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RESEARCH NOTE

Winners of the Italian Recovery Plan (With or Without Draghi)

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The €200 billion Italian Recovery and Resilience Plan is entering the implementation stage and with it comes a number of lingering questions. Is Italy on track to pass reforms that would condition the full amount of disbursements in the next five years? Will the required bureaucracy involved in the allocation, accounting, and reporting of the flows be carried out? Will there be enough capacity to absorb this amount of funding and, if so, what sectors stand to benefit?

The election of the next president hangs on all of these questions—but it doesn't have to. With the plan structured and operationalized, the bureaucratic machine needed to implement it was set in motion, and whomever assumes the role of prime minister will have a limited influence on its functioning.

Warranted, should Prime Minister Mario Draghi move to the presidential post—the most likely outcome—the reformist impetus may weaken, and this would have consequences for Italy's long-term growth prospects. However, European institutions will have to green-light each future disbursement after having assessed the achievement of a detailed set of milestones and targets attached to each project in the plan[1] so that a strong incentive to reform will remain.

The recovery plan could be seen as a softer version of the structural adjustment plans Southern Europe and Ireland went through. In the short term, we regard early elections as highly unlikely, as they go against the interest of all parties in the current majority and, in any case, they are scheduled for next spring.

The presidential elections will thus likely amount to much ado about nothing. We think the €200 billion will be disbursed in full. Which sectors stand to benefit? We examine this question below and detail major interventions and their resulting impact at sectoral level.

1) Reforms & Administration

The Italian Recovery and Resilience Plan ("Piano nazionale di ripresa e resilienza," henceforth PNRR) presents several legislative reforms aimed at reducing the bureaucracy and the constraints that limit growth and, as a result, the achievement of the main objectives of the PNRR: increasing productivity and creating a more sustainable and inclusive economy. If properly implemented, these reforms have great potential in the long run, but they are unlikely to foster particular sectors in the near future.

The main reforms are on track. The competition law, budget law, and a series of decrees delineating the government-proposed interventions on the tax system, the justice system, civil, penal and tributary trials have been completed by the end of this year, as planned. There are questions about the quality of the reforms, as some government proposals are not the transformative interventions many hoped for (e.g., a thorough shift of taxation from labor to wealth), but this is a risk for future growth, not for the recovery fund money to be disbursed.

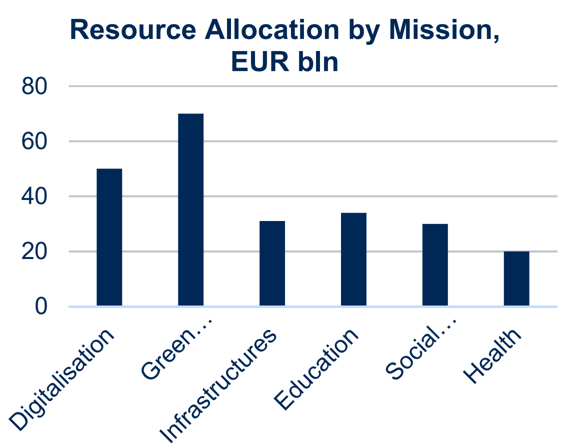
[1] See Section 6, Monitoring, for details on milestones and checks.

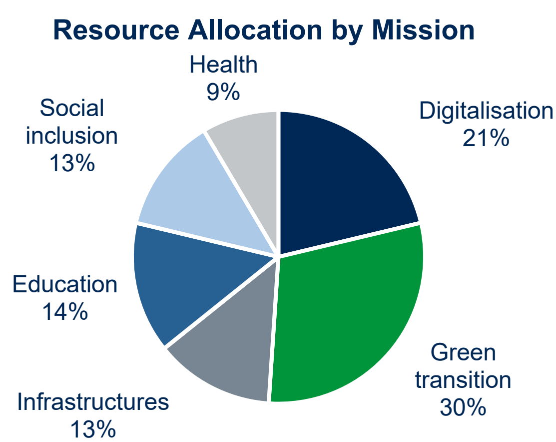
It is too early to understand how meaningful the risk of substantial, remaining unspent amounts is. Early reports suggested that just over half of the resources have already been allocated to those local, public entities that will manage the project. The election of the president of the republic should not impact the functioning of the administration of the funds; the projects have all been approved, so they cannot be altered.

