# The Labour Market and Inflation in Transitional Growth: Lessons from the Italian Experience *

## 1. Introduction

On the whole, the Italian economy in the last thirty years has shown a considerable growth. In the last decade, however, as table 1 shows, the rate of growth has fallen markedly and the rate of inflation has leapt from 3.5 per cent in 1961 to 1969 to a peak of more than 20 per cent in 1980.

The slide into 'stagflation' has been accelerated, especially since 1973, by international factors such as the oil crisis and the restrictive policies adopted by the main industrial countries to keep within bounds their balance of payments deficit.

However, the fact that Italian inflation started a few years earlier (and has remained markedly higher since 1969) than in most of the main industrial countries, suggests that there are also endogenous factors at the root of the crisis.

The main purpose of this paper is to show how in countries developing later, such as Italy, that have chosen an export-led growth strategy and have therefore opened their economies to the international market and to international influences, the growth process is likely to be sped up in the initial stage, when the imitation of international technologies allows the increase in labour productivity to counterbalance the rise in money wages. But later on, as the stage of 'unlimited supply of labour' comes to an end, and the imitation of international wage levels spreads, increasing inflationary tendencies appear. At the same time, the imitation of the welfare systems built up by richer neighbours inflates government expenditures and deficits, thus lowering the national propensity to save and the 'warranted' rate of growth.

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TABLE 1

RATES OF CHANGE IN REAL GDP AND IN THE DEFLATORS OF GDP. EXPORTS AND IMPORTS - ITALY: 1951-1980 *

| Years | Real GDP | | GDP Deflator | | Export Deflator | | Import Deflator | |
|---|---|---|---|---|---|---|---|---|
| 1952 | 4.5 | | 3.2 | | −6.3 | | −2.1 | |
| 53 | 7.5 | | 2.8 | | −5.2 | | −6.9 | |
| 54 | 3.6 | | 2.8 | | −0.5 | | −3.7 | |
| 55 | 6.7 | | 3.4 | | 1.3 | | 1.7 | |
| 56 | 4.7 | | 3.9 | | −0.4 | | 2.9 | |
| 57 | 5.4 | | 2.0 | | −0.5 | | 5.2 | |
| 58 | 4.9 | | 2.3 | | −9.1 | | −2.1 | |
| 59 | 6.6 | | −0.2 | | −6.3 | | −6.0 | |
| 60 | 6.3 | | 2.0 | | 2.6 | | −0.2 | |
| 61 * | 8.3 | 8.2 | 2.7 | 2.8 | −1.5 | − 1.8 | −2.1 | − 2.3 |
| 62 | | 6.2 | | 5.7 | | 0.2 | | 0.2 |
| 63 | | 5.6 | | 8.4 | | 2.8 | | 1.7 |
| 64 | | 2.8 | | 6.5 | | 3.2 | | 3.5 |
| 65 | | 3.3 | | 4.2 | | − 0.9 | | 0.5 |
| 66 | | 6.0 | | 2.3 | | — | | 1.7 |
| 67 | | 7.2 | | 2.8 | | 1.2 | | 0.6 |
| 68 | | 6.5 | | 1.7 | | 0.1 | | 0.5 |
| 69 | | 6.1 | | 4.1 | | 2.7 | | 1.3 |
| 70 | | 5.3 | | 6.8 | | 6.2 | | 3.5 |
| 71 | | 1.6 | | 7.2 | | 4.1 | | 5.2 |
| 72 | | 3.2 | | 6.3 | | 2.3 | | 3.7 |
| 73 | | 7.0 | | 11.6 | | 15.6 | | 26.3 |
| 74 | | 4.1 | | 18.5 | | 36.6 | | 57.2 |
| 75 | | −3.6 | | 17.5 | | 10.9 | | 6.0 |
| 76 | | 5.9 | | 18.0 | | 20.5 | | 24.0 |
| 77 | | 1.9 | | 19.1 | | 19.2 | | 16.9 |
| 78 | | 2.7 | | 14.0 | | 7.7 | | 4.5 |
| 79 | | 4.9 | | 15.9 | | 15.9 | | 17.5 |
| 80 | | 3.9 | | 20.8 | | 17.9 | | 22.1 |
| 81 | | −0.2 | | 17.6 | | 20.5 | | 27.8 |
| | | | Average annual rates of change | | | | | |
| 51-61 | | 5.8 | | 2.5 | | − 2.7 | | − 2.4 |
| 61-69 | | 5.5 | | 3.5 | | 0.9 | | 1.0 |
| 69-79 | | 3.3 | | 13.3 | | 13.5 | | 15.4 |
| 80-81 | | 1.8 | | 19.2 | | 19.2 | | 25.0 |

* The data before 1961 are drawn from the old series of National Accounts. See: FAZIO A., "Inflazione e indicizzazione delle retribuzioni in Italia", *Moneta e Credito*, March 1981.



