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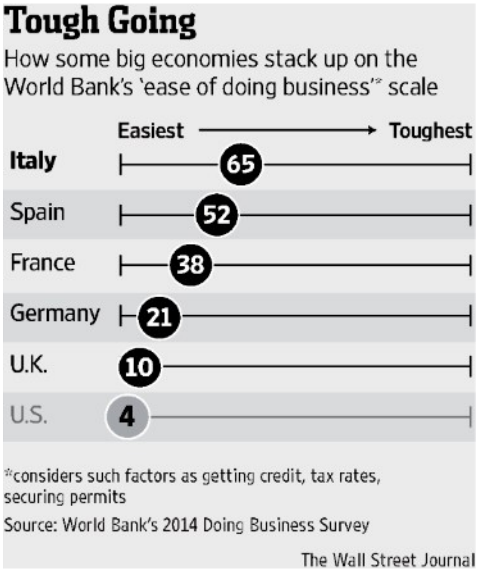
IN DEPTH

Italy Struggles to Find Way Back From Economic Crisis



Many family business owners prefer to stay small, sticking to the staff and customers they already know and trust, says Matteo Bugamelli, senior analyst at the Bank of Italy.

By Marcus Walkere
And Deborah Ball
Florence

Bernardo Caprotti was a 45-year-old entrepreneur when he agreed to buy a suburban plot of land for a new supermarket.

Building permits recently came through. He's now 88. His Milan-based retail chain, **Esselunga** SpA, had grappled since 1971 with local bureaucrats who raised shifting concerns about traffic volumes, architectural suitability and proximity to a medieval monastery.

"It has become so difficult and complicated to do business in Italy," Mr. Caprotti said in an interview. "Italy can't go on like this. Either we change or we go nowhere."

Mr. Caprotti's wait to open a store is a small symbol of a persistent problem for Italy. Like some other European countries, it has struggled to change and grow its economy fast enough to shake off a long debt crisis.

Entrenched interests and hardened habits have accumulated in Europe over decades, slowing once-dynamic economies to a crawl, and are now proving difficult to overcome. From bureaucrats to businesses, unions to pensioners, interest groups vigorously defend the status quo, even when it leaves no one satisfied.

Italy, like the 18-country euro zone, is slowly recovering from a six-year slump, leading some to believe Europe's crisis is receding. But the difficulty of economic renewal, say economists and business leaders, means the crisis hasn't been solved—it has merely mutated from an acute condition to a chronic one.

A tepid recovery after a long fall, towering debts and high unemployment have put Europe in danger of suffering a lost decade—one in which its economies have to limp forward while some other world regions march on. The economy of the euro zone is still 2.7% smaller than it was in early

L'Italia si sforza per trovare una strada per uscire dalla crisi economica

2008.

Many Europeans blame years of austerity policies that have sapped demand and prolonged the post-2008 downturn.

But the deeper malaise, say some economists and policy makers, is a long-term decline of Europe's economic growth rate. In societies whose populations aren't growing, sustainable growth comes from improving productivity, or the efficiency of the economy's supply side. And that requires constant change: Europe's Achilles' heel.

The European Union's executive arm, the European Commission, warned in January that the euro zone's long-term productivity growth has been slowing since the mid-1990s, and that the crisis years have done further damage to the region's ability to grow.

The pressure of the debt crisis has forced some euro members, such as Spain and Greece, to enact overhauls of labor rules and highly regulated business sectors, among other measures. But the reforms are widely seen as partial at best, and momentum has faded since the peak of the financial-market panic.

Italy has emerged as a Technicolor example of the problems. Its growth has been stuttering for 20 years. Since 2008, its economy has shrunk by 9%, and this year it is struggling to expand by even 1%.

Without faster growth, Italy will struggle to tame its public debt of over €2 trillion ($2.77 trillion), or 133% of gross domestic product. If its debt mountain keeps rising, fears for Italy's solvency could return, reigniting the capital flight that nearly tore the euro apart in 2011-12.

