

## Six Months of Italian Economic Policy

by  
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1. — It is always difficult to pass judgment upon an economic policy which is still in course of evolution. Apart from other considerations, such a judgment must be based upon a variable complex of observed facts which do not always show much logical coherence. I consider it essential to make this reserve from the outset, when discussing the present economic policy of the Italian Government, since I do not know whether it will have further developments. Therefore, I shall confine my attention to certain particular aspects of this policy which, in my opinion, are in contradiction with one another.

Until the middle of last November, this policy might have been referred to as "the Einaudi and Del Vecchio policy", as in its approach to the problems of the money market, it clearly reflected the mentality of professional economists, as are Professor Einaudi, Vice-President of the Council of Ministers and Minister of the Budget, and Professor Del Vecchio, Minister of the Treasury (1). But the

measures adopted at the end of November concerning public finance and foreign exchange are such as to generate strong suspicions concerning the real paternity of the Government's latest economic orientation (2). For this reason I prefer to call this recent phase "the economic policy of the Government", stressing the fact that responsibility for it is shared by all the Ministers.

It is thus evident that an analysis of the purposes and characteristics of Italian economic policy during the second half of 1947 is not an easy task. I fail to discover in this policy any clearly defined rational purpose; it strikes me rather as being incoherent and embodying contradictory economic directives. Accordingly, in the following pages I shall deal first with the "economic policy of Einaudi and Del Vecchio" (which, for the sake of brevity, will be referred to as "the policy of Einaudi") and then pass to the Government's more recent economic policy, explaining why I consider the policy pursued in this second phase liable to hamper the success of the policy that preceded it.

2. — The economic policy of Einaudi assumed technically the form of a credit policy; it was put into effect by new regulations concerning reserve requirements, which were imposed upon the Italian banking institutions as from September 30, 1947 (3).

*Die Geldtheorie* (Tübingen, 1931) won international recognition. (Editor's note).

(2) In this connection (concerning fiscal provisions and exchange regulations) see paragraphs 11 and 12 of the present study.

(3) The legislation which has now been repealed dates from 1926, when the banks were required, in order to protect depositors, to pay into special accounts with the Bank of Italy the whole of the deposits received by them in excess of 20

There is no need to enter here into a detailed examination of these regulations; still less is it worth our while to consider whether the new regulations are more or less stringent than the old ones. During the last few months these questions have given rise to sharp controversy. But I think that everyone will recognize that even though the percentage of deposits to be paid to reserve accounts with the Bank of Italy or the Treasury under the new regulations as of September 30, 1947, are lower than those laid down in the old regulations, in practice the new system proves far more restrictive for the banks. And this for two reasons. First, the old rules were not generally observed by the banks; they were forced to realise part of their investments before the end of last September so as to secure the balance of cash they still needed to bring the reserve requirements up to the fixed proportions. Secondly, all the banks were now obliged, when conducting operations, to pay much greater attention than formerly to their state of immediate liquidity, that is, to the relation between cash and deposit liabilities. Because, under the present regulations, if the cash is diminished by 100 lire through the withdrawal of a deposit for this amount, the bank concerned, having to keep intact the fixed proportion between deposits and reserves, can no longer make up its loss of cash by drawing 100 lire from its reserve with the Bank of Italy, but can only withdraw from the reserve a sum which, according to circumstances, may amount to 15, 20, 25 or 40 lire.

Thus pressed from both sides, the Italian banking system, instead of merely refusing to extend advances, was forced to an outright contraction of credit and a complete overhaul of its whole credit policy. This, indeed, was inevitable and most welcome, since, if any exten-

sion their net assets. In February 1946 this proportion was raised, owing to the devaluation of the lire, from 1 to 30.

Under the new regulations, the banks are now obliged to pay into special accounts with the Bank of Italy:

a) on deposits received up to Sept. 30, 1947, 20 per cent. of the amount in excess of ten times their net assets (capital plus reserves). The amount thus tied up must not, however, exceed 15 per cent. of the total deposits;

b) as from October 1, 1947, 40 per cent. of any further increase in deposits. The amount thus tied up must not exceed 25 per cent. of the total deposits.

sion of advances has now to be confined within narrower limits, the advances should be distributed with much greater care, bearing in mind the depressing effects the new credit policy is bound to have on the movement of prices and on business activity. Indeed, up till last August (and especially till last spring) the banks were very liberal in granting credit, with the unfortunate result of encouraging among the entrepreneurs the extension of practices resulting from the abundance of paper money and the abnormal political and economic conditions, which led to a far-reaching distortion of the financial structure of Italian business.

This brings us to the substance of the problem, *i.e.*, to the examination of the objects of Einaudi's policy.

3. — According to the statements made by Professor Einaudi himself, the policy of credit control was inspired by the necessity of imposing greater circumspection upon the banking system, which in 1946 invested almost the whole of the new deposits received (252,000 million lire out of a total of 273,000 million), and during the first seven months of 1947 actually disposed of a sum (219,000 million lire) in excess of the deposits received during the same period (188,000 million lire). The Minister had repeatedly called attention to the danger of these practices and there is no doubt he was seriously concerned to protect the depositors and, naturally, the banks themselves (4).

