BANCA NAZIONALE DEL LAVORO QUARTERLY REVIEW

7

Interest Rate Policy and Reconstruction Requirements (G. [illegible]) [illegible] — The E.R.P. and the Problems of Italian Agriculture (G. [illegible]) [illegible] — The Depreciation of the Peso and Trade between Italy and Argentina (G. [illegible]) [illegible] — Unemployment and Emigration in Italy in the light of the E.R.P. and O.E.E.C. ([illegible]) [illegible] — The Housing Problem in Italy ([illegible]) [illegible]

BANCA NAZIONALE DEL LAVORO

HEAD OFFICE: ROME

VIA VITTORIO VENETO, 119

Condensed Statement of Condition, June 30th, 1948

(Lire)

LIABILITIES		ASSETS	
Capital	1,150,000,000	Cash, Balances with Banks & Money at call	52,271,956,572
Ordinary Reserve Fund	307,500,000	Bills Receivable	27,338,343,332
	1,457,500,000	Investments (Govt. & semi-Govt. Securities, Treasury Bills & other Securities	14,743,081,797
Deposits & Current Accounts (Including Balance of Profit & Loss)	129,520,778,711	Contango, Advances on Securities & Loans	59,912,646,767
Cheques in Circulation (*Assegni circolari*)	8,473,161,293	Sundry Accounts	1,323,968,480
Bills for Collection	3,365,046,331	Premises	276,306,689
Guarantees & Acceptances for A/C of Customers	24,344,383,730	Furnitures & Fixtures	1
Sundry Accounts	9,840,916,759	Customers' Liability for Guarantee & Acceptances	24,344,383,730
Staff Individual Retirement Accounts	2,570,988,443		
Unearned Discount & other unearned Income	637,912,101		
	180,210,687,368		180,210,687,368
Depositors of Securities	23,046,199,715	Securities deposited by Third Parties	23,046,199,715
Accounts guaranteeing special Accounts	11,477,653	Special guaranteed Accounts	11,477,653
Bank's securities guaranteeing staff Assistance and Retirement Fund	1,033,433,874	Staff Assistance & Retirement Fund-Securities deposited by the Bank as guarantee	1,033,433,874
	204,301,798,610		204,301,798,610

AUTONOMOUS SECTIONS FOR SPECIAL CREDITS

SECTION FOR CREDIT TO MEDIUM AND MINOR INDUSTRIES

Capital and Government Guarantee Fund L. 2,275,000,000

SECTION FOR HOTEL AND TOURIST CREDIT

Aggregate Capital and Reserves L. 202,171,869

SECTION FOR CO-OPERATIVE CREDIT

Capital L. 500,000,000 - Government Guarantee L. 2,000,000,000

SECTION FOR MORTGAGE CREDIT

Aggregate Capital and Reserves L. 99,974,926

SECTION FOR CINEMA CREDIT

Aggregate Capital and Reserves L. 411,778,073

SUMMARY

Prof. Gino Borgatta, in an article on "*Interest Rate Policy and Reconstruction Requirements*" sums up his enquiries into policies aiming at lowering the cost of money. Illustrating his views by a historical and critical review of the advantages and disadvantages of such policies he is led to conclusions substantially confirming current opinions unfavourable to a cheap money policy. However, the A. does not limit his study to the present post-war period, but extends it to the whole period running from the close of the first world war down to the present day. In this long-term survey, Prof. Borgatta aims at showing the fundamental conditions regulating the rate of interest in so far as they determine the general economic equilibrium, and the disturbing effects caused by artificial monetary manoeuvres. Viewed against this background, the *monetary* theories on interest rate may seem—as the A. has himself judged them in other writings of his—reactions caused by the special monetary vicissitudes of the last thirty years, rather than the expression of general economic laws.

* * *

In his article "*The E.R.P. and the Problems of Italian Agriculture*", Prof. Giuseppe Medici, Senator and President of the National Institute of Agrarian Economy, analyses some aspects of Italian agriculture, as seen in the framework of national economy: the congestion of the agricultural population, the relations between agriculture and industry, the structure and forms of land tenure, the importance of the agricultural trade balance for international trade as a whole. The A. illustrates the main lines that agricultural development should follow in the next few years if a general increase of production is to be secured and insists on the need of taking immediate steps towards the solution of the more important problems facing Italian agricultural by a wise use of the E.R.P. Funds. Prof Medici lays special stress on the need of increasing the production of fresh fruit and vegetables and the products of animal husbandry; on the execution of land-reclamation and irrigation works; the improvements of conditions in mountain areas; the mecanisation of agriculture; agricultural training for the peasantry; experiment stations and research work; the organisation of agricultural producers; and the strengthening of agrarian credit.

