an endowment from SURE of € 27.4 billion, according to the European Commission (2020c). Whereas, starting from 2021, Italy should receive from Next Generation EU € 81.4 billion in non-repayable funds[7] and € 127.6 billion in loans at almost zero interest and repayable in thirty years:

[5] According to the International Monetary Fund (2020), in the Eurozone, the GDP debt ratio will rise to 101.1%, while GDP will suffer a loss of -8.4% in 2020.

[6] The estimates of the IMF (2020) are more pessimistic for the Italian economy expecting a GDP debt ratio of 161.8% in 2020 and 158.3% in 2021.

[7] Of these 81 billion, 65.5 billion are those of the Recovery and Resilience facility to partially finance the national recovery plan. The rest of the transfers will come through other Recovery Fund instruments, including React-Eu, rural development

€ 209 billion in all. The times and procedures for examining the national Recovery Plans should be two months for the judgment of the Commission and one for that of the European Council. Beneficiary countries must submit their detailed projects, which are likely to arrive no earlier than January 2021. As a result, the first disbursements from the fund will occur later. The final decision on the European Commission's proposals will come in April 2021, and the first 10% down payment will likely be paid in June.

The debt that Italy will incur toward the Commission through the Recovery and Resilience Facility will not receive special treatment, but will be considered on a par with that contracted with the markets. Italy will therefore have to convince Brussels that recourse to this amount of loans will have no impact on the sustainability of its budget. Then the following question arises: Will Italy's public debt be more or less sustainable than before COVID-19? The answer depends on the likely evolution of the public debt in relation to Italy's GDP.

Three variables matter for the sustainability of the Italian public debt: economic growth, interest on government bonds and the primary surplus net of interest. It is obvious that growth is the main road to overcome the crisis caused by the COVID-19 pandemic, as well as to stabilize first and then decrease debt/GDP ratio, and reduce the weight of debt. As a large proportion of the global communities have been hit by the COVID-19 pandemic, the current economic slowdown is leading to a sharp recession at a global level. According to Reinhart and Reinhart (2020), the recovery will not be as robust or rapid as the downturn and will diverge among countries. Hopefully, a positive sign of growth will come in 2022. The estimates of the IMF (2020) confirm this thesis. Italy does not seem to be an exception.

In the current situation and in the near future, the Italian national debt is sustainable because the ECB keeps purchasing it; in 2020, the ECB will have purchased approximately € 200 billion Italian bond issues. Although currently the average cost of Italian debt is 2.4% (Banca d'Italia, 2020b),[8] which is a high value, the data show a favorable trend. In October 2020, the spread on ten-year government bonds (BTPs) fell to 120-basis, and the effective costs on some ten-year government bonds fell to 0.72%, a very low level for Italian debt. However, over the medium–long term, policy objectives of the ECB with respect those of the Italian government may no longer converge, making policy choices more problematic.

In the Update Note to the Economic and Financial Document (DEF)[9] approved by the Italian cabinet at the beginning of October 2020, the official forecasts of "planned" growth that should be achieved thanks to government measures include a provisional estimate of the use of resources of the Next Generation EU for the years 2021–2023 and are an increase of 6% in 2021 – a physiological rebound compared to 2020 after the steep decline – even if the additional boost from the Next Generation EU fund will be a few decimal points.[10] Then the rate of growth should be 3.8% in 2022 and 2.5% in 2023. However, after 2021, Italy is unlikely to grow more than twice as much in just two years as it has grown in the last twenty. The government argues that all of this should happen mainly by running more deficits in 2022, and in 2023, even during a first net tightening of the budget. These growth estimates imply that the government expects a high multiplier effect of government spending or tax cuts over the next three years, which has never been seen in Italy, not even during boom times in the recent or distant past of its economic history. This growth, not very likely, would allow the debt ratio to fall rapidly to 151.5% in 2023.

The real crucial issue regarding the growth and high public debt is that the government should have a strategy to address the recovery and relaunch the economy in the medium to long term. A strategy is needed to overcome the COVID-19 crisis and the structural weaknesses that have made the GDP in Italy fragile for so many years. In addition to the necessary strategy, the country should have the capability to efficiently manage all the factors that enable us to make that strategy. It is also necessary to address the problems due to the structural change of our economy, as the COVID-19 crisis has made the different evolution between sectors more evident, with dramatic repercussions for employment. A list of important things to do to relaunch the growth of the Italian economy and unblock those bottlenecks that have been blocking it for a long time is as follows. First, focus on investments, which are the main factor to ensure long-term and sustainable growth. More specifically, anticipate mature public investment projects; promote private investments; favor the investments of capital goods with high technological content by companies[11] and, thereby, improve the productivity of capital; focus on green investments, in particular on clean and efficient production and use of energy; provide incentives for investments that favor digitization. Second, implement reforms to improve the

---

funds, and the Just transition fund, the fund to help the countries that are most dependent on coal achieve the green transition.

