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# The failed convergence of Italian capitalism

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*Abstract*

In the 1990s and partially in the 2000s, Italian capitalism underwent one of the widest programmes of reform. The Italian institutional configuration, often named as *Mediterranean Capitalism,* was seen as unfit to the further European integration and to the adoption of the euro. A set of economists and "technicians", from Padoa-Schioppa to Ciampi, have been protagonists of the conception and implementation of reforms. The political crisis helped to perform some rapid and deep changes in the structure of the economy. The paper, after shortly illustrating the institutional arrangement and the *growth regime* of this capitalism before 1992, presents the position of many economists and bureaucrats on the need of reform and on the way to perform them. Reforms and the political context that allowed them will be presented to understand the logics that concretely moved actors. Then, the effects they produced in terms of economic performance will be contrasted with the change in the model of capitalism (referring to the coherence of institutions) to understand the process of path-dependence. Particular attention will be paid to the idea of interaction between the institutional arrangement and the political constituency as well as civil society culture and values. Finally an evaluation of the reasons of the failed convergence will be discussed. The conclusion will present some reasons why capitalisms cannot escape their culture and history.

**JEL:** E61; O40; P16;

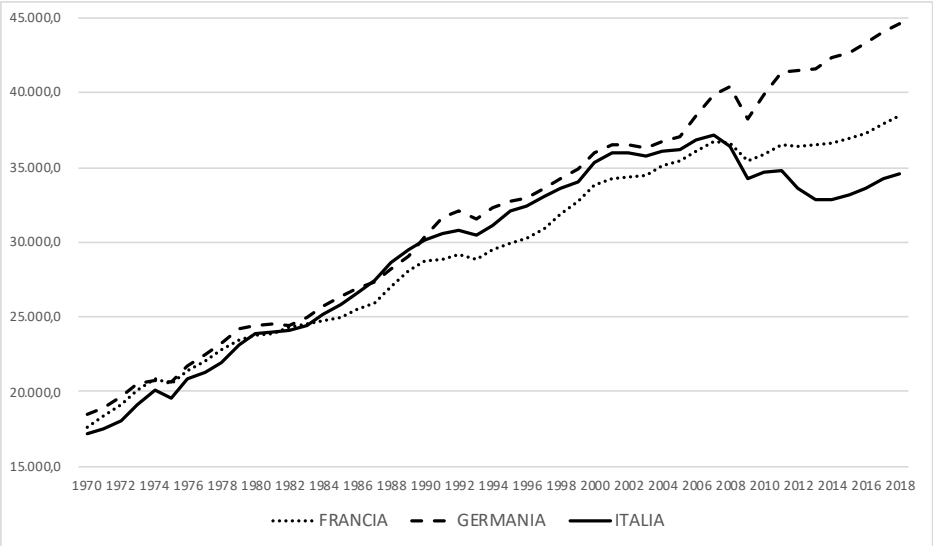
**Key words:** Southern European model of capitalism; economic reforms;

## 1. Introduction: a major policy experiment leading to stagnation

The aim of the paper is to analyse the parable of Italian capitalism in the times of globalisation in relation to the comparative political economy of capitalism literature. The latter has expressed the relevant idea of variety of capitalism. The end is consequently to evaluate how useful is this framework to understand the present day crisis.

The Italian institutional configuration, often named as *Mediterranean Capitalism,* was seen as unfit to the further European integration and to the adoption of the euro. It already showed some difficulty to survive in the European Monetary System of the 1980s and it was considered as unfit to the progressive opening and integration of the economy. Therefore, in the 1990s and partially in the 2000s, Italian capitalism underwent one of the widest programmes of reform experimented by a non-formerly-communist system. The result can be summarised with the tile of the paper of Storm Servaas (2019b) "How to ruin a country in three decades".

**Fig.1 Per-capita income** *(USD PPP, OECD)*




The question is why does the Italian economy suffer so much under the rigour imposed by EMU – which anyway it has never respected (fig.3)? Or, has institutional change and the attempt to move in the direction of a liberal-market model (never rejoined) been harmful? Or, is the Italian economic structure and specialisation at odds with globalisation? The fact is that too many changes took place from 1992 to the adoption of the euro that it is hard to technically detect the causes.

Italy has been one the fastest growing countries since the mid-fifties of the last century, and it became one of the largest economies, thereby gaining also some political role in the world economy. Even when the driving force of its large public and private enterprises lessened, the emergence of an innovative network of SME's of industrial districts kept it on a good track. Nonetheless, the recent decline seems less the outcome of contingent elements such

as external financial bubbles that hit countries such as Ireland and Spain in 2007-8, than the result of underlying factors that possibly date further back and slowly deploying their long-term effects. The effect on both per-capita income and labour productivity (fig.1 and fig.2) is remarkable. No other crisis (including wars) has produced such an impressive stable downturn trajectory of growth.