* * *

In his article "*The Depreciation of the Peso and Trade between Italy and Argentina*" Prof. Gino Luzzatto describes the main outlines of the Argentine peso crisis, pointing out its nature and origin, diagnosing it as one of the "growing pains" of a country engaged in carrying out a bold plan of rapid industrialisation, and notes that the possibilities of a favourable settlement depend largely on a more balanced development of the economic potential of the country, and on securing the necessary contribution of foreign labor forces. In the last part of his article the A. examines the economic and commercial relation between Italy and Argentina, the opportunities offered for Italian emigration, the obstacles that hinder its development, and the strictly complementary character of Italian and Argentinian economies.

* * *

Dr. Giandomenico Cosmo, in his article "*Unemployment and Emigration in Italy in the light of the E.R.P. and O.E.E.C.*" deals with one of the most delicate aspects of the present Italian economic situation, that of the labor market seen both from the standpoint of unemployment and of emigration. The A. recalls the weight and importance these two factors have had in the development of Italian economy; he makes a brief analysis of the causes that have led to the present aggravation of the situation, arising both from the upheavals due to the war and international political uncertainties, and he tries to foresee probable developments as affected by the reconstruction plans to be carried out with E.R.P. help.

The A. is led to the conclusion that Italy's excess of workers presents a problem that cannot be solved by action limited to structural changes in the Italian economy; a large current of emigration is essential, and this requires the active co-operation of the several countries concerned.

* * *

Prof. Salvatore Alberti's article on "*The Housing Problem in Italy*" considers the other most pressing of Italian problems, *i.e.* the scarcity of dwellings which in Italy has much more serious features than in other Western European countries, including those that have suffered most seriously from war destructions. The A. examines first the special features of the housing question in Italy since 1931, givin data for the number of dwellings, new buildings, war destructions, sanitary conditions, over-crowding, internal migrations, etc., and goes on to describe some of the consequences of the legal restrictions placed on rents, as shown by the new economic and social relations between landlords and tenants, the supply of dwellings, and, above all, by the more rapid deterioration of house property, one of the more serious factors making for the destruction of national wealth. Finally, he deals with the measures taken by Gvernment to encourage building. In this connection the A. summarises the leading features of the plan presented some months ago by the Minister of Labor, Fanfani, and refers to a bill introduced after World War I by the deputies Matteotti and Turati, which under present conditions is of special interest.

The Banca Nazionale del Lavoro assumes no responsibility for opinions or facts stated by authors whose contributions are published in the present Review.

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Interest Rate Policy and Reconstruction Requirements

by

GINO BORGATTA

I. — *General benefits and disadvantages of a low interest rate policy.*

1. - The experience of the last decade shows that the policy of a low rate of interest was the result of monetary factors unsuited to the supply and demand of goods of immediate or deferred availability. It was rather dictated by a war economy and by governmental intervention and manoeuvres.

However, to appreciate the benefits and the disadvantages of this policy, it is necessary to view it from the angle of the Treasury (and of the political groups in charge of it) and from that of the general and long-range interests of the community.

The advantages to the Treasury from a lower cost of war loans and war financing are evident: smaller budget outlays are necessary for servicing the loans floated during the war and the immediate post-war period, while it is easier to obtain quickly the large sums needed for the war and for reconstruction in the expensive period of reconversion to a peace economy.

This policy, by a gradual conversion of the redeemable debt into lower interest-bearing bonds, coupled with a reduced purchasing power of the currency in which interest and principal are paid, while revenue from taxation increases, has also brought about a fall in the cost of loans floated before the war.

The advantage is not limited to a lower taxation for servicing the public debt; it also affects the *distribution* of wealth by reducing the ratio between outlays for the public debt and outlays for other services, particularly social, as well as the ratio between outlays for the public debt and total fiscal revenue. Thus, it causes a lower *redistribution* of wealth, inasmuch as less revenue from tax payers (including those not holding any public bonds) is needed to pay interest to bond-holders. While the public debt grows faster than its servicing and faster than the national income, the ratio between the yearly outlays for servicing the debt and the national income may decrease or remain relatively low. The lower cost benefits the Government since the war period and reduces, correspondingly, the necessity to resort to inflation. Facts, however, prove that this benefit is relatively slight, because the expenditure on the service of the debt is only a small part of total governmental expenditure during the war and the first post-war years. Even now it would be an exaggeration to affirm that a 1-3 % increase in the interest rate could be a decisive stimulus to inflation.

