

**PROMETEIA
DISCUSSION
NOTE N. 6**

JULY 2018



***NO SILVER BULLET
FOR ITALY'S REGIONAL
DISPARITIES***

Main points

-  The March 2018 general political elections highlighted the Italian North-South divide
-  Regional economic disparities in Italy are deeply rooted in the past, but have worsened since 2008
-  Some productivity clusters are emerging in the South, but they are still too sparse
-  The redistributive role played by the public sector (and by EU funds) is significant but unable to close the gaps
-  Going forward, the South has to face two challenges: a persistent fall in human capital, due to population ageing and brain drain, and a possible reduction in the EU funds
-  More than additional resources, the South needs better policies to make the fundamental public services work, together with more infrastructures to ease doing business

I. Introduction

The March 2018 political electoral results were further proof of a divided country. The South voted *en masse* for the 5 Star Movement, while Lega and Forza Italia prevailed in the Centre-North. A coalition government has now been formed joining the 5 Star Movement, strongly rooted in the South, and the Lega, strongly rooted in the North-East of the country. The agenda of the two political parties aims at catering their own constituencies.¹ This has forcefully highlighted Italian regional divisions once again.

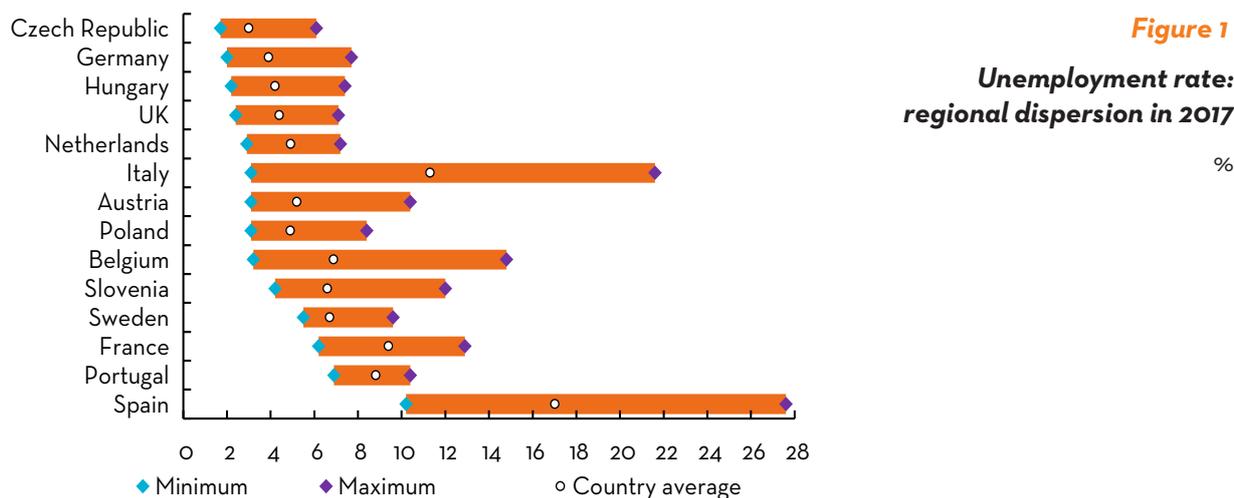
This note aims at describing the economic performance of the South compared to that of the rest of the country.² We will look at employment and income statistics (Section II), the structure of production and productivity (Section III), the role played by the public sector and European funds in redistributing resources (Section IV), and finally we will look at future challenges (Section V). Section VI concludes.

¹ The Lega's agenda includes the attribution of more fiscal autonomy and larger competences to local governments, in line with some Northern regions requests to retain more of their tax revenue.

² The data used in this note follow the regional classification as defined in the Eurostat Classification of Territorial Units for Statistics (NUTS2) administrative levels. In Italy there are 15 Regions with ordinary status: Piemonte, Lombardia, Veneto, Liguria, Emilia Romagna, Toscana, Umbria, Marche, Lazio, Abruzzo, Molise, Campania, Puglia, Basilicata, Calabria; 5 Regions with autonomous status (Regioni a Statuto Speciale): Valle d'Aosta, Friuli Venezia Giulia, Sicilia, Sardegna; 2 autonomous provinces: Trento and Bolzano. The aggregation in macro-areas is defined as follows: North-West (Piemonte, Valle d'Aosta, Lombardia, Liguria), North-East (Emilia Romagna, Veneto, Friuli Venezia Giulia, Trento, Bolzano), Centre (Toscana, Umbria, Marche, Lazio), South (Abruzzo, Molise, Campania, Puglia, Basilicata, Calabria, Sicilia, Sardegna). The latest available year is 2016 for the regional accounts and 2017 for the macro-area accounts. Regional data for 2017 are Prometeia forecast.

