Savings in Italy Today(*)

1. - The savings of an individual operator (or sector) take the form either of investment in real goods or the acquisition of claims on other operators (or sectors). The total savings of the individual operator (or sector) are the algebraic sum of the two components real investment and financial surplus (or deficit). The total of a nation's savings is obtained by adding up the accounts of the individual sectors. In this operation, intra-sectoral debits and credits cancel each other out, so that national savings are equal to domestic investment plus the change in claims on foreign countries, i.e. plus the surplus (or minus the deficit) in the balance of payments on current account.

An analysis of the formation of the financial component of savings, by sector and by type of asset, has been presented in the Bank of Italy's studies on Italy's financial accounts (*I conti finanziari dell'Italia*). Table 1 has been drawn from the study published in the November-December 1971 issue of the Bank's statistical *Bulletin*; it has been updated to 1973 by the authors.

The table, which thus covers the years 1964-73, shows that the distribution of sectoral balances has been constant over time. The household sector regularly shows a surplus that is counterbalanced by the recurrent deficits of the other three sectors, namely, enterprises, public administration and the foreign sector. With the passage of time, the household sector's surplus has increased, while the deficits of enterprises and the public administration have risen correspondingly. The deficit of the foreign sector, on the other hand, shows a declining trend from 1969 onwards, giving way to a surplus in 1973.

Since the financial balance of one sector is equal to the difference between its savings and its investments, it is necessary to establish whether the growth of the financial deficit of enterprises and the public administration was due to a drop in their savings or to an increase in their investments.

A sectoral break-down of the development of net savings is contained in the Central Statistical Institute's Annual Report on Italy's national accounts. Table 2 has been drawn from that document, updaded to 1972.

It will be seen from the table that the savings of non-financial enterprises declined from 1968 to 1971, and then recovered slightly in 1972; savings of financial institutions remained virtually unchanged. The deterioration in the financial balance of enterprises compared with 1964-66 levels as shown in Table 1 is not, therefore, attributable from 1968 onwards to an expansion of the sector's investments but rather to a smaller degree of self-financing.

* Introductory report presented at a round table conference held at the Accademia Nazionale dei Lincei in Rome on 8th March 1974.

TABLE 1

FINANCIAL BALANCES OF FINAL USERS 1
(in billions of lire)

Years	Households	Enterprises	Public administration and autonomous government agencies	Foreign sector
1951-58 average	339		− 381	+ 13
1959-63 average	540		− 448	− 124
1964	2,115	−1,110	− 691	− 387
1965	3,112	− 230	−1,719	−1,381
1966	4,279	−1,176	−2,097	−1,323
1967 (*)	4,428	−2,449	−1,454	− 999
1968 (*)	5,258	−1,903	−2,149	−1,642
1969	6,138	−3,049	−1,849	−1,462
1970	6,454	−3,079	−3,452	− 476
1971	8,345	−3,436	−4,591	− 981
1972 (*)	9,736	−2,396	−6,401	−1,169
1973 (*) (**)	13,250	−6,471	−8,261	1,405

1 The credit institutions (banking system, special credit institutions and insurance companies) transfer savings from surplus sectors to deficit sectors, leaving a financial balance that is negligible in relation to the volume of funds concerned. If the financial balances of the credit institutions are included, together with the net change in non-classifiable items and statistical discrepancies, the algebraic sum of the financial balances in the Table works out, for each year, at zero.

(*) Data adjusted to take account of the effects of the bank strikes.

(**) Provisional data.

TABLE 2

NET SAVING, BY ECONOMIC SECTOR; USES OF SAVINGS AND NATIONAL INCOME 1961-72

Years	Net national income at factor cost (billions of lire)	Saving: As a percentage of national income at factor cost						of which		
		Non-financial enterprises 1	Financial institutions	Total enterprises	Public administration	Households	Net national saving	Invested at home	Current payments balance	
									Capital movements 2	Change in reserves 3
1961	19,446.0	2.3	0.6	2.9	4.7	14.5	22.1	20.5	0.2	1.4
1962	21,958.0	1.4	0.5	1.9	4.4	15.2	21.5	20.6	1.3	−0.4
1963	25,215.0	0.4	0.7	1.1	3.8	13.9	18.8	20.6	1.3	−3.1
1964	27,591.0	0.4	0.5	0.9	4.3	13.4	18.6	17.1	−0.3	1.8
1965	29,655.0	1.2	0.8	2.0	0.8	15.7	18.5	13.8	1.4	3.3
1966	32,235.0	1.8	0.8	2.6	0.4	14.5	17.5	13.3	3.1	1.1
1967	35,373.0	1.2	1.0	2.2	2.5	13.3	18.0	15.1	2.3	0.6
1968	38,392.0	2.0	1.0	3.0	1.6	14.2	18.8	14.5	3.4	0.9
1969	42,427.0	1.8	1.2	3.0	1.0	15.8	19.8	16.2	5.4	−1.8
1970	47,219.0	0.7	1.2	1.9	1.6	15.0	18.5	17.4	0.5	0.6
1971	51,561.0	−0.7	1.2	0.5	−1.6	17.6	16.5	14.6	1.0	0.9
1972	56,646.0	−0.1	1.1	1.0	−3.3	17.8	15.5	14.0	2.8	−1.3
Simple average		1.0	0.9	1.9	1.7	15.1	18.7	16.5	1.9	0.3

1 In the national accounts "Non-financial enterprises" includes the autonomous government agencies.
2 Capital movements have been calculated as the difference between the current payments balance and changes in the reserves.
3 Change in the official reserves and the banks' net foreign position.

