The Vanoni Plan Re-examined (*)

1. Origin and Nature of the Vanoni Plan

The " Vanoni Plan " was announced in 1954 at a juncture in Italy's post-war economic history when two very important factors were leading to a situation which called for special attention. The first of these was the approaching exhaustion of several elements which had in the preceding years eased Italy's path towards economic reconstruction. Three such elements were especially significant. First, the availability of unutilised industrial capacity, which had so far permitted substantial increases in production without a corresponding growth in investment, was henceforth reduced to normal dimensions. Secondly, agriculture, which had been able to make exceptional progress through the rapid introduction of technical improvements the exploitation of which had been delayed by the war, was likewise now reduced to the normal pace of development. And finally — what was perhaps still more important — it was no longer possible to rely on large-scale foreign aid. It followed rather obviously from these three changes in conditions that if economic progress was to continue at the same pace as in the immediate past, the volume of investment would have to be larger than in the past.

The second factor which had become unmistakeably apparent was that the impressive post-war development, which had brought

(*) Lecture delivered on October 24th, 1957 at the Economic Development Institute, International Bank for Reconstruction and Development, Washington.

industrial production in 1954 to almost twice the pre-war level, was leaving largely unsolved the big structural problems that had characterised the Italian economic scene ever since the time — almost a century ago — of the country's political unification.

The failure to solve these problems was reflected in the persistence of two phenomena of serious social and political concern. One was heavy unemployment. The other was the wide discrepancy in economic conditions between the South on the one hand and the rest of Italy on the other.

It was clear that no solution could have been reached otherwise than through a more rapid process of economic development. But the intensification of that process just at a time when the favourable conditions to which I have referred were diminishing in strength, confronted the country with a task which demanded the adoption of a more determined attitude on the part of the Government. More precisely it was necessary that, starting out from a clear understanding of the terms of the problem, the State should take action capable of setting the economic system moving towards a better balanced income and employment structure.

According to the Vanoni Plan the goals at which such action had to aim were three: The first was full employment of the country's labour force. The second was closer economic equality between the industrialised North and the poor agricultural South. And the third was balance of payments equilibrium.

The two problems of unemployment, and the economic backwardness of the South, are so closely connected as to represent in large part two aspects of one and the same problem of structural disequilibrium. Indeed, the attainment of a high and stable level of employment is conceivable in Italy only in a situation in which the economic disequalities between North and South have in large part at least been removed.

With this necessity in mind, the Plan traces the main lines of economic policy which would need to be followed in the ten-year period 1955-64 with a view to achieving full utilisation of the Italian labour force.

The document foresees that during the ten years 1955-64 employment will need to be found in Italy for 3.2 million additional labour units, while a further 0.8 million are taken off the labour market by emigration. It is presumed that all of the additional domestic employment has to be created in industry and in the tertiary activities. And the additional employment would represent 31 per cent of the 1954 employment figure for those sectors.

On the supposition that the developments envisaged in the " Plan " actually come to pass, the Central-Northern area, taken by itself, ought to present in 1964 the characteristics typical of a highly industrialised country with only 18 per cent of its gross income deriving from agriculture and as much as 45 per cent deriving from industrial activity.

But it is first and foremost the structure of the economy of the South which ought, in accordance with the goals set by the " Plan ", to change most markedly. Thus, while in 1954 43 per cent of the income of the South was derived from agriculture, and 57 per cent from industrial and tertiary activities combined, in 1964 — assuming that the employment aims of the " Plan " were reached — the proportion of income derived from industry and the services would have to have risen to 76 per cent. And this is after making allowance for emigration from the South to the North and abroad of 1.1 millon workers.

Special notice should be taken of the last of the three aims of the " Plan " — that of attaining balance of payments equilibrium. The intention is that this should be achieved while preserving a high degree of liberalisation of imports and a high volume of foreign trade, and not by resorting to restrictive policies.

With the three aims in mind, the " Plan " adopts certain assumptions about three important parameters of the problem: first, the capital that would be required for the dual purpose of providing jobs for workers not yet employed and of raising the productivity of those already employed; secondly, the productivity of the capital used for these ends; and thirdly, the proportion of national income which it was reasonable to assume might be allocated to investment purposes. The conclusion arrived at on the basis of these aims and assumptions was this: A necessary, though certainly not sufficient condition for reaching the aims within ten years was that the national income should increase at an average annual rate of not less than 5 per cent. The " programme " indicated the movements in consumption, investments, exports and imports that might be considered compatible with the desired development pattern. Particular emphasis was laid on the point that it would be necessary to increase the proportion of income devoted to investment purposes. It was estimated that gross investment would need to rise from 20 per cent of gross income in 1954 to 25 per cent at the end of the ten year period, an increase which implied that the rise in consumption (50 per cent) would have to be less than that in income (63 per cent).

