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Donato Di Carlo & Marco Simoni

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ARTICLE

Constrained economic policy in Italy's dual-hybrid economy

Donato Di Carlo[a] and Marco Simoni[b]

[a]Luiss Hub for New Industrial Policy and Economic Governance (LUHNIP), Rome, Italy; [b]Luiss University Guido Carli, Rome, Italy

ABSTRACT

This article examines recent developments in Italy's economic and fiscal policymaking. It does so by contextualising the 2023 changes in the Italian National Recovery and Resilience Plan (NRRP) within three broader aspects which have characterised the Italian political economy: (1) the country's conservative fiscal trajectory inside the monetary union (EMU); (2) the expansionary economic policies pursued in the face of both the pandemic and energy crises; (3) the peculiar characteristics of Italy's 'dual-hybrid economy'. The article posits that, since the EMU, Italy has continuously run primary budget surpluses higher than its EMU peers. Only since Covid-19, and with the relaxation of EMU constraints, has Italy's fiscal stance turned expansionary. This has allowed space for various socioeconomic policies to partially shield households and firms from the crises' fallout. However, with a return to fiscal conservatism, the NRRP now represents the only game in town to try and address Italy's dual hybridity characterised by weak state capacity and supply-side institutional inconsistencies as well as two diametrically opposed regional growth regimes in the North and the South.

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Introduction

On 23 November, the European Commission (EC) formally approved the Italian government's changes to the National Recovery and Resilience Plan (NRRP). The Italian plan is the largest among the national post-Covid EU investment programmes designed under the umbrella of 'Next Generation EU' (NGEU) and comprises both grants and EU-backed loans. As a result of the changes, the plan has been slightly enlarged, now totalling €194.4 billion and including seven new reforms, for a total of 66 reforms adopted as 'self-imposed' conditionality to obtain the funding.

During 2023, discussions on the NRRP in Italy focused on the difficulty of implementing such a large plan in such a short time horizon.[1] An interim report by the national Court of Auditors in March 2023 (Corte dei Conti 2023) highlighted that half of the NRRP projects were still at an initial phase of development. The Court warned that a marked acceleration in the projects' implementation was necessary for the investment plans to be successfully realized by 2026 and underlined that amendments were needed to overcome the

CONTACT Donato Di Carlo ddicarlo@luiss.it Luiss Hub for New Industrial Policy and Economic Governance (LUHNIP), Rome, Italy

uncertainty associated with several projects. The NRRP revision has deleted or reconfigured several projects while increasing the resources for those related to the green energy transition with the inclusion of Italy's RePowerEU plan (see the third section) in the NRRP. After the successful NRRP revision, Italy asked the EC for payment of the fifth funding instalment, which will bring the sum already disbursed by the EC to around €110 billion, above half of the total (Presidenza del Consiglio dei Ministri 2023).

This article examines recent trends in Italian economic policy. It will show that given Italy's limited fiscal capacity, the NRRP constitutes the country's main, if not its only, policy programme promising to have a meaningful economic impact. In fact, given the fiscal constraints imposed by the Economic and Monetary Union (EMU), managing the Italian economy remains a daunting task for any government due to the very high levels of public debt, the Italian economy's longstanding structural weaknesses and marked regional inequalities.

In the last twenty years, every European country has been subject to international shocks with adverse economic implications: the global financial crisis (GFC) first, and more recently the COVID-19 pandemic and the energy crisis linked to the resurgence of inflation. In the case of Italy, however, these shocks have hit an economy that was already experiencing one of the longest periods of stagnation in modern history. Italian productivity growth has been so dismal that real GDP growth has stagnated since the late 1990s (Bugamelli et al. 2018), despite the total employment rate (as a percentage of the adult population) growing slowly, but steadily – and reaching in 2023 an all-time peak, from 57.4% in 2004 to 61.5%.

The inability of the Italian economy to grow at a satisfactory pace was first documented in the early 2000s, when it was attributed to the lack of total factor productivity growth (Daveri, Jona-Lasinio and Zollino 2005). Since then, a large body of literature has emerged attempting to identify the root causes of Italy's economic decline (for a review, see Krahé 2023). While some scholars have focused on demand-side weaknesses and the impact of European monetary integration (Baccaro and D'Antoni 2020; Guarascio, Heimberger, and Zezza 2023), others have emphasized supply-side structural inconsistencies (Simoni 2020). Other scholars have instead highlighted long-term political and/or economic factors such as the dominance of narrow vested interests, or persistent under-development of the *Mezzogiorno* (Capussela 2018), as well as a generalized restructuring of Southern European economies towards low value-added sectors and productive specializations, such as tourism (Bürgisser and Di Carlo 2023).

This article will examine recent developments in Italy's economic policy by placing the modifications of the NRRP and the 2024 budget law within the context of Italy's mid-term fiscal stance and the broader set of economic policies. The article is organized as follows. The second section presents data on Italy's fiscal policy since the launch of EMU and discusses governments' fiscal and economic policies since 2020, with a particular focus on the most recent budget laws. The third section details the changes made to Italy's NRRP during 2023. The fourth section introduces a stylized account of the characteristics of the Italian economic system, looking at both the supply and demand side. Finally, the concluding section provides a tentative analysis of Italy's prospects considering the peculiar characteristics of the Italian economic model.

