

Sunset of the "Economic Miracle"

1. The crisis of 1962-63

The postwar years saw a steady improvement in the balance of trade as exports continuously outpaced imports.¹ Italy's share of world trade increased from 3.2 per cent in 1953 to 5.3 per cent in 1963.² The improvement in the balance of payments, which, as mentioned, recorded substantial surpluses, was even more evident. But from early 1959 to June 1962 an increasing payments surplus was accompanied by a robust expansion in domestic demand, industrial production and exports. As long as Italian unit labour costs in manufacturing remained below the level prevailing in the other industrial countries and Italian export prices were competitive, domestic demand, production and exports grew at quarterly rates of 3, 3 and 5.4 per cent respectively. These relationships changed greatly between July 1962 and December 1963, as the quarterly rate of increase in exports fell to 1.6 per cent, that of domestic demand hovered around 3 per cent and that of production declined to 2.2 per cent.³ Simultaneously, imports increased. The imbalance between production and consumption was promptly reflected in the balance of trade, and the trade deficit, which had been modest for quite a few years, ballooned from \$138.6 million in 1959 to \$578.1 million in 1961, and then jumped to \$915.1 million in 1962 and \$1,903 million in 1963.⁴

While some considered the severe crisis that rocked Italy between 1961 and 1963 the outgrowth of an adjustment, working off Italy's persistent balance-of-payments surpluses, others did not rule out the possibility that the excess of imports and simultaneous contraction in exports might be due to price problems, reflecting a loss of competitiveness for Italian products. Accordingly, the prime objective of economic policy had to be the promotion of higher productivity, for the purpose of ensuring Italian workers a lasting prospect of full employment; and since productivity gains depended on increased capital investment in production, new technologies had to be rapidly introduced.⁵ In reality, however, what grew was not so much investment demand as domestic consumer demand.⁶ Between November 1962 and August 1963 the deficit arising

¹ G. Miconi, "Foreign trade in the last 10 years (1954-1963)", *Review*, XVIII, 1 (January 1964), p. 87.

² L. Lacci, "New changes of tendency in Italy's economic structures", *Review*, XXVIII, 4 (July 1974), p. 298.

³ F. Masera, "Foreign trade in the present economic situation in Italy", *Review*, XX, 1 (January 1966), pp. 34 *et seq.*

⁴ F. Ventriglia, "Results and prospects of the policy for Southern Italy", appendix, *Review*, XXVII, 1-2 (January-March 1973), p. 27.

⁵ Masera, "Foreign trade", pp. 22 *et seq.*

⁶ *Ibid.* p. 30.

from the growth in imports to satisfy galloping domestic consumer demand was covered by Italian banks with borrowings of \$1,219 million from foreign counterparts.⁷

2. Towards planning

To comprehend the causes of the crisis, one must recall that postwar reconstruction had been entrusted primarily but not exclusively to market forces. Not only had the government established ENI to promote and guide development in the energy and petrochemical sectors, but for similar reasons it had also strengthened IRI and made the latter responsible for the large-scale reorganization of the steel industry.

With autarky abolished, Italy once again began to operate within the horizon of a mixed economy. There were sectorial plans and programmes. The "annual overall plans" for imports for the years 1946, 1946-47 and 1947-48, aimed at coordinating international aid with the process of economic growth; the long-term 1948-49/1952-53 Programme or Tremelloni Plan (named after the minister who had proposed it in connection with the Marshall Plan), sought to lay the foundations of economic rebirth not only with land reclamation and irrigation but also with agrarian reform, the division of great estates and the provision of aid for farm modernization; the creation of the Southern Italy Development Fund and a 10-year programme of investment in the depressed areas of the South. Plans were unveiled for oil refining, oil and gas exploration, the reorganization of shipyards, the construction of low-income housing, agricultural development (the 10-year plan included in Law 949 of 25 July 1952), and other sectors.⁸

As the economy advanced, the conviction took root that better results would be achieved if state interventions were framed in a general plan setting objectives and priorities. In 1954 these discussions gave birth to the Vanoni Plan, named after the budget minister who presented it. More than an actual plan, the Vanoni Scheme (as it was also called) was an analysis of Italy's economic situation and an approach for coordinating economic policies, based on a forecast of 5 per cent annual growth in national income, with a view to eliminating unemployment, creating jobs for labour market entrants, achieving balance-of-payments equilibrium and reducing the socio-economic gap between North and South.

The Vanoni Plan did not inaugurate a planned economy, since it did not envisage the creation of bodies vested with decisionmaking and control powers and the associated procedures. Still, large sectors of Italian political opinion were increasingly persuaded that Italy's remaining economic and social problems could best be tackled through expanded government intervention, a more activist approach and more effective structures and instruments for economic

⁷ *Ibid.*, p. 36.