Sources: ISTAT, *Annuario di contabilità nazionale*, Vol. III, 1973 edition; BANCA D'ITALIA, Report to the Annual General Meeting, various years.

The deterioration in the public administration's financial balance is of longer standing, dating back to 1965 (with a brief respite in 1967). In this case, too, the deterioration was due not to an increase in investment activity in the sector but to a contraction in its net savings, which were considerably lower in the second half of the sixties than in the first half (not only in national income terms but also in absolute monetary terms) and which have been negative since 1971 (with deficits on current account). It may be said that since 1971 the households' propensity to save has been thwarted by the public administration, because to the extent that households' savings are swallowed up by the public administration's current-account deficits there is no accumulation of wealth whatsoever on the social level. In other words, no additional sources of income are created to meet the claim on the community as a whole which savers in the household sector have built up (on paper).

With the contribution of enterprises to the formation of national savings diminishing and with that of the public administration first dropping and then becoming negative, the share of households' savings in national savings rose from 66 per cent in 1961 to 81 per cent in 1970; it then went up to 107 per cent in 1971 and to 115 per cent in 1972 — years in which the public administration's negative saving exceeded the savings flow from enterprises. It was in these years that an illusory situation began to arise in which households' savings were not fully reflected in an accumulation of real wealth.

2. - There is also another factor that tends to reduce the amount of households' savings that is devoted to domestic investment, namely the proportion of savings absorbed by the foreign sector, in the form of both net exports of capital from Italy and, to a much smaller extent, a rise in the country's foreign exchange reserves. In the twelve-year period covered by Table 2 the proportion of national savings channelled abroad, including export credits, was between one-eighth and one-ninth of the total flow. On average over these twelve years the ratio of savings to net national income was 18.7 per cent of which 16.5 per cent went to net domestic investment and 2.2 per cent was exported (1.9 per cent as capital exports and 0.3 per cent as the increase in the net foreign assets of banks and public authorities). In 1972, with net savings by households representing 17.8 per cent of national income, domestic investment was substantially lower — 14 per cent of national income. In 1973 the direction of foreign

flows was reversed: the balance of payments on current account moved into deficit, there was a net inflow of capital, and the foreign position of the banks and public authorities deteriorated (as it had already done in 1972).

These data on the contribution of the various sectors to the formation of national savings and on the export of part of those savings are a reminder that a policy aimed at promoting the accumulation of real resources within the country necessarily involves such vital factors as production and market conditions (which govern the investment decisions of private enterprises), industrial relations, the size of the public sector, price/cost relationships in public enterprises, the expansion of government transfers to the economy, and the management of the social security agencies and the local authorities: in short, it is bound up with the policies which determine the income and expenditure of all those centres where investment programmes are decided and there is potential for savings formation, but which in fact make only a scant or even a negative contribution to investment and savings. As regards the flow of capital abroad, such a policy involves not only the question of the availability of adequate financial instruments and satisfactory yields but also the basic issue of confidence in the stability of the political and social system.

Compared with these main strategic issues, the other steps which may be taken to stimulate the already large flow of households' savings look like a mini-policy, the limitations of which, viewed against the real dimensions of the problems to be tackled, should be duly borne in mind.

The international comparisons provided in Table 3 show that the level of households' net savings in Italy is very high — second, in terms of gross national product, only to Japan. The highest rates of national savings formation are recorded in countries in which a satisfactory flow of savings from the household sector is supplemented by substantial contributions from the public administration and enterprises. In countries where this is the case (e.g. Japan, the Netherlands, Switzerland and Germany), the total formation of savings is greater than in Italy.