The importance of the short-term debt compels the Government to maintain as long as possible a low rate of interest, so as to keep down the expenditure on new loans as well as on the old loans which come to maturity and are renewed. It would perhaps be more convenient to the Government, while interest rates are low, to convert a large part of the short-term debt into a long-term one, even if the latter bears a slightly higher rate. Unless there is a marked increase in inflation a further fall in present interest rates is not anticipated.

The policy of the low rate of interest also benefits entrepreneurs, as it favors a reduction in production costs. If it is kept in mind that a large part of the national product is purchased by the Government, it can be assumed that the low interest rate policy also contributes indirectly to lower public expenditures. There is, however, the danger that some investments, otherwise uneconomical, will be effected only because of this artificially low rate of interest.

2. - The Government's benefit does not identify itself, however, with the community's benefit, if it is borne in mind that the payment of interest on the public debt (and of the taxes needed for it) affects only the *distribution*, but not the size, of the national income. Assuming that taxpayers buy bonds in the same proportion as they pay the taxes needed for their servicing, any rate will serve the purpose, inasmuch as each taxpayer would pay in taxes the same amount he receives as interest. If, however, it is remembered that there is no necessary identity between bond-holders and taxpayers, the benefit of the low rate of interest is appreciated. Taxpayers have to pay less and bond-holders receive less. The problem, then, is to compare the utility of the income subtracted from bond-holders, and the utility of the investments they would effect with the subtracted income, with the utility of the income saved by taxpayers and with the utility of the investments they can effect with the saved income. It is not demostrated *a priori* that the latter will exceed the former.

This is, however, only a first approach to the problem. The economic harm of a low interest rate, induced or aggravated by an artificial policy operating essentially on monetary factors, can be appreciated only if its effects on the fundamental factors of the rate of interest and of the accumulation of savings are kept in mind. The monetary factors prevail as long as the dynamic phenomena caused by the war, the exceptional income redistribution and the increasingly expanding amount of credit money (governmental and banking), last. A time comes, however, when these conditions lose their importance and come to an end. At the same time, the other coercive provisions, that have brought about a governmental quasi-monopoly, are repealed (control of private consumption and prices, hindrances to the more convenient investments from the viewpoint of investors). Although conditions have changed considerably since the end of the war, this time has not yet arrived in any country and monetary stability is not yet restored.

In many markets, the income redistribution brought about by war expenditures and inflation has been replaced with a *political* redistribution of incomes, which, however, is caused mainly by inflation. Here also the problem exists and will emerge fully when inflation ceases or when foreign grants, compensating for the insufficient internal accumulation of savings, come to an end.

When money is stabilized and a "normal" economy is restored, the accumulation of exceptional monetary supplies, which have made the low rate policy possible, must necessarily decrease and then stop, the liquidity preference rates must get close again to the subjective preference rates for goods. This phenomenon could be vividly observed in the post-World War I period, particularly in the countries that experienced extreme inflation (1). It appeared first as an acute need for operational capital during the monetary stabilization and in the following period (2). The maladjustment between fixed capital, in the increase of which war and inflation profits had been invested, and operational capital, was only one aspect of the more general maladjustment between demand and supply of capital which stabilization brought into prominence. After the last war, the problem should have appeared differ-

(1) It was observed in Germany with great perspicuity by Bresciani Turroni (see *The Economics of Inflation*). The official discount rate remained unchanged from 1915 to July 1922 although prices (in paper money) increased from 109 in July 1914 (1913 = 100) to 7,030 in June 1922. In the Berlin open market the interest rate moved to 3.19 % in 1919, 3.60 % in 1920, 3.49 % in 1921, and was between 4 % and 5 % in the first half of 1922. While inflation was running its course, the rise in the rate of interest was much less than the depreciation of money loaned (the purchasing power fell by more than 9[illegible] per cent from July to December 1922, and by almost 100 % from Januar to October 1923). In the open market in January 1923 the rates for daily money corresponded to monthly rates oscillating between 250 % and 800 %. In December 1923 after the first monetary reform, the rate in force on the Frankfurt Stock Exchange was higher than 32 % per month; in the first half of 1924, in Berlin, it was still 72 % per year. When stabilization came, the influence of the almost daily devaluation of the currency was removed. The need for operational capital then appeared; this need was reflected in the high rate of interest, not only *nominal* but also *effective*, given the relative stability of prices and rates of exchange in the period when the loans were made.

