

3.12 Italy

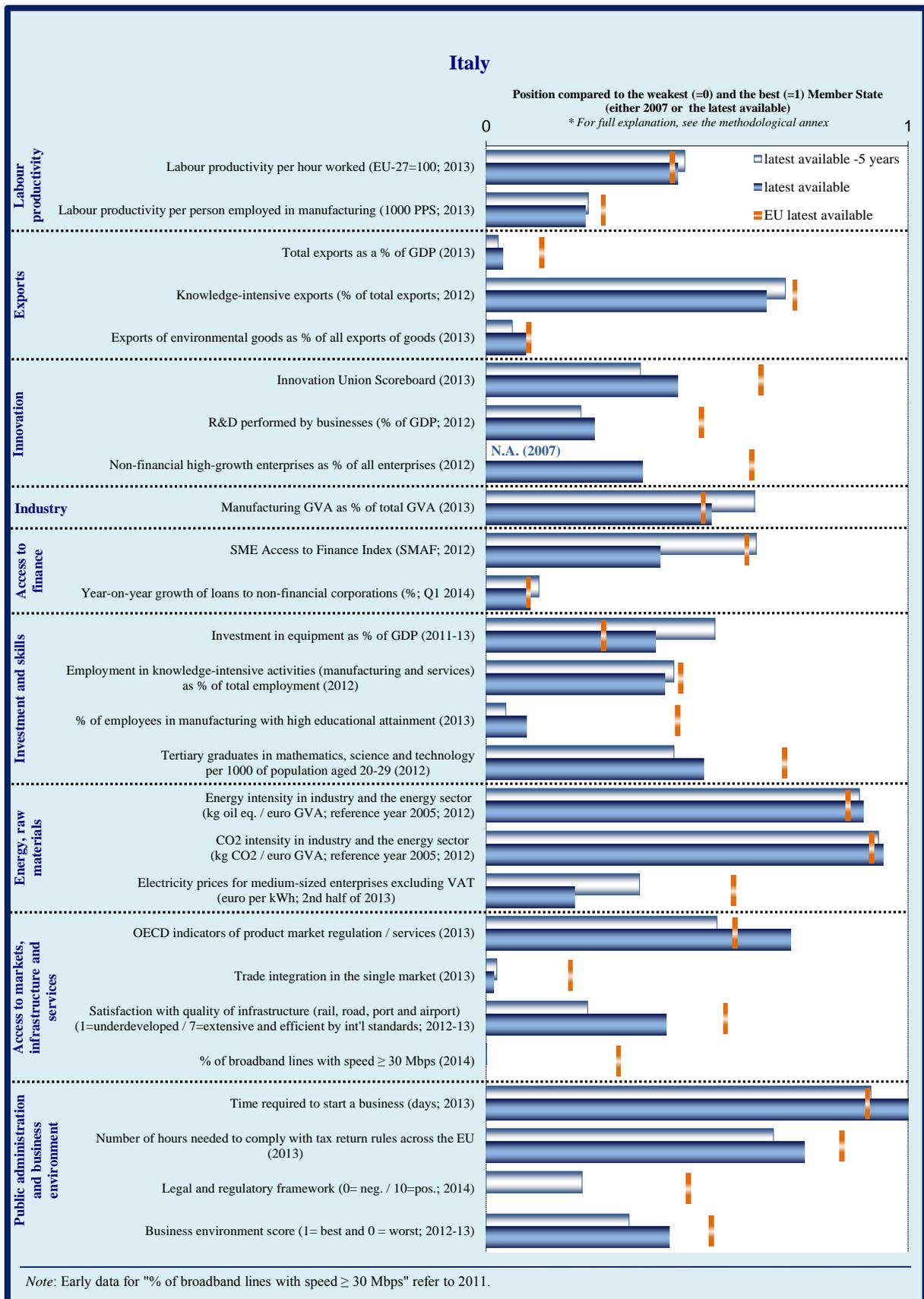
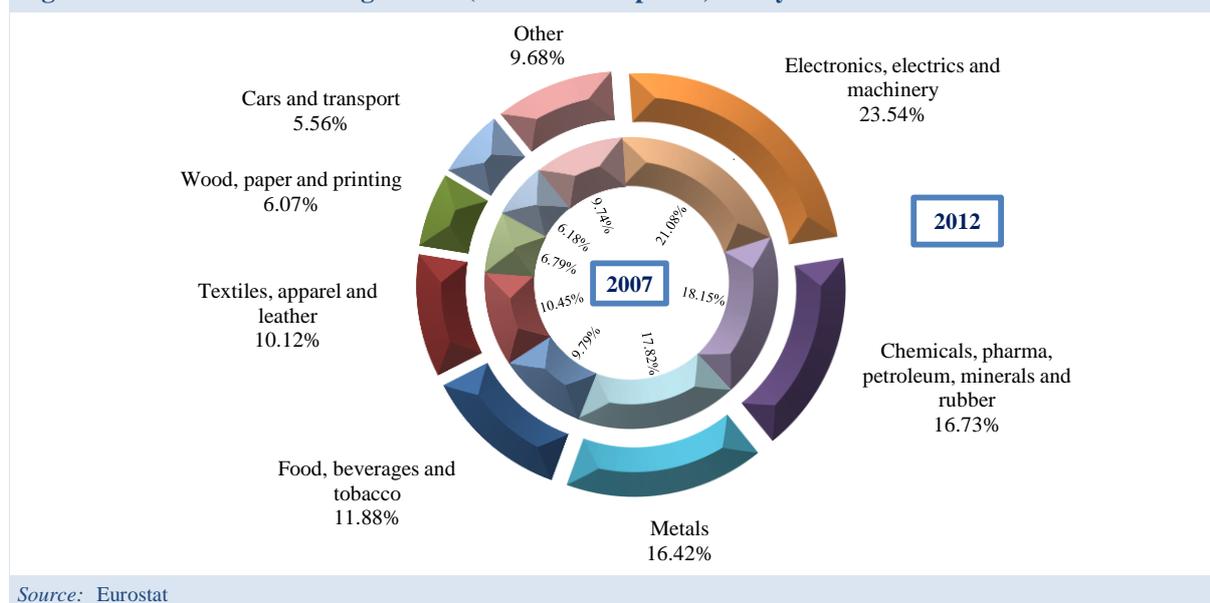


