ITALY’S ECONOMIC GROWTH: AN OVERVIEW

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When - on May 5, 1860 – Garibaldi’s *One Thousand* red-shirt volunteers boarded the two
steamships that would ferry them from Quarto in Liguria to the Sicilian port of Marsala, the Italian
peninsula was a poor and slow-growing “geographical expression” (in Metternich’s words) at the
periphery of Europe. Less than a year later, on March 17, 1861, the “geographical expression”
became the Kingdom of Italy. In the following decade, the unification process was largely
accomplished with the acquisition of the Venice region (1866) and of Latium, the remaining
territory under the rule of the Roman Pontiff (1870).

A few numbers suffice to describe the new kingdom’s absolute poverty. Its GDP per person was
roughly equal to the average of today’s “richest” 42 African countries (Maddison 2001).
Life expectancy at birth was about 30 years, considerably lower than in any of today’s least
developed countries. Almost one baby out of three did not reach its first birthday. Four Italians inive were illiterate; recruits were short, averaging only 163 centimetres, and income distribution
extremely unequal (the Gini coefficient for 1861 was 50.4, Vecchi 2011: 430 and Chapter 8).
Income inequality was mirrored in expenditure (Rossi, Toniolo and Vecchi 2002) and caloric-intake
inequality. If, around 1861, a daily availability of about 2500 calories per person made Italians on
average better nourished than citizens of other countries with similar GDP per person, for as many
as 30 per cent of them the caloric intake did not reach 2000 calories per day, making them
chronically undernourished (Vecchi 2011: 12-23; Vecchi and Coppola 2003). About 40 per cent of
the population was close or below an absolute poverty line defined as “sufficient income to buy the
essentials of life” (Vecchi 2011: 295), namely 1.5 euros per day per person at 2010 purchasing
power.

In the 150 years since political unification, Italy’s GDP per person multiplied by about 12 times
(Chapter 6). Life expectancy at birth grew to 82 years (one of the longest in the world), only 0.45
per cent of children die in their first year (the comparable figure is 0.7 in the United States), income
distribution is much more egalitarian (the Gini coefficient is about 0.33) and absolute poverty has
been reduced to 4 per cent of the population (Chapter 8).
Table 1

Welfare indicators: 1861 and 2011

<table>
<thead>
<tr>
<th></th>
<th>1861</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per person (Euros at 2010 prices)</td>
<td>2,190</td>
<td>25,668</td>
</tr>
<tr>
<td>Life expectancy at birth</td>
<td>30</td>
<td>82</td>
</tr>
<tr>
<td>First year death rate (per 1000)</td>
<td>289</td>
<td>4.5</td>
</tr>
<tr>
<td>Income distribution (Gini coefficient)</td>
<td>0.50</td>
<td>0.33</td>
</tr>
<tr>
<td>People in absolute poverty (% population)</td>
<td>40</td>
<td>5</td>
</tr>
<tr>
<td>Literacy rate (% population)</td>
<td>22</td>
<td>98</td>
</tr>
</tbody>
</table>

Sources: Chapters 6 and 8

Striking as the above figures are (Table 1), Italy’s progress in production and welfare is broadly similar to the progress made by any other Western European country from the beginning of its “Modern Economic Growth” (Kuznets 1967) to the present day. Even so, Italy’s case is worth studying for the following reasons: (i) despite progress made in the last couple of decades, Italy’s quantitative economic history has thus far been under-researched; (ii) its long-term economic history is important to shed light on the country’s poor economic performance since the beginning of the twenty first century. (iii) Italy’s sheer size also makes it important in contributing to Europe’s long-term growth; (iv) its growth pattern and growth factors present similarities to those of other European countries, but also not entirely understood peculiarities.

This Handbook is the fruit of new research on Italy’s “Modern Economic Growth” conducted on the occasion of the sesquicentennial of the country’s political unification. Chapters 2 and 3 provide an overview, focused on the major policy issues, of Italy’s economic progress respectively in the period before and after the Second World War. The other chapters, mostly co-authored by Italian and foreign scholars, contain the outcomes of their research on specific issues in Italian economic history. As the expert reader will note, the chapters contain a considerable amount of fresh quantitative findings that advance our knowledge of Italy’s growth experience in a number of fields, including new national accounting and productivity statistics; welfare (including income distribution) indicators; measures of human and social capital, comparative advantages, real exchange rates, public finance, innovation (patents), firm size, migration flows, efficiency of the banking system. Two chapters are devoted to the thorny issue of Italy’s persistent geographical
disparities. The Handbook also contains a comparison of the post-war growth in the three countries who “lost the war but won the peace”, a view of Italy from abroad and case studies of Italian multinationals.

This introductory chapter draws from these research findings to summarize a “story of convergence and two tails”. Framed in a standard convergence narrative, Italy’s economic history from 1861 to 2011 is seen as being characterised by a central period of about a century (mid-1890s to early 1990s) of robust catch up, framed between two “tails” of sluggish growth (1861-1896 and 1992-2011) when the country lost ground to the productivity leaders. In what follows I shall outline the main features of Italy’s economic growth since 1861 and to advance explanations both for the secular rapid growth and for the disappointing beginning and final periods.

1. A tale of convergence and two tails.

In order to assess the economic performance of united Italy, the country’s initial backwardness must be taken into account. Gerschenkron (1962) argued that, if and when a “traditional economy” manages to overcome the “stumbling blocks” on the road of “modern economic growth”, then initial backwardness may prove to be an “advantage”, allowing for more rapid growth than in the more advanced countries. Economists talk about convergence of low-income countries on those with higher income. Since the early 1800s, catch up by lower-income countries is a key feature of the pattern of “modern economic growth” as described by Kuznets (1967). One of the main reasons given by economists to explain convergence is that it is cheaper to import than to develop technology. Less developed countries grow faster than the productivity leaders by borrowing technology from them at a low cost and adapting it to their own comparative advantages, by cheaply transferring resources from low-productivity agriculture to high productivity manufacturing, by exporting labor-intensive products, and by the emigration of their unskilled workers. The long-run economic performance of a given country must, therefore, be assessed taking into account its initial relative level of development, as measured by GDP per person. How economically backward was the Italian Peninsula at the time of its political unification?

From the 13th to the 16th century, Northern-Central Italy was probably the most prosperous European region. In 1500 its GDP per person was possibly about 35 per cent higher than Western Europe's average. From about the middle of the 17th century onward, Italy began to lose economic ground relative to the faster growing North Western part of the continent. In the 18th century output
in the Peninsula hardly kept up with population growth. According the Malanima (2005 and 2006), by the end of the 18th century the average citizen of central and northern Italy might have been about 20 per cent worse off then his ancestors had been two or three centuries earlier. During the Napoleonic wars, Italy's real GDP per person probably reached its lowest level since the 14th century. This view is somewhat more pessimistic than Maddison’s (2001), on which Table 4 is based. There is broad agreement that slow recovery started in the 1820s, possibly slightly accelerating in the 1850s.

### Table 2

**Italy and the advanced countries: GDP per person, 1500 – 1870**  
(US dollars at 1990 purchasing power parity)

<table>
<thead>
<tr>
<th></th>
<th>Italy</th>
<th>UK</th>
<th>France</th>
<th>Germany</th>
<th>Japan</th>
<th>Western Europe</th>
<th>Italy as a share of Western Europe (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1500</td>
<td>1100</td>
<td>714</td>
<td>727</td>
<td>676</td>
<td>500</td>
<td>796</td>
<td>138</td>
</tr>
<tr>
<td>1820</td>
<td>1117</td>
<td>1706</td>
<td>1135</td>
<td>1135</td>
<td>669</td>
<td>1245</td>
<td>89</td>
</tr>
<tr>
<td>1870</td>
<td>1499</td>
<td>3031</td>
<td>1876</td>
<td>1876</td>
<td>737</td>
<td>2088</td>
<td>72</td>
</tr>
</tbody>
</table>

Source: Maddison (2001)

At the time of unification, Italy’s income per person. At purchasing power parity, was roughly half that of Great Britain, the productivity leader of the time, and about two thirds that of France, neighbouring country to Italy and, in many ways, similar (Maddison 2001). More generally, Italy was lagging behind the North- Western corner of the continent. Indirect indicators such as life expectancy, infant mortality, height of recruits, literacy rates, are all consistent with Italy’s relative backwardness. The composition of employment was typical of a backward economy, with agriculture’s share of full-time equivalent labour accounting for as much as 63.2 per cent, followed by the services sector (19.1 per cent) and industry (17.7 per cent). The Italian Peninsula was also lagging behind the more advanced parts of the continent in terms of social overhead capital (infrastructure). In 1861 there were in fact only 2,404 kilometres of rail in operation, almost entirely located in the northern Po Valley, against 14,603 in Great Britain (smaller in size than Italy) and 11,603 in the area of the future German Reich (almost twice as large as Italy).

At the beginning of 1859, the Italian Peninsula was divided into eight states (including the tiny Republic of San Marino which did not become part of the new kingdom), with varying degrees of backwardness (see map on p. xxx). Almost two millennia of disunion had produced deeply rooted
cultural and institutional differences across the Peninsula. In particular, around 1861, estimates of the number of persons capable of shedding their local languages, or dialects, and communicating in Italian vary from 2.5 per cent (De Mauro 1991) to about 10 per cent (Castellani 2009) of the population. French was the working language of the Sardinian Parliament based in Turin. How deep were regional economic differences at the time of unification? The question is not trivial, given the persistence of the North/South divide throughout the 150 years following unification. The issue of the "initial conditions" looms large on the never-ending debate on the "Southern Question". Was the economy of the Kingdom of the Two Sicilies (by and large coinciding with today’s Mezzogiorno) substantially less developed than the country’s Northwestern corner? If so, the new state can only be "blamed" for not closing an already existing gap. Or was Southern Italy almost as developed as (some say even more developed than) the North West? In this case, the new Kingdom of Italy would be guilty of having actually created a hitherto non-existing North-South divide. In spite of a new wave of quantitative research the issue unfortunately still remains unresolved.