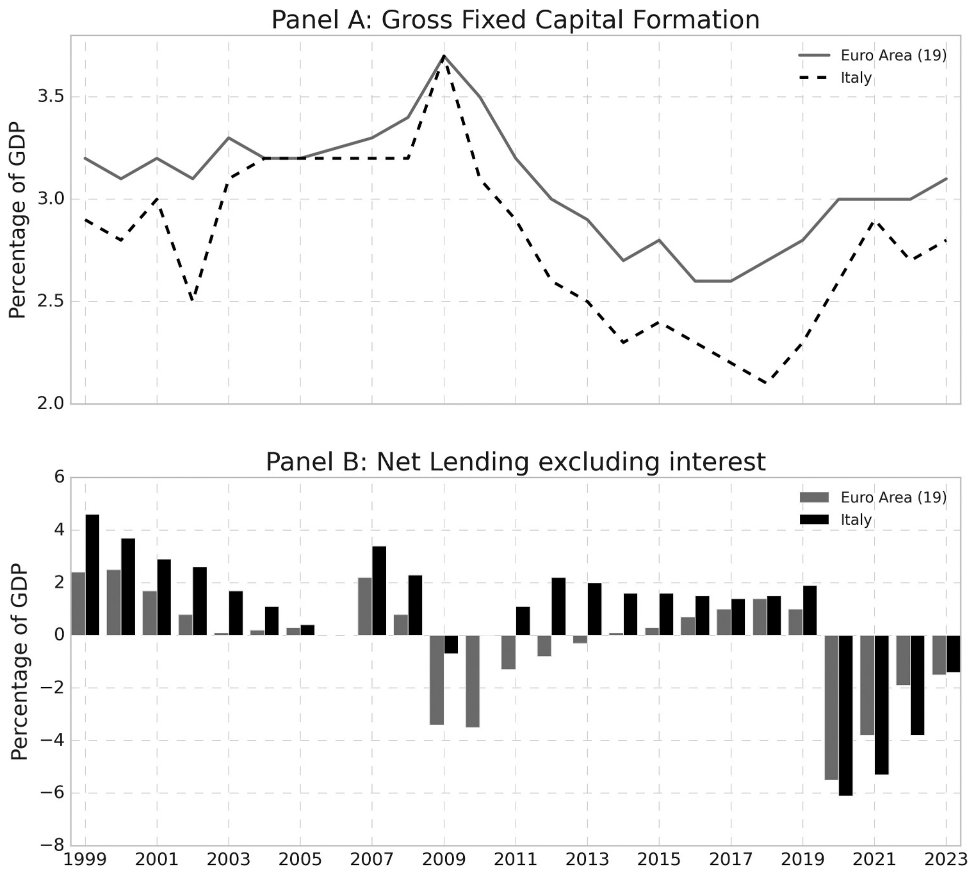

Figure 1. Public investment (panel A) and the primary balance (net of interest repayments, panel B) in Italy since launch of the European single currency, 1999–2023. Source: Authors' elaboration based on data from the AMECO database.

Trends and recent developments in Italy's fiscal policy

In this section, we analyse the fiscal stance of Giorgia Meloni's government during 2022–2023 by first situating it within a longer-term stylized analysis of Italy's public finance developments.

Since the launch of the single currency, Italy has been among the most fiscally conservative countries operating under the constraints of the Stability and Growth Pact (SGP). Italy's public debt had largely accumulated during the 1980s (Bastasin, Mischitelli, and Toniolo 2019). Yet, since the late 1990s, Italy has reported primary surpluses (i.e. public spending net of interest repayments) virtually every year (Figure 1, panel B). Before the GFC, Italy's primary surplus was higher than the Eurozone average on a yearly basis. Italy ran a primary deficit only in 2009, when the US-borne financial crisis eventually hit Europe. Still, even then, the fiscal resources employed for economic stabilization were considerably smaller than the Eurozone average in 2009. Italy rapidly returned to primary surpluses

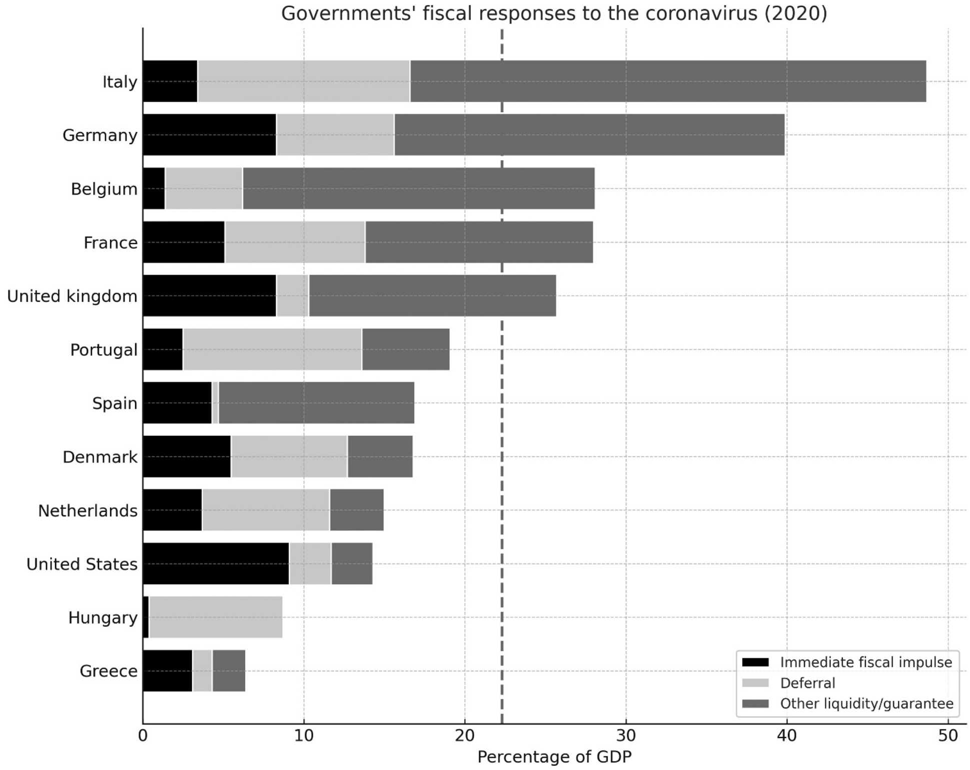

Figure 2. Italy's 2020 fiscal response to the economic fallout from the COVID-19 pandemic in comparative perspective. Source: Authors' elaboration based on Bruegel's dataset, 'The fiscal response to the economic fallout from the coronavirus'. *Notes*: The ratio of the 2020 measures is calculated based on 2019 GDP. The category 'Other liquidity/guarantee' includes only government-initiated measures (excluding central bank measures) and shows the total volume of private sector loans/activities covered, not the amount the Government put aside for liquidity support or guarantee (the amount of which is multiplied to cover a much larger amount of private sector activity).

through austerity measures implemented under the aegis of 'informal conditionality' by the ECB (Braun, Di Carlo, Diessner, and Düsterhöft 2024; Sacchi 2015).

During the last decade, public investment has decreased or stagnated across Europe, even in countries spared the effects of the sovereign debt crisis like Germany (Bremer, Di Carlo, and Wansleben 2023). In Italy, public investment collapsed between 2008 and 2018, decreasing from 3.2% to 2.1% of GDP – well below the average of the Eurozone countries (Figure 1, panel A).

