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# Happy 150th Birthday Italy?
# Institutions and Economic Performance Since 1861

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**Abstract**: In the last twenty years the Italian economy showed claer signs of structural crisis. Using a variety of secondary literature, this paper claims that the recent decline must be seen as part of a long-term trend of sub-optimal performance driven by the inability of the country to remain congruent with the tecnological frontier. This problem, in turn, is the result of week and/or poorely-enforced rules that regulate economic activity. Specifically, legal institutions in areas such as firms' governance (bankruptcy law; balance sheets regulation, use of inefficient forms of governance), banking supervision, education, and tax compliance, favoured "extractive" behaviour from firms' owners, discouraged businesses to reach a size compatible with innovation in advanced sectors, and frustrated investment in education, research, and innovation. The paper also analyses the origin of this institutional failure and uses the example of football to show the persistency of inefficient rules. The picture that emerges is that institutional failure finds its origin in the feature of the process of State formation and, later, in the post WWII political equilibrium. Distorted institutions serve the interests of a constantly-changing minority, big enough to protect the status quo.

**Jel classification**: N24, K35, P16, P48

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> 'Against the background of these purely economic factors, other social and cultural forces were at work. The social structures of the country had grown rigid, as had the prevailing mindset …. Commenting on the attitude of the Italians at the beginning of the seventeenth century, Fynes Moryson wrote:
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> "Italians are so convinced that they know and understand everything …so that they never travel abroad unless forced to by necessity. The opinion that Italy is well stocked with everything that may be seen or known makes Italians provincial and presumptuous."
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> This state of mind went hand in hand with technological and organizational backwardness.'[1]

## 1. *Introduction: an unhappy birthday*

Had Italy been the girl in *The Smiths* song, whishing her unhappy birthday would have been a success.[2] Beyond the rhetoric of the event, the 150th anniversary of the Unification celebrated in 2011 was in fact a very sad birthday.[3] During the year, the economic downturn that followed the international banking crash of 2008-2009 led to a potentially fatal crisis of the Italian public finances. In November 2011, in the middle of such crisis, the Prime Minister Silvio Berlusconi eventually resigned after months of political instability. This happened among rumours that the decision had been, in fact, the result of strong international pressure,[4] something that reinforced the feeling of a progressive marginalization of the country in the international political and economic arena.[5]

However dramatic *per se*, 2011 fits very well a clear trend of economic decline which started two decades earlier, and has been noted at least since 2000 by authors such as de Cecco, Gallino and Visco et al.[6]. Recent data and comparative analysis[7] support this view. In the last 20 years, the rate of growth of the Italian GDP has been less than 1% (0.97) per year, and half of the average

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[1] Carlo Maria Cipolla, *Before the Industrial Revolution. European Society and Economy, 1000–1700* (London, 1976: 194).

[2] "I've come to wish you an unhappy birthday
I've come to wish you an unhappy birthday
'Cause you're evil and you lie and if you should die
I may feel slightly sad but I won't cry."
The Smiths, "Unhappy birthday", from the album *Strangeways, Here We Come*, Rough Trade (UK), 1987.

[3] The international press too picked-up on the sense of mixed feelings in the country in the eve of the anniversary. See "Italy at 150: Happy-ish birthday", *The Economist*, March 17th 2011.

[4] "Deepening Crisis Over Euro Pits Leader Against Leader", *The Wall Street Journal*, December 30th, 2011

[5] Among other events it is revealing, for example, that in October 2011 Italy was not invited to a key Franco-German meeting, and the Italian foreign minister even admitted that the content of the discussion had remained a secret to him "Merkel-Sarkozy, la "guerra" di Frattini. L'asse Parigi-Berlino appoggiato da Obama", *La Repubblica*, October 10th 2011.

[6] Marcello de Cecco, *L'economia di Lucignolo: opportunità e vincoli dello sviluppo italiano* (Roma, 2000); Luciano Gallino, *La scomparsa dell'Italia industriale* (Torino, 2003); Vincenzo Visco *et al.*, *Il declino economico dell'Italia. Cause e rimedi* (Milano, 2004).

[7] Emanuele Felice and Giovanni Vecchi, *Italy's Modern Economic Growth, 1861-2011*, Quaderni del Dipartimento di Economia Politica e Statistica, Università di Siena, no. 663 (Siena, 2012).

(2.25%) of the four largest countries of the European Union (France, Germany, Spain and UK). If we consider only the last ten years (2001-2011), the situation appears even worst: the Italian rate of growth of GDP has been 0.4% per year, while Germany, France, UK, and Spain have grown at least almost three time faster: respectively 1.15%, 1.17%, 1.63%, and 1.98%.[8] A logical counterargument to this analysis can be that the post 2008-09 crisis probably marked a relative decline of the advanced Western countries in favour of other economic areas of the world and, indeed, showed the fragility of the finance-driven model of growth of countries such as Spain and the UK. However, this remark, if anything, makes the Italian performance looking even worst if we consider the relatively smaller weight of finance over the economy and a milder short-term impact of the crisis itself. Also, the same gloomy picture appears by looking at other aspects, for example international trade. In 2007, Italy had a share of 4 per cent of the total of the world trade, almost 40 per cent less than 15 years earlier. Moreover, its export specialization is more and more oriented towards low-technology traditional goods in sectors with the slowest rates of growth in the world markets.[9] Italy also showed a weak performance in science and technology, with scarce attention to technical education, limited capacity to invest in R&D activities and, as a consequence, very weak patenting activity mainly concentrated in those fields far away from the technological frontier.[10]

The evident state of economic decline, paralleled by deep political crisis,[11] which characterises the 1990s and the 2000s, raises the fundamental historical question of whether the last twenty years must be seen as a temporary slowing down in the journey *Dalla periferia al centro* (from the periphery to the core), analysed by Vera Zamagni's influential book,[12] or whether Italy had simply embarked on a return trip, and went back to its "career as an underdeveloped area within Europe" predicted by Cipolla,[13] looking at the situation of the peninsula at the beginning of the XVIII century.

