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## In search of a growth model for Italy: The failed attempt of an export-led recovery strategy?

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# In search of a growth model for Italy: The failed attempt of an export-led recovery strategy?

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## **In search of a growth model for Italy: The failed attempt of an export-led recovery strategy?**

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### **Abstract**

We analyse Italy's growth pattern from 2001 to 2019 using the demand and growth regime categories proposed in the post-Keynesian tradition and recently adopted in the comparative political economy (CPE) literature. We argue that Italy followed an export-led recovery strategy after the Global Financial Crisis. In this respect, Germany's growth model emerged as the successful one to follow. In the dominant view, Germany's economic success since the mid-2000s was attributed to a series of painful but necessary economic reforms. The success of Germany's export-led mercantilist regime became particularly attractive to Italy given the similar export-oriented manufacturing industry. However, Italy has followed the "wrong" German model based on wage compression and restrictive budget policies while the "true" German model is based on non-price competitiveness factors. To conclude, we show the contradictions of the mercantilist export-led regime.

**Keywords:** Demand and growth regimes, export-led growth, competitiveness, internal devaluation, Germany, Italy

**JEL code:** E10, E69, F14

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## 1. Introduction

When trying to analyse the stagnation that has characterised the Italian economy over the past three decades, two main lines of interpretation emerge. The first set of arguments, which are of orthodox inspiration, focus on the problems of the Italian economy from the aggregate supply side. The discussion focuses on labour market institutions and the degree of centralisation of the collective bargaining system, on the role of competition in the domestic market for goods and services, and on the functioning and quality of public institutions.<sup>1</sup> The second group of arguments, of heterodox inspiration, look instead at the role (and lack) of aggregate demand and how this has shaped the growth performance of the country.<sup>2</sup>

This approach is reflected, not surprisingly, in the comparative political economy (CPE) literature. In the CPE literature the dominant paradigm until recently has followed the so-called Varieties of Capitalism (VoC) approach. Based on the institutional and supply-side characteristics of advanced capitalist economies, the VoC approach proposed the well-known distinction between liberal market economies (LMEs) and coordinated market economies (CMEs) (Hall/Soskice 2001). In their well-received article, Baccaro and Pontusson (2016) suggested to move away from the categories of the VoC tradition illustrating a new approach to CPE that places at the centre of the analysis the core elements of post-Keynesian/Kaleckian economic thinking, namely aggregate demand and income distribution.<sup>3</sup> The authors suggest the concept of “growth models”, where the two opposing but, at the same time, complementary models are the so-called export-led growth model and the consumption-led growth model. In the former, growth is driven by net exports and thus by foreign demand whereas, in the latter, growth is driven by household consumption and thus by domestic demand. The fall in household income witnessed since the late 1970s in advanced capitalist economies implies that consumption was increasingly sustained by debt rather than income so that the consumption-led growth model can be labelled the debt-led growth model. The two models are complementary since the current account deficits of the debt-led growth model allow the export-led growth model to run trade surpluses.

Post-Keynesian scholars have also investigated the emergence of different growth regimes and the shift of the regimes after the Global Financial and Economic Crisis (GFEC) of 2007-09.<sup>4</sup> The regimes are the debt-led private demand boom regime, the domestic demand-led regime, and the export-led regime both in its mercantilist and weak constellation (Dodig et al. 2016, Dünhaupt/Hein 2019, Hein 2019, Hein/Martschin 2021). Academics of post-Keynesian inspiration have thus welcomed the new approach to CPE by Baccaro and Pontusson highlighting some shortcomings with regard to the distinction between the wage-led and the profit-led regime (that is how aggregate demand reacts to a change in income distribution), and the source of aggregate demand that is, for example, debt-led growth or export-led growth (Hein/Martschin 2021, Stockhammer 2022). As highlighted in Amable (2022) and in Amable’s contribution in this special issue, the notion of growth models can be also traced

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<sup>1</sup> Here the usual call for structural reforms prevails, i.e., more flexibility in the labour market, more competition in the market for goods and services and the decentralisation of wage bargaining (see for example European Commission 2019).

<sup>2</sup> In support of this view, see Storm (2019) and Cesaratto and Zezza (2018).

<sup>3</sup> In defence of the VoC approach, see Hope and Soskice (2016).

<sup>4</sup> In this literature the term “growth regime” is preferred to “growth model”, but the two concepts are similar. We use the two terms as synonyms.

back to the work of the French *Régulation* theory and in particular to contribution of the French economist Robert Boyer and Michel Freyssenet appeared in the 1990s/2000.

According to the VoC approach, the Italian model is seen as ambiguous, showing incoherence and lack of complementarities among institutions and is thus relegated to the case of a “mixed market economy” (Molina/Rhodes 2007). As argued by Della Sala (2004), in the post-war period Italy tried to mimic elements of a CME and in more recent times, under the impetus of the European integration process, the country tried to adopt elements of an LME without becoming either one. The VoC approach predicts that countries that best fit one of these two fundamental types of capitalism will register better economic outcomes while countries somewhere in between the two—and this is the case in Italy—will not perform as well.

