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Industrial Districts and Economic Decline in Italy

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Abstract

The paper argues that the so-called canonical view of the Italian industrial district (ID) depicts it as a system whose economic and social vitality requires the interaction between two major sub-systems: a community of people and a community of firms. A range of circumstances - including insufficient aggregate demand, competition from low-cost countries and technological change - have determined inconsistencies between the rationales of these two sub-systems. As a result, lead firms have emerged that substitute the ID as coordinating instances. In the pursuit of their goals, they tend to prefer cost scrapping to quality enhancement, thereby determining a competition that further undermines the ID as a system. The paper contends that this outcome is not the only possible one. An alternative would require the regulatory - as opposed to merely permissive - action of public actors in that it would have to change the incentive system that leads firms to choose short-sighted strategies. *

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1 Introduction

The aim of the paper is to discuss the role of Italian industrial districts (IDs) in the light of present discussions concerning the stagnation, if not downright decline, of the nation's economy. It argues that these discussions tend to downplay, among other things, the role that social cohesion actually plays in the performance of IDs.

The paper argues that the so-called canonical view of the ID depicts it as a system whose economic and social vitality requires the interaction between two major sub-systems: a community of people and a community of firms. A range of circumstances – including insufficient aggregate demand, competition from low-cost countries and technological change – have determined inconsistencies between the rationales of these two sub-systems. As a result, lead firms have emerged that substitute the ID as coordinating instances. In the pursuit of their goals, they tend to prefer cost scrapping to quality enhancement, thereby determining a competition that further undermines the ID as a system.

The paper contends that this outcome is not the only possible one. An alternative would require the regulatory – as opposed to merely permissive – action of public actors in that it would have to change the incentive system that leads firms to choose short-sighted strategies.

The paper is arranged as follows. The section that follows briefly summarises the key issues involved in discussions concerning Italy's dismal economic performance. This concise introduction provides a terms of reference to better situate IDs within the overall performance of the Italian economy and to appreciate the theoretical peculiarity of the district-based approach. Section 3 focuses on what allows IDs to be competitive, to achieve economic growth and to reproduce themselves as a socio-economic system. It contends that the key issue is that IDs must comply with stringent requirements for social cohesion: economic activity must interact with the social and cultural environments in a way that reinforces both, thereby reproducing the district as a coordinating instance. This does not appear to be the case, however. Section 4 discusses some data concerning the performance of IDs on economic and social grounds. It suggests that while the former may have some positive traits, these are obtained at the expense of the latter, by undermining social cohesion. The implication is that the conditions for the persistence of districts may eventually disappear, thereby leading to different types of local organisation, such as clusters, which, as the subsequent section argues, would require a definitely more active public policy. Section 5 discusses two alternative views of the outlined process. According to the prevailing account, it is the somewhat natural outcome of the institutional rigidity of districts

and of their evolution towards a firm-centred local system. The alternative account that the paper suggests is based on the existence of inconsistencies between the two subsystems that IDs comprise. The institutions that underlie the community of firms lead the latter towards strategies that clash with the institutions that underlie the community of people. The demise of the ID is therefore possible; it is not necessary, however. In order to overcome this inconsistency public policies are required that go beyond the merely ancillary role that the district-based view tends to assign to public action.

2 Industrial districts and recent trends in the Italian economy

A fairly large amount of Italy's economic literature has recently focused on the country's stagnation. Italy's growth rate has been decreasing over time and it is lower than in most other industrialised countries (Table 1). Some authors have explicitly referred to a downright economic decline (Gallino 2003; Toniolo, Visco 2004; Nardozi, 2004; Rossi, 2006). Based on the claim that this is a long run phenomenon, many scholars suggest that it must be regarded as a supply side issue and argue that the main reason for the decline lies in the slow growth of productivity, which, in their view, is associated to the structural features of the Italian economy². Nardozi (2004: 100) contends that "the slowdown in the productivity of our manufacturing industry relative to countries, such as France and Germany, [...] is accounted for by two persistent peculiarities: the "dwarfness" of firms and a productive specialisation in traditional sectors."³. Following a classification à la Pavitt, Nardozi argues that traditional sectors are not technology intensive, so that their techniques are hardly subject to any upgrading. They are easy to establish in less developed countries and their competitiveness ultimately depends on production costs. The small size of firms reinforces the negative consequences of this sectoral bias in two ways. First, precisely because they are small, firms cannot reap the benefits of scale economies in production. Second, independently of production, they do not have the minimum efficient scale to carry out R&D or to follow up their productive activity with appropriate marketing strategies. As a result, P. Ciocca (2003: 87*) argues, Italy is "squeezed" between "new trade partners (...) who are prone to export consumption goods that Italy produces and to import investment goods

²Although there is reason to believe that such a distinction is not appropriate - in that, as we shall see further on, the decline in aggregate demand definitely affected the supply side - we will not go into this issue.

³Unless otherwise stated all translations from Italian texts are mine.

that Italy does not produce [and] economies, such as the United States, that can supply products – consumption and instrumental goods and services – characterised by scale economies, R&D, and innovation.”. The incapability of Italian firms to increase their size “far from being forced upon them by [Italy’s] pattern of specialisation, freezes that pattern, restricting investments abroad and limiting exports” (*ibid.*).

Nardozzi views the “two persistent peculiarities” as a structural backlog: “In the Seventies and up to the mid-Eighties the rate of growth of labour productivity in small firms was greater than in large firms. This was the time of decentralised production and of the insurgence of districts. Subsequently, this relation switched and the rise in the productivity of large firms was almost twice as big as in the small ones. [...] The newly established firms of that period remain small, however, and their “dwarfness” is reflected in productivity” (Nardozzi, 2004: 96).

Considering that districts are formed by small and medium sized firms and that they tend to specialise in traditional sectors, views such as those summarised above deny – or, at the very least, downplay - the relevance of districts for economic growth in Italy today. More specifically, Nardozzi’s remarks raise two issues. The first one is theoretical in that he argues that “dwarfness” and specialisation in traditional products are a problem in general. The second one is empirical in that he claims that the time when districts were the most vital element in the economy has passed. Consequently, in order to appreciate the role that IDs have in the evolution of the Italian economy, we must address both of these levels of inquiry. Let us first consider the theoretical issue⁴. We will discuss the empirical ones in Section 4.