**Fig.2 Labour hourly productivity** *(USD PPP, OECD)*

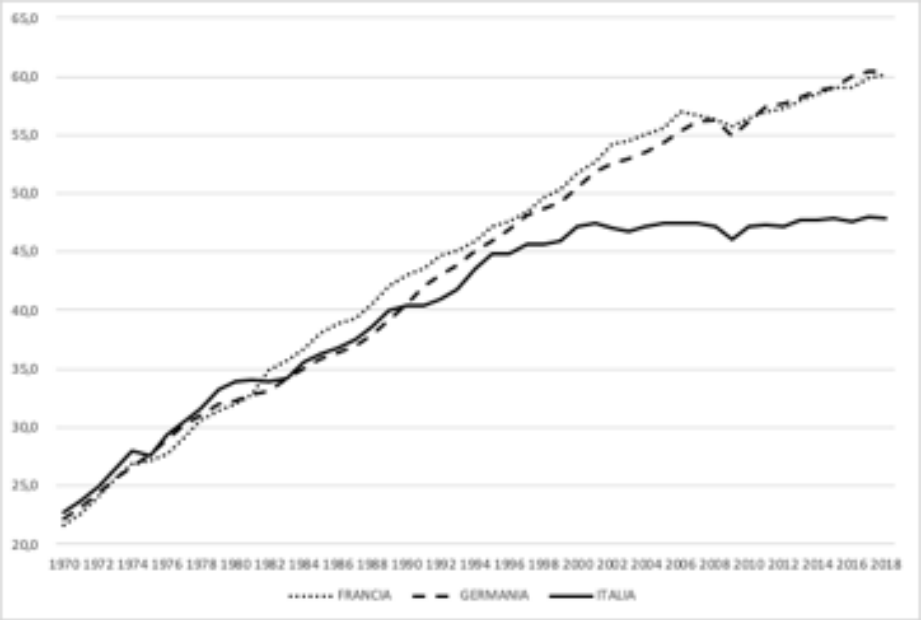
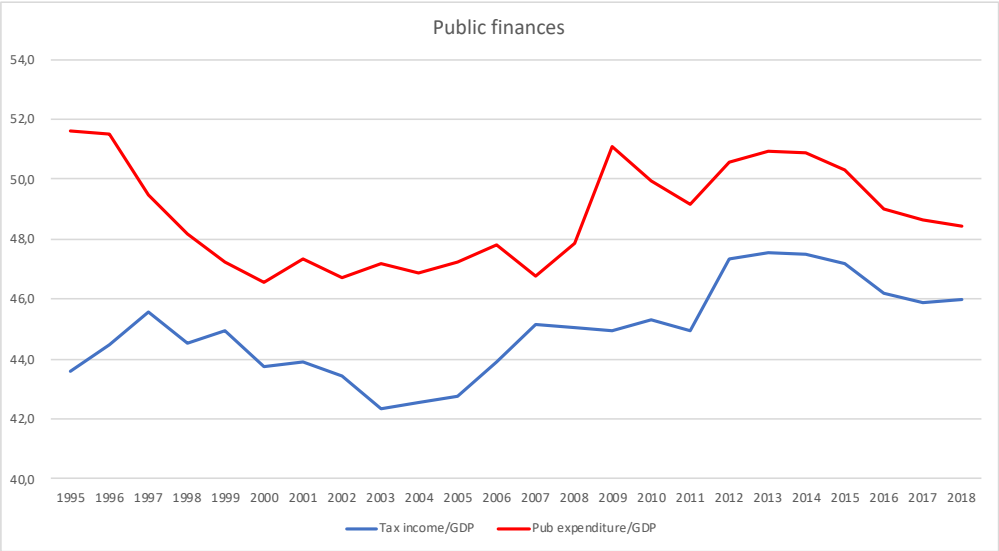



**Fig.3 Public finances %GDP** *(euro, ISTAT)*




As a consequence, this is not a momentary difficulty, nor a slow-down caused by fiscal rigour that Italy never seriously applied except in 1996-97 and in 2005-07 (fig.3). Therefore, the Italian is a case where the study of the relationships between the dismantling of the Mediterranean model of capitalism and the macroeconomic growth regime is surely

valuable. According to those who analysed the case using Post-Keynesian economics, the Kaldor-Verdoorn law (by and large, fig.1 causing fig.2) working in reverse is the most solid macroeconomic explanation of the Italian difficulty (Bagnai, 2016; Forges-Davanzati, Patalano, Trafficante, 2019). The connection between institutional change and the growth regime is therefore the most promising way of addressing the issue.

In the next section some methodological issues are examined concerning the model of capitalism. In the third, the fundamental facts are presented and put in a theoretical frame.

