

The sustainability of fiscal policy in Italy: a long term perspective.

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The recent fears of a sovereign debt crisis have spurred interest in the sustainability of public debt. There are two different approaches to the assessment of sustainability: the use of sustainability gap indicators (Blanchard et al., 1990); the time series approach (Trehan and Walsh, 1988). In this paper we analyze the sustainability of public debt in Italy by using the tools of the econometrics of time series.

We examine the entire life of the Italian State, i.e. 1861-2009, by employing a database containing several statistical novelties: new time series estimates of public debt and GDP (respectively Banca d'Italia, 2008 and Vecchi, 2011) and an original reconstruction of the revenues of the State.

The long-term analysis of new homogeneous statistical series has led to a different perspective, in particular when compared with the existing Italian literature about the debt to GDP ratio.

Three hitherto unexplored issues are addressed. First, we examine the size and dynamics of the public finance's aggregates. In particular, we carry out a detailed historical analysis, aiming to identify, in a narrative approach, the determinants of public debt and its ratio to GDP. Second, exploiting cointegration techniques, we test for the sustainability of the public debt in Italy following the approach proposed by Trehan and Walsh (1988). Finally, exploiting VEC Models, we comment on the complex dynamic interaction between the tax burden and public spending ratio, controlling for the debt ratio.