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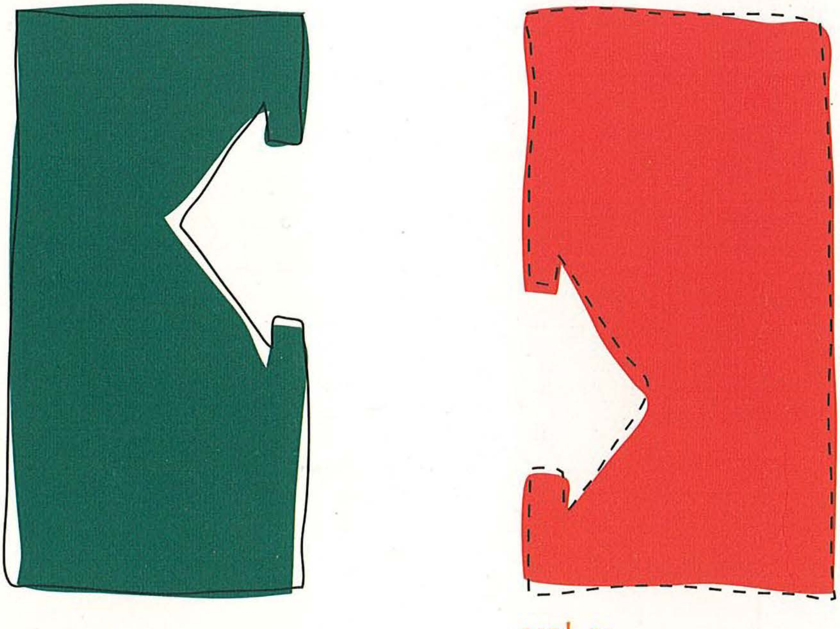

vol. 1: the european challenge

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Italy: Resilient and Vulnerable, Volume I: The European Challenge

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Contents, Volume II: Politics and Society (Summer 2001)

Preface to the Issues "Italy: Resilient and Vulnerable"

DÆDALUS, THE JOURNAL of the American Academy of Arts and Sciences, has very rarely published two issues simultaneously, never on a single country. For reasons that are not always obvious, mass-media representations of Italy are often rendered in terms that seem incongruous to those who live there permanently. To put the matter concisely, Italy is certainly less disaster-prone and indeed less unstable than many who observe it from a distance imagine. Given the almost dizzying succession of short-lived Italian governments over the last half century—interpreted by many as irrefutable evidence of the country's disorder—Italy's essential stability is very rarely looked for or acknowledged. While all foreign observers recognize the remarkable economic strides Italy has made in recent decades, too few ask how this has proved possible if the country is indeed so chaotic. Given all that has happened to change Italy in recent decades, making it a nation fundamentally different from what it was in the immediate post–World War II period or indeed as late as 1989, a critical inquiry into Italy's present condition, taking account of its accomplishments as well as its problems, can only prove useful to those in the

European Union, the United States, and elsewhere who, even when prepared to acknowledge Italy's role in the world today, know too little about the society, incontestably modern yet still in many ways distinctive.

The title of these two *Dædalus* issues, "Italy: Resilient and Vulnerable," is intended to convey a specific message: it suggests the extraordinary vitality of contemporary Italy—its ability to accept change, to reform and renew itself—while at the same time indicating that this is not a sanguine nation, resting on its laurels, unaware of dangers that lurk, however different they may be from those common before 1989, a time when the Soviet Union existed and the Italian Communist Party was the largest in the democratic West. Each of these *Dædalus* issues bears a different subtitle; the first, "The European Challenge," explores the extraordinary importance of the European Union and its predecessors in contributing to the creation of a modern and democratic Italy; the second, "Politics and Society," is concerned with how the nation has been transformed in recent decades so that it barely resembles the one created by the founders of the Republic after the end of World War II.

If some still choose to think of Italy as a vast open-air museum—scarcely realizing that it is only cities like Venice that qualify as such, that Milan, Bologna, Rome, Florence, and Naples, not to speak of a hundred other less-celebrated cities, are today vital industrial centers seeking to thrive in the world's now global economy—they ignore what has made Italy a modern society. This is not a nation living in the past, believing that some earlier periods need to be recalled as memorable and that the present can only be seen as a falling away from previous greatness. Indeed, what makes the country interesting, and perhaps bewildering, is its capacity to meld the contemporary with the traditional, to see itself as European, distinctively so, never to be mistaken for being a clone of its more prosperous neighbors, France and Germany.

We are fortunate to be able to open these *Dædalus* issues with an introduction by the President of Italy, Carlo Azeglio Ciampi. This is the first time in almost four decades that a head of state has consented to write an introduction for a *Dædalus* study. When Lyndon Johnson did so in 1965 and 1966, he understood that we were asking for something other than a conventional presidential statement on America's race problems, our subject at the time. So, in this issue, President Ciampi is not suggesting that all goes well in Italy, that *tout va bien*. But recognizing as any responsible Italian must that Italy confronts serious problems, he knows also how much in fact is going well, how important Italy's deep and continuing commitment to the European Union has been. In his view, major reforms, passed in the last decade, have done a great deal to transform the country, and he scarcely exaggerates when he writes that these changes, together with recent new financial policies, have served to strengthen Italy's position both in the European Union and in the Atlantic Alliance.

The country's ardent and noisy political debates, he writes, ought to be seen for what they are—proof of the vitality of its democratic institutions. This is not to say that the institutional and political "transition," so fully described in these *Dædalus* issues, has come to an end; it continues and will continue, and not simply because of the general election of May 13, 2001, which resulted in the victory of Silvio Berlusconi. In today's Europe, Berlusconi's triumph, predicted for months and anticipated by many who attended the *Dædalus* authors' conference in Fiesole last year, is of course a capital event whose significance will be closely watched in the coming months. For those abroad who imagine that Italy is always changing, that nothing remains the same, Berlusconi's accomplishment will simply confirm their sense of the transience of all things Italian. For those who read these *Dædalus* issues, a more important lesson may be learned: Italy is both resilient and vulnerable. It has shown these qualities in the past; it is likely to show them in the future.

These issues of *Dædalus* would not have come into being but for the generous help of a number of Italian friends who recognized the importance of a critical study of Italy at this time, intended for readers in the English-speaking world, in the European Union, but also outside who retain an interest in Italian society and culture. The idea for these issues originated with the late Fabio Luca Cavazza, a great friend of *Dædalus*, who wrote frequently for the Journal and deserves to be recognized as the true inspirer of the effort to render Italy comprehensible to many very different audiences. All who knew and profited from Fabio Cavazza's generous nature and wise counsel mourn his untimely death, and it is only fitting that these issues should be dedicated to his memory. Romano Prodi, recognizing the commitment of our late friend to this *Dædalus* inquiry, agreed to do what he could to see it brought to fruition. While serving as Italy's prime minister, Prodi took on the arduous task of encouraging busy Italian men and women to reserve time to plan the issues and ultimately to write for them. Our debt to him is very great, and it was only after his departure for Brussels to assume the presidency of the European Commission that Beniamino Andreatta, one of our prospective authors, agreed to become, in effect, the Editor's principal counselor. Universally esteemed for his intelligence and wit, Beniamino Andreatta gave generously of his time until he was cruelly felled by a stroke. Serious thought was given then to abandoning the project, and it was only the willingness of Tommaso Padoa-Schioppa to assume the duties of Guest Editor that allowed us to move forward, commissioning additional essays and planning our authors' conference. Few *Dædalus* Guest Editors in the last forty years have contributed more in keeping a dialogue open with planners and authors; few have been so willing to share responsibility with both.

The planning conference, which met in Rome, was absolutely critical to our effort, and it is a pleasure to acknowledge our indebtedness to Gian Maria Gros-Pietro for making the IRI headquarters available to us. The list of advisers, as given in this issue, will suggest how intensive were the efforts made by Romano Prodi, Beniamino Andreatta, and Tommaso Padoa-Schioppa to seek the opinion of individuals representative of Italy in many of its intellectual dimensions. It is a pleasure also to recognize how much we owe to Antonio Zanardi Landi, former Secretary General of the European University Institute in Fiesole, who offered the authors its unique conference facilities, admirably suited to the full and candid discussion of each of the draft essays.

In most issues of *Dædalus* the Editor's thanks are reserved for the closing paragraphs of the preface. In this instance, they have been put forward because without the help of the individuals cited, and absent the willingness of the authors to revise their drafts, in some instances many times, these issues would never have come into being. There is also a second reason for wishing to emphasize their contributions. Readers will note that with two exceptions—American professors at MIT—all the authors are Italian. With few exceptions, these essays are remarkably dispassionate, which is not to say that their authors are unwilling to advance their own ideas or to withhold judgment about the contemporary Italian political, economic, social, and cultural scene. That these men and women, coming from different professions and with divergent political and ideological preferences, knowing that the *Dædalus* issues would be appearing shortly after Italy's general election, were prepared to risk themselves, writing not for the moment but for a longer future, demonstrates that few of their arguments are likely to be rendered obsolete by Berlusconi's success in the May 2001 elections. As men and women of several generations, at once Italian and European, they have written as much for a European as for an Italian audience, hoping also to reach those in the United States who retain more than a passing interest in both Europe and Italy.

The essays are intended to instruct, but also to stir debate. No effort has been made to minimize the seriousness of many of Italy's problems today—and one thinks not only of the poverty of the Mezzogiorno, crime, the mafia, a declining birth rate, high unemployment, and the like, subjects treated extensively in these issues. The country's plight—if so negative a term may be used—is never concealed. At the same time, there is a sense of accomplishment in these pages, and a constant reminder of how often in the last fifty years Italy has encountered serious problems that it has managed to overcome. Those who have underestimated Italy's capacity to deal with adversity have generally been proved, at least in the recent past, to be mistaken. Whether this will be the case again—given the new political situation created by the Berlusconi victory—is a question many in the European Union are certain to ponder.

Readers cannot fail to be struck by the originality of the discussions of Italy's place in Europe, of why Italy has been so ardent in its support of the European Union, and of what that connection has done to influence Italy, contributing to the transformation of both its economic and its political structures. This is what makes Romano Prodi's contribution to this issue so invaluable. In contrasting the American republic and the European Union, he remarks on the difference between the American "E pluribus unum"—Out of Many, One—and the European Union's motto, "Unity in Diversity." Europe, he writes, is neither a "melting pot" nor a "salad bowl." Its emphasis has always been on diversity. Recalling, as Padoa-Schioppa does, how important was Italy's role in the founding of the European Communities—it is significant that he recognizes these as being several in the beginning—he knows that Italians were among the "fathers" of these institutions, that they helped define their purposes, using Italy's influence always to favor greater European integration. The Italian acceptance of the euro became a national priority, and though it involved changing decades-old habits in business and public administration, Italians know that the price for achieving a goal that fostered democracy, encouraged economic development, and helped to preserve peace could never be thought excessive. In his mind, the partnership of the European Union and the United States, committed to common goals, is an imperative if they are to provide the leadership called for by the global and regional challenges of today.

If Italians may properly claim credit for being among the most conspicuous founders of the European Union, and if the Treaty of Rome by its very name suggests the importance of Italy in the shaping of a united Europe, Italy's contributions over the years ought never to be underestimated. Padoa-Schioppa explains in considerable detail how Italy, in its fundamental respect for the ultimate objective of a politically united Europe, has promoted policies calculated to demonstrate and improve its democratic potential. Italy, to "break the vise of unanimity," he writes, also favored widening the use of the majority rule. In its concern that the EU's democratic credentials never be questioned, the direct election of members of the European Parliament figured among Italy's strategic objectives. So, also, Italy has consistently refrained from making a claim of *juste retour*, by which other member states have asked for a reward at least equal to their share of any cost. Finally, Italy has always recognized the importance of keeping the EU door open to new members. Only by pursuing such policies has Italy imagined that the European Union could remain dynamic, faithful to the letter of the treaties that brought it into being. Still, this is a time, Padoa-Schioppa writes, when a new generation of "gardeners" is needed to tend the European garden, to make certain that the plant continues to bear fruit. While there is no suggestion in Padoa-Schioppa's essay that the plant is still a delicate shoot—it is obviously much more than that—he knows that if the union's more universal aspirations, supported so enthusiastically by Italians, are to be realized, the hurdles still to be negotiated are considerable. What role Italy will play in the European negotiations for expansion now underway, and even more in the crises likely to erupt in the future—as they must in any community of sovereign states—is a matter of importance to Italy, given its unquestioning loyalty to the institution, not to speak of the benefits it realizes from its active involvement in its affairs.

Because 1989 had such great significance for Italy as for all of Europe, the United States, and indeed the world, in that it ushered in the collapse and ultimate demise of the Soviet Union, Filippo Andreatta's concern is to show how Italy has sought to adjust its foreign policy to something other than a bipolar international system defined principally by a continuing Soviet-American rivalry. Those "Cold War" decades, he argues, gave Italy its membership in NATO and the European Community, but also guaranteed its international standing, providing the country with protection at a very low cost, assisting also in the country's economic and democratic development. Today, a decade later, he believes Italy to be at risk—at a "crossroads"—in one of the most dangerous and unstable of European neighborhoods, the Balkans. At this time, particularly, domestic stability is essential if a consistent foreign policy suited to a multipolar world is to be devised and pursued. Whether that stability will be achieved is an issue of the greatest importance not only for Italy but for all of Europe, particularly when one considers what earlier Italian participation in the Gulf War, in

Somalia, Bosnia, and Kosovo has been, and how much this has stretched Italian military capabilities to the limit.

Luigi Federico Signorini, writing about Italy's economy in the last fifty years, describes a country that has changed from being largely agricultural to being heavily industrial, that was initially plagued by inflation and budget deficits, that is still experiencing today high and very unevenly distributed unemployment. Writing of the underdevelopment characteristic of the South, a subject addressed by others as well, and of the poverty that is common there, Signorini notes that Italy is still sufficiently prosperous to rank sixth among the world's economies. If the country's economic performance during the 1990s was disappointing, inflation is now low, as are interest rates, and the public finances are described as "more or less on track." There is no reason for complacency, we are told, and even if the "draconian" measures of the recent past are unlikely to be necessary again, there are still reasons for concern. What, then, in Signorini's view, are Italy's economic problems? In a sentence, that the country will not be able to prosper as well in the so-called new economy, based on information technology, as it has in the recent past, that it will not be able to exploit its economic opportunities, that it is too wedded to the proposition that jobs can be created, firms made competitive, and consumers protected through regulation or direct public action. The "potential of market mechanisms" is still insufficiently appreciated in a country that has such limited experience with these, that has for so long relied on other policies and practices.

Fabrizio Barca, writing of the Mezzogiorno, "Italy's greatest political failure," sees it also as the society's greatest challenge—to make the twenty-one million citizens of the South less poor, with many fewer unemployed, and all its citizens less at risk because of the activities of criminal organizations that rival the state in their power. To achieve these fundamental changes, after the many abortive attempts of the last half-century, labor and goods markets need to be liberated and there has to be greater flexibility in negotiating wages, with provisions made for increased job mobility. The region's public transport deficiencies, so inimical to economic development, have to be attended to, and there must be stronger law enforcement.

Nothing less than a modernization of the justice system will create the confidence that is so obviously lacking in the region. Finally, the government must be prepared to invest heavily in the restoration of its many cultural monuments, and concern itself more assiduously with protecting the area's natural beauty, knowing that such measures will add to the income of those who understand what tourism in the modern world can bring in the way of benefits. Given the European Union's readiness to make substantial monetary contributions for those purposes—resources already pledged—the local authorities must be willing to change their ways. The need is for nothing less than "a new ruling class," able to perceive what Barca sees as Italy's opportunity to provide Europe with an "important test of a new regional policy."

Fiorella Kostoris Padoa Schioppa, writing about Italy's budgetary policies and administrative reform, recognizes how much the European unification process and Italy's wish to join the European Monetary Union—to comply with the Maastricht requirements—led it to make fundamental reforms. In her words, "the sick patient finally chose to recover, even though the treatment had to be quick and sometimes painful in order to be effective." Her argument is that Italy's economy, while today "alive and well," shows "the after-effects of the disease and the cure." The country's poor economic performance in the 1990s, in her view, was caused not by constraints imposed on deficit spending by the Maastricht criteria but by inflexibility in both the product and the labor markets. Italy, she writes, along with Spain, Greece, and Portugal, appears to lead in the costs of hiring and firing. If wage rigidity has been slowly declining since 1993, and if the labor market has become more flexible, with privatization becoming more significant, the Italian government still makes insufficient provision for welfare and other social services, including social security, health care, and public education. Not always guided by principles of equity, the delivery of these essential services has been inefficient. The poor and the socially excluded fare badly in Italy, and Kostoris Padoa Schioppa reflects on how these situations can be remedied. Addressing the other issue that has agitated the country—public pensions—she knows that some reduction is mandatory if state expenditures for these pensions are not to continue to rise. The country's low fertility, together with its high life expectancy, is exacerbating a situation that has made Italy one of the few countries in Europe already suffering from a social security deficit. Because so many reforms, first bruited in the 1990s, are still pending, Italy's continued competitiveness in the world economy remains at risk, and the suggestion is made that there is much that the European Union can do—indirectly—to help.

It is appropriate that the first of these two *Dædalus* issues on Italy should concentrate so heavily on the European Union, given all that it has done to advance Italy's interests, and that the last of the essays should suggest that the EU could do a great deal to assist Italy in the social sector even though its mandate does not specifically call for such intervention. Whether Italy will profit in these or in other ways from its European connections in the coming decades is, of course, impossible to say. In light of the problems that confront the European Union today, the weakness of the euro, the continuing complex negotiations for the entry of additional members—principally the former communist states of Eastern and Central Europe, but also Turkey, Cyprus, and Malta—and the proposals for major structural institutional reforms, a great deal of change may be expected in the next decade. Whether Italy's importance in the EU will grow, rivaling that of Germany and France, how other member states will respond in the long run to the arrival of a Berlusconi government, and whether the ambiguities surrounding the United Kingdom's relations with Europe will be resolved are all matters that may make the first decade of the twenty-first century very different from the last of the twentieth.

So, also, in the role of politics and culture—the subject of the second of the two *Dædalus* issues—it is difficult to know whether the trends of recent years will continue, or whether we will witness further major transformations, particularly in Italian politics. Edmondo Berselli, in very broad brush strokes, describes the changing political party situation in Italy from the time the Republic was founded until the fall of the Berlin Wall and the disintegration of the Soviet Union, neither recognized immediately as major events destined to have important conse-

Carlo Azeglio Ciampi

Introduction

THE ACCURATE AND CHALLENGING PORTRAIT of contemporary Italy offered by the collection of essays included in these two special issues of *Dædalus* will be of interest not only to the American reader but also to the Italian reader, not to mention that large company of Europeans, members of the European Union, who will certainly find its content both instructive and stimulating.

All the important facts and figures are there. I propose to add briefly not a "view from the top," but a view from inside Italy, as I have come to know it through many years of public service, the last two as president of the Republic, having been elected to this post as a nonprofessional politician by a very large cross-party majority.

The duties connected with my new office have offered me the opportunity to get an overall and, at the same time, an in-depth picture of the political, social, cultural, and economic landscape of my country through frequent visits to all its regions and innumerable conversations with representatives of our society. I have also met repeatedly with the leaders of all of the main foreign partners and friends of my country, in Europe and throughout the world. Luckily, Italy has few or indeed no enemies in the world. This is a highly privileged condition.

Having suffered personally the dramatic experience of Europe's last great civil war, I have always declared that I consider myself a citizen of Italy and a citizen of Europe. I can sum up my experiences of the last two years by saying that my confi-

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Carlo Azeglio Ciampi is President of the Republic of Italy.

dence in the future of Italy, my first fatherland, and Europe, my second fatherland, has increased, even while I was developing a deeper perception of the problems and challenges that Italy and the European Union must face at the turn of the century and millennium.

At a time of great changes in our domestic political scene, there has emerged a substantial, remarkable acceptance of the main values that have inspired our domestic and foreign policy in the last decades, embracing a wider political spectrum. At a time of fierce political debate, there has been, nevertheless, wide agreement on most fundamental political decisions, both in the domestic field and in foreign policy. The great changes that have occurred in Italy's political landscape, as well as in the conduct of our financial policy, have strengthened Italy's position as one of the leading countries of the European Union and of the Atlantic Alliance.

I shall repeat here a key passage of my last end-of-year message to the nation: "*Ciò che ci unisce è molto più di ciò che ci divide*" ("what unites us is much more than what divides us"). I am not so sure that the same could have been said, with equal confidence, fifty or thirty or even twenty years ago. The intense political dialectic that is typical of a democratic country does not contradict but possibly confirms my words. I could say the same for the present state of relations between the European nations. More than ever before in our history, what unites us is much more than what divides us.

European institutions keep growing. Some of them, like the European Central Bank, already can only be defined as federal institutions. We do not know clearly what will be the final shape of the new united Europe. We know that it is becoming ever more united and aware of its unity. The process of unification continues, possibly at an accelerating pace, through political discussions that involve today nearly all the nations of the European continent.

Let me first remind the non-Italian reader of some of the main elements of continuity in Italy's foreign policy.

1) Italian popular and political support for European unification has, if anything, increased. If it is true to say that Europe has been an important factor for Italy's modernization in all

fields, and is so perceived by Italians of all political areas, it is equally true that Italy has repeatedly played a decisive role in the development of an ever more united and greater Europe. Italy, to borrow the expression used by one of the authors of this collection of essays, has been and remains one of the key "federators" of Europe.

2) Since the end of the Cold War, Italy has remained one of the leading members of the Western alliance. Indeed, it could be said that it has acquired greater prominence. In the Balkan crises of recent years, Italy has played a major role. Italy's heavy political and military involvement in Bosnia, Albania, and Kosovo has received near-unanimous support in Parliament.

3) History, as well as geography, continues to confer to Italy a special role in the field of relations between the European Union and all the countries that border the Mediterranean. The achievement of an ever higher level of political, economic, social, and cultural cooperation between nations that share an ancient common heritage, north and south of the inland sea that saw the birth of the first civilizations in history, is the common aim of all political and cultural forces of Italy, giving rise to multiple initiatives by Italian governmental as well as private institutions.

4) Italy continues to believe firmly in the function of international institutions, such as the UN (to whose finances Italy is one of the top contributors), NATO, and the European Union, as basic factors for global stability and as the main instruments of intervention in support of peace and human rights in the world.

5) Italy has taken the lead in the debates that have led to the decision by the "developed nations" to cancel or reduce the debt of the underdeveloped and is dedicating considerable resources to helping the developing world.

In domestic affairs, in spite of the great changes that have occurred in the party landscape, or possibly as a result of them, the principles of most basic reforms now being undertaken have enjoyed near-unanimous support.

1) Those reforms needed to put our financial affairs in order (a necessary precondition for Italy to join our main political

partners as one of the founding members of the European Monetary Union) had been indicated many years ago. In my annual report of May of 1981 as governor of the Bank of Italy, I pointed out the three main "prerequisites for a return to monetary stability": full Central Bank autonomy; reinforcement of budgetary procedures; and a code for collective bargaining. The first of these aims was achieved while I was still at the helm of the Central Bank, thanks to the committed support of successive ministers of the Treasury, Beniamino Andreatta and Guido Carli. The other two aims had to wait until the 1990s to be reached. As prime minister, in 1993, I promoted a new pact (the byword was "*concertazione*") between the government, the unions, and the entrepreneurial organizations that completed a multistage process of cutting any automatic link between wages and prices. This was essential to rein in inflation. In the late 1990s, as minister of the Treasury in the Prodi government, I had the privilege to guide Italy's economic policies through the final steps that led to our fulfillment of all conditions necessary to join from the start the European Central Bank. A new "culture of stability" had by that time been accepted by social and political forces. Public opinion supported a temporary higher level of taxation, once this was defined as a "European tax." (All relevant figures of Italy's "impressive quantitative fiscal adjustment" are reported by one of the following essays.)

2) The still incomplete institutional and political "transition"—a basic theme of all political debates in Italy throughout the 1990s—has, however, seen the achievement of a number of important reforms in the direction of greater administrative and political decentralization. The principle of "subsidiarity" is accepted as applying to relations both between the European Union and the national states and between the national state and local authorities—municipal, provincial, and regional (in favor, of course, of the lower level of governance), as well as between the public and private sectors.

The regions, provinces, and municipalities (their legitimacy being based on ancient history as well as on new laws) have acquired increasing administrative and financial powers. Such trends are, again, supported by all main political forces. Through trial and error, and as a result of a heated political debate, a new "federal" state is being built in Italy, and some of its main structures are already in existence. "Secessionist" tendencies have only known a passing and highly localized fortune.

3) The somewhat feverish character of political competition in the central state (possibly a result of our national character, some would say) has not prevented the achievement of a very high level of cooperation between parties at the local level, thanks to an equally typical and widely shared friendly spirit in our human relations. An unprecedented *alleanza delle autonomie* ("alliance of autonomies"), involving the various levels of local government, social and economic organizations, research institutions and universities, and the ever more widespread "volunteer" citizens' organizations, has proved to be a key factor of economic and social progress all over Italy, from North to South.

4) The spectacular growth of small and medium-sized industries, accompanied by the emergence of a large number of "industrial districts" (a typical, and highly praised, Italian economic institution, as shown by some of the following essays), is spreading from North to South, showing the high economic vitality and inventiveness of Italian society. This is an element of great strength in the global competition. Cooperation between business, the universities, and other research institutions is accelerating the spread of technological progress at all levels of production.

I have indicated only a few of the reasons that justify my confidence in the future of Italy as well as in the European Union.

Italians have been acquiring a greater pride in their identity as a nation. They are feeling, at the same time, more "Italian," more "European," more aware of the enduring strength and value of their ancient municipal and regional traditions. These trends are not perceived by the Italian people as contradictory. They do not create confusion in our minds. Rather, they make us better aware of the richness and complexity of Italy's ancient civilization, itself the cradle—with Rome's law, the Church, humanism, and the new art and science of the Renaissance—of European and Western civilization.

This is a country of many capitals. It likes to call itself the country of the "*cento città*," which means of a hundred, or indeed hundreds of, opera theatres; thousands of great art museums; many thousands of age-old castles, palaces, and churches of unequalled beauty.

We know that we—we the Italians, the Europeans—are going to face, in the new century and millennium, many dangers and challenges. We know that we must continue our unceasing efforts for economic, social, and political reforms, at both the national and the European levels. We are proud of having left behind the national, religious, and ideological conflicts that have led to two disastrous world wars. Europe offers to the world today the example of its new peace.

We have faced with success many extremely serious threats during the last few decades. We are reasonably confident that we shall be able to meet the unexpected trials of history in the age of globalization, by acting together with our sister nations beyond the oceans—America being the first, repeatedly called, during the last century, to help save Europe from itself. Our horizon, when we look forward to the uncertainties we shall have to face, certainly includes, as an element of strength, those "new Europes," our sister nations, located in the continents that our fathers "discovered," populated, and civilized.

Romano Prodi

Italy, Europe

ITALY, THE BEL PAESE

THE WAY THAT CITIZENS of different countries see each other is almost inevitably affected by cultural stereotypes. Although they certainly contain some truth, these icons often relate to realities of the past. What is worse, however, is that stereotypes fail to take account of the differences, the multifaceted variety, of the real world, reducing it to a single dimension.

Italy, for instance, is more than just the images of the masterpieces produced in the 1950s by our celebrated film directors, more than its natural beauty and artistic heritage can convey. While taking great pride in its filmmakers as well as in its unique resources of beauty, Italy is also keeping pace with the most advanced nations in many industrial sectors and is more and more involved as a major actor in the ongoing process of shaping the European Union. Italians take very seriously the role of their country as a partner in what has rightly been called the greatest political innovation of our times.

I realize that the notion of "European Union" is as vague to many American readers as their picture of Italy, so I will briefly try to explain what Europe is about and what Italy can mean for Europe, taking as a convenient touchstone the United States.

THE EUROPEAN UNION

The European Union and the United States are both continental coalitions of democratic countries, enjoying the benefits and

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facing the problems of modern industrialized nations in an increasingly globalized economy: welfare and mass education, immigration, an aging population, and pollution are concerns shared on both sides of the Atlantic.

Their institutional organization, however, is entirely different: whereas the United States is a federation of states, the European Union is something more complex, for which a name has yet to be found. This difference is apparent in the very mottoes of the two unions. To the American "E pluribus unum" (Out of Many, One), Europe answers "Unity in Diversity."

The historical evolution of the European Union differs greatly from that of the United States: whereas the latter was born out of a bloody war against British colonial rule, the former has been conceived to prevent new wars from breaking out between the nations of the old continent. The United States enlarged by incorporating the almost virgin territories along the shifting western frontier, while for the Union enlargement implies the spontaneous adhesion of fully developed and structured nations—and now takes on the added challenge of a difficult reunification with the Central and Eastern European countries formerly belonging to the Soviet bloc.

Lastly, the inherent philosophy of the whole enterprise is totally different. The chief ambition of the Czech, Polish, Irish, and Italian immigrants coming to the United States was for a long time quick and complete assimilation into the American mainstream, the first sign of which was adoption of the English language. Europe, on the contrary, is not a "melting pot," nor is it a "salad bowl." The emphasis is rather on diversity. The first regulation approved by the European institutions back in 1958 states that documents of general application "shall be drafted in the four official languages." With the successive enlargements, these languages are now eleven, and they might become twenty or more in the near future. It is a difficult challenge, but we are convinced that the preservation of our cultural identities amply repays the effort.

This is the wider scenario of which Italy has definitively become a part with its adoption of the euro, the single currency that is already in use for financial transactions, which will, at the beginning of 2002, replace the notes and coins of twelve European states.

THE ROLE OF ITALY IN EUROPE

With an area slightly larger than Arizona, Italy has a population of some 58 million people—that is to say, the equivalent of California, New York, and New Jersey put together. Italians make up 15 percent of the total population of the European Union (at present, 380 million) and include German, French, Slovenian, Greek, and Albanian minorities. The homeland of millions of emigrants for centuries, Italy is now becoming a host country for people coming from North and Central Africa, the Balkans, Eastern Europe, Asia, and South America.

