

The Italian Investment Problem Revisited

by

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1. — The controversy over the rate of Italian investment which has been going on intermittently over the past three years has performed an extremely important function. It has led to a consideration of the investment problem along modern lines, and in terms of the national income approach. It has focused attention increasingly on the question of the production level which is consistent with monetary stability, rather than, as had previously been the case, on the relation between production and the supply of savings in monetary form. It has not been without effect on the actual policies of the Italian Government and the Bank of Italy. It has narrowed down the difference between the two opposite viewpoints to a matter of degree rather than of principle. In some respects, however, the controversy has been moving around in a circle, and has acquired an increasing tinge of unreality. There has been a tendency to discuss the problem in terms of the merits and the dangers of a quantitative expansion of credit and investment, without due regard to other equally important factors which bear on the problem of the optimum investment level. The discussion has too often degenerated into an empty tug of war between the Keynesian and «classical» economics. Finally, new factors, including the international tension which has followed the invasion of Korea and the related defense problem, have become injected into the picture. All this seems to justify a brief reconsideration of the problem, and an attempt to put it into a somewhat broader context and perspective.

2. — It so happens that the present writer was among those who, at a very early stage of

the game (1), and before the problem had become a «cause célèbre» through the publication of the famous — or shall we say notorious? — ECA country study of 1949, pleaded for a bolder and more up-to-date approach to the investment problem on the part of the Italian authorities, notably the Treasury and the Central Bank. Since, however, that plea has apparently been interpreted by some commentators (2) as a sort of advance endorsement of what could be described as the ECA viewpoint, it may be desirable to stress that the framework for an investment policy outlined in my book was fairly comprehensive, and was not focused primarily on the advocacy of a purely mechanical expansion of credit. Actually, five basic principles of policy were outlined, as follows: (a) necessity for continued effective control of the stability of the price structure; (b) a fundamental change in methods of tax assessment and collection, and a better distribution of income through tax and land reform; (c) large-scale cooperation between public and private planning for the use of Marshall Plan aid; (d) a clear realization of the need for a full employment policy and its implications, including the ruthless elimination of high-cost and inefficient units, going hand in hand with a new wave of industrialization made possible through Marshall Plan aid; (e) as a final fundamental prerequisite for industrial expansion and for the success of the Marshall Plan in Italy, the adoption, and implementation by degrees, of a policy of cheap money, (3).

(1) BRUNO FOA, *Monetary Reconstruction in Italy*, «Carnegie Endowment for International Peace Series», New York, 1949.

(2) Including Professor and Mrs. F. LUTZ, in *The Economics of Freedom* edited by Howard S. Ellis, «Council of Foreign Relations», New York, 1950.

(3) *Monetary Reconstruction*, etc., pp. 140, 141.

3. — In retrospect, and speaking with the benefit of hindsight, I still think that the framework which I ventured to outline in the Fall of 1948 was a pretty good one, and perhaps more pertinent to paving the way toward a solution of the Italian investment problem than the somewhat crude controversy, centered around the sheer volume of credit and investment, which broke out a few months later. And while I fully recognize, as indicated above, that the controversy, by dramatizing, even though in an oversimplified form, issues of the greatest significance, has rendered great services, a shift in emphasis and a search for more fundamental factors and relations appear to me by now overdue. In what follows, an attempt will be made to review briefly, together with the background of the problem, the main bottlenecks to full investment and employment which obtain under present conditions, and possible remedies.

4. — I shall begin by restating certain truisms which, however, are often lost sight of in the heat of controversy. The first is that, in the present state of statistical techniques and economic knowledge, the determination of the optimum investment level, defined in such a way as to satisfy the requirements of both full employment and monetary stability, is, in any specific situation, largely a matter of trial and error. This is the more so when, as is the case in Italy, structural difficulties, originating from overpopulation in relation to resources and related balance of payments difficulties, stand in the way of expansion in investment and employment even when some of the necessary resources (*i.e.*, manpower) are available for employment. Consequently, in the present situation (and disregarding temporarily, for the sake of simplicity, the post-Korean complications), no one can tell definitely whether the current level of Italian investment and production can or cannot be substantially increased.