The "programme" did not prescribe specific measures of economic policy, apart from declaring that it was a government responsibility to reach, or cause to be reached, certain aims in the sectors in which State intervention had long been customary in the Italian economy. These sectors were agriculture, public utilities, and public works. Intervention in these sectors was to be what was called in the "Plan" *propulsive* or, that is, action intended to stimulate private investment activity of the volume and pattern which the "Plan" required.

Direct guiding action on the part of the State was also envisaged in two other sectors: building and reafforestation. The investments in these sectors were, however, to be complementary to the "propulsive" investments, in the sense that the State would seek to speed them up or slow them down according as the general development process was in need of an accelerator or of a brake. The relevant sectors were for this reason called "regulatory" sectors.

But, by their nature, neither the "propulsive" nor the "regulatory" sectors could be expected to provide any considerable number of additional permanent jobs. These would for the most part have to arise in the other sectors as an effect of the additional investment opportunities opened up to private enterprise by the economic policy which I have just described. These sectors are not, in reality, completely private, since part of Italian industry is State-owned. Nonetheless it was not intended, according to the "Plan", to entrust special tasks to public enterprise. The document merely observes that, with a view to the realisation of the "Plan's" aims, investments in State-owned industries might "to whatever extent was necessary, supplement private investments where these proved inadequate in regard either to volume or to location". This is an important point to which I shall return later. Let me first try to show how the results reached by the Italian economy, in the three years 1955-57 which have elapsed — or almost — since the "Plan" was formulated, compare with the targets that were defined by the "Plan".

2. Economic Developments in Italy 1955-57

It is generally admitted that developments in the Italian economy during the three years have in many respects been better than those envisaged in the "Plan". The annual rate of growth of income in real terms has on the average been just a little higher than the 5 per cent indicated in the "Plan". And the absorption of labour, and the improvement in the balance of payments position, have been approximately in line with the figures of the "Plan". The point where the results have been poorer than was hoped concerns the reduction in the economic disparity between North and South. According to the latest estimates, total income has grown at about the same rate in the South as in the North. This is a result which is not without its positive side, as is evident when we remember that the industrialised North, aided by the world boom, has been going ahead at a very rapid pace, while the economy of the South, which is still predominantly agricultural, has felt the effects of the boom only to a limited extent and has at the same time suffered considerably from crop damage due to bad weather.

Thus it is a sign of the success of the development policy initiated in the South in 1951 — with the foundation of the Cassa per il Mezzogiorno — that it was possible to compensate for two important forces tending to aggravate interregional disequilibrium in the past three years, and possible to induce, perhaps for the first time after many decades, equal rates of income growth in the two regions.

It must nonetheless be observed that the "Plan", just because its object was to reduce the existing disequilibrium, looked towards a rate of income growth in the South substantially higher than that in the North. The precise figures aimed at were 4 per cent for the North and 8.1 per cent for the South. This result did not come to pass; nor can it do so until the policy of intervention succeeds in creating in the South an independent development mechanism with its own motive force, in place of one which, as at present, is largely dependent on continuous Government action.

It should be added that although labour was absorbed at a rate which for the country as a whole was even slightly higher than that envisaged by the "Plan", this result was the consequence of heavier emigration than had been foreseen. The rate at which domestic employment rose, though higher than previously, was still below the desired rate. And the improvement in the balance of payments position is due to large increases in receipts from the invisible items, while the balance of commodity trade still shows a considerable deficit. An important point to notice is that, in the wake of the liberalisation policy which Italy had followed in the foreign trade sector, and of which the "Plan" had reaffirmed the desirability, the volume of imports rose during the three years at an annual average rate of about 14 per cent, as against an average rate of growth of income of 5.5 per cent. At the present stage, the elasticity of imports with respect to income is thus very high in Italy: it is 2.6. Despite the growth of exports the deficit in the balance of trade is still, as I have said, substantial. As the Minister of Foreign Trade, Dr. Carli, recently stated in the Senate (1), this means that Italy must make still greater efforts to render her products more competitive in world markets.

The experience of almost three years as it appears from the movements which I have just described shows that general economic progress on a scale as massive as anything yet seen in the history of Italy cannot be a substitute for an economic policy which is directly inspired by the aims of the "Plan". The boom has introduced into the Italian economy powerful additional impulses which were not envisaged in the "Plan", and which have promoted, especially in the industrial sector, high rates of increase in investment and income. But the regional distribution of this advance has not been that for which the "Plan" allowed. And, what is still more serious, experience confirms that even prolonged boom conditions are incapable, by themselves, of promoting a development mechanism in the South strong enough to raise the living standards of the population to the extent required.