The argument here outlined will be developed as follows. Section II sets out a simple model of inflation in an early developed economy: that is, one in which the basic industrialization process has already taken place, and there are no large and structural productivity differences among firms of different sizes, sectors and regions. In Sections III and IV, the model is modified in order to take account of the specific situation of late developing countries, where a modern sector typically grows by taking away labour (and other productive factors) from the traditional, less productive activities.[1] Section V introduces the international wage demonstration effect, while Sections VI and VII deal with the 'welfare' demonstration effect and its negative influence on the 'warranted' rate of growth.

## 2. Unemployment and Inflation in Industrial Countries: a Basic Framework

The simple two-equation model set out below may be regarded as a fairly general explanation (an explanation, that is, which is consistent with a variety of theoretical viewpoints) of the inflationary process in a closed, earlier developed economy (as defined in the previous section [2]):

$$w_t = a - bU_t + cp_{t-1} \qquad (1)$$

$$p_t = w_t - q_t \qquad (2)$$

hence

$$p_t + (a - q_t) - bU_t + cp_{t-1} \qquad (3)$$

$w_t$, $p_t$ and $q_t$ denote the rates of change in time t of money wages, prices and labour productivity, respectively; $U_t$ denotes the rate of unemployment, and represents the market pressure on money wages. The role of

[1] The problem of economic dualism in Italy has been dealt with in several articles published by this *Review*. See, in particular, V. LUTZ "The Growth Process in a Dual Economic System", September 1956; L. SPAVENTA "Dualism in Economic Growth", December 1959; and, more recently, G. FUÀ "Lagged Development and Economic Dualism", June 1978, and P. ALESSANDRINI "Lagged development and Structural Imbalances: the Relative Position of Italy", June 1979.

[2] See also FUÀ G., *Lo sviluppo economico in Italia: storia dell'economia italiana negli ultimi cento anni*, Milano, F. Angeli, 1981, vol. 1, ch. 1.

price expectations, on the one hand, and of sliding scales, on the other, is taken up by the lagged change in actual prices, $p_{t-1}$; the parameter c reflects the extent of wage adjustment to recent inflation rates. Three main cases may be distinguished in this regard.

a) *'Money illusion' and the Phillips curve*

If workers are assumed to be subject to perfect money illusion, that is, if $c = 0$, then

$$p_t = (a - q_t) - bU_t \quad ;$$

$$\text{therefore} \quad p_t > 0 \quad \text{if} \quad U_t < \frac{a - q_t}{b} \quad . \qquad (3.a)$$

Equation (3.a) may be regarded as a linear approximation of the Phillips curve, provided the following two constraints are imposed on it: $p_t \geq p_{min} \geq 0$ and $U_t \geq U_{min} > 0$.

b) *'Real wage resistance' and the 'natural rate' hypothesis*

If on the contrary perfect 'real wage resistance' is assumed, that is, if $c = 1$, then equation (3) becomes:

$$p_t / p_{t-1} = (a - q_t) - bU_t \quad ; \qquad (3.b)$$

therefore

$$p_t > p_{t-1} \text{ if } U_t < \frac{a - q_t}{b} \quad .$$

In other words, if unemployment drops below some critical value (the 'natural rate of unemployment') the rate of inflation not only becomes positive, but tends also to accelerate. As can be noticed, the 'natural rate' is in any case inversely related to the rate of productivity change.