Estimates of regional GDP for the early years of unified Italy are in fact still tentative, they become more solid from the 1890s onward. Daniele and Malanima (2007), on the basis of their assessment of national GDP per caput in the eighteenth and early nineteenth centuries argue that when average national income is close to subsistence, regional disparities cannot be wide. According to Felice (2007), in 1871 GDP per head for the whole South was about 10 per cent below the national average with a large within-South variance (Calabria being better off than most northern and central regions). For the same year, the authors of Chapter 20 estimate manufacturing value added per person in the South to be about 30 per cent below the North West’s, but only 10 per cent below the nation’s average. Fenoaltea (2007) points to an East-West gap in addition to the North-South divide. The notion of an initial relatively small income gap between the north-western and southern parts of the country is not entirely consistent with the large gaps revealed by some indicators of well-being, normally quite strongly correlated with GDP per person. In 1861, the average height of recruits was 163.7 centimetres in the North – West (165.2 in the North East) as against 160.9 in the South (Vecchi 2011: 57). Only 15 per cent of the population aged over 15 could read and write in the South against 47.9 per cent in the North-West (Vecchi 2001: 425). These data are mirrored in a higher incidence of child work in the South than in the rest of the country (Vecchi 2011: 147; Toniolo and Vecchi 2007) as well as in lower rates of school attendance. Less clear-cut are indications on the North-South gap coming from measures of life expectancy at birth and infant mortality. While a wide regional dispersion in these indicators existed at the time of unification, no
precise latitudinal pattern emerges: citizens of Liguria enjoyed the longest life expectancy (36 years), and those of Basilicata the shortest (28.5), but then the second longest life expectancy was recorded in Apulia (for a map of Italian regions see p.xxx).

In spite of the enormous progress recently made in quantifying regional income and living standards at the time of unification, the evidence remains sufficiently contradictory to settle the long-standing debate on whether or not the new state is to blame for creating a “Southern Question”. We are still unable to adjudicate between Giustino Fortunato (1973 [1904])’s thesis, which emphasized the unkindness of nature in the South, the persistence of feudal power, the low level of physical and human capital, the trade disadvantages created by geography (see also Chapter 21) and Francesco Saverio Nitti (1900, 1958)’s opinion which instead stressed the accumulated gold and silver wealth of the Bourbon Kingdom, its low public debt and the post-unification diversion of Southern savings to the payment for of social overhead capital in the North. For the time being, on the basis of all available evidence, we can only conclude that (i) a fairly wide dispersion of regional indicators of income and welfare existed at the time of unification (not confined to the traditional North-South representation), and (ii) that the North – South divide, while evident in several dimensions, is likely to have been less pronounced than it became at later times (Chapter 20)

Starting from the conditions of economic backwardness described above, between 1870 (the first year when internationally comparable data exist for a large number of countries) and 2008 Italy’s real GDP per person grew at the annual average growth rate of 1.9 per cent, slightly higher than Western Europe’s rate and about the same as the United States’. Figure 1 plots the results of a simple unconditional convergence exercise for a number of today’s “advanced” countries. Italy’s growth rate, together with that of Spain and Germany, appears to be somehow lower than expected given its GDP per person in 1870. Why, over the 150 years following unification, did the Italian economy slightly underperform with respect to its initial catch-up potential? In trying to frame an answer, let’s consider the time pattern of Italy’s growth characterized by a central period of robust catch-up to the more advanced countries with two “tails” of sluggish growth on each side of it. From the mid-1890s to the early 1990s, the narrative of Italy’s economic development can be framed in the catching-up paradigm: one of Europe’s “peripheral” countries converging to the “core”
FIGURE 1
Unconditional convergence, 1870-2008


of the early industrializers. A backward country at the turn of the end of the nineteenth century, for a hundred years Italy grew faster than the main Western European countries and at about the same rate as the United States [Table 3].

Table 3
A tale of convergence and two tails

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ITALY</td>
<td>0.6</td>
<td>2.4</td>
<td>0.5</td>
</tr>
<tr>
<td>FRANCE</td>
<td>1.4</td>
<td>2.0</td>
<td>1.0</td>
</tr>
<tr>
<td>GERMANY</td>
<td>1.5</td>
<td>1.9</td>
<td>1.2</td>
</tr>
<tr>
<td>UNITED KINGDOM</td>
<td>1.1</td>
<td>1.4</td>
<td>1.8</td>
</tr>
<tr>
<td>UNITED STATES</td>
<td>1.4</td>
<td>2.0</td>
<td>1.5</td>
</tr>
<tr>
<td>JAPAN</td>
<td>1.2</td>
<td>3.1</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Sources: Maddison (2001), OCSE (2011), Chapter 6 and Data Appendix
Italy’s economic history, in its first and final tails, however, is also a proof that convergence does not naturally follow from initial backwardness. For over a generation after unification, the new country failed to exploit its “latecomer’s advantages” in a rapidly expanding Atlantic economy to catch up with its most prosperous north-western neighbors. From 1861 to about 1896, rather than catching up, Italy fell behind the more advanced areas of Western Europe.

The economic history of the fifteen-odd years before the Great Recession of 2008-9 is also characterized by slower growth rates than the rest of Western Europe (itself an area not shining for rapid growth). This is, however, not so much a story of failing to catch up, as Italy’s GDP per caput was then close to Western Europe’s average, as rather one portraying the more subtle malaise of a slow, progressive relative decline; malaise already suffered by the Peninsula in the 18th century.

2. 1861-1896: tenuous growth. Unfulfilled expectations?

Italy’s political unification took place at a time when the so-called “first globalization” was unmistakably under way, driven by technical change in transportation and communication and by a steady movement toward free trade, with “modern economic growth” gaining speed, and spreading from the northwestern cradle of the industrial revolution to the European “periphery”. After the repeal of the Corn Laws, European average tariffs kept falling throughout the 1850s (Findaly and O’Rourke 2007:396). In January 1860, France and the United Kingdom the Cobden-Chevalier treaty, which, by incorporating the “most favored nation” clause, opened the way to further reductions of import duties throughout Europe. International trade increased. More generally, in the 1850s and 1860s, Western Europe’s GDP per head grew at a good pace, particularly in the lands of the future German Reich (1.6% p.a. in 1850-70 as opposed to 0.4% p.a. in the previous twenty years). Great Britain and France also grew at relatively good rates.

The timing of political unification, therefore, was not “ill chosen” from the vantage point of economic growth. International conditions in the so-called Atlantic economy favoured trade, capital
inflows, labour mobility and the transfer of technology from the more advanced industrial
“pioneers”. These conditions notwithstanding, for about 35 years growth-acceleration eluded the
Kingdom of Italy. Rather than forging ahead, the Peninsula lost ground to the productivity leaders.
The secular relative decline continued, despite unification.

If the economy was not the main ideological and political driver of the Risorgimento, it was
nonetheless present in the minds of its architects (Ciocca 2007: 70-77). A customs union modeled
on the *Zollverein* was proposed in the 1840s, and advocated by France in the wake of the 1859
Villafranca armistice, which stopped on its tracks the eastward thrust of the French-Piedmontese
armies. The liberals that forged unification saw protectionism, particularly in the Kingdom of
Naples, as an unwise choice for small economies, at times of rapid integration of the West-
European economies. In the 1850s, Piedmont’s free trade coupled with a programme of public
investment in transport infrastructure showed that such policies could result in growth acceleration.
However, the idea that unification *per se* would perform the miracle of rising the welfare of the
Italian people was illusionary in the absence of sufficient “social capability for growth”
(Abramovitz 1989).

From unification to the second part of the 1890s, Italy’s GDP per person grew an annual average
rate about half that of the United Kingdom, the acknowledged economic super-power of the time
(Table 3). Population grew by 0,65 per cent p.a. and total GDP by 1,24 per cent. The average
growth rate (1861-1897) of value added by agriculture was 0,97 per annum, by the service sector
1,37 per cent, and by industry 1,56 per cent (all data at present-day borders, see Chapter 6 and
Appendix).

It is now possible for the first time to measure the sources of growth for this period (Chapter 7). In
the first two decades following unification, agriculture led Total Factor Productivity (TFP) growth
(0.6 per cent p.a.) with industry and services lagging behind with close to zero productivity increase. Growth in GDP was largely driven by labour and capital inputs: the number of full-time equivalent workers grew faster than total population (on average 0.74 per cent p.a.). According to the 1881 population census, labour force participation reached 55 per cent, the highest level in the economic history of united Italy. After a sluggish growth in the 1860s, fixed-investments grew annually by 5.7 per cent between 1869 and 1888 at the peak of a cyclical boom followed by a long and deep recession.

Slow growth in the thirty-odd years after the unification has been variously explained. The debate was particularly lively in the 1950s and ‘60s, when the first output statistics (GDP and industrial value added) for the period were compiled (ISTAT 1957, Fuà 1974). Explanations ran from infrastructure being a prerequisite for growth (Romeo 1959), to the lack of an agrarian reform (Sereni 1947), to “agents of industrialization” (universal banks) being created only in the mid-1890s (Gerschenkron 1962). The debate was framed in the language, fashionable at the time, of take-offs big-spurts or of Marxian “original accumulation”. Objection to such categorizations led to lines of research focusing on slow but steady growth acceleration as in the British industrial revolution (Bonelli 1994), or on the international cycle induced by fluctuations in capital movements (Fenoaltea 1988).

In the early 1990s Zamagni (1993: 81) argued that the existing quantitative evidence only “allowed to postpone” a final judgment on slow growth after unification: the old question about why, for over a generation, catching up was precluded to this latecomer to Europe’s modern economic growth remained an open and interesting one.

In order to answer this question, a preliminary one must be addressed: in what ways Italy’s growth potential was enhanced by the political unification that was almost completed in 1870? Unification
entailed two processes, each with its own economic implication: the fusion of seven states into a single sovereign entity, and the establishment of independence from foreign domination or influence. Independence also implied the belated end of absolute monarchies.