[8] All data provided are our own elaboration on Eurostat (www.eurostat.eu), last access 25th June 2012.
[9] Michele Di Maio and Federico Tamagni, "The evolution of world export sophistication and the Italian trade anomaly", *Rivista di Politica Economica* 98, no. 1–2 (2008): 135–74. For a fully discussion of the topic, see Michelangelo Vasta, "Italian export capacity in a long run perspective (1861-2009): a tortuous path to stay in place", *Journal of Modern Italian Studies* 15, no. 1 (2010): 133-156.
[10] Alessandro Nuvolari and Michelangelo Vasta, *The ghost in the attic? The Italian National Innovation System in historical perspective, 1861-2011*, Quaderni del Dipartimento di Economia Politica e Statistica, Università di Siena, no. 665 (Siena, 2012).
[11] The longevity of the political success of Silvio Berlusconi, a man "unfit to lead" or, more brutally, "who screwed an entire country" is described by the international press as little short of an aberration ("An Italian story", *The Economist*, April 28th, 2001, and "The man who screwed an entire country", *The Economist*, June 9th, 2011). The Berlusconi phenomenon, however, must be cast in a wider picture of disaffection for political engagement and lack of trust in the political system, which also generated the long-lasting success of the *Lega Nord* (Northern League) and the recent success of a new political party *Movimento Cinque Stelle* led by the former comedian Beppe Grillo.
[12] Vera Zamagni, *The economic history of Italy* (Oxford, 1993).
[13] Cipolla, *Before the Industrial Revolution*, 194.

An overview of data on comparative long-term economic growth sheds some light on this question. Data provided by Felice and Vecchi[14] comparing various Western countries to the economic frontier (the US) show that the relative position of Italy hardly changed over time. In 1861, Italy is third from the bottom and in 2011 is second from the bottom, and closer to the worst performer than it was in 1861. During the century and half that separates the two points, the relative position never changes and convergence hardly takes place. Italy thus never really converged not only to the frontier, but also with the average of the core European countries. It is only during the late 1980s that an illusion of catching-up emerges, but the performance of the last twenty years makes that phase looking a temporary one.

Historians' attitudes, implicitly or explicitly, are strongly influenced by the historical circumstances in which they operate, so it is perhaps not surprising that authors writing in the 1990s talked about convergence towards the core, and looked for the long-term roots of the contemporary success.[15] Instead, academic works published in the mid-late 2000s take a much more negative stance on Italian performance and look for the origin of its weaknesses.[16] These are usually identified in the limitations imposed to market mechanisms after WWII and in the unwillingness and/or inability of political forces to correct these problems for reasons of electoral convenience.[17]

Although not entirely incompatible with this view, this paper provides a different interpretation suggesting that since Unification Italy had followed a model of economic development characterized by poor institutions, in terms of badly-conceived and inefficiently-enforced basic "rules of the game".[18] The institutions that we focus upon are mainly, although not exclusively, legal ones and concern areas such as firms' governance (bankruptcy law; balance sheets regulation, use of inefficient forms of governance), banking supervision, education, and tax

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[14] Felice and Vecchi, *Italy's Modern Economic*, Figure 2.

[15] The most striking example of this attitude is certainly Giovanni Federico, "Italy, 1860-1940: a little-known success story", *The Economic History Review* XLIX, no. 4 (1996): 764-786.

[16] See Pierluigi Ciocca, *Ricchi per sempre?: una storia economica d'Italia,1796-2005* (Torino, 2007); Andrea Boltho, *Italy, Germany, Japan: from economic miracles to virtual stagnation*, Banca d'Italia, Quaderni di Storia Economica, no. 14 (Roma, 2011); and Stefano Fenoaltea, *The Reinterpretation of Italian Economic History: From Unification to the Great War* (Cambridge 2011). For an overview of the development of the Italian economy over the last century and half, see also the special issue published by the *Journal of Modern Italian Studies* 1 (2010) and in particular Paolo Malanima and Vera Zamagni, "150 years of the Italian economy, 1861-2010", *Journal of Modern Italian Studies* 15, no. 1 (2010): 1-20.

[17] Alexander Aganin and Paolo Volpin, "The History of Corporate Ownership in Italy" in *A History of Corporate Governance around the World: Family Business Groups to Professional Managers*, ed. Randall K. Morck (Chicago, 2005), 325-361; Fabrizio Barca, "Compromesso senza riforme nel capitalismo italiano" in *Storia del capitalismo italiano dal dopoguerra ad oggi*, ed. Fabrizio Barca (Roma, 1997), 4-117; Boltho, *Italy, Germany, Japan*; Ciocca, *Ricchi per sempre?* provide different variations on the same themes. A more detailed review of this literature is provided in Section 3.

[18] Douglass C. North, *Institutions, institutional change and economic performance* (Cambridge, 1990); Peter A. Hall and David Soskice, "An Introduction to Varieties of Capitalism", in *Varieties of capitalism: the institutional foundations of comparative advantage*, eds. Peter A. Hall and David Soskice (Oxford, 2001), 1-70.

compliance. Following Zysman[19] we argue that Italian "market capitalism", defined as an "historically-determined, institutionally-mediated pattern of growth", was sub-optimal because led to scarce investment in education, low salaries, imitative technologies, and exploitative management of firms from owners who were mainly stockholders rather than stakeholders. These issues remained hidden during unique phases of economic success such as the Golden age or of scarce exposure to competitive forces such as during the fascist years, but surfaced as soon as conditions changed. Again in line with Zysman[20], the implication is that the Italian "market logic", emerging from the interaction amongst different actors, implies a pattern of incentives and constraints which had limited economic growth and full convergence towards the technological frontier. In this sense, Italy never left the semi-periphery of the world economy. On the other hand, thanks to the institutional and cultural "antibodies", whose presence was looked-for by Sylos-Labini,[21] Italy never slipped into a path of economic collapse, and since 1945 stuck to a system of representative democracy. The optimistic twist of this caveat, however, should not be overemphasised. In fact, what this paper looks at is the system of formal rules (and their enforcement) regulating the functioning of normal economic activity. Nothing we say of the failure to enforce basic rules in organised crime-controlled regions of the *Mezzogiorno* and, in wider terms, of the inability to close the economic gap between the North and the South of the country. These are of course enormous structural issues which had they be added to our view would probably strongly question the extent and the power of the Italian "antibodies".