It was only after the outbreak of the COVID-19 pandemic, in 2020, that Italy's fiscal stance turned more expansionary than the Eurozone average. Italy, however, was the country to be hit first and most heavily by the pandemic in January 2020, with the government implementing lockdowns and compensatory social policies to manage an unprecedented economic shock and the health emergency (Bull 2021).

During 2020, Italy's fiscal response to the economic fallout from the pandemic was the largest among the major EU countries, totalling almost 50% of national GDP, followed by Germany, Belgium and France (Figure 2).

However, likely due to differences in country-specific fiscal capacity, the composition of Italy's fiscal package differed greatly, for example, from that of Germany. In Italy, the fiscal resources earmarked for the 'immediate fiscal stimulus' to the economy were much lower than in Germany – and in fact lower than in most of the other countries. Italy's adjustment came predominantly in the form of tax deferrals and guarantees to the private sector, which do not imply a direct and immediate disbursement of fiscal resources. Tax deferrals constitute a form of temporarily foregone tax revenues, but contingent liabilities, such as guarantees, may end up weighing on the Government's finances at a later stage, possibly impacting the country's fiscal space for a longer period.

In 2021, GDP was gradually returning to pre-Covid levels (Table 3) and the Government shifted towards a more restrictive fiscal stance, hoping to rein in the budget deficit by 2024–25. At this point, a technocratic government led by former ECB President, Mario Draghi, passed the 2022 budget and finalized the negotiations of the NGEU programme with the EU, supported by a large coalition.

Draghi's ambition to reduce the public deficit was jeopardized by Russia's invasion of Ukraine in February 2022, and the ensuing energy *cum* inflation crisis which spread across Europe. To shield vulnerable households and firms from the inflationary effects of the energy crisis, the Government enacted various social and economic policies backed by large fiscal resources. Measures ranged from reductions in energy taxes and value added taxes, to social transfers to vulnerable groups and various support measures for private companies – see Table 1 for a more detailed overview.

Overall, under the Draghi government, Italy's fiscal response to the energy crisis was larger than that of most other European countries. Data from the think tank Bruegel indicates that Italy allocated on average €1,572 per capita in compensatory fiscal resources, much above the average of the European countries considered in the sample (see the grey, dashed line in Figure 3 below), but below the level of Austria (€2,364), the Netherlands (€2,226) and Germany (€1,894).

During Draghi's tenure in government, Giorgia Meloni had strategically remained in the opposition camp, vocally signalling her party's hostility to the executive. In Italy, since 1996, the main opposition party has always ended up winning the subsequent general election. The year 2022 proved no exception. This was also the first time since 2008 that elections had delivered a clear political majority. In short, after the 2022 elections, the Italian political landscape was profoundly transformed: a technocratic government supported by parties from across the political spectrum was replaced by a right-wing majority coalition consisting of Fratelli d'Italia (Brothers of Italy, FdI), Forza Italia (FI) and the Lega (League).

Yet, despite changes in the political complexion of the parties in government, economic and fiscal policies remained largely unaltered between 2021 and the end of 2023. Notwithstanding the suspension of the SGP at the start of the pandemic in 2020, the three most recent budget laws (2022, 2023 and 2024, approved in December of the preceding year) showcase the governments' major preoccupation with restoring Italy's balanced budgets while preserving the country's reputation vis-à-vis international financial observers.

Table 1. Measures implemented between 2021 and 2022 to counteract the inflation crisis linked to the covid-19 second wave and the energy crisis, Italy.

Date	Earmarked or Intended Resources	Types of Measure	Intended Effects
27 September 2021	€3 billion total; €2 billion for electricity charges, €480 million for gas bills, CO2 auctions, National Fund of Energy and Environmental Services	Short-term energy price measures	Measures aimed to counter the expected rise in retail power prices by eliminating general system charges in the electricity sector and reducing charges on gas bills.
Oct-Dec 2021	VAT reduction costs; €450 million for social bonus	VAT reduction, social bonus strengthening	Reduction of VAT on natural gas supplies to alleviate the financial burden on consumers and strengthening of the social bonus for families facing economic hardship or serious illnesses.
9 December 2021	€2.8 billion + additional €1 billion	Supplement spending for 2022	Supplementary budget allocation to sustain ongoing measures for energy price containment in 2022.
18 December 2021	€1.8 billion for electricity users, €480 million for gas bills, €608 million estimated revenue loss, €912 million for social bonus	Various measures for 2022	Elimination of system charges for electricity and gas users, reduction in VAT, and increase in social bonus to aid households and small businesses and mitigate the impact of rising energy costs.
12 January 2022	-	Corporate tax increase	Implementation of a tax increase on energy companies profiting from high power prices to generate additional revenue for the state.
21 January 2022	€1.7 billion	New measures against high bills	Introduction of a 20% tax credit for energy-intensive companies and a windfall profit tax on renewable energy producers to support businesses affected by high energy costs.
19 March 2022	€4.4 billion; funded by a 10% windfall tax on energy companies	Social bonus expansion, fuel price reduction	Extension of the social bonus to more households and reduction in petrol prices, financed through a windfall tax on energy companies.
21 April 2022	€8 billion; including a fund of €800 million for the automotive sector	Various economic measures	Maintenance of zero system charges on electricity bills, fixed VAT on gas bills, extension of social bonus, and introduction of tax credits for energy-intensive companies. Measures also include support for the automotive sector and renewable energy installations.
2 May 2022	€14 billion	Comprehensive support package	A broad package including €200 one-off bonuses for workers and pensioners, tax cuts for civil servants, funding for businesses trading with Russia, Ukraine, and Belarus, and incentives for SME investments. Extension of the Superbonus and social bonus for energy expenses, along with a prolonged cut in fuel excise duty.
End of June 2022	€3 billion	Decree to lower energy bills	Continuation and expansion of measures to mitigate the increase in energy bills, including maintaining unchanged general system charges for natural gas and implementing a social bonus for less well-off families.

(*Continued*)

Table 1. (Continued).