From an economic viewpoint, the most obvious result of the establishment of the Kingdom of Italy in 1861-70 was the emergence in the Italian Peninsula of the eight world’s largest economy (Table 4). Poor as they were, the Italians were numerous. In 1870, the population of the new Kingdom totalled about 26 million, whereas the Kingdom of Naples, by far the most populous among the pre-unification states, only counted 9 million subjects. The advantages of a large single market had not escaped the moderates, such as Vincenzo Gioberti, who had advocated a federation of independent states and a customs’ union rather than outright unification in a single sovereign state (Gioberti 1845). A priori, therefore, the most obvious economic benefit deriving from political unification would come from the creation of a large single market out of a number of small closed economies, with the attendant improvement in resource allocation and economies of scale, particularly relevant

Table 4  
The G10 In 1870 and 1998  
Shares in World GDP (1990 PPP dollars) and Population (%)  

<table>
<thead>
<tr>
<th></th>
<th>1870 GDP</th>
<th>1870 POP</th>
<th>1998 GDP</th>
<th>1998 POP</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>17.2</td>
<td>28.2</td>
<td>11.0</td>
<td>21.0</td>
</tr>
<tr>
<td>India</td>
<td>12.2</td>
<td>19.2</td>
<td>5.0</td>
<td>16.5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>9.1</td>
<td>2.5</td>
<td>3.3</td>
<td>1.0</td>
</tr>
<tr>
<td>USA</td>
<td>8.6</td>
<td>3.2</td>
<td>21.9</td>
<td>4.6</td>
</tr>
<tr>
<td>Russia</td>
<td>7.6</td>
<td>7.0</td>
<td>3.4</td>
<td>4.2</td>
</tr>
<tr>
<td>Germany</td>
<td>6.5</td>
<td>3.1</td>
<td>4.2</td>
<td>1.4</td>
</tr>
<tr>
<td>France</td>
<td>6.5</td>
<td>3.0</td>
<td>3.4</td>
<td>1.0</td>
</tr>
<tr>
<td>Italy</td>
<td>3.8</td>
<td>2.2</td>
<td>3.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Japan</td>
<td>2.3</td>
<td>2.7</td>
<td>7.7</td>
<td>2.1</td>
</tr>
<tr>
<td>Spain</td>
<td>2.0</td>
<td>2.0</td>
<td>1.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Rest of the World</td>
<td>24.2</td>
<td>26.9</td>
<td>25.3</td>
<td>46.5</td>
</tr>
</tbody>
</table>

Source: Data from Maddison (2001).
for the most dynamic sectors of the so-called second industrial revolution. While the degree of openness (import + exports/ GDP) of the Kingdom of Sardinia was about 40 per cent (Graziani 1960), that of Lombardo-Veneto, the two Emilian Duchies, and Tuscany was only 20 per cent. The Papal States and the Kingdom of Naples lagged behind with ratios of about 10 per cent (Zamagni 2007: 42-42 and Chapter 6). Moreover, the Bourbon Kingdom of Naples (excluding Sicily), traded almost entirely overseas, with Italian trade accounting only for about 13 per cent of its exports (Graziani 1960). Market unification would, therefore, also imply a considerable amount of trade diversion, particularly considering that the Austrian Kingdom of Lombardo Veneto was part of the Habsburg customs’ union.

In addition to market unification, in order to assess the potential economic impact of independence from foreign domination and constitutional government, institutions at large must be taken into account: the adoption of civil and commercial codes, the introduction of checks and balances between government branches, the diffusion of compulsory elementary education, increased freedom of enterprise all spring immediately to mind as potentially growth-enhancing factors (Chapter 19). In addition, benefits would come from the necessary complements to market unification: single currency, homogeneity of weights and measures, unified regulation of financial intermediaries, uniformity of taxation, a single tariff, commercial treaties and the like. The end of foreign dominance might also have had a direct impact on growth, in so far as some policy decisions were made more in the interest of foreign than domestic citizens (the port of Venice, for instance, was left with little investment by the Austrians who instead privileged Trieste, their traditional sea outlet, Toniolo 1977). Moreover, one might assume that the government of a large single country would be more successful in international economic negotiations than those of uncoordinated individual small states.
If these were the ex-ante potential benefits of unification, ex-post Italy’s growth in 1861-1896 showed that they were either too small or not adequately exploited. Why then did a larger market and new institutions not impact on growth for a long period of time after 1861?

Part of the explanation is quite simple: political unification was only a pre-condition to market unification. Its actual implementation took time. The reduction of transportation costs depended on building railways, roads and harbour infrastructures. Italy’s orography made the task both expensive and time-consuming (Fenoaltea 1983, 1984). The new Kingdom was relatively efficient in connecting the main urban centres of the country by rail: if in 1861 trains could reach only as far south as Ancona on the Adriatic coast and no connection existed south of Genoa on the Tyrrhenian side, by mid-1864 one could already travel by train as far south as Bari. In 1870 it was possible to reach Naples from Milan and Turin and to cross the Peninsula from Rome to Ancona and from Naples to Bari (Ciocca 2007:87). But, as was persuasively argued by Fenoaltea, a consistent reduction in transportation cost derived only from the construction of the so-called “secondary” lines, connecting the main to the lesser cities and spreading from the coast to the interior: a longer task that produced its fruits in reducing price differentials across the country not earlier than in the 1880s.

The replacement of old monies with the new single currency (the Piedmontese lira renamed Italian lira) was slow: by 1870 only 57 per cent of the pre-1861 money stock had been changed into lira, and the last large chunk of Neapolitan minted silver was only brought to the Treasury for change in 1894 (De Mattia 1959). The unification of weights and measures was equally slow. Financial market integration, as measured by bond price differentials across the regional stock exchanges did not take place until the early 1880s (Toniolo, Conte, Vecchi 2003). Only by that time, therefore, infrastructure and market-institution can be seen as sufficiently advanced for the economy to take
advantage of a single market that was therefore only “announced” in 1861, but took at least two full decades to materialize.

Institution building was also slow (Chapter 19). A Civil Code of French imprint but containing numerous idiosyncratic norms was voted by Parliament in 1865 together with a Commercial Code, regulating business practices, that however derived directly from the Code of the Kingdom of Sardinia with minor modifications. Only in 1882 did Italy introduce its own new Commercial Code based on the “revolutionary” premise that, in business matters, commercial law should prevail over the Civil discipline. As argued in Chapter 19, the creation of a national bureaucracy and of a set of administrative laws turned out to be not as growth-friendly as elsewhere in Europe.

Human capital creation was even slower than the building of infrastructures and institutions (Chapter 9). Compulsory primary education (for three years) was introduced immediately after unification but its implementation, mandated to local (city) governments, was poorly funded and supervised. Only in the first decade of the twentieth century did the national government take over the task of providing free and compulsory five-year elementary education. In spite of these shortcomings, however, literacy in the population aged 15 – 19 rose from 27 per cent in 1861 to 45 per cent in 1881 and 62 per cent in 1901 (Vecchi 2011: 425), albeit with huge regional disparities.

Slowness in the implementation of the single market, in human capital creation and in the diffusion of modern legal institutions account for part of the failure of the new-born state in immediately catching up with its richest European neighbours. External shocks and policy mistakes also delayed convergence.

Moreover, its first decade, the New Kingdom fought two wars (in 1866 and 1870), with the attendant suspension of convertibility of the lira and increase in government spending. Southern
brigandage – a mix of social unrest and legitimist guerrilla – was met by ruthless action by a large military deployment. Throughout this period, many – in Italy and abroad - doubted about the viability and even the future existence of the new Kingdom. Perceived instability was hardly conducive to business confidence. Neither probably was a fiscal policy aimed at balancing the state budget by 1876. A commercial policy characterized by moderate (1878) and then (1887) higher protection for both manufacturing and agriculture figures prominently in the contemporary and historical literature as one of the main culprits for unsatisfactory growth. As argued in Chapter 2, Italy’s shift to protection was hardly an Italian peculiarity, including the pactum scleeris between iron and wheat. The tariff of 1887 ignited a trade war with France that damaged silk and wine exports. The import duty on wheat, a response to falling transatlantic transport cost, was undeniably technically irrational, but it was seen by moderate free traders of the time as a useful compromise to ease the cost of globalization borne by a relatively small number of people.

By the late 1870s, the single market began to take shape and modern institutions to impact on the economy. At the same time, equilibrium had been restored to public finances, and the 1874 banking law had somehow better organized the financial system. Italy looked more stable to investors and the expectation of a return to convertibility of the lira (which took place in 1883) made the country more attractive to foreign capital. Growth acceleration in both GDP and investment took place from the late 1870s to the late 1880s. It was then frustrated by the fragility of a poorly regulated banking system, fraught with inexperience and greed. In an only too-well-known sequence of events – familiar to late twentieth and early twenty first-century readers – convertibility allowed banks to borrow abroad at relatively low rates. In Luzzatto’s imaginative metaphor, “the atmosphere was hyper-oxygenated by gold […] For the first time since 1861, the public could nourish the illusion – if short lived – of cheap money: in 1884 the official discount rate was reduced to 4%, but commercial banks practiced a 3% to their best clients” (Luzzatto 1963: 208). Easy credit was largely directed to the construction industry, particularly in Turin, Roma and Naples, soon fuelling a
bubble. For a while interest rates remained relatively low but soon risky borrowers entered the
market and systemic leverage increased. By the late 1880s the flow of foreign capital dried up and
then reversed; Italy’s international reputation was not aided by the tariff war with France and the
sudden shift of alliances by a treaty with Berlin and Vienna. Italian banks were forced to reduce
their exposition to industry, particularly to the construction sector. The gold outflow made it
difficult for the six banks of issue to maintain the mandated reserve ratio. Questionable accounting
practices were used to conceal the lack of full metal coverage of notes. It would be later discovered
that, to avoid collapse, one of the main banks of issue, Banca Romana, even resorted to the criminal
practice of printing two sets of banknotes bearing the same serial numbers. The construction bubble
bust, a number of companies were forced to receivership, the smallest and least capitalized banks
began to fail. Contagion spread to the larger commercial banks as well as to some of the six banks
of issue. By 1892-3 the large majority of the Italian commercial banks were either illiquid or
insolvent. Convertibility, de facto unavailable since 1887, was suspended in 1893. Weak political
leadership, in the venomous climate of the struggle between Crispi and Giolitti, scandals, and
turncoats (vividly described in Federico De Roberto’s novel Imperio), allowed the crisis to drag on
until the 23rd hour. Only in the summer of 1893 a sweeping banking reform created the Bank of
Italy out of the merger of three banks of issue. In 1894 the two largest commercial banks were
liquidated and two better-managed and capitalized ones grew from their ashes. The appearance of a
modern central bank and reorganization of the banking system on a sounder basis put an end to the
panic, clearing the board for a sustained period of catch up growth to take place.