The district-based view stresses that in rich capitalist economies goods should not be classified in terms of their natural (e.g. metal) or technical (e.g. mechanical) characteristics but in terms of the types of customers who are likely to buy them. The nature of modern markets suggests that consumers look for tailored goods, so that diversification and customisation are less the exception than the rule. Rather than reflecting a defensive strategy carried out by those who are unable to compete on the “open” market, niches are what consumer markets are all about. In this perspective, the distinction between shoes and clothing may be misleading, a more appropriate distinction being that between high quality products – e.g. high quality clothes and shoes, which are likely to be sold in the same shop – and cheap ones.

⁴I will here focus on what is sometimes called the canonical view of industrial districts - as it is outlined by authors such as Becattini and Brusco – because I believe that it reassesses the economist’s toolbox in the light of the distinctive features of industrial districts rather than trying to encompass them in the framework of conventional economics.

The implication is that, in so far as districts specialise in the former type of goods, they have little to fear from import penetration by less developed countries.

Obviously, this is not to say that such a specialisation actually exists. Whether it does or not, however, depends less on the maturity of the industries than on the ability of districts to “choose” the appropriate strategy to deal with foreign competition. In this perspective, the strategy that IDs actually pursue may be appropriate or not but the standard classification of industries – whether those generally used by statistical bureaus or the Pavitian one – is nonetheless misleading, at least when it refers to the types of products districts deal with.

Another aspect of the district-based view is that firms do not only compete, they also cooperate. Cooperation in production leads to a different division of labour within firms as well as among them, which affects also what and how they learn and innovate. Similar considerations apply to activities such as R&D or marketing: firms can cooperate for these just as for other activities. Thus, what is relevant for economies of scale is not the size of the firm as such but either the size of the single activity that a firm carries out or the size of the set of activities jointly carried out by a group of firms. The critical distinction is not between large and small firms but between large and district firms on the one hand and isolated small firms on the other. Furthermore, within a single industry, it is most likely that if firms consist in single units of production, the goods that large firms produce differ from those that small firms produce. Small firms may produce intermediate goods for the larger ones or they may simply specialise in products that require smaller minimal efficient scales. This argument, along with the ones discussed above, suggests that differences among firms are likely to be even stronger, making it pointless to compare the productivity of large and small firms. Here, too, just as in the discussion of industries, these considerations do not imply that cooperation as it is today actually is effective in terms of all of these activities. They do imply that the vitality of districts depends less on the formal boundaries of firms than on an appropriate district-centred strategy.

The district-based view does not deny that districts may be facing grievous problems. What it argues is that the appropriate strategy should take into account the nature of consumer demand in present developed economies and the potential underlying cooperation among small and medium sized firms. It is rather skeptical that structural changes such as those purported by the critics of the “two persistent peculiarities” can be carried out without disrupting the cultural and social circumstances that underlie the resurgence and success of IDs.

Despite the richness of the debate, the above discussions tend to downplay two issues⁵. The first one is the role that large firms are actually playing in the Italian economy. Whatever long term changes may have made scale economies less important than in the past, there seems to be a difference in the performance between large firms in Italy and in other countries. On the one hand this suggests that there is scope for scale economies and that the vitality of large firms may even feed back on IDs, so that it probably is inappropriate to consider large firms and IDs as alternative economic setups⁶. On the other hand, if Italian large firms can perform better than they actually do, a crucial issue is why they do not. It is obviously reasonable to claim that they were mismanaged both at the managerial and at the industrial policy level (Gallino, 2003; De Cecco, 2004). But such a contention only shifts the problem: how can we rely on large firms if we cannot rely on the required managerial and political conditions to hold? Can these conditions be reduced to (lack of) political will and to (lack of) managerial expertise or are there historical and institutional implications that beg for a more in depth inquiry? For instance, could it be that managers and politicians were so busy trying to bypass the lack of social cohesion and a latent - when not explicit - social conflict that they conflated the dynamic efficiency of the economy with the redistribution of real income, thereby forsaking whatever action in favour of innovation⁷? Isn't there a risk that, in the absence of proper answers to these questions, policies centred on the removal of the "two persistent peculiarities" may aggravate Italy's industrial performance?

The second issue that the above discussions downplay is whether districts are actually meeting the conditions for their vitality. The peculiar characteristics of IDs do not allow us to rely on a mere assessment of their economic performance⁸. An ID is vital – i.e. it can materially and socially reproduce itself over time – only if it meets the requirements both of the community of people and of the population of firms that constitute it⁹. In order to ade-

⁵A discussion of some theoretical and methodological issues underlying the above debate is in (Ginzburg 2005).

⁶Becattini and Dei Ottati (2006:22) partially acknowledge this when they point out that the relatively good performance of the provinces where both industrial districts and large firms operate suggests that these two realities may well complement each other.

⁷Italian governments have been particularly active in reducing welfare expenditure and in liberalising the labour market while both public and private R&D expenditure – as a share of GDP - has remained at Europe's lowest levels for quite a long time.

⁸To be true, this applies to economic activity in general (Sen, 1987) but, for the reasons that follow, it is especially true for IDs.

⁹In Becattini's words, an ID is "a socio-territorial entity which is characterised by the active presence of both a community of people and a population of firms in one naturally and historically bounded area." (Becattini 1990: 38).

quately appreciate this contention, the section that follows focuses on social cohesion. On the one hand social cohesion reflects the extent to which the requirements of the community of people in the ID are met. On the other, it is crucial for the organisation and coordination of production and innovation. So the question is whether it is actually possible to meet these two requirements.

3 Industrial districts and the centrality of social cohesion

Social cohesion is a central feature in all discussions of IDs because it is, at one time, a condition for and a consequence of the vitality of the district¹⁰. The term “social cohesion”, however, is somewhat ambiguous. Let us briefly consider its characteristics.

Social cohesion often refers to the absence of social conflict. Persuasion and bargaining may not provide generally accepted solutions to problems that relate to industrial relations or to the welfare provisions of central and local government. The ensuing social conflict is the cause of great concern, on strictly economic grounds, because it may lead to social disruption, economic uncertainty and, ultimately, a decline in economic growth. This notion of social cohesion applies to practically any type of economic organisation.

The notion of social cohesion I refer to here is more restrictive. It consists in the involvement of economic actors. It is not enough that they should not disrupt the economy; they must, at least to some extent, feel that the ends they pursue match those of the economic organisations they act in¹¹.

