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Italy: rise, decline and restructuring of a regionalized capitalism

Carlo Trigilia and Luigi Burroni

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Abstract

During recent decades, the varieties of capitalism approach has provided one of the most important contributions on the analysis of advanced capitalism. However, there are national experiences that seem to be hard to explain from this theoretical perspective. In this article we underline that this is particularly true for countries that are characterized by a high degree of internal diversity, such as the Italian case. For this reason we propose to combine the national and regional dimensions, studying what can be defined as a 'regionalized capitalism': a complex and heterogeneous system that entails both remarkable dysfunctions and elements of strength. Analysing the Italian case, we show the importance of centre-periphery relations, which produce a mix of local economic dynamism and national public disorder (public deficit and debt, inefficient policies). At a local level, SMEs and their networks cooperate in a flexible and neo-voluntaristic way to produce territorial competitive advantages: a networked economy based on relational capacities. However, the success of local economies has delayed the adjustment of public policies at a central level. In the last decade, this process has endangered economic development, while Italian firms were challenged by increasing globalization. Drawing attention to the regional dimension, this research approach offers not only useful insights for understanding a single national case study, but also holds broad theoretical implications for the analysis of change and restructuring of advanced economies.

Keywords: Italy; local development; varieties of capitalism.

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Introduction

Since the 1990s advanced economies have had to face a remarkable reorganization to deal with the new challenges brought about by globalization. Comparative studies have focused on different reactions at the national level. As is well known, one of the most important theoretical and empirical contributions in this field was provided by the 'varieties of capitalism' (VoC) approach (Hall & Gingerich, 2004; Hall & Soskice, 2001). This strand of research identified two main ideal-types – liberal market economies and coordinated market economies – and analysed their comparative strength and weakness in reacting to global pressures. More recently, other contributions have focused on 'hybrid cases', such as the Mediterranean variety of capitalism and the new models experimented with by Central and Eastern European countries (Hanckè, Rhodes & Thatcher, 2007). These cases differ from both liberal market economies and coordinated market economies.

However, some national cases, such as Italy or Spain, cannot be fully explained by the traditional version of the VoC model. Even if they are defined as hybrid cases, using the Mediterranean model, the results are not completely satisfactory. The main reasons are to be found in two peculiar features of these models. First of all, they refer to the national level and therefore are not well equipped to take account of deep internal diversities in economic organization. Second, they strongly rely on the idea of institutional complementarities that may lead to overlooking tensions and contradictions between different institutions at the national level, but also between centre and periphery. These tensions and lack of integration can hinder overall economic performance, but can also open up chances for adjustment and change. In the case of Italy, for instance, an analytical frame strongly based on the national level and on the assumption of institutional complementarities would face difficulties in explaining the remarkable and longstanding performance of some Italian industrial districts or the ability of Italian institutions to change.

In this article we argue that an alternative approach can offer a more fruitful contribution to the understanding of countries with significant territorial diversities. We propose to combine the national and regional dimensions, especially for those countries that are characterized by internal diversity (Whitley, 1999). Italy can be defined as a 'regionalized capitalism': a complex and heterogeneous system that gathers together both remarkable dysfunctions and strengths, where local institutions, SMEs and their networks cooperate in a flexible and neo-voluntaristic way to produce territorial competitive advantage. This approach will not only offer useful insights for understanding a single national case study, but it also has broad theoretical implications for the analysis of change and restructuring of advanced economies.

In the following sections, we will briefly discuss the VoC literature, with particular attention to recent contributions that make reference to the Italian case. We will then focus on the historical background of the relations between the regional and national levels of regulation. This will help us to analyse recent changes and challenges to Italian regionalized capitalism. In the concluding remarks, we will focus on some general implications of this case study.

The Italian case and the varieties of capitalism literature

As is well known, the strand of literature on VoC has its main focus on the national dimension: a coherent set of national institutions shapes the organizational architecture of firms and the governance of the economy. Hall and Soskice (2001) identified two ideal types of capitalism: the coordinated market economies (CMEs) (Austria, Germany, Japan and Nordic European countries) and the liberal market economies (LMEs) (including Anglo-Saxon capitalism).[1] Hall and Soskice acknowledge that this typology is less effective in classifying countries such as Italy, Spain and France; in this regard, they refer to the definition by Martin Rhodes of 'Mediterranean capitalism'. This is characterized by a past tradition of extensive state intervention, persistence of non-market coordination in the corporate governance arena, together with a growing liberalization of the labour market (Rhodes & Apeldoorn, 1997). However, this attempt to define a 'residual' model remains unsatisfactory, especially because of the significant differences between the cases included in this ideal type.

More recent empirical and theoretical contributions have focused on the so-called 'mixed-market economies' model (MMEs), including cases of Mediterranean capitalism and of Central and Eastern Europe (Hancké *et al.*, 2007). According to these authors, the Mediterranean variety of capitalism has hybrid features and combines market and non-market forms of coordination with an important role played by the state. Molina and Rhodes (2007) emphasize that MMEs are characterized by limited social protection and high employment protection. As for the production regime, 'lower competitive pressures due to high levels of product-market regulation and state intervention help maintain stable bank-industry relations and contain the growth of financial markets' (2007, p. 226). These two features promote an industrial specialization based on small-scale firms that compete mainly on low-priced, low-quality goods.

Some authors stress that these mixed models lack the institutional architecture able to support their competitiveness. Amable (2003), for example, showed that MMEs do not have a coherent system that triggers the emergence of valuable and effective complementarities; Hall and Gingerich emphasized that pure systems – such as LMEs or CMEs – perform better than mixed cases (Hall & Gingerich, 2004). Moreover, this suboptimal competitive architecture will be retained by the action of strong actors – including the state – interested in maintaining the status quo (Hancké *et al.*, 2007).

This recent strand of literature on mixed models offers a useful standpoint to understand better those countries with idiosyncratic institutional features. The Italian case, for example, is not characterized by a coherent and integrated

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set of national institutions. On the one hand, there are similarities with the CME model: a high level of labour market rigidities, tripartism in economic and social policies, a medium-high level of institutionalization in industrial relations, a weak role for the stock market. On the other hand, there is a clear separation between banks and firms as in LMEs; SMEs with family management prevail and firms rely mainly on self-financing and short-term loans by banks – a financial system quite different from that of both the CMEs and LMEs. Furthermore, the Italian case is characterized by a more pluralist model of industrial relations, with many fragmented collective organizations and with a less institutionalized system of trilateral negotiations, based mainly on neo-voluntaristic practices. As has been recently underlined by Molina and Rhodes (2007), this model of political economy continues to apply to the category of mixed-market economies.

