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Next Generation – EU: Italy must not miss this opportunity

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1. Introduction

As is widely recognized, the agreement reached at the 17-21 July 2020 European Council meeting can represent a milestone in the European integration process. The Heads of State and Government have kept the framework proposed by the European Commission at the end of May 2020 to respond to the pandemic crisis (that is, Next Generation EU – NG-EU – and, in particular, the Recovery and Resilience Facility – RRF) substantially unchanged. At the same European Council meeting, however, some reductions were made to the funding dedicated to the traditional European Multiannual Financial Framework programs and to other specific NG-EU programs. The ambitious support provided to countries for a robust recovery after the pandemic emergency will thus decrease the resources allocated to European 'public goods' and, therefore, those not attributed *ex ante* to the member states of the European Union (EU).[1]

This support remains an extraordinary opportunity, but its actual implementation will depend on the extent and the way in which member states will be able to use the resources made available by the EU to profoundly reform their national economies and the European economy as a whole. With potential access to 209 billion euro in transfers or loans, Italy is one of the largest beneficiaries of these new European funds. Italy, therefore, has a crucial role to play. It is no exaggeration to stress that the success or failure of NG-EU and the RRF will depend, to a large extent, on the choices that the Italian government and parliament make in the coming weeks. In particular, in order to lay the foundations for an effective and efficient use of the earmarked resources, three tasks should be carried out during the summer of 2020.

The *first task* consists in identifying the 'bottlenecks' that have condemned the Italian economy to a succession of phases of stagnation and recession, interrupted only by sporadic periods of growth,

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[1] The *Appendix* shows the main differences between the NG-EU proposal prepared by the European Commission (see in this regard: Buti-Messori 2020) and the version of NG-EU approved by the European Council in the second half of July 2020. It should be noted that the European Council's version may also undergo changes because it requires endorsement by the EU member states and, as it is linked to the EU's Multiannual Financial Framework, it will be the subject of a trilogue between the European Parliament, the European Council and the European Commission.

from the mid-nineties to today. It is necessary that the structural constraints to growth are resolutely addressed in order for the Italian economy to initiate that sustainable development for which the funds of the RRF and - more generally - of the other NG-EU programs are destined. Consequently, the *second task* requires: defining a strategy that allows Italy to implement the necessary reforms and start a process of convergence within the EU; concretizing this strategy by setting priorities and defining a hierarchy of projects that will obtain the approval of the European institutions and that, once made operational, will be covered by the financial resources allocated to Italy by the RRF and other NG-EU programs; carrying out these projects, thus satisfying the European Commission's objectives (Green Deal + innovations in digital and telecommunication sectors) and reacquiring the proper position of one of the great founding countries of the European construction. The *third task* consists in mobilizing the "country system" in order to prepare the conditions for the future implementation, in the foreseen timing and modalities, both of the selected operational projects and of an adequate and transparent monitoring of these projects by public structures.

The accomplishment of these three tasks is a complex operation that requires the mobilization of enormous organizational, institutional and financial resources. Therefore, it must count on the involvement of both public and private actors, on new forms of public-private cooperation and on the strengthening of the non-banking segments of the financial market. The design of a strategy that identifies and overcomes the current Italian 'bottlenecks' in effective ways and the definition of the consequent operational projects for the implementation of this strategy must arise from cooperation with private operators and with intermediate institutions and bodies. The political-institutional level, on the other hand, maintains full responsibility in defining the national policies that set priorities and the consequent hierarchy of operational projects. In any case, even the efficient and effective implementation of these projects requires a collective effort that the government is tasked with controlling and verifying at every junction. Appropriate public monitoring, however, can only be carried out if an adequate degree of efficiency of the bureaucratic systems is guaranteed.

2. Why it is essential to overcome path dependency

To address the first task, it is necessary to present an annotated list of the most significant constraints that have hindered the growth and evolution of the Italian economy over the last twenty-five years. These constraints can be summarized in seven points:

(a) the negative combination of an aging population, low participation rates, and stagnant labor productivity;