In order to achieve the first type of social cohesion, economic actors need only acknowledge that social conflict is ineffectual: although, in abstract terms, it might allow them to achieve their goals, in practice power relations or other circumstances suggest that this would not be the case. In order to achieve the second type of social cohesion, economic actors must acknowledge that cooperation is the most appropriate way to achieve their own goals. In what follows, I will refer to this second type.

¹⁰This is, arguably, the distinguishing feature between (Marshallian) industrial districts and other types of local production systems such as Porter’s (1998) “clusters”.

¹¹“In order to achieve a capacity for invention and innovation, (...) it is essential that many people understand the technology with which they work. This, in turn, requires continual informal interaction in cafès and bars and in the street. In this way, new ideas are formed and transmitted.” (Brusco 1990: 16). The informal interaction Brusco refers to would hardly be possible if all actors were not involved in the general goals of the firms they work for.

Social cohesion involves trust. Trust is the belief that other actors will behave according to some justice criterion, independently of their personal gain. Justice is viewed, here, in broad terms: it may involve what is deemed good in absolute terms, e.g. from a religious point of view; it may also involve what an outside observer would – pragmatically - deem appropriate for specific transactions, independently of more general considerations.

Trust is important in interfirm relations within IDs because it allows actors to maintain cooperative relations in a competitive context. It is also important in intrafirm relations. Mutual trust, here, implies that workers are willing to do more than is formally required of them because employers are willing to acknowledge this extra-effort¹².

Trust reduces the scope for opportunism, thereby leading to governance and coordination mechanisms that downplay the latter, to the advantage of other priorities. Rather than forcing economic activity within the straight-jacket of control, districts can enhance the interaction among workers within firms and among different firms. Rather than protecting their knowledge – their skills and their capabilities - in order not to lose their bargaining power, actors can share it. In so far as they do so, they enhance not only the diffusion of existing knowledge: they allow the creation of new knowledge. In this perspective, Charlie Chaplin’s parody of the Taylorist division of labour in “Modern Times” would reflect a waste of resources - the actual and potential skills of the worker – at the expense of the capabilities¹³ of the firm, as well as of the district as a whole.

Social cohesion also involves confidence¹⁴. While trust has to do with the behaviour of other actors, confidence has to do with a system’s overall performance. From the perspective of entrepreneurs, confidence includes positive expectations in terms of market demand and profit opportunities. It involves reliance on the district as a buffer: should a firm suffer a downturn, it can always rely on what other firms choose not to produce directly but to subcontract. From the perspective of a worker, it includes a non decreasing income and the possibility – should she want to – to set up her own business. Here too, the district may act as a buffer: should one’s business be

¹²“*Trust and co-operation*, so crucial to the successful performance of the district, is helped by an attitude that seeks competitive success not by aggressive cutting of direct labour costs but by general organisational competence, standards and productivity. The maintenance of labour standards, including good wages, improves the performance of labour and the performance of the district.” (Sengenberger, Pyke, 1992: 5; emphasis in the original).

¹³Reference is to the notion of capabilities as depicted in the capabilities approach to the theory of the firm. See Loasby (1994) and Dosi, Nelson and Winter (2000).

¹⁴Mistri and Solari (2003) and Mistri (2006) provide an extensive discussion of the relation between trust and confidence.

unsuccessful, one can always return to her previous type of job.

Social cohesion allows an ID to operate differently from a large firm, as well as from an undifferentiated set of (small) firms. In so far as this specific organisation and this operational mode provide its firms with a distinctive competitive advantage, they eventually validate the actors' mutual trust and their confidence in the district¹⁵. This reinforcement effect, coupled with shared knowledge, allows the district to act a firm incubator, thus to reproduce entrepreneurial capabilities over time (Becattini 2003).

Despite the positive features depicted above, however, a district may be unable to maintain its competitive advantage. Districts have to adapt to two types of change: change coming from outside the district, such as, for instance, the emergence of India and China in the World economy, technological breakthroughs that affect the competitiveness of its products, or changes in the level of aggregate demand; change within districts, such as generational changes in expectations.

Adaptation to these changes involves a range of possible actions, which may reflect the purposive conduct of some actor or the spontaneous outcome of a self-organising process. The type of actions that are actually taken reflect a (sometimes implicit) choice as to whether it is better: to rely on path dependent knowledge in the existing industries or to shift to new industries; to focus on cost scrapping or on qualitative upgrading; to focus on technology or on design; etc.. Although in practice these alternatives may not be as clear cut as they are presented here, the issue remains of what the priorities are.

What is important about these actions is that their priorities cannot be identified in terms of competitive advantage alone. The systemic nature of a district consists in the interaction between two sub-systems: its community of people and its population of firms. The actions must therefore meet the requirements of both of these sub-systems: while they must allow the material reproduction of the district, they must also be consistent with the reproduction of the district's social environment. First and foremost, they must prevent a disruption of social cohesion. Thus, a district may fail to adapt to change either because it does not achieve the competitive requirements related to the goods it is specialised in or because it does not maintain the social cohesion that underlies and supports its productive structure. Such a failure may occur because of self-referential reliance on past patterns of infra-district interaction, which is likely to prevent district actors from appreciating the features of economic change and adapting to them. In other terms, the specific features of social cohesion may preclude

¹⁵Furthermore, both entrepreneurs and workers are likely to take into account the general quality of life associated to working in a cooperative environment.

competitive adaptation. The obverse is also possible, however. The strategy that pursues competitive adaptation, involving a combination of the choices outlined above, may eventually undermine social cohesion. The discussion that follows aims to focus on how these intertwined constraints have affected the vitality of IDs and, possibly, Italy's overall economic performance.

4 Recent trends in economic performance and social costs

In a recent paper, G. Becattini and G. Dei Ottati (2006) provide a statistical analysis of the Italian economy during the Nineties. They divide the manufacturing sectors into four groups: heavy manufacturing industries, agricultural goods and tobacco, light manufacturing industries, and goods for individuals and households. The third and fourth groups typically are those that IDs are specialised in. Becattini and Dei Ottati also divide Italian provinces into four classes, according to their prevailing industrial structure: large firm, ID, residual and mixed¹⁶. The main conclusion they draw - based on data from the 1991, 1996 and 2001 censuses - is that IDs generally outperform other territories and other manufacturing sectors both in strictly economic terms and in terms of quality of life. Let us briefly summarise their results.

The two district-related groups account for a high share of Italian exports (62% in 2001) and a positive trade balance, whereas the other two groups have a negative balance, which, in the case of heavy manufacturing industries, tends to worsen over time. Similarly, district-related provinces export more than large firm ones, both in absolute and per capita terms. Value added rises more in the district-related provinces than elsewhere.