In the growth models perspective, Baccaro and Pontusson (2016) argue that Italy has failed to find a substitute to the Fordist “wage driver” of growth and that “persistent stagnation is always an option”.<sup>5</sup> In Hein et al. (2020), Italy’s growth regime shifts from a domestic demand-led regime in the period 2000-08 to an export-led regime in the period 2009-16. Kohler and Stockhammer (2021) suggest that the classification of growth models according to the dichotomy export-led/consumption-led may have lost its explanatory power for the period after the GFEC. The authors show how in the sample of 30 high-income OECD countries used in Hein et al. (2020), 24 countries (including Italy) out of 30 can be classified as export-led in the post-crisis experience. The authors question the validity of this interpretation highlighting how in most cases the growth contribution made by net exports is primarily due to the fall in imports rather than by the growth of exports. Hein and Martschin (2021) keep the regime distinctions also for the post-crisis period arguing how it is the macroeconomic policy regime, i.e., the combination of fiscal, monetary and wage policies as well as open economy conditions, that influences the country’s growth regime and its change. In the case of Italy, a highly restrictive macroeconomic policy regime after the global crisis has forced the country to shift from a stagnating domestic demand regime to a stagnating export-led regime (Hein and Martschin 2021).

Against this background, we attempt to explain the country’s post-crisis regime with the (failed) attempt to adopt an export-led recovery strategy. This does not mean that the stagnation of the Italian economy begins with the GFEC of 2007-09. The stagnation of the Italian economy has been going on for almost three decades. In this contribution, however, we focus on period from 2001 to 2019 trying to explain the paradigm shift in the Italian growth model after the global crisis in the context of the European Economic and Monetary Union (EMU) and the relative economic policy constraints. We argue how after the crisis, Germany’s export-driven growth model emerged as the successful model to follow for Italy and for the eurozone as a whole. In the dominant view, Germany’s economic success since the mid-2000s was attributed to a series of painful but necessary economic reforms that were able to kick-start growth and employment. The success of Germany’s mercantilist export-led growth model has been especially attractive to Italy given the similarly export-oriented manufacturing industry and the strong similarity in the range of products exported. However, we argue, Italy has applied the “wrong” German model (the model portrayed in the mainstream interpretation) based on wage compression and restrictive budget policies. On the contrary, Germany’s export success, or the “true” German model, is based on non-price factors, such as the technological improvement of the exported products and the reorganization of outlet

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<sup>5</sup> This consideration is, however, based on the theoretical shortcoming in the paper to which we referred earlier.

markets (Simonazzi et al. 2013; Storm/Nastepad 2014). Not least, even if Italy would have been able to emulate the success of Germany's mercantilist export-led growth model, export-led growth suffers from intrinsic contradictions as it depends on the capability and willingness of the exporter's trading partners to run permanent current account deficits.

Our paper is organized as follows. In section two, we identify the demand and growth regime of Italy looking at the GDP growth contributions and the sectoral financial balances. We show how the export-led growth model is the only viable option for a country where both the private and the public sector aim at running budget surpluses. In section three, we show how Germany emerged as the successful model to follow. In the dominant interpretation, the recovery of the German economy since the second half of the 2000s has been attributed to the success of deflationary policies based on the combination austerity and flexibilisation. In section four, we argue how Italy followed the "wrong" German model based on wage compression and price competitiveness while the success of German exports can be attributed to non-price competitiveness factors. Here, our comparative analysis will focus on two aspects: The reorganization of export markets and the improvement in technological competitiveness of exports. In section five, we draw the conclusions highlighting the contradictions of export-led growth.

## **2. Which growth model after the GFEC?**

In this section we assess Italy's growth model looking at GDP growth contributions and sectoral financial balances. We adopt the same periodisation as in Hein and Martschin (2021). The first period goes from 2001 to 2009 and it includes the GFEC while the second period ranges from 2010 to 2019 and it includes the eurozone crisis. Tables 1 shows the contributions to real GDP growth of the component of aggregate demand (private consumption, gross (fixed) capital formation, government demand, and net exports) together with the sectoral financial balances of the main macroeconomic sectors, the household sector, the corporate sector (forming together the private sector), the government sector, and the foreign sector. In the period 2001-09, the main source of growth is represented by public and private demand with 0.22 and 0.23 percentage points, respectively (average values over the period as for the rest of Table 1). Private investment did not contribute to aggregate demand and the contribution of gross fixed capital formation is zero while trade balance contributed negatively to real GDP growth. Growth contributions sum up to real GDP growth, which in the period 2001-09 was equal to 0.18 percent. Looking at the sectoral financial balances, we can see that the balance of the household sector was positive (private demand was not deficit-financed). Even if the corporate sector registered a small deficit (equal to 0.23 percent of GDP), the private sector taken together was still in surplus. Throughout the 2001-09 period, the government sector ran a deficit of 3.28 percent and the foreign sector recorded a surplus of 1.11 percent, which is equivalent to a deficit in Italy's current account. The sectoral financial balances sum up to zero, as the surplus in one sector must be by definition equal to the collective deficits of the other sectors. Italy's growth regime in the period 2001-09 can be identified as domestic-led.