(b) the quantitative and qualitative inadequacy of both public investments, attributable to serious disequilibria in the national balance sheet, and private ones, largely induced by the very small

average size of Italian firms; inadequate investments have been a major cause of stagnation in labor productivity (and in other forms of productivity);
(c) the predominance in Italy of family businesses in which there is no distinction between the ownership of property rights and managerial responsibility; the binding organizational and financial constraints deriving from this overlap have been the fundamental cause of the lack of dimensional growth even of many successful Italian firms;
(d) the lack of investments and the insufficient size of the firms have held back both tangible and intangible innovations, have prevented the related productive reorganizations and have induced a low quality of labor demand with the effect of favoring wage compression as the main factor of competitiveness;
(e) the consequent lack of attention towards the quality of the job offer, which has relegated investment and expenditure on education and training to the background and has directed public spending towards the allocation of substantial transfers to privileged social aggregates or to a certain component of the middle class, as well as towards the provision of modest but widespread subsidies for marginal social aggregates;
(f) the consequent accumulation of a very high stock of public debt compared to the size of the national economy, which has become unmanageable also due to its inefficient composition and which has had a negative impact on the quantity and quality of the decided public investments;
(g) the inability to implement, in the time and modalities planned, much of the already insufficient amount of the public investments decided; something that has made the excessive economic costs deriving from bureaucratic-institutional inefficiencies even more evident.

The international financial and 'real' crisis of 2007-09 and the subsequent European crisis did not motivate the Italian economy to change its economic activity model; and Italian economic policy has not seized the opportunity for a qualitative breakthrough. Countries that had to resort to the European aid programs between 2010 and 2012 but that were able to leave these programs in a reasonably short period (Ireland, Spain and Portugal) modified, between 2014 and 2016, their economic policy strategies and started strengthening their growth potentials. Even Greece, which paid high social and economic costs also due to excessively accelerated public budget adjustments in the first phase of the EU-IMF program, has been able to trigger new reform processes in the most recent years (before the pandemic) and is modifying the pre-existing and distorted activity model of its economy. Italy, on the other hand, was one of the few EU countries not to use the multiple and persistent crises of the 2007-13 period to implement internal transformations. It has reproduced and strengthened its own 'bottlenecks', as exemplified by aforementioned points (a) - (g). Basically, while the financial crisis has changed the growth paradigm and the economic policy priorities of the most affected countries, this has not happened in Italy.

The indications that emerge from the new economic crisis triggered by the pandemic shock in the spring of 2020 show that today Italy must avoid reproducing a similar result, that is, exacerbating its own structural weaknesses without using the unrepeatable opportunities for transformation.

Despite the limited fiscal capacity already underlined in point (f) (see above), after Germany, Italy was the EU country that approved the most pronounced increases in public spending and one of the largest (albeit temporary) tax revenue reductions. During the emergency phase, these choices were justified by the need to protect and support a society and an economy hit hard by the pandemic. With the 'National Recovery and Resilience Plan' (NRRP) that - starting from October 2020 - Italy will have to submit to the validation of the European Commission and the approval of the EU Council in order to gain access to the RRF funds, the transition to a post-emergency phase, based on more binding forms of selectivity, and the outline of a new paradigm for the 2021 recovery phase will have to be launched. For inspiration it is useful to look at Germany, which during the emergency phase and - even more so - during the transition strengthened and is strengthening its public spending and fiscal incentives to lay the foundations for a recovery. German policy makers are aware that this recovery will no longer be driven by EU net exports but will depend on a stronger European single market and on the capacity of member states to be innovative and to satisfy conditions of social and environmental sustainability.

The resources that Italy can obtain from the RRF, the other NG-EU programs, the initiatives already implemented by the euro area (SURE, MES, EIB),[2] and the transfers planned in the 2021-27 EU Financial Framework are quantitatively adequate to overcome the 'bottlenecks' examined above. These resources could allow for radical processes of reform and transformation of the development paradigm of Italy’s economy and society. An approximate calculation, which does not consider the enormous inflows of liquidity made available by the European Central Bank, indicates in fact an amount that is close to 400 billion euro in loans and transfers. To take advantage of these extraordinary financial resources, Italy must however adopt a medium-long term strategy that goes beyond the current “rent-seeking economy"; it must then translate this strategy into operational reforms and innovation projects. In any case, the implementation of NG-EU can allow for the launch of new sustainable development in the EU and in the euro area; the member states that will not be able to partake in this process will go down a path of divergence that will condemn them to marginalization and rapid decline.

3. The obstacles to overcome and the opportunities to exploit

The seven points (a) - (g) listed in the previous section are the basis for a shared economic policy strategy. In fact, they suggest reforms and projects that comply with the specific recommendations addressed annually by the European Commission to Italy as part of the reports on individual member states (see in particular: European Commission 2019 and 2020).