c) *The intermediate case*

Unless workers' behaviour is characterized either by perfect 'money illusion' or by perfect 'real wage resistance', that is, if $0 < c < 1$, then each value of $U_t$ generates a given equilibrium rate of inflation:

$$p = p_t = p_{t-1} = \frac{(a - q_t) - bU_t}{1 - c} \qquad (3.c)$$

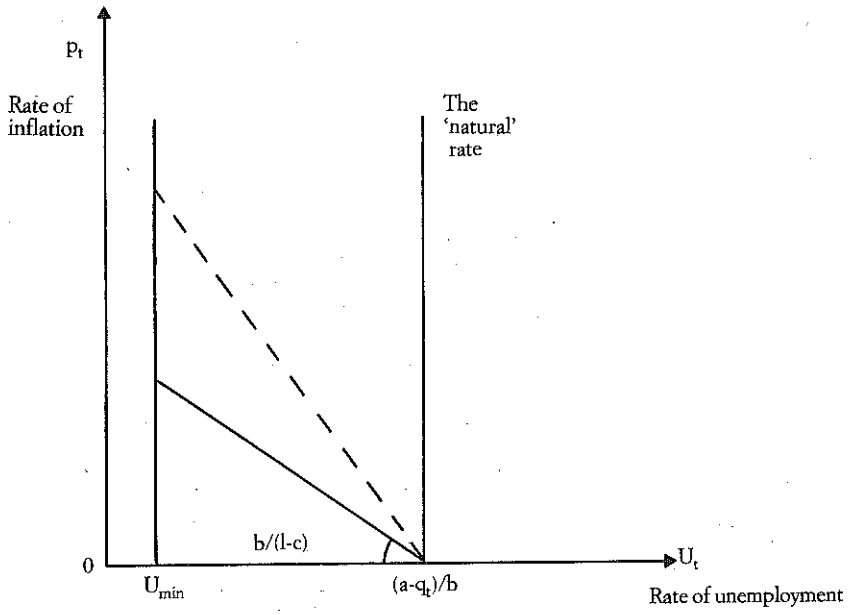


It can be noticed that the rate of inflation resulting from equation (3.c), on the one hand is 1/(1-c) times greater than the rate resulting from the simple Phillips hypothesis (3.a), but on the other hand is an equilibrium rate [as opposed to the accelerating rate resulting from eq. 3.b when $U_t < (a - q_t)/b$].

It is then clear that the parameter c plays a crucial role in the inflationary process. In this regard, the experience of Italy in recent years, and of many other countries as well, suggests that c is likely to become an increasing function of both the rate and the duration of inflation.[3] In other words, in prolonged inflationary periods, people's expectations about the future rate of inflation become more and more elastic, sliding scales and other indexation systems are introduced or reinforced, and the Phillips curve begins to rotate northeastwards, as in fig. 1, thus increasing the rate of inflation for any given rate of unemployment. The 'natural rate' situation (the rightward vertical line in fig. 1) may be regarded as the final

FIGURE 1

UNEMPLOYMENT AND INFLATION




[3] LAHIRI, F. (1976), "Inflationary expectations: their formation and interest rate effects", *American Economic Review* (March), provides a useful summary of the evidence on expectations in several countries.

stage of this process of increasing inflationary expectations: a stage that the Italian economy has been dangerously approaching in the last few years.

## 3. The 'Industrial Reserve Army' and Inflation in Transitional Growth

In 'Late-developing countries' (abbreviated to: Late DCs) a meaningful relationship between the rate of inflation (or the percentage change in money wages) and unemployment statistics is seldom found, or at least is more difficult to find than in 'Earlier-developed countries' (Earlier DCs). The main reason is the one outlined in the Introduction and is well-known.

In the countries that succeed with a certain historical delay in taking off into sustained growth, there are at the beginning, almost by definition, very few firms able to produce 'modern' goods and to make use of 'modern' techniques.

A relatively small modern sector with a high productivity level will, therefore, long coexist with a traditional low-productivity sector that can be identified by and large with agriculture, handicrafts and traditional services. This productivity dualism, in its turn, is at the origin of large wage and income differentials between the two sectors.

As the modern sector develops, it can draw the labour needed from the 'reserve army' of the traditional sectors: the first ones to move from rural areas to urban employment are probably those workers whose productivity is either zero (the so-called 'disguised unemployment') or very low (the so-called 'marginal workers'). In this stage, therefore, the unemployment statistics are a very poor indicator of the tightness of the labour market, since the number of persons who pose a job threat to those employed in the modern sector is much higher than the number of the 'statistically'unemployed.

But as the 'reserve army' diminishes, the marginal productivity of labour in the traditional sector rises, and may even grow faster than productivity in the modern sector. If this happens, the income differentials between the 'modern' jobs and the traditional ones become lower, especially if the two types of income are measured in real terms (given the fact that the cost of living is usually higher and rises faster in towns than in rural areas); moreover, one must also, in order to appraise the opportunity cost of the urban jobs, consider that the contribution (in



money or kind) to the total income of the family by some of its members (women and older people in particular) usually disappears for lack of opportunities as the family moves from the country to the town. For all these reasons, the pressure on money wages is likely to grow as the country develops and the size of the traditional sector becomes smaller.

