ITALY: A DIFFICULT ECONOMY?

In 1992, the Italian economy descended into its worst recession since World War II: the rate of growth fell below 1 percent, half the average of other European countries. Unemployment dropped 11 percent nationwide and more than 20 percent in the less-developed South. The demand for domestic products declined, and import penetration increased resulting in the negative trade balance. Sales in foreign markets deteriorated due to a loss of price competitiveness, sluggish demand, and a lack of product differentiation. Italian public debt rose to 108 percent of GDP, second only to Greece among the 12 European Community (EC) economies[1] (see **Exhibit 1**).

The economic problems were compounded by dramatic political upheavals. Following a seemingly inconsequential arrest of a local Socialist party official in Milan in February of 1992, Italian magistrates initiated a series of investigations that unveiled decades of corruption, patronage and monetary kickbacks between Italian industrialists and local and national politicians. The resulting political scandals and fear of possible future indictments effectively froze all public investments in Italy. In the local elections of April 1992, all major political parties—Christian Democrats (DC), Socialists (PSI), and former Communists (PDS)—experienced significant losses. By contrast, protest parties, including the radical wing of the Communist party, the neo-Fascists, regional and secessionist parties, among them, Lega Nord (Northern League) in the industrialized North and La Rete (the Network) in the South, fared extremely well, establishing themselves as dynamic forces. To make things worse, the Mafia responded dramatically to the state's unsuccessful, perhaps reluctant, attempts to quell its influence in the South. In 1992 and 1993, the Mafia claimed responsibility for the killings of a prominent DC official, two key anti-Mafia investigators, and a series of bombings in Rome, Florence, and Milan. The government of Giuliano Amato, whose inherent weaknesses surpassed even the legendary failings of Italian coalition governments, seemed to "preside over the death throes of postwar Italy."[2]

The combination of economic and political crisis raised serious doubts about Italian ability to fulfill the so-called "convergence criteria" set by the Maastricht Treaty of 1991 as the

---

[1]*OECD Economic Survey: Italy 1994* , OECD, Paris, 1994, 11-12.
[2]This brief assessment of Italian political life mostly relies on Patrick McCarthy's book, *The Crisis of the Italian State* (New York: St. Martin's Press, 1995), 144.

entry requirements for the European Monetary Union (EMU). In 1992, Italy was the only major European country to widely diverge from each of the four Maastricht criteria on inflation, interest rates, the budget deficit, and public debt.[3] Fueled by the general instability in European markets surrounding the ratification of the Maastricht Treaty and the stubborn insistence of the Bundesbank on high interest rates, the Italian lira came under a series of speculative attacks in summer of 1992. In September 1992, the government of Giuliano Amato was forced to abandon the European Monetary System (EMS) and devalue the currency. Economic analysts, both inside and outside Italy, agreed that the future of the Italian economy hinged upon the ability of small and medium-sized Italian enterprises to respond promptly to this devaluation and pull the country out of the crisis.

Italy In Europe?

"Is Italy converging with the rest of Europe or moving towards the African shore?"[4] The question, raised by Innocenzo Cippoletta, president of the Italian employers' association, Confindustria, was on everyone's mind in the early 1990s. In a speech before the Senate on the vote of confirmation for his newly formed government, Giuliano Amato asserted that there was no alternative to Italy's commitments to Europe. The choice was not whether or not Italy would become a part of the European Union (EU), but rather whether it would be relegated to the second tier, becoming the EU's Disneyland economy, or endeavor to meet the Maastricht convergence criteria.[5]

"A state with weak economic management capacity," writes Vincent della Sala, "should be susceptible to the transforming forces of markets and supranational authority such as the European Union."[6] As one of the original signatories of the Treaty of Rome, which established the European Economic Community (EEC), Italy has always been an enthusiastic supporter of the European unification. In late 1970s, despite advice of economic experts and the Bank of Italy that the country should not resort to devaluation, the government decided to join the EMS.[7] In 1985, at the Milan summit of the EC Council of Ministers, the Craxi government was instrumental in drafting the Single European Act, a blueprint for "deep integration" of the European economies.[8] In late 1990, at the time of the preparations of the Maastricht Treaty, Italy held the EC presidency. In December 1991, Italians enthusiastically signed the Maastricht Treaty, although it was already obvious that the country would have serious difficulties in meeting the Treaty's monetary criteria.

---

[3]*OECD Economic Survey: Italy 1992* (Paris: OECD, 1992), 50.

[4]Innocenzo Cipolletta, "Italy: an Ever-Lagging Economy?" in Mario Baldassarri and Franco Modigliani, *The Italian Economy: What Next?* (London: Macmillan Press, 1995,) 9.

[5]Alberto Rapisarda, " Il paese e' investito dalla tempesta," *La Stampa*, July 1, 1992. All translations from Italian to English by A. Hozic.

[6]Vincent della Sala, "Hollowing Out and Hardening the State" in Martin Bull and Martin Rhodes (eds.), *Crisis and Transition in Italian Politics,* Frank Cass, London, 1997, 19.

[7]See Donald Sassoon, *Contemporary Italy* (London: Longman, 1986), 82.

[8]McCarthy, *The Crisis*, 53.

Both EMS and the Maastricht Treaty, the latter in particular, severely limited the government's scope of maneuver. The main purpose of the EMS was to create a "zone of monetary stability in a world of wildly fluctuating exchange rates" in the late 1970s.[9] It established a range—between 2.25 and 6 percent—within which the currencies of member countries could fluctuate against each other. Any other fluctuation would require an officially agreed upon realignment of all currencies.[10] Eventually, the EMS also became a mechanism for combating inflation, synchronizing interest rates, and promoting growth in EC economies.[11] Thus, it was widely acclaimed and perceived as the foundation for the Single European Act of 1986.[12] Italian experiences were somewhat more complex. On the one hand, there was no doubt that Italy's participation in the EMS was most responsible for the reduction of inflation rate from 21.2 percent in 1980 to 4.5 percent in 1987.[13] On the other hand, a strong lira, coupled with an even stronger deutsche mark, threatened Italian export competitiveness, particularly among its main European trading partners, France and Germany, and competitors, Spain, Greece, and Portugal.