In some countries where the social security system is highly developed (such as the United Kingdom and Sweden), the level of households' savings is low. Social security weakens the incentive to save in order to provide for misfortune, for old age, or for surviving

TABLE 3

NET DOMESTIC SAVINGS AND AMORTIZATIONS AS A PERCENTAGE OF GROSS NATIONAL PRODUCT IN THE MAJOR INDUSTRIAL COUNTRIES

Sector	Italy 1		Belgium		France		Federal Republic of Germany		Netherlands	
	Average		Average		Average		Average		Average	
	1960-61	1968-69	1960-61	1968-69	1960-61	1968-69	1960-61	1968-69	1960-61	1968-69
Households	11.7	12.2	7.3	10.1	6.5	7.0	5.4	7.8	9.0	10.1
Public administration	3.7	1.1	— 0.1	1.0	3.9	4.3	7.5	5.0	5.5	4.7
Enterprises 2	2.3	2.4	2.1	2.2	3.5	4.5	6.7	5.1	5.3	4.2
Total net savings	17.7	15.7	9.3	13.3	13.9	15.8	19.6	17.9	19.8	19.0
Amortizations	8.5	8.2	10.6	9.5	10.0	10.1	8.7	10.6	9.2	9.0
Total gross savings	26.2	23.9	19.9	22.8	23.9	25.9	28.3	28.5	29.0	28.0
	United Kingdom		Sweden		Switzerland		United States		Japan 3	
Households	4.0	3.5	4.1	1.6	6.8	9.3	3.7	4.8	12.3	12.7
Public administration	0.6	5.4	6.1	9.6	5.8	4.9	1.7	1.4	7.6	6.7
Enterprises 2	5.7	1.9	4.1	2.6	4.9	4.5	2.6	1.9	5.8	6.2
Total net savings	10.3	10.8	14.3	13.8	17.5	18.7	8.0	8.1	25.7	25.6
Amortizations	7.5	8.1	9.3	9.2	9.6	10.2	8.7	9.9	10.5	13.7
Total gross savings	17.8	18.9	23.6	23.0	27.1	28.9	16.7	18.0	36.2	39.3

1 1961, instead of the 1960-61 average.
2 Only companies for Italy, Belgium, France, Netherlands and Japan.
3 The public administration includes public enterprises.

SOURCES: ISTAT, *Annuario di contabilità nazionale*, 1973; OECD, *National Accounts*, 1960-1970.

relatives. Thus, if the social insurance systems do not themselves give rise to savings formation, there may be a reduction in the total flow.

In Italy, with the real value of the system's invested reserves having been drastically reduced during and immediately after the war, the principle adopted for managing the compulsory disablement, old-age and surviving dependants' insurance scheme was changed: outpayments were no longer made from income on capital but from current contributions. The amount of capital which the National Social Security Institute (INPS) should have accumulated to meet its commitments to the insured population (active workers and pensioners) can be put at about 80 thousand billion lire if a capitalization rate of 4½ per cent is adopted, or at 60 thousand (raughly equat to 100 billion dollars) with a capitalization rate of 7 per cent.

3. - A savings policy with the aforementioned, more restricted aim of stimulating households' saving is conditioned by the growing inflation which for some years has afflicted the economies of the developed western countries. This makes it harder, and often impossible, for the saver to obtain some real benefit from his financial assets, or even merely to preserve their value over time.

In Italy during the sixties those holding financial assets obtained yields which in real terms were modest, zero or even negative depending on the type of asset held and the year of investment or disinvestment. Since the pace of inflation has accelerated in recent years, the longer the investment was held, the worse its fate (except that the loss was heavier for those who sold their investments during the financial-market crisis in 1970). This can be seen by reading down the columns of Tables 4 and 5, where the data have been calculated on the assumption that all income received on the security initially purchased has been reinvested in the same type of security.

A similar loss has been suffered by those who invested in shares after the beginning of the sixties (Table 6).

These have been the negative effects of creeping inflation on the investor; recent monetary trends have made things still worse, especially as regards uncertainty.

If price stability is excluded from the list of priority objectives of economic policy (as has in fact been the case), the price level becomes to some extent a residual variable that tends to move, over time, in fits and starts. It is no longer possible to correct monetary instability by adjusting interest rates upwards; this simply means that

TABLE 4

EX-POST AVERAGE ANNUAL COMPOUND YIELD AT CONSTANT PRICES 1

Investments in government securities

(*percentage values*)

Year of investment 2	Year of disinvestment													
	1955	1960	1965	1966	1967	1968	1969	1970	1971	1972	1973
1950	0.85	3.75	2.40	2.40	2.35	2.42	2.29	1.04	1.47	1.73	1.36
1955	0.72	6.21	3.10	3.04	2.93	2.97	2.77	1.09	1.65	1.97	1.49
1960		5.71	0.50	0.77	0.87	1.17	1.04	— 1.20	— 0.23	0.35	—0.17
1965			7.44	4.90	3.77	3.73	2.95	— 1.50	0.21	1.10	0.20
1966				2.42	1.99	2.52	1.86	— 3.20	— 0.95	0.22	—0.67
1967					1.55	2.57	1.67	— 4.55	— 1.61	—0.14	—1.11
1968						3.59	1.73	— 6.51	— 2.38	—0.48	—1.54
1969							—0.09	—11.18	— 4.29	—1.47	—2.54
1970								—21.03	— 6.33	—1.92	—3.14
1971									11.11	9.30	3.69
1972										7.52	0.16
1973											—6.69

1 The yield has been calculated in each case by taking an initial capital sum and assuming (a) that from year to year income from the investment is reinvested in the same type of security and (b) that disinvestment is effected at the market price on the given date. The effect of monetary erosion has been estimated on the basis of the cost-of-living index.