[8] The average residual life of the debt is 7.2 years.

[9] The Economics and Finance Document is the text in which the Italian Government proposes the policies it intends to implement based on certain growth forecasts.

[10] According to the Update Note to the DEF, the grants will be used first (around € 81 billion) and only later will be the loans, the use of which will be compatible with the achievement of budgetary targets.

[11] To avoid that the increase in investments leads to an increase in imports of capital goods.

efficiency and functioning of public administration and simplify bureaucracy to avoid, among other things, late payments to businesses. Third, reform the judicial system to speed up the resolution of disputes between companies and between public administration and businesses. Fourth, COVID-19 has exposed the shortcomings and frailty of the national health system; it is therefore necessary to face public health problems and solve them with investments in new technologies, adequate infrastructures and human capital. Fifth, despite the problems related to structural change and the crisis of some sectors, it is necessary to evaluate carefully whether helping companies without future prospects with public money is a correct choice, or whether it is better to seek solutions that tend to facilitate the reorganization of industrial sectors and, at the same time, partly bear the social costs of these processes. Moreover, especially in the southern regions of Italy, we should support the birth of ecosystems in which the concentration of companies and workers with high skills favors the proliferation of ideas and innovation. This is possible by aggregating and networking the best experiences of researchers, entrepreneurs and workers. Sixth, it is therefore necessary to work on the debt component, both because it is crucial to reassure those who buy the debt that it will be honored in full, and because it is necessary to have the room for maneuvering in the future that other countries have had. Thus, it will be important that there is a fairly high primary surplus in order for debt to fall at an adequate rate. This means to achieve sufficient growth rates to support a primary surplus of 1.5% of GDP, to maintain a low interest rate, and to ensure a natural and progressive consolidation of the debt. This primary surplus should be what Italy must strive for and must maintain over time, and budgetary policy must be thought of with this reference. From a medium to long–term perspective, Italy cannot think of having a budget out of control. For this purpose, it is critical to implement a systematic spending review to minimize waste and inefficiencies that are tied up in public spending. In addition, it would need to carry on a credible, medium-term program for the disposal of public assets, making the procedures more streamlined and transparent (Schilirò, 2019, p. 1697). Also, a reform of the tax system is more necessary than ever to reduce the taxation on labor, and to lower as much as possible the taxes on the income of the middle class, in order to stimulate the demand for consumption. But at the same, it is necessary to simplify the tax system and its laws and procedures; finally, it is necessary to identify and seriously hit tax evasion, which in Italy is particularly widespread. Another action is that of the equitization of the economy; that is, a generalized capital strengthening (i.e., more equity) of Italian companies. In fact, equitization means channeling financial resources (of savers, entrepreneurs, owners) to businesses. All this requires creating widespread investment opportunities in risk capital for savers.

In short, it is important to have a clear strategy – and be able to implement it – to lower debt and stimulate growth. What matters is the ability to express long-term planning skills and consistency in choosing a path that strengthens the economy toward innovation and knowledge (Schilirò, 2012). Italy needs a challenging and bold plan that sees companies as protagonists with investments in strategic supply chain projects and that provide training of new skills.

Fiscal policies to support growth, the labor market, schools and skills, productivity, competitiveness, and justice are all crucial issues for implementing an overall reform that should be able to dissolve the structural knots that prevent growth in Italy. Above all, it is fundamental to have a management tool that is able to finalize these extraordinary interventions that should relaunch growth, decrease the debt burden, and transform the Italian economy into a more efficient, competitive, inclusive and sustainable system and, at the same time, give hope and concrete opportunities to the new generations.

The guidelines for the Next Generation EU fund "Next Generation Italia," issued by Italian government on September 15, 2020, set the objectives that Italy must pursue for the relaunch of its economy. Six major areas of investment are indicated. They concern digitization, innovation, infrastructure, the reduction of polluting emissions, education and research. There also reforms chapters. However, it does not seem to be a clear strategy nor a detailed plan of measures indicating how, where and to what extent action is to be taken. Few numbers appear in these guidelines, so it is difficult to grasp the effective impact of these investments and reforms, also no priority assigned to the six areas is perceived.