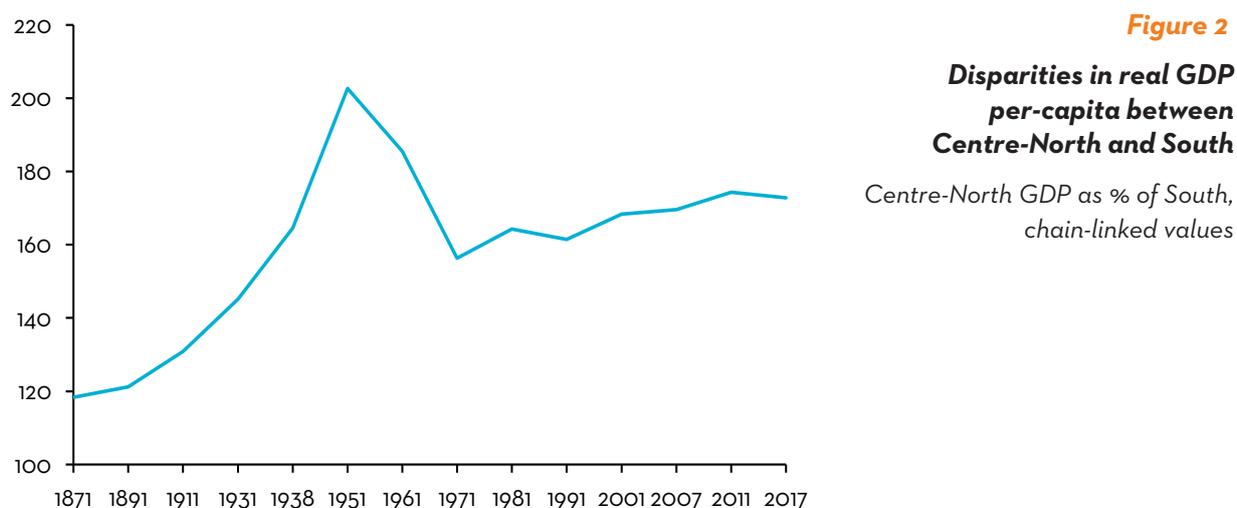
II. Regional disparities have worsened with the two recent economic crises

Gaps in unemployment rates are emblematic. In 2017, Italy showed the widest regional disparities of all European countries (Figure 1), similar only to Spain. Over the last 10 years, since the global financial crisis, disparities have increased. In 2007 labour market conditions among European countries were less polarized and Italy ranked fourth after Spain and Germany. Over the course of a decade, the unemployment rate has increased and the North-South divide has widened by 8.2pp to the detriment of the South (where unemployment rates have almost doubled).



Source: Prometeia's calculations on Eurostat data.