There was a clear realisation of this fact in Italy. But in the phase of intense economic activity through which the Italian economy was — and still is — passing, it would not have been possible at one and the same time to do all of three things, i.e.

(a) to maintain monetary stability,

(b) to let productive activity expand freely under the impulse of the boom, and

(1) Closing speech in the debate in the Senate on Italy's foreign trade position, 9th July, 1957.

(c) to increase public investment of the so-called "propulsive" type through a policy of deficit spending.

Since point (a) is beyond discussion, the question was to decide between (b) and (c). And (b) was preferred. That is to say it was thought best not to hinder the spontaneous expansion of productive activity. And, in order to facilitate the financing of this expansion, an effort was made to keep down the budget deficit by keeping down public expenditure. At the same time, a new law has been passed in order to supplement the effects of public expenditure by provisions designed to encourage industrialisation in the South and thus to channel a larger share of the benefit of the boom towards that area.

3. The Aims of the Plan in the Light of Italy's Participation in the European Common Market

A policy which aims at solving the basic problems of the Italian economy has now to deal with a new situation in consequence of the coming into force of the Treaty establishing the European Common Market. Indeed Italy's position as a signatory of this Treaty raises the following question. How do the aims of the Vanoni Plan link up with the aims which must guide our economic policy now that it is dominated, as it must be, by the process of European economic integration?

In attempting to answer this question, the first point to keep in mind is that the Vanoni Plan places equal emphasis on two objectives both of which imply an acceleration of the rate of capital accumulation: the first is to raise productivity per head and the second is to increase employment. The necessity for this is obvious as soon as we compare Italy's position with that of other countries, whether they are at a high or a low stage of economic development.

It is a familiar fact that in the highly developed countries, new saving is almost exclusively devoted to raising the productivity of the existing labour force and not to creating additional employment. This is because, practically speaking, the whole of the labour force of a highly developed country is already provided with capital equipment conforming to modern standards, and the need for equipping additions to the labour force is limited to what is required by the natural increase in the population, an increase which is often relatively small. In underdeveloped countries, on the other hand, the labour force, because of the inadequacy of the capital stock, is far from being fully employed. In such circumstances the aim of maximising income is often satisfied by maximising employment even at levels of productivity lower than those prevailing in highly developed countries and by giving customs protection to the productive system so as to allow it to survive alongside other systems which, because better endowed with capital, can produce at lower costs.

Now in Italy it will be necessary, for a number of years, to drive towards both aims: that which is typical of highly developed countries, and which consists in raising productivity to the maximum levels allowed by the most advanced techniques and most modern organisational methods; and that which is typical of economically backward countries, and which is represented by the creation of additional employment far in excess of what would be required merely by the natural growth of the Italian population. The necessity of accomplishing with equal urgency these two tasks derives from Italy's poverty in natural resources in relation to the volume and structure of existing requirements and to any future growth of those requirements.

In fact, as I said earlier, every increase in income and employment leads to a more than proportional increase in imports of raw materials and foodstuffs. Hence the need for heavily expanding industrial exports, and for preserving, in Italian industry, a high degree of competitiveness on international markets. In short, a policy aimed at reaching fuller employment cannot succeed in Italy unless the competitive capacity of her industry is great enough to earn the foreign exchange which will finance an increased flow of imports of raw materials and foodstuffs sufficient to satisfy the additional demand of the newly employed.

What then does the formation of a European Common Market mean for Italy? It means essentially that certain increases in productivity must be reached by certain precise dates. For, if the European Common Market has got to be achieved within the period 1971 to '73, it is necessary that the average productivity of the employed labour force in Italy should by that time have reached a level not far short of the rest of the area of the Common Market.

Now the Vanoni Plan presupposed that the tariff system would remain as it now is. But this prospect is henceforth excluded since the Rome Treaty implies the immediate adoption of a policy of gradual tariff reduction. It thus places the Italian economy — probably from as early as 1958 on — in situations which will year after year be increasingly dissimilar from those imagined in the now distant days of 1954, when the Plan was drawn up. Among other things, the Rome Treaty foresees that the year 1961 should mark the end of an intermediate stage after which the process of integration so far accomplished would be jointly reviewed by the six countries. This stage falls, it may be noticed, entirely within the period of the Vanoni Plan, and thus necessitates at a date not very far off a reconsideration of the Plan itself. In fact the Plan is going to be reviewed by the Committee of Experts appointed to advise the Government on its implementation.