In the second period (2010-19), the source of private demand disappears with gross fixed capital formation and public demand contributing negatively to GDP growth (-0.14 and -0.10 percentage points, respectively). The contribution of private consumption is minimal (0.06 percentage points), and the only significant contribution to GDP growth in the post-GFEC

period comes from net exports and thus foreign demand (0.37 percentage points). In this period real GDP growth was equal to 0.27 percent. The stance of the sectoral balances confirms the slowdown in private consumption and investment. The household and business sectors are both in surplus, and the balance of the private sector as a whole is even larger than in the previous period (3.42 percent). At the same time, the deficit of the government sector decreases to 2.77 percent.<sup>6</sup> The external sector is in deficit which is equivalent to Italy's current account surplus. It follows that in the period 2010-19, Italy can be classified among the export-led economies (Hein et al. 2020; Hein/Martschin 2021). Net exports, with the additional (albeit minimal) contribution of private consumption, appears to be sole source of growth in the post-GFEC period.

**Table 1. Contributions to real GDP growth (percentage points) and sectoral financial balances (percent of GDP), average values, Italy.**

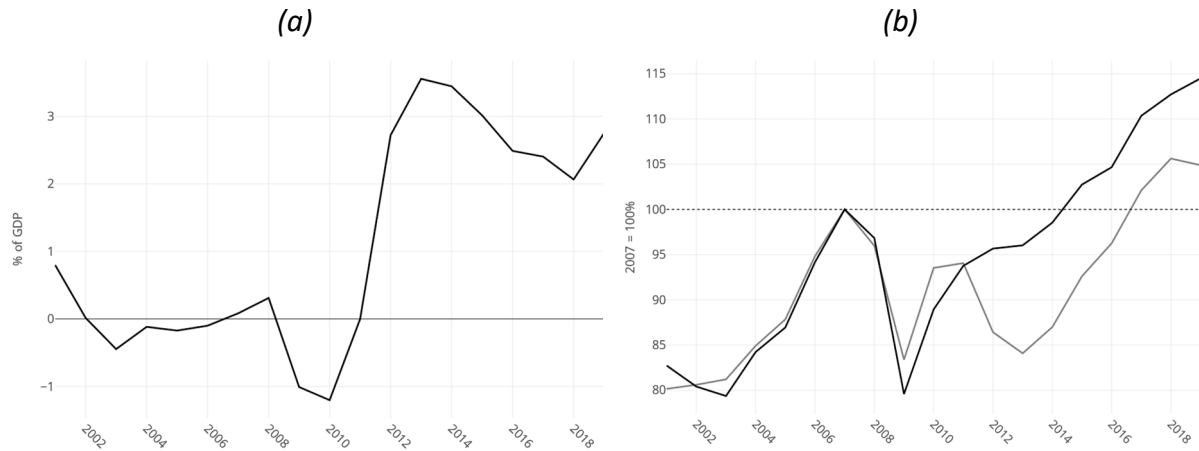
	2001-2009	2010-2019
	<i>GDP growth &amp; growth contributions</i>	
Real GDP growth (percent)	0.18	0.27
Private consumption	0.23	0.06
Gross capital formation	-0.09	-0.06
- Gross fixed capital formation	0.00	-0.14
Government demand	0.22	-0.10
Net exports	-0.19	0.37
	<i>Sectoral financial balances</i>	
Household sector	2.46	1.27
Corporate sector	-0.23	2.45
Government sector	-3.28	-2.77
Foreign sector	1.11	-0.89

Source: AMECO. Own calculations.

Figure 1a shows the evolution of net exports as share of GDP. Starting in 2010, we observe a rapid improvement in net exports followed by a slight decline until 2018 when net exports stopped around 2 percent to then rise again in 2019. If we analyse import and export trends separately, we observe how the improvement in the trade balance in the period 2010-19 has been driven primarily by a reduction in import demand rather by a genuine increase in export. Figure 1b shows exports and imports as an index, where the base year is 2007. After 2009, Italian exports enters a growth path that continues until 2019 while import declines both as a consequence of the global crisis and of the eurozone crisis. Imports recovered only from 2014 and managed to surpass the pre-global crisis values only in 2017. In this light the classification of Italy's growth regime in the post-crisis experience as export-led does not appear to be dictated by a genuine shift in the growth paradigm of the country from one driven by domestic demand to one driven by foreign demand (Kohler/Stockhammer 2021).

<sup>6</sup> More specifically, the primary surplus goes from an average value of 1.62 percent in the period 2001-09 to an average value of 1.47 percent in the period 2010-19. Interest payments on debt in relation to GDP went from an average value of 4.89 percent in the first period to 4.23 percent in the second period.

**Figure 1. (a) Net exports of goods and services in percent of GDP and (b) exports (black) and imports (grey) at constant 2015 prices (2007 = 100 percent), 2001-2019, Italy.**