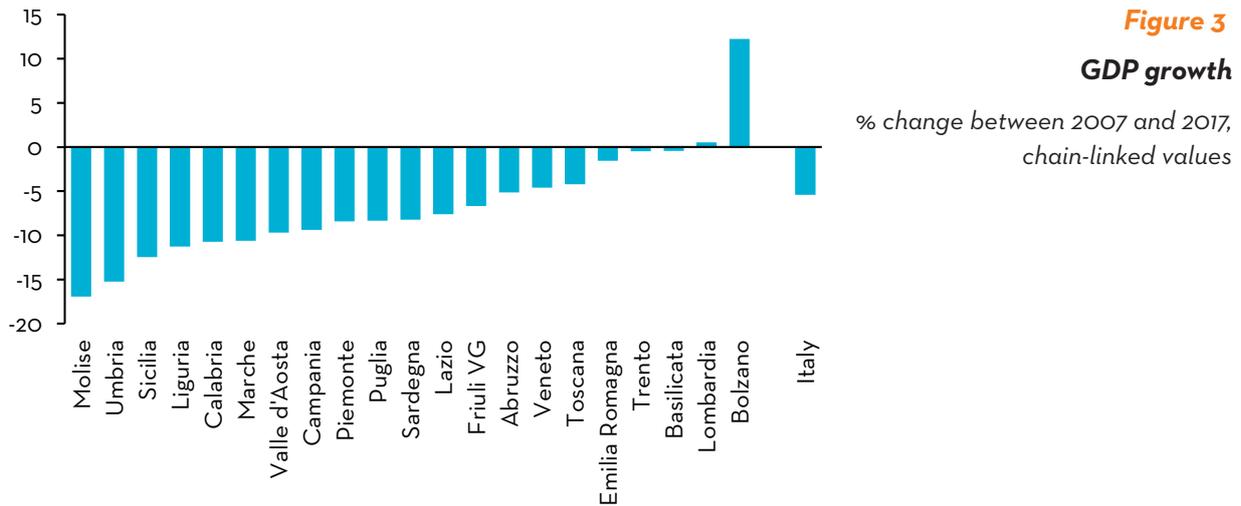
Italy has a long history of regional disparities. Over the last 150 years, territorial gaps have mostly increased (Figure 2), excluding the period from the end of World War II to the early 1970s, that represented a turning point. During this period, the convergence in per-capita GDP increased thanks to an exceptional Southern regions growth, productivity gains and a relative decline in the Southern population as a result of migration. This process was favoured by state intervention with important investment in infrastructure.³ The convergence process came to an abrupt halt,



Source: Prometeia's calculations on Felice and Vecchi* and Istat data.

* Felice E. and Vecchi G., 2015, *Italy's growth and decline*, *Journal of Interdisciplinary History*, XLV:4.

³ Viesti G., Pellegrini G. and Iuzzolino G., 2011, *Convergence among Italian Regions, 1861-2011*, *Economic History Working Papers*, Bank of Italy, number 2.

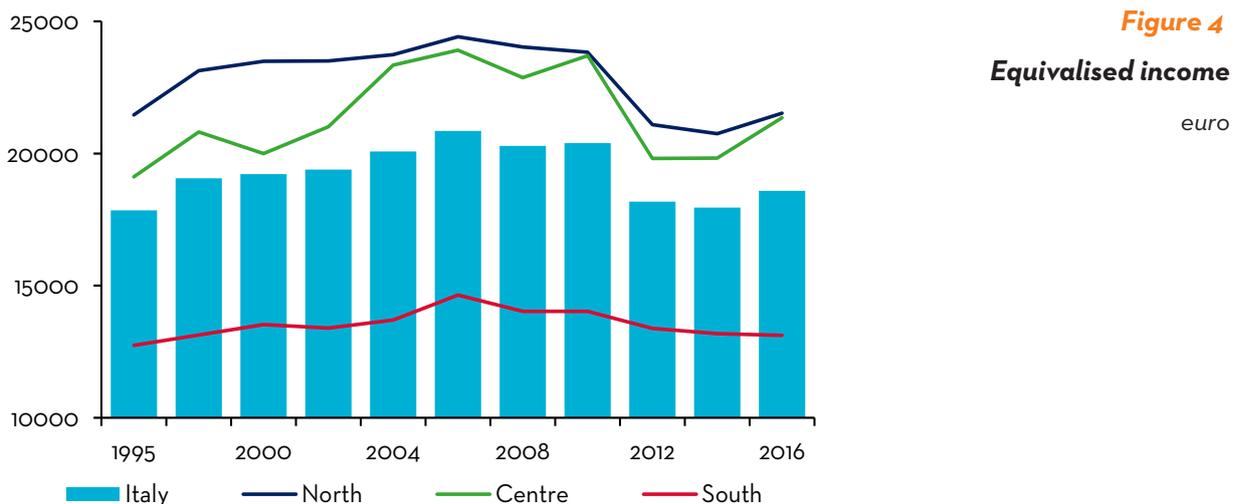


Source: Prometeia's calculations on Istat data.

as the Southern economy proved to be less able to face the modified macroeconomic context (oil shocks, international competition). Regional disparities increased further following the 2008 crisis, as the recovery was much weaker in Southern regions,⁴ although some regions showed GDP growth levels above average. For instance, Basilicata's GDP (where there is a significant car manufacturing industry and an oil extraction activity) is almost equal to the pre-crisis level whereas, at the other extreme, Molise's GDP loss was -17 per cent (Figure 3).