What the results of such a review are likely to be cannot be predicted at the present early stage when the Treaty is still awaiting ratification. But what I have said so far seems to justify two important conclusions. First, the lines of economic policy which are appropriate to the purpose of gradually inserting the Italian economy into the European Market certainly do not conflict with the lines of the Vanoni Plan. On the contrary, they must represent an extension of those lines. Secondly, there are large additional capital requirements due to the necessity of raising the competitiveness of Italian industry to the point where its products can be offered on equal terms with those of the other countries of the European Market, countries in which the process of capital accumulation has in the past been more intense than in Italy. It may also be observed that Italy's capital needs are in any case larger than was foreseen in the Plan, because technological progress is in fact proceeding at a quicker pace than the Plan assumed.

In considering the problem of how the greater capital needs per head of the employed labour force are going to be met without sacrificing the aim of reaching approximately full employment by 1964, three prospects are relevant. First, it appears likely that the total capital burden will be lightened by larger emigration. This, as I remarked, has already been proceeding at a faster rate than the Plan envisaged, and may remain at the present high level, or even rise further, if labour mobility within the area of the European Common Market is really increased. Secondly, the proportion of gross income saved in Italy has moved up during the past three years about as the Plan foresaw and, if adequate policy measures are taken, it is possible that the level of domestic capital formation which the Plan aimed at reaching by 1964 may in fact be attained some years earlier. While these two developments may help to reduce the capital gap, it will doubtless still be necessary to look for part of the solution from a third source: that of capital imports. The original Plan relied upon these to make a relatively small contribution to the total capital needs, and one which diminished gradually as time went on until it reached zero in 1964. It now appears that the movement towards equilibrium in the balance of payments on current account will have to be slowed down. But here too the European Common Market opens up new possibilities. At the same time as it facilitates the emigration of Italian workers, it may make it easier for the Italian economy to draw upon foreign capital.

On the whole, European economic integration is bound to accelerate the process of structural change which is already going on in the Italian economy at a rapid pace. An idea of what this implies is given by a consideration of the change which will probably have to take place in the agricultural sector. Within the European Economic Community taken as a whole 27 per cent of the labour force is employed in agriculture (in the United States the percentage is 18 and in Great Britain 5). The figure of 27 per cent is, however, an average of very different situations. Broadly speaking, we can divide the area into three regions within each of which conditions are fairly homogeneous, but between which they are very different. Thus for Western Germany and the Benelux taken together the figure is 18 per cent; for France and Northern Italy it is 31 per cent; and for Southern Italy — if we include the unemployed and underemployed who press on the labour market in ways analogous to those of the excess agricultural population — it is 60 per cent.

Now if we suppose that industrial activity within the European Community expands, as a result of integration, to an extent sufficient to bring down the agricultural population of the area from the present 27 per cent to 20 per cent — which is the figure today in Western Germany — 6 million workers or more would have to shift from agriculture to other sectors. And the major contribution to this movement among the active population would have to be

made by Italy, since she accounts for about 40 per cent of the present agricultural labour force of the Community (2).

The few figures I have just quoted make it clear that Italy's economy is bound to be put under particularly heavy strain, but that, at the same time, it will be very radically transformed by the process of creating the Common Market.

In short the Common Market appears to the Italian view with two faces. On the one side it presents Italy with an essential condition for economic development. For the welding of her economy into the larger market will be a strong stimulus to the attainment of higher levels of productivity than could have been reached within the limits of the narrow national market. Certain of our more rapidly advancing industrial groups have in fact already reached, or are in sight of reaching, production levels which are beyond the absorption capacity of the domestic market. For these groups the European market thus opens up development opportunities for which they would search in vain in the domestic sphere. Even Italian agriculture may find it possible, in consequence of the wider market, to move towards greater crop specialisation and higher productivity.

But these development possibilities could not be fully exploited in the absence of policy measures of the kind to which the Vanoni Plan pointed as a means of strengthening the weaker groups in the Italian economy. If adequate measures are not taken, the Common Market, instead of being an instrument for promoting economic development — as is its natural function — may become a retarding influence. All of us are aware of the danger that the bringing into contact of economies at very unequal levels of development may set working mechanisms which tend — unless they are corrected by appropriate policies — to make the inequalities greater instead of smaller.

