

Stagnation and Restructuring

1. The energy problem

The fourfold increase in oil prices brought the energy problem dramatically to the attention of the industrial countries. Their economic development and much of the well-being they enjoyed would be jeopardized if adequate energy supplies could not be guaranteed. The problem was especially severe in countries like Italy with few domestic sources of energy. The crisis forced the entire Italian economy to make a concerted effort to adapt to higher oil prices, while the consequences of abandoning the nuclear-energy option after only a few plants had been built were also making themselves felt.

Writing in 1980, Felice Ippolito, a long-time advocate of nuclear energy, lamented the fact that there was no real energy policy in Italy and pointed out that even the much-criticised 1975 energy plan had not been implemented; nor after two years of further discussion had the 1977 plan. Ippolito analysed two possible growth scenarios based on 1979 data for global energy consumption in Italy through to the year 2000. One scenario treated energy savings as a "source", while the other focused on changes in the composition of energy sources.

The first scenario, which assumed the lowest probable rate of economic growth in Italy and energy savings of 25 per cent, forecast an increase in consumption of close to 300 million tons of oil equivalent (TOE). The second scenario did not assume any energy savings and forecast an increase of 34.8 per cent in energy requirements, satisfying which would require "a massive programme for the construction of coal and nuclear power stations, the contribution of which in the year 2000 should be greater than that of oil".¹ According to Ippolito, at least until 2000 there was no serious alternative to oil for electricity generation other than coal or nuclear fission. More efficient overall use of hydroelectric potential would yield at most only about 10 billion kWh of extra power per year, while supplementary sources (solar power, biogas, etc.) would only provide a maximum of 4.3 per cent of total energy needs, equal to 10 million TOE.

The choice of energy sources for both immediate and medium-term needs was therefore essentially one between oil and nuclear power. On his analysis, oil would still account for at least 47 per cent of total energy consumption in 2000. Apart from the possibility of energy conservation envisaged in the first scenario, the two forecasts differed not only in the greater energy production forecast in the second but also in the different percentage composition of energy sources, with a significant change in the proportion accounted for by nuclear

¹ Felice Ippolito, "Italy's position in the current world energy scenario", *Review*, XXXIV, 1 (February 1980) p. 32

energy: in the first scenario nuclear power accounted for 7.7 per cent of electricity output, in the second, 22.2 per cent. Recourse to nuclear power seemed inevitable to Ippolito: "the choice, despite the psychological and emotive arguments against nuclear power, must necessarily include both for the following reasons: the need to diversify the country's sources of energy; and environmental balance".² He argued that the Italian energy situation in 1980 was extremely grave, requiring urgent short and long-term intervention.³

2 The high cost of labour

No less worrying for the industrial outlook than the energy problem was the cost of labour, the considerable rise in which was seen as one of the causes of Italy's industrial and economic decline.⁴ Bruno Jossa and Salvatore Vinci emphasised how, especially from 1962-1963 onwards, the strengthening of the trade unions and employers' associations had transformed the labour market into a sort of bilateral monopoly, as had, in fact, occurred in all of the industrial countries. Wage levels were thus determined by collective bargaining largely independently of market forces and in close connection with political and institutional considerations.⁵

Disfunctional capitalism and bad government⁶ were therefore behind the increase in the cost of labour, which, in the author's view, was the fundamental cause of the inflation and the prolonged economic crisis that Italy was experiencing. Although profit margins had narrowed after 1962, which had led to a slowdown in investment,⁷ they underlined the negative effects of automatic wage-adjustment mechanisms. Every price increase aimed at restoring profit margins was followed by a rise in wages that again eroded earnings. Profits were therefore squeezed by the convergent pressures of higher wages and increasing international competition.⁸

The fluctuation of the exchange rate of the lira after 1973, with sharp depreciations in 1973 and 1976, did nothing to boost corporate incomes since the exchange rate was nevertheless kept under control. It was acknowledged that Italian economic policy had not allowed inflation to increase unchecked, seeking to contain the rise in prices by modifying the depreciation of the lira and implementing deflationary measures in order to prevent the rise in costs from being immediately passed on to final prices.⁹

² *Ibid.*, p. 34.

³ *Ibid.* 36 *et seq.*

⁴ Bruno Jossa and Salvatore Vinci, "The Italian economy from 1963 to today: An interpretation", *Review*, XXXV, 1 (February 1981), pp. 9, 16.

⁵ *Ibid.*, 16 *et seq.*

⁶ *Ibid.*, p. 17.

⁷ *Ibid.*, p. 18.

