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The EU's future hinges on Italy's recovery fund reforms

The task is formidable but Mario Draghi has the heavy hand of history resting on his shoulders

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The government of Italian prime minister Mario Draghi is putting the finishing touches to an investment and economic reform programme that is to be powered by some €200bn in EU grants and loans.

This is likely to be the largest national allocation from the EU's €750bn post-pandemic recovery fund for the bloc's 27 member states. On the success of Draghi's proposed reforms hang the prospects not just for Italy's economic revival but for the fiscal and political integration of Europe.

The EU grants and loans should help to spur growth in Italy after a contraction in gross domestic product last year of 8.9 per cent, the worst annual slump since 1945. But such growth may not be enough in itself to reverse Italy's long-term relative decline.

If Draghi's national unity government were to succeed in overcoming Italy's deep-seated structural weaknesses with the help of the EU funds, the benefits for Europe could be immense. In Italy itself, Euroscepticism would be dealt a blow.

Elsewhere, critics of European fiscal transfers would find it harder to contend that EU money poured into Italy is a waste. Supporters of integration would be on stronger grounds in arguing that the time is ripe for completing the EU's economic and monetary union, still only half-built more than 20 years after the euro's launch.

The tasks that face Draghi are formidable. Much attention focuses on Italy's public debt, which stood at 155.6 per cent of GDP at the end of last year. In fact, Italy manages its debt skilfully and has taken full advantage in recent years of exceptionally low borrowing rates on financial markets. Still, the debt remains a latent threat to Europe's currency union, as demonstrated by the 2011 crisis of Italian sovereign bonds.

A more serious issue is stagnant productivity. As finance minister Daniele Franco told parliament last month, productivity rose between 1995 and 2019 by little more than a quarter of the eurozone average. GDP per capita fell to 10 per cent below the eurozone average from 9 per cent above.

Yet in that quarter of a century, some Italian governments made reform efforts that were more intensive than those of many other EU countries. Except for during the past decade, a lack of investment was not the problem. Rather, the reason why these efforts achieved little boils down to the weakness of the rule of law and of political accountability in Italy. This sets the country apart from its eurozone peers and is Draghi's biggest challenge.

The clearest example is tax evasion, which is a mass phenomenon in Italy. The gap between theoretical and actual VAT revenue, for instance, is between 6 and 8.6 per cent in Spain, France and Germany. In Italy it is 24.5 per cent.

Mass tax evasion harms public services, corrodes trust in the state and reduces political accountability. The vast majority of Italian firms and citizens would prefer a country where tax compliance is the norm. But once low levels of compliance set in, tax evasion becomes a rational strategy.

In that context, paying all of one's taxes means subsidising delinquents and receiving fewer public services than one's tax bill would justify. People respond by evading taxes themselves. They know tax compliance is preferable but are unwilling to make the first step.

The logic of this cost-benefit calculation also explains the diffusion of corruption and organised crime in Italy, as well as the comparatively low reliability of company accounts. Each of these phenomena contributes in turn to depressing productivity, chiefly through their effects on the size and capitalisation of companies.

Politics in Italy can play a positive role by sending signals to citizens that genuine change is coming and society as a whole will gain. This requires political programmes based on reliable analyses of Italy's decline and attractive visions of the common good. Before Draghi's government took office in February, no such programmes existed, partly because Italy's political parties are weak and often influenced by segments of the elite that benefit from the status quo.

These are problems that the EU grants and loans to Italy cannot in themselves solve. Nor will the planned EU supervision of the way that Italy uses the funds be sufficient to put Italy decisively on the right track.

The heart of the question, as so often in Italy, will be the implementation of investment plans and reforms that look good on paper but need to be put into actual practice. Draghi, his ministers, business leaders and citizens must show that they will make efficient use of the EU money. The wellbeing of the Italian people and the future of the EU depend on it.