

## Public Expenditure, Savings and Foreign Loans in the Development of Southern Italy

by

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### 1. *Effects of an Additional Public Expenditure on Consumption, Public Finance and the Balance of Payments.*

The pre-condition for an action designed to raise the economic level of a depressed area is the ascertained fact that, side by side with an insufficient level of income and consumption, there are productive factors lying idle; more precisely, there is a state of insufficient employment which the natural growth of current economic activities does not succeed in eliminating or — sometimes — even in attenuating; in fact this state of unemployment often shows a tendency to grow worse (1).

The action to be taken in the case of Southern Italy should be based on the premise of utilising only unexploited factors; in other words, it does not intend to achieve its purpose with absolute priority over all other objectives, depriving, if necessary, other enterprises already under way of the factors they require.

This would be the premise of a war economy; but in that case the action to be taken should also provide for:

- (a) the rationing of scarce factors;
- (b) the adoption of forms of compulsory savings in order to limit the demand for said factors;

(1) Obviously if the unexploited factors are to be of economic value, they must be available in the combination necessary for the process of development to be undertaken; thus the existence of a large unemployed labour force would not in itself be sufficient, if this labour force could not be combined with other factors either to supply directly the goods required for the process of expansion or to supply indirectly the goods to be exported in exchange for those which national resources are unable to supply economically and must consequently be imported.

(c) the levying of taxes limiting the demand for factors in short supply;

(d) the beginning of an inflationary movement.

Since recourse to such measures is not foreseeable in the current Italian situation, it is to be assumed that the action to be taken will not be allowed to avail itself of productive factors that are expected to be required for private and public enterprises already under way.

Since, then, private enterprise is to be allowed to dispose of the factors it intends to utilise and yet, despite this, in the depressed area we are faced, on the one hand, by an insufficient exploitation of the available factors and, on the other, by an insufficient level of income, we are bound to draw the conclusion that a process of development in the depressed area can only find its centre of propulsion in public finance.

Past experience proves that governmental action limited only to promoting new enterprises by means of facilitations and encouragements of various kinds granted to private enterprise would be unable to achieve satisfactory results, owing to the absence of environmental conditions and outlet markets such as would be necessary to ensure the success of new undertakings.

Consequently, governmental action can only be imagined in the form of additional investment expenditure, contributing, on the one hand, to create plants and engendering, on the other, a supplementary demand for consumer goods, thus creating not only a higher standard of living, but also an outlet for new enterprises.

Under the circumstances it would not, as a general rule, be logical to expect public expenditure

to be used to install new industries, since if they are not profitable for private enterprise, they are hardly likely to be so for the State. Quite apart from the fact that it would be difficult to conciliate a mainly private industrial apparatus in Northern Italy with a mainly nationalised apparatus in the South. In the industrial sector, therefore, governmental action should be limited to supplying the above mentioned facilitations and to completing the capital contributed by entrepreneurs and by the ordinary money market to private enterprises induced by the public expenditure.

In short, public expenditure should be devoted to the four main types given below:

#### 1) *of a social nature*

(a) works whose purpose is gradually to bring living conditions in the more backward areas up to the level of the rest of the country (water supply, schools, hospitals, sewerages and other public works);

(b) civilian construction which will gradually improve the housing situation in the most overcrowded localities;

#### 2) *of a strictly economic nature*

(a) projects for the exploitation of local resources (land reclamation, roads, railways, harbours, power stations, prospecting for minerals);

(b) financing of private enterprises, particularly those of an industrial nature, induced by public expenditure, as explained above.

The performance of the works paid for out of public expenditure will immediately result in two benefits, since part of the funds will be distributed as wages, while part of them will be used to order materials from other enterprises which, in turn, will set new processes going by paying new wages and ordering new materials at a less advanced stage of production. During the whole process, moreover, taxes will be levied; besides, a part of the materials required will be imported.

The payment of wages, moreover, will result in savings and in a demand for consumer goods. In the same category as savings we may place the repayment of debts and the formation of money deposits on the part of enterprises; in the same category as taxes, on the other hand,

we may place other fiscal benefits resulting from the execution of the plan, such as withdrawals and other burdens and social contributions borne by the enterprises and workers carrying out the investment plan, as well as the reduced expenditure on unemployment benefit and other special forms of assistance granted to the depressed area.

The proportions in which the additional public expenditure will be transformed into wages savings, taxes and demand for imported goods, as well as the rate at which such transformation will take place, depends on a number of factors: the nature of the works performed, the structure and level of previous incomes, the fiscal system, the nature and quantity of the factors available as compared with the factors required for the process of investments.

