150 Years of Italian Political Unity and Economic Dualism: An Introduction

Michele Fratianni
Indiana University
Università Politecnica delle Marche
MoFiR

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by Michele Fratianni*

Abstract

This Special Issue of *Rivista Italiana degli Economisti* celebrates the 150th anniversary of Italy's political unity. Since 1861, Italy has evolved from a poor, backward and agrarian economy to a rich and industrial economy; has gone though bouts of economic insularity and integration; has swung from massive emigration to large immigration; has experienced an inflation rate much higher than that of the reference industrial countries; has accumulated a debilitating public debt; and has blessed the demise of the lira to embrace a new currency, the euro, which now is under threat of imploding. Amidst all these changes, two features have endured: political unity and a deep economic divide between the North and the South.

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* Indiana University, Università Politecnica delle Marche and MoFiR

In 2011, Italy celebrated its 150th anniversary of political unity. Over this period, the country has evolved from a poor, backward and agrarian economy to a rich and industrial economy; has gone though bouts of economic insularity and integration; has swung from massive emigration to large immigration; has experienced an inflation rate much higher than that of the reference industrial countries; has accumulated a debilitating public debt; and has blessed the demise of the lira to embrace a new currency, the euro, which now is under threat of imploding. Amidst all these changes, two features have endured: political unity and a deep economic divide between first the North and later the North-Center and the South. Economic dualism, for some stretching to pluralism, has persisted despite massive injections of state funds into the South. These transfers, however, have enabled the Italian monetary union to last until the creation of the European Monetary Union (EMU) in 1999. EMU, on the other hand, suffers from the absence of an inter-country transfer mechanism (Alessandrini et al, 2012).

Before discussing some aspects of Italian economic dualism, it behooves us to look at the evolution of two critical national macroeconomic variables: the growth of real per capita income and the inflation rate. Italy is compared with six other industrial countries that, together with Italy, today form the G7 group of countries.[1] During the 19th century, France, Germany and the United Kingdom were Italy's most important partner countries in terms of both trade and finance. In the 20th century, and especially after World War II, the economic and political importance of the United States grew. The United Kingdom was the reference country and the pound sterling the dominant international money during the international gold standard. This standard was suspended during World War I and

[1] The seven countries are Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

resurrected after the war for a few years. Sterling, although weaker, continued to play a role as a unit of account and international reserves until the onset of World War II. At the end of this war, the United States and the dollar replaced the United Kingdom and sterling, respectively, as the leading economic power and key international currency. In 1999, Italy lost monetary sovereignty and adopted the common currency of EMU, the euro.

Potted macro-economic history

The brief history of the two critical macro-economic variables covers the period spanning from political unification to 2008, the year before the onset of the recession sparked by the financial crisis. These 147 years are then divided in the following sub-periods: 1861-1895, 1896-1913, 1914-1920, 1921-1937, 1938-1949, 1950-1972, 1973-1978, 1979-1992, 1993-1998, and 1999-2008. The first sub-period, 1861-1896, is characterized by a budding industrialization process, especially in the North-West part of the country; investments in infrastructures (railroads); a shift from a free-trade to a protectionist commercial policy; adherence to the international gold up to 1866, resurrected in 1883 and then abandoned again in 1894; creation of the Banca d'Italia following a banking crisis and the demise of the Banca Romana. The second sub-period, 1896-1913, features an acceleration of the industrialization process, a rise in economic growth, and monetary and exchange-rate stability even though the country is off the gold standard. The two sub-periods of 1914-1920 and 1938-1949 are distinctive for the large and protracted fiscal, monetary and real shocks connected with war activities.

The inter-war years, 1921-1937, cover the great worldwide depression and institutional and policy innovations. The Fascist state, in response to the banking and economic crisis, nationalizes a significant portion of Italian industries and virtually the entire banking system; more by default than by design, it becomes a state-entrepreneur (Cianci, 1977). This massive transformation is executed by newly created government-owned holding companies (*Istituto di Ricostruzione Industriale* or IRI and

Istituto Mobiliare Italiano or IMI) that would become the hallmark of Italian industrial policy. Reflecting in part the inclination of the times, the Fascist state is protectionist, but keen to reestablish monetary stability and to restore the gold standard. It also consolidates the banks of issue into a single institution (Banca d'Italia) and overhauls the commercial banking industry.

