



BANCA D'ITALIA  
EUROSISTEMA

## **The Mezzogiorno and economic policy in Italy**

Opening address by the Governor of the Bank of Italy  
Mario Draghi

Rome, 26 November 2009

The Bank of Italy's interest in and commitment to what would once have been called the "Mezzogiorno question" is of long standing record. Donato Menichella, Governor of the Bank from 1948 to 1960, was in the select group of new southern experts who, through the establishment in 1946 of the Association for Industrial Development in Southern Italy (SVIMEZ), launched the programme of extraordinary intervention in the South. Ever since then the economists of this institute have continued to develop their analyses of the regional disparities.

A stronger growth trend than that recorded in the last decade is vital for financial stability; for reducing the public debt; for developing our infrastructure – education, social protection, justice; and for lowering taxes. This is the purpose of the research that we present today: to reappraise the question that has shaped the economic history of Italy since unification. The development of the Mezzogiorno is in the interest of the whole country.

Southern Italy's economic performance has long been disappointing. The gap in per capita GDP compared with the Centre and North has remained basically unchanged for the last thirty years: in 2008 it stood at around forty percentage points. One third of Italy's population lives in the South, which produces one quarter of national GDP; it remains the largest and most populated underdeveloped economy in the euro area.

Change is too slow in coming. While the other European regions lagging behind are gradually converging towards the euro-area average, the South of Italy is not catching up. Migratory flows towards the Centre and North are once again substantial, affecting large numbers of young people, including those with high levels of education, and impoverishing the human capital of the South. The participation rate in the labour market remains among the lowest in Europe, above all for young people and women. One fifth of employment is still irregular, more than double that in the Centre and North, which nonetheless has more irregular workers than in France, Germany and the United Kingdom.

The South's integration in the international economic system is limited; not counting the refinement of oil products, less than one tenth of Italian exports come from this area. As a result, the global crisis transmitted its effects above all through the subcontracting chain originating from firms in the Centre and North; in the South too, payments were subject to long delays and the terms of access to credit deteriorated.

In 2008 GDP contracted more severely in the South than in the Centre and North: by 1.4 per cent as against 0.9 per cent. In the second quarter of 2009 employment in the South fell by 4.1 per cent compared with the previous year; in the Centre and North it declined by 0.6 per cent. In part, the gap reflects the lower level of protection actually provided by the Wage Supplementation Fund in the South, owing to its different productive structure. The Mezzogiorno is penalized by the weakness of its economy.

The South continues to lag well behind the Centre and North in the provision of essential services for citizens and firms. The analyses we present today reveal alarming gaps in quality between the two macro areas in education, civil justice, health, playschools, social assistance, local transport, waste management and water distribution. In many cases – a typical example is health – the gap clearly depends on the lower efficiency of the service rendered and not on a lack of expenditure. Running a business is often more difficult in Italy than elsewhere, also due to the lower effectiveness of general government; in the South, these difficulties are even greater.

Organized crime casts a pall over much of the South. It infiltrates the public administration, erodes trust among citizens, hinders the free play of competition, and entails greater economic and social costs. The Bank of Italy has made analytical resources available to the Italian parliamentary commission of inquiry into the Mafia and other criminal organizations, for an assessment of the economic cost of crime.

At the root of the South's problems is the lack of trust among citizens, and between citizens and institutions, the low level of regard for the law, inadequate monitoring exercised by voters with respect to their elected representatives, and a feeble spirit of cooperation: what is lacking, in short, is "social capital". These aspects call for greater attention by economists and statisticians. Accurate quantitative data on these phenomena and their development over time are essential for assessing which innovations, including those of an institutional nature, are capable of changing the present state of affairs.

Our data show that there are no marked divergences in trends in banking credit between the Centre-North and the South. During the crisis lending to households slowed considerably in both areas of the country, although it continued to grow more in the South. Even if the starting conditions differed, loans to firms and the cost of credit displayed broadly similar patterns in both areas. The observation we have been making since the start of the year as regards the entire Italian banking system is equally applicable to the South: in this period of extraordinary difficulty for firms, the fortunes of our best enterprises and the long-term competitiveness of Italy also depends on the ability of bankers to assess and screen creditworthiness with prudent farsightedness.

The gaps between the two macro areas, which persist in the conditions of access to credit and the cost of loans, are largely owing to structural differences in the two economies and the greater fragility in the South of the institutions responsible for enforcing contracts. Considering the relative economic weight of the two areas, the same number of banks open in the South as in the rest of the country.

