

# Fiscal Policy and Italy's Economic Development

by

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1. — In previous periods the fiscal theory centered around the effects of public finance on the distribution of national income. But since some decades we find a large and growing interest in the relations between fiscal policy and the size of national income and consequently also in the use of finance to promote and to control the rate of economic development. The main line of this evolution has been made up by researches about the function of public finance in offsetting cyclical fluctuations and in ensuring the maintenance of full employment. For this purpose new objectives and new tools of fiscal policy have been elaborated with reference to the conditions and requirements of economically mature countries.

The development of backward countries has indeed also aroused remarkable interest, particularly during and after the last war. It has been recognised that policies suitable for these countries can be based partly on the schemes derived from the experience of mature economies. The instability of these economies is accounted for mainly by the cumulative effects of changes in effective demand and in income: changes in one direction in demand evoke changes in income which react, always in the same direction, on demand and so on. A similar circle is found also in backward economies: demand is scarce because the employment of factors and income are scarce; on the other hand employment (and income) do not expand because they are not stimulated by a sufficient demand and so on. The use of fiscal policy to promote recovery, by expanding total expenditure during a depression, resembles its use against the vicious circle of poverty which creates poverty, by bringing into being — through public expenditure or a lowering of taxes or other inducements to private expenditure — a new demand which speeds up econo-

mic development. The analogy is still more obvious if, instead of comparing this function of fiscal policy in the economic development of backward countries to a policy of cyclical stabilisation, we compare it to the expansion of total demand as a means for shifting mature economies from an under-employment equilibrium to a full employment equilibrium.

On the other hand a far-reaching difference between the policies suitable for mature economies and a policy aiming at the development of backward economies, is commonly held to depend on the fact that the latter lack a proper degree of complementarity between the available factors of production. The relative scarcity of certain factors of production might easily lead to inflationary pressure if a policy aiming at expanding demand were adopted. In the case of backward countries, such a policy must therefore be supplemented or even substituted by measures fit to preserve the equilibrium between demand and supply — on the whole and in each separate sector — by eliminating or at any rate restricting inflationary pressure. These measures may be divided into two groups: foreign financing and a system of financial and, if necessary, physical controls to check consumption and regulate investments.

The scope of foreign financing is deemed to be rather narrow both because the concrete size of requirements is usually far higher than the flow of foreign capital can possibly be expected to be (1), and because main reliance upon domestic financing « is the pre-requisite for enabling countries to implement the social, political and economic policies which they consider most suitable for the improvement of

(1) See particularly *Industrialisation et commerce extérieur*, Société des Nations, Genève, 1945, pp. 82 ff., 147.

their standards of living» (2). In conclusion, therefore, the main role in the development of backward countries has to be played by domestic funds mobilized by an efficient fiscal policy.

2. — Italy occupies an intermediate position between the more advanced and the more backward economies and, moreover, its economy is characterised by substantial differences in the stage of development between one department and another. There are departments where economy as a whole, including agriculture, industry and services, may be compared with that of the most advanced countries, and others which present all the features of backward economies: a low per capita income, a low level of industrialisation, a large surplus population in agriculture and even an insufficient development of monetary economy.

The best way of giving a general idea of these local differences is to compare some indices of economic activity in Southern Italy with the same indices in the rest of Italy, bearing in mind however that there are very important differences even within these two large groups. According to the last census of the population (1936), the active population in Southern Italy was 37.7 per cent and the population engaged in industry and transports 10.4 per cent of the total (as against 46.3 and 17.0 in the rest of Italy). The persons engaged in industry in Southern Italy represented 19.3 per cent of the Italian total, but this percentage varied from 32 per cent for handicrafts and small industries to 15 per cent for medium-size and 11 per cent for large industries (figures of the 1938 industrial census). In 1938 the income per capita was estimated at 1700 lire in Southern Italy and at 3100 lire in the rest of Italy (3).

Consequently, Italy's conditions offer a wide scope both to the measures suggested for solving

(2) From a report of the Sub-commission on Economic Development quoted in *Methods of Financing Economic Development in Underdeveloped Countries*, United Nations, Lake Success 1949, p. 114. See, in the same sense, a memorandum of the International Bank for Reconstruction and Development reproduced in the above mentioned volume, p. 94.