There are some specific reasons why the contribution of the varieties of capitalism approach to the understanding of the Italian model of political economy remains limited. Here we will focus on three main points.

First, the analysis of the Italian case from the standpoint of the VoC focuses on variables that have recently undergone significant changes in Italy. Since the beginning of the 1990s there have been important reforms: to the labour market (1996–2003), corporate governance (1998–2004), financial market and credit system (1990–8) and training and university systems (1996–2004). Even though we will not cover the details of these reforms, one should take into account that the Italian model is not as static as is suggested by the VoC approach. At the same time, changes did not entail a coherent shift of the Italian political economy towards one of the two ideal-types of capitalism. On the one hand, there has been a flexibilization of the labour market, with a remarkable growth of atypical and time-limited contracts, while national collective bargaining nevertheless remains well entrenched. On the other hand, the corporate governance reform seems to stem from the US model, but the role of the public company is still limited as well as the role of the stock exchange in financing private firms (Barca, 2001). At the same time, pyramid leveraging and cross-shareholding are still prevalent, together with family control. Last, the professional training system is closer to the CME model, where training is seen as a collective good.

This leads to a second specificity that complicates the analysis of the Italian case based on the VoC approach. Italy is not characterized simply by a peculiar set of *national institutions*: the political economy is more influenced by *local formal and informal institutions*. The Italian model can be defined as '*regionalized capitalism*', characterized by two main features. First, most innovative and competitive firms that are open to international competition rely on non-market coordination mechanisms: their competitiveness is based (a) on cooperative structures based on informal social ties (individual social capital) involving both entrepreneurs and entrepreneurs and their employees and (b) on more formal relationships (collective social capital) between collective organizations, local and regional governments aimed at producing

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and allocating local collective competition goods. Thus, it is possible to define this model as a *networked economy based on relational capacities*. A second important feature of the Italian model as regionalized capitalism is related to the strong and persistent territorial differences in terms of organizational architecture of firms (large firms, industrial districts and clusters of small firms) and regulatory mechanisms of local economies. Therefore, the Italian case is characterized by remarkable intranational differences (Burroni & Trigilia, 2001; Whitley, 1999).

Third, the VoC approach adopted the concept of institutional complementarities in a pretty 'functionalist' way (Crouch, 2005): the competitiveness of a country is related to the presence of a coherent and integrated set of national institutions (Hall & Gingerich, 2004; Hall & Soskice, 2001) and hybrid cases such as Italy are supposed to be static and to perform worse. As we will see, this view underestimates the possibility of change in loose, hybrid and less-structured cases. In some Italian industrial districts, for example, a long-standing historical background and a flexible regulatory framework have triggered industrial restructuring and change and the generation of new territorial competitive advantages. Thus, hybrid and loose institutional architectures do not necessary act as constraints, but may have beneficial effects.

The two latter points suggest that adopting this 'regionalized' perspective on analysis allows us to identify processes and features that are often overlooked by the VoC approach and that can shed new light on changes and challenges for specific forms of European capitalism, such as the Italian one. This can also explain why hybrid cases sometimes break the rule that 'pure cases perform better' (Amable, 2003; Hall & Gingerich, 2004). At the same time, as our concluding remarks will make clear, this research path may have broader theoretical implications for concepts that are extremely important for economic sociology and political economy, such as institutional complementarity and change.

Two methodological qualifications are necessary. First, studying the Italian model of political economy from a regionalist perspective does not mean the adoption of a 'localistic' view that overlooks the role of national regulatory mechanisms and institutions. On the contrary, we will stress that, for complex historical reasons, the role of national institutions has become mediated by regional institutions. Therefore, their influence is subject to a high degree of territorial variation. At the same time, we will show how national institutions are, at least in part, reshaped by this interaction with local and regional institutional structures. Second, in the following part of this article we will adopt the concept of a local production system (LPS), meaning local labour markets (travel to work areas) in which there is a level of industrial activity higher than the national average. Thus, the concept of the LPS is broader than that of industrial district or clusters, including also manufacturing areas characterized by large-scale firms (see Crouch, Le Galès, Trigilia & Voelzkow, 2001).

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Historical roots of a regionalized capitalism

The presence of differences in the political economy arena and in the productive organization of firms among Italian regions is a feature that has longstanding historical roots. In order to understand more recent changes it is necessary to analyse briefly how these regional differences emerged and how they were influenced by specific national policies; at the same time, it is particularly important to identify the institutional architecture that triggered the competitiveness of different kinds of local systems up to the end of the 1980s.

We can distinguish three large areas where the economy is embedded in a particular urban structure and in a social setting shaped by local institutions. This is the well-known image of the 'three Italies' (Bagnasco, 1977). The first is the area of the oldest industrial regions of the north-west and the second is the south. The discovery of the third Italy, in the 1970s, emphasized the role of the small-firm regions (centre and north-east) by distinguishing them from the large-firm areas of the north-west and the underdeveloped regions of the south. The southern areas of the country, with more than one third of the overall population, have traditionally been backward. After the Second World War their economy was still based on large rural estates. The agrarian reform of the 1950s and the successive efforts to foster industrialization through state-owned firms have had a limited success, while the local institutional setting was not able to sustain small-firm development (with some exceptions to which we will return later).

The north-west (the so-called 'industrial triangle' which includes the metropolitan urban systems of Turin, Milan and Genoa) is the territory where the first wave of industrialization took place at the beginning of the twentieth century and where large firms mainly developed in the 1950s and the 1960s, sustaining the rapid industrial growth of the country. This was the part of the country where the Italian Fordist model emerged, based on the standardized production of large firms. During the 1950s and 1960s these firms grew at a fast rate and increased their exports. The main sectors were the automobile industry, office equipment, mechanical engineering and chemicals. After two decades of industrial growth most of the largest industrial firms and almost half of the Italian working class were concentrated in the regions of the north west. In 1971, with 26 per cent of the national population, these regions produced 40 per cent of national income and around 50 per cent of industrial income.

The postwar Italian 'economic miracle' had its territorial basis in the north-west. First, this area possessed a deep-rooted industrial culture, which nurtured entrepreneurial traditions, and a skilled labour force; there existed infrastructure and services, which included good technical schools. These factors had their roots in the first wave of industrialization, which took place at the beginning of the twentieth century and continued during the fascist regime. In this period some of the most important firms had already developed

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under family control (such as Fiat, Olivetti and Pirelli). A substantial component of industry was owned by the state through two holdings: IRI, created during the fascist period, and ENI which was established in the early 1950s. In the postwar period state enterprises were concentrated in steel and in the energy sector. Finally, one has to take into account that the industrial structure of the north-west suffered less from war damage. Therefore, there were material and institutional resources that favoured the development of mass production and of an export-led economic model.

