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'New' Regional Policies of the EU and the Italian Experience

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Abstract: The new participatory approach of Italian policymakers to regional policies has led to a set of instruments called *negotiated planning*. In this paper it is argued that the new measures may suffer from drawbacks similar to the ones often imputed to public enterprise: ambiguity of objectives, scant accountability, dependence from political lobbies, which can be serious obstacles for policy effectiveness. To direct the abundant resources still untapped towards activities favourable for development, it is instead necessary to debureaucratise the economy, removing power and opportunities for rich pickings from political groups, bureaucracies and local potentates. To this end, a type of public enterprise able to overcome the failures of the past and to operate efficiently in competition with private firms, could achieve the fundamental objectives of generating positive externalities and beneficially altering the returns pattern of private activities.

Key words: Mezzogiorno, negotiated planning, public enterprise, regional policy

JEL Classification: H20, R58.

Introduction

In recent years European regional policies have been characterised by an increasing favour toward a participatory approach. According to this philosophy of intervention, policies should widely hinge on partnership between different layers of government (national, regional and local) and a wide range of local stakeholders (trade unions, employer organisations, community-based organisations). The direct involvement of local institutions, civil society and the corporate sector in policy definition, implementation, monitoring and evaluation should offer a way to improve

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governance and make policies more effective thanks to the exploitation of local knowledge and skills, the creation of a favourable climate of trust and cooperation, the growth of the so called social capital[1].

In this perspective, several European countries have recently revised their regional policies[2] recognizing more room to partnership. For example, in Austria, the 1999 National Action Plan for employment stated that 'employment policy can only be successful if supported by the social partners, the Lander and the municipalities'; nowadays local partnerships are operating or being initiated in all the Lander both at Land level and at a lower level. In Finland, since 1997, several Local Partnerships have been established with the purposes of creating employment opportunities or fostering sustainable economic growth or fighting social exclusion. They are formed by municipalities, unemployed associations, voluntary bodies and producers representatives and are supported by a national coordinating team appointed by the Ministry of Labour. Ireland was one of the first countries to adopt an area-based strategy in the National Programme for Economic and Social Progress (1990-1993). Since then a number of Local Partnership Companies and Community Groups have been set up. In Belgium, the establishment of District Platforms, operating at subregional level with the participation of Regional Development Agencies, social partners, chambers of commerce etc., dates back to 1994, while more recently Subregional Employment Committees and Territorial Employment Pacts have been constituted. Finally, France (Programme Contracts) and Sweden (Regional Growth Agreements) have also taken steps toward a similar framework.

Even in Italy the last decade brought major changes in regional policies. Throughout the previous 40 years, regional policies, which substantially coincided with policies for development of southern regions (the so called Mezzogiorno[3]), were aiming basically at: filling the gap in the infrastructure endowment (especially during the 1950s), fostering industrial development through a direct intervention of public enterprises (especially in the 1960s), and setting up a framework of financial and fiscal incentives to offset the structural disadvantages of Mezzogiorno (due to negative externalities, the poor development of finance and credit and so on; particularly in the 1970s and 1980s). At the beginning of last decade, notwithstanding the remarkable financial commitment implied by these policies, the economic structure of Mezzogiorno remained characterised by several features of relative backwardness. This outcome generated strong frustration and widespread criticism by the public and scholars[4] and, together with the EU Commission interventions for the safeguard of competition, urged for a deep revision of Italian regional policies. Therefore, in 1992 the *Intervento Straordinario per il Mezzogiorno* (Mezzogiorno Extraordinary Aid Programme), which had long permitted to finance infrastructures and subsidies to producers, was abolished. In the meantime, the system of *Partecipazioni Statali* (i.e. public and semi-public enterprises operating in several industries in southern regions) was being rapidly dismantled because of both the poor performance of some companies and the needs of public finance burdened with an increasing stock of public debt. In 1992-96 the new Italian regional policy was born, consisting of a mixture of an 'innovative' set of financial and fiscal incentives, designed not only for Mezzogiorno but also for the other critical areas of the country, and the measures introduced by law 662/1996 known as *Programmazione Negoziata* – i.e. negotiated planning (henceforth NP) – clearly inspired to a participatory approach.