## 2. The dynamics of institutional change and the variety of capitalism

Recently, some literature on comparative capitalism has remarked the importance of *growth models* (Baccaro and Pontusson, 2016) or *macroeconomic regimes* (Blyth and Matthijs 2017; Hopkin and Blyth, 2018), in relation to the classic tradition of the school of *Régulation.* The latter, is still active (Boyer, 2015) in this kind of analysis (even if less object of attention). It actually had some difficulty to fine tune a set of models of the so called *financialised model of capitalism* as it successfully did for the *Fordist* regime. These analytical frameworks allow the connection of the institutional set-up with the growth regime as well as with policy regimes. They can in this way help connecting institutions and slow growth and rising poverty inequality.

Some analytical problems persist as the theoretical status of the *model of capitalism* remains a bit ambiguous relatively to "temporality and typology" (Blyth, 2013). As scholars wide their focus from Old Europe to all OECD countries a plurality of specific models emerge. Moreover, as globalisation proceeds, economic systems become less and less self-contained loosing their systemic properties (autonomy, self-adjustment, steering capability). The institutions that frame contemporary systems are integrated or superposed by international institutions (in the Italian case surely European Union and EMU) and economic production processes are more and more transnational or defined at a supranational level (think of internet services). nevertheless, capitalisms still makes sense as a unit of analysis thanks to their relative systemness. the fact that they display some system-like property (Becker, 2007). Actually, the systemic closure that once was assured by an autonomous currency, a balance of payments and a sovereign set of institutions is now suffering not only of some holes, but by a radical *national indeterminacy*. The connection between the nation-state and the type of capitalism is in this way more and more difficult due define.

Political boundaries of states are losing relevance as concerns the regulation of economic processes. Political systems represent a self-reference steering process that are loosing their drive on the economy. Policies and institutional change in particular are always shaped by the aggregation of interests forming government majorities.1 But the political demand cannot be met by sound policies as their drive on the changed context is very low and sometimes harmful. Therefore, the political-economic system is more and without controls. This is in part the effect of the so called neo-liberal reforms, in part the effect of the EMU

[1] See the model of economy-politics interaction applied by Amable and Paalombarini (2009; 2014; 2017) to France and Italy. Amable and Palombarini introduced the concepts of "socio-economic model"; "the dominant social bloc" to point the way the political system feed-back to the economy.

institutional configuration, in part of the globalisation. At the end, the clear identification of the national economic system with the state and with the political institutions disappears.

This phenomenon (dis-impairment of systems) has effects also on the definition of economic aggregates. As a consequence, we continue torturing national data time series (there is no technical alternative…), but these data are less and less able to represent what is going on in our economy. At least, the economic variable is no more related to the national dimension. Only its collection is performed within political borders, but it measures something that has no more a sharp national definition.

Differences among capitalisms really exist and they are a problem for the EMU (Johnston and Reagan, 2016). We may say that now we have *regional models of capitalism*, partially constrained by the same institutions, partially having specific institutional arrangements. The constraints of the common supra-regional institutions have different effects in each region and therefore policies have a very different impact in different countries. But the idea of model of capitalism still has its force explaining the changing situation.

## 3. The demand-led growth model of Italy and the introduction of external anchoring

From the end of the 1960s and more clearly with the policies in reaction of oil crisis of the 1970s, Italy adopted a *demand led model* of growth. Both wage dynamics, private investments and public deficits remained very high, up to 1992, at the expense of trade deficits. The latter have been controlled by moderate devaluations of the lira, which partially recuperated the real appreciation of the currency due to high inflation. Productivity conserved a good dynamics due to both private and public investments as well as to the increased demand. A negative effect has been the loss of foreign markets by many Italian production due to the real appreciation of the lira and the consequent internal orientation of their strategy that led to a misalignment of prices.

This model, in part, resisted the reforms of the 1990s: in 1995-2000 wage increase was 3,5% average against 0,9% increase in productivity, the same difference of 2,6% remained also in 2001-2007 (Gambarotto and Solari, 2015). Similarly, public deficits never wend below 2,0% (although primary deficit is normally positive of one or two points)(fig.3).

This way of producing growth was quite problematic as it was producing a dis-alignment of Italian prices with European prices. Inflation redistributed the costs of structural adjustment after oil crisis. Moreover, high inflation was problematic for savings that were consequently addressed into the real estate producing difficulties with the affordability of flats by lower income families. On the other hand, inflation helped to reduce financial fragility of firms, inflating their debts and helping self-financing.

The two main changes, oriented to re-address the model of growth by posing different incentives to economic actors – including the government – have been the decision to adhere to the European Monetary System in 1979 and the so-called "divorce" of the Bank of Italy from the Treasury. The former reform was driven by entrepreneurial association in Europe (UNICE, *Confederation of European Business*), even if Guido Carli,[2] President of the Italian association (1976 to 1980) was very prudent as he was aware of the macroeconomic

[2] Speach at the Association Confindustria 6 maggio 1980.

difficulties. Carli argued that the anchoring of the lira to the European currencies could have distorted the equilibrium exchange rate with the dollar, that was quite important for controlling imports. At the same time, abandoning the EMS could let Italy slide towards a South-American kind of regime (Merloni, President of the Association of entrepreneurs).[3] This alternative between a bad anchoring and the South-American kind of regime will persist in policy-makers framework and still is present in contemporary political discourses on the euro and the dangers of the eventual Ital-exit.

