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Implementing the Recovery and Resilience Plans: The Case of Italy

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1. Introduction

The exceptionality of the pandemic, its exogenous nature that has reduced the importance of the 'moral hazard', and the growing awareness that the European Union (EU) must optimise its 'internal' growth engine (i.e. the single market) have created the conditions for a 'high'-quality response to the crisis. As is widely acknowledged, the agreement reached at the European Council in mid-July 2020 regarding 'Next Generation - EU' (NG - EU) and its main programme, the 'Recovery and Resilience Facility' (RRF), can become a milestone in the European integration process.

This initiative presents an extraordinary opportunity. However, it can be exploited only to the extent and in the way in which Member States use these financial resources to relaunch their growth and profoundly reform their national economies - and consequently the European economy. In addition, the preparation and completion of the national Recovery and Resilience Plans (RRPs) – which must be evaluated by the European Commission (EC) and approved by the Council of the EU in order for each Member State to gain access to the RRF resources – are taking place during the pandemic's second wave, which inevitably will have serious economic and social consequences.

As the EC autumn forecasts have shown (cf. *European economic forecast,* November 2020), the European economy's robust recovery in the third quarter is losing strength due to the worsening of the pandemic. There are growing risks of a 'square root' economic trend ('√'): after the strong rebound in the third quarter, which was still insufficient to compensate for the fall in the previous semester, the new recession-recovery sequence is destined to lead to prolonged stagnation. If appropriately used, the

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European interventions could instead minimise the negative impacts of the second pandemic wave, allowing for the start, even in the short term, of a new robust economic and social development of the EU.

With potential access to over 200 billion euro thanks to NG - EU transfers and loans, Italy is, in absolute terms, the largest beneficiary of the new European funds. It therefore has a crucial role to play. As we stated in a previous contribution (see M. Buti and M. Messori, "Next Generation EU: Italy must not miss this opportunity", *SEP Policy Brief*, August, n. 34, 2020), it is not an exaggeration to underline that the success or failure of the European programme in general and of the RRF in particular will largely depend on the credibility of the Italian RRP. It is a matter of seizing an opportunity and overcoming a challenge that have no precedent in the recent past. That calls for the mobilisation of the Italian public administration and stakeholders in innovative ways. Such mobilisation should involve every phase of the elaboration and implementation of the national strategy and projects. Moreover, together with Greece, Italy is the euro area country with the most limited fiscal capacity due to its very high public debt/GDP ratio accumulated before the pandemic (134.7%) and due to the substantial increase of this ratio during the first phase of the emergency (based on current estimates, 159.6% at the end of 2020). Therefore, the Italian RRP must create the conditions both for growth and for a progressive containment of the public debt in the medium term. This is especially the case in view of the inevitable fiscal responses to the pandemic's second wave. These responses need to be more selective than those of last March-July. They must effectively combine the management of the new emergency and the use of European resources to support growth and to promote sustainable development from an economic, accounting, social and environmental point of view.

To achieve these results, Italy's RRP needs to have at least three characteristics. First, it must be based on a macroeconomic framework capable of incorporating the changes taking place; this requires a review of the Update to the Economic and Financial Document and of the draft of the Budgetary Plan that had been formulated before the strong resurgence of the pandemic. Secondly, while being in line with the indications of the Italian administration and stakeholders, the Italian RRP must adopt a top-down approach and thus select a limited set of projects that respond to strategic priorities and absorb the bulk of the available resources. Finally, it must incorporate a governance centred on a "steering board" that mirrors that of the EC, that can cooperate with the RRP's authorities in other Member States concerning the launch of supranational projects, and that has decision-making power (even a commissioner-like decision power, if circumstances require it).

This paper summarises the cornerstones of European intervention, first (cf. Section 2). Then, it examines the specific Italian situation, especially in the light of the second wave (cf. Section 3). We thus analyse the steps in constructing the Italian RRP (cf. Section 4) and to specify the governance requirements (cf. Section 5). The problems posed by the resurgence of Covid-19 are indeed so significant with respect to Italy's limited fiscal capacity that they require an ad hoc examination (cf. Section 6). Finally, some brief Conclusions will summarise the main arguments.

2. Where we are coming from

By adding together the NG - EU programme and the 2021-2027 European Multiannual Financial Framework (MFF), the EU has committed to mobilise financial resources for more than 1.8 trillion euro. This is an injection of financial resources that, in combination with the huge amount of liquidity deriving from the initiatives already implemented by the European Central Bank (ECB) through the monetary channel (another 1.8 trillion euro by mid-2021) and the banking channel (up to 3 trillion euro by 2022), are adequate to support both the national fiscal responses to the emergency and the expected economic and social transformations due to the pandemic shock of the first months of 2020.[1] Moreover, given the intensity of the pandemic's second wave in the autumn of 2020, it is very likely that by the end of the year the ECB will strengthen its temporary programme of purchases of government bonds and - perhaps - extend the T-LTROIII.[2] Monetary policy interventions can thus preserve favourable financial conditions, and effectively create space for national fiscal policies that are expansionary and aimed at supporting demand and, in particular, investments.