Income disparities remain significant even after important factors are taken into consideration.

The disparities previously described remain even after taking into account the relative importance of the informal economy, which has a higher incidence in the South. In fact, GDP data include an estimate of the black economy, showing that in 2015 (latest available official estimates⁵) it represented 19 per cent of total value added in the South, compared to a national average of 14 per cent (12 per cent for the Northern regions). The highest proportion of the illegal economy



Source: Prometeia's calculations on Bank of Italy, SHIW data.

⁴ In 2017, GDP at constant prices was 9.5 per cent lower than in 2007 in the South, whereas it was 4.1 per cent lower in the Centre-North (the Italian average loss amounted to -5.5 per cent). The widening of the territorial gap (5.4pp) is less pronounced in per-capita terms (only 1.7pp), partly due to migration from the South to the North, especially of highly educated young people (see part V).

⁵ Istat, *L'economia non osservata nei conti nazionali, Anni 2012-2015*, 11 October 2017.

is estimated for Calabria (21.3 per cent), while the lowest is estimated to be in the Autonomous Province of Bolzano (10.7 per cent) and in Lombardia (10.9 per cent).

A second important element is the family composition: even when considering equivalised household income, that is a measure of disposable income that accounts for household composition, average income in the North is almost double compared to that in the South (Figure 4).

III. Going into a little more depth: production structure and productivity in the South

The public sector dominates the economy of the South (Figure 5). According to 2016 data, the macro sector that includes mainly public services (public administration and defence, education, health, etc.) represents around 30 per cent of value added in the South, compared to 16.2 per cent in the North-West, 18 per cent in the North-East and 23.4 per cent in the Centre (20 per cent excluding Lazio).⁶ Industry accounts for 11.8 per cent of the total economy in the South and for 15 per cent in the Centre. The share of industry on total value added is higher and almost double in the North (22.2 per cent and 24.6 per cent in the North-West and North-East, respectively), similar to Germany's average values. Agriculture is still relatively more important in the South, accounting for 3 per cent of total value added compared to 1.9 per cent in the North. Hotels, restaurants and the leisure sector are as important in the South as in the rest of the country. However spending by foreign tourists is still 15 per cent lower than the national total.

A lower share of manufacturing translates into a lower propensity to export. The ratio of exports to GDP of the Southern regions in 2016 was the lowest of all the macro regions, around a third of that recorded in the North-East (12 per cent and 35 per cent, respectively), despite a remarkable role of agriculture and fishing exports.

Manufacturing activities are concentrated into five industrial sectors: Automotive, food, clothing-fashion, aeronautical (the so-called 4A group from the Italian names 'Auto, Alimentare, Abbigliamento and Aeronautica') and pharmaceuticals. The 4A supply chains and pharmaceuticals



Figure 5
Valued added composition
in 2016
%, chain-linked values

Source: Prometeia's calculations on Eurostat data.

⁶ 2016 is the latest available year.

achieve 43.6 per cent of manufacturing value added in the South and are worth €12.7 billion.⁷ They employ 45 per cent of the South's total manufacturing workforce. These sectors have a propensity to export that exceeds the manufacturing average (17.2 of exports as a percentage of value added against 12.3 per cent).

Productivity also shows large regional disparities. On average, GDP per-employee is more than 20 per cent lower in the South than in the rest of the country. Nevertheless, some high productivity (blue) areas in the industrial sector can be spotted (Figure 6), whereas services appear to be uniformly less productive. According to the “areas of industrial vitality” indicator, calculated by the Bank of Italy⁸, industrial vitality in the South is concentrated both sectorally and geographically. For example, the food sector specialization areas include bakery products in the provinces of Naples and Barletta, processing and preserving fruits and vegetables in the provinces of Salerno and some Sicilian provinces, as well as the production of dairy products in the Caserta area. While the high technology sectors are almost absent, among the medium-high technology activities, an area of industrial vitality is the aerospace sector in the province of Naples.