(2) The increase in interest rates is a common phenomenon in the countries that have stabilized their currencies after a period of extreme inflation and deflation. In October 1925 the official discount rate was 12 % in Poland (14 % on advances), 9 % in Germany (11 % on advances), Austria and Hungary, 8 % in Finland, 7 % in Czechoslovakia.

ently, because if, on one side, the need for liquidity has lasted much longer and the hoarding of bank-notes, gold and hard currencies has been extensive, on the other side, there was an increase (at least in Europe) in the need for operational capital as well as in that for fixed capital, owing to the exceptional wear and tear of the war period and to war damage. But after a few years of exceptional rises in wages, taxes and prices of other circulating capital, and as soon as inflation has been checked, the need for operational capital has prevailed (or has appeared to prevail) over that for fixed capital.

3. - The main economic harm caused by the low interest rate policy is outlined below. The war changed deeply the essential factor determining the rate of interest, viz. the preference for present goods over future ones. It enormously increased the need for present goods; it caused a decrease, or only a small increase, of the national product; it hastened the consumption of a part of the national capital and of all producers' goods and destroyed, without any economic compensation, another important part of the national capital.

The exceptional demand for present goods lasts in the post-war period for the purpose of restoring the capital worn out or destroyed and of meeting the greater demand for consumers' goods made possible by a progressive repeal of economic restrictions and a better redistribution of money incomes in favour of the poorer and more numerous classes. At the same time the real product increases, but more slowly.

To adjust the disequilibrium between present needs and incomes, adequately higher interest rates would have been necessary. These higher rates would have made more attractive the allocation to the future of a greater part of the present product and would have vivified the forces tending to the accumulation of savings. The higher rates should have remained in effect in the post war period to counteract the greater propensity to consume and to stimulate the means necessary to restore capital and, therefore, the national income. The policy pursued, owing mainly to financial causes, is in contrast with these needs: it has lowered interest rates by means tending to weaken and destroy the forces that lessen the preference for immediate consumption and increase the utility of deferred consumption, without achieving the effects of an increase in interest rates. The subjective need for present goods has been largely preserved by this policy; only its materialization in demand has been either forbidden or hindered. This policy has not prevented the decrease of productive capital, thus paving the way for a long-term decrease in the flow of future incomes. By decreasing the utility of the part of present incomes allocated to meeting future need, it has weakened the forces tending to the accumulation of new savings among the social classes that now experienced the loss of the whole, or of a considerable part, of the purchasing power of their previous savings.

From a certain viewpoint, the phenomenon of hoarding is not an index of the fall to zero of the subjective interest rates. On the contrary, it is an index of a lessened confidence in, and of a smaller value attributed to, forms of investment that were prevalent before the war. By hoarding the saver prolongs the possibility of allocating his resources either to immediate or to future consumption, and the choise of the most convenient future incomes. This appears to be an increase, rather than a decrease of the subjective rates.

The stabilization of the currency, the ceasing of continuously new supplies of governmental and banking money, the progressive repeal of consumption and price restrictions, necessarily entail the end of an artificial accumulation of monetary supplies equal to, or greater than, the demand for them; at the same time, the rise in the prices of the factors of production, wages and taxation, brings again the present demand for money to a level equal to, or greater than, the present demand for goods.

Two series of consequences can be reasonably expected: I) After the stabilization of prices and currency follows an increase in the short and long term interest rates and a period of relatively high rates. These have already appeared in several markets, in spite of the fact that inflation has not yet been checked and the need for present goods is partly met by foreign grants and loans bearing artificially low rates.

The reduction, and eventually the discontinuance, of foreign gifts and loans, if not followed by a new inflationary process, will stimulate the upward movement. II) The disequilibrium between the need for immediately available goods (both consumers' goods, owing to an increase in wages and other incomes consumable immediately, and producers' goods, for the rebuilding of capital and equipment worn out or diverted from their most economic utilization or destroyed by war) and present availabilities of real incomes and savings is aggravated by the low rate policy pursued during the war and the immediate post-war period, inasmuch as its causes have been unfavourably affected by such policy, which has increased the advantage of a hastened consumption of capital and decreased that of the accumulation of new savings.

The latter effect will remain after the stabilization because the losses suffered by savers are lasting: the incomes necessary for savings have fallen and the advantage of allocating a part of these incomes to future consumption is weakened (*i.e.*, the subjective preference for present goods increases) owing to the volatilization of past savings, particularly those invested in fixed future incomes. The experience of the years following World War I (even if not conclusive) shows that these effects are substantial in the years immediately after inflation is checked and then fade and cease with a relative rapidity. In the present post-war period, however, they are worsened by the redistribution of a greater part of the national income in favour of those classes which feel less stronghly incentive to save.