Employment in the private sector rises more in district-related provinces. It rises especially in non-trade service sectors, mostly in business-related services. Employment in manufacturing drops everywhere but less in district-related provinces and in district-related sectors. In the heavy manufacturing industries, the drop in employment is paralleled by a rise in local units, thereby leading to a significant decline in the average size of local units.

Activity ratios are higher and unemployment is lower in district related provinces. In general, per capita income is higher in these same provinces. Migration tends to flow in district-related provinces and out of large firm

¹⁶A prevailing structure of a province is "large firm" ("district") if the share of employees in large firms (districts) exceeds the national share of those same employees. A "mixed" province is both "large firm" and "district". A residual is neither one.

and residual provinces. This final information is particularly important, according to Becattini and Dei Ottati. They argue that: “it is unlikely that people move from areas where they live better and have better job opportunities (according to the conventional wisdom these are the areas with large firms) towards areas that are less advanced in social terms and where employment ultimately ought to be more precarious (according to the conventional wisdom, these are the areas where small firms prevail, as is the case of district-related provinces). Obviously, something must be wrong with the ‘conventional wisdom’” (Becattini, Dei Ottati 2006: 20).

This remark on the quality of life in IDs not only contends that people live better in the existing districts but it also reasserts the role of social cohesion as a distinctive feature of the vitality of IDs. “The data on well being [...] show that on average it is higher in the district-related provinces. We care to stress that, according to the theory of the ID, this is not only the outcome of what we pointed out above but, since it is a factor of social cohesion, it is also a cause of the higher labour productivity in IDs (in the goods they specialise in), relative to its accumulation-related (more per capita instrumental goods) and technology-related (better instrumental goods and better firm based organisation) determinants.” (ibid.: 20-21).

Despite this positive performance, a few problems stand out and should not be disregarded. Becattini and Dei Ottati distinguish two district-related groups of industries but, although they do point out that these groups perform differently, they do not elaborate on these different performances, which substantially lead to a recomposition: the light manufacturing industries (M) tend to become more important as the goods for individuals and households (H) decline. Employment in the latter group drops by $-15,3\%$ from 1991 to 2001 while it rises by $7,3\%$ in M. Local units in H drop by $13,4\%$ and rise by the same percentage in M. This recomposition does not lead to any significant (positive) change in the foreign accounts: judging by the trade balances provided by Becattini and Dei Ottati, the net exports of the rising group of industries (M) declined after 1996 and never recovered completely, while the net exports of the declining industries (H) basically kept on rising.

Unfortunately, compensation between the two groups of industries has not been complete: during the Nineties, employment in M rose by only 46% (119857 units) of the corresponding drop in H (281576 units). Since these two groups of industries are generally based in different provinces, the effects on employment have been rather grievous: in some of the district-related provinces, jobs dropped by 6-8 percentage points from 1995 to 2002. The impression is that this recomposition led to significant social costs¹⁷. Can

¹⁷The notion of social cost used here is the one discussed by K.W. Kapp in his work,

it be possible that they did not affect social cohesion? Given the above discussed centrality of social cohesion for IDs, this seems to be a rather important issue.

The share of non regular employees in total employment complements the above data (Figure 1). The figure for H is always more than twice as big as the figure for M, while the heavy mechanical industries are somewhere in between. This suggests that H is characterised by relatively precarious employment conditions: non regular employees can be sacked whenever their employer chooses; they are therefore forced – as opposed to willing - to comply with what s/he deems appropriate; finally, they get no (otherwise compulsory) social security contributions. Truly, when market demand is high and growing, the cost of precariousness may be low, as Brusco (1982) argued, but the above data on employment suggest that this is not the case today. In these industries, firms are shifting their private costs onto workers, thereby bypassing competition through the creation of social costs.

The strong difference between these two groups of district-related industries calls for further inquiry. An account for the different performance could be that H is less subject to technological progress, thus more easily reproducible in low-cost countries. But this would imply that social cohesion in the related districts either does not exist or it cannot make up for the technological drawbacks. The data that follows focuses on social cohesion. It does not allow for a comparison between the two groups of industries but the aggregate picture is worth taking into account.

Figure 2 provides data on deadly accidents occurring to workers in Italian provinces, classified according to the criteria followed by Becattini and Dei Ottati¹⁸. The data shows that working conditions are more dangerous in district-related provinces than in large firm-related ones. Truly, districts-related provinces are not the most dangerous areas and the firms involved may be external to the districts but it is nonetheless striking that this kind of precariousness should occur where social cohesion is so important¹⁹.

especially in Kapp (1978). See also Elsner, Frigato, Ramazzotti (2006) and Berger, Elsner (2007).

¹⁸Deadly accidents are more difficult to conceal, so data on deaths is more reliable than data on professional injuries and diseases. It is nonetheless plausible that if firms are not willing to prevent deadly accidents, they are just as unwilling to prevent other types of damage. The data in figure 2, therefore, is the sad proxy of what is likely to be a more extended phenomenon.

¹⁹Actually, one might argue that accidents are more likely in IDs precisely because social cohesion is so strong: workers may feel so involved that they are willing to take a risk in order to achieve the firm's goals. This could be true but, much like for irregular employment, it makes sense when achievement of the firm's goals affects workers as well. Social cohesion – in the strong sense outlined above – is unlikely if workers take the risk

The data considered here has to do with the situation any worker may be in, as a worker. Let us now consider a situation a worker may look forward to, that of setting up his/her own business. Indeed, one might be willing to suffer the social costs depicted above provided they are the price to pay in order to achieve social mobility. Figure 3 shows that, in the period 1995-2005 more firms were shut down than were set up. Setting up one's own business became ever more difficult. Nor is the turnover of firms such that it provides some opportunity: figure 4 shows that inceptions as such are declining.