In any case, the prevention of a banking crisis and of the numerous failures which would inevitably follow in Italy, may be considered as the main object of Einaudi's policy only on the assumption that, in the event of a run on the banks, the latter would be abandoned to their fate, at least beyond certain limits of assistance, as happened after the First World War when the *Banca Italiana di Sconto* was allowed to crash. Except on the assump-

(4) Sometimes the Minister of the Budget expressed his concern in very strong terms: "I will permit myself to describe as insane and criminal a banker who invests 100 per cent. of his deposits; as reckless, one who invests 90 per cent.; as imprudent, one who invests 80 per cent.; and as just on the margin of prudence one who invests 70 per cent." (From the statement of Prof. Einaudi at Turin, 9 November, 1947).

tion that the Government would definitely take no interest in the fate of the credit institutions, the objective of preventing the banks from involving themselves in a critical situation should be considered as of secondary importance compared with the wider and more general objective of preventing a further expansion of the inflated currency to meet the liquidity needs of the banks.

Professor Einaudi did not explain on which hypothesis—abstention or intervention of the Treasury in case of a banking crisis—he based his determination to impose prudence upon the bankers. Hence, we cannot judge with certainty the real objects of his policy in respect of the banks. It is probable, however, that the Minister acted on the second hypothesis, having considered what is and what is not practicable in a country which has just emerged from a ruinous war, is passing through a phase of acute social conflict, and has not for many years had any really serious business failure (such cases having been carefully prevented as part of a costly policy of false national prestige). I am therefore inclined to think that his policy was determined by considerations of prudent currency management.

4. — But I cannot help having some doubts as to whether the objective just discussed really formed the essential purpose of the Einaudi policy. Despite the insistence with which the Minister himself repeatedly stressed this point in his public statements, it seems to me that, although it may have great intrinsic importance, this objective is too modest and too limited in scope compared with the magnitude of the problems Italy is now called upon to face. Moreover, such an objective had no particular character of urgency, as a panic and a run on the banks, causing a liquidity crisis, is impossible while the country is still in the inflationary phase. The fear aroused in Professor Einaudi by the rapid expansion of bank credits appear to me sufficient to justify the energetic intervention which actually took place only if they are considered primarily from the point of view of their effects upon the monetary situation. In other words, a more convincing objective for Einaudi's economic policy could be found in the reduction

or the stabilization of the total quantity of the means of payment available for the market (5).

5. — It is clear that this object is not at all "neutral" in regard to the level and the trend of prices on a market in an advanced state of inflation.

First, when inflation has reached a certain point, prices rise, other things being equal, not only as a result of the impulses they receive at each successive increase in the volume of currency, but also under the expectation of further increases in the near future. Therefore, if the situation changes so as to eliminate this expectation, the first reaction is the disappearance of the impulse *ex-ante* to the rise in prices; after which there takes place an adjustment *ex-post* of the price level to the monetary situation, the extent of such adjustment being determined by the degree to which prices had risen in anticipation of future currency inflation which failed to materialize.

Secondly, always starting from a certain level of inflation, business activity becomes hyper-normal and the structure of production undergoes some modification. The volume of business is swollen by the addition of many speculative transactions and the average duration of the productive cycle is extended. This results in immobilizing capital resources and, therefore, in calling for increased supplies of money. This development is cumulative and anticipatory in character, in the sense that during each successive phase of inflation a fresh quota of funds is immobilised in anticipation of a future rise in prices. When the volume of money in circulation ceases to increase, the available amount becomes *ipso facto* insufficient to meet the needs of the market. There follows a liquidity crisis which brings about a more intense and inelastic offer of commodities, with a consequent fall in prices.

(5) The volume of circulation increased, during the year 1947, to the following extent (the figures in brackets represent index numbers, the figures at the beginning of 1946 serving as base):

	Legal tender	Bank deposits
Beginning of 1946	503,000 million lire (106)	628,000 million lire (100)
End of 1947	787,000 million lire (156)	1,000,000 million lire (143)

• Provisional.

The Einaudi policy was, therefore, quite capable not only of checking, but even of reversing, the upward trend of prices: all the more so under the conditions prevailing in Italy at the time. Indeed, the Italian market, at least up to September 1947, was particularly liable to develop an eventual crisis due to lack of liquid assets as a result of the widespread use among the majority of industrialists and merchants of practices designed to preserve their working capital from the risks of a depreciation of the lira and, at the same time, to enable them to realise speculative profits from inflation.

With a view to the first of these aims, the entrepreneurs invested as large a part as they could of the capital of their businesses in "real values", including buildings, machinery, raw materials, finished products, shares in joint-stock companies, foreign currencies, and so on. As a result, while part of the working capital was diverted from its original use to an abnormal purpose (purchase of securities or foreign exchange), another part was so used as to cause far-reaching modifications in the normal proportion between fixed and working capital in the enterprises. This led industry in general to develop a financial structure which, owing to the prevalence of fixed capital, was more highly capitalized than the economic possibilities of the country can permit.

As for the speculative aim, Italian businessmen greatly extended their operations so as to have as large a share as possible of the monetary profits deriving from the rise in prices. But as the capital thus immobilized, or diverted to abnormal uses, was not simultaneously available for financing even the normal volume of business, industrialists and merchants were forced to have recourse to bank credits to an unprecedented extent, in the form either of normal working advances or of loans on securities or against merchandise.

6. — The above naturally represents only a general outline of the financial conditions of Italian business at the end of the summer of 1947. Yet, on the whole, the conditions were as described above, for the reasons given, so that the situation of the market was very strained and its equilibrium so precarious as to ren-

der it highly sensitive to the depressive influence exercised upon commodity prices by the Einaudi policy. And, indeed, as the Italian banks proceeded to revise the principles and the scale of their credit policy, holders of securities, of merchandise stocks, of foreign exchange or of precious metals, who were indebted to the banks or dependent on them for the financing of their business, were compelled to liquidate more or less hastily (more inelastic supply) either the whole or part (more intense supply) of these investments. This caused a marked reduction in the prices of commodities, stocks, etc., during the last quarter of 1947, but caused also strong and widespread resentment against the policy of Einaudi (6).