Before moving to Italy’s century-long catch-up growth, it is useful to note a peculiarity of the post-
unification Italian economy. Recent research (Vecchi 2011 and various Chapters in this book)
shows that the most relevant welfare indicators monotonically improved during the post-unification
low GDP growth years. Between 1861 and 1891, life expectancy at birth grew from 29 to 38 years
(catching up with France), infant mortality declined from 223 to 189 per thousand (catching up with
both France and Great Britain), the average height of recruits increased from 162.9 to 164.4. These numbers point not only to improved nutrition but also to better sanitation, due to investment in aqueducts and sewerage systems. The already mentioned literacy improvements were mirrored in a reduction in children participation in the labour force (Toniolo and Vecchi 2007). If income inequality probably did not change much until about 1900, consumption expenditure became more egalitarian (Rossi, Toniolo, Vecchi 2001) and, what probably matters most, absolute poverty declined from 44 to 35 per cent of the population (Vecchi 2011: 297). Slow GDP growth notwithstanding, there were considerable welfare gains accruing from unification to the first generation of Italians, particularly to the least privileged of them. If not in GDP per person, Italians caught up with the more advanced neighbours in other important aspects of individual and collective welfare: those who showed their disappointment for the economic outcomes of the Risorgimento were only partly justified by facts.

3. The long convergence, 1896-1992

3.1 Hooking into the “first globalization” 1896-1913

By the late 1890s Italy’s GDP per person had fallen to 38 per cent of Great Britain’s (down from 45 per cent in 1870); by 1913 it reached almost 54 per cent. Sharp growth acceleration took place from the late 1890s onward: the cyclical component explains about one fifth of it, the rest is due to trend change (Ciocca 2007:142-3). For the first time since the seventeenth century, rather than falling behind, the Peninsula forged ahead reducing the income gap relative to the most productive country of the time (Toniolo 1990, Zamagni 1993).

Between 1897 and 1913 Italy’s total and per person real GDP grew on average respectively by 2.4 and 1.6 per cent per annum, industrial production grew on average by 3.8 per cent, and agriculture by 1.7. The pace of productivity growth across all sectors increased from the 1880s onward and further accelerated at the end of the century. Between 1901 and 1911 - a period also called the
“Giolittian era” after Giovanni Giolitti the leading political figure of the time - labor productivity grew by 2.5 per cent p.a. in industry and by 2.2 per cent in the services sector (Chapter 7).

Some industries – metal-making, steam engines, electricity and electro-mechanics – expanded at a double digit rate. In this phase some “first mover” firms established an enduring advantage in key sectors of the second industrial revolution: FIAT in automobiles, Pirelli in cables and tires, Ansaldo in shipbuilding, Falck, Piombino and Terni in the mass production of steel (Chapter 16).

Power generation (mainly hydroelectric) and the electro-mechanic sector, already quite sophisticated at the beginning of the 1890s, expanded rapidly from 1900 onward. The first foreign direct investments by Italian companies date back to this period. Both foreign direct investments (FDI) and imports of machinery were responsible for technology transfers from the most advanced producers. If French, Belgian, Swiss and British FDI concentrated mainly in public utility and transportation, German and, later, American FDI favored manufacturing (Chapter 15).

Modern industry, however, was mainly concentrated in the Northwestern part of the country - in 1911 Milan, Turin and Genoa produced 55 per cent of the country’s value added - thereby increasing regional economic disparities (Chapters 20 and 21).

After 1896, once the light at the end of the financial-crisis tunnel was in sight and the economy again took a central place in the political arena, monetary, fiscal, and exchange rate policies supported growth in a time-consistent fashion (Toniolo 1990, Chapters 2 and 13). A sequence of balanced budgets revived the interest of foreign investors in Italy. The debt to GDP ratio rapidly declined (Chapter 18). In 1906, confidence was so high that the voluntary conversion of Italian Consols (Rendita Italiana) from 5 to 3.75 per cent was subscribed by all but a handful of bondholders who were redeemed at par. Cleverly, the gold standard was never officially reinstated, but monetary authorities consistently mimicked it, holding the exchange rate within the “gold
points”, at times even above the old parity (Cesarano, Cifarelli, Toniolo 2011). Interest rates slowly converged on those of Paris and London.

A virtuous circle set in whereby the exchange rate stability was both a cause and an effect of emigrant remittances, emigration being one of the most conspicuous results of Italy’s increasing participation to the “second globalization’s” Atlantic economy (Chapter 10). In spite of substantial export growth, the trade deficit increased (Chapter 21) due to the import of raw materials and cheap overseas grain but also, and to a large extent, of machinery embodying new technology (Warglien 1985). The relatively high, but far from prohibitive, tariff of 1887 remained in statute books but commercial treaties embodying the “most-favored nation clause” progressively tempered it.

Industrial growth was mainly concentrated in the Northwest of the country (Chapter 20, Ciccarelli and Fenoaltea 2009, 2010) that enjoyed both an original natural advantage and easy access to the largest domestic markets for the new industries, particularly engineering (Chapter 21). The never-to-be-solved “Southern question” arose. It was intertwined with a “social question” that sometimes took violent forms but never reached again the pitch of 1898, when Milan had been the theatre of the most violent repression ordered by the government.

It is perhaps surprising, given the record of the industrial revolutions that took place in other countries during the first half of the century, that Italy’s late industrialization turned out to be unusually “benevolent” towards the lower classes (Toniolo 2003): average life expectancy lengthened to 45 years, the incidence of child labor sharply declined, Italian recruits grew taller (Chapter 8, Vecchi 2011). Certainly surprising is the fact that income and consumption distribution became less unequal and absolute poverty was reduced (Rossi, Toniolo, Vecchi 2001, Vecchi 2011, Chapter 8). The egalitarian and poor-friendly features of Italy’s late industrialization are in need of a rigorous explanation (Toniolo 2003). For the time being a tentative hypothesis points to its taking place in an increasingly open economy during the so-called first globalization. It is likely that
migrations reduced both the rent to wage and the skilled to unskilled wage ratios (Chapter 10), while at the same time international trade increased the worker’s real purchasing power through the import of cheaper foreign “wage goods” The social and political environment is also likely to have played a role: the Socialist Party was created in 1892, trade union membership increased, socially-motivated Catholics grew stronger (in 1891 Pope Leo XIII published his social encyclical *Rerum Novarum*) and, what matters most, the governments of the so-called “Giolittian era” had a more open view of liberal democracy and took an inclusive stance towards both moderate socialists and Catholics (Gentile 1977).

3.2 Economic survival and political collapse

Index-number problems exacerbated by the enormous shift in relative prices that is typical of war economies make it hard to determine Italy’s progress in catching up with the more developed countries during the First World War. What can be said is that the steel, shipbuilding, engineering, and chemical industries – all heavily subsidized – underwent rapid expansion. A factor of particular importance for subsequent growth was the high investment in the hydroelectric power industry, a sector in which Italy was on the technological frontier, at a time when electrification was the world’s new “general purpose technology”. After a fall in 1915, the year Italy entered the war, industrial production and GDP recovered and remained in 1916 and 1917 at the all-time level reached in 1913. After the war, part of the excess productive capacity was eliminated, not without pain in a crisis that saw a drop in GDP by almost 9 per cent between 1917 and 1921. Part of the wartime productive capacity, however, endemically outstripped demand for many years, typically in the shipbuilding sector. Other wartime high-tech investments were converted to peacetime use.

The war tragically marked the watershed between the “first globalization” and a period known to historians as the “globalization backlash”. As for convergence, the story of the Italian economy in the interwar years divides into two periods. Up to 1929 Italy’s growth rate was somewhat above the
western European average, significantly higher than in the United Kingdom but significantly lower than in France. In the 1930s, on the other hand, Italy’s growth trailed behind that of the major European powers.

Between the 1917 and 1929 (both cyclical peaks) Italy’s GDP grew by 2.2 per cent per annum (against 2.5 per cent in 1898-1913). Between 1922 (the year when the highest pre-war GDP level was roughly regained) and 1929, Italy’s annual growth rate was an impressive 4.0 per cent, and 6.1 per cent in 1922-25, the “liberal” years of the Fascist regime, with exports growing yearly at the tune of 18.7 per cent. The first Mussolini government resumed the successful pre–war macroeconomic policy stance: the budget deficit was eliminated by 1925, the GDP/debt ratio fell, the Bank rate was kept at a relatively low level. At the same time, the wartime suspension of import duties on grains remained in effect (Toniolo 1980, Chapter 3).

1925 was the political and economic watershed of the Fascist period. Coincidentally with Mussolini’s formalizing his dictatorship and with a stock market crash (due to overtrading by banks), the wheat import duty was reintroduced together with an increase in the overall protection of the so-called heavy engineering and metal-making industries (Chapter 2). Giuseppe Volpi, a high-profile representative of the heavy-industry compound, replaced Alberto De Stefani, an economics professor, as the Minister of Finance. The following year, Mussolini launched his campaign for the revaluation of the lira aimed at the reintroduction of the gold standard. 1925-26 witnessed possibly the most sudden and complete 180 degrees turnaround of economic policy in Italian history. From then until the end of the Second World War, the Italian economy was increasingly inward-looking. The Fascist ruling elites did not understand that a medium-sized economy, still relatively backward and prevalently agricultural, lacking mineral resources and dependent on imports for food, raw materials and advanced technology could only prosper by competing on the world markets and would suffer more than others from the rigors of autarky.
3.3 *Catch-up intermission, 1929-1945*

Growth continued at a slower pace until the onset of the Great Depression (2.5 per cent per annum in 1925-29). Among the results of our research project (Chapter 6), is an estimation of industrial production in the 1930s, based on hitherto unexplored output and employment sources (Giugliano 2012). We now know that the Italian Great Depression lasted longer than previously believed: only in 1935 GDP and industrial output reached the level of 1929, to fall again in 1936. The crisis would have been more devastating without the measures taken in 1931-33 to bail out and reform the big universal banks that over the years had turned themselves into something similar to industrial conglomerates holding majority stakes in the largest Italian firms. Swift, effective and secret action by the state and the monetary authorities prevented the banking crisis from producing the crippling Austrian or German outcomes (Toniolo 1996). As an initially unintended consequence, the crisis produced one of the most important institutional innovations in the history of the Italian economy, the establishment of the Institute for Industrial Reconstruction (IRI). The state took over the control of most of the largest companies from the banks, creating one of the major tools it would use to support reconstruction and growth after the war (Castronovo 2012).

