

CONVERGENCE OF ITALY'S TRADABLE SECTOR GROWTH RATE AND WAGE STAGNATION

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ABSTRACT

In the last five years the Italian manufacturing sector has reduced the growth gap vis-à-vis the euro area, in the face of a continuing growth differential in the service sector.

The improvement of cost competitiveness is among the factors that led to this recovery in the manufacturing sector. However, as long as competitiveness gains mainly depend on the slowdown in wages rather than on increases in productivity extended to all sectors of the economy, the process cannot be considered virtuous. It entails not only beneficial effects on exports, but also unfavourable consequences on real wages and household incomes and, therefore, on domestic demand.

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1. INTRODUCTION

For more than 20 years, Italy recorded a wide growth differential vis-à-vis the main euro area economies. There is a consensus that a slowdown in productivity lies behind this poor performance. However, there is not a shared explanation for this productivity slowdown.

In the last five years some significant improvement has characterized the relative performance of the manufacturing sector. Italian industry closed the growth gap with the euro area despite a continuing growth differential in service activities.

It is not still clear whether this represents a reversal of a long-term trend. However, the gradual strengthening of the manufacturing sector is one of the very few positive facts of the Italian economy in recent years.

The recovery in manufacturing's relative growth rate was also associated with a stabilization of the Italian export market shares.

There is still no agreement about the causes of the different relative performances of manufacturing and service sectors in Italy. The debate in recent years has pointed to the industrial firms' ability to adapt to the external environment; lower exposure, thanks to foreign demand, to the weakness of our domestic demand during the fiscal adjustment of 2012-2013; firms' selection in the 2008-2013 period and the survival of the strongest firms. The firm selection was also based

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on changes in product specialization and the ability to change the exports' regional destination moving to more dynamic markets.

Overall, in the last years a pronounced ability to compete in international markets was observed, which compensated for the weakness in domestic demand. Service sectors instead have suffered much more from their dependence on domestic demand.

Among the factors that have favoured Italian industry is the improvement in cost competitiveness. In the last eight years the manufacturing unit labour cost in Italy has grown less than in the other countries of the euro area, symmetrical to what happened, in the opposite direction, during the 2000s.

Competitive gains in terms of manufacturing unit labour cost have mainly reflected the wage slowdown, although the gap in labour productivity growth was also reduced.

However, this process cannot be considered virtuous as long as the competitiveness has recovered mainly thanks to the slowdown in wages, rather than to gains in productivity.

It involves not only positive effects on exports, but also unfavourable consequences for real wages and household incomes and, therefore, for domestic demand. Not surprisingly, the different performances of the manufacturing and service activities are also reflected in the contribution to GDP growth of the components of aggregate demand, with a poor relative performance of domestic demand and a recovery of export performance.

Moreover, the growth model followed by the Italian economy in recent years remains very dependent on foreign demand, and therefore much exposed to fluctuations in international trade as well as to changes in international trade policies.

As the gains in competitiveness of the manufacturing sector are mainly based on wages moderation, they do not seem to constitute an adequate response to Italy's low-growth problems. They would instead require a turnaround in structural factors at the basis of the productivity stagnation, particularly in service activities.

2. PRODUCTIVITY SLOWDOWN AND ECONOMIC DECLINE

The growth differential between Italy and the other countries of the euro area has been around a percentage point for several years. Fluctuations of this differential depended on the macroeconomic characteristics of each cyclical phase. Similar considerations apply if we examine the differences in terms of per capita GDP.

Of course, a growth differential of this size, accumulating over time, entails the opening of a gap in the levels of development with respect to the other economies of the euro area, with relevant consequences on the standard of living of the population. We have been referring to this trend for some time now using the expression "economic decline" (Ciocca, 2003; Nardozzi, 2004; Toniolo and Visco, 2004).

There is a broad consensus that a productivity slowdown is at the root of this

trend. On the other hand, there is no shared explanation about the factors that lie behind the Italian productivity slowdown.

The various attempts to understand the productivity slowdown in Italy can be summarized according to four main types of explanation: the first remarks the characteristics of Italian manufacturing firms; the second focuses on general elements related to the “system” in a broad sense; the third refers to the economic policies adopted in recent years; the fourth is based on the possibility of measurement errors.

Among the explanations that emphasize the characteristics of the Italian manufacturing sector, a relevant point is the sector specialization, more based on traditional activities. Technologically more advanced sectors, with higher content of human capital, have a low weight in the structure of the Italian economy. A crucial point is the small size of firms; small firms face greater difficulties in adopting innovations related to new technologies as well as appropriate strategies for internationalization. The low size of the Italian firms is a historical legacy, depending also on cultural factors. It is reinforced by explicit or implicit forms of protection to small firms (for example, changes in labour regulations as the size of the firm increases, or implicit incentives to firms operating in the black economy through the possibility to evade taxes).

The second group of explanations focuses on the general economic environment. It includes the difficulties of “doing business” in Italy, such as bureaucratic excesses, infrastructure gaps, and problems related to organized crime. Also included are problems of the educational system and the school-work transition; in particular, the low rates of tertiary education and the low preference for scientific disciplines, which are at the basis of a large deficit with respect to our competitors in terms of skills, exacerbated by the fact that Italian graduates frequently tend to emigrate in search of good job opportunities abroad.