A final feature of IDs that deserves some attention is the emergence of formal and informal groups of firms within districts. Carone and Iacobucci (1999: 347) conclude their inquiry on Italian SME groups by stressing “the progressive ‘hierarchisation’ of inter-firm relations and the consequently increasing importance of medium-sized firms that have focused their competitive strategies on two circumstances: a progressive shift towards high quality market segments (better quality of the product); the control of the final market (through brand-centred strategies and control of distribution).”. This is somewhat consistent with the account that Dei Ottati (1996a) provides of the Prato district²⁰. However, while at the time of her essay, Dei Ottati argued that, despite these changes, the Prato district remained “more a bilateral or multilateral governance structure than a hierarchical or unified one” (ibid.: 48), Arrighetti and Traù (2006) tend to believe that a more general phenomenon is now occurring, namely “an organisational and dimensional consolidation of existing production units. In particular, this change consists of a rise in the relative weight of middle sized units, the development of ‘quasi-hierarchic’ governance patterns such as company groups, a decline in the demographic growth that for a long time characterised the emergence of the small business sector, and a stop to the deverticalisation of production at least in some dimensional classes of firms” (Arrighetti, Traù 2006: 44-5).

Owing to the lack of appropriate data, all conclusions remain tentative but these elements do suggest that the organisational convergence between small and large firms that Regini and Sabel (1989) refer to may be leading to something quite different from the IDs depicted in the first sections of this paper. Although districts never consisted of homogeneous firms, an

only because there is no alternative.

²⁰“First, the recession of the second half of the 1980s hampered the maintenance of the equilibrium between competition and cooperation in local markets, so threatening the regular functioning of the district as an organisational model. A second, more structural, reason relates to the increased need for coordination [associated to] product diversification and quality upgrading” (Dei Ottati 1996a: 47). A third reason Dei Ottati mentions is the riskiness of investment “particularly for specialized subcontractors who have little contact with increasingly variable final markets” (ibid.).

accentuated differentiation tends to be a distinctive feature in their evolution. Ferrucci and Varaldo (1993) argue that only some firms – i.e. lead firms - are able to enhance the required organisational change within districts, which suggests that a shift is occurring from the “invisible mind” of the district to “more visible minds” (Lombardi 2003a).

Let us return to the data presented above. Despite the differences between H and M, the overall decline in the turnover of district-based firms, coupled with the drop in employment, suggests that businesses are having a hard time. The decline implies that it is unlikely that unsuccessful firms can nonetheless survive through subcontracting. The data concerning irregular employment and accidents does not tell us whether these phenomena date back to the Seventies – the Golden Age of IDs – or emerged in more recent times, as a response to economic changes. Thus, it is not clear how important precariousness was to the economic vitality of IDs in the Seventies, relative to the dynamics of demand and other exogenous circumstances. The data shows, however, that firms are now pursuing competitiveness any way they can and that one of these ways is cost scrapping through employment and income precariousness, as well as through precarious working conditions.

By shifting their costs on their workers, firms socialise costs. They ultimately call upon the family to substitute the district in its role as a social buffer. This redistribution between firms and society is coupled with redistribution within the value chain. The control of the final market that Carone and Iacobucci refer to is not only an (efficient) way to manage a turbulent market: it is the means whereby lead firms may control the distribution of value added within the group and/or the network of firms they interact with (Ramazzotti 2004).

The implication is that districts may well attract migration flows but, contrary to what Becattini and Dei Ottati argue, this is no evidence of social cohesion. It only suggests that districts provide some opportunity for a living whereas other areas do not: rather than social cohesion, this is more likely to be resignation.

The data suggests that rather than taking advantage of the distinctive feature of districts - i.e. the positive interaction between the technical features of a flexible organisation of production and social cohesion - district firms are disrupting it by trying to achieve a competitiveness that undermines the quality of life of IDs, and social cohesion along with it. Truly, M districts perform better. They do not appear to make up for the decline in the H districts, however, so that the overall picture is all but reassuring. Ultimately, the relatively good performance of IDs may quite trivially reflect

the mismanagement of large firms and of industrial policy²¹.

5 What's wrong?

Three major circumstances affected the competitive environment of the Italian economy and of its IDs over time, leading to a marked change from the mid-Eighties onwards: increasing competition from less industrialised economies; technological change, especially associated to information and communication technologies; restrictive macroeconomic policies, thus a lower growth in effective demand. Roughly, three main strategies were available: restructuring, i.e. a quantitative change in capacity and costs; repositioning, i.e. a qualitative change in output; reconversion, i.e. the switch to different industries²². They were difficult to enact, however. Leaving aside the last one, which is the alternative fostered by the authors discussed in Section 2, the first two roughly correspond to what Sengenberger and Pyke (1992) refer to as the “low road” and the “high road”. “[T]he ‘low road’ to restructuring [...] consists of seeking competitiveness through low labour cost, and a deregulated labour market environment. [...] The principal alternative to such ‘destructive’ competition is the ‘high road’ of constructive competition, based on efficiency enhancement and innovation; that is, through economic gains that make wage gains and improvements in social conditions feasible, as well as safeguarding workers’ rights and providing adequate standards of social protection.” (Sengenberger and Pyke 1992: 12-13).

The outlook of the previous section is that a great many IDs are following the ‘low road’. To some extent this should not come as a surprise. The potential unsustainability of the district model when demand is not high was pointed out by Brusco (1982), who foresaw that a problem of social costs would arise²³. Brusco (1990) also stressed the difficulties associated to technological change when coordination is decentralised and learning is

²¹As Signorini and Omiccioli (2005: 20) argue, “the evidence does not suggest that industrial districts are leading Italy’s industrial decline. Whatever its causes, it is more visible outside of industrial agglomerations than within them; thus, it is associated less to the specific weakness of the districts than to the general weaknesses of the Italian system, along with the even more marked weaknesses of alternative productive organisations.”

²²Obviously, these strategies could be combined to some extent.

²³“There is only one way to avoid the dilemma of ensuring primary conditions of employment in all Emilian firms and yet preserving the flexibility of the system as a whole in a situation where demand is uncertain. To achieve such a result it would be necessary to construct a new secondary sector of firms and workers outside the region. (...) The internal contradictions of Emilia gradually become in this way external ones, which other regions have to face and resolve.” (Brusco 1982: 177).

a widespread process²⁴. These difficulties are aggravated by public policy, when it enhances cost-centred restructuring - rather than innovation-centred policies - or when, alternatively, it determines competitive devaluations. The absence of a consistent set of incentives increases uncertainty, to the detriment of long term investment. Thus, it is no wonder that short-termism has prevailed²⁵.

The “low road” basically violates the conditions for social cohesion in that it undermines both trust and confidence. It precludes an innovative process based on participation as well as the district’s function as an entrepreneurial incubator. It therefore leads the district away from the canonical model, possibly towards something similar to Porter’s (1998) notion of an industrial cluster. Under these circumstances most of the arguments against the “two persistent peculiarities” of IDs may actually appear to be relevant.