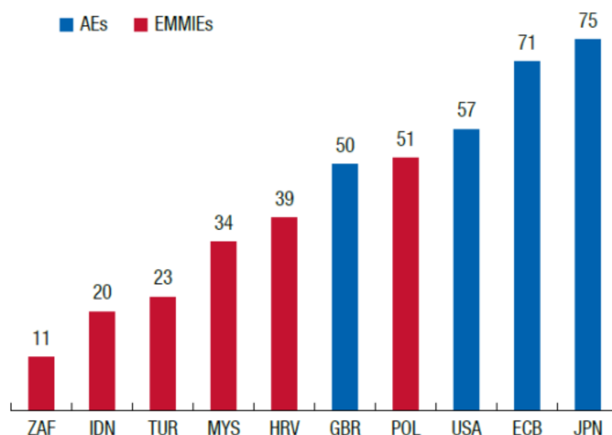
It has already been mentioned that the crucial pillar of NG - EU is constituted by the RRF which, alone, provides for transfers (312.5 billion euro) and loans (360 billion euros) for a total of 672.5 billion euro, i.e. some 90% of the total resources of NG - EU. Loans will be divided among individual EU countries in proportion to their gross national income (up to a maximum of 6.8%). The distribution of the 312.5 billion euro in transfers will, on the other hand, respond to a double redistributive criterion: 70% is intended to compensate for the disadvantages in terms of *per capita* income and unemployment rates accumulated by individual Member States in the five years preceding the pandemic and weighted for their population; and the remaining 30% aims at compensating for the negative impact of the pandemic shock on gross national products. Therefore, the general objective of the RRF is to allow all EU countries to carry out those reforms and investments that ensure environmental and social sustainability and digital innovations; the specific objective is to strengthen the most fragile countries, favouring their convergence towards the 'core' economies of the EU and - in particular - of the euro area.

[1] Cf. Figure 1 from: International Monetary Fund, *Fiscal Monitor. Policies for the recovery*, October 2020, p. 2. Furthermore, the effectiveness of the asset purchase programmes (APP and PEPP) strengthened or launched by the ECB as a response to the pandemic is indirectly proven by the reduction of the differentials between the interest rates on 10-year government bonds of peripheral Member States and on those of Germany (the so-called spreads), which had accompanied the explosion of the national public deficit/GDP and public debt/GDP ratios. Finally, the effectiveness of the T-LTROIII and other national initiatives (for example, public guarantees on bank loans and moratoriums), is indirectly proven by the stability in the loans supply despite the increased riskiness of borrowers; the most recent mixed evidence is insufficient to cancel this trend.

[2] In a recent regular meeting (29 October 2020), the ECB's Governing Council did not accentuate the already expansionary stance of monetary policy. However, President Lagarde stressed that the ECB is concerned about the new deterioration of the economic outlook; and added that, in December 2020, a "recalibration" of the tools already in place will be carried out in order to prevent the second pandemic wave from compromising the effectiveness of monetary support for the EMU economy. It is reasonable to believe that such statements are a prelude to a strengthening of the PEPP and may also lead to an enhancement of the APP and the T-LTROIII.

Figure 1 – Central Bank Purchases of Government Debt

(Percent of central government marketable securities or debt issued since February 2020)



Sources: Country authorities; US Federal Reserve Economic Data; Haver Analytics; and IMF staff calculations.
Note: Data labels use International Organization for Standardization country codes. AEs = advanced economies; EMMIEs = emerging market and middle-income economies.

Source: IMF Fiscal Monitor, 2020.

These considerations make it clear that the positive post-pandemic evolution of the EU is linked to the success achieved in the design and actual implementation of the RRF; and this explains why the "Guidelines" of this programme (GL-RRF), made public by the EC on 17 September 2020, are so detailed and comprehensive.

The GL-RRFs focus, first of all, on the planning and implementation of the programme.[3] The national RRPs should be submitted to the EC by the end of April 2021, concurrently with the presentation of the documents for the European Semester; the link between the latter and the RRPs is, indeed, so close as to recommend individual Member States to merge their RRP and their usual National Reform Programme into a single document. However, as the GL-RRFs advocate close cooperative interaction between the EC and Member States, individual countries were invited to submit drafts of their national RRP starting in mid-October 2020. To date, only a few countries have made use of this opportunity by submitting full drafts of their RRP, while others have submitted incomplete texts. The preliminary discussion of the drafts should ensure that each country include, in the final version of its RRP, a coherent set of reforms and investments capable of responding to national strategic priorities and, at the same time, pursue the environmental and digital innovations. This interaction would increase the likelihood that individual Member States, and therefore the EU, strengthen their potential growth rate as well as the basis for socially (employment and protection) and environmentally sustainable development.

[3] It should be remembered that the laborious agreement between the European Parliament, the EC and the European Council was finalized in the first ten days of November 2020.

However, the GL-RRFs are not limited to the general design of the national RRPs. They underline that this design must be translated into concrete projects that substantiate the implementation of the consequent reforms and investments in priority areas, given the constraints of not falling below the minimum thresholds of resources to be allocated in digital innovation (at least 20%) and in the ecological transition (at least 37%). To this end, the GL-RRFs insist that EU countries must not resort to elusive definitions of reforms and investments, but focus on capital accumulation (infrastructural and intangible) and on the training and protection of human resources as part of the establishment of more efficient institutional and market structures. To prove that these are not generic options, the EC identifies seven 'flagships' in the GL-RRFs that exemplify these commitments: three areas on climate transition, three on digital transition and one on social aspects (cf. European Commission, *2021 Annual Sustainable Growth Strategy*, 12 September 2020, pp. 10-12). Therefore, each RRP should be conceived as a "matrix" that crosses the "Country Specific Recommendations" received in 2020 and - above all - in 2019 by the country under consideration as part of the European Semester with these seven flagships.

Moreover, the GL-RRFs define the degree of detail of the projects. The various reforms and investments proposed by a given EU country should be grouped into homogeneous sets (the so-called components) which, in addition to interacting effectively with each other, should be specifically linked to one or more of the seven flagships or to other priority areas of intervention. In this way, each of the components is able to contribute to the implementation of the "Country Specific Recommendations" and of the particular digital innovations of the country under examination as well as to the strengthening of its potential growth rate and its foundations for sustainable development. These granular indications are summarised in a template that each country should fill in to define each of its projects (see European Commission, *Guidance to Member States Recovery and Resilience Plans*, Commission Staff Working Document, 17 September 2020). It is essential that the projects of a given component have objectives that are realistically achievable through policy initiatives.

Once each national RRP, broken down into its various projects, has passed the scrutiny of the EC and has been approved by the Council of the EU (ECOFIN), the Member State can receive pre-financing equal to 10% of the total European financial support.