Figure 3.12.1: Manufacturing sectors (GVA at basic prices) - Italy

3.12.1 Introduction and performance

The double-dip recession that started in 2008 bottomed out in summer 2013. Industrial production is experiencing a slow and erratic recovery, driven by improved business confidence based on growth of export orders.

Indeed, since 2011 export performance has been the only component that has contributed positively to growth.

The recession has taken its toll on Italian industry: in the manufacturing sector alone, the number of firms has contracted by about 19 % since 2007, with sectors such as pharmaceuticals, textiles, leather goods and apparel particularly badly hit. Italian manufacturing potential is about 15 % below the pre-crisis level (a decline of at least 20 % was recorded in 14 sectors out of 22, with a peak of 40 % in the automotive industry). This is the result of an average decline of 24.5 % in manufacturing output and a decrease of 8 percentage points in the capacity utilisation rate.

Despite the significant reduction in volumes produced, productivity remained substantially unchanged, widening the gap with major competitors even further.

Because of subdued productivity, in 2013 unit labour costs in industry increased by 3.9 %, even though the increase in hourly labour costs slowed to 1.7 %.

Overall, since the beginning of the crisis, the cost competitiveness of Italian manufacturing has declined only slightly more than that of German industry (-2 percentage points), but this has increased the already wide gap that built up over the previous decade (-35 percentage points from 1997 to 2007).⁽¹⁾

Slow productivity growth is mostly due to inefficiency in allocating resources. Indeed, Italy's investment rate is comparable to that of other euro-area countries, but its level of capital efficiency is lower and declining.

