

## Concluding Remarks for 1972

### The Evolution of the International Monetary System

The period since the last Annual Meeting has been dominated by monetary events, both within countries and in their external relations. Domestic and international monetary developments are irreducibly linked: had there been more orderly monetary management in the main industrial countries at least, there would be less urgency to reform the system erected in the post-war period, which was based upon fixed parities changeable only in situations of fundamental disequilibrium.

The Washington agreement of December 1971 represented, under certain aspects, progress towards choosing the pattern for building a monetary order.

The realignment of exchange rates involved all currencies, including the dollar. Hence it represented a move towards a more symmetrical system than the one devised at Bretton Woods which bestowed upon the dollar the special role of bridge-currency for the conversion into gold of all the other convertible currencies. However, the measures taken in August 1971, which cut the link between the dollar and gold, also formally weakened the technical justifications for the asymmetry on the basis of which the authorities of the convertible-currency countries were hitherto required to defend their own exchange rates vis-à-vis the dollar, whereas the US authorities were under no such obligation. After August 1971, special treatment for the dollar could only be based upon its still dominant position on the international money and capital markets. Nonetheless, even this position has been undermined by fears of devaluation, which have twice proved to be founded, while the US authorities have kept the dollar inconvertible both in terms of gold and of other reserve instruments.

The desire for greater symmetry in international monetary relations is an outgrowth of the gradual trend towards the creation of large areas of comparable economic and commercial weight: the European Economic Community's foreign trade, excluding intra-Community commerce which should be considered internal trade – if related settlements were made in Community-created monetary instruments – exceeds that of the United States. Japan trails somewhat behind; nonetheless it must be classed among those countries, or groups of countries, which together dominate the world economy.

A further outcome of the Smithsonian agreement was substantial recognition that the determination of exchange rates, especially for the main industrial countries, is not by its nature a unilateral question, or even a bilateral one. The multilateral negotiations were arduous. But they demonstrated that, despite conflicts of interest among actual or evolving monetary areas and the deep-rooted persistence of mercantilistic instincts, there exists an underlying solidarity among those in charge of running the world economy. This solidarity was further demonstrated last March at the ministerial meeting of the Group of Ten in Paris and of the Committee of Twenty held in Washington. It is grounded in the awareness of the common interest in the smooth working of the international monetary system, in an era in which technology and integration in manifold forms have assured that the goods, services and ideas coming from the rest of the world play an important role in our individual and collective lives. This awareness, rather than any change in the mechanism and in the agreements governing them, differentiates the present situation from the one that characterized the period between the two world wars.

Finally the change in the dollar's parity, for the first time in little less than 40 years, and hence not since that currency had been made the support of the international monetary system founded at Bretton Woods, opened the way for the United States to be able to use the exchange rate as a variable in the adjustment process. This tended to eliminate another of the system's asymmetries: an asymmetry, in this case, unfavourable to the reserve currency country. The variation in the dollar's parity and, to different extents, in the parities of the currencies of the other main industrial countries was another indication of the trend, which appeared some years ago, to have exchange rate changes play a wider role in achieving and maintaining domestic and external equilibrium.

All parties involved in negotiations for the reform of the international monetary system are agreed that it is necessary to modify the way in which the Bretton Woods agreements have been applied concerning parity changes. At last March's meeting, agreement was reached on the *fixed but adjustable parities* formula. In the meantime, however, market developments have forced many countries to resort to a type of flexibility that tends to blur the concept of parity.

Indeed, in December 1971 the United States announced a new parity for the dollar, but not its convertibility, nor a commitment to defend the new parity on exchange markets. Hence, we asked last year just what was "the economic logic linking the declaration of official parity of the dollar and declaration of the parities of the other currencies" and expressed our doubts as to the possibility, under the circumstances, of defending such a system from the consequences of flows of unwanted funds. Over the last twelve months, the majority of Western European countries, inside and outside the EEC, have had to resort to floating in a form which is global for some, partial for others. The intensity with which funds have left, or poured first into one country and then into another, has not, in fact, made possible any other choice. The rise in intensity has been matched by the frequency with which those massive shifts of funds have taken place, as businessmen everywhere attempted to ward off losses, or profit, from expected parity changes in the currencies considered, in turn, the weakest or strongest links in the chain.

The weakening of the notion of parity was heralded by the introduction of the concept of *central rate*. The new exchange rate structure set up in December 1971 did not bring about the improvement in the US balance of payments that might have restored confidence in the dollar's new parity. The mercantilistic attitudes still underlying international economic relations prevented exchange rates from being adjusted to the necessary degree. Moreover, the initial stage, during which devaluation tends to produce perverse effects on the current account balance, appears to have become longer. The speedier recovery of the US economy also added to the negative impact on the balance of payments.

The task of defending parities has generally become more difficult, due to the weaker effectiveness of policies aimed at keeping an appropriate ratio between domestic prices and the average of prices in the countries most active in world trade. In the Western world today,

prices and costs only partially respond to changes in the equilibrium between supply and demand of goods and productive factors that can be obtained over the short run by using conventional instruments – including monetary ones – to regulate demand, while still avoiding unacceptably high social costs. To a constantly growing extent, cost and price trends depend upon the behaviour of organized social groups, which determine them largely independently of supply and demand conditions.

In a situation such as this, parities, even when representing an equilibrium position at the outset, tend to become rapidly obsolete. If they are not promptly adjusted, exchange rates tend, in fact, to break away from parities under the pressure of swift and massive flows of funds.

The dichotomy that has been a feature of monetary and credit regulations in the majority of the European countries, with regard to the domestic and international market, has given rise to what can be ultimately considered as a market monetary power endowed, so to speak, with extraterritoriality. The Euro-dollar and other Euro-currency markets, thriving upon a lack of controls similar to those regulating banking activities on domestic markets, upon the economies of scale which its international dimension makes possible, and upon the professional talent which growth and profit potentials have attracted within its sphere, has seen its initially marginal impact develop in the span of a few years into an influence matching and competing with the one exerted by the national monetary authorities on their own markets. This is especially so in Europe, where the regulation of monetary base and credit is fragmented into so many domestic policies which are supposed to be autonomous.

The existence on the Euro-market of dollar-denominated financial resources without their corresponding counterpart in the United States has led to their being attracted into official reserves. This has been possible because of the size of the reservoir from which they flow and because of the convertibility commitment of the currencies with declared exchange rates.

Unless we assume an abdication on the part of the monetary authorities, the power to create money and credit will also have to be regulated in those sectors which have grown up as outposts of the movement towards integrating national banking and financial systems. This is not a simple task, but the challenge will have to be taken up.

We should not fall, however, into the trap of believing that the stability of the international monetary system can be secured simply through the creation of a panoply of controls on international capital movements. We shall discuss this topic later in these Concluding Remarks, but it should be stressed at this point that the integration of economies, the spread of technological progress, the attainment of economies of scale, in those production sectors where they are crucial, can be crippled by restricting the circulation of capital; keeping in mind that financial flows do not always ensure the expected effects of rationalizing production. Nor should it be forgotten that exchange control generally starts with capital movements, but tends to spread its grip to the flow of goods and services. Controls on foreign currency settlements, that have proliferated over the last few years for financial transactions, have recently touched the trade sector.

If in most countries inflation is eroding the confidence in the currency from within, it is illusory to hope that confidence will be restored in an international currency, which constitutes at the level of official and private operations the necessary corollary to a system built around fixed exchange rates. The system set up at Bretton Woods rested upon the assumption that monetary stability would be safeguarded in the largest economy and that this, in turn, would be transmitted to the rest of the world since, as a condition for exporting and importing, the other industrial countries would be forced to compete with the largest economy in efficiency and price stability.

The need for reforming the system became compelling as the redistribution of economic power moulded the international economy into a more balanced, polycentric-type shape. The need was felt because the European economies, once again capable of independent cyclical behaviour, could not – without damaging the growth process and deviating from the order of socio-economic priorities accepted in Europe – remain unsheltered from the influence of a US monetary policy meant to cater in the first place for American requirements. In addition, the growing depreciation of the dollar in terms of buying power made it too costly to hold reserves of liquidity in the form of monetary assets on the United States, on the part of countries already possessing large reserves in that currency. Thus, resistance towards building up these reserves stiffened, especially whenever fresh additions were linked to US investments abroad at a moment when the technological gap seems to have shrunk.

The restoration of orderly and stable monetary conditions, a prerequisite to a smooth-functioning international monetary system, has been hampered in Europe by the massive flows of dollars inundating those countries which have pursued more stringent monetary and credit policies. Shifts of dollar liquidity hamper stabilization policies, even when the United States itself is not experiencing inflation. In a system built around large monetary areas, the importance of the country with the highest propensity for stability grows, since the impulses being transmitted by the economy, which from the point of view of overall real and financial resources continues to dominate, are not focused on the *target country*, but are diluted across the entire group of the countries forming each monetary area.