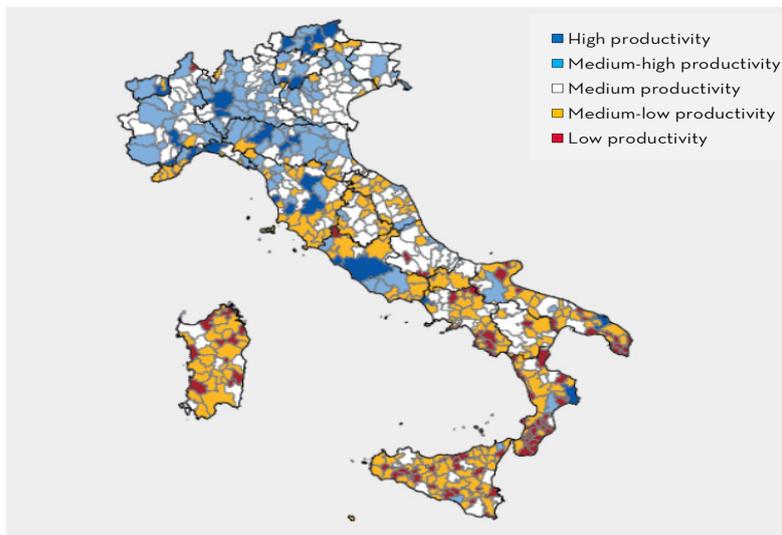


Figure 6

Labour productivity in industry

value added per employee in 2014,
latest available data

Source: Istat, Annual Report 2017.

IV. The redistributive role played by the public sector, important but insufficient

The gaps in development between Italian regions involve an inevitable interregional redistribution of public resources. This redistribution stems primarily from the two constitutional principles of equal access of citizens to the essential public services and progressivity criteria in income taxation, which result in transfers of resources from the richest to the poorest regions. In addition, other transfers result from the implementation of policies sought to promote territorial rebalancing and to fill the economic gaps.⁹

⁷ SRM- Studi e Ricerche per il Mezzogiorno, *Il valore delle filiere produttive nel nuovo contesto competitivo e innovativo, tra Industria 4.0 e Circular economy*, 2018.

⁸ *L'economia delle regioni italiane*, Novembre, 2017, Banca d'Italia. The indicator identifies with a high degree of sectoral/geographical detail the production areas characterized by positive and widespread growth in value added, turnover and productivity throughout the country.

⁹ The relevance of interregional redistribution operated through fiscal flows is highlighted by an abundance of empirical studies (for a historical review see Giannola A. et al., 2015, *Net fiscal flows and interregional redistribution in Italy: a long-run perspective (1951-2010)*, in *Structural Change and Economic Dynamics*, n.39). This literature has developed significantly since

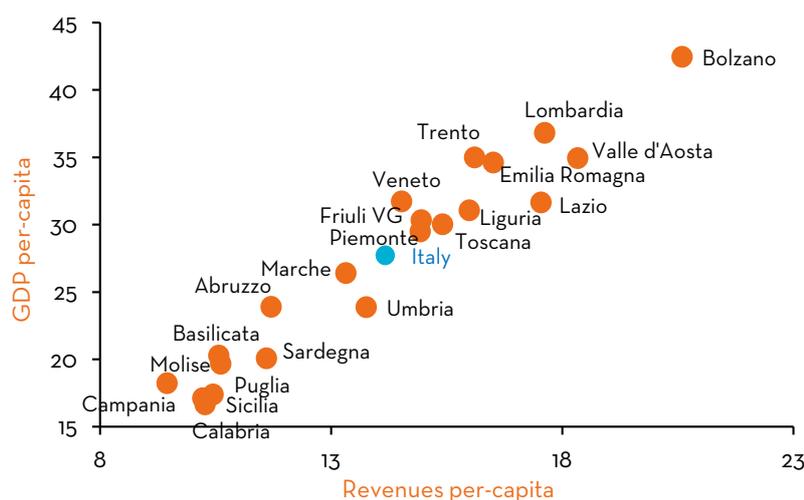


Figure 7
Public revenues and GDP, 2016
thousands of euros per-capita

Source: Sistema dei Conti Pubblici Territoriali.