The years 1950-1972 are roughly coincident with the fixed exchange rate regime of Bretton Woods. The new world order consists of an international monetary system that gravitates around the United States, the dollar, and a liberal international trade policy. Western Europe agrees to form the European Economic Community. For Italy, like for other countries, it is a golden age of high economic growth and low inflation. Many Fascist economic institutions, built in the 1930s, not only survive but expand their activities. The proclivity of the state-entrepreneur is strengthened (Petrilli, 1967). Government-owned holding companies design and execute a national industrial policy (Cassese, 1977; Barca, 1997). Prosperity raises the public's demand for a much more expansive welfare state. The political elite responds to this demand in full force, not only in terms of old-age and disability pensions, but also with a plethora of transfer payments to firms and households (Fratianni and Spinelli, 1982). Rent-seeking activity comes packaged under a variety of tools, ranging from subsidized bank loans to political prices on utilities and train tickets targeted to specific groups. In these years, also massive transfers are legislated for the development of the South through the newly created *Cassa del Mezzogiorno* (Cassese, 1977).

The demise of Bretton Woods, two oil shocks and a costly welfare state contribute to a regime of discretionary policy activism in the following period, 1973-1978. Italian monetary authorities, lacking independence (from the executive branch of government) and under the thrust of large government budget deficits, pursue objectives that are incompatible with monetary stability. Inflation rates reach the highest values in peacetime post-unification Italy and government debt as a percent of GDP gives early signs of alarm (Fratianni and Spinelli, 2001a and 2001b).

In 1979, Italy joins the European Monetary System (EMS), the precursor of EMU. The EMS exchange-rate regime, at the start, is less rigid than Bretton Woods'. The high and persistent Italian inflation rate is partly compensated by periodic lira depreciation relative to the German mark and the the currencies that shadow the mark. When the EMS is hardened in 1987, the lira suffers a growing and debilitating real exchange rate appreciation that leads to the currency crisis of 1992 and the country's exit from the EMS (Fratianni and Artis, 1996). After the currency crisis, the Banca d'Italia gains complete autonomy from Treasury. Gone is the regime of fiscal dominance that was at the heart of monetary instability. The Banca d'Italia Governor, Antonio Fazio, implements a progressively tight policy that enables the country to qualify for EMU entry on the inflation criterion (the fiscal criteria, however, are not met but are ignored by European leaders). Gone is also the age of the state-entrepreneur: the assets of government-owned companies are privatized more to raise cash for the state than by a deliberate policy design.[2]

In the last sub-period, 1999-2008, Italy loses its monetary sovereignty to join EMU, where monetary policy is decided jointly by its members. The newly created European Central Bank (ECB) is independent of governments, has a strict inflation rate mandate, and cannot exercise the role of lender-of-last resort to member governments. Fiscal policy as well loses some degree of national sovereignty as a consequence of upper limits imposed on budget deficits (as a proportion of GDP) and the objective of reducing public debt (as a proportion of GDP) to a specific target (60 per cent); these limits are set in the new European Treaty. The loss, full or partial, of traditional macro-economic tools to offset idiosyncratic shocks to the economy is the cost of participating in the monetary union. These costs have become increasingly apparent during the ongoing sovereign debt crisis.

[2] In this period, Italian political parties undergo a cleansing process by the hands of an active judiciary. The Christian Democrats, who had been at the center of the political system since the end of World War II, implode; the Lega, a party with secessionist tendencies, gains electorate shares; and Silvio Berlusconi enters politics.

With this background, we can have a better appreciation of the quantitative evolution of the two macro-economic time series from 1861 to 2008. The data for real per-capita real income come from Angus Maddison (www.ggdc.net/Maddison) and are denominated in 1990 international dollars; see Table 1.[3] The data for the inflation rate come from Fratianni and Spinelli (2001a) and the database FRED of the Federal Bank of St. Louis; see Table 2. In 1861, Italy had a per capita income that was about half of the United Kingdom's, 82 per cent of France's and 91 per cent of Germany's. Over the 147-year period covered by Table 1, Italian per capita income grew, on average, more rapidly than that of the other three European countries: 35 basis points (bp) higher than the United Kingdom's, six bp higher than France's, and three bp higher than Germany's. The rate of economic growth changes over time. It is lower than the growth achieved by the United Kingdom, France, Germany and the United States in the period 1861-1895; it is higher during the so-called Giolitti boom era, 1896-1913, when the country benefits from an industrialization transformation; it is lower during the Fascist period, 1921-1937, with the exception of the United States; and it is higher during the Bretton Woods era, 1950-1972, with the exception of Germany. The last years that define the Italian "economic miracle", a miracle that touches, however, other countries, in particular those who lost World War II and suffered massive destruction of capital (Germany and Japan). Bretton Woods coincides with what Hobsbawn (1994) calls the "golden age" of high economic growth and low rates of inflation. The golden age is followed by years of stagflation, 1973-1978, when Italian growth is higher than for the rest of the G7 group of countries. The growth differential remains positive during the EMS regime that precedes the Maastrict Treaty of 1992. The disinflationary period that follows the currency crisis in the Fall of 1992 comes with a slowdown in growth, a slowdown that continues in the first nine years of the monetary union. The poor performance of the Italian economy, both in an absolute sense and especially in relation to countries that do not adhere to fixed exchange rate arrangements (Canada, the United States