This paper is based on a critical review of the literature and it is structured as follows. In the next Section, we set-up the conceptual framework of the paper by looking at the theoretical link between economic performance, innovation, and institutional settings. Section 3 analyses various institutions-bases views of Italian economic performance, including our own. Section 4 offers specific examples of institutional failures which support our interpretation, while Section 5 introduces a tentative analysis of why inefficient rules have not been changed over time, using the perspective of Italian football. The final Section provides some concluding remarks.

## 2. *The macro-micro relation: performance, innovation and institutions*

A very influential and still-developing literature, whose detailed analysis goes well beyond the scope of this paper, argues that institutions are the strongest single determinants of long-term

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[19] John Zysman, "How Institutions Create Historically Rooted Trajectories of Growth", *Industrial and corporate Change* 3 (1994): 243-283.
[20] Ibid.
[21] Paolo Sylos Labini, *Berlusconi e gli anticorpi. Diario di un cittadino indignato* (Roma-Bari, 2003).

economic performance.[22] In general, institutional views tend to be seen as alternative to explanations based on the role of technology.[23] This, with the relevant exception of evolutionary economics that puts innovation and technology at the core of the analysis but, at the same time, stresses the role of institutional settings in the promotion of both activities.[24] The link institutions-innovation represents the backbone of our interpretation and starts from the idea that long-term macroeconomic success of a country is linked to its congruence with technological leading countries.[25] Such congruence is not automatically given, and it is limited by a country's resource endowment and factors supply but, as Abramovitz argues, the successful assimilation of foreign technologies can be nonetheless achieved by constructing a proper set of "social capabilities", embodied in firms and other organizations of the importing economy. In turn, it can be argued that in order to develop the most dynamic and innovative manufacturing sectors, the following elements are crucial: the "right" firm's dimension, an innovative and "entrepreneurial" approach from businesses owners and managers and, more in general, an environment conducive to innovation via specific investment in factors such as education, finance, etc. Institutions are fundamental in this process as the nature of the rules of the game impacts on all these aspects. For instance, commercial codes, regulation of corporate governance, and bankruptcy laws can limit firms' growth, or allow them to reach a dimension compatible with process of innovation in complex and most advanced technologies.[26] On the other hand, entrepreneurial activity can turn towards innovation and risk-taking or rent-seeking depending on the incentives provided by formal and informal rules.[27] Similarly, the enforcement of compulsory education, incentives to develop technical schools and the organization of scientific research, are pivotal in forging an innovation-supportive environment.

Before moving to the analysis of the impact, in Italy, of specific institutions on these three aspects a quick overview of firms' size, entrepreneurial attitudes and the nature of the general

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[22] See Douglass C. North and Robert P. Thomas, *The rise of the Western world* (Cambridge, 1973); Mancur Olson, *The rise and decline of nations* (New Haven, 1982); Paul A. David, "Clio and the economics of QWERTY", *American Economic Review* 75, no. 2 (1985): 332-337; North, *Institutions, institutional change*; Id, "Economic performance through time", *American Economic Review* 84 no. 3 (1994): 359-368; Daron Acemoglu, Simon Johnson and James A. Robinson, "The colonial origins of comparative development: an empirical investigation", *American Economic Review* 91, December (2001): 1369-1401; Avner Greif, *Institutions and the Path to the Modern Economy. Lessons from Medieval Trade* (Cambridge, 2006); and Daron Acemoglu and James Robinson, *Why Nations fail. The origins of power, prosperity and poverty* (London, 2012).

[23] Allen influential book on the Industrial Revolution (Robert Allen, *The British Industrial revolution in global perspective* (Cambridge, 2009)), for example, explicitly argues against the role of institutions, while Acemoglu and Robinson 2012's book hardly mentions the role of technology.

[24] Richard R. Nelson, *What makes an economy productive and progressive? What are the needed institutions?*, InSTePP Paper 07-01, 2007.

[25] Moses Abramovitz, "Catching Up, Forging Ahead and Falling Behind", *Journal of Economic History* 46, no. 2 (1986): 385-406.

[26] Timothy W. Guinnane *et al.*, "Putting the Corporation in its Place", *Enterprise and Society* 8, no. 3 (2007): 687-729.

[27] William Baumol, "Entrepreneurship: productive, unproductive and destructive", *Journal of Political Economy* 98, no. 5 (1990): 893-921.

economic environment is provided in order to show that the country suffered from problems in all these areas.

In the light of several studies, no doubt exists that Italy has a productive system historically characterised by firms unrivalled small in comparative terms.[28] This applies to the whole century and half since 1861, but the degree of difference between Italy and the rest of the Western core economies was not constant, and a reduction on this gap was positively correlated with rapid growth. For example, it has shown that phases such as the Giolitti years and the Golden age were also characterised by some degree of similarity of the Italian industrial structure with the one of the leading countries.[29] In particular, the diffusion of the technological regime of the mass production, which started in the interwar years and fully developed in the post WWII period, saw an increase in the average firm size thanks to the expansion of big businesses, with growing importance of State-owned enterprises. Conversely, the post 1990 crisis coincided with a decline in firms' size due to the downsizing of state-owned companies together with the persistency of small dimension firms that showed their inability to "mature". Moreover, the specialisation of the Italian firms entrenched in traditional sectors (textiles, clothing, footwear, etc.) becoming more and more similar to that of the low-wages emerging countries. There is also ample evidence that the link firms' size-macroeconomic growth passed through the ability to innovate. For instance, a recent study showed how since 1861 small dimension critically affected the ability of Italian firms to establish and remain close to the technological frontier.[30] From a different, yet consistent perspective, various authors noticed how during the Golden age the Italian innovative capacity reached its historical peak both as patenting activity, and as a number of success stories of breakthrough innovations.[31]

As far as entrepreneurial attitudes are concern, recent work by Toninelli and Vasta[32] has shown that the Italian case is characterized historically by a structural shortage of genuine Schumpeterian entrepreneurs. The small Schumpeterian component of the Italian entrepreneurship seems not to have had a key role as engine of growth of the country's economy. Entrepreneurial attitudes, in fact, are consistent with a general economic environment characterised by conservative views towards technology; Nuvolari and Vasta provide diverse and strong evidence of the historical

[28] Andrea Colli and Alberto Rinaldi, *Institutions, politics and the corporate economy*, Quaderni del Dipartimento di Economia Politica e Statistica, Università di Siena, no. 664 (Siena, 2012); Bart Van Ark and Erik Monnikhof, *Size distribution of output and employment: A data set for manufacturing industries in five OECD countries, 1960s-1990,* Oecd Economic Department WP, no. 166 (Paris, 1996).