It is possible to summarize the lines of a similar strategy, already hinted at in various analyses (see for example: Carli - Messori 2020), with the following eleven factors:

[2] These are well-known programs which, if fully used by the Italian government, would make available resources for slightly less than 100 billion euro.

(i) adjust the bureaucratic inefficiencies so that the decided public investments can be implemented in compliance with the planned costs and the scheduled time horizons;
(ii) re-launch the decided public investments in order to overcome the negative infrastructural and institutional 'externalities';
(iii) design public incentives that make it more worthwhile for private firms to pursue 'leaps' in their size and to implement the necessary innovative investments, consequently reorganizing their production activities;
(iv) adapt the quality of the labor supply to the highest qualifications required by the demand for labor that derives from the production reorganizations indicated above, thus investing in education and training;
(v) reallocate the expenses of the welfare state in order to protect workers who, in the short term, are displaced by the increase in the quality of labor supply and demand, activating processes for their retraining and their reinsertion in the labor market;
(vi) on this basis, convince the different social actors and their representatives that the competitiveness of the Italian productive system cannot be based on wage compression, but must be fueled by innovations and the associated increases in various forms of productivity;
(vii) implement reforms and offer social services that raise the participation rate in the labor market of the working age population not involved in educational or retraining processes;
(viii) contain budget deficits through a re-composition of public expenditure which must be based on drastic reductions in the transfers and subsidies that feed the 'rent-seeking' positions of various social aggregates;
(ix) thanks to the reduction of budget deficits and the revival of growth, pursue gradual but persistent adjustments in the dynamics of the public debt/GDP ratio;
(x) complete the 'opening' of an economy, that can offer adequate social protection thanks to points (iv) - (vii), by enhancing competition and improving the organization and quality of the public administration and civil justice;
(xi) implement initiatives sub (i) - (vii) in Southern Italy with special force and emphasis so as to take into account the fact that the problems in that area are similar, although with stronger intensity and gravity, to those typical of the rest of the country.

If we examine the specific recommendations that the Commission addressed to Italy in 2019 and that were approved by the European Council, we immediately see a substantial affinity with factors (i) - (xi) (cf. also Messori 2020). These factors, therefore, make it possible to specify the major issues (clusters) on which the Italian NRRP should focus. This involves elaborating reforms and initiatives relating to the labor market and to training, education and research, to the Public Administration - including civil justice, and to new industrial and social policies. This set of initiatives should provide space and maximize the effectiveness of those innovative investments in tangible and intangible infrastructures and of those reorganizations of production processes that are essential for reviving labor productivity and achieving the digital and environmental transition of Italy's economy and society.

There are three main obstacles that stand in the way of drafting the Italian NRRP along these lines. First of all, the horizon of the choices indicated by factors (i) - (xi) promises medium-long term benefits; therefore, the risk to be avoided is for both the government and the various parliamentary groups to pursue instead very short-term objectives aimed at safeguarding the various 'rent-seeking' positions for the purpose of immediate consensus. Secondly, the Green Deal and digital innovation represent a horizontal dimension that characterizes all the individual reforms and the various public and private investments; this dimension thus makes the need to challenge vested interests and to extend the horizon of choices and benefits even more stringent. Finally, the clusters required for the construction of an adequate NRRP must be translated into specific and operational projects; bureaucratic-institutional inefficiencies, which heavily affect the activity of ministries, and cumbersome rules and regulations, which lengthen the time and make the costs of carrying out public investments uncertain, go in the opposite direction. This last obstacle is aggravated by two further elements. The actual operation of each project presupposes the setting of its priorities; and this decision risks creating a 'vicious circle' with the distorted time horizon of the Italian government's choice. Moreover, once the priorities and the concrete configuration of the individual projects have been defined, it is necessary to ensure their urgent operability; in fact, the agreement reached by the European Council on NG-EU requires that all the resources of the RRF attributed to individual countries be committed by the end of 2023.

The aforementioned considerations confirm that the European initiatives focused on NG-EU and on the RRF and - even before - on the Eurogroup programs offer EU member states, and above all Italy, a unique opportunity to converge towards sustainable development centered on strengthening the European single market (see Buti et al. 2020). However, these considerations also show that Italy will be able to exploit this opportunity only if it makes an exceptional planning and execution effort. It is a question of creating radical discontinuities in the political-institutional functioning, so as to develop a medium-to-long term strategy that organizes, in an orderly and effective sequence of operational projects, those clusters of reform, innovation and investment that are necessary to overcome the 'bottlenecks' that have characterized the Italian economy and society since the mid-nineties.