With reference to the type of works mentioned above, the per cent division of public expenditure may be estimated more or less as follows:

(a) *savings*: in consideration of the fact that a large portion of the newly formed income will go to workers in the depressed area and of the great propensity to consume of the inhabitants of said areas, savings are likely to be negligible. There will however be enterprises that will pay their debts or form deposits with the cash they receive as a result of their increased activity; we may therefore estimate the larger amount of liquid money placed on the market by new investments at 5 per cent;

(b) *taxes*: since fiscal pressure in Italy amounts to 20-25% of national income and, once more taking into account the special nature of the income induced by the new investments and the importance of indirect taxation in our tax system, tax collections are estimated at 12 per cent; the benefit deriving to the budget from the drop in unemployment subsidies and other assistance to the depressed area and from the increase in the insurance premiums paid by enterprises and workers engaged in the investment plan is estimated at 10 per cent of the expenditure;

(c) *imports*: we need hardly go into a detailed technical dissertation proving that the programmes being considered will be able to avail themselves of large quantities of unutilised productive factors currently available in

Italy; also the process of industrialisation mentioned in item 2) (b) would call almost exclusively for machinery that can be obtained in our country. Imports, consequently, will consist mainly of the raw materials used to manufacture the products required for the public works; their amount may be estimated at about 7 per cent, namely a little less than half the present ratio of imports to national income;

(d) *consumption*: the proportion that will be devoted to consumption is now obtained by drawing the difference between 100 and the percentages calculated so far, the result being 66.

Public investment expenditure of 100 may therefore be divided as follows:

savings	5
taxes and other fiscal benefits	22
imports	7
consumption	66
<b>Total</b>	<b>100</b>

The process of converting public expenditure into purchasing power in the hands of consumers, additional fiscal receipts, increased savings and increased imports of industrial raw materials does not last long in the case of works of the type to be undertaken in Southern Italy; it would last longer if the public expenditure were to be used, for instance, to build a war factory. From the very first round a large part of the expenditure is converted into wages and, for the rest, into orders for materials of easy and current production. For these reasons we may assume that the public expenditure of the first two months will be divided in the proportions given above during the next two months.

What happens in the following period of two months? The larger demand for commodities is in turn converted, through the enterprises supplying said commodities, into savings, taxes, imports and consumption. While we may assume, however, that savings and taxes will continue in the same proportion, the demand for imported goods will increase considerably, since the growing consumption of foodstuffs will result in larger import requirements, domestic resources being practically exhausted.

Since the ratio of imports to national income in Italy is about 16 per cent, the ratio

which the imports induced by an increase in income bear to that increase in income cannot be estimated at less than 25 per cent of the effective domestic demand manifested by consumers (2).

The division of expenditure in the second period may therefore be calculated as follows, with reference to the effective demand of 66:

increase in income during second period to be deducted:	66
savings (5%)	3.3
taxes (22%)	14.5
	17.8
effective demand	48.2

of which, imports (25% of 48.2)	12
consumption of goods and services and services on the home market	36.2

Consumption during the second period results in turn in new savings, taxes, imports and consequently new consumption and so on, in a succession that slows down progressively.

We may assume the period required for the completion of such a process of propagation to be two months and its total effects may be represented as follows:

EFFECTS OF AN INCREASE IN PUBLIC INVESTMENT EXPENDITURE = 100

Two-monthly periods following on that of the public expenditure	National Income	Taxes and other fiscal benefits	Savings	Imports	Consumption
I . . . .	100.00	22.00	5.00	7.00	66.00
II . . . .	66.00	14.52	3.30	12.05	36.13
III . . . .	36.13	7.95	1.81	6.59	19.78
IV . . . .	19.78	4.35	0.99	3.61	10.83
V . . . .	10.83	2.38	0.54	1.98	5.93
VI . . . .	5.93	1.30	0.30	1.08	3.45
VII . . . .	3.25	0.72	0.16	0.60	1.77
VIII . . . .	1.77	0.39	0.09	0.32	0.97
IX . . . .	0.97	0.21	0.05	0.18	0.53
X . . . .	0.53	0.12	0.03	0.10	0.28
XI . . . .	0.28	etc.	etc.	etc.	etc.
XII . . . .	etc.				
<b>Total</b>	<b>245.8</b>	<b>54.1</b>	<b>12.3</b>	<b>33.6</b>	<b>145.8</b>

(2) By effective domestic demand we mean the income spent on goods and services after taxes have been paid and savings effected. On this point see: J. E. MEADE, *National Income, National Expenditure and the Balance of Payments*, in "The Economic Journal", March 1949, p. 38.

From the figures given above it would appear that insofar as the additional expenditure leads to an increase in imports — which, we have estimated at about 34 per cent of the amount of public expenditure — it adversely affects the balance of payments; in order, therefore, that the latter may be restored to the position prevailing before the programme was initiated, an expansion of exports is necessary.