Experience over these last few years has taught that, in practice, recourse by a single country to technical instruments such as flexible foreign exchange rates, exhausts its usefulness long before the country has succeeded in sheltering its economic and monetary policy from the inflows of liquidity in dollars. Since nearly 50 per cent of the foreign trade of EEC countries is intra-Community trade, no single member can make an appreciable use of exchange rate changes to solve what is essentially a monetary problem with the United States, without at the same time jeopardizing its own competitive position within the Community. Not even joint floating solves the problem, as far as concerns competition with the United States on respective domestic markets and on those of third countries. The fact that the equilibrium rate for capital movements tends to diverge from that for current account transactions makes it hard to do without administrative controls on capital flows, if only in the form of a separation of the two exchange markets. But administrative controls are less damaging in terms of inefficiency in the allocation of resources, if applied along the perimeter of a wider area.

Joint floating presupposes that the conditions within the participating economies be homogeneous. Last year, we warned that fledgling Community monetary unification would succeed to the degree in which it was sheltered from the tensions rocking the international monetary system as a result of the divergencies in cyclical trends of the major industrial countries and of differences in their economic and monetary policies. We added that: "The progressive limitation of national autonomy in the areas of foreign trade, capital movements and credit policies, and, in the final analysis, of

global demand policy could influence economic development favourably in some countries and regions, adversely in others”.

The European Economic Community was not able to meet in a concerted fashion that which has been called the *American monetary challenge*, because cyclical patterns in the different member countries continue to diverge; in other words, although largely integrated on the commercial level, the Community has not achieved a high enough degree of economic integration. The latter extends beyond the commercial sector, to the factors of production, the institutions in which those factors are organized in modern Western societies, the rules which promote and govern their circulation, fiscal and social security burdens, the yield on savings and investment, and income transfers. Without economic integration some countries may be damaged if they give up the autonomous use of exchange rates and other monetary policy instruments. As things stand today, it appears likely that full participation in the joint float would have pushed exchange rates in the direction suiting the needs of the nations which in effect did take part, and hence in a direction detrimental to the others.

If moving towards monetary union well in advance of economic integration can harm some countries, they will not give their consent until the Community is in a position to come up with measures designed to level the gap between the direct gainers and losers in the process of unification. The narrowing of the intra-Community fluctuation margins – which implies a reduction not only in the autonomy of interest rate policy, but also in manoeuvring room for fighting currency speculation – was accompanied by agreements making intra-Community settlements harder than the norm outside the Community. This has not been counterbalanced by the type of credit facilities that have been agreed upon, which are not even satisfactory on the strictly technical level.

Indicative of the attitude still prevalent in the Community were the reactions to proposals submitted at Brussels last March to increase the credit potential of the European Fund for Monetary Cooperation. The proposals were made in the course of negotiations which centered around enunciation of the autonomous use of exchange rates to meet primarily the needs of some member countries whose monetary equilibrium was endangered by inflows of foreign funds.

The Italian proposal to raise the Fund's resources to 10 billion units of account was a compromise between the actual situation and the British proposal for unlimited credit. It was based upon the

conviction that a commitment to float jointly would stand no chance of thwarting speculation if the size of resources available to defend the joint parities was not credible.

Beyond the immediate operational considerations these negotiations were of course a testing ground for the priority which Community members are willing to give to growth and full employment, even when these goals are threatened in a country other than their own. Imbalances in payments similar to those within the Community crop up within the single countries. In the latter, there exists monetary and fiscal mechanisms which make it possible to stretch the adjustment process over a longer period of time. The nearly total lack of these mechanisms in the Community context makes that process abrupt, exacerbating it until it exacts large sacrifices in terms of priorities among the objectives of economic policy. If the fight against inflation seems to be of utmost priority at present, European monetary union cannot nonetheless pivot around a mechanism which tends to place the goals of growth and full employment at the bottom or, in other words, to overturn a value system that has received nearly universal acceptance in the postwar period.

### **The International Monetary Crisis and the Floating of the Lira**

Our policy choices during 1972 and the beginning of 1973 were shaped by the criterion of keeping the balance-of-payments constraint from hampering the pursuit of a policy of money management aimed essentially at stimulating a recovery in productive activity and employment, without undermining the forward momentum of European economic integration.

As 1972 opened, the low degree of plant utilization and the stagnant behaviour of unit and overall profits, on the heels of 1971's particularly unsatisfactory performance, discouraged fresh undertakings. Construction activity continued to flag at low levels, even if the first signs of a slight recovery could be noted. The public administration was unable to promote the expansion of demand proposed by government policymakers; activity in the public works sector slowed down, even while outlays were rising. Exports continued to represent the most dynamic component of overall demand, but their expansion was faltering, after the 1971 year-end spurt.



The depressed economic situation kept price increases within more moderate bounds than those being experienced in the other European countries, which had already turned the corner towards vigorous recovery. The climb in wholesale prices, which between December and June moved at a four per cent annual rate, was for the most part spurred by pressures from abroad, such as hefty jumps in raw materials and beef quotations. The growth rate of manufactured goods prices continued to lag behind that for costs per unit of output thus heightening the inflationary potential building up within the system.

In the January-May period, our balance of payments was showing particularly favourable results – especially because of the increase in the current account surplus – thus making feasible the policy of prepaying loans taken out in the previous two years: in these five months, repayments amounted to 260 billion lire and the other items on the balance of payments showed a surplus of 160. Under these conditions, monetary policy was kept on the previous year's expansive track, moving, rather, towards an acceleration of the most directly controlled components in respect to the second half of 1971. Seasonally adjusted, the creation of monetary base, channelled for the most part through the financing of the Treasury's cash needs, came to nearly 2,500 billion in the first six months of 1972, against some 3,300 for all of 1971; bank reserves, again for the first six months of 1972, rose by nearly 1,300 billion, only slightly less than over the entire arc of the preceding year.

The sharp expansion of the Bank of Italy's other assets gradually led, during 1971, to an increase in the banks' unused borrowing margin in ordinary advance accounts as a result of the repayment of funds previously borrowed from these accounts and, later, to the accumulation of deposits with the central bank. These accounts stayed at a high level in the early months of 1972. In April it was decided to lower the return paid on them, linking this decision with a reduction of 0.50 per cent in the discount and advance rates, in order to foster greater use of the banks' excess reserves and stimulate a faster decline in interest rates.

The banking system reacted as hoped, increasing its credit lines and securities investments and fostering a further lowering of the entire interest rate structure. The level of lending rates in the second quarter of 1972 settled 0.70 per cent lower than that of the fourth quarter of the previous year.

Given the volume of outstanding loans, it can be calculated that every percentage point the lending rate falls means nearly 100 billion in per-quarter savings for borrowers. Every type of loan was affected by the reduction in rates but, as already noted in 1971, the cut-back was lower for the small- and medium-sized enterprises and larger for the public enterprises and, more generally, for large enterprises.

In the first six months of 1972, the overall flow of domestic financing to all sectors of the economy, excluding the Treasury, was some 3,600 billion, versus 2,400 for the same half in 1971.

Bank loans, or nearly 80 per cent of the total, registered a faster rise for operations in favour of enterprises and agencies located in Southern Italy and the Islands (5.5 per cent increase versus 3.4 per cent for the other regions).

In the month of June, the international monetary system was rocked by a deep crisis. A string of unfavourable news reports on the performance of the United Kingdom's balance of payments and the restatement of the British government's policy to give priority to domestic development targets fed expectations of an imminent devaluation of the pound. This set off massive flows of funds both through leads and lags in exports and imports, and the conversion of foreign-owned, pound-denominated deposits. After a brief shut-down of the foreign exchange markets, the British government announced its decision to float the pound sterling.

Despite the fact that Italy's reserve and balance-of-payments situation appeared solid at the end of June, expectations of further rises in costs and prices bolstered the conviction that sooner or later the lira would follow in the pound sterling's footsteps. The upshot was a round of speculative attacks against our currency, which forced the Bank of Italy to sell more than 900 billion lire on foreign currency exchange markets during June and July, nearly a third of this in the last three days of June.

At the end of that month, measures were taken aimed at curbing certain forms of outflows and at curtailing their impact on reserves, through the acquisition of liquid financial resources denominated in other currencies. More specifically:

*a)* the facility of crediting lira banknotes in capital accounts was discontinued and at the same time the policy of encouraging foreign indebtedness was reactivated; as a result, foreign currency loans for circa 500 billion lire were contracted in June-July and another 400 billion were taken out before the end of the year;

b) there was no relaxation of the ban on the banks' taking on net creditor positions abroad; instead they were given the go-head to assume net debtor positions vis-à-vis the same sector;

c) the banks were instructed to keep their overall foreign exchange position balanced, through the repayment of outstanding dollar-lira swaps with the UIC – this latter measure fostered the reflow into reserves of those dollars acquired by Italian businessmen to repay foreign-currency loans taken out with the commercial banks; in the June-December period these loans fell off by 1,150 billion and repayments made to the UIC amounted to 1,161 billion.

The uncertain international monetary situation and rising demand in many industrial countries were reflected in the behaviour of prices for raw materials and foodstuffs. This worked its way into domestic prices, sharpening the difficulties already appearing in the wake of a bad agricultural year. The economic situation in Italy continued to stagnate, even if there seemed to be a turnaround in investments, especially in inventory building, as indicated by an acceleration of imports. Monetary policy was kept on an expansive tack, even if liquidity inflow from abroad completely fell away.

