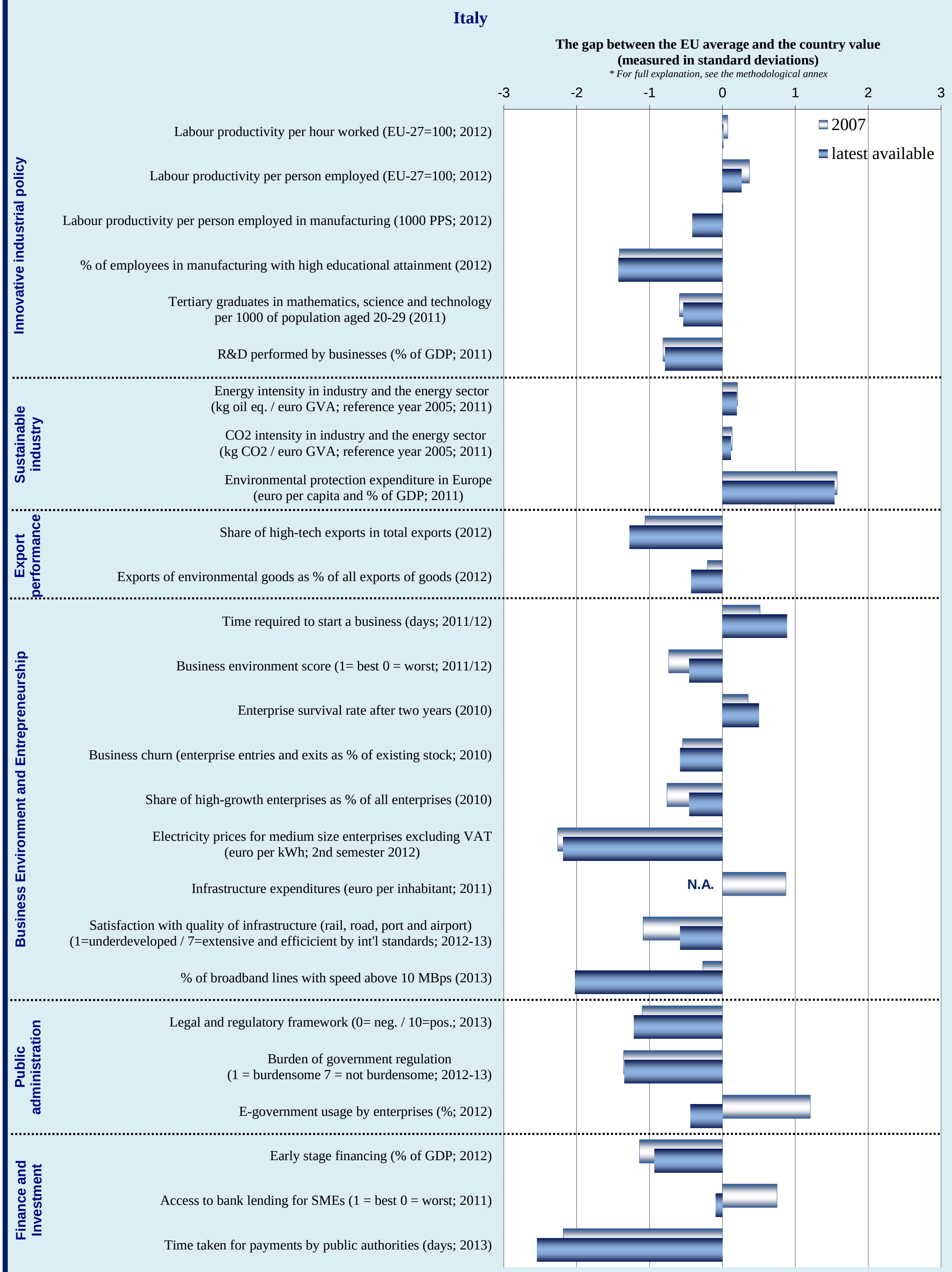
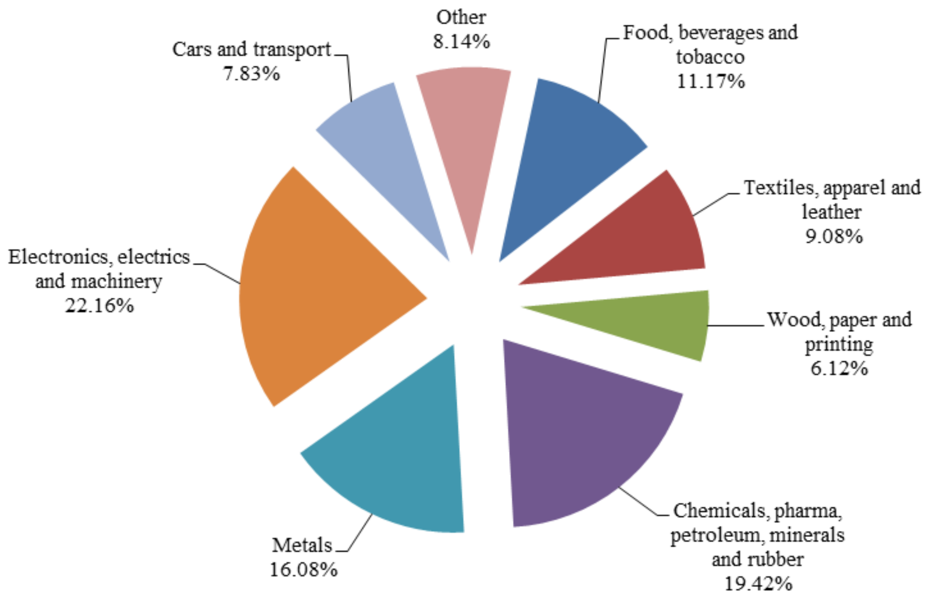
4.12. Italy