The third area includes explanations based on economic policies.

Some studies focus on the effects of joining the single currency: the problems of Italian industry are linked to the loss of competitiveness, especially with respect to Germany in the 2000s. The loss of competitiveness would therefore have discouraged business investment, with consequences in terms of technological delay and productivity growth. In fact, the adjustment of the competitive position in a currency area where the leading country has very low inflation rates becomes almost impossible. According to some studies, this would lead to the exit from the single currency (Bagnai, 2012).

Other studies draw attention to labour policies (Biagi and Treu reforms with the introduction of fixed-term contracts and more recently the 2014 Poletti reform). Thanks to more flexible contracts, the “implicit” cost of labour has been reduced, and that reduction has increased the use of labour at the expense of productivity. Firms would find it convenient to focus on broadening the employment base by delaying policies aimed at boosting productivity growth (Codogno, 2009; Tronti, 2010).

Finally, the fourth point of the debate highlights the errors in manufacturing productivity statistics.

In particular, some authors have argued that there was an overestimation of prices and therefore an underestimation of manufacturing value added at constant prices. This in turn may have led to an underestimation of manufacturing productivity growth.

This would have been due to errors in measuring the prices of the exported products (Codogno, 2009; Romano and Traù, 2019; Tiffin, 2014). According to this thesis, the structural transformation of our industry has altered the export price statistics. In particular, the qualitative upgrading of production would have resulted in an increase in the unit value of these goods, which therefore in the national account statistics should be incorporated in the value of exports at constant prices, leading symmetrically to a reduction in the growth of export deflators.

Following this interpretation, even the value added at constant prices, and consequently also the productivity of the manufacturing sector, would have been underestimated. This thesis has indeed been confirmed in the revision of the national account statistics over the years, and in particular considering that the estimate of labour productivity has been repeatedly revised upwards by ISTAT (De Nardis, 2019). However, the revision that has already taken place in the national accounts statistics leads us to believe that the data of the most recent releases, on which the analysis of next paragraphs is based, are not altered much by this type of problem.

3. RECOVERY OF THE MANUFACTURING SECTOR

With respect to this long-term scenario of low growth and stagnant productivity, recent trends in the Italian manufacturing sector have shown some elements of transformation. In particular, the export performance improved since 2011, and since 2015 there has been a reduction in the growth differential of Italian industry vis-à-vis the other “core” euro area countries.

Figure 1 shows the ratio of the Italian industrial production to the euro area. The relative performance of Italian industry had been systematically worse during the 2000s, continuing a trend that began in the mid-nineties. The decline stops in the first quarter of 2015. In the following period the ratio stabilizes, meaning that Italian industrial production grew at the same rate of that of the euro area.

The period of convergence of the growth rate of Italian industry includes the five years from the beginning of 2015 to the end of 2019. It is a sufficiently long period to wonder whether it is due to contingent factors or whether it is the beginning of a long-lasting recovery.

Actually, some asymmetric temporary shocks have played in favour of Italy’s relative position in recent years. Since the last quarter of 2018, the German industry has been hit by a crisis in the automotive sector, due to the fall in demand for diesel engine cars. However, the Italian manufacturing growth rate also exceeded that of France in the same period, and was only slightly lower than the Spanish one.

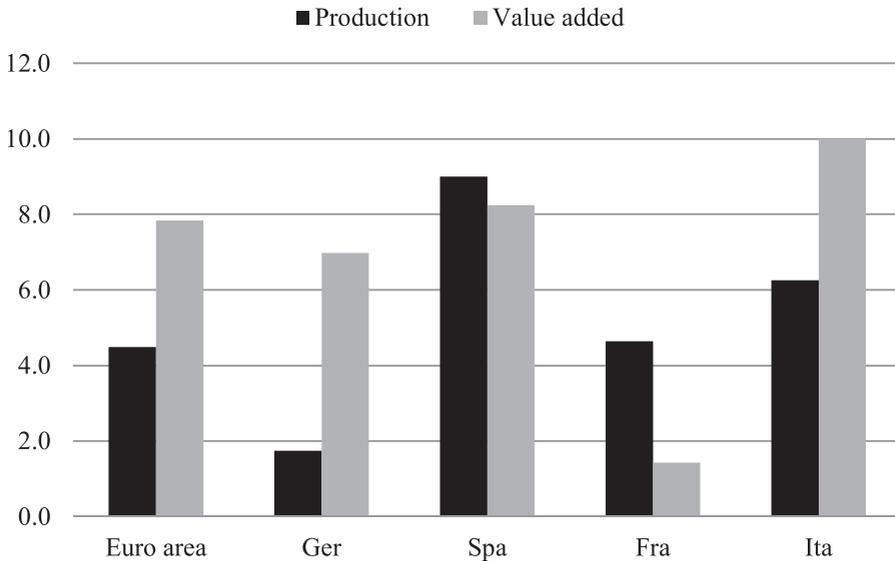
FIGURE 1 – *Industrial production; Italy – euro area ratio*



Index 2015 = 100

Source: Calculations on Eurostat data.