⁸ See Chapter IV.

management. This was, in part, because the Vanoni Plan had not marked the passing of economic policy conducted according to sectorial plans (motorways, railways, the agricultural plan, school construction, etc.), even though its forecast of 5 per cent income growth was met with room to spare: 6.6 per cent in 1959, 6.8 per cent in 1960 and 7.9 per cent in 1961.⁹

It was no coincidence that the idea of basing national economic policy on a less indicative, more general plan than the Vanoni Scheme arose with the political crisis of 1960-62 and the passage from Centrist governments to the Centre-Left coalition. It was the first Centre-Left government, with Ugo La Malfa as budget minister, that proclaimed the need for firmer coordination of government economic policy. The outcome was the "Additional Note" approved by Parliament on 22 May 1962. The Note opened by observing that sectorial and regional economic imbalances and social disparities continued to plague Italy despite the country's high rate of economic growth. It was therefore necessary for economic policy to adopt every measure necessary in order to balance the process of growth.¹⁰ Accordingly, on 6 August 1962, the newly instituted National Committee for Economic Planning, including representatives of business and the trade unions as well as non-partisan experts, was charged with drafting a document setting the guidelines for the government's economic programme. In March 1964 the document, signed by Pasquale Saraceno, deputy chairman of the Committee, formed the basis of the five-year economic programme for 1965-69¹¹ which Antonio Giolitti, La Malfa's successor as budget minister, presented to the National Economic and Labour Council.

The programme's goals for 1969 were to bring unemployment down to 1.5-1.6 per cent, compared with 2.7 per cent in 1964; to reduce the difference between farm and non-farm incomes by increasing agricultural production at an annual rate of 2.8-2.9 per cent and cutting agricultural underemployment by 750,000; to locate 40-45 per cent of all new non-farming jobs in the South, compared with 25 per cent in the 5 years from 1959 through 1963; and to raise the proportion of disposable domestic resources allocated to social uses (housing, education, social security, scientific research, transport, etc.) from 24 per cent in 1959-63 to between 27 and 27.5 per cent. These objectives assumed continued national income growth of 5 per cent a year, provided employment and productivity gains were in line with the forecasts and resources were allocated as planned among investment, social expenditure and consumption.¹²

⁹ F. Mascera, "Recent developments in the Italian balance of payments", *Review*, XVI, 6 (November 1962), p. 497.

¹⁰ G. Pieraccini, "The five-year economic development programme (1965-1969)", *Review*, XIX, 2 (March 1965), pp. 103-107.

¹¹ *Ibid.*, p. 107.

¹² *Ibid.*, pp. 107-108.

3. Social and collective consumption

As can be seen, the government proposed an expansion of social consumption, to be charged mainly against productive investment and Italy's long-term external equilibria. In a lucid analysis, Francesco Masera, a senior manager of the Bank of Italy, pointed out that this seemed to imply a transfer of the role of flywheel of domestic economic growth from exports and the private investment to the public sector. Masera expressed serious doubts about the real possibility of channelling private savings largely towards consumption of a kind that would enhance productivity, given that the tax system discouraged the employment of equity capital in financing production. The economic structure taking shape was, he said, unstable and based on a model that could be considered valid only for the short run at best. In his view, the aims of Italian economic policy were tending to slide from the production to the use of income and did not assign enough weight to the necessity of increasing the presence of invested capital in the context of European integration.¹³ In any event, the programme was not a success. As early as 1968, with the plan still having to run its course, the figures fell short of the objectives.¹⁴

4. The fall in profit margins

Clear signs of an improvement in exports emerged while the 5-year economic plan was still on the drawing board. Exports began to revive in late 1963 and strengthened progressively over the 18 months between January 1964 and June 1965. In terms of quarterly measures, production grew at an unchanged rate, exports by 6.1 per cent p.a. and domestic demand by only 2 per cent.¹⁵

With exports rising and imports falling, the surplus on the current account of the balance of payments began to grow again. On the other hand, fixed capital investment declined by 8 per cent in 1965 after contracting by 10 per cent in 1964, even though the 1965 surplus had not only provided a good margin of saving for investment but had also allowed Italy to repay around \$500 million of short-term commercial debt, so that Italian banks' foreign indebtedness fell from \$618 million to \$194 million in the 12 months to December 1965.¹⁶ Finally, the positive performance of the balance of payments helped to increase the central bank's net reserves by \$972 million.¹⁷ As Livio Magnani reported in a 1968 essay,¹⁸ the remarkable expansion of exports, notwithstanding a stiff increase in

¹³ F. Masera, "Italy in ten years of the Common Market", *Review*, XXI, 5 (September 1967), pp. 386-87.

¹⁴ Lacci, "New changes of tendency", p. 298.

¹⁵ Masera, "Foreign trade", pp. 31 *et seq.*

¹⁶ *Ibid.*, p. 36.

¹⁷ *Ibid.*, p. 35.