The dualistic nature of the labour market in transitional growth may be taken into account by introducing into the traditional wage equation a new variable, $R_t$, representing the 'reserve army' of the traditional sector (the total employment in the latter as a ratio to the labour force may be taken as a statistical approximation). Equation (3) therefore becomes:

$$p_t = a - q_t - b_1 U_t - b_2 R_t + c\, p_{t-1} \qquad (4)$$

As the economy develops, $R_t$ diminishes (and the pressure on wages and prices therefore rises), not only because of the growth of the modern sector, but also because of the retirement from work of some sections of the labour force, and because of emigration which is just one of the channels through which the very existence of Earlier DCs modifies the growth path of Later DCs.

## 4. The Participation Rate

In many countries, a negative correlation between total employment and per capita income (or the share of agricultural employment) has been observed in the first stages of economic growth.[4] In Italy, for instance, total employment, and the participation rate with it, fell substantially from 1958 to 1972, as the fall in agricultural employment was greater in absolute terms than the increase in extra-agricultural jobs. One explanation [5] is that the supply of manual work normally has a negative income elasticity, especially in certain sectors of the labour force, such as females, young and aged people, who consider it a social promotion to be able to give up unpleasant jobs: and they do so as soon

[4] See GALEAZZI G. and ROBOTTI L., *Struttura della forza lavoro e sviluppo economico*, Il Mulino, 1978 (P. Alessandrini ed.); and OECD, *The Labour Market Situation in Less Industrialized Member Countries*, preliminary report, 1978.

[5] See DE MEO G., *Sintesi statistica di un ventennio di vita economica italiana (1952-1971)*, ISTAT, Roma, 1973.

as the economic conditions of the head of the house make it possible. Perhaps more important is, however, the argument recalled in the previous section; namely, after the emigration from country to town, it very often becomes impossible (or very difficult) for many women, who where previously engaged in a part-time activity in agriculture (normally in a situation of self-employment), to reconcile housekeeping with going out to work. They are therefore induced to withdraw from the labour market.[6]

Lastly, Government social policies may also greatly contribute to the fall in the participation rate.[7]

The factors mentioned above may then accelerate the fall in the variable R in the course of economic development, and accelerate the end of the 'unlimited supply of labour' growth stage (as occurred in Italy at the beginning of the 70s).

It is true that the participation rate is likely to rise again (with a typical U-curve) at a later stage, when the 'mechanization' of the household, on the one side, and the spread of education, on the other, make it possible for a large share of the female population to go out again to work, or in any case to look for a job. In Italy, for instance, there has been, in the last ten years, a remarkable increase both in female employment, chiefly in services, and in the number of female unemployed. But the jobs sought by the latter are mainly clerical, moreover, the spatial mobility of female labour is very low.

In conclusion, the demand for labour in Italy in recent years has probably been in excess of supply in the manual labour market (as is also suggested by the fact that several types of job have been filled by immigrants from poorer countries); while the opposite has been the case in the clerical labour market, where supply tends to exceed demand.[8] It can therefore be said that at present the aggregate unemployment statistics (i.e. the variable $U_t$) are not very meaningful for the opposite reason to the one mentioned in the previous section: the actual number

[6] FUÀ G., *Occupazione e capacità produttive: la realtà italiana,* Il Mulino, Bologna, 1976, ch. 1.

[7] The extension of the incentives to higher education, on the one hand, and, on the other, of disability pensions in Italy in recent years, is a typical example of a policy favouring a reduction in the activity rate of a large proportion of the population. In fact, the term 'disability' has been interpreted by Italian authorities as inability to *find* rather than to take up an employment.

[8] As a consequence, the gap between wages and salaries has been shrinking to a considerable extent (especially since 1975, when a unified system of indexation was obtained by Italian trade unions), but that was due to an exceptional rise of money wages rather than to a stable or moderately-rising salary level. See VALLI V., "Inflazione e mercato del lavoro", in: Targetti F. (ed.), *Lezioni di economia: l'inflazione* Feltrinelli, 1979, p. 77.



of unemployed workers who pose an effective job threat to those employed, and whose presence acts therefore to discipline wage demands, is now considerably *lower* than the total number of persons included in $U_t$. The recent rise of the latter variable, ensuing from the rise of female activity rates, has then only seemingly (and in any case only partially) counterbalanced the remarkable fall in $R_t$.