2 The purchase is regarded as having been carried out at the average quotations ruling in the year before the investment is made.

TABLE 5

EX-POST AVERAGE ANNUAL COMPOUND YIELD AT CONSTANT PRICES 1

Investments in bonds

(*percentage values*)

Year of investment 2	Year of disinvestment										
	1955	1960	1965	1966	1967	1968	1969	1970	1971	1972	1973
1950	3.10	5.67	2.76	3.12	3.11	3.15	3.05	1.95	2.31	2.69	2.45
1955	5.17	8.22	2.79	3.29	3.27	3.32	3.17	1.72	2.20	2.68	2.38
1960		9.51	−1.33	0.08	0.44	0.82	0.86	− 0.99	− 0.11	0.72	0.46
1965			6.56	7.76	6.13	5.59	4.68	0.57	1.87	3.01	2.33
1966				8.97	5.92	5.26	4.22	− 0.59	1.11	2.51	1.82
1967					2.96	3.46	2.68	− 2.84	− 0.39	1.47	0.83
1968						3.97	2.55	− 4.70	− 1.21	1.18	0.49
1969							1.14	− 8.77	− 2.87	0.49	−0.20
1970								−17.70	− 4.82	0.28	−0.53
1971									10.08	10.69	5.96
1972										11.31	3.96
1973											−2.91

1 The yield has been calculated in each case by taking an initial capital sum and assuming (a) that from year to year income from the investment is reinvested in the same type of security and (b) that disinvestment is effected at the market price on the given date.
The effect of monetary erosion has been estimated on the basis of the cost-of-living index.

2 The purchase is regarded as having been carried out at the average quotations ruling in the year before the investment is made.

TABLE 6

EX-POST AVERAGE ANNUAL COMPOUND YIELD AT CONSTANT PRICES 1

Investment in shares

(*percentage values*)

Year of investment 2	Year of disinvestment										
	1955	1960	1965	1966	1967	1968	1969	1970	1971	1972	1973
1950	17.55	19.54	9.57	10.15	9.21	8.80	8.98	8.30	6.65	6.01	6.56
1955	41.85	25.08	7.95	8.89	7.71	7.27	7.61	6.80	4.79	4.09	4.87
1960		48.84	−1.71	1.11	0.25	0.41	1.56	0.99	− 1.24	− 1.71	− 0.30
1965			−0.84	8.99	3.93	3.36	5.12	3.45	− 0.78	− 1.59	0.60
1966				19.81	6.40	4.81	6.67	4.33	− 0.77	− 1.70	0.78
1967					−5.51	−1.98	2.62	0.78	− 4.43	− 4.89	− 1.68
1968						1.69	6.95	2.97	− 4.16	− 4.76	− 1.02
1969							12.47	3.61	− 6.04	− 6.31	− 1.56
1970								−4.55	−14.12	−11.85	− 4.78
1971									−22.73	−15.28	− 4.86
1972										− 7.12	5.57
1973											19.99

1 The yield has been calculated in each case by taking an initial capital sum and assuming (a) that from year to year income from the investment is reinvested in the same type of security and (b) that disinvestment is effected at the market price on the given date.
The effect of monetary erosion has been estimated on the basis of the cost-of-living index.

2 The purchase is regarded as having been carried out at the average quotations ruling in the year before the investment is made.

the risk of changes in the rate of inflation is redistributed so as to be less unfavourable to the creditor. In fact financial obligations cease to have a well-defined economic meaning.

In particular, in periods of accelerating inflation (such as the present one) interest rates rise, and holders of fixed-interest securities are exposed to a twofold loss — a loss resulting from currency erosion and, in addition, a fall in stock exchange quotations due to the rise in interest rates.

Confronted by these two dangers, savers (if they do not choose investment in real assets or investment abroad) tend to prefer bank deposits, which safeguard them against the risk of quotation losses, and they are further prompted to do so by active competition between the banks for new deposits. For, whereas the saver has no protection against the ups and downs of the stock market, the banks feel themselves to be protected against the risk of illiquidity by the fact that they can have recourse to the central bank. (It is true that the total formation of deposits is a function of the creation of monetary base, but that creation is itself adjusted to changes in the composition of the total flow of credit).