¹⁸ L. Magnani, "Evolution of Italy's trade with abroad", *Review*, XXII, 5 (September 1968), p. 369.

labour costs, persuaded some experts in Italy and abroad that Italian price competitiveness had not depended so much on the variations in labour costs as on the size of planned profit margins.¹⁹ In other words, Italian producers had trimmed their margins in order to sustain exports. Other observers maintained that the export expansion had been due mainly to the undervaluation of the lira, a position which Magnani said was borne out by a comparison between the trend of Italian prices with price trends in the main industrial countries. The trend had worsened in Italy in 1964, improved in the next two years and then deteriorated slightly again in 1967. The latter year saw strong growth in domestic demand, especially for capital goods,²⁰ and a contraction in exports owing partly to the weakening of demand in West Germany and the decline in Italian products' competitiveness and partly to the surge in oil prices caused by the war between Israel and Egypt, which had resulted in the closing of the Suez Canal. This had repercussions on the balance of payments.²¹

5. The flight of capital from Italy

Although imports continued to mount, in July 1968 the current account of the balance of payments still showed a substantial surplus and prices were nearly stable. But rising social protest and other factors revealed an increasing softness in the economy. This prompted the government to attempt to stimulate the economy and stem the outflow of capital with a firmly expansionary policy. Accordingly, the target of GDP growth, which had been set at 5 per cent p.a. in the Forecasting and Planning Report submitted to Parliament on 30 September 1968, was now revised upwards to between 6.5 and 7 per cent.²² Instead of seeking to reinvigorate domestic demand by spending on enhancement of physical infrastructure and human capital, the government opted for an increase in public pensions in November 1968 and, a few months later, a civil service pay raise.

This injection of public spending increased demand. But if the measures mentioned above boosted GDP growth, which approached the target of 7 per cent, they also caused prices to accelerate and thus further fuelled domestic tensions. To be sure, the rise in prices did not affect foreign trade,²³ since the situation in 1969 was completely unlike that which had prevailed in the early

¹⁹ *Ibid.*, p. 374.

²⁰ *Ibid.*, p. 377.

²¹ *Ibid.*, pp. 369 *et seq.*

²² F. Ventriglia, "The balance of payments and Italian economic growth", *Review*, XXIII, 5 (September 1969), pp. 397 *et seq.*

²³ Between May 1968 and June 1969 wholesale prices rose by 2.4 per cent in Italy, less than in Belgium, Germany, the United States and France. The rise in retail prices was a good deal smaller in Italy than in the other EEC countries, the United States and the United Kingdom. *Ibid.*, p. 386.

sixties. In 1963-64 retail prices had increased by 7.5 per cent owing to a cost-push inflation; in 1969 the payments deficit was not due to an excess of imports but reflected capital movements.

There was, in fact, a steadily growing outflow of capital. The deficit on capital movements rose from 492 billion lire in 1968 to 1,129 billion in 1969. Whereas the foreign currency reserves had increased by 110 billion lire between 1967 and 1968, in the first seven months of 1969 they decreased by 180 billion, despite the restrictive measures that the monetary authorities had introduced in March. Although those measures had admittedly been essential to prevent a fall of 534 billion in the reserves, they could not be easily repeated. A further deterioration in the situation would imperil the official reserves, which amounted to around \$5 billion.²⁴ The example of France stood as a warning. Following the events of May 1968, France's official reserves had plummeted from \$5.7 billion in early June 1968 to \$3.6 billion a year later. An identical pattern was observed in Britain. In short, Italy, like France and Britain, was running the risk of a currency devaluation, while the flight of capital threatened to bring economic growth to a halt.

The flight of capital from Italy reflected a combination of factors: higher interest rates abroad, especially in the United States, where banks were offering as much as 13 per cent at a time when local inflation was holding at between 7 and 8 per cent; the lower risk of taxation of capital abroad; the political situation in Italy, where youth rebellion was accompanied by severe labour conflict and protest strikes against the Vietnam war, translating into enormous losses of man-hours.²⁵ The nation's increasingly frayed political and social fabric left little choice: either Parliament had to show its resolve to eliminate the causes of flight of capital, protecting the reserves and restoring the equilibrium of the external accounts; or else the monetary authorities, charged with safeguarding the external and internal value of the lira, would have to rein in growth, dealing a blow to the more developed parts of the country and frustrating the efforts for the economic rebirth of the South.²⁶

6. Labour conflict and absenteeism

Between August and December 1969 the seasonally adjusted annualized growth rate of industrial production (excluding construction) contracted to 2.2 per cent. It rebounded to 6.8 per cent in the first two months of 1970 before plunging to an average of 1.4 per cent over the next four months.²⁷ In effect,

²⁴ *Ibid.*, pp. 386-87.

²⁵ *Ibid.*, pp. 389-95.

²⁶ *Ibid.*, p. 388.

²⁷ *Ibid.*, p. 381.

industrial production recorded a serious setback²⁸ mainly on account of labour conflict. Millions of man-hours of production were lost to strikes for numerous contract renewals: 40 million in the autumn of 1969, 4 million a month in January and February 1970 and 9.6 million a month in March through June. The effect was compounded by the impossibility of resorting to overtime.