According to a recent analysis, one of the root causes of modest productivity growth is that labour market reforms have focused mainly on flexibility and have neglected to address rigidities in the wage-setting mechanism. This is producing perverse effects: since 2000 wages have increased more in sectors where labour productivity has grown less, and, in the short term, employment is tending to move towards sectors where labour productivity is increasing less.⁽²⁾

⁽¹⁾ Confindustria, Scenari Industriali, giugno 2013, No 4. However, disparities in competitiveness indexes are particularly evident in Italy. For example, when using a producer price index-based measure, the gap with Germany is considerably narrower and Italy is not materially less competitive than it was in 1999.

⁽²⁾ P. Manasse e T. Manfredi, Flessibilità, mito infranto del lavoro in Italia, e-book, 2014.

3.12.2 Access to finance and investment

Although there are recent signs of an easing in credit conditions, lending to the manufacturing sector continued to shrink, decreasing by 6.1 % in 2013.

Since July 2012, the interest rates on bank overdrafts and on new loans have remained broadly stable at around 5.2 % and 3.6 %, respectively. But the latter is still 150 points higher than the rate paid on comparable credit in Germany and France.

Both supply and demand conditions are driving the contraction in credit provided to manufacturing firms. Restrictive credit supply conditions have mainly affected SMEs, whereas larger firms have been able to replace bank loans by issuing bonds.

The government has acted by strengthening the traditional tools to tackle the credit crunch, such as broadening the criteria for access to the Guarantee Fund for SMEs, giving support from the National Deposit and Loan Bank for productive investment by SMEs, providing subsidised loans to firms that invest in capital goods, and capitalising Consortia and Credit Guarantee Cooperatives (CONFIDI). In addition to improving these schemes, the government has taken steps to diversify firms' access to finance and reduce the bias towards debt financing. ⁽³⁾

The corporate equity allowance has been first increased from the initial 3 % to 4 % in 2014, 4.5 % in 2015 and 4.75 % in 2016 and then further strengthened to encourage capitalisation. Mini-bonds, which were established in 2012 to diversify access to finance, especially for SMEs, but have seen only modest take-up so far, have been made more cost-effective by reducing their costs of issuance and stimulating their securitisation. Greater involvement of institutional investors other than banks (namely, insurance companies and credit funds) has also been enacted. The framework for equity crowdfunding for innovative start-ups, which allows limited risk capital to be raised through on-line portals, has been finalised with the necessary implementing decrees.

The success of these measures should help in supporting the recovery of the economy. According to a study by Confindustria, the Italian employers'

⁽³⁾ Raccomandazione del Consiglio sul programma nazionale di riforma 2014 dell'Italia e che formula un parere del Consiglio sul programma di stabilità 2014 dell'Italia

federation, assuming investment growth over five years in line with pre-crisis levels (+5.2 % annually), there would be a need for between EUR 90 and EUR 150 billion of capital whereas available bank credit is unlikely to exceed EUR 60 billion. ⁽⁴⁾

In particular, the reform of mini-bonds has potential to appeal to a large number of family-owned firms, which are more reluctant to sell shares and thus dilute their control.

Finally, the payment of general government commercial debts (EUR 26.1 billion in the year to July 2014) is sustaining firms' liquidity. According to a survey by the Bank of Italy, about one-third of the firms with commercial claims against general government report having received payment of a fairly large sum. They intend to use this to pay off part of their debts to suppliers and staff, reduce their bank loans and make new investments. The payments also appear to have helped to improve prospects for the firms that still had claims against the administration. Recently, the government made available around EUR 9 billion more in addition to the EUR 47 billion already allocated for paying arrears, and it is committed to meeting all arrears by the summer. The exact amount still to be paid is unknown; Bank of Italy estimates, based on a sample survey, point to EUR 75 billion.