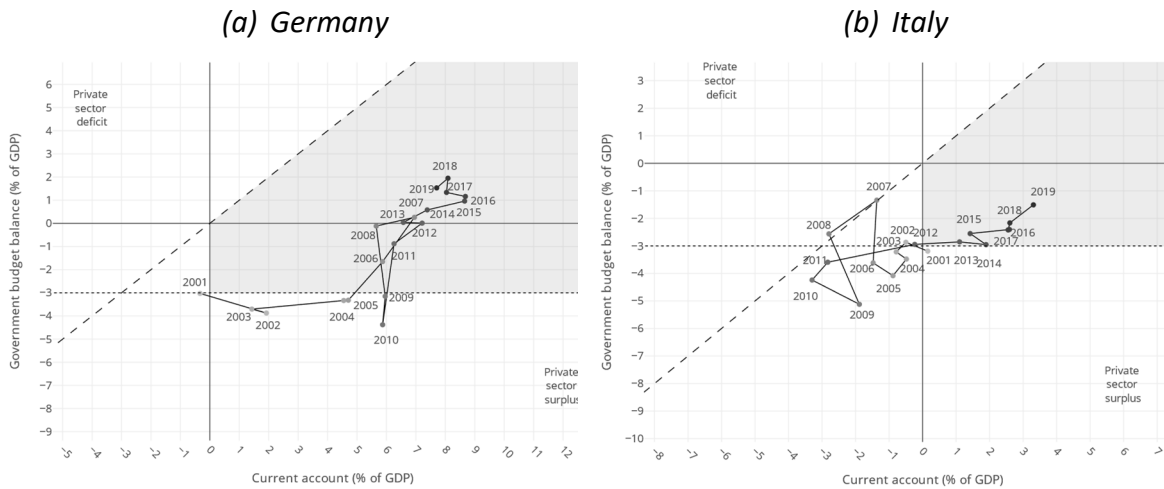


Source: AMECO. Own elaborations.

From the arithmetic of the sectoral financial balances, we know that if the public sector and the private sector would like to achieve simultaneous financial surpluses, it is necessary that the foreign sector runs an offsetting current account deficit (from the domestic perspective a current account surplus). This means that if the private sector accumulates savings and the public sector is constrained by a balanced budget rule, as in the European context, an offsetting current account surplus is required. In Figure 2, we show the evolution of the sectoral financial balances from 2001 to 2019 for Germany and Italy. We report the government budget on the vertical axis and the current account on the horizontal axis both expressed in percent of GDP.<sup>7</sup> The diagonal 45-degree line represents all combinations of government budget and current account where the financial balance of the private sector is in equilibrium (i.e. where saving is equal to investment). Above the equilibrium line, the private sector records a deficit while below the equilibrium line, the private sectors register a surplus. We can observe how over time both Germany and Italy moved toward the area that we have highlighted in grey. In the grey area three conditions are simultaneously met. A current account surplus, the compliance with the European deficit rules (the grey area is limited below by a dotted line cutting the vertical axis at the 3 percent mark) and the surplus of the private sector.

<sup>7</sup> Such graphical representation of the sectoral financial balances is based on Zezza (2020) and Kregel (2018) which in turn draw on the framework proposed in Parenteau (2010). This graph has also found its way into some heterodox macroeconomics textbooks (Mitchell et al. 2019; Lavoie 2022).



**Figure 2. Evolution of the sectoral financial balances, 2001-2019.**

Source: AMECO. Own elaboration.

In the case of Germany (Figure 2a), we observe how starting from the beginning of the 2000s, the country took a clear mercantilist stance running high and persistent current account surpluses (Zeza 2020). At the same time, the private sector registered large surpluses, thus becoming a net lender to the country's trading partners. The government sector drastically reduced deficit spending so that in 2012 it reached a balanced budget and from 2013 it started to record continuous budget surpluses until 2019 (Germany's path enters the grey area above the horizontal axis in 2012-13). As of the early 2000s, Italy's current account is negative and the government deficit is negative. The private sector is in surplus (except for 2008). After the GFEC of 2007-08, we can see how the country's trajectory rotates counter-clockwise and it starts heading toward the grey shaded area. In fact, an even more restrictive European fiscal policy framework pushed the country to run current account surpluses. Similar to Italy, the eurozone as a whole followed a counter-clockwise trajectory. After the crisis, the eurozone needed to achieve persistent current account surpluses in order to offset shrinking government deficits imposed by the restrictive fiscal rules (Zeza 2020).<sup>8</sup> As highlighted by Hein (2019), before the crisis, the eurozone showed the features of a domestic demand-led regime while, after the crisis, the eurozone turned towards the export-led regime. A recovery strategy driven by foreign demand is therefore the only available option when fiscal policy is hindered to stimulate domestic aggregate demand and the private sector wishes to save (Kregel 2018). As we will see in the following sections, in the case of Italy, the policies adopted to boost exports depressed domestic demand without stimulating export demand, turning the growth pattern of the country into a failed export-led regime.

### 3. Germany as a role model

#### *The crisis*

The economic and financial crisis exposed the fragilities that had been building up within the EMU since the inception of the single currency. For the peripheral countries of the eurozone,

<sup>8</sup> The graph for the eurozone can be found in Zeza (2020). A dynamic graph showing the evolution of sectoral balances for individual eurozone countries can be found at the following link: [www.alessandrobramucci.com/graphs/dynamic\\_graph.html](http://www.alessandrobramucci.com/graphs/dynamic_graph.html).

including Italy, the first years after the introduction of the single currency corresponds to a period of (light) expansion. The convergence of interest rates due to the disappearance of exchange rate risk favoured the inflow of capital from the core countries of the currency area, predominantly Germany. Capital inflows boosted domestic (debt-financed) demand, supporting growth and employment. Current accounts between the core and the periphery of the eurozone started to deteriorate as the exchange rate between eurozone countries was now fixed. At the same time, higher growth rates in peripheral countries led to higher prices and wages which in turn contributed to further loss of competitiveness of the peripheral countries vis-à-vis core EMU countries. Italy particularly suffered from the introduction of the euro as the country lost the exchange rate instrument that it used to resort to improve its foreign trade balance in the past. The single currency together with historically higher inflation rates compared to the core EMU countries contributed to the erosion of Italy's external competitiveness. In Europe, the international crisis soon turned in what in the mainstream interpretation became known as the "sovereign debt crisis" involving, in particular, Greece and Italy as well as other peripheral countries of the EMU. The debt crisis was interpreted as a problem of excessive public spending, and to stop the speculative spiral that had formed in the financial markets around the public debt of peripheral EMU countries, severe austerity policies were imposed.<sup>9</sup>