Date	Earmarked or Intended Resources	Types of Measure	Intended Effects
End of July 2022	€13 billion + €2 billion	'*Aiuti bis*' draft-bill	Extension of measures such as VAT and fuel levy cuts, cancellation of taxes on energy bills, and support for towns and the transport sector. Introduction of a higher tax-free limit for company bonuses used for household bill expenses and extension of tax credits for businesses.
13 September 2022	€17 billion	*Aiuti-bis* bill	Extension of smart working for vulnerable workers, formation of a Parliamentary Committee for Security, permanent hiring of temporary workers in the Public Administration, and modification of liability rules for the Superbonus.
16 September 2022	€14 billion	*Aiuti-ter* decree law	Enhanced tax credits for businesses, increased social bonus for households, a one-time bonus for low-income individuals, and new allocations for public transportation bonuses.
11 November 2022	€9.1 billion	*Aiuti-quarter* decree	Modification of the Superbonus, extension of tax credits for businesses, continuation of reduced excise duties, and provision for instalment payment plans for energy bills.
22 November 2022	€35 billion	2023 budget	Introduction of a higher windfall profits tax on energy companies, allocation of funds to support households and firms with high energy prices, extension of zero system charges for electricity users, and various measures to alleviate the impact of energy costs on low-income individuals.

Source: Authors' elaboration based on Bruegel's Dataset, 'National fiscal policy responses to the energy crisis'.

When comparing the 2022 (Draghi) with the 2023 and 2024 (Meloni) budget laws, the main differences can be traced to a relatively limited number of items, mostly aimed at paying lip service to election pledges without significantly altering Italy's fiscal trajectory. In 2023, Meloni considerably reduced – by tightening conditionalities and rebranding it – the so-called 'citizens' income', an income subsidy for poor individuals and households introduced by the Five-star Movement in 2018. This created some of the fiscal room needed to approve an increase in public-sector wages and other, smaller, expenditures for family policy.

The 2022 budget introduced by Draghi included extra spending of €45.3 billion, i.e. an increase in the deficit of 1.3% of GDP. The main expenditure headings included health, the continuation of the fiscal stimulus in support of the construction sector (*Superbonus* and *Ecobonus*), and support measures introduced during the pandemic, e.g. for home renovations and energy efficiency. There was a temporary reduction in the tax wedge (*cuneo fiscale*) for low earners, various forms of liquidity support for firms, and other

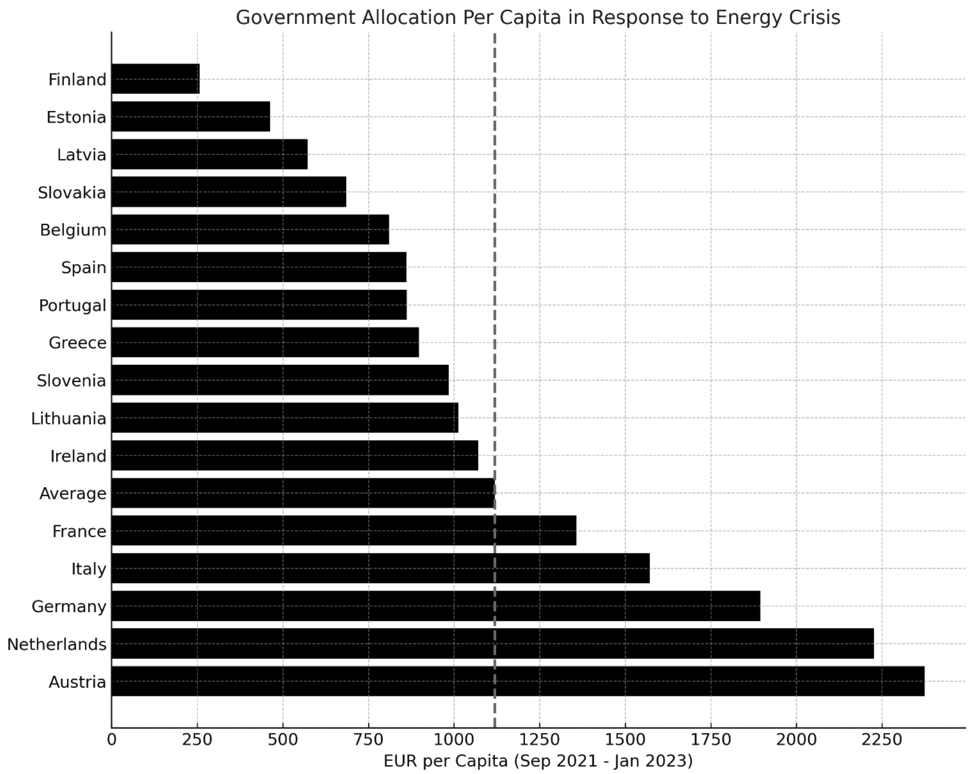

Figure 3. Governments' earmarked and allocated funding to shield households and firms from the energy crisis (Sep 2021 - Jan 2023), € per capita. Source: Authors' elaboration based on Bruegel's dataset.[2]

forms of financial support for a variety of economic sectors (MEF 2022). The Superbonus programme was approved in 2020 as a mid-term expansionary measure and broad-based subsidy to the private sector. It aimed to support the construction sector and enhance buildings' energy efficiency, with a prolongation until 2023. As explained earlier, the use of tax credits or other deferred guarantees has spread the financial costs of the economic adjustment over the subsequent years. Specifically, the cost of this policy exceeds €100 billion for the period 2022–27, and the Bank of Italy estimates the measure's multiplier to be around 1. That is, the stimulus roughly corresponds to its cost. However, the measure is regressive in distributive terms, and has exacerbated inflationary pressures on the sector due to excess demand (Banca D'Italia 2023).

At €23.6 billion, the expansionary stance of the 2023 budget – the first approved by the new right-wing coalition – was roughly half that of the 2022 budget, then further reduced to €21.3 billion in 2024. In 2023, the main expenditure items revolved around the continuation of some of the subsidies to counteract the increase in energy prices, and the continuation of Draghi's cuts in the tax wedge for low-income earners. In 2024, by contrast, only the latter was continued, which accounted for roughly one half of the total additional disbursement. Table 2 details the spending items contained in the 2024 budget, approved in December 2023. Additional fiscal room was created by eliminating various expenditure items altogether.[3]

Table 2. Key measures contained in the 2024 budget with related earmarked resources.

	Main Measures	Earmarked resources (€bn)	Earmarked resources (%)
Real incomes' support	Extension of labour tax cuts	~10	41.7
	Tax cuts for lower-middle classes personal income tax (IRPEF Reform)	~4	16.7
Refinancing of public sector wage-setting;	Funding for the national health service, in particular, to renew contracts	~3	12.5
Social policies	Funding to renew public sector collective agreements	~5	20.8
	Funding for family policy and pro-natal policies	~1	4.2
Miscellaneous items		~1	4.2
TOTAL		**24**	**100%**

Source: Authors' elaboration based on Italy's Draft Budget.