Italy was one of the six original member states of the European Communities, and has since—in spite of occasional difficulties—played a significant part in the process of European integration. One of the leading figures who helped shape the new entity following World War II was the Italian federalist Altiero Spinelli. In his bold Ventotene Manifesto, written in 1941 with Ernesto Rossi and Eugenio Colorni, he called for the creation of the United States of Europe—the only alternative, in his view, to a continuous risk of war and destruction.

A significant political contribution to the European venture came from Alcide De Gasperi, probably the main architect of Italy's recovery after the war. His vision was crystal clear. A European community of states was the only way to put an end to the tragedies of continental wars; and, at the same time, it was the only instrument that could take Italy into the circle of the most advanced countries.

The clarity of this vision helped to persuade Italians of the close correlation between Europe and progress, between Europe and democracy. This correlation has—with the exception of some very short periods—been Italy's guiding force since the end of World War II. It has inspired policies for domestic development and our international alliances. And it has allowed our country, throughout the difficult stages of the European construction, to always play a positive role. Even at times when it was particularly difficult to reach an internal political equilibrium, Italy has always made its weight and influence felt in favor of a greater European integration. Nationalistic voices were hardly ever heard, and only rarely did the interests of small groups prevail over the long-term historical vision—namely, that European integration was the only way to ensure our common future. However trivial this accomplishment might seem, it can be applied to very few countries.

Some might think that transferring a part of national sovereignty to the European level is bound to be easier in a country such as Italy, where the notion of national identity is less clear-cut and less visible than in other European countries. Although this explanation certainly contains some truth, the reason Italy is different also lies, I believe, in the great sense of realism and concreteness of the Italian people.

Most Italians are acutely aware that they cannot play a leading role if they are acting alone on the global scene—something that cannot be said of many European countries in a similar position. At the same time, however, they are eager to accept the only real alternative, realizing that such an objective can only be reached by pooling the forces and resources of many countries. Other European nations have not been able to make such a definitive and coherent choice.

From this point of view, Italy is able to interpret its historical future much better than countries characterized by greater stability and a stronger identity. We have learned all this from history.

To help young Europeans understand the phase that Europe is going through today, I instinctively tend to refer to Italian history, particularly to the role played in the Renaissance by the tiny Italian states. At the end of the sixteenth century, these small states embodied the state of the art in almost all fields: from political science to scientific research, from technology to military arts, finance, and economy. Then, as a result of the transport revolution and geographic explorations (the "discovery" of America), there was, to use a modern-day phrase, what could be called the first globalization.

Unwilling or unable to join forces in order to prove their worth in these new arenas, the small and divided Italian states failed to react to these new challenges. Missing this opportunity to become a nation—and the nation was then the correct measure for answering the challenge of globalization—Italy disappeared from the geographical maps of the movers and shakers. Midway into the twentieth century, this distant lesson from the past was supplemented by the lessons and memories of the war and of nationalism, which provoked the decline of our democratic institutions and the tragic economic and political isolation of Italy.

One could say that the distant and the recent lessons are both instinctively present in the minds and hearts of Italians, even if, naturally enough, they are partly obscured by the fears that always accompany any change. Such fears, which up to yesterday concerned mainly the field of economics, are today focusing on migration and on the loss of certainties that this phenomenon implies for our identity and for our everyday life. I am inclined to think, however, that once again Europe will be seen as a reference and an instrument for dispelling or at least allaying such anxieties and fears.

I personally realized how much Europe matters in the future of Italy when, as Italy's prime minister and together with President Ciampi, I led the campaign to get the Italian lira into the euro system. This clearly implied changing decades-old habits in the behavior of the public and of business, of the world of Italian politics and of public administration. The Italians were almost unanimous in taking up the challenge, accepting sacrifices that in other circumstances would have caused an open rebellion. Nobody in Italy would have hidden his or her shame and frustration if our country had been excluded from the euro zone. The choice of explicitly calling the increase in taxation a "tax for Europe" persuaded them to accept what in different circumstances would have been scorned and violently refused.

If you analyze the last fifty years, you can certainly say that Europe has given a lot to Italy, and Italy in turn has given a lot to Europe. Europe has given Italy a direction; it has given support at times when Italian society was internally divided but had unprecedented opportunities for development and modernization if placed within the adequate international framework.

In various circumstances, both in the period of social transformation in the 1950s and 1960s and in the difficult period of terrorism, the country would have drifted away if it were not for the European anchor. Italy, in turn, has contributed heavily to Europe by courageously making the unification of the continent the constant objective of its policies, even at the cost of national interest.

EUROPE AND THE UNITED STATES: A FRUITFUL RELATIONSHIP

In the last few years, the differences between European policies and those of the United States have often been emphasized. This approach is fundamentally wrong, because the elements of agreement have always prevailed over the reasons for dissent.

The United States and Europe have always marched in the same direction, especially as concerns fundamental issues. Italy has constantly played a constructive role in reducing tensions between the two shores of the Atlantic. The differences between the United States and the European Union are not necessarily an obstacle to the development of an already fruitful relationship: as I said above, the entire philosophy of the EU is based on the value of diversity. The three main lines of development we are now following (the single currency, the pacific reunification and stabilization of the continent, and the implementation of a common foreign and security policy) will make the European Union a stronger partner for the United States, in a constantly developing transatlantic partnership.

Decades of productive cooperation have shown that when we join our forces we can obtain great results. From trade to research and environment, from defense policy to all sorts of multilateral forums, Europe and America can work together and provide the leadership needed to address many global and regional challenges. The growing interdependence of our societies means that we are bound to face the same problems, and that the best solutions will be those that we can work out together.

As for Italy, I am confident that, true to its political tradition, in the coming years it will be, as it always has been, a key player on the European and global stage.

Tommaso Padoa-Schioppa

Italy and Europe: A Fruitful Interaction

INTRODUCTION

IN THE 1990s ITALY CONTRIBUTED DECISIVELY to the advent of a single European currency, even as its debt and budget deficits rose to unprecedented and potentially disastrous levels. The currency was devalued twice, each time by over 20 percent. Political parties that had governed the country since the end of World War II disappeared. In the same decade, Italy had seven prime ministers, and, for the first time in the history of the republic, general elections twice (in 1994 and 1996) reversed the existing majority. In the later part of the decade, inflation and fiscal disorder were tamed, and against all odds, the lira joined the euro from the start. Yet only a few months later, the political system overthrew Mr. Romano Prodi, the prime minister who achieved this goal. Shortly afterwards, the same person was unanimously chosen by his former European colleagues to become president of the European Commission. Yet even with a former prime minister now president of a major European institution, many Italians wonder about the country's long-term ability to cope with the challenges of a single European currency.

Outside observers sometimes formulate the key questions more sharply than insiders who are immersed in daily events. This essay addresses a question that friends of Italy have recurrently asked: how is it that Italy is simultaneously the most pro-European of the European Union's member countries and the least compliant with European norms of business? How is it

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possible to reconcile the strong support of Italians for a united Europe, the effective contribution of its politicians to its construction, the success of its export-oriented enterprises, with the country's permanent delay, with the need to be driven by Europe rather than from within the country itself?

HISTORICAL BACKGROUND

It is impossible to understand Italian attitudes toward the process of European unification without referring to two crucial world-historical phenomena, both centered on the Italian peninsula: Roman civilization and Western Christianity. Universalism is their common feature. By this word one can mean, following Webster's definition, the belief "that all men will eventually be saved," or, in a more secular definition, the notion that all humans share a certain essential worth. From these convictions grew an aspiration to construct an order applicable to all human beings; a disposition to make that order accessible to diverse peoples, cultures, and traditions; and a corresponding awareness of the limits and relativity of every experience, every community, and every institution. Humanism and the Renaissance, perhaps the foremost Italian contributions to modern civilization, have their roots in a combination of Roman and Christian convictions. It was indeed a humanist scholar, warrior, and, later, pope, Enea Silvio Piccolomini, who first used the adjective "Europeaus."

Tribalism and ethnicity ceased to play a role long ago in Italian history. The people living in the country partly belong to ethnic groups that have been there for millennia, partly to groups that arrived from the north and the south, the east and the west in the course of the first thousand years of the Christian era. The wealth of the place, combined, after the fall of Rome, with its political weakness, made the Italian peninsula a natural destination for migrants and conquerors. While Italian is a neo-Latin language, Greeks, Lombards, Arabs, Franks, and Normans have all left an indelible mark on how the language has evolved. For many centuries, the Roman-Christian culture favored assimilation and integration. Then, in the nineteenth and for most of the twentieth century, Italy became a country of emigrants. Only in the last decade, when a new wave of immigrants arrived, did Italy start to meet the challenge of being a multicultural, multiethnic society.

The future is, of course, uncertain. But it is fair to say that the Italian people have a predilection for universalism, both in theory and in practice.

Universalism has also been one of the obstacles to the emergence of a modern unitary state such as those created by the great European dynasties in France, Spain, and the British Isles. When trying to explain the delay in the achievement of Italian political unity, it is commonplace to mention the power of the Roman Catholic Church. Ever since the pope, with the help of Charlemagne, blocked the expansion of the Lombardic kingdom to the whole of Italy, the Church has viewed a strong Italian state as a threat to the conduct of its mission. Similarly, it is often suggested that the lack of a Protestant reform deprived the country of one factor, a "nationalization" of religious life, that led in other countries to the creation of a modern nation-state.

Both observations have merit. The Risorgimento in fact unified Italy largely against the will of the pope and the clergy. There has been no special link between the Church and Italy as such; there has been no "Church of Italy" as there has been a Church of France or a Church of Spain. And if for many centuries popes were always Italian, it is perhaps also because this provenance carried little political significance and had a distinctly universal character.

However, an equally large obstacle to the political unification of Italy was the fierce rivalry of the peninsula's many regional city-states. With their magnificent local capitals and courts, these city-states experienced an "international" politics of their own. The competitive and often conflictual relationships between a multitude of small sovereigns impeded the formation of a larger political entity. As a result, the peninsula eventually lost its political independence to foreign powers.

From the Renaissance until the middle of the nineteenth century, important parts of Italy were provinces of foreign kingdoms. The ruler lived abroad. This may explain the mistrust that many generations of Italians have felt for the central government, but also, paradoxically, their relative equanimity at being ruled, in part, from Brussels.

The case of Milan is revealing, and still influences national life. Unlike other celebrated cities in Italy, Milan for centuries did not rule over its own state. It was rather a provincial outpost governed, from afar, by Madrid, Vienna, or Rome. As a result, Milan developed a municipal rather than a state political culture. Since the capitals of which it was a prosperous provincial town were so remote, the conviction developed that state affairs were not so relevant after all. The citizenry took pride in adopting an unideological, matter-of-fact outlook on public affairs. As the most wealthy and modern center of the country, the city and its attitudes have influenced the way Italians have approached national life. And it is not entirely by accident that Milan has served as a springboard for various political figures—Mussolini, Craxi, Berlusconi—who rose to national power on the basis of antipolitical sentiments.

During the centuries when the country was largely ruled from abroad, important Italians played key political roles in other European countries, where powerful dynastic states offered them more opportunities for the expression of their talents. One thinks, for example, of Alberoni in Spain, Mazarin in France, and Eugenio of Savoy in Vienna. One could thus speak of an active diffusion between Italy and the rest of Europe, not only in cultural and economic life, but even in public life.

The lack of Italian statehood did not mean a lack of nationhood, if by that we mean a shared language, shared habits and traditions, and a shared cultural identity. As a matter of fact, a shared cultural identity emerged in Italy earlier than in other parts of Europe. The Italian language forged by Dante is much closer to the Italian presently spoken on television than the written or spoken idioms of the late thirteenth century are to today's French, German, Spanish, or English. Indeed, Ronsard and the Pleïade Group, Luther, Cervantes, and Shakespeare fixed their respective national languages only some centuries after Dante. The diversity of communal and regional traditions, the strong attachment of every person to the native bell tower (or even, as it is still the case in Siena and other cities, to the town district), the rivalries and conflicts between Italian states and *signories,* did not exclude strong common traits, nor did they cancel, in cultivated strata of society, an awareness of "Italy" being an identifiable whole of which they were parts. The great figures of Italian culture (from Dante and Petrarca to Machiavelli, Vico, and Manzoni) were acutely aware of the handicap constituted by the division and political fragmentation of Italy. As for many centuries European elites looked at Italian culture (in music, theater, poetry, architecture, and painting) as a model, so did Italian political elites look at Europe as the source of new ideals and new models that could foster political progress in Italy. Statehood was generally not seen as a necessary support of nationhood, and nationhood was not seen as a value that needed to be coupled with power or asserted against others. It is probably because of this elastic and loose relationship between nationhood and statehood that, in spite of recurrent separatist temptations, national unity is not seriously threatened by regional particularism in Italy today.

While Italy, as Germany, in the nineteenth century finally succeeded in complementing the reality of the nation with the creation of a unitary state, the distinct features that characterize the Italian national tradition did not get lost. Of course, the creation of an Italian unitary state was primarily the achievement of the political and military genius of Cavour, who did not refrain from the use of arms. Yet even during the Risorgimento—the cultural, political, and military movement whereby Italy became a nation-state—nationalistic elements were remarkably weak. The key words were unity, freedom, and independence, rather than power, conquest, or state. In the thought of Giuseppe Mazzini, the main prophet of Italian unity, the universalistic approach was explicit. The nation was seen as a bridge between the individual and mankind. The moderate wing of the patriotic movement did not advocate the creation of a fully fledged nation-state, but rather favored a loose confederation of the city-states in whose public life they were themselves actively engaged. Both Mazzini and the Catholic adherents of the Risorgimento saw the unification of Italy as a step toward the unification of Europe.

After becoming a nation-state, Italy experienced a period of aggressive nationalism. Nationalist sentiment came in two waves:

at the end of the nineteenth century, it mainly took the form of colonial wars; then, after World War I, it coalesced around the fascist regime. The first episode should be seen mainly as an outcome of the nineteenth-century romantic ideology of the nation-state and the idea that young nations too should have their own colonies. Fascism had a more complex origin in the experience of World War I, the frustration of the peace settlements, the fears generated by the Bolshevik revolution, and the emergence of the masses as a key factor in political life. What matters here is that in both cases aggressive nationalism proved unsuccessful. Italy had neither the economic and military strength nor the state structure to sustain an aggressive nationalism. The country entered World War II militarily unprepared and without popular enthusiasm. Suffering swift defeat, for two years Italy was partially occupied by its former enemies, partially controlled by its German former ally. By 1945, no taste for nationalism was left.

In the aftermath of World War II, Italy had to be reconstructed in every sense: physically, politically, and morally. It was a poor, predominantly rural country, where the newly established democratic regime was threatened by the strongest Communist Party outside the Soviet bloc. Apart from the funds of the Marshall Plan, its main source of foreign reserves was the remittances of emigrants. Italian political leaders made the strategic decision to anchor Italy to the Western alliance and to the creation of a united Europe. The key figures who designed and implemented this strategy—De Gasperi, Einaudi, Sforza, Saragat, La Malfa—were acutely aware of the structural weaknesses of Italy. They felt strongly that only through a full participation in the key initiatives of other European countries with more solid democratic traditions could Italy consolidate its own political system. As a result, Italy's active involvement in European integration became a key ingredient in the country's postwar foreign policy, and this involvement was consistently maintained by successive governments and foreign ministers, irrespective of party composition and affiliation. One explanation for this continuity has been the pro-European attitude of the career officials serving in the Ministry of Foreign Affairs. Successive generations of officials in the foreign service have provided a rare example of the competent and consistent implementation of a judicious policy.

It is true that Italy has developed a sort of natural disposition to promote, and participate actively in, the process of European unification. It is no less true, however, that the country has lacked some of the key instruments effectively used by other countries to influence this process and take full advantage of it. Such instruments include administrative skill in the handling of state affairs, a trained instinct for the perception of the national interest, a capacity to overcome internal divisions and rivalries when the national interest is at stake, and an ambition to play a larger role on the world stage.

As is natural, both the contributions and the obstacles that each member country brings to the EU grow out of distinctive features of its national heritage. The diversity of national heritages is what enriches the endeavor and makes it so arduous. To fully appreciate the case of Italy it is useful to compare it with some other countries.

Consider, for example, Germany. Both Italy and Germany had a long history of internal division. In both, nationhood preceded statehood, and political unity was achieved only in the second half of the nineteenth century, under the influence of a romantic ideology that emphasized the mission of the nation, and thanks to the impulse of one of their states (Prussia, Piedmont) that had risen to military prominence in the previous century. Both countries had disastrous experiences with imperialism and aggressive nationalism. And in the years since both countries were defeated in World War II, both have reconstructed themselves as loyal members of a united Europe.

Despite these similarities, the differences between Germany and Italy are no less significant. Discipline, thoroughness, and single-mindedness are often seen as prominent characteristics of the German people; fantasy, inertia, and unreliability are widely attributed to Italians. Politically and economically, Germany is a strong and stable country, on the verge of becoming a major player on the world stage; Italy, in spite of all its postwar progress, appears unstable and shaky, a latecomer in the G7. The universalistic character that has marked Italian culture for more than twenty centuries cannot be found in

Germany until the late eighteenth century, in spite of the global ambitions of the Holy Roman Empire. Ethnicity has long been seen as the basis of the German nation, while it has played no relevant role in Italy. The ideals of liberalism and tolerance that drove political unification in Italy could not be further from the principles of power and hierarchical authority (*Obrigkeit*) that inspired German unification. Trying to explain these differences would carry us too far. What matters here is this: for Italy, as for every other member state, the national heritage that helps to explain its present relationship to Europe is unique—even when some of its elements are shared with other countries.

THE COMPROMISE EUROPE

Obviously, the current relationship between Italy and Europe also depends on the peculiar characteristics of the European Union. For present purposes, two such characteristics are especially relevant. First, member states are expected to play an important and active role within the EU. Second, the EU is an ongoing process rather than a fixed institution.

The importance of the role played by member states in the EU derives in part from the very nature of the EU. It is widely recognized that it has been from the start a combination of federal-supranational and confederal-intergovernmental elements: it is neither the American Confederation of 1776 nor the United States of America of 1789.

In some important respects, the European Union contains, in an embryonic form, all the elements of a federal state. Using, for the sake of clarity, a comparison with the U.S. system, the EU has presidential functions entrusted to the heads of state and government (the European Council, meeting four times a year), an executive branch (the European Commission), a shared legislative power jointly entrusted to a representation of member states (the Council), and a directly elected Chamber (the Parliament). The EU, finally, has a "supreme" judiciary (the Court of Justice). Citizens of the member states are also citizens of the EU. Supremacy of European law over national law is recognized.

In other respects, however, intergovernmental and confederal elements are more salient. In the first place, the EU's founding documents, while the equivalent of a constitution, retain the character of international treaties. Second, the internal functioning of the organs and institutions of the EU retains procedures and provisions (such as the requirement of unanimity even for rather minor decisions) that are not found within a state and are typical of an intergovernmental decision-making process. Third, national governments often play a dominant role in both the legislative and executive areas, through the Council of Ministers. In various matters, the Council can still legislate against the will of the elected Parliament and limit the power of the Commission in the implementation of policies. The Council mainly functions as a forum where national interests are reconciled. In the EU, key constitutional principles formulated by political philosophers in the age of Enlightenment, such as the majority rule and the equilibrium of powers, fail to be fully respected. Last but not least, the EU has limited powers. Not only does it lack the "universal" power of the centralized nation-states created by the European monarchies; it also lacks any power to provide key public goods, such as national security. Only recently has the EU made some first steps in this direction.

Although in its early days the EU was seen by its advocates as spelling the end of the nation-state, the member states have been assigned key functions, even in fields where the competence of the EU was fully acknowledged. This was probably the only viable route to union. Even today, the sentiments for preserving the nation-state are too strong to defeat or ignore. Thus, in Europe politicians and policymakers as well as ordinary citizens continue to refer primarily to the power structure of the nation-state, in spite of rather wide popular support for the idea of a united Europe.

National sentiment plays an active role in the exercise of "federal" powers. A few examples may suffice. In the United States, the "Chamber of the States" is composed of senators elected to a federal body and residing in the federal capital. In the EU, the analogous Council of Ministers is composed of members of national governments who are expected to pursue a national interest. Federal law in the EU mainly takes the form of directives that only become applicable through national legislation. The enforcement of European legislation is primarily the responsibility of national courts. Financial support for EU policies depends on the support of national authorities. In sum, nation-states, far from disappearing, have become the essential gears of the EU mechanism.

Nation-states contribute to the functioning of the EU not only by cooperating, but also by competing against each other. Indeed, competition is one of the instruments meant to achieve the objectives of the EU. Of course, any federally organized state leaves a great deal of discretion to sub-federal entities. What is unusual about the EU is the fact that the very objective of the EU—a large multinational common market—is an engine fuelled by competition. Had common security been the primary object, the EU would doubtless have taken a different form. In the EU as it is, local political actors collaborate with corporate actors to pursue their self-interest, not the common good of the EU. In fact, a principle of competition among national rules and regulations was deliberately adopted in the mid-1980s to build the common market. Instead of pursuing a full harmonization of national rules and regulations as a precondition for the opening of national markets, integration has been based on a very limited body of universal European laws, supplemented by a mutual recognition of national laws. Every member state is thus encouraged to make its public policy as favorable as possible to its own welfare, subject only to universal laws and the principle of nondiscrimination. This competitive game allows states to experiment with different policy approaches. But it also perpetuates national rivalries.

The creation of a united Europe was not conceived as a single and comprehensive constitution-building event, such as the 1789 convention in Philadelphia that created the United States. The EU is, instead, a dynamic process. It started with the limited but path-breaking decision to have a supranational authority manage the coal and steel industries of member nations. Then came the Treaty of Rome and the progressive implementation of its program. Successive amendments to the treaty broadened its scope and strengthened its instruments and procedures. The replacement of national currencies with the euro and the creation of the European Central Bank were part of this process. So were Schengen (i.e., the abolition of physical frontiers for a group of EU countries), the initiation of a common foreign and security policy, and the setting in motion of cooperation in the fields of internal security and judiciary action.

The dynamic and incremental character of the EU, like the combination of federal and confederal elements, is largely the result of a tactical choice, in the words of Jean Monnet, "*se concentrer sur un point précis qui entraîne le reste*" ("to concentrate on a specific area that implicates other areas"). As noted above, the popular roots of the nation-state were too powerful to separate statehood from nationhood at the start of the EU. Sentiment for shared sovereignty had been developed by overcoming cultural parochialism and generating new transnational interests.

The product of this approach has been a very peculiar institutional system. While most organizations tend to be static, the EU is dynamic. Like a bicycle, it remains upright only if it is moving forward.

The dynamic character of the EU's constitution has required European policy to be conducted simultaneously in a variety of modes. First, the established powers of the EU must be exercised. Second, policymakers must pursue objectives and programs laid out by the Treaty of Rome, but not yet implemented. Third, the EU must arrange for the progressive accession of new members, from the core six onward. Fourth, the Treaty requires periodic revision to strengthen its instruments, enlarge its scope, and move the EU forward. Different institutions and bodies within the EU are involved in this multi-tier action in different ways. Keeping the EU dynamic requires active leadership and vision, and particularly an ability to set new objectives. The type of political talents required bears scant resemblance to those required in a traditional nation-state.

ITALY AS FEDERATOR

This complex historical background may help to explain the fruitful character of the interaction between Italy and Europe in the postwar period. In a fortuitous way, the features of Italy and those of the emergent EU, as described in earlier sections, have formed a special and surprisingly productive amalgam, benefiting both. In a united Europe, Italy found a congenial ground for its own growth into the league of prosperous democracies; Europe, in turn, found in the Italian political tradition a deposit of precious ideas, methods, and attitudes, from which it drew repeatedly and successfully. Indeed, Italy has played a consistently positive role in the construction of the EU. At the same time, European factors have much influenced the economic, social, and political change experienced by Italy in the last fifty years.

In the following brief review, I shall first examine Italy's role in the making of Europe. At the outset, it was a second-level player, working within a framework set primarily by the Franco-German partnership. Indeed, France and Germany were the two most influential nations on the continent, and the very idea of a united Europe was based on the need for their reconciliation. These were the two countries that had fought each other in three bloody wars between 1870 and 1945. And from France came Jean Monnet, the key architect of the unification process, the man who invented and implemented the dynamic and incremental "functionalist approach" that proved successful. He was also the person who, in Europe and the United States, educated generations of politicians about the idea of a united Europe.

Despite its limited weight, Italy has played a quite significant, and on several occasions decisive, role in the evolution of the EU. It never lost sight of the final goal: the creation of a politically united Europe based on supranational powers. Other countries rarely allowed this final goal to be explicitly used as the reference point for their actions and decisions—but Italy did. Policymakers constantly referred to the goal and did not refrain from reminding their European partners what the ultimate benchmark of common decisions should be. Italy's unflagging support for supranational solutions was only occasionally shared by France. Its support for the EU was even more staunch than Germany's, partly because Italy did not have to filter its positions through a special relationship with France, and partly because its smaller political weight made it easier for Italy to resist the temptation to go its own way.

One of Italy's main contributions to the making of Europe has been the elaboration and propagation of ideas, not least by such thinkers as Einaudi, Spinelli, and Albertini.

Luigi Einaudi (1874–1961) was a distinguished conservative economist and writer, highly respected inside and outside Italy, who exerted a powerful intellectual influence in the first half of the twentieth century. After World War II, he became governor of the Bank of Italy, a member of the Constituent Assembly, an architect of postwar economic stabilization, and the first president of the Republic. Long before, in a series of classic articles published in 1918, Einaudi had urged the creation of a European federal state as the only way to establish a lasting and peaceful order in Europe. Again in 1943, he argued that the time had come to take away from the nation-state the power to print money, and to attribute it to a supranational authority. Under Einaudi's influence, a provision was introduced in the postwar Italian Constitution stating explicitly that Italy welcomes, on "condition of equality with other states, the limitations of sovereignty that are necessary for an order that ensures peace and justice among nations."

Altiero Spinelli (1907–1986) is the author of the so-called Ventotene Manifesto (1941), the founding text of the European federalist movement, not only for Italy, but for most European countries. He entered prison before his twenties as a communist conspirator and spent sixteen years in jail. There he read widely in philosophy, literature, and political and economic thought, broke with communism, and reached the conclusion that Einaudi had reached in 1918. After the war, he was for more than thirty years an advocate of the EU, influencing leading Italian politicians in all parties. In the 1970s, Spinelli served as a European commissioner in Brussels. Subsequently, as a member of the first directly elected European Parliament, he organized and led the project for a new treaty, helping to transform the EU into a federal system. This work won support from the vast majority of all national and party groups in the European Parliament and launched such seminal ideas as the principle of subsidiarity, the generalization of majority decisions, and the co-decision of the European Parliament.

Mario Albertini (1919–1997), a political scientist, was the head of the federalist movement in Europe for more than forty years. His life was entirely devoted to the goal of European union. He wanted to turn Europe into a real multinational democracy, politically legitimated by popular consensus. In the 1950s, he organized the federalist movement as a precursor to today's nongovernmental organizations, winning independence from governments and established parties of the Left and the Right and helping to mobilize public opinion at critical junctures. At a time when the European Community was widely regarded only as an economic alliance, Albertini grasped the importance of political action. His intellectual contribution to the making of Europe—which he elaborated in the review *The Federalist*—can be summarized in three basic points. First, he was an outspoken critic of the model of the nation-state and the political ideology based on it. Second, he elaborated a theory of political federalism that led to the conclusion that unifying Europe should be seen as part of the process of unifying mankind and building world peace. Third, he insisted that democratic support through the participation of citizens was necessary to set European political union on a sound constitutional basis.

It is always difficult to measure intellectual influence. Still, in different ways and at different moments, Einaudi, Spinelli, and Albertini all influenced the elaboration of ideas that proved central to the emergence of the EU. Moreover, their thought, and often their advice, shaped the policies of successive Italian leaders, from De Gasperi to Andreotti, Craxi, Prodi, Ciampi, and D'Alema.

Turning from ideas to action, Italy's strategy toward Europe has been consistently governed by a few clear assumptions. Two of them should be emphasized: first, the conviction that Italy's national interest is well served by the progress of European unification. The memory is still alive of an instruction given by an Italian ambassador to his subordinates engaged in a negotiation in the 1950s: "Whenever there is a discussion between alternative solutions, your task is to support the most pro-European one." Second is the conviction that Italian political actors in Europe had to recognize the limits of their power. As long as the so-called Franco-German axis was effectively promoting a united Europe, it was generally felt that Italy should not oppose it. Rather, Italy should complement the axis by exploiting the dialectics of the Franco-German relationship. In the field of monetary union, to give just one example, Italian diplomacy effectively reconciled the French desire to end the dominance of German monetary policy with the unwillingness of Germany to settle for less than a treaty-based European central bank.

In promoting the EU, Italian politicians have often shown admirable resourcefulness and determination. In some cases, typically Italian devices, some of them rightly deplored in the domestic arena, proved useful in the European context. A few examples make the point: delaying decisions when agreement was hard to reach, searching for support from the opposition, aiming at consensual decisions acceptable to any participant in the governing coalition, etc. The pro-European policy and its techniques became, over time, part of the political culture of Italian politicians, officials, and analysts. They did not need to be explicitly imparted, because most persons involved in European matters almost instinctively thought and acted according to them.