Regional fiscal imbalances show that a substantial amount of resources are transferred every year from the Centre-North to the South. The main indicator of fiscal imbalance between regions is the Net Fiscal Flow (NFF), or fiscal residuum, i.e. the difference between public revenues raised from an administrative area/region and public expenditure returned to that area in the form of services, wages and transfers.¹⁰ Apart from the methodological differences and the time spans covered, the NFFs estimated by the various empirical studies document the existence of a significant shift of resources to the Southern regions from the rest of the country.

The greatest variability is in tax revenue which depends on income. In all Southern regions, per-capita revenues are lower than the Italian average, reflecting the fact that revenue is highly correlated to the degree of development in the region (i.e. GDP per-capita, Figure 7).

Expenditure levels are more homogeneous than revenue levels but not completely aligned. On the expenditure side, a positive correlation with GDP per-capita is observed in social security expenditure, especially for pension benefits, which are on average higher in the Northern regions

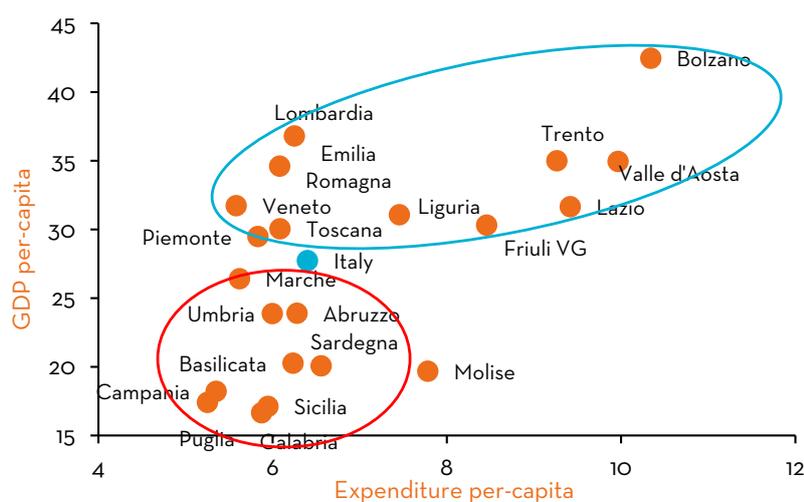


Figure 8
Public expenditure net of social benefits and GDP, 2016
thousands of euros per-capita

Source: Sistema dei Conti Pubblici Territoriali.

the mid-1990s, when the Italian Economic Development Ministry started to systematically collect data on public revenues and expenditure at regional level. These data are the "Sistema dei Conti Pubblici Territoriali" (Regional Public Accounts System).

¹⁰ Interest expenditure is not taken into account in the calculation of the NFFs.

due to the higher employment and wage levels. Net of social benefits, the link with GDP becomes less consistent (Figure 8), due to the need to ensure a homogeneous level of public services throughout the whole country.¹¹

Differences in NFFs, therefore, mainly reflect differences in fiscal capacity. The highest NFF, in per-capita terms, is recorded in Lombardia followed by Emilia Romagna, while the regions with the most significant negative NFFs are Molise and Sardegna (Figure 9). The Southern regions are all characterised by negative NFFs, confirming the redistributive flow of resources from the rest of the country to these areas.

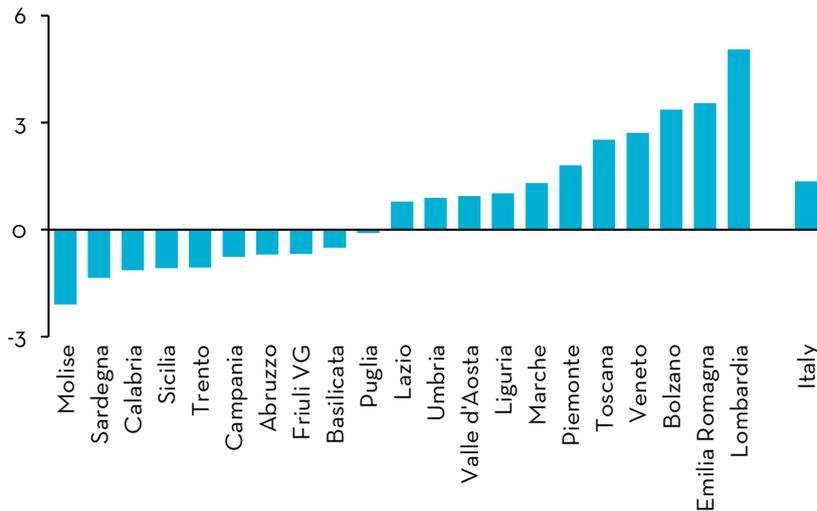


Figure 9
Net Fiscal Flows,
average 2014-2016
thousands of euros per-capita

Source: Sistema dei Conti Pubblici Territoriali.