⁸ *Ibid.*, p. 29 *et seq.*

⁹ *Ibid.*, pp. 28 *et seq.*

3. The Italian model of economic development

The scope for industrial growth in Italy at the beginning of the 1980s appeared considerably limited by a range of problems: economic stagnation, a growing budget deficit, energy dependency and high labour costs. In addition, inflation and fears that this could worsen induced many firms to set their export prices in foreign currency. According to one study, one third of firms interviewed set their export prices in foreign currency at the spot rate of exchange, which meant that if the lira weakened, the full benefit of the depreciation was captured by the domestic exporter.¹⁰ Only 6.9 per cent of firms in 1977 used forward exchange rates in setting prices, while 30 per cent stated they did not use any exchange rate to set their export prices. Nevertheless, price-setting practices had only a marginal role in determining total export volumes, in that, when firms were able to set their prices in foreign currency, they tended to maintain that price whatever its lira value. In other words, for many exporters setting prices in foreign currency was sufficient to cover their costs and ensure an adequate profit.¹¹

In order to contain production costs and meet the challenge of international competition, the Italian economy had developed a dual labour market, one regular, the other irregular. In the regular labour market, the average hourly wage in manufacturing industry – taking account of the equality of male and female labour costs, better conditions for older workers, the many concessions for female workers, etc. – had risen to the same level as that in the most advanced countries. Italy, which was not one of the richest countries in the world, nevertheless had one of the most progressive bodies of labour law in the world.¹² Since international competition was forcing Italian producers to set competitive prices in both the international and domestic markets, preventing them from passing their higher labour costs through to prices, firms set out to automate production as far as they could, thus reducing employment. By contrast, employment increased in the irregular labour market, where restrictions on job placement, minimum wages, insurance requirements, redundancy laws, career paths, safety regulations were ignored. This situation produced negligible employment growth in union-protected sectors, while there was a rapid increase in employment in non-union sectors, characterised by a prevalence of underpaid, off-the-books jobs, a category that was destined to expand, at least in certain sectors, under the pressure of competition.

This analysis largely followed that carried out by Giorgio Fuà and the thesis advanced in the 1950s by the English economist Vera Lutz, who had used it to explain the North-South divide in Italy. For Lutz, in central and northern Italy

¹⁰ Giorgio Basevi, G. Pecci and A. Steinherr, "Exchange rate changes and their effects on international trade: Empirical studies of the Italian experience", *Review*, XXXIV, 1 (February 1980), pp. 49 *et seq.*

¹¹ *Ibid.*, pp. 52 *et seq.*

¹² Bruno Jossa and A. Amendola, "Italian economic development: Comment on an interpretation", in *Review*, XXXV, 3 (October 1981), pp. 485 *et seq.*

medium-sized and large firms could automate production to a greater degree, and thereby replace expensive labour. By contrast, in the South, where most firms were small, further automation was generally not possible and firms could only survive by hiring workers off the books at low wages with no social-security contributions.

Although apparently identical, the arguments of Fuà and Lutz were, in fact, quite different. Fuà attributed the segmentation of the labour market, and therefore differences in the process of capital accumulation and investment, to an endogenous cause, i.e. the increasing demands of workers, a situation which led to the exclusion of less efficient firms from the official market and stifled the expansion of efficient firms. By contrast, Lutz argued that the segmentation had an exogenous explanation, i.e. the different industrial structure of the two macro-regions. Fuà's analysis was certainly more effective in helping to interpret the situation in Italy in the 1980s, when the crisis of large and medium-sized firms led to mass redundancies, while at the same time regular and irregular small firms were expanding, with both making considerable use of off-the-books labour.¹⁵

While agreeing that this interpretation of the Italian economy probably explained a key aspect of the problem, other economists argued that Fuà's own figures did not necessarily show that the high cost of labour in manufacturing was the *cause* of the low level of regular employment. It could well have been that high labour costs were the *consequence* of the fact that, given international prices, large and medium-sized firms in Italy, having imitated their more modern European rivals in achieving high levels of efficiency, could afford to pay high wages while maintaining significant profit margins.¹⁶

4. The 1981 census of industry

Italian industry experienced a large number of changes between 1971 and 1981, especially considering that it was a difficult decade: the first oil crisis came in 1973, triggering a wave of inflation. This was followed by the second oil crisis and a subsequent recession. The first surprise of the 1981 census was Italy's modest overall population growth accompanied by a noticeable change in its regional distribution. A projection through 1991 showed that while the Centre's population share remained unchanged in 1971, 1981 and 1991 at 19 per cent, the North's share was forecast to decline to 44 per cent in 1991, down from 46 and 45 per cent in 1971 and 1981 respectively, while that of the South rose from 35 to 36 per cent in 1981 and was expected to reach 38 per cent in 1991.