## 5. The International Wage Demonstration Effect

The process of urbanization and of industrial concentration, that inevitably takes place as the economy develops, reinforces trade-union power. This factor may be represented by a rising value of the parameter *a* in equation (4), and by rightward shifts of the unemployment-price curve in fig. 1.

There are, however, no reasons to believe that trade union power is necessarily greater in Late DCs than in Earlier DCs, and that it is therefore responsible for the inflation differentials between the former and the latter countries. There is instead a specific factor that may greatly contribute to explain such a differential: the so-called wage demonstration effect.

Indeed, as the process of economic, political and social integration proceeds in Europe, as the national barriers to the free circulation of goods and productive factors (in particular, labour) are dismantled, and as communications of all types improve (through such channels as emigration, tourism, advertising and trade, the workers of the Late DCs are unavoidably induced to struggle for wage levels close to those of the Earlier DCs. Some of the firms in the modern sector of the former countries can probably afford to pay higher wages, but the bulk of the labour force cannot possibly be granted international *real* wage as long as the average productivity of labour remains lower. It is therefore inevitable that the increases in money wages exceeding the productivity growth are shifted to prices. In the country in which that happens the currency must then be devalued, money wages again rise, and a wage-price-exchange rate inflationary spiral is thus set in motion. The demonstration effect may then become a powerful and permanent source of inflation and of social discontent.

The inflation model set out in the previous sections could be modified as follows, in order to take account of the international influences on the rate of inflation in a Late DC:

$$w_t = a - b_1 U_t - b_2 R_{t-1} + c\ p_{t-1} + d\ w^i_{t-1} \qquad (1^*)$$

$$p_t = \lambda\ (w_t - q_t) + (1 - \lambda)\ (m_t + p^m_t + e_t) \qquad (2^*)$$

where $w^i_{t-1}$ is an indicator of the gap, in time t-1, between the average level of international wages and the average level of domestic wages. If, for simplicity's sake, it is assumed that the demonstration effect comes from a single country, the following specification could be chosen:

$$w^i = \frac{W^B E^B - W^A}{W^A}$$

where $W^A$ and $W^B$ denote the average wage-rates (expressed in their own currencies) of the imitating country and of the imitated country, respectively, while $E^B$ denotes the rate of exchange between the two currencies.

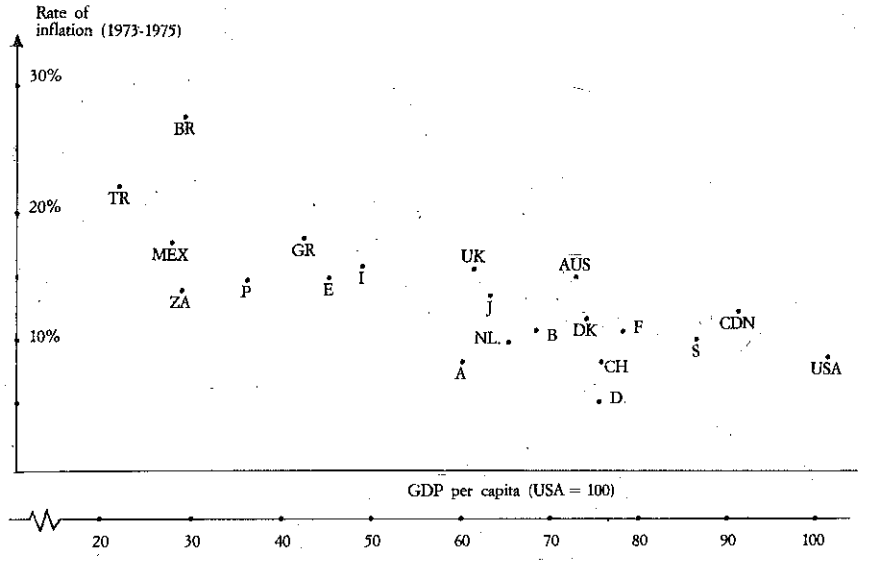
As regards equation (2*), it is now assumed that the direct cost of domestic ouput has two components: the labour cost and the cost of an imported raw material. The new variables of that equation are so defined: $m_t$ = the rate of change in time *t* of the input quantity required per unit of output; $p^m_t$ = the rate of change in time t of the import price, $p^m$, of the raw material; $e_t$ = the rate of change in the exchange rate with the currency in which $p^m$ is expressed; $\lambda$ and $(1-\lambda)$ = parameters defining the weights of the two components of total cost.