(3) These figures are taken from a study by A. MOLINARI, *Southern Italy*, in this review, 1949, pp. 25 ff., which contains further ample documentation.

the cyclical and structural problems of mature economies and to those suggested for forwarding the development of backward economies. Further, since the economic relations between regions in the same State present some close affinities with the economic relations among States, the fact of having regions at different stages of development, side by side under the same political and economic regime, offers an interesting test for certain aspects of economic relations between backward and advanced countries, namely foreign loans and the effects of the industrialisation of backward countries on the size of international trade.

At this point, it must be duly stressed that there is ample proof that the industrialisation of backward countries is not detrimental to the development of international trade, but generally encourages it (4). Applied to the regions of Italy, this means that the development and industrialisation of Southern Italy may be accompanied by an expansion of trade between Southern Italy and the rest of the country and consequently by further economic progress for the latter. Conflicts of interests between the regions may therefore accompany a policy incapable of promoting the development of the country's economy as a whole, but not in the case of an active policy which exploits the industrial capacity of the advanced regions in order to promote progress in the rest of the country, so that this progress may in turn expand markets and the possibilities of development in the advanced regions.

3. — In considering briefly the relations between fiscal policy and economic development in Italy, we must observe first of all that the existence of an economically advanced area, with unused productive capacity (5), forms a more favourable background for the development of backward regions than is to be found

(4) See *Industrialisation et commerce extérieur*, op. cit.

(5) No analytical figures concerning the degree of exploitation of industrial plant are available, though some estimates were attempted in *Italy, Country Study*, ECA, Washington, February 1949, pp. 16 ff. Since the time to which these estimates refer, the exploitation of industrial plant has increased as a whole; but judging from the economic press, statements made by industrialists and industrial associations, etc. there is reason to believe that there are still large margins of unused capacity. See for instance the statements by Alberto Pirelli and R. Lombardi, in « *Rivista di politica economica* », June 1950, pp. 69-757.

in countries where backward conditions are general. We have already seen that, in the latter case, the possibility of forwarding economic development by an expansion of total demand is limited by the disequilibrium existing between the large supply of certain factors — mainly unskilled labour — and the scarcity of others, mainly industrial equipment and technical knowledges.

But if the factors which are scarce in one part of the country are available in fairly large quantities in the other, a policy in favour of the less developed areas, through public expenditure and inducements to private expenditure, is faced with less dangerous and less immediate bottlenecks than in typically backward countries, provided it is planned and carried out on a nation-wide scale.

For instance, a concrete analysis of the possibilities of development of Italian economy, would probably show the main bottleneck in a shortage of skilled labour, particularly in certain regions (6). But this shortage could obviously be overcome far more slowly and with greater difficulty in a country at the first stage of industrialisation than in a country like Italy where there is already a considerable number of trained workers, an extensive even if unsatisfactory school system and, above all, the possibility of efficient vocational training. Fiscal policy (in this case public expenditure), finds a readily responding environment and can aim, therefore, at rapidly removing the bottleneck of skilled labour.

To give a further example, another serious bottleneck might arise from monopolistic restrictions (7). Here again the very existence of a comprehensive governmental apparatus affords — in spite of its shortcomings — important tools for overcoming the obstacles pla-

(6) Foodstuffs, another bottleneck to which attention is frequently called, is probably less important. In fact agricultural production barely reached pre-war levels in 1949 and could be substantially increased by using fertilizers and other productive implements which could be manufactured by the present surplus capacity (see *Italy, Country Study*, op. cit., p. 40). On the other hand markets for certain important foodstuffs are depressed even at current levels of production and steps have to be taken to sustain prices. A progressive increase in demand should be filled up rather easily.

(7) See *Economic Survey of Europe in 1949*, United Nations, Geneva 1950, pp. 102-103 and G. Demaria, in « *Rivista di politica economica* », June 1950, pp. 651-653.

ced in the way of development by monopolistic practices. The more so because the State control of some leading industrial sectors affords wide means of direct action in framing the industrial and price policies. That State ownership and control of industry have not been worked up to achieve a consistent economic policy (8) is another matter and does not exclude the possibility of efficient action.