The low rate policy has thus aggravated the problem of reconstruction. The benefit of lower taxes and of a weaker stimulus to inflation (for the expenditure not covered by taxes and loans) is outweighed by the increased disequilibrium between the need for present goods and the flow of real products, and by the weakening of the incentive to save. These disadvantages may for a time be hidden by inflation or by foreign gifts of cousumers' goods, raw materials and machinery, or by foreign loans, free of interest or bearing only a low rate of interest. Inflation defers the appearance of the disequilibrium, although, from another aspect, it worsens it. Foreign gifts and loans adjust, in part, the disequilibrium, but they affect the interest rates in the countries granting the gifts and loans, which represent a loss of part of the national income. The increase in interest rates in the donor countries will be proportionate to the ratio of gifts and loans to the total national output.

It seems unlikely that the present need for good in the European countries that have suffered from the war can be met, in full or in the greater part, by grants and loans: however, too high an increase in the interest rate may be avoided and, at the same time, an adequate interest rate may stimulate a greater supply of savings.

A change in the interest policy, *i.e.* the discarding of the provisions that have kept the rates artificially low and allowing economic forces to operate more fully, must not be viewed only from the angle of public finance.

It is true that the public debt will be, for a time, the main conveyor of savings from the community to the organizations, public and private, carrying out the reconstruction program; but it will not be the only one. It is doubtfull whether it is an advantage to let the Government prevail over the private initiative in the work of reconstruction. Even in Italy a substantial part of the reconstruction in industry, agriculture and housing is carried out by private enterprise without grants or subsidies by the Government which has hindered it by a short-sightet and irrational taxation policy and by too much red tape. The Government, on its part, can support the accumulation of savings and private financing with the interest paid on the public debt and, above all, by stabilizing the currency and balancing the budget.

The problem affects the allocation by individuals and by corporations of income either to consumption or to savings, *i.e.* to future income. The Government can help in this by creating favourable conditions for bridging the gap between nominal and effective interest rates; or, even better, by gradually removing the conditions caused by its own policy that have greatly widened the gap. The prices of goods immediately available in terms of goods available in the future must be adjusted to the relation between present demand and supply.

This adjustment may eliminate the marginal enterprises that cannot afford to pay a higher rate of interest. It will be a selection for the survival of the better enterprises, capable of a higher prouctivity which will pay for the higher rate of interest (3).

II. — *Particular effects of the low interest rate policy on banking and insurance institutions; on income distribution; on international capital movements; on hoarding.*

4. - A less known instrument, often undetected by savers, of artificially low rate policy is the gap between changes in *effective* rates and changes in *nominal* rates; the latter may be kept unchanged or lowered or increased proportionately less than the prices of the goods in which the loans are invested. Even though the market may realize this fact, it is understood only vaguely and inadequately: yet its understanding is very important from the viewpoint of the transfer of wealth from creditors to debtors and the interpretation of the movements of the rates of interest. To keep the effective and nominal rates equal, the latter should include a quota exactly equal to the fall in the purchasing power of the loan while it is outstanding (4).

The data available show that this condition is not substantiated as long as commodity prices increase. The gap between the two rates, which means a loss to the savers, becomes wider when prices increase faster (5). Nominal rates, except for the final period of uncontrollable inflation, appear not to be affected by changes in effective rates. This will be proved also by the post-war period in Italy when better yearly price averages from 1944 to 1947 become available.

5. - The consequences of this phenomenon are evident. The low rate policy could minimize its economic evil effects only if the price level were kept completely *stable*. But if the purchasing power of the currency in which loans and interest are denominated decreases continuously and to a marked degree, the saver suffers, *in addition* to the loss from the artifi-

(3) For an analysis of this point, see: L. Federici: *Sulla convenienza e possibilità di una politica di basso saggio d'interesse*, in "Rivista Bancaria", March -April 1947.

(4) It is interesting to see what commodities should be taken for calculating the change in purchasing power while the loan is outstanding. It does not seem right to take the general price index. From a rational viewpoint, the rate demanded by the money-lender should be based on the change in the prices of goods in which he would otherwise invest the amount of money he now lends. The rate offered by the borrower should be based on the change in the prices of goods in which he wants to invest the loan. Therefore the rational rate should be the meeting point of these two rates of demand and supply of money. The comparison between nominal and effective rates must be set in a definite period of time. Forecasts of price changes during this period will, however, be different from actual changes. If, for each year, a *uniform price increase* is expected, the rate of interest that will discount it exactly will not be increasing but will remain *constantly* high; *e.g.*, if the current rate, when prices are stable, is 5 %, and if prices rise at a yearly rate of 15 %, the nominal rate (in order to remain equal to the effective one) should be allowed to increase from 5 % to 20 % in the first year of rising prices and should then be kept stable at 20 % as long as prices rise at a yearly rate of 15 %.

