

North and South: The Tragedy of Equalization in Italy

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Executive Summary

- Decades of interventionism have failed to address the economic disparities between Italian regions.
- Instead of closing the gap, over time Italy's powerful central government has engaged in policies of equalization that have made conditions worse for poor regions.
- A very expensive "Fund for the South" merely expanded rent-seeking and public interference in the economy.
- Despite significant political pressures for reform, the system of equalization and the negative incentives it creates are entrenched.
- Attempts at fiscal equalization between regions have done nothing to spur needed development in the South.
- A bias towards public infrastructure for "have not" regions has expanded dependency and criminality.
- Efforts to equalize employment have driven poorer regions into unproductive activity and accentuated the dominant role of the private sector in the North.
- Wage equalization prevents the South from attracting more private investment.
- A better solution lies in a less powerful, decentralized state and free markets.

Introduction

Italy's brilliant, glorious history is marked by the names of many cities like Venice Florence, Naples, Milan, Siena and Genoa that were once independent polities. At the end of the Middle Ages and during the Renaissance, when the country did not exist as a unitary reality, Italy was at the centre of the Old Continent. The extreme variety of that Italian society continues to typify contemporary culture and current customs, a phenomenon easily perceivable by any tourist.

Yet in spite of many recent discussions about the idea of federal reform, at the beginning of the Third Millennium Italy's institutional structure is very centralized. The Italian constitution has been revised twice since 2000 – although the second reform has not yet been passed by both chambers of the Italian parliament – but these reforms have not introduced any significant decentralization of powers or conferred any real tax autonomy on the country's regions.

The Italian economy contains very different situations, with strong inequalities among the regions – especially between North and South. In contemporary, socialist Europe, this inequality is morally unacceptable. For a long time, national governments have promoted public policies aimed at a sort of economic "equalization." Not only a rhetorical weapon of Italian politicians, the idea of reducing territorial inequalities has produced many consequences, including legislative reforms and state investments.



But the process has failed. After decades of economic interventionism promoted to reduce the gap between the North and the South, the latter remains very poor; most problems have not been solved and, in fact, they have worsened over time. Southern Italy still suffers a lack of industries and factories, and its ruling elite is largely corrupted. Politicians are often closely allied with local mafias and their behavior is influenced, if not determined, by the need to get or maintain the support of such criminal organizations, largely funded by an unlawful use of the public money.

Many other countries – including Canada, Belgium, Sweden, Australia and Britain – are faced with difficulties because they pursue policies of equalization. Italy is another country that provides evident proof of those negative consequences.

Historical Background

The goal of equalizing Italy's northern and southern economies has been part of the country's political agenda since Unification in 1861. The country was unified by the

army of Piedmont, a region that had in Italy the same role as Prussia in Germany. Very soon afterwards, the statesman Massimo d'Azeglio said: "We made Italy, but now we have to make Italians."

At that time, the idea of eliminating historical, cultural and linguistic inequalities mainly occupied the project. Just a small minority regarded Unification itself as a desirable task. Most people either opposed it or were indifferent. In the middle of the 19th century, almost all Italians were Roman Catholics. The Church was the first and most important victim of the new kingdom; ecclesiastical properties were expropriated by the state, many Catholic schools were closed and the educational system was entirely nationalized. In that context, equalization implied the construction of a "civil religion" consistent with the values and the interests of the political elite – in order to forge docile people.

Moreover, in the South the new rulers had to fight the strong opposition of a legitimist guerrilla group. Italian historians call them brigands (*briganti*), but in fact those groups of rebels were largely composed by loyal subjects of the last Bourbon king. Fearing secession in that part of the country, the new Italian rulers refused any kind of federal arrangement and the Savoy kingdom was built as a Jacobin and bureaucratic state. In following years, especially during Fascism and the democratic Republic, this unitary structure proved quite useful to interventionist governments.

After Unification, a pressing need to help poor Southern regions and improve their situation became one of the most important political issues for all Italian governments. In those years, "the Southern problem" (*la questione meridionale*) was frequently discussed as a priority. Yet ironically, in the late 19th century economic intervention was largely a function of Northern protectionism, policies that deeply harmed the Southern economy. As with as many other European countries, Italy introduced a number of restrictions to free trade. The purpose was the protection of an infant Italian industrial economy, especially in the North. The decision, however, penalized a Southern economy based on agriculture and largely interested in exporting freedom. As a result, millions of Southern people left the country and moved to the Americas. In turn, the conditions of Southern peasants became even worse.