FIGURE 2 – *Industrial production and value added*



Industry (except construction)

% ch 2015q1-2019q3

Source: Calculations on Eurostat data.

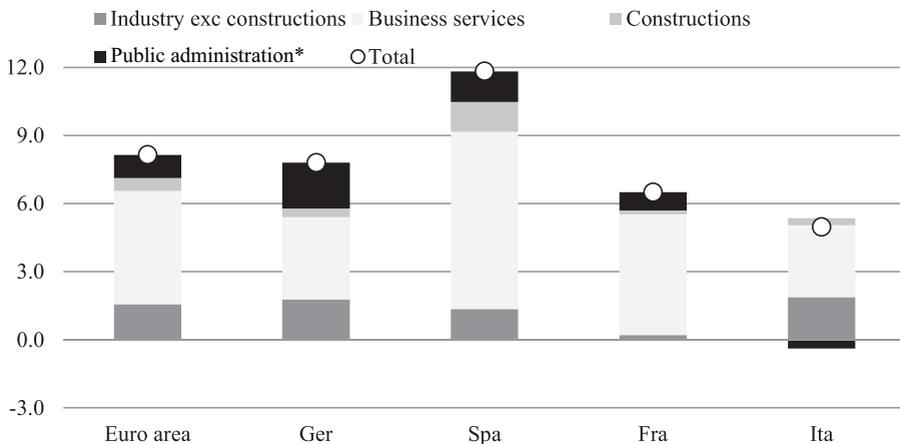
Furthermore, one has to take into account that in recent years, due to the negative gap in productivity growth in non-tradable sectors and the prudent fiscal policies, Italy also had a low growth in domestic demand. This in turn implies that the tradable sectors have been disadvantaged with respect to the other euro area competitors. In fact, even exporting firms sell a large part of their production on the domestic market.

Another relevant point is that over the last five years the growth of the manufacturing value added has exceeded that of industrial production. This also applies in the German case. It implies a reduction of the weight in the final product of inputs imported from abroad or purchased from other sectors. It implies a transformation in the structure of the manufacturing sector with the increase of the parts with greater value added, and is less based on the transformation of intermediate inputs.

The recovery of manufacturing sectors is also associated with a relatively positive performance in international markets. Market shares of Italian exports in world trade have stabilized since the beginning of the current decade, after a long period of contraction. Exports in volume terms after 2010 showed a trend in line with the demand of Italian export markets.

However, the strengthening of Italian industry was not followed by a similar improvement in other sectors of the economy. Indeed, over the same period Italy maintained a large negative gap in service sectors growth vis-à-vis the “core” countries of the euro area.

FIGURE 3 – *Value added by industry*



Net contribution to total value added % change, 2015q1-2019q2

° Public administration, defence, education, human health

Source: Calculations on Eurostat data.

Given these different trends, the share of manufacturing value added on the whole economy, after declining from 20.5 per cent in 1995 to 15.4 per cent in 2013, recovered to 16.8 per cent in 2018. This trend in the sector composition is not replicated by employment data, given the very low productivity growth in services activities. Within private services, a strong recovery emerged in the sectors of restaurants and hotels. These sectors are related to tourism, so their output can be considered tradable, and dependent on foreign demand and price and non-price competitiveness.

The improvement in the relative performance of the Italian manufacturing sector has received little attention from commentators and policymakers.

This is partly due to the fact that attention was drawn mainly to the performance of the economy as a whole, which remained, as seen, very poor; this, in turn, shifted the discussion to the issues of financial stability.

Furthermore, in addition a skeptical view about the perspectives of our manufacturing sector is still prevailing because there have been no major changes in the structure of manufacturing, and especially in some particular aspects traditionally considered as sources of weakness of our industry.

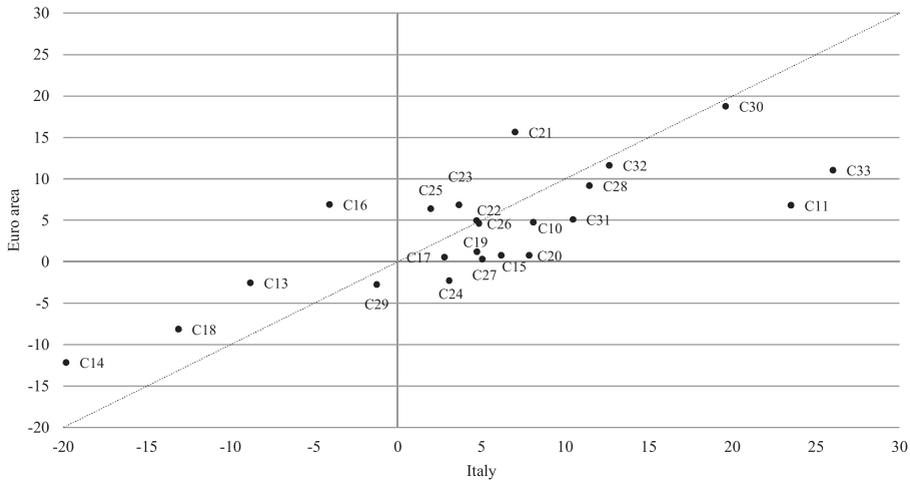
First of all, the sectorial specialization has not changed much (De Nardis, 2019) as Italian industry is still based on two pillars of the so-called “Made in Italy”, especially the mechanical and consumer goods sectors (De Benedictis and Tajoli, 2016). The growth in Italy exports has been led by various traditional sectors – like food and beverages, clothing and leather, and personal care industries. This was surprising as the common view was that these sectors would have been declining due to competitive pressures from foreign producers.