Note: In the graph, data are presented in such a way that data bars pointing to the right (left) always indicate performance which is better (weaker) than the EU average. * Access to bank lending for SMEs 2009 (instead of 2007); % of broadband lines with speed above 10 MBps 2008 (instead of 2007).

Figure 4.12: Manufacturing sectors – Italy (2010)



Source: Eurostat

4.12.1 Introduction

Manufacturing accounts for 15.5 % of total value added in the economy, which is slightly above the EU average (15.3 %). It is relatively concentrated in low and medium-low technology sectors, including clothing, leather, textiles, wood and metals, while the share of more innovative high and medium-high tech sectors is smaller than in other EU economies. Beyond sectoral specialisation, the uneven performance of Italian industry has its roots in the fragmentation of the industrial structure, as Italy has the largest number of enterprises in the EU, with more than four million SMEs, twice as many as in Germany.

In terms of average unit labour costs, Italy's competitiveness has eroded considerably over the last ten years, due to an increase in nominal gross wages combined with sluggish productivity growth. However, real wages have remained almost stable, highlighting the importance of addressing the productivity gap while better aligning wages on productivity. Alleviating the tax wedge on labour would also help.

Italy is experiencing a real deindustrialisation, as the industrial production index has lost 20 percentage points since 2007. This development seems to be attributable both to subdued activity due to the downturn, and to the closure of many plants in some industrial basics (petrochemicals, steel, and biofuels). In order to deal with as many as 150 plant closures, the government has overhauled the relevant legislation to help plant conversion and regeneration of industrial sites.

4.12.2 Innovation, skills and sustainability

Innovation

In 2011, Italy invested a total of 1.3 % of its GDP in research and development. This keeps the country close to its national target of 1.5 % by 2020, but well below the current EU average (2.0 %) and far behind the R&D intensity of countries at the technology frontier. Although the share of public R&D is largely in line with the country's main competitors, the contribution of the private sector to R&D intensity is particularly low (0.7 % of GDP). The Innovation Union Scoreboard[1] points to major weaknesses in the Italian system, in particular the limited availability of finance for corporate research and innovation, and the insufficient commercialisation of the results. Thus, the innovation policy would benefit most from focusing on instruments that could enhance technological specialisation, and that would be oriented towards the commercialisation of innovation.

[1] http://ec.europa.eu/enterprise/policies/innovation/files/ius-2013_en.pdf.

