THE IMPACT OF POLITICAL CALCULUS ON THE REFORM OF INSTITUTIONS AND GROWTH

Old and new examples

Leone Leonida, Dario Maimone Ansaldo Patti and Pietro Navarra

Introduction

Italy is experiencing a dramatic economic and social crisis. It is known that the economy has lost one fourth of industrial production over the period from 2008 to 2013. In addition, and differently from other economies in the European Union, at the time of writing the economy does not seem to be in the recovery phase. However, even before the economic crisis, the economy was not performing well. In fact, Italian economic growth has been slowed down by numerous structural issues for a long time. The country is indeed known to be an example of a so-called dualistic economy, where regions in the South of Italy are known to be lacking in industrialization, in the sense that they are substantially based on the agricultural and service sectors, while regions in the North are known to be among the richest regions in Europe. There also exists a divergence pattern between the North and the South of the country. The 2012 report by SVIMEZ shows that Southern Italy has been growing at a lower rate than Central and Northern Italy over the last ten years.1 According to the report, the southern economy shows signs of greater difficulty during the crisis period that began in 2007, which is easy to show in the trend of employment and production.

Why do regions converge to different long-term equilibria? Are multiple equilibria the result of different institutions? What is the impact of political institutions on the convergence and growth processes? Despite the (recognized) importance of the industrialization process in catching-up dynamics, its theoretical and empirical role has been largely neglected in studies of growth (De la Fuente, 1997, 2000; Durlauf and Quah, 1999; Islam, 2003) and in particular in ‘growth accounting approach’ studies (Temple, 1999). These theories, in addition, originally tended to put aside the role of political competition in economic development, assuming that
The State plays the role of the so-called social planner and therefore acts in any case in the interest of citizens and in favour of economic growth and development.

Acemoglu and Robinson (2006) highlight instead the crucial role played by the political calculus of incumbent governments in the decision to undertake market-oriented economic reforms. The authors emphasize the role played by incumbent governments, whose political power is eventually put under threat by the implementation of institutional reforms that are in turn critical to production. They argue that the implementation of growth-enhancing reforms clearly increase societal welfare, but, at the same time, may destabilize the existing political system and reduce the possibility of incumbent governments remaining in power and resisting the political challenges posed by new competitors. They discuss the history of industrialization to support their theory.

The two main questions that we want to answer in this chapter are the following. First, we suggest using the theory put forward by Acemoglu and Robinson (2006) in order to understand the different levels of development between Northern and Southern Italy and the reasons why the economy is experiencing a lack of growth. We make use of this theory to interpret the history of industrialization in general and in the Italian case in particular, and some of the current problems associated with economic growth in Italy. In light of this theory Italy is a particularly interesting case study. The country is a developed economy as its production level is classed among the top ten in world economies. Moreover, in Italy some regions are fully industrialized; others, however, represent a case of missed industrialization, where the less industrialized regions are geographically located in the south of Italy. These experienced a slowdown of the industrialization process during the late 1960s and, since then, their ability to create growth and employment has been poor.

The second main research question, which we want to address in this chapter, refers to the explanation of why the Italian parliament is facing several difficulties in reforming the TV broadcasting sector, although such a reform is called for by several parties. As we will note, mass media development and, more generally, investment in information and communication technologies (ICT) are critical to production and growth both directly and indirectly (Daveri, 2002; Haacker and Morsink, 2002; Bandyopadhyay, 2009). Also in this case, we believe that the theory of Acemoglu and Robinson (2006) could be useful in investigating the lack of reform of the broadcasting sector.

The remainder of the chapter proceeds as follows. We summarize the theory that links economic growth to political competition, according to Acemoglu and Robinson (2006). Next we describe the convergence process across Italian regions and the extent of dualism between the two main areas of the country, and discuss how the theory we have presented can be used to interpret the absence of industrialization in the southern part of the economy. Then we discuss the case of the (lack of) reform of the Italian TV broadcasting sector, by explaining the link between mass media development, investment in ICT and economic growth. We discuss the main features of the discipline of the Italian broadcasting service and then we explain why it has not been reformed. Finally, we provide some concluding remarks.