The Maastricht Treaty further eroded states' sovereignty in economic matters. The treaty set the timetable for European Monetary Union (EMU) and envisaged three distinct stages of integration.[14] In the first stage, which started in 1990, member countries were supposed to bring their currencies within the narrow band of the EMS and remove all obstacles to free capital movements. Committed to the system of fixed exchange rates, the Italian government placed the lira within the 2.25 range (from its previous 6 percent) in January of 1990, and subsequently lifted the last remnants of capital controls.[15] In the second stage, which was to start on January 1, 1994, the treaty expected member countries to secure economic convergence and establish the European Monetary Institute. In the third and final stage, the currencies were supposed to be irrevocably fixed and the European Monetary Institute replaced by the European Central Bank. Most importantly, European Council was to make the final decision about each country's entry into the EMU based on the four "convergence criteria" set by the Maastricht Treaty.

The "convergence criteria" were very clear and focused almost entirely on monetary aspects of economy. The first criteria established that the rate of inflation could not diverge more than 1.5 percent from the best performing member. According to the second criteria, planned or actual budget deficit should not be greater than 3 percent of the Gross Domestic Product (GDP), and the public debt should not exceed 60 percent of GDP. The third criteria

---

[9]Desmon Dinan, "The European Community 1978-1993," in "The European Community: To Maastricht and Beyond," *The Annals of the American Academy of Political and Social Science* 531, January 1994, 15.

[10]Stephen F. Overturf, "The Economics of the Renewed Integration Movement," also in "The European Community: To Maastricht and Beyond," 86.

[11]Ibid.

[12]Dinan, "The European Community," 15.

[13]Franco Modigliani, "1993: The Year of Great Opportunity?" in Baldassarri and Modigliani, *The Italian Economy*, 99.

[14]For a detailed description of stages of integration and Maastricht "convergence criteria," see Loukas Tsoukalis, *The New European Economy Revisited* (Oxford: Oxford University Press, 1997), 168-9.

[15]*OECD Economic Survey: Italy 1990/91* (Paris: OECD, 1991), 11.

required that currency must stay within the narrow band of the EMS for at least two years prior to admission into the EMU. Finally, the fourth criteria set the average nominal interest rates on long-term bonds to a maximum 2 percent divergence from the three best performing countries. According to these four criteria, wrote Loukas Tsoukalis,

> Italy was likely to present the most difficult problem. Its exclusion, even though temporary, from the select group participating in the final stage would be politically loaded: it is after all a founding member of the Community and also a big country which has always supported moves towards further integration. In economic terms, however, its participation may be difficult to reconcile with the need to strengthen the credibility of EMU, especially in its early stages, because of Italy's large public debt and its poor record in terms of stability-minded policies.[16]

The Ninth Recession

Political and economic crises were not novelties on the Italian peninsula. Indeed, according to a daily business newspaper, *Il Sole 24 Ore*, by the beginning of the 1990s Italy had already gone through eight recessions.[17] In the decades since the end of World War II, the country had witnessed more than 50 governments, several failed military coups, and successive waves of left- and right-wing terrorism. The Italians had weathered an abundance of conspiracy theories and practices, and periods of inflation so high that coins had to be withdrawn from circulation and replaced by candies and lollipops in stores throughout Italy.[18] An editorial in *The Economist* reminded its readership in the midst of the ninth, 1992 recession,

> [Italy] seemed to be in permanent crisis, yet prospering in spite of everything. "How is your crisis going?" inquired Ronald Reagan when he met the Italian Prime Minister of the day in 1985. "Very well, thank you," came the reply.[19]

What made this ninth recession different and more difficult than others was not just the threat of exclusion from the European Union. It was the realization that the "model Italy"—constructed around mass political parties, a vast public sector, and state protection of the largest industries—was itself the cause of the crisis. The two previous recessions (in 1975 and 1980-83) could, at least in part, be attributed to the first and the second oil shock respectively, and to the increase in international, particularly Asian, competition in sectors such as car manufacturing, steel, and electronics. Despite attempts in the fall of 1992 to blame the Bundesbank for its high

---

[16]Tsoukalis, *New European Economy*, 179.

[17]Innocenzo Cippoletta, "Che cosa indicano i dati congiunturali della fine '90 e il confronto con i precedenti cicli di crisi; La nona recessione sara' cosi'" *Il Sole 24 Ore*, January 4, 1991, 5.

[18]An entertaining and intelligent description of the "coin crisis" and "lollipop economy" can be found in Hans Magnus Enzenberger's *Europe, Europe* (New York: Pantheon Books, 1989).

[19]"Fall of the Roman Empire," *The Economist*, November 28, 1992, 19.

interest rates—and hence, for the overvalued lira—the majority of Italians had little doubt that the ninth recession was entirely of their own making.

In the words of the two well-known economists, Mario Baldassarri from Universita de la Sapienza in Rome, and Franco Modigliani from MIT, the crisis was a direct consequence of a "perverse enveloping growth model" that Italy adopted in the 1980s.[20] The model relied on excessive deficit spending—public deficit and debt, on the one hand, and current account deficit, on the other. The deficit, in turn, required high interest rates to ensure a continued placement of the public debt bonds and maintenance of the lira exchange rate (via an "aggregate" balance-of-payments equilibrium and at the cost of a growing foreign debt). The high interest rates further squeezed production investment while fueling consumer demand, particularly for imports. The net result of all these "cogs" was that Italian economy "was increasingly less satisfied by domestic production and increasingly more satisfied by foreign production, in the form of imported finished goods and imported semifinished goods and components."[21] Declining export flows and further deterioration of public debt and current account deficit closed the vicious circle (see **Exhibit 2**).