5. — The second truism is that the indicated structural difficulties have the tendency to keep the maximum level of investment in Italy that is consistent with the avoidance of outright inflation considerably below the optimum investment level, which would correspond to the

point of full or near-full employment. So long as the supply of productive factors other than labor remains very limited, and inelastic in terms of income, a certain part of the labor force remains not only unemployed but, for the time being, unemployable. Once all available supplies of physical resources have been attracted into production, full investment is reached at a point well below that of full employment. The maximum practicable level of investment falls short by far of the optimum level at which unemployment other than that of the frictional variety disappears.

6. — The third point, which is also a truism, consists in the surmise that, while it cannot be stated that all physical resources (other than labor) of Italy have been actually attracted into production, no dramatic increase in the volume of Italian production could be expected even under extremely favorable assumptions concerning world trade and the balance of payments situation. Italy could improve somewhat its economic status by going more deeply into specialized industrial production, somewhat along the lines of the Swiss economy, but could never achieve the desired level of industrialization, and raise substantially real income per head, except within the context of a much higher import balance and related offsets in its international accounts.

7. — These basic considerations lead by and large to the conclusion, which is the heart of what might be called the Bank of Italy and Italian Government case, that the expansion of investment and employment in Italy is ultimately limited by structural factors, and that consequently chronic large scale unemployment is not amenable to the monetary treatment which would be in order under different conditions, or in the event of cyclical or temporary unemployment. They also point to the conclusion, which is a commonplace, that the problem of outlets for Italian emigration and surplus manpower deserves a high degree of priority at the intra-European and international levels. It would be a grave mistake, however, if these conclusions should lead to a spirit of hopelessness concerning possible remedies, or alternatively of complacency with respect to the

accomplishments achieved in the face of the indicated difficulties. For one thing, there is the danger of laying too much stress on the peculiarities of the Italian situation, and of pinning one's hopes on some dramatic external development — such as the sudden lifting of the foreign barriers to immigration — which is not very likely to occur. For another, there is an inclination to overlook some of the possibilities which are within the grasp of Italy, and which in turn might influence favorably the external economic relations of the country, in the climate of international cooperation which, slowly but surely, is developing under our eyes, and which has already found such major expressions as Lend-Lease, the Marshall Plan, and the still infant Point Four.

8. — To be more specific. Looking at the picture from the vantage point of the United States (and while fully conscious of the limitations inherent in any outside point of observation), one can't help feeling that a determined Italian effort to increase investment, production and employment, despite all difficulties and with complete awareness of the limitations which stand in its way, would have a great impact upon the place of Italy in international counsels and upon American public opinion. This in turn might set into motion a chain reaction of international effects, which might lead among other things to a fuller recognition of the fact that the equilibrium level of the Italian economy must be geared permanently to a higher level of imports, and might pave the way for its financing, either through expanded international trade or through special programs of economic cooperation. Admittedly, such a policy involves an element of gambling. To that extent, some of the criticisms which were levied against its advocacy at an earlier occasion are quite legitimate (4). No one would suggest for a moment that it should be adopted rashly, and pushed to the limit. It is not contemplated for a moment that the Italian authorities should embark upon a policy of indiscriminate credit expansion (even less so now, when the inflationary pressures of the international situation

are so strong) or of an open door to imports, which would quickly lead to difficulties such as those currently experienced by Western Germany. The point is that, whenever an additional increase in production is warranted on its own merits, in terms of its contribution to a stronger and better balanced pattern of industry and distribution, considerations concerning its possible unfavorable impact upon the import balance should not act as a deterrent. Within these limits, I feel that a policy of additional investment would involve only a calculated risk, which might be well worth taking.

9. — To sum up the argument thus far developed. A very vast and immediate expansion in Italian production is not to be expected or hoped for. However, a determined effort to increase production is required just the same. For while there may not be a wide margin of unemployed natural or industrial resources in Italy, there is a great deal of maldistribution in investment and in the employment of productive resources. Consequently, even disregarding the implications of a bolder policy concerning the balance of payments situation, there is room in Italy for a considerable, if not immediate, increase in production, through the elimination of certain bottlenecks related chiefly to the income and tax structure, as well as to imperfect information, and through the increases in productivity resulting from a better adjustment of the current investment structure. This readjustment in itself would make room for additional investment without the necessity of making recourse to massive injections of credit, and hence without serious inflationary implications.