[29] Andrea Colli and Michelangelo Vasta, "Introduction", in *Forms of Enterprise in 20th Century Italy. Boundaries, Structures and Strategies*, eds. Andrea Colli and Michelangelo Vasta (Cheltenham, 2010), 1-21.

[30] Franco Amatori, Matteo Bugamelli and Andrea Colli, *Italian firms in history: Size, technology, and entrepreneurship,* Banca d'Italia, Quaderni di Storia Economica, no. 13 (Roma, 2011).

[31] Matteo Gomellini and Mario Pianta, "Commercio con l'estero e tecnologia in Italia negli anni Cinquanta e Sessanta", in *Innovazione tecnologica e sviluppo industriale nel secondo dopoguerra*, eds. Cristiano Antonelli *et al.* (Roma-Bari, 2007), 359-594; Lucio Russo and Emanuela Santoni, *Ingegni minuti. Una storia della scienza in Italia* (Milano, 2012).

[32] Pier Angelo Toninelli and Michelangelo Vasta, "Opening the black box of Entrepreneurship: the Italian case in a historical perspective", *Business History*, forthcoming.

weakness of the Italian "ghostly" National Innovation System.[33] The recent evidence on the dynamics of productivity growth over the last twenty years shows clearly that both the assimilation of technologies from abroad and the generation of new technologies is a key-ingredient of a successful process of catching-up.[34] In this perspective, Italy's position among the richest countries of the world is not to be considered as firmly secured.

## 3. *Institutional failure: many voices but no chorus*

From the analysis above it appears that Italy lagged behind in the frontier of innovation and this affected its ability to grow. In turn, this was due to issues of firm's size, entrepreneurial attitudes and an unsupportive environment. As we claim in the Introduction, all these problems have a common root in the ineffectiveness of the basic rules of the game regulating the Italian economy. The idea of institutional inefficiency as the main issue of the Italian economy is not new. For example, one interpretation provided by a growing body of literature, based on mainstream approach, argues that at least since the end of WWII the Italian economy showed remarkable weaknesses in the regulation of corporate governance, specifically in the protection of the rights of minority shareholders. This led to the underdevelopment of the financial market, fewer companies implementing a sound separation between ownership and control, and structural problems of "tunnelling".[35] In line with the "political economy of finance" view suggested by Pagano and Volpin,[36] the lack of efficient regulation in the field of corporate governance is the result of the action of an oligopoly of few powerful industrialists allied with a "cast" of long-serving politicians refusing to open-up the countries to the virtue of competition. The defence of insiders, the lack of proper competition, and collusive attitude of the State also underpin the recent view that the post 1990s Italian decline has been mainly the effect of a long-term *à la* Olson institutional capture from conservative trade unions, with the consequent decline of the quality of the labour market.[37]

Our interpretation of the institutional failure is not necessary incompatible with some of the aspects of these views, but it differs on many crucial points. In particular, contrary to the views described above, we believe that institutional problems were (and are) not confined to individual

[33] Nuvolari and Vasta, *The ghost in the attic?*.

[34] Stephen Broadberry, Claire Giordano, and Francesco Zollino, *A Sectoral Analysis of Italy's Development: 1861-2010*, Banca d'Italia, Quaderni di Storia Economica, no. 20 (Roma, 2011).

[35] Alexander Dyck and Luigi Zingales, "Private benefits of control: an international comparison", *Journal of Finance* 59, (2004): 537-600; Luigi Zingales, "The value of the voting right: A study of the Milan stock exchange experience", *Review of Financial Studies* 7, (1994): 125-148; Id, *Capitalism for the People: Recapturing the lost genius of American prosperity* (New York, 2012).

[36] Marco Pagano and Paolo Volpin, "The political economy of finance", *Oxford Review of Economic Policy* 17, no. 4 (2001): 502-519.

[37] Boltho, *Italy, Germany, Japan*.

markets or spheres of the economy, but extended to the basic, day-by-day interactions among economic agents. Also, we argue that the institutional failure did not necessarily serve the interests of specific and easy-identifiable lobbies, rather the ones of a "silent minority" whose composition changes over time and in which the advantages are not equally distributed among its members. Our view is that, following Douglas North,[38] "political entrepreneurs" provide rules in line with their personal interests. Inefficient rules thus emerge (and survive) when vested interests are not consistent with the public good, but also if "benevolent" rule makers suffer from a form of "cognitive deficit". This means taht they fail to understand what institutions the economy really needs, or cannot foresee that the actual effects of the rules they provide might end-up being very different from the expected one. What we claim is that in Italy ineffective rules of the game are the result of a mix of these two aspects. Specifically, up to WWII, problems were mainly, although not exclusively, linked to issues of "cognitive deficit", while since 1945 the defence of vested interests became the dominant force in the process of institutional failure.

Political entrepreneurs' "cognitive deficit" finds its origin in the features of the process of State formation. As recently argued by Cassese, this was very fast, and ultimately failed 'to integrate people in the institutions',[39] meaning that it was unable to customise standard institutional settings to the specific needs of the Italian economy. The speed of the process also meant a very strong degree of centralisation of power that made whatever decision taken by the "political entrepreneur" less subject to the check of democratic counterbalances, hence more prone to the problems described above. Political and administrative unification was accomplished through an extension of the boundaries of the Kingdom of Sardinia, led by politicians, such as Cavour, believing that the liberal institutions, designed for Piedmont, would be able automatically to produce the economic progress of the entire country. Unfortunately, this political class did not know appropriately the situation of the country; for instance Cavour in his life never visited a place South of Florence.[40] The result was that many rules they introduced were not suitable for the whole nation.