Figure 4 shows the cumulative percentage change of the industrial production index for the period from 2015Q1 to 2019Q3. The cumulative growth in Italy is compared with that in the euro area. The line represents the bisector of axes, so when a sector is above this line it means that the euro area has grown more than Italy, and vice versa when it is positioned below. The graph highlights that the majority of sectors rank below the line, so the higher growth of Italian manufacturing has been shared by a large number of sectors.

There are seven sectors in which Italy performs worse: in four of these, production has fallen in this period (textiles, wearing apparels, products of wood, printing of recorded media). In three cases the variations are positive, but lower than those observed in the average of the euro area (fabricated metal products, “other” non-metallic mineral products, basic pharmaceutical).

In other sectors, Italy does better than the rest of the euro area. Within these sectors there are also several activities belonging to the traditional “Made in Italy”, specialized in consumer goods (manufacture of food products, beverages, leather products, furniture) and machinery (manufacture of electrical equipment, repair and installation of machinery and equipment, machinery and equipment nec).

Figure 5 shows the trend prevailing during the previous period, from first quarter 2007 to first quarter 2015. The changes are negative in almost all cases due to the impact of two recessions. In this period, Italian industry performance was worse than the euro area in almost all sectors.

FIGURE 4 – *Industrial production by economic activity: Italy and euro area*

cumulated % ch, 2015q1-2019q3

Source: Calculations on Eurostat data.

ECONOMIC ACTIVITIES - NACE CODES

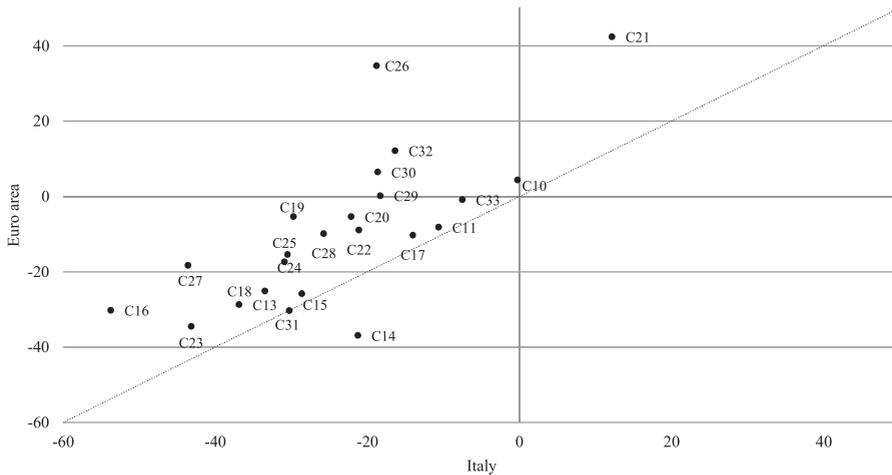
C10 Manufacture of food products	C22 Manufacture of rubber and plastic products
C11 Manufacture of beverages	C23 Other non-metallic mineral products
C12 Manufacture of tobacco products	C24 Manufacture of basic metals
C13 Manufacture of textiles	C25 Fabricated metal prod, except mach and equip
C14 Manufacture of wearing apparel	C26 Computer, electronic and optical products
C15 Manufacture of leather and related products	C27 Manufacture of electrical equipment
C16 Wood and products of wood except furniture	C28 Manufacture of machinery and equipment n.e.c.
C17 Manufacture of paper and paper products	C29 Motor vehicles, trailers and semi-trailers
C18 Printing and reproduction of recorded media	C30 Manufacture of other transport equipment
C19 Coke and refined petroleum products	C31 Manufacture of furniture
C20 Manufacture of chemicals and chemical product	C32 Other manufacturing
C21 Basic pharmaceutical products	C33 Repair and installation of machin and equip

Another point is that the growth convergence of the manufacturing sector has been achieved while maintaining the prevalence of small-sized firms, which are commonly considered less suitable to adapt to the changes required by technological innovation processes and the international competition (Barba Navaretti et al., 2012; Pellegrino and Zingales, 2014). Some studies (ISTAT, 2019) show that, despite the severe firms' selection after 2008, the Italian manufacturing firms' size remained unchanged.