(5) By taking the wholesale price index and its variations from year to year, and the capitalization rates of long term and irredeemable Government bonds, it is possible to see the gap existing between nominal ad effective rates:

Year	U. K.		U. S. A.		France		Italy	
	Current nominal rate	Equilibrium rate	Current nominal rate	Equilibrium rate	Current nominal rate	Equilibrium rate	Current nominal rate	Equilibrium rate
1943	3.10	5.14	2.47	6.85	3.11	14.90 (a)	5.34	17.65
1944	3.14	5.14	2.48	4.15	3.01	14.70	—	—
1945	2.92	4.88	2.50	4.15	2.99	16.19	—	—
1946	2.60	5.80	2.50	16.30	3.35	76.15	5.24	—
1947 First quarter	2.80	4.80	2.50	22.50	3.42	37.02 (b)	5.40	64.68

(a) 1942.
(b) Arithmetical mean of the monthly price averages in 1947. The example is merely indicative of a trend. For a theoretical analysis, see: I. Fisher: *The Theory of Interest*, Chapters II and XIX.

cial control and fall in nominal rates, the loss of a part of the principal while the loan is outstanding. The rigid rate policy prevents the savers from being compensated, at least in part, by the small increase in nominal rates, as was the case during previous wars, including the First World War. This policy is, therefore, another economically arbitrary cause of the deep alteration in the distribution of wealth brought about by war and inflation; it aggravates the privations of the money-saving and lending class; it weakens the incentive to save. These losses can be fully assessed only when the currency has been effectively stabilized.

The possible harm and disturbances encountered by those industries (*e.g.*, banking, credit, insurance) normally operating on the basis of the *economic* determination of rates are another effect of the low rate policy. The artificial lowering of the rates may, at a certain point, affect the costs of these industries in such a way as to hinder or make less profitable their activities. The increase in the outlay for wages, taxes, rents, compels credit institutions, for instance, to look for investments bearing rates of interest much higher than those paid to depositors; if the policy being pursued does not allow a sufficient difference in rates, the efficiency and regularity of their operations may be imperilled (6). The artificial lowering of rates has the effective result of making more *expensive* the service of banks to their clients; this is proportionate to the quota of deposits, assets and reserves that, by law, must be invested in Government bonds or other low interest-bearing public debt. Similar considerations hold good for insurance companies.

In this particular field, the low rate policy may become counter-productive, inasmuch as it compels the banks to look for investments yielding more, and having a more stable purchasing power, than Government bonds and, in general, investments yielding a fixed income. The Government can neutralize these consequences only by coercion, that later results in a deterioration in the activity and efficiency of this business.

6. - It may be of interest to see whether the artificial lowering of the interest rate may be considered as an instrument of the policy of income redistribution on behalf of the lower income groups, *i.e.*, whether it may directly contribute to an increase in the portion of the national income which is allocated to wages and salaries.

The classical theory and the socialist theories dialectically derived therefrom, would warrant this assumption, because their hypothesis is that the social product is arithmetically divided between rent, interest and profit, and wages. Therefore, a reduction in the amount of the national product allocated to one of these elements automatically results in an increase in the amount allocated to the others, and vice-versa. The theory seems to have been confirmed by the events of the recent war (in some countries) and for the post-war period (in many countries). In such countries, the portion of the national income represented by wages and salaries and, in general, by income from labour, has proportionally increased much more than in the past, owing to the rapid and substantial increases in unit wages during the last four years. The fall in the interest rate and the increase in nominal wages are however not *cause* and *effect*; their coincidence is due to the concurrent action of other factors, mainly monetary. In a previous instance, in the years 1929-35, facts proved different: interest rates decreased and at the same time nominal wages and employment decreased (the fall in real wages being less marked). On the other hand, it cannot be denied than an artificial or political decrease in interest rates may affect wage increases; the relation is, however, more complicated, more mediate and less uniform than that supposed by the classical theorists.

First of all, the relation works through the financial mechanism: the smaller expenditure on the service of the public debt make it possible to impose lighter taxes on wage-earners' consumption, or to spend a larger share of the revenue from taxation on service useful to wage-earners. The main fact to notice is that the means used to lower the interest rate and to keep it low—new issues of governmental and

(6) This point has been clearly illustrated, in relation to the Italian banking system, by C. Bresciani Turroni in *Capitali disponibili, saggio dell'interesse, costi bancari*, in "Rivista Bancaria", May-June 1946.

banking money—are the *same* that are available to the Government for increasing social assistance, raising the salaries of civil servants, or for carrying out public works that increase the demand for labor. In this way, wages rise, or are prevented from falling. The result is an increase in bank deposits, which permits a further expansion of the banking money requested by businessmen for payment of wages. The *same causes* are at work in the lowering of interest rates and raising of wages; the process, however, is artificial, temporary, and foreign to the mechanism of the distribution of the social product as envisaged by classical economists.