This policy was bound to prove unpopular. Yet I am certain that it is essentially sound, and I venture to think that, quite apart from the ideological positions of the various political parties, this would have been the economic policy of any other Government which seriously wanted to save the currency, given the circumstances in which such an attempt was begun by Einaudi.

Now it is true that in saving the money, one must not damage the whole economic system, as happened both in Great Britain and in Italy about 1925-1926, out of respect to the mythical concept of money as a symbol of national prestige. Yet it is no less true that we cannot hope for normal conditions for both producers and consumers, and a general economic improvement which would relieve the various hardships and lessen the social tension of this post-war period, if we allow the currency to depreciate with a consequent indefinite rise of prices. The only effective way out of the difficulties due to the increasing disparity between the abundance of money and the shortage of available goods, obviously consists in checking the expansion of the volume of currency, on the one hand, and in increasing the supply of goods on the market, on the other hand.

(6) For data concerning the fall in prices—slow and moderate in the case of commodities and utterly ruinous in that of securities—see the Statistical Appendix, Table D, p. 265. This fall in prices was particularly serious when contrasted with the movement of wages, the index of which shows a definite rise (see Table G, in the Appendix).

The policy of Einaudi, while painful to those directly affected by it, is precisely intended to operate in both these directions. Therefore, when judging its general expediency and dealing with the criticisms to which it gave rise, one must always consider its ultimate results.

7. — These criticisms are all focused upon the alleged harmful effects of the credit restrictions on the national economy, owing to the difficulties created for business activity. However, while some of the objections are particularly concerned with the difficulties of current management, others focus attention primarily upon the effects of this policy on the capital situation of the businesses.

The first type of objection lays stress on the fact that, as a result of the contraction of credit, Italian businesses found themselves, in general, unable to meet their outstanding liabilities, including the payment of accounts falling due and of wages and salaries. A dangerous situation had thus arisen which might touch off a succession of business failures and, at the best, cause a slowing down of the production programme. This would inevitably result in an increase in unemployment and a diminution in the supply of goods. It was pointed out that, precisely with a view to preventing, as far as possible, such an undesirable development, the State had already been compelled to take the place of the banks by granting emergency financial aid to several industrial establishments threatened with bankruptcy. In this situation, say the critics, what are the actual advantages to the country of the economic policy of Einaudi?

Now, in order to examine objectively the reliability of these criticisms, it is essential to distinguish between the businesses which were granted financial assistance by the Treasury, and all the other Italian businesses. The former cannot be quoted in support of these criticisms, because financial assistance was granted by the State to businesses which were largely dependent upon banking facilities for quite exceptional reasons: businesses which had been typically engaged in war production, and could not easily convert to peace-time conditions; which had large outstanding credit accounts with the

State; which had to bear an enormous burden of overhead charges, as well as a large surplus of personnel. Sooner or later, they would in any case have faced serious risks of failure. While, therefore, it is true that their position became desperate as a result of the credit stringency, it is equally true that the policy of Einaudi did no more than accelerate a crisis which was unavoidable.

The reverse is true in regard to the other Italian businesses, where the contention that the policy of credit restriction was bound to have catastrophic results has so far been proved false. The simple reason for this is that the majority of the Italian industrial establishments were, and to a certain extent still are, in a position to finance their business out of their own capital. Faced with the alternative either of closing down or of obtaining from other sources the funds they could no longer obtain from the banks, they preferred, even if reluctantly, to dispose of their reserves of foreign exchange and their holdings of shares or, if they had to import merchandise from abroad, to draw on their foreign balances. Thus they have done precisely what Einaudi wanted them to do, by restoring to its original use that part of the circulating capital which they had previously diverted from productive uses, and have succeeded in getting out of their difficulties in a way which was satisfactory from their own point of view and also to the general economic advantage of the country.

There does not seem to be any reason to think that the restriction of credit has caused or might cause a contraction of production in some industries. There is no reason to fear a reduction in the national income of the country as a result of this policy. The more probable result will be a speeding up of the productive process, due to a quicker turnover of stocks in the warehouses and fewer transfers of finished goods on their way from the factory to the ultimate consumer. But even admitting that there may be some diminution in the real national income, to be borne by the national economy, there can be no justification for doubting the expediency of the Einaudi policy, from the national point of view. So long as it is a matter of paramount importance for Italy to see its economic conditions restored to normal,

that is, until we can do away with all the abnormal situations created by inflation, we must recognize the absolute necessity of a policy which aimed at correcting one of the worst of these anomalies: namely, the situation of those businesses which, having deliberately deprived themselves of part of their working capital, operated by means of excessive recourse to borrowed money.

8. — The second type of objection is based upon the assumption that since the credit restrictions had caused a heavy fall in share quotations, the companies would be hampered in obtaining the necessary capital resources; indeed, potential investors, frightened by the slump on the Stock Exchange, are unwilling to subscribe to the fresh capital issues already announced by many companies. And as the new issues are designed to obtain the necessary funds for reconversion or extension of plant or to make good capital losses due to the war, the policy of Einaudi, according to these critics, is in opposition to the real interests of the country, which consist in attracting into productive investment a sufficient amount of the nation's savings.

In dealing with this contention, it is essential that our ideas should be quite clear, as any apparent force in this argument is based upon a misunderstanding. The misunderstanding consists in confounding the monetary aspect of the problem with its real substance, in thinking that the amount of savings available in Italy or which may be accumulated within a certain period of time, say a year, would be sufficient to meet the needs of the country's industries, either immediate or arising during the given period of time. In fact the real amount of such savings falls far short of the effective demand of industry for new capital for two reasons: first, in the abnormal conditions of the post-war period, the demands of industry for capital are exceptionally heavy; secondly, the accumulation of savings during the last few years has been, and still continues to be, relatively slow, partly owing to the fall in the aggregate private income of the nation, partly as a result of changes in the distribution of this income (owing to the marked levelling of dif-

ferences in salaries and wages, to rent controls, and to speculative profits, etc.).

