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### Fighting crime

## Italian business schools try to take on the Mafia

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PEOPLE who live in Calabria and Sicily have average incomes less than half of what their fellow citizens earn in Lombardy and Tyrol. Some, if not most, of that difference can probably be attributed to the pervasive crime and corruption caused by the Mafia in southern Italy. The mob is so persistent because, like all good businessmen, Sicily's Mafiosi have done a good job of tying their welfare to that of their local communities. One strategy is to operate many legal businesses with more employees than necessary, paying wages that would be hard to sustain if there were no illicit revenue streams available to supplement legal cash flows. This presents a problem for law enforcement agencies because many people generally resent what happens when these legitimate businesses are seized by the state. Today's *Financial Times* has [the story](http://www.ft.com/intl/cms/s/0/22e7e2ce-2734-11e2-abcb-00144feabdc0.html#axzz2BMjasspg) (<http://www.ft.com/intl/cms/s/0/22e7e2ce-2734-11e2-abcb-00144feabdc0.html#axzz2BMjasspg>) :

*“ It is normal for a decade to pass between when an asset of someone charged with being part of an organised crime group is confiscated and the final court verdict that passes the assets definitively to the state. Often, as with the San Paolo [a hotel], it then takes many more years before the government finds a buyer, while businesses languish or fold, leading to job losses and social unrest... The more than 1,600 confiscated businesses in Italy include construction companies, healthcare providers, mines, castles, manufacturers, villas, vineyards, hotels and supermarkets. ”*

Court-appointed administrators of forfeited businesses often have a tough time filling in for the old bosses, which is why so many firms get liquidated:

*“ Intimidation from the local crime boss and finding that the crime boss’s mistress was on the staff are just a few of the challenges Mr Turchio has faced in the 19 years since a court appointed him to manage the 283-room hotel on the edge of the Mafia-infested Brancaccio neighbourhood of Palermo, the Sicilian capital. His job has included weeding out employees still answering to the jailed crime boss and renegotiating contracts formerly made with the mafia. That Mr Turchio is still in charge of the San Paolo is an indication of the leisurely pace of Italy’s judicial system...Mafia-run businesses tend to be generous in handing out jobs locally to build consensus in the neighbourhood. Mr Turchio acknowledges that his 71 full-time employees are probably more than he needs, but only those who have been implicated in dealings with the Mafia have been dismissed...“I arrived at the door of the hotel with my briefcase and the court document showing I was in charge, and nobody here had any idea what to make of me,” he says. He was 30 when he took over in 1994, just three years after the hotel had opened. “I received some threats at the beginning, including people telling me to take my hands off their money, but on the whole I have not had any problems.” ”*

On the other hand, some have managed to do relatively well running the Mafia’s old businesses:

*“ Fifteen kilometres east in the town of Bagheria, Andrea Dara, another accountant working as a court-appointed administrator, has invested and turned the Villa Santa Teresa radiology and nuclear medicine clinic into a thriving business. This is thanks to a mortgage and a competent manager who took over as chief executive. “Not everybody appointed by the court is lucky to have a good manager so it is important to have trained managers who can come in with clear ideas,” says Mr Dara, speaking in the shade of lemon trees outside the clinic. “My manager could leave and then what do I do if there aren’t properly trained people ready to step in?” Like Mr Turchio, Mr Dara found he had too many employees when he took over. Estimating that 40 of the 120 staff were not needed for the jobs they had been hired to do, he paid for retraining, including for 11 drivers to become medical technicians. ”*

But these are isolated cases. As noted above, most of the time there are not enough good managers to run these seized firms, which leads to liquidation and job loss. Little wonder that the Mafia’s power persists in Sicily. Now, however, a group of Italian business schools are trying to provide a practical education for people interested in managing former Mafia assets without cutting jobs:

*“ A group of business schools and business associations this year launched a postgraduate course offering formal, practical training for would-be managers of ex-Mafia concerns. The course, which included visits to see Mr Turchio and the San Paolo, aims to train a cadre of experienced managers to be deployed across Italy. “We need professional managers to come in not only to keep a business from closing but to develop it so we can demonstrate that when the state takes over from the Mafia, that doesn’t mean job losses,” says Marella Caramazza, director-general of Fondazione Istud, a business school located near Milan, which is leading the course along with two other business schools, Bocconi in Milan and Luiss in Rome. “We must show that when managed legally these can be profitable businesses that bring employment to the community.”*

[...]