It is difficult to foresee what type of policy will be pursued. It seems likely, however, that we shall be confronted with two conflicting conceptions. The first, of which Germany will probably be the leading exponent, expects integration to follow smoothly from the gradual bringing into contact with each other of the

(2) It may be recalled that the Vanoni Plan envisaged for the Italian economy alone and merely for the ten-year period 1955-64 the shift of a million persons from agricultural to non-agricultural activities.

individual economies. The second conception sees the building up of the Common Market as requiring a series of measures of common economic policy agreed to by all the six countries, measures specifically aimed at converting the existing productive systems into so many sections of a single and organic community system. It is this conception which is the more appropriate to Italian conditions, and which, by giving the greater promise of a rapid approach to full employment and a high rate of income growth, is in the best interests of the European Community as a whole.

4. Increases in Productivity and Expansion of Employment

How near Italy can come to the aims of the Plan with the aid of additional domestic savings, and imports of foreign capital, will largely depend on the manner in which productivity increases are distributed over the economic system. This distribution problem is, we may say, common to all economic systems. Thus it confronts today a number of industrialised countries which are experiencing severe inflationary pressure because they have not found a satisfactory way of relating increases in income to increases in productivity. And it confronts underdeveloped countries, which meet with growing difficulties of this kind as new contingents of workers move out of agriculture, where productivity is low and improves slowly, into industry where productivity is usually higher at the start and also improves more rapidly.

The situation in Italy, given the heavy unemployment and the high proportion of the employed labour force which is engaged in agriculture, may be likened more to this second type than to that of the industrialised countries. On the other hand, the fact that a considerable industrial labour force already exists in Italy renders the consequences of errors in wage policy more serious there than in other countries that are at a less advanced stage of development.

Let us consider what are the effects in the Italian economy of a wage policy based on the principle of allowing wages in the sectors where productivity is increasing most rapidly to rise in proportion to the growth in productivity. The wage rise in the relevant sectors will inevitably spread to others, and will cause aggregate demand to move in a manner which is not in harmony with the policy of the Vanoni Plan; in a manner, that is, which fails to give sufficient benefit, or probably even does harm to important groups, or sectors, of the economy. This is because the adjustment of prices to the new cost structure is imperfect, owing to price rigidities. Particularly insensitive are many agricultural prices, the prices of the products of artisans and small industry, and certain " political " prices. Even within a single, rapidly advancing sector, difficulties may arise because of the existence of a wide variety of productivity levels in that sector. Those units which are at the lower end of the scale may be pushed out of the market by the wage increases; and in this way capital equipment which could otherwise be used may be made redundant. Finally the unemployed will be harmed both because of the rise in the cost of living and because of the effect of the wage rise on the pace of capital formation. I shall return to this last point in a moment.

In face of these considerations, Italian policy has recently followed the line of seeking to prevent the cost of labour from rising in proportion to the increase in productivity. In this way, it aims not only at keeping the general price level from rising, but also at raising the share of the weaker groups in the productivity increase that is realised in the more rapidly advancing sectors. A policy which limits the rise in the cost of labour in the most progressive sectors aids the weaker groups in two ways. The first is through a lowering of the prices of the products of the stronger sectors. The second is through the additional capital formation which the policy makes possible, and which is of special benefit to the weaker groups.

The extent to which the weaker sectors benefit in the first way (i.e. from an improvement in their terms of trade with the strong sectors, through a reduction of prices in the latter) depends, given the stability of the cost of labour, on the degree of competition in the strong sectors. This may be influenced by factors which are independent of government action as well as by specific measures taken by the government for the purpose. The government is at present giving its attention to possible measures of this kind. One prospect which is already clearly in view is connected with the reduction of customs duties under the Treaty of the European Common Market. The coming into force of the Treaty will in any case tend to raise the degree of competition. But, since the Treaty leaves a certain margin of flexibility in tariff regulation, it will be open to the government to consider how and where it should adapt the rates of duty to this object of promoting more competitive conditions in particular industries.

Failing an increase in the degree of competition, the proportion of the productivity increase which will be passed on to the weaker sectors will, of course, be smaller than otherwise. But even in this case, the higher profits in the progressive sectors may indirectly lead to an improvement in the real income levels of the weaker sectors. They may do so either by providing additional self-finance — and thus leaving free for investment in the weaker sectors funds which the strong ones would otherwise have demanded from the capital market — or by raising the volume of funds which the State, by taxation or other means can channel into public investments or government-guided investments.

A phenomenon to which I would draw special attention in the Italian case is the inequality, to which I have referred, of productivity levels between different producing units within one and the same sector, even when this is what I have called a strong sector. Some of these units are not only on a lower productivity level than the more advanced ones, but are able to raise that level less fast. Only if the rise in the cost of labour is kept within narrow limits, can these weaker units survive without having to make large additional capital investments which would constitute an extra drain on national savings. The importance of enabling the weaker units in the strong sectors to survive is the more apparent when we consider that the productivity levels of these units are higher than the levels prevailing in the other sectors. The phenomenon of unequal productivity levels within sectors which at present exists in Italy is partly the consequence of a prolonged and rapid expansion of demand in conditions of capital scarcity, combined in some cases with a decline in foreign competition. It cannot be the aim of Italian economic policy to reduce this inequality by means which would imply raising the average capital-intensity of the system as a whole beyond the level which is compatible with the objective of providing jobs for the unemployed and underemployed.