Generally speaking, savings never have been, and still are not, sufficient to meet the demand for capital in Italy. Hence, while it may be admitted that the slump on the Stock Exchange between May and December 1947 prevented the investment in shares of a certain amount of the nation's savings, this does not justify the deduction that, if this slump had not occurred, all the fresh issues of capital launched by our joint-stock companies would have been absorbed by the public. It is precisely the effective absorption of new capital issues that constitutes the essential point of the whole matter, but this aspect is entirely overlooked by the critics of Einaudi's policy.

If it had not been for the restriction of credit, which reversed the trend of Stock Exchange prices by increasing the sales of securities and keeping down the demand, the new issues of capital would have been easily absorbed by the market. But, just as happened with the capital increases floated during the early months of 1947, the balance of the new issues, in excess of the volume of savings available for investment, would have been subscribed by speculators with funds obtained from the banks by contango operations. Hence, a more or less considerable part (which, I imagine, would have been very large) of the capital required by industry would not have come out of genuine savings but from credit. This would mean that in order to meet a demand for new capital which was out of proportion to the savings capacity of the country, another impetus would have been given to inflation by creating an additional amount of bank money.

The dangers inherent in such a solution are obvious. First, an enormous increase in the volume of fluctuating stock on the share market, with the result that this market would become even more unstable than it was in May 1947; the prospects of a slump in stock prices would then be even more appalling than was the slump that actually took place during the second half of that year, tragic as that was. Secondly, the stability of the banking system would have become even more dependent upon that of operations on the Stock Exchange. Finally, the enormous extent to which bank

money would have been substituted for genuine savings, creating a huge amount of purchasing power not accompanied by a corresponding expansion in the volume of available goods, would inevitably have increased the pressure exercised by the mass of money on the market, leading to a further rise in prices. And this rise, among other results, would have made the amount of capital raised by industry in order to finance its various programmes insufficient for the purpose.

Taking all this into consideration, the policy of Einaudi could hardly be condemned even from the point of view of its effects upon the capital situation of Italian industry, provided the judgment is based upon the real and lasting economic interests of the country.

One becomes both perplexed and apprehensive at the insistence with which some people, including some in official positions, clamour for administrative and fiscal measures designed to reverse the downward trend of Stock Exchange prices (and thus to favour speculation on the rise) with the aim of allowing our businessmen to proceed with the fresh capital issues they had planned. Apprehension becomes fear, when one sees stockbrokers pushing the demand for a public financial institution, naturally supported by the Bank of Italy on behalf of the State, which should acquire the fresh capital issues of the Italian companies with a view to disposing of them gradually on the market. Those who support such schemes have evidently failed to understand that the real problem which must now be solved in the national interest does not consist in supplying business concerns with all the capital they want, but in adjusting the volume of the demand for capital to the available volume of savings. They have not yet understood that any artificial device which attempts to satisfy the demand of industry for liquid funds beyond the limits fixed by the available volume of monetary savings, is exceedingly harmful to the country, as it opens the way to inflation.

Should Italian industry have to pay a rate of interest in proportion to the modest volume of available savings, its demand for capital would immediately be reduced. But those who maintain that production should be financed on a liberal scale, naturally imply such

financing at low interest rates; in other words, though perhaps inadvertently, they propose to continue along the inflationary way. Unfortunately, they do not realise that so long as the abundance of money keeps the rates of interest low, the small amount of available savings continues to be used most uneconomically, being scattered in relatively unprofitable investments instead of being concentrated in those productive activities which yield the greatest relative advantages to the national economy.

9. — During the last months of 1947 the depressing effects on commodity prices of the Einaudi policy were accentuated by a combination of other factors. There was, for instance, the abundant production of olive oil; there was a certain slowing down of exports, as Italian prices were too high, at the current rates of exchange, in relation to prices in other countries; there have been very large imports (representing a total value of 50,000 million lire in four months) of meat, sugar and other foodstuffs authorized on the system "franco valute", that is, the importers being permitted to pay for these commodities out of their available foreign balances. It is clear that the reduction in the Italian price level can be lasting or, rather, the level of prices in Italy may be expected to oscillate round about a lower point than that they had reached in the summer of 1947, only on condition that costs of production are simultaneously brought down. Otherwise, one would have to agree with those who maintain that the policy of Einaudi forces manufacturers and traders to sell their goods at prices which are bound to prove lower than the future costs of replacement.

Now the restriction of bank credit can only contribute to a very limited extent to the reduction of costs. It is true that there has been some reduction in the prices of certain industrial raw materials, as a result of the restriction of credit, which means that the cost of production of certain commodities has been reduced. But, on the whole, such reductions were slight, because, given the types of product and the methods of production that prevail in Italy, raw materials only account for a relatively small part of the total cost per unit. A really significant reduction in the costs of production

necessitates consideration of the other items of expense, which may roughly be grouped under the following heads: fiscal burdens, overhead costs and labour costs.

Fiscal burdens in Italy cannot, for the present, be reduced; they are actually tending to increase, owing to the ominous growth of Government expenditure (7).