For Germany, the early 2000s were instead years of economic crisis as the country was still bearing the burden of reunification. With the introduction of the euro, Germany experienced the opposite situation to that of Italy. Thanks to the euro, a weaker currency with respect to the older *Deutsche Mark*, Germany improved international competitiveness outside the eurozone. In addition, thanks to lower inflation rates compared to the rest of the eurozone, the country was able to gain a strong competitive edge vis-à-vis peripheral EMU members. Structural reforms and, in particular, labour market reforms (the well-known Agenda 2010 and the Hartz IV reforms of the red-green political coalition) pushed wage growth below productivity growth boosting the competitiveness of German exports.

### *The post-crisis European policy agenda*

Thanks to its newfound economic and thus political strength, Germany, together with European and international institutions (the "Troika"), dictated the policies of the European post-crisis recovery agenda. In the dominant view, Germany's economic success since the mid-2000s was attributed to a series of painful but at the same time necessary economic reforms. Thanks to labour market flexibilisation measures and restrictive budgetary policies (*Schuldenbremse*) Germany was able to quickly turn from the "sick man of Europe" to the leading European economic power showing positive GDP growth rates, low unemployment rates, large current account surpluses and a declining debt-to-GDP ratio. Due to its rapid economic success, Germany and the "German model" soon became a role model for the entire EMU and in particular for the crisis ridden countries of the periphery (Piattoni/Notermans 2021; Notermans/Piattoni 2021). The dominant interpretation of Germany's economic success was criticised in several respects. Hein and Truger (2005) questioned the mainstream assumption of institutional sclerosis, i.e., rigid labour market regulations and a generous welfare state, being at the root of the German economic malaise of the 1990s/early 2000s pointing instead to the restrictive policy mix both at the domestic and European level.

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<sup>9</sup> We know well how in peripheral EMU countries the debt-to-GDP ratio was stable or even decreasing as in the case of Spain and increased dramatically as a result of the global crisis.

Cesaratto and Stirati (2010) argued how Germany implemented restrictive wage and fiscal policy to deliberately pursue a clear mercantilist strategy to the detriment of its European partners. Truger and Rietzler (2019) questioned whether the “debt brake” (*Schuldenbremse*) is the reason behind the successful budget consolidation beginning in 2010, instead arguing it was rather the positive macroeconomic environment enjoyed by the country that favoured the realisation of budget surpluses and the reduction of the debt-to-GDP ratio. Nevertheless, the image of Germany’s export-led economic success based on wage moderation and fiscal discipline remained deeply ingrained in the European policy discourse so that the post-crisis European policy agenda was shaped around the two pillars of fiscal austerity, to reduce public debts and the restore confidence of financial markets, and labour market structural reforms, to improve external competitiveness and relaunch export (Notermans/Piattoni 2021).

Italy undertook several reforms following the European policy agenda. However, the policy mix adopted soon proved to be self-defeating. Fiscal consolidation efforts did not help to reduce debt-to-GDP ratios that jumped from approximately 120 percent in 2011 to 135 percent in 2014. The Italian labour market was also subject to a series of reforms aimed at increasing flexibility and boosting employment. Labour market structural reforms instead pushed the adoption of temporary and part-time working contracts over permanent contracts (Cirillo et al. 2017). Perez and Matsaganis (2019) showed how labour market structural reforms in Italy and in southern Europe were effective in achieving internal devaluation but did not help to boost export and employment. The adoption of structural reforms in Italy has been pushed by international institutions. The most prominent case of urgent call for structural reforms is certainly the letter received in August 2011 by the Italian government led at the time by Silvio Berlusconi co-signed by the president of the Bank of Italy, Mario Draghi, and by president of the ECB, Jean-Claude Trichet. However, as argued by Amable and Palombarini (2014), neoliberal structural reforms in Italy found support in the dominant social bloc of the country, which the authors refer to as the *bloc bourgeois*. The *bloc bourgeois* is an elitist social alliance that brought together parts of the right and of the left and that was deeply committed to the neoliberal principles of the European integration project.

### *Italy as an export-led economy?*

Historical evidence seems to support the thesis that exports played a key role for growth in the Italian economy. In his work on the development of the Italian economy, Graziani (2000) argued how after WWII a country as poor in raw materials as Italy was pushed to develop an export-oriented industry in order to avoid persistent current account imbalances. However, instead of specialising in labour-intensive sectors in which the country had a comparative advantage, the Italian industry was able to specialise in those sectors where world demand at the time was booming, such as consumer durable goods and luxury goods (Graziani 2000). Econometric analysis provided mixed evidence on the export-led growth hypothesis for the Italian economy after WWII. Federici and Marconi (2002) provided evidence in support of export-led growth for the period 1960-98 while Pistoiesi and Rinaldi (2012) found weak evidence arguing how export growth was only one of the factors driving economic growth after WWII.