Beyond these critical points, the central question remains around aiming for an effective development strategy, overcoming short-term logic and renouncing wasted resources in unproductive subsidies and economic aid that will not bear any fruit in terms of improving the efficiency of the country system. Italy must re-establish a virtuous trajectory of growth and debt containment if it does not want to risk a perennial decline and dangerously expose itself to the debt crisis.

Discussion And Conclusion

The COVID-19 epidemic has caused unprecedented global economic and financial turmoil, a significant recession in the global economy, an increase in healthcare spending, and continued uncertainty about the duration and depth of the crisis, which is reflected in its economic and financial management.

Unfortunately, the pandemic is not over, and recovery is fragile and uneven among countries. Particularly in Europe, the resurgence of the virus risks blocking the recovery. Such uncertainty among consumers and businesses is likely to remain high.

Moreover, this crisis will determine a structural change of the economies, where a structural change means an economy in a state of qualitative and quantitative transformation. Indeed, the evolution of technologies, changes in consumer behavior, and the changed the role of the state and central banks will have a disruptive effect on the structure of economies.

As governments roll out economic recovery packages and borrow to compensate for the loss of revenues due to the crisis, the public debt in many countries is increasing sharply. Any government's economic policy that focuses on aid and subsidies is understandable in the short term to deal with the emergence of the global crisis due to COVID-19, but it cannot constitute the medium to long–term strategy to exit the crisis and restore public finances. Debts are only useful if the money is well spent. In the case of Italy, the health system, education, research, infrastructure, digitization and modernization of the public administration are all areas where debt can be spent well.

Indeed, the COVID-19 pandemic marks a new paradigm. It is characterized by government borrowing, money-printing and intervention in capital markets in a low-inflation environment. According to macroeconomic theories of government debt, aside from default, there are only three ways to reduce such debt: first, by higher economic growth; second, through reducing fiscal deficits; and third, by using central banks to print money and monetize debt. As written in the previous section, the main road is growth. Reducing the fiscal deficit becomes a necessary complementary measure, especially for countries with high debt, such as Italy, while printing money and monetizing debt (i.e., central bank that finances the government) is a measure best avoided because of the risk of unwanted inflation in the future.[12] Indeed, the COVID-19 crisis has led to an unprecedented combination of radical monetary and fiscal policies.[13]

Anyhow, the policy of providing improvised and ineffective subsidies to citizens and businesses, which have been adopted in Italy, risks progressively reducing the productivity of businesses and frustrating future growth prospects. At the same time, it risks wasting the resources of citizens who finance state loans through taxation. Furthermore, a system of subsidies discourages production and the will to innovate. However, when the production system is hindered and stops, it is the weakest in the society that pays the highest price.

Economic policy very often requires making choices based on a tradeoff that is between two equally desirable but contrasting options. Policymakers must turn their attention to the practical tradeoffs involved in balancing current needs, the imperative to invest in the future and the undeniable costs of debt. Unfortunately, there is no easy way to manage that balance. This happens, for example, in fiscal policy choices that affect the well-being of citizens, as in the case of fiscal expansion in support of the recovery; however, it is necessary to assess the risks associated with medium-term fiscal sustainability. The economic literature, as we have highlighted, warns about the risks that a country with high public debt could run even in the presence of low interest rates.

Theoretical considerations and historical examples serve as a critical reminder to policymakers – particularly in a moment when deficit spending may truly be necessary – of what happens when governments fail, over long periods, to take responsible measures to balance their checkbooks throughout the business cycle.

Structural reforms as foundations for growth and employment are among the general objectives that European countries, including Italy, should comply with. To these must be added the consolidation of the financial system as a driving force for economic growth. No less important are the promotion of sustainable development, "green" growth and the effects of climate change. In particular, the agenda for the recovery of the Italian economy must include the Fourth Industrial Revolution and the digitization of countless economic activities. In addition, a valuable proposal to modernize its public administration "machine" and increase productivity is the migration to the cloud of the data of the 23,000 Italian administrations today dispersed in eleven thousand "data centers" that are very often old, inefficient and unable to communicate with each other. Also, the need for high-speed broadband across the country is crucial. The European average coverage is 60%, that of Italy is 25% and in the South it is even lower. Italy needs innovation and investment in knowledge.

Public spending can be positive for growth, especially when it is well spent, in targeted projects that improve the productivity of the country system, and when it is complementary to private spending, particularly investments in R&D, innovation, and human resources. Public spending can strengthen productivity, competitiveness, promote the dissemination of knowledge and the development of skills among the new generations, and increase the growth potential of the economy. However, a negative effect of public spending

[12] The partial monetization of the fiscal deficit by the Bank of England is an example.
[13] Central banks around the world have engaged in quantitative easing and are buying an enormous amount of bonds. The line that separates central banks supporting the economy through quantitative easing from central banks financing governments directly (i.e. 'monetizing debt') is very fine.

on growth occurs when it is used, as has happened too often in Italy, to seek political consensus (Persson and Tabellini, 2000).