We review here the main arguments against the traditional incentive policies adopted in Italy until the 1980s, and analyse how criticisms led to set up a new system of interventions inspired to the partnership approach. We also make a theoretical evaluation of the new policies highlighting some possible limitations, and recall the main shortcomings of public enterprise, both from a theoretical viewpoint and in reference to the Italian experience of *Partecipazioni Statali*. We do argue that many arguments against public enterprise can be countered on various grounds, and that NP suffer from similar drawbacks. Finally, we conclude that neither economic theory nor the empirical evidence demonstrates that public enterprises are intrinsically less efficient than private ones. When the focus shift from comparison between public and private ownership to comparison between the public enterprise and other forms of intervention and expenditure, it becomes even more difficult to draw unequivocal conclusions.

From Traditional Incentive Policies to Negotiated Planning

The negative assessment of traditional incentive policies has been based on two main considerations, which are clearly interdependent: first, this kind of intervention has given rise to an inefficient allocation of material and human resources; second, it has concentrated exclusively on the accumulation of physical capital, with no concern for the consequences of public expenditure on the 'rules of the game', on individual behaviour, and on the formation of human and social capital.

It has been argued that regional policies, may engender an unsatisfactory allocation of resources in at least two distinct ways. They may do so directly if they are unable to distribute subsidies efficiently: that is, if they are unable correctly to single out the initiatives to promote and devise procedures which finance precisely those initiatives and not others. They may do so indirectly if they produce distortions in relative prices and, especially, in the pattern of returns yielded by economic activities so that private individuals gain little profit from engaging in entrepreneurial activity, and more generally in activities with genuinely productive content, and instead find it more remunerative to adopt opportunistic behaviour geared to the redistribution of wealth and rent-seeking.

This reluctance to undertake productive activity has been increased by another limitation of the *Intervento Straordinario*: its emphasis on physical capital accumulation alone. It has been rightly pointed out that for individuals, the economic convenience of occupations depends on the benefits that can be gained from the alternatives available, and on the costs that each of them entails. A substantial proportion of these benefits and costs, however, are not technologically determined but instead depend upon the behaviour of other actors, on the formal and informal rules that prevail in a society, and on the values that it embraces. From this it follows that an area's capacity for development, its competitiveness and that of the enterprises operating within it, cannot be explained solely by the availability of financial capital, technologies and human capital. Of crucial importance is the availability of social capital – a network of relations among individual and collective actors based on cooperation and trust – as well as the institutions and social norms imbued with civic consciousness that form the vital humus for the efficient allocation of resources and the formation of significant external agglomeration economies.

The criticisms reported above suggest remedies which on the one hand seek to devise more efficient procedures for the granting of subsidies, and on the other foster the growth in the southern regions of social capital, as the prerequisite for the start-up of a development process which is truly autonomous and free from clientelism and corruption. Recent regional policies for Mezzogiorno have given concrete form to this strategy both by modifying incentive measures on innovative procedures for an automatic or semi-automatic assignment of grants[5] and above all through NP measures, intended to promote and realise integrated investment projects to favour the creation and consolidation of enterprise agglomerations in areas of delayed development. With NP, public intervention in the economy is no longer conceived solely in terms of adjustment of and substitution for the market, as was the original intent of the *Intervento Straordinario*, but as a necessary complement to orient market mechanisms and behaviours in a direction favourable to development. The design of instruments and economic policy lines for the Mezzogiorno has abandoned attempts to impose development paths on the southern regions 'from above' by injecting resources, technologies and skills from outside. It now concentrates on a 'bottom up' strategy of intervention in which the protagonists are workers, firms, institutions and local administrations. This, it is widely stressed, is not solely in order to exploit all the knowledge and information on the true strengths of each local area – the concrete 'know-how' available locally – it is above all intended to create the sense of participation in a shared development project which is one of the factors indispensable for its success.

The 'Mezzogiorno Development Programme' for the period 2000-2006 approved by the Italian government has substantially increased the resources earmarked for action to develop local systems and reinforce firms' agglomerations through the instruments of NP. In this way, regional policy has equipped itself with an instrument to coordinate the systematic management of structural and specific measures, singling out areas for close strategic, financial and economic collaboration between public and private actors. The forms of intervention envisaged are many, and they vary according to the actors involved and the area of operationality. They range from *Intese istituzionali di programma* (preliminary agreements with which the central and local authorities undertake to collaborate on specific multi-year projects) to *Contratti di programma* (agreements intended to stimulate the delocalisation of large firms to the regions of the Mezzogiorno by offering direct and indirect incentives), to *Patti territoriali* (territorial pacts providing for active collaboration between public and private actors in order to consolidate newborn industrial districts in the Mezzogiorno by means of agreements promoted by local authorities, trade unions or employers' associations under which the parties undertake to pursue a set of concrete objectives), to *Contratti di area* (area agreements among local authorities, the social partners and the financial institutions designed to create a non-conflictual economic environment which fosters business initiatives in areas hit by industrial and employment crisis).