The second reform, consisted in a letter written by the Treasury minister Beniamino Andreatta to the Governor of the Bank of Italy in which he released the Bank from the obligation of buying un-opted treasuries at tenders. The Bank of Italy did not cease to buy unsold bonds, but the effect was to define a more stringent tie of financial markets on government deficits. The real interest rate, which was negative of a couple of points, suddenly became positive of three / four points. As governments did not reduce deficits, the public expenditure in the service of debt exploded, reaching 12,5% of GDP in 1992. As a consequence the first attempt of anchoring the economy to induce a growth-regime change failed. As a consequence, the economic and political crisis of 1992 erupted devastating the political system as well as inducing an abrupt change in the structure of prices.

According to Padoa-Schioppa (1997), the anchoring to the EMS leading to a slow progressive re-evaluation of the lira as well as and the high interest rates would have induced a pro-active restructuring of the large firms. Ciampi, Governor of BAnca d'Italia, expected the gradual real appreciation of the currency could have helped the reallocation of resources (Ciocca, 2017). Many economists dissented. Federico Caffé worried the reduction of macroeconomic policy instruments in an unstable and dependent economies as the Italian was. Fabio Masini argues that Spaventa was afraid that the EMS could become an area of deflation in which the stability of the exchange rate is pursuived at expenses of development. Also Mario Monti was pessimist at that time (1978, debates on joining the EMS).

The 1992 September crisis erupted just a few week after signing the Maastricht Treaty (July 29, 1992) that represented a definitive anchoring of the economy to European currencies. Panerai and Savona (2017) discuss the decisions taken in these times underlining the contrary position of Paolo Baffi and the perplexities of Guido Carli. Italy kept its economy on track in the 1980s thanks to deficit spending and now the Treaty was blocking both deficit spending and devaluation. Therefore, the Maastricht Treaty further reduced the policy instruments. Only real market reforms were left as economic policy levers. Baffi was even more critical, particularly he completely dissented on the disconnection of monetary policy and exchange rate from the underlying real economy conditions (Panerai and Savona, 2017, p.15). Baffi predicted a loss in the ability of the Italian economy to produce income as well as the difficulties experimented by banks. On the other hand, Guido Carli did not trust Italian ruling class to be able to perform such reforms (and to achieve a diffuse comply at any level of administration) in a way to get the real economy back on track.

In Italy there was no political conditions to perform deep reforms with a large consensus. Governments opted for a political raid, taking advantage from the chaotic political situation. The only rational for this move is the idea that an external constraint would help stabilising

[3] Speach at the Assemblea di Confindustria, 15 aprile 1981.

both financial markets and firms' strategies, putting the political system on a traced pattern of reforms. As we have seen, it was not able to induce financial stabilisation. But also institutional reforms did not deliver the expected results.

1992 marked the beginning of a tough political crisis, triggered by the so called "Tangentopoli", for which a whole lot of capable politicians underwent investigation and even put in jail accused of bribery and illegal financing of political parties. This difficult political situation led to "technical" governments which enjoyed a broad formal political support, although expressing a minority-defined political address. Yet, thanks to a strong external legitimation (by international economic and political institutions), technical governments could implement some deep reforms, appealing to external constraints such as international treaties and compelling situations (e.g. the Maastricht criteria set by the SGP, European Competition Policy, threats posed by global competition). The agreement between the Minister Baniamino Andreatta (him again…) and Van Miert on the dismantling and privatisation of IRI (the State participations holding that so well did its jobs some thirty years earlier) is a symbol of this new way of thinking.

Such a policy change had two aims: first, to re-orient the growth pattern; second, to radically change the State-market relation. As a matter of fact, the Italian State reduced its direct intervention by privatising banks, companies and public utilities, while started regulating markets to increase competition. At the same time, Montedison, which was the only large Italian private company, dissolved. The only big organisation, potentially able to induce a stabilisation of the economy and a push towards innovation, investment and the cultivation of competent labour was fragmented and winded up. It underwent the same process of disaggregation and selling to heterogeneous clients as it will be done with the other big holding: IRI. The result will be the fragmentation of Italian capitalism (while nothing like that would happen in Germany and France where big groups persisted and achieved a leadership in the continent.