Overall domestic financing of the economy, excluding the Treasury, came to 12,500 billion in 1972, against circa 9,000 in the previous year; the portion going to the public sector and the public enterprises increased faster than the total. Outlays to the Southern regions and the Islands rose by 19.6 per cent, versus 16.9 per cent for the other regions. Bank lending rates continued to fall, albeit more slowly, in the second half of the year, finishing on average for the year 1.15 percentage points below the previous year's level. In the closing part of 1972, with credit still widely available, the acceleration of exports, and vigorous stockbuilding activity and consumption – spurred by pension increases and the impending switch-over to VAT – gave a decisive lift to productive activity. Company profits improved and there were clear signs of recovery in investments. In the construction sector, the turnaround in non-residential building in progress since the beginning of the year was joined by a still uncertain, but improved, performance in home-building.

Industrial output registered, between the third and fourth quarter, the exceptional jump of 7 per cent, generating a sharp recovery in productivity, and provided a respite in the steady growth

of unit labour costs. However, improved demand conditions, against an international background of expanding inflation, spurred the spread of price rises to manufactured goods, which, while demand was stagnating, had been lagging behind cost increases. Further pushes originated from raw material quotations, already soaring on world markets. In addition, there were increases connected with the imminent change-over of the tax system.

Although it had survived the violent crisis of June-July, the lira continued to be attacked throughout nearly all of the second half of 1972 by domestically generated speculative pressures. These were veiled by the usual summer inflow of foreign currency, which made interventions on foreign exchange markets unnecessary. The telltale signs were the speed at which imports were settled and especially the delay in the settlement of exports: the loss of reserves stemming from this behaviour can be set, in the seven months between June and December 1972, at some 850 billion lire. At first, the authorities took compensatory steps by contracting loans abroad; later, that is in January 1973, when it seemed wise to curtail the further expansion of these loans, they decided to shorten the terms of payment for foreign trade in order to restrict the creation of export credit.

Thus, moves aimed at defending the quantity of our reserves were integrated with others shielding their quality.

According to the agreements brought into force on April 24, 1972, interventions to keep the spread between the exchange rates of any two Community currencies from exceeding 2.25 per cent were to be carried out in Community currencies; interventions in dollars only being permitted when that currency's exchange rate reaches its outer limits. These same agreements also stated that eventual debtor positions growing out of interventions in Community currencies were to be settled through the proportional use of all of the debtor country's reserve instruments; the ongoing market price applying for currencies and the official one for gold.

Conforming to these rules would have forced our country continuously to relinquish gold at a price growing ever more out of line with the free market quotation, and made it practically impossible to recoup these gold losses should the balance-of-payments situation turn around: we would thus have had to suffer an unjustified drain, while other countries would have received an unjustified gain.

In order that the lira might be kept within the agreed-upon Community band, the agreement was modified at the end of June.

We were then permitted to intervene exclusively in dollars, an eventuality which had been expressly anticipated in the agreements. In this way, our reserve losses in the June-December period, of 318 billion lire, were strictly in dollar-denominated assets.

Throughout the second half, the lira hovered close to the floor of the Community band; the strongest Community currencies having all risen to the maximum appreciation permitted vis-à-vis the dollar. This meant that our country was forced to maintain its exchange rate vis-à-vis the dollar close to its central rate, in a period in which the balance of payments was registering a substantial deficit. In the autumn, speculative pressures against the lira stiffened: as the leads and lags for trade settlements widened, there was an increase in capital outflows earmarked for securities investments. Capital flows, after deducting trade credits, offsetting loans and banknote remittances, are usually in surplus in Italy; instead, they registered a deficit of 230 billion in the third quarter of 1972 and one of 130 in the last.

In the fourth quarter, interventions on the foreign exchange spot market accelerated and, at the same time, interventions were also made on the forward market, in order to keep the spread in spot and forward rates from sparking off further capital outflows. Further measures aimed at fortifying the foreign exchange market were taken at the beginning of December; while the interest rate on fixed-maturity advances was increased, the UIC declared itself ready to provide a portion of the lire which the banks needed for their end-of-year operations, against dollar sales, with exchange guarantees. As a result the UIC's creditor position for forward dollars turned around to a short position of nearly 350 billion lire.

As the year came to a close, the seasonally adjusted Italian balance of payments, despite the recovery of exports in course, showed a deficit on current account. This reflected a speed-up of raw material and semi-finished purchases at steadily rising prices, and the reduction of net receipts for services, while the net capital outflow was expanding and only being partially offset by recourse to foreign loans. Interest rate conditions played no part in stimulating these outflows. Net of the surcharge levied against non-residents, our long-term rates were above those on the Euro-market, in France, West Germany, the United Kingdom and in the other major countries. A negative spread did open up in autumn with respect to short-term rates in West Germany and the United Kingdom, but not

so wide as to spark off large movements of funds. The key stimulant was expectations of devaluation, reflected in the discount on forward lira. The latter was narrowed by the interventions mentioned above: had these interventions been carried out by the commercial banks, they would have lopped off reserves.

Correcting the disequilibrium by adjusting domestic interest rates seemed an unwise course, as any adjustment would have had to be so large that it would have had a disruptive influence on the financial system. But basic to any decision against recourse to monetary measures was the state of the economy; a rollback in credit would have throttled the recovery just as it was getting under way.

Against this backdrop, it was decided to set up a two-tier exchange rate. In the Report given in May 1970, we had already expounded on the advantages and disadvantages of such a solution. At the time, we stated that the establishing of a financial lira would have resulted effective "insofar as the divergencies in prices between the official market and the financial market ... [were] restricted by intervention by the authorities and thus, ultimately, by sales of foreign currency taken from the reserves". As it happened, the spread between rates on the two markets was kept in bounds, without the need to intervene, by the decision in February to allow the commercial lira to float. Nonetheless, the establishment of the two-tier market provides no protection against changes in the terms of payment on the part of foreign traders.

In March 1969, repeated proposals were made insisting that the flight of capital from Italy could be blocked by suspending the purchase of banknotes abroad by the UIC. On that occasion, I stated "it is necessary to warn that any such measure will be ineffective in a country in which inflows from foreign tourists and remittances from workers abroad amount to some two and a half billion dollars per year. It seems plain that the foreign currency saved by not repurchasing banknotes will be offset by the reduced inflow of currency imported by tourists, who will purchase their banknotes abroad and refrain from exchanging their own currency on the official market. The same behaviour can be expected of Italian workers abroad and this would respond above all to their right to a fair deal. Nor would it be worthwhile to station an arrayment of special police along the border to carry out personal searches on foreigners coming to visit our country".

Events have clearly borne out these predictions: the total of net receipts from tourism and emigrants' remittances slid from 330 billion in the final quarter of 1971 to 213 in the same period of 1972; considering the upward momentum of these flows in the first half of the year, it can be estimated that this phenomenon sapped some 150 billion lire from the balance of payments. It is possible that these measures did produce a modicum of desired results, but to a much lower measure than reported statistically.

The series of monetary flare-ups in February and March of this year must be laid squarely to the size of flows of funds spurred by expectations of parity changes. The size of reserve losses suffered by Italy during January and the first part of February, notwithstanding the ban on crediting banknotes and the establishment of the two-tier market, ruled out any solution that would entail a further draining of reserves. In the light of a deficit in the balance of payments on current account, it would not have been feasible to keep the lira's value vis-à-vis the other European currencies unaltered and accept the constraint of limiting its fluctuation to no more than 2.25 per cent of their respective parities. Acceptance of that constraint would have been possible had the embryonic European Fund for Monetary Cooperation been equipped with the financial resources necessary to convince the market that eventual reserve losses would not, sooner or later, lead to a parity change.

The decisions of February and March gave rise to bitter criticism; it was charged that it was merely a ploy masking an actual devaluation of the lira. Another oft-repeated argument was that it would have caused Italy to break loose from its European moorings.

As to the first of these two accusations, it should be recalled that arriving at the new level in exchange rates while the authorities were making defensive interventions precludes any willingness on their part to cause a depreciation. To keep the old level would have entailed higher reserve losses. These losses would have led to a decision to devalue, without sufficient reserves to contain the size of the change.

Non-participation in the joint European float does not seem liable to the interpretation that it caused a break between Italy and Europe; if anything, just the opposite is true: our currency was suddenly affected by shortcomings in international and domestic behaviour, the latter cutting across every social group and fostered by the policies carried out over past years. As a result, the process of integrating our economy in the Community has been slowed.

I recalled that behaviour and its consequences to the attention of the monetary authorities towards the middle of January 1972; at that time I wrote: "The international monetary situation is in unstable equilibrium; it is likely that the restructuring process will lead to the establishment of monetary areas; one of these would revolve around the enlarged European Economic Community. The acceleration of integration within this area will force the member countries to move more quickly towards homogeneous economic structures. Do the transformations we have recently achieved and those on slate support the conviction that our economy is able to make this evolutionary transition? are not symptoms appearing that might lead to the opposite conclusion? and what is to say of its gradual drift away from the European Community?"

We had better, however, take sides on one or the other interpretation of the difficulties lying before us, and make it plain once and for all if it is our belief that the remedy lies in speeding up the process of merging economic activities into a state or quasi-state apparatus, ever less mindful of the restraints necessarily respected by the managers of private enterprises that survive on their efficiency, and that all problems can be solved by the money printers, provided that they are willing to obey the command to crank their presses ceaselessly. If this is really the case, however, we cannot pretend that the majority of citizens should take seriously the repeated declarations promising to keep a solid link between our economy and those of the rest of the Western world.