V. Looking ahead, two big challenges linked to population ageing and lower European funds

The ageing of the Italian population started decades ago, but more recently in the South.

The fertility rate, in Italy, was already below 2 children per woman at the beginning of the 1980s and the natural growth rate of population became negative at the beginning of the 1990s (the natural rate is the difference between births and deaths as a share of total population;¹² Figure 10). Nevertheless, the increasing influx of immigrants kept total population growth positive until 2015. Rates of natural growth had already dropped sharply by the late seventies in the Northern regions and have become negative since 1980. In contrast, in the Southern regions natural rates, historically higher, have remained positive until 2010.

Southern regions are expected to age much more rapidly in the future. In other words, while the demographic transition started about 40 years ago in the Centre-North, in the South it started much more recently. Indeed, the South is the only area where total population is expected to decline, more than compensating increases in the other areas (Table 1). This means that the Northern regions are more aware of the economic and social implications of ageing, whereas they are still to fully emerge in the South.

¹¹ Lazio represents an exception, as the high public expenditure is mainly due to the presence of the capital city (Rome).

¹² The natural growth rate of the population does not capture the effects of mobility, i.e. the fact that people born in the South move to the North.

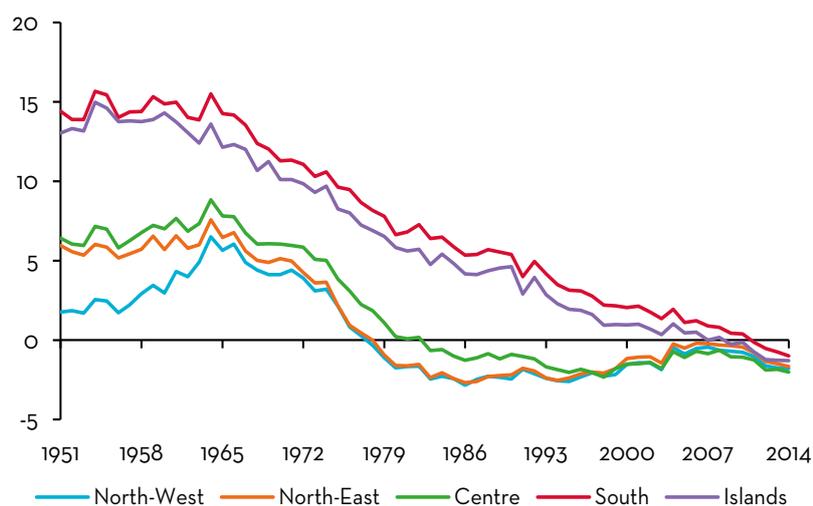


Table 1 Projected changes between 2017-2030

	Italy	North	Centre	South
Total population (thousands)	-219.4	399.9	171.5	-790.9
Active population (thousands)	-1861.8	-420.1	-164.6	-1277.1
Active population (%)	-4.8	-2.4	-2.1	-9.4
Active population ratio (percentage points)	-2.9	-2.4	-2.2	-3.8
Old-age dependency ratio (percentage points)	9.1	8.1	7.6	11.2

Source: Prometeia's calculations on Istat data.

Moreover, the “brain drain” phenomenon is likely to continue. Over the last ten years, around 700 thousand people have left the South to move to the Centre-North, and of these 20 per cent were graduates.¹⁵ As people with a tertiary degree represent slightly more than 10 per cent of total population in the South, it is clear that migrants are generally the most educated people, causing an impoverishment of the South's human capital. A level of human capital which is already weaker, since the share of people with tertiary education is about 20 per cent lower than the Italian average (14.1 per cent), and the overall quality of education (based on the results from OECD-PISA assessment) is poorer.