This change of orientation induced such measures as radical pension reforms (introducing notional contributive system and complementary pension funds), labour market deregulation and financial markets reforms that would allow companies to rely more on the stock exchange through increased transparency (Rangone and Solari, 2012b). However, the change was only partial as the public administration reforms carried on by ministers Cassese and Bassanini to introduce more market principles in the regulation of public management simply brought increased costs and less competences and responsibility. Moreover, in the area of state-civil society interaction, little progress was done in dismantling the clientship logic pervading any position of responsibility in society and the penetration of private interests into the state (see Piattelli, 2001). There was no real change in the culture of the "managing class" of the country, an aspect evolving slowly if at all. The political shake of Tangentopoli really had no positive effect on civil society. Ruling classes, rather of eventually feeling relieved from the force of external corruption, thought of themselves as permanently under attack of the judiciary system. Evidence shows that corruption became more diffused and fragmented, as the scope of intervention was reduced by the general policy change. Unfair and personalistic practices in the management of public resources became perhaps more aggressive even under the campaign of "efficiency and meritocracy" performed by the pan-European élites from the middle of the 1990s. Therefore, if the conflict between capital and labour smoothed, conflict spread and increased in many other sectors of the polity.

All these failures determined a dysfunctional state-economy relationship model. Reforms prospected a new model of "regulatory state" (Grillo, 2017 argues inspired to German Ordoliberalism). But as we see it today, was not ready to be a fair and severe *regulatory state.* Corruption, clientship in the form of penetration of private interests in the public decision-making led to a quite bad performance. Therefore, we assisted to a worsening quality of the functions played by the state and a total penetration of private interests into the decision rooms of public administration.

The changed economic policies and above all the reduction of public expenditure for investments had a relevant impact on the economy. Labour market reforms and devaluations helped producers current accounts, but by the end of the decade medium and large sized companies found more convenient exploiting low labour cost opportunities in Easter Europe or in East Asia and started massive relocation of production. That induced a relevant slow down of industrial districts as well as large firms did not evolve in the sense of more efficient organisations.

The policy change campaign continued in the new millennium. Governments pushed structural reforms towards more competitive and transparent "markets" by furthering liberalisation and privatisations. However, no cultural change in line with the direction taken by policies, symbolically represented in the ambiguous attitude of Berlusconi's governments. Politics found difficulties to produce consent without distributive expenditure.

The result was a set of non-effective reforms, dis-aligned with the structure of society and of the economy (e.g. University). Deregulation and increased competition acted against labour and the weaker tie of the economy, amplifying the power of actors enjoying positional advantages, who did not change their culture based on short-term opportunism and extortion. All this led to a huge loss of redistributive capability of the socio-economic system.

In this situation, financial policy was not effective and the fall of public and private investments caused a slow down of productivity. The increased contestability of companies in the stock exchange led to huge speculative take-overs (e.g. Telecom/TIM, banks…), with minimal general benefits in terms of increased investments. No consistent industrial policy was performed to counter the slowing productivity. The communication network remained long underdeveloped. Fiscal policy was bend to tackle deficit and debt goals (public expenditure cuts mainly in basic services and investments) reducing the growth push it previously had.

There was a difficulty to find a synergy between changed institutions and the economic structure (Rangone, Solari, 2012b). This was in part due to non-coherent regulations, e.g. privatised Alitalia was left with high competition of low cost vectors in former richest routes (Milan-Rome or Venice-Rome), and with loss-making routes assigned as public service. But it has been also caused by an economic structure made of small producing units unfit to the European competition regulations conceived for large organisations able to reduce prices and squeeze profit margins. On the banks and finance side, we register a policy of aggregations informally performed by the Bank of Italy with the support of various governments. This aggregation on the one hand dis-impaired banks and the small average size of client-firms, on the other was not able to protect the Italian property as in the case of Unicredit (now controlled by French capital). Moreover, conflict of interest increased in the role of banks that seriously misbehaved in the main financial disasters (Parmalat, Cirio,

Alitalia, Argentinian bonds, etc.) as well as in the attempt to survive independently (Veneto Banca, Banca Etruria, ecc.).

Finally, the need to keep profitability of firms in a context of no productivity increase led to a loss of redistributive capability of the system. This resulted in increased poverty, exit from the labour market and worsening working conditions (Rangone, Solari, 2012b). Consequently, using the words of Reichlin (2019, p.419),

> "The Italian policymakers decided to join the European Monetary Union in the hope that the costly adjustments that the country had to make to improve economic and institutional efficiency could be more easily implemented under the pressure of the European oversight and by the inability to respond to popular discontent with fiscal and monetary profligacy. This hope proved to be partly illusionary".

## 4. From the demand-driven growth model and its pathologies to the weaknesses of the export-led model

According to Padoa-Schioppa (1997) there were four main difficulties of the Italian economy:

- the persitent public deficit;
- the lack of production of public goods;
- excessive extension of public property;
- the bad use of command by the government.