To sum up, as the process of international economic integration proceeds, the Earlier DCs determine an increasing upward attraction on the wage levels of the neighbouring Late DCs, while the downward pressure exerted by the 'industrial reserve army' tends to become weaker and weaker. In such a situation, external shocks like the rise in the prices of oil or of other imported raw materials may seriously exacerbate the internal struggle for the distribution of the (lower) value added among social classes, groups and productive factors. The rate of inflation is therefore likely to reach higher levels than in Earlier DCs. As fig. 2 shows, immediately after the increase in oil prices (i.e. in the period 1973-75), the rate of inflation became higher in Later DCs than in Earlier DCs. Moreover, while in the following years (1976-1978) the latter were able to reduce their average rate of inflation markedly, the situation of the former kept worsening (see fig. 3).



FIGURE 2

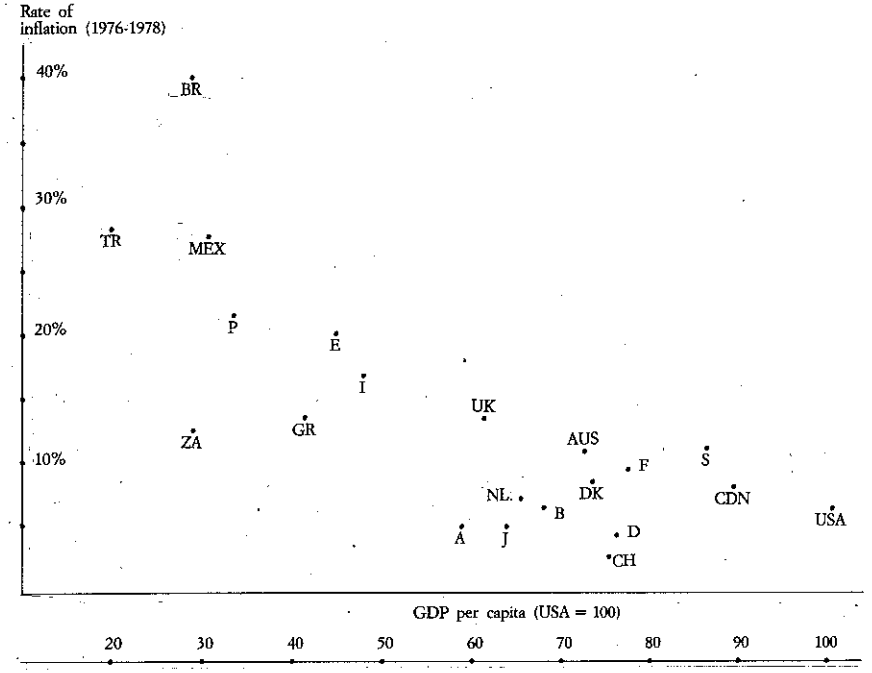
INFLATION AND GDP PER CAPITA IN 21 COUNTRIES (1973-1975)
(indicated by international motor-car abbreviations)




*Source*: TAMBERI M., *Note sui differenziali di inflazione*, Facoltà di Economia e Commercio, Ancona (unpublished).

FIGURE 3

INFLATION AND GDP PER CAPITA IN 21 COUNTRIES (1976-1978)




*Source*: see Figure 2.

## 6. Inflation and Capital Accumulation

In the last decade Italian authorities in this period have frequently had to resort to tight monetary policies with a view to lowering the rate of inflation and reducing the deficit in the balance of payments. Such policies, however, have also resulted in the slackening of the rate of capital accumulation and in the fall of the rate of growth of GDP. Moreover, the reluctance of the authorities to devalue the lira in the proportion required to allow prices to rise as much as money wages (or rather as labour costs per output unit) has not only resulted in a heavy fall in the profit margins of the firms operating in the modern sector, but has also accelerated the expulsion of the 'marginal' firms from the market, and therefore reduced the productive capacity of the country. It can be (and has been) argued that this process of 'natural' selection is a necessary and physiological component of the growth mechanism in a free market economy. But this argument is correct and can be accepted only if the less efficient firms (or establishments) are replaced through new investments by more modern ones. In Italy, on the contrary, the propensities to save and to invest have fallen markedly since 1969.