4. — It should be added moreover that, with the exception of very primitive economies, the difficulty of finding productive factors in adequate proportions never means the existence of absolute limits to a policy of economic development. The combinations of factors of production are not rigid, but can vary considerably. It has in fact been remarked in the main consumption goods industries that a choice between more or less mechanised methods of production is possible and the yield per unit of capital is not necessarily greater in a highly mechanised factory than in a small concern (9). Moreover, even in certain industries the yield of more capitalistic processes appears at first sight to be higher, in overpopulated countries this is not a decisive reason for putting aside combinations which require more manpower and a lower capital outlay (10). In fact it is necessary to consider both the immediate social costs saved as a result of a greater employment and the prospective advantages of a growing economic activity, in terms of external economies and of an expansion of the home market.

(8) *Italy, Country Study*, op. cit., pp. 39-40.

(9) *Industrialisation et commerce extérieur*, op. cit., pp. 58 ff.

(10) With regard to the investment policy now being followed in Italy, this point is clearly set forth in *Italy, Country Study*, op. cit., p. 50-51. In connection with the big investments in the textile sector, we read: « Apparently this investment is mainly of a cost-saving or modernization character. The question may be raised to what extent this is required to make export costs competitive and to what extent these investible resources might better be used to expand capacity and employment in this or other industries ». And again: « A similar question may be asked concerning a part of the planned investments in the machinery and equipment industry... It would seem that the proposed structure of production for this industry should be carefully reviewed in order to determine whether, within the limits of foreseeable foreign and domestic demand for capital goods, more investment could not be used for expansion of capacity rather than to increase output per man. »



In reality, those persons who in Italy assert the rigidity of productive combinations and the impossibility of choosing the solutions best suited to our economic structure base their conclusions, explicitly or implicitly, on the necessity of adjusting our costs to international prices. But this necessity, in the extremely crude form in which it is frequently asserted in Italy, is only compatible with a conception of the advantages of international trade based exclusively on the consideration of short run costs for a single firm. As soon as we take into account not only these costs, but also long run effects and social advantages (11), the expediency of taking international prices as parameters of action becomes a matter to be considered case by case (12). Once the limit of a strict adjustment to international market conditions has been removed, there is a reasonable freedom of choice between the possible combinations of factors of production, and policy is faced with the problem of substituting the combinations which would have been chosen by private decisions by others more in keeping with social costs and advantages. Generally speaking, a number of factors which are important and real even if private accounting must disregard them, should be allowed to play a due part in determining economic development.

Fiscal policy can work to this end with a set of means. On the one side there is the full recognition of private motives and the attempt to harmonise them as far as possible with social motives, so that the social cost and advantages may become elements of the private calculation. This is what happens in the case of tariffs (if

(11) The term is rather indefinite and is only used here for the sake of brevity. It should then be specified that it is intended to include not only elements which are merely relevant to a collectivity, but also elements having a direct impact on business decisions, such as the advantages to each enterprise from the general process of economic development, in terms of enlarged markets and reduced costs.

(12) Among the writings on the revision of the theory of gains by international trade, I would choose one quotation only which is particularly appropriate in the case of Italy: « The conclusion that a country can increase its real income by importing even those goods which it can produce more efficiently than external suppliers, if by so doing it can specialise on other lines of production in which its advantage is even greater, loses its validity when the choice for a country is not between more or less efficient uses of available resources but between employing some resources or leading them idle ». (*National and International Measures for Full Employment*, United Nations, Lake Success 1949, p. 7).

the latter are on a level with the social advantages of protection) and still more typically in the case of various forms of subsidies and incentives (13).

On the other side, private decision can be replaced *in toto* by collective calculation through nationalisations and the creation of public undertakings. Here too there is no lack of typical examples such as forests, roads and railways. Needless to say the true substance of the nationalisation of certain economic activities lies in the substitution of criteria of collective utility to criteria of private utility. If a public undertaking endeavours to act according to the criteria of a private manager, it loses sight of its very aims.