The political replacement effect

The relationship between political competition and economic growth is more controversial than one might expect. On the one hand, some authors argue that democratic systems are needed for implementing institutional reforms that are in turn likely to deliver economic development and growth. For example, de Haan and Sturm (2003), Giavazzi and Tabellini (2005) and Amin and Djankov (2009a, 2009b) suggest that democratic institutions strongly influence economic
reforms. Besley et al. (2010) believe that economic growth is associated with higher degree of democracy and political competition. The authors discuss the case where competition among political parties is likely to boost economic development by inducing incumbent governments to support policies leading to economic development. They support their theory by using evidence from US states. A similar approach has been applied by Padovano and Ricciuti (2008) in Italian regions and their results support the existence of a positive impact of political competition on economic performance. On the other hand, some scholars argue that authoritarian regimes are more likely to lead to economic reforms that boost economic growth. They argue that the distributional conflict that characterizes democratic systems is likely to lead to delays, and eventually failures, in the adoption of economic reforms that are critical to economic development (Fernandez and Rodrik, 1991; Rodrik, 1996). Edwards (1991) also notes that countries such as Chile, South Korea and Taiwan introduced democracy only after undergoing economic reforms. China is an obvious and recent example of this idea.

Acemoglu and Robinson (2006) offer a theoretical framework that unifies these opposing views. They highlight the crucial role played by the political calculus of incumbent governments in the decision to undertake market-oriented economic reforms. Unlike the mainstream literature that focuses on the role of distributional conflicts in discouraging changes in economic policy, the authors emphasize the role played by incumbent governments, whose political power is eventually put under threat by the implementation of institutional reforms that are in turn critical to production. The authors discuss the existence of the political replacement effect, and define it as the decision of incumbent governments to block economic reforms if they believe that the reforms themselves are likely to reduce their chances of staying in power. Their key argument is that the introduction of growth-enhancing reforms may change the political, economic and social characteristics of a country. While such reforms increase societal welfare, they may lead to a change of the current leadership in power, as more political competitors may emerge.

When are reforms more likely to be blocked? The authors suggest that the answer is strongly correlated to the level of political competition the economic system is experiencing. Indeed, if political competition in the country is low, then the governments’ incumbent advantage with respect to other parties is high and, therefore, replacement is unlikely. In this context, the government’s political power is secure and market reforms are more likely, even though they might generate political turbulence. The opposite situation is characterized by a high degree of political competition. In this case, the governing body has little incumbent advantage and prefers to carry out economic reforms because, given their potential beneficial effects on the well-being of society, they might increase the probability of their staying in power.

A particular situation occurs when the degree of political competition is neither high nor low. Since the political situation is not well-defined, the risk associated with the implementation of growth-enhancing reforms is an increase in the probability that the incumbent government may be replaced by new political competitors. Under those circumstances, the existing leadership does not have the incentives to introduce economic reforms, as the cost associated with them is greater than the benefits that it could receive.

**Missing convergence and the political replacement effect**

Acemoglu and Robinson (2006) present a number of historical examples to support their theory, and consider industrialization as a concrete example of the mechanism they describe and, finally, analyse cross-country differences in industrialization during the nineteenth century. Their theory appears to be able to explain why Great Britain, Germany, and the United States
enacted institutional reforms that encouraged entrepreneurs to adopt new technologies leading to industrialization and economic development, while Russia and Austria-Hungary blocked those reforms, causing economic stagnation.

The theory the two authors propose is in our opinion helpful in interpreting the history of industrialization in Italy. Despite being a developed economy, as its production level is classed among the top ten in the world economies, part of Italy is known to be a case of missing industrialization. Iona et al. (2008), among many others, present some stylized facts about industrialization, the quality of political institutions and growth in Italy. The authors present evidence from 1960 to 2010 regarding the per capita gross domestic product as a measure of welfare in the country. They show southern regions have a per capita gross domestic product considerably smaller than the richer ones. Moreover, while regions experienced a strong convergence process until 1971, this process tended to slow down thereafter, and the difference between the per capita GDP of the South and the North is increasing. The crucial importance of industrialization to the growth process is highlighted by the evidence that, over the period 1960–5, the South had greater added value in the agriculture sector and lower production in the manufacturing sector than the North, and that investment in the industrial sector in the southern regions has been always lower than across northern regions. In summary, northern regions have experienced a faster growth process mainly because of a stronger industrialization process than that of southern regions.