Consequently, Padoa-Schioppa believed that there was a bad coupling between the political constituency and external ties. Paolo Savona (2018) proposed a similar view of the defects of the Italian political economy:

- the propensity to support the search for rents;
- the systematic recourse to public debt;
- the lack of a geopolitic vision;
- the tolerance to the violation of the *rule of law*;

However, Savona considered the application of an external tie and the reduction of policy instruments as counterproductive as he believes that those defects are well embedded at the social level and hard to change with any austerity. Therefore, Savona points at institutions, particularly those of the polity, socially rooted, as the cause of slow or costly change of regime.

The fact is that the growth model was not changed but only repressed up to the 2008. The period 1992-2007 saw deep institutional reforms, concerning at least the formal organisational setting of markets, but little change in the structure of the economy and little change in the growth model. From 1992 to 1996 the devaluation helped rising exports and creating foreign demand, but the anchoring to the euro of 1996 was made re-evaluating the lira to a very high exchange rate repressing again external demand. Wages continued to grow too much as their moderation was overcome by the slow-down of productivity. Therefore, up to 2007 the entity of variables was reduced, but there was no clear sign of change in the growth model.

The 2007-08 world financial crisis hit Italy as reduced exports (investment sectors) and the credit crunch severely hit a production structure highly indebted with banks, particularly small firms. Although old-fashioned credit oriented banks, rather inward oriented, suffered no losses from the financial crack, they had difficulty to meet the increased demand of liquidity from firms due to the falling demand as well as to finance themselves. However, Berlusconi and Tremonti's government managed to control the situation till 2011 by the means of mild austerity policies. Austerity, however, eroded the political consent of the government which had difficulty to act coherently in the difficult crisis of the Spring 2011, losing compactness. That attracted speculative attacks from international financial actors, causing a (heteronomously planned) financial and political crisis. The subsequent austerity policies enacted by Monti's government exacerbated the situation of the economy inducing a severe recession. Today we see the deflationary policies of Monti as an unnecessary suffering that induced a hard recession to the economy. But at that time he had to restore the credibility face to financial markets without the support of the ECB. But the worst effect on the Italian economy was induced by the banking union and the transfer of surveillance over banks to the ECB. Banks had to perform huge devaluation of bad credits (bad as a consequence of the crisis but also of deflationary policies). That caused huge losses and a radical renewal of the property structure of major banks and financial companies.

The change in the regime of growth was not costless as the production structure was consolidating too slowly and small firms were totally blocked. That induced a deep political crisis. Thomas Fazi (2019) talks of an *Organic Crisis,* a term coined by Gramsci, that is to say a "comprehensive crisis," encompassing the totality of a system or order that, for whatever reason, is no longer able to generate societal consensus … don't necessarily lead to the swift collapse of the dominant order … interregna in which "the old is dying and the new cannot yet be born" and during which time "a great variety of morbid symptoms" can appear" (Fazi, 2019, p.1). Similarly to Sapelli, Fazi argues that interest supporting the adhesion to the eurozone represent a peculiar kind of **comprador capitalism**—a term generally used in the context of the old colonial system to describe a regime in which a country's ruling classes ally with foreign interests in exchange for a subordinated role within the dominant hierarchy of power. Also the analysis of Storm Seervas is rather critical with the logic of anchoring and change of regime.

> "It is not a coincidence that the sudden reversal of Italy's economic fortunes occurred after Italy's adoption of the "legal and policy superstructure" imposed by the Maastricht Treaty of 1992, which cleared the road for the establishment of the EMU in 1999 and the introduction of the common currency in 2002… Italy kept closer to the rules than France and Germany and paid heavily for this: The permanent fiscal consolidation, the persistent wage restraint and the overvalued exchange rate killed Italian aggregate demand—and the demand shortage asphyxiated the growth of output, productivity, jobs and incomes. Italy's stasis is an object lesson for all Eurozone economies, but—paraphrasing G.B. Shaw—as a warning, not as an example" (Seervas, 2019b, p.23).

Anke Hassel (2015, p.3) affirmed that "the interaction of the institutional set-up of coordinated and mixed market economies, with the effects of the common currency area, can explain both the evolution of the crisis, as well as the reactions to it". Al that considered, the real change in the growth regime of Italy happened with Monti's internal devaluation of 2012. The balance of payments turned steadily into black and wage inflation was definitively stopped, as well as the deficit spending reduced to low levels. Therefore all

rise in demand since 2012 came from exports as in Germany. However, productivity stagnates as the demand source of increase of productivity was lost (Forges DAvanzati et al. 2019; Gambarotto et al. 2019; Reichlin, 2019; Cesaratto, Zezza, 2018).