2) The Recovery Plan Structure

The PNRR details the way the €205 billion funded by the European Union (EU) through grants and loans will be spent. Six missions identify the main areas of intervention; there are an additional €30 billion financed directly by Italy for projects considered to complete the PNRR but were not financed by the EU. The total resources mobilized amount to 14.3% of GDP.

The resources are allocated to six missions, as outlined in the following graphs:





Source: Piano nazionale di ripresa e resilienza, Ministero dell'Economia e Finanza. May 2021.

Roughly half of the resources are allocated to digitization and the green transition; the rest of this note focuses on them. The sizeable spending items in other missions are presented briefly in Table 1 below:

TABLE 1: TOP 10 SPENDING ITEMS BY AMOUNT

Item	EUR bn	% GDP
Railways upgrade	24.7	1.5%
Buildings energy efficiency	15.3	0.9%
Education	14.4	0.9%
Manufacturing digitalization (Industry 4.0)	14	0.8%
Academic research upgrade	11.4	0.7%
Urban regeneration	9	0.5%
Sustainable transportation	8.6	0.5%
Hydro-geological safety	8.5	0.5%
Healthcare technological upgrade	7.4	0.4%
Regional/local healthcare upgrade	7	0.4%
Total top10 items	120.3	7.3%
Total EU Funds	205	12.4%
National investment fund	30	1.8%
Grand total	235	14.2%

Source: Piano nazionale di ripresa e resilienza, Ministero dell'Economia e Finanza. May 2021.

3) Green Transition: The Biggest Mission

The green transition represents the PNRR's biggest area of spending: €70 billion, roughly one-third of the total. To reduce CO_2 emissions, the plan focuses on increasing the energy efficiency of buildings, greening transportation, energy production, and hydrogeological safety.

- €15.3 billion (0.9% of GDP) allocated to **make private and public buildings more energy-efficient**. Buildings' heating and cooling represent one-third of energy consumption. The allocation is expected to increase the energy-efficiency of 100,000 buildings, each estimated to reduce its energy consumption by 30-40%.

    - Measures include a 110% tax break on heat isolation, efficient windows and fixtures fitting, new generation conditioning systems and renewable energy production systems fitting. The tax break is conditional on the building upgrading its energy class by two notches.

    - ***IMPACT***: Construction sector, and in particular energy-savings fixtures, heating systems and small-scale renewables production units.

- €8.6 billion (0.5% of GDP) assigned to **double the share of commuting with public transport.** This involves the construction of 230 km of public network projects, between metro (11 km), tram (85 km), bus (120 km) and cable cars (15 km). The bus and train fleet will also be upgraded, with the most polluting vehicles being replaced by low-emission substitutes.

  - The creation of 570 km of new cycle paths and installation of 20,000 car recharge points will flank these initiatives.

  - ***IMPACT***: Road and transport infrastructure construction companies, high-efficiency vehicles producers.

- €13.2 billion (0.8% of GDP) to bring the share of **renewable energy** in the consumption mix from the current 20% to 30% by 2030.

  - Financial and fiscal incentives target solar-powered agri-businesses, off-shore wind turbines, self-production (micro-plants), bio-methanol and hydrogen production, digitization of grids (smart grids), and hydrogen distribution.

  - ***IMPACT***: Renewables producers, hydrogen sector, big and small production units' producers, utility companies.

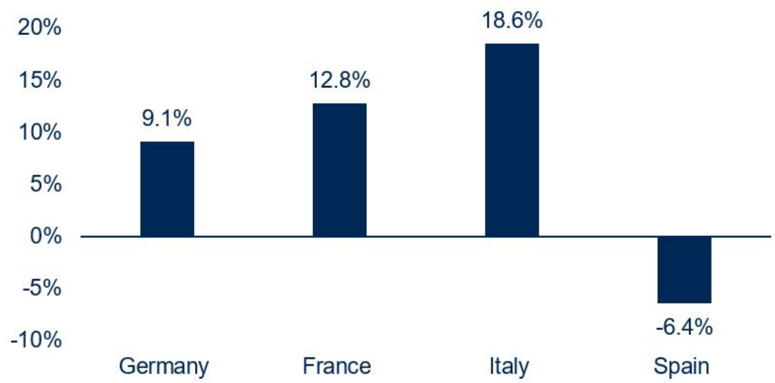
- €15.3 billion (0.9% of GDP) will be used to fight the **hydrogeological damage** and safeguard the territory in light of increased risks due to climate change.