Table 3. Selected macroeconomic indicators for Italy, percentages of GDP, 2019–2025*.

	2019	2020	2021	2022	2023*	2024*	2025*
Public balance	−1.5	−9.5	−8.8	−8	−5.3	−4.3	−3.6
Primary balance (net of debt servicing)	1.8	−6	−5.3	−3.8	−1.5	−0.2	0.7
Gross debt	134.6	154.9	147.1	141.7	140.2	140.1	139.9
Real GDP growth	0.5	−9	8.3	3.7	0.8	1.2	1.4

Source: Italy's NADEF 2023.

Over the last decade, the sovereign debt crisis and the pandemic have led to a deterioration of Italy's public debt. By 2020, public debt had reached 155% of GDP, then falling to around 140% in 2023 (Table 3) thanks to economic growth and high inflation. Table 3 indicates that, throughout 2021 and 2023, governments' fiscal stance was expansionary, although at a decreasing pace. That is, Italy took advantage of the relaxation of the SGP rules decided by the EU to pursue counter-cyclical fiscal policy to stabilize the economy and compensate households and firms affected by both COVID-19 and the energy crisis.

Draghi's 2022 budget was the most expansionary, still relatively close to the previous budget implemented during the pandemic, and included various measures to support households and firms. The subsequent budgets aimed at reining in the deficit and signalling virtue to the financial markets (Financial Times 2023).

Thus, while Italy's fiscal stance was expansionary between 2020 and 2023 – after two decades of recurring primary surpluses (Figure 1) – the honeymoon appears to be over. As the emergencies have been addressed, the Meloni government has now pledged to restore the soundness of Italy's public finances, following the track record of her predecessors. These preoccupations are motivated by Italy's high outstanding debt and have recently been reinforced by the agreement on the new SGP rules as part of the reform of European economic governance agreed by the European Council in December 2023 (Bastasin 2023). With Italy returning to austerity, it thus becomes increasingly important to turn to the NRRP as the only remaining opportunity for Italy to address its longstanding structural weaknesses and regional inequalities.

Next generation EU: reforms and investments

The Italian NRRP is part of the NGEU programme, negotiated and approved during 2021 by the EC and the Draghi government. The NGEU national plans (NRRPs) consist of two interrelated chapters: structural reforms and investment plans. EU funding to implement the latter is conditional on progress on the former.

In contrast with the past, conditionality is not imposed by the EU, but is 'self-identified', meaning that each country has had to propose and then agree with the EC a list of national structural reforms to be carried out. Such reforms should incentivize public and private investment, thereby increasing growth potential in the longer term. Once negotiated and agreed, national governments' plans require implementation so that, regardless of the political parties in power, countries are locked in and must comply with the scheduled multi-year trajectory of reforms and investment plans to access grants and loans provided by the EU.

As mentioned, in 2023 Italy succeeded in renegotiating its NRRP with the EC. NGEU rules make it possible for member states to apply for a renegotiation only due to unforeseen changes in material circumstances, such as higher construction costs due to an unanticipated inflationary shock. Italy presented its application in August, and the amended NRRP was approved by the EC in November. Changes to the plan are relatively limited but not insignificant in absolute terms. Total investments have increased by €2.8 billion, reaching €194.4 billion. Seven new reforms have been added, reaching a total of 66. Additionally, 123 single investment initiatives have been either changed or added, so that roughly €11 billion have been reallocated, mostly to fund new expenditure on renewable energy within the broader 'RepowerEU' framework. The inclusion of RepowerEU in the NRRP also accounts for five of the new reforms introduced (Camera dei Deputati 2023).

The Italian plan consists of three main reform domains. The first, referred to as 'Horizontal reforms', aims to improve state capacity, with reference to the public administration and judicial system. Italy's state capacity has been eroding steadily in recent decades, after years of fiscal austerity and inconsistent reforms, so that Italy ranks well below other EU countries in metrics of executive capacity (Capano and Lippi 2021). In this respect, four main sets of policies have been envisaged, namely: (1) the reform of recruitment procedures; (2) the general streamlining of administrative and bureaucratic procedures; (3) training and re-skilling in the public sector, including enhancing merit-based career paths; (4) the digitalization of the public administration. Regarding the judicial system, its inefficiency has long been singled out as a determinant of low investment in Italy, due to an unfriendly business environment where the enforcement of civil and commercial claims suffers from excessive delays in court proceedings (Esposito, Lanau, and Pompe 2014). The plan's declared ambition is to cut the average length of legal proceedings by half.

The second area relates to administrative simplification and competition policy. Dozens of reforms are planned in this area with the broad aim of streamlining the Italian legislative framework, while making it simpler and more predictable. The scope of interventions is very large, aiming at improving the quality of regulations on investment, public procurement, environmental regulations, corruption, urban planning, etc.