In more general terms, Italy is often presented as an export-led economy and there are numerous studies comparing the Italian and the German export-led model in various respects (Foresti/Trenti 2012; Guerrieri/Esposito 2012; Jones 2021). The success of Germany’s export-

led growth turned out to be particularly attractive to Italy.<sup>10</sup> As a matter of fact, the two countries are among the largest industrial platforms in the European Union (EU). The German industry (excluding construction) produces 30.5 percent of the entire value added of the EU followed by Italy (13.9), France (13.2), Spain (7.8), Poland (4.8), and Netherlands (3.8).<sup>11</sup> Similar to Germany, Italy's exports are mostly comprised of goods. Between 2001 and 2009, the share of exported goods in the total value of exports was equal to 79.9 percent in Italy and to 84.7 percent in Germany. After the global crisis (2010-19) it increased to 81.4 percent in Italy and it dropped to 82.7 in Germany. France and Spain exhibit considerably lower shares, equal to 74.3 and 67 percent in the period 2001-09 and to 70.8 and 69.2 percent in the period 2010-19 respectively. Germany and Italy show also a strong similarity in the relative composition of exported goods (Foresti/Trenti 2011; Heimberger/Krowall 2020). At the top of the list of exported goods as a share of total exports, as shown in Table 2, we find industrial machinery, vehicles, electrical machinery and equipment, and pharmaceutical products in both Italy and Germany. There exist also important differences between German and Italian exports. As we can observe from the last column of Table 2, the export share of vehicles, electrical machinery and equipment, optical and medical equipment, and aircrafts is higher in Germany, while the export share of beverages, precious metals and stones, footwear, apparel and leather products (luxury and fashion goods) are higher in Italy.<sup>12</sup>

**Table 2. Top ten exported products for Germany and Italy and top five differences and bottom five differences in exported products between Italy and Germany, share of total export, 2-digits products (HS 1992), year 2019.**

<i>Germany</i>		<i>Italy</i>		<i>Difference</i>	
Industrial machinery	17.57	Industrial machinery	18.95	Vehicles	-8.65
Vehicles	16.45	Vehicles	7.8	Electrical machinery and equipment	-4.68
Electrical machinery and equipment	10.66	Pharmaceutical products	6.26	Apparatuses (optical, medical, etc.)	-2.87
Pharmaceutical products	6.07	Electrical machinery and equipment	5.98	Aircrafts	-2.02
Apparatuses (optical, medical, etc.)	5.34	Plastics	4	Other commodities	-1
Plastics	4.23	Articles of iron or steel	3.46	Beverages	1.57
Aircrafts	2.91	Mineral fuels and oils	2.93	Precious metals and stones	1.68
Other commodities	2.37	Precious metals and stones	2.87	Footwear	1.72
Mineral fuels and oils	2.29	Furniture	2.6	Apparel, not knit	1.75
Articles of iron or steel	2.1	Apparel, not knit	2.59	Leather	2.12

Source: ITC. Own elaboration.

However, in recent decades, the performances of Italian exports lagged behind the export performance of Germany and of the other eurozone peers as the Italian industry suffered from the increasing competition with China (Bugamelli et al. 2018).

#### 4. Italy learned the “wrong lesson” from Germany

The progressive interpretation of the euro crisis concluded that trade imbalances between Germany and the peripheral eurozone countries were to be explained with the competitive

<sup>10</sup> An explicit recommendation to imitate the German export-led growth model can be found in Carlo Cottarelli's popular book titled “The seven deadly sins of the Italian economy” (Cottarelli 2018).

<sup>11</sup> Average values over the period 2001-2019 (Eurostat 2022).

<sup>12</sup> We have computed an export similarity index by product (Finger/Kreinin 1979) between Italy and the largest industrial countries of the EU (Germany, France, Spain, Poland and Netherlands). The highest value over the period 2001-19 is between Germany and Italy.

edge that Germany achieved through restrictive wage policies. An expansionary wage policy in Germany was therefore necessary to rebalance the current account of Germany vis-à-vis the eurozone deficit countries (Stockhammer/Onaran 2012). Hein and Truger (2017) questioned this interpretation, arguing that an expansionary wage policy in Germany would not have the effect of deteriorating price competitiveness of exports (unless the wage expansion is very large), but rather only the effect of increasing domestic demand and so closing the current account balance. The factors that explain the competitiveness of German goods are in fact to be found in its strong non-price (i.e., technological) competitiveness factors (Storm/Naastepad 2015; Neumann 2020) but also in the reorientation of the export markets, in the specialisation in advanced sectors and in the reorganisation of the German production network including Eastern European countries (EECs) (Simonazzi et al. 2013).