However, in order to understand this process it is also necessary to consider the role of national policies. Suffice it to say here that three factors were particularly important. First, the end of protectionism and the decision to liberalize the economy exposed modern sectors – concentrated in the industrial triangle – to the winds of competition and stimulated their further modernization. Second, the choice of keeping and strengthening state enterprises contributed substantially to lowering the cost of raw materials (especially steel) and energy. Third, the consolidation of a political coalition, centred on the role of the Christian Democratic Party, reassured business elites and small entrepreneurs, and brought about fiscal and labour policies favourable to firms, while unions were kept weak and divided. In addition, the labour market became increasingly influenced by huge waves of migration from the south of the country, where the economy was stagnating, towards the north-west, where industrial firms were concentrated. As a result labour costs remained low in the 1950s and 1960s and increased much less than productivity. This gave a remarkable competitive advantage to the large Italian firms specialized in mass production.

Therefore, the combination of local institutional resources and national choices can help to explain why Italy enjoyed a fast growth of mass production, concentrated in the north-west. However, the same set of institutional conditions triggered the severe crisis that was experienced in these areas in the early 1970s. These features became a constraint when it was necessary to manage the social effects of intensive and rapid growth. In a relatively short time – less than twenty years – a regionally concentrated, poorly skilled and socially underprivileged working class was created as a result of this development. The growth of industrial employment was accompanied, especially after 1958, by a constant inflow of immigrants, mainly from the south. Between 1951 and 1971, immigrants in the north-west numbered more than two million.

Therefore, the growth of mass production required an institutionalization of industrial relations and a system of social services. In brief, it required the introduction of a more effective welfare state, which was already well developed in other European countries. However, that objective was not achieved by the Italian government. A powerful set of interests, related to the more backward and protected industrial sectors, to commerce, agriculture and self-employment, strongly opposed prospective reforms for fear of an increase in fiscal pressure and more union and state influence on labour relations.

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Thus, the development of the Fordist model of industrialization led to problems that were too serious to be tackled only at a local level. Industrial relations were poorly institutionalized and local government did not have the financial resources and the powers necessary to pursue effective policies, especially in the field of housing and social services (Trigilia, 1997).

The productive system of the industrial triangle, upon which postwar development was based, became a serious constraint on the future of the country. The culture of the most industrialized regions was under stress, while the traditional forms of social and political integration were eroded under the pressure of immigration and over-urbanization in the metropolitan areas. Between 1969 and 1973 a wave of industrial and social conflict developed, which was harsher and lasted longer than in other industrialized countries. Large firms and the large industrial cities of the north-west were strongly affected by these conflicts, with long-term implications. Large firms were weakened and large cities, for a long time, were unable to play an innovative role.

A spiral of rising costs, inflation and devaluation resulted, which continued throughout the 1970s. The main reason for the high rate of inflation was the wage pressure triggered by the industrial conflict. However, public expenditure grew at a fast rate in this period and the resulting rise in public deficit also played an important role. The roots of the growth in public debt are to be found in changes that affected the political system. The new demands of the unions, especially in the case of social policy, were stronger and were addressed not only to firms but also to the state, even though the government was weak and divided. The new demands for an expansion of the welfare state and better working conditions were largely satisfied. However, powerful sections of the government coalition were concerned that this trend should not damage the interests of their traditional supporters by raising taxation and restructuring public expenditure and redistributive policies for the southern regions in order to make them more efficient.

The result was a sort of compromise, which was based upon considerable growth in expenditure to satisfy the new demands for social protection without sacrificing the old economic and social policies. Therefore the growth of public expenditure was not accompanied by a parallel growth in tax revenue or by an improvement in the efficiency of public administration and public expenditure. Here lie the origins of public deficit, public debt, inflation and devaluation. However, considering the real variables – gross production, income and employment – the picture of the 1970s and 1980s appears less gloomy. How was this result possible?

The answer to this question can be found in the growth of small and medium-sized firms. This trend was mostly concentrated in the regions of the 'third Italy' in the centre–north-east. In this area there was a growth of local systems of small firms. These were concentrated in small urban areas (with populations of usually no more than 100,000), made up of one or more towns. These systems were characterized by a local labour market and a certain degree of sectoral specialization. The most represented sectors were the 'traditional' ones (textiles, clothing, footwear, furniture, ceramics, etc.), but there was also a significant development in the more 'modern' sectors, particularly mechanical engineering and the machinery sector.

Where sectoral specialization and horizontal integration between small firms were more developed, the local systems took the form of 'industrial districts'.[2] A district is formed by many SMEs, each specializing in a particular stage or in the production of a particular component of the productive process. Only a small group of these firms has any direct relation with final markets. Their task is to deal with orders and to entrust substantial parts of production to 'stage firms', or subcontractors.

In other words, production takes the form of a decentralized process and requires a high level of collaboration between specialized subcontractors and buyer firms. Sometimes the relations are more formalized, including agreements and forms of ownership control. This trend has increased over time to deal with problems of innovation and quality improvement. The capacity to increase productivity and innovate is made possible by the existence of economies that are external to the single firms but internal to the area in which they are located. These external economies involve the presence of specialized collaborators, a skilled labour force and collective services and infrastructure. But there are also important intangible factors that influence productivity, such as the circulation and rapid diffusion of knowledge and information, as well as a high level of trust among small entrepreneurs and between workers and entrepreneurs. As a result, districts can have a technological and productive dynamism, and a capacity to sustain both high salaries and employment.

The combination of three institutional elements was crucial for the growth of a social system of production based on districts of SMEs. These were present in the most typical form in the central and north-eastern regions (Bagnasco, 1988; Bagnasco & Sabel, 1995; Trigilia 1986, 1990). First, a thick network of small and medium towns, which can be traced back to medieval communes, played a crucial role. They enjoyed widespread traditions of artisan and commercial practices, which had not been eroded by the first wave of industrialization, urbanization and immigration. In many cases the role played by good local technical schools was also important. The entrepreneurship for small firms came mainly from these small cities. Second, the presence of self-employment in agriculture (large households of sharecroppers or small farmers) before industrialization was also important in supporting the formation of a flexible and cheap labour force, with basic skills and motivations adequate to work in a small firm. In these areas, extended families played – and still play – an important role in the organization of production, in supporting family incomes and in providing care for the children and the elderly.