Regional policies in the last decade – those aimed explicitly at furthering the development of weaker areas through specific interventions – also set out to increase social capital, by improving the transparency of information, financial reporting, and the monitoring and assessment of government action. But the results have proved disappointing, undermined by local interests, the lack of continuity in the interventions, the difficulty of setting priorities and the overlapping of the competencies of the various government bodies.

There is a lesson here: regional policies can supplement the available resources, allow them to be concentrated more effectively in each area, combat the negative externalities and reinforce the positive ones. But they cannot replace the proper functioning of the ordinary institutions. Regional policy is not the royal road to closing the gap between the South and Centre-North. The focus should be above all on general policies, whose objectives concern the entire country, and on the local conditions that make their application more difficult or less effective in certain areas.

In reality, the same government policies produce different effects depending on the quality of the local administration and regional context. When it comes to defining the regulations and resources, these aspects must be taken into consideration; there is also a need to design corrective mechanisms for when the quality of the service provided to the general public is unsatisfactory. This thesis can be illustrated with many examples, as will be seen presently. In the case of education, where various initiatives are already under way, it is impossible not to take account of the poorer ability of schools and universities in the South to stimulate pupils' appetite for learning: incentives must be studied and assessments introduced aimed at improving the efficiency of each institute, but also of strengthening teaching activities for students who need help.

Similar considerations hold for the labour market. A legal and contractual environment that enables high rates of employment in many regions in Italy does not preclude the existence of employment rates in the South that are among the lowest in Europe. In some regions the ratio of workers to citizens of working age is lower than 45 per cent; in others, irregular workers account for more than 20 per cent of the total. A better overall organization of local contexts through the development of supplementary wage bargaining can help to increase employment and reduce the waste of human resources.

But there is another reason why Italy should focus on general policies: the primary public expenditure that is channelled for various purposes to the South is substantial compared with the resources allocated to regional policies, which account for just 5 per cent of the total. Nowadays a policy that pursues the objective of speeding up the South's development must not overlap with the general policies; it must concentrate first and foremost on the mindful and judicious expression of these general policies in each area.

This, then, is the message our research brings to the debate: in order for the South to become a national question, not rhetorically speaking but with reasoned pragmatism, every time the state intervenes in the economy and society, the potential differences in application from area to area must be borne in mind from the outset, and provision made *ex ante* for adequate adjustments. Traditional regional policies can make a contribution only if they are consistent with general interventions.

Our analyses show that subsidies to firms have proved largely ineffective: incentives are frequently provided for investments that would have been made in any event; distortions of various kinds have been introduced, often to the detriment of more capable entrepreneurs. Subsidies are therefore not the key to achieving a lasting development of productive activities.

In short, there is a need to invest in application, rather than in subsidies. Translating this into concrete government action is no easy task. Efforts must be made to improve the quality of the services provided by every school, hospital, and court, by every administrative body or provider of transport or waste management services. This is why it is necessary first and foremost to measure and assess the results of government action, in every sphere, from the major infrastructural projects to the performance of individual operators. The papers presented today demonstrate that some progress has been made. But much remains to be done.

There is need for independent, systematic and frequent surveys, against which the progress of local administrations can be measured, as well as for a proper system of incentives and prudent channelling of public resources. "Know then Decide" is a celebrated motto, of enduring relevance, which we owe to the Bank's first Governor in the newly liberated Italy, Luigi Einaudi.

Of course, then it is necessary to decide. This implies recasting old rules and practices by shifting the emphasis from the quantity of the resources to the quality of the results, and by exploiting the resources that are already available, which the budget transfers to the most affluent areas. The papers presented today demonstrate that there are significant margins for a more effective use of the public resources, especially in the South. Per capita public expenditure on

medicine is, for example, much higher in this area than in the Centre and North. At the same time, the merit of those who serve the country with distinction in a particularly difficult context must be acknowledged and rewarded.

With the greater autonomy of fiscal federalism comes greater responsibility: it will provide an opportunity to make government action more effective only if decentralized taxation and expenditure reward efficiency and only if local administrators are capable of channelling resources towards the most productive uses and most urgent priorities. These objectives are harder to meet in the South, but if reached the benefits will be considerable, probably more so than in the rest of the country. Otherwise the gaps will just get wider.

In the South as in the North our aim must be to guarantee the public function par excellence, defining a uniform context and climate in the country: schools, hospitals, public offices that ensure common service standards from one end of the peninsula to the other.