## 7. The 'Welfare State' and the 'Warranted Rate of Growth'

The average propensity to save has fallen during the seventies in all the main industrial countries, but the consequence of that is more serious for a country such as Italy which has a lower income per capita and should therefore grow faster than Earlier DCs. In Italy, as can be seen in table 2, both corporate savings and, to a greater extent, government savings have become negative in the 70s: the former, because of the profit squeeze mentioned in the previous section; the latter, because of the huge extension of the 'welfare state' that has taken place in such sectors as social security, health and education. In this case, too, the 'demonstration effect' from Earlier DCs may be held at least in part responsible.

The consequences on the 'warranted rate of growth' determined by the fall in the government 'propensity to save', on the one hand, and the rise in the relative prices of imported raw materials, on the other, can be illustrated by the following system of equations:



$$Y = QP - MP^{m}E \tag{1}$$

$$Q = C + I + X + G \tag{2}$$

$$Y = Y^{d} + T \tag{3}$$

$$Y^{d} = S + CP \tag{4}$$

where Y = money GDP; Q = the real domestic output; P = the price of Q; C = the real personal consumption; I = the real investments; X = the real net exports of Q; G = the real collective consumption; M = the real imports of raw materials; $P^{m}$ = the import price of M; E = the exchange rate; $Y^{d}$ = money disposable income; T = the money tax revenues (net of government transfer expenditures); S = the money personal saving; CP = the money personal consumption.

If equilibrium in the balance of trade (i.e. $XP = MP^{m}E$) is taken as a long-term constraint, the following formula can be obtained after a few passages:

$$g_{w} = \left(1 - \alpha \frac{P^{m}E}{P}\right) \frac{s(1 - t) + t - \gamma}{v} \tag{5}$$

where $g_{w}$ = the 'warranted rate of growth'; $\alpha = M/Q$ = the quantity of raw materials required per unit of output; $s = S/Y^{d}$ = the average propensity to save of the private sector; $t = T/Y$ and $\gamma = GP/Y$, hence $t - \gamma$ = the government propensity to save; $v = K/Q$ = capital-output ratio.

As equation (5) shows, a long-run tendency of $\gamma$ to grow faster than t determines, other things being equal, a fall in the national propensity to save, and, as a consequence, in the warranted rate of growth.[9]

It can also be noticed that the warranted rate of growth is inversely related to the relative price of raw materials ($P^{m}E/P$).

## 8. Concluding Remarks.

The emphasis on the propensity to save does not imply the belief that an increase in the latter, and therefore a lower government deficit is a condition not only necessary, but also sufficient for a higher *actual*

[9] In Italy, however, government 'dissaving' was due in the 70's to an exceptional increase in transfer expeditures (and therefore to a fall in *t*, as previously defined) rather than to an increase in $\gamma$.

TABLE 2

SAVINGS SOURCES
(relative shares)

| Countries | 1960 - 1969 | | | |
|---|---|---|---|---|
| | Corporate savings | Government savings | Personal savings | TOTAL |
| USA | 32.7 | 14.8 | 52.5 | 100 |
| Japan | 20 | 28.8 | 51.2 | 100 |
| Germany | 29.2 | 32 | 38.8 | 100 |
| France | 23.6 | 27.6 | 48.8 | 100 |
| G.B. | 40.1 | 23.2 | 36.7 | 100 |
| Italy | 11.3 | 13.5 | 75.5 | 100 |

| Countries | 1970 - 1977 | | | |
|---|---|---|---|---|
| | Corporate savings | Government savings | Personal savings | TOTAL |
| USA | 19.6 | −14.1 | 94.5 | 100 |
| Japan (70-76) | 12.46 | 22.85 | 64.7 | 100 |
| Germany | 12.7 | 22.7 | 64.6 | 100 |
| France | 8 | 21.5 | 70.5 | 100 |
| G.B. (70-76) | 0.14 | 22.4 | 77.4 | 100 |
| Italy (70-76) | −10 | −27 | 137 | 100 |

*Source:* FERRI P., SZEGÖ G. (1980), "La struttura del risparmio in un processo di crisi", *Economia Italiana*, October.

rate of growth. The lack of modern firms and of entrepreneurial capacities is probably a more serious bottleneck than the lack of savings. Two main reasons can be given for this statement.