Finally, traditional production organization by local industrial "districts" is also confirmed. After the crisis, the recovery of firms belonging to districts was more lively than that of not-district firms (IntesaSanPaolo, 2018). Small and medium-sized Italian firms have traditionally offset the difficulties in achieving economies of scale through the "district economies". This trend is also interesting because

Italian industrial districts are very widespread, and are often located in the neighborhood of small-sized municipalities; their success therefore goes in the opposite direction to the theses that highlight the growing importance of the so-called “agglomeration economies” that are leading many other countries to concentrate economic activities in large cities.

FIGURE 5 – *Industrial production by economic activity: Italy and euro area*



cumulated % ch, 2007q1-2015q1

Source: Calculations on Eurostat data.

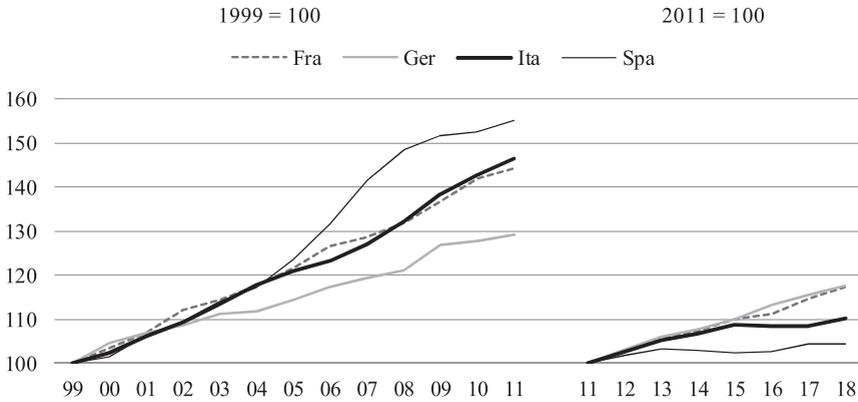
To conclude, Italian industry has recovered after a phase of recession that resulted in a severe selection among firms. This selection has operated above all at the individual firm level, with the exit of weakest firms regardless of their specific sector or dimension.

4. THE ROLE OF PRICE-COST COMPETITIVENESS

Even recent recovery has therefore confirmed several of the structural features of Italian industry. However, some changes are highlighted by price-cost competitiveness indicators.

A description of the trend of the Italian industry’s competitive position vis-à-vis the major economies of the euro area can be proposed through the comparison of the unit labour cost in manufacturing. As these countries have been sharing the same currency since 1999, the growth differentials in manufacturing ULC can be thought of as a change in real exchange rate indicators.

The relative levels of manufacturing ULC in the 2000s show divergent trends in the euro area countries. In the first phase of the monetary union, the intra-area competitive position has changed much more than in the previous decades, when

FIGURE 8 – *Labour compensation per hour worked, manufacturing*

Source: Calculations on OECD data.

The stabilization of the cost competitiveness of Italian industry in the recent period is therefore mainly due to the effects of wage moderation, and only secondarily to improvements in labour productivity.

This behaviour is similar to that of Spain. It seems to reflect the labour market deterioration in both countries after the great crisis and the second recession of 2012. The 2012 labour market reform in Spain has also modified the wage bargaining system, giving greater priority to the firm level over the regional and sectoral level.

The deceleration in Italy's manufacturing labour cost is mainly due to the performance of contractual wages. As in the 2000s, Italian wages had grown at higher rates than the Eurozone "core" countries, in the same way that in the last years they recorded a gradual slowdown, and to a greater extent after 2016. This different wage dynamics also reflects changes in the wage bargaining system.

The Italian system of industrial relations is based on a centralized wage setting process, which rests on the foundations of the approach adopted in the 1990s. This model was based on the link between wages and domestic inflation targets (*tasso d'inflazione programmato*, "planned inflation rate").

The bargaining model adopted in the early nineties was based on a wage policy aimed at linking contractual wages to inflation objectives defined through an agreement between the government and the employers' and employees' representatives: trade unions and employer federations. However, a "recovery clause" to compensate in each contract for the difference between actual and objective inflation in previous contracts was also included. This was a sort of indexation aimed at preserving the purchasing power of centrally negotiated wages. Given the strict link between inflation rates and wage growth, in this wage setting system the possibility that the purchasing power of total wages would increase depended on decentralized bargaining (second level). However, this second level of bargaining was available mainly to workers of the medium- and large-size firms, and had a modest impact on wages.

This contractual model was particularly effective in driving the convergence of Italian inflation in the 1990s, favouring the process that would lead to Italy's entry into the euro area.