The common goal of these various forms of interventions is to stimulate local development by means of initiatives devised and managed locally and involving various actors present in the area. The aim in particular is to activate forms of collaboration among these actors which foster the growth of clusters of firms and reinforce already-existing agglomerations. NP is therefore an ambitious attempt to involve all local energies in a shared development project which simultaneously pursues the objectives of promoting productive investments, producing social capital, and creating the climate of trust and cooperation typical of the areas of diffused industrialisation, such as the ones of the northern, central and eastern regions of the country.

How successful NP has been so far? Although NP is of too recent introduction for thorough empirical analysis of its impact on the development of the Mezzogiorno to be possible[6]. From a theoretical point of view its limitations are evident and can be summed up as follows: (i) excessive bureaucratisation, (ii) scant accountability, (iii) high risks of collusion.

Despite the determination to prevent the formation of new bureaucratic apparatuses (see Barca, 2000 and 2001) there is no doubt that NP multiplies the numbers of decisions and decision-makers, strengthening the power of local authorities and intermediaries. Moreover, in order to avert the risks of over-fragmentation, the damaging duplication of expenditure, and total lack of coordination in the allocation of incentives, it is still the central government alone that decides on both the resources to be budgeted and the initiatives to be financed, thereby favouring, as De Rita (1998) puts it, 'the long-standing 'Christian Democrat' linkages between central power and local politicians'.

A programme of such complexity raises major problems of transition, because numerous local administrations still lack the capabilities necessary to handle these new decision-making processes. Moreover, the negotiative structure of NP by it very nature creates opportunities for complex political trade-offs very often at odds with development and highly likely to create clientelistic relationships. There is an obvious risk that not only will NP turn into a new way to deliver subsidies indiscriminately, but it may foster corporative practices, pressure groups, and more generally the various forms of rent-seeking behaviour that have already been mentioned. Work will proliferate for lawyers, accountants and consultants of every kind, an outcome that will inevitably strengthen the power of local bureaucracies. It is quite evident that these various factors will hamper the endeavour to 'simplify' the institutions, deregulate the economy, and free firms and citizens from the grip of politics and the administration and it is equally obvious that NP helps create a returns pattern which is certainly not the one most likely to stimulate entrepreneurship and dissuade the most talented residents of the Mezzogiorno from mediation, redistribution and rent-seeking.

Further problems with NP are the ambiguity of objectives and the difficulty of assessing its efficacy. When the aim of public intervention is no longer the accumulation of physical capital, but the formation of social capital or a change in people's mentality and behaviour, the obstacles against evaluation, an objective to an extent, of the results, obviously become nearly insurmountable.

The transparency of NP initiatives and the possibility of subjecting them to critical scrutiny are therefore very limited. The difficulty of monitoring the actors (public or private) responsible for management of the resources allocated, and of implementing the agreements stipulated, are enormous. Finally, the negotiative form of these instruments tends to de-responsibilise those participating in the decisions, enabling them to evade responsibility by shifting blame onto other exigencies, or vetoes imposed elsewhere. It is indeed true, as Barca (2001) and Bobbio (2000) have forcefully argued, that the contractualisation of decisions makes relationships among administrations, as well as between the public and private sector, less hierarchical and more flexible, and obliges each party to state its positions and strategies for local development transparently and in (potentially) public debate. But it is equally true that NP entirely lacks that decisive element of normal negotiative relations which is the ex-post verifiability of the actions stipulated.

A Discarded Alternative: Public Enterprise

Beside *Intervento Straordinario*, the second pillar of Italian regional policies between 1950 and 1990 was the system of *Partecipazioni Statali*. Not surprisingly, the idea and the implementation of a public direct intervention through a system of public enterprises has drawn even more radical criticism. The same being directed against the public enterprise as an instrument of industrial policy on following grounds:

(a) the ambiguity of objectives;
(b) difficulties of control;
(c) the inadequacy of incentives;
(d) the lack of information.

First, since the justification for the public enterprise is the existence of market failures, its objective function cannot consist in the maximisation of profits; rather, it should somehow relate to social well-being. This introduces an element of indeterminacy and scant transparency which makes it difficult to evaluate the performance of public enterprises, increases the risks of collusion between political power (the government) and public managers in pursuit of private ends, and hampers the specification of suitable incentives for efficient management of the enterprise.