The model performed relatively well until 1987, the year of "il sorpasso," when the Italian economy surpassed Mrs. Thatcher's Britain and became, much to everyone's surprise, the fourth-largest economy in the world. But, according to Baldassarri and Modigliani, the competitiveness of the Italian economy fell by 15 percent between 1987 and 1992. In the same time period, the current account deficit increased from 1,878 billion lire to 30,000 billion lire with nearly 25,000 billion lire in interest payments. In their estimate, the growing current account deficit led to a loss of some 800,000 jobs since mid-1970s, net of the 1,000 000 jobs created in the public sector.[22]

The Structure of Italian Industry

The main characteristic of the Italian economy in the postwar period has been a series of profound dualisms: between the industrialized North and the underdeveloped South, the public and private sectors, and large industrial enterprises and small family-ran firms. The often spectacular growth of the economy just as often exacerbated internal divisions. The rise of the Northern industrial complex largely depended on internal migration and wage differentials between the North and the South. Highly politicized attempts of the state to mitigate discrepancies of regional (under)development resulted in public sector inefficiencies and redundant industrial projects. Support of large public and private corporations perpetuated the rigidities of the internal labor market and indirectly encouraged the surge of an informal economy where labor had remained unregulated until the early 1990s.

---

[20]Baldassarri and Modigliani, *Italian Economy*, 3-6.
[21]Mario Baldassarri, "Italy's Perverse Enveloping Growth Model Between Economic Reform and Political Consensus: the 1992 Crisis and the Opportunity of 1993" in Baldassarri and Modigliani, *Italian Economy*, 80-81.
[22]Baldassarri and Modigliani, *Italian Economy*, 4.

The Italian political system suffered from its own idiosyncrasies. Italian politics was long dominated by a single political party—Christian Democrats—who focused all their efforts on the exclusion of Communists from the government. Since the Italian electoral system relied on proportional representation, the party system was highly fragmented and government coalitions sometimes comprised representatives from as many as five different political parties. Consequently, the governments were weak and rarely lasted more than six months. Yet, despite this nominal instability, their composition rarely changed. The economic policy of Christian Democrats, ever in search of voters and clients, was expansionary and interventionist: as a result, the Italian state evolved into a miracle of inefficiency. Management positions in public sector companies became the main source of patronage, and state-owned enterprises became instruments of industrial policy. The latter "lacked coherence and foresight" and consisted of "random public interventions, including extensive bailing out and feather-bedding of large ailing private companies . . . aimed at protecting jobs and safeguarding peace in labor relations."[23] The intrusion of the state in the economy created numerous opportunities for corruption. The lack of any meaningful alteration of power in the government further encouraged it.

In such a context, the organizations that seemed to cross all the above dichotomies were pyramidal business groups. According to an OECD study of the Italian industrial structure, the groups—such as FIAT, Feruzzi, Pirelli, Rizzoli, Parmalat or Benetton—were mostly hierarchical, with an exclusively vertical chain of control within each particular group and multiple equity linkages between groups.[24] A 1991 industry survey discovered that 87 percent of firms with sales larger than L500 billion ($333 million) had equity stakes in other firms and that 151 group controlled more than 6,500 firms.[25] The groups enjoyed support of the government, privileged access to capital mostly channeled through the Milan-based Mediobanca, and their size (as well as the size of firms in general) directly correlated to their degree of internationalization[26] (see **Exhibits 3** and **4**). Thus, given the difficulties in obtaining long–term financing in Italy and sluggish financial markets, "dominant group structure may have constituted a framework in which flexible inter-firm and labor relationships could be established, providing smaller firms with an efficient long-run structure of incentives to suppliers, managers, and workers alike."[27] The study concluded with a warning that small and medium-sized firms, which had constituted the backbone of Italian economy and the essence of its competitive advantage in traditional goods-producing sectors, might no longer be able to withstand the pressures of international competition. The solution, the study suggested, could be sought in the strengthening of their links with large business groups and improved and more democratic access to long-term capital.[28]

---

[23]*OECD Economic Survey: Italy 1990/91* (Paris: OECD, 1991), 79.
[24]See special section on corporate governance in Italy, *OECD Economic Survey: Italy 1995* (Paris: OECD, 1995), 51-109.
[25]Ibid., 63.
[26]For a detailed account of intricate relations between the state, Mediobanca, and Italian business groups, see also McCarthy, *The Crisis*, particularly 86-94.
[27]*OECD Economic Survey: Italy 1995*, 84.
[28]Ibid., 106-107.

Small Is (Not) Beautiful

Small firms have been the "life blood" of the Italian economy at least since the 1970s. Small and medium-size enterprises in traditional sectors such as textile, footwear, leather products, ceramic tiles, wooden furniture, musical instruments, and machine tools have pulled the economy out of a severe crisis. Located in Northeastern Italy, in a triangle geographically defined by Udine, Pisa, and Ascoli Piceno, centered in Bologna and Florence, the majority of successful small firms have been clustered in industrial districts. Textiles are principally manufactured in Prato and Biella, furniture in Poggibonsi, ceramic tiles in Sassuolo, kitchen utensils in Omegna, fountain pens in Settimo Torinese, and sport rifles in Gardone Val Trompia. According to Fabio Sforzi, researcher at IRPET (Institute for Planning of Tuscany), between 1971 and 1981, industrial districts experienced the fastest increase in employment both in manufacturing and in total employment, far ahead of all other local systems and the national average.[29] By 1981, their official share of total manufacturing employment in Italy was 73.9 percent or more. Since much of the small-business employment eluded the census, it is quite possible that more than three-quarters of Italian manufacturing in the 1980s was in the firms with fewer than 500 employees.[30] In 1992, small and medium-size firms captured 70 percent of total sales in the Italian economy and 40 percent of the country's exports. According to Confindustria, companies with fewer than 20 employees made up 95 percent of all Italian companies and employed 36 percent of the workforce; companies with fewer than 100 employees accounted for 99 percent of all companies in Italy and employed 59 percent of the industrial workforce. [31]

The remarkable performance, particularly in exports, of small and medium-size firms in industrial districts and their ability to generate employment in times of crisis attracted the attention of economists, sociologists, and political scientists since it countered dominant economic and organizational models of the 20th century. The latter had long favored capital-intensive, vertically integrated, and, preferably, multinational corporations; by contrast, family-owned small firms with their artisan production, often for specific customers or niche markets, were generally viewed as the inefficient vestiges of a bygone era.[32] Arnaldo Bagnasco first made the case for the small industry of Northeastern and Central Italy in 1973. Arguing against the dualism of the North and South in interpretations of Italian economic history, Bagnasco described "La Terza Italia" (the Third Italy), a peripheral economy in the stretch between Rome and Milan characterized by small and medium-sized firms. In 1979, Giacomo Becattini, still one

---

[29]Fabio Sforzi, "The Quantitative Importance of Marshallian Industrial Districts in the Italian Economy" in Frank Pyke, Giacomo Becattini, and Werner Sengenberger (eds.), *Industrial Districts and Inter-Firm Cooperation in Italy* (Geneva: International Institute for Labour Studies, International Labor Organization, 1990), 106.