Williamson (1965) looks optimistically at such a geographical imbalance. He suggests looking at these imbalances as growth-boosting devices as, because of them, southern regions would catch up in a second stage of the Italian development process. He explicitly links the level of national development with the process of absolute convergence across regional economies, introducing the hypothesis that the lower the degree of development of a nation, the faster some of its regions will grow and diverge from each other. The laggards would catch up in a second stage, by taking advantage of the progress of the fast-growing regions: 'the evidence on Italian regional dualism suggest optimistic projections regarding the future size of the north–south problem as Italy passes into mature stages of growth and rapidly ascends into high-income classes' (Williamson, 1965: 28).

In Williamson’s analysis, therefore, sector imbalance causes convergence. However, this has not been the case. Southern regions have not caught up with northern ones, and it seems unrealistic to suppose that a convergence process is going to take place in the future. Why a different level of development persists between the two areas of Italy is thought to be related to the behaviour of economic elites – entrepreneurs in the North and land owners in the South – that have pushed the decision of the incumbent government towards blocking industrialization in southern economies, what is known to be part of the Southern Question (La Questione Meridionale; see Chapter 1 in this volume). During these years, incumbent governments did fear the consequences of a different economic policy, and the sectorial imbalance between the North and the South of Italy, which has caused economic stagnation in these regions, can be seen as a consequence the political replacement effect.

Reform of the media, economic growth and the political replacement effect

Acemoglu and Robinson (2006) make use of a notion of institutions critical to reforms that accounts for a broad range of factors which boost economic performance. According to Orr (1987) the media should be treated as an economic institution. Among other things, it should be acknowledged that the media convey information. In particular, they represent a tool for
gathering and circulating information. In this view, their role is largely critical in offering individuals the correct amount of information in order to play a more active role in social life.

The media are an important part of the more general concept of ICT. The relationship between them and economic growth has been investigated from several points of view. The link between them can be both direct and indirect. For instance, Bandyopadhyay (2009) shows that a larger media development is associated with a lower level of corruption, inequality and poverty. In turn, this generates a better environment in which economic growth and production may take place. In addition, the effectiveness and completeness of the information that the media may offer is largely determined by the way in which governments treat them. As Besley et al. (2002) acknowledge, countries which are rated as democratic experience a larger media penetration.

In this section, we study the media law introduced by Italian government in 2004, and, in particular, we try to explain in light of Acemoglu and Robinson (2006) the reason why such an Act has not been modified, although a change is called for by several different parties and organizations.

**Media penetration and economic growth**

Our first concern is to explain the link between media penetration and economic growth. As we mentioned above, such a relationship may be both indirect and direct.

As far as the direct impact is concerned, there exists a large literature that acknowledges the role of investment in ICT and economic growth. Although the initial studies did not find any positive relationship, but, on the contrary, a negative one (Pohjola, 1998), there is now a general consensus on the positive impact. For instance, Haacker and Morsink (2002) show that investment in ICT leads to a large increase in total factor productivity. Clearly, there exist differences in such an impact among developed and developing countries. However, it is commonly held that the positive effect is consistent across a large cross-country sample. Indeed, Daveri (2002) shows that investment in ICT boosts significantly economic productivity in several developed countries, although in some cases, such as Germany, France, Italy and Spain, the impact of such investment is negligible.