During the 20th century, the weight of the Italian state in the economy grew more and more. One of the main justifications offered by governments for that was exactly the exigency to help the "poor" part of the country. Some colonial wars – in Libya (1911) and in Ethiopia (1935), for instance – were considered a good solution for unemployment in the Italian South.

The Fund for the South

In the first couple of decades of the 20th century, and in a stronger way during the Fascist regime, Italian governments developed an expensive political economy. In 1933, Benito Mussolini created the *Istituto per la Ricostruzione Industriale* (IRI), which in the second part of the century would become the biggest

Italian industrial group. At the beginning, IRI was tasked with nationalizing companies in crisis, helping them to be efficient and putting them back on the market. But IRI initiatives were rarely successful. As a consequence, the public sector grew year after year and played a special role in the poorest regions.

After the Second World War, this Keynesian attitude of supporting the development of the South with taxpayers' money pushed the government to design a very large program. This project, called the Fund for the South (*Cassa del Mezzogiorno*), was charged with helping the industrialization of the South: Sicily, Sardinia, Abruzzo, Molise, Calabria, Puglia, Basilicata and the Southern part of Lazio. The model for the Fund was the American Tennessee Valley Authority, a federal agency created by President Franklin Roosevelt. As with that project, the *Cassa* didn't bring about its intended consequences.

The *Cassa del Mezzogiorno* has been one of the worst scandals in Italian politics. For more than 40 years it wasted huge sums of money. In 1950, it received 1,000 billions liras as a ten-year endowment fund, but two years later the program was extended to 12 years and the budget increased to 1,280 billion. In 1957, it became a 15-year program and the budget grew to 2,069 billion. Some bills passed that introduced fiscal benefits for the South and every corporation controlled by the state was also forced to build at least 60% of their plants in the South.

In 1965, the *Cassa* became a 30-year program and in following years continued to get state funds. Its main activities were redistributing money and directly controlling a number of enterprises. It became a centre of power almost without comparison in the country. The main consequence was to create a strong incentive for young people, especially those in the South, to develop strong skills for intercepting public money. From a cultural point of view, the different situations in the North and the South today are largely an outcome of this state intervention and its bad incentives. The *Cassa* became an object lesson in how public money can destroy a society.

Over the years, Italian governments passed complex legislation governing subsidies and privileges. In 1978, the country promulgated a "*Testo unico*" about the South – a sort of code with the task of unifying on paper all of the laws concerning public interventions in this part of the country, where 40% Italians live. In almost all segments of the public sector, including research and infrastructure, Italian laws mandate special treatment for Southern regions, and sometimes also for Southern people. Predictably, the main casualty of the program of equalization has been the value of state neutrality in legislation. But politics is the realm of the distribution of favours and privileges, and it serves those values well.

After more than 30 years, the *Cassa del Mezzogiorno* was abolished. In fact, in 1985 it collapsed, but only two years later other similar agencies were created. Italian rulers never gave up the idea of throwing support to the Southern economy, but only modified its style. Government continued to pursue Southern development through government spending, and even a few Northern provinces were included in the program.

The Impossibility of Change

In the last 15 years, Italy has changed its equalization programs in only minor ways. They are very expensive and force political leaders to increase either taxation, public debt, or inflation – or any combination of the three. If the beneficiaries of these initiatives are in the South, the bill is largely paid for by the Northern economy: most net tax payers are from Lombardy, Veneto and regions that are characterized by dynamic economies. By some estimates, a member of the *Parlamento* from a Northern region represents on average 868 billion liras (around 430 million euros), versus 452 billion liras (around 225 million euros) for the average Southern MP.

Nevertheless, in the '80s and especially in the '90s, popular resistance to this high level of redistribution grew more and more. It led to the birth of the Northern League, a political movement promoting regional autonomy and/or independence. Traditional Italian parties – both left and right-wing – did lose many voters. In 1993, the Northern League obtained about 20% of votes nationally and more than 40% in the North.