[30]Giacomo Becattini, "Italy" in Werner Sengenberger, Gary Loveman and Michael J. Piore (eds.), *The Re-emergence of the Small Enterprises* (Geneva: International Institute for Labour Studies, International Labor Organization, 1990), 155.

[31]Antonia Sharpe, "Survey of Italian Industry," *Financial Times*, October 19, 1992, 14.

[32] All in Sebastiano Brusco, "The Idea of Industrial District: Its Genesis" in Pyke, Becattini, and Sengenberger (eds.), *Industrial Districts*, 11.

of the most influential scholars of the phenomenon, focused his attention on industrial districts, particularly in Tuscany. Finally, the most persuasive argument in favor of small enterprises came from Charles Sabel and Michael Piore in *The Second Industrial Divide*, where Italian small firms (along with Japanese machine tools, German mini steel mills, and high-tech districts in the United States) served as the premier example of flexible specialization.[33]

The geographic concentration of small firms in particular manufacturing sectors is now generally regarded as the essential feature of industrial districts. The districts are “geographically defined productive systems characterized by a large number of firms that are involved at various stages, and in various ways, in the production of a homogenous product.”[34] But, as experts on industrial districts are quick to warn, not all agglomerations of firms in a geographic region are industrial districts. According to Werner Sengenberger and Frank Pyke, the crucial characteristic of the industrial district is *organization*. The existence of *networks* between small firms, of division of labor according to the principles of specialization and subcontracting, is particularly important since it results in a combination of economies of both scale and scope for the district as a whole. The second important feature is the combination of *cooperation* and *competition* among the firms. The readiness to share information and services is balanced by competition on a range of dimensions—such as quality, design, innovation, speed—and not just on price. Finally, industrial districts generally possess an unusual degree of *entrepreneurial dynamism* and an *adaptable, well-trained, and cooperative workforce*.[35]

Consequently, the explanations of the success of small and medium sized firms in industrial districts have generally focused on their flexibility and ability to generate (and benefit from) the so-called external economies. The flexibility refers to both adaptability and innovation. It entails that firms are able to respond to market signals very quickly: in the late 1970s, for instance, Italian manufacturers promptly shifted their exports from Germany to the United States as soon as the terms of trade across the Atlantic tilted in their favor.[36] But it also entails the ability of firms to constantly innovate and switch production from one line of products to another and, hence, to seize the market at the time when the price is at it highest. Thus, at least in Sabel's and Piore's view, the competitiveness of firms that are truly flexible should not be based so much (or not exclusively) on the price as on the quality, design, or uniqueness of the product.[37] At the same time, as Becattini noted (borrowing the term from the late 19th century economist Alfred Marshall), possible drawbacks of small volume production in industrial districts are compensated by economies of scale external to the firm but internal to the district. In addition, industrial districts often generate other “externalities” such as cumulative knowledge and skills, research and development funds and findings, and/or information about the market, which are then shared among all participants in the district. Combining elements of competition

---

[33]Michael J. Piore and Charles F. Sabel, *The Second Industrial Divide* (New York: Basic Books, 1984).

[34]Pyke, Becattini, and Sengenberger, *Industrial Districts*, 2.

[35]This broader description/definition of industrial districts can be found in Frank Pyke and Werner Sengenberger (eds.), *Industrial Districts and Local Economic Regeneration* (Geneva: International Institute for Labour Studies, International Labor Organization, 1992), 3-29.

[36] *OECD Economic Survey: Italy 1988/89* (Paris: OECD, 1989), 29-31.

[37]Piore and Sabel, *Second Industrial Divide*.

and cooperation, industrial districts are able to achieve the efficiency of vertically integrated corporations without losing any of their flexibility.[38]

While the emergence and economic performance of industrial districts around the world—from Hollywood and Silicon Valley in the United States to Jutland in Denmark, Baden Wurttemberg in Germany, or Smaland in Sweden—would indicate that the phenomenon of small and medium enterprises is not uniquely Italian, several institutional factors, specific to Italy, have definitely made it more salient in Italy than elsewhere. Sociologist Carlo Triglia has named three such factors: (1) a network of small and medium-size urban centers with craft tradition which acted as principal sources of entrepreneurship and skills; (2) a number of family-based agricultural small holdings (sharecropping, peasant farms) which provided the original, highly flexible and relatively inexpensive, pool of labor, and (3) the presence of Catholic and socialist/communist political traditions. Both traditions were, for their own reasons, susceptible to community-based development and interested in the creation of a strong middle-class base. Paradoxically, small industry also benefited from the embedded weaknesses of the Italian state. As Massimo Paci argued, the Italian welfare state, just like all other aspects of Italian political and economic life, has been characterized by a significant degree of dualism. On the one hand, the state has had an interventionist tendency, partly based on corporate guarantees and partly on protectionist-clientelistic types of policies. On the other hand, the state has left three extremely important issues to be regulated by and within the private sphere: fiscal policy, black market, and some welfare measures that fell onto family.[39] Hence, the dualism was directly reflected in the Italian industrial policy (or lack thereof): while the state often intervened to protect big industries, it left the regulation of the small industry almost entirely to the private sector—through tax evasion, unregulated labor, and communal solidarity/welfare in hard times. Among the factors that encouraged the growth of small firm employment was the exemption of firms with fewer than 15 employees from job protection legislation until May 1990.[40]

However, by the late 1980s, many of the exogenous factors that had initially prompted the development and success of small firms had changed or disappeared. According to Triglia, Italian entry into the EMS "put an end to the policy of gradual lira devaluation that had propped up Italian exports throughout the 1970s. International competition grew tougher and there was no slackening of uncertainty and instability. The devaluation of the dollar had a very negative effect on exports."[41] Exports in the Italian footwear industry decreased from 1985 onwards; in 1990 Italy was still the leading exporter in the world, but its share of the world exports had decreased to 19.9 percent from 43.2 percent in 1970 (see **Exhibit 5**).[42] High interest rates tightened access to capital, and many small firms found themselves "caught in a net of costly short-term debt,