This expansion of exports will take some time, however, and it is in order to be able to tide over this period, which may be quite long, that a programme aiming at developing a backward area must be able to count on foreign capital. The re-establishing of the former equilibrium of the balance of payments by means of an increase in exports leads to a further increase in productive activities and consequently in consumption, savings and fiscal revenue (3).

Regarding the relation of public expenditure to the balance of trade, we may therefore imagine two opposite positions: a first position in which the imports induced by greater public expenditure are all financed by foreign loans (with the results set forth in the table given above), and a second position in which the induced increase in imports is completely offset by an increase in exports.

The following table gives a comparison of the effects of additional public expenditure in the two aforesaid positions, all the assumptions set forth in this analysis remaining unchanged:

ALTERNATIVE TOTAL EFFECTS OF AN ADDITIONAL PUBLIC INVESTMENT EXPENDITURE = 100 (in percentage of the public expenditure)

	1st stage imports financed by foreign loans	2nd stage imports covered by exports
National Income	246%	370%
Savings	12%	18%
Taxes and other fiscal benefits	54%	81%
Foreign loans required	34%	—
Effective demand	146%	270%
of which:		
(a) domestic consumption	146%	214%
(b) exports	—	56%

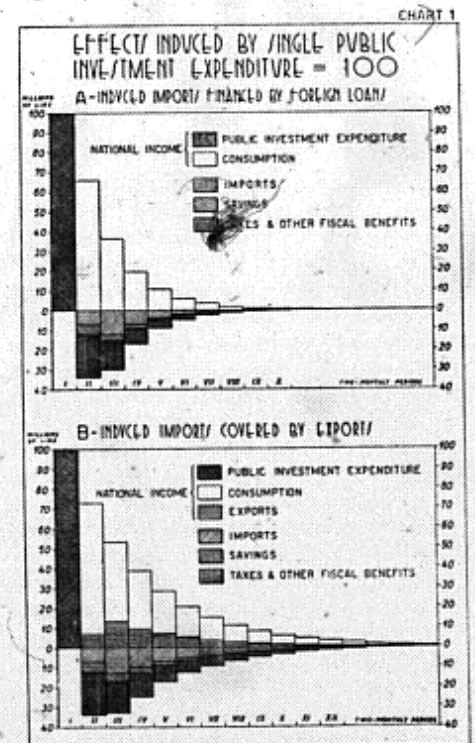
(3) These exports will result in new import requirements and in further repercussions which we do not intend to go into here.

Naturally the effects of public expenditure increase in importance as new export currents come into being; the increase in demand rises from 146% of public expenditure to 270% and the increase in fiscal revenue from 54% to 81%.

The period of propagation is of course longer: table I shows that the effects of the expenditure are felt to an appreciable extent up to the seventh two-monthly period, namely — if recourse has been had to a foreign loan — up to one year after the initial investment.

If an expansion of exports is accomplished, the effects will continue to make themselves felt until almost the end of the third year, starting from the two-monthly period in which the public funds are spent.

The following chart may serve as an illustration of the process we have just described:



At a third stage, exports should expand still farther in order to provide the funds required

for the servicing of the foreign loans negotiated for the execution of the investment plan.

## II. Relation between Public Investment Expenditure and Private Investments.

In the previous section we considered the effects resulting over time from public investment expenditure occurring in a given period assumed to cover two months: obviously we must imagine a long series of such periods. To the decreasing series of effects arising from the investments of the first period with regard to consumption, taxes, savings, imports and exports, a second series must be added, a third series and so on, starting respectively from the second and third period and so on, till the end of the programme.

Let us suppose that the public expenditure called for by the investment plan remains constant throughout the ensuing two-monthly periods; what will happen will be that in the second two-monthly period the secondary effects of the public expenditure of the first two-monthly period will be added to the primary effects of the expenditure of the second two-monthly period. In the third two-monthly period, the third wave of the first expenditure, the second wave of the second expenditure and the first effects of the new expenditure will all combine together and so forth and so on.

Consequently consumption, taxes, savings, imports and exports will follow an upward trend until the effects of the expenditure of the first period are completely exhausted. From this moment onwards, if expenditure continues at a constant level, the aforesaid effects will remain stabilised at the highest level reached.

It should be remarked, however, with regard to the above assumption according to which the level of public expenditure remains constant, that a plan of investments aiming at raising the economic level in a depressed area can only be developed gradually up to the extent required by the nature of the problems awaiting a solution.

Even if labour, raw materials and productive capacity are available in large quantities, there is always one factor that is insufficient in depressed areas in relation to a large scale programme — this is organisation.

Certainly it is a factor that can be increased rapidly; nevertheless it is necessary to foresee that public expenditure will expand gradually during the successive periods on which our study is based.