[3] More precisely, it is the Geary-Khamis dollar with purchasing power parity.

and the United Kingdom) persists to these days (2012) when the country faces the worst post World War II crisis.

The average annual rate of inflation during the period of Italian monetary sovereignty, 1861-1998, has been seven per cent, five percentage points higher than the inflation rate in the United States and four percentage points higher than the inflation rate in the United Kingdom. With reference to the G7 group of countries, Italy is clearly more distinctive along the inflation dimension than the economic growth dimension. This distinctiveness becomes even sharper when the prevailing exchange rate regime is one of flexibility.[4] The Seventies and the Eighties, plagued by widespread social conflict, are the years that best underscore this Italian distinctiveness. The welfare state explodes, but its aspirations run into the harsh reality of two large oil shocks. Monetary policy becomes subservient to fiscal policy, which is incapable of controlling consistently large government budget deficits (Fratianni and Spinelli, 2001b). These are the years when Italian public debt as a ratio of GDP starts rising rapidly, that is the genesis of today's sovereign debt crisis.

(Insert Tables 1 and 2 here)

[4] Table 2 underscores the positive correlation between fixed exchange rate and the quality of monetary and fiscal policy.

Table 1: **Real per-capita GDP in the G7 group of countries, 1990 international dollars, 1861-2008**

	Average annual percentage change							Country-pair differences			
Periods	IT	FR	GE	CA	JP	UK	US	IT-UK	IT-FR	IT-GE	IT-US
1861-2008*	1.8	1.74	1.77	1.98	2.52	1.44	1.86	0.35	0.06	0.03	-0.06
1861-1895*	0.28	1.1	1.57	1.35	1.7	1.05	1.61	-0.77	-0.82	-1.29	-1.33
1896-1913	2.71	1.54	1.7	3.98	1.64	0.87	2.46	1.84	1.17	1.01	0.25
1914-1920	0.29	0.05	1.49	0.69	4.18	1.32	2.46	1.61	0.34	1.78	-2.17
1921-1937	1.72	2.39	2.66	1.81	1.38	2.13	1.19	-0.41	-0.67	-0.94	0.53
1938-1949	0.14	0.93	3.74	4.09	-2.76	0.95	3.5	-1.1	-1.07	3.6	-3.64
1950-1972	4.91	3.99	5.05	2.69	8.14	2.24	2.35	2.67	0.92	-0.14	2.56
1973-1978	2.56	2.12	2.37	2.53	1.94	1.3	1.94	1.26	0.44	0.18	0.61
1979-1992	2.09	1.6	1.46	0.89	3.06	1.57	1.67	0.51	0.48	0.63	0.42
1993-1998	1.65	1.63	1.61	2.41	0.8	2.93	2.6	-1.29	0.02	0.04	-0.95
1999-2008	1.03	1.32	1.38	1.78	1.36	2.2	1.31	-1.17	-0.29	-0.36	-0.28

Notes: the average annual change of real per-capita GDP (Y) has been computed as [Y(T)/Y(1)]exp(1/T-1) -1, where Y(T) = value at time T, Y(1)= value at time 1. IT = Italy, FR = France, GE = Germany, CA = Canada, JP = Japan, UK = United Kingdom, US = United States.
* For Canada, Japan and the United States the Y series starts in 1870.
Source: Angus Maddison, *Historical Statistics of the World Economy* (1-2008 AD), www.ggdc.net/Maddison

Table 2: Rates of inflation in Italy, the United Kingdom, the United States and Germany: 1861-2008

	Average annual percentage change				Country-pair differences		
Periods	IT	UK	US	GE	IT-UK	IT-US	IT-GE
1861-1998	6.99	3.05	2.28		3.93	4.71	
1861-1895	0.37	-0.51	0.19		0.88	0.18	
1896-1913	1.25	0.90	2.04		0.35	-0.79	
1914-1920	27.92	17.66	11.45		10.26	16.47	
1921-1937	0.00	-2.25	-1.53		2.25	1.53	
1938-1949	42.00	5.52	5.40		36.48	36.60	
1950-1972	4.08	4.80	2.98		-0.72	1.09	
1973-1978	17.13	14.48	6.88		2.65	10.25	
1979-1992	10.60	7.13	4.82		3.47	5.78	
1993-1998	3.78	2.54	1.84		1.24	1.94	
1999-2008	2.44			1.73			0.71