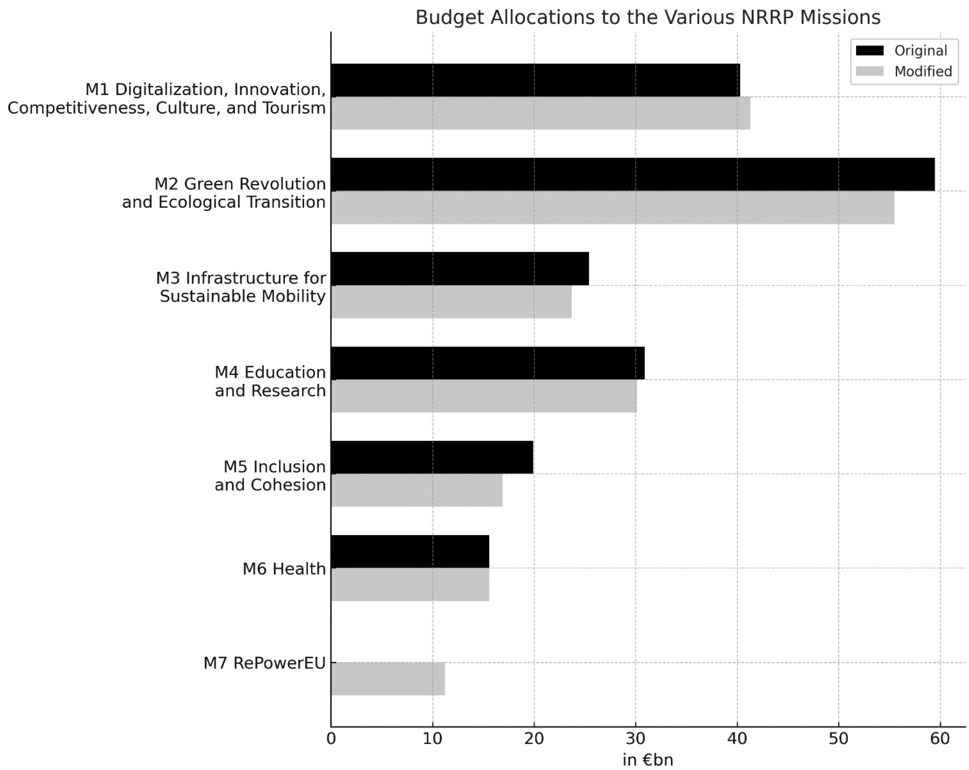

Figure 4. Variation between the original version and the modified plan of November 2023, in the resources allocated to the various missions of the NRRP. Source: Authors' elaboration based on OpenPolis data.[6]

The third domain envisages sector-specific reforms, which include dozens of specific interventions, ranging from education and research to transport, air pollution, energy, active labour-market policy, etc. Each reform aims at improving the regulatory framework and the institutional context within which the different sectors operate, with an eye to improving investment attractiveness and fostering economic growth. As mentioned, after the recent changes, the plan now also includes five reforms focusing on the green energy transition, as added after the negotiations with the EU.

With regard to the investment pillar of the Italian NRRP, the broad EU guidelines identify two overarching objectives, i.e. promoting the digital and green transition. To these, Italy has added the objective of promoting economic growth in the *Mezzogiorno*, Italy's Southern regions, which have historically lagged economic development in the rest of the country. To this end, Italy's NRRP stipulates that at least 40% of the total sums for investment projects must be earmarked for projects implemented in the Southern regions.[4]

Following the 2023 renegotiation, the plan was slightly amended to include a seventh mission: to the original six, 'RePowerEU' was added (Figure 4). Across the different missions, a few spending items were recalibrated to free up resources for new measures.

Some of the measures aim at enhancing the production of renewable energy. Others aim at increasing the diversification of energy supplies, thus reducing dependency on fossil fuels and on imports from non-EU countries. The distribution of expenditures in the rewritten plan is such that 25.6% of the resources are earmarked for the digital transition. This is only slightly above those envisaged in the initial NRRP. Up to 39% of resources are instead earmarked for the green transition, a notable increase from the initial 37.5% of the original plan.

The other investment measures included in the Italian NRRP are as follows. The first mission focuses on digitization, innovation capacity and competitiveness, as well as culture and tourism. Italy is far behind Germany and France in terms of broadband access, for example. Only Austria, Lithuania, Latvia and Poland among EU member states, have fewer broadband subscriptions than Italy.[5] Hence, one objective is to expand the coverage of ultra-fast broadband, paired with other types of investment projects to enhance innovation and competitiveness.

The second mission focuses on the green transition and includes enhancing waste management technologies and the energy efficiency of buildings, both public and private. The third mission focuses on physical infrastructure: railway and other mobility networks. This part of the investment plan has a strong focus on infrastructure investment in Southern Italy, where physical endowments lag behind those in the Northern regions (SVIMEZ, 2023: Ch.XVI). The fourth mission pertains to education and research. It includes improving Italy's early childhood education system, school buildings, universities' research facilities and platforms for technology transfers linking research institutions and industry. The fifth mission includes various measures to foster 'inclusion and cohesion', for example through the extension of special economic zones (SEZs) to the whole of Southern Italy with the objective of increasing foreign and national direct investment. It also includes new re-training programmes for workers in atypical employment, and infrastructural improvement in deprived rural areas. The sixth mission focuses on the health system and aims to enhance its resilience while fostering its modernization, especially in the post-Covid context.

Overall, the NRRP promises to be a vehicle for structural reforms and for (much needed: see Figure 1) public investment in Italy. However, such an ambitious plan is being implemented in an economic system that presents various supply-side structural weaknesses and marked regional inequalities, in terms of productive structures, sectoral specialization, and levels of economic development. In the remainder of this article, we approach our conclusions by introducing some basic concepts from the comparative political economy (CPE) literature and providing a stylized account of the Italian economy's supply and demand-side characteristics – useful for a very tentative assessment of the NRRP and a reflection on Italy's prospects.

Italy's 'dual hybridity'

Two main approaches to the study of different models of capitalism, and thereby of the Italian economy, can be identified in the CPE literature. The first is based on the analysis of ideal-typical supply-side institutions structuring, and regulating, economic systems and economic actors' interactions in the production process (Hall and Soskice 2001).

The second focuses on the demand side of the economy, namely the growth models/ regimes (Baccaro and Pontusson 2016; Hassel and Palier 2021), analysing the economy's key demand-side growth drivers: private consumption, investment, government spending, and net exports. Italy represents a peculiar case because, on the supply side, it has undergone a gradual process of incoherent 'hybridization' of its national economic system – meaning that it is neither a 'coordinated market economy' (like e.g. Germany), nor a 'liberal market economy' (like e.g. the US or the UK). Nor has it maintained a central role for the state in the direction and organization of the economy as in the post-WWII era (Shonfield 1968). On the demand side, too, Italy is *sui generis* because it is a country that incorporates two distinct growth regimes into a single national economy, namely an export-led growth regime in the Northern regions and a public sector-led regime in the Southern regions (Di Carlo, Ciarini, and Villa 2024). This has implications for both economic policy and the success of the NRRP.

In terms of supply-side hybridization, throughout the post-war era, the state in Italy had played a prominent role in structuring markets and in directing economic actors through e.g. state-controlled banks or large investment programmes in the South (Shonfield 1968). Scholars working within the Varieties of Capitalism paradigm have characterized the Italian system as a Mixed-Market Economy, where the state plays a prominent role in directing the economy and solving coordination problems among producers in various institutional spheres, such as industrial relations, social policy, and corporate governance (Molina and Rhodes 2007). However, due to its institutional weakness and its tendency to be captured by vested interests, the state's predominance in Italy has been increasingly characterized in negative terms (Della Sala 2004).

In the 1990s, Italy embarked on a wide range of reforms largely induced by the process of economic and monetary integration in the EU single market. The Government privatized state-owned enterprises and banks at a larger rate than any other EU country. It liberalized key strategic sectors hitherto sheltered from international competition and deregulated its labour and product markets, as well as enhancing market-based competition in the service sector (Baccaro and D'Antoni 2020; Guarascio, Heimberger, and Zezza 2023).

