

# Current Account Deficit, Foreign Borrowing, and Monetary Policy: The Italian Experience

## 1. External Deficit and Foreign Exchange Management

The 'seventies witnessed a change in the structure of the Italian balance of payments. For a number of years, there had been substantial surpluses on current account, offset by heavy net capital outflows — some official, some not. This was followed by a period punctuated by considerable deficits, rendered more serious by the oil crisis. Compared with the country's earlier experience, in the 'seventies and more recently both the direction and intensity of the problems caused by the balance of payments constraint have changed (Table 1).

However, the need to ensure a new equilibrium in the allocation of real resources between home and abroad continued to be met by regulating domestic demand, more specifically through monetary policy. Increasing recourse was made to intervention measures, especially financial and short-term, which were often enriched by means of significant innovations. The particular circumstances in which the difficulties arose and the rapidity with which the crises developed, moreover, hampered the elaboration of the necessary structural solutions. And the recurrence of the crises made it more urgent to find new answers, but more unlikely that they would in fact be found.

After the 'seventies, the deterioration in the economic climate stimulated capital outflows. As it was not considered desirable to take prompt steps to raise the real yield of domestic financial assets, there was no alternative to falling back on an increasingly complex system of administrative controls. This approach, which is bound to give rise to bureaucratic drawbacks and defects, led to the transformation of the balance of payments. The autonomous components of both short- and long-term capital movements other than those linked to trade in goods, gradually became less important. Over any stretch of time, however, export credits are necessary, and they can only be dealt with by matching the

maturities of commercial credits with those of the corresponding debts or by envisaging measures to mobilize them on the international market (which was the line taken by the Ossola Law in 1977). In the short term, given the volume, at the present time, of trade in both directions (about 20,000 billion lire a month), the leads and lags between movements of goods and foreign exchange settlements have developed into a very serious potential source of instability.

TABLE 1  
BALANCE OF PAYMENTS DEFICIT AND HOW IT IS FINANCED  
(millions of dollars)

Year	Deficit net of loans	Foreign loans	Compensatory loans	Banks debts (*)	Official reserves (*)
1970	-1239	102	1493	19	- 375
1971	- 2	967	- 182	181	- 964
1972	-2182	455	452	439	836
1973	-4931	365	4128	25	413
1974	-8539	947	2047	691	4854
1975	-2307	1277	- 974	- 587	2591
1976	-1414	440	- 335	2279	- 970
1977	1940	657	- 615	4025	-6007
1978	6393	2731	- 839	- 989	-7296
1979	1039	3626	-2480	1475	-3660
1980	-14106	7138	- 409	8119	- 742
1981	-8000	10000	- 320	-1590	- 90

(\*) Including exchange rate adjustments.

When, from 1973 on, increasingly serious signs of disequilibrium were visible on the current account as well, the scope of the measures designed to restrain the demand for foreign exchange on the market was widened in order to deal with the heavy drain on official reserves. Italy kept faith with the basic decisions made in the 'fifties on trade regime and international integration; though refraining from introducing specific restrictions on trade, it continued to act on financial variables. Compulsory deposits on payments abroad amounted to direct pressure on the cost of credit and to indirect depreciation of the lira in foreign payments. The tax on purchases of foreign exchange, in turn, had the effect of directly lowering the rate of exchange in such transactions.

In addition, since it was not sufficient to restrict the demand for foreign means of payment, the necessity arose, at least temporarily, to increase the supply thereof. The shortening of the terms for settlement was supplemented, especially after 1976, by the financing of capital outflows by means of funds raised abroad through the banking system. However, it is obvious that the success of this move was largely due to favourable conditions regarding, in particular, the rates of interest and the stability of the rate of exchange.

The steps taken for the immediate defence of the reserves, however, were unable, of themselves, to restore the equilibrium on current account. Moreover, had exclusive reliance been placed on the management of the rate of exchange to adjust the balance of payments, it would not have been possible to achieve lasting results. In the Italian institutional context, characterized by rigidity in the system of relative prices, the functional relationship between rate of exchange, prices and international trade in goods seems to be that of the vicious cycle. The increase in import prices caused by devaluation reduces the volume of imports, to start with, but it sets off an increase in consumer prices, which, through the mechanisms of wage indexing, is reflected in a rise in the cost of labour per unit of output. This inflates, in nominal terms, the industrial value added and that of exports. In addition, the depreciation of the lira directly affects the prices of the goods and services sold abroad, and thus eases the constraint of international competition. According to recent estimates which incorporate the effects due to the policy of restricting demand carried out in the period in question, the inflation induced by these two means cancels a large part of the competitive edge initially acquired by the depreciation in the twelve following months, and does away with it almost completely in not more than two or three years.