Traditional parties therefore felt the need to answer these voters' demands. In order to keep their positions, they elaborated some regional reforms, with the idea of eliminating some central controls over the local power and reducing the redistribution of money. Nevertheless, the situation is changing very slowly. In fact, many politicians oppose the idea to modify a traditionally centralized state into a

decentralized one. They exploit the fears of many Southern people, who cannot envision a future of responsibility and autonomy for their regions. In a way, the effect of receiving so much taxpayers' money produces is addictive. Southern society finds it difficult to give up its present privileges.

That leaves Italy as a centralized state. In 1999, the central government levied 75% of total tax revenue, which shows how decisive a role Rome plays. Moreover, the most recent reforms don't substitute national taxes with local ones; they just give local administrations the possibility of introducing new taxes on top in order to better finance their spending.

The effects of such a centralized system are highly negative. Welfare programs largely funded by Northern people have destroyed incentives to work and improve the Southern economy. After 50 years of equalization programs, the South continues to have serious problems, with high rates of unemployment and important social tensions like criminality, illiteracy and outmigration. In spite of the public subsidies reserved for companies investing in the South, many Italian entrepreneurs prefer to build new factories in Croatia, Romania, Russia or Bulgaria. Equalization programs have eradicated the desire to take risks in a large portion of the South. This part of Italy is not considered a good place to invest – not to mention the risks due to the power of the local mafias, which often force entrepreneurs to pay protection money (*pizzo*).

Four Ways to Plan a “Society of Equals”

Equalization policies generally fall into four categories. The main one involves equalizing income with money transfers. The others try to improve the quality of the economic environment through equalization of public infrastructure and to establish the same opportunity to have a job through equalization of the level of unemployment and nationalization of labour contracts, in order to eliminate significant differences between Northern and Southern salaries.

A. Equalization of Income

A 1993 study by the *Fondazione Agnelli* showed that only four Northern regions – Lombardy, Piedmont, Veneto and Emilia-Romagna – were net contributors to government coffers. In other words, they all paid more taxes than what they got back in terms of government program. On the other hand, all of the Southern regions are net beneficiaries of government spending.

There is a significant divide between average personal income in the North and the South. This leads to a major difference in how tax monies are spent and collected. The North also pays more taxes in relative terms: for example, while the actual tax rate is about 50% in Lombardy, it is as low as 40% in Puglia.

Per capita GDP in the richest regions is more than the double that in the poorest ones. For instance, with 100 assumed as the average per capita income at the national level, in 1998 the average citizen from Lombardy, a large Northern region with 10 million people, earned 126.2, versus 60.9 in Campania and 62.0 in Calabria, two poor regions in the South. (*Istat, Conti regionali*, Rome, 2000).

The high costs of redistribution have resulted in low benefits in the short run, and negative effects in the long run. Yet those data demonstrate the failure of the program to equalize incomes. A massive money transfer from the North to the South couldn't help the development of one of the poorest parts of Europe.

B. Equalization of Infrastructure

The next method implemented to equalize North and South is through public investments in infrastructure. The main consequences have been:

- an increase in the power of the ruling class;
- incentives to invest time and money in public relations with bureaucracies and politicians and engage generally in rent-seeking;
- a distortion of markets, because enterprises not drawing resources from government have to compete with heavily subsidized companies, and the latter often expel the former from the market;
- a diffusion of parasitic attitudes; and
- the creation of opportunities for criminal organizations, who can easily make money if they install their members in both local and central governments.

The last point is important, because one of the most important dramas of the Italian South is the presence of very strong and aggressive criminal organizations: the *mafia* in Sicily, the *camorra* in Naples and its environs, the *'ndranghera* in Calabria and the *Sacra Corona Unita* in Puglia. Literature on the subject clearly shows that increases in public expenditures for roads, public schools or other infrastructure "had the effect of multiplying the presence of criminal activities around some sectors of the public activity." (Pio Marconi, "*La minaccia criminale affrontata con gli strumenti dell'esperienza antiterroristica*," Gnosis, available at www.sisde.it.)

The South does need new infrastructure, but it would be more effectively built by private entrepreneurs in a free market. But the opposite has occurred. The struggle against mafias has had the effect of strengthening and extending checks on entrepreneurial activities and of increasing the power of politicians and bureaucrats. Thus the link between politics and criminality remains important, as crime news reported every day demonstrates.

