A Chief Culprit For Italy Woes: Services Sector

By Christopher Emsden
And Alessandra Galloni

ROME—Italy has been pulled back from the precipice of default, but reviving the country's stagnant economy is still proving an uphill battle—in large part because of a woefully lagging services sector.

In an interview, the head of Italy's statistics agency said that—contrary to foreign perceptions—Italy's industrial sector has held up well despite four quarters of recession here. Many manufacturers' exports have returned to precrisis levels. Figures released Thursday show industrial orders, a proxy for future production, ticking up, including from Italian companies.

The real problem is that companies in the transport, communications, tourism, retail and social services—all sectors where Italy lags peers in other countries—are dragging down the rest of the economy, said Istat Chairman Enrico Giovannini.

"The manufacturing sector is not a disaster; quite the contrary," said Mr. Giovannini. "But it is only one-sixth of the economy. The services sector is the country's big problem."

Mr. Giovannini was speaking hours before the government, as widely expected, downgraded its growth forecasts for this year and next, reflecting austerity measures introduced to keep a commitment to balance the country's budget by 2013 that have weighed on the pocketbooks of Italian individuals and businesses.

The government said it expected gross domestic product to fall this year by 2.4%—twice as big a decline as it had predicted in April—and fall by 0.2% in 2013, partly because of a darkening of the global economy. Many economists see next year's forecast as too optimistic; BNP Paribas this week forecast a 0.8% contraction for Italy next year.

On Thursday, Economy Minister Vittorio Grilli defended the tight fiscal policy aimed at keeping Italy's promise to run a balanced budget next year, saying that "without that, the recession would have been even worse."

Italy's technocratic government has earned some fiscal breathing space over the past few months, because of measures such as unpopular tax increases and a rise in the retirement age, said Mr. Giovannini, who spent several years as the chief statistician of the Organization for Economic Cooperation and Development. The goal now is to try to focus on helping Italy's services sectors become more dynamic, he said.

For reasons that predate the financial crisis, Italy's services sector is largely bereft of the right kind of human capital and investment, and has therefore become a huge drag on national productivity, Mr. Giovannini said.

Information technology's contribution to the growth in Italian labor productivity was the lowest in Europe, according to the European Investment Bank. One result: Italy's total efficiency gains slipped half a percentage point a year from 1995 to 2005, while Finland, by contrast, posted 3.4% annual gains. Italy's service sectors, especially in retail and tourism, were the main culprits, the study found.

"Information and communications technology is the key problem" that has thwarted the development of the services sector, Mr. Giovannini said.

He said a restoration of business dynamism and confidence is a key ingredient of economic recovery, in large part because it is a precondition for a revival in Italy's severely dented household confidence.

Mr. Giovannini pointed to a proliferation of flea markets in the country's capital, Rome, as a sign the widespread sense of helplessness that has gripped Italians amid the crisis. "People feel vulnerable, so they are selling their things," he said. If this marks a change in how households consume, "then it could have long-term behavioral effects."

Mr. Giovannini said the next big steps have to be aimed at areas such as gearing education and training to emerging job opportunities.


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Euro-Zone Business Activity Continues to Slide