This "cognitive deficit" is visible in many areas. For instance, it led not to recognise the key role of education, scientific research, and the creation of an innovative environment for the process of economic growth of the country. Still at the end of the XIX century, for example, the Italian Minister of Education maintained that universities should have only the basic things but nothing more, since "vexatio dat intellectum".[41] Another example regards bankruptcy law, which was *de facto* a copy of the very advanced French one, but with peculiar twists that made it hard to apply

[38] North, *Institutions, institutional change*.
[39] Sabino Cassese, *L'Italia: una società senza Stato?* (Bologna, 2011).
[40] Ibid, p. 35.
[41] Quoted in Roberto Maiocchi, "Il ruolo delle scienze nello sviluppo industriale italiano" in *Storia d'Italia. Annali 3. Scienza e Tecnica,* ed. Gianni Micheli (Torino, 1980), 900.

and enforce.[42] Similalry, while long debates took place to decide which commercial code would have best suited the economic needs of the nation, much less attention, if any, was turned to the fact that the enforcement of basic property rights in the fast developing sulphur industry in Sicily was rapidly becoming a monopoly of organised crime.[43]

Up to 1945 "cognitive deficit" also went hand in hand with the defence of stakes resulting, for example, in little attention to rules about firms' governance and banking regulation.[44] After WWII, this process of distortion of the rules of the game for the direct gain of "political entrepreneurs" took momentum. A clear effect of this was the defence, for electoral pourposes, of small dimension in all economic sectors: manufacturing,[45] banking,[46] distribution,[47] and probably agriculture too. In turn, as we will show in the following section, this led to the provision of laws and policies with negative spill over, as well as the constant lack of sanction for abusing or not comply to some basic rules.

## 4. *Institutional failure: some evidence*

As recalled in the previous Section, the institutional failure of the Italian economy is not a recent feature, suddenly materialized in the last decades, but it has its roots on the process of unification of the country. An important example of the cognitive deficit, which affected the country at the unification, is the organization of primary education provided by the Casati Law. Amongst many rules, it made municipalities bear the burden of primary education. The legislative framework − designed for a relatively developed area as Piedmont − was completely inadequate for the poor regions of Southern Italy which could not carry the burden. This led to a significant delay in the process of literacy of the South and of course of the country's economic growth.[48] Another aspect of the long lasting institutional failure is the impact of the rules of the game on firms' growth and,

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[42] Paolo Di Martino, "Banking crises and the evolution of bankruptcy legislation in Italy (c. 1890-1939)", *Rivista di Storia Economica* XX, no. 1 (2004): 65-85; Id, "Approaching Disaster: A Comparison between Personal Bankruptcy Legislation in Italy and England (c.1880-1939)", *Business History* 47, no. 1 (2005): 23-43.

[43] Oriana Bandiera, "Land reform, the market for protection, and the origins of the Sicilian mafia: Theory and evidence", *Journal of Law, Economics and Organization* 19, no. 1 (2003): 218-244.

[44] The banking scandal that took place in the early 1890s, for example, revealed the direct involvement of the majority of members of parliament, including the Prime Ministers Crispi and Giolitti.

[45] Alessandro Arrighetti and Gilberto Seravalli, "Istituzioni e dualismo dimensionale dell'industria italiana" in *Storia del capitalismo italiano dal dopoguerra a oggi*, ed. Fabrizio Barca (Roma, 1997), 335-388; Andrea Colli and Alberto Rinaldi, *Institutions, politics*.

[46] Francesca Carnevali, *Europe's Advantage: Banks and Small Firms in Britain, France, Germany, and Italy since 1918*, (Oxford, 2005); Anna Spadavecchia, "Financing Industrial Districts in Italy, 1971–91: A Private Venture?", *Business History* 47, no. 4 (2005): 569-593; Giuseppe Conti, *Creare il credito e arginare i rischi. Il sistema finanziario tra nobiltà e miserie del capitalismo italiano* (Bologna, 2007).

[47] Emanuela Scarpellini, *Comprare all'americana. Le origini della grande distribuzione in Italia (1945-1971)* (Bologna, 2001).

[48] Only in 1911 with the Daneo-Credaro Law the State took fully charge of primary schooling. Still in 1911 the literacy rate of the southern regions was 40.3%, while in the Northern and Central regions had overcome the threshold of 80%.

consequentially, on size. One example is the effect of bankruptcy law and practices that did not protect firms aiming at growing from the exposure to the effects of the business cycle. As argued by Teti,[49] there is in the backward context of the Italian economy after unification a very hostile attitude against people who failed. Also, in this case there seems to be a "cognitive deficit" in understanding the cause that this approach could create. As cursedly suggested by Ciocca[50] and fully analysed by Di Martino and Vasta,[51] Italian rules dealing with bankruptcy and insolvency gave firms no useful device to re-start, with the result that businesses ended-up liquidated to an extent unknown in other countries. However, nothing in the debate among lawyers and policy makers remotely suggests that this was the desired outcome.

After WWII, although the issue of cognitive deficit persisted, the defence of vested interests, in particular the protection small dimension, became a more noticeable issue. To an extent, this responded to the logic aim of protecting the country's competitive advantages, but some of the reasons behind it were "less noble" than others.[52] In particular, this approach was part of a political and institutional set-up promoted by the *Democrazia Cristiana* – partly shared also by *Partito Comunista* – and supported by the central bank aiming at creating a block of consensus to counterbalance the growing influence of big businesses.[53] One example of this is the artificial protection of artisan firms pursued mainly via lower tax rates, privileged interest rates and a softer bankruptcy law,[54] a policy conducted on a scale incomparable to all other European countries. As mentioned in the previous Section, however, this policy is visible in many other industries.