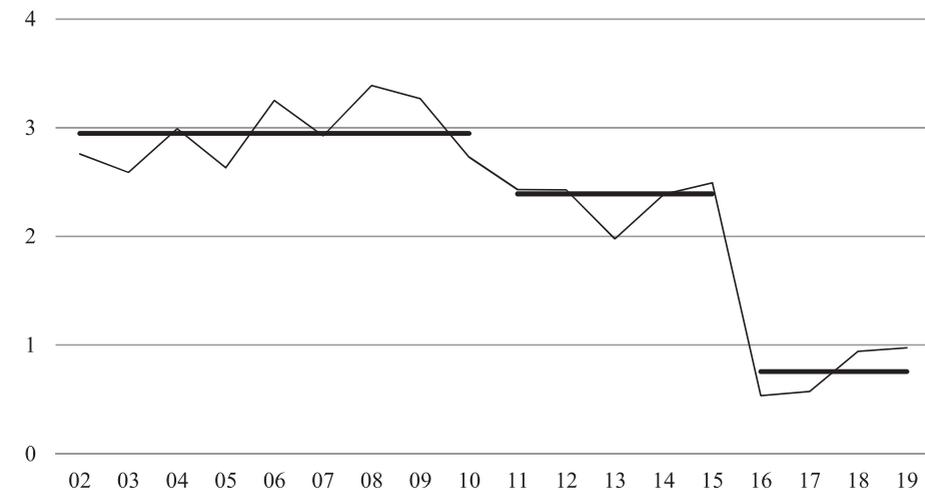
Compared to this scheme, however, the national contracts had been repeatedly renewed during the 2000s in the industrial sector with increases well above the planned inflation rate.

Despite the loss of competitiveness in the manufacturing sector, contractual wages had grown in the 2000s at a rate of around 3 per cent, which compares to a planned inflation rate of 1.7 per cent on average. The growth of total compensation per hour worked, as we have seen, had also been higher, leading to the loss of competitiveness of the industry that we have discussed.

It seems that the industrial relations system had operated in the 2000s without taking into account the fact that exchange rate depreciations were no longer possible. It is also meaningful that wage increases were agreed in those years without relevant pressure in terms of strikes by the unions.

In fact, once the entry into the euro was achieved, wage policies had been abandoned. There are analogies with what happened in the same period in Italy on the side of public finance objectives.

FIGURE 9 – *National collective agreements hourly wages, manufacturing*



yoy % change

Source: Calculations on Istat data.

Since 2009 the inflation objectives have been replaced by inflation projections (in terms of the inflation rate excluding the effects of energy products projected by ISTAT, the National Statistical Institute). This change can be considered a normal consequence of the loss of credibility of the planned inflation rate.

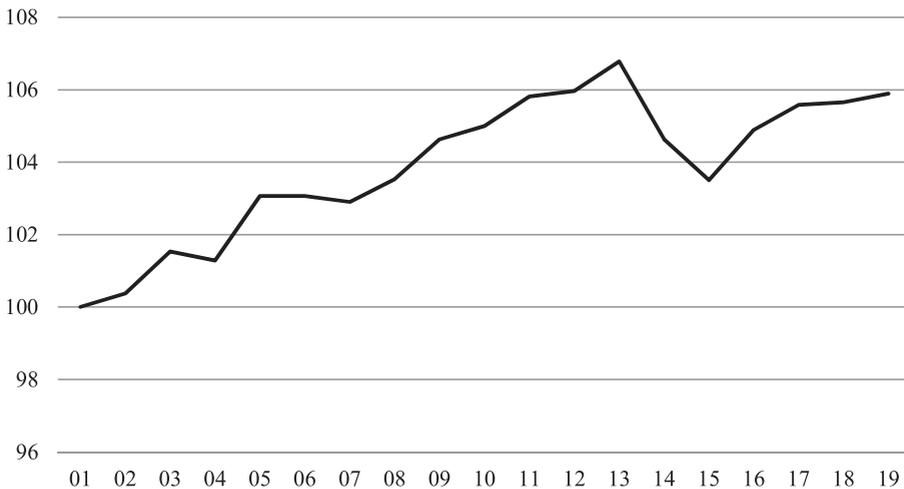
The fall in growth rate of contractual wages since 2016 was due to the fact that

wage bargaining incorporated low inflation forecasts for the following years, and had also taken into account the fact that in previous years inflation had been lower than the projections the previous contracts had been based on. This has therefore implied a “recovery” of this differential, so that contractual wages in recent years have grown even less than the projected inflation.

Finally, the weakness of the labour market also played a role, so that in the last few years the wage drift growth (the difference between actual wages compared to the centrally negotiated wages) has been nil.

Moreover, in normal conditions growth in wages would have been higher than that resulted in centrally negotiated wages. This is due to the transformation in the structure of the labour force, with the entry of more educated and skilled young workers, which should increase the levels of human capital. On the other hand, the rise in the number of temporary workers, whose wages are generally lower, must also be considered. The increase in temporary workers has contributed to moderating the average growth in manufacturing wages.