*"The chance to be able to contribute in some way to help these companies survive and flourish is very appealing and is why I applied," says Antonio Pardo, 49, a marketing and auditing consultant who took the course. Twelve days of classroom work, with lecturers including an anti-Mafia magistrate from the organised-crime ridden Calabria region, were combined with 30 days visiting businesses. Mr Pardo says: "We have all read how money-laundering works, but with our on-site visits and case studies we were able to see first-hand how it takes place." The students, ten of whom were female, studied the financial peculiarities of confiscated assets, such as unwinding Mafia contracts with suppliers and alternatives to the Mafia as sources of funding. "*

We wish these students well when it comes to fighting crime in Italy, but it is possible that there is a broader lesson here. The fact that managers in southern Italy are forced to waste time on these problems helps explain why that part of the country has such a comparatively low standard of living. Moreover, the legitimate firms subsidised by the Mafia have little incentive to be productive, which further lowers everyone's welfare.

Relatively recent academic evidence explains the how this process works in other places with underdeveloped legal institutions and cultural norms. In 2009, Hsieh Chang-Tai and Peter Klenow [found that \(http://www.nber.org/papers/w13290.pdf\)](http://www.nber.org/papers/w13290.pdf) a big part of the reason why China and India are so much poorer than the United States is that wildly unproductive firms are more likely to survive in those countries than in America. After running a novel experiment, Nicholas Bloom, of Stanford University [concluded \(http://www.stanford.edu/~nbloom/DMM.pdf\)](http://www.stanford.edu/~nbloom/DMM.pdf) that these firms were so unproductive because they were horribly managed (as opposed to having worse workers or inferior equipment). He speculated that the unproductive firms were able to survive because better-managed businesses were limited in their ability to expand thanks to uncooperative capital markets and, intriguingly, a dearth of trustworthy managers.

The problem is not the absence of people who know how to run businesses but the society at large. In another paper, Mr Bloom and his colleagues [argued \(http://www.stanford.edu/~nbloom/org\\_2012.pdf\)](http://www.stanford.edu/~nbloom/org_2012.pdf) that entrepreneurs in poorer countries are reluctant to trust people who are not directly related to them to manage any part of their enterprises. They are afraid that people from outside the family will steal from them

and that the judicial system will not protect them. This (not unjustified) fear limits the ability of good firms to expand. Once you run out of siblings and cousins, you can't open more factories. The result is that bad firms are not driven out of business. Conversely, countries with higher levels of "social capital," i.e., trust, generally have higher productivity and are therefore richer, precisely because good firms have more resources available to drive out the bad ones and increase the standard of living through creative destruction.

This was the inspiration behind Paul Romer's ill-fated [Charter Cities project \(http://chartercities.org/concept\)](http://chartercities.org/concept) , which ran aground in Honduras. The goal was to import the values and institutions of societies with high levels of "social capital" to poor countries in the hope that it would allow them to become richer and more productive. Ironically, the Honduran mission failed precisely because the [agency that was supposed to ensure transparency refused to allow outsiders to audit agreements made between the government and private firms \(http://marginalrevolution.com/marginalrevolution/2012/09/paul-romer-on-what-happened-in-honduras.html\)](http://marginalrevolution.com/marginalrevolution/2012/09/paul-romer-on-what-happened-in-honduras.html) . Fortunately, Calabria and Sicily are part of Italy, so there is good reason to suspect that the business schools' plan will be more successful. Still, even with this novel weapon added to the crime-fighting arsenal, I suspect that the convergence between north and south still has a long way to go.