During the 1930s Italy’s secular convergence to the most advanced countries came to a halt: between 1929 and 1939 growth averaged about 1 per cent a year, against a western European average of 1.1 per cent. Over the same period the autarkic German economy, despite its collapse between 1929 and 1932, grew by over 2 per cent a year, thanks to the mobilization of the country’s abundant natural resources and to its advanced technology. In Italy, protectionist policies, progressively tightened until reaching risible forms of autarky, the stubborn overvaluation of the real exchange rate (Chapter 13, Toniolo 1980) especially after the 1931 devaluation of sterling, participation in the “gold bloc”, and tight exchange rate controls go a long way in explaining the decade-long halt in Italy’s convergence. Nor did an increasingly the *dirigiste* approach to resource allocation yield results comparable to those of Nazi Germany: a command economy would have
required a stronger and more efficient state apparatus and probably coercive measures like those employed by the Nazi regime, which, fortunately, Mussolini was unable or unwilling to manage.

In contrast with the experience of 1896-1913, income inequality rose in the 1920s (Chapter 8; there are no reliable data for the 1930s). The number of average hours worked per person employed rose in the early 1920s, and then sharply declined after 1925. Elementary school attendance rates declined between 1926 and 1936 and the growth of aggregate accumulation of human capital slowed down (Chapter 9, Vecchi 2011). In the 1930s, the progress in life expectancy somehow slowed, the number of poor increased as did that of children at work. Despite his far from negligible approval rate by the Italian people, and his obvious claims to the contrary, Mussolini was not as effective in promoting the welfare of the ordinary Italian citizen as much as his propaganda claimed.

3.4 Reconstruction: setting the stage for long-term growth

Italy’s participation in the Second World War turned out to be an economic disaster. Whereas between 1915 and 1918 GDP had grown on average by 1.9 per cent per annum, it decreased on average by almost 10 per cent every year between 1940 and 1945, with most of the decline concentrated in 1943-45 when the country was divided and war was fought on its territory. In 1945, Italy’s GDP stood at the level of 1906. Reconstruction however was fast: by 1949 Italian GDP was already higher by 10 per cent than in 1939, the best pre-war year.

It is an accepted tenet in the literature that the “second postwar settlement”, unlike the 1919 Versailles Treaty, was a key factor in setting the stage for the subsequent rapid growth in Western Europe and Japan (see Chapters 3 and 4 and references thereof). The Marshall Plan was a crucial ingredient of the settlement, not so much for its size (less than 2 percent of Italy’s GDP in the years 1948-52) but for easing the ‘dollar gap’ for import of raw materials and US technology, and for lessening the distributional costs of monetary stabilization. The Marshall Plan was also an
institutional tool in that, through the Organization for European Economic Cooperation to which Italy eagerly participated, it opened the long way towards international competition and European integration. The policy of progressive, irrevocable opening up to the international economy represented a sharp break with the past. It was a fundamental political choice, upheld even in the face of resistance from powerful economic lobbies, the same that from 1925 onwards had advocated autarky (Toniolo and Salsano 2011). International trade liberalization was set on course by slowly dismantling the autarkic apparatus and progressively moving from bilateral to multilateral payments (Guido Carli, future Governor of the Bank of Italy, was the first chair of the European Payments Union board).

As for domestic policies, runaway inflation was stopped in its tracks in the summer of 1947, not before however it was conveniently instrumental in wiping off most of the government debt. From then onwards, the early postwar governments and the Bank of Italy took an ‘orthodox’ macroeconomic policy stance, including the reconstruction of foreign exchange reserves, that, in the minds of the main policy-makers, had served Italy so well before 1914. This policy was met by fierce criticism not only from the left, but also from the ERP administration (Chapter 5).

Then as in future years, domestic market liberalization proved more difficult to realize than opening up to international competition. A comprehensive political economy study of the long-standing preference of Italians for international competition matched by tightly regulated domestic markets has yet to be made. In the immediate postwar years, however, the international free trade stance, and the European treaties themselves, was largely the initiative of political authorities that were able to overcome the opposition of powerful vested interests. The same political authorities, however, nurtured a good dose of mistrust – resulting both from ideology and the experience of the 1930s – on the ability of the private enterprise to generate adequate capital accumulation, technology, and productivity growth (Chapter 3). The decision, already made once back in 1937, not to privatize IRI was confirmed. A non-trivial corollary was the decision to keep practically the entire system of
financial intermediation in public hands. The financial system remained bank-oriented and strictly regulated (Chapter 17). The stock market stayed thin, oligopolistic, and vulnerable to the speculative forays of a handful of raiders. Overall, the post-war economic institutions corresponded to the idea of a “mixed economy” – characterized by a strong role for the state as producer and regulator – that had inspired the constitutional compromise among the various political parties which sealed the creation of the Republic in 1947.

Chapter 4 argues that “the reconstruction period opened an institutional gap between Italy on one hand and Germany and Japan on the other”, a gap that may help explaining the long-run weaknesses of the Italian economy in comparison to that of her wartime allies. In particular, Germany was better able than Italy to create a Soziale Marktwirtschaft commanding a social consensus on the country’s economic goals that was unattainable in Italy’s more polarised social and ideological environment.

The stock of human capital that the Republic inherited from the previous decades was lower than that of the main European countries. Primary education had made huge strides, and by 1951 the illiteracy rate among the population older than 15 was down to 15 per cent. But the average number of years of schooling – 4.1 years, with large regional disparities – was the lowest among the twelve countries of western Europe, and, despite great advances, Italy continued to lag behind in education attainments over the next sixty years.

3.4 The Golden Age

A good part of Italy’s secular convergence towards the more advanced countries occurred between 1950 and 1973. In the above-mentioned context of rapid opening-up to international competition coupled with protection and regulation of the domestic market, per capita GDP grew by an average of 5.3 per cent per year between 1950 and 1973. Industrial production increased annually by 8.2 per cent and labor productivity by 6.2 per cent. Together with Germany and Japan, the other former
Axis powers (Chapter 4), during this quarter of a century Italy converged strongly towards the high-income countries. In 1950 - 1973 Italian GDP per person income rose from 38 to 64 and from 50 to 88 per cent of respectively the United States’ and United Kingdom’s. In 1951 Italy’s product per hour worked was only 46.5 per cent of the United Kingdom’s, it was 101.6 per cent in 1973. Total factor productivity grew at the fastest rate in Italian history and explained more than half of GDP growth (labor and capital inputs accounted respectively for about 17 and 29 per cent of GDP growth, Chapter 7).

Italy’s growth was faster than could be expected given the initial development level. In other words, Italy’s growth in the Golden Age cannot be explained by catch-up only. Many factors in Italy’s growth are common to all of Europe but some were idiosyncratic to the Italian Peninsula. The technologies of the day, largely adaptations of the Fordist model, were well suited to a country endowed with an abundant labor force, possessed of basic education, and a relatively small but sophisticated cadre of engineers. Up to the mid-1960s, the plentiful availability of labor ensured that wages did not outstrip productivity growth. A large domestic market allowed the exploitation of economies of scale, especially in the production of durable consumer goods, which in turn generated competitive advantages in export markets. During this period, public enterprises under excellent middle managers were an engine of investment and technical progress. IRI produced at internationally competitive prices intermediate goods such as iron and steel in which the private sector had historically been uncompetitive and in need of protection from 1887 onward. The impact of international technology transfers, including rapidly increasing foreign direct investment, was mainly due to the ability of Italian firms to acquire and diffuse technical knowledge through imitation, reverse engineering and adaptation (Chapter 14). This was true not only of the large firms but also of the medium-size enterprises organized in “districts”, one of the most peculiar and successful Italian institutions (Chapter 5).
The rapid transformation of the Italian economy is witnessed by changes in the composition of export trade, by then largely based on medium-tech manufacturing (Chapter 12), and by the fact that the majority of manufacturing employment (60 per cent in 1970) was concentrated in capital-intensive industries such as automotive, chemicals, heavy engineering, steel making, and shipbuilding (Chapter 16).

In the time-span of less than a generation, the life of the average Italian was culturally, socially as well as economically transformed, also as the result of mass migration from countryside to city both in Italy and across the border, this time mostly to neighboring European countries (Chapter 10). If aggregate caloric intake was already adequate, the daily diet became more diversified and, what matters most, malnutrition was almost eradicated and absolute poverty radically reduced (Vecchi 2011). Houses became larger and healthier, with universal access to sanitation and the rapid diffusion of central heating. In collective memories, the Golden Age stands out as the triumph of mass consumption in consumer durables; the small Fiat 500 and 600 crowned the ordinary person’s dream of private transportation (Toniolo and Vecchi 2010). The progressive improvement in the public provision of health services and retirement pensions together with longer-term job opportunities lowered workers vulnerability to poverty. Income distribution became steadily more egalitarian (Chapter 8). The North-South income gap narrowed for the first and only time since unification (Chapters 20, 21).

Overall, Italy’s post-war economic arrangements – based on extreme openness to foreign trade, accompanied by ample safeguards for domestic producers naturally sheltered from international competition, and on an important role of the state as producer goods and services – proved capable of generating fast growth in an initially still backward economy. Things began to change towards the middle of the 1960s, when the North approached full employment. It became harder to meet increased wage demands, while at the same time maintaining high levels of investment. Endogenous innovation was growing too slowly at a time when the advantages of backwardness,
typically unlimited supply of labor and imported technology, began to fade. By the end of the 1960s it was already clear that Italy had to adapt institutions, financial markets, training and research, and the economic role of government to the characteristics of a no-longer backward economy. Little was, however, done and this omission weighed on subsequent growth.