And since, as has already been said, there should be a gradual development of exports aiming firstly at re-establishing the previous equilibrium of the balance of payments and secondly at servicing the foreign loans negotiated in order to be able to carry out the plan, we now come upon three elements which give a progressive character to the process of development in the depressed area:

(a) the accumulation in each period of the effects of a growing series of expenditures effected in the previous periods;

(b) the gradualness of public expenditure which is imposed by the above mentioned technical considerations.

(c) the gradual development of new export currents.

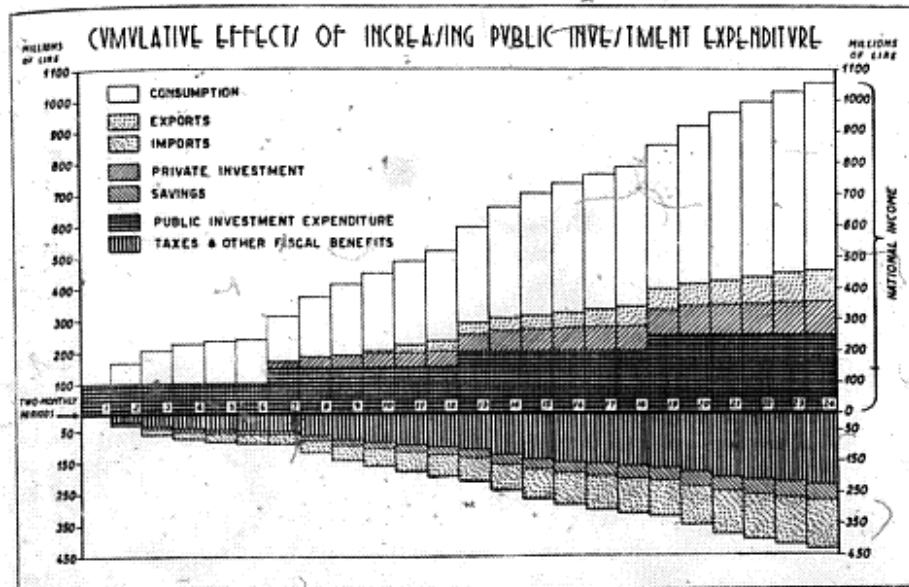
The public expenditure resulting from the investment plan leads, therefore, to an increase in demand for three types of goods:

- consumer goods;
- materials required for the investment plan;
- export products.

Consequently there is bound to be an increase in the activity of the concerns manufacturing the foregoing products and, as soon as such concerns see that they can expect greater profits, plant renewal will be speeded up in the sectors where the productive capacity was excessive and new plant will be built where capacity was only just sufficient. This will cause a supplementary flow of investments or, in other words, what is known as an acceleration of current investments.

These investments will mainly come from private sources or from local agencies, communal organisations etc.; it is perhaps the most interesting aspect of the process inasmuch as, if it is properly directed and sustained, it helps to bring about that change in the productive pattern of the depressed area which, at a certain moment, should make it possible to reduce the flow of public investments. Particularly so at

CHART 2



the current of private investments induced by public expenditure will in turn influence consumption, savings, imports, exports and new investments.

In order to make the line of thought we are following still clearer, we will attribute values also to the process of acceleration of investments generated by public expenditure.

Considering therefore that in our country new investments are equal to about one fifth of national income, let us assume that the new investments and extraordinary renewal of plant induced by public expenditure will also be equal, on an average, to a fifth of the income induced by said expenditure (4).

(4) Obviously this valuation is open to serious objections. In favour of the attribution of a very low value to the acceleration militates the existence in Italy of a certain amount of unused productive capacity; on the other hand, in favour of high values militates the fact that the investments required by many types of production are often equal to the value of a full year's output or more and not to a fifth of its value.

Moreover, it is necessary to consider that the acceleration of the process of renewal and of new investments cannot but have a very irregular pace, since it depends on the margin of unused productive capacity, on the degree of mechanisation prevailing in the factories that are renewed or enlarged and on a number of other circumstances.

If we attribute the same effects to private and public investments, we shall have to increase the values given in the previous diagram by one fifth.

Taken as a whole, the process will then appear to us as in the chart 2 above, always leaving out the increase in imports caused by the expansion of exports (5).

(5) The acceleration of investments induced by public expenditure may call for a larger amount of monetary capital than can be provided by the savings generated by the same public expenditure.

This is the case resulting from the figures given above, which show induced private investment requirements amounting to 20 per cent of public expenditure and savings amounting to only 5 per cent.

Under these circumstances, if the initially mentioned condition of not subtracting funds from current investments and consumption not connected with the investment plan is to be observed, the gap between savings and the funds needed for private investments will have to be filled by public expenditure: as will be remembered, the four groups of investments among which public expenditure is to be divided also include the financing of private enterprises which have become profitable as a result of the investment plan. It will be precisely this type of expenditure that will have to be developed to a sufficient degree to cover the difference between the new capital needed for private investments and the formation of new monetary savings.