While these reforms have reduced the capacity and the reach of state-led economic governance, they did not move Italy towards a coherent model. By introducing elements typical both of Coordinated Market Economies (e.g. through greater centralization/ coordination in wage setting and industrial relations during the 1990s) and of Liberal Market Economies (e.g. in corporate governance and finance), Italian policymakers have transformed Italy into a hybrid and dysfunctional economic model (Simoni 2020).

Supply-side reforms have not enhanced state capacity either, which remains poor in comparative perspective (Capano and Lippi 2021). The inability of the state to coordinate the economy and provide modern services to households and firms remains a key impediment to economic growth and innovation (Bugamelli et al. 2018). The erosion of state capacity has been exacerbated further by the austerity measures prompted by the sovereign debt crisis in the 2010s (Sacchi 2015). Public sector wage-setting has been frozen for most of the past decade and, coupled with a concomitant decrease in public employment (Di Carlo, Ibsen, and Molina 2024), has contributed to a further deterioration of the public administration system. Subsequent reforms in the labour and financial markets have attempted to address some of Italy's major shortcomings. Some reforms in the 2010s aimed to reduce the

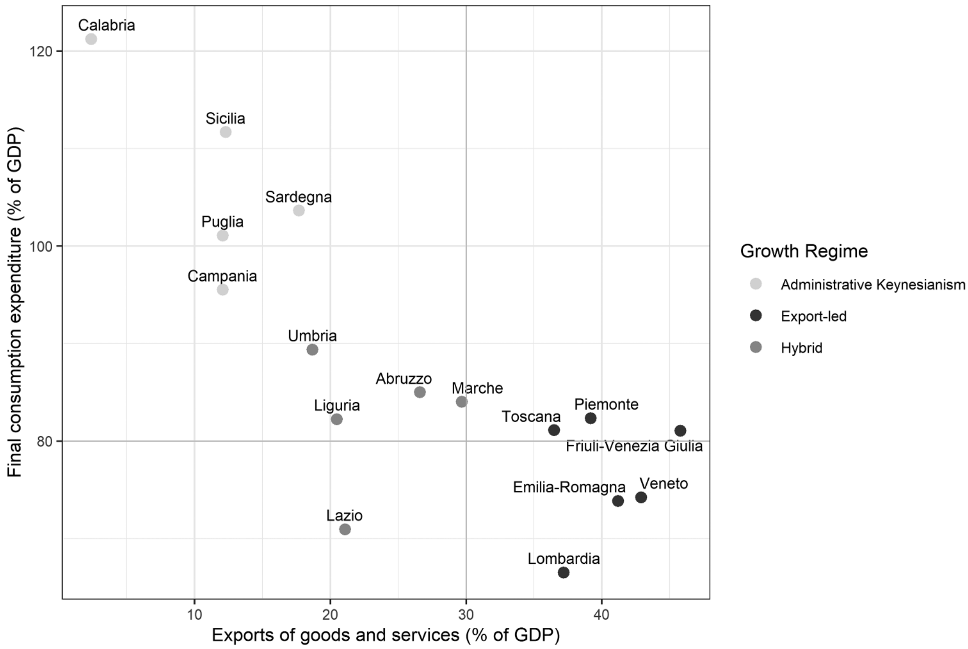

Figure 5. Export share and final consumption (public and private) as percentage of regional GDP in Italian regions, average values 2015–2019. Axes represent national average values for the selected variable. Source: Di Carlo, Ciarini, and Villa (2024).

dualization in the labour market, e.g. by curtailing the most extreme forms of liberalized employment contracts, and by introducing new unemployment insurance schemes (Galanti and Sacchi 2019). However, overall, public spending on education and social policy has been curtailed (Stefano and Vesan 2022). Other reforms have aimed at expanding the array of financial instruments available to companies, boosting the development of private equity funds, credit funds, and venture capital funds, both through less strict regulations and direct state intervention (MEF 2016). Thus, Italy remains an example of a hybrid model with several elements of structural incoherence and weakness.

When looking at the demand side of national economic systems, recent CPE scholarship has increasingly focused on the study of countries' growth models, i.e. the drivers of demand, on the assumption that demand rather than supply conditions drive investment and growth (Baccaro and Pontusson 2016). It has been argued that, in the context of a post-Fordist and increasingly globalized economy, countries have relied on only two main growth strategies, i.e. an export-led strategy (based on current account surpluses and subdued domestic demand, public and private), or a growth strategy based on domestic consumption sustained by real wage growth of debt-backed household consumption. Germany is a typical case of the former, while the UK is a typical case of a model driven by credit-based consumption. In contrast, Sweden has been able to combine both an export-led and domestic-led growth strategy driven by a large public sector and a prominent role for the welfare state

(Hassel and Palier 2021). Italy, however, has fallen between these models. The export sector is vibrant and strong, but not large enough to drive economic growth. The domestic demand sector is anaemic due to the lack of private credit for consumption and the regulatory constraints imposed by the single currency on public spending (Baccaro and D'Antoni 2020; Guarascio, Heimberger, and Zezza 2023).

Recent research (Di Carlo, Ciarini, and Villa 2024) has applied this perspective to the study of Italian regions' growth regimes. The authors identify two clear growth regimes within Italy. Figure 5 plots, for each region, levels of final consumption (public and private) as percentages of regional GDP (vertical axis), against levels of regional exports to the rest of the world as percentages of regional GDP (horizontal axis). The figure reveals the presence of two neat clusters, with Emilia-Romagna, Friuli-Venezia Giulia, Lombardia, Piemonte, Toscana, and Veneto clustering in the bottom-right corner of the figure as regional economies with high export shares and low regional consumption. Thus, Northern regions feature an export-led growth regime, driven by large export sectors stemming from a resilient regional manufacturing sector. In contrast, in Southern Italy (the upper-left quadrant in Figure 5), the authors identify a regime termed 'administrative Keynesianism' which indicates an economic system primarily driven by regional demand (public and private) underpinned by the state's use of consumption-enhancing social programmes (e.g. disability pensions, unemployment benefits, citizens' income) and other channels of fiscal spending, e.g. through a relatively larger public sector.

