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Sustainability of Public Finances: The Case of Italy, 1861-2016

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ABSTRACT

Are Italy's primary-surplus policies compatible with the sustainability of government debt? We address the question by examining historical budget data in post-unification Italy, from 1861 to 2016. Controlling for temporary output, temporary spending and world war-time periods in assessing whether primary surpluses significantly reacted to changes in debt, we find the following results: (i) the hypothesis of nonlinearity in the surplus-debt relationship significantly outperforms the hypothesis of linearity; (ii) there exists a threshold level in the debt-GDP ratio, approximately equal to 105 percent, above which Italian fiscal policy makers are concerned with corrective actions to avoid insolvency; (iii) the robustly positive reaction of primary surpluses to debt beyond the trigger point ensures fiscal sustainability.

Classification JEL: *N40; N43; N44; C24; E62; H60.*
Keywords:*Fiscal Sustainability; Government Debt; Fiscal Policy Rules; Non-Linear Models,*

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