---

[38]Becattini, "The Marshallian Industrial District as a Socio-Economic Notion," in *Industrial Districts*, 37-51.
[39]See Massimo Paci, "Pubblico e privato nel sistema Italiano di welfare," in Peter Lange and Mario Regini (eds.) *Stato e Regolazione Sociale* (Bologna: Il Mulino, 1987).
[40]*OECD Economic Surveys: Italy 1996* (Paris: OECD, 1996), 90.
[41]Carlo Triglia, "Work and Politics in the Third Italy's Industrial Districts," in *Industrial Districts*, 160-84.
[42]Roberta Rabellotti, *External Economies and Cooperation in Industrial Districts* (London: Macmillan Press, Ltd., 1977), 58.

declining domestic demand, and fierce international competition."[43] The mounting budget deficit and the pressures from the EU forced the Italian government to confront the issue of tax evasion,which amounted to 260 trillion lire in 1989 (21 percent of GDP).[44] Thus, in 1990 and 1991, there were more investigations of tax fraud. In 1991, the receipts from retrieved taxes amounted to 10 trillion lire compared to 5.5 trillion in 1990.[45] Given that most tax evasions were taking place among small entrepreneurs, self-employed professionals, and individuals with multiple jobs, it is quite obvious that any attempt to increase the efficiency of tax collection was bound to affect them the most. The final fiscal blow came in October of 1992, less than a month after the initial devaluation of the lira. The government, in a desperate move to quickly increase revenue, imposed a one-time 7.5 percent tax on all bank accounts, thus potentially penalizing all businesses that kept their operating capital in banks.[46]

Significant changes were also taking place within the industrial districts themselves. Many small firms, which constituted the essence of the "made in Italy" phenomenon in the early 1980s, were no longer small in the 1990s. Some were suffering under the weight of their own success; others, prompted by the prospect of the common market and heightened international competition, were actively engaged in mergers and acquisitions within their own sectors and sometimes beyond. A year-long survey of Italian industrial districts conducted by *Il Sole 24 Ore* in 1991 and 1992 revealed a growing tension between fragmentation and fierce competitiveness on the one hand, and monopolistic (or oligopolistic) tendencies towards consolidation and sectoral integration on the other.[47] Some of the most interesting cases in the survey included the following:

> In Murano, the famous glass-making island in Venice, a high degree of fragmentation (in 1989 there were 256 firms with 2,000 employees total) was threatening the success of their products on the international markets. According to the owners of some of the most prestigious glass-making companies, Murano was much better in production than in

---

[43]Robert Graham, "Survey of Italian Industry," *Financial Times*, October 19, 1992, 11.
[44]The Economist Intelligence Unit (1992), "Country Report on Italy, No. 1," 15, quoted in *OECD Economic Survey: Italy 1992* (Paris: OECD, 1992), 61.
[45]Ibid., 62.
[46]Graham, "Survey," 11.
[47]According to Giacomo Becattini, the series of articles in *Il Sole 24 Ore* was undoubtedly the most systematic—if nonacademic—effort to collect and present information about some aspects of Italian industrial districts that had previously been neglected by even the most vocal proponents of the "small is beautiful" phenomenon. The series consisted of reports on 65 localities that ranged from well-known local manufacturing systems, like Prato, Biella or Pesaro, to micro-realities completely unknown to the public (and even economists) such as Frosolone, Palosco or Thiesi. In the middle, there was a "bit of everything": brilliant examples of industrial districts such as Santa Croce sull'Arno, Carpi, and Sassuolo; relatively accidental agglomerations of firms such as Casarano; authentic industrial regions like Brianza; and places with mixed industrial-tourist vocation such as Viareggio-La Spezia. Becattini noted that some aspects of the report made Italian entrepreneurs look like "obsessive individualists," embroiled in cut-throat competition with each other. See Giacomo Becattini, "Viaggio nei distretti industriali – In Alcuni beni di consumo e nei macchinari per produrli si e delineata una supremazia," *Il Sole 24 Ore*, April 16, 1992, 8.

sales, marketing, or distribution of its products. The latter, in their view, could definitely benefit from integration of firms into fewer entities.[48]

In Castelgoffredo, the European capital of ladies' hose and stockings, the number of firms was rapidly declining in face of the diminishing demand. While the area was still producing 70 percent of hose in Italy and controlled more than 40 percent of the European market, market predictions were less optimistic. The increase in quality of tights and hosiery, Lycra in particular, has improved their durability and, consequently, undercut the demand. Small firms felt most of the pressure: the number of firms with fewer than 5 employees decreased from 63 percent in 1985 to less than 33 percent in 1992. The road to continued domination of the European market thus seemed to be the road of mergers and acquisitions, joint ventures, and sectoral integration.[49]

In the production of frames for glasses, mostly concentrated in the area of Belluno in Veneto, integration started taking place in the late 1980s. The industry is dominated by just two firms—Safilo and Luxotica—which control more than 50 percent of business conducted in this sector. Competing with each other, Safilo and Luxotica have forged not just national but also international alliances. Safilo purchased Optifashion and Oxfol in Italy and Starline Optical in the United States. Luxotica responded by acquiring AvantGarde Optics in the United States and Fidia and Florence Line in Italy. Safilo succeeded in getting contracts with Ralph Lauren, Ferrari, Gianfranco Ferre, Missoni, John Sterling, Gucci, and Laura Biagiotti; Luxotica, on the other hand, attracted Armani, Genny, Byblos, Giugiaro and Valentino. More recently, however, the entry of Benetton into the sector further solidified the trend towards oligopolistic competition and integration.[50]

