# The Italian Mezzogiorno: Markets or Policies? *

## Introduction

Two authoritative official voices have recently joined the debate on how best to promote the development of Southern Italy. Writing in this *Review* in 1989, the Director General of the Italian Treasury, argued for a multi-faceted strategy:

> "The emphasis will have to be placed on the joint operation of all mechanisms furthering Italian integration: the flexibility of real wages, the mobility of the factors of production ... and adequate public transfers, especially those increasing ... capital" (Sarcinelli, 1989, p. 161).

One year later, the OECD, faithful to its newly-found free market credo, stressed the importance of getting relative prices "right" and, in particular, of: "making regional wages more sensitive to regional labour market conditions" (OECD, 1990, p. 79). Policy activism, on the other hand, was to be shunned and the suggested role for public intervention was limited to its traditional functions:

> "Government, local, regional and national, should concentrate on developing infrastructures and on the efficient provision of public goods ... rather than allocating and controlling business capital" (*ibid.*, p. 80).

These different judgments should not mask the fact that both participants in the debate share much in common. The issue at stake is not the crude one of whether development is best promoted by *laissez faire* or by intervention, but the much subtler one of the right

* Chris Allsopp and Gianpaolo Galli, who made very useful and insufficiently heeded comments, bear no responsibility for the final outcome.

proportions in which policies and market forces should be combined. Yet, there would seem to be an important contrast in the weights that these quotes put on the two mechanisms. The purpose of this brief note is to look at which of the two approaches is, in the light of past evidence, the one most likely to further Southern development.

## Markets or policies?

Economic theory provides little guide as to whether regional differentials are likely to be smoothly reabsorbed or not in the absence of policies. At one extreme, the static, neo-classical, framework would predict that free trade and free factor movements within a country would lead to an equalization of marginal productivities and factor returns and, hence, to increasing regional equality. At the other end of the spectrum, Kaldorian theories of "cumulative causation" would stress, instead, the operation of Verdoorn's law and moves away from equilibrium, as richer regions monopolize a country's best resources, exploit dynamic scale economies and grow at the expense of less developed areas (Kaldor, 1970).

Yet both approaches would seem to exaggerate the strength of the forces making for, or against, regional equalization. Thus, "theoretical equilibrating mechanisms in practice have little explanatory power, with factors limiting the operation and speediness of adjustment often being more important" (OECD, 1989, p. 111). In particular, one obvious instance of "market failure" (limited factor mobility), prevents full market clearing and hence impedes the movement towards equilibrium. But by the same token, it also restricts centripetal tendencies, thus diminishing the importance of "cumulative causation". The longer-run empirical evidence for the United States or the EEC is hardly very conclusive – a movement towards equalization has occurred, but often thanks to special events (*e.g.* World War II), or policy intervention (Boltho, 1989).

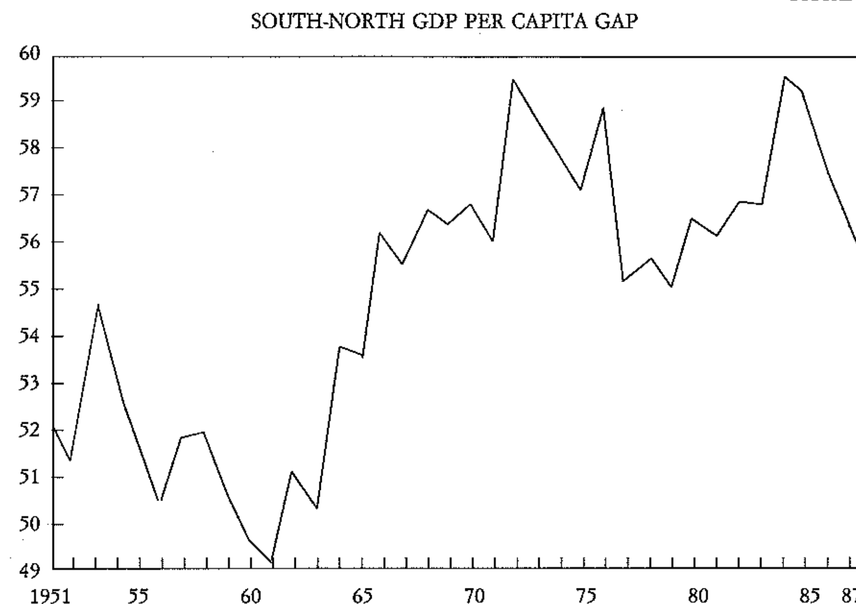
The same would, broadly, seem to be true for Italy where, despite a massive policy effort, regional differentials in income, productivity and unemployment have persisted for a long time, with only a weak tendency to narrow. Attention in the following will be



concentrated on one major synthetic measure: the gap in GDP per capita between the Southern and Northern halves of the country. This widened in the 1950s, when "cumulative causation" may have been present, shrank rapidly in the 1960s, opened up again from the mid-1970s onwards, and is at present not much smaller than it was nearly four decades ago (Figure 1).