### *Reorganisation of export markets*

One of the main factors contributing to the success of German exports has been the ability of German companies to take advantage of new high-growth markets. German firms were able to reorient their export destinations from the traditional partners (Eurozone countries, UK, US) to the new emerging markets, especially China and EECs (Celi et al. 2018; Simonazzi et al. 2013). As we can observe from Table 3, from 2000 to 2019 the share of German exports to China rose by 5.68 percentage points, to Poland by 2.5 percentage points and to Czech Republic by 1.17 percentage points. In 2019, China became the third largest export market for Germany (7.25 percent export share) after the United States (8.94 percent) and France (7.99 percent). The share of Italian exports to China and EECs also increased, but only to a lower extent. The share of exports to China increased by 1.8 percentage points, to Poland by 1.35 percentage points and to Czech Republic by 0.73 percentage points. Switzerland turned out to be the largest growing share in Italian exports, with an increase of 2.13 percentage points. At the same time, the share of exports to major eurozone countries and the other major developed countries (UK, US) declined albeit to a lower extent than in Germany. Italy's top export destination in 2019 remained Germany followed by France and the US while China appeared only in the ninth position.<sup>13</sup> Foresti and Trenti (2012) argued how German and Italian companies follow different approaches to access foreign markets. German companies display a strategic and organised approach that aims at building long-term relationships in the export region. Italian companies, on the other hand, tend to act individually with a more flexible approach, managing to intercept even the smallest sources of demand but failing to establish long-term links with the foreign market, and so create few positive externalities for the entire Italian production system (Foresti/Trenti 2012). In addition, Germany has been able to seize the opportunities of globalisation not only on the demand side by increasing export flows to the fastest growing markets but also on the supply side by fragmenting and reorganising its production activities on an international scale (Guerrieri/Esposito 2012). Germany managed to integrate EECs in its production network through selected relocation strategies outsourcing only the low-skill intensive segments of the production chain while keeping the high-skill intensive activities at home. This strategy was able to stimulate domestic productivity and job creation in the high added value segments of the production chain. The Italian industry was also able to take advantage of the eastward enlargement of the EU. Italian companies,

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<sup>13</sup> The fact that mercantilist Germany is the main market for Italian goods raise further doubts on the effective functioning of an export-led recovery strategy for Italy. In this sense, it would be interesting to investigate to which extent Italian firms may have become an integral part of the German production chain looking for example at the value-added content of the German exports produced by Italian firms.

however, have tended to relocate their entire production lines abroad, particularly in low and medium quality sectors, with clear negative consequences in terms of employment for the Italian economy (Simonazzi et al. 2013).

**Table 3. Export shares by destination country for Germany and Italy (in percent).**

	<i>Germany</i>			<i>Italy</i>			
	<i>Export share in 2000</i>	<i>Export share in 2019</i>	<i>Difference</i>	<i>Export share in 2000</i>	<i>Export share in 2019</i>	<i>Difference</i>	
France	11.43	7.99	-3.44	Germany	15.09	12.18	-2.91
Italy	7.59	5.08	-2.51	France	12.64	10.53	-2.11
United Kingdom	8.33	5.92	-2.41	United Kingdom	6.88	5.25	-1.63
Belgium	5.08	3.46	-1.62	Spain	6.21	5.1	-1.11
United States	10.26	8.94	-1.32	Greece	2.06	0.97	-1.09
Spain	4.55	3.31	-1.24	United States	10.21	9.48	-0.73
Japan	2.21	1.56	-0.65	Portugal	1.38	0.92	-0.46
Austria	5.32	4.75	-0.57	Denmark	0.78	0.61	-0.17
Sweden	2.28	1.87	-0.41	Netherlands	2.65	2.5	-0.15
Finland	1.16	0.83	-0.33	Brazil	0.94	0.83	-0.11
Mexico	0.83	1.03	0.2	Belgium	2.72	2.97	0.25
Hungary	1.72	2.02	0.3	Korea, Rep.	0.69	1.01	0.32
Slovak Republic	0.56	1.05	0.49	Slovak Republic	0.27	0.66	0.39
Korea, Rep.	0.76	1.3	0.54	India	0.38	0.83	0.45
India	0.35	0.9	0.55	Romania	1.02	1.63	0.61
Romania	0.42	1.26	0.84	Russian Federation	0.97	1.64	0.67
Russian Federation	1.11	2.04	0.93	Czech Republic	0.64	1.37	0.73
Czech Republic	2.14	3.31	1.17	Poland	1.47	2.82	1.35
Poland	2.43	4.93	2.5	China	0.9	2.7	1.8
China	1.57	7.25	5.68	Switzerland	3.29	5.42	2.13

Source: ITC. Own elaboration.

### *Improvement of international non-price competitiveness*

In order to capture the degree and dynamics of non-price competitiveness of exports, we have looked at three proxy indicators. First, we have looked at public spending on secondary and tertiary education. This indicator captures, to a rough extent, the degree to which a country invests in its human capital and therefore in the ability of the younger generations to advance the country's future technological frontier. As we can see from Table 4, in 2019 (as in 2001 and 2007) government education spending in Italy lagged behind France (2.8 percent) and Germany (2.4 percent). Recent empirical analysis showed how the underfunding of public universities in Italy contributed to the migration of young university researchers with the consequent loss of skills and human capital (Nascia et al. 2021). In addition, Truger (2018) showed how public spending on education was subject to heavy budget cuts during the crisis years, particularly in the peripheral eurozone countries, with obvious negative consequences on long-term growth potential.