Montebelluna is the largest center of brand names in sports shoes manufacturing. The area produces 50 percent of ski boots, 70 percent of after-ski boots, 80 percent of motorcycling boots and skating shoes, 50 percent of hiking boots and cycling shoes, 45 percent of soccer shoes, and 40 percent of tennis shoes in the world. It hosts firms such as Alpinestars, Anniel, Artex, Asolo, Brizia-Munari, Diadora, Dolomite, Lange, Lotto, Nordica, Rossignol, SanMarco, and Tecnica. However, the industrial structure in this sector is also shifting towards greater concentration. The new trend was signaled by Nordica, which maintains the world leadership in ski boots with 28 percent of global market share. In the late 1980s the company was purchased by Edizioni Holding, itself a part of Benetton. Nordica was the most precious piece of a mosaic that family Benetton controlled in the sport sector; others included Kastle (ski), Rollerblade (roller-skates), Asolo (running shoes) and Prince (tennis rackets). Simultaneous to the acquisition of Nordica by Benetton, Brixia acquired Munari and San Marco, which made it the third-largest snow-sport brand in the world, after Nordica and Salomon. In 1990, it merged

[48]Marco Moussanet, "Viaggio nei distretti industriali/1," *Il Sole 24 Ore*, July 23, 1991, 12
[49]Ibid., "Viaggio nei distretti industriali/4," *Il Sole 24 Ore*, August 2, 1991, 11.
[50]Aldo Bernacchi, "Viaggio nei distretti industriali/2," *Il Sole 24 Ore*, July 25, 1991, 7.

with the Dutch Group HTM, which united a set of other famous brands—Head (skis), Tirolia (bindings), and Mares (diving equipment). The decision was mostly motivated by a desire to reduce distribution costs and increase the financial weight of the company.[51]

The area circled by Cusio, Omegna, and Casale Corte, and nestled between the shores of Lake Maggiore and Lake Orta, hosts some of the most prestigious manufacturers of kitchen products and utensils such as Calderoni, Bialetti, Lagostina, and Alessi. A nucleus of approximately 40 medium-sized enterprises supports a network of hundreds of smaller firms, artisan stores, and family workshops which control nearly all of the Italian market and export some 25 percent of their products. In the 1990s, however, the industry faced a grave crisis, mostly attributed to the saturation of the domestic market and difficulties in accessing world markets. The solution, according to some industry leaders, should be sought in the integration or creation of an industry consortium.[52]

In Sassuolo, the world center of ceramic tiles, some 220 firms produce 330-million square meters of tiles, nearly 75 percent of Italian production or 54 percent of EU production and 28 percent of the world production of tiles. In other words, the district produces one out of four ceramic tiles in the world and accounts for nearly 60 percent of the world's exports in this sector. However, the world demand for ceramic tiles grows slowly, and Brazilian and East Asian producers have seriously threatened Italian dominance. In response, Sassuolo's manufacturers resorted to mergers and acquisitions and redesigned the property map of their district.[53]

Prato, the world center of wool textile production, changed quite profoundly in the period between 1987 and 1992. The number of firms declined by 5,000, the number of employees declined from 55,000 in 1985 to 48,000 in 1990. The change was a result of numerous problems inherent to the Prato production system that the area experienced in the 1980s—lack of modernization in management methods, too many family-run micro-enterprises, marketing and distribution external to the firm, declining quality, and rising prices. The local culture, however, remained strongly opposed to integration; in the views of the reporters from *Il Sole 24 Ore*, the majority of firms "would rather disappear than fall into someone else's hands."[54]

The problems of small and medium-sized firms all over Italy, analogous to those described in the above vignettes, became so grave by September of 1992, that Confindustria felt compelled to publish a "white book" on conditions of small firms across Italy. The "white book" represented a series of snap shots, detailing the crisis region by region. In Piedmont, for instance, small firms generated 12,500 new jobs in the first four months of 1992, but lost 23,900.

---

[51]Luca Paolazzi, "Viaggio nei distretti industriali/3," *Il Sole 24 Ore*, July 27, 1991, 7.
[52]Vera Viola, "Viaggio nei distretti industriali/7," *Il Sole 24 Ore*, August 14, 1991, 6.
[53]Alessandro Palteroti, "Viaggo nei distretti industriali/10" *Il Sole 24 Ore*, August 24, 1991, 8.
[54]Marco Magrini, "Viaggio nei distretti industriali/13," *Il Sole 24 Ore*, August 31, 1991, 7.

In Bergamo, a well-known industrial city, 36 firms had to shut down their operations. In Trentino Alto Adige, there was an increase of 42 percent in applications to Cassa integrazione (an unemployment fund), while the continued exodus of jobs to Eastern Europe turned into an obvious sign of de-industrialization of the Italian North. In Veneto, sectors such as footwear and leather manufacturing registered a significant decline in production (-14.6 percent and 10.4 percent respectively). In Venice itself, more than 1,000 jobs were in serious jeopardy. In Liguria, the situation was plagued by difficulties and restructuring in senior industrial sectors such as steel and shipbuilding. Between 1982 and 1992, the region lost 5,008 small enterprises and nearly 45,000 jobs. In Emilia Romagna, more than 50 percent of small firms signaled a reduction in their earnings, particularly from exports. In Tuscany, Prato on its own lost more than 20 percent of its textile production units and 12 percent of employees. In Southern regions, the situation was even more difficult: in Campania the unemployment was approaching 22 percent, whereas in Sicily more than 10,000 workers were about to lose their jobs.[55]

A report by the research center "Furio Cicogna" of Bocconi, a prestigious business school at the University of Milan, confirmed that small enterprises were facing new challenges and difficulties. The profits declined from 6.4 percent of the revenue to 3.6 percent. An increasing percentage of firms identified price as their key instrument of competitiveness (39 percent in 1990 as opposed to 35 percent in 1989 and 32 percent in 1988). Finally, financial obligations and short-term debt rose to over 25 percent of the revenue, twice as much as in mid-1980s. The majority of small firms, therefore, were forced to search for other sources of competitiveness aside from price while facing ever-increasing pressures from external competition and technological change. Not surprisingly, more than 57 percent of the firms interviewed in the Cicogna report viewed quality as the single most important determinant of their continued success in world markets.[56]

According to Romano Prodi, professor of economics at the University of Bologna and the future prime minister, the creation of the European common market aggravated the position of the Italian small industry. "The transformation of more than 60 percent of our commerce with the outside world into a domestic affair will represent a great strategic challenge to our industry, especially to the small and medium-size enterprises that are not used to considering the European market as a truly domestic one." In his view, the frailty of the Italian system stemmed from Italy's dominant world market position in sectors that were highly exposed to international competitiveness such as textiles, apparel, and footwear.[57]

Stefano Micossi, head of the research department at Confindustria, was even more radical in his assessment of the Italian crisis and the role—or lack thereof—of small industry in the country's recovery. "Devaluation does not offer a solution to the fall in Italian industry's

---

[55]See Vera Viola, " Presentato ieri un "libro bianco" che fotografa la situazione regione per regione; Piccole imprese: e sempre piu crisi – la Confindustria lancia l' allarme," *Il Sole 24 Ore*, September 17, 1992, 12.