Italy in the postwar period made four crucial strategic contributions to constructing the EU. The first was to break the vise of unanimity. When a decision requires unanimity, rather than a simple majority, a minority can block action. In the context of the emergent EU, this practice privileged the national perspective. On countless occasions, Italy advocated majority votes in the EU. But three episodes stand out, each of which fostered important and otherwise impossible advances. In 1977, under the influence of Prime Minister Moro, the European Council in Rome bypassed the opposition of two countries and set a date for the first direct election of the European Parliament. It was thus decided that elections would be held even if the United Kingdom and Denmark refused to participate (which in fact did not happen). In June of 1985, at the European

Council held in Milan, Prime Minister Craxi and Foreign Minister Andreotti unexpectedly, and for the first time, applied the majority principle to the call of an intergovernmental conference to amend the treaty. That conference passed the Single European Act that opened the way to the implementation of a common market. The third episode occurred in October of 1990. Under the leadership of Prime Minister Andreotti, Italy masterfully used successive rounds of bilateral negotiations to transform the essential elements of the Delors Report on Economic and Monetary Union, i.e., a technical blueprint, into an act of political will, binding the ensuing intergovernmental conference. It is not an exaggeration to say that the last twenty years of European developments would not have been the same without those three episodes.

Strengthening democratic control in the EU is the second major strategic contribution Italy has made to the EU. Italian policy in Europe has been directed toward the objective of assessing the legitimacy of the EU on the democratic principle, not only on the procedures of international agreements. This was, and to some extent remains, a very innovative aspect of European integration. In spite of vast popular support for a united Europe, the actions actually undertaken by the EU have retained the character of international negotiations. Moreover, the provisions of the treaties themselves granted only marginal influence to the European Parliament, relying instead on intergovernmental cooperation. Over time, the lack of democratic control became a major impediment to the further development of the EU. In response, Italy promoted direct election of the European Parliament. In addition, the country has been a consistent advocate of European democratic control. In 1951–1952, for example, De Gasperi, advised by Spinelli, inserted a provision (Article 38) in the European Defense Community Treaty, instructing its Parliamentary Assembly to draw up the statute of a "European Political Community." In 1979–1984, in the first legislature of the elected Parliament, Spinelli, as rapporteur on the Community budget, convinced the Parliament to reject the budget, making use of the strongest democratic power granted at the time by the treaties. In the same legislature, Spinelli obtained overwhelming approval for the draft treaty on the European Union. In 1985, the Italian government made the Italian ratification of the Single European Act conditional on a positive vote in the European Parliament, thus effectively elevating its role.

Avoiding the so-called *juste retour* (fair reward) approach has been Italy's third formative strategic contribution to the EU. In EU jargon, *juste retour* is the claim, made by every country and for each EU decision, of a reward that is not inferior to its share in the cost. Over the years, Italy has refrained from making such claims, forcefully warning that the very idea of *juste retour* runs counter to a genuine union and would eventually destroy it. Although fairness is indispensable, no one would use *juste retour* to decide whether a region should continue to be part of a state. Italian delegations in Brussels were generally instructed to favor the achievement of a "European" agreement, even at some national cost.

What can be said for national negotiators in the European Council can also be said about Italian officials serving in the Commission and in other European institutions. More frequently than their colleagues from other countries, Italians tend to adopt a European point of view. They have inestimably strengthened the supranational character of the EU and its key institutions.

Keeping the EU open to new members has been Italy's fourth key strategic contribution to the EU. According to a principle enunciated in the Paris Treaty and reiterated in the Treaty of Rome, "any European state may apply to become a member." Openness on an equal footing is indeed a defining feature of the EU, one that differentiates it both from an alliance of states and from an organization like the United Nations, where the founders still retain special privileges. Italy has supported openness even in the case of new Mediterranean members who were bound to become competitive producers of such products as olive oil and citrus fruits. Lorenzo Natali, Italian commissioner in 1976–1988, worked tirelessly to counter anti-enlargement sentiments, helping pave the way for Greece, Portugal, and Spain, in turn, to join the EU.

Italy's strategic contributions to the EU have played a key role in keeping the EU dynamic. A closed group of countries that stipulates to act together through procedures divorced from the political process, only when all agree, only if each member draws—from the specific action—a benefit equivalent to its contribution: this is the kind of Europe we would have today if the four principles had been completely disregarded. Those principles had been inscribed in the treaties from the start, with clear Italian support. And although Italy's strategic commitments have sometimes met with powerful opposition, over time they have gained ground and extended their field of application. This owes much to the fact that Italy has consistently and shrewdly acted in support of the key principles.

EUROPE AS REFORMER

Observers of Italy, inside and outside the country, often note that the strongly pro-European sentiment of the government and public opinion are matched neither by political influence within the EU, nor by punctual compliance with EU rules and guidelines. The previous section has shown the impact of Italy on the EU. This section, on compliance, presents more of a mixed picture. On the one hand, Italy has often failed to implement EU rules in a timely fashion. On the other hand, the EU has deeply and pervasively influenced Italian policies over the last fifty years. On the whole, it would be a mistake to suppose that Italy has had only a nominal relationship with Europe over these years.

Between 1953 and 1998, Italy was brought to the European Court of Justice 355 times for failure to fulfill obligations—twice as many times as France, and triple the number of times Germany was so arraigned. While Italian governments were keen to launch European initiatives, they were often reluctant to implement them, demanding long transition periods or failing to meet the deadlines, or both. Essential parts of EU legislation became effective in Italy only years after they had been implemented in other countries, often putting Italy's economy at a comparative disadvantage. In Brussels, the Italian administration won the reputation of being unreliable. This reputation was only aggravated by Italy's cumbersome parliamentary procedures, delays in the transposition of EC directives into national legislation, frequent political crises, and the carousel of different ministers representing the country at European Council meetings.

Dramatic episodes further contributed to the deterioration of Italy's image: the decision of the first Italian president of the European Commission—Franco Maria Malfatti—to leave his post in 1972 to assume low ministerial responsibilities in Rome; the undistributed tons of publications on the EU; the failure of the local administrations to spend the funds they had been granted by the European Community; the impunity granted for years to private and public bodies not complying with European Community rules.

Italy's performance has improved over the years, so the country is no longer the weakest pupil in the class. For example, the percentage rate of Internal Market Directives not yet transposed fell in 1999 below the 4 percent threshold, which is considered normal by the Commission. At the same time, the rate of utilization of EU funds and instruments has markedly risen. It nevertheless remains true that Italy's administrative inefficiency, the endemic instability of its political system, and the consequent lack of continuity in its government policies make it difficult for the country to flourish within an EU in which the most successful countries have efficient bureaucrats with a command of technical details and tenacious negotiators with long memories.

This bleak picture, however, does not tell the whole story. The disposition of the country to welcome European influence should play no small part in a meaningful definition of "compliance," in spite of the fact that such a disposition is not easily measured by statistical indicators. Looking at compliance in this broader sense, it appears that Italy, more than other countries, has embraced the pervasive influence of the European process on its political evolution. Over the second half of the twentieth century, the country experienced a number of radical transformations, almost all of them triggered by the wish to join a larger community of Europe.

Consider, for example, how Italy has been reconstructed as a nation-state. The distinctive features of Italy among European nations were fruitfully reinforced by the process of European unification that started at the end of the 1940s. That process offered a historical opportunity to make Italian universalism not only a culture, but also a public policy. This is one reason that the meeting between a nation with a relatively weak state, such as Italy, and a "state in the making," without nationhood, such as the EU, has proved so remarkably productive for both sides.

When Italy emerged from the war physically and morally destroyed, its dignity and self-respect needed to be reconstructed. The task was made more daunting by the fact that the key agents of postwar reconstruction were political parties dominated by Catholics (the Christian Democrats) and Marxists (the Communists). In spite of their profound differences, both of these parties were rooted in ideological traditions alien to the Risorgimento; although both parties lacked any deep adherence to the principles of political liberalism and economic freedom, both were strongly committed to universalism in theory and practice. For both, internationalist goals were ultimately more significant than national ones.

Active participation in the endeavor to unite Europe was a major factor in the reconstruction of Italy as a nation-state. Indeed, Italy's multifaceted role in European integration had a positive impact on the country itself. The making of Europe offered Italy the opportunity to play a strategically important international role in a way that the European "concert of nations" of the previous centuries had not.

In these years, Italy, once the richest region of Europe, dramatically recovered its economic vitality. When the European Community was created, Italy ranked far below its five partners in terms of all relevant indicators of welfare and affluence. Most of its citizens lacked not only such recent inventions as domestic appliances, telephones, and motor vehicles, but also such basic goods as housing, adequate health care, and basic literacy.

Although not exclusively (recall the major contribution of the United States), Europe helped Italy out of poverty, turning it into a modern and affluent nation. Between 1950 and 1990, the average per capita income of Italians was multiplied by five. In the same period, the share of agriculture in the economy fell from 20 to 3 percent. People moved from the fields to the cities, from the South to the North.

Since the route initially chosen to unify Europe was an economic one, and Italy was economically weak, there were intense debates about the pros and cons of struggling to join with the rest of Europe at every important junction of the route: the custom union, the common market, the single currency. Sometimes European and domestic policies were in patent contradiction, as in 1989–1991, when the Italian government helped negotiate the Maastricht Treaty while running large budget deficits. Hence Italy's paradoxical reputation as a non-compliant pro-European nation.

At every junction, a divide emerged, between those who trusted and those who mistrusted the country's economic capacity to meet the challenge of full participation. The skeptics included not only those with a vested interest in a closed economy, but also independent and respected figures who simply took a pessimistic view about Italy's economic prospects. Repeatedly, political leaders confident about Italy's economic potential have prevailed, committing Italy to meet European norms, knowing that this would force reforms impossible to obtain in any other way.

In retrospect, it must be recognized that the challenges never proved disproportionate to the capacity and deepest will of the country. Indeed, on many occasions, due to deep-seated cultural attitudes, the challenge itself became the activator of energies and qualities that would perhaps otherwise have remained dormant.

The resurrection of the Italian economy was primarily the achievement of a seemingly inexhaustible supply of talented entrepreneurs, many drawn from the lower social strata of manual workers, artisans, and peasants in the Italian provinces. First-generation industrialists created fast-growing, export-oriented, innovative enterprises in such product branches as mechanics, food, machine tools, domestic appliances, fashion, and textiles. In many cases, a small firm would become a world leader in the market for its own product. The secret of this astounding success was a peculiar blend of very mixed motives: an ambition to succeed, a longing for independence, pride in artisanship, a passion for work, a taste for design—but also greediness and a sporting interest in cheating the state by evading taxes and circumventing regulations.

The creation of the European economic community did more than create a vast export market for a new class of entrepreneurs, just as the mechanization of agriculture was driving millions of families out of the fields. The common market also transformed the economic system, turning Italy into a modern, albeit not fully realized, capitalist economy. At the start, in the mid-1950s, the "four freedoms"—freedom of circulation of goods, services, capital, and persons—that constitute the basis of the Treaty of Rome were notably missing within Italy. Various forms of forced savings prevented citizens from investing capital freely. It was illegal to create a new bank and open a new shop without prior government approval. Even the ability to establish official residency anywhere in the peninsula was inhibited by law. The country was stuck with a mixture of corporatism, statism, and capitalism, standing at a juncture between a command economy and a market economy. European integration became a powerful factor pointing Italy, in a progressive and consistent manner, toward modernization, openness, and emancipation from the Roman Catholic and communist churches.

The EU also encouraged policies that addressed problems of economic backwardness in the Mezzogiorno and other parts of Italy. For many years, Italy has been a primary recipient of European Investment Bank (EIB) loans, and the EU has been a prime source of funds for the Mezzogiorno. The same can be said for the European Regional Fund. This was not only important in quantitative terms; it also forced an improvement in the transparency of Italian financing practices.

Finally, the influence of Europe has been crucial in restoring price stability and budgetary equilibrium. Both were lost in the early 1970s, under the impact of wage demands, the two oil shocks, and the progressive adoption of necessary but often ill-designed social legislation in such fields as labor relations, pensions, and health care. Participation first in the European Monetary System, then in the Single Market, and finally in the European Monetary Union persuaded policymakers to abandon indexation mechanisms, to moderate salaries, to increase tax revenues, and to control public expenditures.

Given the predominantly economic content of the EU, its strongest influence has been on economic institutions. Italy's 1948 Constitution had been drafted in a way that kept the options open between a centrally planned, Soviet-style command economy and a market economy. At the time, the laws regulating economic activity were incomplete, sometimes obsolete, and often in conflict with basic constitutional freedoms. Many of the key institutions of a modern market economy had yet to be created.

The Treaty of Rome and the subsequent body of European law forced Italian lawmakers to resolve the ambiguity of the Constitution through a thorough revision of the legal code as it affected every field of economic activity. Fundamental laws concerning the banking and financial sectors were rewritten, and the independence of the Central Bank was achieved. New public agencies were created to regulate the markets for securities, the energy industry, and telecommunications. Anticompetitive practices were subdued. Since state aid for chronically unprofitable firms had to be curtailed, the government started to sell state-owned assets. What had been public monopolies became open to private competition.

At the same time, the integration of Italy with Europe also inspired reforms in fields outside of the economy. Two examples are especially relevant. The first concerns parliamentary procedures. For many years, Italy was chronically behind schedule in its implementation of European laws. More importantly, fiscal responsibility was seriously deteriorated at both central and local government levels. In 1989, the need for quicker compliance produced one of the first major postwar reforms of legislative procedure in Italy. The so-called La Pergola law delegated a great deal of power to the executive, in order to facilitate a speedier discussion in Parliament. Similarly, between 1993 and 1999, largely under pressure to meet the convergence requirements of the EU, new budgetary procedures were introduced through successive reforms in the legislative procedures of the Parliament.

The second example of EU-inspired transformations outside the economy concerns the structure of the state. After 1861, the administrative structure of the newly founded Kingdom of Italy was organized according to the French model of centralization. The regional decentralization anticipated by the 1948 Constitution was belatedly implemented in 1968, but then in a merely token manner. Only in recent years has federalism become a salient factor in the internal reform of the Italian state. This was partly due to the fact that integration with Europe had made key political actors more familiar with the theory of federalism. But it was also due to the influence of the Northern League, which exploited popular fears that Italy was in danger of being cut out of the EMU because of the excessive centralization of the state.

Finally, the ongoing integration of Italy with Europe has had a clear impact on the party system. For most of the postwar period, Italy was virtually a one-party (or, rather, one-coalition) state. Like pre-Mitterrand France and pre-Brandt Germany, Italy did not experience an essential feature of a true democracy: the coming to power of an opposition party. Moreover, there were serious reasons to think that the country could not afford to experiment with true democracy, since two of the major opposition parties, on the right and on the left, were themselves antidemocratic. The ruling Christian Democrats launched irresponsible policies, and the lack of an eligible opposition gradually allowed a deterioration of ethics to creep into public affairs.

As this situation became more and more precarious in the 1980s and 1990s, the EU played a major role in shoring up the political process. It did so first of all by providing a steady focus for policymakers. The pro-Europe stance of successive prime ministers and foreign ministers, based on the strongly pro-Europe attitudes of the people, became perhaps the most important unchanging element in the policy platform of successive governments. Second, the European Parliament enabled members of the Italian opposition parties to meet politicians from other European democracies, who encouraged their Italian colleagues to seek democratic legitimization. As a result, the opposition parties started to revise their programs and positions. For the Communist Party, a change in attitude toward the EU became the first tangible sign of a democratic transformation that was only completed after the fall of the Soviet Union. For the extreme Right, the change came in the second half of the 1990s, with its participation in the Berlusconi government and the decision to ally in the European Parliament not with the French group around Le Pen, but rather with the Gaullists.

LOOKING AHEAD

As we have shown, Italy has effectively contributed to the making of the EU. The EU, in turn, has been a major factor in the reform of Italy's economic, political, and institutional system. However, a skeptic might object, perhaps Italy is only coming to the end of a particularly propitious period of reform. Such a worry is legitimate. Italy has yet to complete the transition to a well-functioning political system, it has yet to overcome the problem of the Mezzogiorno, it has yet to move from micro to macro capitalism, and it has yet to consolidate the profound change in habits and social attitudes that marked the recent past. It is possible that the current spirit of pro-European reform may dissipate. What follows then is an attempt not to predict the future, but rather to explore some of the factors at play.

Some important factors suggest that the fruitful interaction should continue. Neither of the two veins that have nourished the European and the Italian evolution of the last two decades seems to be exhausted. The EU is still unfinished and incomplete, and the deepening of the union still requires the distinctive contributions that Italy has consistently made. No other important EU country has so consistently stressed the need to strengthen democratic controls, to avoid a narrow cost-benefit approach, to welcome new members, and to avoid the paralysis entailed by always requiring unanimity. At the same time, Italy has not yet reaped all the potential benefits of European influence on its politics as it develops into a modern nation-state. Above all, the deep historical and cultural roots of the Italo-European relationship are unlikely to wither away any time soon.

Still, a growing divergence between Italy and Europe is also possible, and one detects some signs that it may already be underway. The long and fruitful interaction between Italy and Europe was not only due to historical and cultural traditions; it was also due to more contingent circumstances that have disappeared over the last decade.

Consider, to start, the end of the bipolar world order. In a bipolar world with Central and Eastern Europe belonging to the Soviet bloc, and with Italy housing the largest Communist Party in the Western world, the country had a strategic importance exceeding its economic and political strength. Neither the United States nor its Western European partners were willing to let Italy opt out of the EU. On certain occasions, a blind eye was turned to Italian shortcomings, not because of Italy's political influence or economic power or diplomatic ability, but because neither Europe nor the larger Western world could afford to let Italy drift into instability and disorder.

At the same time, Italy's traditionally bipartisan support for pro-European policies can no longer be taken for granted. The pro-European strategy was a pillar of the parties that governed Italy until the early 1990s, particularly the Christian Democrats. Along with NATO, the European economic union was the bulwark against Soviet communism. This policy, adopted in the late 1940s and early 1950s, never changed. In the meantime, the Italian Communist Party gradually jettisoned its traditional platform and began to advocate pro-European policies as well. The result was not only continuity in the European policies toward Italian governments, but also a bipartisan support for those policies.

This configuration started to change in the 1990s. Political democracy and market principles were no longer at risk. Since both the right- and left-wing opposition parties now had a real chance of winning power, policy differences came to the fore that had been muted in the years of the Christian-Democratic-led coalitions. Under these circumstances, it is unclear whether Italy's European policy will remain bipartisan. Abandonment of bipartisanship in European policies would be a major change for Italy and would surely entail a loss of influence.

Until the early 1990s, Italian political life was dominated by personalities formed by the historic dilemmas of the 1930s and the 1940s. Their very long tenure produced a gerontocracy, but also ensured consistency and continuity. In the span of few years, a new generation has now come to the forefront. Almost none of the important political figures of today's Italy had a relevant role before the 1990s. This long-awaited turnover has produced in turn an array of new attitudes and a willingness to reconsider policy assumptions in many fields, including European affairs. Both in the Center-Right and in the Center-Left coalition, new attitudes have emerged that clearly depart from postwar tradition. As head of a Center-Right government, in 1994, Berlusconi appointed two clearly pro-European commissioners, Monti and Bonino, but also a foreign minister who was quite critical of the traditional European line of his predecessors.

In the meantime, economic factors no longer exert the political influence they once did. Particularly in the course of the 1990s, when the political system was in a state of turmoil and the key challenge facing Italy was to qualify for the euro, the pressure to take the road of macroeconomic stabilization came primarily from the international financial market. Having lifted foreign exchange and capital control Italy was fully exposed to the daily plebiscite of the market, which judged Italy on its ability to fulfill the Maastricht criteria in time. Governments had little choice but to strive for compliance with the criteria, and hence to behave in a pro-European way regardless of their political convictions. The success of Prodi and Ciampi in 1996–1998 arose in large part from the confidence they inspired in the international market. Now that Italy is part of Euroland, the market factor may no longer be as powerful as before, although it is still present. The incentive to "behave European" will increasingly have to come from within.

These new circumstances do not alter the fundamental interest of Italy in a strong EU, nor do they justify, in my view, a change in direction of Italy's European policy. The changed circumstances, however, do call for a reassessment of the ways in which the positive aspects of the interaction between Italy and Europe can be preserved. This, in turn, requires a realistic review of the strengths and weaknesses of Italy's position and a renewed commitment to exploit the former and correct the latter.

The main strength of Italy's European policy should remain its guiding vision of the final outcome of the unification process: a democratically and constitutionally based federation of states that should comprise an efficient supranational power that nevertheless preserves a large role for national and subnational levels of government. This vision, rooted in Italy's postwar tradition of political federalism and advocated by Einaudi, Spinelli, and Albertini, has inspired Italian political leaders from De Gasperi to Craxi, Andreotti, Prodi, and D'Alema. The moment is approaching in which a vision like this will stand at the center of debate over the future of Europe. In the spring of 2000, Fischer, Chirac, and Ciampi opened the debate over the European Constitution and the final configuration of the EU. Italy has long held the position to which other member countries now seem to be coming. Its leaders have the advantage of having reflected on European federalism for a very long time. In any process such as this one, the party that has the clearest perception of the common good enjoys an advantage as negotiator. This advantage, which Italy has had in the past, should be an even greater source of strength in the future.

Italy's geopolitical position is also a source of strength. This is due no longer to international bipolarism, but rather to the situation in the Mediterranean area and in Southeast Europe. From the point of view of the economy, human rights, demography, and the peaceful coexistence of religions, these are the two critical frontiers of the EU on which Italy lies. The role Italy can play, and is already playing, in the Balkans and in the Mediterranean region is not only in the interest of Italy—it is in the interest of Europe.

A third source of strength for Italy is the characteristic flexibility of the country. This concerns the economy as well as the social system, the attitudes of people as well as the inclination of organizations, both private and public.

Finally, a considerable source of strength is the public's very strong support for a united Europe. In nations where public opinion is uncertain and divided, governments are seriously constrained in their European policies. It is very common for Italian officials to hear from their colleagues in other EU countries how fortunate they are to be able to operate on the European scene with strong popular support for the very idea of a united Europe.

However, Italy also has some important weaknesses. First and foremost is the inefficiency of the state. This affects almost all the key services provided by the government: law enforcement, education, the regulation of economic activities, environmental protection, health care, immigration, the pension system. In all these areas, the services that Italy provides are often far below the standards for services offered by other European countries. The situation varies from region to region and is generally worse in the Mezzogiorno, thereby contributing to its backwardness. The inefficiency of the state constitutes a major competitive handicap for the economy. For citizens, it is a source of frustration, discomfort, and hostility toward the government, in spite of rising standards of living and greater opportunities for Italians. A number of factors perpetuate the inefficiency of the state. The rules regulating social services are often rigid and bureaucratic. There are too many public employees, and many are insufficiently paid. Some lack managerial skills. The fact that many public employees come from the South and serve in the more efficient and industrialized North only widens the gap between the state and the citizens it serves, aggravating cultural tensions. To make matters worse, the power of the labor unions makes reform difficult.

A second and related weakness of Italy is inadequate domestic competition in many sectors of the economy. The country is increasingly exposed to external competition, but lacks experience with domestic competition in the labor market, the financial sector, the retail sector, the professional services sector—the list of fields in which competition has been thwarted for generations is a long one. In general, Italians are hostile to competitive pressures in all fields, including intellectual and academic activities. In school and university, collusion rather than competition is the norm. The corporate sector, protected for generations, was reluctant to enter the common market and resisted legislation and competition. The labor unions form a cartel that has delayed necessary reforms for decades. By imposing the principle of equal wages in the North and the South, they have dramatically impaired employment prospects in the Mezzogiorno. They tend to block competition and meritocracy in both the private and the public sectors. Anticompetitive attitudes are very difficult to eradicate.

A third and even more insidious weakness could be called a lack of national ambition. Having survived for so long without a strong state, Italians do not expect important collective objectives to be achieved by the nation-state. The dismal experience of imperialism and fascism further discredited, in the eyes of many Italians, national pride. While Spain restored democracy and a sense of national purpose in less than a generation, Italy seems to be capable of national purpose only when on the brink of disaster. When the objective is to lead, rather than to catch up, national ambition seems to be relegated to the fields of soccer and cycling. This lack of confidence also permeates attitudes toward Europe. Thus, whereas in most European countries the anti-European front mainly comprises those who see Europe as an impediment to higher national ambitions, in Italy it is largely composed of those who do not believe that Italy can cope with the challenge of full participation in the EU.

Italy's strengths and weaknesses are not new. They are an enduring feature of the country and its relationship to Europe. What may have changed is that the EU has, in some respects, become less favorable to the Italian configuration of strengths and weaknesses. The bigger the EU becomes, the wider becomes the field of competition. There is no direct incentive to be competitive coming from Brussels or from other member countries. Every country is obliged to offer access to competitors from the whole EU in a nondiscriminatory way. Countries are forbidden to damage their partners but are free to damage themselves by being uncompetitive, inefficient, unfriendly to business, or unsafe.

At the EU level, there is no clearly defined political or administrative mechanism to spur inefficient countries to become more competitive. Now that the euro has been established, there is no clear way for international financial markets to react when a country slides to the rear of the European group. Decline rather than crisis may therefore be the consequence of a poor competitive performance. While these observations cannot predict Italy's future in the EU, they do suggest two areas of concern.

The first is Italy's need to strengthen its fragile state. Paradoxically, the more Europe becomes a political union, the more Italy needs a well-functioning state. The days when Europe could compensate for Italy's political weaknesses seem to be over.

The second area of concern is Italy's national ambition. In order to succeed in the new Europe, the whole Italian establishment, and not only professional politicians, will have to make a special effort. Over recent decades, Italy's European policies were widely supported by popular sentiments and by the political elite. By contrast, businessmen, union leaders, and intellectuals were often more skeptical. A shared sense of where Italy's national interest now lies needs to be hammered out among politicians and the rest of the country's leaders.

CONCLUSION

Over the second half of the twentieth century, the interaction between Italy and Europe has been especially fruitful, contributing to positive developments in both the construction of a united Europe and the reform of the economic and political system of Italy. Italy came to the interaction with a universalistic culture and a tradition of political dexterity, forged through centuries of nationhood without statehood. The Europe that Italy sought to join needed to limit sovereignties through the construction of a new supranational order, after centuries of failed efforts to unite the continent through conquest by one or the other of its component nation-states. Both parties were vitalized by the encounter, because each found in the other solutions for some of its problems.

It is true, of course, that the unification of Europe was primarily the outcome of a reconciliation between France and Germany, the two countries that had most fiercely fought each other in the seventy-five years before 1945. However, without

Italian participation, the initial leap toward supranationalism would probably soon have given way to a drift toward a simple alliance, a *Traité d'amitié* as illusory, precarious, and reversible as the many failed alliances that dot modern European history.

Similarly, if performance is measured by quick compliance with community directives, then Europe's influence on Italy appears questionable. If, however, the impact of Europe on Italy is gauged in terms of influence rather than compliance, then it appears that Europe substantially transformed the economic and political structure of Italy.

Is this fruitful interaction likely to last? It is hard to picture new circumstances quickly destroying the deep roots of the relationship described in these pages. But it would be an illusion to expect those roots to continue to bear fruit without the patient and imaginative action of new gardeners.

Filippo Andreatta

Italy at a Crossroads: The Foreign Policy of a Medium Power after the End of Bipolarity

INTRODUCTION

An intense debate among analysts of international relations revolves around the question of the relative role of domestic politics and international incentives in the formation of a country's foreign policy. Theorist Arnold Wolfers, who suggested that domestic political factors are more salient when international constraints are weaker, made a classic contribution to this traditional debate.[1] One of the most potent variables in determining the strength of international incentives for states is the polarity of the international system. In bipolar systems, international politics is simpler and more structurally determined, while in multipolar systems, politics is more complex and structural determinants are looser, allowing a larger role for national preferences in the formation of foreign policy. Bipolar systems are more static, allowing states to adopt a relatively fixed foreign policy. On the contrary, multipolar systems are more fluid and produce situations that can change very rapidly, complicating the attempts of states to fashion their foreign policy.

Up until the collapse of the Soviet Union, postwar Italy found itself in a bipolar international system, defined by the rivalry between the United States and the Soviet bloc. Italy had well adapted to the Cold War system, in which its membership in the European Community and NATO guaranteed, at low cost,

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international standing and protection as well as economic and democratic development.

The end of the Cold War has unsettled these certainties and left the country exposed to nearby regional conflicts. As a result, Italy has had to raise the profile of its foreign policy in order to deal with these crises and avoid being isolated from its allies. A "new look" has emerged, in which Italian policy is more assertive than during the Cold War. However, the end of the Cold War has also unleashed a number of domestic forces that have destroyed the old political system, but that have yet to produce a stable alternative. In these circumstances, the consensus on which the "new look" rests is still fragile, and Italy could encounter significant risks for its security. In foreign policy, as in other areas, the end result of the Italian transition is still ambiguous.

THE "GOLDEN AGE" OF THE COLD WAR

During the Cold War, Italian foreign policy was undoubtedly successful. Even though the country faced daunting political, economic, and international challenges in the 1940s, successive governments succeeded in securing its membership in the Western alliance, providing a stable environment in which to consolidate democracy and economic growth. In the years that followed, Italy's standing progressively improved while its major interests were protected—and this is what a successful foreign policy should accomplish by any standard. Some critics of Italian policy have painted a negative and amateurish image of passivity. But these criticisms were confined to those, on the Right and Left, who rejected participation in the Western alliance or even in the democratic domestic political system. Their criticism was motivated more by prejudice than by honest analysis.

This is not to say that Italian foreign policy has been perfect. However, given the enormous problems that the country faced after the end of World War II, the considerable improvement in conditions over the last decades represents a major achievement that should not be taken for granted. In 1945, Italy found itself at risk with respect to its international image, its economic development, and its political stability; in 1989, at the end of the Cold War, each of these problems was a distant memory, largely because of careful and appropriate foreign policy choices.