As regards overhead costs, there is reason to believe that, precisely because of the change in the trend of prices and the restriction of bank credit, industrialists have been induced to overhaul the technical and administrative organization of their establishments. The new credit policy, expressed in a monetary policy of stringency, tends to modify the conditions which determine the scope, complexity and organizational costs of business projects. So long as money was abundant, such projects could be conceived on a grand scale, without paying attention to the cost. But since money became scarce and dear this attitude has been reversed, and it is reasonable to assume that businessmen are now making every possible economy. Hence, provided the policy of Einaudi is strictly adhered to, without direct or indirect concessions, costs of production ought to be lowered by a reduction in general overheads. But it is useless to exaggerate the possible extent of this reduction, as there are several factors which limit its effect. Both the length of time and the financial outlay involved in a far-reaching modification of the organization of an industrial establishment depend upon the size of the establishment, the complexity of the technological processes used, the degree to which it is engaged in production with joint or complementary costs, etc. Thus any significant reduction in costs will only be realised after a considerable period of time. Moreover, beyond a certain limit of contraction, there exists a somewhat rigid link between the volume of overhead costs and the technological organization of production, so that costs can be further reduced only by a change in this organization which may easily involve an increase in costs

under another head. Finally, in branches of production characterized by diminishing returns, a reduction in overhead costs may often be offset by an increase in the costs of production due to the smaller volume of output.

Under such conditions, there remains only the third solution: a reduction in labour costs. Here we confront a complex and delicate problem, as this solution affects the standard of life of millions of people whose economic claims have great social importance. In fairness it must be recognized that any general reduction in wage rates in Italy would be impossible at the present time. Hence the contribution which labour might make to a reduction in the costs of production could be obtained in three specific ways. The first consists (in conformity with an agreement on this subject already reached in August 1947) in lifting the embargo on the dismissal of workers, so that surplus manpower now maintained by many businesses may be dispensed with. This surplus-manpower is practically idle, thus representing a dead weight on the balance of the establishments concerned and merely increasing the costs of production per unit. The second form of contribution is an increase in productivity per worker in factories and offices, by means of greater effort and better organization. In this respect some progress has already been made during 1947, compared with the preceding years. Yet much still remains to be done in increasing the discipline and the goodwill of the workers and employees before the average output per worker is restored to the pre-war standard in Italy. Finally, the third method by which labour can help consists in revising the system of supplementary bonuses, paid in accordance with a sliding scale based on the cost of living index and known as *contingenza*. At present this bonus is being paid on the arbitrary assumption that each worker is the only member of a family to be gainfully employed, while, in fact, in most workers' or employees' families there are two, three or even more persons employed in factories or offices. As a result, most family units receive several times over the supplementary bonus, which should only be paid once to each family in order to bring the income of the family group up to the level determined by the changes in the cost

(7) For the increase in fiscal burdens see below, paragraphs 10 and 11. For the Italian fiscal problem, see CESARE COSCIANI: *Italian Tax Policy in this Review*, July 1947, p. 86, and BENVENUTO GRIZIOTTI: *Three Forms of Capital Levy in Italy*, in this Review, October 1947, p. 149.

of living. This system represents a very heavy burden for the national economy; apart from its other defects, it increases the costs of production. It should, therefore, be thoroughly overhauled. This seems to me all the more reasonable since the economic policy of Einaudi has effectively raised real wages, restoring unskilled workers to the conditions in which they were in 1938 (8).

As things now stand, however, it is discouraging to have to admit that the structure of costs in Italy is decidedly rigid, for the reasons given above. There is little hope of seeing costs reduced sufficiently, other things being equal, to keep prices permanently below the level they reached in the summer of 1947. Even if the policy of Einaudi continues to be applied with all the initial vigour, there are substantial reasons for doubt whether it could produce a lasting reduction in the Italian price level.

10. — The sceptical nature of this conclusion is confirmed by the fact that the economic policy of the Government (as defined in paragraph 1 of this paper) gave free play to forces which are working against the Einaudi policy. I refer to the measures concerning public finance and the new policy for foreign exchange inaugurated at the end of November 1947.

The necessity of balancing the Budget in order to eliminate the principal cause of the increasing issue of paper money has been recognized by everyone, in Italy as elsewhere. For this reason last spring a special Ministry of the Budget was set up with Professor Einaudi at its head, having the responsibility of co-ordinating the work of all the other Ministries which dealt with public revenue and expenditure. The financial situation of the State at that moment allowed for an estimated budget deficit of about 312,000 million lire for the current financial year. This deficit resulted from estimated revenue of 520,000 million lire against expenditure estimated at 832,000 million; and this gap, unless it could be reduced or financed

(8) The check in the rise of prices during the last few months has been accompanied by increases in wages, due to extensive unrest among organized labour, with the result that the index numbers of wages of many categories of workers have actually risen above the corresponding indices of the cost of living. See in this connection Table G in the Appendix, p. 266.

by some other means, would necessarily have caused a considerable additional issue of paper money. During the following months, the revenue expectations improved considerably. Indeed, as a result of more efficient tax assessment by the fiscal offices, the normal progress of tax collection, and the revival of economic activity, etc., by the end of September 1947 it was estimated that the revenue for the current financial year would actually amount to about 800,000 million lire, which would mean an increase of 280,000 million, or of nearly 54 per cent., on the original estimates. Unfortunately, however, the expenditure of the State had also increased during the same period, so that the estimate for the whole financial year had to be raised by at least 264,000 million lire. Thus the only effective result obtained till then by the Budget Minister was to keep the deficit approximately unchanged at the originally estimated figure of about 300,000 million lire.