### **The Enterprises within the Framework of Economic Integration**

All of the Western economies are presently undergoing thorough transformations which have also touched upon labour relations and the distribution system, but none have deviated from a market economy. The founding treaty of the European Economic Community explicitly states that it shall pursue its own goals in the establishment of a common market, thereby implying rules revolving around the enterprise. These rules presuppose the existence of private and public enterprises, managed autonomously and operating on an equal basis.



A hostile attitude, sometimes masked, sometimes not, towards private enterprises has taken root in our country over the years and a preference for public enterprises had even entered into the law books: for instance, the law of October 22, 1971 No. 685, art. 27, paragraph 6 reads like this: "The Municipality shall use the expropriated areas for the construction of productive facilities for industrial, handicraft, commercial or tourism purposes" and the paragraph goes on "should competing claims be made, preference shall be given to those presented by public agencies and state-controlled companies".

The rules governing labour relations in private employment have been brought into line with those governing public employment with the aim of guaranteeing job security. The private enterprises are presently threatened with a generous law in favour of war veterans, that also covers other categories suffering war damages, which hitherto has been restricted to the employees of public agencies, including municipal workers. This law brings about a situation in which the private owner is not able to make overhead projections and is ever more tempted to give in to takeover offers by a larger firm or a public agency.

The employees greet this transfer from the private to the public sector with little remorse, yearning to become members of a privileged community. The process is monotonously one-way; not once has it happened that a municipally-run company that goes out of business because of accumulated liabilities, even in a field where it has no monopoly, ever had its service returned to a private enterprise.

The widening of the public sector is detrimental to the process of management recruitment: the circle of eligible citizens tends to shrink around the members of the political parties in power, thereby fostering a bureaucratic corps of managers, with little zeal for innovation. The expansion of public enterprise tends in the long run to award those groups which can most easily influence the executive branch.

It does not seem haphazard to state that the public sector's action has been geared more towards extending its reach than towards improving the administration of those sectors already under its control. This has inserted an element of instability in the institutional framework which, I believe, has had a negative impact on the process of capital accumulation. When the Italian market was first opened to foreign competition, that process was stimulated and there was a sharp rise in investments. In the ensuing years, the private

enterprises' fears for their own survival may have convinced them of the wisdom of limiting their investment activities to reorganization programmes, before full employment had been reached. Supply has expanded basically through increases in productivity, mainly in the manufacturing industries. Consequently, the system has not grown as fast as it might have.

Capital that might have gone into domestic investment has instead been exported. Had we tried to promote more vigorous investment in real assets, depressing the yield on financial assets through the expansion of liquidity, the result most likely would have been a larger exodus of funds towards foreign financial assets. Below-par domestic investment, a surplus in the balance of payments on current account, and the outflow of capital are all phases of a vicious circle experienced by an economy which is open to the international market, but has a different organizational structure.

The public enterprise has unquestionably proved itself a potent development instrument in the Mezzogiorno; the same has been and can be true when it comes to accomplishing fundamental aims both in the infrastructure and the basic industry sectors, and providing operational guidelines to other industrial sectors as well. But expanding the public enterprises' field of action through interventions aimed chiefly at proffering a lifeline to floundering firms, but not responding to a coherent economic policy design, leads to the degeneration of public and private entrepreneurship and slams shut the door to European integration.

Without efficient enterprises, the dismantling of economic borders produces an asymmetry of effects, since the penetration of foreign enterprises is not matched by a similar movement in the other direction. The resulting imbalance sets off a reaction which, in the long run, boils down to an attempt to use the arm of public industry as a hedge against the feared expansion of foreign industry.

To avoid that the gradual transference of management responsibility to the public sector and that hardships being experienced by the private enterprises (which are partially at the bottom of this process) do not combine to drive a wedge between our country and Europe, we must urge the aid of European forces for undertakings aimed at solving our structural problems. In parallel, we must clear the way by speeding up the adjustment process for our institutions. In addition, we must eliminate those hurdles regarding the joint stock company and the stock market which make it comparatively more

difficult in our country to finance enterprises, for the households to invest their savings profitably and to implement an economic plan which, dictated by basic choices, guarantees the free exercise of entrepreneurial decision-making. In direct contrast with this policy is the oft-deplored dearth of public action in its most directly pertinent sphere, from environmental protection to education, from professional training to assistance and the other basic social services.

In the autumn of 1969, trade union pressure, after having been applied during contract negotiations for the usual matters, such as the improvement of wages and reduction of the working week, shifted, on the factory level, to those aspects most closely linked to on-the-job working conditions and, on the national level, to those problems of general interest concerning the betterment of the labourer's general standard of living. Relations inside the factory broke down against the combination of demands and the ensuing methods of struggle, reflecting states of mind uneager to evolve toward constructive goals.

From mid-1970 on, a clear pattern could be discerned in which the wave of claims, which initially might have appeared similar to those produced in 1962-1963, now have shifted its focus towards sweeping social changes. The demands were often confused, but rarely lacking in appeal. Their scope went beyond the redistribution of income and reflected the need for radical innovation. Development clogged against the barriers that were thrown up in front of productive activity.

It grew harder to overcome the crisis inasmuch as its solution seemed linked, both on the factory level and on that of the system, to the re-establishment of relationships which could no longer be resolved in a return to past normality, but the outcome of the quest for a new one. The task would not be an easy one, since neither the problems nor the solutions were clearly defined and there would inevitably be collisions not only of interests, but of ideological viewpoints.

The structure of the enterprises was strained both on the economic-financial and on the organizational level. The fall-off in profits, that began towards the end of 1969 in terms of units of output, reached exceptional lows in 1971 also in terms of overall volume. The most hard-hit categories, as emerges from a survey taken of the balance sheets of 423 manufacturing companies with a net worth of at least 1 billion lire, were first the state-controlled companies and, among the privately owned, the smallest and largest companies.

The impact of declining profits on the private enterprises' investment programmes varied in intensity. Already in 1971 the smaller companies, also on account of their greater financial difficulties, were forced to cut back sharply their investment projects, while the larger ones slowed down theirs – which, nonetheless remained positive – gearing them chiefly towards retooling company structures to the situation created by the increase in wage costs and by the changes that had taken place in labour relations. Indicative of this behaviour was the growing tendency on the part of the large firms to slough off facilities that had become economically obsolete. The value of these operations, expressed in book-keeping terms, doubled in 1970 and tripled in 1971 with respect to the 100 billion registered in 1969. A similar pattern did not occur in the state-controlled companies, since they had already taken steps along these lines during the recession of 1964-1965. In 1972, the phenomenon seems to have decelerated to a level some 25 per cent below that of the previous year, thus indicating a trend towards normalization in enterprise management.

The process of restructuring the productive apparatus was accompanied by parallel behaviour in the financial field. The recovery in share-issuing on the part of the Italian companies can in fact be linked to their need to restore financial equilibrium, in order to clear the way for the implementation of development programmes.

In 1972, the investments of the entire industrial sector, which in 1971, according to recently released data, had still shown a slight increase, dropped at constant prices by 3 per cent. The anticyclical action of the state-controlled companies was not sufficient to offset completely the decline in investments on the part of the private enterprises, despite the broad support given to industrial investments by the special credit institutions which, bolstered by a monetary policy geared to fostering intermediary activities, were able to satisfy to a considerable extent the backlog of loan requests.

The effects of the enterprises' different investment performances began to be felt already during 1972. Capital accumulation – which had been vigorous for the state-controlled companies and still fairly active for the large private concerns – fostered a rise in productivity, both directly and indirectly through the reorganization of the productive process leading to labour savings.

Adjustment in employment levels, hardly noticeable in the previous year, was more marked in 1972, as the enterprises' two-pronged actions to improve the productive efficiency of their facilities and

more rationally organize the factors of production worked their effects. In addition, numerous small business failures also took their toll on the employment level.

In the early months of 1972, achievement, albeit partial, of the above aims helped to curtail the increase of manpower costs per unit of output. In the second half, the first hints of perking demand and price rises fostered an increase in unit and overall profits. From national accounts data it can be estimated that there was a turnaround in the enterprises' net savings after the previous year's drop; the 9 per cent growth of incomes in the industrial sector (excluding those earned by employees) supports this assumption.

Looming on the horizon together with these signs of improvement were contract renewals involving more than three million industrial employees. The importance that is attached to both the way in which the new contracts were negotiated, and to their contents, seems justified when we consider that they occur within a wage reality which, in the last decade, has gradually approached the European average, almost fully matching it in terms of labour cost. Whereas in 1960 in the manufacturing sector the latter was nearly 25 per cent less in Italy than the average for the other countries, the United Kingdom included, by 1970 the gap had been substantially closed. In fact, in that year it was down to 6 per cent, an average deriving from quite different situations from sector to sector: costs in the footwear and clothing industry were still appreciably below the European averages, those for foodstuffs and means of transportation were basically equal, while costs in the metallurgy sector were higher.

