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FT BIG READ. EUROPEAN POLITICS

Now Brussels has a huge amount of money to spend on its member states, it will gain greater influence over their economies. But that brings the risk of a backlash in Italy and Spain. How will it use its leverage?

By Sam Fleming, Miles Johnson and Daniel Dombey

Draghi and the EU's recovery mission

'We expect Italy to do its homework . . . Don't forget it is an explicit part of the deal. We will stick to it'

€200bn
Possible value of EU funding that will power Italy's economic reforms

€70bn
Possible value of EU grants that Spain expects to get over the next three years

40
Percentage of the EU recovery fund that will go to Italy and Spain

'Spain cannot wait for the funds. We have a very difficult economic situation, with an 11 per cent fall in GDP last year'

Nine years ago, Olaf Bussink launched a consultancy business for foreign online retailers looking to set up operations in Italy. His advice to them was simple: don't.

Bussink discovered that rather than incorporating a company in Italy and setting up a warehouse there, it was easier to send packages to Italian consumers that were shipped in from the Netherlands. Today his thriving business helps online retailers set up websites in Italian that target local customers, shipping products ranging from electric bikes to cosmetics from the Netherlands that beat local rivals on price and speed.

"It is slightly more expensive to send things from Holland but for my clients the cost of setting up a business in Italy is so much higher," he says. "Italy has what I call a 'bureaucracy tax'. My clients can add 10 per cent to their prices compared with Italy-based companies and still be very competitive."

As Italy draws up the most ambitious reform plans in a generation to relaunch its sclerotic economy, powered by €200bn of EU funds, uprooting the barriers to investment will help define whether the scheme is a success.

The country is turning to Mario Draghi, the former European Central Bank president, to form a new government from the rubble of its latest political crisis. His programme involves harnessing a once-in-a-generation package of grants and loans underwritten by all 27 EU member states, while also pushing through often unpalatable reforms aimed at energising an economy that in real terms has failed to grow since the start of the millennium.

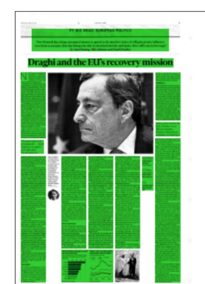
It is hard to overstate the stakes. Draghi's success or failure in deploying the recovery fund and embarking on key reforms will be critical not only for Italy's future, but also for the credibility of the EU's most ambitious joint economic undertaking since the birth of the euro. "This is a historic chance for the country to invest in its economy and prepare for the future with an ambitious reform plan," says Manfred Weber, the head of the European parliament's powerful European People's party group. "We expect Italy to do its homework, like we expect from all member states. Don't forget it is an explicit part of the deal. We will stick to it."

The news that Draghi had been approached by the Italian president to form a government was greeted with huge relief in Brussels and other EU capitals given his reputation as the man who saved the single currency during the sovereign debt crisis.

In a brief speech accepting the request, delivered inside the Italian presidential palace on Wednesday, Draghi made explicit reference to the challenge of ensuring the EU recovery plan is a success.

"We have the extraordinary resources of the EU at our disposal — we have the opportunity to operate with a careful eye on future generations," he said.

Yet to do so he must first convince enough of Italy's warring lawmakers to provide him with a stable majority in parliament. This will require bringing politicians into his cabinet from differ-



Draghi e la missione del recovery fund dell'UE

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ent parties who will have strong views on how the money should be spent.

Draghi's entrance last week shook the Italian political establishment, prompting fissures in parties and political alliances and forcing leaders to make decisions over supporting him that will define both their own and their country's future.

Disagreements over how Italy should deploy what is expected to be the biggest chunk of the EU's recovery fund triggered the series of events that resulted in Draghi receiving the emergency call.

Toxic politics

The country's unstable previous coalition government, led by the lawyer Giuseppe Conte, was born in 2019 out of an unlikely alliance of the one-time anti-euro Five Star Movement and the staunchly pro-European Democratic party as a way of blocking Brussels antagonist Matteo Salvini's bid to become prime minister.

Last month, however, former prime minister Matteo Renzi began to attack the coalition's handling of the recovery spending plans. The former Democratic party leader pulled his small Italia Viva party out of the government, stripping it of its majority in Italy's upper house and leaving Conte crippled.