Summing up, a depreciation of the lira produces an improvement in the current accounts, which disappears in a relatively short space of time. The adjustment of the rate of exchange is translated into an increase in prices and wages which, in equilibrium, is close to the rate of devaluation. These relations depend basically on the high degree of indexation of wages and prices and on the intensity and rapidity with which export prices react directly to variations in the rate of exchange.

In these circumstances, the deterioration in the external value of the lira from the start of the fluctuation till the present time has been the fruit of experiences which have matured under a new regime. Beyond the influence of the monetary situation on the rate of exchange in the different periods into which this interval can be subdivided, a basic

objective has been to maintain or re-establish, by judicious management, a structure of costs and prices in line with the evolution of these variables in the other main industrial countries. With Italy's adhesion to the EMS, the conviction has been reinforced that the rate of exchange should be used as a braking device to force the adjustment of the basic variables. If the effects of devaluation are to be less ephemeral and the reallocation of real resources is to proceed more rapidly, steps must be taken to restrict domestic demand, as is confirmed by experience in 1975 and in 1977-79 when large surpluses on current account were achieved. Since reliance had to be placed on the joint operation of these factors, adjustment was firmly pursued in the medium term, during which time the financing of the deficits had to be faced and solved. These were particularly serious following a devaluation, when perverse effects are felt on the balance on current account in terms of value.

In the first half of the 'seventies, two main types of debt were cultivated — compensatory loans and "official" ones. The former were taken up abroad by Italian agencies on the suggestion or on the initiative of the monetary authorities. They are so called because of their purpose and of the fact that the interest servicing was "compensated", i.e. it was passed on to the authorities. Between 1972 and 1974, loans of this kind were contracted for about 8 billion dollars. From the second half of 1974, this channel was no longer used, and official loans were negotiated with the EEC and IMF, the drawings of which were tied to specific commitments of economic policy, and in the framework of bilateral agreements with the Bundesbank and the Federal Reserve Bank of New York. From 1974 to 1976, the official loans received amounted to more than 8 billion dollars.

From 1977 to 1979, following a policy severely restricting demand which had made it possible to exploit effectively the competitive edge gained as a result of devaluation, there was a sharp reversal in the trend of the balance of payments. The current account registered substantial surpluses (12,000 billion lire in the three-year period). It was thus possible to implement a policy to keep down the interest burden and to reduce the medium- and long-term foreign debt to a reasonable level. Wherever it was possible to make a reimbursement before it was due and did not involve penalty clauses, officially organised debts were settled in advance. Overall, official and compensatory debts were reduced from 14 to 4 billion dollars.

From the end of 1979, there was again a deterioration on current account because of the unfavourable terms of trade resulting from the

second oil crisis, the downturn of the cycle at that point and the loss of competitiveness. The real adjustment has been taking time; balance of payments problems have again come to the fore. From the end of 1979 till 1981, private and public medium- and long-term loans were incurred for 16 billion dollars; short-term bank indebtedness increased by about 5 billion. This huge capital inflow was facilitated by the plentiful funds available on the international market, the restoration of the Italian borrowers' credit standing and the particular terms on which, after Italy's adhesion to the EMS, the EEC and EIB granted part of their loans. Another factor operating in the same direction was the extension of the exchange risk cover by the Government, which had been introduced by law some years back.

From the macroeconomic point of view, there are no important differences between official and compensatory debts, on the one hand, and private and public borrowing on the other. However, the former have the advantage, in particular, of making it possible to "sterilize" the proceeds in foreign exchange — and thus do not call for offsetting interventions — and of accelerating reimbursement when the foreign account situation improves, as was the case in 1977-79; the main disadvantages lie in the fact that the foreign exchange risk and responsibility for interest payments are borne by the monetary authorities, which reduces the incentive for the firms and the intermediaries to expand the supply to foreign countries of goods and services to repay the debt. When it comes to choosing and assessing the appropriate combination of short- and long-term foreign borrowing, account must be taken, as regards short-term debts, not only of the fact that the alternative is the direct use of official reserves, but also that the evaluation of the degree of stability of their components is crucial. Long-term debts, moreover, bring out directly the need for an appropriate schedule of maturities. At the end of 1981, net short-term bank borrowing was over 13 billion dollars. Medium and long-term borrowings, whether private or official, were around 33 billion.