Rises stemming from the recently signed contracts must be weighed in this light. The chemical workers' contract put into effect immediate rises of 14 per cent in terms of contractual wages, as emerges from the official indexes, and an estimated 18 per cent in terms of labour cost for its entire span of three years, the latter necessarily approximate because of the difficulty of calculating the cost of several items. These increments are lower, even if not far off those awarded by the 1969 contract; nonetheless they cannot be considered any less serious in terms of their impact on competitiveness for the reasons mentioned above. A similar conclusion may be drawn from the settlement in the mechanical engineering sector even if, given its more recent signing, its impact on the contractual wage indexes has not yet been quantified.

Without doubt, from the way in which the bargaining was accomplished and the work stoppages themselves, the trade unions demonstrated a greater representative capacity while both sides of the table displayed a more responsible attitude towards the problems relating to the enterprises' global reality; both are hopeful signs in the quest for normality in productive activities. The limited space dedicated in the new contracts to agreements regarding labour organization inside the factory and the postponement of this phase of factory-level bargaining inserts, however, an element of uncertainty in the planning of productive activities and above all of investment programmes. This, however, has been mitigated by the contents of several statements made by trade union leaders. Application of the new contracts aimed at coordinating factory-level bargaining with goals touching society as a whole can be accomplished only by constant cooperation between the trade unions' national headquarters and their factory councils. The fact that the latter fully represent workers' interests on the factory level does not contradict the need for coordinating each factory's demands within the framework of more general problems touching the entire working class.

A string of fresh burdens was thus thrust upon the enterprises as they were approaching a satisfactory degree of internal equilibrium, threatening consolidation of the partial recovery experienced in the final months of the year and, above all, the start of a fresh round of investments as the plants reached full capacity levels and profits began to rise. Adding to these burdens sharply contradicts the conclusions of several recently held debates from which there emerged some signs of agreement between economists and politicians approaching the problem from a different standpoint. There was agreement in recognizing the market's intermediation role in supply and demand relations and its function as an indicator of efficient combinations of the factors of production, within an institutional framework capable of offsetting oligopolistic tendencies. There was also consensus that enterprises are organizations governed by the principle of economic viability and responding to the needs of specialization and of the decentralization of the decision-making process, as also imposed by the modern productive process. Finally opinions converged upon the necessity of limiting the spread of the public area.

These considerations call for coherent behaviour, not only in terms of trade union relations. This does not only mean coming up

with innovative production methods, but, more specifically, deciding where the emphasis shall be placed in the production of goods and services: leaving to market forces the fundamental choice of the composition of demand, provided that intervention by the political authorities channels these forces towards goals having the public's consensus. Should profit be considered the final objective, distortion would arise in productive activity as the supply structure dictated that of demand. This might exact costs in terms of resources waste and debasement of the social and physical environment. The concept of economic efficiency itself would become uncertain, unless we succeeded in guaranteeing the autonomy of the goals of productive activity, in respect to the activity itself. The efficiency of the entire system, in fact, derives from its capacity to fulfil requirements which, insofar as relevant to the society as a whole, transcend the immediate aims of the single productive units.

If a balance is to be struck in factory-level relations, it is essential for us to direct overall demand towards fulfilling those needs whose urgency is recognized every day by wider segments of the public.

We have noted that the cost of labour in our country has nearly reached the level of our neighbours; nonetheless, the same data reveal that wages remain at lower levels, the difference mainly taken up by the higher burden of social security charges on our industries. These charges, in 1969, took up 29 per cent of the overall wage bill in the Italian manufacturing industry, against 20 per cent, on average, in the other Community member countries, the United Kingdom included. This is an example of the reciprocal ties linking the economic situation and the reforms; setting one against the other, as has been often done, basically creates false dilemmas, as is generally the case when short- and long-term problems are counterposed, that is, when we are not talking about a situation in which the means for the present and overall solution of the problems themselves and thus, the need to make choices are lacking.

An example of this is the employment problem. The low employment rate for adults and the gradual decline of this rate attest to the existence of a large pool of manpower reserves other and above those officially jobless, made up of people who do not even bother looking for work when the market is depressed.

Like the potential source of energy compressed in the ice packing a glacier, exploitable only gradually as the heat melts it, these manpower reserves become actual only when demand is such as to

suck them into the market and, through on-the-job training they gain enough experience to qualify as skilled workers.

The solution to the problems of unemployment and under-employment lies in regulating the cycle to keep up sustained and steady productive activity. Fast spurts of productive activity are choked off quickly by scarcities in readily available manpower and can bring about, as experience in the recent past has demonstrated, the contradictory coexistence of problems related to full employment and the under-utilization of labour.

The country's development requires a productive nucleus, whose efficiency is constantly being honed by international competition, to stimulate the entire system and provide its own determining contribution towards balancing foreign accounts.

But this does not mean that demand composition cannot, and must not, for that matter, be channelled towards meeting the needs highest on society's list of priorities and which have been repeatedly urged by the planning bodies. If the enterprises' investments must be guided by the action of the planning bodies in regard to the public and private productive system, satisfying society's more specific needs still remains the task of public expenditure. As things stand now, one cannot fail to note the government's inability to implement an adequate policy of social investments in the near future, but this serious shortcoming cannot continue over the intermediate period.

Recent years' experience has demonstrated the public administration's incapacity to expand its direct investments to the degree held necessary. The weight of these investments, with respect to overall public spending, has appreciably diminished from 10.5 per cent on average in the 1950s, to 7.8 in the following decade, and to 6.4 in the most recent years.

This trend has highly conditioned the growth of the supply of public goods and services and has thereby to a large degree helped being about the social and economic difficulties we are presently facing, despite the fact that the expansion of public investments has been given high priority in every government programme of recent years.



## Current Problems

The thoroughness with which we have analyzed the transformations that have taken place in our economy, as well as recent domestic and international monetary events, does not absolve us from our duty to examine and offer solutions to the current problems most directly interesting us, as the central bank, in the light of the far-reaching changes occurring in the international monetary system. The most crucial problem is inflation. The economies of the industrial and raw-material producing countries have been struck by an inflationary storm that is without precedent in the last twenty-five years. In the second half of 1972, wholesale prices soared, mainly in the industrial raw materials and foodstuffs sectors. Between June and December, the general index rose at a yearly rate which ranged from 6.4 per cent in West Germany to 13.8 per cent in France. As a result of tensions spreading into the manufactured goods sector, the index reached exceptionally high levels during the first quarter of the year: about 22 per cent on a yearly basis in the United States and 14 in West Germany. Inflows of funds from abroad weakened the central banks' capacity to control the money stock; moreover, financing of the government deficit has had a similar impact.

The declaration of the dollar's inconvertibility, following a long process stretching from March 1968 to August 1971, combined with the expansion of dollar deposits held by the official authorities and the public both inside and outside the United States. De facto convertibility of the dollar into gold for private non-US residents was maintained until 1968 by sharing the relative burden among the countries taking part in the gold pool. Towards the end of 1967 and the beginning of 1968, it seemed that this form of convertibility at the official price of 35 dollars per ounce would result in the outflow of all gold reserves to the public. At that time, we made known our intention to offset our market gold sales covering pool commitments by purchasing equivalent amounts from the United States Treasury. In March, support for the free market price of 35 dollars per ounce was withdrawn. The dollar continued to be convertible for the central banks; however, in August 1971 this form of convertibility was also abolished.

The United States' external indebtedness stemming from monetary movements rose from 38 billion dollars at end-1968 to 83 at the

end of 1972. Almost the entire amount of dollars created through this form of indebtedness flowed to the central banks: the amount of dollars held in reserves increased from 17 to 62 billion, most of which flowed into the central banks of West Germany, Japan, France, Benelux and Switzerland. During the same period, the Euro-dollar market expanded at the same pace: the dollar-denominated assets and liabilities of the commercial banks of eight European countries rose, respectively, from 27 to 97 billion and from 30 to 98. At the same time, the market for other Euro-currencies, mainly Deutsche Mark and Swiss francs, which was practically non-existent at the end of 1968, also expanded. Excluding assets and liabilities towards US residents, in December 1972 the commercial banks of the eight countries administered a volume of foreign-currency denominated funds amounting to about 120 billion dollars.

One feature of the present international monetary system is the lack of any commitment on the part of the United States, Canada, Japan, Switzerland, the United Kingdom, Italy and Ireland to intervene in defence of their parities; the remaining Community countries and Sweden and Norway will defend their reciprocal parities, but not against the US dollar. Despite persistent warnings about the need to limit the multiplier effects arising from deposits of reserve currencies in countries other than the issuing ones and from the diversification of these currencies, lately the latter phenomenon has been especially marked, mainly in terms of the Deutsche Mark.

None of the oil-producing countries deposit dollars in the United States and all of them have converted dollars into other currencies. Under these circumstances, floating exchange rates hamper the further accumulation of reserve currencies and the conversion of one currency into another and act as a stabilizing factor for the system. The results of the recent test run appear satisfactory. Other countries carry out a policy aimed at fostering the use of portions of excess reserves to purchase raw materials, thereby helping to push their prices upwards. The search for profitable investments entails shifts of liquid assets, which adversely affect the financial markets. Frequently, shares are purchased on the basis of prices which bear no relation to the enterprises' capital or their performance. Gold is becoming ever more enticing.