At this point it would be interesting to try to value the results which may be obtained through State action of the type described; however such a valuation cannot be made through a comparison between a given initial position of equilibrium or disequilibrium and another position reached at the end of the period considered as a result of the aforesaid hypothetical action.

The action has indeed induced a whole set of changes: in national income, in consumption, in savings, in imports, in exports, in the volume of investments, public finance and so on. As a result of these changes the disequilibrium has been attenuated in certain cases and has been increased in others; unemployment has diminished, consumption has increased, the balance of payments has taken a turn for the worse and the budget deficit has increased. How can all this be expressed with reference to a single, synthetic initial position?

In other words, the economic system we are considering presents different aspects, each expressing itself in a particular balance.

Thus we have a balance of employment, that is to say of demand and supply of labour, a balance of effective demand and production from which may be drawn particular balances of savings and new investments, of wear and tear of the existing plant and their renewal and upkeep. There is also a balance of foreign trade and lastly, limiting our survey to the most important aspects of economic life, a balance of public finances.

Some of these balances appear in equilibrium, whereas others do not; in all of them forces are operating that tend to change the existing positions; further, all balances are interdependent, inasmuch none of them can, by its proper equilibrium, restore the equilibrium of the others.

The contrary is more likely, as a matter of fact: restoring the equilibrium of the balance of employment may, in the beginning, involve the upsetting of the equilibrium of the budget and of the balance of trade; on the other hand, to concentrate on restoring the equilibrium of the budget may mean upsetting the balance of employment and the savings-investments ratio,

Consequently, it is necessary to choose the system of disequilibrium and equilibrium which is most advantageous, at the time, in order to achieve the desired ends, assuming, as modern economic policy does, that:

(a) there is a general interest, entrusted to the State, in the fullest possible utilisation of the factors available;

(b) this utilisation, as well as the type of income distribution most in keeping with the interests and ideals of the State-controlling social forces, cannot always be achieved through the efforts of private enterprise alone.

Having made this point, we may now sum up what has been said so far by stating that, in depressed areas, governmental action must aim at attenuating the disequilibrium existing in the balance of employment, by deliberately upsetting the balance of public finance and preparing to face a disequilibrium of the balance of payments.

The limits within which these various types of disequilibrium must be kept are obviously determined not only by technical but also by political factors; consequently they are outside the scope of this paper (6).

We will instead merely complete the previous schematisation by giving the following chart 3 showing the net variations occurring in the yearly — no longer two-monthly — balances mentioned above.

From the above chart it appears that for a first group of balances the original disequilibrium has been attenuated; this group includes income and consumption (7).

In the second group we find the three balances in which an anti-depression policy, in the beginning, increases the already existing disequilibrium: they refer to public finance, the balance of trade and the ratio of monetary savings to new investments.

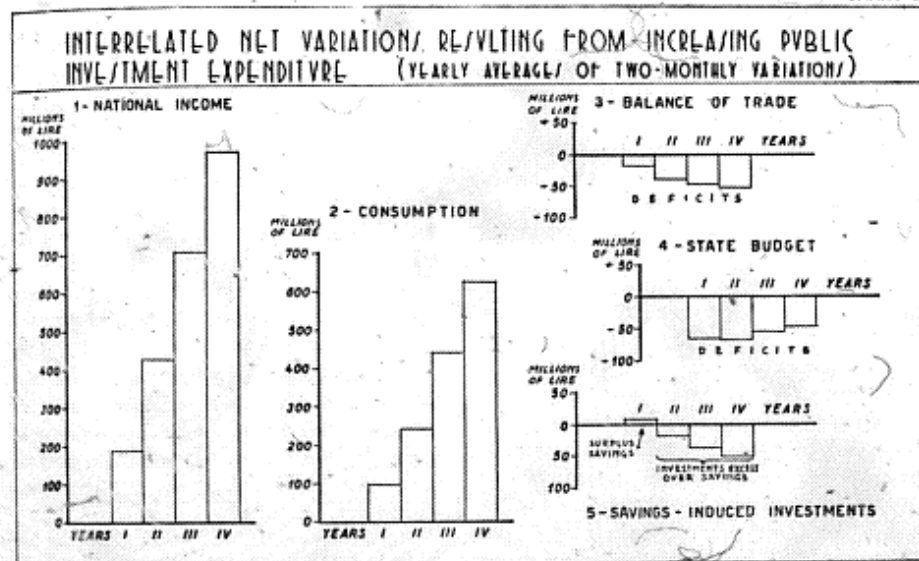
(6) Here we may again refer to a war economy as to a case in which certain objectives become more important than the preservation of the equilibrium of the State budget and the balance of payments.