These developments had an impact on monetary policy. Between July 1967 and December 1968 the growth in the monetary base had been in keeping with the surplus on the balance of payments, while the growth in lending to the banking system and to the public sector had made it possible to hold nominal and interest rates unchanged, even though rates were rising abroad. At the same time, Italian bank lending abroad had increased. The situation changed radically at the turn of 1969. From January 1969 to June 1970, as the payments surplus gave way to a deficit and Italian credit positions were cancelled, the growth in the monetary base served primarily to cover the public-sector deficit, curtailing the scope for banking lending to the private sector.

With 1969 a period opened in which the demand for money grew more rapidly than supply. The result was a rise in domestic nominal interest rates and an increase in prices, i.e. a dose of inflation, which, it was hoped, would propel the economy towards full employment and slow down the flight of capital.²⁹ The year 1970 thus closed with a deficit on the current account of the balance of payments, notwithstanding a pick-up in industrial production in September. The figures for 1971 were worse, especially after the take-off of US inflation and the end of the Bretton Woods agreements.

7. The end of Bretton Woods and the new parities of the lira

The protracted crisis of the US balance of payments came to a head in August 1971. It had been accompanied by a deterioration in the balance of trade, which between January and July 1971 accumulated a deficit of around \$3 billion. With the dollar officially valued at \$35 per ounce of gold at a time when the free-market price of gold was considerably higher, the United States suffered a continuous leakage of gold. Seeing no prospect of stemming the outflow of reserves and reversing the trend, on 15 August 1971 President Nixon suspended the dollar's convertibility and imposed a set of tax, financial and commercial measures.³⁰ This buried the Bretton Woods agreements,³¹ which for nearly three decades had fostered unprecedented growth in world trade and had led countries to develop by following policies radically different from those of the period between the wars.

²⁸ F. Masera, "Interest rates and prices in recent Italian experience", *Review*, XXV, 3 (May 1971), pp. 173-74.

²⁹ *Ibid.*, pp. 174-79.

³⁰ R. Ossola, "The international monetary crisis currency realignment", *Review*, XXVI, 1 (January 1972), p. 5.

³¹ *Ibid.*, pp. 5 *et seq.* and 15 *et seq.*

The end of the Bretton Woods system did not fail to raise questions and reflections on the reason for the system's breakdown and demise. The *Review* weighed in with an article by Rinaldo Ossola, who stressed the consensus view that the system's failure was due not to any intrinsic flaw but to the way in which it had been managed by the individual member states. Effective rules ensuring sufficient worldwide liquidity for growth would have been necessary to avert the breakdown, Ossola remarked. In the late fifties, when the largest disequilibria had emerged in the system, neither the countries in deficit nor those in surplus had taken adequate steps to eliminate the imbalances, apart from the minor realignments of 1961. "The system, in effect, ended up by encouraging those international monetary crises which it was meant to avoid".³² Its inability to regulate and adjust the payments deficits and surpluses of the member states had prompted the United States to decree its end. Nixon had found it impossible to halt or reverse the growth in America's payments deficit; standing pat would have meant a deficit of no less than \$11 billion by the end of 1972, Ossola acknowledged.³³

In addition to the above-mentioned measures, Nixon took steps regarding trade relations between the United States and the other industrial countries and called on Japan, Canada and the European Economic Community to cover a greater part of the cost of their defence and to satisfy several demands advanced by U.S. exporters. According to the suggested American agenda, the United States and the European Community would in 1972 re-examine the existing agreements, eliminating or amending those that harmed US exports, and in 1973 undertake a total revision of their trade relations. Some regarded the U.S. proposals as an attempt by the U.S. to shift the burden of adjusting its external accounts onto other countries belonging to the Group of Ten.³⁴

Numerous meetings ensued at various levels during the second half of 1971 within the European Community joined by the United Kingdom (which had gradually been approaching the Community), the Group of Ten and the IMF. The result was a decision on 18 December 1971 to set new parities between the various currencies, to be announced by each country individually. Compared with the dollar parities in force on 1 May 1971, the yen was revalued by 16.9 per cent, the German mark by 13.58 per cent, the Dutch guilder and Belgian franc by 11.57 per cent, the French franc and British pound by 8.57 per cent, the Swedish krona by 7.49 per cent and the lira by 7.48 per cent. The dollar was devalued by 7.89 per cent and the official dollar price of gold increased to \$38, but actual convertibility was postponed until after the resolution of the trade

³² R. Ossola, "The shape of international monetary reconstruction", *Review*, XXVIII, 1 (January 1974), p. 3.

³³ Ossola, "The international monetary crisis", pp. 5 *et seq.*

³⁴ *Ibid.*, p. 6.

problems between the United States, the European Community, Japan and Canada.