10. — Let it be remembered, in this connection, that, other things being equal, the distribution of income, and the actual production structure, have very much to do with the attainment of an optimum rate of investment. An equitable pattern of income distribution helps investment in many ways. It provides steady markets to a very extensive range of products and services. It leads accordingly to a better organization of industry, with emphasis on volume production and low cost per unit of product. It brings about, within the limits

consistent with balance of payments considerations, a high level of effective demand, originating from the classes whose expenditures are more elastic in terms of income. It spreads the effects of short-term changes in the income flow (such as higher wages or profits) throughout the whole economic system, instead of concentrating them, often with devastating inflationary effects, within certain segments of the community. It helps to correct, to some extent, the inequities of inflation or deflation, when these occur. On the other hand, an inequitable pattern of income distribution works the other way. By depriving industry of the advantages of volume production and of the mass market, it encourages a semi-monopolistic structure of production, based on high profits per unit and on restrictions of output. By depriving industry and business of the opportunities which are opened by a steady and widespread growth in national income, such a pattern compels business activity to depend upon abnormal conditions, such as wars, armament drives or chronic inflation, for survival. In short, it may easily lead, especially in comparatively poor countries, to levels of investment which fall far short of the limits set by the inelasticity of supply of resources and other productive factors in terms of income. It follows that, generally speaking, a given volume of resources will lead to comparatively high levels of investment, gross national product and disposable income under an equitable structure of income distribution, and viceversa when the income structure is inequitable. Income equalisation, within a certain range at least, definitely helps production.

11. — Another factor which, under modern conditions, helps to increase production and productivity is the wide dissemination of information concerning industry and, indeed, all facets of economic life and activity. This is not only because major economic decisions on the part of the central authorities require nowadays a great amount of statistical and factual information, but also — and chiefly — because, if industry and business are to grow and expand, the veil of secrecy which, in Italy as in most other European countries, surrounds their operations, is to be discarded. In the

United States, industry and business live in a glass house. The published statements of incorporated business include, partly because of statutory regulations and partly because of custom, a vast amount of information, which in Europe is usually withheld from shareholders and from the general public. Investors, and potential investors, have access to a tremendous wealth of detailed information concerning corporate business. Industrial and business operations even on a modest scale are conducted in a climate of full publicity. Technical and business information and know-how are constantly being disseminated, through the press and other mass communication media, to all corners of the country. All aspects of production and merchandising are continuously and publicly discussed in open forums. The whole structure of the national economy, in its essentials but also in its minutest details, is always under the spotlight, and as such is at all times under discussion and review. All this helps tremendously investors, technicians, producers and consumers alike. It facilitates the direction of investment, enterprise and labor. It spreads around technical and business knowledge and know-how. It spotlights the sectors in which the opportunities are the highest, and it brings to light at the same time the gaps in production and trade which exist and which may be filled by fresh enterprise. Even with respect to the sectors of American industry which are dominated by huge corporations, and which are characterized by semi-monopolistic features, the climate of publicity helps to throw some light on them, and to place their activities under the scrutiny of public opinion. Everything considered, and even making due allowance for differences in conditions and environment, it seems clear that the dissemination of a greater and freer flow of information concerning corporate and business life, as well as industrial and other know-how, should help Italy and other European countries to move toward higher levels of production and toward a better use of their existing productive resources.

12. — Modern industrialization is not only and merely a matter of machinery and heavy

(4) I refer in particular to Mr. M. A. Kriz's otherwise sympathetic review of my book in "The American Economic Review", June 1949.

installations. It involves some, but not necessarily all-out, mechanization. To an increasing extent, it is a matter of know-how, and of the capacity of a given environment to give life and substance to advanced techniques of business operations. It is for this reason that so many widely advertised Three, Four or Five Year industrial plans in comparatively underdeveloped countries fail to make a real dent on the conditions of the country, and that the International Bank for Reconstruction and Development and other similar agencies lay so much stress on the combination of prerequisites which is essential to pave the way for industrialization. Under the Marshall Plan, Italy is undergoing a very considerable process of modernization and in some cases expansion of its industrial capacity, and it is to be hoped that the increased procurement difficulties in the United States will not substantially interfere with its completion. Already notable increases in production, and undoubtedly in productivity, are taking place in such fields as automobiles and the steel industry. It is quite essential that, hand in hand with plant modernization, a vast if silent revolution take place in methods of management and business operations. Some of the managers of Italy's leading corporations are keenly aware of that need, and extremely eager to assimilate as far as possible American methods of business operation. Needless to say, this process calls also for common sense and selectivity, since it would be absurd to attempt to import *in toto* American methods into a quite different environment. But unquestionably there are many American business and operational techniques (quite apart from technical processes and industrial know-how as such) which lend themselves to adaptation and application even on the part of medium-sized and small scale industry in Italy. In turn, all this cannot happen in a vacuum. It calls for a detailed and undramatic but definite reconsideration and streamlining of many features of Italian industrial and business activity. There are already various firms in Italy which are pioneering in that direction, and giving evidence of an aggressive and progressive spirit. It is essential to do whatever possible, at the government and private levels, to see to it that