3.12.3 Innovation and skills

In 2011, the percentage of GDP invested in research and development slightly decreased to 1.25%, widening the gap with the national Europe 2020 target for R&D, set at 1.53% of GDP.

One of the major weaknesses of the Italian R&D system is the low contribution of private sector to R&D intensity. In fact, despite a slight increase to 54,6% of private contribution to R&D expenditure, this remains very far from the European average (63.1%) as well as from countries such as Germany (67.7%), France (63.9%) and the UK (63.6%).

Nevertheless, Italy experienced growth in most indicators of the Innovation Union Scoreboard 2014. In particular, all but one of the indicators that try to capture the economic effects of innovation activity improved, including the sales share of new

⁽⁴⁾ Confindustria, Nuova finanza per le imprese: più capitale, più bond e strumenti innovativi per le PMI, pdf 2013.

innovations and the contribution of medium and high-tech products exports to trade balance, two indicators where Italy is overall in line with the EU average.

This apparent contradiction between enabling factors and output is explained by Italy's industrial structure, which has a preponderance of SMEs, concentrated in low and medium-low technology sectors. The globalising value chains have led these firms to gradually lose their links to larger internationalised firms in Italy. This has reduced the scope for innovation dissemination to these firms.

In such a context, the level of expenditure on R&D may underestimate the innovative effort of an economy, given that SMEs do not account for all the R&D carried out. In addition, in sectors where Italy competes successfully on international markets, capacity for innovation relies less on high spending in R&D than on so-called incremental innovation, which builds upon existing knowledge and involves modest technological change. Indeed, in Italy the share of firms that have introduced product or process innovations without carrying out formal R&D activities is 40%. This is greater than or close to the level in other major countries except Germany.

However, the effect of innovative activity on the growth potential of such companies is limited. Compared to those that perform formal R&D activities, they have a significantly lower capacity to register patents, a lower share of sales from innovative products and lower overall productivity than those that carry out formal R&D activities.⁽⁵⁾

In addition, the economy's high share of low-to-medium technology sectors is both a driver and a result of Italy's dismal performance in terms of knowledge and skills. In 2011, Italy had the fourth highest share of population in the EU with only basic education and the lowest share of population with tertiary education. Similar evidence emerges regarding skills: in an OECD survey⁽⁶⁾ Italy ranks bottom in literacy among the countries covered, and above only Spain in mathematic skills. The fact that this is the case for all age groups and all levels of education suggests that shortcomings in the education system are being compounded by a lack of professional training and by the fact that work tasks neither contribute to maintaining existing skills nor require workers to learn new ones.

On the policy side, the government has allocated EUR 200 million per year for the period 2014-2016 for tax credits to support companies that invest in R&D. But it is unclear whether this measure also has also the potential to bring to light R&D activities that have so far not been accounted for, as the tax credit is calculated on additional expenditure in R&D compared to the previous year. Other measures worth EUR 250 million in 2014 have been allocated to promoting the recruitment of researchers and to digitalisation and technological modernisation in SMEs. The progressive increase in the allowance for corporate equity in the coming years might also contribute to raising R&D by businesses.

The government is also drafting a National Programme for Research (2014-20) that is designed to take full advantage of the opportunities provided by the EU's Horizon 2020 research and innovation programme and the European structural and investment funds. The National Programme has three pillars: bringing highly qualified human resources into the country's productive fabric, a limited number of major thematic projects with a strong impact on people's welfare and support for innovation by companies.

A prerequisite for the success of the specific measures is a sharp improvement in the performance of administrative bodies. Despite some progress, regulatory instability and uncertainty over disbursement timeframes continue to hold back innovative activities. At the same time the government is trying to overcome the piecemeal nature of its efforts by creating eight national technological clusters that are intended to become the backbone of industrial research in Italy.