FIGURE 10 – *Wage drift: actual hourly wages/ negotiated wages ratio, manufacturing*



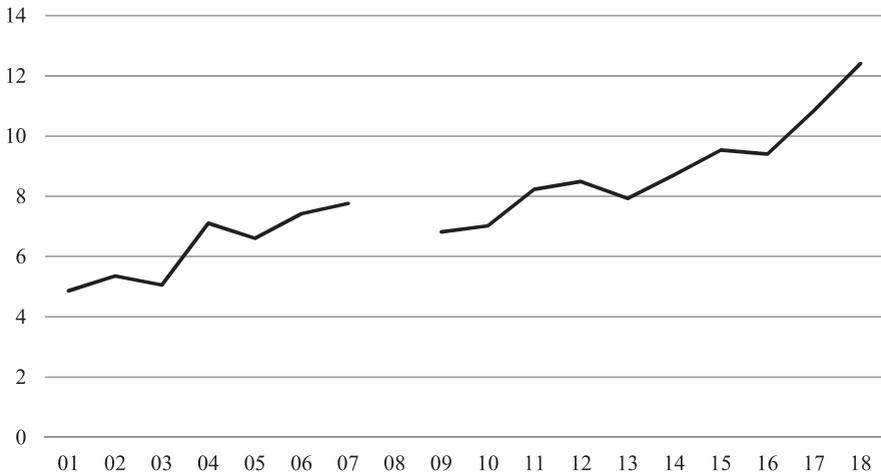
Index 2010 = 100

Source: Calculation on Istat data.

In recent years fiscal incentives have tried to favour second-level bargaining. A relative diffusion of firms’ “welfare plans” was also observed, as a form of compensation totally non taxed. However, the success of these measures has remained confined to large and medium-size firms (Leonardi, 2017).

The slowdown in wage growth occurred in all the sectors of the economy in recent years. Indeed, in service sectors, the wage growth has actually been even lower than in the manufacturing industry.

FIGURE 11 – *Temporary employees as per cent of total employment, manufacturing*

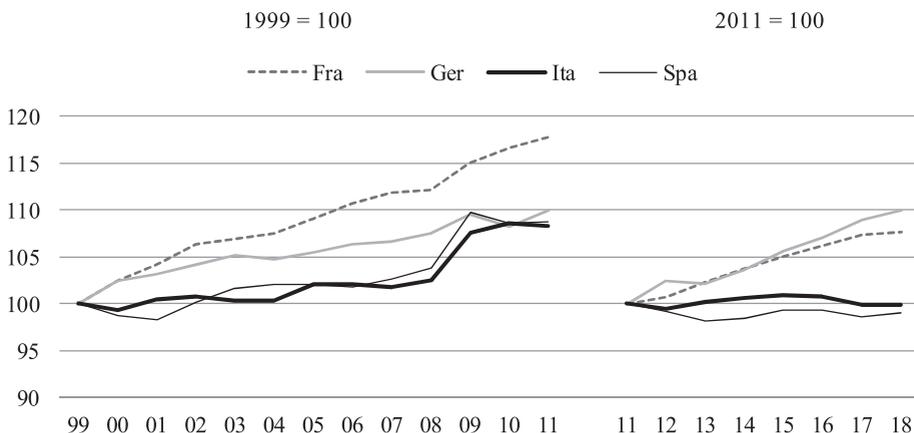


Source: Calculation on Istat data.

The slowdown in nominal wages was therefore reflected in the extremely weak trend of real wages. The purchasing power of wages recorded a weak trend in Italy, both in absolute terms and in relative terms. Since 2011, Italy accumulated a differential by almost 10 per cent compared to France and Germany, more than during the period 1999-2011.

Figure 12 refers to the business sector. Moreover, the trend for the whole economy is even weaker, considering the long-lasting freeze in public sector wages.

FIGURE 12 – *Real wages*



Business economy, based on consumption deflator.

Source: Calculation on OECD data.

5. WAGE STAGNATION AND AGGREGATE DEMAND

The purchasing power of wages was also reduced by the increase in fiscal pressure, mainly after the fiscal consolidation realized in 2012. In 2015 this increase was offset for a large group of workers by the “80 euro monthly tax bonus”, a tax credit to the employees with a gross annual income of between 8145 and 26,000 euros.

The tax wedge for salaries below the higher threshold to benefit from the 80 euro tax bonus has therefore been reduced, reaching the level of the years before the crisis, while for workers above this threshold it has risen by two percentage points, thus further worsening the trend of their purchasing power.

The difficult situation of Italian workers has led governments to adopt other measures to support household incomes in recent years. In addition to the 80 euro tax bonus, some other interventions, not specific to the wedge on labour cost, had a positive impact on household disposable incomes, among which was the abolition of the IMU (a tax on properties) on homes used as main residence. An indirect positive impact has come from the fiscal incentives for firms hiring workers with permanent contracts in 2015 (a part of the so-called “Jobs act”, a reform of the labour market). Other measures to support consumers’ purchasing power were introduced in 2019, with the “Citizenship’ income”.

The impact of these measures was actually to mitigate, at least partially, the weakness of household incomes. On the other hand, to finance these interventions other restrictive measures were introduced, mainly through a strict control of public spending. So, the overall fiscal policy stance was not expansionary.

Overall, domestic demand was therefore very weak, both because fiscal policy has only partially compensated the impact of the labour market conditions on household income, and because public spending has suffered from a slowdown that has few historical precedents.

Thus, the pattern of demand in recent years shifted to an industry-friendly sector mix, which affected the relative growth rate at sector level. The next Table 1 summarizes this symmetry by splitting GDP growth in the main economic activities and according to the components of aggregate demand. For each variable the cumulated percentage increase over the period and the contribution to the percentage change in GDP are presented.