To set this achievement in proper context, it is useful to review briefly the key challenges foreign policymakers confronted in 1945:

- Italy was a defeated country. It had been forced to surrender part of its territory and to limit its military capacities. Defeat was the result of the unskillful and tragic foreign policy of the Fascist regime, whose imperialist tendencies had first turned the country into a junior partner of Nazi Germany, and then thrown the country into an unwinnable war. The Fascist legacy hurt Italy in two ways. On the one hand, it damaged its credibility and created suspicions in the Western alliance, despite its belated attempt to switch sides and join the alliance in 1943. On the other hand, the militaristic rhetoric of the Fascist regime had alienated large sections of Italian society, which now sought in pacifism and neutrality the peace of mind that had been denied them in previous decades. This was compounded by the ideologies of the two main parties in the political system, the Christian Democrats and the Communists, which were inspired by universalistic principles.
- From an economic point of view, Italy in 1945 was in dire straits. Twenty years of autarky had taken their toll. Italy in the 1940s was still a predominantly agricultural society, and its economy was generally uncompetitive. The war had squandered the resources of the industrial sector, while the fighting between 1943 and 1945 had completely destroyed its infrastructure, especially in the North. In other words, the economy was on the verge of collapse. It needed foreign aid in massive quantities. As a result, it simply did not have the resources to pursue an active and independent foreign policy.
- Last, but not least, Italy was a divided country. As soon as it had recovered from the civil war between supporters and opponents of Mussolini, the country staged a constitutional referendum that abolished the monarchy by a narrow margin.

> When the Cold War reached its height, a profound political cleavage emerged between an extremely popular Communist Party and the coalition of pro-Western democratic parties that had won the 1948 elections. The presence in Italy's democratic system of the most sizeable pro-Soviet political party in Western Europe threatened the country's membership in the Western alliance and its stable adherence to Western social and economic norms.[2]

Under the circumstances, it is not surprising that Italy was ill equipped to face the escalating tensions of the early Cold War, not least because of its geopolitical proximity to the Iron Curtain. Nevertheless, Italy managed to secure its status in the Western bloc. The process of European integration ensured an international environment conducive to economic and democratic development without alienating the Communists.[3] These accomplishments were made possible by a sober assessment of the international and domestic balance of power, and also by a skillful application of the "Italian style" of diplomacy. This involved a sophisticated mixture of orthodox and eccentric measures, which were inextricably linked. The Cold War stalemate made it possible to pursue a heterodox foreign policy, so long as it did not jeopardize Italian membership in the Atlantic Alliance. Only a heterodox foreign policy could forestall a domestic political crisis.

The apparently schizophrenic nature of Italian foreign policy has been vehemently criticized by critics on both the Right and the Left. However, it was not an authentically contradictory policy, but rather a balancing act.[4] On the one hand, Italy was one of the most loyal members of the Western coalition. Its government never wavered in its commitment to the alliance, even at difficult moments, such as the founding of NATO, the deployment of Jupiter missiles in the 1950s, and the deployment of Intermediate Nuclear Forces in the 1980s. Support for the European Economic Community was similarly unwavering. On the other hand, Italian foreign policymakers kept a low profile. Italy had the lowest level of military expenditures in NATO. Policymakers exercised great restraint in the use of military instruments of policy, which appeared inconsistent with the militant environment of bipolar confrontation.[5] Even more strikingly, Italy maintained close commercial and diplomatic contacts with pro-Soviet countries in Europe and the Middle East. These contacts were reinforced by the actions of public and private corporations, left-wing parties, and Catholic organizations. Still, this openness to the Communist bloc never jeopardized the country's basic alliance with the West. It also alleviated some of the pressure on domestic politics. Although the public's antimilitaristic reaction to fascism inhibited the adoption of an activist policy, the non-Communist parties developed a profound consensus on foreign policy, virtually unbroken throughout the postwar years.[6]

FROM BIPOLARITY TO MULTIPOLARITY

Bipolar systems, in which only two units have a decisive impact on outcomes, are characterized by the centralized nature of security arrangements and by static alignments and integrative institutions.[7] Since there are only two main actors, each of which represents the main and only real threat to the other, they will both consider any improvement in the position of the other as a potential danger. Security, in other words, becomes a zero-sum game in which the gain of one is a loss for the other, and vice versa. Neither superpower will therefore want to leave any advantage to the other; each will try to extend its sphere of influence preemptively, at least until it comes into conflict with the other's sphere. In time, no peripheral region will be immune from bipolar competition as each superpower tries to enhance its position in order to deny its rival the possibility of gaining ground. Attempts to outflank the rival by gaining access to neutral regions are therefore liable to be frustrated by the rival's response. Stability results from the fact that each action triggers an equal and opposite reaction. The prospects for global and local equilibrium are linked, as the confrontation between the superpowers spills over into other regions.

In a non-nuclear setting, such as the bipolar systems established between Athens and Sparta and between Rome and Carthage, rivalry is likely to lead to war. In a nuclear setting, the intolerable risks of a "hot" war result in a "cold" war, a static situation in which each superpower guards its own sphere of power, but is deterred from encroaching on that of the other by the fear of a devastating retribution.[8] Bipolar nuclear systems tend therefore to produce fewer wars because of the constant menace of escalation. Superpowers will impose stability on their own side and refrain from provoking the other in its sphere. Regional powers also have neither the incentive nor the opportunity to engage in aggressive policies. On the one hand, their security needs are well served by the protective umbrella of their superpower. On the other hand, their superpower protector will not allow them to pursue an independent policy, for fear that it might trigger a response from the rival superpower. The possibility of war is therefore limited, so long as there is no direct confrontation between the leaders of the two blocs. In general, wars that do occur evolve from a conflict between a superpower and a member of its own bloc willing to defect to the other side, on the model of Vietnam or Hungary.

These characteristics of a bipolar system in a nuclear setting lead to an integrated alliance system.[9] Integration is favored by the stability of alignments. Since there are only two blocs, once a state has chosen its superpower protector, there are high costs for defecting to the other side. The stability of alignments allows states to develop long-term relationships and to discount worries that their allies will turn against them in the future. Economic and political interdependence can thus develop without fear that partners' gains from cooperation will be used for dangerous purposes. On the contrary, robust allies can be harnessed for the common cause and are therefore welcome.[10] It is also for this reason that bipolar struggles generally transcend purely strategic issues and tend to become instead confrontations between rival social and economic worldviews. At the same time, integration within each bloc is fostered by a process of functional differentiation. Superpowers will tend to shoulder a disproportionate share of the allied burden because the stakes are, for them, higher, and because they are the only actors that can balance the actions of the other.[11] Superpowers are, in fact, in a class of their own. This allows a superpower's allies to take a free ride and enjoy the benefits of bloc security without paying the full costs of its production. The main value of smaller allies is the geostrategic advantages they confer rather than any proportional economic or military contribution.

The end of the Cold War broke the straightjacket of bipolar rivalry. The collapse of the Soviet Union eliminated one superpower and removed a key incentive for the other, the United States, since its global reach was mainly motivated by the presence of its rival. The nature of security and of alliances is, under these circumstances, transformed. In the words of Glenn Snyder and Paul Diesing, "the clearest difference between multipolar and bipolar systems is the greater importance of alliance consideration in the former, which are therefore more complex mechanisms."[12] On the one hand, the mobilization of resources requires cooperation between independent centers of decision-making, since power is no longer concentrated in two sets of hands, each capable of acting on its own. On the other hand, the less rigid configuration of alliances allows states more freedom to maneuver and allows them to choose a foreign policy on the basis of their preferences and individual objectives.

Because the absence of a bipolar conflict severs the link between global and local equilibrium, multipolar systems tend to produce fragmented security arrangements, organized around various regional subsystems. Since threats and responses to them are no longer global in their implications, outside powers can afford to ignore distant conflicts that do not threaten their interests directly. In these circumstances, perceptions of a threat may depend upon geographic position, ideological orientation, or political preference, rather than merely upon membership in an alliance. Furthermore, even if the threat to a state's security is significant, the diffusion of power allows any state to balance this risk with external alliances rather than exclusively with internal rearmament. Reactions can be less automatic and more selective than in a bipolar system. The tendency of regional conflicts to blow up into global crises is therefore reduced, delayed, or eliminated. Regional powers with aggressive agendas can produce more local instability without necessarily triggering a superpower response. The absence of a nuclear deterrent is likely to produce a higher number of conventional wars.

Conflicts in different regions will take different courses, depending on regional alliances and the relative strength of regional aggressors. Rather than a single global balance in which, according to Pierre Hassner, "peace is impossible, war unlikely," multipolar systems produce segmented systems in which "both peace and war" are likely to coexist in different places at the same time.[13]

Table 1. Bipolarity versus Multipolarity

	Bipolar Systems	Multipolar Systems
Threat	Global	Local
Perceptions of threat	Uniform	Differentiated
Reaction to threat	Automatic	Dependent on circumstances
Regional stability	Tied to central equilibrium	Fragmented
Nature of alliances	Durable	Shifting
Nature of agreements	Formal	Informal
Role of superpowers	Special	Similar

As a result, alliances in multipolar systems will display peculiar characteristics. In particular, more flexibility brings less durable alliances. The presence of multiple potential partners allows each state to be less dependent on any other individual state and thus to choose among various alternatives, changing alignments according to preference or necessity. The possibility of shifts in alignments blurs distinctions between friends and enemies, as today's allies may become tomorrow's enemies, and vice versa. Unlike bipolar systems, in which members of rival blocs will be unable to cooperate, multipolar systems allow for crosscutting relationships, in which political, military, and economic networks do not necessarily coincide. Cooperation between states also tends to become more specific in terms of time, with allies in one period being opponents in another. Membership in international organizations therefore diminishes in importance. Instead, states enter into ad hoc arrangements and temporary coalitions. Given the more concrete and less abstract nature of regional conflicts in a multipolar setting, the political weight of a country in a specific conflict will be measured in terms of its economic or military contribution, rather than merely in terms of its geostrategic position within an institutionalized alliance.

The other difference between alliances in a bipolar and a multipolar world is that in the latter case there is less functional differentiation based on a hierarchy of power. Since regional conflicts are less compelling because power is less concentrated, such conflicts can often be resolved, at least in theory, without the involvement of bigger powers. Because their participation is no longer necessary, big powers can be more selective and behave more "normally," that is, more like less powerful states. Since the latter, in turn, can no longer count on the automatic intervention of the former, they must prepare themselves to bear a more proportionate share of the burden. In this case, role allocation is less static and varies according to circumstances. Coordination becomes more difficult because there is no longer a single overriding threat creating a shared perception of danger. This does not mean that established alliances will break down in a post-bipolar system. There is still a need to cooperate. But cooperation will no longer be a foregone conclusion based exclusively on alliances or membership within formal organizations. Rather, the extent of cooperation will depend on concrete interests and the skills of diplomats in each specific situation.

ITALY'S POST–COLD WAR FOREIGN POLICY

These general transformations of the international system have had a specific effect on Italy. In particular, the fragmentation of global security arrangements has left Italy more vulnerable than it was during the Cold War, due to its geostrategic proximity to the Middle East and the Balkans, two of the most unstable regions in the world. While the country is eager to exploit the opportunities of the new international environment and meet the challenges of economic globalization, it does not always welcome the new problems it must face in foreign affairs. The end of the Cold War, which has been warmly welcomed in Italy and elsewhere, has brought risks as well as rewards. The Middle East, the Balkans, and the Caucasus are all areas of severe potential disorder, caused by ethnic and religious divisions, domestic upheavals, and local arms races. Only the Adriatic and the Eastern Mediterranean separate Italy from this area. It is therefore particularly vulnerable to spillovers of regional instability. For example, during the war over Kosovo, Italy was the only NATO country that had some reason to fear Yugoslav military retaliation. In 1986, Libya responded to the American bombing of Tripoli by launching two Scud missiles against the Italian island of Lampedusa. An even more pressing threat to Italian interests, given the easy sea access to the Italian peninsula, is the social spillover from regional conflicts in the form of refugees, drugs, illegal weapons, and organized crime. As Mary Kaldor has argued, wars in the new era blur distinctions between public and private uses of violence. As a result, the potential for violence becomes difficult to detect and control.[14]

What is worrisome from the Italian point of view is that this new and more fluid international setting produces situations that are serious enough to threaten the country's tranquility, without being sufficiently serious to concern the wider international community. From a global point of view, the various conflicts that have erupted since the end of bipolarity have posed a limited danger, as is demonstrated by the slowness of international efforts to resolve them. The bloodiness of specific conflicts, for example in the former Yugoslavia and Rwanda, has constituted more of an obstacle than a reason for action, because it has been difficult for Western governments in the absence of a compelling strategic necessity to justify to their public the potential costs of intervention. During the Cold War, Italy could afford to maintain a low profile because any regional conflict was sure to involve NATO and the United States. Since the end of the Cold War, Italy by contrast has to worry that regional conflicts will be ignored by outside powers. Italy runs the risk of being ignored by its traditional partners, as happened when the Contact Group on Former Yugoslavia excluded Italy in the spring of 1994. Because the European Union and NATO were similarly reluctant to discuss the possibility of a multilateral intervention in Albania, Italy was forced to mount its own independent operation.[15]

Italian efforts to adapt to the new environment have led to a bifurcation of policy. On the one hand, within a "circle of global engagement," Italy continues to pursue its traditional policy of cultural and commercial exchange, especially in Africa, Latin America, and East Asia. Church-related organizations (such as the S. Egidio group, which has sponsored the peace agreement in Mozambique) continue to play a visible role in foreign affairs, as do academic institutions and private enterprises. On the other hand, within its own "circle of geographic proximity," Italy has made a break with postwar policies, especially in its willingness to consider military options. In Eastern Europe and the Mediterranean, Italy can no longer afford to keep a low profile; the risk of facing a regional conflict without necessarily receiving automatic support from its allies has forced Rome out of its shell. The main thrust of policy has thus been dedicated to avoiding isolation within the region.[16] Italy has maintained its traditional multilateral diplomacy by proposing to strengthen those institutional organizations able to contain regional instability. At the same time, it has tried to upgrade its participation in the activities of those organizations, in order to advance Italian interests and to strengthen its institutional position.

In its quest to strengthen international institutions, Italy has proceeded on multiple fronts, unlike France, which favors a European armed force, or Britain, which favors NATO, or other, non-NATO EU states, which favor strengthening the United Nations. The belief in Rome seems to be that the real choice is between a world with strong security arrangements (which is preferable) and one in which countries are left on their own, rather than between one institution and the others. In general, Italy has tried to persuade NATO, the European Union, and the United Nations to be more flexible, in order to allow for "ad hoc" coalitions to form. In this way, Italy may hope to engage each of these organizations in regional problems that it feels it cannot solve by itself.

- In the United Nations, Italy has filed a proposal for the reform of the Security Council that has catalyzed discussion in the General Assembly on the subject. The idea is to reserve a third of the seats in the council for a number of regional powers on a rotating basis. The aim is to give Italy and other regional powers, besides Germany and Japan, a chance to serve on the council, thus more closely involving the countries that contribute significantly to UN peacekeeping missions.

- In NATO, Italy has been an ardent supporter of enlargement, and it has, unsuccessfully, fought to include Slovenia, in hopes of widening the alliance base as well as focusing more of the alliance's attention on southeastern Europe. Italy has also formed a common brigade with troops from Hungary and Slovenia, in order to ease their way into NATO. Further, Italy has supported the new strategic concept adopted in Washington in 1999, which envisages a more active "out-of-area" role for the alliance.
- In the European Union, Italy undertook an epic, and unexpectedly successful, program of structural adjustment in order to join the euro at its inception, thus demonstrating its determination to avoid isolation from Europe's core group.[17] Italy has also supported EU enlargement and is one of the main sponsors of the Mediterranean applicants, which include Malta, Cyprus, and Turkey. The country has traditionally been one of the staunchest proponents of further integration and unification, especially in the foreign policy and security fields. Italy has also undertaken an initiative with other EU members, notably France and Spain, to create joint land and naval forces for military intervention in the Mediterranean.

Italy has also demonstrated a resolve to complement these proposals with active participation. Given its postwar reluctance either to expose itself directly or to employ military means, this new readiness to commit its troops is one of the most striking features of Italian foreign policy and of post–Cold War European politics. One reason for this change of policy is to be found in the progressive relaxation of the political and economic constraints that Italy faced in the immediate aftermath of World War II. Italy has in fact participated in multinational military interventions since the early 1980s, starting with the operation in Lebanon in 1983. Nevertheless, the scale and scope of Italian military actions since the early 1990s represent more than a mere continuation of a process begun earlier. Italy's emergent new strategic conception has raised the stakes of direct Italian participation in multilateral military efforts.

- Italy joined the naval and air forces deployed in the Gulf War, despite strong domestic opposition and unlike other major countries, such as Germany and Japan, that contributed only "checkbook diplomacy."
- In the UN, Italy participated in Operation Restore Hope in Somalia along with the United States, in its first major military intervention since World War II.
- In NATO, Italy participated in operation I-FOR in Bosnia and in operation K-FOR in Kosovo, with significant land forces; in the case of the Kosovo crisis, it also contributed most of the military bases for logistical support.
- When Albania threatened to collapse into anarchy and no international institution appeared willing to mount a multilateral operation, Italy managed to organize and lead a major multinational intervention to keep the peace—what became known as Operation Alba.

These interventions have stretched Italian military resources to the limit. They have also induced the defense ministry to switch from the traditional draft to a professional military service in order to prepare for future overseas contingencies in which the political expendability of conscripts is, at best, doubtful. Some of these interventions have already created, as will be argued below, real domestic political problems. They cannot therefore be discounted as pure maquillage, because they have imposed serious costs on the government. Only the realization that the international system had radically changed Italy's strategic position, and that the country's security required a higher profile in both political and military terms, could have justified such an extensive investment of men and material at such political risk.

THE DOMESTIC RISKS OF A HIGHER PROFILE

The "new look" responds to Italy's strategic needs in a more fluid international system. The higher levels of political and military commitment are well within the reach of a dynamic economy and a modern and self-confident society. The main risks of the "new look" come from domestic politics. While Italy's foreign policy during the Cold War managed to balance domestic and international constraints, and to build a consensus that lasted for decades, its new policy may fall apart because of internal political disagreements, even if the policy is well suited to the new international environment. The end of the Cold War has in fact marked a traumatic change in Italy's domestic politics. The transition is still incomplete. It has unsettled traditional mechanisms for achieving consensus without yet replacing them with new ones.

Given the abnormal size of the Italian Communist Party, or PCI, the most important feature in the Italian party system was, as already remarked, the cleavage between the pro-Soviet parties and the others. It was therefore natural that the end of the Cold War would bring about a drastic change, since the Communists could only jettison their old political stance or wither into obsolescence. Unable to agree on its future, the Communist Party dissolved. Out of its ashes emerged a nostalgic splinter party, the refounded Communists, or PRC, and a mainstream social-democratic party, the PDS. The disappearance of the domestic and international Communist threat destroyed one of the crucial assumptions of the Italian political system: that the pro-Western parties would always cooperate in order to keep the PCI out of government. Despite the rapid turnover of individual governments, this meant that majorities in Parliament were extremely stable, and that there was never a real change in the governing coalition so long as the Cold War continued. Another result was a considerable amount of consensus on foreign policy: the government would support NATO and the European Union, but avoid divisive confrontations with the Communists. The changes on the Left interacted with two other crucial events. The "Tangentopoli" investigations led to the indictment of most senior politicians for corruption. And the electoral law changed from a pure proportional representation system to a mixed but predominantly first-past-the-post system. The simultaneous change in cleavages between parties, the composition of the leadership class, and the electoral rules produced an authentic revolution in the political system.[18]

Most of the liberal and socialist parties that had allied themselves with the ruling Christian Democrats, or DC, disappeared, while the DC itself collapsed, leaving behind various groups, the largest of which were the People's Party, or PPI, and the Christian Democratic Center, or CCD. The fate of the Communists has already been described. A similar process overtook the neo-fascist Italian Social Movement, or MSI, which split apart into the European populist National Alliance, or AN, and a reactionary splinter group called Fiamma. New parties emerged, most notably Forza Italia, or FI, a heterodox party led by Silvio Berlusconi, a media tycoon, and the regional Northern League, or LN, which advocated a separatist platform for the North. The new electoral rules transformed yet another traditional custom. Rather than leaving the composition of the governing coalition and the selection of the prime minister to party leaders after the elections, the new parties formed wide coalitions before the vote, and each coalition supported a prospective prime minister. After considerable instability, two main groups emerged: the Center-Left, or Ulivo, which included the PDS (now DS), PPI, the Greens, and a number of smaller parties; and the Center-Right, or Polo, which included FI, AN, CCD, LN, and a number of smaller parties. Despite widespread hopes that this new system would produce more stability in governments and favorable implications for foreign policy, the average longevity of prime ministers has not improved. Not only have there been seven changes of prime minister in the eight years between 1992 and 2000 (Andreotti, Amato, Ciampi, Berlusconi, Dini, Prodi, D'Alema, and Amato again), but the majorities supporting them have changed five times, including a radical shift to the Right in 1994, a shift to the Center in 1995, and a shift to the Left in 1996. Instability has led to overheated political debate, inhibiting collaboration between the two coalitions on matters of national interest and often reducing foreign policy to a tool for daily domestic political skirmishes. Unless party and coalition survival is ensured, it is unlikely that foreign policy, or the construction of a bipartisan consensus about foreign policy, will rate very high on the political agenda.[19]

As a result of these confusing changes, the “new look” of Italian foreign policy has engendered mixed initial responses. The pro-Western orientation of the policy has been accepted, at least in official statements, and is upheld by both coalitions, even by the majority of former Communists and former neo-Fascists, who are eager to display a presentable image. The nation’s higher military profile appears dictated by strategic need, and the success of its operations has been a source of national pride. However, there have also been signs of strain on this happy façade. The need to organize wide coalitions in order to exploit the majority electoral system, coupled with the continuing proliferation of parties, has produced heterogeneous alliances that lack internal cohesion on international issues. At the same time, the discipline imposed on the democratic parties during the Cold War by the need to resist communism has broken down, leading to more open dissent over foreign policy. The diffuseness of the current international system in any case produces more fluid and ambiguous situations than those that usually arose during the Cold War, provoking a wide range of opinions and more disagreement about foreign policy. In these new circumstances, at least four views can be distinguished:

- There are orthodox supporters of the “new look” who support both the pro-Western and the pro-European orientation of Italian policy, and also a high level of involvement in the West’s multilateral institutions. This view is strong, although not uncontested, in all of the mainstream parties on both the Right and the Left.
- There are also those who support a pro-Western stance, but not multilateralism, arguing that Italy should be more willing to conduct its foreign policy unilaterally. This group is strong within the euro-skeptic wing of FI and in the more nationalistic AN, and it managed to influence policy during the brief Berlusconi government of 1994, especially on the issue of Italy’s veto of EU negotiations with Slovenia, and in the Polo

platform in the 1996 elections, when it criticized the process of European monetary union.

- By contrast, there are some who cherish a multilateral approach, but would like to use it to contest, rather than support, the policy of key Western allies. This group is strong especially in the PDS and in the Catholic PPI, although it is a minority view, and in the PRC, where it is part of the party's fundamental ideology. This group favors an idealistic approach to international politics that focuses on North-South issues and regards the UN as a world government in embryo, as an alternative to NATO and the United States. This group has had a serious impact on the foreign policy debate, and it induced the PRC to withdraw parliamentary support for the Prodi and D'Alema governments, which almost fell as a result of the crises in Albania and Kosovo. At times, this group joins forces with the nationalistic Right in criticizing American policy, as recently happened over the Cermis incident (in which an American warplane crashed into a ski lift full of tourists, leading to calls for the closure of NATO bases in Italy) and the Ocalan affair (in which a Kurdish rebel leader was captured by the Italian police, prompting calls to offer him political asylum).
- Finally, there are those who prefer a more neutral and isolationist stance. This group, strong in the extreme Right and in the LN, is suspicious of foreign entanglements and hostile to both European integration and UN globalism. It sympathized with Serbian President Slobodan Milosevic during the war in Kosovo, and sided with Austria's neo-nationalist leader Jeorg Haider in condemning EU sanctions against Austria.

Table 2. Views of the "New Look"

	Accepts Western Orientation	Rejects Western Orientation
Accepts multilateralism	Orthodoxy (majority of Left and Right)	Global revisionism (minority of Left)
Rejects multilateralism	Unilateralism (minority of Right)	Isolationism (minority of Right)

As a result of these ongoing disagreements over foreign policy, no stable consensus has emerged. Deep divisions are often found within a single party. In particular, the Center-Left contains a strong and vocal minority that rejects a pro-Western policy, while the Center-Right contains an equally strong and vocal minority that rejects either multilaterialism or the "new look" altogether. Although majorities in both coalitions support the "new look," or at least pay lip service to it, these majorities face constant pressure from heterodox minorities. The fact that both coalitions include a number of independent parties in which individual groups have veto power over common policies poses a constant threat to the maintenance of a stable and coherent foreign policy. Furthermore, because both coalitions tend to campaign on disagreements over foreign policy, it has been all but impossible to secure a bipartisan consensus in which the leaders from the mainstream parties can count on each other to shore up parliamentary support for mainstream policies when they come under attack from the Left or Right. In certain instances, such as the war in the Gulf, a left-wing minority has voted against the policy of the left-wing government. In other instances, even when a rival mainstream party has supported the coalition in power, its support was not to be taken for granted, as demonstrated by the Polo's tactical attacks on the Prodi government during Operation Alba and by the attempts to embarrass the D'Alema government during the Kosovo crisis. The very dependence on parliamentary alliances tends to produce backroom deals that have the potential to weaken dramatically the power of government leaders. Unless and until a less complex party system emerges, in which government leaders will be able to exert discipline over members of Parliament, it is possible that support will collapse for the "new look" foreign policy, especially if the country is exposed in a critical action.

CONCLUSION

The end of the Cold War has unleashed a number of complex and contradictory forces, simultaneously accelerating globalization and fragmentation. A debate has emerged on the significance of these changes, exemplified by the contrast between Samuel Huntington's pessimistic prediction of an inevitable conflict between rival civilizations and Francis Fukuyama's more optimistic expectation of universal democratization at the "end of history."[20] As argued in this essay, both visions have an element of truth. While in the West peace and economic development seem paramount, in other regions, including the Balkans, the Middle East, and the Caucasus, poverty and war persist. Italy is at a crossroads. The success of its Cold War foreign policy has given it a prominent voice in Western institutions, but its location forces it to worry about its relationships with some of the most unstable countries in the world today.

These circumstances have led Italy to revise its foreign policy and to give it a new and more activist twist. As a result, the country should be able to resolve or contain regional conflicts. At the same time, Italy's hard-earned standing in the eyes of its Western allies increases the probability that Italy's point of view will be acknowledged and respected in allied capitals. Its various proposals for reforming NATO and the European Union, if implemented, would make these organizations more flexible and also more involved in the regional problems that concern Italy. In the longer term, Italy seems to have no alternative but to pursue further European integration, in order to contribute to the creation of a multilateral power of sufficient strength to guarantee stability in Eastern Europe and the Mediterranean.

For a medium power such as Italy, the end of the bipolar system of the Cold War has created opportunities but also risks. If domestic instability and tension prevail, it will be hard if not impossible for Italy to secure a stable consensus on its foreign policy. One can only hope that the country will develop a domestic political system capable of making difficult decisions—and elaborating a consistent foreign policy to meet the challenges of a multipolar world.

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ENDNOTES

[1]Arnold Wolfers, *Discord and Collaboration* (Baltimore, Md.: Johns Hopkins University Press, 1962).

[2]For the role of the Cold War in Italian domestic politics, see Norman Kogan, *The Politics of Italian Foreign Policy* (London: Pall Mall, 1963).

[3]On the importance of the NATO choice see Pietro Scoppola, *La Repubblica dei partiti 1945–1990* (Bologna: Il Mulino, 1991), 209–250.

[4]Stefano Silvestri, "L'Italia: partner fedele ma di basso profilo," in Luigi Caligaris, ed., *La difesa europea: proposte e sfide* (Milan: ISPI, 1990); Christopher Seton-Watson, "La politica estera della Repubblica Italiana," in Richard J. B. Bosworth and Sergio Romano, eds., *La politica estera italiana* (Bologna: Il Mulino, 1991).

[5]Filippo Andreatta and Christopher Hill, "Italy," in Jolyon Howorth and Anand Menon, eds., *National Policy Making and the European Community: National Defence and European Security Integration* (London: Routledge, 1997).

[6]The main exception is the Sigonella episode in which the government openly and successfully opposed American attempts to secure Palestinian terrorists on Italian soil, which led to the resignation of the defense minister, but which represents the only example of the eccentric style of Italian foreign policy directly contradicting the basic alliances of the country. Cf. Frank J. Pieson, "La politica estera italiana: il caso Achille Lauro," in Piergiorgio Corbetta and Robert Leonardi, eds., *Politica in Italia* (Bologna: Il Mulino, 1986).

[7]Kenneth Waltz, *Theory of International Politics* (Reading, Mass.: Addison Wesley, 1979); Waltz, "The Stability of a Bipolar World," *Dædalus* 93 (3) (Summer 1964). Cf. also John Mearsheimer, "Back to the Future: Instability in Europe After the Cold War," *International Security* 15 (1) (Summer 1990); John Lewis Gaddis, "The Long Peace," *International Security* 10 (4) (Spring 1986).

[8]Raymond Aron, *Peace and War: A Theory of Peace and War* (Garden City, N.Y.: Doubleday, 1966), 186.

[9]Thomas Christiansen and Jack Snyder, "Chain Gangs and Passed Bucks: Predicting Alliance Patterns in Multipolarity," *International Organization* 44 (1991).

[10]Joanne Gowa, "Bipolarity, Multipolarity and Free Trade," *American Political Science Review* 83 (1989).

[11]Mancur Olson and Richard Zeckhauser, "An Economic Theory of Alliances," *The Review of Economics and Statistics* 48 (1966).