Notes: The rate of inflation is measured as the annual percentage change of the national income deflator for the period 1861-1998 and of consumer price index for the period 1999-2008. The average annual percentage change was computed with the same formula as in Table 1. IT = Italy, UK = United Kingdom, US = United States, GE = Germany.
Source: Fratianni and Spinelli (2001, ch.. 2) for the period 1861-1998 and database FRED of the Federal Reserve Bank of St. Louis for the period 1999-2008.

Economic dualism[5]

When Italy unified politically in 1861, the income divide between the North and the South was relatively small. The Mezzogiorno problem (*questione meridionale*) became an issue, both economic and political, at the end of the 1870s and at the beginning of the 1880s. According to Daniele and Malanima (2007), regional disparity in Italy rose considerably from 1891 to 1953, declined in the subsequent 20 years, and rose again after 1973; in the mid-1990s, the disparity was no different from what it had been in 1930 (Daniele and Malanima 2007, Figure 5). The policies of wage flexibility in the South and interregional mobility of labor and capital (Lutz, 1962) failed. Labor unions have been traditionally opposed to a decentralized wage-bargaining process; and interregional labor mobility has remained low (Mocetti and Porello 2010), which is difficult to reconcile with the gap in per capita income (Faini et al., 1997). The fact is that Italian regional income disparities have been persistent for a long time and have been impervious to treatment and, most of all, to massive governmental transfers.

Various explanations have been proposed for this persistence. I mention three relative modern "structural" or micro-based views of dualism.[6] The first is the "varieties of capitalism" explanation (Dunford and Greco 2006). The political compromise between the southern land aristocracy and the northern entrepreneurs, achieved by the ruling Christian Democrats after World War II, gave impetus to and sustained economic dualism. The North was characterized by family capitalism, "a system of many family-owned small and medium-size enterprises dominated by few large dynastic families. The South relied on massive governmental transfers and investments by government-owned companies. At the same time, economic inefficiency was permitted and indeed sustained . . . [through] systematic use of clientelistic practices in which jobs, subsidies and recommendations were exchanged for political support and social consensus" (Dunford and Greco 2006, page 94). Inefficiency and clientelism

[5] This section draws from Fratianni and Marchionne (2012).

[6] I omit an older and fashionable "macro" literature on economic dualism that developed from the 1950s to the 1970s; see bibliography in Vita (no date).

distorted incentives and reduced the productivity of government investments in the South, which often took the form of “cathedrals in the desert.”

The second explanation attributes persistent regional economic disparities to differences in social capital (Putnam 1993). By social capital, Putnam meant civic participation in community institutions. The roots of these differences go back in time. Differences in old agrarian property rights and corporate structure might have influenced modern differences in social capital and, ultimately, in economic development (Del Monte and Pennacchio, 2012). Before political unification, Italy was primarily agrarian. In the North, owner and fixed-wage farmers worked and lived in large and vertically integrated agricultural firms (*cascina padana*). This structure promoted group solidarity among people with similar jobs that was later transferred to trade unions and cooperative associations. In the South, seasonal farmers were used on extensive agriculture, whereas the owner lived off his property and had his interests cared by a manager. The state was seen by the population as an extension of the owner’s authority. Since solidarity and trust were feelings reserved for families, this structure was not conducive to the development of civic institutions. In the center of the country, the dominant model was sharecropping. The sharecropper not only worked and lived with his extended family on the property, but made managerial decisions to improve the productivity of the land. When the sharecropping firm gave way to the industrial firm, the skills and values learned while sharecropping were transferred to the establishment of family-owned firms.

The three different agricultural models in the North, Center, and South of Italy may have been responsible for different patterns of human capital, organizational skills, and degrees of solidarity and civicness. These models provide some historical justification for Bagnasco’s (1977) contention that Italy goes beyond dualism. It can be divided into three broad, distinct economic areas: an old capital-intensive Northwest (First Italy), an agricultural and industrially backward South (Second Italy), and a newer Northeast and Center (Third Italy). Third Italy is replete with dynamic small and medium-size

firms that outsource production and are located in industrial districts (Brusco 1990). These districts specialize in different products and are distinctive in their developmental paths, local institutions, and manners of generating externalities (Becattini, 1990).