The future of large sectors of the Italian economy depends on the policy which I have just described. Among them are a large part of agriculture, the major part of artisan activities, and those parts of other sectors which would not be able to meet the financial and technical requirements of increased mechanisation. And not least to gain would be the public finances, which would benefit from larger tax revenues, lower interest rates for borrowing on the capital market and lower costs of the capital goods required for public investment projects.

I may sum up this part of my lecture by saying that Italy's wage policy, which is directed towards limiting the rise in the cost of labour, aims simultaneously at several objectives of fundamental importance:

(a) at guaranteeing monetary stability,

(b) at promoting faster capital accumulation, and

(c) at influencing the distribution of the new capital so as to raise the proportion that is used for expanding employment, and to keep capital-intensive investments within the limits that are appropriate to the conditions of the Italian labour market.

It should be noticed too that the pursuit of these aims will entail action designed to increase the degree of competitiveness of Italian industry or, at least, to control the effects of monopolistic positions.

5. The Industrialisation of the Mezzogiorno within the Framework of Present Italian Economic Policy

As I have indicated, the Italian economy is faced with a series of structural problems the solution of some of which may be partly in conflict with the solution of others. Thus we have, first of all, the problem of securing increases in productivity all over the economy within a framework which, it is intended, should remain basically that of a free market economy. At the same time we must accelerate the rate of absorption of the unemployed, and this is a task which requires a measure of Government intervention. Further we have the problem of harmonising the policy of trade liberalisation and tariff reduction with a policy of aiding the development of industrial activities in a region — the South — which is inhabited by nearly 40 per cent of the Italian population, and which contributes between 60 and 70 per cent of the current natural increase. And finally we have to provide for increased capital formation in a situation where there already exists a deficit in the balance of payments on current account which exceeds the possibilities we can contemplate in the near future of foreign capital imports.

In face of the necessity of reconciling these requirements, it is worth considering the main types of economic policy in relation to the Italian situation.

As regards a policy of complete non-intervention on the part of the Government the verdict is clear. Its inadequacy for dealing with the Italian situation is generally admitted. A second type of policy — that of raising effective demand, or what is usually called a "Keynesian policy" — is inapplicable to the Italian situation, as the Italian monetary authorities have rightly maintained ever since 1948-49. This is because in Italy the unemployment does not come from a slowing down of the economic machine, a slowing down which leaves temporarily unutilised some part of the existing stock of capital. It comes from a lack of balance between the available stock of capital and the labour force, a lack of balance which is made more serious by the fact that it is concentrated in a particular geographical area. And this situation can be corrected only by speeding up the process of capital accumulation in the area concerned, and not by the mere expansion of aggregate money demand.

A third type of policy, of which the Cassa per il Mezzogiorno has been the principal instrument since 1951, consists in measures of intervention designed to facilitate economic development in the backward areas through the building of the so-called infrastructure, through investments and other improvements in agriculture, and through the granting of incentives to industrial investment.

This type of policy, which in Italy has been called a "pre-industrialisation" policy, was probably the only one which could have been followed in the situation of 1950-51, when the government took the decision to assume heavier responsibilities in respect of the economic development of the South. But it cannot by itself counterbalance the tendency for industrial development to be concentrated in the North. Its inadequacy depends on the fact that the process of capital formation necessary for a solution of the Southern problem cannot be obtained otherwise than within the framework of the development process of the entire Italian economy. The existence, to which I referred earlier, of a partial conflict of aims means that it is only through a broad vision of the problem that the whole complex of aims can be approached in the most economical manner.

It was to this need for a general development policy that the Vanoni Plan — drawn up in the second half of 1954 — responded. Essentially the Plan looks towards a form of government action

which is now usual in almost all countries that are industrialising. This action stems from the idea that when an autonomous mechanism of economic development is lacking, the State must establish, in the form of a definite programme, the lines of development which it wants to follow, the volume and pattern of the investments which are required, and the economic policy which is necessary if such investments are to be realised.

Such a policy must, if we want to preserve and expand a free market economy, conform to two principles. On the one side it is necessary to encourage private enterprise. On the other side the State, since it has to assume the overall responsibility for the development process, must be ready to promote, and if necessary carry out itself, all those investments which are essential to the process but are not undertaken by private enterprise. And since the development process is centred on industrialisation, it is in the field of industrial investment that the State will evidently need to intervene most actively.

