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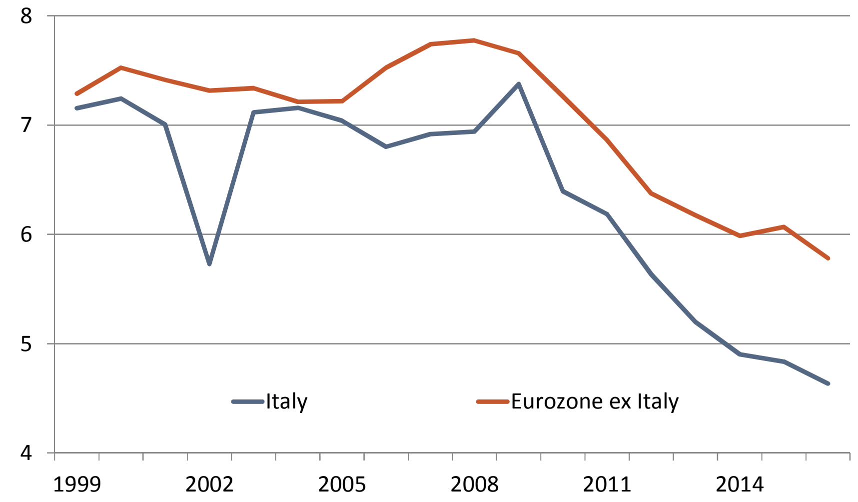
Public investment: Italy and Europe need to get it right

Share of public investment in overall public spending, %



Overall public spending excludes interest expenses, in nominal terms. Sources: Eurostat; Ameco database

- **Getting the priorities right:** The tragic collapse of a bridge in Genoa has re-kindled the debate about the need for more public and private investment well beyond Italy. Having travelled many roads of differing quality and in varying need of repair on both sides of the Atlantic, we do not want to offer any specific comment about Italy's transport infrastructure. However, as Italy prepares its 2019 budget, a look at fiscal priorities seems appropriate.
- **The wrong kind of austerity:** In an acute fiscal crisis, the urge to axe public investment is understandable. Policy-makers find this much easier than to cut current spending or to raise taxes. Apart from some immediate job losses in construction and other sectors, the costs of underinvestment take a long time to become visible. It is no wonder that Italy and – to a lesser extent – other Eurozone members went down that route in the tough years after 2009.
- **The real challenge** is to get the priorities right once the acute crisis is over. While overall spending growth still needs to be kept on a tight leash for a while to bolster credibility and keep borrowing costs low, the fiscal space that opens up during the post-crisis recovery ought to be used primarily to return investment to normal levels, rather than to reverse any cuts in current spending. This has not happened yet in Italy or in the Eurozone as a whole.
- **Austerity is not Italy's key problem:** Italy's need to run tight budgets reflects a low rate of trend growth of below 1%. Held back by major structural rigidities, arcane regulations, lengthy court procedures, a partly inefficient public sector and a big north-south divide, Italy needs serious pro-growth reforms (see *Italian basics*). More reforms like those started by Matteo Renzi during his time as prime minister in 2014-2016 could make Italy a better place to invest in and create jobs. The resulting growth would ease fiscal pressures over time without a need for painful cuts.
- **Why not use one's own savings better?** Despite a fiscal deficit of 2.3% of GDP last year, Italy is running a current account surplus of 2.8% of GDP. This shows that Italian companies and households, who are ardent savers, prefer to put a significant part of their savings to use abroad rather than at home. Making it more attractive to invest more of these savings at home in Italy should be the key task for economic policy. In a more dynamic economy, the government would also find it much easier to finance more public investment.
- **Hard choices ahead:** Italy's radical government wants to set the key parameters for its 2019 budget by 27 September. More public investment would be welcome. However, the government cannot simply add that on top of other plans to raise welfare spending and cut taxes. If Rome does not respect its constrained fiscal space, a fiscal deficit of close to 3% could spark a surge in yields that could cost Italy dearly. Unfortunately, the earlier decision to roll back some aspects of Renzi's labour reform makes the fiscal task even a little harder as it reduces the economy's flexibility at the margin. While most eyes are on Turkey this week, Italy remains Europe's key risk to watch.

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