On the other hand, the indirect impact of media penetration on economic growth is considerable. Bandyopadhyay (2009) shows that media development reduces corruption, inequality and poverty. Brunetti and Weder (2003) and Ahrend (2001) find that greater press freedom is associated with low corruption. Even more interestingly, Djankov et al. (2003) show that state ownership of media is negatively associated with the quality of political governance. A similar negative correlation is witnessed in Shi and Svensson (2006), where the authors show that a limited media penetration (identified in the distributions of radios among the population) finds a counterpart in larger political budget cycles. It should be acknowledged that such a relationship is not undisputed in the literature. Besley et al. (2002) argue that the presence of larger media groups generates sufficient conditions for the emergence of a free press. In fact, such large groups prevent any attempts at bribery by politicians.

Another indirect effect of media penetration on economic development comes from the relationship between investment in ICT and social inequality. While at a macro-level we may notice the tendency of clustering in the media industry as with any other kind of production, Quah (1996) shows that such a clustering is more pronounced in Europe than in US. In a similar fashion the lack of access to ICT may worsen the existing inequality among individuals, because of the lack of information that individuals may have access to in their lives.
As with the corruption issue, we cannot neglect that the development of mass media allows voters to exercise more effectively their control of governments’ actions. If individuals are aware of politicians’ choices, they can decide freely which candidate they will support in upcoming elections. This is particularly true for less developed countries. However, political accountability goes hand in hand with the issue of media ownership. Privately owned media possibly do not guarantee the necessary independence of the editors that is required to punish government’s inappropriate actions and to reward the choices that are in fact beneficial for individuals’ well-being.

**The Italian Act on TV broadcasting**

The Italian TV broadcasting industry has been subject to some legislative interventions in the last 20 years. The most important interventions were an Act introduced in 1990 on regulations for the public and private broadcasting industry (the so-called *Legge Mammì*) and another Act introduced in 2004 on regulations for the broadcasting industry and the publicly owned body, *RAI*. The last Act also authorized the Italian government to promulgate a general act on the entire broadcasting service in Italy (the so-called *Legge Gasparri*).

The 1990 Act recognized the right of private bodies to broadcast over the entire country, which broke the monopoly of public television. It came after the partial rejection of earlier regulations issued in 1985, which were declared against Italian Fundamental Law by the Constitutional Court. It recognized the role of private broadcasting bodies and introduced both internal and an external pluralism in the service. The internal pluralism was meant to guarantee adequate space in the broadcasting service for different opinions and political, social and religious ideas. The external pluralism allowed entry into the market by players different from the publicly owned broadcasting body.

The *Legge Mammì* introduced a duopoly in the Italian broadcasting industry formed by the publicly owned body and the privately owned *Fininvest* (now *Mediaset*). Each of them consisted of three channels and controlled almost the entire national broadcasting service. Admittedly other private bodies were operating in the broadcasting industry. Nonetheless, their market share was significantly smaller than the two main competitors.

The broadcasting service was severely reformed in 2004. The objective of such a reform was to offer a solution to the conflict of interest produced when the owner of *Mediaset*, Silvio Berlusconi, was appointed prime minister. The approval of that Act was unusually long and controversial. According to Italian Fundamental Law, acts are promulgated by the Head of State. However it is his right to refuse approval if he considers some elements in the bill to be in conflict with the Constitution. In the case of the *Legge Gasparri*, the president of the Republic exercised his constitutional right because of two elements. On one hand, there was the necessity of fixing a shorter term to regulate access to terrestrial digital television, while the original version of the *Legge Gasparri* aimed at postponing a deadline fixed by the Constitutional Court. On the other, the president of the Republic recognized the risk that the regulations regarding the calculation of advertising revenues could generate a detrimental situation for pluralism in the broadcasting sector.

Eventually, the *Legge Gasparri* was approved with the following characteristics:

- definition of an integrated system, which covers among other things newspapers and TV advertising;
- a limit of 20 per cent on the total amount of advertising obtained in a year according to the integrated system for a single body;
- a progressive move from analogue to digital terrestrial television by the end of 2006.
It should be noted that the change to the digital terrestrial television occurred 6 years later than the date fixed in the *Legge Gasparri*.