The COVID-19 pandemic has put the global economy in trouble and resulted in strong growth in countries' debts. Economic growth is, however, largely dependent on the exceptional stimulus measures introduced in all major economies, while the prospects remain conditioned by uncertainty about the evolution of the pandemic. Italy has suffered considerably from the effects of the COVID-19 crisis. Its public debt, already high, is growing at a worrying pace, even in a context of falling interest rates and low inflation. Its sustainability, currently mainly ensured by the ECB through the PEPP, will largely depends on the ability to implement long-needed reforms and stimulate growth through a clear strategy. It also depends on a tax system reform that should be transparent, fair, simple, effective and efficient. The opportunity of the EU Next Generation funds is unique. Getting out of the crisis depends on Italy's ability to develop credible projects and reforms aimed at growth and at consolidating its debt to prevent the country from likely decline.

REFERENCES

Alcidi, C., & Gros, D. (2019). Public debt and the risk premium: A dangerous doom loop. *VoxEU.org*, 23 May. https://voxeu.org/article/public-debt-and-risk-premium

Banca d'Italia, (2020a). Finanza pubblica: Fabbisogno e debito. Banca d'Italia: Statistiche. 14 Agosto 2020.

https://www.bancaditalia.it/pubblicazioni/finanza-pubblica/2020-finanza-pubblica/statistiche_FPI_20200814.pdf

Banca d'Italia, (2020b). *Bollettino Economico*, *4/2020.* Roma, Ottobre.

https://www.bancaditalia.it/pubblicazioni/bollettino-economico/2020-4/boleco-4-2020.pdf

Bénassy-Quéré, A., & Weder di Mauro, B. (2020). *Europe in the time of COVID-19: A new eBook*, VoxEU.org, 22 May. https://voxeu.org/content/europe-time-covid-19

Blanchard, O. (2019). Public debt and low interest rates. *American Economic Review*, *109*(4), 1197–1229.

Buiter, W. (2009). Negative nominal interest rates: Three ways to overcome the zero lower bound. *North American Journal of Economics and Finance, 20*(3), 213–238.

Buiter, W. (2020). Paying for the COVID-19 pandemic will be painful. *Financial Times, May 15, 2020*. https://www.ft.com/content/d9041f04-9686-11ea-899a-f62a20d54625

Burriel, P., Checherita-Westphal, C., Jacquinot, P., Schön, M., & Stähler, N. (2020). Economic consequences of high public debt: Evidence from three large-scale DSGE models. *ECB Working Paper 2450.*

Chatelain, J. B., Tinel, B., Azizi, K., & Canry, N., (2012). Are no-Ponzi game and transversality conditions relevant for public debt? A Keynesian appraisal. *European Journal of Economic and Social Systems*, *25*(1–2), 45–58.

Chudik, A., Mohaddes, K., Pesaran, M. H., & Raissi, M. (2017). Is there a debt-threshold effect on output growth? *Review of Economics and Statistics*, *99*(1), 135–150. https://doi.org/10.1162/REST_a_00593

Codogno, L., & Corsetti, G. (2020). *Post-pandemic debt sustainability in the EU/euro area: This time may (and should) be different.* VoxEU.org, 18 September. https://voxeu.org/article/post-pandemic-debt-sustainability-eueuro-area

Corsetti, G., Erce, A., & Uy, T. (2019). *Official lending and debt sustainability in the euro area.* VoxEU.org, 13 February. https://voxeu.org/article/official-lending-and-debt-sustainability-euro-area

Debrun, X., Ostry, J. D., Willems, T., & Wyplosz, C. (2019). Public debt sustainability. In S. A. Abbas, A. Pienkowski, & K. Rogoff (Eds.), *Sovereign debt: A guide for economists and practitioners* (pp. 1–45). Oxford: Oxford University Press.