5. — In the same way fiscal policy should have wide opportunities as to the specific Italian problem of the disequilibrium between economic levels in the different regions. Clear evidence has indeed been brought, that this disequilibrium does not depend upon, or is at least only partially accounted for, by natural causes (14), but is due to a difference in en-

(13) At this point mention should be made of one of the most important results of recent studies on economic development in backward countries, namely the insufficiency of an action based exclusively on the old instruments of protective policy. In backward countries, even to ensure the whole of the existing internal demand to home industry may not suffice to provide it with a large enough market (see K. MANDLBAUM, *The Industrialisation of Backward Areas*, Basil Blackwell, Oxford 1947, p. 5). On the other hand, since the inferiority with regard to foreign competition depends largely from environmental factors, direct action taken to modify these factors, by improving public services or expanding the home market, may advantageously substitute or integrate a protective policy (see *Industrialisation of Commerce Exterior*, op. cit., pp. 88-89), and may even be a necessary condition for the good issue of the protective policy.

(14) See particularly G. GENZATO and S. GUIDOTTI, *Il Problema Industriale del Mezzogiorno*, Ministry of Industry and Commerce, Roma 1946. On the basis of this and other studies on the subject, it is very interesting to underline the part played by commercial policy in determining the present economic inferiority of Southern Italy. At the time of the political unification of Italy there were no substantial differences in industrial development between Northern and Southern Italy. But industry in the South, which had developed under protection, suffered very much from the removal of customs inside Italy and from the passage to international free trade. Industry in the North, already accustomed to foreign competition, found itself at an advantage; so it developed rapidly and was able to exploit in its favour the protective policy started in the eighties. At that time Southern industry had already fallen too low to benefit from protection. Measures of compensatory fiscal policy

environment conditions ranging from less efficient public services in the Southern regions, to the poverty of Southern markets, to lesser external economies for Southern industry as a whole and to the persistence of backward social structures (15). In a situation of this kind the spontaneous mechanisms, which should re-establish equilibrium through the movements of factors towards the areas where they are comparatively scarce and the levelling of the marginal productivity of factors between one place and another, do not function. There is, on the contrary, a cumulative action which, if it is not offset by public bodies, leads to greater and greater differences in the economic standards of rich and poor areas (16).

Quite apart from phenomena of inertia or friction or from considerations which escape monetary estimation, this can easily be explained by the fact that in backward areas there is not only a shortage of capital, in the meaning and dimensions of business accounting, but there is also a shortage of environmental factors (including the productivity of labour) which are free for private enterprises. Since the decisions to invest depend upon the global productivity of capital, including the produc-

tion in favour of Southern Italy were subsequently adopted at various intervals, but always on an insufficient scale.

In view of this historical experience, we must knowlege the solid ground of an observation contained in the *Economic Survey of Europe in 1949*, op. cit., p. 104 in the matter of the liberalisation of inter-European trade: « ... the removal of protective measures might seriously hinder the growth of industry in areas where development has lagged. For example, in the case of Southern Italy, the freeing of trade may tend to retard rather than help development unless it is accompanied by some form of special external assistance ».

(15) The importance of political and social innovations as prerequisites for the development of backward countries is stressed in *Industrialisation et Commerce Exterior*, op. cit., pp. 51 ff.

(16) The insufficiency of the spontaneous equalizing mechanisms is generally neglected in plans for super-national economic unions (a strong criticism of which is to be found in R. W. ROYCE, *The Small Nation and World Trade* in *The Economic Journal*, April 1944). On the other hand we cannot but consider with scepticism the hypothesis that in the framework of such unions efficient policies might be adopted to compensate the initial inferiority of certain member countries. Indeed, even in the oldest states and federations we find depressed areas and a lack of an adequate fiscal policy.

Consequently, to consider the problems of a national unit, as we are doing in this paper, is not a token of nationalistic bigotry, but merely depends upon the desire of reasoning about ways within which there is some probability of achieving a uniform fiscal policy.

tivity of environmental factors, it is perfectly plausible that a shortage of capital may be accompanied by a low marginal productivity, and that investors may prefer to lay out their money not in the areas where there is a shortage of capital, but in those where capital is plentiful.