3.5 A Sliver Age, 1973-1990

In the early seventies the pace of growth slowed down abruptly both in Europe and in the United States. In Europe, the impetus from such key factors of post-war growth as reconstruction, and the progressive European market integration petered out. A long phase during which cheap raw materials had maintained favorable terms of trade for the West came to an end. In the initially more backward countries, the advantages of an abundant supply of labor faded. Convergence itself reduced the productivity gains that could be wrung from technology transfers (Crafts and Toniolo, 2010, 1996, Toniolo 1998). All this makes the decline in productivity growth comprehensible, although the reasons why it was so sharp and sudden and occurred simultaneously in every country, west and east of the iron curtain, are not entirely clear. The negative expectations caused by the end of the Bretton Woods cooperative monetary order and by the first oil shock are only part of the explanation.

The Italian economy, now well integrated in the world economy, participated in the events that affected the latter, notably the negative productivity shock, although with an evolution that reflected its own peculiar features. Between 1973 and 1992 per capita GDP grew at the respectable rate of 2.5 per cent per year. The convergence on US per capita GDP reached 76 per cent (up from 65 per cent in 1973). The convergence on Western Europe was virtually complete: in 1992, per capita GDP in Italy was equal to that in Germany and the United Kingdom. Convergence of product per hour worked was also almost complete.
If the convergence on US GDP came to a halt at about three quarters of the way, the productivity story is different. The productivity convergence needs to be stressed, not least in view of the contrast with the following twenty years. Hourly output in the Italian economy rose from 66 percent of the US figure in 1973 to 86 percent in 1992. In other words, per capita GDP grew more slowly than labor productivity; the Italian labor force participation rate was lower than the US rate, and the gap widened over time. This feature was common to all the continental European economies, but it was especially marked in the case of Italy. It is not clear whether this was a preference for free time over work or the result of an inability on the part of the Italian economy to meet the demand for employment.

The continuation, albeit at a slower rate, of convergence in the twenty years that followed the Golden Age was achieved with a succession of policies that in the short term stabilized cohesion, a key ingredient of the “social capability for growth”, and boosted aggregate demand. The needed structural reforms were half-baked, as weak political leadership was unable to effectively counteract the weight of distributional coalitions. The cost of Italy’s inability to change its institutions as the advantages of backwardness faded and the international competition changed the conditions for growth sustainability would come to a head in the 1990s.

From the “hot autumn” of 1969 and throughout the difficult 1970s, a series of off-the-cuff measures were adopted to expand welfare provisions and provide indiscriminate subsidies to firms. Political micro-management in resource allocation grew in importance, particularly in public enterprises. In the process, the allocative effectiveness of the credit system decreased (Chapter 17). Double-digit inflation was higher and lasted longer in Italy than in the countries it competed with. The quality of the school system deteriorated. The time required in obtaining justice in civil and administrative courts lengthened (Chapter 19). Growing signs of frailty in large private-sector firms accompanied the weakening of public enterprises. The labor market became more rigid.
Italy remained locked into a product specialization concentrated in sectors marked by low or medium technology (chapters 12 and 16), although there was a continuous drive for quality in many branches of traditional Italian products. Employment came to be increasingly concentrated in small and medium-sized firms, more flexible and adaptable but less capable of R&D. It was probably thanks to this flexibility, another ingredient of the country’s “social capacity for growth”, that Italy succeeded in maintaining its share of the world export market.

However, while the system’s ability to sustain growth in the long run weakened, and while domestic terrorism and social turmoil shook the country, the overall performance of the Italian economy during the 1970s was surprisingly good. In spite of 1975 being the first postwar recession year with real GDP falling by more than 2 per cent, over the decade, real GDP grew annually at the respectable rate of 3.4 per cent (3.6 per cent between 1973, the year of the first oil shock, and 1979). Income inequality decreased at the fastest pace than in any decade since unification (Chapter 8).

The good performance of the real economy in the 1970s can be explained by the expansive fiscal and monetary stance adopted to soften the economic and social impact of the two oil shocks. The cost was two-digit inflation, and foreign exchange depreciation. Social tensions were oiled by increasing welfare provisions (Chapter 3). The resulting budget deficits were partly monetized, hence the relatively moderate growth in the ratio of debt to GDP. The jury is still out on the costs and benefits of Italy’s macroeconomic policy in the 1970s: it has been authoritatively argued that it kept profits and demand high, thereby supporting employment and lowering the costs of the subsequent disinflation in the 1980s (Giavazzi and Spaventa 1989, Boltho 1986). The opposite opinion holds that, both the neglect of the fiscal constraint and the heavy-handed state management of resource allocation, including credit (Chapter 17), simply postponed, and thus made more costly, the necessary macroeconomic adjustment (Andreatta and d’Adda 1985; Onofri and Basevi, 1997).
At the end of the 1970s, however, consensus built up about bringing inflation under control. Three main decisions were made: participation in the European Monetary System, the introduction of a form of incomes policy, and the repeal of the agreement between the central bank and the Treasury whereby the latter bought the unsubscribed government bonds at every auction (the so-called divorce between the Treasury and the Bank of Italy). It was hoped (in vain as it turned out) that the latter decision would also increase fiscal responsibility, by making policy-makers come to terms with the existence of budget constraints.

Disinflation came at the cost of sluggish growth (only 0.8 per cent p.a.) in 1980-83. Then GDP growth resumed at a quite sustained pace (3.1 per cent annually between 1983 and 1990). By 1984, social tensions had receded and governments could count on larger and more stable majorities. A window of opportunity opened to address Italy’s macroeconomic problems. The Bank of Italy, freed from the previous obligations towards the Treasury, succeeded in taming, if not entirely defeating, inflationary expectations. The government, on the other hand, did not seize the opportunity afforded by growing GDP to stabilize the debt-to-GDP ratio. The overall budget deficit, that averaged 7.6 per cent of GDP in the 1970s, rose to 10.7 per cent as the average for the 1980s. Public spending expansion was amplified by interest payments, as lower inflation meant high real borrowing costs to the government. Rather than being stabilized, in the 1980s the ratio of the debt to GDP rose from 56 to 94 per cent (Chapter 18). No similar pattern is to be found, in such a short period of time, in any other developed country after the Second World War. The roots of the debt crisis of twenty years later are to be found in the missed opportunity of the 1980s.

In the medium term, however, everything looked pretty shiny. Productivity convergence with France and Germany was completed, the United Kingdom “overtaken”, and the United States closely approached. Distributional equality reached its all-times highest level in the mid-1980s. Social tensions were reduced to a “physiological” level, and public opinion was engulfed in a wave of optimism.

4.1. From convergence to divergence

The secular process of Italy’s catch up came to an end in the early 1990s. In the following two decades, the growth in GDP per person was roughly the same as that of the first decades after unification and in both periods Italy, rather than catching up, lost ground to the most advanced countries. In 1992, Italy’s GDP and labor productivity stood at 76 and 86 per cent of the respective US values; by 2010 the ratio of Italian to US per capita GDP was back to its 1973 level (64 per cent). To be sure, during the same period of time the growth rate slowed down in several other advanced countries, in an international economy seeing not only the rapid emergence of the leading Asian countries but also by renewed US economic vitality (Rhode and Toniolo 2006). Japan and Germany, in particular, turned from rapid catch-up to a divergence: their gap with the United States widened by about a dozen percentage points. Italy’s performance, however, was particularly disappointing from about the year 2000 onwards (Table 5).

Table 5

Economic performance, Italy and advanced countries, 1992-2010
(Average annual growth rate in GDP per person and Total Factor Productivity)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>0.5</td>
<td>1.7</td>
<td>0.7</td>
<td>-2.2</td>
<td>0.7*</td>
</tr>
<tr>
<td>France</td>
<td>1.0</td>
<td>1.7</td>
<td>1.1</td>
<td>-1.0</td>
<td>n.a.</td>
</tr>
<tr>
<td>Germany</td>
<td>1.2</td>
<td>1.5</td>
<td>1.3</td>
<td>0.1</td>
<td>1.5</td>
</tr>
<tr>
<td>Japan</td>
<td>0.7</td>
<td>0.7</td>
<td>1.5</td>
<td>-1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>UK</td>
<td>1.8</td>
<td>3.1</td>
<td>2.1</td>
<td>-1.9</td>
<td>0.7</td>
</tr>
<tr>
<td>USA</td>
<td>1.5</td>
<td>2.7</td>
<td>1.4</td>
<td>-1.2</td>
<td>0.9</td>
</tr>
</tbody>
</table>

* 1993-2007
Sources: OCSE (2011), Chapter 7 and Data Appendix
Between 1992-2000 Italian per capita GDP annual growth rate at an average annual rate (1.7 per cent) was slower than the average for the 12 western European countries, but faster than Germany’s and Japan’s. It was only 0.8 percentage points below the secular catch-up trend (1896 – 1992) and above the growth rate realized during the so-called “Giolittian era” (1900-1913). Output per worker and total factor productivity growth, however, progressively slowed down (see Chapter 7).

2000-11 was technically a lost decade, with total GDP in 2011 a mere 1.1 per cent higher than it had been 10 years earlier, and still about 5 per cent lower than it was in 2007 (in the previous major depression, the 1929 GDP level was reached again in 1935).

Especially serious for a country that was still the second-largest industrial producer in the euro area was the weakness of the manufacturing sector, where output contracted by about 4 per cent between 2000 and 2007.