The above Act has been criticized in several respects. The most critical was the limit on the amount of advertising revenues that each body could obtain from the integrated system. Although the percentage was reduced from the 30 per cent fixed by the previous legislation, to 20 per cent, in absolute terms this resulted in an increase from 12 to 26 billion euros. Moreover, the new Act would incentivize advertising on TV rather in newspapers. Finally, the Act did not tackle the problem of the assignment of TV frequencies. A further important point is that the European Commission required some amendments, since it recognized the presence of elements at odds with European Law.

As can be noted, the introduction of such a reform of the broadcasting sector was quite controversial. Moreover, nowadays there are continual requests for changes, which have been systematically neglected. More importantly, it was difficult to amend the *Legge Gasparri*, even when the government was supported by left-wing parties.

The crucial questions we would like to answer are consequently the following: Provided that the necessity of amending the *Legge Gasparri* was recognized by several parties, organizations and even single persons, why was it so difficult to change it and why is it still in operation after 10 years? What prevented left-wing parties changing an Act which they have always recognized as unfair and detrimental to pluralism?

**Political calculus and the Legge Gasparri**

It should be noted that the necessity of solving the so-called conflict of interest emerged when Berlusconi was appointed prime minister. This happened in 1994. After his replacement in 1995, another four governments were in office and all of them were mainly supported by left-wing parties. Although Berlusconi had already changed his status from TV tycoon to politician, nobody solved the conflict of interest. In addition, the broadcasting sector was reformed by a government run by Berlusconi himself and, as has been recognized, the *Legge Gasparri* appeared to favour the owner of the largest private broadcasting body, who was, of course, Berlusconi himself. His second government ended in 2006 and was replaced by two left-leaning governments. Eventually, Berlusconi came to power again in 2008 for another three years before resigning because of the international financial crisis.

Our objective in this subsection is to answer a simple but important question. Why did no government of the last ten years have the necessary power to change an Act which was recognized as detrimental to the effective development of the media sector? Answering the above question is not straightforward, Moreover it requires a critical interpretation of different features of the Italian broadcasting sector and political system.

The first important point concerns the relationship between political power and the publicly owned broadcasting body. As we mentioned above, Italian public television consists of three channels. The key corporate positions are determined by the political powers. Therefore, people appointed to positions are usually close to a particular party. For instance, the first channel is usually assigned to the main party, which supports the government in office, while the third channel has usually been run by people who are close to left-wing parties. It appears that the quality of the information provided may be heavily affected by political power.

The second key factor, which occurred in the same period, when the broadcasting sector was reformed, is the approval of a new Act regulating electoral competition, which was introduced in 2005. There are two features of the new Act that are interesting for our purposes. First, it allows for multiple nominations. In other words, the same person may run for a position...
in different constituencies. This practice has been widely used by parties which prefers to indicate as the first candidate in the list the most representative politician, in order to maximize the number of votes that they can obtain. The second characteristic is that voters cannot choose their most preferred candidate, but they can only vote for a party or a coalition. The list of candidates is chosen by the same political parties and, depending on the position of a candidate on the list, his probability of being appointed to a position is high or low. Given the characteristics of the Italian electoral rules, it is certainly true that elections are free and everyone may express his or her own preferences, but at the same time voters cannot choose their most preferred candidate, but they need to accept the choice made by parties. In this view, it could be acknowledged that Italian elections lack full freedom of choice. Therefore, competition in the political arena occurs among parties and/or coalitions but not among candidates. In this view, we may argue that political competition in Italy is not fully developed, since voters can choose their most preferred political platform, but they cannot choose the candidate that they feel could best represent their interests.

Why may the above issues explain the reasons for the absence of a change in the regulations for the broadcasting sector?

Let us consider again the theory put forward by Acemoglu and Robinson (2006). The two authors argue that the implementation of policies which are growth-enhancing is more likely to occur in those countries in which the degree of political competition is either high or low. On the other hand, when the degree of competition is neither high nor low, the government in office prefers not to introduce reforms which could generate a dramatic change in the economic, political and social structure of the country. In turn, this could lead to a change in the political leadership.