The smooth running of the international monetary system is hampered by the coexistence of excess liquidity and increasing limitations on its use. The widening spread between the official price of

gold and market prices has persuaded official holders to regard it as a frozen component of their reserves; we warned our European partners of this last June and, after six months of negotiations, obtained their pledge to hammer out common solutions aimed at removing the freeze on the use of gold in intra-Community settlements. Gold can, in fact, be used in these settlements, through operations which will be settled when a new official price has been determined or when the central banks are once again allowed to trade on the free market, and official or market prices are considered acceptable. The use of dollars in settlements runs up against barriers, insofar as certain creditor countries refuse to accept them into their reserves. Finally, within the Community framework, the amount of resources administered by the European Fund for Monetary Cooperation is negligible. Given these circumstances, the time is ripe to call a halt to our various crusades and meet head on the problem of the place of gold in the international monetary system.

On various occasions, I have expressed doubts as to the possibility of re-establishing an international monetary system based on the principle of universality; that is, a system in which the obligation to settle debts and credits among countries by means of reserve instruments available in limited quantities would force each country, without exception, to respect the balance-of-payments constraint. Then and still today, I find it difficult to imagine a system in which the adjustment process takes place in the same way in the large and the small, the developed and the developing countries. Along the spectrum which ranges from a single universally acceptable currency to one currency for each province or city, there are single economic areas in which the degree of integration is higher than that possible for outside zones. The development of monetary areas consisting of countries bound to each other by a system of fixed exchange rates and to other areas by more flexible exchange rate relationships, has led some observers to draw the conclusion that reserves are superfluous. Others believe that the function of reserves might be to control possible exchange rate fluctuations among the areas so that they reflect the medium-term trend of the basic balance of payments.

If, among the integrating countries, there exist differences in the propensity to inflation and divergent cyclical trends, surpluses and deficits will show up in their balances of payments. If priority is given to integration then the adjustment process must take place without recourse to changes in exchange rates. However, the integration

process must be put on a proper footing by also providing an adequate supply of credit lines, administered by a regional organization to which reserves should gradually be transferred. A possible solution for the new international monetary system would be to set up funds for monetary cooperation on a regional level and grant them the power to create monetary units which the member states would use in settling balance-of-payments surpluses and deficits. The above-mentioned monetary units would have many of the characteristics of special drawing rights; suspicions that their creation was influenced by the contingent needs of a dominating economy would be less likely to arise. Relations between the various monetary areas would benefit from reciprocal credit arrangements that would be adjusted from time to time by mutual agreement, geared to the need of defending the desired exchange rates. Thus, the need for reserves, in both gold and special drawing rights, would be reduced.

A polycentric international monetary system does not necessarily imply weakening of the general cohesion among its different units. The more the adjustment process among the large areas takes place through a system of flexible exchange rates, the more necessary it becomes to abide by the rules which ensure the orderly development of trade and carrying out of settlements. A system of this type must rely upon institutionalized consultation on the national and area level. The International Monetary Fund is the institution best suited to this purpose. It should be added, moreover, that as we arrive, through the existence of a flexible system, at more credible exchange rates between the currencies of the large areas, the less exposed the latter will be to destabilizing shocks from funds shifting from one market to another in expectation of parity changes.

When special drawing rights were introduced, it was felt that their creation would be regulated according to the liquidity needs of the international monetary system. Their creation was envisaged for a time when the US balance-of-payments deficit would cease to provide the system with liquidity. When they were evolved, it was not thought that SDRs would be the only means of increasing reserves; a certain amount of gold might continue to enter the system, though not enough to meet requirements. Despite massive influxes of dollars to the international monetary system resulting from the balance-of-payments deficit, about 10 billion worth of SDRs were created; the rigidity of the procedures for their activation prevented the amount

of SDRs from being adjusted to meet changing circumstances. Newly mined gold was absorbed by the market at rising prices.

One solution to the problem of restoring gold circulation within the international monetary system might be to raise the official price of gold considerably. The resulting overnight surge of liquidity creation could be kept in bounds by agreeing that the central banks, when intervening to defend the exchange rate level, would not be allowed to sell gold to each other but on the free market, up to the amount gained from the revaluation of gold, when the market quotation rises above the official price. This would act to neutralize the liquidity thus created. The deficit country would repurchase its own currency from non-resident holders or, alternatively, would purchase the creditor's currency through gold sales on the free market. The central banks' residual gold holdings could circulate among the same banks or be transferred to the International Monetary Fund in exchange for SDRs or sold on the market. The Fund could sell portions of the gold it holds on the free market in order to obtain the necessary currencies for its operations. The Washington agreement of March 1968 would have to be revoked. Newly mined gold should enter into the free market.

If the solution of an increase in the official price of gold were rejected, as an alternative the notion of an official price could be done away with altogether. In this case, the central banks could exchange gold among themselves on the basis of an agreed price and sell and purchase the metal on the free market. SDRs would no longer be expressed in terms of gold content; they would become an abstract unit on the basis of which relations between national currencies would be expressed. The international monetary system would change over from material to immaterial money, backed solely by man's own wisdom. The price of gold in central bank transactions could be determined either on the basis of market prices or periodically revalued in relation to the weighted average trend of prices for internationally traded goods and services, through decisions taken by international bodies. Thus, gold and SDRs would be assigned two different functions, fulfilling two distinct and equally important requirements: to provide the single national communities with a means of storing value or, basically, the means for maintaining their foreign purchasing power, and also to provide the international community with the system's numéraire for expressing the parity ratios of the single currencies.

The central banks' freedom to sell portions of their gold holdings on the market would enhance the effects which can be obtained through the above-mentioned open market operations on the Euro-dollar market. Letting gold once again circulate within the international monetary system would offer a further opportunity of moving the reserve structure closer to what is considered desirable and would thus provide an element of stability to the system.

The foregoing solutions to use gold in intra-Community settlements do not solve the problems faced by countries, such as Italy, with a large percentage of gold in their reserves. Since there are widespread expectations that gold can be sold at a higher price than the present official one, these countries find themselves unable to benefit from that increase just when they may be running balance-of-payments deficits. Until someone comes up with a global solution to the problem of the price of gold, it might be feasible to consider a partial solution for intra-Community settlements. The creation of monetary units on the part of the European Fund for Monetary Cooperation and their allocation to the member countries would have an expansionary impact on liquidity no different from an increase in the price of gold in intra-Community settlements, but would be more in line with the logic of economic and monetary union. If no solution were found, we believe that our country should be quite cautious in taking on the obligations imposed by narrowing the fluctuation margins between the Community currencies.

However, it is not enough to re-establish these commitments in order to bring the nation's economy into step with that of the other European countries. The main roadblocks which have hindered progress towards common positions must be tackled.

Italy's shortcomings, and those of her associates and of the Community organizations, have raised obstacles towards unification. Little has been done on the institutional level. As far as concerns the heterogeneous nature of the economies' structures and dynamics, experience has shown that removing trade barriers will not alone spark off an autonomous process towards integration. The free circulation of goods and services does not ensure that uniform prices for production factors will be attained within a free trade area. The additional condition of full mobility of production factors could help to achieve this aim, but entrusting labour mobility with the predominant task of pulling the economies' structures closer together would involve both a drop in the growth rate of the economy

providing the manpower and human costs which no country could accept without serious reservations.

The basic failure of monetary unification projects which rely on formal obligations can undoubtedly be ascribed to the fact that the heterogeneous nature of structures has been disregarded. We have, for instance, asked the Community to provide us with subsidies so that we can move ahead in adjusting our productive structures; but the insistence with which we requested aid was matched by our inability to use that which we obtained.

Finally, homogeneous structures do not mean parallel development. If the long-run trends of costs and prices differ widely in the various Community countries while a system of rigidly fixed exchange rates is in force, then the balance of payments on current account can only be kept in equilibrium in the countries with higher rates of inflation at the cost of minor success in bringing the growth of income closer to its potential. Even without considering the equilibrium of the balance of payments on current account as a constraint, if the return on investments differs from country to country then the costs of unification will be greater for those countries less able to attract the area's productive investments, and this would result in their having a lower growth rate.

Thus, our contribution to the integration process should not be exercised through the resigned acceptance of the method that makes unification depend on imposing certain constraints on symbol-variables, such as the rate of money growth and the relations which link the various European currencies. Our contribution must be free of the fear that any criticism we make of the methods being used will leave us vulnerable to attacks of being anti-European. There was no fear of such accusations among the Members of Parliament who, at Community meetings, rejected plans put forward by the Commission for a restructuring of agricultural prices, and challenged the underlying rationale for the existence of a European unit of account used in settling payments for agricultural trade. Those who took this stance thought that by magnifying the effect of revaluations and devaluations on domestic prices, parity changes would be definitely eliminated. However, since this result was not obtained, is not the time ripe now to ask ourselves whether by persisting with this fictitious system we will create tensions harmful to the integration process?

A more reasonable way of dealing with unification problems is that of moving on to the comparison and to the coordination of

programmes regarding medium-term real flows – in which the strategic variable is the volume of investments – in order to ensure the consistency of the balance on current account and on intra-Community capital movements. This process could lead to a partial revision of each country's income and investment targets. When, instead, it is not made clear at the beginning that the various targets are in conflict, the adjustment process is necessarily left to the play of market forces and uncoordinated economic policy interventions. In this type of situation it is quite likely that the whole burden of bringing the objectives into line will be left on the shoulders of one group of countries, while another group makes no move to revise its own aims. We do not think it is futile to widen the discussion of the foregoing issues, as far as this lends to spreading the certainty that the European choice is irrevocable, not only because commitments have already been undertaken but above all because it responds to deeply rooted yearnings within Italy.