Italy’s weak performance since the early 1990s and particularly in the first decade of the century is largely due to low productivity, in particular TFP, growth. In 1995, Italy’s output per hour worked reached 90 per cent of the US, the narrowest gap ever. From then onward, Italy’s productivity growth did not keep pace with that of the productivity leaders (Table 6). Between 1995 and 2000 the increase in hourly output was about half that of the euro area. TFP growth was also abnormally low. On the other hand, the number of hours worked continued to increase, up to the onset of the crisis in 2008. This was partly due to the increase in employment deriving from important – albeit incomplete – labor market reforms. After peaking in 1995, in less than 10 years unemployment returned to levels similar to those of the early 1980s. Investment also continued to grow, in fact “the demand for factors of production continued to expand satisfactorily in the first decade of the 21st century” (De Novellis 2012: 26).
### Table 6
Labor and Total Factor Productivity
(average annual growth rates, %)

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
<th>Total economy</th>
<th>Total economy</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-2010</td>
<td>3.0</td>
<td>0.8</td>
<td>0.6</td>
<td>0.9</td>
<td>0.4</td>
</tr>
<tr>
<td>1993-2000</td>
<td>5.9</td>
<td>1.8</td>
<td>1.0</td>
<td>1.6</td>
<td>1.3</td>
</tr>
<tr>
<td>2000-2007</td>
<td>1.4</td>
<td>0.3</td>
<td>0.2</td>
<td>0.3</td>
<td>0.2</td>
</tr>
<tr>
<td>2007-2010</td>
<td>1.0</td>
<td>-1.0</td>
<td>-0.1</td>
<td>-0.3</td>
<td>-1.0</td>
</tr>
</tbody>
</table>

* Estimates built using the FTE measure of labour. Valued added is the October 2011 ISTAT data release. It includes both housing and Government services.
** TFP estimates built using the FTE measure of labour and the capital services measure for capital. Value added from October 2011 Istat data release has been netted of housing. Factor shares are variable, based on actual wage data.

Source: Elaborations from Chapter 7 and Data Appendix

An economy that was somewhat recovering between 2005 and 2007 was hit by a crisis that in two years resulted in the loss of over 5 percentage points in GDP per person, a decline comparable to that of the Italian Great Depression of the early 1930s.

### 4.2 Losing growth capability

From the mid-1990s onward, Italy seems to have somehow lost its “social capacity for growth”. As in the first decades of its history as a united country, in the most recent years divergence rather than catch-up characterized the Italian economy. Why did Italy’s robust secular convergence stop at the turn of the twentieth century? This question inspired the launch of the research project that resulted in this book. Each individual chapter provides building blocks for those who will try and provide a comprehensive answer to this complex question. What follows is my own attempt to do so.

Needless to say, no parallels can be drawn between the 1990s and 2000s and the years of divergence that followed unification in 1861, besides the similarity in the aggregate growth rates. In
the 1860s, Italy was a backward country in a rapidly integrating Atlantic economy, trying to engineer a typical catch-up process by importing technology and exporting labor-intensive goods and labor itself to the most advanced countries of the time, once the disadvantages of foreign domination and internal market fragmentation had been overcome. In 1992, Italy’s economy was possibly slightly larger than the UK’s and the seventh largest in the world (when measured at purchasing power parities, Maddison 2001). What matters most, it was very close to the productivity frontier with a product per hour worked at about 90 per cent of the US level (1995).

In the international economy, major changes had been slowly building up in the 1980s, overlooked by Italian producers, trade unionists and policy-makers alike. Then, between 1989 and 1992, a bundle of major shocks suddenly changed the playing field: a technological revolution; a rapid opening of the world markets for goods, services and capital (known as the “second globalization”); an acceleration of European integration leading to the creation of the Monetary Union; the irreversible establishment of two giant countries, China and India (together almost two fifths of the world population), as major players.

Each of these shocks required rapid adjustment, first and foremost cultural, by entrepreneurs, workers and political decision makers, i.e. the whole of society. Not many European countries were ready to carry through this adaptation. The Scandinavian countries succeeded quite well, others found the adaptation to the new environment harder. Italy was the large European country that was possibly the least successful in making the productive, social and cultural changes needed to turn each of the shocks from fetters into growth opportunities.

In the search for the reasons for Italy’s diminished “social capacity for growth” one might usefully try to distinguish between: (i) the weakening of growth factors that sustained growth until the 1980s; and (ii) long-standing weaknesses of Italy’s economy, institutions and society that did not
prevent (some even fostered) the previous convergence process but which, in today’s conditions, have become obstacles to growth.

5.3. Missing growth factors

Seen in a long term perspective, three major changes took place in the Italian economy from the late 1980s onward that stand out as potentially affecting its growth rate: (i) a decrease in size, scope and productivity of the large firms, (ii) an increase of the Debt/GDP ratio over and above the supposedly “critical” threshold of 90%, and (iii) a shift from under- to overvaluation of the real exchange rate of the currency.

Chapters 15 and 17 highlight the quantitative and qualitative progressive weakening of Italy’s large firms. More than other countries, Italy has always been the country of small firms: at the beginning of the 1960s Italy’s average firm size was 49 workers, compared with France’s 72 and Germany’s 78. As often emphasized, the resilience of the Italy’s system of small companies is one of the idiosyncratic features of its economy: it gave and continues to give Italian industry a flexibility that is one of the country’s competitive advantages. Small companies, however, drew major advantages, not only as subcontractor, from the existence of sufficient number of efficient large enterprises as the main producers of applied research, with fallouts on the rest of the economy, and vehicles for foreign direct investment, probably the main channel of technology transfer. In recent decades, the average firm size has declined in every European country, but the phenomenon was especially pronounced in Italy. In 2008 the average number of workers in Italian firms was half the average of the five leading EU countries. The downsizing of large company entailed a reduction in Italy’s R&D capability, at a time when the rapid development and adoption of new techniques was more important than in the past. Moreover, the quality if Italy’s larger companies also declined: between 2000 and 2005 output per hour worked contracted by about 20 per cent in firms with more than 500
workers, more than in the rest of the system. The short-lived recovery of 2005-07 was driven by an improvement in the productivity of large firms, thus confirming their systemic role.

High public expenditure and a large public debt growth emerged in the last two decades as another potential cause of lower growth. While Italy was always a high debt country (the debt to GDP ratio exceeded 90 per cent for 75 years since unification), Italy’s postwar growth took place in a low debt and public expenditure environment. In 1979, the debt to GDP ratio was about 60 per cent (Chapter 18). By the end of the 1980s the ratio had risen to 90 per cent and reached 105 per cent in 1992. While it is hard to set debt levels, valid for all times and countries, which negatively impact on aggregate growth, a number of economists argue that a debt to GDP ratio above 90 per cent is likely to reduce growth (this is also the view emerging from Chapter 18). “Thresholds” aside, there is little doubt that, other things being equal, a large public debt is a drag on growth. It drives up interest rates, requires heavier taxation and often, as in Italy over the past decade, results in reduced public investment in research and infrastructure. In the long run it is a threat to the welfare state, potentially undermining social cohesion. Italy’s economic history shows that the country is more “debt tolerant” than most other countries, and has an excellent reputation for paying both interest and principals. Nevertheless, a prolonged period of high debt, with no discernible downward trend, coupled with tax rates above 40 per cent (high both in historical and comparative perspective) was not seen in peacetime since the first decades after unification, another similarity between the two “tails”. In the late 1890s the debt/GDP ratio was nearly 120 per cent, a credible and time-consistent commitment to debt reduction was one of the macroeconomic conditions for convergence growth that took place in the following years.

A third “novelty” of the 1990s and 2000s was the overvaluation of the real exchange rate, in contrast to Italy’s previous economic history when it was almost always undervalued or close to parity. Chapter 13 argues that undervaluation fosters growth by shifting resources from protected
sectors to high productivity growth export-oriented industries. The authors of Chapter 13 also maintain, however, this effect became weaker as the economy grew. It was probably a fairly significant factor until the start of the 1970s, much less so thereafter. It is thus unlikely that the historical novelty of an overvalued real exchange rate slowed down growth after 1993. More than a cause of the disease, it was probably a symptom. As the nominal exchange rate rose, Italy did not respond with adequate product and labor market policies aimed at keeping unit costs in line with its Euro area competitors.

5.4 The impact of old weaknesses

Most of the chapters in this book highlight cultural, social, and institutional as well as economic weaknesses of Italy’s long-term growth since the unification of the country. Many of such weaknesses – North-South divide, low human and social capital, weak competition in the domestic product and labor markets, financial intermediation defined a “petrified forest”, narrow capital markets, inefficient public administration, insufficient R&D – show an incredible secular persistence. Many of them also figure prominently in the literature as the causes of Italy’s unsatisfactory economic performance since the mid-late 1990s.

To argue that ossified and never corrected weaknesses explain Italy’s divergence in the 1990s and 2000s one must explain why the same weaknesses do not seem to have been an obstacle to rapid catch-up growth until the last decade of twentieth century. More so since the 1990s witnessed a good number of reforms trying to improve upon at least some of the above-mentioned weaknesses (see Chapters 3, 17, 19).

In 1990-1993 a comprehensive banking reform, the first since 1936, set in motion the privatization of the savings banks as well as the IRI-owned “big three” creating the conditions for the emergence
of large banking groups in an open and market-oriented environment, which improved the allocative efficiency of the financial system (Chapter 17). In 1997 and 2003, legislation was introduced that considerably increased labor market flexibility (at the cost, however, of increasing the gap between protected “insiders” and “outsiders”). Important changes were introduced in the university system. In 1998, Italy’s product markets were the fourth most tightly regulated among those of the OECD countries (after Poland, Turkey and Greece), they are now less regulated than France’s, Belgium’s, Austria’s. Even more impressive have been improvements in administrative regulation and overall “barriers to entrepreneurship” (Wolfi et al 2009). Some, at least, of the chronic weaknesses of the Italian economy have been addressed and partly solved after 1992, even though the implementation of the reforms met with grassroots’ resistance that rendered them often incomplete, ill-applied, distorted. Moreover, at the turn of the century the reform drive ran out of steam, and Italy has continued to slip downwards in the “doing business” rankings of the World Bank (www.doingbusiness.org/).