FIGURE 1

SOUTH-NORTH GDP PER CAPITA GAP




*Source:* See Appendix.

Disentangling the role of policies and of other forces in these developments is fraught with difficulties. At an impressionistic level, all the factors singled out by Sarcinelli (mobility, flexibility and public support) may well have been important in shaping trends in the gap. In the 1950s, resources were reasonably mobile, but policies were weak. In addition, with the wage gap closing faster than the productivity gap, Southern unit labour costs began their slow movement towards convergence with Northern levels. In the 1960s, on the other hand, a number of favourable conditions were simultaneously present – the process of integration continued, the unit labour cost gap stabilized and the policy effort gathered momentum. In the 1970s and 1980s, conversely, these conditions were all absent as the labour cost

differential between North and South disappeared, capital inflows were limited by a major restructuring effort in Northern industry, and regional support policies were scaled down.

These, of course, are only qualitative impressions. Quantification is required to strengthen them, ideally through the construction of a "counterfactual" experiment. The difficulties of such an approach, however, are formidable – it is hardly possible to rewrite Italy's economic history over the last three to four decades by excluding, for instance, the influence of regional development policies. The following, therefore, attempts to quantify the role of some of the major factors that may have influenced the development of the per capita South/North income gap, by way of a much simpler single regression approach.

The choice of variables follows quite closely the suggestions made by the OECD and Sarcinelli. Both authors point to the importance of wage flexibility and to the insensitivity of regional wages to regional labour market conditions, a factor deplored also by many other commentators (*e.g.*, Banca d'Italia, 1988). The most appropriate proxy for such a variable would seem to be a measure of unit labour costs in the two halves of the country, ideally for all tradables, in practice, given data limitations, for the manufacturing sector alone.[1]

In addition, Sarcinelli also underlines the importance of factor mobility and, hence, of integration. Through the last four decades, the two halves of the country have come increasingly together, a process that could, *ceteris paribus*, have favoured a closing of differentials. Data on integration are not available, but a not inappropriate proxy could be a simple time trend that would be picking up many of the forces at work. One particular component of integration, labour migration, can however be allowed for separately, though, for well known reasons, the influence of this variable on differentials is, *a priori*, uncertain.

Finally, the role of policy could be represented by a synthetic indicator of the industrial policy effort made by the Italian government in the South relative to national policy (Del Monte, 1984). Unfortunately, this indicator is available only from 1957 to 1981. A very rough extrapolation to 1987 has been made with the help of data on expenditure in the South by the Cassa per il Mezzogiorno

[1] Data sources are provided in the Appendix.



(SVIMEZ, 1989), but not too much store can be put on the resulting findings.[2]

The results (Table 1) suggest that there may be more truth in the eclectic Sarcinelli view than in the OECD's narrower focus on relative prices.[3] Looking at the first equation, longer-run integration clearly contributes positively to the narrowing of income differentials (while labour migration appears not to have a statistically significant effect). Similarly, rising unit labour costs in the South (lagged one

TABLE 1

MAJOR DETERMINANTS OF REGIONAL INCOME GAP

| | CON | TIM | $ULC_{t-1}$ | $MIG_{t-1}$ | $IRP_{t-1}$ | $R^2$ | SE | DW |
|---|---|---|---|---|---|---|---|---|
| | Dependent variable: YGAP | | | | | | | |
| | *1957-81* | | | | | | | |
| (1) | 79.6<br>(13.2) | 0.73<br>(8.3) | –0.49<br>(5.3) | –0.01<br>(1.2) | | 0.82 | 0.41 | 1.69 |
| (2) | 79.9<br>(15.1) | 0.72<br>(9.4) | –0.51<br>(6.3) | –0.02<br>(2.2) | 0.06<br>(2.7) | 0.87 | 0.36 | 2.19 |
| | *1957-87* | | | | | | | |
| (3) | 74.3<br>(17.1) | 0.69<br>(8.8) | –0.41<br>(6.1) | –0.01<br>(1.2) | | 0.81 | 0.40 | 1.41 |
| (4) | 70.2<br>(16.5) | 0.65<br>(9.0) | –0.37<br>(5.9) | –0.02<br>(2.1) | 0.08*<br>(2.6) | 0.85 | 0.37 | 1.72 |