A third significant factor was the strong influence of local political traditions and institutions tied to the Catholic or to the socialist and communist movements. Thus these regions were characterized by a 'white' or 'red'

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regional political subculture. First, the political subcultures, albeit in a different way, had contributed historically to preserving a specific socio-economic fabric. This was characterized by a network of small cities with a peculiar mixture of modern and traditional components and a high level of social integration. As a result, they helped to strengthen a network of trust and patterns of social relations important for the growth of small firms. Trust and strong local social ties helped to lower the transaction costs, which were potentially high for a model of economic organization based on networks of firms and on labour flexibility. Second, the rooting of both Catholic and socialist–communist cultures in the regions of the third Italy influenced industrial relations and local government activities in such a way as to help the growth of small firms. Industrial relations developed on a cooperative and localist model based on territorial agreements that did not hinder flexibility. Local governments in turn provided social services favouring labour flexibility (day care centres, transport, housing) and often provided economic services and infrastructure (industrial areas, training and other services for firms). Finally, immigration and urbanization were relatively low and this helped to preserve traditional forms of social integration based on family, kin and community ties, together with the stability of local political affiliations and local governments.

In conclusion, the growth of SMEs in the third Italy was an unplanned process, even if it was influenced by some policies at a central level. The shrewd policy of devaluation pursued by the Bank of Italy certainly had positive effects, while fiscal protection also favoured small firms. The growth of local productive systems and industrial districts was, nevertheless, based mainly on economic, social and political resources available at a local level. In this sense we can talk of a regionalized capitalism based on local networks and strong non-market mechanisms of coordination. This trend, in turn, helped to compensate, in terms of production, exports and employment, for the shortcomings of large firms. This gave rise also to the paradox of a national economy characterized by a remarkable level of productive dynamism, together with inflation and a public deficit and an increasing public debt. In fact, small-firm dynamism, by easing the impact of the economic crisis, reduced the pressure for a change in macro-economic management (Trigilia, 1997).

New challenges and the restructuring of the 'Italian model'

The regionalized model of Italian capitalism was a case of success in the 1970s and 1980s and was largely analysed by the literature on flexible specialization, social systems of production and regional economies (Bagnasco, 1988; Piore & Sabel, 1984; Pyke, Becattini & Sengenberger, 1990). However, in the last fifteen years three significant constraints have endangered this model of development: first, the persistent lack of efficiency in the service sector; second, the pressure of globalization, which has been particularly strong for the productive specialization of Italian manufacturing firms; third, the difficulty of setting up and implementing adequate territorial policies for local development.

Between 1995 and 2005 there occurred a loss of dynamism: per capita GDP growth was among the lowest in Europe (the gap was around 2 per cent); export market shares declined by some 30 per cent; productivity (both total factor productivity [TFP] and labour productivity) slowed down in comparison to that in EU and OECD countries; inflation was higher than in the Euro area; public debt was among the highest; the number of firms in light industry sectors declined (-8 per cent in textiles, -3 per cent in clothing and leather production in the period 2000–3).

First, the origins of these problems must be traced back to the peculiar relationship between local dynamism and inefficient economic macro-management of the previous decades. Looking for example at financial and monetary variables, it emerges that during the 1980s Italy still had a higher inflation rate than the average for the EEC countries: inflation grew at an average rate of 11.6 per cent from 1979–88 compared to 7.7 per cent in the EEC, 7.3 per cent in the UK, 7.7 per cent in France and 2.9 per cent in Germany. For the three years 1989–91, although it had fallen to 6 per cent, the Italian rate was still above the EEC average (5.3 per cent) and above that of other important countries (with the exception of the UK). A significant contribution to inflation came from the public deficit. The deficit in the public sector was an average of 10.8 per cent a year as a percentage of GDP at current prices between 1978 and 1990. It was the highest among the most industrialized countries (the average rate for those countries was 2.6 per cent). Only Belgium and Ireland, in the first half of the 1980s, and Greece, in the second half, were close to the Italian value. An important contribution to the public deficit was made in the early 1970s when expenditure rose above revenue. In those years a primary deficit was formed which fluctuated between 6 per cent and 8 per cent of GDP. In the second half of the 1980s the primary deficit started to shrink and in 1992 it was eliminated. However, in the same period interest payments on the debt grew to 10 per cent of GDP and became the major component of the deficit. The rise in debt, from 60 per cent to 100 per cent of GDP, is thus principally due to the rise in interest payments, which increased during the last decade due to higher interest rates (see Salvati, 2000; Trigilia, 1997).

As mentioned, local dynamism delayed macro-economic adjustment, which would have entailed high political costs in terms of electoral support for the government. But this delay brought about higher public deficit, public debt and inflation than in other European countries. In addition, there were growing inefficiencies in public and private services and infrastructure. Small and medium firms, exposed to international competition, were increasingly penalized by these trends because of the higher domestic costs. Therefore, for a long time, a crucial condition for keeping the export market shares was devaluation. The last one took place in 1992 and brought about a recovery of export. However, in the late 1990s the government took an important decision: Italy joined the euro – the new European currency.

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This was a bold political choice with far-reaching consequences. Joining the euro brought significant advantages to the Italian economy. The cost of public debt was lowered by a remarkable reduction of interest rates and the two-digit inflation rate declined to 3 per cent. In addition, the risks of attacks against the Italian currency were avoided. However, it was no longer possible to devalue.

This brought about a radical challenge to the productive model of Italy. Three main constraints emerged. First, it became necessary to deal with the high costs and inefficiencies of the service sector, which were a heavy burden for the firms open to foreign competition. Second, dealing with the increased competition brought about by globalization in the traditional production of 'made in Italy' goods required effective choices to improve quality production and to foster the knowledge economy. Third, national politics faced these changes by promoting a process of de-regulation (for example in the labour-market arena) and giving financial incentives to firms, but overlooking the introduction of effective territorial policies for the production of 'local collective competition goods' (Crouch *et al.*, 2001, 2004).

As far as the service sector is concerned, one has to take into account that these activities (which to large extent are not open to international competition) had been traditionally protected by the Italian political system in order to build electoral support (La Spina, 2003; Trigilia, 1992). In the public sector, much must be done to improve the efficiency of public expenditure, to reduce a high fiscal pressure on firms, to simplify the relations between firms and public administrations and to increase the efficiency of civil justice. No less important are bold measures to modernize the private-services sector through liberalization and the promotion of effective competition. The costs of energy, legal and professional services, insurance and financial services are higher in Italy than in other European countries (in some cases, as for energy, by around 30 per cent). Transport and logistics are not able to cover the needs of developed regions fully or to promote growth in the regions of the south (DPS, 2006). At the same time, public and private sectors invest a limited amount of resources in research: in 2005 only 0.5 per cent of national GDP was devoted to fund research as against 1.4 per cent in France and 1.7 per cent in Germany. A process of privatization and liberalization in some service sectors – such as transport or telecommunications – started during the mid-1990s, but it was limited and its effects in terms of efficiency and support to market competition have been weak (Barca, 2006).