This is the logic behind the bottom-up approach of the 'smart cities and communities' platform, to which EUR 890 million have been allocated. The Ministry of Research has identified it as a driver of R&D investments in the priority areas for the improvement of urban services: security, ageing, welfare technologies, waste management, health, transport, last mile logistics, smart grids, sustainable architecture, cultural heritage and cloud computing technologies for smart government. Another strand in innovation policy is the development of national technology clusters, identified as catalysts for growth and structural change. Nine priority themes have been identified: green chemistry, agrifood, ambient intelligence and ambient assisted living, life sciences, smart communities technologies, advanced mobility systems, aerospace, innovative energy systems, and intelligent manufacturing.

Italy lags behind in the adoption of information and communication technologies, and the government's growth initiative[2] has created a new digital agency with the task of promoting demand-led innovation, including through innovative and pre-commercial procurement.

One explanation of the limited investment of the private sector in R&D is the preponderance of small firms, as the average size of Italian firms is much smaller than that of other leading European economies. Thus, an important objective would seem to be to encourage firm growth, while at the same time encouraging cooperation in order to increase the capacity to bear the risks associated with R&D activity. The government has addressed this weakness by simplifying the procedures for concluding network contracts,[3] identified as a tool to promote research and innovation. The government has also adopted tax incentives for hiring researchers, but these have not yet been implemented. The European structural funds will also contribute to investment in research and innovation in 2014-2020.[4]

As the venture capital market remains weak, other measures are needed to enhance the equity capital of many firms as the debt/equity ratio is higher than the EU average, which hampers access to finance and investment, in particular in intangibles (see the section on finance and investment below).[5]

Finally, the government has devised a new legal framework to support innovative start-ups.[6] The scheme can provide welcome funding for many firms that have been denied credit due to the risk aversion of the Italian banking system. It should be noted that the framework contains an ambitious scheme on crowdfunding that is one of the first equity crowdfunding frameworks in the world.

Skills

There are observed shortages of skilled labour in the manufacturing sector. In recent years a series of reforms have aimed to strengthen the provision of technical and vocational training to better respond to labour demand. Of particular importance are the certification of skills, and the introduction of post-secondary technical institutes[7] to provide two-year tertiary qualifications focused on key sectors of the economy. Although they still involve only a limited number of students, the 62 institutes have the potential to further develop the vocational higher education system. In the same vein, the government has reformed the apprenticeship system, but at least for the time being, its use remains marginal. Discussions are ongoing about possibilities to improve the attractiveness of the system.

Sustainability

According to estimates,[8] almost one in four enterprises (23.6 %) have invested in green products and technologies in the last three years. In the context of overall diminishing fixed investment, these figures show that there is business confidence in the potential of the green economy. Further, over 37 % of firms that invested in green technologies were active on international markets (against about 22 % of firms that didn't). Such firms tend also to be innovative, as about 38 % of firms that invest in the green economy introduced product or service innovations (against slightly more than 18 % of

2 The decree is called 'Crescita 2.0'.
3 'Contratti di rete'.
4 European Structural and Innovation Funds for 2014-2020.

5 Also in the Council recommendation on Italy's 2013 national reform programme and delivering a Council opinion on Italy's stability programme for 2012-17: "Promote further the development of capital markets to diversify and enhance firms' access to finance, especially into equity, and in turn foster their innovation capacity and growth."
6 The decree is called 'Sviluppo 2.0'.
7 Istituti Tecnici Superiori.
8 http://www.symbola.net/assets/files/Rapporto_Green Italy_2012_1358333078.pdf.

firms that didn't). Even when taking into account employment changes in the difficult period in question, these firms proved more resilient than others, as their workforce decreased by 0.7 % against 1.4 %.

As far as policy measures are concerned, the government has adopted tax incentives for hiring young workers in the green economy. The network contracts referred to above are also helping firms to go green, as out of 458 contracts, 87 are related to sustainability.