The GL-RRFs also concern the implementation of projects and the related methods of disbursement of the European financial support that follow the pre-financing. The implementation phases of the reforms and investments of each component must satisfy intermediate stages which are assessed both on the basis of qualitative results (milestones) and on the basis of the quantitative achievement of specific indicators (targets); and, thanks to the completion of the various stages, they must lead to the achievement of the final goal clearly stated ex ante (*ibid.*, pp. 21-2). It is necessary that the quality and measurement criteria are objective and effective in verifying both the progress of individual projects and their correspondence with the predefined timing. The tranches of European grants or loans that are intended for each project can be requested by the country concerned at the achievement of the budgeted milestones and targets and, in any case, no more than twice a year. The EC will verify that this request is justified by the actual degree of implementation of the project and by compliance with the expected deadlines. In the event of a positive assessment, before disbursing the loan tranche, the

EC is however required to carry out a further check by requesting the opinion of a technical consultative body (i.e. the Economic and Financial Committee, composed of the directors general of the Member States' Ministries of Economy and the Commission).

This rigorous procedure does not exhaust the conditions for carrying out the national programmes. In exceptional cases, if a Member State considers that another EU country's plan is radically deviating from the original plan, it may request corrective action from the European Council. The EC is required to suspend its disbursements until the European Council has examined the problem, in the first meeting following the request, and corrected any possible discrepancies.

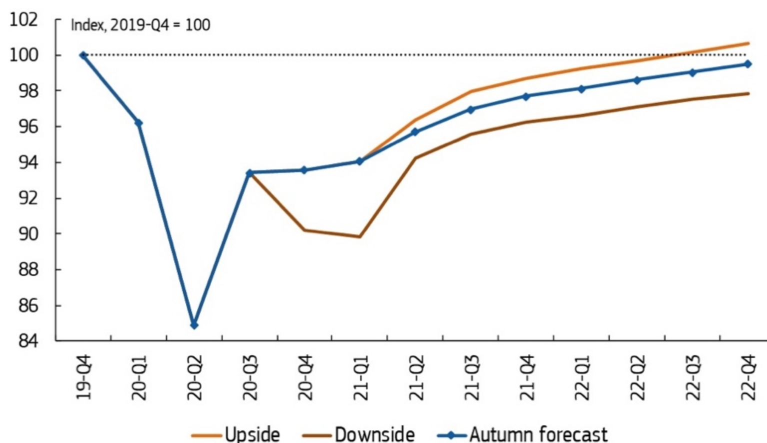
The previous considerations underline that, as stated by President von der Leyen in her "2020 State of the Union Address " last September, the RRPs must provide for reforms and investments centred on the digital innovation/environmental and social sustainability axis, and they must carry out these reforms and investments on time and with predefined financial resources.

3. From the 'Update to the Economic and Financial Document' to the RRP

In the third quarter of 2020, the rebound of the Italian economy was higher than expected (16.1% compared to the previous quarter). Yet the forecast of a fall in the 2020 Italian GDP of 9% (or 10.5% in the most negative scenario) advanced in the Update to the Economic and Financial Document (hereafter, NADEF, as in the Italian acronym) and in the first draft of the 2021 Budgetary Plan, appears optimistic because it was elaborated before the worsening of the new wave of Covid-19 (October 2020). The EC's autumn forecast, which does not include the robust Italian growth in the third quarter, predicts an annual fall in the 2020 Italian GDP of 9.9%. Our expectation, however, is that the main problem does not concern the GDP deviations for 2020: the impact of the fourth quarter on the current year will not be so strong. Rather, having been prepared before the intensification of the second pandemic wave, the official documents risk underestimating the negative drag effects of the macroeconomic data of the fourth quarter of 2020 in terms of the real growth rate of the following year, and therefore they risk formulating excessively positive forecasts for 2021. The EC expects Italian GDP to grow by 4.1%; and the NADEF sets an expected trend rate of 5.1% (in the most negative scenario, 1.8%) to be pushed up to the programmatic target of 6%.

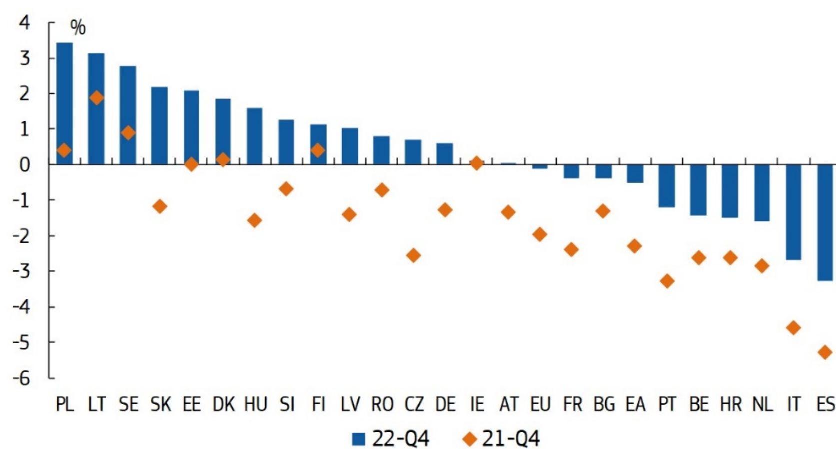
It should be noted that, despite the underestimation of the possible drag effects, the EC forecasts with respect to the short to medium-term trends of the euro area offer a worrying macroeconomic outlook: as Figure 2 shows, on average, euro area Member States will not be able to recover their real income level at the end of 2019 even at the end of 2022; and, after Spain, Italy will be the country with the highest negative gap (cf. Figure 3). Also based on these forecasts, the risk is that the deterioration in the short-term prospects of the Italian economy (as well as those of the euro area) will add to the already modest potential national growth rate in the years before 2020 and negatively affect Italy's growth also in the medium to long term. This will especially be the case if the EC's forecasts and - above all - those of the scenario favoured by the NADEF prove to be too optimistic.