In order to properly assess the above process, let us try to understand what is going on from a broader theoretical perspective. One possible explanation is that the institutional characteristics of IDs prevent them from adapting to changing markets. Basically, the argument goes as follows. Districts consist of institutions that, together with the market, co-ordinate economic activity. Institutions, however, tend to be resilient. They take time to change, more than the market allows for²⁶. The outcome is that firms fail to innovate and to achieve the required competitiveness.

Viewed from this perspective, lead firms appear as the Schumpeterian innovators who break up consolidated views and institutional rigidity, thereby providing breakthroughs in business. The social costs pointed out above turn out to be the inevitable consequence of change, possibly requiring some compensation by local or national authorities.

In this perspective, the shift of the unit of analysis from the district as a whole to the district firm (Ferrucci, Varaldo 1993; Brioschi, Brioschi, Cainelli

²⁴ “The fact that the district has neither a head nor a hierarchical structure, makes a move towards new technology much more difficult. The district is characterised by a sort of strong, heavy inertia. It goes on learning the technology in a deep, personal and creative way, but it is very difficult to move this huge mass of people - not just the dependent workers, but the whole competence of all the people.” (Brusco 1990: 17).

²⁵ Garofoli (1999) points out, for instance, that following the devaluation of the Lira in 1992, firms did not reinvest their profit in innovative investment but transformed it into rents by progressively giving up production to smaller firms, who tended to turn from “district firms” into “outsourcing firms”. “Under the previously described circumstances the goal was not innovation or development but only short term viability and the preservation of cost competitiveness and of the lead firm’s extra-profit.” (Garofoli 1999: 397).

²⁶ The “rules of interaction are stable and inertial elements [...] and tend to persist even during phases of radical change of the external environment, to the point that they turn into factors that block the system’s innovation.” (Varaldo et al., 1998: 30-31).

2002; Biggiero, Samarra 2003) apparently reflects not only the empirical evidence about the increasing importance of lead firms but also the internal inconsistency of the district as a system and the emerging role of a new coordinating instance arising from one of the latter's sub-systems. Although the authors who follow this approach do not deny that the district is important, its importance is reduced to that of a context, an environment where externalities enhance the market-related activities of firms. Social cohesion makes (economic) sense, in this perspective, in so far as it reflects the consistency between market forces and the institutional setup.

Leaving aside the fact that, based on this approach, nothing warrants a satisfactory solution to the competitive and growth requirements of the districts - in that, in the absence of the institutional setup of a district, single firms are likely to pursue the redistribution of existing value added, at the expense of their workers and of other firms, rather than try to increase it through quality enhancing innovation - the novelty that the approach focuses on is that lead firms can afford the economies of scale in areas such as marketing, finance and R&D. We are not that far from the "dwarfness" thesis outlined in Section 2.

What is important about this approach, however, is that, implicitly drawing on North (1990), institutions are assessed in terms of their efficiency, i.e. their effect on growth. This is a reasonable criterion but when it entails that growth - or some other market-related metric - is the only objective function that institutions comply with, it denies the overall theoretical relevance of districts and of the district-based approach depicted in Sections 2 and 3. The distinctive feature of the latter is precisely that the institutional setup must ensure not only the material reproduction of a community but the reproduction of a "socio-territorial entity which is characterised by the active presence of both a community of people and a population of firms". Growth may surely be a goal to be pursued but it must not clash with other goals that emerge within that community. In so far as the above explanatory approach does not deal with this requirement, it must be considered unsatisfactory.

These considerations lead us to an alternative explanation. The reproduction of the district as a socio-territorial entity is possible so long as there is social cohesion, in the sense that the institutional setups associated to the population of firms and to the community of people are mutually consistent. The first setup includes what is functional to market performance, thus to competitiveness-enhancing and profitability-enhancing interaction. The second setup involves what affects the quality of peoples' lives: income and occupational stability; safe working conditions; social mobility; etc..

Although social cohesion tends to be self-reinforcing, the two sub-systems maintain different rationales. Whenever internal or external circumstances

change, these rationales may – at least to some extent – become inconsistent²⁷. In some instances this may disrupt the district system. This is precisely what occurs with the “low road”. It puts internal rivalry (within the firm and within the value chain) before external rivalry (between the district and other areas). It subordinates the values and institutions concerning the quality of life to the institutions affecting the market. In so doing, it generates an inconsistency between these two sets of institutions, thereby undermining the conditions for district vitality.

Contrary to the previous explanation, there is no reason to assume that the only way out of this inconsistency is to forsake those institutions that preclude a prompt adaptation to market requirements, especially because, as the data shows, there is no reason to believe that compliance with those requirements achieves employment and growth. The “low road” strategy is the consequence of an incentive structure that disregards innovation, that favours short-termism, that does not preclude cost shifting and the consequent insurgence of social costs, and that does not consider social cohesion as a priority. It is the outcome of only one out of many possible incentive structures. The alternative strategy we have been discussing - the “high road” – would reinforce the virtuous cumulative effects of the canonical model. It would require an appropriate public action, however. In the case under discussion public action would involve, among other things, the introduction and enforcement of laws in favour of safe working conditions and against irregular labour, and incentives that make precarious jobs ever more costly.

The key issue is not the specific type of intervention but the need for public action that is not merely supplementary to the decisions of the major actors involved in a district. Doubtless, measures that provide “real services” (Brusco 1992) or “collective goods” (Crouch et al., 2001), and the “provision of forums for regular exchange and debate among representatives of the various interest groups (...) in order to develop a shared understanding of local problems and to come to commonly-agreed programmes of action.” (Dei Ottati, 1996b: 62) are important. These policies allow actors to properly choose and carry out their strategies. They affect the incentive structure only up to a point, however.

In order to prevent strategies that are convenient in the short-run – and only to some actors - but not in the long-run – and not to the district as a whole - policy makers must not simply enable actors to choose their best strategies within a given scenario: they must create the appropriate sce-

²⁷Franchi and Rieser (1991), drawing on the evidence from the province of Modena, argue that this inconsistency tends to occur - independently of external circumstances such as those outlined above - as a consequence of economic behaviour in modern societies, which is based on what Weber referred to as formal rationality.

nario. In this perspective measures against economic and health precariousness would change the incentive structure in favour of a “high road” scenario, thereby changing expectations, strategies and the very frameworks for “commonly-agreed programmes of action”.