First, if in a Late DC there are, as is usually the case, obstacles or physiological limits to the speed with which new modern firms can be created and the existent ones can grow, the marginal capital-output ratio may rise, and the income rate of growth may therefore fall (or rise less than was expected from a given increase in the propensity to save).



Second, a given 'warranted' rate of growth may be, or become, inconsistent with a long-term equilibrium in the balance of payments, as probably occurred in Italy at the beginning of the last decade, because of external shocks (rising prices of oil and other raw materials, competition from the 'newly industrializing countries', falling world demand for industrial products, etc.) and/or because of home difficulties (rising wages and social contributions, worse industrial relations, social tensions, political instability, and so on). An improvement of managerial, technical and entrepreneurial abilities, both in the private and in the public sectors, would be an adequate remedy for such a situation; were this not possible, and were the devaluation of the exchange rate ineffective because of 'real wage resistance', import inelasticity, and other reasons, the actual rate of growth would have to be reduced. An increase in the propensity to save would then be completely out of place in this case, since it would enlarge the gap between the 'warranted' rate of growth and the rate consistent with equilibrium in the balance of payments (to abbreviate: the 'consistent' rate of growth).

In the specific case of Italy, the same factors that were responsible for the fall in the competitivity of the country determined, toward the end of the 60s and the beginning of the 70s, a marked fall in the profit margins of industrial firms (see table 3), and hence an endogenous reduction of their rate of capital accumulation.[10] Italian authorities, on the other hand, as was previously recalled, reduced the gap between the warranted rate and the new (lower) actual rate by means of an increase in government expenditures, and, in particular, an increase in transfer payments to households, temporarily unemployed (not necessarily dismissed) workers, and inefficient firms (especially the larger ones, and the state-owned corporations) which would otherwise have gone bankrupt. One could, then, even interpret the fall in the government

[10] Table 3 shows that the small and medium size firms have largely recovered their profit margins after the squeeze of the beginning of the last decade, while the situation of the firms with more than 1,000 employees has remained critical. As a result, while in 1965 (and most probably in the 50's) the correlation between the size of the firm and the profit share was positive, in more recent years the correlation has apparently become negative. The crisis of the large firms has in turn determined a process of "de-industrialization" in the "earlier industrialized areas" of the country (four North-Western regions) and at the same time a process of "diffuse industrialization" based on small- and medium-size firms, mainly located in the regions of the Adriatic coast and of Central Italy. The share in Italian manufacturing production of the "newly industrializing regions" mentioned above rose from 32% in 1961 to as much as 38% in 1977. Several factors have enabled that system of small firms to complete successfully in the Italian and world market, as they have actually been doing. See FUÀ G., *"Experiences of diffuse industrialization in Italy"*, to be published.

propensity to save not as the *cause*, but as the *consequence* of the fall in the 'consistent' rate of growth, the latter fall being determined by the 'exogenous' shocks and difficulties previously mentioned.

TABLE 3

THE LABOUR-COST SHARE IN THE GROSS PRODUCT OF ITALIAN INDUSTRY BY FIRM SIZE

| Size of firm (no. of employees) | 1961 | 1965 | 1972 | 1973 | 1976 | 1979 |
|---|---|---|---|---|---|---|
| 20 - 49 | | | 72.1 | 62.3 | 66.1 | 65.3 |
| 50 - 99 | 65.0 | 77.3 | 73.5 | 66.4 | 69.6 | 67.4 |
| 100 - 499 | 68.3 | 76.7 | 75.0 | 68.9 | 71.2 | 69.0 |
| 500 - 999 | 66.3 | 74.2 | 76.0 | 72.3 | 70.8 | 67.6 |
| 1,000 or more | 68.0 | 72.3 | 84.0 | 78.3 | 77.1 | 72.5 |
| TOTAL | 67.8 | 73.9 | 78.3 | 72.0 | 72.8 | 69.7 |

*Source:* ISTAT, *Il prodotto lordo e gli investimenti delle imprese industriali,* anni vari.

There is probably some truth in this argument.[11] But instead of being "wasted" in transfer payments to the households or to obsolete firms and industrial sectors, the government expenditures should be directed to loosening the bonds that constrain the Italian economy, and therefore to raising the "consistent" rate of growth, instead of simply lowering the "warranted" rate.

*Ancona*

PAOLO PETTENATI

[11] See THIRLWALL A.P., "The Balance of Payments Constraint as an Explanation of International Growth Rate Differences", in this *Review*, March 1979.