C. Equalization of the Unemployment Rate

Some public policies have the deliberate purpose of reducing the unemployment rate in the South, especially in Campania, Sicily and Calabria. An important means to that end has been the creation of a large number of public employees in education, the health system and social security.

Incomes are higher in Northern Italy, where there are more entrepreneurs, less unemployment and more foreign investment. Its somewhat free-market culture pushes young, bright people to skip opportunities to join the bureaucracy and they opt instead for industry, the services sectors or liberal professions. The preference of people living in Lombardy or Piedmont to avoid a career in public administration has had huge consequences for the public sector.

In the South most people look for a job in the public sector. Generally, the Italian state is like a big company whose employees come mostly from the South. At the same time the number of such employees cannot be reduced, despite growing evidence of this policy's economic unsustainability, because of possible social consequences in the *Mezzogiorno*.

In a sense, it is no exaggeration that in Italy many public jobs exist just to reduce the unemployment rate in some regions. In Calabria, for example, a few dozen thousands of forest guards are in charge of protecting the woods of a very small region. The risk of fires is used as a pretext to justify this; everybody knows that such a huge number of guards exists only to lighten the dramatic unemployment of the region.

But if you are poor, your problem is not a job; your problem is money. So another Italian way to reduce the unemployment rate in the South is to use resources from social security. Invalidity pensions – a sort of state subsidy to the handicapped – are often in fact given to people who are not handicapped. They just need money and, well, pretend to have a disease. The rate of invalidity pensions in Calabria is double than in Lombardy, and there is no reason to imagine that in that Southern regions people have more health problems than in the North, or at least not to this extent. With the complicity of doctors and the protection of the political class, this program of social security simply pursues the goals of reducing unemployment and redistributing money.

Finally, with regards to the highest levels of public administration, the South is vastly over-represented. In the ranks of 100 prefects, 93 are from the South, 5 from the North and 2 from foreign countries.

D. Equalization of Salaries

In 1968, the government introduced another tool for equalizing the economic conditions of Italians. Until then, different regions reported different salaries, as a consequence of differences in marginal productivity. Such a situation was, and is, regarded as unjust and unfair. A bill was passed which eliminated regional collective contracts in order to equalize salaries across the country. It created a system of national bargaining between trade unions, entrepreneurs' associations and government. This aspect of equalization has two main consequences: it reduces incentives to invest in the South and it pushes many people into the black market.

Italy therefore has no effective relationship between low salaries and low unemployment, a common market signal in other countries (David Blanchflower and Andrew Oswald, *The Wage Curve*, MIT Press, 1994). Southern regions have low salaries and high unemployment, but actual salaries are more or less at

the same level everywhere. In order to reduce unemployment, the South needs lower salaries that attract investors. Without that an incentive, capital doesn't migrate towards Sicily or Calabria. The result for these areas is an extremely negative connection: low salaries and high unemployment. Only a free market in labour would help the South change this state of affairs, but central wage regulation, strongly defended by trade unions, prevents the only viable solution.

Many recent European Union directives have strengthened this sort of imposition of wage rules. European programs of "equalization" are thereby added to traditional old-style wage interventionism and multiply its bad consequences. That explains why Italian and foreign companies don't find a good environment for investments in the South, and prefer Central and Eastern Europe.

Conclusion

While benevolently intended over its long history, the entrenched system of equalization in use in Italy has accomplished little.

Despite the wide disparity between how much the central government collects and spends in rich and poor regions, economic development in the latter is stalled. Nor has the equalization of public infrastructure succeeded in jump-starting economic activity in the South. Instead, it's created a spoils system that enhances the power of the political class, distorts markets by dampening the entrepreneurial spirit and spreads parasitic and criminal behaviour. Attempts to equalize employment have encouraged Southern Italians to seek public sinecures or dependency and strengthened the North's hegemony over private-sector growth. Wage interventionism prevents poorer regions from exploiting their comparative cost advantages and instead discourages the very private investment that might enhance economic growth.

The chronic Italian problem of wide disparities in economic performance between regions will never be solved by equalization programs. A better solution is available through a rededication to a decentralized government characterized by neutrality and open, unimpeded markets for investment and employment.

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