As to the means by which the Budget should be balanced, both the Minister of Finance and the Minister of the Budget, speaking in the Constituent Assembly at the beginning of October, gave it to be understood that they did not consider it possible to increase taxation. Signor Pella, the Minister of Finance, calculated that, compared with the financial year 1938-39, ordinary taxation had been increased about 40 times, while extraordinary fiscal levies had been raised 48 times, so that, taking into account the depreciation of the lira, the Italian taxpayer was already paying the State the equivalent of his pre-war fiscal contribution. Signor Einaudi added that the present taxation took from 20 to 25 per cent. of the private income of the nation, which was exceedingly heavy, considering that the average income per capita in Italy hardly reached 160-200 dollars a year, compared with 1,200 dollars per capita in the United States. "The sacrifices we are making by the payment of taxes", to quote his exact words, "are thus far greater than those made in countries with which unfair comparisons are frequently made".

After such authoritative statements it was legitimate to expect that the measures taken in order to improve the budget situation would have as their primary aim the reduction of public expenditure. Yet instead of taking this

course, the Government introduced at the end of November, 1947, a series of new increases in taxation which were expected to yield 96,000 million lire before the end of the current financial year, and this not with a view to reducing the deficit, but merely to keep abreast of the increase in expenditure. Now I recognize that the anxiety to prevent an increase in the deficit is perfectly well founded; but I am equally convinced of the impracticability of increasing taxation. This method, which has been practised in Italy for years, has by now become very dangerous. Not only, as stressed by the two Ministers quoted above, because we have already apparently reached the extreme limits of the taxable capacity of the people (in fact unless I am mistaken, the yield of taxation is beginning to show some signs of reaction), but also because it is contrary to the spirit of the Einaudi policy to base the management of the public finances exclusively on forcing an increase in the revenue. In my opinion, this is the crucial point of any judgment passed on the present financial policy of the Italian Government.

11. — The policy of Einaudi, as I have shown above, is essentially aimed at modifying, through a liquidity crisis which it produced in private business, the psychological and material conditions which determine individual behaviour on the market. It has, indeed, the effect of forcing everyone to keep a certain sense of proportion in his business activity, while it also demands certain sacrifices from both the employers and the workers in the general interest. Now it is inadmissible for the State, as a participant in the economic life of the nation, to be diverted by political pressure from following the lines of economic policy on which it has decided. In other words, it is inadmissible that the State should be prevented from doing itself what it pretends others should do; or, to put it in yet another way, that the State should continue to manage its finances according to principles inherited from the epoch of monetary abundance.

This attitude is always dangerous, because by favouring private interests on the false pretext of serving the common good, it generates the practice of easy-going administration and

leads to inflation. At the present time this is altogether ruinous for the country, because opposed as it is to the spirit which inspires the other Government measures, it compromises the effectiveness of the Einaudi policy to such an extent as actually to threaten it with failure. Even if it were possible to keep the budget deficit unchanged at its present figure, which in the long run is impossible as the cumulative growth of expenditure cannot be made good by a cumulative increase in revenue; even if the Treasury succeeded in systematically drawing on the money market by the sale of Treasury Bills; even so, the increase in Government expenditure would tend to cause a rise in prices. Such a rise in prices would be all the more probable as the new fiscal burdens, failing to hit the dwindling income and capital of the citizens, will be borne by the production and exchange of commodities, as actually happened with the new taxes introduced in November 1947.

Thus there exists a sharp contradiction between the policy of Einaudi and the financial policy of the Government. This may probably be attributed to the pressure of political interests and perhaps to considerations of electoral strategy, which had the better of sound economics. If this is so, an explicit warning must be given that the problem of public finance is so vital an issue for Italy, whose future prosperity is dependent on its right solution, that it must be faced, even in the political field, with much greater courage and in a more disinterested spirit than is usual among politicians. It is perfectly true that the greater part of the public expenditure in Italy is at the present time due to various forms of public assistance: to industry, to the unemployed or to the poorer groups of the population. In September 1947, it cost the Treasury 100,000 million lire to keep the price of bread artificially low; another 24,000 million lire were spent in social subsidies, and so on. But unfortunately it is equally true that, until the expenditure is reduced, the budget will be bound to close with a deficit; that so long as the budget deficit exists, the country will always be threatened with inflation; and that until the risk of inflation has passed, the economic life of the country cannot resume its normal course.

This is proved by the latest available figures concerning the financial situation. Public expenditure is increasing at a rate which, according to data referring to the last days of 1947, justifies an estimate of expenditure for the whole financial year as high as about 1,400,000 million lire, while the revenue is estimated for the same fiscal year at about 900,000 millions. The total amount of money in circulation at the end of October 1947 amounted to over 680,000 million lire, as against 496,000 million in January, 558,000 million in May and 667,000 million in September of the same year. By the end of December 1947, it rose to 787,000 million, with an increase of 85,000 million in the course of a single month. Such an alarming rate of increase in the volume of money appears to have been due, since the month of May, to the increased demand of the market, which resulted in drawing more money from the Bank of Italy by means of expanded rediscount operations. Yet precisely because the monetary situation is already so strained, the pressure of public expenditure upon the resources of the Treasury justifies a feeling of grave apprehension.

The rehabilitation of Italian public finance is therefore an urgent necessity; any delay in taking decisive measures will inevitably make the situation more complicated and a solution still more difficult to achieve.

12. — Another aspect of Government policy which conflicts with the Einaudi policy is the change in the foreign exchange system which came into force at the end of November, 1947.

Up to that time, anyone receiving sums in foreign currency was obliged to hand part of this money over to the State at the low official rate of exchange of 350 lire per dollar (pro rata for other currencies). Only after having complied with this regulation, which in most cases involved the surrender of half the amount of foreign currency received, was the person concerned permitted to sell the balance at the free rate of exchange quoted for the so-called "*valuta di esportazione*". As from the end of November these regulations were considerably modified. The holder of foreign currency is still compelled to hand over at least half, and not less than half, of the total amount. But the State now pays for this foreign exchange at

a rate varying from one month to another and corresponding, within certain widely fixed limits, to the average prices quoted on the free market during the preceding month for the "*valuta di esportazione*". Consequently the average price at which foreign currency can now be legally sold in Italy is much closer to the effective market price and, indeed, may even exceed it if the trend of prices on the free market has been going down or if a phase of declining prices follows a period of rising prices.