Italy's new Prime Minister Matteo Renzi, a kinetic 39-year-old with big plans to cut taxes and stem regulation, shot to power with widespread support from a public yearning for someone to break the country's impasse. Yet even many sympathizers doubt he can reinvigorate Italy's growth.

The roots of the problem, say many Italians, lie in how vested interests in the private and public sectors gum up the economy, preventing change that replaces old practices with new, more efficient ones, and repeatedly frustrating political attempts to shake up the country.

It adds up to "deep-seated cultural obstacles to growth," says Tito Boeri, a professor at Milan's Bocconi University who is one of Italy's top economists. "In Italy you define your identity in terms of your membership of some specific interest group," he says, making it hard to rally support for any notion of the common good.

Outside perceptions of Italy's enviable lifestyle mask a stubborn resistance to change. Smaller family companies led by aging owners rebuff outside investors even when they lack the money or vision to compete. Regulated professions such as lawyers and pharmacists consistently beat back efforts to break their cartels. Powerful bureaucrats bog down the implementation of new laws for years. And Rome's political class is so quarrelsome that governments last little more than a year on average.

It used to matter less. Italy's economy grew rapidly in the postwar era despite a stonewalling bureaucracy, legions of tiny companies and a fragmented, often corrupt political system. But growing was easier then: Relatively poor Southern European countries mainly had to copy technology from more-developed economies such as the U.S., and use it to churn out goods cheaply.

Making the wheels turn in an advanced economy requires the efficient rule of law, reliable public administration and more capital and expertise than many mom-and-pop businesses can muster, says Fabiano Schivardi, an economist at Rome's Luiss University who has studied the stagnation of swaths of Italy's business sector.

"Our institutions were good enough for an economy that was catching up, but they're not good enough any more," he says.

Some of Italy's best-known companies, such as **Prada** SpA, **Ferrero** SpA and **Luxottica Group** SpA, have flourished globally, showcasing the country's prowess at fashion and food. Yet according to the Bank of Italy, 98% of Italian companies employ fewer than 15 people.

Many family business owners prefer to stay small, sticking to the staff and customers they already know and trust, says Matteo Bugamelli, senior analyst at the Bank of Italy. "Often, all of the family wealth is in the firm, and there isn't the risk appetite that you need to invest and grow," he says.

Roberto Zuccato, an entrepreneur from Vicenza in Italy's affluent northeast, wanted to break out of his niche and build a business with more international heft.

His company, Ares Line, makes furniture for offices and public venues such as theaters, employs about 90 people, and has annual sales of €20 million ($27 million). The market leader, **Steelcase** Inc. of the U.S., has annual sales of $2.9 billion.

In 2005, Mr. Zuccato teamed up with a Milanese private-equity firm and sought to merge with local Italian rivals under a holding company with sales of €100 million. With fresh capital and economies of scale, they planned to invest in building a global brand that played to Italy's reputation for elegant design.

But only struggling companies wanted to partner up. Others chose to stay alone, even if they weren't growing, Mr. Zuccato says.

"The culture here is be the *padrone* in your own house," he says, using the Italian for "boss." Many family entrepreneurs "don't trust outsiders and prefer to bring in their own son, even if he's not well qualified," he says.

In 2009, after fruitless talks with around 20 companies, the private-equity fund sold its investment in Ares Line back to Mr. Zuccato.

Red tape is one factor that deters businesses from growing. Esselunga, the supermarket chain, says it has scaled back plans for new stores after several frustrating experiences involving building permits and other permissions—although it will finally open its long-awaited Florence store this fall.

What maddens locals can baffle foreign investors. In 2012 **British Gas** PLC threw in the towel on a €500 million gas import terminal in southern Italy after struggling for over a decade to get the necessary permits.

It is a problem familiar to Mr. Caprotti. "If we start something today, it could take 15 years to finish," he says. "Then you're lost because you find that the size or the location doesn't work anymore."

