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Genuine Recovery or Secular Stagnation?

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So, are we there? Has Europe (Italy included) really "turned the corner?" European leaders keep telling us so, asserting that a recovery is now under way and that it will gather steam over time, as in every cycle. Economic indicators indeed show a marked improvement. But the pickup remains slow and weak, a mini-recovery that fails to match the escape velocity seen in previous exits from deep recessions. In short, the economy is not taking off and, like a plane that fails to reach cruising speed, it risks a hard landing at the first turbulence. Against this background, Italy's recent Economic and Financial Document (DEF) did well to be prudent in its GDP growth projections (0.8% in 2014 and 1.3 % next year) – although these remain slightly above those of the IMF (by 0.2 percentage points).

But the real issue does not lie in these decimal point wiggles. It resides rather in the question, currently much debated among economists, of the phase that we are going through and of the longer-term prospects. Are we really in a recovery phase, albeit a slow one, but still destined to lift us to a safe cruising altitude? Or are we bogged down in a "new normal" of prolonged anemic growth, or even – in the definition of former U.S. Treasury Secretary Larry Summers – in the grips of a secular stagnation? If the recovery's weaknesses were due solely to the impact of the Great Recession on demand (still hampered by a debt overhang) and on supply potential (stunted by missed investment), the passing of time would bring its own remedy. Consumption and investment would gradually resume, the economy would self-correct. But the new normal and secular stagnation hypotheses, fed also by the disquieting example of Japan, identify more persistent phenomena and a basic inability of the economy to self-recalibrate. Two explanations prevail in most analyses. The first, on the demand side, points the finger at the increasing concentration of income and wealth (see the remarkable success of Thomas Piketty's book), resulting in an excess of savings and a lack of global demand. The second, on the supply side, argues that the advanced countries have already reached their technological frontier, and that one cannot expect a new wave of innovation that would boost productive potential. There are, of course, also many scholars who dispute this argument, including Barry Eichengreen, who noted in a recent column that "technology skeptics have been consistently wrong for 200 years" (see il Sole 24 Ore of April 20).

We certainly will not try to settle a dispute that involves the best economic minds of our time. But a few points seem to stand out clearly. First, that the recovery – while underway – is following a lower and feebler trajectory than customary, even in the United States. Second, this likely reflects restraining factors of a longer-term nature – even though they are not forcibly "secular." Third, that in such a setting, the risks are asymmetric: they are much more pronounced on the downside, with a high probability of mishaps. Fourth, and most important, that one must avoid falling prey to forms of economic determinism, wherein the new normal becomes indeed "normal," and economic policy is seen to be basically helpless. Let us not forget that economics is often prone to interpretative fashions: witness the recent passing of the "great moderation" thesis, whereby central banks were deemed to have become so adept as to have eliminated cyclical volatility. Truth be told, this was the very period that saw the ascent of the toxic products that then ravaged international finance.

Policy must thus set aside any determinism and the fatalism that accompanies it. On the contrary, precisely because the forces to be countered are deeply rooted, there is a need for greater decisiveness and activism. The current debate has offered various remedial proposals, among which two stand out. First, direct more resources toward public infrastructure and technology investment, to build for the future. Second, accept a higher level of inflation in order to generate negative real interest rates, so as to spur demand – starting with a more resolute reaction to halt the slippery slide to deflation. In Europe, both of these indications require changes in common policies that now seem out of reach, but that Italy will do well to raise for debate during its upcoming semester at the helm of the European Council. But there is also a third inescapable ingredient for countries such as Italy, with an anemic growth potential: the imperative of structural reforms, which not only benefit the country but also confer it with greater negotiating authority when seeking flexibility, as per Minister Pier Carlo Padoan's recent letter to the EU Commission. Such reforms should be taken in good time before Brussels' response, due on June 2, thereby also starting the Italian semester in a position of strength. For the Renzi government, the speed of action is a must; be it maintained.

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