*Note:* For data sources, see Appendix. Figures in brackets are t-ratios.
YGAP = Ratio of per capita incomes (Southern Italy to Northern Italy).
TIM = Time trend.
ULC = Ratio of industrial unit labour costs (Southern Italy to Central-Northern Italy).
IRP = Indicator of the intensity of regional relative to national industrial policy.
MIG = Migration from Southern to Northern Italy (1970=100).
* = The IRP indicator has been roughly extrapolated for the years 1982 to 1987; variable not lagged.

[2] The very simple model being tested is, thus, of the following form:

$$Ygap = a + b \text{ time} + c \text{ ULCgap} + d \text{ Migration} + e \text{ Policy} \quad (1)$$

where Ygap stands for the ratio of GDP per capita in the South to the North, and ULC gap for the industrial unit labour cost ratio between South and Centre-North; the expected signs of the coefficients are: $b>0$; $c<0$; d ?; $e>0$.

[3] The results are very similar if the dependent variable is the South/Centre-North gap in GDP per capita rather than the South/North gap.

year) heavily penalize the Mezzogiorno. Both these trends would seem to confirm the importance of market forces.

Industrial policy, however, seems also important. The introduction of this variable, lagged one year, clearly improves the statistical properties of the first equation,[4] even if the size of the coefficient on the policy variable suggests that the contribution made by official intervention to the closing of the gap is relatively small. The improvement is also less marked in the case of the 1957-87 results, but, as already noted, the 1982-87 observations for the "relative intensity of industrial policy" indicator are only rough approximations.

Interestingly, two other broader indicators of policy intervention (Del Monte, 1984) which, in addition to industrial support, also include public consumption and infrastructure investment in the South relative to their levels in the North, are statistically much less significant than the indicator chosen, suggesting that the strongest impact on Southern development is obtained precisely by intervention that focuses on productive investment in the manufacturing sector. Migration now appears with a significant negative coefficient in both periods, supporting the interpretation that "emigration is likely to have creamed off the more dynamic and entrepreneurial members of the population" (OECD, 1990, p. 77).

## Some concluding thoughts

Econometric estimate can hardly ever "prove" anything, the more so when they are based on very simple techniques. In this instance, however, the results may, nonetheless, have some merit. Not only are they reasonably satisfactory from a statistical point of view, but, and much more importantly, they also conform to common sense. What they show is that Southern development requires the fulfillment of a whole host of conditions needed to create that "favourable external environment" which has, so far, proved to be so elusive.

[4] In so far as the policy indicator includes investment by state-controlled enterprises, which also appears in the GDP per capita figures, there may be a very small element of spurious correlation between the dependent and the independent variables.



The vagueness of the term itself underlines the difficulty of the task. Obvious priorities are a better infrastructure, a more efficient provision of public services, and a more effective presence of law and order. Yet, even more crucial would seem to be as favourable as possible a combination of factor prices, given that both unit labour and borrowing costs are, by now, well above Northern levels (De Caprariis and Heimler, 1988; Marzano *et al.*, 1983). This, in turn, would seem to require not only a policy of deregulating labour markets, whose effects will inevitably be felt only very slowly, but also an active policy of support of industrial investment, as the one which prevailed in the 1960s when differentials narrowed most rapidly.

At the time, the emphasis was on subsidizing capital. More recently, it has shifted towards subsidizing labour. In present circumstances, both forms of support may be necessary to prevent emigration on the one hand and to attract footlose capital on the other. Indeed, the scope for the latter policy may well be much greater now than in the past, as the mobility of capital, quite low in earlier periods, seems to have been boosted by recent technological changes. While in the 1950s and 1960s "workers moved to jobs", advances in communication, transportation and production technology have progressively diminished the importance of traditional scale and locational economies and have made the opposite movement of "jobs to workers" more feasible and widespread.

