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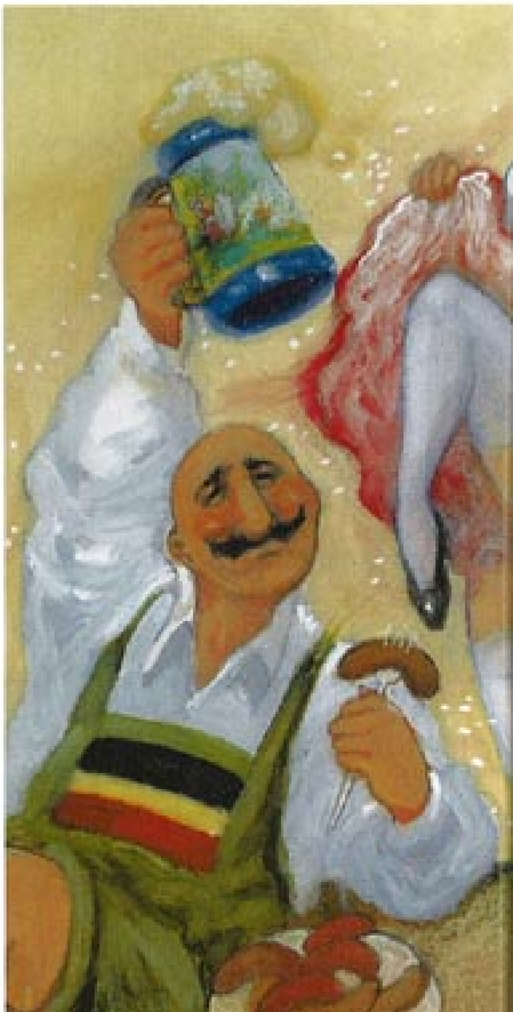

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ITALY

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"*Eppur si muove*" ("and yet it moves") mumbled Galileo under his breath when forced to recant his heretical notion that the Earth moves around the sun. Similarly heretical—though less dangerous—is the notion that there is movement in the Italian economy, indeed, that in many respects it has achieved considerable success.

There are, of course, ample grounds for criticizing Italy's past economic policy and performance. After engaging in a painful effort during the early and mid-1990s, Italy confounded the skeptics by meeting the criteria enabling it to join the European Union's single currency area at its inception in 1999. Since then, however, Italy has slipped to the back of the pack, moving from low GDP growth into recession and showing seemingly little progress in addressing, let alone resolving, a number of fundamental economic problems.

Nonetheless, a closer look at the Italian economy should start with recognition that Italy has not one but two economies, the north and the south. Regional differences in the European Union are not unique to Italy, but the sharpness of the economic cleavage, and its seeming intractability, are unique. As a result, the high level of economic performance in the north is diluted in national economic statistics. On an EU-wide basis the northern regions fare extremely well. While Italy's per capita GDP is only marginally higher than the EU average, the figure for Lombardy is 135 percent of the average, in Emilia-Romagna it is 129 percent, Piedmont's is 120 percent, and the northeast region's is 121 percent (the first two fall in the top 10th percentile). In contrast, per capita GDP of southern Italy is 66 percent of the EU average and only 58 percent that of the north and center. The employment rate in the south is about two-thirds that of the north, and unemployment

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is sharply higher (19 percent in the south, 4 percent in the north).

The structure of the Italian economy differs from that of most of the other EU member states in that it is characterized by few large enterprises (*Business Week*'s "Global 1000" includes only twenty-five Italian firms, of which only two in the top 100) and a predominance of medium-sized and, particularly, small firms (SMEs). The average size of Italian firms is the smallest in Europe. In the manufacturing sector, 98 percent of firms have fewer than fifty employees, while 83 percent have less than ten. SMEs (less than 250 employees) account for 70 percent of GDP, while for small firms (fewer than 20 employees) alone the figure is 42 percent.