For this purpose resort must be had in the first instance to two sets of measures. One consists in the creation of institutions for industrial finance able to provide funds and take risks on a scale commensurate with the investments that are expected to come from private enterprise. And in Italy, thanks in part to the support given by the International Bank, considerable progress has been made in this direction.

The other set of measures consists in the provision of incentives adequate to the purpose of counterbalancing the higher costs of establishing firms in a new industrial area as compared with an old one. The scope of these measures has been greatly extended by the Law of July 1957. This does not merely grant additional funds for financing further public investments. It also provides incentives intended to encourage more private investment in the South, especially in industry.

These incentives, which represent a rather new departure in Italian economic policy consist primarily in contributions towards the cost of new industrial plant, and especially towards the capital required for providing the services which are needed by industrial establishments, such as road and rail links, water and power supply, and sewage disposal.

In addition a new type of measure has been introduced, a measure which is designed to prevent self-finance from being concentrated in the North or, that is, in the area where the greater part of the profits of Italian industry is earned. Thus the law grants to firms in all parts of the country exemption from part of the income tax — that part which is levied on a proportional basis (3) — on business profits which are invested in the South, subject to the condition that the non-taxable part of profits may not exceed 50 per cent of total declared profits nor exceed 50 per cent of the total sum invested in the South. This exemption is equivalent to a subsidy of about 25 per cent of the capital coming from business profits.

The law also regulates the distribution between North and South of investments by State-owned industrial establishments. It provides that investments by these establishments in the South should not be less than 40 per cent of their total gross investments.

This is undoubtedly the most delicate point in the policy of government action. And I would like, in this last part of my lecture, to deal with it somewhat more fully by referring to a few general considerations which are suggested by an experience coming from a double source: that of twenty five years' association with the largest State institution controlling industrial enterprises along with the briefer, but intense experience of the development policy of the South.

This second experience, which I believe is similar to that of many other countries, shows quite clearly that the availability of funds, and the existence of powerful incentives, are not always sufficient to induce all the industrial activity which the market and the existing "external economies" justify, and which the development plan requires.

It is sufficient to observe that in the South of Italy — despite its many advantages compared with other underdeveloped areas — almost all the new industrial activities of importance have been promoted by groups which have their entrepreneurial centre outside the area, or else in the State. Significant progress has, it is true, been made by local enterprise. But there can be no doubt that it would have been lacking had the infrastructure, the financial provisions, and the special incentives not been accompanied by public and private initiative coming from outside the area.

(3) The *imposta di ricchezza mobile.*

And since the process of development cannot be subordinated to the entry into the area of entrepreneurship from outside, it is clear that the State must consider the advisability of directly intervening itself.

6. Organisational Rules for Public Enterprises Operating in a Market Economy

It follows from what I have so far said that if we want to be realistic, the question which we must ask today is not whether the State should or should not act as entrepreneur, but what type of action towards this end it should undertake, and how far it must go in order to foster a development process that will really give rise to a market economy rather than represent a transition towards an economic system of a collectivistic type. In other words, it is essential to have a clear conception of the limits within which State action must be confined if the State is merely to assume the political responsibility for the development process, and not to take over the permanent managerial responsibility for running industry.

There seems to be no doubt that in order to satisfy this criterion, productive activity carried on by the State should conform to three principles:

1) The business units run by the State should operate under the same conditions as those run by private firms.

2) Each unit should have complete economic and financial independence, so that it is possible to evaluate the results of its operations in terms of costs and receipts and thus to appraise the market rating which the unit has achieved. In particular it is important (a) that the credit enjoyed by the individual business enterprise should not be confused with that enjoyed by the State, and (b) that the profits of one business undertaking should not be used to conceal the losses of another.

3) The running of industrial undertakings by the State should be regarded as temporary, in the sense that the management should be passed over to private hands whenever State management is no longer useful for development purposes.

The most important of these three principles is undoubtedly the first, i.e. equality of conditions as between public and private enterprise. What this means is that public enterprise should neither be saddled with burdens that are unrelated to its normal operations, nor be endowed with special privileges. For in the first case, given that oligopolistic situations are frequent in the sectors of large-scale industry where public intervention is most necessary, there is the risk of establishing price levels which allow private competitors to make excessive profits. And in the opposite case the survival or emergence of competitive private firms would be rendered impossible, and the result would be *de facto* nationalisation of the sector concerned.