## 2. Experience and Limits of Foreign Borrowing

Most of the industrial economies were faced by the sharp dilemma between immediate and deferred adjustment of external disequilibria as a result of the oil crises. The choice in favour of financing was made in

different ways and at different times by the various countries, especially if we analyze events in 1973, when recourse to borrowing was not general. Floating exchange rates seemed, at least to some, to offer a new and effective instrument of adjustment. The increase in oil prices was unexpected, but the response of the industrial economies was slow because they counted on a subsequent lasting reduction in quotations. The disequilibria on current account were concentrated in some countries. The reaction on the part of Germany and Japan was particularly swift, and took the form of an expansion of their exports.

In the second crisis, there was a widespread conviction that the real price of crude would be maintained; from the autumn of 1980, the dollar entered a period of gradual appreciation; the distribution of current disequilibria proved to be less uneven; possibilities of boosting exports were poorer because of the slower growth of the world economy.

A growing need to carry out both structural and short-term policies in the energy sector was left. The inadequacy of official reserves as a means of financing was clearly recognized. Recourse to foreign borrowing became general, even if practised with varying intensity.

There was thus a deterioration in the net debtor positions. In the EEC countries, the worsening was most visible from 1978 to 1980 in Belgium, Denmark and France. If no account is taken of official reserves, France moved from a substantial equilibrium to a net negative imbalance of about FF 30 billion. Germany, too, incurred external debts, particularly in 1980, moving from a net creditor position at the end of 1978 of DM 9 billion to a net debtor figure of 6 billion at the end of 1980.

In relation to GDP, the most heavily indebted country at the end of 1980 was Denmark (32 per cent), followed by Greece (24 per cent), Belgium and Italy (10 per cent). France is around one per cent, and Germany stands at 0.5 per cent. The United Kingdom has a creditor position of about 2 per cent of GDP.

A summary analysis of these data shows that, in general, the level of EEC countries' foreign debt seems relatively low, and certainly not such as to weaken the credit standing of the EEC area internationally or *vis-à-vis* OPEC.

There is, however, a limit, even if it is not quantifiable, to indebtedness. Some countries are nearer to it, and others less so. There is no doubt, however, that the rapidity with which that limit is reached does not depend only on the speed at which the country's financial

position deteriorates, but also on the economic policies followed within the country and by the evolution of the international variables not controlled by each of the national governments. The various aspects of borrowing policy can be more thoroughly analyzed in terms of individual countries' experiences, but certain factors can be reduced to a common denominator.

When the effects of destabilizing influences from abroad are superimposed on a preexisting or resultant disequilibrium, the need for a fundamental adjustment cannot long be ignored. To finance the external deficits by loans means running the self-deceptive risk that it is possible to eliminate a requirement which in fact can only be delayed.

Even if practised for a short time, recourse to foreign borrowing calls for the adoption of a clearly defined policy. In the first place, the programmes for incurring and repaying debts must be in line with forecasts of the multi-year evolution of current accounts, which is a highly risky undertaking owing to the difficulties of making a reliable estimate of the main exogenous variables.

The frame of reference becomes more complicated when a large part of the exports to non-industrial countries is financed by credit. This long tradition, which is determined by international competition and sanctioned by agreements such as the OECD "consensus", involves constraints on the exporting countries in the form of creditor interest and of maturities. Important aspects of this process are consistency between the rates of interest applied to credits and debts; the equilibrium between the maturities of the assets and those of the liabilities; and the different nature of the credits and the debts.

The contraction of liabilities with foreign countries, moreover, usually involves foreign exchange risks. Only the few economies in a position to run into debt in their own currency can remain immune from them.

Lastly, in borrowing abroad, especially through private channels, all countries must define the limits within which such borrowing is compatible with their monetary policy. Since the amount of credit is directly influenced by the inflow of capital, the solutions are to be sought through direct controls or by techniques which sterilize the domestic currency equivalent of the loans. There is a second difficulty — as regards the rates of interest. This is more serious where the loans are in foreign currency and the monetary policy is not anchored to aggregates.