Contrary to views whereby self-organising districts provide an alternative to active welfare state intervention, part of this regulatory action would consist of measures that prevent the shifting of private costs on the community in general and especially on social groups who have no bargaining power whatsoever and would therefore have no voice in the above mentioned forums.

What this view ultimately suggests is that districts are a special type of organisation. Like all organisations, there is no self-equilibrating mechanism that ensures the solution to conflicts. As March and Simon (1958) taught us half a century ago, such solutions may require not only persuasion and bargaining but also politics, i.e. the establishment and management of appropriate power relations. When the balance between the two subsystems of a district is dubious, explicit public action may be better than “spontaneous” adjustments.

6 Conclusions

The available data suggests that social cohesion in IDs – a crucial requirement for the vitality of these socio-economic setups – is declining as a result of circumstances that include changes in aggregate demand, in technology and in international trade. Thus, the relatively positive economic performance of IDs seems to occur at the expense of their long term social and economic viability as IDs. This need not mean that they are going to disappear: they are changing into something else - possibly industrial clusters – with less stringent requirements in terms of social cohesion. The literature cited in Section 2 suggests that IDs should become similar to big business. The above discussion of ID performance suggests that this is what is probably going on, and that the consequences are not wholly satisfactory.

IDs in the light manufacturing industries tend to perform better, both in economic and social terms, than IDs that produce goods for individuals and households. This difference remains to be explained. It does suggest that differences in technology – in a broad sense - may have prevailed over common district-specific characteristics. While this may be true, the question remains whether this was inevitable or it depended on how district actors reacted to the above circumstances. Further investigations may clarify these issues but the overall picture is one where social costs are high to the point

that the fairly good performance of IDs seems to depend less on their specific characteristics than on the bad performance of large industry and big business in general. As for the latter, in the absence of a fully satisfactory account of their dismal performance, it might be worth while to investigate whether it might depend on circumstances that are similar to those depicted for IDs, namely that the “low road” dominates its manufacturing strategies, making it ever less competitive and ever more prone to financial rather than manufacturing activities.

The changes in IDs raise a few issues. First, how can we judge them? It is doubtful that the substitution of lead firms for the social and economic interaction that characterised IDs is going to prevent social costs such as unemployment, precarious working conditions and overall quality of life. Since there is a subjective component in the perception of the quality of life, it may well be true that people eventually adapt to unpleasant circumstances, at the very least because they wish to avoid the cognitive dissonance between their desires and the status quo. Such a situation is questionable, however, from a more general – i.e. community - perspective. If a community’s goal includes the well being also of people who are unable to foresee a better quality of life, then ancillary adaptation to the status quo may not be the best strategy.

Second, what can be done? If we accept the above remarks, whereby strictly economic goals should not prevail over the general goal of well being, a possible strategy may consist in pursuing policies that enhance social cohesion. Public policy is required because the choice context that private ID actors are faced with does not allow them to choose how to overcome this situation: when profit priorities prevail over social needs, firms substitute the – fairly demanding – social coordination of economic activity within the ID with the definitely less demanding coordination carried out by relative prices and the profit motive. Social needs become constraints rather than goals and the ensuing action and institutions tend to enter a path dependent process that leads IDs astray.

In this perspective, any action that, following the canonical theory of IDs, aims to increase the competitiveness of IDs and their contribution to economic growth must re-establish a balance between the requirements of the two subsystems that comprise them, i.e. the social requirements of the community of people and the market-related requirements of the population of firms. The two strategies depicted as the “high road” and the “low road” are important, from this point of view, because the former is consistent with such a goal while the “low road” does not safeguard social cohesion, thereby undermining the conditions for the social reproduction of the ID and, as a consequence, the very institutions that firms need to profitably carry out their economic activity.

Public policy cannot play a merely ancillary role, favouring appropriate choices within that path. It must change the incentive structure and the institutional and choice contexts so as to change that very path. Another way to look at the same issue is that policy makers must try to re-establish the synergy between the subsystems of IDs. When that synergy fails to occur, the alternative does not consist in some trade off between profit and social requirements: it is either a new synergy – such as some of the authors mentioned in Section 5 foresee - or *overall* decline, something that the strictly *economic* decline discussed in Section 2 is just a part of.

This leads us to a third issue. As Section 2 argues, major contributions concerning Italy's industrial structure and possible economic decline are generally based on the assumption that the social division of labour is determined by strictly technological peculiarities and relative prices. In this perspective, institutions tend to be assessed exclusively in terms of whether they are functional, and consequently are able to adapt, to the resulting market conditions. The approach followed here suggests that if the institutions that relate to the population of firms subsume the institutions that relate to the community of people, one or both of these subsystems may be negatively affected. In some instances it is a matter of value judgement whether this is desirable. In general, however, the long run viability of the economy and/or of society may be undermined, an issue that is somewhat neglected in the literature on Italy's economic decline.

It is therefore reasonable to believe that - quite independently of the relevance of economies of scale and hierarchies, as opposed to interaction and complementarities – this insight, which dates back to authors such as K. Polanyi and K.W. Kapp but is consistent with the canonical theory of IDs, should not be dismissed when discussing Italy's economic performance.

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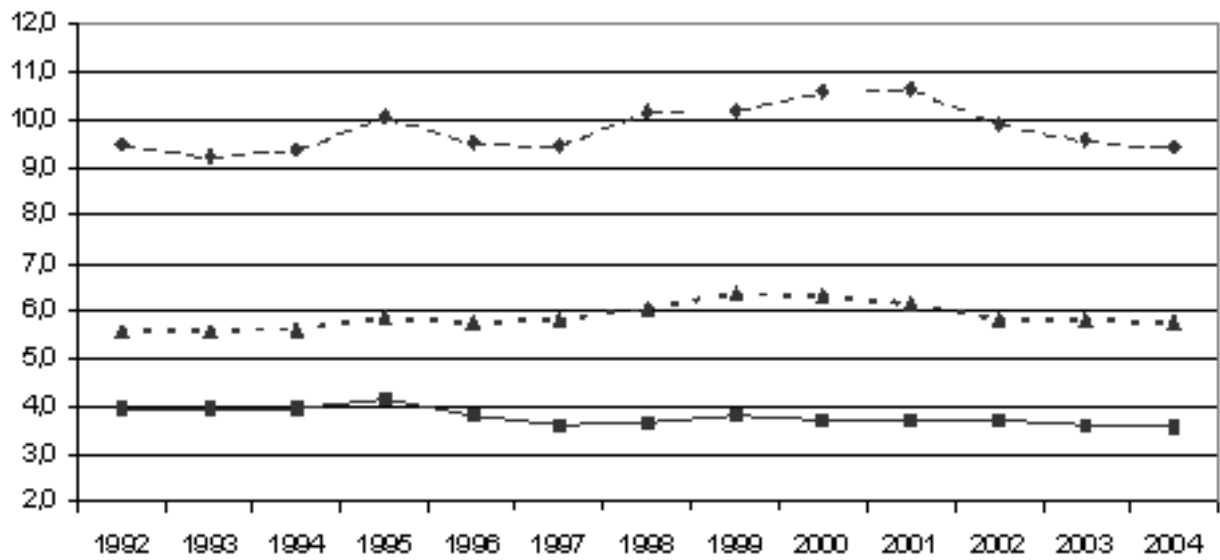
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Table 1 - GDP growth in Italy,
Source: Ciocca 2003