As the toxic politics that have already blighted Rome's plans to tap the fund show, reaping the benefits of this European bounty is far harder than it might look. The EU has deliberately avoided going down the route of the last sovereign debt crisis, in which the technocratic government of Mario Monti was under pressure to enact brutal economic programmes and a hard-charging austerity drive.

The EU has this time suspended its fiscal rules, allowing the Italian public debt to exceed 150 per cent of GDP, while putting the might of stronger treasuries, including Berlin's, behind an unprecedented commission borrowing programme.

But that does not mean the new recovery fund riches come without strings attached. Accessing the money will require a member state to sign up to a swath of regulatory and administrative reforms. These will need to be delivered according to timelines and milestones set in conjunction with the commission, led by president Ursula von der Leyen, as part of so-called recovery and resilience plans.

Historic opportunity

The idea of common European borrowing was profoundly controversial among fiscally frugal northern EU states such as the Netherlands when they agreed to the concept last July.

They signed up in the belief, however, that the commission would enforce tough reforms alongside investment plans aimed at making weaker economies more resilient the next time a crisis comes along.

"The commission is really serious about these reform programmes," says one senior EU diplomat. "They won't let us get away with anything."

Paolo Gentiloni, the Italian commissioner who oversees EU economic policy, sees a big difference between the expected Draghi government and the technocratic Monti regime that led Italy between 2011-13.

The latter served at a time when sovereign debt yields were unsustainably high and the "troika" of the commission, the ECB and the IMF was imposing deeply unpopular reforms on beleaguered euro members, such as Greece.

"The Monti mission was a rescue mission. This is a mission to avoid missing out on a historical opportunity — that is why Draghi's leadership is so important," explains Gentiloni, himself a former Italian prime minister.

"It is a very different environment from the one we had eight or nine years ago. Some of the problems are still there, but now there is the opportunity to address them in a positive context of a strong boost to growth and the recovery, and not in the context of saving the country from the troika."

Italy has made advances in areas such as pension and labour market reform in recent decades, Gentiloni says in an interview with the Financial Times, but he cautions that there had been less progress in areas such as speeding up the judicial process and reforming competition rules, as well as curbing red tape.

"I am sure that he [Draghi] will use his extraordinary experience and his strong leadership to make the right things happen," he adds. "He knows very well all the bottlenecks, the difficulties, the challenges involved in making reforms happen in Italy."

The country has, for example, one of the slowest legal systems in Europe. A 2018 study by the Council of Europe concluded that the average time for commercial legal cases to be settled was 514 days, among the worst in Europe and longer than in Malta and Turkey.

In 2016, Italy had 4.1 civil and commercial litigation cases pending per 100 inhabitants, compared with 2.4 in France and 0.9 in Germany.

Partly as a result, the country was ranked 58th globally in the World Bank's Ease of Doing Business report for 2020 — with low results for features such as enforcing contracts and paying taxes. That put it just below Romania, Kosovo and Kenya.

Lucrezia Reichlin, a London Business School professor and former head of research at the ECB, stresses that Draghi is not "some technocrat coming down from the sky" who plans to push the country through "a crash course in liberalising its economy".

The focus of his proposals to the commission needs to be on addressing "Italy's structural incapacity to spend money, which is related to the public sector's ability to make decisions, pursue transparent processes, and undertake auditing", she says.

This points to one of the commission's biggest questions about Italy and the recovery fund: whether the country is up to the task of spending such a vast quantity of money wisely over a contracted period of time. Italy's history here is far from encouraging.

Along with Spain, Italy has one of the worst track records for efficiently spending EU structural funds. In the 2014-20 EU budget period, Spain managed to spend only 36 per cent of those funds by late last year, with Italy only a little better at 43 per cent. By contrast, France's absorption rate was 61 per cent, and Finland's was 81 per cent.

Yet together Italy and Spain will receive no less than 40 per cent of the EU recovery fund harvest — dominating the spending programme. This means the reputation of the entire project rests on those countries' ability to come up with credible programmes that meet the commission's green and digital priorities and minimise boondoggles, waste and fraud.