Second, the ambiguity of objectives and the difficulties of the exit option for citizens substantially reduce the efficacy of control over the ownership (i.e. control by voters or their elected representatives), while the absence of any real risk of failure removes all effective control exerted by creditors and the market.

Third, without effective controls on the management of public enterprises, and without a financial involvement of this management in the life of the enterprise, it is inevitable that incentives for the improvement and innovation of products and production processes will be reduced to the minimum.

Fourth, it is rather difficult for the public operator to obtain detailed and reliable information about the quantity and quality of the resources left untapped in a particular area, the constraints imposed and opportunities provided by civic traditions and local culture, the relational networks that exist or could be activated. The potential profitability of resources and the capacity to create positive linkages constitute, it is pointed out, information that is highly concentrated locally, and which cannot easily be acquired by operators external to the local context such as state enterprises.

Finally, looking in particular to the Italian real experience, the risks connected to the dependence of managers and administrators from politicians have been correctly pointed out. With reference to *Partecipazioni Statali*, many observers ascribe to this dependence a decisive role for the failure of public enterprises more prone to second the interferences of influential lobbies than devoted to pursue their institutional targets.

All these arguments can be countered on various grounds. Firstly, if the public intervention is justified because resources allocation is not optimal for economic growth, and if this is due not (just) to market failures but to a structure of returns on activities dictated by cultural, institutional and social factors, then profit maximisation is in principle a goal that also public ownership can pursue. In these cases, in fact, the hypothesis is that all individuals maximise their utility, but then the structure of economic and social returns is such that they neglect certain activities important for growth. To deal with this problem, the government may seek to act directly on the returns pattern; but it may also choose to undertake certain activities discarded by the private sector, maintaining the objective of profit maximisation.

However, even when the objective of the public enterprise is not profit maximisation, this by no means entails that it is impossible to assess its performance. Public criteria could be established for calculation of the externalities produced by the public enterprise; standards of other kinds could be set for the quality of services; the action of public enterprises could be constrained to a minimum level of profit or a maximum level of costs (or losses). The risks of collusion between politicians and the administrators of public enterprises could be reduced drastically by laying down rules ensuring the separation and independence of public enterprises, or by setting up independent supervisory bodies along the lines of the French *Commission de verification de comptes des enterprises publiques* or the German *Rechnungshof*. On careful consideration, this is exactly what has happened in many countries in the case of their central banks – with the full endorsement of economic theory which, as is well known, recommends that production of the monetary base[7] should be entrusted to a public authority operating independently of political power and pursuing a well-defined social goal (price stability) fixed by statute in precise quantitative terms and made public.

Likewise, there is no reason to believe that devising an incentive system for the managers of public enterprises is logically and practically more difficult than devising one for the managers of large private firms.[8] Unless one hypothesises, as Hart, Shleifer and Vishny (1997) have done, that ownership and control coincide in private enterprises, or introduces some other *ad hoc* difference, it is difficult to show that public managers are systematically less motivated to introduce product and process innovations than private managers. Moreover, an important stimulus to public managers may also derive from markets. For example, if the public enterprises operate in competitive markets, the competition raised by private firms may be sufficient to push the former towards efficient management.[9] Similarly, the market for managers (or other occupational categories) and their mobility between public and private enterprises may be a major incentive for efficiency and improvement. One needs only to admit that the complementarities between state and market can operate in both directions: action by the state can make markets more efficient, while markets can be used to complement the state and give it greater efficiency.

Finally, the scarcity of information is undoubtedly a serious problem for the public operators, but it is so to an extent not significantly greater than for other agents. Therefore, there is no reason to believe that public enterprises must by their nature be entities extraneous to local settings, alien to civic traditions, relational networks and local knowledge. They may, for example, be local public enterprises of medium (even small) size, closely integrated with the local community, and whose operations are socially recognisable, verifiable and sanctionable. On the other hand, assuming that private organisations always possess greater information about the profitability of investments is also to assume that it is impossible to judge a particular allocation of resources as unsatisfactory. But in this case, not only would the creation of public enterprises have to be discarded but also any kind of interference in the destination of resources decided by private agents.

Overall, it seems rash to conclude that on theoretical grounds private ownership is in all circumstances preferable to public ownership[10]. Admittedly, there is still the experience of history to remind us of the practical difficulties involved in managing public enterprises efficiently – even though, as said, the evidence available is difficult to interpret and does not allow definitive judgement to be passed. In particular, the Italian experience of public enterprise has been often judged as a failure, even if a satisfactory analysis of the history of *Partecipazioni Statali* and of causes of their failure is still lacking. Without undervaluing its shortcomings, we believe that, rather than the notion of public enterprise, it has been its concrete application to give rise to such a meagre outcome. The concept of public enterprise encompasses more than the nationalisations and economic planning of the 1960s. It does not necessarily signify state-owned large firms run from the centre or monopolising all sectors of the economy. A public enterprise can also be a small-sized enterprise, locally based, which supplies real and financial services to citizens and businesses in competition with the private sector.