(7) The development of income — which includes public investments, consumption, exports and induced private investments — might approximately be taken as the index of the increase in employment.

Since this paper has always referred to increments of public expenditure, consumption, exports and so on, there is no possibility of estimating the size of any disequilibrium as compared with the initial position; we may however compare the variations in disequilibrium

of one to five and one to seven, the budget deficit falls from 1 to .70 while the deficit in the balance of trade increases from 1 to 2.80, however at a decreasing rate. Also the excess of investments over savings follows a decreasing trend.

CHART 3



occurring in the various yearly periods, taking the first year as a basis:

TABLE III  
NET VARIATIONS RESULTING FROM AN INCREASING PUBLIC INVESTMENT EXPENDITURE  
(first year variation = 100) (a)

	1st. year	2nd year	3rd year	4th year
Income and employment	100	220	365	500
Consumption	100	253	467	665
Budget deficit	100	101	82	71
Trade deficit	100	213	250	280
Excess of private investments over monetary savings	-38	100	182	252

(a) For the savings-private investments ratio the second year variation has been taken as the basis.

The above figures show that, whereas income and consumption increase in the propor-

All these figures go to prove that — assuming an adequate increase in exports — the State budget, the balance of trade and the ratio of savings to investments would tend to return to the initial position even in the presence of a progressively expanding employment and consumption.

### III. - Relation between Public Investment Expenditure and Foreign Loans.

As we already mentioned in the first section new imports may reach 34 per cent of public expenditure, given the economic structure of our country; we also saw in the second section that the demand for imported goods is further increased by the acceleration of investments. According to the assumption contained in this latter section the value of the imports resulting from additional public expenditure

would be one fifth higher, thus amounting to over 40% of the amount of the public expenditure which induced the imports. Accurate enquiries regarding the income and consumption pattern in the regions of Southern Italy might reveal even higher percentages.

The beginning of a programme of public investments aiming at overcoming a state of economic depression is bound, therefore, to come as a blow to the existing equilibrium of the balance of payments.

The blow is particularly hard with regard to the structure of consumption and to the productive possibilities of our country, not so much because of the necessity of covering requirements arising directly from the execution of the programme of investments as because of the growing demand for foodstuffs and imported raw materials deriving from the higher standard of living resulting from the process of development.

However the imports required in order (a) to carry out the works considered by the initial public investment programmes, (b) to meet the demand for consumer goods induced by the latter, (c) to feed new export currents and (d) to keep pace with the acceleration of private investments, will be progressively determined, in quantity and in quality, in relation with the overall changes taking place in the whole of the country's economy.

The effects on imports of an additional volume of investments will be greatly different in an economy working to the utmost of its capacity like in Great Britain and in an economy like ours, which still has considerable unexploited capacity. They will differ in an economy such as that of Yugoslavia, where low technical standards make a rapid expansion of the productive capacity out of the question, and in an economy where such an expansion is possible, as in our case. During the initial stage when the flow of investments and consumption is increasing, the volume of imports required will vary according to whether or not the tempo of increase is in keeping with the capacity of our productive apparatus to expand sufficiently to meet this growing demand.

For instance, if cement has to be imported at a certain tempo, a lower tempo will allow for imports of machinery to equip new cement factories, while at a still lower tempo it will be sufficient to import the steel required by the Italian factories manufacturing cement-making machines or even the scrap iron needed for increasing the domestic output of steel.

Now, what is our position regarding the availability of productive factors? We know that:

(a) part of the productive capacity of our industries is not being utilised;

(b) our technical standards are high and capable, within a reasonable period of time, of farther expanding the aforesaid productive capacity;

(c) considerable numbers of workers could rapidly be trained in order to meet the needs of expanding production.

Consequently, our country has ample opportunities for a policy aiming at raising the economic level of Southern Italy. One might almost say that such action should be favoured rather than hampered by the other economic interests of our country.

Regarding the possibility of expanding our exports, for instance, there is no doubt that, once a home market is created for certain foreign goods now being offered to our exporters in exchange for Italian goods, they will be able to expand appreciably, taking into account the unutilised margins of productive capacity existing in certain sectors of our economy.

Thus, the recovery of certain industrial branches, such as the engineering industry, might be favoured by a policy of public expenditure in Southern Italy: it is sufficient to consider, on the one hand, the list of products being offered to Italy by foreign countries in exchange for our machine exports, and, on the other hand, the benefits that would derive from a flow of such products to the exhausted economy of Southern Italy.

And, once the unutilised capacity were exploited, better market prospects might give rise to an expansion of productive capacity. In view of Italy's satisfactory technical level, the demand for capital goods arising from this

expansion could, to a great extent, be conveniently met by the home market.