Figure 2 – Real GDP level, euro zone



Source: European Commission, *European Economic Forecast*; November, 2020.

Figure 3 – Real GDP level compared to 2019-Q4



Source: European Commission, *European Economic Forecast*; November, 2020.

In the latter scenario, in 2021 the trend real growth rate of 5.1% should translate into an expected real growth rate of 6% thanks to expansionary policy interventions amounting to almost 40 billion euro, financed for a small amount by the RRF resources. Our concern is that, if the intensity of the second pandemic wave instead pushed the trend rate of Italian real growth closer to or even below 1.8% (i.e., to the most negative scenario of the NADEF), this approach to fiscal policy would result in a quantitative expansion of public spending well beyond the 40-billion-euro threshold: many of the emergency interventions launched in 2020, that implied public spending over 100 billion euro, should be extended for several months in 2021.[4] In addition, this further fiscal expansion would certainly not lead to the

[4] The recent policy initiatives following the social restrictions introduced in Italy between the second half of October 2020 and the first half of November 2020 are going in the direction envisaged in the text.

achievement of a programmatic growth target of close to 6% (or 4.1% envisaged by the EC); and, consequently, Italy's public debt/GDP ratio would undergo a further surge so that the national fiscal constraints would become binding despite the ECB's ultra-expansionary interventions.

The picture described makes it difficult to implement the forecasts formulated by official documents with respect to trend and expected real growth rates for the two-year period following that of an effective recovery. Faced with a growth potential of the Italian economy which - before the pandemic - was below 1% and which certainly did not strengthen during 2020 (and, if our forecasts were confirmed, it would not strengthen in the course of 2021), the NADEF assumes trend rates of real growth of 3% in 2022 and 1.8% in 2023; and sets itself the goal of raising these rates - respectively - by 0.8% and 0.7% thanks to policy interventions. These objectives are incompatible with 'square root' economic trends (' $\surd$–') such as those outlined above. They would become feasible for the two-year period following an effective recovery only if the Italian economy achieved a discontinuity also with respect to the management of the emergency induced by the first pandemic wave. The Italian government has a tool at its disposal to achieve this discontinuity: an effective use of the RRF that implements reforms and investments capable of leading, in a few years, to a structural strengthening of the national economic system so as to place it on a more robust path of potential growth.

Italy is not the only EU country to place high hopes in the use of the European resources. Spain, which is the other Member State to be the recipient of a very large portion of the RRF's resources and to show a strong vulnerability to the pandemic shocks, maintains that it expects strong short-medium term benefits from the implementation of that programme (cf. "España Puede. Recovery, Transformation and Resilience Plan"). The fact remains that, to substantiate the positive expectations of the Italian and Spanish governments (as well as other European governments), it is necessary to address at least two aspects: (i) specify some minimum conditions in the use of the RRF resources that must be met to obtain favourable macroeconomic results already in the short to medium run; (ii) verify whether the GL-RRFs are adequate to stimulate national governments to implement these policies. If we want to go deeply on points (i) and (ii), at least the first must be calibrated on national specificities. Therefore, below we continue to refer to the Italian case.

In this regard, the Italian RRP should fulfil at least three tasks.

As has already been pointed out in previous papers (see M. Buti and M. Messori, "Next Generation EU: Italy must not miss this opportunity", cit.), the first task consists in focussing on those 'bottlenecks' that have long been known and have condemned the Italian economy to a succession of phases of stagnation and recession - interrupted by sporadic and weak phases of growth - from the mid-nineties to today. It is necessary that the Italian RRP resolutely tackle these structural constraints in order to achieve higher sustainable growth for which the funds of the RRF and - more generally - of the other NG-EU programmes are allocated. It follows that the Italian Plan should clearly specify the reforms and adjustments to be implemented, including the contributions of these reforms to the long-term sustainability of the public debt/GDP ratio.

The second task lies in the construction of a strategy that allows Italy to organise the reforms and investments already specified in the Plan according to a sequence of homogeneous sets. Such "components" should order the projects according to clear priorities and combine them so as to meet the European goals of environmental protection and digital innovation and foster a process of convergence within the EU. As said in Section 2 above, each project must obtain the approval of the European institutions and must base its implementation on an expenditure plan compatible with the foreseen share of the financial resources allocated to Italy by the RRF (and, possibly, by other NG - EU programmes).

The third task requires building a governance that is appropriate to the definition and implementation of individual projects, one that is capable of splitting complex projects into operational phases to be completed within the foreseen time and costs. This same governance must provide for transparent monitoring by European and national public institutions, so as to guarantee control of the ongoing implementation and - at the same time - to solve the problem of "who watches the watchers". These elements underline that governance cannot be an add-on, but must be an integral part of the national RRP. As mentioned in the introductory section, it is above all a question of building a political "steering board" that is centralised and acts as a counterpart of the steering board which already operates within the EC and is coordinated by the President and composed of the three Executive Vice-Presidents (EVP) and the Commissioner for Economy. The national "steering board" should play a decision-making role, entailing - if and when necessary – commissioner-like powers for the implementation and verification of projects. These functions also require a more technical structure, able to deal with the EC services that coordinate relations with Member States (DG Recovery, created for this purpose, and DG ECFIN).

4. From bottom up to top down

Carrying out these three tasks is a complex operation that requires the mobilisation of huge organisational, institutional and financial resources. It is therefore necessary to involve both public and private stakeholders and to experiment with new forms of public-private cooperation that make the best use of European resources and that are also able to give continuity to the reforms thus implemented. This need is, for example, evident in the case of one of the bottlenecks that hinder the economic and social development of Italy: the lack of an increase in the size of the successful small firms which would be able to imitate the innovators and thus be able to support the country's macroeconomic growth. In the absence of cooperation from the entrepreneurs-owners of the best small firms and for lack of efficient tools of non-banking financing, it would be impossible to address this 'bottleneck'. However, it is equally impossible to build economic and social conditions for its removal in the absence of effective institutional measures and incentives and a broad consensus on the part of business and worker representatives.