Some officials hope the Next Generation EU project — which is officially designed to be temporary — could become a permanent feature of Europe's set-up. But as Erik Nielsen, chief economist at UniCredit, says, that dream "only has a chance if the money is well spent and certainly not wasted".

Windfall fears

To date officials have been more encouraged by what they see from Spain than by the draft proposals that have been discussed in Rome. Madrid expects to receive some €70bn in grants over the next three years, followed by roughly the same amount in loans in the period up to 2026. It has already approved a budget that allows it to borrow €27bn against future grants from the fund, passed legislation last month to eliminate bureaucratic bottlenecks in disbursing the money, and drawn up a list of 170 reforms to submit to Brussels.

Among the top priorities in the country's recovery and resilience plan are the digitalisation of Spanish business and the transition to green energy. Big corporates are hurrying to register themselves as possible beneficiaries. Other goals include turning Spain into a hub for the video games industry and boosting the country's sport sector.

"The country cannot wait for the funds," says Manuel de la Rocha, the official entrusted by Prime minister Pedro Sánchez to keep track of the resources. "We have a very difficult economic situation, with an 11 per cent fall in GDP last year, and we need to inject funds into the economy right now . . . and accelerate the absorption of these resources."

But critics of Sánchez's Socialist-led government demand more transparency over how the funds will be allocated, as they voice concerns about the power the prime minister will wield over the resources.

The anti-bottleneck legislation, which set out the government structures responsible for co-ordinating the funds, was opposed by the main opposition

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People's party, the centrist Ciudadanos grouping and Catalan nationalist MPs — only passing because of the abstention of the hard-right Vox party. Pablo Casado, the PP leader, argued it would give the prime minister "a free bar" and lead to "clientelism" that ends in corruption.

The government has rejected opposition calls for an independent agency to administer the funds, arguing that setting up such an institution would waste valuable time and that it would be overwhelmed by the task.

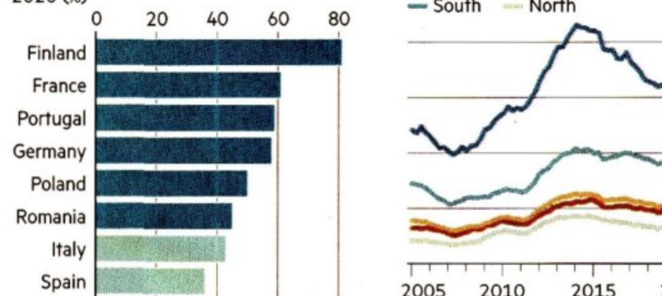
"The government has shown it is willing [to carry out reforms], but governance is a huge issue, with political fragmentation and the rise of populism across southern Europe," warns Toni Roldán, director of the centre for economic policy at Esade business school in Madrid. "I fear that with this windfall of money, there will not be substantial reforms. And the commission has little room for manoeuvre, since they would be terrified of assuming the political cost [of halting payments of funds]."

Similar concerns swirl around Italy, which is acknowledged among EU officials and diplomats to be behind Spain when it comes to drawing up its recovery plan before an April 30 target date. Business leaders warn that the existing draft plan, which set out priorities including digitalisation, energy transition, health and education, lacks crucial detail on governance and procedure.

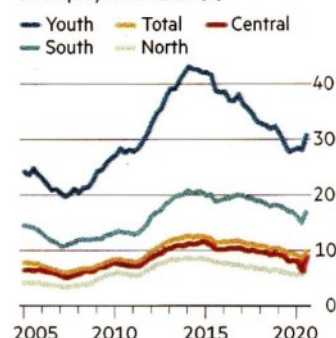
The commission also faces a hugely difficult task as it prepares to police the countries' plans. Withholding recovery fund money if countries fail to hit their reform and spending deadlines and targets would trigger political uproar. Yet Brussels cannot afford to preside over a project that becomes tainted by squandered billions, abandoned projects and lost opportunities for economy-boosting reform.

Bussink, who has profited by finding ways to navigate Italy's administrative barriers, stands to lose out if Draghi is successful in overhauling Italy's economy as part of its recovery plan. But he is not overly concerned.

"If shipping got super-efficient here it would hurt me for sure," he says. "That still wouldn't take away the bureaucracy. That is the most painful thing, and the hardest thing to resolve."



Source: European Commission



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