The final structural explanation of dualism complements the social capital explanation by emphasizing the character and quality of institutions. Tabellini (2008) tried to answer how we may get different types of institutions by developing a model of value transmission. The basic postulate is that individuals respond, not only to individualistic incentives, but also to social norms acquired through the family structure. The implication of Tabellini's model is that distant transactions are primarily enforced by laws and legal institutions because informal methods are not effective at long distance. On the other hand, informal methods and local institutions, like a clan or mafia, are better suited to enforce local transactions. Furthermore, informal methods rise in importance when legal institutions are weak. In the South, weak institutions can be traced back to the lateness with which feudalism was abolished (the early part of the nineteenth century in Sicily). When feudalism was abolished, and private property rights replaced feudal rights, the demand for protection of these rights increased. The state, with weak institutions, was unable to meet the demand; the void was filled by the local mafia institution (Gambetta 1993). Once established, a criminal institution destroys social capital and induces people who have a preference for laws to migrate. This pattern, in turn, weakens the population's resistance to the "bad" local institution in a sort of vicious circle.

The contents of the Special Issue

Four articles have been selected for this Special Issue. The first is on "Agricultural productivity, banditry and criminal organisations in post-unification Italy" by Alfredo Del Monte and Luca Pennacchio. The main thesis there is that banditry and criminal organizations reflect the underlying property right structure. Banditry flourished in regions where land property was highly concentrated

and land productivity was low, whereas mafia-type organizations prospered in areas when economic growth and land productivity were relatively high and the state failed to enforce property rights. It follows that, given a low enforcement regime by the government, banditry is an “inferior” activity (low income elasticity), whereas mafia-type activity is a “superior” one. The authors do their outmost to obtain a small but informative dataset to test the implications of their mafia-type activity model in Southern Italian provinces (late 1800s) and Sicilian towns (early 1900s).

The second paper is by Miranda Cuffaro, Maria Davì and Erasmo Vassallo and is titled “What can we learn from long time series? Italian living standards after unification and dualism North-South.” This is a well developed topic in the literature and the authors’ main contribution is in providing long time series on material (economic) and social well-being measured in terms of real per capita disposable income, different consumption shares, calorie intake, numbers of graduates and some demographic indicators. The main results are strong *time convergence* for living standards at the national level, especially in the period 1861-1940. The higher standards of living favourably affect social well-being, as reflected in drastically reduced rates of infant mortality and higher education levels. Concerning the geographical distribution of these higher living standards, we obtain a confirmation of earlier findings, namely that income disparities between the North and the South widened from 1911 to 1951, narrowed from 1951 to 1971 and then approximately stabilized afterwards.

The third article is on “Economic growth and dualism in Italian regions: A spatiotemporal model” by Cristina Brasili, Francesca Bruno and Annachiara Saguatti. The focus here is on the characteristics of regional economic growth using relatively high-frequency data. The authors compute an Indicator of Regional Economic Activity for the period 1993-2010 based on co-movements of 38 monthly and quarterly macroeconomic variables. The Indicator is then analyzed by means of a hierarchical model of regional economic growth that takes into account both space and time

dimensions. The main result is that Italy, in the period under consideration, is more pluralistic than dualistic, an unexpected result also to the authors. The recent financial crisis, interestingly enough, has damaged more the North-East of the country, through a collapse of exports, than the more insular South.

The fourth and final article, by Alessandro Piergallini and Michele Postigliola, deals with "Fiscal policy and public debt dynamics in Italy, 1861-2009." The hypothesis to be tested is whether the debt-to-GDP ratio has been statistically mean-reverting over the period 1861-2009. The conclusion is that it has been, after controlling for fiscal feedback policies, meaning that mean reversion of the ratio has been achieved, not only through growth of GDP, but also through restrictive budgetary policies. This sounds like good news for the prospects of resolving the current sovereign debt crisis through austerity. But we should keep in mind that the "stationarity" finding encompasses two exceptional reductions in the debt-to-GDP: one after World War I, achieved thanks to the forgiveness of foreign creditors and one debt consolidation, and the other after World War II, achieved through a rate of inflation that devastated the real value of government debt. Neither of these conditions exists today: foreign creditors appear to be in no bail-in mood and the ECB is not a lender of last resort to governments. The critical questions for the future of the country are: What alternative is there should fiscal austerity fail to redirect the debt-to-GDP towards the long-run average? Is there a new *deus-ex-machina* on the horizon?

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