As can be seen, Italy exports in recent years have grown at a faster rate than those of France and Germany. Also investment had a good performance in relative terms (also due to fiscal incentives), and this is another sign of the manufacturing sector recovery.

On the other hand, Italian imports have grown as much as those of other countries (less than in Germany, more than in France). Given the lower growth of Italy’s domestic demand, this means that the elasticity of imports to total demand has remained high. This is partly due to the characteristics of the growth process, as export and investment normally have a higher content of imports than consumption.

TABLE 1 – *Growth Decomposition by Demand Components and Industries*

	<i>Ger</i>	<i>Fra</i>	<i>Spa</i>	<i>Ita</i>	<i>Ger</i>	<i>Fra</i>	<i>Spa</i>
	<i>% change 2015 q1 - 2019 q2</i>				<i>Italy differential</i>		
GDP at market prices	8.0	6.7	12.1	4.6	-3.4	-2.2	-7.5
Household cons	7.3	5.5	9.6	4.8	-2.4	-0.7	-4.7
Pub Admin cons	11.7	4.9	6.9	1.3	-10.5	-3.6	-5.6
Investment	14.7	13.8	18.5	15.2	0.5	1.4	-3.4
Export	12.4	12.8	18.4	13.4	1.0	0.6	-5.0
Import	18.1	11.8	15.5	15.5	-2.6	3.7	-0.1
	<i>contributions to Gdp % growth</i>				<i>Italy differential</i>		
Household cons	3.8	3.0	5.6	2.9	-0.9	-0.1	-2.7
Pub Admin cons	2.3	1.2	1.3	0.2	-2.0	-0.9	-1.1
Investment	2.9	3.0	3.3	2.6	-0.4	-0.5	-0.8
Export	5.8	3.9	6.2	4.0	-1.8	0.1	-2.2
Import	-7.1	-3.8	-4.7	-4.1	3.0	-0.4	0.6
Net export	-1.3	0.1	1.4	-0.1	1.2	-0.2	-1.6
Inventories	0.3	-0.6	0.4	-1.1	-1.3	-0.4	-1.4
	<i>% change 2015 q1 - 2019 q2</i>				<i>Italy differential</i>		
Value added, base prices	7.8	6.4	12.0	5.0	-2.8	-1.4	-7.1
Agriculture	-2.7	-3.6	6.7	-0.4	2.3	3.1	-7.2
Industry (exc construct)	7.0	1.4	8.2	10.0	3.0	8.6	1.8
Construction	8.5	3.2	22.9	7.0	-1.5	3.8	-16.0
Private services	7.1	9.5	13.9	5.5	-1.6	-4.0	-8.4
Public Services *	11.2	3.6	7.3	-2.2	-13.4	-5.8	-9.5
	<i>contributions to value added % growth</i>				<i>Italy differential</i>		
Agriculture	0.0	-0.1	0.2	0.0	0.0	0.1	-0.2
Industry (exc construct)	1.8	0.2	1.4	1.9	0.1	1.7	0.5
Construction	0.4	0.2	1.3	0.3	-0.1	0.1	-1.0
Private services	3.6	5.3	7.8	3.2	-0.4	-2.1	-4.6
Public Services *	2.0	0.8	1.4	-0.4	-2.4	-1.2	-1.7

*Public administration, defence, education, human health and social work activities.

Source: Calculations on Eurostat data.

The low growth rate of the Italian economy in recent years is therefore largely due to the relative weakness of both household consumption and public expenditure. A better relative performance of exports and a less dynamic domestic demand are the typical traits behind the growth of recent years.

Since the wage slowdown is part of the explanation of both phenomena, this could mean that Italy's growth pattern will remain different from the other major European countries as long as the labour market conditions remain weak, keeping the wage growth lower than in the other countries of the euro area.

6. CONCLUSION

The Italian economy has experienced a long period of low growth. The main explanations of the Italian stagnation are focused on the low growth in productivity, especially in the non-tradable sectors.

Since there are no signs of a productivity recovery in non-tradable sectors, it is predictable that in coming years Italy will maintain a lower growth rate than that of the other main countries of the euro area.

This pattern based on stagnating wages and low productivity also prevents the manufacturing recovery from spreading to the whole economy.

However, the convergence of the manufacturing sectors growth over the last five years is a relevant fact, which should not be underestimated by policymakers.

Policies should aim to further strengthen this segment of industrial firms, which is already achieving good results in international markets. However, policies should focus more on the objective of an economic growth based more on productivity gains. From this point of view, over the last few years some measures have been introduced, such as tax incentives to investment for the adoption of process innovations ("superammortamento" and "Industria 4.0") and R&D expenditures. Other important steps should concern policies for the growth in the size of firms, stimulating the aggregation through firms' mergers and acquisitions, as well as policies that favour human capital accumulation, through increasing the number of graduates in scientific disciplines and interventions to improve the school-work transition, overcoming the scarce predisposition of small Italian firms to acquire technical and managerial skills.

Overall, the signs of strength in the manufacturing sector are not sufficient to support a recovery of the whole economic system. However, they may represent a first brick on which to begin to rebuild an economic system that is eroding from its foundations.

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