The reasons which suggested this new policy were manifold, according to a statement made by the Minister of Foreign Commerce. However, if we eliminate all the duplications occurring in his explanation, it seems that the Government adopted this new foreign exchange system for three reasons. First, in order to facilitate the sale of our goods and services to foreign buyers. Then, in the hope of inducing Italian citizens holding balances abroad to transfer these balances to Italy. Finally, it was intended gradually to prepare the ground for restoring a single market rate of exchange in Italy, which is an indispensable condition for the eventual stabilization of the lira; and such a return to a uniform rate of exchange would also be indispensable (according to the Minister's statement) in order that Italy could avail herself of the assistance of the International Monetary Fund.

This last reason was considered particularly important by those who maintained that the official rate of exchange was not proportionate to the depreciation of the lira inside the country. The supporters of this view have failed, and still fail, to realize that at the present time no equilibrium in foreign exchange can be achieved. So long as international trade is hampered by barriers put up by ourselves and by other countries; so long as there is no free international circulation of people and of capital; so long as the monetary systems of practically all countries are under inflationary pressure; so long as prices are subject to Government control, and consumers are still rationed, etc., — just so long will the market be unable to quote a rate of exchange that would make prices at home and abroad effectively equal. In any case, the Directors of the Monetary

Fund have recognized, in regard to member States which established their exchange parities several months ago, the precarious character of such declarations; while our own reform in this field was received with evident reserve.

The real reasons for this measure, at a time when transactions in foreign exchange must of necessity remain subject to Government control, are the two others mentioned above: facilitating the repatriation of capital which had fled from Italy since 1946, and encouraging our faltering export trade. But if these are the reasons, I cannot help feeling doubtful of the real expediency of this measure if it is considered, as I insist it must be, from the point of view of the general advantage of the country.

Meanwhile, it is strange to try to encourage the repatriation of fugitive capital by acknowledging the depreciation of the lira. Such capital might, indeed, return if the owners could be convinced that there would not be another devaluation in the near future, which might have been true if the lira had really been on the eve of effective stabilization. As, however, this is very far from being the case, it is possible that the "incentive" offered to those who had transferred their capital abroad will actually produce an effect exactly contrary to that aimed at by the Government, by generating new doubts concerning the stability of the lira. Until the country is really on the point of stabilising the lira, capital will return during a period of revaluation upwards of the currency but never during one of devaluation, so that in this respect our reform of the foreign exchange regulations may prove quite useless. At best, on the other hand, it has been superfluous, since a certain amount of capital had already been repatriated, owing to the liquidity crisis and the fall in prices (which actually involves a certain revaluation of the lira on the domestic commodity market) produced by the Einaudi policy. Why then, it may well be asked, change the existing regulations?

13. — At first sight, the objective of encouraging Italian exports is more in line with the general interests of the country. Our exports, indeed, after a period of boom in 1946 due to the urgent European demand for goods and to the absence of competition from other countries,

were hampered in 1947 by the rise in our price level, and by the revival of intense international competition. By reducing the value of the lira in terms of foreign currencies, the new system could secure compensation for the adverse effects of the internal depreciation of the lira; Italian home prices having been restored to the level of normal competition. Now I do not object to this practice on the ground, so to speak, of "fair play", considering that owing to the marked rise in our prices the adjustment of the rate of exchange, on which our exporters have to base their calculations for sales abroad, does not actually involve underselling or dumping. Accordingly, I do not condemn this measure on the ground that it leads to the wholesale export of our labour and our wealth at prices below cost price, or because it has disadvantageous results on our international trade. Instead, while recognizing that this measure has done away with multiple rates of exchange and the discriminatory character inherent in such rates, I deplore, for reasons of a more general nature, its elimination of barriers which restricted our exports, because at this time I consider intensive and indiscriminate exports to be harmful to the Italian economy.

This attitude to the export problem seems to me justified because, other things being equal, the rise in prices in Italy would not have been so pronounced during the last two years if some of the goods exported had been sold on the home market. These exports, as we are always told, were necessary to secure the foreign exchange we needed in order to buy from abroad essential commodities and foodstuffs. This statement, however, is not convincing, both because it misrepresents the objective pursued and because, even if this objective were as alleged, it did not represent a genuine need. In fact the aim alleged is false, because by far the greater part of the foreign exchange obtained by the export of Italian products was not actually used to pay for essential imports but served to transfer abroad Italian capital. There are naturally no statistics to prove this fact; but the available evidence is sufficiently convincing. Thus, it will be enough to notice that between January 1946 and May 1947 the value of Italian exports, according to official returns, amounted to 135,000

million lire, while during four months in the second half of 1947 Italy imported foodstuffs to the value of 50,000 million lire, by drawing on the balances in foreign currency Italian citizens had fraudulently accumulated abroad. This means that at least to the extent of 50,000 million lire, but really to an amount certainly much larger, Italian exports up to that time had served not the alleged interests of the country but those of certain groups of private individuals. Besides, to pass now to the second point, even if all the foreign exchange received by the exporters had really been used to pay for essential imports, the actual necessity of such imports would still need to be proved. In fact, from the moment after the war when we resumed our foreign trade relations, 80 to 90 per cent. of our imported goods have been free gifts, as we have been unable to pay with our exports for more than 10 to 20 per cent. of the value of the commodities imported. It must be added that some of our exports are only possible on condition that the necessary raw materials are first imported. Under such conditions, on what reasonable grounds is it possible to assert that exports are essential to permit Italy to import the commodities her economy needs?