  - The works will focus on the safety of dams, rivers, and local authorities' buildings, as well as rewilding projects, modernization and protection of the water management system and supply, reducing waste, and the need for emergency interventions.

  - ***IMPACT***: Construction sector, water utilities, water management facilities construction companies.

The construction sector, both in real estate as well as infrastructure, stands out as the most evident winner. The impact on the sector is already visible, with a proper boom already underway in Italy. In Q3 2021, the added value generated by the Italian construction sector was already 19% above pre-COVID levels, the fastest growing among major EU economies (see graph below). High-frequency activity measures, such as construction PMIs and monthly construction output, point towards continuing acceleration in this sector.

CONSTRUCTION SECTOR GROWTH (BASELINE Q1-2020)



Source: Haver, national statistical offices. May 2021.

4) Digitization

Italy is pursuing a different path from other EU countries. Recognizing both the strength of its industrial sector (second-largest EU exporter, after Germany) and its weakness (small size of firms, limited ability to fund R&D and internationalization), the PNRR focuses most of the spending on furthering investment in the **digitization of manufacturing firms (Industry 4.0).**

- This segment accounts for €14 billion and consists of tax breaks for firms investing in the digital transformation of productive processes and intangible goods (i.e. specialized software).
- Tax credits will be recognized for firms investing in: a) capital goods used in digitizing production; b) R&D, and; c) workforce training and education on digital productive processes and related know-how.
- ***IMPACT***: Digital support/specialized software companies; cutting-edge companies investing in Industry 4.0, and increasing international competitiveness (likely the export champions).

The second-biggest item is **connectivity**, which targets having 1 gigabyte/second broadband and a 5G network throughout the entire country by 2026.

- The coverage of "market failure areas" (i.e., areas where it is not economical to install high-speed connectivity), is also identified, as are efforts to reduce bureaucratic requirements for small and major enterprises working on the construction and maintenance of the networks.
- ***IMPACT***: Telecommunications and telecommunication infrastructure companies.

The third item is the **digitization of the public administration (PA),** a package aimed at transitioning interactions between the PA and the public to digital platforms—all of which are connected in a single cloud-based data lake, creating greater efficiencies across all PA sectors.

- Main areas: cloud infrastructure construction, data interoperability system across the PA, training and support for these PA transitions, strengthening of existing digital platforms (e.g., payment systems to and from the PA), cybersecurity, and vertical integration of digital structure for key PA sectors (Justice, Defense, Social Security and Internal Affairs).
- ***IMPACT***: Cloud services, data management software, cybersecurity and related companies.

5) Other Major Spending Items

Smaller undertakings include various big-spending items—the single biggest spending item in the PNRR involves a major investment in the improvement of the **railways**. It includes €24.7 billion in funding (or 1.5% of GDP) and is far reaching.

- Main improvements: extension and stronger integration of high-speed national and regional networks, modernization of obsolete regional networks, extension and improvement of intra-modal (railway-motorway-port-airport) systems, and new public concessions for railway services connecting ports, airports, and terminals (both passenger and cargo).

- Digitization of management systems (introduction of the ERMTS[2]), upgrading obsolete regional networks, and expansion of metropolitan hubs take up the rest. Easier access for new business/services are also pursued with legislative simplifications.

- ***IMPACT***: Railway management companies, high-speed train systems, digital railway transportation management systems.

- €14.4 billion (0.9% of GDP) is invested in **education** with a plethora of interventions, most with high-growth enhancing potential in the long run, but unlikely to create immediate gains.

  - Measures with high, short-term impact: a) expanding the available nurseries, funded with €4.6 billion (0.3% of GDP) and b) the school safety and requalification plan, which aims at restructuring obsolete school buildings, while also upgrading their energy efficiency. This second plan is funded with €3.9 billion (0.2% of GDP).

  - ***IMPACT***: Construction sector.

Urban Regeneration (€9 billion – 0.5% of GDP):

- Financing local authorities' urban requalification/upgrade projects in deprived, inner-city areas (e.g., transforming abandoned public buildings in social-cultural centers, demolishing unauthorized buildings), social housing, and urban plans aimed at closing the infrastructural gap and connecting regional urban centers with their surroundings.