The lira's parity against the dollar, which on 30 March 1960 had been set at 625 lire,³⁵ was now fixed at 581.50 with a fluctuation margin of plus or minus 2.25 per cent, allowing the lira to float between 568.40 and 594.60 to the dollar.³⁶ In the realignment, however, the lira was devalued by 3.6 per cent against the currencies of the European Community and the United Kingdom and by 2.1 per cent against those of the other G-10 countries.³⁷

8. The flight of capital intensifies

The decline of the lira had been evident as early as 1964.³⁸ Between 1959 and 1964 average annual inflation had been 4.5 per cent in Italy, compared with 2.2 per cent in the OECD area. In the five years from 1964 to 1969 the average inflation rate in Italy slowed to 2.8 per cent, whereas that in the OECD countries as a group picked up to 3.7 per cent.³⁹ But the situation changed for the worse between 1968 and 1969 and especially in 1970 and 1971, when Italian firms began to feel the effects of the contracts signed during Italy's "hot autumn" of 1969 and in the subsequent round of company-level bargaining.⁴⁰

The surge in inflation was not limited to Italy. In 1969 prices began to rise at an average annual rate of 5 per cent in the United States, West Germany, Japan and many other countries. Nor did the spiral end in 1970-71 or 1972.⁴¹ In June 1972 the United Kingdom left the monetary snake; Italy followed suit in January 1973 and France was forced to do likewise in January 1974.⁴²

The flight of private capital from Italy, which had been under way since 1963 and then had abated somewhat between 1969 and 1971, regained momentum as interest rates rose on account of the increase in the external debt of the public sector.⁴³ From the economic point of view, the phenomenon struck some observers as incomprehensible. They emphasized the paradox of a country possessing sizable foreign currency reserves that was unable to employ them

³⁵ With this parity, the exchange rate of the lira was supposed to fluctuate between 620.50 and 629.50 to the dollar. On 21 August, shortly after the new US measures were adopted, Italy informed the IMF that it had suspended the lira-dollar parity that had been in effect up to then. *Ibid.*, p. 18.

³⁶ *Ibid.*, p. 17.

³⁷ *Ibid.*, p. 18.

³⁸ See G. Miconi, "New aspects of an old problem: Inflation", *Review* XXVII, 1-2 (January-March 1973), p. 53.

³⁹ *Ibid.*, p. 54.

⁴⁰ F. Ventriglia, "The life of enterprises and the policy of reforms in Italy", *Review*, XXVI, 4 (July 1972), p. 273.

⁴¹ *Ibid.*, p. 55.

⁴² R. Ossola, "Reflections on today's international monetary problem", *Review*, XXVIII, 6 (November 1974), pp. 515-16.

⁴³ *Review*, XXVI, 4 (July 1972), p. 330.

profitably; a country that exported men as well as capital, seeing that the South had lost 2.2 million inhabitants between 1961 and 1970 (two thirds to the Centre and North, one third abroad). Put differently, Italy had gone into debt but had simultaneously made capital and labour available to the international economy.⁴⁵ Yet the problem was primarily not economic but political. This train of events stemmed from the conflicts that had "poisoned the Italian economy".⁴⁶

Those years of protests and strikes were revealing the narrowness of vision of an economic policy concerned more with conditions in the short run than in the medium and long term. The state, it was stressed, had not provided the national community with the material and social infrastructure indispensable for orderly economic growth. The ministries of public works, agriculture and education, for example, had underspent their budget allocations. The ministry of education, in particular, had limited itself to raising the salaries of certain categories of teachers.⁴⁶ The inefficiency of governmental administrative machinery had not been remedied; rather than making civil servants more responsible, increasing their autonomy and altering the rules for managing public expenditure, recourse had been had to "the overabused method of career and salary modifications".⁴⁷ In other words, investment demand had been suffocated by two hard-to-surmount obstacles. Firstly, Italian industry had grown considerably but remained confined to the traditional sectors; industry had not kept pace with innovation, had not developed new productive sectors or even done very much to modernize existing lines of production. Secondly, industrial growth had been concentrated in a handful of areas; labour had been drawn from the outside, particularly from the South, but the offer of employment in industrial centres was not accompanied by the provision of essential social services. This had been a shocking error; in addition to its deleterious effects on many immigrant workers and their families, concentration in industrial enclaves had increased workers' leverage and bargaining power.

The failure of government to provide services had made firms a lightning rod for immigrant workers' discontent over their precarious living conditions. Yet the workers' attitude had been "surprising and irrational". Permanent conflict had created a "climate of tension in the factories". Absenteeism had reached "unimaginable levels" and strikes by "small numbers" of strategically located workers had "blocked whole factories".⁴⁸

The government's largesse in dealing with public-sector employees and pensioners had been a further goad to factory workers to demand higher wages. With a view to stimulating consumer spending and thus production, the

⁴⁵ Ventriglia, "The life of enterprises", pp. 268-71.

⁴⁶ *Ibid.*, p. 268.

⁴⁷ *Ibid.*, p. 269.

⁴⁸ *Ibid.*, p. 277.