As a result, the Italian RRP will be able to fulfil the first two tasks examined above only if it will involve the energies of private agents, intermediate institutions and bodies for the definition of a collective effort. Moreover, this involvement must be based on adequate governance. It cannot, in fact, interfere

with the responsibility of the political-institutional level regarding the setting of priorities, the execution of projects, and the verification of results. It follows that the third task is crucial to complete "the plot of the movie" dedicated to the RRF and the RRP. This latter task shows that what is at stake is so important that it calls for both a mobilisation of the public administration and national stakeholders and a political commitment along innovative lines. The challenge lies in combining the two levels in a harmonious way.

Italy pursued a bottom-up approach for the months of July and August 2020, then proceeding with the drafting and publication of the "Guidelines for the definition of the National Recovery and Resilience Plan. Next Generation Italy" (9 September 2020). This document, while being very useful for setting a reference framework and acknowledging the major reforms invoked by the 'Specific Recommendations' addressed to Italy in the context of the 2019 European Semester,[5] remains at the level of principles. The seven 'missions' that define the intervention 'clusters' of the Italian RRP will have to be further developed and specified to actually transpose the seven flagships evoked in the GL-RRF at a national level and - even more so - to determine the components. In order to define projects to be implemented through reforms and public investments and to be submitted to EC assessment and approval by the EU Council, the contents of the second part of the Italian document require further specifications. As recognised by the Italian document, the translation of the missions into specific projects to be part of one or more components and to be financed through the RRF, is still in progress. This requires the selection and specification of investments and reforms that are intended to be undertaken as a matter of priority to give substance to key projects. The latter will have to be limited in number and be characterised by a virtuous interaction between reforms, public investments and stimulus to private investments.

Italy is not the only country that is still working on its RRP. A few Member States have already submitted complete drafts of their national plan; other countries have listed their priorities in terms of investment projects leaving the reform chapter unaffected. Therefore, Italy does not have any major delays to overcome. In addition, given the complexity of the problems that Italy must face in order to overcome its 'bottlenecks', the Italian government is called upon to draft an RRP with particular care. This plan must include several aspects: the relaunch of growth that has been blocked for too many years, the support for economic and social development that must make up for the serious shortcomings in digital innovation and that must enhance the progress already made in limiting the environmental impact, and the management of the national public debt to ensure long-term sustainability (see Table 1).

[5] 2019 is an important year to get a picture of the Italian structural problems perceived at a European level. Unlike 2020, the specific recommendations for Italy of 2019 were not in fact overdetermined by the pandemic.

Table 1 – Public investments in the recovery strategy

Phase	1. Great Lockdown	2. Partial Reopening	3. Post-Pandemic
Priority	Save lives and livelihoods	Safe reopening where possible	Transform to more inclusive, smart, and sustainable economies
Key fiscal policies	Lifelines for people and firms	Preserve lifelines; target support better; encourage workers to take new jobs	Depending on fiscal space, consider fiscal stimulus, repair balance sheets
Role of public investment	Continue projects where safe, start planning	Boost maintenance and job-rich projects; reassess priorities; prepare pipeline	Satisfy infrastructure needs and support progress toward the SDGs; increase resilience to crises
Preferable project characteristics	Maintenance	Maintenance; ready for implementation; small-size, job-intensive with large short-term multiplier	Large, transformational projects with large long-term multiplier
Public investment management actions	Review portfolio of planned and active projects	Review, reprioritize, restart feasible projects put on hold; plan for new priorities; prepare pipeline of appraised projects to be implemented within 24 months	Strengthen project planning, budgeting, and implementation practices to improve public investment efficiency
Priority sectors	Health	Health, including R&D in vaccine and therapeutics; water and sanitation; digital; safe buildings, schools and transportation	Health; climate change adaptation and mitigation; digital

Source: IMF staff.

Note: Countries do not necessarily progress smoothly through all phases of pandemic. Appropriate fiscal responses will be country-specific depending on the fiscal space, the development of the pandemic, and the strength of the recovery. Measures included here are not exhaustive. R&D = research and development; SDGs = Sustainable Development Goals.

Source: IMF Fiscal Monitor, 2020.

Some specific examples may be useful to better illustrate the difficult "equation" that must be solved by the Italian institutions in order to build a RRP appropriate to the importance of its objectives.

As the European institutions and experts in the field have pointed out for years, in Italy it is not conceivable to implement effective reforms and public investments without preventive interventions that would increase the efficiency of the public administration and of the binding legal procedures and that would strengthen juridical safeguards. The point is confirmed by the persistent and large gap between the (albeit insufficient) amount of public investments, decided and approved in Italy even in recent years, and the share of these investments that has actually been implemented. The difference becomes even larger if only those investments completed on time and with the estimated costs are classified as achieved. Yet, if the crucial objective is to increase the growth potential of the Italian economy already in the years close to the pandemic peak (cf. above, Section 3), it would be unrealistic to pursue a comprehensive reform of the public administration and civil justice in the Italian National Plan. Instead, it is necessary to split such a reform into a sequence of milestones and targets that are hierarchically ordered, have a direct and positive impact on the execution of public investments and are feasible over the five-year RRF horizon (end of 2026). That is, each stage of the reform must be spelled out and prioritised into a set of organisational innovations and investments that are capable of producing tangible and coherent, even if partial, results in due time.