Naturally this does not mean that foreign capitals are not indispensable in large amount for such a programme; it merely means that import requirements will shift over from capital goods which can be manufactured in Italy to the raw materials needed to make them, to the foodstuffs and again to the raw materials required to satisfy the increase in consumption induced by the aforesaid domestic production of capital goods.

However, since the expansion of exports cannot but develop later than the demand for imported goods induced by public expenditure, foreign capital will be needed to start the plan of investments; and the amount of foreign capital needed will be determined by the ratio of imports to public expenditure and the tempo at which the exports induced by the investment plan will expand.

#### IV - *Anti-cycle Policy versus Anti-depression Policy.*

Any governmental action aiming at the utilisation — in a situation of stable currency — of the factors available in a depressed area, including the goods obtainable in exchange for larger exports or from the proceeds of foreign loans, is undoubtedly beset with difficulties and hazards still in great part unexplored.

The general line of thought followed by contemporary economists concerning the diffusion of the effects of additional public expenditure, which is that on which this enquiry is founded, does not in fact fit completely into the framework within which a proper policy for the depressed area must be carried out.

This line of thought considers mainly the various situations arising in the course of a business cycle and points out the new tasks which — in a cyclical economy — must be taken on by the State at the different stages of the cycle in order to ensure the smooth working of a system which, as far as possible, must always be based on private enterprise.

The reasoning, as is well known, is based on the fact that investments and consumption

increase and decrease together. An expansion of consumption is an incentive to invest more; on the other hand, if there is a drop in consumption, not only do investments decrease or cease completely, but even the renewal of plants is delayed or suspended. In the same way an increase or decrease in investments speeds up or depresses consumption and this in turn affects investments again. Either in one direction or in another, therefore, forces are set in motion which make it more and more difficult to restore equilibrium, by which we mean a situation in which all the available factors are employed and prices remain stable. Omitting for the moment to examine how these movements can be checked, we are faced by the alternative either of inflationary movements — that is to say of a demand exceeding the available factors — or of deflationary movements — namely towards situations in which large quantities of available factors remain inactive.

There is no denying that in such a situation governmental action, aiming at opposing the general upward or downward trend, is fully justified and, in principle, no longer questioned to day.

Rather it is interesting to compare the conditions of a governmental policy in the depression phase of a business cycle with the situation that must be faced in a depressed area.

During a slump, savings are not fully utilised for investments and, consequently, a growing availability of idle productive factors appears: in such a situation governmental policy, by deliberately incurring additional expenditure not covered by revenue — that is to say creating a budget deficit — endeavours to employ and, as a result of the effects of this policy, induce others to employ the largest possible amount of unutilised factors.

Naturally, governmental action is conceived as transitory: varied as opinions are, concerning the form to be taken by said action, it is generally agreed that if it is taken in time and with sufficient energy, that is to say if the State compensates private expenditure with a sufficient amount of public expenditure, there

will be an increasing flow of private investment which will soon make any further governmental action of an anti-cyclical nature superfluous.

The anti-cycle action to which, we repeat, usually economic doctrine refers to (8), is very different from the action demanded on the basis of the same line of thought in the case of a non transitory economic depression.

The differences may be summed up as follows:

(a) anti-depression action cannot be conceived merely as a helping hand designed to set going again a system that has got jammed, but is able to operate at a satisfactory level with its own forces. Where backward areas are concerned, governmental action has to be protracted for a long time; in our case, for instance, for a period which cannot even be determined, in any case more than one generation;

(b) governmental action which does not aim at « pump-priming » an efficient productive mechanism which has temporarily got jammed, but carries out low-profit works mostly of a merely social value, cannot expect a rapid increase in the volume of production proportionate to the volume of investments;

(c) idle factors in backward areas are not matched by a mass of monetary savings left unutilised by private enterprise and which the State can draw upon to carry out its investment policy.

The three above-mentioned points characterising the situation in a backward area deeply affect the modalities of governmental action such as it is usually suggested in the case of anti-cycle action; and this despite the fact that the common feature of factors not being used by private enterprise and only exploitable as a result of governmental action would appear to justify the same modalities both for anti-cycle and anti-depression policy.

Let us briefly examine the three points of differentiation mentioned above (9).

(8) Cf. A. H. HANSEN, *Fiscal Policy and Business Cycles*, New York 1942, p. 261.

(9) For a brilliant discussion of various points related to this subject see F. DI FENIZZO, *Studi Keynesiani*, Milano 1949, p. 76 and *passim*.

Regarding the first point — the longer duration of governmental action — great importance is assumed not so much by the intensity and timeliness of the action — as in the case of anti-cycle policy — as by the capacity of public economy to persevere in its effort intensifying it progressively.

Consequently, the balance of payments will be subjected to a growing pressure, which leads us to the conclusion that a programme of economic development in a depressed area cannot be undertaken unless ample funds are available from abroad, ensuring the possibility of integrating the factors available on the home market with those which will have to be purchased abroad.