4.12.3 Export performance

Italy's share of world trade trended down between 2002 and 2011 (from 3.9 % to 2.9 %). However, exports increased by 5 % in 2012, helping the trade balance to reach its best level since 1999 – although improvements in trade balance are also driven by a decline in imports owing to weak domestic demand. Italy's exports are now back to pre-crisis levels in value terms, but they remain below in volume terms. The export performance is hampered by two constraints. Geographically, exports go to countries whose economic growth has tended to be below average. Italy is also specialised in low-tech sectors, where the competition from countries with a lower cost base is stronger. Clearly, it would be beneficial to move along the international value chains to activities with higher technological and knowledge intensity.

In 2012, the government made a considerable effort, welcomed by the business community, to improve the governance of its internationalisation policy. Primarily it reactivated and rationalised the operations of the *Istituto Commercio Estero*, a government agency for the promotion and internationalisation of firms. In addition to providing business intelligence, consulting services and investment promotion to Italian firms, one of its main tasks is to implement the *National plan for exports 2013-15*.[9] The aim is to increase the value of exports in three years to EUR 620 billion (35-38 % of GDP), from EUR 473 billion in 2012, by improving the coordination of internationalisation policies.

The government has also sought to attract more foreign direct investment. To this end it has established *Desk Italia*, which is a one-stop access point for foreign investors on all administrative matters relating to investment projects. In addition, the recourse to the judicial system has been streamlined, as cases involving foreign investors will be dealt with by only three courts (Milan, Rome and Naples), to allow for higher certainty in the decisions.

4.12.4 Business Environment and public administration

Business environment

Overall, Italy ranks 73rd in the World Bank Doing Business, drawn down in particular by construction permits, getting electricity, getting credit, and enforcing contracts. There seem to be too many obstacles to firm growth, as few firms become international players. Although there are policy initiatives to improve its business environment and facilitate the life of SMEs, their implementation is lagging and the administrative burden on businesses remains high. Entrepreneurship issues continue to be problematic, as the relative ranking of Italy worsened in the ease of starting a business,[10] and schools are not able to create an entrepreneurial mindset.[11] Competitiveness may improve if the domestic electricity grid is upgraded to remove existing bottlenecks and new gas storage and import facilities are improved.

Italy has introduced market-opening reforms in many of its product and service market regulations. However, challenges remain in local public services, transport and the energy sector, and there are signs that the reform process is slowing down. High electricity and gas prices reflect limited competition and infrastructure bottlenecks. In many cases the necessary decrees to implement the general liberalisation measures have not been adopted yet. In some cases the liberalisation initiatives have been diluted, and the recent reform of the legal profession seems to backtrack on the previous reform of professions. The implementation of the proposal aimed at eliminating all regulations across the board — except where strictly necessary — is not progressing.

9 This plan was established by the '*Cabina di regia per l'Italia internazionale*', a policy body composed of four ministers, the *Conferenza delle Regioni* and social partners (*Unioncamere, Confindustria, ABI* and *Rete Imprese*).

10 World Bank Doing Business 2013.

11 SBA factsheet Italy 2012.

Public administration

Despite the efforts made in recent years, the performance of public administration as measured by the World Bank's Government Effectiveness Indicator is well below the EU average. The main shortcomings include the long proceedings in civil justice, and a burdensome administrative and regulatory framework. The often unclear division of responsibilities between the state and the regions that ensued from the 2001 constitutional reform reduces the effectiveness of simplification measures introduced at the central level.

The regions' exclusive right to regulate economic activities, combined with inadequate inter-regional coordination, has increased differences between regions' administrative requirements. In the same way, the inefficient power-sharing between the state and regions, for example regarding energy, is hampering the development of essential infrastructure. Overall, the administrative complexities place a heavy burden on enterprises. The annual costs of complying with administrative procedures have been estimated at EUR 26.5 billion.

The government has stepped up efforts to reform the judiciary in order to streamline judicial procedures.[12] A geographical reorganisation of courts should be completed by September 2013. For civil cases the right to appeal has been limited to controversial cases. Commercial courts have been introduced for cases concerning intellectual property, limited companies and public procurement. However, they will not have jurisdiction in commercial disputes. The government has adopted a decree-law on the compulsory use of mediation in some private law subjects. Further, a range of measures regarding civil justice have been adopted. Additional staff will help to reduce the case backlog in the Courts of Appeal, and in the courts of first instance; case-handling in the Court of Cassation is being strengthened; and compulsory mediation is being reintroduced with slight adjustments.[13]

4.12.5 Finance and investment

Bank lending to non-financial firms has continued to contract and was in June 2013 down 4.8 % year-on-year.[14] This reflects weak demand, higher firm risk and tightening credit standards. The average cost of credit, albeit decreasing, remains 90 basis points higher than the euro-area average. However, survey results[15] point to some easing of the overall financing conditions for SMEs.