A second example is offered by the very high ratio between public debt and GDP which, for more than thirty years, has heavily constrained Italy's fiscal capacity. Thanks to the massive interventions of the Eurosystem of central banks for the purchase of government bonds in the secondary financial market and the related policy of low interest rates, and thanks to the appropriate relaxation of the European

fiscal rules, in 2020 even the Italian government has been able to massively increase its budget deficit in order to face the pandemic emergency. As is partly foreseen in the NADEF and as will be imposed by the second wave of the pandemic, this increase will recur in 2021 and - perhaps - in a part of 2022. In the years following the pandemic, however, it will be necessary to put limits on public spending in order to guarantee a gradual decline in the public debt/GDP ratio.

These considerations suggest that an effective design of the national RRP is a necessary but not sufficient condition for triggering such a significant change in the economic functioning of a fragile EU Member State and to raise significantly, already in the short term, its potential growth rate. To this end, it is also essential that the design of the RRP of that country be translated into a specific and well-coordinated set of large-scale projects that must be implemented on time and in the planned way. In the case of the Italian economy, this means that only a virtuous combination of strategic design, careful planning and efficient execution of the RRP can prevent the abrupt break in GDP growth expected in the fourth quarter of 2020 due to the second pandemic wave from having lasting negative effects, and the consequent downward drag of the 2021 macroeconomic data.

5. The role of governance

As mentioned in the previous sections, the implementation of this combination is based on a complex process that requires the mobilisation of the entire public administration and all key national stakeholders. A more internal, though no less important, ingredient for the success of this process is that the Italian RRP and - in general - that of all the fragile EU countries make use of an adequate national organisation consistent with the European legislative and regulatory framework. If the term 'governance' refers to the set of principles and procedures that define the effective organisation and management of a collective instrument,[6] it can be argued that good governance is crucial for the construction of an effective national RRP. The governance of the latter, which must be one of the engines of the initial project, has various aspects. Here it is enough to focus on three of them. Governance of the RRP involves, first of all, both forms of participation and the attribution and division of competences among the various actors involved; it also contributes to defining the essential organisational safeguards that must ensure internal functionality and efficient relations with external interlocutors; finally, it must identify the most efficient ways of adapting to the rules and norms that condition the pursuit of the collective instrument's objectives.

The first element of governance concerns aspects already mentioned. The necessary mobilisation of the public administration and key stakeholders in the construction of the national RRP implies that, at least with reference to Italy, the definition of the strategic design of the Plan and the related discussion on the constraints on growth and on the 'package' of reforms and investments necessary to overcome such

[6] Cf.: O.E. Williamson, "The Economics of Governance", *American Economic Review*, 95 (2), P&P, 2005, pp. 1-18; M.J. Roe, "The institutions of corporate governance", in *Handbook of New institutional economics*, edited by C. Menard and M.M. Shirley, Springer: New York, 2005.

constraints cannot ignore the contribution from intermediate institutions and bodies. If it is true that the RRP is a collective instrument capable of conditioning Italy's future potential growth and development, it would be inconceivable to proceed without the contribution - for example - from national regulatory and territorial institutions and without the contribution from organisations representing the main economic and social actors. A good governance structure must, however, avoid that the involvement of these intermediate institutions and bodies result in a decentralisation of the projects' preparation and in the components' definition since this would restate a bottom-up procedure and risk being prey of vested interests. Listening to different points of view and opening up to suggestions with a general value are an essential component for building an effective national RRP. However, the ultimate responsibility for selecting projects according to clear priorities and for combining these selected projects in accordance with European rules and "guidelines" rests with the country's central political authority, in cooperation with the EC and under the scrutiny of the Council. This responsibility also extends to the monitoring of the projects' implementation phases: compliance with the procedures and deadlines must be certified by national public structures centralised and controlled by the political authority, so that subsequent European checks do not reserve unwelcome surprises.

This first element of governance offers further justifications for the establishment, within the Italian government, of a political "steering board" made up of a limited number of members, one that has decision-making powers and is supported by an adequate technical structure. That is, Italy's central political authority could exercise its decision-making tasks with respect to the RRP by establishing this "steering board" in the organisational form just specified. In the previous sections, such an option was justified with the opportunity to adopt decision-making structures complementary to the committees and services activated by the EC. The need to keep possible centrifugal forces under control in the preparation of the national RRP now adds further and important reasons for the creation of a political "steering board" and for entrusting it with important decision-making powers. The government should be ready to go as far as the attribution of 'commissioner-like powers' for the implementation and monitoring of the previously decided projects.

In addition to assuming responsibility for the construction and implementation of the RRP and to adapting it to the organisational forms adopted by the EC (cf. above, Section 3), the political "steering board" should ensure that the contents of the national RRP comply with the conditions included in the GL-RRFs.

In this regard, it has been stated that, beyond their apparently binding constraints, the GL-RFFs could leave various options open.[7] In particular, they could incentivise 'vertical' or 'horizontal' coordination and involve 'narrow' or 'broad' conditionality. Unlike the 'vertical' choice, which leaves autonomy to individual Member States by merely centralising the assessment of priority national challenges, the 'horizontal' choice aims to link national priorities to the European axis of digital innovation and green

[7] The reference is to: J. Pisani-Ferry, "European Union recovery funds: Strings attached, but not tied up in knots", *Policy Contribution*, 2020/19, October, Bruegel. See also: O. Blanchard, T. Philippon and J.P. Ferry, "Is needed as countries exit Covid-19 lockdowns", *Policy Brief*, 2020/8, June, Peterson Institute for International Economics, Washington.

transition. The 'vertical' choice could then be combined both with the offer of European financial support to the whole set of reforms and priority investments to be carried out in a given country ('broad' conditionality) and with specific European funding for each of the national projects ('narrow' conditionality). On the other hand, the 'horizontal' choice would tend to combine with 'narrow" conditionality alone.

In line with Pisani-Ferry's argument, it is correct to affirm the legitimacy of all three of these hypothetical combinations; and we can go so far as to support their potential coexistence, provided that there is a clear framework to distinguish the processes. Pisani-Ferry himself recognises, however, that the political relations between the EU Member States make recourse to 'narrow" conditionality inevitable. Our previous examination of the GL-RRFs (cf. above, Section 2) leads us, in different ways, to a similar conclusion. In fact, we believe that these guidelines imply a 'narrow' conditionality combined with a 'horizontal' approach. Therefore, the political "steering board" becomes essential to ensure that the Italian RRP satisfies both conditions.