**Table 4. Government education spending, R&D spending and economic complexity index, selected years.**

	2001	2007	2019
	<i>Government education spending* (% of GDP)</i>		
France	3.2	2.9	2.8
Germany	2.7	2.5	2.4
Italy	2.5	2.4	2.1
Spain	2.2	2.1	2.1
	<i>R&amp;D spending** (% of GDP)</i>		
France	2.1	2.0	2.2
Germany	2.4	2.4	3.1
Italy	1.0	1.1	1.4
Spain	0.9	1.2	1.2
	<i>Economic complexity index (rank)</i>		
France	10	13	15
Germany	2	2	4
Italy	13	18	17
Spain	19	26	34

Source: Eurostat, World Bank, OEC. Note: \*Secondary and tertiary education. \*\*Public and private; last value 2018.

Second, we look at R&D spending (public and private). Again, Italy lags constantly behind Germany and France. We can see that in 2019, Germany's R&D spending (3.1 percent) was more than double the figure for Italy (1.4 percent). Indeed, there is a positive relationship between R&D, innovation and export performance. The empirical study by Guarascio et al. (2016) highlighted the existence of a "virtuous circle" between R&D spending, new product development, and increased export market share. In their econometric study, the virtuous circle breaks down when the sample is narrowed down to Central/Mediterranean countries (France, Italy, Spain) confirming how Italy's low values in R&D spending had a significant negative effect on export performance. Third, following Kohler and Stockhammer (2021) and Hein and Martschin (2021), we look at the Economic Complexity Index (ECI). This indicator provides an excellent measure of the degree of competitiveness of the goods exported by a country.<sup>14</sup> Here the gap between Italy and Germany is evident. While in 2019 Germany reached the fourth position in the ECI ranking, losing two positions compared to 2001 and 2007, Italy reached the seventeenth position losing four positions compared to 2001. We can therefore conclude that despite the similarity in the range of exported products between Germany and Italy, Italy did not manage to properly emulate the factors that make German exports competitive and so explaining the decline of Italian export in increasingly competitive international markets.

## 5. Conclusions

We have attempted to explain the disappointing performance of the Italian economy after the GFEC of 2007-08 as the failure of an export-led recovery strategy. This does not mean that the poor growth performance of the Italian economy starts after the GFEC. The stagnation of the Italian economy has persisted for almost thirty years. In this contribution, we have decided to

<sup>14</sup> For a detailed account about the construction of the ECI, see Hidalgo and Hausmann (2009).

focus on the period 2001-19, investigating Italy's growth model and, in particular, the shift of the growth model after the crisis in the context of the EMU and the relative economic policy constraints. First, we have looked at growth contributions and sectoral financial balances. We have showed how Italy transformed from a stagnant domestic demand-led economy in the period 2001-09 to a stagnant export-led economy in the period 2010-19 (Hein/Martschin 2021). We have also noticed how net export growth was the result of the deceleration of imports rather than of the growth of exports, raising doubts on the interpretation of the Italian growth model in the post-crisis period as being truly export-led (Kohler/Stockhammer 2021). Based on the arithmetic of the sectoral financial balances we have showed how achieving current account surpluses are required by definition when the private sector aims at running surpluses and the government sector is constrained by a balance budget policy. A growth strategy based on foreign demand was therefore the only viable option, for Italy and for the eurozone as a whole. In an attempt to pursue export-led growth, however, deflationary policies were adopted that instead of stimulating foreign demand have reduced domestic demand (Kregel 2018; Zezza 2020).

Second, we have argued that, after the GFEC of 2007-09, Germany and the "German model" became a role model for the entire EMU and, in particular, for the crisis-ridden countries of the periphery. In the dominant view Germany's economic success since the mid-2000s was attributed to a series of painful but at the same time necessary economic reforms. Thanks to structural reforms, in particular labour market flexibilisation policies, coupled with restrictive budgetary policies, Germany was able to quickly turn from the "sick man of Europe" to the leading European economic power showing a series of positive macroeconomic indicators. Due to its rapid economic success, Germany took the political leadership of the EMU and was able to dictate the European economic policy agenda. Germany became the role model for Italy, two large export-oriented manufacturing economies with close similarity in the array of exported products. Borrowing terminology from Storm and Naastepad (2015), we have argued how Italy's attempt to restore export competitiveness following the "wrong" German model, i.e., the model adopted in the European reform agenda, while the success of German exports, or the "true" German model, was based upon the reorganization of outlet markets and the improvement in non-price competitiveness.

Finally, regarding the possibility of replicating mercantilist export-led growth in Italy (or elsewhere), we would like to emphasise to the intrinsic contradictions of the model.<sup>15</sup> First, the export-led growth model contributes to the accumulation of financial fragilities at the international level. For the deficit country, persistent current account deficits imply an increase in foreign debt. As soon as the deficit country is no longer be able to finance its current account deficits, it will be forced to consolidate, thereby suffering an economic crisis that will affect the surplus country as well. Second, the export-led model suffers from a fallacy of composition problem. Not all countries in the world can expect to grow simultaneously through increases in net exports as it will become more and more difficult, if not impossible, to find the necessary export markets. Third, the export-led model is based upon a beggar-thy-neighbour strategy. Growth in the export-led country is based on demand generated elsewhere. The country will therefore grow at the expense of others becoming a drag on international growth. Instead of living below its means, a country with successful exports should consume and invest more, thus creating the necessary market space for the exports of other countries. For these reasons, we argue in favour of a growth revival based on domestic

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<sup>15</sup> Here we follow primarily the arguments in Hein (2019) but also Simonazzi et al. (2013).



demand, both public and private, in Italy and in the entire eurozone. Whether this will be possible remains to be seen.

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