Furthermore, this policy, by lowering and fixing nominal interest rates at a time of rising prices, leaves a greater profit to entrepreneurs borrowing capital; they earn, to the loss of the savers, the difference between nominal and effective rates. A greater number or business activities thus become attractive resulting in a greater demand for labor and in higher wages. Even in this case, however, the effects of the low rate on wages are mediate, subject to the effects on profits; they result from temporary dynamic conditions, different from those on which the classical theory had been built. When prices are stabilized, when new issues of money stop, nominal rates tend to equal or to exceed effective rates, abnormal profits disappear, and only coercion can keep the artificial employment and wages of the previous period at the same level.

In addition, new issues of money, which permit the Government to lower interest rates, make available to entrepreneurs additional means of payment for hiring more labor and paying higher wages. The classical scheme, on the contrary, presupposed a normal economy, monetary stability, a system of distribution unaffected by inflation and governmental intervention intended to lower interest rates and to keep them low.

It may be asked whether, given monetary stability and budget equilibrium, while new artificial issues of money have been stopped, the artificial lowering of the interest rate alone could increase the level of wages and employment. The harm appears to be greater than the benefit. It is in the interest of the wage-earners that the market supply the greatest possible amount of saving and that this amount be invested in the most advantageous form (in this way, real and monetary income would tend to coincide). Only through an optimum and continuous increase of the national product can an increase in wages result in a substantial and lasting betterment of the standard of living of the wage-earning class, particularly when foreign grants and consumption loans have ceased to flow into the country.

The low rate policy does not encourage an increase in the supply of savings; as a matter of fact, it favors a diminution of savings by the amount that marginal groups would save in consideration of a higher rate. It favors less productive investments, inasmuch as good as well as bad entrepreneurs have an equally favourable access to the limited supply of capital; in this way, the optimum distribution of the capital available is endangered, even in subsequent periods. Furthermore, this policy stimulates entrepeneurs looking for *alternative* factors of production to employ more capital, which has become cheaper than labour, which has become more expensive (7).

The most important consequences are to be found in the supply of saving for investment. Once the amount and the purchasing power of the currency have been stabilized, the subjective preferential rates for immediately available goods are no longer lowered artificially by the monetary conditions created by the Government; they contrast, therefore, more and more, with the low rates imposed on the market by that policy, which, from this point of view, tends to depress and not to increase employment and wages.

In conclusion, the artificially low interest rate has not caused a rise in wages except indirectly and temporarily. This has been the concurrent result of the inflationary process. The redistribution of the national income so as to increase the share composed of wages and salaries has been made possible, and has been

(7) This point was illustrated by L. Federici in *Sulla convenienza e possibilità di una politica di basso saggio*, op. cit., pp. 21 and 22.

mostly fed, by new issues of governmental and banking money: It is still to be seen what will happen when these issues come to an end.

7. - Characteristic of the last war were the imposing international transfers of capital in forms different from the traditional interest-bearing loans that still prevailed during the first world war. It would take a long time to analyze these forms of transfer, which have survived the war and are still continuing under the E.R.P. (8). The international loan of an "economic" type is essentially justified by differences in the interest rates, *i.e.* in the net yield of loans, prevailing in the debtor and creditor countries (9). By lowering the rate in the borrowing country and increasing it in the lending country, the economic international loan tends to bring the rates to the same level and to ensure a better international distribution of capital from the viewpoint of differences in net yields.

When *political* consideration replace *economic* ones in the negotiation of an international loan, its character and effects are changed, inasmuch as its *economic* conditions are changed (uneconomical loans are granted; they are granted at rates, at maturities, etc., less profitable than those of strictly economic loans; loans that would be profitable are not granted, etc.). Therefore the effect on interest rates and on the distribution of capital are altered by non-economic elements; the resulting deviations are, however, still relatively limited.

The deviations resulting from transfers made for strictly political reasons or in accordance with a long-term economic policy (and therefore unrelated to interest rates and net yield) are much deeper and more far-reaching.

The equilibrating trend of the interest rates in the various markets is thus replaced by effects that may be partly in the same direction but are in unequal proportions for the various countries involved in the transfer.

They are, moreover, interwoven with other effects, political or economic, which require a particular *inductive* inquiry as they cannot be drawn from the economic theory of international loans. In the case of *coercive* transfers of factors of production, unpaid requisitions, etc., the economic consequences may even contrast with those stated in the general theory, especially as regards the rates of interest (10).