Therefore, without the escape valve of devaluation, firms open to foreign competition have been hit particularly hard. They cannot offset the higher domestic costs due to the inefficiencies of private and public services. Therefore, the modernization of the service sector is strongly required.

The delay in tackling the problem of services also exacerbated the second constraint, related to the effects of increased globalization. As we saw, after the crisis of large firms in the 1970s, Italy reinforced the productive specialization in 'light' sectors (textiles, clothing, footwear, furniture, machine tools). There are very few large firms: according to the Italian National

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Statistical Institute in 2006, 0.3 per cent of industrial firms have more than 250 employees while 83 per cent of industrial firms have fewer than ten employees. Except for the car industry (that means Fiat), and telephone services, large firms are mainly public (in sectors such as energy or mechanical engineering). Shares in the international market are therefore mainly related to the productive specialization of small and medium-sized firms, and industrial districts, in sectors that are more exposed to competition from low-cost suppliers in developing countries (Becattini & Dei Ottati, 2006; Fortis, 2005). According to the Fondazione Edison, 'made in Italy' sectors (leather, textile, clothing, jewellery and so on) accounted for 57 per cent of total national exports in 2001.

As a consequence, globalization has hit the Italian economy particularly severely. Without the aid of devaluation, and because high-tech sectors are weaker than in other European countries, there are no compensating factors. The intensity of these processes grew after 2001, when there was an increase in global supply and a decline in the demand for those goods in which Italian manufacturing firms were specialized. International competition based on lower labour costs favoured offshoring of production towards developing countries. This path has been particularly important for Italian medium-sized firms, which have recently developed international chains of production and distribution (Becattini & Dei Ottati, 2006).

The third constraint concerns the introduction of national policies aimed at promoting the competitiveness of the Italian economy. These were based mainly on three pillars: (a) flexibilization of the labour market, (b) incremental reform of the welfare system and (c) financial incentives to private firms. On the one hand, these policies reached their goals, promoting labour market flexibility with a series of laws (such as the Laws 196/97 and 30/2003), favouring a rise in employment and strengthening the sustainability of the welfare system: in the period 1993–2003 the unemployment rate declined from 10.1 per cent to 8.4 per cent while the employment rate rose from 52.5 up to 56.2 per cent.

But, on the other hand, there was less attention to policies aimed at increasing the competitiveness of local economies through the production of local competition goods. The Italian case has been characterized by the lack of coherent national policies to encourage (a) the mobilization of local resources, (b) more effective vertical coordination between local and national public actors and (c) the rise of horizontal links between public institutions (such as universities) and private firms (see Bagnasco, 2006). We are not referring just to political decentralization but rather to national policies to promote and strengthen bottom-up relationships and territorial policy communities. This trend emerges clearly from the analysis of public incentives for economic development: during the period 2000–6 territorial policies such as territorial pacts and area contracts received €5333 million while non-territorialized policies for direct incentives to single firms such as the Law 488/92 received €9463 million.

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Despite these shortcomings, which promoted a debate on the decline of the Italian economy, in more recent years private firms and their networks started a process of restructuring that led to a partial, but encouraging economic recovery. The national GDP increased by 1.9 per cent in 2006, after four years of an average annual increase by 0.4 per cent, which was the worst performance among EU countries. The value of exports rose by 5.5 per cent in 2005 and by 9 per cent in 2006; unemployment levels continued to shrink, from 8.4 per cent in 2003 to 6.8 per cent in 2006. At the same time, the value of manufacturing activities in Italy remains – together with Germany – higher than in other countries: in 2003 the proportion of industrial employment in total employment reached 29 per cent in Italy, 19 per cent in the United Kingdom, 21 per cent in the US and 24 per cent of the EU15.

It is particularly important to underline three major changes that modified the Italian model of regionalized capitalism: (a) the territorial concentration of manufacturing activities rose in industrial districts and local production systems; (b) the role of local productive systems widened even outside the third Italy, such as in the north-west and in some regions of the south; (c) there has been a remarkable growth of medium-sized firms in many local production systems.

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a. Employment in manufacturing activities declined by 7 per cent at national level during the period 1991–2001. At the same time, however, manufacturing employment in industrial districts and local productions systems declined only by 0.4 per cent, and total employment in these areas rose by 10 per cent. This trend has continued in more recent years, and is associated with the widespread provision of well-developed collective goods and resources (ISTAT, 2007; see also Viesti, 2000). The result of these changes is the growing territorial concentration of manufacturing activities that tend to cluster in areas with high levels of specialization in such activities (Table 1). Together with the rise of manufacturing employment, these areas experienced a notable increase in business services: during the period 1991–2001 more than half of the total employment growth in local production systems was due to employment in services to private firms that grew by 59 per cent.
b. A second important change concerns the formation of new local productive systems (LPSs) in non-metropolitan areas, including the non-metropolitan areas of the north-west and some parts of the south, especially along the Adriatic coast. More than forty local systems became specialized in manufacturing activities: seven are located in the northern part of the country, nine in the centre and twenty-eight in the south (Table 2). Therefore, we can see the diffusion and consolidation of an 'Italian model' based on small and medium-sized firms and rooted in small and medium-sized cities, even in backward regions. This diffusion is due to a series of reasons. On the one hand, in the north-west there was a process of reorganization and outsourcing by large firms that promoted the rise of

Table 1 Territorial concentration (Lq*) in manufacturing activities per type of local system

	Lq in 1991	Lq in 2001
Local systems specialized in manufacturing activities	1,427	1,526
Local systems without specialization in manufacturing	0,517	0,553
Total	0,842	0,938

Source: Processed data from Istat database.
Notes: Lq = location quotient.
* The index Lq has the following algorithm:

$$\text{Lq for the Local System A} = \frac{\textit{Employment 1}}{\text{Employment 3}} : \frac{\textit{Employment 2}}{\text{Employment 4}}$$

Employment 1: employment in manufacturing activities in the local system A
Employment 2: employment in manufacturing activities in Italy
Employment 3: total employment in the local system A
Employment 4: total employment in Italy

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specialized inter-firm relationships based on close and locally-rooted networks of small and medium-sized firms. At the same time, the effort of local public and private actors and organizations in creating competition goods for networks of SMEs created an institutional environment particularly favourable to the emerging of this kind of firm also in areas traditionally characterized by large firms. Finally, some local contexts of the north-west were already characterized by an institutional architecture in term of skills, competencies, productive specialization that favoured the emerging of networks of SMEs able to exploit the opportunities offered by globalization. On the other hand, in many regions of the Adriatic coast it is possible to find specific resources similar to those in the third Italy, such as a thick network of small cities with widespread artisanal traditions, together