## 5. Effects of institutional impairment: demand and banks

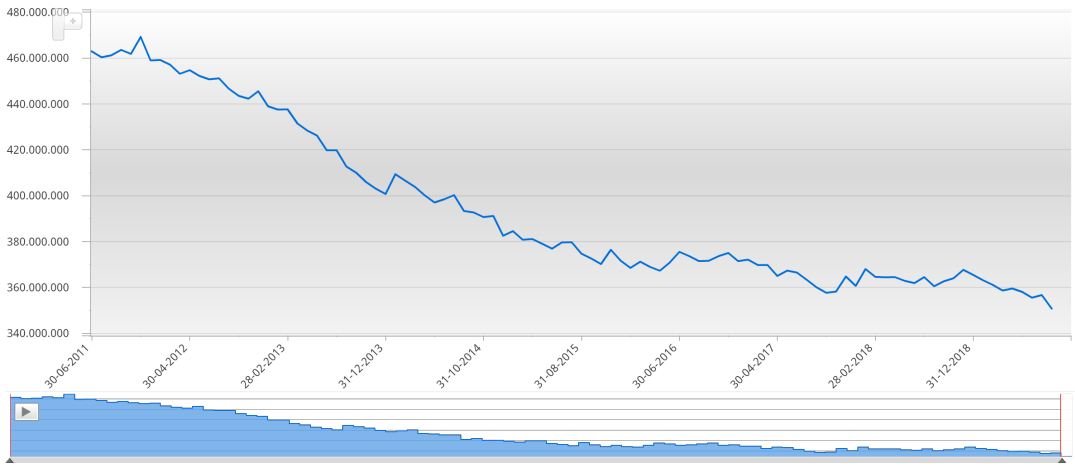
Many effects of institutional impairment. Some institutional changes are uncontroversially delivering good results as those concerning corporate governance, pension reforms. Other are difficult to evaluate as had mixed effects (public administration). Surely two main changes of regimes proved quite difficult and delivering the main sources of stagnation: the reduction of wage-inflation and the banking reforms.

Demand has been reduced to a level in which it caused no external deficit and no inflation. Wage moderation protagonist as public deficits difficult to curb because the reduction of income reduces tax income. The changed vector of demand penalised small firms in favour of standardised productions and public utilities. High percentage of value added produced by small and medium-sized enterprises.Therefore had a certain recessionary effect on most of Italian firms and on employment. That feed-baked also on banks, highly exposed with credit to production.

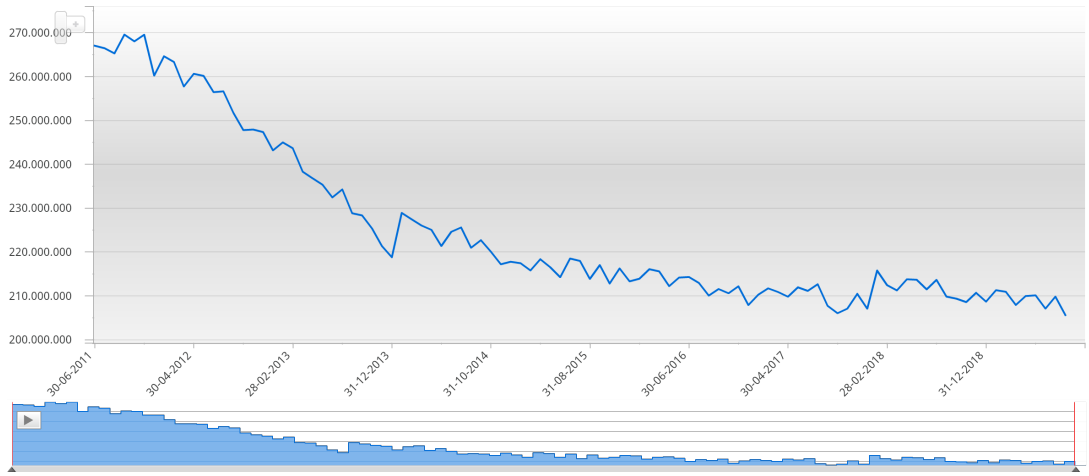
A second line of recessionary tension concerns the allocation choices of banks. The basic Mediterranean model bases the financing of production on bank lending. Actually, multi credit lines was the standard way to finance small and medium sized firms. Consequently, most of the elasticity of increased production was due to credit. No growth of small and medium sized firms took place without the support of banks. The reform of banking regulation of 1993 adopted the lines of the European regulation that re-introduced mixed banks and eliminated the strict limitations of the previous ruling. That allowed a process of merger and acquisition, favoured by the Bank of Italy, oriented to reaching a more concentrated banking structure. That was obtained in the first decade of the century when the majority of popular banks and local savings banks disappeared and were merged in a few large banks. Therefore, in twenty years, the credit market became very concentrated, similarly to Continental regions.

Following Basel agreements, multiple credit lines became an indicator of risk and banks reoriented credit from production to consumption. The banking union received the lines of Basel 2 and 3 agreements and begun considering credit to small firms as an indicator of high risk. Therefore, after the crisis of 2008 and 2011, banks found convenient to cut credit from production and particularly from smaller firms to public bonds, considered risk free by the international conventions adopted by the European Banking Union.