[12]Glenn Snyder and Paul Diesing, *Conflict among Nations* (Princeton: Princeton University Press, 1977), 429. Cf. also Ted Hopf, "Polarity, the Offense-Defense Balance, and War," *American Political Science Review* 85 (1991); Karl Deutsch and David Singer, "Multipolar Power Systems and International Stability," *World Politics* XVI (1964): 401; Richard Rosecrance, "Bipolarity, Multipolarity and the Future," *Journal of Conflict Resolution* 10 (1966); Charles W. Kegley Jr. and Gregory A. Raymond, *A Multipolar Peace? Great-Power Politics in the Twenty-first Century* (New York: St. Martin's Press, 1994); Jack Levy, "The Polarity of the System and International Stability: An Empirical Analysis," in Alan Ned Sabrosky, ed., *Polarity and War: The Changing Structure of International Conflict* (Boulder, Colo.: Westview Press, 1985); Manus Mildarski, "Polarity and International Stability," *American Political Science Review* 87 (1993); Alan Ned Sabrosky, ed., *Polarity and War: The Changing Structure of International Conflict* (Boulder, Colo.: Westview Press, 1985); and Edward Mansfield, *Power, Trade and War* (Princeton: Princeton University Press, 1994).

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[14]Mary Kaldor, *New and Old Wars: Organised Violence in a Global Era* (Oxford: Polity Press, 1999).

[15]Ted Perlmutter, "The Italian Response to the Albanian Crisis," *The International Migration Review* 32 (1) (1999): 203–222.

[16]Filippo Andreatta and Christopher Hill, "Italy's Adaptation to the End of the Cold War: The Importance of Ideas on Foreign Policy," in William Wallace, ed., *European Views of the International Order after the Cold War* (Oxford: Oxford University Press, 2000).

[17]G. Frederico Mancini, "The Italians in Europe," *Foreign Affairs* 79 (2) (March/April 2000): 122–135.

[18]Stefano Guzzini, "The Implosion of Clientelistic Italy in the 1990s: A Study of 'Peaceful Change' in Comparative Political Economy," *EUI Working paper SPS No. 94/12*, European University Institute, Florence, 1994.

[19]This process is compounded by the traditional provincialism of the Italian media in the foreign policy field, which fails to hold politicians to their responsibilities of coherence and competence.

[20]Samuel Huntington, "The Clash of Civilizations?" *Foreign Affairs* 72 (Summer 1993); Francis Fukuyama, "The End of History," *The National Interest* (16) (Summer 1989).

The final destination of Europe's long journey is in sight. Despite the ambiguity of its text, the Maastricht Treaty, with its functionalist formula of an "ever closer community," puts into motion a political dynamic which has contributed to the clarification of which cards may be played to define, or at least circumscribe, the final destination of Europe. Today, for the first time, Europeans may discard certain destinations which are now recognized to be clearly impossible: for example, the self-annihilation of the individual European nation-states and their fusion into a new European federal superstate. If the authors have not succeeded in finding a single word to define the final destination towards which Europe is moving, a formula, while not being entirely satisfactory, may be offered: The final destination of Europe will be something more than an alliance but something less than a union. We are not about to see a United States of Europe.

Fabio Luca Cavazza and Carlo Pelanda

From "Maastricht: Before, During, After"
Dædalus 123 (2) (Spring 1994)

Luigi Federico Signorini

Italy's Economy: An Introduction

INTRODUCTION

THIS ESSAY SEEKS TO EXPLAIN the Italian economy to the curious nonspecialist. Volumes have been written on the subject of Italy's strengths and weaknesses, so this presentation will have to be selective. I shall try to avoid overburdening the reader with data and technical concepts and to make the main points as clear as possible. The reader will understand, however, that behind each of them, however simply put, stands a rich literature, and sometimes a lot of controversy.

In just two generations, Italy has grown from a largely agricultural, migrant-pool country into a large and prosperous economy. The decision, made in the 1950s, to open up the country to trade and to let it integrate into the world market allowed it to catch up rapidly with the leading economies. A peculiar industrial structure, based largely on small firms, has proved unexpectedly competitive and dynamic over the decades.

However, for most of the past quarter of a century Italy was plagued by high inflation and substantial budget deficits. Both were in a sense the result of the country's inability or unwillingness to reconcile mutually inconsistent claims on resources, in the hope that the day of reckoning might never come. It did, of course. But, thanks to a mix of European constraints, market pressure, and policymakers' finally coming to their senses, Italy now enjoys low inflation, moderate deficits, and general macroeconomic stability—though the accumulated debt is a burden that will not go away soon.

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Two connected problems remain: unemployment, which is high and very unevenly distributed, and the underdevelopment of the South. Subsidies, protection, and restrictive rules—the traditional solutions—are beginning to be seen as counterproductive, but Italy is still reluctant to embrace wholeheartedly the idea that market forces can be effectively harnessed to work toward solving both of these age-old problems.

Still, state-owned firms have been privatized on a large scale, and deregulation of markets has begun. With participation in the monetary union a hard-earned fact, the aim should now be to consolidate these results and build on them, in order to reap the benefits of a larger, more open market and the increased productivity that technological progress allows. On the side of macroeconomic stability, Italy's economy has come of age; on the microeconomic side, it still has progress to make. Above all, it should improve the provision of public services and place less trust in overregulation. If it can do so, then its powerful entrepreneurial forces can be expected to meet the economic challenges of the near future as effectively as they did those of the past.

FROM RAGS TO RICHES

The title of this section may overstate the point. Italy has never been so poor, in comparative terms, as some older Italians (or Italian-Americans) may think they remember. And, of course, there are richer countries now. Still, the progress in the last half-century has been enormous.

Italy is today a large and prosperous economy. With a GDP of about €1.1 trillion (over $1 trillion) in 1999, it ranks sixth among the world's economies, after the United States (eight times as large), Japan (four times), Germany (almost twice), France, and Britain (with Britain it has been in a neck-and-neck race for some years). Italy accounts for about 18 percent of the euro-area economy, and something like 4 percent of the world. The comparison with non-euro countries is influenced by the vagaries of the exchange rate, and thus suffered recently because of the weak euro; in purchasing-power terms (i.e., using conventional exchange rates that take account of differences in price levels), the relative position with respect to, for example, the United States is even better.

Per capita income in 1999 was about €319,000, slightly less than the average for the European Union. According to World Bank figures, in 1998 only fifteen countries (excluding ministates) in the world had a higher per capita income. On the other hand, Italy's per capita GDP is about nine times higher than Russia's, almost thirty times higher than China's, and almost fifty times higher than India's (in purchasing-power terms, the differences are, of course, much smaller, as the price level in those countries is low).

Since World War II, the relative position of Italy has improved dramatically. In 1950 Italy's per capita GDP was less than one-third of America's (today's position of, say, Argentina or Portugal); now it is two-thirds. The improvement slowed down, but did not stop, after the years of the postwar "economic miracle." According to one estimate, between 1970 and 1998, real per capita GDP grew by 80 percent in Italy, as against 68 percent in France, 67 percent in Britain, 62 percent in the United States, and 37 percent in Germany. Among the main advanced countries only Japan has grown more.

THE MIRACLE . . .

What caused Italy to grow at such a satisfactory pace over a half-century? The first answer is obvious: the scope for catching up. In a world that is open to exchanges of commodities, capital, people, and ideas, those who start at the back can capitalize on certain advantages. It is usually easier to innovate by buying or copying an existing technology than by inventing a new one from scratch, as leaders must do to progress. Thus, latecomers enjoy an inherent relative advantage, provided (a) that they keep their economies open; and (b) that internal costs, notably labor costs, rise in line with productivity. On the other hand, countries that shut themselves out of the world market tend to lose ground: this is what happened to the socialist countries and some large countries in Asia and Latin America, which long cultivated the delusion that it was possible to promote growth by means of protectionism and autarky.

In 1945 Italy was a "backward" country, shattered by a lost war. The Marshall Plan helped to boost its postwar recovery. Later on, the key factor in Italy's "economic miracle" was probably the bold and farsighted decision to open up the economy since the late 1950s—a decision that was taken against strong opposition, especially from business circles, which feared that international competition would destroy the country's still-weak industrial base. Significantly, the founding act of the European Economic Community (later to become the European Union) is the 1958 Treaty of Rome.

The catch-up factor was decisive in the early years. It probably played a role even later, though as the distance from the leaders grew shorter, its importance diminished. Not surprisingly, Italy's growth rate gradually slowed down. It was over 6 percent a year, on average, in the 1950s and 1960s; 3.6 percent in the 1970s; and 2.4 percent in the 1980s. In the last decade, at just above 1 percent it was lower, not higher, than in most of the other advanced countries (see below, "A Lost Decade?").

. . . AND THE PARADOX

I turn now to the second answer to the question of what has caused the satisfactory economic growth of Italy in the last few decades. This answer is less obvious than the first one and requires a longer discussion.

Italy is peculiar among large advanced countries because of its industrial structure. It is specialized in a number of non-capital-intensive, low-technology industries. For example, almost a quarter of manufacturing workers are employed in the textile and clothing industry, as against 10 percent in the United States, 6 percent in Japan, and as few as 5 percent in Germany. This specialization does not appear to have decreased over time; quite the contrary. The prevailing size of manufacturing firms is no less remarkable. Almost a quarter of total manufacturing employment is accounted for by micro-firms with fewer than ten employees; about 65 percent by firms with fewer than 100 employees (1996 data). The latter figure compares with, say, 19 percent in Germany and 28 percent in Britain (1990 data).

Italy's specialization in light industries and small firms makes it in certain respects more similar to developing economies than to other advanced countries. This fact is an endless matter of debate in Italy, both as a puzzle and as a source of concern. The puzzle consists in the fact that it is not easy to explain why Italy is so different. Some invoke certain cultural features of Italian society: a supposed prevalence of individualism, or the strength of family ties as a focus of loyalty and a source of assistance in bad times. The concern, of course, refers to the competitiveness of the Italian economy. To put it in the simplest (if slightly exaggerated) terms: if developing countries compete through low wages, and developed countries through high technology, where does that leave Italy, with a first-world wage structure and a third-world industry structure?

This concern sounds plausible and has been expressed time and again for decades. But it has, so far, proved unfounded. As we have just seen, in a long-term perspective the performance of the Italian economy has by no means been worse than that of the other major developed countries. Also, "traditional" industries have usually provided foreign-trade surpluses, whereas "modern" sectors have mostly been stuck in the red.

Thirty years ago, most economists thought that Italy's structure was simply backward, and would change with the catch-up process if just left alone. A trend toward ever-larger firm size was then deemed inevitable worldwide, because it was thought that technological progress would continue to increase the minimum efficient production scale.

As it turned out, this was not to be the case. Since the mid-1970s, developments in technology and tastes (the twin deities of any microeconomic theory handbook) have moved in the opposite direction: toward flexible production processes based on digital technologies, on the one hand; toward fragmented and variable demand, perhaps due to the saturation of basic needs and the desire for something new and distinctive, on the other. Both developments lessened the importance of economies of scale. In fact (though international comparisons are difficult), the prevailing firm size seems to have decreased in most countries over the last three decades.

But this does not quite explain the Italian paradox, for in Italy—where the prevailing firm size was smaller than average to begin with—it has decreased even *more* than in other countries, thus widening the gap.

Some see this as evidence of inefficient constraints. One popular explanation for the expansion of small firms during the 1970s and early 1980s was defensive decentralization. This was the unintended effect of rapidly rising real labor costs (from 1969 on), stricter labor-protection laws (from 1970 on), and a general worsening of labor relations, all of which hit large firms harder than small firms. Small firms were either explicitly exempted from some legal or collective-bargaining provisions, or found ways to circumvent them, thanks to lower visibility and weaker union militancy. As a result, many large firms tried to decentralize parts of the production process to smaller plants.

This interpretation contained part of the truth, but could not entirely account for some patterns of the development of small firms. Despite such defensive moves, the old industrial structure of the Northwest lost ground in the 1970s; the areas of highest growth were northeastern and central regions such as Tuscany, Emilia-Romagna, and Veneto, economically dominated by small, traditional firms, mostly unconnected to larger firms, and specializing in different industries. Furthermore, the trend toward smaller firm size continued—albeit at a slower pace—long after labor relations returned to normal even in large firms. The most recent industrial census (1996) revealed a further increase in the share of small firms in manufacturing employment with respect to 1991.

An alternative line of thought points to efficiency as the reason for the success of small firms. The distinguishing feature of the industrial structure in regions where small firms have flourished is that the firms are not isolated, but are concentrated in integrated "industrial districts," where a single production process (for the manufacture of, say, knitwear or pottery) is distributed among a myriad of different firms, some of which act as an interface with the final-product market, while the others are set within a complicated web of subcontracting arrangements. The existence of a pool of skilled workers, their collective knowledge of production and market processes, the favorable attitude of local authorities, and a high social regard for profit and risk are some of the main elements in the industrial districts' success. Local agglomerations of small firms substitute external economies of scale, supplied by the local business and civil environment, for the internal economies of scale that small firms do not enjoy. This kind of arrangement is particularly well-suited to an economic world where rapidity, flexibility, and "flair" can at the same time reduce costs and command a premium price in the markets.

This pattern of development emerged in Italy's northeastern and central regions in the 1970s more or less spontaneously, sometimes out of a century-old artisan tradition, sometimes out of the disintegration of big firms that had failed. In later years, a similar development took place in other regions, notably in the Marche and (later still) Abruzzo on the Italian peninsula's east coast, and in Friuli in the northeastern corner of the country. It is not unknown even in traditional industrial-heartland regions, such as Lombardy and Piedmont. On the other hand, it is still rare in the Mezzogiorno, where problems of structural backwardness are very real (see below, "The North-South Divide").

Of course, the production process has to be technically amenable to fragmentation into several stages, if a district-type organization of the production process is to flourish. Thus, there are few districts in industries such as cars, airplanes, or steel where vertical integration of at least part of the process is essential. This seems to account for Italy's unusual pattern of industrial development—and for its seemingly paradoxical economic success.

Although industrial districts, similar in certain respects to the Italian ones, have been recognized in many countries, this kind of firm agglomerations appears to be especially frequent in Italy. Why? Much has been written about this, with no settled consensus. Some argue that the particular "district climate" can only have grown out of the deepest historical roots, and point out that the more district-intensive regions in Italy have a civic tradition that goes back to the flourishing city-states of the Middle Ages. Whatever one thinks of this explanation, it is a fact that the emergence and subsequent development of such agglomerations seem to owe little to explicit public policies: I know of no Italian district that was born as the effect of one. Local, spontaneous forces, whatever they are, have invariably played the key role.

Some economists, while recognizing the strengths that industrial districts have displayed so far, are still skeptical about their long-term prospects, pointing to the advance of globalization and recent technological leaps. Since Italian light-industry districts, defying prejudices, have lived and prospered thanks to exports, it is less than obvious that increased trade flows will hurt them. Commercial sunk costs—an oft-cited barrier for small firms wanting to go global—should, if anything, be lower in the Web age. And more generally, though it is true that the wider application of information technologies will benefit firms of all sizes, on the whole recent developments appear to have lowered, rather than raised, the minimum efficient size for many economic activities.

The question, therefore, is not about firm size per se, but about the future of the family and community ties that have been the backbone of local manufacturing agglomerations in Italy for a couple of generations. Whatever medieval roots the districts may have, values change over the decades. Transportation and communication technologies widen the territorial range of day-to-day interactions and weaken local cultures. Ultimately, the Web may make physical proximity entirely irrelevant, though it remains to be seen whether the "relationship bandwidth" it provides will be enough to foster virtual business communities that are as close-knit and efficient as traditional, locally based ones. In sum, efficient networks of small firms will not disappear—quite the contrary—but the form of their links with a particular territory may well be challenged.

Be this as it may, the unusual structure of the Italian manufacturing industry has not hampered its economic growth so far. This by no means implies that Italy's economy has not had its problems and weaknesses. To these we now turn.

LEARNING TO DO OUR SUMS

Italy is probably best known for the fine arts, pizza, soccer, the mafia, inflation, and budget deficits. The arts and pizza are still as ubiquitous as ever. Soccer remains the national religion—the national team being one of the few things that are capable of uniting the country, in joy or sorrow, from the Alps to Sicily. The mafia, though battered and in retreat, sadly refuses to die. Inflation and budget deficits, on the other hand, are (almost) gone.

Many developed countries experienced substantial inflation during the 1970s and 1980s, but Italy's was significantly higher than average for a long time. It reached almost 20 percent in 1974. It averaged 13 percent between 1970 and 1980, no more than in the United Kingdom then, but considerably more than in France (10 percent), Japan (9 percent), Germany (5 percent), and the United States (8 percent). In 1980 it passed 20 percent. Then it started to decrease gradually, thanks to the combination of a tight monetary policy, the nominal anchor provided by a crawling-peg regime within the European Monetary System (EMS, established in 1979), and a degree of wage restraint. Around the middle of the decade lower oil prices and a weaker dollar helped contain inflationary pressures. But all countries saw inflation decline in the 1980s, so the gap remained: Italy's average inflation rate during the decade was just below 10 percent, against 2.5 percent in Germany and 2 percent in Japan.

Inflation is rooted in expectations that may become self-fulfilling; it is therefore usually a very persistent phenomenon. However, despite a depreciation of the lira in 1992, which forced Italy to leave the EMS temporarily, inflation continued to slow down in the 1990s. One key factor was the prospect of monetary union. The Maastricht process provided an explicit goal (to qualify, a country had to keep inflation within a short distance from the best performers), and thus helped to focus the public's expectations. The government announced inflation targets, and the main agents (most importantly, the trade unions) by and large adapted to it. The 1992 devaluation thus failed to start the wage-price spiral that many had feared. The monetary stance became very tight from 1994 on, draining liquidity, keeping aggregate demand in check, and reinforcing the expectations cycle. A severe fiscal restraint, again partly dictated by the Maastricht conditions, put further brakes on demand. By the time the European Economic and Monetary Union (EMU) was launched on January 1, 1999, Italy's inflation had fallen below 2 percent.

In the context of monetary union, a low inflation rate is now taken for granted (oil prices permitting) and highly valued by nearly everybody. Large inflation differentials with respect to other European countries are anyway impossible by definition now. In this respect, Italy is a completely different country from even ten years ago.

The story about public finances is a bit less reassuring, but in this case the deadweight imposed by past recklessness was even greater. It all started in the 1970s. At the beginning of the decade, public expenditure was roughly one-third of GDP; by 1984 it had risen to one-half, and a few years later it was nearly 60 percent. This large increase was driven partly by increased demand for public education and health services, and partly by the fact that the government, in the late 1970s and early 1980s, put a lot of money into industrial policies to aid the restructuring of manufacturing firms, suffering because of the two oil shocks and worsening labor relations. The problem is that revenues, despite a significant increase in direct taxation, failed to keep pace, so that large deficits began to appear and the public debt mounted.

The debt is a way to shift the burden of today's outlays onto tomorrow's generations, which can be done but only within certain limits. New primary deficits add to the debt, as does interest on the debt outstanding. (The primary deficit is the deficit before the payment of interest on the public debt.) If primary deficits are large, and/or real interest rates are high, and/or new generations are not much richer or more numerous than older ones, then the public finances are set on an unsustainable path: at some point in the future, the burden of debt will become unbearable, whatever the patience of your grandchildren. Italy's public debt shot up in the early 1970s, to about

60 percent of GDP in 1975, but later stayed almost unchanged for a few years, thanks to the inflation tax: as nominal interest rates rose less than inflation in the 1970s, real rates (i.e., nominal rates less inflation) were low or negative throughout the decade. Starting in the early 1980s, however, with Italy's participation in the EMS, the gradual opening up of its financial markets, and a worldwide increase in interest rates, real rates became much higher. Primary deficits were still high, and inflation-adjusted interest payments rose sharply. Thus the debt began spiraling up. In 1990 it passed 100 percent of GDP; it was to rise to almost 125 percent in 1994.

Action was required. The primary deficit had begun to shrink in the late 1980s; two facts, however, accelerated the pace of decrease in the overall deficit. The Maastricht Treaty on monetary union (signed in 1990) set targets for the public finances; a currency crisis in 1992 signaled that the markets had begun to lose confidence. The latter had a more immediate effect, but the former was taken very seriously in later years, when joining the monetary union from the start became a matter of national pride. Corrective actions initially taken were somewhat haphazard, consisting mainly of temporary measures and emergency mid-year supplementary budgets. In any event, in 1991 a primary surplus was recorded for the first time. In late 1992, in the aftermath of the currency crisis, an emergency budget was passed that was much stronger than usual. In later years, structural problems began to be tackled: for instance, in 1995 there was a reform of the pension system, neither the first nor the last, but the most comprehensive reform to date. Less recourse was made to temporary measures. The primary surplus reached the unusually high value of almost 7 percent of GDP in 1997. (It has since come down.) The overall deficit shrank from nearly 10 percent of GDP at the beginning of the decade to about 1–2 percent now.

Thus, the days of recklessness are over, but the burden of the past is still heavy. The debt/GDP ratio has decreased since 1995, but very slowly; it is the highest in the euro area. More worryingly, much of the improvement in the public finances has been achieved through increased taxes and reduced interest payments; noninterest expenditure as a share of GDP is still about as high as at the beginning of the decade. Long-term commitments, especially for pensions, despite a string of reforms that forestalled the certain bankruptcy of the welfare system, are still large in comparison with those of other countries; further reform is, however, anathema to the trade unions. The large debt means that Italy will need sizeable primary surpluses for many years if the overall balance is to be kept in check. And since the inception of the monetary union, some of the sense of urgency that prompted action in the 1990s has gone.

Stereotypes may no longer apply. Inflation as a way to solve conflicts of distribution is now clearly seen as illusory; large deficits and a mounting debt, the traditional ways of accommodating claims from all sides, are now perceived as unsustainable. Italians have come to realize that they cannot have their pizza and eat it too. But there is still some way to go.

A HUGE WASTE OF RESOURCES

In the labor market, less progress has been made. The unemployment rate is higher than in most other industrial countries. The employment rate is, in comparative terms, even worse. But here, too, there are reasons for hope.

The unemployment rate is the ratio of the unemployed to the labor force (consisting, in turn, of the unemployed themselves plus the employed). This is the "headline" rate, the one usually most closely watched. It is currently 10 percent in Italy, about one point above the average for the euro area. The rate in France is close to the euro-area average; somewhat lower in Germany (8 percent); much lower in Britain (6 percent), the United States (4 percent), and, despite recent troubles, Japan (5 percent). Among the large industrial countries only Spain has a higher rate (14 percent), but in that country it has come down by ten points since 1994. In Italy, it was virtually unchanged for years—though the latest figures are more encouraging.

Even if the headline rate is not much higher than in France or Germany, in Italy unemployment is uniquely concentrated along several dimensions: gender, age, duration, and location.

The difference between the male and female unemployment rates in Italy is seven points (8 and 15 percent, respectively). This difference is much smaller in Germany and France, virtually nonexistent in the United States, and reversed in the United Kingdom, where unemployment is higher among men. Youth unemployment is about a third of the labor force in the relevant age bracket in Italy. Furthermore, unemployment in Italy is mostly long-term: two-thirds of the unemployed have been out of work for a year or more. It is one thing if most workers stay out of work for some of the time; quite another if a fraction is permanently unemployed, risking social exclusion. In France and Germany, under half the unemployed are long-term; in the United States, under a tenth.

But the regional dimension of unemployment is the most important one. In the North of Italy, the unemployment rate is 5 percent; in the South, it is 21 percent. Though there are geographical discrepancies in other countries, the size of these discrepancies is particularly large in Italy; even in Germany the difference between East and West is smaller, despite the special circumstances of Eastern Germany. This means that the average unemployment rate is a very misleading figure for Italy.

We shall presently come back to the North-South divide. For the moment, let us just observe that such striking differences between various groups of job-seekers suggest that the labor market is deeply segmented, with a core of insiders effectively protected against the risk of unemployment, and a fringe group of outsiders (women, the young, people living in the South) who face formidable barriers.

The rate of employment (i.e., the fraction of the working-age population that has a job) is less often cited than the rate of *un*employment, but it is just as important. For one thing, it is conceptually clearer. Whereas it is relatively straightforward to say what it means to be *employed,* it is more difficult to say what it means to be *unemployed,* that is, to be subjectively willing to work but unable to find a job. One illustration of this is that when jobs are scarce people may get discouraged and stop searching, thus reducing the number of the unemployed; in cyclical upturns, as some of the unemployed get jobs, more people start searching, with the paradoxical (but not infrequent) result that employment *and* unemployment may grow at the same time.

Ultimately, the employment rate represents the degree to which an economy is able to exploit its human potential. It is the product of a mix of opportunities and attitudes. People may stay at home because they do not want to work, or think they are not expected to work (for example, women in certain cultures), or cannot find work: in every case, the economy produces less than it otherwise might.

Italy's employment rate is very low. As a share of the population aged fifteen to sixty-four, it was 54 percent at the end of 2000; that is, only just above one working-age person in two actually works in Italy. This, to say the least, is a huge waste of resources. The rate is 60 percent in France and 64 percent in Germany; this again shows how comparisons based on the "headline" unemployment rate can be misleading. Spain's employment rate, six points lower than Italy's in 1994, is now about the same as in Italy. In Britain and the United States, the employment rate is above 70 percent. It is interesting to note that the difference in employment rates between Italy and the United States largely accounts for the difference in per capita incomes between the two countries. Furthermore, in Italy there is a wide gap in employment rates between men and women; women's employment rate is about 30 points lower in Italy than in the United States.

Cultural attitudes, slow in changing, may be part of the explanation. But the generosity of the pension system is likely to be even more important. Until a few years ago it was possible in some cases (especially for women in the public sector) to retire extremely early, even before age forty (so-called baby pensioners). Though this has changed, the minimum retirement age for old-age pensions is still only fifty-seven, and there are of course many former baby pensioners around, happily enjoying their long retirement years.

All this has reduced the *supply* of labor; on the *demand* side, over-regulation may have discouraged potential employers. This point is treated at length in other essays in this volume of *Dædalus,* so I need not go into details. Suffice it to say that a thick, complex, and sometimes contradictory set of rules, while effectively increasing the security of those who do have a job, makes it harder for the other half of the working-age population to find one, as potential employers are wary of entering into a basically open-ended commitment.

And the reasons for hope? The pension system has been reformed in recent years, and its worst excesses are gone. Cautious deregulation of the labor market has begun: restrictions on part-time and fixed-term contracts have been eased; temporary-work agencies, previously forbidden, have been allowed; the monopoly of public-sector agencies on job placements has been ended. More room for flexible arrangements has been allowed in national labor contracts and, most significantly, in actual practice.

This, coupled with a modest cyclical upturn, is starting to have effects. Employment has been growing for five years; in 1999 there were about seven hundred thousand more full-time equivalent workers than in 1995. The trend is still up. The increase may have been smaller than in other European countries, but the economic cycle was less favorable, too (see below, "A Lost Decade?"). Given Italy's disappointing growth rates in recent years, it is remarkable that there has been any increase in employment at all. Surveys suggest that the time young job seekers spend searching has been significantly reduced. Most of the recent increase in employment is accounted for by nontraditional employment contracts (part-time, fixed-term, temps), suggesting that deregulation and more flexible practices may have indeed played a role in raising overall employment levels. The unemployment rate did not change until early 1999, but this was just one example of the "unemployment paradox" mentioned above: as job prospects improved, more people came back to the labor market, thus initially swelling the ranks of the unemployed. Even here, however, the prospects look better: in the past two years the unemployment rate has finally started to decrease, albeit slowly.

Many economists think that all this is not enough, and that more liberalizing moves are needed, as is another reform of the pension system to speed up the implementation of the 1995 reform and introduce a more realistic retirement age. This is unlikely to be politically easy, as the unions are reluctant to concede further ground, and even the public at large is suspicious of too much freedom in the market (a proposal to ease restrictions on individual firings was rejected by referendum in 2000). Notwithstanding the examples of Spain and other European countries where more courageous deregulation has been followed by larger increases in employment, reform is likely to come in small doses. And, of course, while greater flexibility in the labor market would probably increase the average level of employment in the long run, it would also make it more sensitive to the economic cycle.

Even in the South employment has increased in recent years, though later and by less than in the North. But whatever improvements may follow from any reforms, the North-South employment gap is unlikely to be eliminated for a long time to come. Deeper factors are at work here.

THE NORTH-SOUTH DIVIDE

Italy is, economically, a divided country. In the eight regions that comprise the "Mezzogiorno" (South), where more than one-third of the population lives, per capita GDP is virtually half (54 percent) of per capita GDP in the Center and North. The South's unemployment rate is twice the national average, and more than four times the rate in the North. The employment rate is abysmally low. The share of agriculture and public services in employment is much higher than average. Exports account for 8 percent of GDP, against 25 percent in the Center-North. Per capita private wealth is much lower than in the Center-North, but inequality is greater. One could go on and on. Nearly every economic indicator shows a huge gap compared with the rest of the country.

The GDP gap narrowed significantly from the postwar years until the mid-1970s. Per capita GDP in the South rose from 53 percent of that in the Center-North at the beginning of the 1950s to more than 60 percent between 1970 and 1975. In the 1980s there were ups and downs; in the early 1990s, the gap grew wider again (though recently released revised figures point to some improvement in the second half of the decade).

Some Mezzogiorno regions have been more dynamic than others. Abruzzo has experienced a mix of subsidy-driven and endogenous, small-firm-based development. Similar development has taken place in neighboring Molise and in scattered areas in other regions. These, however, are the exceptions. On the whole, in the last quarter of a century the North-South gap has, if anything, widened.

There is a huge literature on the Mezzogiorno's backwardness, but no consensus on its causes. Some blame it on geography—i.e., the sheer distance from rich markets. Some prefer to invoke history, arguing that it is a result of divergent political legacies, northern city-states versus southern feudalism. Ancient legal and social differences may have survived for centuries, but it seems remarkable that almost a century and a half since Italy became a unitary state, with a single market, a single legal and administrative system, and no legal barriers to mobility, the gap between North and South should persist.