3.12.4 Energy, raw materials and sustainability

Electricity prices for end users in industry are among the highest in Europe due to a combination of heavy taxes and levies (the highest in the EU) and high energy supply costs (the third highest in the EU).

However, Italian firms' good performance in terms of energy intensity, which is among the best in the EU,

⁽⁵⁾ Banca d'Italia, Annual Report for 2012, 31 May 2013

⁽⁶⁾ OECD, *Survey of Adult Skills (PIAAC)*

implies that the ratio of energy costs to gross output and to value added is in line with the EU average. Increasing reliance on renewables will help reduce Italy's dependence on imported energy.

Generally, Italy shows significant progress in all four of the indicators that define sustainable industry. In the period 2007-2012 it is estimated that per year i) waste production was reduced by almost 2%, ii) Non-disposable waste was cut by 2.7% and iii) greenhouses emissions were reduced by 2.4%. Lastly, energy consumption had the best result, thanks to a reduction estimated at 6.3% per year. Overall, in 2007-2012 Italian manufacturing reduced its environmental impact by 3.5% annually.

This effort to achieve greater sustainability is making a major difference not only for the environment but also for competitiveness: of the companies that have invested in green technologies, 17.5% are exporters (compared with only 10% of those that did not make green investments), 23% introduced product innovations in 2012 (11% for the other companies) and 54% increased or consolidated their sales. Of all the jobs created in 2013, 38% are estimated to have come from companies that invested in sustainability.

Sectors investing in energy efficiency and renewables fared better during the crisis, creating new firms and increasing employment. This was particularly the case for renewables and construction, thanks to a system of incentives established by the government, but waste management and electronics also benefitted.⁽⁷⁾

Another dimension of sustainability is the re-industrialisation or reconversion of industrial sites. This is a strategic issue in Italy, whose high population density means there is little land available for building 'greenfield' industrial plants. Given this situation, the government recently further simplified land reclamation procedures, better specifying responsibilities in the different reclamation phases and developing tax relief measures. These provisions are expected to facilitate environmental recovery projects and should have an impact on generating additional investments.

⁽⁷⁾ Fondazione Symbola e Unioncamere — GreenItaly, *Nutrire il futuro*, pdf 2013.

3.12.5 Access to markets, infrastructure and services

After the highs of 2011 (+6.9%) and 2010 (+12.4%), the growth in export volumes of goods significantly decelerated in 2012 (+2.1%) and 2013 (+0.2%).

Two trends are worth mentioning when assessing export performance. First, there has been a geographical refocusing towards non-EU markets to compensate for the weakness of the EU economy (compared to 2007, the share of Italy's non-EU exports rose by more than four percentage points). Secondly, a modest shift in the export mix has been seen from low-tech to medium- and high-tech goods.