Table 2 Financial resources of the European Structural and Investment Funds (2014-2020 programming period, € billion)

	Total resources	National co-financing (%)
South	47.6	35.4
Centre-North	25.4	51.2
Unattributed	3.2	51.7
Total	76.1	41.3

Source: Prometeia's calculations on data from Agenzia per la Coesione Territoriale.

Also European Funds, provided by the Regional and cohesion program, are relevant. The amount of financial resources of the European Structural and Investment Funds (ESIF) for the 2014-2020 programming period provides the Italian regions with approximately €76 billion in total resources, of which more than €47 billion is going to the South (Table 2). National co-financing accounts for 41.3 per cent of the total on average and seems destined to absorb a substantial part of the national resources allocated to regional policies,

¹⁵ Rapporto SVIMEZ 2017 sull'economia del Mezzogiorno, Documentazione Statistica, Camera dei Deputati, Roma, 7 Novembre 2017.

and hence the Southern regions, in the coming years too.¹⁴ Overall, the financial resources available for the current programming period account for 1.4 per cent of the GDP of the Southern regions and for 0.5 per cent of Italian GDP on an annual basis. The importance of the European funds is even greater when compared to public administration expenditure: it is about 2.3 per cent of public expenditure in the Southern regions and 1.1 per cent at national level.

Underutilization of EU funds, differently from the past, appears not to be a problem anymore. According to the last available data, in the 2007-2013 Programming Period the share of certificated expenditures amounted to more than 99 per cent of available funds.

Despite the fact that these resources are still considerable, their effects in narrowing economic gaps are weak according to most available analyses. This is partly due to the fact that only a small part of the European funds is directly aimed at increasing the competitiveness of the regional productive system (only 21.2 per cent of the 2014-2020 funds are dedicated to the competitiveness of SMEs). It is also important to remember that direct support for productive activities is limited by European regulations on State aid and by European competition policy.

The level of European funds available could decrease in the near future. For the next EU budget 2021-2027 the Commission has proposed reducing the share of resources assigned to traditional expenditure items, including the European funds. The Commission's proposal foresees an amount of €328 billion for structural funds provided by the Regional and cohesion program, down from €347 billion allocated under the 2014-2020 programme. Thus, in a context of reduced funding, it will be even more important to focus more on how efficiently these funds are used.

VI. Summing up

150 years since Italy's political unification, the South is still lagging behind the Centre-North.

Several analyses agree in identifying the root of the South's current poor performance in the vicious circle between the poor infrastructure system (especially in transport), low human capital endowment, the particularly limited dimension of companies, the general low quality of public services (civil justice, education, health care system, public administration¹⁵), corruption and organized crime.¹⁶ According to some studies, there could be a sizeable impact on productivity from enhancing government efficiency, in particular in the education and justice sectors, at both central and local levels.¹⁷

Southern regions account for one-third of Italy's population and a quarter of GDP, thus they cannot be neglected if Italy's potential growth is to increase. Certainly, there is no silver bullet able to resolve such a long-lasting problem. Nevertheless, some priorities can be identified, starting from the need to improve the local environment in order to favour firms' growth and export ability. In this context, the quality of public services and infrastructures is one of the key factors for the structural improvement of the Southern economy.

¹⁴ At the same time, according to estimates released by the Agenzia per la Coesione Territoriale, expenditure from the National Cohesion Fund declined from about €7 billion on average in the period 2000-2002 to less than €2 billion in the period 2014-2015.

¹⁵ According to the European Commission's European Quality of Government Index, Italy has the widest variation of all European economies between its worst and best performing regions in terms of quality of public governance. For instance, it takes more than twice the number of days to get a construction permit in Sicilia than in Lombardia (World Bank, *Doing Business in Italy*, 2013).

¹⁶ Among others, cfr. Bordignon M., 2017, *Italy: Fiscal federalism and the division between North and South*, *Politica Economica, Journal of Economic Policy*, 3/2017, Il Mulino.

¹⁷ Giordano R. et al, 2015, *Does Public Sector Inefficiency Constrain Firm Productivity: Evidence from Italian Provinces*, *IMF Working Paper, WP/15/168* and Panetta F., 2018, *Economia e sviluppo del Mezzogiorno, Intervento alla Presentazione del rapporto L'economia della Campania*, Napoli, 11 giugno.

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