This conclusion is reinforced by a further aspect that characterises the GL-RRFs and that is examined in the essay cited above (cf. footnote 8): the hope that some of the projects included in the RRPs of different countries will produce interdependencies or lead to supranational initiatives capable of creating positive externalities for the countries involved and for the entire EU. A typical example is represented by the joint construction and centralised management of infrastructure networks at European level. From a long-term perspective, such possible links between the initiatives of various countries would have significant potential. They would in fact tend to strengthen the impact of the European Semester and to accelerate coordination between national fiscal policies, creating forms of supranational cooperation that would be irreversible and would go beyond the necessary European constraints on the national fiscal policies. Once a critical threshold is reached, these irreversible forms of cooperation would erode spaces for national sovereignty; and increasingly important items in the public balance sheets of individual Member States would be financed through centralised debt instruments.

It is almost superfluous to recall that the RRF and the NG - EU are, today, contingent addenda of the 2021-2027 MFF. The possible supranational initiatives of the RRPs could, however, contribute to the transformation of these programmes into the first important step towards a European fiscal policy. On the other hand, without looking towards such long federal horizons, interactions between national RRPs could have positive effects even in the short to medium term. In fact, they would tend to strengthen the European Parliament's aim of restoring those spaces for European public goods that had been downsized, in the 2021-2027 MFF and in various programmes of the three pillars of the NG - EU, in order to allow the approval of the EC proposal (end of May 2020) by the European Council (second half of July 2020). In the recent trilogue with the EC and the Council completed in the first ten days of November 2020, the European Parliament succeeded in reinstating 16 billion euro to mitigate these downsized projects. Public goods produced by interactions among various RRPs would mark further progress in the same direction.

By ensuring complementarity between Italian governance and the new organisational structures of the EC, the political "steering board" could enhance this aspect of the GL-RRFs.

6. The second pandemic wave: additionality and substitutability

Compared to what has been said so far, the second pandemic wave risks compromising the positive effects that the RRF could have had on the potential growth rate and on the convergence of Italy and the most fragile EU countries towards the other Member States. The persistence of Covid-19 does not simply imply the postponement over time of the exit from the emergency phase and the start of the recovery phase and for the use of RRF funds (see M. Buti and M. Messori, 'Next Generation - EU': An interpretative guide", *SEP Policy Brief*, May, n. 29, 2020). This persistence also undermines - above all - the 'linear' evolution between these three phases. In so doing, it makes it almost impossible to avoid mixing economic policy responses to the economic-social impacts of the emergency and the implementation of reforms and investments intended to support (economic, social and environmental) sustainable development and to strengthen the resilience of European economies with respect to the post-pandemic world.

Today (mid-November 2020), in Italy, national fiscal policy makers are forced to extend a substantial part of those spending disbursements that had been activated during the emergency phase induced by the first pandemic wave in order to protect the economic activities and the population most affected by the second wave. It is necessary to support the income of those who entered poverty or have low purchasing power and lost access to the 'grey' economy; to extend income support to the new and old unemployed, to a large part of atypical workers and to a part of the self-employed; and finally, to reproduce or restore transfers in favour of economic activities that are on the verge of bankruptcy but retain potential for competitiveness and profitability in post-pandemic markets. These policies require significant budgetary commitments that, moreover, will tend to rise over the next few months. Combined with the increasingly higher degrees of uncertainty and the related fall in aggregate demand, healthcare measures will have negative impacts on GDP dynamics (cf. Section 3). It is therefore reasonable to believe that, if the resurgence of Covid-19 continues for several months in 2021, Italy will have to face further and substantial increases in its public debt/GDP ratio and a new weakening of its productive structure and social cohesion.

This assessment shows that we have entered a new emergency phase and that emergency policies are thus needed. It is reasonable to assume that, thanks to the health and economic-social experience acquired in Spring, this new phase will be less intense and will allow for more selective public spending. However, it must also be considered that, unlike what happened last Spring, now the Member States will have much less access to additional aid from the European institutions. There are no sources that can be used to strengthen the financial resources of the programme to support workers in conditions of unemployment or with precarious jobs (SURE); and, since the health precautionary line activated by the European Stability Mechanism (ESM) has not been used, this institution has no room to launch new

financial support in favour of the euro area countries.[8] On the other hand, it would be unrealistic to expect an extension of the NG - EU programme and, in particular, of the RRF. The start of a re-negotiation would, in fact, risk shattering the hard-won compromise reached in the European Council last July; and to frustrate the equally hard-to-reach agreement between the EC, the Council and the European Parliament. The almost certain outcome would be that of a long delay in the final approval and implementation of the RRF; moreover, there would be a high risk of reducing - rather than increasing - the amount of transfers and loans made available by the entire programme.

As happened during the peaks of the recent crises that preceded the pandemic shocks, during the renewed emergency the only tool capable of mitigating the difficulties of the EMU Member States with reduced fiscal capacity in managing their balance sheets is the ultra-expansionary policy of the ECB. The purchases of large quantities of national public bonds made by the Eurosystem of central banks in secondary markets, in fact, loosen the market constraints of the most indebted countries and make - at least temporarily - even very high debt ratios sustainable. This unstable equilibrium does not, however, cancel the fact that public debt/GDP ratios must eventually be kept under control.

In Italy, the government aims to contain the impact of the second pandemic wave on public finance using the RRF resources allocated to the country in a differentiated way. The goal is to allocate all the grants for new reform and investment projects; and to use a large part of the loans, which directly increase the deficit and public debt even if they decrease the share of the related bonds held in the portfolios of market investors, to finance national public expenses that would have been made anyway.