Yet these firms—a large percentage of which are family-owned—have prospered by developing niche specialization both in Italy and globally. In large part, production covers a range of consumer goods where Italy has become a world leader. It accounts, for example, for over 20 percent of world ceramic tile production, 16 percent of shoes and leather goods, and over 10 percent of glass and ceramics, and it holds or shares world leadership in trade for a long list of products from eyeglasses, jewelry, and wool and silk textiles to furniture, white goods, and specialized industrial machinery. Their success is due in large measure to a combination of imagination, innovation, flexibility, and adaptability.

"Industrial districts" are a key element of the SME sector—clusters of firms located near one another, engaged in different aspects of the production of the same or related products, involving elements of cooperation and competition. While these districts exist throughout Italy, they are most prevalent in the north. In some sectors, a single Italian district accounts for a remarkable share of world exports—for example, Sassuolo for almost 40 percent of tile and ceramics exports, Como for over 25 percent of silk fabric, and Belluno for 18 percent of eyewear.

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While Italy has a well-merited reputation for cumbersome bureaucracy and heavy-handed regulation, Italian governments have made significant progress in improving the conditions under which businesses operate. The OECD gives Italy high marks for its program of reform of the public administration. For example, the administrative cost of opening a new business has fallen by more than half over a two-year period, and the number of steps required has declined even further. As a result, the average time required for starting a business has dropped from twenty-two weeks to four weeks.

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In addition, the Berlusconi government's early legislative successes included the elimination of seven hundred administrative laws. Italy's success in easing administrative burdens is reflected in its ranking among the OECD countries on fewest restrictions on foreign direct investment—Italy is seventh lowest out of 28 members.

Improvements have also taken place in the regulation of the labor market and in corporate governance. Reform of the labor market began in 1997, and the most recent legislation dates from early 2003. The public monopoly on job placement has ended, intermittent work contracts have been authorized, and scope for use of temporary contracts has been expanded. The resulting increase in labor market flexibility has been reflected in employment growth. In the field of company law, 1998 and subsequent legislation has enhanced shareholder rights, strengthened accounting standards, and increased the efficiency of the securities market (in many respects taking Italy beyond the rest of continental Europe, according to the OECD).

Another major, beneficial development has been the sharp reduction in the role of the state. Overturning long-standing policy, successive governments initiated a massive sell-off of the economically and politically important state-controlled enterprises about ten years ago—one of the largest privatization programs in the OECD area. Full or partial privatization has taken place, inter alia, in the industrial conglomerate Finmeccanica, the electrical monopoly ENEL, the oil and gas company ENI, the telecommunications monopoly Telecom Italia, and some bank holdings. Privatization netted about $100 billion in the 1990s, equal over a ten-year period to about 12 percent of GDP, a considerably higher amount than elsewhere in continental Europe.

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Price controls in many sectors have been removed. In line with EU legislation, liberalization was begun in telecommunications in 1997 and electricity in 1999, and gas in 2000 (the latter termed "positive, bold and innovative" by the OECD). Measures have been adopted to increase transparency and efficiency in the public sector—for example, public agencies have adopted electronic procurement, resulting in a 31 percent cost reduction.

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Italy's traditionally weak financial services sector has been significantly improved by the banking reforms that began in 1990 and have transformed the Italian banking system. Privatization has reduced the heavy hand of public institutions, which now control 10 percent of total bank assets, compared to 66 percent ten years ago. The abolition of operating restrictions and geographic barriers has resulted on the one hand in consolidation and on the other in increased domestic and foreign competition. While bank profitability and productivity have increased, consumers have benefited through the sharp increase in the availability of banking services, the expansion in the supply of asset management services, and the lowered spread between loan and deposit rates.

Finally, though scandalous and in part corrupting, one must not forget that the black economy makes an important contribution to Italy's economy. True, it reflects tax avoidance, but looking objectively, it also serves to some extent as a counter-weight to government regulation and clearly adds to the level of economic activity beyond that usually recognized. Though difficult to measure for obvious reasons, the government estimates it accounts for about 15 percent of GDP.

Conclusion: Major problems and deficiencies exist in the Italian economy, yes, *eppur si muove.* ◆