### 3. Monetary Policy and External Financing

In a context characterized by recurring destabilizing influences, monetary policy, designed to recover the equilibrium in the markets of factors, products, currency and foreign exchange, is faced with the alternative of defining its intermediate objectives in terms of interest rates or credit aggregates. On very restrictive hypotheses, theoretical analysis shows a preference for the second solution, when the factors making for instability mainly influence the real sector of the economy. And the disequilibria which arose in the 'seventies originated in the markets for basic products, energy, and labour.

Particularly because of the disappearance of fixed rates of exchange, and, at least in the case of the United States, because of the need to secure acceptance of high and variable rates of interest as a result of the market's behaviour, the authorities of the main industrial countries have taken the line of controlling monetary or credit aggregates. In Italy, the stabilization of the interest rates was suspended in the course of 1974 in view of the dramatic deterioration in the terms of trade, the acceleration of inflation, and the deficit on foreign account as a result of the oil crisis.

In an economy structurally open to international trade, the maintenance of external equilibrium is a major objective of the monetary authorities. In the short term, this may be pursued by recourse to capital inflows from abroad induced by market conditions or organized by the authorities. Over a longer stretch of time, however, an industrial country cannot but try to balance its foreign trade in goods and services. International loans, by easing the constraint and strengthening domestic demand, can postpone the adjustment beyond acceptable limits.

The preference on the part of the authorities, in the different historical situations, for a given velocity in the process of real reequilibrium is reflected in the choice of those intermediate objectives of monetary policy which can be defined in terms of quantity.

A first alternative consists in picking out the stock of money or the domestic credit with a monetary counterpart (the "domestic credit expansion" of the IMF) offered by the central bank and by commercial banks to the Treasury and to the other national sectors who are the final users of the resources. A deficit in the balance of payments can result in high rates of growth of credit coexisting with a moderate expansion in the amount of money. With a credit target, an unexpected and undesired worsening of the foreign account position is corrected by a

reduction in the growth of money which that very deterioration brings about. This choice therefore reflects a specific preoccupation with external equilibrium.

That reequilibrium, it should be added, can be referred, in the more general sense, to the exchange market, or, with particular attention to a real process of adjustment, to the current account in the balance of payments. In the latter case, it is better to define an aggregate larger than the one represented by domestic credit alone (with money counterparts) and extended to include loans made by non-banking intermediaries or granted directly by savers to the final users of the funds. The relation between flows of credit and expenditure becomes more direct and stable, and external effects are concentrated on trade in goods and services rather than on movements of capital.

From 1974 on, the intermediate objectives of Italian monetary policy were defined in terms of total domestic credit expansion (known in Italian as CTI). This aggregate, as is well known, is considerably greater than that of bank loans, but differs from the total finance granted to domestic users of resources because it excludes not only issues of shares and other minor items, but also credits made directly available by foreign lenders to these users.

Given the borrowing requirement of the public sector, it is possible, by controlling the total flows of funds to the economy, to exert a direct influence on expenditure flows of business and households. The velocity and precision of impact will depend on the initial liquidity situation of firms and on their ability to finance their needs, as well as on the possibility of households to increase the liquid component in their portfolio.

The need to redress a structural disequilibrium in foreign accounts was therefore fully reflected in the objectives of monetary policy. If moves to control monetary flows were designed exclusively to absorb the deficit on current account, the credit aggregate subject to control would also have to include external funds obtained directly by business and by the public sector. It is therefore necessary, in fixing the desired expansion of the CTI (total domestic credit), to take account of the capital flows caused by the rise in interest rates resulting from the credit squeeze. The more strongly capital movements react to the state of the credit market, whether at home or abroad, the more confidently may it be expected that the effects of the altered availability of finance and of the adjustment of the portfolio will have a rapid impact on movements of funds.

The choice in 1974 of a credit aggregate, such as the CTI, which excluded direct foreign loans, reflected a willingness to agree to a partial offsetting of the credit squeeze by means of capital inflows to finance the oil deficit. In addition, the concern with checking the loss of official reserves suggested measures specifically designed to stimulate inflows of capital from abroad such as the introduction of compulsory deposits on imports.