8. - Another phenomenon of the war and post-war period—hoarding of bank-notes, gold, jewels, and the like—which, according to a widely-held opinion, has abnormally increased, appears to be related to the low rate policy. It is my opinion that estimates on this subject are exaggerated; data derived from conversions of currencies have not supplied accurate information, as sometimes claimed.

In any case, granted that hoarding in general has been very extensive in this period (as it was the case during previous great wars) and that hoarding of the legal currency has most likely been higher than during previous wars, it would be interesting to know what influence the low rate policy has had on this process. The hoarding of goods has presumably been little influenced by the low rate policy; in fact the main causes of anxiety were the devaluation

(8) It is necessary to consider transfers deriving from Lend-Lease, in both directions, from gifts and loans free of interest, or bearing a lower rate than the current one; transfers made possible by coercion exercised by Occupying Powers (unpaid imports and exports, etc.). In all cases there was a transfer of immediately available goods (merchandise, services, means of payment), which decreased the flow of products immediately utilizable in the donor or lending or exporting market, without any assurance of a present or future refund. The rigidity of the interest rates has prevented these transfers from reacting, as they should have done from an economic viewpoint, on the comparative appraisal of present and future goods.

(9) It would appear that an international loan is profitable when the net rate of interest paid abroad is *lower* than that which would be paid inside the country, other things (price of issue, maturity safety) being equal. This is, however, only an index of the fundamental conditions underlying the balance of payments and the productive structures of the contracting countries, at least in all cases when the transfer of capital, interest and sinking installments, results in a transfer of products and services from the lending to the debtor market, either directly or through third markets, and viceversa. Therefore, a reasonable judgement on the convenience of a loan has to take into consideration the productive capacity in relation to the increase in exports that the loan will make possible, the use to be made of the goods and the changes that will result in international relations, the status of the balance of payments of the two countries, etc. All these considerations may make an international loan not convenient even when there are substantial differences in the interest rates and in the supply of loan capital.

(10) For a more detailed analysis of this subject, see: Gino Borgatta: *La finanza della guerra e del dopoguerra*, Chapter XXI, Tip. Ed. Chiarvetto, Alessandria, 1946.

of the legal currency and the attempt to maintain a relatively constant purchasing power or, at least, a more stable level than that represented by deposits, loans, and other assets denominated in the legal currency. In view of this purpose and the dread of the fall in the purchasing power of the currency, the loss of interest on the amount hoarded was an almost trifling factor.

On the other hand, it cannot be denied that many savers have preferred hoarding to loans denominated in the legal currency just because the nominal interest rate was not sufficiently high to discount the loss of the purchasing power of the currency while the loan was outstanding.

The low rate policy has probably had a greater influence on the hoarding of bank-notes, since this did not insure against devaluation (the necessary dis-hoarding, later on, with the bank-notes flowing back into circulation, would accelerate it). That was the case of savers who had kept full confidence in the currency. The hoarding of bank-notes can only be explained by the necessity to keep concealed monetary supplies that may have derived from extra-legal transactions, or to keep them in a ready form when the registration of many investments became compulsory; it can also be explained by the feeling that monetary supplies kept personally are more secure, or by the certainty that they can be invested at any time, when a good occasion arises.

These requirements could, however, be met in full by short-term, tax-free, bearer's Treasury bonds or bills, payable at maturity upon demand. It would not have been impossible to find an indifference point, *i.e.* a sufficiently high rate above which these investments would have been more attractive than hoarding.

Therefore the low rate, by weakening the incentive to part temporarily with available bank-notes, has undoubtedly increased, *coeteris paribus*, the hoarding of legal currency, particularly by the savers more sensitive to a high yield; it has increased devaluation in subsequent periods, when the fear of a currency conversion, the increased taxes and, most important, the rapid increase in wages and prices of the other factors of production, have brought back into circulation the hoarded bank-notes.

9. - In conclusion, the above considerations cast doubt on the economic convenience of the low rate policy prevailing in public finance during the war and post-war period. It has allowed the governing class to solve brilliantly the *short-term* problems of public financing. But it has increased the difficulties of post-war rehabilitation, it has stimulated the preference for immediate consumption of the national product when it was necessary to maximize investments. It has weakened the incentive to accumulate new real savings; encouraged the hoarding of legal currency, delayed the revival of real income. It has effected an illusory redistribution of income which will beget new unrest and disturbance when new issue of currency stop and foreign grants and favourable loans ceases.

If a normal economy with budget equilibrium and stable money is to be restored, it would be advisable to discard the monetary maneuvers and the administrative restrictions that have artificially controlled these, as well as many other prices. It would likewise be advisable to leave the distribution of private incomes between consumption and saving to the free play of the fundamental economic forces of which the rate of interest is both a part and a result.