The problem with aim of defending small dimension, to an extent even justifiable in economic terms, was that it conducted in a way that had two structural negative implications for the institutional setting. The first one is that some of the actual rules promoted to defend small dimension in some sectors or areas emend-up producing the unexpected result of contributing to the general problem of the "dwarfism" of Italian firms. Artisans' firms, for instance, remained artificially small, because in order to receive support by the State they do not exceed a certain size

[49] Raffaele Teti, "Imprese, imprenditori e diritto", in *Storia d'Italia. Annali 15, L'industria*, eds. Franco Amatori, Duccio Bigazzi, Renato Giannetti and Luciano Segreto (Torino, 1999), 1226.

[50] Pierluigi Ciocca, "Law and the economy in modern Italy", *Rivista di Storia Economica* XIX, no. 2 (2003): 205-210; Id, *Ricchi per sempre?*.

[51] Paolo Di Martino and Michelangelo Vasta, "Companies' insolvency and 'the nature of the firm' in Italy, 1920s-1970s", *Economic History Review* 63, no. 1 (2010): 137-164.

[52] Giuseppe Conti and Giovanni Ferri, "Banche locali e sviluppo economico", in *Storia del capitalismo italiano*, ed. Fabrizio Barca (1997), 429-466.

[53] Ibid. This view had undermined the stereotype according to which Italian "Mancunian-like" enterprises had flourished in the absence of state intervention and based on self-financing, Giacomo Becattini, *Distretti industriali e made in Italy. Le basi socioculturali del nostro sviluppo economico* (Torino, 1998); Luciano Cafagna, "Contro tre pregiudizi sulla storia dello sviluppo economico italiano", in *Storia economica d'Italia, vol. I: Interpretazioni*, eds. Pierluigi Ciocca and Gianni Toniolo (Roma-Bari,1999), 297-325.

[54] Giuseppe M. Longoni and Alberto Rinaldi, "Industrial policy and artisan firms (1930s-1970s)" in *Forms of Enterprise in 20th Century Italy. Boundaries, Structures and Strategies*, eds. Andrea Colli and Michelangelo Vasta (Cheltenham, 2010), 204-224.

threshold. Another example is the law which kept consultancy businesses small (mainly sole-ownership) by forbidding the incorporation of such firms. However, for reasons linked to the complexity of the fiscal legislations, consultants (*commercialisti*) detained an enormous power over small/medium firms and tended to expand their influence in all other aspects of their management. Because unincorporated small consultancy firms had the capacity and the capabilities to serve only relatively small concerns, thus they had all the incentives, as informal managers, to discourage their growth. The same can be said about governance: consultants were hired by the owner(s), not the firm, and had no advantage in suggesting the entry of other investors as this would have weakened their position.[55] The second negative implication of the defence of small dimension is that the aim of protecting some interests was pushed as far as allowing formal rules to be bent or by-passed, and borderline or even illegal behaviour to persist unchecked and unchallenged. To go back to the policy of the protection of the artisan firm, this also created incentives for proper industrial firms too hid behind a faked form of governance to enjoy the artificial protection reserved to the artisans. The inability of punishing such behaviour meant that a norm conceived for a given aim, ended-up producing the unwanted result of frustrating the growth of non-artisans businesses too.[56]

Although the attitude of keeping a blind eye in front of lack of compliancy for reasons political convenience probably became more common after WWII, it was not unknown earlier. Since 1861, poor enforcement of basic laws paved the way for the rise of an environment prone to extractive attitudes, and "predatory capitalism" to the advantages to the insiders and the detriment of businesses themselves. In this context, the most revealing problem is certainly the lack of tax compliance, a phenomenon as old as the history of the country and largely acknowledged by the literature.[57] Historians such as Crainz[58] and Ginsborg[59] go as far as arguing that after 1945 the lack of enforcement of tax evasion was an explicit policy conceived to support those very segments of the middle class already benefiting from the protection of small scale in manufacturing, distribution and services. Possibly the best impressionistic piece of evidence is the phenomenon, occurred at least since the late 1980s, that the employers (particularly shopkeeper and artisans) had on average an official declared income lower than the salary of their employees.[60] This segment of middle class cheated systematically the State finance. On the one hand, through tax evasion and, on the other

[55] Paolo Di Martino and Michelangelo Vasta, *The dark heart of Italian capitalism: informal governance, "self-dealing", and the role of business consultants* (mimeo, 2012).
[56] Alberto Baccini, "Artigiancassa: da Istituto di credito speciale a banca per le imprese artigiane", in *Atti e Documenti di Artigiancassa S.p.a., Artigiancassa: da Istituto di credito speciale a banca per le imprese artigiane 1953-2001* (Firenze, 2002), 7-101.
[57] E.g., Stefano Manestra, *Per una storia della tax compliance in Italia*, Questioni di Economia e Finanza - Occasional papers Banca d'Italia no. 81 (Roma, 2010).
[58] Guido Crainz, *Autobiografia di una repubblica. Le radici dell'Italia attuale* (Roma, 2009).
[59] Paul Ginsborg, *L'Italia del tempo presente. Famiglia, società civile, Stato. 1980-1996* (Torino, 2007).
[60] For some references on this topic, see Ibid, 99.

hand, by reinvesting part of these resources in Italian government bonds, they got high interest and made the Italian public debt huge. Although more research is needed in this area, this might be also an explanation to the lack of Schumpeterian entrepreneurship analysed by Toninelli and Vasta:[61] the possibility of evading taxation on the one hand, and the prompt availability of a safe and high-return investment on the other, might have pushed firms' owners away from engagement with advanced technologies, new products, and so on. However, other elements suggest that this attitude probably predates WWII. For example, until the appearance of a new commercial code in 1942, the *de facto* absence of norms regulating the information to be included in companies' balance sheets provided strong incentives to both extractive behaviour,[62] and to fiscal evasion. Already at the 1911 National Congress of Joint-stock Companies an anonymous, yet recorded, voice suggested that it would have been unreasonable to expect true balance sheets in front of the existing high level of taxation.[63] This argument, de facto identical to ones often used by Silvio Berlusconi to justify tax evasion and to back-up his government's decision to de-penalise the falsification of balance sheets, shows the very old existence of a link between the regulation of balance-sheets and lack of tax compliancy.