1953-1972		5,3
1973-1982		3,2
1983-1992		2,3
1993-2002		1,6
1993-2002	Europe	2,4
1993-2002	Germany	1,3

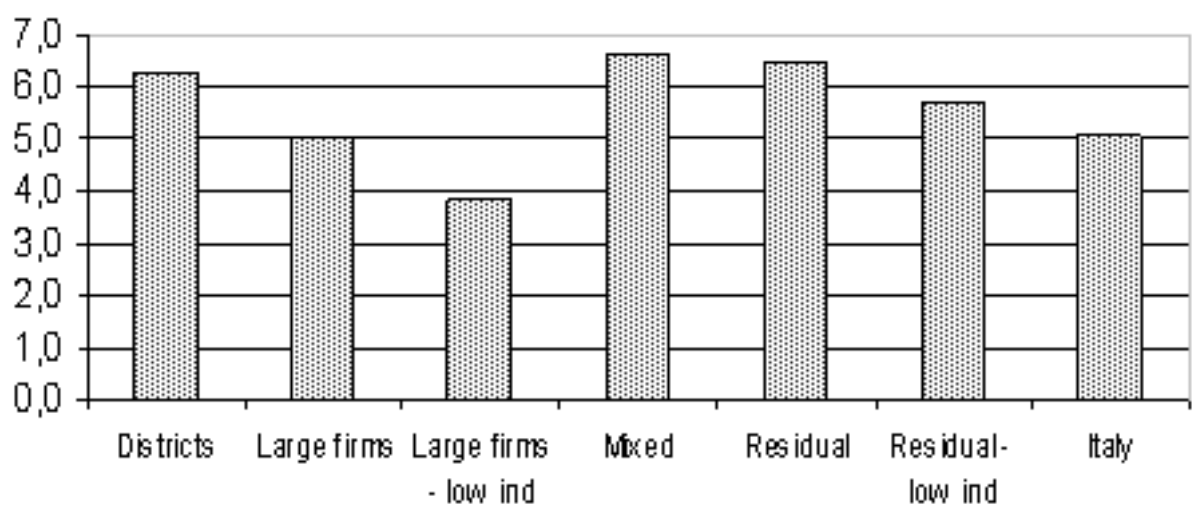
Fig.1 - Share of irregular employees - Italy



Source: ISTAT

--♦-- H —■— M -▲- Heavy Industry

Fig. 2 - Deadly accidents per 1000 workers in manufacturing and services by groups of provinces (2002)



Source: Istat; Inail

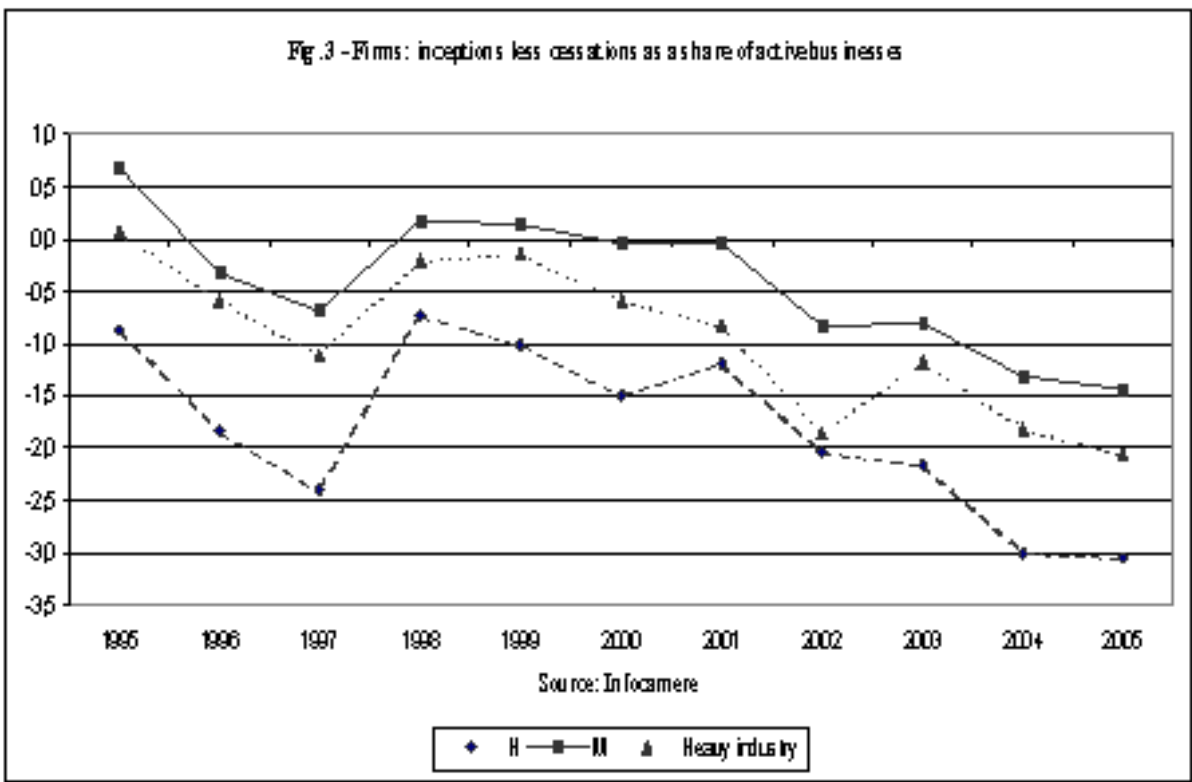


Fig. 4 - Firms : inc eptions as a share of active firms