[56]Luca Paolazzi, "Risultati allarmanti nel rapporto del centro Furio Cicogna che sara presentato oggi; Rischio-export per le piccole imprese, *Il Sole 24 Ore*, January 24, 1992, 10.

[57]Gerardo Pelosi, "Piccole imprese, grande sfida," *Il Sole 24 Ore*, February 3, 1992, 25.

[58]David Lane, "Survey of Italy," *Financial Times*, July 7, 1992, IV.

competitiveness," he said in an interview with the *Financial Times* in the summer of 1992.[58] The country, thought Micossi, needed more fundamental changes in wage structures, bargaining procedures, and an industrial-relations system that would support part-time work, job mobility, and flexibility. In addition, an end to the recession would demand a reduction in costs imposed by the inefficient infrastructure of services and public administration. "National and local utilities, the banking system, distribution, government offices, and local authorities provide services with a poor quality-cost ratio. Yet those are non-tradables that are not subject to exchange-rate discipline," he added. "Italy's public infrastructure and service sector need the kind of radical restructuring undergone by industry between 1982 and 1985. That would definitely give the Italian manufacturing industry a huge competitive boost."[59] In short, in Micossi's view, flexibility and efficiency on the firm's level were no longer sufficient to ensure the placement of Italian exports on world markets—the restructuring had to extend to the organization of the state, job and wage relations, and public and service sector.

Thus, in the fall of 1992, Italians were facing some very difficult choices. While the past held some promise that devaluation would prompt the Italian small and medium-size enterprises to turn towards the most profitable export markets and pull the country out of the crisis, the situation in both the domestic and world markets seemed far more complicated than it was in the 1970s. Italian entry into the European Union depended on the fulfillment of the Maastricht "convergence criteria" which required both the reduction in public debt and a stable exchange rate. Therefore, devaluation could not be an on-going solution. In addition, an overhaul of the Italian public sector—while desperately needed—was bound to create social unrest, exacerbate divisions between North and South, and undermine the often cozy relationship between big business groups and the Italian state. Finally, small and medium-size enterprises were no longer certain that their size and regional concentration constituted a competitive advantage in global markets: the costs of marketing and distribution as well as their effective organization seemed to require more integrated, internationally oriented, enterprises. In the words of David Landes, well-known historian of the Industrial Revolution, small was no longer beautiful.

---

[59] Ibid.

Exhibit 1

ITALY: A DIFFICULT ECONOMY?

Selected Background Statistics

	Average 1983-92	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Percentage Changes											
Private consumption	2.8	0.7	2	3	3.7	4.2	4.2	3.5	2.5	2.3	1.8
Gross fixed capital formation	2.5	-0.6	3.6	0.6	2.2	5	6.9	4.3	3.8	0.6	-1.4
Public investment	7	12.5	9.4	9.1	3.9	4.3	7.2	5.6	9.5	7.7	1
Private investment	1.5	-2.7	2.5	-1	1.8	5.2	6.9	4	2.5	-1.1	-2.1
Residential	0.6	4.4	-0.5	-2.8	-2.1	-2.4	1.3	2.4	2.8	3.1	0.6
Nonresidential	2	-6.6	4.3	0	4	9.1	9.5	4.7	2.3	-2.9	-3.3
GDP	2.4	1	2.7	2.6	2.9	3.1	4.1	2.9	2.1	1.3	0.9
GDP price deflator	8.2	15	11.6	8.8	7.9	6	6.6	6.2	7.6	7.4	4.7
Industrial production	1.5	-3.2	3.3	1.2	3.5	3.9	6	3.1	0	-1.9	-0.6
Employment	0.5	0.2	0.4	0.4	0.5	-0.2	1.1	0.1	1.8	0.9	-0.6
Compensation of employees (current prices)	10.1	15.1	11.6	11.7	8	8.6	10	9.5	12.3	9.2	5.1
Productivity (real GDP/employment)	1.9	0.7	2.3	2.2	2.4	3.3	2.9	2.9	0.3	0.4	1.6
Unit labor costs (compensation/real GDP)	7.5	14	8.7	8.8	5	5.3	5.7	6.4	9.9	7.8	4.2
Percentage Ratios											
Gross fixed capital formation as percentage of GDP at constant prices	21.3	20.9	21.1	20.7	20.5	20.9	21.5	21.8	22.1	22	21.5
Stockbuilding as percentage of GDP at constant prices	1.3	0.5	1.6	1.8	1.7	1.6	1.5	1.1	1.1	1.2	1.2
Foreign balance as percentage of GDP at constant prices	-2.8	-0.9	-1.7	-1.9	-2	-3	-3.3	-3.2	-3.7	-4.3	-4.4
Compensation of employees as percentage of GDP at current prices	45.4	47.4	56.2	46.2	44.9	44.6	44.2	44.3	45.2	45.4	45.2
Direct taxes as percentage of household income	10.4	9.7	10.1	10.3	10	10	10.8	10.7	10.7	10.8	10.7
Unemployment rate	17.4	20.2	18.6	17	16.7	16.4	15.7	15.8	17.7	17.9	18.2
	11.2	10	10.1	10.2	11.2	12.1	12.1	12.1	11.5	11	11.6
Other Indicator											
Current balance (billions of dollars)	-8.3	1.7	-2.3	-3.6	2.4	-1.6	-5.9	11	-14.8	21.4	-26.6

Source: *OECD Economic Survey: Italy 1994* (Paris: OECD, 1994), 154.

Exhibit 2

ITALY: A DIFFICULT ECONOMY?