The alternative of extending controls to the whole of credit flows may be rejected, and was in fact turned down at that time, for three reasons. In an economy already practising indexation and with serious inflation, the rate of exchange cannot in the short run fall below certain limits without the cost-price spiral getting dangerously under way. In addition, the restriction of capital inflows from abroad risks hampering, in the short and also long term, foreign trade in goods. The repercussions would be particularly negative for a country whose economic growth has always been assisted, and in more than one phase led, by exports. Lastly, although the forecasting techniques of macroeconomics have improved, the "dosage" and the timing of the instruments and of the objectives of economic policy cannot be established in accordance with methods approximating to a deterministic model. It is therefore prudent, especially when a credit squeeze is in force, to retain some degrees of freedom, thus allowing the system to correct any errors from overshooting. These errors may prove to be specially serious in an economy characterized, as in the case of Italy, by a high and increasing dispersion around the mean of the conditions of profitability, liquidity and indebtedness — to sum up, of the financial structures — in the productive sectors and among economic agents. Recessive processes of a cumulative nature, which are always possible, then become more probable.

Even with these reservations, the reequilibrium of the balance on current account constituted the main preoccupation of monetary policy in the first oil crisis. The limits set to the expansion of the CTI were respected *inter alia* because restrictions on the inflow of bank capital from abroad were imposed. In addition, the counterpart in lire of the compensatory loans organized by the authorities was sterilized by the central bank. Between the second quarter of 1974 and the first one of 1975, the rate of growth of total domestic credit was not higher than 16 per cent, and thus remained over two points below the limit agreed with the IMF. As a proportion of GDP the CTI fell to 17.5 per cent in 1974 — almost six points less than in the previous year.

In 1976 when the restrictions were introduced because of serious disequilibria in the public finances which arose in 1975, the relation between monetary policy and that regarding the foreign debt was for various reasons different, and the equilibrium in the foreign exchange market assumed relatively greater importance. The main reason for this was the fact that the policy of financial redressment, and hence of real adjustment, was assisted to a significant extent by fiscal and budgetary moves. In addition, the higher degree of indexation in the economy made it even more advisable to avoid a sharp depreciation of the rate of exchange which might have revived inflationary tensions.

The more exacting indexation mechanisms arising from the 1975 agreement between employers and workers rendered the economy much more vulnerable to destabilizing influences stemming from abroad. The mechanism for adjusting the differentials in inflation between Italy and other countries through the rate of exchange was more difficult to operate in the new institutional context, in which the gains in competitiveness from the depreciation of the lira were cancelled sooner than in the past by the race between wages and domestic prices. While a substantial depreciation of the lira was accepted in the first months of 1976, since then an attempt has been made to exert an influence restraining the growth of domestic inflation through foreign exchange policy.

The move restricting the CTI led to inflows of funds which were further stimulated by the introduction, for the second time, of the compulsory deposit on purchases of foreign exchange. Within the credit aggregate subject to control, a change in the composition between lira and foreign exchange loans was brought about by exempting the latter from upper limits. In relation to GDP, total domestic credit fell between 1975 and 1976 from 25 to 21 per cent, and there was a further fall — of over two points — the following year.

The first part of the most recent period of restrictive monetary policy is also marked by an extensive substitution between lira and foreign exchange credits. In 1980, the sharp increase in bank loans in foreign currency and in direct loans from abroad to business and to the public sector made it possible to avoid drawing on official reserves despite the high current deficit, while helping to buttress domestic demand.

This policy of offsetting the current deficit enabled the authorities to keep the rate of the lira stable in the EMS and to limit the effects of the monetary restriction on investment. In 1981, after the imposition of

the upper limit on loans in foreign exchange for imports and the reintroduction of the non-interest bearing deposit on payments abroad, the channels for the inflow of funds from outside changed, and bank loans were replaced by medium- or long-term loans and commercial credits.

In this phase of restrictive monetary policy, not only was recourse mainly had to instruments making possible the indirect control of credit flows through the influence exerted on the relative yields of financial assets, but also there were major developments in credit market structures. These factors have certainly helped to increase the mobility of capital into Italy. At least in certain periods, another factor operating in this sense was the relative stability of the rates of exchange in the EMS.