the general character of the national economic environment moves in step with these pioneer efforts, and with the times.

13. — It is generally assumed that, because of the scarcity of capital in real terms with respect to population, the Italian industrial structure should be oriented toward types and methods of production requiring a comparatively low rate of capital intensity. This inference is inevitable, and it applies in particular to productions for export to highly advanced industrial countries, since it is more difficult for Italy to compete in the field of mass-produced goods. There is no reason, however, why the preference for employment creating activities should be pushed so far as to deny to the nation the advantages deriving from a hard core of highly mechanized (though not necessarily heavy) and fully modern industry. For while the primary employment generated by the latter type of investment would be smaller, all-around levels of productivity and income per head would increase, thereby making room for secondary and other derivative employment. Ultimately, it would seem preferable to have a smaller total of industrial employment, in the context of an efficient and up-to-date industrial system, rather than to spread employment around at the expense of productivity and real income per head. This point has, incidentally, a bearing on the role of the handicraft trades and production in Italy. Without going into detail, it may be stated that there is still great room in the Italian economy for these trades, provided, however, they are increasingly coordinated around a core of industrial activity proper. Actually, as industrialization goes on there is more and more scope for small industrial business, specializing in the production of parts or in other phases of a complete industrial cycle. The artistic and typical handicrafts of Italy have also a permanent role to play in the national economy, but they, too, need to be somewhat coordinated with industrial activity, for which they can provide among other things the skills necessary for the assembly, decoration, etc., of parts or of semi-finished goods. At the same time, the perpetuation of many types of handmade products which can be handled better and more cheaply on an industrial basis

would make little sense. Their elimination, however, should be allowed to proceed gradually, to avoid serious problems of transition.

14. — It has become increasingly realized that one of the major bottlenecks standing in the way of a better use of the existing Italian economic resources is to be found in the tax system. A poor, inefficient and inequitable tax system prevents, of course, that long-term, moderate but effective redistribution of income which obtains in countries where income taxes, at steeply progressive rates, are the mainstays of the tax system. An inequitable pattern of income distribution is thereby perpetuated. Furthermore, when taxpayers and revenue officials are engaged in a constant game of hide-and-seek, the main facts pertaining to business operations, such as business turnover, earnings, main items of cost, etc., are surrounded by a thick protective smokescreen. Under the circumstances, it is impossible to bring about that climate of full information and publicity which, as indicated above, is so important in stimulating investment and economic progress. The lack of candor — to put it in the mildest terms — which is customary in all matters which have a tax angle (and there is hardly a business matter nowadays that has not one or several tax angles), reflects itself in all stages of business operations. It prevents the adoption, except on the part of a comparatively few large firms, of standardized methods of bookkeeping and accounting, and the organization of records in a full and proper form. It leads to confusions which often mislead their very perpetrators, and reflect themselves in mistakes in cost and other estimates and accounting. It condemns business to a perpetual double life.

15. — There are considerable differences of opinion, even in this country, as to the limits within which fiscal policy can be effective in controlling inflation or encouraging recovery from a depression. There is no doubt in anybody's mind, however, as to the fact that, whatever the limits, fiscal policy is a powerful tool of economic management, particularly under contemporary conditions, when public expenditure absorbs varying but invariably high fractions of the national income. It is also clear

that the effectiveness of fiscal policy is predicated to a large extent upon the efficiency of its machinery, and upon the role played by income taxes in the tax structure. Obviously, inflation control is particularly effective when a sizable slice of current income can be siphoned off through increases in income taxes. By the same token, an expansionist policy can be followed by the central authorities with fewer dangers than otherwise, when the inevitable inflationary pressures can be held in check by a prompt absorption, through increased tax payments, of the undesirable « pockets » of excess income.