The lack of enforcement of tax evasion and the fuzzy nature of norms regulating balance-sheets are is in line with a the soft touch of laws governing other key aspects of businesses' management leading in the possibility of transferring resources from firms to owners. In this area, the literature is still in its infancy, but some interesting evidence is already available. Some of it goes back to the issue of the widespread role of business consultants analysed earlier in the paper. Given that the power of the consultants depended on firms' remaining small in size, and their remuneration and volume of activity on the satisfaction of the customers (i.e. the owners of firms), consultants had a double incentive to channel resources from companies to their owners.[64] This could have been done, for example, by promoting faked investment in assets directly endorsed on the owner.

[61] Toninelli and Vasta "Opening the black box".

[62] Pier Angelo Toninelli, "Ragioneria, contabilità e storia d'impresa: alcune osservazioni in margine al caso italiano", in *Annali di Storia dell'impresa* 10 (1999): 79-113. In a previous work, the author shows how Edison tunnelled its profits from the shareholders to firm' investment. Although these flows did not enrich the owner, this situation shows the existence of poor rules unable to ensure the right of the shareholders. See Id, *La Edison. Contabilità e bilanci di una grande impresa elettrica (1884-1916),* (Bologna, 1990).

[63] See Teti, "Imprese, imprenditori", p. 1243, who reports a note on this Congress published in a leading Italian commercial journal.

[64] The large diffusion within the Italian capitalism of predatory behavior in which consultants play a crucial role is well epitomized, amongst many other cases, by a novel by Lucio Mastronardi, *Il maestro di Vigevano* (Torino, 1962). It shows the existence of a diffused system of tax evasion within the system of footwear small medium enterprises during the Italian miracle of the 1950-60s. As shown also in the movie (1963), directed by Elio Petri with Alberto Sordi, based on the abovementioned novel, the entire system of tax evasion was guaranteed and managed by a powerful consultant and lawyer named Racalmuto.

Evidence of tunnelling activities among small and medium unincorporated business is evident since the 1940s.[65]

The idea that the rules of the game gave excessive power to insiders and promoted predatory attitudes and tunnelling activities is exactly the central argument of the interpretation recently provided by some Italian mainstream economists and described earlier in this paper. In our view, however, this literature only looked at the tip of the iceberg. In fact, these problems were not restricted to incorporated companies, but it affected all forms of Italian businesses, including small and medium firms operating in competitive environments (competitive, at least, from the point of view of low barriers to entry). It was therefore a much wider phenomenon, hardly explainable as the result of a collusive alliance between few politicians and the industrial families.

Finally, the fantastic record of banking scandals further supports the argument that in Italy economic activity has been subject to poor rules of the game and particularly open to extractive behaviour. Summarising here their history goes well beyond the scope of the paper, but it is worthwhile to remind that all scandals, from the events of the 1890s[66] to the ones of summer 2006 (which led to the resignation of the Chair of the Italian central bank), indicate serious problems of supervision of insider lending, as well as dangerous connections between banks and regulators. In some instances, such as in the Calvi-Sindona case, the events cast an even more sinister shadow on possible perverse and illegal links between the financial sectors and elements of the political elite.[67] In this sense, these scandals cannot be simply dismissed as the operations of few criminals, but reveal substantial problems in the set of rules surrounding financial activities. In fact, similarly to the cases of tunnelling activities and inefficiency of commercial rules described earlier in the paper, it is difficult to say to what extent the problem lied in the formal design of laws and rules (which were structurally changed in 1936), or in the lack of enforcement and the easiness to bypass and bend them.

## 5. *The rules of the game and the rules of the "beautiful game"*

From the analysis conducted so far it appears that the Italian economy has been the victim of a long-term institutional failure, and one can wonder why Italians did not try to correct this anomaly. Our interpretation is that such institutional failure was probably able to favour a large enough minority of people, whose composition changed over time and space, and its members got different

[65] Di Martino and Vasta, *The dark heart*.
[66] Paolo Di Martino, "L'esito fallimentare di un intervento di ultima istanza; la Banca nazionale e i salvataggi del 1889", *Imprese e Storia* 24, no. 1 (2001): 307-336.
[67] Milano, C.d.a.d., *Sindona: gli atti d'accusa dei giudici di Milano* (Roma, 1986).

levels of benefits. We think that the best example of this situation comes from what Italians love most: football.

First of all it is worth noting that Italian football represents an important industrial sector, being the production value of professional football clubs equals to 0.15 per cent of Italian Gdp in 2011. Moreover, it has been estimated that about 70 per cent of Italian people are interested in football, and for all TV networks it is one of the most important businesses, considering the amount of the advertising revenues it produces.[68] However, much to the surprise to Anglo-Saxons observers for which football is just a game, in Italy it has extremely controversial social and cultural ramifications, and its meaning and importance goes well beyond its economic value.[69] For example, it has been argued that the advent of Berlusconi in the mid-1990s as politician it can be understood only considering his successful career as owner and president of AC Milan, one of the most famous Italian football clubs.[70] In fact, references to football constituted the backbone of Berlusconi's language and messages, from the continuous use of football metaphors in his speeches, to the very name of his party (*Forza Italia*), cloned from the traditional motto of the supporters of the Italian national team.[71] On the other hand, one must not forget that one of the biggest Italian private companies (Fiat) also controls the most powerful Italian football club, Juventus.