Selected Variables in Public Sector Finance
(annual percentage changes and percentage ratios to GDP)

	Percentage Changes				Percentage Ratios to GDP		
	1980-1991		1987-1991		1979	1986	1991
	Nominal	Real	Nominal	Real			
Total spending	16.1	5.1	10.9	4.5	41.2	51	53.9
Net of interest	15.4	4.4	10.3	4	36.2	42.5	43.7
Current spending	16.3	5.2	11.3	4.9	37.1	45.9	49.4
Interest payments	20.5	9.1	13.8	7.2	5	8.5	10.2
Personnel	15.1	4.2	11.5	5.1	10.8	11.7	12.7
Pensions	16	5	12	5.6	9.6	11.2	12.4
Transfer to enterprises	12	1.3	4.1	-1.9	2.8	3.1	2.4
Total revenues	16.7	5.6	12	5.6	31.6	39.4	43.7
Tax revenues	17.8	6.6	13.1	6.6	16.5	21.9	25.6
Direct	18.8	7.5	12.3	5.9	8.4	12.9	14.5
Indirect	16.7	5.6	14.2	7.7	8	9.1	11.1
Social security contributions	14.9	3.9	10.8	4.5	12.8	13.9	14.7
Total balance as % of GDP	-10.9		-10.6		-9.6	-11.6	-10.2
Net of interest	-2.9		-1.6		-4.6	-3.1	
Current balance as % of GDP	-6.3		-6		-5.6	-6.8	-6.1
Total debt					61.6	88.2	104
Per memoriam							
GDP	13.6	2.8	9.7	3.4			

Source: Stefano Micossi and Pier Carlo Padoan, "Italy in the EMS. After Crisis, Salvation" in Mario Baldassari and Franco Modigliani, *The Italian Economy: What Next?* (London: Macmillan Press, 1995), 147.

Exhibit 3

ITALY: A DIFFICULT ECONOMY?

The 20 Largest Domestic Economic Groups in Italy (1992)

Rank	Subsidiaries	Sales [1]	Quoted	Main Activities	Intl.[2]	Financial gearing[3]
1	IRI	75 912	18	Steel, machinery, financial services	18	2.2
2	FIAT	54 790	14	Transport equipment, financial services	44	18.9
3	ENI	49 779	8	Oil, machinery, media	23	1.2
4	Feruzzi	19 900	7	Chemicals, food, general trading	46	7.3
5	Fininvest	10 036	2	Retailing, media, financial services	n.a.	2.6
6	Pirelli	8 252	2	Tyres, cables	77	5.2
7	Olivetti	8 025	3	Office equipment, electronics	36	15.9
8	Fintermica	4 252	0	Energy	n.a.	1.0
9	Barilla	3 327	0	Food	15	1.0
10	SMI	3 112	2	Steel	81	n.a.
11	Rizzoli	2 922	0	Media	34	1.0
12	Benetton Group	2 513	2	Clothing, footwear	50	n.a.
13	Marzotto	1 952	5	Clothing, textiles	30	3.4
14	Italcementi	1 713	3	Cement	n.a.	3.1
15	Parmalat	1 637	1	Food	47	n.a.
16	Gruppo PAM	1 626	0	Retailing	n.a.	1.0
17	Cartiere Burgo	1 570	1	Paper	n.a.	n.a.
18	GFT	1 555	0	Clothing, textiles	46	1.0
19	Piaggio	1 431	0	Transport equipment	35	1.0
20	Merloni	1 307	1	Domestic appliances	35	n.a.

[1]Billions of lire.
[2]Employment abroad as a percentage of total group employment.
[3]Capital controlled for each lira invested by controlling shareholder.

Source: *OECD Economic Survey: Italy 1995* (Paris: OECD, 1995), 134.

Exhibit 4

ITALY: A DIFFICULT ECONOMY?

State Holdings in Industry and Services in the Major 1898 Enterprises, (1991)

	of public employment in total (%)	of public enterprises in total (%)	of public enterprises with rank <10	of public enterprises with rank <20	of public enterprises with rank <50
Food and agriculture	8.1	3.37	0	0	0
Electronics	22.5	24.42	0	0	1
Plant engineering and installation	52.28	33.96	0	0	0
Mechanical	20.53	9.52	0	0	1
Iron and steel	49.28	23.88	1	1	1
Chemicals	30.9	8.96	0	1	2
Vehicles	23.83	15.71	0	1	2
Energy	52.34	26.92	2	3	4
Public services	93.69	70.73	2	2	3
Mining	93.28	54.55	1	1	1
Transportation	73.58	27.5	0	1	1
Advertising, film	72.58	31.25	0	1	1
Retailing	23.11	20.83	0	0	1
Domestic appliances	3.22	6.82	0	0	0
Rubber	7.95	7.14	0	0	0
Clothing	0	0	0	0	0
Trading, import/export	0	0	0	0	0
Textile	0	0	0	0	0
Pharmaceuticals	0	0	0	0	0
Synthetic fibers	41.33	43.75	0	0	0
	3	6.78	0	0	0
Beverages	0	0	0	0	0
Civil engineering and building	9.62	18	0	0	0
Paper	7.89	9.09	0	0	0
Glass	20.51	19.23	0	0	0
Publishing	9.17	14.29	0	0	0
Leather goods	0	0	0	0	0
Other manufacturing	8.87	7.14	0	0	0
Total	28.52	12.49	60	55	36

Source: *OECD Economic Survey: Italy 1994* (Paris: OECD, 1994), 136.

Exhibit 5

ITALY: A DIFFICULT ECONOMY?

World's Largest Exporters of Footwear

Country	Exports, 1990 (000s pairs)	Share of World Exports 1970	1990
Italy	245.2	43.2	19.9
South Korea	193.2	1.9	15.7
Brazil	152.3	0.5	12.3
Taiwan	108.1	0.9	8.8
Spain	77.7	9	6.3
Portugal	69.4	0.8	5.6
China	41.8	0.4	3.4
Hong Kong	39.3	0.3	3.2
Mexico	4.6	0.2	0.4

Source: Roberta Rabellotti, *External Economies and Cooperation in Industrial Districts* (London: Macmillan Press, 1997), 60.