50th Credit Day

Credit, competitiveness and competence: the foundations of development

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As President Pellicanò has already said, this is an important day. We are celebrating the fiftieth anniversary of Credit Day, an annual occasion for taking stock together of the world of credit and the role it plays in Italy.[1]

Italy has changed greatly over the last half century, at least in some respects. In 1968 Italy was emerging from the economic miracle that had turned it into a modern country and was heading for stormy years of social and political turbulence.[2] Today, it is still one of the leading advanced economies, though it is threatened by decline. Fifty years ago the credit system was almost entirely public and now it is almost all private. Yet banks continue to do essentially what they have always done: they collect deposits from a vast array of savers and use these resources to make loans to a smaller group, consisting mainly of firms. Italy's banks find themselves at a crossroads today, as loans may no longer be their fundamental prerogative.

That said, we are not here for a history lesson. Today's conference has a theme and we must engage with that. In my introduction I will take a brief look at its four sub-themes, but in reverse order: development, competence, competitiveness and credit.

Development

The economic development of a country or a territory is an old and ambiguous concept. Scholars down the ages have defined it in many ways and in various fields of study. The main thing for us as Italians nowadays is that development has to be focused on firms and their ability to innovate and grow. It is firms that

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1 My thanks go to Francesco Franceschi, Francesco Manaresi and Francesco Palazzo for helping me write this speech. Any remaining errors are my sole responsibility.

2 For a brief history of Italy's economy starting from that year, see Rossi, S., *La politica economica italiana 1968-2007*, Laterza, Roma-Bari, 2007.

must use Italy’s resources and talent in order to succeed, and in doing so, to increase well-being for everyone.

We know that Italy’s economic development has been stuck for more than twenty years now. From 1997 to 2007, in the decade prior to the world crisis, Italy’s gross domestic product grew by less than one point a year on average, against three and a half points in the rest of the euro area. Then came the double-dip recession towards the end of the 2000s onwards, first originated at the global level and then in Europe; Italy was overwhelmed, far more so than the other advanced countries. In the second quarter of this year, and despite three years of recovery, GDP was still 5 per cent lower than the peak level reached in 2007; it has risen by 6 per cent in the rest of the euro area.

How is it that the other economies have grown so much more than Italy’s? By increasing the average efficiency of firms, especially in technology and business organization, the component of productivity that economists refer to as Total Factor Productivity (TFP). From 1997 to the present day, that component has remained flat in Italy, while it has boosted annual average economic growth by half a percentage point in Germany and France and by 0.2 of a point in Spain.

Italy’s production system has shown itself to be too fragile and fragmented overall to be able to aim for technological and organizational efficiency, and has become less competitive at international level. Some firms, mainly medium-sized ones, have now emerged from the financial crisis with a renewed capacity to compete and are sustaining Italian exports, but the other firms are still weak.

Skills

A very important reason for Italy’s firms being at a disadvantage lies in the mismatch between the demand and supply of qualified employees, and therefore in the relative inability of Italy’s education system to provide students with the necessary skills.

I’ll refer here to some well-known data from the Organization for Economic Cooperation and Development (OECD), which has long used many research resources and statistics to make a comparative study of education in the advanced countries. There are a quarter fewer high-school graduates in Italy compared with the European average: 60 per cent of the population in the 25-64 age bracket, against 80 per cent. The situation is even worse for university graduates in Italy, as their number is just over half that of the European average, at 17 per cent of working age adults, against 35 per cent.

If high-school and university graduates are relatively rarer in Italy, they should be more sought after, yet this is not the case: there are as many instances of over-qualification for jobs in Italy as in other countries,[3] especially early in working life.[4]

These results are not accidental, but rather the outcome of a strategic choice made a century ago and that has never been changed, whereby public resources were channelled more towards nursery and primary schools, less towards secondary schools and even less again for universities and postgraduate studies. This choice was made to solve the serious problem of mass illiteracy at that time in Italy.[5] Compared with the major European countries, Italy's primary schools still receive more public funding than those in France or Spain, and are almost on a par with Germany's schools. Yet Italy slips back into last place for secondary schooling, just below Spain, and is also in last place for university funding, well below Spain. In any case, the amount of public money set aside overall for education in Italy is lower than that in the other three countries, given similar, mainly public education systems.