Hence the difference in economic standards can only be overcome by the action of public bodies both by creating incentives for the development of backward areas through public expenditure and by allowing an adequate accounting of the advantages which individual enterprises present from the point of view of the collectivity. It has been remarked in fact (17) that in a backward country each enterprise contributes to an extent — that may often be considerable — to the improvement of the conditions of the existing enterprises and of those which may subsequently come into being, either by expanding their markets or by reducing their costs in a number of different ways. For lack of integration, these advantages give no yield to the enterprise which creates them and cannot therefore become an element of the entrepreneurial decisions. Here again, if these advantages are to have full weight in determining economic development, there are two ways to follow: to impute to the entrepreneur part of the advantages he creates for the collectivity, *via* the granting of bonuses, subsidies etc.; or to cover various enterprises with a unified accountancy, so that the advantages which each of them affords to the others show itself in the unified balance-sheet (18).

6. — The conclusions which can be drawn from this summary analysis are the following:

(i) the problem of economic development in Italy, as in all under-developed countries, can find no satisfactory solution if it is left to the free play of economic forces. To quote from a recent F.A.O. report, « a rocket or moon-ship must attain a definitely established « speed of release » before it can escape from the

(17) MANDLBAUM, op. cit., p. 11; P. M. ROSENSTEIN-RODAN, *Problems of Industrialisation of Eastern and South-Eastern Europe* in « *The Economic Journal* », June-September 1943, p. 207.

(18) See again the works quoted in the previous note.

earth's gravitational field and become a free-moving astronomical object. Similarly, the process of development in any country must attain a given speed before it can exceed population growth. Only then can it begin to improve standards of living, reduce excessive farm population and help slow down population growth » (19). The first impulse must come from an expansion of the home market and a change in environmental conditions. Fiscal and trade policy are not enough to fulfil these tasks, but they can however afford a substantial contribution in the framework of the general government policy;

(ii) Italian conditions; unlike those of colonial countries, present special problems of inter-regional equilibrium and, at the same time, offer opportunities to inter-regional cooperation in economic development. The national indices of economic activity and capacities are not a realistic basis for determining development possibilities. The existence of an industrially advanced area reduces the importance of the bottlenecks standing in the way of a policy of economic expansion. But also this inter-regional integration cannot be expected to be achieved as a result of spontaneous action. By themselves, in fact, the differences between rich and poor areas are very likely to increase rather than to shorten and the distribution of factors of production does not follow the simple mechanism of elementary theory. Here too fiscal policy must play an important role, particularly in guiding the regional distri-

bution of public expenditure and the aggregate effects of finance on expenditure and enterprise towards a relative expansion of the Southern markets and the protection of the development of Southern industry;

(iii) the Italian situation makes physical bottlenecks to be not very tight, and it makes less urgent also the more general limit which comes from the size of internal savings (20). In fact, the availability of savings sets a rigid limit only in conditions of full employment, when real income is not allowed to increase in a short period. But this is not the case in a country like Italy, which has a large amount of unemployment and an industry working considerably below capacity. Unfortunately no attempt has as yet been made to determine the levels of income and savings which could be achieved in Italy with the full employment of the factors that are available now or that are likely to become available in the near future. Only an inquiry of this kind, accompanied by an analysis of the principal physical bottlenecks and of the prospects for the balance of payments (as they should result from a proper combination of fiscal and commercial policies), could lead to a concrete determination of the rhythm and means of a policy of economic expansion.

(20) The availability of savings as an inflexible limit is stressed for instance by F. A. and V. C. LUTZ, *Monetary and Foreign Exchange Policy in Italy*, Princeton University Press, 1950, p. 29 and by C. BRASCIANI TURRONI, *The Problem of Depressed Areas and the Financing of their Economic Development*, in « Review of the economic Conditions in Italy », May 1950, p. 173. A more flexible view is taken by B. FOWLER, *Monetary Reconstruction in Italy*, King's Crown Press, New York 1949, pp. 121 ff.

(19) *Methods of Financing*, op. cit., p. 60.