It should be emphasized that, if Italy were not able to implement this complex combination of the establishment of concrete medium-long term objectives and the implementation of a set of concrete projects in the short-to-medium term, it would not stabilize the - rather precarious - position it had in the years preceding the pandemic shock. Bureaucratic constraints and other environmental and production inefficiencies would condemn the country to a downward path, which would make the Italian gaps towards other EU member states, those capable of exploiting the potential of the internal market and achieving sustainable development, irreversible.

4. The necessary cooperation, in new forms

In this paper, we do not want to substitute the political decision-making process by suggesting a hierarchy of priorities or, worse, a list of operational projects. Instead, it may be useful to advance four methodological suggestions aimed at increasing the probability of Italy's PNRR's success with respect to the scrutiny of the European Commission and the related approval of the EU Council.

First of all, it is essential that the Italian NRRP propose a comprehensive design centered on the European axis of sustainability and digital innovation. Therefore, it would not be effective to compose the clusters and the connected set of operational projects with a pure bottom-up strategy based on the initiatives that the various ministries or individual regions already had in the drawer or that they develop independently of each other. The past and repeated failures which have characterized Italy's use of European structural funds, should represent a useful negative guide to the mistakes that must be avoided. Furthermore, we should bear in mind that the RRF and - in general - NG-EU are aimed at financing *ad hoc* projects for change and growth, not permanent expenditure or even a temporary one but without structural effects. Secondly, the consequent top-down strategy of an appropriate NRRP does not at all imply that the Italian government can centralize all analyses and decisions without making use of the contributions of the economic and social actors. The government should also play the role of collector, coordinator and selector of the requests formulated by intermediate institutions and bodies that do not act as mere bearers of sectorial or particularistic demands. The stakes, already stressed at the end of the previous section, are so significant for Italy that the intermediate institutions and the representatives of the various economic and social aggregates should find it worthwhile to pursue cooperation that focuses on the general interest rather than 'trade unionist' requests. Each of these intermediate bodies should go beyond its own comfort zone, so as to trigger a 'cooperative game' with respect to the EU and its national counterparts that avoids falling into 'bad' equilibria and leads to a selection of 'better' equilibria for everyone.

The third and fourth suggestions, on the other hand, concern a subsequent phase in which Italy's NRRP must define the operational details of the selected projects. In proposing the relative allocations of European resources by 2023, Italy would strengthen its credibility with the European institutions and its community partners by assuming - on a voluntary basis - two irreversible commitments towards the European Commission: that of discarding *a priori* all the operational initiatives that have planned costs higher than the European benchmark for comparable activities; that of interrupting the use of European funds already earmarked for initiatives that, upon actual execution, exceed the scheduled costs or do not meet the deadlines in the absence of binding and extraordinary reasons.

The implementation of these four suggestions requires reducing the 'political discount rate' that underlies political-institutional choices (see the previous section). The reforms which could lengthen the time horizon of various institutions and facilitate economic and social changes are manifold (see Clarich 2020). They range from the reorganization of work in the bureaucratic administration, which is often devoid of direction and which perceives the digital revolution as a threat to protected niches of routine activities, to a re-empowerment of high-ranking bureaucrats who must be incentivized to take on the burdens of the decision making and the managerial roles that characterize their hierarchical rank; from stronger protection (substantial and temporal) of fundamental rights to institutional regulations that do not mortify changes; from the simplification of rules and greater transparency of standards to the redesigning of competences and territorial powers so as to eliminate overlapping and ambiguous decision-making duplications that discourage innovations; from the re-legitimization of the role of independent authorities to avoid distorting defenses of the *status quo* to safeguarding the territory and the choices of patient investors.

In the current Italian situation, the aforementioned reforms are essential because they would contribute to removing serious inefficiencies and to weakening the crystallized 'rent-seeking' positions. Yet, they will not be enough to lengthen the time horizons of the political choices in the strict sense, if the search for consensus in the short term leads to pursuing a strategy of *ad hoc* benefits for the largest possible number of voters. In that case, the potential elected representatives are not concerned with contradictions and the negative consequences of their choices that will emerge in the medium to long term. To overcome this situation, it would be necessary to restore that political function of re-composing the (almost always) conflicting interests expressed by the various social aggregates. Effective intermediate institutions and bodies (including, first and foremost, political parties) would guarantee representation for these social aggregates and, at the same time, would rationalize and make their specific interests less incompatible. However, only political choices can translate this potential cooperation into initiatives for the collective well-being. In this form of representative democracy, the consent and legitimacy of the potential elected representatives would not depend so much on the pervasive disbursement of subsidies in response to particular interests as on the political capacity to give a response to these same interests that is compatible with the effective functioning of the socioeconomic system.