TABLE 7

FINANCIAL ASSETS OF THE ECONOMY
Absolute end-year figures

Items	Amounts outstanding in billions of lire			
	1950	1960	1970	1972
Domestic				
Liquid assets	4,394	14,685	51,335	70,980
Notes and coin	1,116	2,369	6,385	7,852
Deposits				
sight	1,315	4,685	23,430	33,671
other	1,963	7,631	21,520	29,457
Other deposits and interest-bearing bonds	34	263	1,599	2,523
Fixed-interest securities (at nominal value)	640	3,492	11,639	15,778
Mathematical reserves and other assets	291	1,597	5,699	7,294
Shares and participations (at market value)	1,491	16,277	13,573	13,542
Total	6,850	36,314	83,845	110,117
Foreign	254	665	9,587	12,890
Total	7,104	36,979	93,432	123,007

TABLE 8

FINANCIAL ASSETS OF THE ECONOMY
Percentage composition

Items	1950	1960	1970	1972
Domestic, excluding shares				
Liquid assets	82.0	73.3	73.0	73.5
Other deposits and interest-bearing bonds	0.6	1.3	2.3	2.6
Fixed-interest securities	12.0	17.4	16.6	16.3
Mathematical reserves and other assets	5.4	8.0	8.1	7.6
Total	100.0	100.0	100.0	100.0
Domestic, total				
Liquid assets	61.8	39.7	54.9	57.7
Other deposits and interest-bearing bonds	0.5	0.7	1.7	2.1
Fixed-interest securities	9.0	9.5	12.5	12.8
Mathematical reserves and other assets	4.1	4.3	6.1	5.9
Shares and participations	21.0	44.0	14.5	11.0
Total	96.4	98.2	89.7	89.5
Foreign	3.6	1.8	10.3	10.5
Total	100.0	100.0	100.0	100.0
(Index of the ratio between the market value of shares and their nominal value)	(1.52) 1951 [1]	(3.20)	(1.64)	(1.46)
Gross National Product (*billions*)	10,499	21,828	58,261	68,976
Financial assets of the economy/G.N.P.	0.80	1.69 [2]	1.60	1.78

1 The first ratio refers to 1951 since the data on national income are available on a uniform basis from that year on. Financial assets in 1951 amounted to 8,353 billion lire.
2 The index figure 1.69 falls to 1.32 if the ratio of market value to nominal value of shares is taken to be 1.60; i.e. a ratio half-way between those for the years 1950 and 1970.

Evidence of the saver's preference for bank deposits is provided in Tables 7 and 8. In 1950 82 per cent of domestic financial assets, excluding shares, held by the economy (households and enterprises) consisted of liquid assets. With the conditions of satisfactory monetary stability prevailing in the fifties, this proportion dropped to 73 per cent by 1960. In the subsequent decade it remained unchanged, but showed signs of rising in the last few years, with a shift towards sight deposits.

If shares are included in total domestic financial assets held by the economy, the proportion of liquid assets, after having dropped from 64 per cent in 1950 to 40 per cent in 1960, a year in which the high level of stock exchange quotations inflated the share component in the total, rose to 61 per cent in 1970 and to 65 per cent in 1972.

If foreign assets, which rose sharply after 1960, are included in total financial assets, the liquid component, after falling from 61.8 per cent in 1950 to 39.7 in 1960, recovered to 54.9 per cent in 1970 and to 57.7 per cent in 1972.

In these conditions, those responsible for placing fixed-interest securities have had to rely increasingly on the banks' purchasing for their own portfolios.

Of the total of fixed-interest securities in circulation, the proportion held by the Bank of Italy and by credit institutions increased from 27 per cent in 1950 to 54 per cent in 1972 (Table 9).

A significant shift that is revealed in Table 8 is the decline from 1960 onwards in the relative importance of shares (valued at current prices) in the total of existing financial assets. In 1950 they accounted for 21 per cent of the total and in 1960 for 44 per cent (the peak); by 1972 this proportion had dropped to 11 per cent.

4. - These data suggest that, if investment in securities is to increase as a proportion of the total financial savings of the economy, the credit instruments offered to savers should be diversified in three directions.

In order to reduce the risk of fluctuations in market quotations, an attempt has been made to stabilize the long-term security market. This has been hampered by the shift in the supply of financial resources to the short-term market which, because of the international mobility of money, must be kept more closely in line with the varying interest rate level obtaining on the international market. If there is a shift towards bank deposits, it is necessary to impose "portfolio requirements" on the banks (as has in fact been done), obliging them to invest in long-term securities and thereby further reducing their freedom in regard to credit management.

One line of action might therefore be to offer shorter-term securities, which by their nature are less exposed to quotation changes. This could be done not so much by limiting the range of maturities as by offering short-term securities whenever the final use to which the funds are to be put is compatible with short-term financing.

TABLE 9

HOLDINGS OF FIXED-INTEREST SECURITIES, BY CATEGORY OF INVESTORS 1

End of year	Bank of Italy	Credit institutions	Other financial intermediaries 2	Economy	Total
	(billions of lire)				
1950	37.3	252.6	158.2	640.0	1,088.1
1960	229.0	1,491.8	640.7	3,492.0	5,853.5
1970	3,641.5	10,634.5	2,533.7	11,639.0	28,448.7
1972	5,855.1	16,150.8	2,875.7	15,778.0	40,659.6
	(percentage composition)				
1950	3.4	23.2	14.6	58.8	100.0
1960	3.9	25.5	10.9	59.7	100.0
1970	12.8	37.4	8.9	40.9	100.0
1972	14.4	39.7	7.1	38.8	100.0

1 Excluding short-term securities (Treasury bills and certificates of the Central Post Office Savings Fund).

2 Includes the Central Post-Office Savings Fund, special credit institutions and social security institutions.

Government bonds could be among the short-term securities offered to the economy.