During Italy's *Risorgimento*, the European ideal was deeply engrained in the effort to achieve national unity, so that the two ideals were not seen as contradictory but as phases of a single process moving towards the expression of a culturally homogeneous community. Events in the last decades have given a sense of urgency to what might have seemed a utopian vision during the last century, so that the accomplishment of European unification is considered an indispensable development for the very survival of the values embodied in national ideals.

During the period covering June 1, 1972 to February 13, 1973 – the day on which, together with the announcement of the dollar's devaluation, it was decided to float the lira – the Bank of Italy was forced to intervene in support of the lira with foreign exchange sales amounting to 2,824 billion lire, under the terms of the Community agreement narrowing fluctuation margins. If the currency sales made by the *Ufficio Italiano dei Cambi* for its own operations are included then the total rises to 3,024 billion. This represents 78 per cent of the Bank of Italy-UIC's net external assets at the beginning of the period. If we had not taken out compensatory loans and assuming that priority was given to the use of convertible currencies, the latter would have been completely wiped out and our gold holdings, including gold-convertible reserves, would have fallen from 2,208 billion to 764. This did not happen, thanks to a series of operations of a one-time nature: namely, unwinding the UIC's long position of 870



billion in respect to swaps with the banks; activation of swaps creating a short position for the UIC of 544 billion vis-à-vis the banks; and compensatory loans amounting to 939 billion. Despite the above-mentioned operations, the Bank of Italy-UIC's net foreign position registered a fall-off of 671 billion and the banks' foreign indebtedness, excluding operations involving compensatory loans, increased by 145 billion.

The Bank of Italy-UIC's foreign position, calculated on the basis of a gold price of 42.22 dollars per ounce and of the new exchange relations, amounted to 3,454 billion on February 13; on April 30, the total was 3,501 billion. From February 15 to April 30, the banks' indebtedness, excluding the above-mentioned operations, grew by 322 billion. During the same period, recourse to compensatory loans was almost non-existent; instead, a few funding operations took place, moving the due dates of these debts to between 1976 and 1980.

After February 13, intervention policy on the exchange market was, in principle, based on the need to avoid, as far as possible, sharp swings in rates and to earmark the possible inflow of foreign currency for the repayment of swaps, debts with banks, and the compensatory loans. As it happened, currency influxes were only registered during the second half of February. These did not amount to much and were mostly used to repay swaps. Instead, during the following months it became necessary to intervene occasionally through currency sales, to avoid too great a depreciation of the lira; nonetheless, these sales did not affect the volume of reserves, given the influx, in April and May, of the receipts of loans taken out by ICIPU (public utility credit institute) and IMI (Italian industrial credit institution).

From balance-of-payments data it emerges that capital movements in 1972, particularly those linked with a different use of the terms of payment for exchanges of goods, led to the building of a deficit: as a result, the net outflow of funds amounted to 1,345 billion lire, versus 374 in 1971. The current account balance also deteriorated, although only slightly: between 1971 and 1972, the relative surplus in fact dropped from 981 to 844 billion; this result was influenced by unusual factors, such as large imports of gold, moreover at rising prices, during the last four months, and the above-mentioned distortions in flows from tourism and emigrants' remittances.

During the first months of 1973, excluding March when results were distorted by the customs strike, a large increase was registered in imports, along with a marked slowdown in exports. The former are

moving up at a vigorous pace, in connection with revived productive activity and the replenishing of inventories: their value was inflated further by the rise in international prices and by the impact of the lira's depreciation. The slowdown in exports was influenced by shortages in the supply of mechanical engineering products, the result of prolonged strikes. On the whole, during the first four months, the balance of payments registered an overall deficit of about 550 billion lire, two-thirds of which in January alone when large numbers of investors made heavy purchases of foreign securities.

On the basis of the exchange rate relations – as they unfolded in the first three weeks of May – between the lira, the Community currencies and the dollar, the weighted average devaluation rate, in respect to exchange rates on February 9, was 8.50 per cent for imports and 9.70 per cent for exports. These relations allowed manufacturers to transfer costs onto the prices of their products without harming their competitive position.

We have stated that the policy followed by the monetary authorities during 1972 was based on the need to keep the balance-of-payments constraint from undermining those moves aimed by-and-large at stimulating a recovery of productive activity. On the other hand, the origin itself of upward price movements seemed to rule out that satisfying results might be obtained by manoeuvring monetary aggregates. In January of this year, this interpretation of the facts was accepted: once the two-tier market had been set up, it was decided that part of the enterprises' burden of social security contributions would be switched over to the government. The cost of labour, but not wages, had reached, and in some cases surpassed, the level registered in the other Community countries, the difference due wholly to the enterprises' social security burdens. Transference to the government of part of these contributions was seen as a move towards lining up the Italian economic structure with that of the remaining European countries.

Had this measure been put into force immediately, focused on the manufacturing industry sector and linked with price controls on products of the major industries it would have been effective in fostering the revival of production and curbing inflationary pressures. But, since it was designed to include all the enterprises, rather than a chosen few, important power centres made no move to get it approved. Once again, it appears that the economic policy followed in our country tends towards keeping the production system perma-

nently afflicted, every now and again promoting some merciful intervention to bring thanks showering down upon the inner circle backing these measures. The most obscure scruples are invoked to obstacle measures benefitting all the enterprises; however, these scruples vanish the moment it is a question of increasing the endowment funds of the state-holding companies. We have not yet rid ourselves of our ancient predilection for tyrannical laws which, being of use to one or to few, are most ensnaring.

While the balance-of-payments constraint weakened, steps were taken on the international and Community level to strengthen existing anti-inflationary policies. The OECD member countries committed themselves to coordinating their respective fiscal and monetary policies, in an attempt to help curtail inflationary phenomena; more specifically, the Community countries established ceilings on the creation of money. Most countries overshot these bounds.

In 1972, the United Kingdom's money stock increased by 25 per cent against an increase of about 11 per cent in income at current prices, about 7 per cent of which stemming from price rises. The lowest rate of increase for the money stock (12 per cent) was registered by the Netherlands against an increase of 14 per cent in income at current prices, 10 per cent of which due to price rises. With regard to the other countries, increases were registered at intermediate rates, although certainly higher than growth rates for income at current prices; Italy showed an increase of 18.6 per cent, against a 9.3 per cent increase in income and 5.9 for prices.

The goals which the Community bodies set for themselves have not been accomplished. On the other hand, the tightening of monetary policy would immediately tend to affect mainly the level of output; in fact, in the Community countries, the inflation component linked with cost increases is more dynamic than pressures arising from increased demand. In addition, the money stock is only one of the components determining credit volume: an equal increase in means of payment can support widely differing levels of expansion of overall credit. It is this latter variable, in particular, which must be watched if we wish to correct, over the short run, the volume of overall demand; in most countries, its rate of development also widely exceeded that of income at current prices.

In the first quarter of this year, further upward impulses from abroad, superimposed on the ongoing rise in domestic costs and prices, caused the rate of price increases in Italy to move up to among

the highest being registered in the industrial countries; nonetheless, the increase seems among the lowest in the manufactured goods sector, whereas there was a particularly large upswing in the agricultural and industrial raw materials sector, where imports carry considerable weight. Progress was made towards restoring more balanced conditions for the enterprises; the economic system was shaken out of the lethargy in which it had seemed to loll in the recent past. This opinion is confirmed by the latest data on industrial production, even though in the first quarter of the year the overall index, seasonally adjusted, dropped by almost 6 per cent compared with the last quarter of 1972; this fall-off was, in fact, greatly influenced by production slowdowns in the wake of strikes in the mechanical engineering sector preceding the signing of the national contract. If this sector is excluded, the slowdown in productive activity is reduced by two-thirds, which indicates that, after the previous quarter's hefty increases, production is evening out to a level over 5 per cent higher than the 1972 average.

Information provided by our branches reveals that the private enterprises, after having refrained from increasing investments in 1972, are now behaving differently: it seems that large-scale investments projects are being carried out all over the country. The trend, even for the large enterprises, is towards medium-sized production units scattered throughout the nation but tending to be located where there is less industrial congestion, and especially in the Mezzogiorno. The new productive set-up seems to be based on medium-sized plants that revolve around a central decision-making body as far as concerns investment planning, financing and marketing. If, however, we are witnessing a promising revival of private initiative, the same sources reveal that these investments will not promise much new employment.

As regards financing methods, in Northern and Central Italy about half the funds were raised through indebtedness while in the South the amount was about two-thirds.

The first thrust towards recovery was provided by foreign demand and by stockbuilding, spurred by expectations of changes in the tax system, while the contribution of public expenditure for social infrastructures was a meagre one. The same forces at the origin of those imbalances which hindered an upswing are still at work within the economic system. Signs of growing tensions in various sectors are looming on the horizon. Price increases could upset the expansion of economic activity.

The awareness of the difficulty of bringing downward pressures on prices through recourse to fiscal and monetary policies has led a large number of countries to set up administrative controls on prices and incomes. The controls were effective in temporarily slowing down the growth rate of costs and prices, allowing the increase in demand to foster an upswing in production. Although the dismantling of those controls was met by a rapid surge in prices, the experiment does not warrant a negative assessment. There is no reason to rule out the use of this instrument in Italy although, in the awareness that this country lacks the proper administrative structures, the scope ought perhaps to be limited.