The "beautiful game", one can wonder, is thus in Italy too an important economic, political, social, and cultural phenomenon, constantly under the scrutiny of the press and the public, to be managed with distorted or just inefficient rules. In fact, this is exactly what happens, and the story of football scandals in Italy is as rich and long as the one of banking ones.[72] The most devastating one for the credibility of the industry emerged in 2006, when it became clear that a criminal organisation rotating around the general manager of Juventus football club, Luciano Moggi, had the power to influence (if not to fix) matches by bribing and black-mailing a network of referees, journalists and directors of other clubs.[73] Disturbingly, it also appeared that the Moggi's relationship network was so wide as to include the Italian Minister of the Home Affairs.[74] Econometric analysis had showed that, in fact, these phenomena (in particular the corruption of referees to the advantage of Juventus) were widespread and structural well before 2006.[75]

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[68] Tito Boeri, *Parlerò solo di calcio* (Bologna, 2012).
[69] See Tobias Jones, *The dark heart of Italy* (New York, 2002), on the straightforwardness of football in England and on the author's inability to understand at first the "politics" of football in Italy.
[70] E.g. Ilvo Diamanti, "Foot Politics: tifo dunque voto", *I Quaderni speciali di Limes* 3 (2005): 7-10.
[71] Ginsborg, *L'Italia del tempo presente*.
[72] Evidence of massive involvement of players (including members of the national team), managers and club directors in illegal betting and match fixing seems to be an endless plague. Both in the late 1970s and again in 2011, this led to the suspension (if not arrest) of players and relegations of clubs.
[73] Oliviero Beha and Andrea Di Caro, *Il calcio alla sbarra* (Milano, 2011).
[74] L'Espresso, *Il libro nero del calcio 2* (Roma, 2006): 187 ff.
[75] Tito Boeri and Battista Severgnini, *The Italian Job: Match Rigging, Career Concerns and Media Concentration in Serie A*, IZA Discussion paper no. 3745 (2008).

For the sake of our argument it is revealing that such scandals were not the result of idiosyncratic criminal behaviour of few individuals, but the direct consequences of ill-conceived rules of the game. Two examples are particularly revealing. The first one concern the way referees were selected for given matches; this happened (and still happens) on the basis of a discretional assessment of their abilities and with a very biased system of allocation which gives the people in charge of the procedure an enormous power. As reported by an American journalist, Franklin Foer "The result is that Juve [ntus] and Milan can often rig the system to assign themselves the most mediocre, provincially minded referees, who are (subconsciously) more deferential towards their prestige clubs.[76] The second peculiarity is that the main Italian clubs also have a direct interest in the media industry, which represents the main source of income.[77] However, media are also used to put pressure on referees, whereby affecting their reputation and their carriers. Again, as Foer claims: "referees who have issued critical penalties against Juve have found themselves working games in the lowly Serie B".[78] In this sense, it can be argued that referees' deference to powerful clubs was not just a matter of subconscious pressure, as often argued, but also of direct and explicit interest.

The 2006 scandals were not a sudden phenomenon; in fact they find their origin in the mid-1990s. A quick summary of the evolution of football in these years is interesting as it reveals how top players too prefer the strategy of bending the rules, rather than using their weight to create a game where, thanks to their resources, were very likely to win anyway. At that time, Juventus had long lost its domination in favour of Berlusconi's AC Milan which had pioneered a system of what nowadays is defined "financial doping" based on acquisitions of key players from other clubs for the very sake of weakening the competition. Rather than following AC Milan along the road of high-profile financial investment, Juventus decided instead to appoint as a general manager that Luciano Moggi, at that time already rumoured to have been able to fix matches, and known with the double-meaning nickname of "Lucky Luciano".[79]

In the following years, despite relatively low-key investment in players, Juventus re-took its place in the Italian league, and the Agnelli family were prodigal of acknowledgments to his general managers. This till investigations proved that at least some of these successes were due to match

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[76] Franklin Foer, *How Soccer Explains the World* (New York, 2004), p. 170.
[77] Boeri, *Parlerò solo di calcio*.
[78] Foer, *How Soccer*, p. 170.
[79] Ala Sinistra and Mezzala Destra, *Lucky Luciano. Intrighi, maneggi e scandali del padrone del cacio Luciano Moggi* (Milano, 2003). The first edition of this book, published in 1998, was written by three Italian journalists. One of them, Marco Travaglio, one of the most important Italian journalists, admitted in 2006 in an interview to *Corriere della Sera* to be one of the authors of the book. See also John Foot, *Calcio. A history of Italian Football* (London, 2006).

fixing, Juventus was stripped of two national titles, and Moggi truck off by Italian Football Association.

## *6. Conclusions*

In the light of the argument proposed by this paper, the analysis of Italian football teaches us two important lessons that can be extended to the rest of the economy. Firstly, institutional shortage in terms of poor basic rules appears in all aspects of the Italian economic life, including the dear "beautiful game". This has important implications. Confining the analysis to macro areas such as corporate governance or the labour market alone only explains the tip of the iceberg, as institutions fail on a day-by-day basis and at grassroots level. The second lesson is that, even when the closest interests are affected by the lack of rules, no reaction takes place as long as a big enough minority has the feeling of benefitting from it. As regard to football, the institutional failure had turned the Italian league close to a joke, reducing the quality of the game, its attractiveness, as well as match attendance. However it provided a large minority of fans (the ones of AC Milan and Juventus, as well as of other minor clubs which managed to preserve a place in *Serie A* via strategic alliances in within the "Moggi system") easy and numerous successes. This contributes to explain why many more voices have raised to complain about the alleged unfairness of the trials which followed the discovery of match fixing, than to ask for more transparent and efficient rules.

As a general conclusion, it is important to add that in this paper we only analysed what North defined the "formal" institutions (i.e. rules, regulations, and the likes) and the weakness of their enforcement. However, one can legitimately argue that the problems with Italy are, in fact, at the deeper level of those "informal" institutions constituted by social norms and cultural habits[80] that do not condemn the pursuit of personal interest at the expense of the public one, and look at lack of compliancy with rules and regulations with a neutral, if not mildly-benevolent attitude. In the light of the state of the research, whether this is true, and up to the weaknesses of a recently-established and top-down, central power, the pervasive influence of the church, the peculiar strength of the family, or a combinations of all these factors remains largely a matter of opinion. What is clear, however, is that the layer of informal institutions evolves in the very long-run and changes very slowly. Although exploring this point goes well beyond the limitations of this paper, it is certainly a worthwhile direction of enquiry. If Cipolla were right in arguing that Italy had the "wrong" informal institutions already at the beginning of the seventeenth century, then one could conclude that the disastrous economic performance of the last twenty years is the sign that Italy had

[80] North, *Institutions, institutional change*.

left a temporary path going from the periphery to the core, and moved back to its carrier as an underdeveloped area.

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