The government has sought to mitigate credit risk by strengthening the guarantee fund for SMEs. With its new operational provisions, in many cases the guarantee can cover 80 % of funding and the amounts guaranteed can be up to EUR 2.5 million.

Other initiatives have been taken to strengthen the balance sheets of firms. The government has introduced rules to make it easier for SMEs to raise debt, in particular through issuing short-term commercial paper and long-term bonds and similar instruments. The introduction of an allowance for corporate equity allows companies to deduct part of the notional cost of newly injected equity from taxable income.

The introduction of the fund for sustainable growth has been a step away from subsidies. It replaces 43 different support schemes, with an allocation of about EUR 600 million in 2012 and EUR 200 million in subsequent years. The fund is organised along three priorities: research and innovation; strengthening the industrial structure; and internationalisation.

In April 2013, the government acted on one of the major problems for businesses, the payment of an estimated EUR 90 billion in commercial debt arrears owed by the public authorities to businesses. An immediately effective provision clears the payment of EUR 40 billion of arrears over the next two years. If correctly implemented, the measure will have a positive impact on the survival rate of businesses, as according to estimates a third of bankruptcies are due to late payments. Effective implementation of the late payment directive, entered into force in January 2013, could also make

12 For indicators on Justice see EU Justice Scoreboard 2013 available at http://ec.europa.eu/justice/effective-justice/files/justice_scoreboard_communication_en.pdf.

13 The compulsory mediation had been repealed by the Constitutional Court last October; it has been adjusted regarding the areas concerned, the maximum duration of mediation and the fees due in case of failure to reach an agreement. Decree-law 69 of 21 June 2013, "*Decreto del Fare*".

14 Bank of Italy, Money and banking statistics.

15 European Central Bank Monthly Bulletin, August 2013.

firms' management and planning easier and their operations more efficient.

4.12.6 Conclusions

Many of the problems that drag down competitiveness in Italy like low private investment in R&D, lack of innovative start-ups, problems in the supply of skills, lack of equity financing, meagre growth of firms, and internationalisation can be at least partially traced back to the administrative and regulatory constraints of the business environment. In particular, paying taxes and enforcing contracts are particularly difficult. Continuing coherent structural reforms of the public sector are needed for a modern and efficient administration to evolve.

The government has continued to pursue reforms improving the business environment and making it more conducive to growth. The reform of the judiciary system in 2013 has introduced some novel provisions (e.g. reduction of judiciary offices, appointment of new auxiliary staff helping judges), the outcome of which in terms of efficiency of justice still needs to be proven. The anti-corruption legislation that was finalised in 2012 is also a promising step.

Encouraging entrepreneurship has been addressed by allowing the possibility of setting up a business with a capital of one euro and by increasing support for innovative start-ups. The system of subsidies to enterprises has been reformed, even if more radical proposals were dropped, including a plan to restrict the use of subsidies to clear cases of market failure, and to use the savings to reduce the tax wedge on labour.[16] The tax allowance for new corporate equity has potential to enhance growth when the recovery starts. However, these effects are likely to be visible only in the longer run, as operating profits will still be low early on in the upturn.

An important message for policy focus can be found in the performance of firms that have adopted a strategy of innovation and internationalisation. These firms have fared far better in the crisis and it appears that the choice to compete internationally is a key factor leading to innovation. While research shows that this choice ultimately rests on the productivity of the firm, the reform of the governance of the internationalisation system can help reduce the productivity threshold at which a firm may enter the international markets and therefore increase the number of exporting firms. From this point of view, the reform of the governance of the internationalisation system can prove a pivotal step for Italian competitiveness.

[16] The *Giavazzi Report.*