The second point governing public action in a backward area — namely the impossibility of obtaining a large and swift increase in the volume of production as is the case of anti-cycle action — also gives rise to particularly serious problems.

What we propose to do, in substance, is to use public expenditure to increase the supply of certain economic and social endowments of outstanding interest for the depressed area — land reclamation, houses, aqueducts, harbours, schools, hospitals, etc. — and this increased endowment will be accompanied by an increase in consumption: now, this increase in consumption may well outstrip the increase in production induced by the investments.

In this regard, a distinction must be made, in the case of developmental programmes which are not of an anti-cyclical nature, between investments aiming at valorising insufficiently utilised natural resources, the exploitation of which responds to recognised calculations of economic profitability, and programmes to be carried out in regions where the level of consumption is low, employment insufficient and the resources economically exploitable scarce. In short, it is necessary to make a distinction between underdeveloped regions — such as the Argentine — and depressed areas.

Obviously the expansion of consumption will need to be constantly controlled in depressed areas with reference to the expansion achieved by production. Should there be a

discrepancy between the two trends, however, it does not necessarily follow that the process of investments should be slowed down, provided of course that the needed factors are available.

If this occurs, it is necessary to take measures to modify the ratio of consumption to public expenditure so that, while public expenditure proceeds in conformity with the programmes drawn up, consumption increases at a more moderate rate such as is warranted by the quantity of consumer goods available.

It would indeed be absurd to renounce to investments justified by the available factors, just because it is not possible to raise consumption above a certain level.

We thus find ourselves in the presence of a situation very similar to that of a typical war economy characterised (10), as we all know, by a sharp increase in investments accompanied by the control of consumption. Since we have excluded from the very beginning the adoption of rationing as an instrument of economic action and want, at the same time, to avoid inflationary movements, and since there would be no sense in adopting a system of compulsory savings, inasmuch as the consumer goods which are not available today cannot be expected to be available tomorrow to the people in whose hands income flows today, there is no choice but have recourse to the fiscal instrument. That is to say, taxes on consumption must be introduced in order to reduce the propensity to consume, limiting it to the amount of consumer goods available.

These brief notes clearly show the decisive rôle that may be played by an efficient fiscal system when public expenditure is large and increasing as will be the case once large scale economic action is taken in favour of the depressed area.

But the most relevant difference between anti-cycle and anti-depression action is that in depressed areas the unexploited factors are not matched by a mass of monetary savings waiting to be invested. On the contrary, there is usually

in depressed areas an acute shortage of monetary capital and very high rates of interest.

In such a situation, despite the government's endeavours to exploit only idle factors and not to deprive other public and private enterprises already under way of the resources they need, an issue of public securities aiming at covering the increased budget deficit would deprive other enterprises of the funds they require to proceed with their programmes at the anticipated rate.

This would lead to a paradoxical situation, in which the required factors of production, although available, would remain unutilised because the market would react as if they were not available.

It would appear, therefore, that the problem of financing the budget deficit will unavoidably have to be solved otherwise than by means of a public loan (11); clearly this possibility does exist, since it must be admitted that, if all the necessary factors are available, both domestic and foreign, there must necessarily be a means by which they can be enlisted in order to attain the purpose desired.

To conclude, it should be remembered that the present paper, though it has made use of figures referring to the present Italian situation, has no intention of estimating the effects of additional public investment expenditure in favour of Southern Italy; its main purpose has been to adapt to Italy's specific situation the only scheme of reasoning that can help us solve a problem that would otherwise appear not only hopeless, but also impossible to understand.

But even if the figures quoted cannot be taken as a measure of the effects to be expected, the results of the enquiry show clearly the national importance of a policy of public expenditure in Southern Italy and the possibility of thus forming a broader basis and a solid and better balanced structure for the whole of Italian economy. In fact:

(a) the results of governmental action on consumption would expand all over the coun-

(10) Cf. *The Economics of Full Employment*, Oxford 1944, Foreword, p. IV. Also J. R. HICKS, *World Recovery after War - A Theoretical Analysis*, in « The Economic Journal », June 1947.

(11) For interesting connections with this subject, see: A. H. HANSEN, *Monetary Theory and Fiscal Policy*, New York 1949, p. 168 ff.

try and would not be confined to the depressed area.

(b) the State budget would have to bear a strain that would bring about far-reaching and permanent changes in its present structure.

Further, it should not be forgotten that the governmental action outlined in this paper contemplates, at first, the securing, of loans

from abroad and, subsequently, the opening of foreign outlets for Italian production; an anti-depression policy would thereby also have international effects of considerable importance, destined to bear more and more weight in the growing international economic cooperation which Italy will be called to realize in the near future.