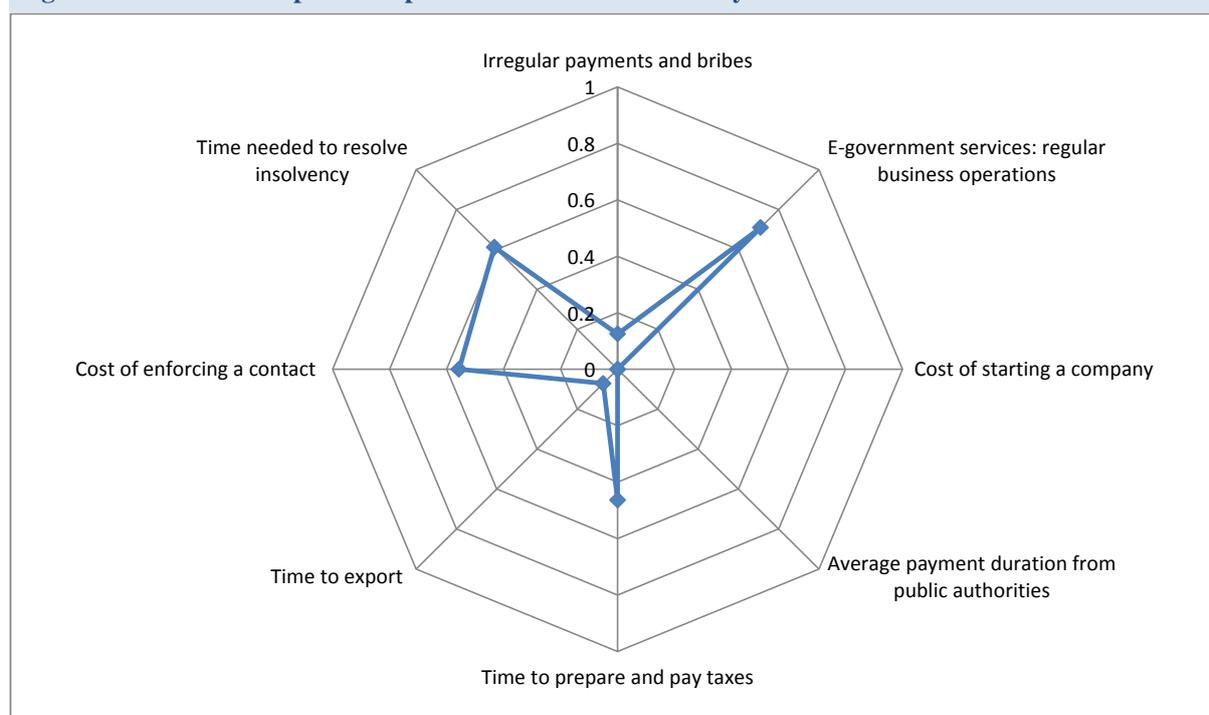
Thus, Italian firms are showing a level of adaptability and resilience that is still a source of strength. According to the WTO/UNCTAD Trade Performance Index, Italy remains the world's top exporter of textiles, clothing and leather goods, and is ranked second in the world (behind Germany) for non-electronic machinery and manufactures (basic and miscellaneous). This seems to suggest that Italian industry is managing in overcoming cost competition injecting innovation and quality in mature productions.

However export strategies adopted by firms remain weak. From a closer look at the characteristics of exporting firms, it appears that only a limited proportion adopt systematic export strategies in their business model, while a majority look to foreign markets only to compensate for weak domestic demand.⁽⁸⁾

With a view to strengthening Italian industry's export base, the government has doubled the budget for promotional activities to almost EUR 60 billion. Agenzia ICE, a government agency for promoting trade and encouraging firms to globalise, is running roadshows in 20 Italian cities to show SMEs the opportunities foreign markets offer and the tools for accessing them. With the same goal, there has been a strengthening both of the financial instruments to support exports to foreign markets and of interest-rate subsidies to export capital goods.

Finally, Italy's trade potential would greatly benefit from better ports management and improved interconnection capacity. The importance of its ports

⁽⁸⁾ A. Belloni, *Esportare l'Italia*, Guerini e Associati.

Figure 3.12.2: Overall profile of public administration — Italy

Note: Values have been scaled so that the best observation (Member State) gets 1 and the worst gets 0.

Source: World Bank Doing Business; Intrum Justitia; OECD; World Economic Forum; European Commission

in terms of trade activity is in fact not matched by adequate performances, in particular in terms of lengthy and costly administrative and custom procedures.

3.12.6 Public administration and business environment

The administrative and regulatory constraints that affect the business environment are reflected in Italy's dismal record in attracting foreign capital: in 2013, Italy was the destination of a mere EUR 12.4 billion in foreign direct investments.

According to the government, the duration and number of formalities required by the administration cost SMEs as much as EUR 30.98 billion a year. Typical problems include unclear legislation, lack of communication between different administrations, lack of transparency and the number of procedures to be followed. In addition, paying taxes is particularly time-consuming and costly: 269 hours per year for a total tax rate of 65.8% of total profits (against an OECD average of 41.3%).