⁴⁹ *Ibid.*, p. 275.

government, rather than enacting income or consumption tax cuts on a temporary basis, had opted for irreversible measures, such as civil-service wage and pension increases.⁴⁹

The difficulties that beset the Italian economy, beginning in the autumn of 1969, were attributable to the new wage levels and the new systems of factory work.⁵⁰ The result of all this was that declining profitability and the losses inflicted on firms were accompanied by a fall in employment levels.⁵¹ The narrow range of industry and its geographical concentration, together with the inefficiency of the public administration and the inadequacy of material and social infrastructure, were also an impediment to correcting the structural deficiencies of the South's economy, which could only grow worse. To ease social tensions in Italy, it was observed, at least three sets of problems had to be resolved: housing, health care and the South.⁵²

The decline in industrial activity emerged in 1971 as the economy slowed down to an annual growth rate of 1.4 per cent, in contrast with the performance of the other industrial countries. The same year also saw a contraction in employment, low investment, strikes over contract renewals and a continuing rise in domestic prices. The situation brightened a little in 1972. GDP grew by around 3 per cent, thanks in part to exports outpacing imports. The trade deficit decreased from 540 billion lire in 1971 to 434 billion in 1972, even though imports increased from 9,901 to 11,247 billion.⁵³ But despite these improvements, the economic situation was "still critical and delicate", necessitating, as it did, a simultaneous effort "to contain prices and relaunch production".⁵⁴

9. Two Inflations: 1962-64 and 1970-72

Libero Lenti, in an analysis of price trends in Italy,⁵⁵ also recognized that Italian prices had risen considerably between 1970 and 1972. In 1962-64 and 1970-72, he added, there had been a marked reduction in productive activity, but wholesale and consumer prices had increased less than had been feared owing to the imbalance between nominal demand and the supply of goods and services. According to Lenti, this had been due to an increase in households' propensity to seek liquidity, reflecting their alarm over the economic outlook. More specifically, there had been an abnormally large increase in bank deposits.

⁴⁹ *Ibid.*, p. 273.

⁵⁰ *Ibid.*, p. 274.

⁵¹ *Ibid.*, p. 275.

⁵² *Ibid.*, p. 273.

⁵³ D. Graziosi, "Italian foreign trade. Final results for 1972 and short-term prospects", *Review*, XXVII, 1-2 (January-March 1973), p. 31.

⁵⁴ *Ibid.*

⁵⁵ L. Lenti, "Business cycles and price trends in Italy", *Review*, XXVII, 3 (May 1973), p. 123.

In the periods from 1962 to 1964 and from 1970 to 1972 Italian inflation had been primarily of the cost-push rather than the demand-pull variety, a form characteristic of periods of stagflation, i.e. weak activity accompanied by rising prices. In Lenti's view, households' high liquidity preference did not benefit firms, as forgone purchases meant lower production and higher costs per unit of output, forcing companies to mark up prices and making it harder for them to withstand international competition.⁵⁶

The two phases examined by Lenti had other consequences as well. As a result of Italian economic development between 1962 and 1972, he noted,⁵⁷ the share of net product accruing to labour in the private sector rose from 74 per cent (1951) to 84 per cent (1972) and probably increased further in 1973. By contrast, the share accruing to equity capital fell from 26 to 16 per cent. The average annual rate of gross investment sank from 9.6 per cent in the period 1951-61 to 2.1 per cent in the years 1962-72, whereas that in consumption accelerated from 4.8 per cent in the former period to 5.1 per cent in the latter.⁵⁸ Furthermore, between 1968 and 1973 GDP grew at an average annual rate of 4.23 per cent and consumption by 4.9 per cent, with a consequently modest surplus on the external accounts.

As for the relationship between foreign and domestic prices, the changes in international prices had been "ruinous" owing to the system's extreme vulnerability.⁵⁹ The latter was magnified by the rise in oil prices, the resulting increase in the cost of large-scale investments, the appreciable price rise for capital goods and the high levels of money and financial-market interest rates, making it difficult to correct the distortions in the Italian economy. In the early part of 1974 the spiralling price of crude oil, the recession in Italy's traditional export markets, eroding their import-absorption capacity, and domestic price pressures led to a substantial balance-of-payments deficit. In agreement with the international monetary authorities Italy resorted to import and credit restrictions,⁶⁰ inaugurating an economically difficult period.

10. The oil shock

As mentioned, the radical change in conditions in the oil market aggravated the state of Italy's balance of payments. Following the end of the Bretton Woods system, a succession of alternatives for repairing the international monetary system had been explored within the IMF. The questions at the centre of debate included: whether to give up fixed rates for floating rates; whether and how to

⁵⁶ *Ibid.*, pp. 123-24.

⁵⁷ L. Lenti, "Productivity and the Italian economic system", *Review*, XXVIII, 2 (March 1974), p. 101.

⁵⁸ *Ibid.*, p. 101.

⁵⁹ Lacci, "New changes of tendency", p. 303.

⁶⁰ *Ibid.*, 303-304.

strengthen the role of Special Drawing Rights; whether and how to establish links between SDRs and the public finances of each country.

