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ABSTRACT

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This paper addresses the problem of the dualism of the Italian economy, particularly of its labor market. Although the Italian labor market is considered to be the most highly regulated among OECD countries, the unemployment rate in the North, which represents two thirds of the whole economy, is one of the lowest in Europe. In contrast, the South faces an unemployment rate between two to five times higher than the North. GDP per capita is also twice in the North than in the South, while nominal wages do not differ substantially across regions. Finally internal migration is the lowest among European countries since the middle seventies. This paper argues that the uniform wage is the result of the centralized wage setting carried on by unions, and that the absence of migration is the result of the proactive role of the government, which in the seventies stopped the mass internal migration from the South to the North and since then is acting to prevent the reappearance of such phenomenon. Uniform wage across regions, the active role of the government to prevent internal mass migration and a structural productivity divide between North and South are the institutional features that, within a general equilibrium matching model, explain the high unemployment rate in the South and, perhaps more interestingly, the low unemployment rate accompanied by low wages in the North even when compared to other western European countries.

JEL Classification: E24, J51, J60

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1 Introduction

Due to regulations imposed by unions and the government, Italy is reported by the OECD¹ to have the highest degree of labor market rigidity, as measured by employment protection legislation (EPL), among European countries. This is undoubtedly the results of having strong unions with strong political and social power. However, compared to other western European countries labor costs and wages in Italy are lower while unemployment is not higher than in the rest of continental Europe.² Moreover, by looking closer at the Italian economy and, in particular, at its geographic differentiation, it can be noticed that across regions unemployment, as well as productivity, is distributed unequally while wages and labor costs are much more equally distributed. Most unemployment is concentrated in the South where the rate is up to five times that of the rest of Italy and productivity is much lower. In contrast, in the last thirty-five years, the unemployment rate in the North has fluctuated from 4% to 7%, while productivity reaches levels above the average of the largest western European countries. This differentiation is in spite of the fact that labor regulations are the same throughout the country.

Another puzzling feature of the Italian economy is that, despite the huge difference in the jobless rate and the challenges that the unemployed face, internal migration between the South and North has been the lowest among developed countries for the last thirty years. This is also in spite of the fact that Italy does not have strong barriers to geographic mobility.

The objective of this paper is to provide a model that reconciles the theory with these facts. By means of calibration the model is then used to explain the large unemployment gap between the North and the South of Italy, and at the same time the low wage productivity ratios paid to northern workers compared to the average in the other western European countries. The model is based on three main pillars. First of all, the centralized unions that set a wage, following a right to manage bargaining model, which is uniform across all regions. Second, a productivity divide that makes southern regions structurally less productive than the north. Finally, an active role of the government that aims at preventing the mass migration phenomenon that

¹See Nicoletti, Scarpetta and Boylaud (1999).

²Most of the evidence presented in this paper is about the year 2000 for which it was possible to find all the data. In 2000 unemployment in Italy was similar than in other continental European countries, however later, due to the introduction of temporary contracts, unemployment went down significantly and in 2007 was 6.8 from a 10.6 in 2000.

has characterized Italy until the mid seventies, by transferring resources from the north to the south targeting especially unemployment. A key feature of the model is that unions “move” first with respect to the government in setting the wage rate. Therefore, they take into account the tax rate that the government sets to collect the necessary resources to sustain unemployed workers and prevent migration. Because the wage rate is the same across regions, firms in the lower productive regions will tend to employ less workers, inducing higher unemployment while firms in higher productive regions will employ more workers and generate less unemployment. Moreover, because unions care about the tax rate as well as the wage rate, they will avoid setting a wage too high, which would generate too much unemployment in the lower productive regions. This mechanism explains not only the large gap between the unemployment in the more productive north and the less productive south, but, especially, the low unemployment in the north as compared to other European countries with similar levels of productivity and labor regulations together with the the lower wages. The centralized wage and the commitment of the government to contain internal migration generates a political-economy equilibrium in which the lower productive south mitigates the unions’ power to set high wages. A counterfactual experiments with decentralized unions shows this feature of the model. By allowing unions to set wages at the local level, a much expected political reform in Italy, the model predicts that wages would increase substantially in the north and decrease in the south, accordingly unemployment would increase in the north at levels comparable to other European countries and would decrease in the south to similar levels.

The dualism of the Italian economy is as old as Italy itself. The Southern part of the Italian peninsula was notably poorer than the North before Italy was unified. Completed in 1871, the unification did not bring the wealth and prosperity that many expected to those regions. However, this may not be completely true for Southerners. After unification the flow of immigrants from poorer regions to richer ones began, and many that chose to move were able to establish better living conditions and greater opportunities in their new homes. Part of a greater phenomenon that saw workers also leaving the South for other countries, this migration continued until the 1920s, when it was temporarily stopped during the fascist era. Migration began again after World War II and continued until the early 1970s, at which point