5. - Another way of reducing the risk of currency erosion might be to make available securities with a monetary adjustment clause.

When inflation was less acute than at present, a system of indexation for fixed-interest securities was adopted, in Europe, by France and some Scandinavian countries, but it cannot be said to have taken root there. Index-linking has also been applied in Israel and in various Latin American countries.

Inflation is the process whereby the sum of the demands made by the various social groups on the national product is brought into line with the size of that product. It makes the volume of demand consistent with the real flow of resources. The greater the success of individual operators or groups in protecting themselves, by means of sliding-scales or monetary safeguard clauses, against the effects of inflation on their purchasing power, the smaller the area in which the

erosion of purchasing power has to take place becomes and the higher, *ceteris paribus*, the rate of inflation. Because of this automatic mechanism and because of the possible unfavourable repercussions on public opinion, indexation may therefore itself represent an inflationary factor. These are among the conclusions drawn by a recent OECD report (*Indexation des valeurs à revenu fixe*, 1973). They have been endorsed by the European Economic Community. Even as far back as 1959 the Radcliffe Report (in para. 573) dealt with the question of indexation. The Report defined this as "an expedient which would too plainly be a confession of failure to maintain a reasonable degree of stability in the value of money and might easily have disruptive consequences for our economic system".

However, in the case of Brazil (described in the excellent book by M. H. Simonsen: *Inflaçao, Gradualismo x Tratamento de choque*) a general system of monetary adjustment, regarded as a means of achieving "a peaceful co-existence between the economic system and inflation" ("neutral inflation"), has increased the propensity to save, breathing new life into the capital market, especially the market for mortgage loans, and thus making it possible to finance the intense activity in the building sector without creating inflationary pressures.

The rapid deterioration of the monetary situation in Europe has revived interest in the system of monetary adjustment. The introduction of such a system has been proposed by A. Chalandon for France (in "Le Monde", 28th December 1973), and on a number of occasions by "The Economist" for England. In Italy, it has been proposed for mortgage loans and for insurance against material damage and life assurance.

In the case both of mortgage loans and of life assurance policies, the term of the transactions is governed by the use to which the funds are put and cannot be shortened. In neither case, therefore, can the monetary risk borne by the creditor be reduced by issuing shorter-term paper or shortening the term of the insurance. The introduction of monetary adjustment clauses would make it possible to agree on low "real" interest rates; in the case of mortgage loans, this would ease the situation for families in the lower income brackets, which at present find the burden of the first redemption instalments plus the extremely high interest payments too heavy. For example, a mortgage of 10 million lire at 10 per cent with amortization in 15 years, involves a constant annual payment of 1,315,000 lire. On the assumption of an annual inflation rate of

8 per cent, the fifteenth annual payment will correspond in real terms to 34 per cent of the first.

A mortgage at the real rate of 2 per cent would involve an initial annual payment of 840,000 lire. Only in the seventh year, i.e. almost halfway through the life of the mortgage, would the annual payment exceed the level of that on the conventional mortgage at 10 per cent (equivalent to the same real rate of 2 per cent).

Another sector in which it would appear appropriate to apply monetary adjustment parameters is that of public utility enterprises. The financing of these enterprises could be effected by means of securities with both principal and interest linked to the value of the enterprises' output, to their tariffs, to the general price index or to composite parameters.

It would not appear advisable in this case (or in the more general one of issues by the State of indexed loans) to link the loans to the price of assets used as a hedge against inflation. For example, in the Pinay loan, which was indexed to the price of the Napoleon, redemption is being effected at more than five times the amounts originally due: protection of the creditor has gone too far.

6. - On the whole it would appear that the application of monetary adjustment clauses would have a favourable effect on both the orientation and the distribution of savings.

Every addition to the range of credit instruments available on the money and capital market is likely to attract to that market savings which would otherwise have been placed elsewhere. On the market the various demands for savings compete and funds go to the user who is able, because of more profitable investment, to offer the highest price; the market is thus, generally speaking, a mechanism for the rational allocation of resources. This conclusion is, however, undermined by the fact that the main user of savings is the public sector, which, instead of channelling them to projects that could be truly classed as being in the general interest, employs them for ends that are partly dictated by the inefficiency, waste and parasitism commonly found in that sector, and by strong pressures from organized social groups.

On the other hand, some of the alternatives to an active system of financial intermediation are also undesirable. These include exporting savings or taking refuge in real-estate and material assets, which, if such assets are imported, is tantamount to exporting capital,

in the sense that savings are being used without creating any additional sources of employment and income at home. Where the search for "safe" investment is satisfied by drawing on material assets and real estate within the country, it does not lead, on the social level, to any formation of savings, but rather to transfers of wealth through the relative appreciation of the goods sought after.