As early as the IMF's meeting of September 1973, the difficulty of a practicable reform of the international monetary system appeared evident. But reform became totally inconceivable towards the end of the year when the Organization of Petroleum Exporting Countries (OPEC) decided to quadruple the price of a barrel of crude oil. This opened a chapter in the annals of the international economy in which the payments surpluses of the oil-poor industrial countries gave way to a string of deficits. The need to finance the oil deficit made it virtually impossible to divert capital from domestic requirements in order to finance the developing countries, which already had accumulated \$125 billion of debt, a figure that would only increase as a result of the oil shock.⁶¹

In response to the grave situation, between January and June 1974 the IMF decided to increase the supply of Special Drawing Rights, raising the SDR lending rate from 1.5 to 5 per cent, and to create an Oil Facility Fund for loans to finance oil deficits. To make the latter operational, the IMF rapidly raised around \$3.8 billion at 7 per cent from the oil-exporting countries, including \$300 million from Canada and \$150 million from the Netherlands. However, the only country to avail itself of the Fund was Italy, which obtained \$800 million, equal to 15 per cent of its oil deficit.⁶²

The four-fold jump in the price of oil caught the Italian economy in an expansionary phase, which rapidly came to an end. GDP growth fell from 6.9 per cent in 1973 to 3.5 per cent in 1974 and slumped further the following year. In 1975 the restrictive measures adopted by the government, coupled with the world economic recession, resulted in Italy recording negative GDP growth (-3.7 per cent) for the first time since the end of the war. An equally dramatic sign of this downward spiral was that the balance of payments swung into deficit. As early as 1973, a banner year for the economy, it showed a shortfall of \$2.7 billion. The deficit ballooned to \$8 billion in 1974 but then contracted to \$300 million in 1975 in response to a set of stringent measures, implemented in the autumn of 1975, that reined in consumption⁶³ and checked growth. Measures of this kind could not easily be repeated. When GDP growth picked up to 5.6 per cent in 1976, the payments deficit began expanding again and reached \$2.8 billion.

As the foreign exchange situation grew worse, the Italian government resorted again in the autumn of 1976 and early 1977⁶⁴ to a series of restrictions,⁶⁵

⁶¹ Ossola, "Reflections on today's international monetary problem", p. 516.

⁶² *Ibid.*, pp. 516-19.

⁶³ G. Magnifico, 'The Italian balance of payments in the present international situation', *Review*, XXXII, I (January 1978), p. 13.

⁶⁴ *Ibid.*, p. 19.

⁶⁵ Including a stiff increase in direct and indirect taxes and in public service charges. The measures reduplicated those adopted in the autumn of 1974. *Ibid.*, pp. 16-17.

which eliminated the payments deficit but also slowed GDP growth to a rate of around 2 per cent.⁶⁶

But in 1977, with the restrictive measures still in effect, GDP grew by barely 1.7 per cent, while the balance of payments showed a surplus of around 2 trillion lire. Exports rose by 5.8 per cent, imports fell by 1 per cent and inflation decelerated.⁶⁷ Inflation, nonetheless, remained higher than in the other industrial countries. However, thanks to the strong showing of the balance of payments, in September 1978 the discount rate was reduced from 11.50 to 10.50 per cent, and, as in 1977, the government again moved to curb the budget deficit by raising some taxes and bringing forward the collection of others.⁶⁸

This suggested that, as long as energy costs remained high, balance-of-payments equilibrium could be obtained only by throttling back social growth, i.e. with large and growing exports of goods and services,⁶⁹ stimulated, in fact, only by lowering the value of the lira. Between February 1973, when the floating-rate regime became general, and the end of 1977, the lira depreciated by 34 per cent against the dollar, but most of its slide occurred between January 1976 and October 1977, when the loss in value came to roughly 23 per cent.⁷⁰ However, 1978 was an especially auspicious year for the Italian economy, according to Michele Fratianni: compared with the previous year, annual inflation subsided from 18 to 13 per cent, the rate of increase in labour costs in industry slowed from 19 to 11 per cent, the rise in prices of imports declined from 17 to 4.5 per cent, profits improved, the growth in industrial output picked up from zero to 2 per cent, GDP growth rose from 1.7 to 2.6 per cent and Italy's foreign exchange reserves more than doubled. Still, the rate of growth of output was only a fraction of what it had been in the fifties and sixties.⁷¹ However, between 1974 and 1978 the lira weakened by 33 per cent, against the currencies of the 17 leading industrial countries, while recording a trade-weighted depreciation of 11.4 per cent, owing primarily to the far-reaching system of exchange controls that the government established in 1976.⁷² Between 1974 and 1978 the rise in the wholesale prices of manufactures was 21.6 per cent larger in Italy than in the 17 leading industrial countries as a group.⁷³

Exchange controls, credit restraints and fiscal tightening were not the sole factors responsible for containing the external deficit. Alongside domestic borrowing, Italy resorted to foreign debt, drawing on the Oil Facility Fund and,

⁶⁶ *Ibid.*, p. 14.

⁶⁷ C. Ruini, "The prospects of the Italian economy", *Review*, XXXII, 5-6 (September-November 1978), p. 355

⁶⁸ *Ibid.*, pp. 355-58.

⁶⁹ Magnifico, "The Italian balance of payments", p. 19.