The *questione meridionale* ("Southern question") in fact emerged soon after the unification of the country. It was initially widely thought (in the North at least) that the poverty of the Mezzogiorno was due simply to the misrule of the Bourbon kings of Naples, and would promptly disappear with a more enlightened government. It did not. Very early, the economic aspects of the *questione meridionale* were seen to be strictly linked with other aspects, mainly the lack of infrastructure and the presence of organized crime (the mafia), both of which obviously discouraged economic initiatives. Over the decades that followed, Italian governments of all political kinds tried to lure firms into the South through subsidies, to reduce the infrastructure gap through public works, and to keep crime in check with (sometimes half-hearted) police measures. Such policies worked only in part. In the very long run, some convergence is likely to have taken place, though precise economic statistics for remote times are hard to come by. But in more recent times the process of convergence seems to have stopped.

A key question is why there was convergence in the third quarter of the last century but not in the fourth. Infrastructure investment was particularly important in the first decades after World War II. Projects managed by a special development agency (the "Cassa per il Mezzogiorno") significantly reduced the infrastructure gap and helped to accelerate growth in the South. The contribution of public investment has been less significant in recent years. One reason is lack of central government funds: when the budget is tight, capital expenditure is the easiest target for cuts. Another reason is corruption, which is thought to have affected public works, especially in the 1980s, increasing the cost and reducing the effectiveness of investment. (Besides, after the famous "Clean Hands" investigations started in the early 1990s, public investment almost stopped for some years, as regulations on public investment became tighter and officials became scared of taking responsibility for expenditure decisions. Though not exclusively, or even mainly, a Southern phenomenon, the "Clean Hands" scare had perhaps a comparatively greater impact on the South, where public works accounted for a larger share of local output and investment.) Finally, there are likely to be decreasing returns to investment in infrastructure, as to many other economic activities: thus investing now in the South is unlikely to yield as large effects as in the 1950s, when even basic needs such as the supply of fresh water had to be met.

In addition, in the 1950s and 1960s there was internal migration from South to North on a large scale. Whatever the personal sufferings and social disruption that this brought, from the economic point of view it was a powerful equilibrating factor, as it redistributed labor from where it was abundant and cheap to where it was scarce and well-paid. The safety valve of migration meant that there was no significant regional divergence in unemployment rates then, and it caused wages and per capita incomes to converge. Migration stopped in the 1970s, for various and perhaps not entirely understood reasons; a hyper-regulated and heavily taxed housing market, which in those years made the decision to move a difficult and costly one, is surely part of the explanation. Regulation of the housing market has been gradually eased in the last decade; possibly in connection with this fact, internal migration has picked up recently, albeit on a smaller scale.

Wages were once, by contract, lower in the South, a situation derogatorily known as "wage cages." When the "wage cages" were abolished and a single national rate was established, this was saluted as a fundamental equity step. Today, however, the unemployment gap being what it is, the concept of a single national wage appears increasingly illogical. Of course it is not rigid regional wages that are needed, but more flexibility to adapt the compensation of labor to specific situations, both between North and South and within each area.

De facto, official, trade-union sanctioned exceptions to the national wage rate are being negotiated (special areas, starting wages in particular conditions, and so on). Much more is likely to be needed if a significant change in unemployment is to take place. Beyond that, irregular labor, with low wages, remains widespread in the South. This takes some of the pressure out of the labor market, but generates a segmentation between an overprotected class of workers and an unprotected one, which is highly regrettable in terms of both efficiency and equity.

State-owned firms invested a lot in the South in the late 1960s and early 1970s in the hope that large manufacturing plants would not only provide jobs themselves, but also kick-start local development through subcontracting networks, local demand effects, or imitation effects. On the whole, this strategy was not a success. Public manufacturing investment did have an impact initially, but the state was unwise or unlucky enough to invest mostly in heavy manufacturing industries like steel and petrochemicals, which became uncompetitive after the oil shocks of the 1970s. Many plants had to shrink or close down eventually, at great cost to the taxpayer. And the spillover effect was much smaller than had been hoped.

One form of policy support for the South has long been subsidies to firms. Subsidies are meant to compensate for local diseconomies. In general it is better to try to eliminate the diseconomies rather than offset them through subsidies, for a subsidy policy that is protracted for several decades will entrench a culture of dependence and support inefficient productions. In any case, the long and disappointing experience of the Mezzogiorno demonstrates that one cannot expect too much of subsidies. Discretionary subsidies in particular may be dangerous because they distort the incentives for the most enterprising people in a way that is detrimental to long-term development.

If generous discretionary public incentives are available in a less developed area, many people may come to think that the surest way to make money is not to start a business that would be successful in the market, but to start one that would be amply subsidized. So their efforts will be devoted to maximizing monetary incentives rather than market profits. Furthermore, if entrusted to dishonest individuals, discretionary incentives will also encourage corruption, which is a brake on long-term development.

Recently, the government has tried to channel subsidies through locally coordinated initiatives, in an admirable attempt to foster a spirit of cooperation and entrepreneurship. But the inherent discretionary element has resulted in difficulties in implementation and long delays.

Is there any hope? This author's suggestion would be: invest in infrastructure (where really needed), education, and reducing the crime rate; put further (official) flexibility into the labor market; further reduce regulations and taxes on housing transactions, in order to eliminate unnecessary constraints on mobility; then leave the market to do its work. There is surely no shortage of entrepreneurial spirit in the Mezzogiorno. Too much reliance on subsidies should be avoided. If some are to be retained, they should be moderate and preferably automatic, in order to minimize distortions, uncertainties, delays, administrative costs, and corruption.

A LOST DECADE?

The 1990s stand in stark contrast to the bright picture painted above ("From Rags to Riches"). The rate of growth not only declined, but became lower than in the other industrial economies. The share of Italy's exports in world trade contracted. Italy slipped in economic league tables. What went wrong?

One partial answer is the end of the "catching-up effect" explained above. But while this may explain a slowdown in growth, it cannot account for a growth rate that was lower than in the leading countries.

The "hangover effect," as it may be termed, is likely to have been more important. By this I mean the depressing effect of the tight fiscal and monetary policies that were necessary to redress the legacy of macro imbalances (see above, "Learning to Do Our Sums"). Italy had long been intoxicated by large deficits and high inflation. Facing strict EU requirements, as well as the threat of financial crisis, Italian governments had to take radical action to bring the public finances under control. Higher taxes depress demand in the short run, and in the longer run make firms less competitive because of higher costs. The reform of the pensions system is likely to have depressed private demand: with about one-quarter of pension "wealth" effectively confiscated by the reforms (according to some calculations), households reckoned they had to save more, and reduced consumption accordingly. Monetary policy could offer no relief, as a tight stance was required to fight inflation, steer the currency, and preserve stability in the markets.

If this is all there is behind Italy's disappointing economic performance in the 1990s, then the prognosis is rather good. Inflation is now low; interest rates are low; the public finances are more or less on track. While complacency would be misplaced, and while it would be wise to bring down expenditure in order to decrease taxes, and to overhaul the pensions system once again, no draconian emergency measures like those seen in the past are to be expected in the near future. Thus, if the slowdown was due only to macro policies, then recovery must be at hand, and the decade will not have been lost. Italy only had a one-off cost to pay for past recklessness. In fact, economic activity has picked up recently (though significant oil price increases were starting to dent consumer and business confidence in the second half of 2000 and may become a real problem if they continue; this, however, is not a problem for Italy alone).

But some think that the hangover effect is only part of the explanation, that there are deeper issues that raise questions about the Italian economy's ability to compete in future years.

One recurrent matter is that of the size and branch structure of industry. This has already been discussed above ("The Paradox"). Two more items appear to deserve attention and will be taken in turn in the final sections.

ITALY AND THE EURO

On January 1, 1999, Italy, along with ten other EU states, entered the monetary union. In contrast with other countries, there had been virtually no debate in Italy on the desirability of the union. Italians (including this author) have always been instinctively pro-European, and they welcomed the further opening up of their market and their country.

The question was whether Italy would qualify. The Maastricht Treaty, to ensure that the undertaking would be viable, required that before the outset of the union all participating countries satisfy certain stringent requirements for inflation, interest rates, exchange rates, and the public finances. In 1992 Italy satisfied none of these requirements. As already noted, the Maastricht criteria focused expectations, were an important aid for action, and helped entrench a culture of stability. In the end, the test was passed.

Though the technical issues concerning the costs and benefits of the union were barely discussed in Italy, it is useful today to consider the rational arguments of those who opposed the union. It is no longer a question of joining or not; it is a question of seeing the risks, and avoiding them.

I shall, however, spare the reader a detailed discussion of the main academic argument against the union, i.e., asymmetric shocks: the notion, that is, that exchange rate flexibility helps when unexpected changes in supply or demand affect different countries in different ways. Apart from avoiding technicalities, the reasons for skipping this discussion are, first, that its practical relevance is still difficult to establish (academic opinion is divided about this); and, second, that there is little we can now do about it anyway. For the informed reader, let me just add that, while Europe may not be a Mundell-optimal currency area, it is far from clear that the pre-EMU member states were such an area in any case—especially Italy, with its vast regional structural differences. Optimal currency areas, an attractive concept in theory, in practice are very difficult to define in a technically uncontroversial way.

A point whose practical relevance is clear is cost competitiveness in the long run. In a monetary union there is no room for permanent inflation differentials. So it is necessary for price- and wage-setters throughout the union to follow similar rules and have the same expected inflation rate in mind to guide their decisions. Opponents of monetary union thought that different wage-setting procedures and traditions in different countries resulted in inherently different inflationary biases. Of course, if wages (or production prices) always increase more in one country than in another, monetary union will lead to ever more serious competitiveness problems, and there will be no currency devaluation available to solve them.

Italy was certainly deviant in this sense in the past. It has changed its ways, as discussed above; it remains to be seen whether it has entirely adapted to the new circumstances. Some omens are good. In the first year of the monetary union, unit labor costs in Italy grew more or less in line with the euro average, though half a percentage point faster than in France and one point faster than in Germany. One point may not sound like very much, but a difference of that order of magnitude sustained over a number of years will build up into a sizeable competitive gap. This is a risk; it is as yet unclear whether Italian decisionmakers are fully aware of it.

My last point is perhaps less conventional. One sure effect of the monetary union is external stability: no more lira crises. This is obviously a blessing, but not an unmixed one. While currency crises are dangerous and disruptive, a crisis (or even the mere possibility of one) is sometimes instrumental in spurring decisionmakers into action; also, it may be the only way to correct accumulated imbalances when collective irresponsibility has ruled out alternatives.

In retrospect, the 1992 Italian currency crisis can be seen as having served both of these constructive functions. Of course, the consequences might have been disastrous. A really disruptive financial crisis could have ensued if the Bank of Italy had not reacted promptly, the government had done nothing, and markets had entirely lost confidence. A wage-price-exchange rate spiral could have been started by the lira's floating (as had usually happened in the 1970s in similar circumstances), if a "social pact" had not just been signed and the unions had not behaved responsibly. And, of course, behaving sensibly from the beginning is better than being compelled to mend your ways later.

But what one can at least say is that, with the monetary union, Italy has replaced a market constraint on collective behavior (the currency-crisis risk) with an institutional constraint (Europe's post-Maastricht "stability pact" and the fiscal rules that go with it). To make this step, Italy has had to change. It has changed; but one should always beware of the dangers of complacency.

ITALY AND THE NEW ECONOMY

The "new economy," whatever the phrase exactly means, is about information technology and the ability to adapt flexibly to it and to exploit its economic potential in full. This last section is a speculative survey of the main issues bearing on Italy's prospective competitive position in this respect. Three points appear to deserve attention (a more specific point concerning industrial districts has been discussed above in "The Paradox").

First, technology leaps produce exceptions to the "law" of catching up. When such leaps occur, leading countries race ahead in productivity growth; latecomers lose ground for a while. This appears to have happened in recent years, and of course it has been to the disadvantage of a country like Italy, which is technologically advanced but not, generally, on the frontier of innovation. On the other hand, for years now America has experienced rates of growth of GDP and productivity that go beyond what most economists had deemed sustainable in normal times. How long this growth differential will last is a moot point (America also has macro imbalances of its own that sooner or later will bite). Information technology innovations, inherently, spread quickly; the catching-up process, when it sets in, will be fast.

Second, the new economy is knowledge-intensive. Here Italy may have a specific problem. On most indicators of educational input or attainment, Italy scores low compared with other advanced countries. Empirical studies have regularly found a low return on education in Italy, and even a negative correlation between education and entrepreneurship. This may be another aspect of the Italian structural paradox described above; small district-type firms may require more practical and commercial knowledge than formal education. But it is unlikely that Italy will be able to reap the full benefits of the information age without investing more in education.

Third, the new economy implies rapid change and the sudden emergence of new profit opportunities, which requires flexibility. Productive and commercial flexibility and the ability to spot and exploit new market niches are defining characteristics of Italy's successful firms, so this per se should not be a problem. But the nation's regulatory framework may be.

According to an OECD study, setting up a new firm in Italy requires more separate permits than anywhere else in the developed world. Hiring and firing workers is a slow and costly process. Cumbersome regulations, well-meant but sometimes ineffective, are myriad. All these are problems if you have to reallocate resources quickly between types of production, and if you want to make it simple for bright young people to try their fortune in a new venture.

Attitudes toward (over-)regulation have been changing for some time. The trade unions, for instance, now accept that flexibility in the use of labor is important, and they are usually ready to reach compromises on, say, the rules governing shifts or overtime (though not on job security). Nontraditional forms of employment are expanding. One point that would have appeared in the problem list some years ago is telecommunications infrastructure. It no longer really does: a radical process of privatization and deregulation has introduced healthy competition in this field, which has driven prices down and promoted a rapid (if still insufficient) expansion of services.

This is, by the way, just one example. Italy, once the home of the "mixed economy" system of partly-public ownership of firms, has been a fervent (though somewhat late) privatizer. For instance, IRI, the main state holding company, which used to own a vast industrial empire spanning steel, cars, telecommunications, canned tomatoes, Christmas cakes, and much else, was liquidated early in 2000; most of its companies have been privatized. Much, however, remains to be done. Electricity still has to be deregulated and privatized, and current plans are too timid. The laws on commerce are too restrictive. Those on the professions are even more so. And the labor market does need more freedom.

One could say that Italians have more or less learned their macro lessons, but are still halfway through the micro handbook. Whereas a culture of macro stability has taken hold, many people retain too much confidence in the possibility of achieving public aims (such as job creation, competitiveness of firms, consumer protection) through regulation or direct public action; they underestimate the potential of market mechanisms. This is the new challenge. The "new economy" just makes facing it all the more urgent.

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Fabrizio Barca

New Trends and the Policy Shift in the Italian Mezzogiorno

THE ITALIAN MEZZOGIORNO: A CHALLENGE AND AN OPPORTUNITY FOR ITALY AND EUROPE

One hundred and thirty years after the birth of the Italian state, the Mezzogiorno stands as Italy's greatest challenge. Encompassing the southern part of Italy, including Sicily and Sardinia, the Mezzogiorno has 21 million inhabitants. With an official unemployment rate of 21 percent, a substantial black-market economy, and a network of criminal organizations, the South still has many unexploited resources that represent the potential for much higher growth and living standards.

Since 1992 major changes have occurred in society, in the economy, and, more recently and tentatively, in public institutions and policy-making that are making it possible for the Mezzogiorno to rise to the challenge. These changes are linked to the revitalization of European integration and to Italy's effort toward and success in being a founding member of the European Monetary Union (EMU). How the Mezzogiorno will emerge from this phase depends largely on the results of the ongoing attempt to reform the state apparatus. Both in the persistence of backwardness and in the novelty of the present transformations, the Mezzogiorno shares its destiny with many other peripheral areas of Europe.

In terms of per capita income, the gap between the Mezzogiorno and the fast-growing Center-North fell in the postwar period until the mid-1960s. After being stable for twenty years, the

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gap between North and South started to rise again until the mid-1990s (see figure 1). It is now measured at about 44 percent, though this figure, while including an estimate of income from the black-market economy, does not take into account the higher purchasing power of a lira unit in the South.

As for Europe as a whole, recent studies have shown that while productivity and income gaps between states have diminished, gaps *within* states have either remained unchanged or increased.[1] More than 80 million Europeans, about one-quarter of the EU population, live in regions with a per capita income that is less than 75 percent of the EU average; this figure will increase when the EU expands to include ten Eastern European states, plus Cyprus and Malta. Only 2 percent of the U.S. population is in a similar bracket.[2] The Mezzogiorno represents, therefore, an extreme version of a more general European condition.

Figure 1. Income Gap: 1951–1998*

*Differential between the per capita income of the Mezzogiorno and the Center-North as a share of the per capita income of the Center-North (current prices).

Source: P. Casavola and P. Sestito, "Politiche di sviluppo e politiche del lavoro: che sta succedendo nel Mezzogiorno?" *Lavoro e Relazioni industriali* (2) (2000). This paper is based on Svimez data, *Economic Accounts for the Italian Regions* (Bologna: Il Mulino, 2000), for the years 1951–1995 (with a break in 1970), and Istat data, *Territorial Accounts,* sec. 95 database at <http://www.istat.it>, for the years 1995–1998.

The persistence of regional gaps is strongly influenced by the slow pace of European cultural and social integration. For many years, there were two further obstacles: national policies aimed at protecting the uncompetitive industries of specific states, and barriers to capital mobility. The first obstacle has been gradually dismantled since 1985. The second was removed in 1998; it made the implementation of new policies a "win-or-lose-Europe" issue. The reason for such a strong statement is straightforward.

Forced to face full capital mobility without the possibility of enacting compensatory mercantilistic policies at a national level, backward regions in Europe—from Cornwall in the United Kingdom to Epirus in Greece, Galicia in Spain to Brandenburg in Germany, Calabria in Italy to parts of Central Norrland in Sweden—must make a difficult choice.

They can enact policies aimed at increasing the competitiveness of their territories by offering capital "credible prophecies" of higher profits.[3] If they do so, they can exploit the new capital mobility and turn the adventurous leap forward of Monetary Union into a major asset. Alternatively, they can take a *laissez-faire* attitude—ignoring that fully mobile capital tends to move away from backward areas—or rely on traditional subsidizing regional policies, ignoring how much they weaken entrepreneurial "animal spirits." In both cases, investors will punish backward regions—and the fragile path of the European Union will be jeopardized by widening regional gaps.

The implementation in the Mezzogiorno of a new development policy aimed at increasing territorial competitiveness thus represents an important test case for all of Europe. At the same time, Europe provides the Mezzogiorno with an indispensable framework for credibly carrying out such a policy. Increasing territorial competitiveness requires highly qualified public investments with as much private financial support as possible. This in turn requires a drastic modernization of public administration and the creation of binding incentives for public officials. Pressure from Europe may lend the Mezzogiorno the credibility to perform these feats.

If this were to happen, Italy as a whole would benefit, and not only via the growth push from its southern areas. Modernization of the public administration and new methods for selecting the ruling class are tasks not limited to the Mezzogiorno; they affect the economic and strategic potential of the whole country. As Tommaso Padoa-Schioppa argues in this issue, the urgency of a well-functioning state has been increased by the progress of the European Union. The Mezzogiorno could provide Italy with a much-needed push to accomplish its long transition process to mature statehood.

ECONOMIC AND SOCIAL TURNAROUNDS

Profound changes are taking place in the Mezzogiorno's economy and society, creating new opportunities for its development. These changes followed three concurrent events: the end of a forty-year-old policy of top-down economic administration; a strong tightening of law enforcement; and the beginning of a radical devolution of political and administrative power. All of these events took place in 1992–1993.

In 1950, the Italian government, in order to ensure development in the Mezzogiorno, created a "temporary" public agency—the Cassa per il Mezzogiorno—that was put in the hands of reputable public servants and skilled technicians.[4] The new agency was part of a general strategy that did not trust ordinary public administrations to be able to carry out public investment policies because of their inflexibility, their links with the fascist regime, and their inability to pay adequate wages. The concurrent creation of state-owned corporations such as ENI, IRI, and Mediobanca were part of the same strategy.[5]

Over the following fifteen years, the Cassa per il Mezzogiorno built up the infrastructure of the South and created incentives for the development of new industrial sectors. The Cassa contributed significantly to the region's very high growth rates in this period. But there were costs: the Cassa's Rome-centered, highly discretionary approach left little room for holding local authorities responsible and making public choices accountable. These turned out to be very serious flaws, especially in an area of Italy where neither local nor state officials were trusted.[6] Members of the local ruling class, mostly acting as mediators for decisions made in Rome, were delegitimated as providers of public goods. In the eyes of many Southerners, local politicians and administrators were exploiting local offices for personal advantage.

In the mid-1960s, the vices of the system became apparent. Major mistakes were made in the allocation of resources. Lack of accountability increasingly allowed public authorities to be captured by private interests.[7] Moreover, both the Cassa and state-owned enterprises were charged with new goals—increasing the pace of investment, creating new employment opportunities—that went far beyond their original charter. The negative economic effects were immediate: the income gap between North and South stopped dropping.

The creation, in 1975, of new regional governments did not change the picture. The ineffectiveness of these new regional governments owed more to the persistence of the Cassa's top-down approach to public investment than it did to some mysteriously innate lack of civic spirit, pace Putnam.[8] As Bagnasco has rightly argued, the performance of a region largely depends on the extent to which local institutions can capitalize on whatever kind of civic spirit does exist.[9] After 1975, Italy's existing institutional framework gave the regional governments of the South little choice but to beg for more resources from the Cassa per il Mezzogiorno in Rome.

Although it was formally dissolved in 1986, the true dismantling of the Cassa was delayed by the network of private interests that it had created.[10] Finally, in 1992, the pressure of European integration made it impossible for Italy to persist in implementing clearly anticompetitive policies. The top-down approach to policy-making for the South was abandoned. And one year later, the process of privatizing state-owned enterprises was launched, bringing "compensatory investments" in the South quickly to a halt.[11]

At the same time, popular resentment of the state's role in the South, long repressed in the Center and North, came to the surface with the rise of the Northern League. As a result, the issue of the Mezzogiorno disappeared from the political agendas of all parties. Since no alternative economic policy was implemented, public investment in the Mezzogiorno started dropping even more than in the economy as a whole: from a top level of 21 billion euros in 1992 (at 1994 prices) to a minimum level of 15 billion euros.

Only in one policy area was the central government more active than in the past: law enforcement. After the mafia assassination in 1992 of the two most prominent members of the antimafia pool—Giovanni Falcone and Paolo Borsellino—measures in favor of collaborators (*pentiti*), from family protections to reduction in sentences, were taken with unprecedented results. In 1993, mafia boss Salvatore Riina was arrested. In the same year, Leoluca Orlando, who had severed his links with Giulio Andreotti's Christian Democrat Party, won the post of Palermo's mayor with a radically new political agenda. Between 1991 and 1993 about twenty-five municipal governments were dissolved each year because of their ties with organized crime. The number of convictions rose in the four regions where organized crime was most active (Campania, Calabria, Apulia, and Sicily: the home bases for, respectively, the Camorra, the 'Ndrangheta, the Sacra Corona Unita, and the mafia).

At the same time, in 1993, another crucial event took place that enabled new local leaders to emerge. A reform in the electoral system of municipal governments was introduced, making it possible for citizens to vote for city mayors. Since then the strengthening and increased personal responsibility of mayors has created the incentive and the means necessary to modernize their administrations and to restore the historical centers of towns as diverse as Salerno and Bari, Catania and Cosenza, Naples and Syracuse.

To sum up: at the beginning of the 1990s, three distinct and partly independent changes took place in the Mezzogiorno. State-sponsored transfers of wealth to the area were sharply reduced; law enforcement was increased; and the responsibilities of local authorities were enhanced. It is too early to tell how much of what has happened since should be attributed to these changes and their interaction. But there is no doubt that local actors in the Mezzogiorno have made themselves more effective and achieved some notable results.[12]

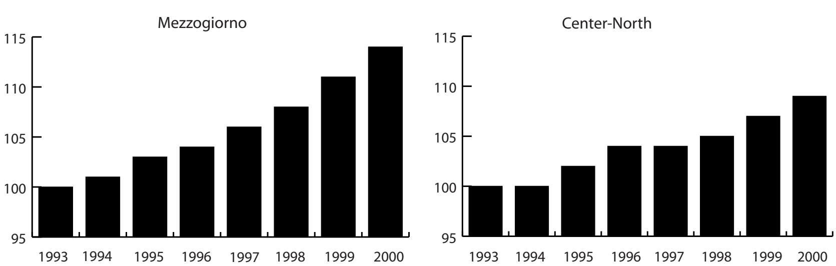
After 1995, the turnover rate of southern nonagricultural enterprises—the number of new businesses opened, minus the number of those shut down—started to rise; by 1997, it had become much higher than in the Center-North (see figure 2). The region's lively entrepreneurial climate led to the strengthening of many local agglomerations of firms. In some areas, private and public actors came together to create "territorial pacts," coordinating business plans and asking the central government to finance a common project.[13] For the first time, national policymakers came to recognize that the Mezzogiorno had some areas of potential economic strength.

At the same time, the region's attitude toward risk and mobility has clearly changed. According to surveys, young Southerners are now much readier than their Northern counterparts to start self-employment enterprises. Surveys also show that Southerners are readier than Northerners to seek jobs in provinces other than their own.

An increase in the competitiveness of the Mezzogiorno's enterprises occurred in the 1990s, as shown by a continuous rise since 1993–1994, both in exports and in the number of tourists (see figures 3 and 4), though both are still low by Italian and European standards.[14]

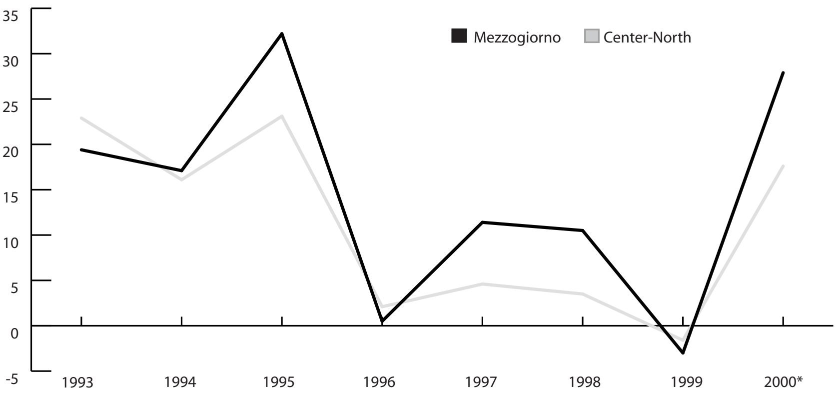
These changes support four provisional conclusions. First, reform can take place even in the Italian Mezzogiorno. With its age-old traditions and idiosyncratic culture, the Mezzogiorno

Figure 2. Stock of Nonagricultural Enterprises
(number of registered firms; 1993=100)



Source: Italian Union of the Chambers of Commerce (Unioncamere), Rome, Movimprese database (2000) at <http://www.unioncamere.it>.

Figure 3. Merchandise Exports, 1993–2000*
(percentage changes at current prices)



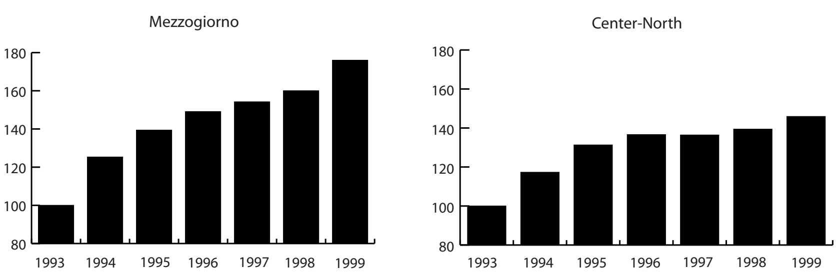
*January-September.

Source: National Institute of Statistics (Istat), Rome, export statistics database (2000) at <http://www.istat.it>.

can move away from its historical backwardness if its heritage of hospitality, curiosity, and open-mindedness is fully exploited with an appropriate institutional design.

Second, reforms took place only after Rome abolished its top-down policy-making: the resulting increase in local responsibility looks like the main driving force for change.

Figure 4. Foreign Tourism (thousands of persons/day; 1993=100)



Source: National Institute of Statistics (Istat), Rome, tourism statistics database (2000) at <http://www.istat.it>.

Third, the key changes have involved a more efficient exploitation of resources peculiar to the Mezzogiorno: the natural resources of the Apennine mountains and the coast lines; the region's cultural heritage and supply of hitherto underutilized human capital, both intellectual and manual.

Fourth, the economic and social turnaround is not yet fast and strong enough to reverse long-held prejudices and redirect national and international capital to the area. Changes affect only a few areas and sectors and are often quite small. And the state has been slow to adjust: increasing municipal efficiency has not yet been matched by regions' and the central state's ability to increase the efficiency of its apparatus and to plan and implement those public investments that are called in by market awakening.

These conclusions suggest the outlines of a new regional policy that can be applied to the Mezzogiorno and to all backward regions in Europe.

IDEAS FOR A NEW POLICY

European regional policy has for a long time largely aimed to compensate backward regions after the fact for their lower incomes. In spite of a recent shift in general principles[15] and several alternative experiences,[16] the European debate still centers largely on efforts to shore up specific sectors—industry, agriculture, communication, training—and on state subsidies to efforts aimed at compensating firms located in backward regions and creating new industrial districts. All this is very unfortunate.

The logic of such state incentives runs contrary to a reduction in competitive barriers and leads backward regions into zero-sum wars of subsidy increases or tax reductions. It also assumes, implausibly, that the central government best knows how to capitalize on business opportunities in the various backward regions. The current trend in the Mezzogiorno calls for a radically different approach that faces up to the challenge of high capital mobility. The goal is to create a permanent incentive for local entrepreneurs to create businesses and for foreign businesses to move into the area.[17]

A policy aimed at increasing territorial competitiveness must be centered on the potential competitive advantages of the region: the Mezzogiorno's human capital; its existing networks of firms; its unique cultural and natural resources. At the moment, these assets are far from being adequately exploited.