Italy's court system also spooks businesses: Routine contract disputes take more than three years on average to resolve in court—and much longer if there are appeals. Italy's lawyers, who outnumber their French brethren fourfold, have resisted efforts to streamline a judicial system that offers rich opportunities for lengthy proceedings. At the end of 2012, there was a backlog of 9.7 million cases, according to the International Monetary Fund.

Italian unions have also often dug in their heels to resist change. For years, union battles held up efforts to save the national airline, **Alitalia**, which struggled to get its labor costs down. Last fall, as the carrier faced imminent bankruptcy, unions agreed to pay cuts and more-flexible working terms.

Fear often lies behind unions' defense of the status quo. Redundant blue-collar workers might never find jobs again in Italy's sclerotic jobs market.

There are some signs of change. **Natuzzi** SpA, one of Italy's leading sofa makers, also grappled with union issues to stay afloat. The company had strained against lower-cost foreign competition once the euro was introduced. For years, it did too little to address high costs—even as losses mounted. But in 2013 it reached a deal with unions to cut labor costs and buy out hundreds of staff, in order to keep production in Italy.

"We can't hide the fact that there are difficulties," says founder Pasquale Natuzzi. "But there is greater awareness on the part of both unions and business" that change is needed to defend manufacturing in Italy, he says.

Companies' demands to cut labor costs grate with workers whose take-home pay has already suffered from the long downturn and tax increases. Italian households' disposable incomes have fallen by 13%, or about €2,400 per worker since 2007, one of the biggest declines in the euro zone, according to the state statistical agency.

Mr. Renzi has made cutting payroll taxes among his highest priorities, with a pledge to trim €10 billion in payroll taxes this year.

Taxes on labor are particularly high. One reason is that taxes that would normally help spread the burden—including on the incomes of small businesses and the self-employed—are widely dodged.

Italian entrepreneurs evade over 50% of the income taxes they owe, while people living off investment income skip over 80%, the country's central bank estimates. The heavy taxes on payrolls deter companies from hiring and weaken consumers' spending power, economists say.

Even when leaders pass reforms into law, change doesn't necessarily follow. Bureaucrats who must implement laws by issuing administrative decrees often stall, dilute them or render them incomprehensible, say reform-minded officials. When the government of Enrico Letta fell in February, about 500 laws had been passed but not implemented. Among them: a measure to reduce the number of permits required for companies to do business and a law to digitize certain processes to simplify dealing with the government.

"There is a great deal of difficulty in moving the bureaucracy and the whole machinery of the state," said Graziano Delrio, undersecretary to the prime minister, in an interview. "There has been this approach of making modest changes, but we need to make a leap in how it all works."

Former Premier Mario Monti tried to inject more free-market competition in service sectors where regulation protects incumbents' profits. Striking taxi and truck drivers, railway workers, pharmacists, lawyers and gas-station owners protested his overhaul attempts and lobbied Parliament to water them down. Even the weakened measures that passed into law have often made little difference, because the public administration hasn't acted on them, Mr. Monti says.

"Across the board, the last ring in the chain of implementation is often not there," says Mr. Monti, looking back on his reform efforts. Prime minister for only 17 months, he says he would have needed more time to take on Italy's uncooperative mandarins. Urgent fiscal measures, he says, were needed against Italy's debt crisis. "I couldn't afford a revolt of the bureaucrats."

Some foreign entrepreneurs are discovering just how tough it remains to penetrate the Italian market.

Uber, the app-based car service that launched in Italy last year, says traditional taxi drivers have verbally abused its drivers, who respond to customers' orders sent by smartphone. The taxi union denies any aggression, and says its members have paid a fortune for their taxi licenses, which now trade at about €170,000, and offer a public service that needs to be protected.

"During a period of change, there are some whose jobs are under threat and a sense of protectionism sets in," says Benedetta Arese Lucini, general manager of Uber in Italy. "Unfortunately, Italy is afraid of changing."