This truth is beyond dispute in normal times, but in our present conditions it has become a slogan bordering on absurdity. It can become dangerous when it justifies a policy of indiscriminate encouragement of exports; because the only commodities which it really suits Italy to export today are luxuries (such as marble, silk, high-class motor cars and, in general, high-class goods), the consumption of which we ourselves must renounce owing to the impoverishment brought upon us by the war. The export of any other commodities, such as general consumer goods, causes economic harm to the country, even if it suits the private interests of the producers concerned, because it contributes to that shortage of commodities on the market which, combined with the increase in the note-circulation, causes high prices — with a rising cost of living, higher wages and higher costs of production.

Unfortunately, this attitude finds little response in Italy, as everybody seeks to profit by the present state of economic difficulty. It is

particularly regrettable that this attitude is not shared by some persons in positions of responsibility who, undoubtedly in good faith, refuse, as a matter of principle, to believe that a restriction of exports may in certain cases be to the general economic advantage. Yet the reasons adduced above certainly deserve to be discussed, not simply rejected *a priori*. They tend to show that in the peculiar economic conditions of present-day Italy, serious doubts are being entertained as to the universal validity of the traditional view, that large exports are beneficial to a country. These doubts are based on the fact that there exists a marked disparity between the average income of the great mass of the Italian population and the average level of prices on the Italian home market, as well as on the rather discouraging consideration that so long as this disparity lasts the miserable condition of life of the Italian people will be bound to continue. This will inevitably mean a continuance of the present state of social and political tension and, through the necessity of granting successive increases in wages, will lead to a rise in the costs of production and a general rise in prices, creating new difficulties for the exporters themselves. Thus, a moment will be bound to recur when, with the customary justification of the need to adjust the lira's rate of exchange to its diminished purchasing power in the home market, one may be compelled to have recourse to another devaluation.

The view that, under conditions similar to those now existing in Italy, exports of basic consumer goods should be reduced rather than expanded, is not, as some people insist, merely a fad of some isolated economists. Indeed, according to members of the United States Congress responsible for the preparation of the Harriman Report on economic aid to Europe, it would not be wise to encourage European exports by means of an excessive restriction of consumption (such restriction may result not only from rationing but also from excessively high prices), because a certain increase in the volume of consumer goods required by the population would seem to be essential to restore the incentive to production (9).

(9) On this subject (par. 13), see also L. C.: *Survey on the Italian Monetary Situation*, in this Review, July 1947, p. 123 seq., especially note (2).

14. — Substantially, therefore, the controversy over the export of essential consumer goods reflects a fundamental disagreement as to the economic policy that is best for the country. In Italy, with the policy of Einaudi, in force between September and November 1947, combined with the temporary difficulties encountered by the export trade, the supply of goods on the home market tended to increase and, consequently, prices came down. In this way one might have hoped to reduce the costs of production or, at least, to prevent their increase, so as to secure, in the end, more favourable conditions for the export trade itself. Yet at the end of November it was decided to change the regulations on foreign exchange in such a way that, by favouring exports, they are bound to counteract the effects of the Einaudi policy. Now, why reduce financial pressure upon those who had not yet liquidated their stocks of goods and reserves of foreign exchange? At a time when the prices of many foodstuffs and industrial products, as well as the rates of foreign exchange, were already moving downward, why reverse this movement and suddenly offer the exporters the unlooked-for prospect of selling abroad the commodities which they could quite well dispose of on the home market, even though at less profitable prices?

It may be said that the reason lay in the necessity of mitigating the difficulties in which many businesses were involved by the policy of Einaudi. Yet in this manner the Government served the interests not of the country as a whole, but of particular sectors of its economy; *i.e.* on the one hand, the complete restitution to productive use of the capital withdrawn from industry was prevented to the extent to which the export trade enabled it to escape from the liquidity crisis; while, on the other hand, the downward trend of prices was more or less hindered, also owing to the fact that the increase in the rates of foreign exchange raises the prices of imported commodities and of Italian goods made from imported

materials. It is true that the Government, realizing these harmful effects, decided to keep unaltered the prices of imported materials (wheat, coal, etc.) which the State sells to private traders. This practice, however, is only applicable without cost to the Treasury in respect of commodities received as a free gift; for all other goods it involves an addition to budget expenditure, and therefore does not eliminate the price-raising effects of the new foreign exchange regulations upon all the numerous other imported commodities.

The present situation does not allow us to cherish any illusions as to a further reduction in the domestic price level. And if we recall the somewhat similar conclusions we reached in the preceding pages with regard to the probable effects of the recent fiscal measures, we feel justified in maintaining the opinion put forward at the beginning of the present study, to the effect that the economic policy of the Government, since the end of November 1947, has been definitely in opposition, both in intent and in methods, to the policy of Einaudi.

From this we can draw two conclusions. First, that within the present Italian Government there is not sufficient agreement as to what should be considered the general economic interests of the country and, consequently, as to the efforts that must be made to serve these interests. Secondly, powerful pressure must have been exercised by private interests upon the Government in recent times, to secure the adoption of measures which could relieve the pressure of the Einaudi policy upon the market.

This does not imply that the policy of Einaudi has been reduced to a shadow, as it will still continue to have a certain effect so long as the credit restriction on the banking system remains in force. But we must admit that this policy has certainly lost much of its original power. And if, for some unfortunate reason, its residual power were to be neutralized, by one means or another, the consequences for the country might prove very serious.