In the Mezzogiorno today, more than one-quarter of all labor time is spent on jobs performed outside any legal framework. While some of this "black labor" goes into illegal activities or very low-productivity jobs, the majority of it involves skilled workers whose potential productivity is high. At the same time, there is a large reservoir of unemployed youth with university educations: this potential asset has been fully exploited only by a few high-tech firms that have invested in university areas such as Bari and Catania—for example, Bosch, Getrag, and ST Microelectronics.

The potential advantage arising from the existing clusters of firms in the South has been largely underestimated in the past. As recent comparisons of similar clusters of successful firms in the South and in the Italian Northeast show,[18] the Mezzogiorno's clusters equal those in the Center-North in quality of labor and ability to produce goods for export. But the Southern clusters have a strong disadvantage, namely, the relative weakness of the formal and informal relations among firms within the clusters: the profitability and productivity of most districts depends precisely on these relations.[19]

Firms in the Mezzogiorno's clusters buy less from each other than firms in clusters in the Center-North, and they prefer to deal with firms outside their districts. Firms in the South also fail to cooperate in setting up shared services, in creating risk-sharing institutions that allow for lower credit costs, and in lobbying together for specific improvements in their local business environments. As interviews have shown, the reason for this difference in behavior between firms in the North and South lies largely in the lack of trust between firms in the South.[20]

All this suggests that, rather than trying to create new clusters or pinpointing preferential areas for development, government policy should aim at enhancing formal and informal relations inside existing clusters. This would increase the returns on investments in those districts and set into motion a virtuous circle of higher productivity and still higher investments.

Similarly underexploited are natural resources. While water is a plentiful resource in the Mezzogiorno and many reservoirs have been built, one household out of five does not have a regular water supply; this is because many of the reservoirs in the South have never been linked to the main water supply. The beds of many seasonal rivers have not been dredged and their banks have not been reinforced for years, creating a constant threat of flooding.

Protected natural areas represent 7 percent of the South, the same share as in the North. They include vast tracts of pristine land, home to many rare plant and animal species—such as the loricato pine and the royal eagle in the Pollino National Park, and the peregrine falcon and the royal owl in Aspromonte. In spite of this variety, the number of visitors per hectare of land in the South is one-third of what it is in the Center-North.

The region's cultural resources are as rich—and poorly utilized—as its natural resources. There are hundreds of cultural sites of extraordinary historical and aesthetic value throughout the Mezzogiorno, quite apart from such famous tourist attractions as Pompeii, Selinunte, or Villa Armerina. Other attractive sites include the Apulian-Lucan cliff-dwellings on the border between Basilicata and Apulia; the great palaces of Caserta and Carditello; the Neapolitan museums of Capodimonte, San Martino, Villa Floridiana, and Villa Pignatelli; and the network of Norman castles in Apulia. In fact, archaeological sites cover 1,400 hectares, compared with 1,000 in the Center-North. But only 38 percent of these archeological areas in the South are open to the public, often only partially. The museums in the South are often extraordinary, but only 7 percent of them offer any entertainment service or any reading and audiovisual material to visitors, as opposed to 70 percent in the Center-North.

Its natural and cultural resources ought to make the Mezzogiorno a major tourist destination. On one composite index of tourist attraction, the Mezzogiorno scores 36, compared with 32 for the whole of the Center-North. But the region's natural and cultural sites are often locked, inaccessible, or insufficiently staffed. Marketing is inadequate. Most locales ignore the opportunities to develop the manufacturing and marketing of traditional crafts to tourists. As a result, there are only 62 tourists per 100 inhabitants in the South, compared with 163 tourists per 100 inhabitants in the Center-North.

Four policy imperatives emerge from this analysis.

- *Increasing competition*. The Mezzogiorno requires stronger competition in its labor and product markets. This means making it easier to enter and leave jobs and allowing a larger share of wages to be dependent on bargaining at the firm level rather than at the national level. It also means privatizing local public utilities and reducing those anticompetitive procedures and barriers in the market for business services that today greatly reduce their quality.

- *Improving transportation*. Much of the Mezzogiorno remains distant from major European and international centers. A fast-growing demand for sea and air transport from the southern regions requires relevant investments in both harbors and airports. The main railway route allows passenger trains south of Naples to run at speeds no higher than 80 km per hour. The fastest developing European transshipment harbor, Gioia Tauro, risks wasting the chance to spur on neighboring areas because of the lack of proper railway connections to the northern regions. In the past, new projects for transport infrastructures in the Mezzogiorno have been seen largely as a source of employment in the construction period; they should instead be undertaken on the basis of an appropriate evaluation of demand and of territorial impacts.

- *Fostering industrial districts*. The third priority requires policies aimed at increasing "relational capital." These include stronger law enforcement and a modernization of the judiciary system to ensure strict observance of contractual relations inside the clusters; a radical modernization of local administration, with the creation of accountable procedures for selecting local projects; the building of institutions in which private and public local actors are encouraged to create partnerships; adequate urban planning; incentives for networking and for making full use of new information technologies, offering high-quality small firms already operating in the South the opportunity to use the Internet to market their territory-specific products to distant consumers; and training of the local workforce.

- *Making natural and cultural resources more accessible.* To achieve this final goal, the government must invest in the restoration of archaeological sites, fortresses, and monuments, the creation of attractive museums, and the protection of natural areas. It also must improve transport to these sites and set aside areas to develop appropriate hospitality services for all types of tourism. Also required is the privatization of the water supply and the investments necessary to increase its effectiveness and efficiency.

In order to increase territorial competitiveness through these four policy imperatives, improvement of the services provided by the state, particularly at the local level, must be achieved. Whether publicly or privately financed, the public investments necessary to achieve these goals must be carefully monitored. This in turn requires a profound change in the way policy decisions are made. In short, a radical improvement in the efficiency of the state apparatus comes to the fore as the primary factor necessary to maintain the Mezzogiorno's momentum.

AN EXPERIMENT FOR 2000–2006

In the spring of 1998, the Italian Treasury was charged with the task of devising a plan for the years 2000–2006 for using about 24 billion euros of European funds—48 billion once national cofinancing is included—for public investments in the Italian Mezzogiorno.

Drawing up the plan involved eighteen months of intense and sometimes bitter negotiations between the federal government, the region, municipalities, and various social partners. The plan was finally approved by the EU in July of 2000.

Not only does the EU require transparent accountability, but the international nature of the plan increases the credibility of its new and binding rules and policy goals. These features make it possible for the plan to become a turning point for the Mezzogiorno.

The plan addresses three of the four priorities we have enumerated. The first, increasing competition, lies outside its reach, but its implementation is necessary in order to achieve the other targets. In particular, more flexibility in negotiating wages and easier job mobility should now be accepted by unions as complementary to the 2000–2006 experiment.

As for improvements in transport, foundations have been laid for selecting appropriate projects. Twenty-five years after engineers first conceived the building of a 3,690-meter bridge between Sicily and Calabria, its economic, social, and environmental impacts have finally been evaluated as opposed to those of an alternative solution—the setting of several competitive sea linkages across the strait. Similar feasibility studies are being carried out for the rest of the area. This new way of planning should finally allow the project to be selected and undertaken and private funds to be attracted.

A hefty 32 percent of the plan's resources are assigned to local development. Despite strong pressure from the conservative Italian Confederation of Industrialists, incentives for businesses have been drastically reduced. A larger share of resources is thus left to finance projects proposed by local partnerships of firms interested in new local infrastructures and training and research facilities. Territorial pacts inside clusters therefore have a relevant role to play.

Law enforcement receives 2.5 percent of resources. And 2 percent of total resources is allocated to the modernization of those administrative structures that have the responsibility for implementing the plan. A further 11 percent of resources is allocated to the training of public and private agents and to improving the match of supply and demand for labor.

The plan similarly sets guidelines for developing the cultural and natural resources of the region. It focuses funding on areas where increased accessibility could attract significant private investment. Maintenance and restoration of natural and cultural resources are linked to training, research, and the construction of the transport services needed to turn these resources into sources of employment and economic growth. A quarter of all funds is allocated to these targets.

These are not easy policies to implement. A skeptic may wonder what guarantees that a public sector that has collectively wasted resources for such a long time will actually put these guidelines into practice? This is where the main thrust of the plan lies, making it a major tool for state modernization.

MODERNIZING THE STATE: A LESSON FROM THE MEZZOGIORNO?

The plan allocates most responsibilities to local governments. But its main point is not devolution. It is rather the building of an institutional framework, both cooperative and competitive, among central, regional, and local governments, whereby each level sets guidelines for and monitors the action of the others. Evaluation and negotiation are the two pillars of this framework.

The policies needed to achieve the three targets of the plan are knowledge-based, and much of the knowledge they require is local: local actors need to be intimately involved. Only local administrations can accomplish this. They have clear incentives to make use of the plan's funds, if only to achieve goals useful to their constituents. On the other hand, local governments tend to pursue narrowly local interests. Moreover, they are more liable to renegotiate rules. The federal government thus has to allocate resources in areas such as law and order and the construction of major transport networks, and also to monitor the process, give weight to local rules, and provide technical assistance to local players.

Negotiation is then needed, both horizontally between public and private local actors and vertically between different levels of government. But for negotiation to allow agents to extract information and devise useful projects, it must be based on quantitative evaluation, both of needs and of alternative means: a practice rarely used in Italy in selecting public investments.

In enacting these principles the plan put to full use the reform of the state apparatus introduced in 1997, which combined devolution with the introduction of principles of new public management (NPM).[21]

The plan allocated responsibilities among different levels of government as follows: the governments of regions were assigned most of the funds (71.4 percent) and the primary responsibility for allocating them among projects. Municipalities, groups of municipalities, and private agents were asked to submit specific proposals for projects. The national government was made responsible for transport networks, research and development, enhancing law enforcement and managing automatic incentives, and, above all, for setting general guidelines, monitoring results, and allocating rewards and sanctions. The credibility of the national government in playing this role was enhanced by the existence of a fourth actor: the European Union. The plan's governance rules were in fact turned into internationally binding regulations by the fact that the plan has been negotiated and approved by the European Commission, which will subsequently monitor it. The body chosen to supervise the implementation of these rules was the Treasury Development Department (DPS).

Ten percent of the budget (as compared with only 4 percent mandated by EU regulation) was allocated to distribute rewards in 2003 to regions and central administrations, creating strong incentives for them to implement the new policy without delay. Rewards were linked to nineteen quantitative indicators measuring administrations' success in concentrating and integrating public investments, enacting some of the general state apparatus reforms, implementing a specific set of administrative target reforms (such as the establishment of a monitoring procedure), the approval of environmental and water system plans, and the performance of feasibility studies for an adequate share of projects.

The introduction of these and other economic targets as well as the need to link public interventions to a proper assessment of needs called for most projects to be evaluated before the event.[22] For that to take place regional governments and central administrations needed to establish technical evaluation units, both to perform evaluation themselves and to act as alerted clients of private consultancy firms. These units were compulsory, and controls were also established to ensure the quality of the evaluators recruited; the implementation of these units is proceeding quickly. A Project Financing Unit (PFI) was also created at the Treasury in March of 2000 to advise administrations on how to tap into private funds.

These innovations are indispensable steps toward a system of NPM, such as those introduced in "Anglo-Saxon" countries in recent years. However, as has become increasingly clear from the experience of several of these countries, these steps by themselves cannot ensure success.[23]

Each level of government has some of the knowledge needed for enacting general guidelines, but much of it is "tacit," in the sense that it cannot be transferred via formal procedures but only via informal interaction with other levels of government. Furthermore, a great deal of relevant knowledge is unavailable to public officials; only businessmen, both local and foreign, are privy to it. Inside knowledge of this kind can only be "produced" and made available for devising regional development projects through interactions between several agents.[24] To achieve good results, different levels of government must cooperate with each other. In order to avoid serious distortions, targets must be set through comprehensive technical and political consultations between upper and lower levels of government, and progress toward meeting them must be evaluated at all levels through continuous diagnostic monitoring. The move toward NPM, therefore, required the establishment of a strong and operational institutional partnership between levels of government.

The very design of the plan has provided the first opportunity to implement such a partnership. The implementation of the plan's targets is being supported by DPS technical assistance. Committees have been set up for each program, where diagnostic monitoring will be implemented by technical units representing different levels of government. Similar partnerships are being attempted between public administrations and associations of private agents.[25]

THE CHANCES FOR A NEW RULING CLASS

The challenge facing the region's ruling class is not an easy one. Implementation of new forms of governance is hard and requires time. This is particularly true for regions where public administration is in very bad shape. In order to attract bright young talent to public administration posts in the Mezzogiorno, not only must good wages be offered, but the political elite must appear committed to serious reform. Since the effects of the policy shift will not be immediate, the new policy can gain credibility only by strict adherence to the plan's new standards. Any wavering by regional leaders will undermine confidence in the plan. It will signal to local and foreign firms that no real change is underway and that no improvement will take place, despite the attractiveness of the Mezzogiorno's human and natural resources.

Lobbies push for local governments to stay clear of the new path, to avoid project evaluations and adopt those actions that have short-term effects on employment, and to slow down any state modernization that can reduce consensus among public employees. Difficulties have indeed been hinted at on both sides of the Italian political spectrum. Italy's endemic political instability has made it perversely difficult for some of the governing coalition to back a plan that they themselves had formally approved. It is politically delicate to support unambivalently the administrative "surgery" that the policy shift required. Strategic hesitation and slow implementation are often purposely magnified by a press either unequipped with the tools to account properly for the technical and case-by-case approach of the policy experiment or financially dependent on specific interests hurt by the new policy.

Furthermore, both business and union associations are slow to adjust to the new policy, since it requires the rise of new skilled cadres who would make redundant and crowd out the old establishment of the associations themselves. At the same time, though, new social actors emerge at the local level that support the pressure for change and see the mix of evaluation and negotiation as a way for their projects to win over others.

The chances for the Mezzogiorno to emerge successfully from the present divide depend on which of the following two coalitions will actually lead the political and decision-making process: the old coalition of state bureaucrats, politicians, and entrepreneurs, who have long benefited financially from barriers to competition, subsidies, and inefficient allocation of public funds; or a new coalition of private and public agents endowed with high and not widely available skills, who are counting on using these skills via innovative activities to enhance their position or to gain monetary benefits.

An important move in the right direction seems to be coming from one recent institutional change. Regional elections were held in April of 2000 under a new law whereby the region's presidents are elected directly, command a strong majority, and cannot be removed without giving rise to a new election. Endowed with strong power and direct accountability, these new "governors" have a much stronger incentive to enact public investments with long-term effects and to modernize their administrations accordingly. They could prove to be the catalyst for the new coalition. The first year of their government indeed shows progress in this direction.

If this happens, the Mezzogiorno, while providing Europe with an important test of a new regional policy, would also signal to Italy a way to achieve a true renewal of its ruling class and to strengthen its statehood via a radical reform of its obsolete administration.

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ENDNOTES

[1]See Daniel Quah, "Regional Convergence Clusters across Europe," *European Economic Review* (40) (1996): 951–958; Diego Puga, "European Regional Policy in Light of Recent Location Theories," mimeo, November 1998.

[2]Puga, "European Regional Policy in Light of Recent Location Theories."

[3]See Paul R. Krugman, *Geography and Trade* (Cambridge, Mass.: MIT Press, 1991).

[4]See Lea D'Antone, "Straordinarietà e Stato ordinario," in Fabrizio Barca, ed., *Storia del capitalismo italiano* (Rome: Donzelli, 1997).

[5]See Fabrizio Barca and Sandro Trento, "State Ownership and the Evolution of Italian Corporate Governance," *Industrial and Corporate Change* 6 (3) (1997) and Barca, ed., *Storia del capitalismo italiano,* where the economic and political rationale for such a strategy—described as an "extraordinary compromise"—is discussed.

[6]See Edward C. Banfield, *The Moral Basis of a Backward Society,* repr. (Bologna: Il Mulino, 1958). For the debate that followed Banfield's "amoral familism" thesis, see Domenico De Masi, "Arretratezza del Mezzogiorno e analisi sociologica," preface to Edward C. Banfield, *Le basi morali di una società arretrata,* ristampa (Bologna: Il Mulino, 1976).

[7]See Carlo Trigilia, *Sviluppo senza autonomia: Effetti perversi delle politiche nel Mezzogiorno* (Bologna: Il Mulino, 1992) and Barca and Trento, "State Ownership and the Evolution of Italian Corporate Governance."

[8]Robert D. Putnam, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton: Princeton University Press, 1993).

[9]Arnaldo Bagnasco, "Teoria del capitale sociale e political economy comparata," *Stato e Mercato* (3) (1999).

[10]In 1986 the Cassa was closed and another agency, the Agenzia del Mezzogiorno, was created in its place. While being formally entrusted with more power, the Southern regions were not put in a condition to exert this power: the Agenzia and special units created inside the main central administrations carried on the old jobs, possibly with less accountability than before.

[11]See Barca and Trento, "State Ownership and the Evolution of Italian Corporate Governance."

[12]Many of the economic and social changes described here were first detected by Giorgio Bodo and Gianfranco Viesti, *La grande svolta* (Rome: Donzelli, 1997) in a volume called "The Great Turnaround" and by essays published by the journal *Meridiana.* See, among others, Domenico Cersosimo and Carmine Donzelli, "Mezzo giorno e mezzo no. Realtà, rappresentazioni e tendenze del cambiamento meridionale," *Meridiana* (26–27) (1996): 23–73; and Piero Bevilacqua, "Riformare il Sud," *Meridiana* (31) (1998): 19–44. See also Gianfranco Viesti, "A quali condizioni può aversi uno sviluppo di sistemi produttivi locali nelle regioni arretrate?" *Meridiana* (34–35) (1999); and Dipartimento per le politiche di sviluppo e di coesione (DPS), "Il Mezzogiorno. Tendenze e politica economica," <http://www.tesoro.it>, April 1999.

[13]In some cases, these "pacts" turned out to be just another way to beg for money from "Rome"; in other cases, though, the territorial pacts fostered genuine cooperation. See Domenico Cersosimo, "I patti territoriali," in Domenico Cersosimo and Carmine Donzelli, *Mezzo giorno* (Rome: Donzelli, 2000) and Dipartimento per le politiche di sviluppo e di coesione (DPS), "Terzo Rapporto sullo sviluppo territoriale 1999–2000," <http://www.tesoro.it>, December 2000.

[14]Exports represent about 9 percent of the GDP as opposed to 20 percent in Italy as a whole.

[15]See European Commission, "The Structural Funds and their Coordination with the Cohesion Fund—Guidelines for Programs in the Period 2000–2006," communication of the Commission, July 1999.

[16]On the Ireland case, see, for example, OECD, *Ireland: Local Partnership and Social Innovation* (Paris: OECD, 1996).

[17]See Fabrizio Barca, "Introduzione," in Ministero del Tesoro, *La nuova programmazione e il Mezzogiorno* (Rome: Donzelli, 1998).

[18]See Fabio Mazzola and Adam Asmundo, "Sistemi locali manifatturieri in Sicilia: Analisi dei potenziali distretti industriali," in *Quaderni di ricerca* (Banco di Sicilia) (1999), and Massimo Omiccioli, "L'organizzazione dell'attività produttiva nei distretti industriali," in Luigi Federico Signorini, *I distretti industriali* (Rome: Donzelli, 2001).

[19]See Luigi Federico Signorini, "Italy's Economy: An Introduction," in this issue of *Dædalus*.

[20]See Mazzola and Asmundo, "Sistemi locali manifatturieri in Sicilia."

[21]See Franco Bassanini, "Italie, notre révolution silencieuse," in Roger Fauroux and Bernard Spitz, *Notre état* (Paris: Robert Laffont, 2001); and OECD, "Regulatory Reform in Italy," Paris, April 2001.

[22]See Fabrizio Barca and Guido Pellegrini, "Politiche per la competitività territoriale in Europa: note sul Programma 2000–2006 per il Mezzogiorno d'Italia," presented at the First Annual Workshop of the Bologna University Center at Buenos Aires, 26–27 April 2000, sec. 5.

[23]See Rory O'Donnell and Charles F. Sabel, "Democratic Experimentalism: What to do about Wicked Problems after Whitehall," mimeo, presented to the OECD Conference "Revolution and Globalization: Implication for Local Decision-makers," Glasgow, February 2000.

[24]See Bruno Dente, *In un diverso Stato* (Bologna: Il Mulino, 1999) and O'Donnell and Sabel, "Democratic Experimentalism."

[25]On the rationale for such arrangements, see, for example, Joseph E. Stiglitz, "The Private Uses of Public Interests: Incentives and Institutions," *Journal of Economic Perspectives* (2) (1978).

First and foremost, the European experience tells us that, while the problem of agriculture can no longer be viewed within closed national limits, neither is it possible to consider it within the closed limits of a Europe made up of six, nine or however many countries participate in an expanded Common Market. In fact, the more the market expands, the more we are compelled to consider it in relation to the so-called third-party countries, who in practice amount to the whole world, from the Americas down to the underdeveloped countries and even to those countries governed by socialist regimes. A common agricultural policy in western Europe must therefore be regarded—as is implicitly admitted by Mansholt and the more intelligent European observers—solely as a course of action leading eventually to international regulation of agricultural markets, and not as a fresh obstacle to the attainment of this goal.

Secondly, the examination of the problems shows that, at least as far as agriculture is concerned—the economic activity that at one time seemed best adapted to the system of free enterprise—the phase of free competition is definitely over and the phase of planning, on both the international level and within the individual countries, has begun. After decades of injurious and unstable restrictive planning of national agricultural policies, we have entered the phase of planning for large areas and of international economic agreements. What we must now discover are the types of regulation and organization best suited to reconcile planned stabilization of prices, and hence planned supply and manipulation of products, with autonomous responsibility in individual or associative farming enterprises. This alone will make for real and continuous agricultural progress, as has already been proved beyond a doubt by the negative experiences of the socialist countries in the field of agriculture.

Manlio Rossi-Doria

From “Agriculture and Europe”
Dædalus 93 (1) (Winter 1964)

Fiorella Kostoris Padoa Schioppa

Budgetary Policies and Administrative Reform in Contemporary Italy

To my best friend, the late Martino Ajmone Marsan (April 8, 1947–August 2, 2000), who first suggested the following quotation by Machiavelli to show how difficult any innovation is in the political (as much as in the personal) life:

"It should be borne in mind that there is nothing more difficult to handle, more doubtful of success, and more dangerous to carry through than initiating changes in a state's constitution. The innovator makes enemies of all those who prospered under the old order, and only lukewarm support is forthcoming from those who would prosper under the new. Their support is lukewarm partly from fear of their adversaries, who have the existing laws on their side, and partly because men are generally incredulous, never really trusting new things unless they have tested them by experience."

—*Niccolò Machiavelli,* The Prince, *1532*[1]

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INTRODUCTION

Italy entered the 1990s as a developed country with major structural problems in its economy.[2] They stemmed from the failure of policymakers to tackle some fundamental constraints that hampered the Italian economic system. Inflation was no longer two-digit, as in the beginning of the 1980s, but remained largely above that of its competitors in Europe and in the OECD countries. Interest-rate differentials were equally wide. Economic growth was fitful. Public expenditure was promoted by powerful interests in political parties, trade unions, state controlled enterprises, and a bloated public administration. Competing social groups had all become addicted to public funding, which, without solving social conflicts, induced a spiral in which the satisfaction of someone's claims was the prelude to spending more money to satisfy someone else's claims. As a consequence, the national deficit and debt were dangerously high and increasing.

Dealing with these problems was difficult. A number of governments lacked the internal consensus to carry out what were necessary but obviously painful reforms. Yet to the surprise of many observers, the European unification process forced the country to confront its budgetary and administrative problems. Italians began to think seriously about what they owed to future generations in terms of sustainable economic growth, acceptable production and income redistribution mechanisms, and a sound framework for public finance. Reform of public finance became a prerequisite for joining the European Monetary Union, and compliance with the Maastricht parameters became a tangible target for elected officials. As a result, a deep change occurred in Italy in the 1990s: the sick patient finally chose to recover, even though the treatment had to be quick and sometimes painful in order to be effective. Today, Italy's economy is alive and well. However, the aftereffects of the disease and of the cure can still be felt.

* * *

The following pages analyze the remarkable fiscal adjustment that occurred in Italy in the 1990s, as observed in the General

Government flow and stock accounts (see below, "An Impressive Quantitative Fiscal Adjustment"). The public deficit-to-GDP ratio was in 1990 at a two-digit level; in 1999, it has declined to 1.9 percent. Italy had to accelerate its fiscal tightening particularly between 1996 and 1997 to comply, first, with the Maastricht convergence parameters and, later, with the Stability and Growth Pact. Thus, the country moved from a primary deficit (deficit net of interest charges)-to-GDP ratio that in 1990 was the second highest in Europe, to a primary surplus in 1997 that was the largest in Europe. In 2003, the Italian General Government is expected to balance its flow account.

Some additional budgetary policies on the General Government stock account led to massive privatizations receipts, with a strong acceleration since 1997. Privatizations, together with decreasing fiscal deficits, allowed the continuous reduction of the public debt-to-GDP ratio since 1995, as required by the European Economic Constitution, even though this ratio remains in 1999 at the level of 115 percent, far above the euro countries average and the Maastricht reference value.

Some shadows obscure, however, the impressive Italian fiscal adjustment of the 1990s. First, the noticeable General Government deficit cut has been obtained through positive instruments, such as the decline in interest rates and interest payments on public debt, but also through negative means, such as the increase in fiscal pressure and the decrease in public investment. The results on growth and job creation could only be disappointing, regardless of the explanations proposed—of a demand-side or of a supply-side kind—particularly because very insufficient counterbalancing policy measures were taken to loosen the large regulatory rigidities of the Italian labor market. The consequences on the Italian economy were, therefore, not unexpectedly hard. The average annual GDP growth rate between 1990 and 1999 was 1.4 percent, 0.7 points lower than the other ten euro countries. The gap across the whole period was equal to 7 percentage points.

Among the major shortcomings of the successful Italian fiscal adjustment of the 1990s, the second is its inadequate focus on those parts of the General Government flow budget where the most severe structural problems emerge, namely, the welfare state (see below, "Inefficient Structural Changes in the Welfare State"). Relative to its European partners, Italy seems to allocate comparable public resources to the overall social protection in percentage to GDP, but with a totally different mix: below average in the social assistance component, above in the pension segment, and similar on health care. The Italian welfare state does not tend to promote growth and still keeps, by the end of the 1990s, significant features of inequity, inefficiency, and ineffectiveness.

On cross-country comparisons, Italy does not rank high as far as poverty and social exclusion are concerned, if poverty is measured by relative income, but if poverty is measured in absolute terms, Italy surpasses the other big European countries. Indeed, it is the only country in Europe (together with Greece) where the legal provision of a minimum income for the poor has been totally missing until 1998, while two years later this minimum income has been experimentally introduced only in a few municipalities. Moreover, most social services are supplied on a universal nonselective basis, on the presumption or rather on the delusion that to be able to give "everything to everybody" in fact ends up giving a "little to all." Hopefully, in the future these welfare state components will be offered according to an index taking into account the household level of income and wealth. As for the social services that have been traditionally provided in Italy on a selective basis, they are allocated without any form of factual means-testing and thus are extended to those who do not need them, without protecting all of the needy: the selection is not based on quantitative tests concerning the targeted groups' needs, ability, and willingness to pay.

Old-age and seniority pensions, after three reforms in the 1990s, still imply in Italy a very large and increasing level of public expenditure in proportion to GDP, leading to a situation whereby even in 2045 part of public pensions will not be covered by contributions. The additional public debt accumulated by social security from now until that moment will be about 1,000 billion euros, corresponding to approximately one year of

GDP. It is technically easy, but apparently politically difficult, to eliminate these imbalances. It would be sufficient to raise the Italian retirement age to a European standard (namely, to put it at sixty-five years for both male and female workers), reducing the replacement rate and boosting the creation of complementary pensions by removing rigidities, disincentives, and constraints currently existing on private-pension funds.

Health care, unlike pensions for old age, could be a very productive way of spending public resources, as they may contribute to human-capital accumulation. However, this is not fully the case in Italy, because the value for money is still somewhat lacking in this field. Various health reforms—both specific and comprehensive—have been adopted in the 1990s, probably reducing wastes and increasing effectiveness. But new policy actions have to be enforced in order to raise the level and the quality of public-health services for given costs, to decrease unitary costs for given inputs, and finally to lower public input levels.

In Italy, any policy implementation requires—as a necessary though not sufficient condition—a deep modification of public employees' culture and attitudes (see below, "The Lack of a Public Employment Reform"). The third major shortcoming of the Italian fiscal adjustment of the 1990s is due to the fact that an innovative public employment approach and job involvement were missing, despite the numerous laws of the last decade trying to carry out an administrative reform in our country (from the General Government decentralization and fiscal federalism, to the simplification of administrative procedures, to the new internal and external forms of control on the legitimacy and results of employees' actions). What was lacking and still is badly needed is a new system of incentives, prizes, and penalties, whereby, for example, public employees' wages partly depend on the individual and the office level of productivity and results. No relevant change has been observed, from this viewpoint, in the Italian General Government of the 1990s, except for one innovation recently introduced in the public-sector management of human resources, aiming at raising the public employees' efficiency and effectiveness: namely, the possibility to hire workers through fixed-term contracts. For the rest, the Italian administrative reform of the 1990s has broadened the responsibility but not the accountability of public employees, (excessively) increasing the number of sanctions (penal, civil, economic), without any credible threat.