Eberhardt, M., & Presbitero, A. (2015). Public debt and growth: Heterogeneity and non-linearity. *Journal of International Economics*, *97*(1), 45–58. https://doi.org/10.1016/j.jinteco.2015.04.005

European Commission, (2020a). Communication from the Commission to the Council. On the activation of the general escape clause of the Stability and Growth Pact. *COM (2020)* 123 final, 20.3.2020. Brussels: European Commission.

https://ec.europa.eu/info/sites/info/files/economy-finance/2_en_act_part1_v3-adopted_text.pdf

European Commission, (2020b). European economic forecast. Spring 2020. *European Economy Institutional Paper 125. May.* Luxembourg: Publications Office of the European Union.

https://ec.europa.eu/info/sites/info/files/economy-finance/ip125_en.pdf

European Commission, (2020c). SURE. The European instrument for temporary support to mitigate unemployment risks in an emergency. Brussels: European Commission.

https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/financial-assistance-eu/funding-mechanisms-and-facilities/sure_en

European Council, (2020). *European Council conclusions, 17–21 July 2020.* Brussells. European Council. https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf

Gómez-Puig, M., & Sosvilla-Rivero, S. (2017). Public debt and economic growth: Further evidence for the euro area. Barcelona: *Working Paper 2017/15, Research Institute of Applied Economics*.

Goodfriend, M. (2000). Overcoming the zero lower bound on interest rate policy. *Journal of Money, Credit, and Banking, 32*(4), 1007–1035.

Hakura, D. (2020). What is debt sustainability? *IMF Finance & Development.* Fall issue. https://www.imf.org/external/pubs/ft/fandd/2020/09/what-is-debt-sustainability-basics.htm

International Monetary Fund (2020). *World Economic Outlook. A Long and Difficult Ascent.* Washington, DC, October.

HTTPS://WWW.IMF.ORG/EN/PUBLICATIONS/WEO/ISSUES/2020/09/30/WORLD-ECONOMIC-OUTLOOK-OCTOBER-2020

Kimball, M. S. (2015). Negative interest rate policy as conventional monetary policy. *National Institute Economic Review,* 234, November, R5–R14.

Lian, W., Presbitero, A., & Wiriadinata, U. (2020). Public Debt and r-g at Risk. *IMF Working Paper 20/137.*

Mauro, P., & Zhou, J. (2020). r - g < 0: Can we sleep more soundly? *IMF Working Paper 20/52*. https://www.imf.org/en/Publications/WP/Issues/2020/03/13/r-minus-g-negative-Can-We-Sleep-More-Soundly-49068

Panizza, U., & Presbitero, A. (2014). Public debt and economic growth: Is there a causal effect? *Journal of Macroeconomics*, *41*, September, 21- 41. https://doi.org/10.1016/j.jmacro.2014.03.009

Persson, T., & Tabellini, G. (2000). *Political economics: Explaining economic policy.* Cambridge, MA: MIT Press.

Pescatori, A., Sandri, D., & Simon, J. (2014). Debt and growth: is there a magic threshold? *IMF Working Paper WP/14/34. https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Debt-and-Growth-Is-There-a-Magic-Threshold-41352*

Presbitero, A., & Wiriadinata, U. (2020). *The risks of high public debt despite a low interest rate environment.* VoxEu.org, August 5. https://voxeu.org/article/risks-high-public-debt-despite-low-interest-rate-environment

Reinhart, C., & Reinhart, V. (2020). The pandemic depression: The global economy will never be the same. *Foreign Affairs, 99*. https://www.foreignaffairs.com/articles/united-states/2020-08-06/coronavirus-depression-global-economy

Reinhart, C., & Rogoff, K. (2010). Growth in time of debt. *American Economic Review Papers and Proceedings*, *100*(2), 573–578.

Schilirò, D. (2010). The Italian economy and the global crisis: Growth, unemployment and public debt. *MPRA paper No. 57546.*

Schilirò, D. (2012). Knowledge based economies and the institutional environment. *Theoretical and Practical Research in the Economic Fields*, *3*(1), 42–50.

Schilirò, D. (2014). Growth and public debt. The Italian economy and the crisis. *MPRA paper No. 86701.*

Schilirò, D. (2019). Public debt and growth in Italy: Analysis and policy proposals. *International Journal of Business Management and Economic Research*, *10*(5), 1695–1702.

Tamborini, R., & Tomaselli, M. (2020). When does public debt impair economic growth? A literature review in search of a theory. *DEM Working Papers N.2020/7.*

Teles, V. K., & Mussolini, C. (2014). Public debt and the limits of fiscal policy to increase economic growth. *European Economic Review*, *66*, February, 1–15.

Wyplosz, C. (2019). *Olivier in Wonderland.* VoxEU.org, 17 June. https://voxeu.org/content/olivier-wonderland

Yared, P. (2019). Rising government debt: Causes and solutions for a decades-old trend. *Journal of Economic Perspectives*, *33*(2),115–140.