The experience accumulated during these years shows that the use of an intermediate objective formulated in terms of CTI did not hinder the adoption of a flexible regulation of flows of capital into Italy depending on the degree of rigidity attached to the external constraint (Fig. 1).

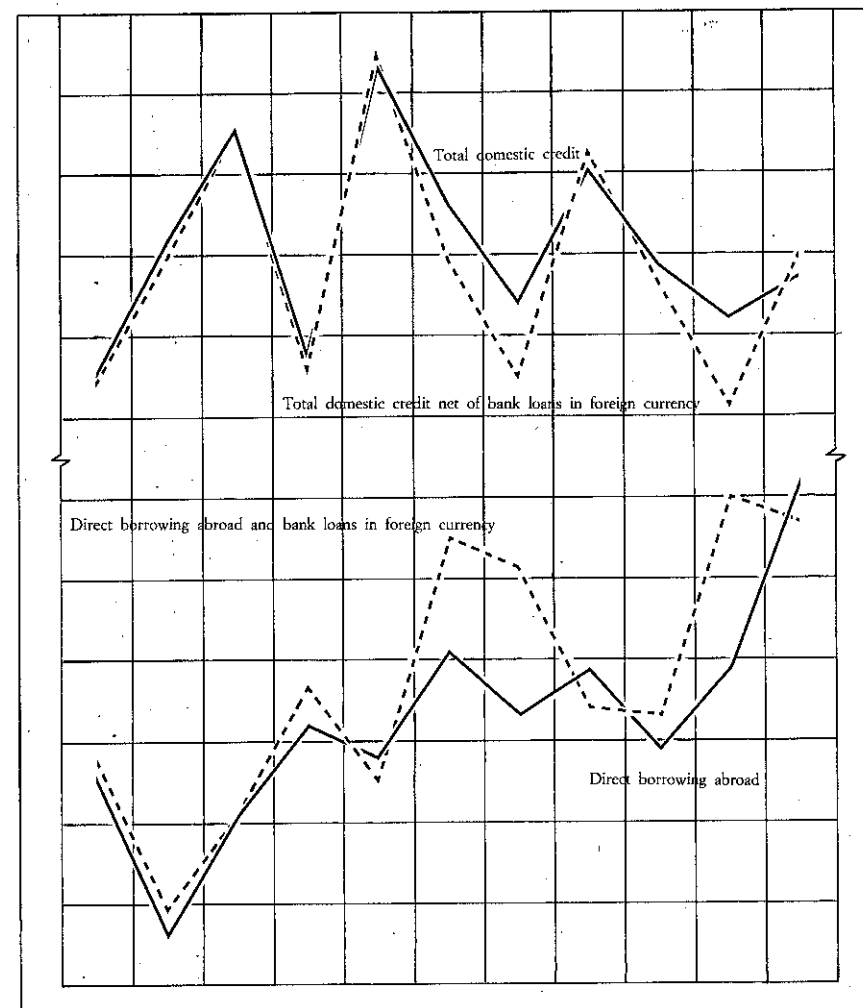
This has naturally led to fairly stringent limits on the total supply of credit through the fixing of the maximum permissible expansion of the CTI. Most important point of all, in certain periods there has been a modification of the composition of the latter aggregate, which, however, has remained a fundamental point of reference for action by the authorities.

An assessment of the degree of restriction exerted by domestic credit — thus defined — on the real variables must necessarily take account of the evolution of the economy's other sources of finance. This is true, not only with reference to business, but also to the public sector. In recent years, Government agencies and nationalized undertakings have had recourse on an extensive scale to the international market to cover a large part of their financial requirement. This borrowing, like that by firms, is not included in the credit aggregate subject to control; apart from the positive effect on foreign exchange reserves, it, too, has, however, had the effect of avoiding the contraction of financial assets in lire resulting from the deficit on current account.

#### 4. Management of Foreign Borrowing

Of the major industrial countries, Italy is the one which, in recent years, has shown the greatest relative and absolute worsening in its net debtor position, always excluding official reserves. An increasingly press-

FIGURE 1

TOTAL DOMESTIC CREDIT AND FOREIGN BORROWING  
(ratios to GDP)

ing need has been felt to chart and implement a foreign debt policy. The problems involved in carrying out monetary policy, especially as regards the intermediate objectives defined in terms of monetary and credit aggregates, have emerged more clearly, as well as those stemming from

the relation between benefits and burdens from foreign assets and liabilities, their distribution between the resident operators, and the country's international credit standing and financial autonomy. The latter aspect acquires special importance in an international context which sees the economic weapon being brandished more and more frequently in the diplomatic battle.