There are two well-known risks in encouraging such a movement via public policies of support. The first one has to do with "government failure". This danger is eloquently exposed by the OECD:

> "Past experience shows that discretionary intervention in the South was subject to significant bureaucratic inefficiency, extremely long delays, political lobbying and even corruption" (OECD, 1990, p. 80).

The sensible answer to this problem which the OECD provides is clearly for "instruments of intervention [that] should be as automatic as possible" (*ibid.*).

The second risk is that even non-discretionary policies may generate inefficient industries and permanently subsidized jobs. This argument is supported by traditional theory which shows that, in most circumstances, artificial distortions of comparative advantage patterns are very costly in terms of efficiency. Yet, the traditional approach may not be the best guide to the realities of today's

international (and therefore also inter-regional) exchanges. Modern theories of intra-industry trade suggest that "exchanges... cannot be attributed so easily to underlying advantages of the countries that export particular goods. Instead trade seems to reflect arbitrary and temporary advantages" (Krugman, 1986, p. 7), resulting in an "essentially random division of labor" (*ibid.*, p. 8). In other words, there is no intrinsic reason why, given a return to a purposeful development policy, the Mezzogiorno could not emulate the successes in attracting and stimulating the growth of new sectors that have, for instance, befallen Ireland and are increasingly spreading in Spain or Portugal.

*Oxford*

ANDREA BOLTHO

## APPENDIX

The GDP data for the Southern, Central and Northern regions for the years 1957-87 have been linked together on the basis of data obtained from several issues of: ISTAT, *Annuario di contabilità nazionale*; 1974 for 1957-70 data, 1986 for 1970-83 data and 1989 for 1983-87 data. Population figures come from the same sources or from ISTAT, *Annuario statistico italiano* (various issues), which also provides annual data on migration flows from the South.

Unit labour costs in the South and in the Centre-North region were obtained by dividing compensation per employee in industry by value added per employed worker in industry (the former series, therefore, applies to the corporate sector only, the latter includes both corporate and unincorporated activities). Industry is defined as mining and manufacturing. Data for 1957-83 come from: SVIMEZ, 1985; 1983-87 data on a slightly different basis (industry now includes the construction sector) come from: SVIMEZ, 1989.

The "index of the intensity of regional relative to national industrial policy" comes from: Del Monte, 1984. It measures the ratio of investment by state-controlled enterprises, venture capital contributions and other subsidized credit facilities in Southern Italy, to the respective national totals.



## REFERENCES

BANCA D'ITALIA (1988), *Assemblea generale ordinaria dei partecipanti*, Roma.

BOLTHO, A. (1989), "European and United States Regional Differentials: A Note", *Oxford Review of Economic Policy*, Vol. 5, No. 2, Summer, 105-15.

DE CAPRARIIS G. and A. HEIMLER (1988), "Struttura produttiva del Mezzogiorno e commercio con l'estero", *Rassegna economica*, Vol. LII, No. 1, January-March, 115-39.

DEL MONTE, A. (1984), "The Effects of Regional Policy on the Industrial Development of the South of Italy", *Mezzogiorno d'Europa*, Vol. IV, No. 4, October-December, 563-83.

KALDOR, N. (1970), "The Case for Regional Policies", *Scottish Journal of Political Economy*, Vol. XVII, No. 3, November, 337-48.

KRUGMAN, P.R. (1986), "Introduction", in P. R. Krugman (ed.), *Strategic Trade Policy and the New International Economics*, MIT Press, Cambridge, Mass.

MARZANO, F., A. DEL MONTE, M. FABBRONI and R. MATTINA (1983), "The Southern Banking System, the Development of the Mezzogiorno and the Entry of Foreign Banks into Italy", *Review of Economic Conditions in Italy*, No. 1, February, 55-96.

OECD (1989), *Employment Outlook*, Paris.

OECD (1990), *Economic Survey of Italy, 1989/1990*, Paris.

SARCINELLI, M. (1989), "The Mezzogiorno and the Single European Market: Complementary or Conflicting Aims?", in this *Review*, No. 169, June, 129-64.

SVIMEZ (1985), "La formazione e l'impiego delle risorse e l'occupazione del Mezzogiorno e del Centro-Nord dal 1951 al 1983", *Studi Svimez.*

SVIMEZ (1989), *Rapporto 1989 sull'economia del Mezzogiorno*, Il Mulino, Bologna.