Trigilia (2020) defines such a political-institutional setting as 'negotiating democracy'. Here the term 'contractual democracy' is preferred in order to emphasize that this setting does not intend to limit conflict and has direct impacts also on economic problems. An emblematic example is offered by bargaining in the labor market. In the long term, the re-launch of the various forms of productivity is of common interest for both worker and employer representatives. Yet, in the short term, an almost irremediable conflict arises between these representatives regarding the causes and consequent remedies to the persistent stagnation of labor productivity. If we believed that the brake on productivity was due to the 'rigidities' in the labor market, the solution would be found in wage compression; vice versa, if the brake was due to the lack of innovative investments and of the related reorganization of production processes, wage compression would reinforce the stagnation of productivity by dis-incentivizing the necessary changes. This opposition can be overcome if the strong intermediate bodies are supported by appropriate political choices. Neither the representatives of the employers nor those of the workers would consider it sensible to oppose incentives for innovative investments and for the necessary productive reorganizations, and bargaining would therefore focus on the extent of wage increases that are adequate for encouraging the re-launch of labor productivity. In such a perspective, the link between centralized and decentralized bargaining would cease to be a divisive factor and would become the tool for the search for an effective compromise, which would be facilitated by the introduction of effective incentives.

5. Conclusions

The exceptionality of the pandemic, its exogenous nature which reduced the importance of the 'moral hazard', and the growing awareness that the EU must optimize its 'internal' growth engine (i.e. the single market) have created the conditions for an ambitious response to the crisis (see Buti 2020). However, the opportunity offered by the EU through the NG-EU and the RRF must materialize in coherent and ambitious operational choices starting immediately. Brussels and the other European capitals look to Rome as the crossroads which, positively or negatively, will mark the evolution of European integration for the next generation.

As we emphasized in a previous paper (Buti-Messori 2020), the Italian NRRP will have to present a compelling narrative, implement a strategy capable of removing the bottlenecks that have hampered the growth of the national economy in the last two decades, transform objectives into concrete projects and into reform and investment 'clusters' consistent with the European axis centered on the Green Deal and digital innovations. In addition, the Italian NRRP will have to provide a credible estimate of the costs of individual projects and subject the execution of the latter to appropriate monitoring.

In other words, what is needed is the unraveling of the plot of an entire 'movie' whose happy ending would lead to Italy's convergence towards the other founding countries of the European construction. It is a challenge that has no equal in the recent past and that, to be successful, must mobilize the 'country system' in innovative forms and in each of the stages of construction and implementation of the NRRP. In addition, this challenge must be met within a very short period: if it wants to start informal interactions with the European Commission before the official submission of its NRRP by mid-October 2020, the Italian government must complete a preliminary version of this NRRP already in mid-September; however, to elaborate a detailed (albeit provisional) version of this NRRP for the latter date, it is necessary that the preparatory work undergo a drastic quantitative and qualitative acceleration in the coming weeks.

Appendix NG-EU: European Commission proposal and European Council agreement

PROGRAMME	COM PROPOSAL MAY 2020	EUCO CONCLUSION JULY 2020
First Pillar: Supporting MS	**655 bn**	**737.5 bn**
Recovery and Resilience Facility (RRF)	560 bn • Grants: 310 • Loans: 250	672.5 bn • Grants: 312.5 • Loans: 360
Rural Development	15	7.5 bn
Just Transition Fund (JTF)	30	10 bn
ReactEU	50	47.5 bn
Second Pillar: Supporting the private sector	**56.3 bn**	**5.6 bn**
InvestEU	30.3 bn • 15.3 bn existing 4 windows • 15 bn new 5th window	5.6 bn
SSI	26	0
Third Pillar: Lessons from the crisis	**38.7 bn**	**6.9 bn**
Horizon Europe	13.5 bn	5 bn
RescEU	2 bn	1.9 bn
Health	7.7 bn	0
NDICI	10.5	0
Humanitarian Aid	5	0
TOTAL	**750**	**750**

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