In the past, theories of foreign borrowing have been constructed exclusively to fit developing countries; moreover, no model applicable to industrial countries seems to be available as a basis for suggesting solutions and, in particular, no operational method for dealing with a particularly complex subject. The experience of the next few years will offer greater elements of analysis and interpretation, but some important points can be identified even at this stage. The massive incurrence of foreign loans stems from the aggravation of the external disequilibrium. The first objective of a policy as regards borrowing is the financing of the balance of payments and the defence of the rate of exchange. For better or for worse, foreign loans leave a greater margin of time for manoeuvre in economic policy making when official reserves are insufficient or it is not advisable to draw on them.

It is crucial to determine *ex ante* the current deficit which can be sustained in the medium term and to identify the limit for the level of net indebtedness. While there is a close connection between the economic policy and that of foreign borrowing, the latter stretches of necessity over the medium term and aims at achieving financial and multi-currency equilibrium. An important part of the debt policy, therefore, concerns its time and currency structure and the repercussions of debt servicing on the balance of payments in future years.

At the end of 1981, Italy's medium- and long-term debts were equal to 33 billion dollars; the reimbursement of these debts, as shown in the amortization plans, will involve a burden of about three billion a year until 1984, and about four billion in the subsequent triennium. The real burden will obviously depend on the evolution of rates on the international market; the prevailing practice in recent years of incurring loans with variable rates has introduced a direct link between the rate of interest and current accounts, which, thus, in periods of tension are overburdened to a significant degree. Moreover, the fixed-rate segment of markets for long-term operations exposes the borrower to excessive costs if and when there is a lasting drop in rates, unless it is possible to insure against this risk by inserting appropriate clauses providing for advance reimbursement.

The regulation of maturities is extremely important and can be efficiently carried out not only by avoiding dangerous concentrations, but also by seeking a kind of matching with the maturities of loans. Equally effective steps on the contrary do not seem possible as regards the choice of currency in which the loans are denominated (at present, the proportion of dollar debts is about three quarters, while, on the credit side, the figure is considerably lower), and, what is most important, as regards the choice between fixed and variable rates, given the characteristics of the international market and the relative size of the Italian demand.

In the joint consideration of assets and liabilities it is essential to take account of the high proportion among the former of loans at subsidized rates of interest designed to encourage exports, especially to economies other than industrial or market ones. They invert the sign of the spread between interest paid and that received; the normal logic prevailing in intermediation and transformation of maturities, which an advanced economy as a whole can carry out, is reversed. By involving forms of rationing, they act, moreover, in the sense of further increasing the rôle of administrative decisions in foreign trade relations.

The minimization of the total cost of operations is the major objective of individual operators, but the actual possibility of achieving it depends to an extensive degree on the credit standing of the country as a whole. It is therefore also an objective of borrowing policy to avoid the emergence of a risk which would lump all the residents together and which would certainly arise if unlimited recourse was had to borrowing.

A selective approach in this case is all the more necessary, the more an indiscriminate resort to foreign borrowing runs the risk of frustrating the achievement of the objectives of monetary policy and foreign exchange stability. On the domestic market, these choices are realized through credit intermediaries. An analogous solution is not practicable in the case of foreign loans. Moreover, that approach could only be applied directly, at the level of the operators.

This can be implemented by determining the quantities or setting an upper limit to the spreads and/or the total cost. The second method implies smaller distortions, and perhaps offers the best way to resolve the conflict between microeconomic and macroeconomic objectives. From an operational point of view, there would, however, be no lack of problems. It would not be possible to fix the same conditions for any loan taker. However, different intervals could be set for different categories of potential borrowers, and these would vary over time.



The implementation of a borrowing policy might in the last resort call for a heavy-handed use of administrative authorization; *vice versa*, it is advisable for it to be carried out more effectively, in accordance with guidelines devised as informally as possible with the operators, and leaving to the control mechanism the usual function of giving its seal of approval to a bureaucratic procedure. Orderly recourse to international markets presupposes that demand will be sifted before it becomes visible to the aggressive international bankers and that it should not give rise, in the necessary search for the best terms as between the different offers, to the impression that the volume of resources demanded is a multiple of the real one.