As we argued above, the elections Act introduced in 2005 removed the possibility of selecting the most preferred candidate. Therefore, broadly speaking, voters are limited in their freedom to choose. Although Italian elections are in general democratic and the degree of political competition is high, the election Act eliminates one of the most important aspects of an election.

If we couple together the above observations, we can develop the following argument. In Italy, the broadcasting service is polarized between two main bodies: one is publicly owned, while the second is privately owned (the main shareholder being the former Italian prime minister). The key figures in public television are appointed by the political powers following a procedure which gives each party some ‘control’ over one of the three channels. If this is the case, the broadcasting services do not play the role of conveying neutral information but it is filtered by the political powers.

Changing the regulations of the Italian broadcasting service by introducing more competition and more efficiency could have two consequences. On the one hand political parties will lose some TV channels through which they may spread information; on the other, an efficient and highly competitive sector may generate the conditions for the emergence of new political competitors. With respect to the first point, according to Acemoglu and Robinson (2006), we can explain why even left-wing governments do not manage to change the existing regulations of the broadcasting service. Although a new Act would limit the power of one of the political competitors (the main shareholders of the private broadcasting body), on the other, a government which acts in this way would lose control of public television.

The second consequence highlighted above is crucial. A more effective broadcasting sector or, more generally, investment in ICT would create an ideal environment for the emergence of political competitors which may threaten the leadership in office. This explains why ten years on, the broadcasting service has still not been reformed. An example of what may happen was given at the last general election in 2013. In a few months a new movement called the Five...
Stars Movement obtained a significant result by collecting around 25 per cent of votes for the Chamber of Deputies. The main characteristic of such a movement is that it uses the Internet heavily as the main vehicle of communication among its members and with its voters (see Chapter 19 in this volume).

The provocative questions we want to pose at the end of this section are the following. What would be the result of the general elections in ten years, if each government in office from now on provided more effective regulation of the broadcasting sector and invested massively in ICT? More importantly, would we have the same political parties in Parliament? Is it convenient for a government in office to reform the broadcasting sector in light of its own political calculus?

Conclusions: political reforms as a condition for a long-term growth strategy

In the economic analysis of convergence one of the reasons why economies do not tend, in the long run, to the same equilibrium level of wealth per capita is that the markets do not transmit appropriate incentives to economic agents (Solow, 1956). If this is the case, the intervention of the government should be directed to remove such obstacles through adequate policies which would allow the market to transmit incentives properly.

The question therefore is: is such a policy possible? Italy needs a development strategy. However, the effects of such a strategy are likely to take place in a period of time that is longer than the urgent need to present voters with results. In other words, the political cycle is shorter than the time this policy requires in order to produce its effects. This reduces the likelihood of sticking to such a policy.

Moreover, the political calculus as outlined by Acemoglu and Robinson (2006) leads us to explain the behaviour of politicians who may or may not implement some growth-enhancing reforms. While in Italy there is the need for a development strategy, it should account for media development and investment in ICT. However, in the last ten years there has been no government which was able to implement such a reform. We explained this inconsistency with the argument that a more efficient television broadcasting service is not in the interests of Italian political parties. Under an electoral rule which limited the voters’ freedom of choice, as they cannot vote for their most preferred politician but only for a party or coalition, the possibility of ‘controlling’ some public television channels is fundamental for conveying and spreading non-neutral information. In addition, the development of the television broadcasting industry may give rise to the emergence of political competitors which may challenge the leadership in power. As we have noted, this could be a big risk, as the experience of the new Five Stars Movement shows.

Note

1 In this chapter we group Italian regions according to the following classification. Northern Italy: Piedmont, Valle D’Aosta, Lombardy, Liguria, Trentino-Alto Adige, Veneto, Friuli-Venezia Giulia, Emilia Romagna. Central Italy: Tuscany, Umbria, Marche, Lazio, Abruzzo. Southern Italy: Molise, Puglia, Campania, Basilicata, Calabria, Sicily, Sardinia.

Bibliography


The reform of institutions and growth