In other words, the commitment of Italy's public sector to education is not in proportion to modern-day needs, which combine a drive for scientific research, continuous innovation and cut-throat competition. Such inadequacy is explained both by the amount of resources used and by how much money is spent on the different levels of education. Yet the idea of greatly increasing the resources provided by the public finances or of redistributing them in favour of universities,

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3 See Flisi, S., V. Goglio, E. Meroni, M. Rodrigues, and E. Vera-Toscano, 'Occupational mismatch in Europe: understanding overeducation and overskilling for policy making' , *JRC Science and Policy Reports*, 89712, 2014.

4 See Colonna, F., 'Chicken or the egg? Human capital demand and supply', *Politica Economica*, 1, 97-123, 2017.

5 See Giunta, A. and Rossi, S., *Che cosa sa fare l'Italia. La nostra economia dopo la grande crisi*. Laterza, Bari, 2017;. and Bertola, G., and Sestito, P., 'A Comparative Perspective on Italy's Human Capital Accumulation', Banca d'Italia, Economic History Working Papers, 6, 2011.

especially postgraduate courses, to forge tomorrow's scientists and innovators, is unrealistic, politically speaking.

However, it is not just a problem of how many resources we have; the education provided also leaves a lot to be desired. The division of secondary schools into high schools and vocational schools with apprenticeships is skewed in favour of the former. Let us not forget that the Constitution assigns the responsibility for professional training to Italy's regional authorities. Theoretical and academic teaching at university still prevails over technical and practical content and there are still very few graduates in technical and scientific subjects.[6] These are all factors that distance Italy's education system from the needs of industry.

One possible policy that would not weigh on the public finances could be to boost professional qualifications and encourage the new higher-education technical colleges that are offering technical specialization courses to high-school graduates, which are making their students highly employable but which are limited in availability because they are linked to local conditions.

Other no-cost policies could be devised: for example, simplifying the bureaucratic, administrative and informative framework both of apprenticeship contracts and, at the other end of the spectrum, of PhDs; speeding up the technology transfer from universities to firms by promoting ways to share intellectual property and revenues from patents among researchers and universities; and finally, promoting international cooperation: education policies have remained national, yet various European countries are harmonizing their university systems.

Competitiveness

The problems of the education system interact with those of the production system, creating a vicious circle: on the one hand there is a lack of qualified human capital that limits firms' propensity to innovate, on the other, take-up of innovative

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6 See OECD, *Education at a glance 2017*, OECD Publishing, Paris, 2017.

technologies is low, thus reducing the return on skills and discouraging investment in human capital.[7]

In the almost twenty years between 1999 and 2017, investment in intangible goods, more than half of which on R&D and patents, only grew by 30 per cent in Italy compared with 70 per cent in France and Germany and 140 per cent in Spain. In relation to GDP, investment in intangibles in Italy (3 per cent) is today below that of Germany (4 per cent) and France (6 per cent) and on a par with that of Spain that has almost doubled in the meantime.

The spread of the new digital technologies, while growing, is still below the euro-area average. As recently as last year, fewer than 10 per cent of Italian firms had introduced a supply chain management system, more than a third less than in Germany and France.[8]

The fragmentation of the production system into many micro and small firms is the main cause of the low propensity to invest in R&D in the Italian economy. But even when they are of an equivalent size, Italy's small firms are less productive than those in countries like France and Germany.[9]

Italian firms start to atrophy at birth; compared with firms in the other developed economies, newborn firms are smaller, grow more slowly and quickly stabilize at a small size.[10]

Consequently, Italian exports have been in decline since the end of the 1990s and were badly hit by the crisis: the average rate of growth of our exports between 1997 and 2010 (1.8 per cent) was well below that of France (3.5 per cent), Spain (3.8 per cent) and Germany (5.9 per cent).