Table 2 New local production systems (LPSs)

	Local systems which specialized in manufacturing activities (LPSs) in the period 1991–2001	Total employment in manufacturing in new LPSs
North-west*	3	7,950
North-east	4	24,268
Centre	9	31,197
South and isles	28	52,756
Italy	44	116,171

Notes: *North-west: Valle d'Aosta, Piedmont, Lombardy and Liguria. North-east: Friuli V.G., Trentino A.A., Veneto. Centre: Emilia-Romagna, Tuscany, Marche and Umbria. South and isles: Lazio, Abruzzo, Molise, Campania, Basilicata, Puglia, Calabria, Sicily and Sardegna. The administrative boundaries of local systems here adopted refer to 1991.

with local competencies and know-how adequate to work in a small firm and to promote entrepreneurship. Here the model of the third Italy emerged later than in central and north-eastern regions and this diffusion was also related to territorial contiguity. At the same time it should be noted that investments of medium and large northern firms promoted all along the Adriatic line a dense network of inter-firm relationships (for a more detailed account of these processes, see Crouch *et al.*, 2001, 2004). Analysing the productive organization of these areas, we can divide the LPSs into three groups: local systems with a large number of small firms (compared to the national average), that is, firms with fewer than fifty employees; those where medium-scale firms (50–249 workers) prevail; and those where large firms with more than 250 workers prevail. Different types of LPSs characterize the various regions (Figure 1). LPSs of small firms are more concentrated in the central regions, while in the north-west, and also in the north-east, medium-sized firms are more present. In the south, LPSs with large firms are more widespread, due to the policy of promoting industrialization through financial incentives, but some small-firm systems also grew in the 1980s and early 1990s. However, the most interesting phenomenon is the formation of a new axis that connects the north-west and the north-east and is characterized by a preponderance of medium-sized firms (Burroni, 2001).

c. This leads to a third change to which we wish to draw attention. The majority of the local systems that registered a growth in manufacturing employment are those with a stronger presence of medium-sized firms (+ 45 per cent). During the period 1996–2003 medium firms experienced a growth in revenues (+ 42.8 per cent *vis-à-vis* 26.4 per cent for large firms), in exports (+ 51.7 per cent, + 31 per cent for large firms), in added value (+ 33.3 per cent, + 11.9 per cent for large firms) and in employment (+ 18 per cent, − 10.2 per cent for large firms) (Mediobanca, 2006). The emergence of medium-sized firms with a leadership role is a particularly important change for the Italian model of regionalized capitalism (Berta, 2004; Rullani, 2004; Rullani & Romano, 2004) These firms are specialized in mechanical engineering and machine tools but also have more traditional specializations in so-called ‘made in Italy’ goods, such as textiles, clothing, footwear, furniture, etc. The management structure is still based on family control, but professional managers are increasingly used. The network of suppliers, especially those with a strong influence on the quality of goods and services for the final market, is often located in the same local system as the client firm. At the same time, these medium-sized firms are intensifying their relationships with foreign subsuppliers, offshoring some stages of the productive process or the making of specific components, while more strategic stages, such as design, development of new products, marketing, manufacturing of components that are crucial for quality, continue to cluster near to lead firms. As a consequence, there is a decline in the volume of production in Italian industrial districts and local

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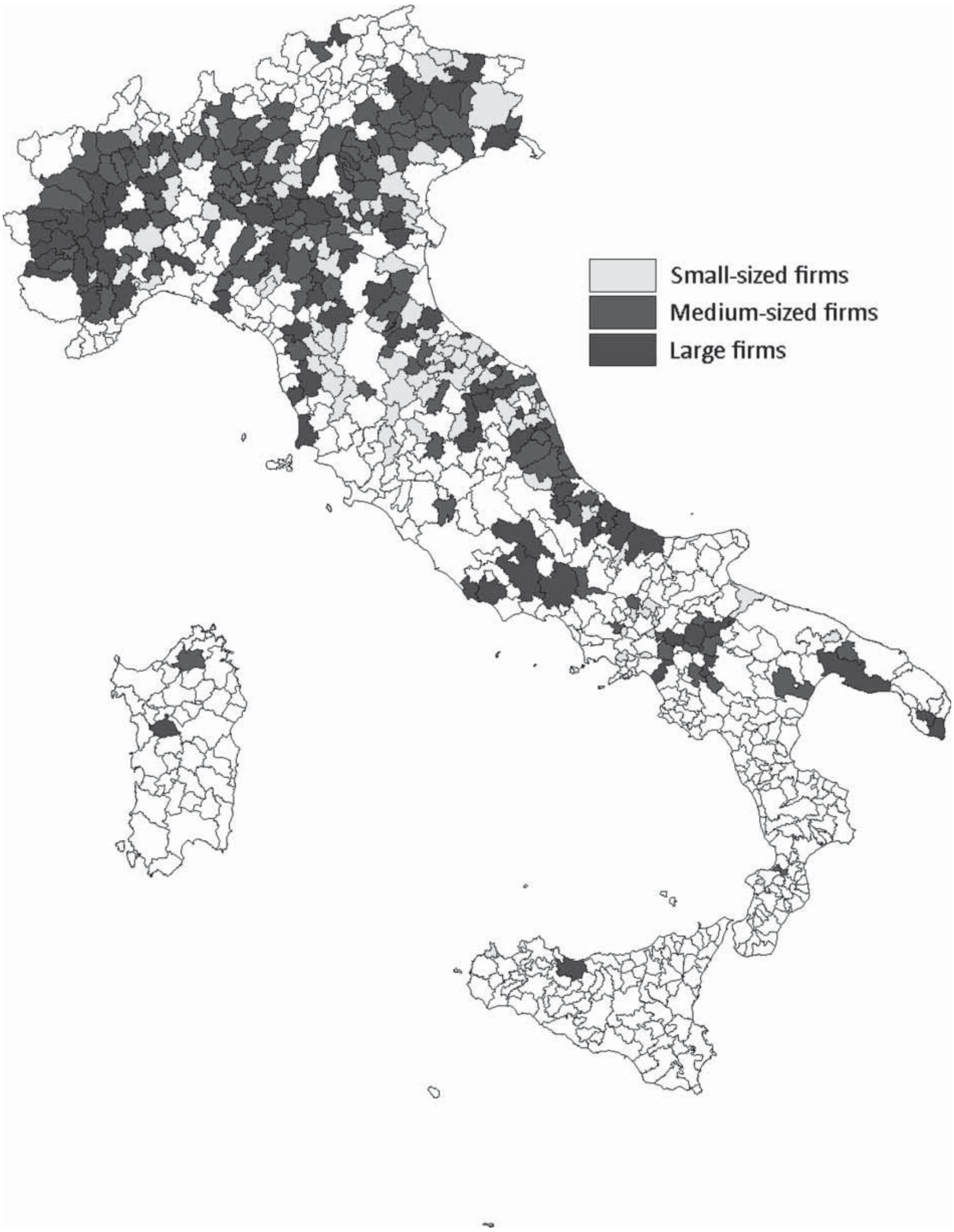

Figure 1 Local production systems and organizational specialization in 2001
Source: Processed data from Istat database.
Note: *The administrative boundaries of local systems here adopted refer to 1991. A full-colour version of this figure is available on the journal's website.

