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By Howard **Schneider**, Published: August 4

Low growth drags down euro-zone prospects

MANZANO, Italy — The traditional network of small family companies that put this city on the map after World War I as the self-proclaimed chair capital of the world has become a burden, presenting the kind of challenge that lies at the heart of Italy's — and southern Europe's — economic struggles.

After a century in the furniture-making business, for example, the Constantini family has its connections wired, with a network of neighbors it relies on to bend wood for chair frames, craft metal parts and upholster the final product. At its peak, Manzano's guild-like system involved perhaps 1,200 family firms.

But the system is proving slow to change, wary of the outside investment needed to expand and easily undercut by Asian firms on price — at a time when Italy and other southern European economies need to show they can compete in the emerging world system and grow as fast as neighbors such as Germany.

Europe's crisis is nominally about public debt. But at the root, it's about economic growth — or, in Italy's case, the lack of it. Since the advent of the euro a decade ago, Europe has become a two-tier economy, with one group of nations that have adapted and are reaping the full benefits of the common currency and another mired in a stubborn slowdown.

Economists and analysts differ about the causes of this dichotomy and possible cures. But on this much they agree: If growth in southern Europe doesn't pick up, the hundreds of billions of dollars being lent to countries such as Greece and Portugal to bail them out of their debt crises will have been for naught, and even deeper traumas will lie ahead in the larger economies of Spain and Italy.
The math is inexorable. Of the factors that influence a country's public debt, the effects of economic growth are the most profound, typically dwarfing the impact of the spending and tax decisions that draw more political attention. The forecasts and models created by agencies such as the International Monetary Fund emphasize the point: Miss a revenue or spending target and the numbers look a little worse; miss the growth forecast and debt spirals out of control.

The Italian paradox

In Italy, the economy is expected to grow only about 1 percent this year and just slightly more in 2012.

"It is very difficult to see what could get Italy going again short of changing the country," said Daniel Gros, director of the Center for European Policy Studies. Gros, like other analysts and economists, notes the paradox: Italy has produced more than its share of world-known brands — Ducati, Ferrari, Gucci, Prada — but has an economy overwhelmingly based on small and often inefficient family firms, which are dragging down the nation's overall performance.

Despite its major manufacturing base, this production system makes Italy a lot like Portugal, one of Europe's lesser economies. And Gros said he sees Italy heading down the same road as Portugal — with global markets wary about the country's inability to pay its bills and skeptical that it can turn its economy around. Portugal, like Greece, is under an IMF rescue program.

The leaders of the 17-nation euro zone last month put in place an expanded program to help the weaker economies in the region, essentially putting the full credit of Germany, France and a few of the euro's other "winners" behind the finances and banking systems of countries with crushing levels of public debt.

It was a bold step politically. But without growth, the weaker economies "will find it increasingly difficult to deal with their high debt levels," said Pier Carlo Padoan, chief economist with the Organization for Economic Cooperation and Development.

Italy benefits from a strong pool of private savings, and much of its public debt is held within the country rather than by foreign creditors, another advantage. But "only sustained growth will reduce the burden" of debt that stands at 120 percent of its annual economic output, the IMF wrote in a recent report.

'Lost decade'

At the start, economists say, the euro brought many benefits to Italy, chief among them an end to the wild currency swings that characterized the country under the volatile lira. And in the years leading up to the currency's adoption a decade ago, Italian politicians were forced to be more disciplined about spending in an effort to get the country's finances in shape so that it could be admitted to the currency bloc.

It has been downhill since then. Over the past 10 years, Italy has been among the world's worst-performing economies. Per-capita income and labor productivity have fallen. Despite the country's penchant for design and its stable of well-known luxury brands, its share of world trade has also declined.

University of Turin economist **Bernardo Bortolotti** said the establishment of the euro inaugurated a "lost decade" for Italy. Over the past 10 years, he said, investment in public infrastructure stopped and debt began climbing amid the global recession as Italy increased spending to stimulate its economy and its tax revenue declined. Some of the country's competitive multinationals have thrived, but their success has been "overwhelmed in an economy of small and medium firms," Bortolotti said.

The persistence of small, traditional companies did not cause the surge in Italian borrowing. But without structural changes to the economy, it will prove challenging for Italy to grow itself out from under its debt load.

Chairmaker Pier Paolo Constantini said the issues are well known in regions such as Manzano, where third- and fourth-generation craftsmen battle to keep alive businesses started by grandparents and great-grandparents.

There is, he said, an ongoing debate among his colleagues about whether to try to expand, borrow from banks and take on outside investors. Local officials estimate that perhaps a quarter of the companies involved in chairmaking have closed in recent years — the low-end companies driven out by competition from China, the high-end ones hit by the strong value of the euro against the dollar.

“I was always told that small is nice. Now they say small is not nice. They want us to grow,” said Constantini, head of the Constantini Pietro company, which began when his grandfather started building chair frames with cheap lumber from Slovenia and with his grandmother weaving the seats. But both bank credit and outside investment are viewed suspiciously among family entrepreneurs “trying to defend their small gardens,” he said.

With 30 employees, Constantini’s is considered one of the larger companies in the region, and he has focused on high-end exports — designing shorter chairs for Japanese clients, for example, and slightly wider ones for the United States.

But he has avoided aggressive growth. Labor rules in Italy, he said, make every entrepreneur cautious about hiring. Employment in the country is “like marriage,” he said. Employment laws make it costly and time-consuming to eliminate workers, with unions allowed to determine who gets laid off.

Alessandro Calligaris, another furniture maker, said it was difficult to decide what to do when French luxury company LVMH offered to take a stake in the company his grandparents had begun.

But Calligaris said he also knew that for the furniture companies around Manzano — just as for many craft industries in Italy — stagnation means demise. The Calligaris company had already moved beyond chairs to other types of furniture and wanted to build a brand with a presence outside Italy.

That required LVMH’s capital, even if the price was a bit less family control. Calligaris now has retail stores in key cities and an online catalogue reminiscent of Ikea for the range of products — not just the chairs the grandparents made, but whole rooms of furniture and the accessories to go with them.

“It has allowed us to start a new strategy, and we are convinced it is the right strategy,” said Stefania Antonutti, the company’s marketing manager. “We are emerging in a very crowded universe.”

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