16. — This is not the place for a discussion of the Italian tax system. It is generally granted that its technical features are excellent, and in some respects superior to those of the British or the American systems. Its basic drawbacks, however, are the preponderant role actually exercised by excise and sales taxes (which give to the system a regressive and anti-productivistic bias), and the defective methods of assessment and collection, which lead to widespread evasion in income tax payments and other inequities, including the penalization of honest taxpayers. It is only fair to add that notable strides have been made, along the way, to increase the collection of income taxes, and to place the tax system on a better and more adequate basis. It is impossible from this distance to express any valid opinion on the tax reform sponsored by Minister Ezio Vanoni and recently (January 1951) put into effect. To an outsider, it may be a matter of regret that the Italian Government and Parliament have not seen fit to go further than they have gone in moving toward a system of income tax assessment based on Anglo-American lines. Since, however, the emphasis of the measure appears to be not on its letter but on the establishment of a new spirit of confidence and fairness between authorities and taxpayers, it is to be hoped that it will improve matters. There are also some signs that increasing numbers of business people would definitely welcome a shift to methods which might increase their actual tax payments, but save a great deal of time, effort and purposeless friction. Altogether, the objective which should be kept in sight, and which is actually the announced aim of

Minister Vanoni and his colleagues, is to bring about, not an increase in tax revenue, but a better distribution of the aggregate load, with the gradual elimination of the regressive and anti-productivistic features of the present system. The cumulative impact, through time, of such changes upon both the volume and the pattern of investment and production can hardly be overestimated.

17. — Monetary policy as such (let it be said once more: disregarding the complications of the post-Korean situation) does not have to play a paramount role in the framework outlined above. Unquestionably, there is a great deal that could be done, gradually and through time, to bring about a more effective use of the nation's savings, and to help create conditions under which more capital could become available, or at any rate be released for investment.

Some useful object-lessons in that respect might be drawn from recent United States experiences. Admittedly, it took many years in this country, and the spur of an unprecedented industrial expansion generated by World War II and the following boom, to bring about conditions which finally attracted on a large scale «venture capital» into business investment. Such a stimulus cannot be expected in Italy under the most favorable conceivable conditions. There have been, however, certain developments, such as the growth of mutual funds and the increasingly vast and aggressive part played by life insurance companies in the capital market, which might be paralleled to a certain extent even in different environments. Moreover, there has been the slow but cumulative and highly effective impact of 15 years of cheap money, and other Central Bank policies, which have powerfully stimulated the recent upsurge in investment. All this would require a detailed analysis which cannot be offered here.

ECA financing has helped to bring down long-term interest rates in Italy, and to weaken somewhat the still inordinately high structure of short-term rates. The process should be continued, and, with respect to the short-term structure, intensified. For the time being, the inflationary pressures, originating chiefly from the primary commodity markets and uncashed

by the international emergency, require, of course, special caution and vigilance on the part of the Bank of Italy. Generally speaking, however, it may be worth while to emphasize that the contribution of monetary policy to the growth in the rate of investment involves far more than mere quantitative changes in the volume of bank credit, and that its effects can materialize only slowly, through time.

18. — Despite all, Italian Treasury and Central Bank policies have veered, in the past few years, toward the acceptance of a more advanced view. National accounting methods are beginning to take root, and as additional experience is gained a fairly accurate and reliable picture of the various segments of the economic structure will become available. This, in turn, will give better tools to the central authorities, and will enable them to plan and implement their policies with greater assurance. The immediate future is, of course, overshadowed by the international tension and the defense emergency, the effects of which may involve — it is to be hoped, only temporarily — some departure from the development trend ushered in by the Marshall Plan. Ultimately, however, the trend should be resumed, in a spirit of sober but definite confidence in the progress that lies ahead.

19. — In the last analysis, of course, the future of Italian production and of the nation's economy will be largely shaped by trends and policies originating from the United States. This adds a further element of uncertainty and unpredictability to the picture. Yet, it may be stated confidently that it seems most unlikely that the United States will turn its back on the broad trend of international economic co-operation, the beginnings of which have already unfolded under our eyes. And while, in any specific situation, it is most difficult to get advance commitments pledging the United States to this or that specific course, or to this or that specific measure of assistance, there are strong grounds for believing that a long-term Italian effort directed toward improving the quantitative and qualitative structure of investment and production will enlist the appropriate and necessary degree of American support.