Finally, for the purposes of gauging the effectiveness of the public enterprise as a policy instrument, the true comparison to make is not with the private firm, but rather with other forms of public expenditure (for instance the present mixture of financial and fiscal subsidies plus NP). From this point of view, it should not be difficult to admit that the formation of bureaucratic institutions, the scant transparency of decisions and the risks of collusion are problems which in many respects pertain more to the intricate structure of NP, than to the well-regulated public enterprises embedded in a competitive context.

Conclusions

The participatory approach to regional policies has crowded out traditional policies and active public intervention in many EU countries. In Italy, current policy choices exclude direct participation by the state in the production of goods and services and leaves it to private actors to put forward proposals and take action. However the drawbacks of public enterprise – ambiguity of objectives, scant accountability, clientelistic relationships etc. – seem to be able to characterise even the new kinds of intervention. Negotiated Planning may 'complicate' the institutional context; reinforce the power of local bureaucracies; set objectives for public action which are difficult to evaluate ex post; create opportunities for political trade-offs; make the redistribution of wealth and rent-seeking excessively profitable; and enhance the gap between advanced and backward areas, whose local administrations often lack the capabilities necessary to handle these new decision-making processes.

We believe instead that in order for the abundant resources still untapped in the *Mezzogiorno* to be directed towards activities favourable for development, it is necessary above all to debureaucratise the Southern economy, removing power and opportunities for rich pickings from political groups, bureaucracies and local potentates. To this end, the efficient performance of the state's minimum functions (efficient civil service, protection of public order, administration of justice), the creation and new and more efficient economic and social infrastructures (where necessary), and schemes for the formation of human capital, are crucial for any effective development policy. But short – and medium – period policy action should give priority to a more courageous solution involving a system of automatic incentives, supplemented by an active industrial policy which directly involves the public sector in the production of goods and services.

NOTES

[1] The 'Commission Guidelines on National Regional Aids', published in the Official Journal C74, March 1998, witnesses the consideration gained by the participatory approach among the EU policymakers. A collection of case studies concerning applications of this approach is in OECD (2001).

[2] On this point, see for example Bacthler J. and Yuill D. (2001) and Wishlade (2003).

[3] *Mezzogiorno* is formed by the eight regions of Southern Italy. In these regions GDP per head ranges between 60 and 85 per cent of the Italian average.

[4] One should not forget that the best outcome in terms of convergence was obtained just when these traditional policies were operating. That is why, even if sharing much of the criticism of literature, we are not convinced that the negative assessment of *Intervento Straordinario* be fully justified.

[5] These instruments have been redesigned in a way to overcome some typical drawbacks of the traditional subsidies (i.e. the excessive discretionality granted to public administration, the perverse rent seeking behaviour of potential recipients and so on). On this point see, Scalera and Zazzaro (2000). Currently, the most important financial incentives are the general ones supplied by law 488/1992, those conceived to favour the diffusion of entrepreneurship among disadvantaged categories such as young people, women and the unemployed, plus subsidies for research and innovation. Concerning fiscal subsidies, the most relevant are the ones obtainable through laws 341/1995 and 266/1997 plus the recent 'Tremonti-bis' introducing partial detaxation of reinvested profits.

[6] Although the evidence available at present is not reassuring. See on this Lodde (2000), Moro (2002) and Svimez (2001).

[7] According to several authors, his is a good which, has neither the characteristics of a public good nor those of a natural monopoly: see White (1999).

[8] Incentives schemes for public managers have been proposed in the literature by, amongst others, Loeb and Magat (1978), Tam (1981 and 1985), Finsinger and Vogelsang (1982 and 1985).

[9] On this see Caves and Christensen (1980), Borcherding at al. (1982), Millward and Parker (1983), Iordanoglou (2001).

[10] In fact, both theory – see: Vickers and Yarrow (1988), Zazzaro (2001) – and empirical evidence have shown that public ownership does not necessarily entail lower levels of efficiency and productivity than in privately-owned enterprises – see: Borcherding *et al.* (1982), Millward and Parker (1983), Altunbas *et al.* (2001) and Iordanoglou (2001).

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