To facilitate doing business in Italy, in September 2013 the government launched, 'Destinazione Italia'

a plan to attract foreign investment and enhance the competitiveness of Italian firms. The initiative consists of 50 measures, some of which have already been implemented, affecting a wide range of activities, from taxation to labour and from civil justice to research.

The entry into force of the simplification contained in the 2013 'Decreto del Fare' has brought savings for businesses totalling EUR 8.99 billion (a 27.4% reduction in businesses' administrative costs). Ongoing efforts to shorten some court procedures are bearing fruit, and this is reflected in Italy's improvement in the World Bank's 'Doing Business' latest rankings.⁽⁹⁾ Moreover, recent legislation tries to limit the need for implementing acts, which has slowed down the enforcement of the legislative provisions.

However, efforts to move towards a modern and efficient public administration are hampered by two constraints. The first is the often unclear division of responsibilities between the state and the regions that resulted from the 2001 constitutional reform; this is limiting the effectiveness of simplification measures taken at central level. The government is working

with the regions and local administrations on ‘An Agenda for simplification’ whose effectiveness remains to be seen.

Secondly, all the provisions mentioned above were adopted by decree-laws, which do not seem appropriate for enacting ambitious structural reforms as they contain provisions regulating very diverse matters and, for the sake of urgency, do not require an impact assessment. In the meantime, a more comprehensive draft law on simplification is still awaiting adoption.

3.12.7 Conclusions

The toll taken by the crisis on Italian industry has been huge in terms of output and employment. Industrial production is around 25 % below the pre-crisis level, a general decrease that also affects sectors — such as automotive, consumer appliances and footwear — that have long been the backbone of Italian industry.

However, Italian manufacturing maintains a percentage of gross value added to GDP (15.5 %) which is still above the EU average (15.1 %). Moreover, it is a key source of innovation and competitiveness: it contributes 70 % of private R&D expenditure and accounts for almost 80 % of exports. It is also a driver for the service sector: 40 % of the total value of industrial exports incorporates value added by the service sector. ⁽¹⁰⁾

Thus, there is a need to strengthen the process that is already under way, i.e. a consolidation of firms and sectors able to manufacture with sustainable methods of production and to face up to international competition. Niches of scientific excellence that exist in advanced materials, nanotechnology, photonics, electronics, robotics and drones have the potential to underpin the modernisation of more traditional sectors and facilitate the upgrading of the industrial base. The potential for Italian companies to become more global-minded is an opportunity to be seized: in addition to increasing the budget for promotional activities the government is also working on a plan to raise the number of exporting firms, including by

enhancing export finance tools and simplifying and speeding up customs procedures.

A prerequisite for growth is the creation of a competitive business environment. Despite the government’s efforts, the business environment and the public administration continue to weigh on Italy’s competitiveness. The time it takes the public administration to pay its bills - 180 days on average – remains a problem; in the fourth quarter of 2013, 62.5 % of the value of invoices due had not been paid.

Some progress has been achieved in the field of civil justice but proceedings are still lengthy and the number of cases pending remains high. ⁽¹¹⁾ The anti-corruption law has strengthened the means to fight corruption, but its effective implementation needs to be watched closely. Some progress towards administrative simplification has also been achieved. But, overall, continued and comprehensive efforts are still needed for a competitive business environment to emerge.

⁽¹⁰⁾ Banca d’Italia, *Il sistema industriale italiano tra globalizzazione e crisi* (The Italian industrial system between globalisation and crisis), Occasional papers No 193.

⁽¹¹⁾ In June 2014, the government announced a new major reform, where both the length of civil proceedings and the backlog of cases would be addressed. However, the details of the reform are not available yet.

⁽⁹⁾ Part of this improvement is due to a different interpretation by the World Bank of the total number of procedures.