These findings dovetail with recent analyses of Italy's productive structure (see SVIMEZ 2023: Ch. VI). Northern Italy is characterized by a manufacturing-based economic system with a much larger presence of multinational groups and larger firms active in the metalworking, engineering, and chemical sectors. By contrast, manufacturing is much less developed in the South, which displays a model of sectoral specialization characterized by smaller firms. Overall, Southern Italy's sectoral specialization is rooted in the public sector and activities linked to low value-added private services such as wholesale and retail trade, and hospitality (SVIMEZ 2023: 129).

The regional approach to the study of growth regimes provides a useful heuristic framework against which to assess national economic and fiscal policies, especially in countries, like Italy, characterized by marked regional inequalities (Di Carlo, Ciarini, and Villa 2024). This is because the empirics provided by this approach is not limited to patterns of economic growth, but rather focuses on the drivers behind growth and employment creation in the regional economies. In other words, to be effective, national reform and investment programmes, like the NRRP, must necessarily take into consideration both the national institutional system which they promise 'structurally to reform', and the demand-side characteristics of regional economies as well as their productive structures.

Conclusions: Italy's economic policy in light of its dual hybridity

Analysing recent developments in Italy's economic policy against the background of the country's dual-hybrid economic system yields several insights.

The economic policy environment is undergoing a significant shift. The recently enjoyed flexibilities within the SGP are dwindling, leading governments to rein in deficits – in the Italian case primarily due to concerns over reputational risks in financial markets. Italy, once again, seems forced to veer towards fiscal conservatism. In this context, the NRRP emerges as an indispensable opportunity to instigate substantive reforms and strategic investments. These considerations bypass partisan politics so that, throughout 2021–2024, continuity rather than change is the main feature of economic policy, despite enormous changes in Italian politics.

Based on existing CPE literature, in the previous section we have highlighted what is in our view one of Italy's major peculiarities, namely its dysfunctional 'dual hybridity'. On the supply side, the capacity of the state strategically to govern the economy has been eroded, and no coherent liberal market or coordinated market economy has emerged. On the demand side, too, Italy is a hybrid system, better understood as 'dual', with two distinct models which coexist uneasily: the export-led model of Northern Italy and a Southern model based on local consumption underpinned by public spending.

We use these conclusions heuristically to assess ongoing economic policies based on the extent to which they: (1) might or might not push supply conditions towards greater coherence and less hybridity as well as strengthening state capacity; (2) conform to the functional requirements of the different growth regimes of the North and South. Due to the narrowing of Italy's fiscal space and the return to fiscal conservatism, at present such an analysis cannot but focus mainly on the NRRP. It is too early to suggest definitive conclusions. Such a grandiose plan is bound to have varying results. Some reforms will work better than others. Some investments will fail. Indeed, the 2023 renegotiation of the NRRP can also be understood as a reaction to several delays and difficulties in implementing the plan. However, several encouraging aspects warrant consideration.

First, a strong focus on increasing state capacity can be found across several reform areas. Besides those directly addressing the limits of Italy's bureaucracy, for example, various measures aim also at strengthening the state's provision of education services or the provision of active labour market policies and social investment. Second, most reforms continue the drive to liberalize the economy, with less red tape and greater room for private actors to implement their projects, including streamlining of investment procedures and easier access to public procurement. Greater state capacity in the provision of public goods and better services to households and firms, coupled with a more liberalized economy, may produce stronger incentives for private investment and growth.

Additionally, including a provision to earmark 40% of the investment resources for Southern Italy adds to the focus on state capacity. An investment campaign for the *Mezzogiorno* holds the promise of addressing longstanding challenges characterizing Italy's Southern regions, where investments in social policies and the public sector have the potential to yield significant economic and social returns. Interestingly, from a macroeconomic viewpoint, the Government does suggest that the NRRP will have a direct effect on Italy's GDP and a higher-than-average effect on the South.[7]

Additionally, the decision to renew the collective bargaining agreement in the public sector, with fiscal resources earmarked in the 2024 budget (Table 2), represents a favourable development in terms of stimulating local demand within the Southern regions – where public employment is over-represented, and many households rely primarily on public sector-related income (Di Carlo, Ciarini, and Villa 2024).

It must be emphasized that, at this stage, such an assessment still relates to intentions rather than the results of the NRRP and related policies. Available data is scant, making it hard to evaluate the deployment capacity of the administrations responsible for the investments, let alone the effects of the reforms. For example, some observers argue that the 40% investment rule for the South is being disregarded in practice (Openopolis 2022). Thus, whether the NRRP succeeds, particularly in Southern Italy, will crucially hinge on the capacity and political willingness of national policymakers to monitor regional and local authorities and support Southern administrations in the investment programmes.

To conclude, Italy's NRRP and its 2023 amendment promises to address several pressing issues long afflicting the Italian economic and political system. Indeed, it seems that the NRRP is currently the only game in town – especially considering the recent reform of the economic governance rules of the EMU. Its short-term effects will depend on the successful implementation of both investments and reforms, while its longer-term effects will hinge on private investors' reactions to the changed supply-side scenario brought about by the structural reforms – and on the expected benefits from higher productivity gains. In short, the NRRP's effects will depend on its capacity to transform Italy into a less hybrid and less dual political economy.

Notes

1. For a full description of the NRRP see Domorenok and Guardiancich (2022).
2. Bruegel's dataset includes some measures prior to Russia's invasion of Ukraine in February 2022.
3. For further details and a description of these cuts, see the article by Cavalieri *et al*. in this issue.
4. See Decree Law n.77, 21 May 2021, available at: https://www.normattiva.it/uri-res/N2Ls?urn:nir: stato:decreto.legge:2021-05-31;77.
5. See OECD Broadband Data Portal. Available at: https://www.oecd.org/digital/broadband/broadband-statistics/
6. Data retrieved from the report, *Senza Dati non si Può Valutare il Nuovo Pnrr*, 4 December 2023.
7. https://temi.camera.it/leg18/temi/il-mezzogiorno-nel-pnrr.html.

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Notes on contributors

Donato Di Carlo (PhD, Max Planck Institute for the Study of Societies, 2019) is a lecturer in political economy at Luiss University in Rome, Italy, and managing director of the Luiss Hub for New Industrial Policy (LUHNIP). His research focuses on comparative political economy, industrial policy, and industrial relations.

Marco Simoni (PhD, LSE 2007) is Adjunct Professor at Luiss University. Between 2014 and 2018 he was an Economic advisor to the Prime Minister of Italy. He has also been the founding President of the Human Technopole Foundation between 2018 and 2022.

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