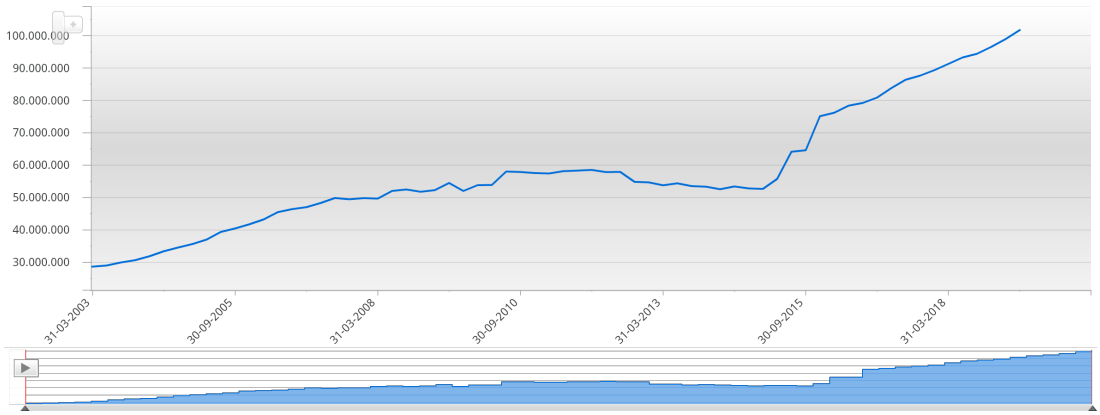
**Fig. 4 Credit to industry,** *thousand euro (Bank of Italy)*




**Credit to services,** *thousand euro (Bank of Italy)*




**Credit to consumers,** *thousand euro (Bank of Italy)*




Effect of Tier1 risk pondering that defined credit to small and medium-sized firms as highly risky, more than the financial products that generated the 2008 crisis. Banks shifted their

assets into consumer credit and into government bonds. That did not help growth, moreover, consumer credit may indirectly finances imports, weakening the internal multiplier effect.

## 5. A system-based view of failed reforms

The opening of an economic system while anchoring it to another currency or to a set of currencies is problematic. The problems worsen when macro-policy instrument are limited. Entering into the SME and the EMU has been discussed in sight of applying the idea of *model of capitalism*.

I do not agree. In order to understand well what is happening we need three levels:

- economic structure (dimension of firms, specialisation, resources, openness);
- macro-institutions of the political economy, plus their social rooting;
- the growth regime (how growth is achieved, where demand comes from).

This idea of regulation provides the model of capitalism a system-like definition (Uwe Becker, 2007). Therefore, it is in the interaction of these elements that crises occur.

Italian reforms treated the economy in a relatively sophisticated way, looking it as a socio-political-system, where the political system is endogenous to the economic system. Therefore, policy-makers considered that the whole system can be induced to reform itself by keeping some macroeconomic constraints and easying some institution (labour, governance, privatisations.)… In particular, the experiment consisted in introducing an external tie on the exchange rate and on prices in general, to induce the system to reform into a virtuous direction. Superficial outcomes of the economic system as prices have been exposed to a hard constraint of external competition to induce a reform of deeper structures and institutions in a direction compatible with globalisation. Therefore a mix of reform, constraint and education was performed. Why it failed, producing instead slow growth and inducing an inconsistent political drift?

Policy-makers successfully changed macro-institutions, although as underlined by Savona (2017) the deep cultural institutions of the polity remained unchanged, rooted into patrimonial views of the polity and to clientship. What policies failed to achieve was a consistent change of growth regime before 2012. The change of regime into an export-led was late and performed in an uncertain context. The flexibilisation of the labour market and the reduction of the average cost of labour successfully helped to keep demand high, but at an insufficient level. Moreover this change of regime of growth handicapped the South of Italy. The main outcome was falling internal demand, crisis of the small firms of the South and high uncertainty for investors.[4]

What went really wrong is the impairment between some new institutions and the economic structure, as in the case of banks. Large banks and small firms do not go together. Large banks do not allocate credit in a minute way as popular banks did. Nor they have the local knowledge to pick-up reliable entrepreneurs. Bank of Italy favoured the concentration of

[4] Surely no problem of specialisation was evident in the North (ROE in small and medium sized firms is rather high), keeping the second industrial intensity in Europe. There is a problem of dissolving large organisations and a problem in the transition from industry to services (old, small scale and lacking investments). See Malanima and Zamagni (2010).

banks to cope with the external competition of giant European banks. But when they obtained the two Italian champions, one (Unicredit) paradoxically fell in the hands of Société Gènérale. Therefore the result was an impairment of economic structure and banks.

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