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production systems, while the employment in services to firms is growing. The intensity of this process of restructuring varies from one region to another, but its influence, together with the growing attempts of firms to follow the 'high road' for development based on quality, is tending to increase. The sectors in which SMEs are mostly specialized are light

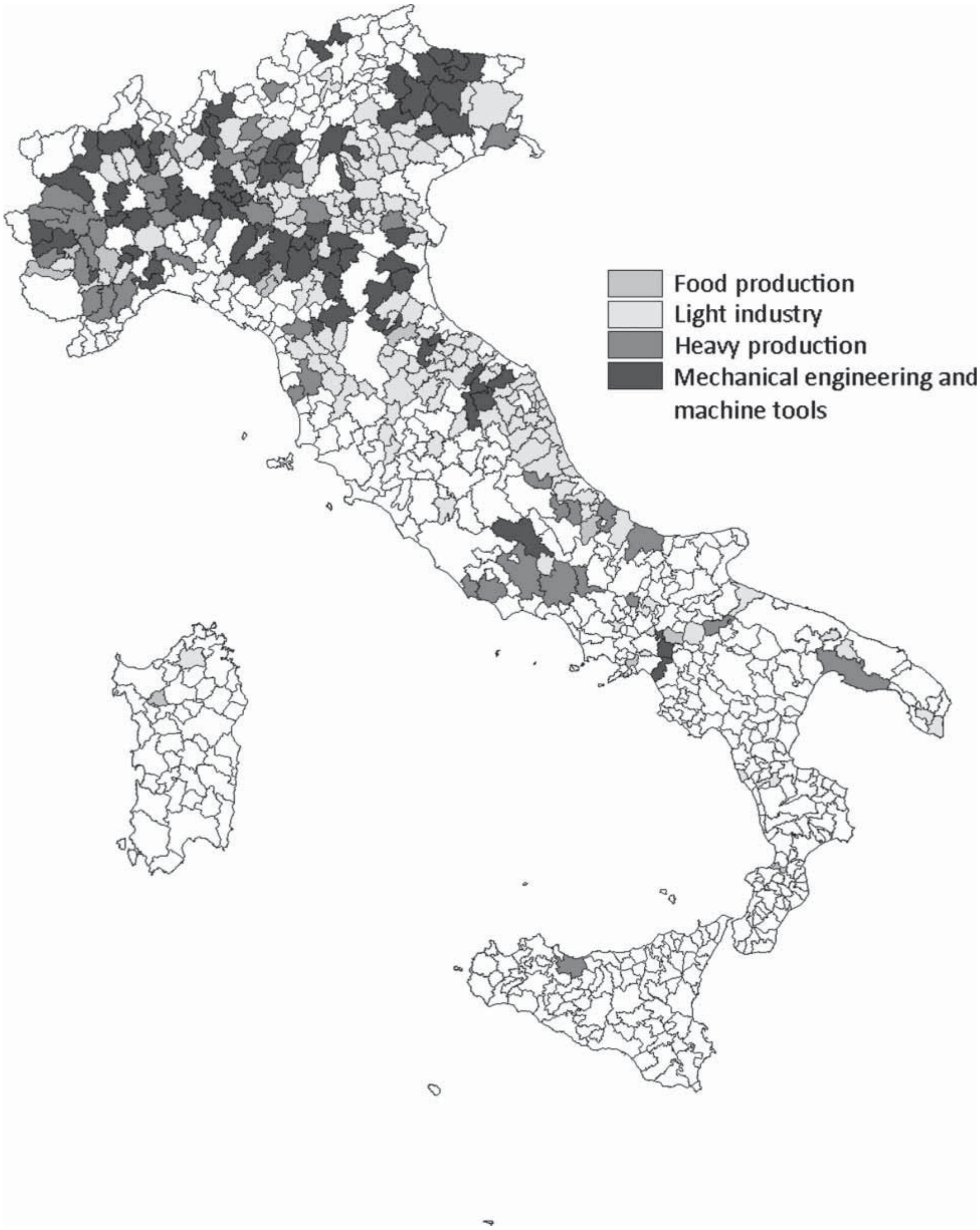

Figure 2 Local production systems and product specialization in 2001
Source: Processed data from Istat database.
Notes: Light industry comprises textiles and clothing, fur, decorating products, jewellery, musical instruments, etc. Mechanical engineering comprises manufacturing, installation, repair and maintenance of machines and mechanical equipment, manufacture of electrical and electronic machines and equipment, and manufacture of metallic products. Heavy industry includes metalwork, production of petrochemicals and means of transport. The administrative boundaries of local systems here adopted refer to 1991. A full-colour version of this figure is available on the journal's website.

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industry (textiles and clothing, footwear, furniture decorating products, jewellery) but also machine tools and mechanical engineering (Figure 2). Over the last two decades, firms producing so-called 'made in Italy' goods, together with the machinery sector, exported about 40 per cent of total national value and employed more than 40 per cent of the total manufacturing workforce.