- ***IMPACT***: Construction sector.

Technological Updating and Digitization of Healthcare System (€7.4 billion or 0.4% of GDP):

- Purchase of 3,200 new machines (TAC (computerized axial tomography), MRS, linear accelerators etc.), expansion of intensive care units (+8,000 beds), and transportation for critically ill patients.

- Digitization of the healthcare provision with the extension of the Digital Health Personal File to all patients and centralized data management for better provision of healthcare services, as well as better planning of future healthcare needs in the country. Investments in healthcare research and personnel training and skill development, and scholarships for medical students will be included.

- ***IMPACT***: High-tech healthcare system manufacturers, ICU system providers, data management and cloud infrastructure.

[2] ERTMS ("European Rail Traffic Management System"), an EU project, is the European standard for train command and control systems. It aims at creating an interoperable railway management system across Europe, making rail operation between the Member States more integrated. It's a part of the decade-long Single European Railway Area project.

Regional health (€7 billion or 0.4% of GDP):

- Measures aimed at decentralizing the healthcare provision from major hospitals to local ones, and to patients' homes. Creation of 1,300 "community homes" by 2026—a sort of "one-stop shop" for all local healthcare services—should substitute the multitude of specialized hospitals and provide care for chronically ill patients. It also includes the creation of a local coordination hub in each of the healthcare districts of the country, which will help coordinate local healthcare provisions via Community Homes, with a shift towards telemedicine.

- ***IMPACT***: Telemedicine system providers, cloud and data management services for the healthcare sector.

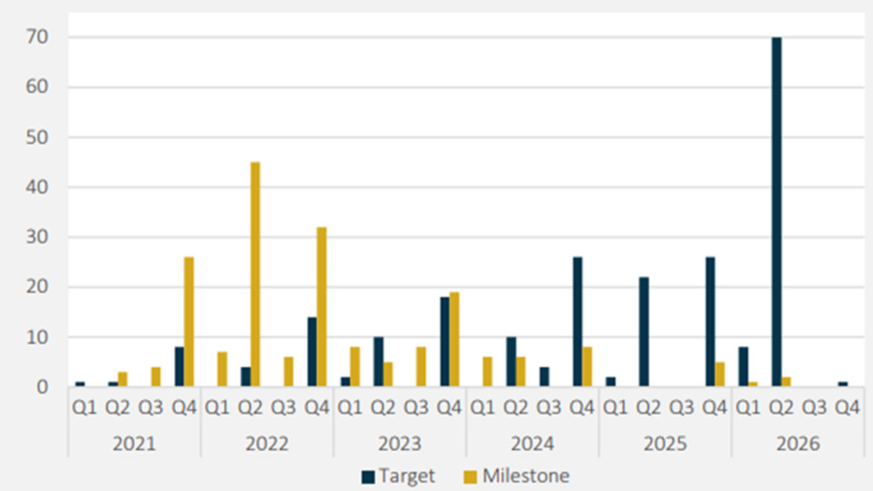
6) Monitoring

The funds will be disbursed in 10 bi-annual tranches, between August 2021 and 2026. Each tranche disbursement is conditional to satisfying milestones and targets that are detailed for each of the 100+ projects. Milestones are qualitative in nature and are typically reform requirements, while targets are quantitative.

To properly monitor the plan, achievement of targets, and fraud prevention, the Ministry of Finance created a taskforce that coordinates lower-level public administration entities, centralizes accounting, and reports directly to PM Draghi. The European Anti-Fraud Office, or OLAF, and external auditors will work with the ministry's taskforce and assess implementation.

Milestones (reforms) are more predominant in the plan's initial years, while most projects will reach assessable quantitative targets after the plan has been implemented for several years. This may be seen as a risk, as milestones are vague and can be achieved even if bad/incomplete reforms are enacted. In this case, it will however be evident that the ability of the government to implement reform and correct the country's structural problems is limited. Indications that this is happening have not surfaced so far, but we will keep a keen eye on the reform performance of the next government, and whoever will head it.

Fig. 1: Distribuzione temporale di milestone e target



Fonte: Elaborazioni OCPI su dati schede PNRR.