In order to try and understand why old deficiencies are now much more of a drag on the economy than they were before, in spite of non-marginal steps taken to correct some of them, two obvious considerations are in order. First, as mentioned earlier, the international environment has been transformed by globalization, technology, and the European single market and currency. And, second, the very success of long-run convergence has altered the conditions that make its continuation possible. Once a country (almost) closes the productivity gap with the most advanced ones, new ways to economic growth must be found. As we have seen, an economy that is far from the technology frontier can exploit its backwardness to grow faster than the leader by adapting imported technology to its own factor endowment and shifting labor from low- to high-productivity sectors, but in the proximity of the frontier, other growth factors become crucial: apt institutions (in the broad sense), research, human capital, and physical and intangible infrastructure.
There is no need to repeat here the list of Italy’s long-standing and never corrected economic weaknesses: they are measured and discussed at length in the various chapters of this book. Most of them proved to be relatively harmless in a backward country engaged in catch up growth in a context of mild protection from international competition. They became more binding as Italy moved close to the productivity frontier, and turned into heavy fetters with the “second globalization”, the single European market and the new “encompassing technology” (ICT) of the twenty first century. Italy ranks 24th out of the 26 countries for which the OECD has produced an index of the capacity to withstand globalization based on regulations, education, labor market flexibility, employment programs and environment for innovation.

To a good extent, Italy missed the chance to exploit the ICT revolution, the present era’s “general purpose technology”, to increase productivity, particularly in the service sector, now by far the largest share of the economy. This is a technology that by its nature cannot thrive in an over-regulated environment. Italy’s timid deregulation was not sufficient to encourage the spread of information and communication technology, nor did it help small firms to grow in size. Above all, the transfer and the diffusion of ICT require more human capital than Italy had built up over the decades. The case of education (Chapters 8, 9 and 11) is a good illustration of how a long-standing weakness became a serious drag on growth only from the 1980s or 1990s onward.

4.5 Education, a case in point

In Italy’s 150 years as a unified nation, school attendance among the population aged 15-64 has risen from an average of just over 1 year to 10.8 years, but this enormous progress has not brought convergence in this field with the other main European countries. Some of them, not richer than Italy in 1861, had then significantly higher literacy rates. Others, such as Finland, began with even lower rates of school attendance but overtook Italy decades ago. Italy’s school attendance rate is
still the lowest in the twelve countries of Western Europe. According to Tullio de Mauro, a
distinguished linguist and a former minister of education, the (relative) neglect of universal
education was the gravis sin committed by Italy’s élites from unification to the present day.

It is likely that the (relative) scarcity of human capital, as gauged by school attendance, did not
negatively impact on the rate of catch-up from the initial backwardness to a productivity level close
to the frontier. Some scholars maintain that it may even have favored growth, as the kind of skills
required in the catch-up phase derived from practical, and informal know-how passed on tacitly on
the job, rather than acquired by formal education. To simplify a complex issue: to successfully
import and adapt foreign technology Italy needed a good pool of highly trained engineers and a
workforce with basic education, and skills acquired in agriculture, construction or craftsmanship. It
was well endowed with both. Close to the frontier, in a globalized world, low human capital is a
barrier to the diffusion of ICT, the new “encompassing technology”, to endogenous innovation and
to the adoption of state-the-art production processes. Moreover, low human capital makes it more
difficult to generally “cope with globalization”, including through the understanding of different
cultures; it is also a barrier to the formation of the intangible social capital of trust and sense of
belonging that is conducive to community cohesion (Chapter 11). Italy’s relatively poor human
capital may go quite a long way in explaining the entrenched reluctance to change of a large portion
of the Italian electorate.

In strictly quantitative terms, it is encouraging that the fastest improvement in average years of
schooling in the population ever achieved by Italy came in the first decade of the 21st century: from
8.3 in 2001 to 10.8 in 2010 (Chapter 9), equal to an increase by 2.9 per cent per year (3.6 per cent in
the South), compared with 1.7 per cent over the previous 30 years. More important still, the share of
population aged 25-64 that completed tertiary (university) education increased from 9.4 per cent in
2000 to 14.5 per cent in 2009 (OECD 2012). The rate of university enrolment in the relevant age
group was in 2009 close to the OECD average and so was the dropout rate. In this area enormous progress was made in the first decade of the 21st century, despite low GDP growth. Given the low starting level, however, it will take several years for the ratio of university graduates in the population of working age to come close to the OECD average and hopefully to impact on growth. Moreover, the quality of Italian education has ample room for improvement: the OECD PISA mathematics score of Italy’s secondary school students is not statistically different from that of the US, a notoriously poor performer, and much below the European, let alone the Asian, averages (www.pisa.oecd.org/).

Education is not the only area where Italy was improving in the years of low GDP growth. Between 2000 and 2009 life expectancy at birth increased by 2 full years, from 79.8 to 81.8, and infant mortality decreased from 4.3 to 3.7 per thousand (OECD 2012). The number of deaths in car accidents decreased from 5669 in 2006 to 4090 in 2010 (http://dati.istat.it/). Poverty, both absolute and relative, remained constant over the years, including the 2008-9 crisis. As in 1861-1896, low growth and divergence did not mean lack of improvements in some crucial quality-of-life indicators.

4.6 The roots of sluggish growth

The points made in this final section can be summarized as follows. In the 1980s, Italy’s productivity continued to converge to the leaders’, if at a lower pace than in the previous “Golden Age”. Growth was sustained by a lax fiscal stance (Chapter 18) and, to a small extent, by the undervaluation of the real exchange rate (Chapter 13). Neither option was available in the 1990s and 2000s. Moreover, a weakening of the public and private large enterprise as an engine of growth had taken place from the 1970’s onward (Chapters 14, 15, 16). Both the high debt/GDP ratios a weaker ability to generate R&D and economies of scale are likely to have impacted negatively on growth in the post-1992 competitive and technological environment, although it is difficult to
quantify their impact. In addition, and despite the reforms of the 1990s, in the new international environment, a number of long-standing weaknesses of the system came to weigh much more heavily than before on the performance of the Italian economy.

According to the *The Global Competitiveness Report* by the World Economic Forum, “Italy continues to do well in more complex areas measured by the Global Competitiveness Index, particularly the sophistication of its businesses (...) producing goods high on the value chain, with one of the best world’s clusters (2nd). Italy also benefits from its large market size” (Schwab Klaus, ed 2011:27). However, the Report notes that such strong points are hampered by structural weaknesses, such as those briefly highlighted above, as well as by high levels of corruption and organized crime. Overall, “Italy ranked 88th (out the 142 countries considered in the Report) for its institutional environment.”

The synthetic quantification of institutions is a complex and controversial task: a good case in point is the different appreciation by different compilers of national rankings of Italy’s labor market efficiency. Its assessment by the above-quoted OECD team (Wolfi et al. 2009) is strikingly more favorable to Italy than that by the World Economic Forum. Nevertheless, most of the chapters in this book point in the direction of widespread and long-standing institutional failures. The adoption of ICT is a good case in point. As argued by Crafts (2011: 8-9): “The diffusion of this new technology was hindered by oppressive regulation and shortfalls in human capital by comparison with the European leaders in the take up of ICT” (Conway et al., 2006) […] In the retail sector, where the potential for ICT to raise productivity was very considerable, it is clear that productivity performance was impaired by regulation; barriers to entry and mark-ups in retailing remained high on average with adverse consequences for TFP (Daveri et al., 2010). However, in districts where competition was stimulated by the 1998 regulatory reform both ICT investment and labor productivity increased (Schivardi and Viviano, 2011)”.

And, if ICT diffusion is aided by
complementary investments in intangible capital and in high-quality human capital, shortcomings in these areas are ultimately due to institutional failures.

Why has Italy so stubbornly resisted to deep institutional change? Why have far-reaching reforms been rare in the country’s history? The authors of Chapter 3, offer four explanations: (i) the severity of the division between groups and parties, paradoxically increased by the demise of ideologies and of the traditional political parties, which only strengthened Olson’s (1982) distributional coalitions; (ii) the difficulty, on the firm’s side, to efficiently allocate entrepreneurial talents due to a closed corporate governance centered on family-controlled and pyramidal business groups; (iii) the lack of political leadership in reforming the public sector: education, justice and security are major growth factors, their weakness is particularly crippling to the southern economy; (iv) an overall institutional (and constitutional) design that renders substantial policy decisions difficult to make.

These weaknesses have ancient roots. The institutional design of the new kingdom in the aftermath of the unification was hastily assembled and, some argue, focused primarily on market unification, thus partly missing the opportunity offered by the caesura of 1861 to build the institutional infrastructure of a modern state, which besides Piedmont hardly existed in the Peninsula (see also Chapter 19). The institutional and political weakness of liberal Italy was exposed immediately after the First World War, another major caesura, giving way to populism and dictatorship. The “modernizing” features of the latter came from agencies created outside of the official state bureaucracy (Melis 1996), which was inefficient, pervasive, and swollen in the Depression to enhance middle-class consensus for the regime. Finally, if second-postwar reconstruction was the result of good leadership and national cohesion behind the surface of fierce political competition, it is possible that Italy’s treatment by the occupation power, less invasive than in Germany and Japan, might have been a curse in disguise (Chapters 3 and 4) as a missed opportunity for a more radical institutional change.
Italy, however, is not unable to change, particularly when cornered by serious crises. In the mid-1890s Italy was in the throes of the potentially devastating epilogue to a banking and balance-of-payments crisis, permeated with episodes of corruption and wracked by fierce political struggle. The country survived thanks to fundamental institutional changes, including the creation of the Bank of Italy, and – in the wake of the shocking military defeat on the battlefield of Adowa – the recovery of national cohesion, which permitted the design of time-consistent economic policies. In the early 1930s a group of technocrats saved the banking system from the fate that befell the Austrian and German banks. After the war, Italy dug itself out of the material, moral and political rubble thanks to a political elite farsighted enough to forge the compromise that produced the constitutional pact for the Republic. In the 1970s and again in the early 1990s Italian society found the strength to overcome the crisis and introduce relevant reforms. Unfortunately institutional reforms were almost ever imperfect and incomplete, and sometimes watered down once the immediate threat was overcome. The truce among the various distributional coalitions often did not last long enough to allow institutional reforms to permeate society. This is likely to change in the medium term as international competition and conditionality create incentives for institutional reforms. Moreover, and more important, the impact of the recent acceleration in human capital formation on ever larger strata of the population will not only weaken negative aspects of Italy’s culture but encode individually-learned techniques and experiences into organizational routines that are possibly more important than formal institutions. More than in other countries Italy’s future crucially depends on the quality and diffusion of education.
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