The periodic comparison between demand and potential supply essentially leads to an examination of the increase in public expenditure and of its consistency with development lines in the private sector. The estimates for 1973 show that, on the basis of the exchange rate relationships between the lira and the Community currencies, the balance of payments should close in approximate equilibrium. This forecast is based on the assumption that policy measures succeed in slowing down the inflationary pressures present in our economy bringing them back to levels close to those being experienced in most of the industrial countries, as well as in keeping the possible current account deficit within an amount that can be financed with inflows of capital. Another condition is that the government sector's net indebtedness must not accelerate with respect to the growth rate of the first part of the year.

Conditions are looming that will make it necessary to use demand-regulating instruments in order to curb pressures on real resources: there will appear a clear-cut need for corrective intervention through increased taxation. If interventions to regulate demand are carried out through monetary policy measures, they are bound to run up against the tightening of constraints due to the expansion of the volume of long-term securities created for financing the public sector's needs.

The amount of outstanding bonds will, in time, create complex problems: at the end of 1965, the volume of outstanding securities was about 13,000 billion lire; for those issued by the Treasury, it was about 4,000 billion. At the end of 1972, the volume of outstanding securities hit the 41,000 billion Mark and those issued by the Treasury, 16,000 billion. Given this recent upswing, their average maturity is much longer, thus market yield fluctuations, albeit slight,

bring about massive changes in capital value. This circumstance stresses the need for a continuous action aimed at defending the price of securities, in order to ensure an adequate demand by the public; however, monetary base creation must be viewed as a function of securities price pegging necessities. Therefore, possible restrictive action must be limited to other channels of monetary base creation and, more specifically, to direct bank financing. In the last five years, the percentage of securities in the Bank of Italy's portfolio rose from 6 to 15 per cent of total outstanding issues.

The policies which we have followed during recent years, when intervening on the bond market, have made possible the easy placement, at sufficiently low interest rates, of large issues of both public and private securities. From this point of view, the setting up of the external two-tier market for the lira and the floating of exchange rates provided us with greater freedom.

It would seem advisable to reduce, at least relatively, the volume of issues by augmenting taxation. It is no less important to have a more segmented structure of public debt so that short-term rates can fluctuate more widely and, at the same time, some stability for long-term rates can be ensured if necessary.

In the past, the large volume of public bonds has not made it possible to carry out adequately an interest-rate policy in line with the achievement of goals; when we begin to progress towards a European system of fixed exchange rates, control over short-term interest rates will have to be sufficiently elastic. It is to be hoped that, in the future, long-term public securities will only be issued in order to finance cash requirements resulting from investment expenditure and that, when necessary, financing through short-term securities will also be permitted.

One cause of the central bank's increased difficulties in regulating monetary base, was the massive transfers made by the Treasury to the regions of funds which were then deposited with the banks. These transfers result in an upswing in the volume of liquid funds available to the banking system as a whole: however, they are spread unevenly within the system, since the banks compete fiercely in order to acquire them. This has a corroding influence on competition: the acquisition of funds is bargained over in a way which contradicts the system's logic and causes distortions in credit activity. We shall suggest that the authorities impose specific compulsory reserves for these regional funds.

The present economic recovery has been interpreted in contrasting lights: some people put stress on the rise in output, others on the accompanying rapid expansion of prices. The latter took place both because inflation is rife throughout the world and because, over recent years, it was only curbed in our country to the extent that we did not manage to expand demand. Numerous factors concurred to pressure the upward spiral of costs; increases in unit costs were not transferred onto prices and, as a consequence, the equilibrium of the firms suffered. Under these conditions, no policy could have enabled the system to achieve nearly full utilization of productive capacity without passing through inflation. We issued frequent warnings on this count. Today, however, in a period in which the system is nearing full utilization of available facilities, given the existing limits on such utilization, the solution to the problems that are arising is mainly the responsibility of the monetary authorities.

The balance of payments on current account is developing in such a way as to confirm that we have nearly reached that point of utilization. A deficit could be tolerated for a short time, to the extent in which it was related to an expansion of investments aimed at strengthening the production structure. It is our belief, however, that we must reject the idea that the possible formation of a deficit should be neutralized by further variations in the actual exchange rates between the lira and the Community currencies. Fiscal and monetary policy intervention must conform to this constraint.

A revival of productive activity without the corresponding effective utilization of resources in both the public and private sector is in danger of being only short-lived rather than the long-awaited beginning of a new expansionary phase.

Therefore, it is necessary to review carefully the policies followed in recent years, which have been too highly directed towards maintaining existing employment structures. By crystallizing the status quo and offering a sort of public guarantee for the permanence of production factors in low productivity areas, such policies have actually worked counter to full employment.

In view of this, we should go back to the drawing board with plans that have not borne their expected fruits in order to reduce the huge deficits that have cropped up in the transport and postal services sectors and in public services in general. Thus, we can avoid that measures aimed at restructuring the sectors do not themselves become, in practice, a means of financing outdated structures.

Within the framework of industrial policy, it will also be necessary to reduce the importance that has been given to interventions, such as the act for the textile industry which, as it worked out, has merely meant the indiscriminate allocation of subsidized resources, rather than selective support of the sector's more economically viable businesses; Law No. 1470, in various and even recent reincarnations, regarding the reorganization of small-sized industries, which, as experience has clearly shown, has had a long and negative record in serving to overcome crises; or in some way GEPI (the state industrial management and holding company) which, in our opinion, can hardly be allocated continually growing resources.

There is no escaping the fact that the tendency to keep the present situation alive is sanctioned by the politicians, entrepreneurs, and trade unions. Underlying this behaviour, legitimate motives of a social nature mingle with others, certainly less explicit but nevertheless present, based on defending outright positions of privilege.

\* \* \*

The manoeuvring space allowed the central bank has shrunk and is still shrinking, as a result of the growing impact of decisions regarding the volume of government expenditure and its use, incentives to public and private investment and, above all, the definition of labour relations. We shall do the best, within our power, to make sure that the recovery of economic activity is not hindered by financial hurdles. This depends on the maintenance of a continuous flow of investments, and this continuity in turn, under the present institutional system, is highly determined by the financing of the industrial credit institutions. These institutions raise funds, for the most part, through bond placements which have to compete with placements by the real-estate credit institutions and state holding companies. The above-mentioned demand for funds must be coordinated with the government sector's funding needs and the latter are not adjustable over the short run. The central bank may be compelled to purchase securities to the extent required to ensure the smooth running of the securities markets. Otherwise, a percentage of total financing might have to be raised through recourse to short-term credit. In coincidence with fewer purchases of securities by the central bank, there might be a corresponding increase in its financing



to the banks, if we wish to maintain a steady flow of credit to the productive sectors; in this case as well, money would be created. Should it become necessary to limit the overall volume of credit, the reduction, owing to the rigidity of the public sector's demand, would mainly affect the directly productive sectors. Shouts of protest would again be raised; the monetary authorities would be blamed for creating a situation that arises from a widespread incapacity in this country to manage our affairs in a modern, clear-sighted, innovative fashion. The foregoing chain of events will surely take place unless proposals for further government expenditure are resisted for the time being.

Throughout the course of the debate on monetary policy, the Bank of Italy's behaviour has been assessed in various ways, nonetheless there has been general consent on the efficiency of the central bank. These acknowledgements are received with pride by our personnel; if we deserve any praise at all it is only because we have acted independently while performing our duties. Nonetheless, warning should be given that along with this increased efficiency we have found ourselves with less scope to display it in concrete moves, because of contrasting steps taken elsewhere which have led to changes in the economic conditions. The harmonization of goals must precede and not trail behind monetary policy moves; it cannot take place without the cooperation of the trade unions: from the role of conflict strategists, they must shift over to the role of participants in the management of the economy. Nor can there be harmonization without the cooperation of the entrepreneurs, who are duty bound to make the institutional framework in which they operate more acceptable, showing their awareness of the fact that, in a modern society, the contrast between *ostentatious wealth and accursed poverty* is becoming increasingly intolerable.

The above remarks would tempt me further along a path leading far from monetary policy themes. Its direction is towards the great themes facing our society. Thus, let me conclude by using the words of a famous Italian, Giustino Fortunato. "No country ... is more backward than our own in its sense of freedom. What is our idea of a free man, according to our ancient creed? Not one who is equal to another, and like him subject to the same law, but he who is his own master and has, at the same time, power over others. Only he who can command, only he who need not obey is free and his own master. And this is why, not only are our people the most individualistic, but

also the most authoritarian in the civilized world: authoritarian to the very core; such is our legacy, our education, our surroundings. Either slaves or masters, inherently rebellious or domineering, this is our nature; obeying the fundamental, unquestionable right of each man from the early ages on to enforce his own law. This is our inheritance, and it still courses through our veins ... unless Italy wants, sooner or later, to revert to what she was ... our most compelling task is to educate; this, then, must be our starting point: a long, vast and difficult task, if to educate means to make the unaware aware, but a worthy and a noble one. It is not enough to assert that freedom is everything; however, to say, as others have said, that absolute rule is preferable to freedom, runs against civilization and contradicts history”.