The interests of the community as a whole, therefore, call for a widening of the scope of the financial market and at the same time more efficient management of the public sector, which has recourse to that market.

In theory it is said that the financial market is an imperfect instrument for channelling flows of funds because it tends to favour large enterprises. In practice, however, the biggest distortion is that in favour of the public sector, which, with its vast ramifications of the government, regional authorities, social security institutions, autonomous agencies and public enterprises, provides lenders of funds with a guarantee that derives ultimately from the right to create fiat money, and this guarantee is often given so that savings can be spent on consumption or on loss-making production units.

This state of affairs suggests that one possible line of policy for savings would be to encourage the formation of savings in those areas or for those purposes that necessarily or normally link savings with investment, as is the case with savings by enterprises (to a large extent) and households' savings used to purchase new living accommodation.

If a larger proportion of funds were absorbed by these forms of savings-with-investment the politicians would be faced with the dilemma of whether to have recourse to inflation or to increase taxation and accept budget deficits smaller than those which the ample flow of savings to the public sector makes possible at the moment. But it is perhaps wishful thinking to expect them deliberately and with a sense of self-discipline to modify the financial framework in which they operate.

As regards the distribution of savings, it should be observed that the various studies that have been made on the subject in Italy confirm that holdings of financial assets, as a proportion of income, are higher in the higher income brackets. Inflation may therefore, if its effects are not neutralized by safeguard clauses, appear at first sight as a good way of reducing the inequality of incomes (and wealth) by eroding the part of income that is not spent.

But this process infact gives rise to a number of discriminations which run counter to the general interest or to the very notion of egalitarianism favouring as it does the following groups: (1) those who, in the higher income brackets, spend more, thus reducing the flow of real resources available to the rest of the community, and those who, because they are in a stronger bargaining position, can raise more rapidly the prices for the goods and services they supply; (2) those who invested their savings abroad; (3) those who chose direct investment, for example in holiday houses, real estate or material assets; (4) those who invested in shares (who are usually among the wealthier members of the population); (5) those who borrow money, i.e. mainly entrepreneurs and persons who can offer property or security of employment as a guarantee to their creditors; and (6) those who hold a relatively low proportion of their income in bank-notes. (The proportion of notes to income is higher in the lower income groups. It has been estimated on the basis of bank-note cancellations that the southern regions of Italy and the islands, which accounted for 23 per cent of the national product in 1972, held 30 per cent of the bank-notes in circulation).

To the extent that the redistribution effects of inflation are neutralized (albeit imperfectly, as already mentioned, because of the variability of the rate of inflation) by higher interest rates, it is in the debtors' interests to maintain inflation, which in many cases is essential if their businesses, crippled by the high nominal interest rates they have to pay, are to survive. The laying-down of specific, low, real interest rates would prevent pressures from arising that encourage the perpetuation of inflation.

For 1973 the nominal weighted average yield on domestic financial assets (excluding shares and mathematical reserves and disregarding the very small negative variation in stock exchange quotations) can be estimated at 4.8 per cent. Since, in the course of the year, the cost of living increased by 12.3 per cent, the yield in real terms was equal to about minus 6.7 per cent.

To estimate the extent of the loss suffered by holders of financial assets as a result of inflation, it would be necessary to know what the level of interest rates would have been in the absence of inflation. To avoid making an overestimate, it may be assumed that the present high rate structure is largely a result of experience and expectations of inflation, and thus the hypothetical interest rate in the absence of inflation may be put at a level approximating those that obtained

at times of monetary stability, for example, 3 per cent; this can be reduced to 2 per cent to take account of assets yielding nothing or very little (such as bank-notes and certain sight deposits).

The loss caused by inflation would then be measured by setting minus 6.7 per cent against plus 2 per cent; in other words, it would amount to 8.5 per cent. Applied to the total of 89,000 billion lire of financial assets at the end of 1972 (110.1 less 20.8; Table 7), the hypothetical loss is equivalent to roughly 7,600 billion lire. To appreciate the significance of this figure, it may be compared to that of total-tax receipts in 1973 (13,600 billion lire). If account is taken of money claims not covered by the statistics on financial assets and of the losses of purchasing power on financial assets constituted in the course of 1973, the conclusion may be drawn that, in present conditions, inflation is a mechanism for transferring purchasing power which has an impact comparable to that of taxation.

The problem of monetary adjustment also concerns progressive taxation. Inflation produces a fictitious rise in incomes, bringing them constantly into higher tax brackets, and hence, with real gross income unchanged, the tax burden increases over time.

For example, applying the current income-tax rates, a man with a wife and two children who has an income equal to 5 million lire in 1974 has to pay 11 per cent in tax. The taxation on the same real income doubles in six years if the rate of inflation is 15 per cent per annum, and in eleven years if it is 8 per cent.

In this connection mention may be made of the problem of monetary adjustment in the case of rents.