The management of a mechanism for the coordination of recourse to foreign markets in the present context presupposes that it will not turn into an instrument for the selection of investment projects and of the most suitable firms to carry them out. In that case, there would be an increase in the risks of a clash with non-credit instruments, through which, one must add, it is preferable, for reasons of efficiency, that policies for the allocation of resources be carried out. Relations with borrowers would certainly become more cumbersome, and their willingness to collaborate, especially by supplying information, might suffer. Lastly, the international markets' reaction to an obviously interventionist mechanism might be somewhat negative.

The capitalization and profitability of business firms who wish to obtain foreign loans is, however, very relevant for determining the overall credit standing of the country. In particular, the international banking community shows a tendency — guarantees being equal — to prefer applications from borrowers who offer the greatest propensity to allocate their funds to productive activity and investment.

Moreover, large scale operations influence the attitude of the international financial community to a specific country, with possible repercussions on the terms applicable to takers of funds on a smaller scale. It is therefore essential to ensure the greatest degree of coincidence between big clients and prime borrowers on international markets. Direct participation in the coordination mechanism, at present restricted to public agencies and to state holding companies, as well as to the larger special credit institutions, might usefully be extended to the larger private concerns interested in keeping down the medium-term cost of their foreign indebtedness. Medium and small firms are showing a more pronounced preference for foreign credit, partly because in Italy smaller lire loans are again subject to upper limits. This type of concern

ought to be very careful in its recourse to international markets, and always be aware that a phase of experimentation, of learning by doing, is necessary if negative occurrences are to be avoided in what is for them a new type of experience.

Rather than with the size of the loan or the desirability of recourse on the part of each borrower, the coordination guidelines may usefully deal with the timing of the loan. This problem should be viewed in flexible perspective, avoiding a strict queuing mechanism or rigid time tables, and permitting most, potential borrowers to obtain satisfaction, at worst on a proportionate basis, in a specific period. Less elastic models would involve the risk of causing unjustifiable distributive effects, partly as a result of the high degree of variability of conditions in the foreign markets caused by the fluctuations in interest rates in the main countries and in the rate of the dollar. Hence, the general clear market clause can appropriately be granted only in those cases where the amount of the loan is so high as to make it improbable that the loan would be placed if other Italian borrowers were at the same time to make further demands on the market. *Vice versa*, recourse to the partial clear market clause would be left to the autonomous decision of each issuer.

The forecast for 1982 suggests a reduction of the deficit on current account in the balance of payments. This is matched by recourse to foreign borrowing on a fairly large scale. The international market shows a moderate but clear trend: the terms for loans are becoming stiffer. Synthetic indicators of the different countries' credit standing, which are circulated by specialized publications, show changes in the relative positions, including that of Italy. A coordination of access to the market on the lines described, therefore, seems particularly desirable. This could help to safeguard the external equilibrium and to remove some of the causes of the slow but gradual accentuation of the burdens on Italian borrowers, i.e. those stemming from the excessive size and the imperfectly coordinated flow of Italian paper on the international financial markets.

We have gone over the whole stormy evolution of current accounts in the Italian balance of payments and the ways and timing by which equilibrium has been, or is in the course of being, restored. The international comparison does not find us alone in the effort to finance a process of readjustment, but only more seriously exposed because of the relative size of the debt and the concentration of the foreign exchange risk. The objective of effecting this readjustment, which must be

tackled, has been pursued thanks to the combined operation of the depreciation of the currency on the exchange market and the restriction of demand. In this latter respect monetary tightness has played a predominant rôle. The concern for external equilibrium has been fully backed by monetary policy, not only in its aims, but also in its enforcement, although emphasis has from time to time been placed on the equilibrium of the current account or on that of the foreign exchange market. The degree of freedom ensured by foreign loans is crucial in this perspective. If maximum freedom were granted, the ultimate objective of reequilibrium between home and abroad and the intermediate objectives of monetary policy would be nullified. Not only so, but today's difficulties would be offloaded on tomorrow's balance of payments. Above all, there would still be even greater delay in the more general process of reallocating resources called for, not only by the altered relative scarcities but also by the swelling public deficit. It is not for the international financial market to reconcile the contradictions of Italian society.

*Roma*

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