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7 See Visco, I., *Investire in conoscenza. Crescita economica e competenze per il XXI secolo*, il Mulino, Bologna, 2014.

8 See OECD, *Science, technology and industry scoreboard 2017*, OECD Publishing, Paris, 2017.

9 See Bugamelli, M. and F. Lotti (eds.), 'Productivity growth in Italy: a tale of a slow-motion change', Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, 422, 2018.

10 See Manaresi, F., 'Net employment growth by firm size and age in Italy', Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, 298, 2015.

These disappointing results can be attributed at least in part to the particular weaknesses in Italy's production system. Our micro and small firms have been less able to absorb the rise in the euro exchange rate and increased competition from abroad.[11]

Exports began to recover in 2010, growing at a rate just below that of Germany. One factor was the increased polarization of the Italian production system, with an innovative group of firms - mainly medium-sized - looking beyond Italy, which not only managed to withstand the rigours of the crisis but came through it stronger than before.[12]

The reorganization of industrial policy, begun in 2012, has produced some encouraging results. Measures in favour of innovative start-ups have increased value added and productivity.[13] Policies aimed at the other small and medium-sized firms were more limited. We still need to properly assess the real effectiveness of incentives to spend more on R&D and to make better use of the 'patent box'.

I think we need to continue in this direction, as these policies go to the heart of Italy's structural problem. There can be no economic growth if we do not resolve this problem.

Credit

Let's now turn to the financial aspects. Today is called Credit Day, but it is a good idea to speak more generally in terms of finance, of which credit is only one component. Of course, it is a component with historical importance in Italy, a country where banks have always been at the centre of the financial system. Yet for some years now we have begun to reflect on what kind of financial structure would be best to support the relaunch of Italy's economic development and therefore the

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11 See Bugamelli, M., S. Fabiani, S. Federico, A., Felettigh, C., Giordano and A. Linarello, 'Back on track? A macro-micro perspective of Italian exports', Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, 399, 2017.

12 See Accetturo, A., Bassanetti, A., Bugamelli, M., Faiella, I., Finaldi Russo P., Franco D., Giacomelli S., and Omiccioli M., 'Il sistema industriale italiano tra globalizzazione e crisi', Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, 193, 2013.

13 See De Stefano, T., Manaresi, F., Menon, C., Santoleri, P., and Soggia, G., 'The evaluation of the Italian Start-up Act', *OECD Science, Technology and Industry Policy Papers,* 54, 2018.

most suitable way of funding innovation in our firms, especially technological innovation, and what role the banks and bank lending should play.

Let's start with the observation that the Italian financial system is smaller overall than those of the leading European economies: it stands at about four times GDP - a lower amount than not only the UK, but also Germany and France. Within the financial system in Italy, the banks, as we know, have a much higher weight than in the UK and a higher weight than in Germany and France, albeit only slightly higher.

Now, investment in innovation is particularly risky and it is difficult for anyone outside the investing company to estimate possible returns. Hence any funding must be made internally for the most part. This is what we have been witnessing for a few years now: self-financing has covered 90 per cent of this kind of investment, 20 points more compared with 2012. The increase in own funds has been accompanied by a fall in bank debt, whose share of firms' total liabilities fell from 24 per cent in 2012 to 19 per cent in 2017.

In newly-fledged firms, a venture capitalist can be of great help by contributing to the firm's capital with money available to fund an innovative idea, but also with specialist know-how.[14] In Italy, the venture capital industry is, however, quite small on an international scale and it is not easy, even for the most promising innovative firms, to find specialized financiers to participate in their capital.