Summing up, we can say that the Italian model of regionalized capitalism underwent important changes in the last decade. After the success of small-firm systems and industrial districts, new challenges emerged in the 1990s. Globalization exacerbated the competition coming from the new developing countries in the productive specializations of Italy. At the same time, the inefficiencies of public and private services – a legacy of a long-lasting public disorder – increased the domestic costs for firms open to foreign competition. In this situation, the political choice of joining the euro was important for managing a huge public debt and for financial stability, but it made it impossible any longer to use devaluation as an escape valve to compensate for higher domestic costs and to foster exports. Therefore, the last decade was a period of increasing difficulties and risks of decline for the Italian model. However, while the national polity was not able to promote a rapid and effective institutional adjustment, once again a silent and difficult restructuring started at the firm level in the local productive systems. The regionalized model became more organized to improve quality and innovation. Recent comparative analysis has emphasized that there are still relevant differences among LPSs, in terms of both organizational structure and institutional architecture and, as we said above, different types of LPS characterize various Italian regions: from this point of view, the regionalization of the Italian variety of capitalism is still strong (Crouch *et al.*, 2001, 2004). However, some elements of convergence can be found, especially in the role played by medium-sized firms that are gaining importance in many local systems. These firms have organized new cooperative networks based on local and foreign collaborators and promoted the growth of new services. Non-market forms of coordination are still crucial, but formalized arrangements, relational contracting and the role of hierarchies have more important in comparison with informal relations.

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Concluding remarks

In this article we have analysed the Italian political economy as a model of regionalized capitalism. Looking at the relations between the national and regional political economy allowed us to draw attention to processes that are overlooked by other approaches. This research strategy is not only useful for understanding the Italian case but may also have some broader theoretical implications. In these concluding remarks we will focus on three aspects.

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The first one is related to a methodological issue. The analysis of the Italian case showed a peculiar institutional setting that can hardly be explained through the ideal-types introduced by the varieties of capitalism approach, even when it focuses on Mediterranean countries. This is due to two main reasons. First, the Italian model is a truly mixed case (Ruysseveldt & Visser, 1996), which combines some of the institutional factors of both CMEs and LMEs but also differs from the ideal-type of MMEs. The second reason has to do with the importance of local and regional institutions. It is not possible to understand the organizational structure and performance of Italian capitalism without taking into account its regional dimension. This is why we defined the Italian model of political economy as a *regionalized capitalism*. This approach does not overlook national institutions and polity, but has rather tried to show how the influence of national institutions was mediated by strong formal and informal institutions at the regional level. At the same time, we emphasized how the national regulatory architecture, in turn, has been affected by regional economies. This research path helps to explain the persistent regional disparities that characterize the Italian case, the reasons for the success that some regional economies experienced during the 1970s and the 1980s and the more recent process of restructuring of Italian firms and local systems.

Thus, devoting more attention than does the VoC approach to the study of regional political economy and to the mutual influence of regional and national institutions allows the shedding of light on recent trends in Italian capitalism. It also means that the analysis of the relations between regional and national institutions and policies is of particular importance for analysing those countries that are characterized by remarkable subnational differences. This is true not only for the Italian case, but also for other national cases of the MME group, such as Spain.

The second point is related to the concepts of institutional change and complementarity. Our analysis challenges the assumption that 'pure cases perform better'. Effective institutional change can occur also in mixed and hybrid cases: for example, the heterogeneous productive organization of Italian industrial districts favoured a process of adjustment that supported the growth of medium-sized firms, promoting the competitiveness of some local systems. At the same time, weak, informal and loosely-structured mechanisms of local regulation favoured flexible adjustments in the production of local competition goods. In other words, the heterogeneity and mixed nature of the Italian case can stimulate processes of change and innovation related to the chances of following multiple paths, as has been emphasized in many studies on innovation (see Crouch, 2005). As for the notion of complementarity, the VoC adopted this concept to underline that the political economy of a country is based on a coherent and well-integrated set of national institutions. But the analysis of the Italian case stressed the importance of an alternative definition of complementarity, where 'components of a whole mutually compensate for each other's deficiencies in constituting the whole' (Crouch, 2005, p. 359). From this point of view, a specific combination of different institutional settings – such as that of the industrial districts of the third Italy and of the Fordist north-western part of the country – can promote a 'complementarity' across regions and policy domains. At the same, the Italian case shows that this complementarity has longstanding historical roots and a bottom-up and 'serendipitous' character with 'the absence of a grand design or a master designer' (Streeck, 2005, p. 364).

Third, our article has implications for the issue of convergence of national cases. As is well-known, Hall and Soskice (2001) and the literature on varieties of capitalism suggest that it is not possible to identify clear paths of convergence towards the LMEs model through processes of deregulation.[3] According to them, despite some changes in financial institutions, LMEs and CMEs tend to persist in following a logic of path dependency, each with its own strength and weakness: the institutional setting of CMEs favours incremental innovation, while the LME context promotes radical innovation. There is some empirical evidence in support of the hypothesis of a persistent divergence among different types of capitalism (Berger, 2005; Berger & Dore, 1996). The Italian case confirms this trend. As we saw, Italy is in the midst of a significant reorganization of the original model of regionalized capitalism. Other research on the European countries shows an increase in the territorial embeddedness of economic activities in advanced economies. In other words, many countries – especially those that are closer to the CME model – try to follow the 'high road' of development by investing in high-quality productions and goods. This competitive strategy implies the reinforcement of non-market forms of coordination at a territorial level and the production of local collective competition goods (Crouch *et al.*, 2001, 2004).

This means that the capacity of firms to innovate is not related only to intra-mural resources, but is also increasingly dependent on the availability of external resources; thus, relational economies are becoming more important.[4] However, local systems of innovation and their firms are not localistic; as mentioned above, they are increasingly open to international forms of cooperation with other specialized firms and institutions. But the local embeddedness may offer specific competitive advantages, such as logistics, infrastructures, specialized services, relationships with universities and research centres, a skilled workforce, tacit knowledge, trust relations, etc. As the literature on social systems of production has emphasized, the growth of these kinds of collective resources requires[5] deliberative forms of policy-making and the specific support of local, regional and national institutions.

Summing up, in order to assess whether CMEs will be able to resist convergence via deregulation, an adjustment of the analytical frame could be useful. Studying how specific relationships between regional and national institutions influence the search for the high road of development becomes more important than the literature on varieties of capitalism has acknowledged so far. This approach could help us to understand the recent trajectories of some Western capitalisms (especially in Europe), suggesting an additional hypothesis: the persistence of CMEs could depend more on forms of

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'horizontal coordination' between local private and public actors for the production of local collective goods and on forms of 'vertical coordination' between national and regional governments to support innovation at a territorial level.

Notes

1 See also Albert (1993).
2 For a detailed analysis of the concept of industrial district, see Becattini (1990, 2001) and Brusco (1989, 1992).
3 See Crouch and Streeck (1997) for an alternative approach.
4 As for relational economies, see Cooke and Morgan (1998), DiMaggio (1994), Streeck (1992), Trigilia (2002, 2005) and Veltz (1996).
5 See Hollingsworth and Boyer (1997), Pichierri (2002), Regini (1995), Sabel (1994), Storper (1998), Trigilia (2005), Whitford and Potter (2007) and Zeitlin (2008).

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