More incisive reforms in Italy—for example, raising the retirement age for public pensions, or eliminating excessive employment protections and reducing hiring and firing costs in the labor market, or setting public employees' wages in proportion to their productivity and results—are, of course, easy to describe, but difficult to decide and to enforce. As Machiavelli recalled almost five hundred years ago, all the agents who would be hit by these reforms—for example, the bureaucracy, the insiders in the labor market, the unions in which the most represented cohorts are those corresponding to the Italian "old age" for retirement—play against these modifications. They are vocal and effective in capturing policymakers, as if their specific interests were coincident with the general ones of the Italian society. The more numerous outsiders, those who would benefit from these reforms—for example, citizens (consumers and producers) vis-à-vis General Government employees, long-term unemployed, median voters neglected by social partners and opinion leaders, young (specially female and Southern) first-job seekers—are unwilling or unable to use exit or voice to obtain more satisfaction for their legitimate interests. They are forced to be loyal by an incredibly large Italian system of public and private transfers, within both the welfare state and the individual family networks.

If the sociologist often tries pragmatically to "all understand and all forgive" on this matter, the political economist sometimes adopts a normative approach. She has, then, to recognize that in the last decade budgetary policies in Italy were highly successful in terms of quantitative adjustments of the General Government flow account, and that the contemporaneous change in the level of public command on the Italian economy was radical and beneficial, due to massive privatizations. However, she has also to evaluate, among the various failures of the 1990s, our policymakers' inability to substantially innovate in the quality and the size of the Italian public control on the economic system. Our country is lagging behind the rest of Europe in regulatory reforms capable of inducing a widening and a deepening of competition and liberalizations, both in the production factors and in the product markets.

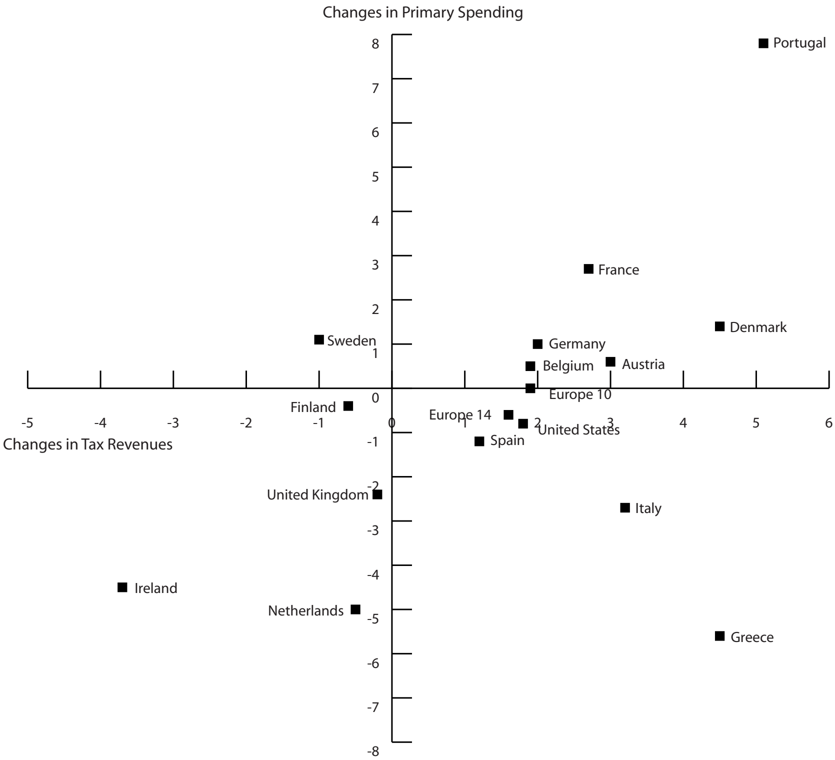
AN IMPRESSIVE QUANTITATIVE FISCAL ADJUSTMENT: LIGHTS AND SHADOWS

In 1990, the General Government deficit-to-GDP ratio was 11.2 percent. It was the second largest in Europe, after Greece, and 7 percentage points higher than the euro countries average. Nearly ten years later, in 1999, the Italian deficit-to-GDP ratio declined to 1.9 percent—only 0.7 percentage points above the euro countries average. Looking at the General Government stock account, one observes that the Italian debt-to-GDP ratio was under 100 percent in 1990, grew steadily until 1994, and remained more than twice the European reference value up to 1996.

The "Standard" Budgetary Policies on the Flow Account

Figure 1 indicates the sharp *cumulative* change in discretionary budget policies that has occurred in the Italian General Government flow account since the beginning of the 1990s. In no other European country, with the exception of Greece, have fiscal variations between 1990 and 1999 been more dramatic. These variations have been caused by a combination of tax receipt increases and primary spending cuts. Changes in tax revenues *or* in primary spending were equally significant elsewhere—but Italy experienced *both* at the same time. For example, Austria, France, Denmark, and Portugal had a similar or bigger increase in tax receipts, as well as a rise in primary spending, while the Netherlands, Ireland, and the United Kingdom had a higher or comparable decrease in primary spending, combined, however, with no increase or even with a substantial decline in tax revenues. It is no accident that these latter three countries were among the most successful in Europe in the fight against unemployment in the 1990s.

Figure 1. Cumulative Changes in Tax Revenues and in the General Government Primary Spending as a Percentage of GDP, 1990–1999



Note: Europe 14 includes Belgium, Denmark, Germany, Spain, Greece, France, Ireland, Italy, the Netherlands, Austria, Portugal, Finland, Sweden, and the United Kingdom.

Europe 10 includes Belgium, Germany, Spain, France, Ireland, Italy, the Netherlands, Austria, Portugal, and Finland.

Source: Elaboration on European Commission, *European Economy* 68 (1999).

The Italian cumulative fiscal changes would appear even wider both in absolute and in cross-country comparable terms if the decade were split into two subperiods: the first up to and including 1997, the second including only 1998 and 1999. The average fiscal performance in 1997 became the basis for evaluating the capacity of each member state to join the third phase of the European Monetary Union. Therefore, Italy, which started its fiscal adjustment later than other European countries, had to accelerate its fiscal tightening between 1996 and 1997 in order to comply, first, with the Maastricht convergence parameters and, later, with the Stability and Growth Pact.

As is well known, in 1997, according to the Maastricht Treaty, the General Government deficit-to-GDP ratio had to be no higher than 3 percent. In addition, according to the Stability and Growth Pact, each country had to "adhere to the medium term objective of budgetary positions of close to balance or in surplus."

Perhaps no other single public finance variable shows the enormous effort Italy made to meet the 1997 deadline than the shifting sign and size of the General Government primary balance. From a 1990 primary deficit-to-GDP ratio that was the second highest in Europe, Italy in 1997 achieved a primary *surplus* that was the *highest* in Europe. This led to a decrease of the overall deficit-to-GDP ratio of 4 percentage points in one single year, between 1996 and 1997.

At the same time, fiscal pressure, including capital taxes, reached a peak in 1997. Other European countries had on average a fiscal pressure higher at the beginning of the decade, and lower than Italy in 1997. Since then, Italy's fiscal pressure has been reduced, for three reasons. First, some of the previous increases were *una tantum*. Second, the government rebated a quota of the so-called Eurotax imposed in 1997, raised tax relief, and reduced tax rates for some income brackets, in order to partially offset the growth of tax receipts obtained through a successful fight against tax evasion. Third, a comprehensive tax reform was implemented, affecting financial assets, corporate incomes, and the value added on production activities at the regional level.

Starting in 1998, the primary budget surplus-to-GDP also began to diminish. This happened despite a continuously decreasing overall deficit-to-GDP ratio, as the public interest payments-to-GDP ratio finally declined, mainly due to the reduction in interest rates. Indeed, one of the biggest achievements of the Prodi government and Treasury Minister Ciampi was the drastic reduction of inflationary expectations, hence of the inflation rate, followed by interest rates. By the end of 1996, after four years of outside floating, the lira was reintroduced into the EMS exchange-rate mechanism.

It is remarkable that the Italian General Government flow budget in the last decade has been able to satisfy first the Maastricht convergence parameters, then the Stability and Growth Pact requirements, and finally the golden rule (according to which only the final capital, not the current public expenditure, should be financed in deficit), despite the very strong fiscal unbalances prevailing in the beginning and still in the middle of the period.

The impressive Italian deficit reduction of the 1990s was produced by three factors: a temporary increase in fiscal pressure, a decrease in net interest payments as a ratio to GDP, and a reduction in General Government capital expenditures. While the decline in net interest payments was good news, the increase in fiscal pressure and the decrease in public capital expenditure were not.

A decline in public investment has negative effects sooner or later on productivity, competitiveness, and employment. As for the tax instrument, its larger use is possibly inconsistent with the narrowing of the public sector in a mixed economy, although it is certainly consistent with the Stability and Growth Pact, the latter looking only at the balance and not at the level of public expenditures and taxes. A rising fiscal pressure does not contribute to the social well-being, and, *ceteris paribus*, it depresses the economic system.

The negative impact on growth and employment of a fiscal adjustment like the Italian one in the 1990s is not really debated. Rather, a difference exists among the experts on the causes of this impact. One school takes a Keynesian tack, arguing that "fiscal tightening had a sizeable negative impact on growth, with the traditional demand effects being predominant."[3] Another school has adopted a supply-side perspective, arguing that "while in successful adjustments almost all the action comes from expenditure cuts, in unsuccessful ones almost all the action comes from an increase in taxes . . . in unsuccessful adjustments the change in transfers and government wages is minimal, and insignificantly different from zero.

Rather, public investment falls by as much as all other expenditures combined."[4]

Our interpretation is closer to the supply-side approach, as our comments to figure 1 have clarified. In any case, we strongly believe that the poor performance of the Italian economy in the 1990s is not exclusively due to the macroeconomic constraints imposed on deficit spending by the Maastricht convergence criteria. Rather, this poor performance is equally due to insufficient flexibility in the product market, to a low and declining interregional labor mobility, and to a strong rigidity in the regulation of the labor market. In particular, in the last available cross-country data, Italy appears to be the leader in Europe (along with Spain, Greece, and Portugal) in the cost of hiring and firing, and in protections for employees in the private sector. A positive correlation clearly emerges from the empirical evidence on European and OECD countries between the successful fight against unemployment during the 1990s and the level of the regulatory flexibility in the labor market. However, it may be of some comfort to recognize that wage rigidity has been slowly decreasing in Italy since the 1993 tripartite agreement between unions, entrepreneurs, and the government. Also, the labor market has become more flexible in recent years thanks to a larger number of fixed-term and part-time contracts that spurred a remarkable rise in private-sector employment in 1998 and 1999, in spite of a very modest growth in GDP.

In conclusion, the spectacular fiscal adjustment observed in the General Government flow account of Italy in the 1990s was not an unmixed blessing, based as it was on a rising fiscal pressure and a decreasing net public investment-to-GDP ratio. These trends reduced growth and job creation during the last decade, without being offset by a sufficiently flexible new regulatory framework of the labor and product markets.

The "New" Budgetary Policies on the Stock Account

Up to now we have looked at the main features of the Italian budgetary policies' success and failures in the 1990s, examining them from a very conventional, flow account viewpoint. But one of the Maastricht Treaty parameters concerns the stock account. In 1997 the debt-to-GDP ratio was not to exceed 60 percent, "unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace." The Italian General Government debt, despite growing continuously in nominal terms and being in 1999 almost double what it was in 1990, has registered a continuously declining ratio to GDP since 1995. The debt composition has also changed in the last decade. In 1990, approximately one-fourth of the debt consisted of short-term bonds, 40 percent of them with a maturity of less than a year; by 1999 both percentages had declined sharply (reaching levels of less than 10 and 20 percent, respectively). Moreover, according to the terms of the Stability and Growth Pact, each EMU country was required to submit an annual Stability Program in 1998 and 1999; in response, Italy launched a massive privatization program.

Privatizations affect the composition of the General Government assets and the level of both assets and liabilities in the stock account. This aspect is worth stressing because, in the past, Italian policymakers proposed to treat privatizations as revenues in the flow account. However, the temptation to use financial revenues from privatizations to decrease public deficits has become weaker in Italy since 1993, thanks to a law that obliges the Treasury to apply any proceeds from companies it sells to decreasing its debt.

Many Italian policymakers in the 1990s were nevertheless inclined to treat privatizations only in terms of their financial effect on the General Government stock account, as if the main goal were to alleviate public debt. Such a view not only neglects the impact of privatizations on capital markets and the industrial system; it also ignores the basic public finance argument in favor of privatizations (i.e., the absence of market failures, the presence of even larger government failures, contestability, etc.). Only the most experienced and enlightened Italian policymakers have taken in the past a longer view. In 1999, the Italian Treasury issued a Report on Economic Reform that correctly described the privatization process occurring in our country as part of the revised role of the public sector in Italy's mixed economy. Still, in our opinion, a closer investigation is necessary to distinguish the impact of privatizations in sectors like electricity, where some conditions for a noncontestable natural monopoly exist, from the impact in sectors like banking and insurance, where private firms will certainly have to compete in the market.

Privatizations became significant only after 1992. In that year, public enterprises in Italy were turned into joint-stock companies. This process, called "cold privatization," meant that joint-stock companies could no longer ask for financial endowment funds supplied by the Treasury to finance their deficits. At the same time, the Treasury became the owner of shares that could be sold on the market. Between 1993 and 1999, partial or total privatizations of public joint-stock companies allowed the government to cash in almost 80 billion euros—a significant sum, even though the shares sold represent only a small part of the General Government assets and liabilities in the stock account.

A new phase of Italian privatizations began in December of 1999. For the first time, policymakers have been prepared to sell not just General Government shares in joint-stock companies, but also real assets (reproducible and nonreproducible capital). For example, some of the real estate owned by the state is now on sale. In this new phase, Italian policymakers have adopted an innovative approach, by exploiting General Government assets not only by selling them, but also by collecting rent on state-controlled property. The innovations have been most notable in the case of "new properties," such as radio frequencies. In the past, the government gave these hertz frequencies away, for example to air traffic control and cellular phone services. Now they are a priced asset. Future licenses of universal mobile telephone services are expected to produce a significant sum of money for the government.

INSUFFICIENT STRUCTURAL CHANGES IN THE WELFARE STATE

A key shortcoming of the Italian fiscal adjustment of the 1990s was its lack of focus on the efficient and just provision of the welfare state, in the form of social protection (social security, health care, social assistance), and, in some definition, of public education as well. The Italian welfare state has not always been guided by principles of equity. Too often, waste has hampered the delivery of services.

Inequity, Poverty, and Social Assistance

Most social services are offered in Italy on a universal basis. They are not targeted to the needs of specific individuals or groups having ascertained their personal or household earnings, their health, their education, their minority status. By trying to give "everything to everybody," the Italian welfare state ends up giving a "little to everybody, particularly to the needy"—and at a very high cost. Social services tend to be simultaneously excessive and insufficient.

Take the case of paid maternity leaves. In the 1990s, these leaves, which are compulsory, had to be taken two months before delivery, and continue for three months afterwards, independent of the mother's needs and desires. Only in 2000 did a new law allow mothers more flexibility in choosing the timing of their compulsory five months of maternity leave.

Consider, too, the delivery of health services in public hospitals. Drugs for chronic diseases or drugs considered to be essential are available to everybody for a very modest fee, regardless of the recipients' ability to pay. The first five years of compulsory education are similarly offered to everybody without charge, regardless of household income and wealth.

These universal programs grew out of the fear of imposing some form of "stigma" on needy people. They have been reinforced by the pervasive skepticism of Italians about the quality of data on income and wealth. Fortunately, in recent years, policymakers have started to modify their approach. Hard public budget constraints forced administrators to study the comparative efficiency of policies used in the rest of Europe. In 1998, two laws were passed enabling the government to provide welfare services and health care at a differentiated cost to different individuals, depending on their need and ability to pay. However, the two laws have yet to be implemented, except for *some* educational services in a *few* Italian cities.

At the same time, those public subsidies that are supplied on a selective basis are still generally allocated without any form of means-testing. For example, unemployment subsidies are offered at a fixed replacement rate of 80 percent by the Wage Supplementation Fund (CIG), regardless of household income and earning ability of the laid-off workers. By contrast, Italy does not provide any unemployment subsidy for first-job seekers, even when they are living in poverty. Similarly, more than half of family allowances, originally meant to reduce poverty among employees' families with children, have ended up going to relatively affluent families, resulting in a very expensive program. Almost half of social pensions for old people go to the non-poor. Estimates show that nowadays retired individuals in Italy have a household poverty rate lower than the national average, while children and teenagers and the young middle-aged unemployed are the population segments most hit by poverty.

Partly as a consequence of Italy's current policies, the country does not rank very high, in comparative terms, in public expenditure on the poor and socially excluded. Relative to its European partners, Italy seems to allocate on average a similar quota of public resources—less of private—to social protection; but the overall distribution is totally different, being downward biased in the social assistance component, upward biased in the pension segment, and similar on health care. The lower level of social assistance in Italy may be partially explained by the relatively low levels of poverty as measured by relative income. Still, even if poverty concerns only a few hundred thousand people in Italy, fighting against social exclusion remains a duty for our democracy. A major question remains: how to set—and satisfy—a minimum level of well-being for all. The answer is still controversial. Policy proposals have ranged from a negative income tax to a guaranteed income for all citizens. But all such proposals are very expensive, according to the proponents themselves. Since the end of 1998, a bill has encouraged local governments to extend a minimum income to all Italians who fall below the poverty line in absolute terms. But two years later, the experiment has been tried only in 39 (out of 8,100) municipalities in Italy.

Health Care

Experts and policymakers often discuss health care and pensions as one topic, as if similar policy issues were at stake in each case. Yet adequate health care, unlike a pension program, is a form of investment in human capital similar to education. In any event, the cost of the Italian National Health Service does not seem excessive, either in relative or in absolute terms.

It is nevertheless well known that the provision of public health care is not fully efficient in Italy. Resources are sometimes wasted and some corruption exists. Italy today needs to reform the health services it offers. A higher value for money in public-health expenditure requires better services for given costs or diminishing costs for given services, and this in turn implies decreasing unitary prices for inputs or lower input levels.

A typical example of the first kind of efficiency-improving public intervention is the recent comprehensive National Health Service reform introduced in Italy by the former health minister in 1999. It stated that doctors who choose to work in public hospitals have to provide their services only there, or alternatively they will be penalized in their wage growth and in their career profile. Even before this reform started to be implemented, the former minister was removed by the current government, and the new health minister has already said that his predecessor's decisions should be revisited and the whole discipline should be revised.

With regard to lowering input levels, a decision was made, for example, in the mid-1990s to determine General Government transfers to public hospitals on the basis of tariff-related pathologies (so-called DRG, i.e., diagnostic related groups), rather than on an actual total cost basis. Five years later, the effectiveness and efficiency of this policy action are still unclear in our country, due to possible moral hazard and fraud on the part of hospitals' managers and doctors.

The cost of health care can also be reduced in a variety of other ways. First, the National Health Service can exploit its quasi-monopsonistic power in the market to negotiate price reductions. For example, in the 1990s, a reference price for all drugs containing the same active ingredients was imposed in Italy. Pharmaceutical firms that did not agree to lower their prices risked losing the National Health Service as a client. As a result, most firms operating in Italy agreed to the lower prices. The National Health Service might similarly be able to use its information on the cost of products and services purchased by different Local Health Care Units in order to induce every unit to choose the cheapest vendors.

It is also possible to reduce costs by making the sellers' market more competitive. When generic drugs are more frequently approved, costs drop; when public procurement of goods and services is opened to competitive bidding by all European firms, costs drop again.

Another way to decrease costs is through increasing the copayment of patients. This produces a much stronger consumer control on the quality, quantity, cost, and effectiveness of the public health care received, together with a decline in public outlays. Copayments already exist in Italy for some visits to specialists—but not for hospital stays.

Public and Private Pensions for Old Age

Three reforms dealing with pensions were introduced in Italy in the 1990s: by the Amato government in 1992, by the Dini government in 1995, and by the Prodi government in 1997. The main feature of the first was to widen to the whole individual life-cycle the earnings period used to calculate defined-benefit pensions. It also gradually raised the retirement age for women and men from fifty-five and sixty, respectively, to the current level of sixty and sixty-five and eliminated double indexation of pensions (to wages and prices). The Dini Reform, as completed by the Prodi government, limited some of the peculiar retirement privileges granted to specific groups while increasing the age and seniority requirements for seniority pensions. It also raised the Social Security contribution rate to a "general level" of 32.70 percent and set for the youngest workers a defined contribution to the old-age pension scheme just reformed by Amato. In the new scheme, the annual pension will be calculated on the basis of the life-cycle contributions and of the residual life expectancy at the age of retirement, which can occur anytime between fifty-seven and sixty-five, both for male and female workers.

In effect, the Dini Reform *reduced* the retirement age for old-age pensions. As Italians show a very high propensity to retire as soon as possible, a majority will probably choose in the future to retire at fifty-seven. On the other hand, the reform *increased* the retirement age for seniority pensions, for which the age threshold had been substantially lower in the past, especially in the public sector.

It is remarkable, though often unnoticed, that after three reforms in the 1990s, Italian old-age public pensions remain a gift of the General Government to retirees, measured by benefits received beyond contributions given. This "gift" will survive for at least twenty more years, remaining especially large for senior employees of both genders, though it will be almost zero for male workers and will be lower than in the past for female workers.

In the long term, this serious shortcoming will be eliminated, since the Dini Reform has switched from a defined-benefit to a defined-contribution pension system. Still, even in the long term, it will be possible to retire at the age of fifty-seven, within a pay-as-you-go scheme that keeps on laying the pension burden entirely on active young workers. With a rapidly falling and aging population, it is not clear if the Italian public pension system can be sustained.

Large savings could be realized by immediately and fully adopting the defined-contribution pension system, both for seniority and for old-age pensions of workers of all seniorities. It would also be more equitable to eliminate the sharp differences in privileges now granted to different workers. As soon as possible, and certainly in the long run, the minimum required retirement age should be raised to the European standard (generally sixty-five years both for male and female workers) and seniority pensions should be eliminated, except for particularly stressful jobs.

Cutting public pension outlays is a must in Italy. It is the only important government expenditure that, after three pension reforms, has kept increasing as a ratio to GDP. Unless further reforms are implemented, expenses will continue to increase for more than thirty years; old age and seniority public pensions expenditure may eventually approximate 16 percent of GDP. Moreover, Italy is one of the few European countries that already suffers from a Social Security deficit. Approximately one-third of public pensions are currently not covered by Social Security contributions.

As is well known, any pay-as-you-go scheme is extremely sensitive to demographic trends. From this viewpoint, the fact that Italy has the second-lowest fertility rate and the second-highest life expectancy in Europe is really worrying. These trends suggest that a private pension system for old age should be developed to supplement the public system. The goal would be a mixed system, where a compulsory pay-as-you-go public component would be combined with voluntary or compulsory private contributions. The former would cover poor people through intergenerational transfers; the latter would enable everybody to choose a pension profile funded on a fair actuarial basis.

Up to now, the transformation from a system based on one public pillar into a two-or-three-pillars mixed system has not yet been achieved in Italy. The very modest ranking of our pension fund assets relative to GDP is documented in European and OECD cross-country comparisons. A balanced pension regime would require three significant changes: a reform of the public pension scheme, particularly to raise the minimum retirement age; a modification of severance pay as a potential source of funds for private pensions; and a reassessment of the basic principles on which private pensions are based. In summary, the comparative underdevelopment of private pension plans in Italy can be attributed to the large public coverage offered, combined with the high cost of the current compulsory Social Security system, as well as to a variety of constraints and fiscal disincentives currently associated with private pension funds.

THE LACK OF A PUBLIC EMPLOYMENT REFORM

The final key shortcoming of the Italian fiscal adjustment that occurred in the 1990s was its failure to reform employment practices in the public sector adequately. As President Ciampi repeatedly said in the 1990s, "there cannot exist a durable re-equilibrium of public finance unbalances without a Public Administration reform, as a volume of resources equal to half the GDP is mismanaged."

Administrative reform has been advocated in Italy for nearly a half century. Finally, in 1993, some reforms were instituted, despite entrenched opposition. As a consequence, the number of public employees began to fall in the 1990s; in two years, from 1995 to 1997, permanent staff decreased by 95,000 people. Overall, the total number of General Government employees declined by 170,000 in the years between 1992 and 1999. Unfortunately, average seniority increased in the same period as old retirees were increasingly not replaced by young workers. In addition, the capacity of the Italian civil service to adapt to new technologies has probably diminished in the last decade, due to the rising average age of the labor force.

In the 1990s, the government also made some effort to simplify administrative procedures, change the internal/external systems of control on General Government results, and decentralize the public sector.

Decentralization, Simplification, and Internal/External Controls

Today, any administrative reformer in Italy inevitably has to come to terms with the ongoing process of regional decentralization. In principle, government tasks are now assigned to the lowest practical local level, assigning as many functions and administrative tasks as possible to regions, municipalities, and local governments. Centralization is defined by a list of exceptions, while the Italian Constitution has taken an opposite—but not inconsistent—viewpoint. However, these principles are sometimes difficult to apply concretely. The responsibility for maintaining historic and cultural public properties, for example, has passed back and forth in recent years from local to central governments, depending on parliamentary legislation.

In the policymakers' intention, regional decentralization has one major rationale for the public sector in Italy. The closer the government is to local communities—to citizens, to households, and to firms—the more effective it is supposed to be at monitoring task performance and evaluating task results from the bottom up. As a consequence of decentralization, public employees should be increasingly held accountable by their local community rather than having to prove to a higher-level civil servant the formal correctness of the procedures they followed.

Incentives in Wage Setting and Fixed-Term Contracts

Unfortunately, it is not clear that decentralization really helps in making policy implementation. It is also not clear if control by local communities is really effective. The most effective controls involve an allocation of resources, within a given budget, proportional to the results obtained, with prizes and penalties and wages for employees at least partially dependent on productivity. In this respect, not much has changed in the public sector. In fact, if one looks at the dynamics of public employment wages and productivity compared with corresponding trends in the private sector, one gets the impression that productivity in the public sector is stagnating. Labor cost per unit of output rises equally in the public and in the private sector, in spite of the fact that the unit wage grows more in the latter than in the former.

As the theory of wage efficiency would predict, relatively low wages for government workers produces a relatively low quality of public employee. Despite the insistence of many recent Italian laws on the so-called privatization of public employment, wage incentives are weak, and the ultimate threats—transfers and layoffs—are not credible. The government's chief innovation has been to hire a legally limited number of workers on fixed-term contracts. This involves offering public employees jobs of a fixed duration; they may be renewable, but not automatically. Part-time contracts, recently strengthened by a European directive and consequently by an Italian law, are, on the contrary, a mixed blessing, as they can be imposed by public employees on the General Government, but not vice versa.

In 1993, the laws regulating the layoff of public employees were formally revised. But the new law has been very rarely applied in Italy. Even if layoffs were enforced, they would not cause significant hardship for public employees. During a temporary layoff, all public employees maintain their seniority. Social Security contributions are paid by the public sector, and employees continue to get 80 percent of their salary, net of additional benefits. Laying workers off in any case requires bravery on the part of upper-level civil servants, who still have no incentives for action. Quite the reverse: they have only disincentives to take the responsibility for penalizing inefficient and ineffective employees. A conspiracy of silence was (and, to some extent, still is) the natural consequence, combined with an understandable, but misplaced, solidarity relative to fellow workers. Of course, such loyalty ignores the deeper sense of solidarity public employees should have relative to fellow citizens and the obligations relative to their principals, the taxpayers.

It is probably neither necessary nor sufficient to keep changing laws on public employment. But a reform should be enacted, with proper incentives, trade-offs, and threats, particularly for the upper-level civil servants under whose direction public employees work. This is the kind of administrative reform Italy badly needs.

Recent Italian laws have formally broadened the area of upper-level civil servants' responsibility. In fact the latter has been widened too much. This is a typical case in which an excess of sanctions (penal, civil, economic) becomes inapplicable and therefore ineffective. Upper-level civil servants are more responsible *ex lege*, but still unaccountable *de facto*. The implementation of policy decisions is thus left to the goodwill of a surprisingly high number of honest and dedicated employees. They try to do their best, without any personal advantage in terms of career advancement or additional income. Meanwhile, the Italian General Government—unaccustomed to working for the well-being of the whole society—is still struggling to change.

CONCLUDING REMARKS

Italy has traditionally been a country where the civil society has considered its government as an alien—if not a hostile—

entity. This is partially the cause and partially the consequence of the fact that the Italian national state was only created in the second half of the nineteenth century. Before the unification of Italy, many little states located in the Italian peninsula were dominated by multinational and mostly foreign powers (for example, the Kingdom of Lombardy-Venetia was under the House of Habsburg, and the Kingdom of the Two Sicilies was under the House of Bourbon). Historically, governments in Italy have been weak and often nonrepresentative.

At the same time, Italians ever since the Roman Empire have always shown a natural tendency to internationalization and globalization. In the second half of the twentieth century, the Italian people were longing to become part of Europe. This is one reason why the Italian government was able to make a number of impressive fiscal adjustments in the 1990s: a new sobriety was a prerequisite to entering the European Union. In that decade, civil society and the state grew closer. Still, as we have seen, many reforms are still pending, particularly those concerning the welfare state and the labor market, both public and private.

Unfortunately, these reforms affect sectors where there are no European directives. Indeed, there is a general agreement that these matters do not concern the European Union. Nevertheless, the European Union can indirectly help Italy again by setting a whole series of (fiscal, social, or sectorial) competition devices. Italy's survival within Europe depends on its ability to reform—and thus to increase its competitiveness in Europe, and throughout the world.

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ENDNOTES

[1]Niccolò Machiavelli, *The Prince* (London: Penguin Books, 1995; originally published 1532), chap. 6.

[2]Please note that this essay was completed in 2000.

[3]Marco Buti, Antonia Carparelli, Nigel Nagarajan, Paolo Sestito, and Marco Suardi, "Italy's Slow Growth in the 1990s: Facts, Explanations and Prospects," mimeo, European Commission, Brussels, 2000, 79.

[4]Alberto Alesina and Roberto Perotti, "Fiscal Adjustment: Fiscal Expansions and Adjustment in OECD Countries," *Economic Policy* 21 (October 1995): 227.