The most consolidated firms can issue and place new capital to fund investment in technology and innovation. In theory this offers some significant advantages: compared with bank debt, equity requires no collateral, reduces moral hazard issues, and allows the investor to share in the profits if the innovative project is a success. The empirical literature shows that in many countries - and in particular in the United States - these advantages are recognized and risk capital often plays a more important role than debt financing for innovation.[15] Nevertheless, Italian firms are relatively capital-poor on average: in 2017 financial leverage was about 40 per cent, which is higher than in France, Germany and Spain.

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[14] See Bronzini, R., Caramellino, G., and Magri, S., 'Venture capitalists at work: what are the effects on the firms they finance?', Banca d'Italia, *Temi di discussione (Working Papers)*, 1131, 2017.

[15] See Magri, S., 'Does issuing equities help R&D activity? Evidence from unlisted Italian high-tech manufacturing firms', Banca d'Italia, *Temi di discussione (Working Papers)*, 978, 2014.

Another path for financing innovation involves issuing bonds.[16] This is the path that large Italian firms have been pursuing more decisively in the last few years. Compared with other European countries, like Germany, whose financial system is dominated by bank credit, the share of corporate bonds in firms' total financial debt is greater, at just over 13 per cent against 12 per cent in Germany and the euro area, while it is considerably smaller than in the UK (23 per cent) and the US (41 per cent), but also less than in France (21 per cent). These are the results of strong growth in the post-crisis years. Recent initiatives, such as savings plans (PIRs) and mini-bonds, are helping to strengthen this process.

Nevertheless, compared with other countries there is a still a difference due to both the characteristics of Italian firms and to the limited role of institutional investors in Italy.

Large firms, especially those already listed and with growth prospects, have a better reputation and are more transparent - fundamental qualities for attracting bond purchasers.[17] For small and medium-sized firms, which are very common in Italy, the lack of information available to outsiders is a formidable obstacle to their accessing the bond market.

Italian institutional investors hold few private bonds and many public securities compared with the other leading European countries. The small share of pension funds worsens the situation in which there are relatively few Italian institutional investors participating in the corporate bond market.

Lastly, let's look at bank credit, which still plays in Italy a very important role in funding innovation, not only for the largest firms with good credit scores and collateral, but also for small firms, including start-ups.[18] As we have already seen, credit is not the ideal financial channel for investing in innovation. However, the banks can play a role in encouraging a broader take-up of bond funding on the part

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16 See Accornero, M., Finaldi Russo, P., Guazzarotti, G., and Nigro, V., 'Missing investors in the Italian corporate bond market', Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, 450, 2018.

17 See Accornero, M., Finaldi Russo, P., Guazzarotti, G., and Nigro, V., 'First-time corporate bond issuers in Italy', Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, 269, 2015.

18 See Bonaccorsi, E. and Nigro, V., 'The financial structure of Italian start-ups, in good and bad times', Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, 449, 2018.

of the smallest firms, especially in the placement and initial purchase of bonds. They would be acting in their own interest by earning commission fees which have grown in the meantime[19] and they would restore balance to a market that is currently dominated by foreign banks.

Conclusions

To conclude, relaunching the economic development of our country after more than twenty years of stagnation or overly slow improvement is the absolute priority for Italy. If our nation does not increase its wealth it will eventually decline, despite its talent and the capabilities recognized the world over. Development must be harmonized and sustainable over time, but it is a *sine qua non*. We can only return to financial balance if there is greater development.

Nevertheless, relaunching development is not easy; we need to make big changes to Italy's underlying character and to the political choices of our national community that are deeply rooted in the distant past.

On this day, we are examining some of these central aspects: the education system, competitiveness, and the financial system. We must not tire of debating these themes, and we should not hold back or be afraid of expressing our ideas. If the ideas are right and convincing, action will follow.

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[19] See Albareto, G. and Marinelli, G., 'Italian banks and market-based corporate financing', Banca d'Italia, *Questioni di Economia e Finanza (Occasional Papers)*, 432, 2018.

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