The allocation of part of the RRF loans offered to Italy to activate "replacement effects", instead of making incremental use, obviously tends to reduce - *ceteris paribus* - the positive macroeconomic impact of the new investments which would be part of efficient projects. The optimal solution for the Italian economic system would therefore be to use both the total loans and the total transfers of the RRF for new reforms and new efficient investments, making public debt sustainable through corresponding cuts in the part of current public expenditure that does not serve to provide essential services, to correct inequalities in income distribution and to reduce poverty, but which instead feeds rent-seeking positions. If this approach proves to be unfeasible, as a second best it is preferable to seek a balance between the efficient use of the RRF resources and the impact on public debt. Even in this case, however, the search for a compromise must result in effective choices. It is crucial that the financing with the RRF loans of a share of the pre-existing or planned national public expenditure have a close interaction with the budget items related to the new projects of the RRP; and that, in general, public expenditure for the emergency can combine economic and social protection with greater selectivity. The "replacement effect" could thus replace a part of the public debt to the market with a debt to the EU without weighing excessively on the support for growth.

[8] It goes without saying that, in a situation such as the one described, the refusal to access the ESM health line by almost all Member States of the EMU appears difficult to understand.

The question is whether it is possible to minimise the negative impact of this option pursued by the Italian government without eliminating the positive "replacement effect" which ensures a relaxation of the constraints to which the national public balance sheet is subjected. The answer can be divided into two parts. First: as has already been said (cf. Section 4), it is necessary that the 'replacement' of the items of the national balance sheet or budget with a part of the RRF loans concern expenses that can be effectively combined with the 'components' and the RRF projects financed with transfers or with the remainder of the related loans. Second: it should be borne in mind that the "replacement" of expenses capable of overcoming the first filter does not end in a simple accounting reversal of market debt funds thanks to the inclusion in the public balance sheet of an equivalent amount of RRF loans. Instead, what is needed is the reformulation of the use of the pre-existing or alleged expense items so that this use can be efficiently and effectively combined with the texture of the related RRP projects.

To make the analysis less generic, it may be useful to offer two interrelated examples.

Given that three GL-RRF flagships refer to digital innovation and that Italy has structural deficiencies and delays in this regard, one would assume that Italy's RRP will include a project to support firms capable of making investments that go in this direction. The proposal to relaunch the so-called "Industry 4.0" contained in the 2021 Budgetary Plan thus seems to offer an effective opportunity to 'replace' an item of public expenditure, already foreseen in the Italian budget, with an equivalent share of RFF loans. However, if Italy limited itself to this replacement, the conditions illustrated above would not be satisfied. National projects financed by the RRF with transfers or loans must be completed by 2026. What sense would there be in directly incentivising innovative investments for only 3 or 4 years, then removing the support for firms that have placed themselves on a trajectory of technological innovation in continuous evolution? Would not such an incentive, even if accompanied by a weakly credible commitment to allocate national public resources from 2027 onwards, end up increasing uncertainty and curbing those innovative investments that would have to be supported? It is therefore appropriate to provide innovative firms with a less random advantage. Every digital innovation involves a reorganisation of production processes which results in an increased quality of the labour demand. For firms, this reorganisation is worthwhile only if the re-composition of their labour demand can be satisfied by a corresponding re-composition of the labour supply. Thus, the need to use the RRF loans also to build a network of high-level technical schools that are capable of training human resources adequate to the future composition of the labour demand.

The second example is a consequence of the first. Two of the missions (2 and 3) that characterise the Italian Guidelines (cf. above, Section 4) concern social inclusion and health. It is therefore reasonable to assume that Italy's RRP will contain projects relating to these matters. At the same time, important expenditure items in the Italian public balance sheet concern "citizenship income" and healthcare, which tend to be quite inefficient. The imbalances in the labour market linked to the radical reorganisation of firms, as briefly described above, will tend to highlight these inefficiencies. Therefore, the 'replacement' of national public expenditure with part of the RRF loans would be an opportunity for using the RRP to make the two welfare items under consideration more effective with respect to the transformations underway. It would also structurally reduce wasteful allocations and the related

crystallisation of rent-seeking positions. The RRF loans could aim at transforming citizenship income into an effective programme to fight poverty and at eliminating its inefficient use as an active labour policy. They could also finance a capillary verification of the cost differentials in the territorial organisation of healthcare, leading to forms of commissioning in cases of significant and systematic upward deviations.

7. Conclusions

The second pandemic wave has called into question the possibility of a rapid return to pre-crisis levels of GDP that had materialised after the strong rebound in the third quarter of the current year. According to the EC autumn forecast, Italy and many other euro area countries will not recover their 2019 GDP level by 2022. European macroeconomic data may be further worsened by the intensity of the second pandemic wave. At a European level, such a worrying situation requires finalising the agreement on NG - EU as soon as possible; at the Italian level, it makes it all the more important for the government to speed up the elaboration and presentation of a credible RRP.

In this last regard, in this paper we have highlighted four main points:

a) The deterioration of growth prospects due to the worsening of the pandemic should accelerate the preparation of the Italian RRP so as to further pursue, in the short term, that informal interaction with the EC services that will make it possible to rapidly approve the Italian RRP once it will be officially presented by April 2021.

b) The Italian RRP should follow a top-down identification of the strategic priorities in terms of investments and reforms according to the guidelines published by the EC, and define a national economic and fiscal framework capable of guaranteeing the long-term sustainability of the public debt/GDP ratio.

c) The construction of an appropriate governance, which must be an integral part of the Italian RRP, is a necessary condition to ensure the feasibility of the projects and to allow transparent monitoring and verification of the processes in progress.

d) Unlike grants, part of the RRF loans can perform substitutive rather than additive functions; in such cases, national policy makers should however take the opportunity to review, redefine or rationalise the interventions financed by the substituted national expenditure, also in order to ensure full compatibility with the priorities of the RRF.