The value of linkage clauses (relating to gold, goods, foreign currency or price indexes) is recognised in law as the application of contractual independence in pursuit of the deserving aim of maintaining over time the economic value of services rendered. But, in the field of housing, a decree law was passed in July 1973 rendering null and void " clauses providing for the adjustment of rents to compensate for possible effects of the decline in the purchasing power of money ".

Since such effects are not just " possible " at the present time but actual and substantial, it is difficult to understand the social utility of a provision which progressively reduces over time (in relation to the original value agreed between the parties) the real value of the monetary payments made for the services provided by housing.

Reference has been made to the regulations governing rents because of their negative impact on the increase in the savings-

investment flow from the households' sector, and more specifically on that part that goes into the market for rented accommodation. That market, like the financial market, stimulates competition between the users, with positive effects as regards efficiency in the allocation of resources.

Inflation also affects the cost of " subsidized " credit, i.e. credit at concessionary rates, which has become of such importance in the present institutional system.

Whereas rates for ordinary credit react to the acceleration of inflation by moving upwards, those for subsidized credit remain unchanged. Depending on the relevant legislation, they range at present from 0.5 to 6.5 per cent.

These rates are all considerably lower than the current rate of inflation. In real terms, therefore, the rates for such credit are negative. Consequently, in addition to the capital grants provided for under certain legislation for specific types of investment, further subsidies are granted in the form of negative interest rates. This applies even in sectors such as the shipping and ship-building industries where cyclical conditions are often favourable for business. In the case of export credits, it is at least partly the foreign purchaser who benefits.

Even allowing for the fact that the aim of providing credit on concessionary terms is to develop certain sectors and regions, this accumulation of benefits creates an excessive distortion of the data underlying the economic calculations that should determine how savings are invested, and does not even seem to correspond to a correct assessment of costs and benefits in social terms.

In the presence of very sizable external diseconomies, rather than providing big incentives to use a scarce resource such as savings, development policy should be directed at reducing these diseconomies.

In conformity with a more discriminating savings policy is the innovation contained in the text of the draft law providing incentives for investment in the South of Italy, under which the Cassa per il Mezzogiorno will make fixed contributions towards interest payments, and consequently the concessionary rate will fluctuate in line with the trend on the financial market.

7. - Thirdly, steps could be taken in times of inflation to channel the flow of financial savings towards shares in investment funds.

The development of investment funds could be fostered by a system of taxation similar to that which applies to fixed-interest

securities, under legislation which would lay down strict quantitative limits on investment funds' participation in the capital of individual enterprises.

Italy's experience in the sixties shows that shares did not offer protection against the risk of devaluation (nor, of course, against industrial risk). Anyone who invested in 1960 in shares which, relatively speaking, did not fare too badly (e.g. Fiat, Stet or Sip), who then reinvested the dividends and finally sold their investment in 1973 would have had a negative yield in real terms on Fiat and Stet (— 0.53 per cent and — 1.18 per cent) and a small positive one on Sip (1.29 per cent). Anyone with an investment in Montecatini (later Montedison) over the same period would have suffered a loss in real terms of over 8 per cent a year.

Convertible bonds offer a greater degree of protection from industrial risk. Shares in investment funds, through diversification of industrial risks, would enjoy greater stability than convertible bonds as regards their quotations. If these funds were also afforded the opportunity to invest in securities with monetary adjustment clauses, shares in these funds would be backed by a balanced assortment of safeguards against devaluation and industrial risk which are especially important for the small saver, for trusts and for charitable organisations.

8. - A more general way of swinging the balance in favour of savings rather than consumption would be to exempt savings from taxation.

The theory that savings are taxed twice over and that therefore expenditure, not income, should be taxed has been upheld by such economists as Stuart Mill, Marshall, Keynes, Irving Fisher, Einaudi and Kaldor.

It has been made topical again by inflation (as a result of which a part of savings is taxed *three* times over), by the need to finance development and by the problem of conserving natural resources.

It may be observed that a *progressive* tax on expenditure such as that advocated by Kaldor, as a substitute for or as a complement to a progressive tax on income, would also, in times of inflation, have the effect of taxing at increasingly high rates rises in expenditure that merely reflected higher prices. For the system to work properly, therefore, a sliding-scale would have to be applied to the income-tax brackets.

9. - In conclusion, account should be taken of three aspects of current conditions in Italy which are somewhat anomalous in comparison with the position in other countries, and even with previous periods of more balanced development in Italy.

These are:

the high rate of inflation;
the negative saving of the public sector, and
the considerable and persistent export of capital.

Any policy to encourage savings that is sufficiently realistic to be effective must take into consideration these anomalies, the first two of which cannot be completely eliminated in the short term. Recognition of their importance implies accepting certain changes, for example a wider range of credit instruments for the saver, monetary adjustment clauses and a high level of interest rates. Such adjustments could in time correct the original anomalies and work in conjunction with an overall economic policy aimed at curbing the rate of inflation, encouraging a larger and more balanced flow of national savings and ensuring that these savings are turned to account within the country.

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