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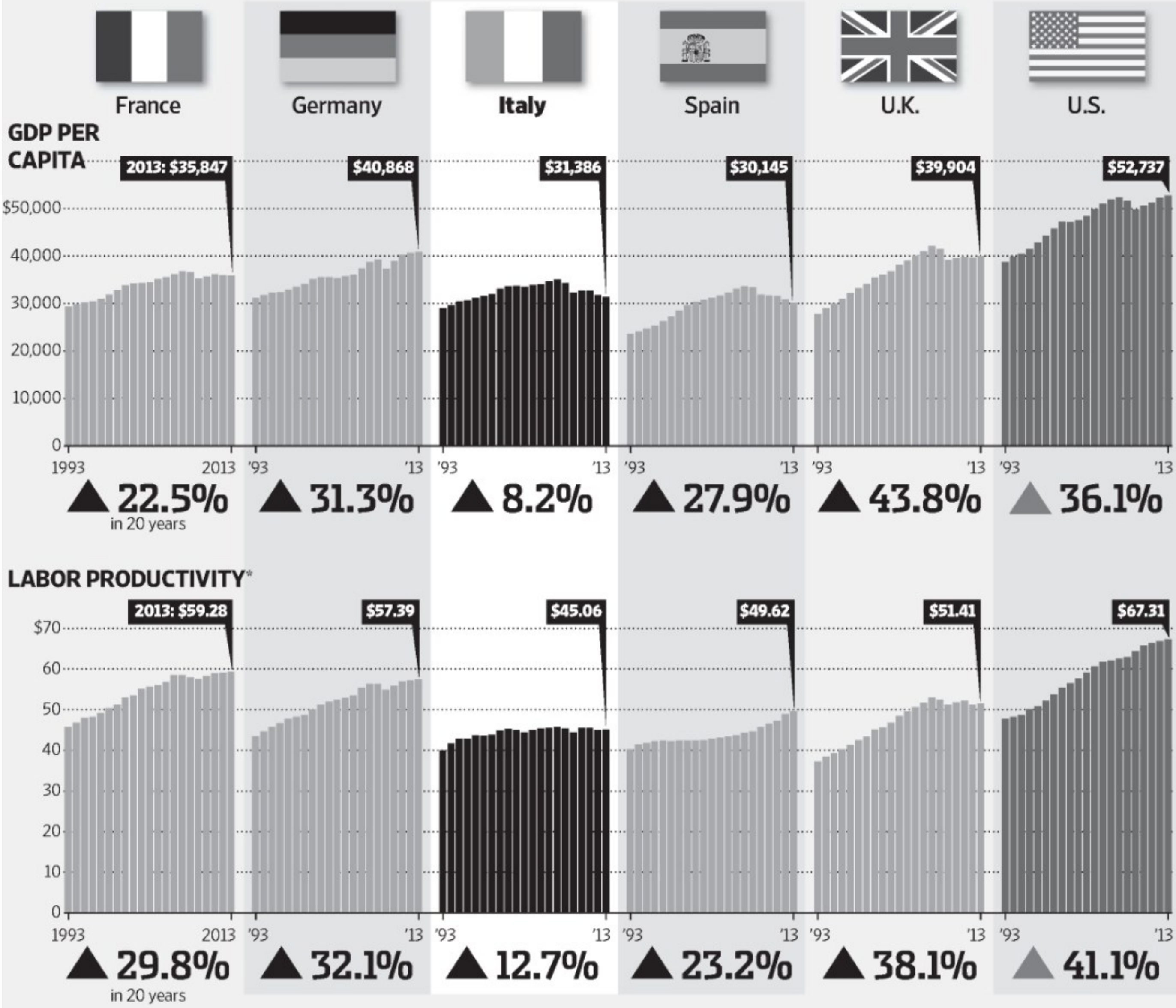
In the Slow Lane

Italy is gradually recovering from a six-year slump, but progress is proving slow compared with others in Europe and the U.S.



Note: All data are in inflation- and purchasing power-adjusted 2013 dollars. *GDP per hour worked   Source: The Conference Board   The Wall Street Journal