⁷⁰ *Ibid.*, p. 15.

⁷¹ M. Fratianni, "The Italian economy in 1978-79", *Review*, XXXIII, 1 (January 1979), p. 35.

⁷² *Ibid.*, p. 24.

⁷³ *Ibid.*

in August 1974, contracting a \$2 billion loan from Germany, 25 per cent of which was repaid by the spring of 1975.⁷⁴ In addition to the steps taken in order to curb non-oil imports, borrowing abroad had been essential to avoid expanding the monetary base, since the collapse in government bond prices made further large bond placements problematic.⁷⁵

The assistance granted by the Oil Facility Fund did not extend beyond two years, and Italy did not cease turning to the foreign capital market.⁷⁶ To cope with the explosion of public spending in the seventies and the associated budget deficits, which more than tripled between 1977 and 1979, causing larger and larger treasury shortfalls,⁷⁷ there was no choice but to borrow or have recourse to the bank of issue. Up to 1977 the deficit was financed almost in full with sales of new government securities, but in 1978 the proportion fell to 70 per cent. The money stock grew by 19.6 per cent in 1974, 19.7 per cent in 1975, 22.3 per cent in 1976, 21.9 per cent in 1977 and 24.5 per cent in 1978.⁷⁸

11. Europe and the oil shock

Italy was not the only country to suffer the consequences of skyrocketing oil prices. Although some member countries came out relatively unscathed, the European Community as a whole was especially hard hit. In 1974 the Community ran a deficit of more than \$10 billion on its balance of payments on a settlement basis, and a further deficit of \$1 billion emerged in the first few months of 1975. All this meant an outflow of dollars. Europe had been laid waste, it was written, by the Four Horsemen of the Apocalypse: inflation, recession, unemployment and OPEC. The GDP of the industrial economies of Europe grew by less than 2 per cent in 1974, compared with 3 per cent in 1967, the last year of severe recession. Consumer prices rose at an annual rate of more than 10 per cent, even though wholesale prices showed a tendency to decline. Unemployment was also more widespread than in the previous recession. The unemployed numbered more than 4 million in the Community. The Community-wide unemployment rate stood at 4.5 per cent, but the situation was far worse in some countries (Ireland, for example, with 8.2 per cent); in others, such as Luxembourg, joblessness practically did not exist.⁷⁹

⁷⁴ V. Barattieri, "The world economy in retreat: the case of Europe", *Review*, XXIX, 1 (January 1975), pp. 237-38.

⁷⁵ *Ibid.*, p. 238.

⁷⁶ Pratianni, "The Italian economy in 1978-79", p. 25.

⁷⁷ *Ibid.*

⁷⁸ *Ibid.*, p. 22.

⁷⁹ *Ibid.*, pp. 234-36.

12. The Italian crisis

The situation of Italy represented a special case, and in a report they drafted Guido Carli and Paolo Savona explicitly stressed that Italy's economic crisis had long been brewing: "Since 1963 and, to an even great extent, since 1969, the pressure of fast-rising wages has brought to the surface the serious contradictions which the 'easy' expansion of the fifties allowed to develop on top of those already accumulated during the historical evolution of the economy".⁸⁰ Carli and Savona recalled the weaknesses in administration and production, the decline in profits in public and private enterprises alike and the indebtedness of their financial structures, the growing deficits of the central government and local authorities on account of mounting expenditure and flagging revenue, the halt in the growth in incomes, investment and employment, high inflation, large payments deficits, high foreign debt and the decline of the lira in the foreign exchange market.⁸¹ Their conclusion was that the Italian economy, unlike that of other industrial countries, had suffered and continued to suffer from an insufficient rate of productivity growth both overall and in specific and important sectors, whose contribution to growth was modest or even negative.

The structure of supply was not in line with that of demand and this aggravated the limitations imposed by the openness of the Italian economy. Carli and Savona also emphasized that "the idea that wage increases are enough to stimulate growth is one of those quack medicines ... and does not correspond to reality". And they added that export growth, which could have eased the balance-of-payments constraints, did not depend essentially on an increase in R&D spending or on Italy entering the technologically more advanced markets or simply on the containment of costs. This, together with the fact that "the greatest increase in world trade is of an inter-industry nature and therefore presupposes freedom to import and the rejection of autarchic temptations", lent weight to the view that Italy had room to manoeuvre on its own technological frontier through the development of "autonomous" products and technologies.⁸² The two authors accordingly called for radical changes in budgetary policy and stigmatized the fact that public expenditure had taken the form of "assistance and redistribution", modified market structures and, in relative terms, "enlarged the area of the less efficient sectors" while, in the backward areas, it had "encouraged the use of 'imported' technology".⁸³

⁸⁰ G. Carli and P. Savona, "Report on the evolution of the Italian economy and the financial structures required to support future growth", *Revue*, XXX, 4 (July 1976), pp. 279 *et seq.*

⁸¹ *Ibid.*, pp. 279-80.

⁸² *Ibid.*, pp. 297-98.

⁸³ *Ibid.*, pp. 299-300.