Equality of conditions is guaranteed first and foremost by the rules governing the method of financing public enterprises. The rule should be that these enterprises must raise the funds they need directly from the capital market without benefit of special government guarantees. Obviously the State will contribute to the capital of such enterprises, but its contribution should depend on Parliamentary appropriations sanctioned by special legislation. There should be no automatic allocations of funds at the time of the voting of the general Budget or endowment of the public sector with the profits of State monopolies. Other essential points are the absence of tax exemptions, and of priority rights to government orders or to the allocation of scarce raw materials, etc. On the other hand, the State enterprises ought not to be burdened with the costs of general measures of public policy such as " political prices ", the payment of wage rates above the ruling level, and so on. It is also implicit in the notion of equality of conditions that the public enterprises should be joint stock companies subject to the ordinary company law.

The general effect of the application of the three principles which I have mentioned is to reconcile the idea of creating a market economy with the necessity — in order to bring that economy into existence — of promoting industrial enterprise through State action. It is of cardinal importance in this connection that those who are responsible for managing the State enterprises should be obliged to give an exact account of what has been done with the part of national saving which the State has allocated to each such enterprise. And it may be added that the ultimate aim of the financial policy of each enterprise should be to have its shares quoted on the Stock Exchange; for in this way it reaches a position where private investors share in the risks of the individual State-controlled enterprise, and where, at the same time, the prestige and independence of the management of that enterprise is increased. It is hardly necessary to point out that an arrangement of this kind serves not merely to maximise the efficiency of the public enterprises, but also to protect them and public institutions from the risk of political corruption. In particular it helps to avoid the danger that the private interests of individual politicians or political groups may be given the guise of national aims which are liable to divert national savings from correct and proper uses.

It will at once be clear that this line of thought, which has in Italy governed the constitution and activities of I.R.I., is markedly different from that which up till now has been characteristic of the conduct of public enterprise in Western countries. The difference is due to the fact that nationalisation policies have been influenced by two factors which are extraneous to the present framework of experience in the underdeveloped countries. The first is of an ideological kind. Under the influence largely of Marxist thought, the most progressive groups in the Western world have been inclined to identify social progress with the gradual nationalisation of the means of production. Aside from the fact that this conception now seems to be losing its hold it does not appear that any similar concern plays a dominant role in the plans of the non-collectivised, underdeveloped countries. The second factor is the influence exercised on the institutions formed in the past by the fact that up until the eve of the second World War capital formation did not constitute in general a problem of economic policy. There was much more concern with the problem of changing the process of income distribution than with that of intensifying capital formation. For the latter was already satisfactorily provided for by the spontaneous forces of the market; and, for some time, especially under the influence of Keynesian thought, the fear had been that there might be an excess rather than a shortage of capital. In the underdeveloped countries the situation is, of course, the opposite; there the heavy unemployment is linked not with the existence of large reserves of unused equipment but with an insufficiency of equipment. And the problem is much more one of raising the level of income through an increase in the capital stock than one of distributing income differently. It is not, however, possible to regard this problem as being automatically solved. But if we hold that it is best solved by means of a mechanism driven primarily by market forces, the criteria according to which public enterprises engaged in production should be organised and managed are radically different from those now generally followed.

Thus, when Italy's Ten-Year Programme points to direct intervention as a way of making good for specific gaps in private activity, it is proposing a line of action which is indispensable but which must be seen as falling within the general framework that I have described. This line of action may be defined more exactly by saying that the industrialisation policy cannot be confined to introducing a given set of incentives with the State merely looking on as a spectator of the reactions to which the incentives give rise. It must also take the form of measures designed to guarantee that specific production units are set up in specific places. It follows that, while the general aims of the Vanoni Plan relate to the whole Italian economy, the activities of the institutions responsible for setting up industries will tend to be localised in the underdeveloped areas.

This does not mean that we run the risk of creating in the South an economic system which is in opposition to the system of private enterprise which is firmly established and continually expanding in the North. The action which is under way will in fact constitute the basis for a much larger volume of private productive activity even in the South than could otherwise take place. Moreover, we may ask how it is possible to call the present-day system of the Southern provinces "private" when it is so largely dependent on public works, on appointments to the Civil Service, on labour camps and on very limited industrial activity, and when this industrial activity, just because it is so limited, is in good part dependent on State aid.

Finally, there is no doubt that under an economic policy which is based on the principles I have described the only interests that may possibly be harmed are those which are linked to stationary positions and therefore to some kind of rent. Others will have everything to gain from a policy which aims at the formation, over the whole country, of a stock of modern productive capital equipment; and not the least to benefit will be the interests of the most advanced part of the Italian economy.

Rome PASQUALE SARACENO