Of even more importance for the structure and operation of the labour market was the ageing of the population. The proportion of persons over 65 years of age rose from 11 per cent of the population in 1971 to 13 per cent in 1981 and was forecast to reach 14.5 per cent in 1991. In addition, 51.3 per cent

¹⁵ *Ibid.*, p. 489.

¹⁶ *Ibid.*, pp. 490 *et seq.*

of the total population was female in 1981, compared with 58.5 per cent of those over 65 years of age.

The ageing of the population was of considerable significance for the future of pension and other social-security programmes, especially as the percentage of young people in the total population appeared to be in progressive decline, partly owing to the sharp divergence in the geographical distribution of the population. It was no coincidence that the areas with the greatest employment problems were in the South, with unemployment standing at 70.5 per cent among 14-19 year-olds, 52.2 per cent among 20-24 year-olds and 29.3 per cent among 24-29 year-olds. It was much easier to find work in the South if one had a university degree rather than a secondary school diploma, even for jobs that did not require a university education.¹⁵

A different Italy also emerged from the figures on industry. First, between 1971 and 1981 there had been a change in firm-size. Over the decade certain stages of production had been decentralized, a process which essentially involved splitting large firms into smaller units. Vertically integrated productive processes were transformed into relatively specialized segments, which it was thought would be more productive if they were decentralized.

These segments had, in turn, generated a market and products that had hitherto not existed: services. Guido Rey, the then president of the National Institute of Statistics, remarked that the real boom of the decade was in business services, which grew even faster than industry, adding 200,000 additional jobs. The same developments were causing a decline in the number of medium-sized firms, with a consequent multiplication of small enterprises in the most dynamic industrial sector, metal and engineering products. In fact, the 1981 census recorded an increase in small and medium-sized enterprises.¹⁶ As was noted, the increase in the number of employees during the decade came almost exclusively in the smallest firms, while larger firms showed a contraction.¹⁷

The growth was not equally distributed throughout the country. There was an increase in firms operating in the North and Centre and a fall in those in the South. This development was associated with the decline in vertical integration, which probably had occurred more extensively in the more industrially-advanced areas of the country. Medium-sized firms declined in north-western and north-eastern Italy, but there were "relatively frequent" examples of growth in large public enterprises, especially in the South. This was interpreted as an indicator of a different type of development in the two areas: in the former, growth occurred by hiving off smaller units; in the latter, it was a consequence of establishing larger plants, which tended to increase average size. The area in which some of the most significant changes of the decade occurred was the zone along the Adriatic

¹⁵ Guido Rey, "Italy of Census", *Review*, XXXVII, 2 (June 1983), pp. 195 *et seq.*

¹⁶ *Ibid.*, pp. 198 *et seq.*

¹⁷ Giovanni Zanetti, "The industrial structure and efficiency of the Italian economy: Trends and planning aspects", *Review*, XXXVII, 2 (June 1983), pp. 255 *et seq.*

coast, whose industrial development "broadly reflects the basic trend found in the various areas of the country, and especially the most highly industrialized".¹⁸

At least as important as the size of individual firms was the fact that not all industrial sectors had advanced at the same pace. Some had contracted significantly over the decade: this was the case in the mining and chemical industries (industries hit by a crisis) and the sectors of food products, textiles, hides and leather goods (traditional industries). By contrast, there was growth in some segments of the metals and metal-products industry and precision engineering, especially in the construction and installation of machinery and mechanical equipment, plant and repair of electrical and electronic equipment, precision instruments, watches and clocks. It was cautiously deduced that the decline was taking place in more traditional industries, while industries with potentially more advanced technology were expanding.¹⁹

The 1970s had been a difficult decade for Italian industry, but some gains had been registered. First and foremost, firms had exploited inflation to devalue the debt they had accumulated. Paolo Gnes, a Bank of Italy manager, showed that the ratio between financial debt and turnover had improved considerably: after rising from 50 per cent in 1968 to 63 per cent in 1972, it fell to 39 per cent in 1981.²⁰

As regards self-financing, Gnes noted that a Bank of Italy survey showed that in the major manufacturing firms "the degree of self-financing of private firms declined for a time and then in the last four years rose to values higher than those recorded in the period 1963-68. On the one hand this underlines the slowdown in investment, but on the other it reveals these firms' renewed ability to generate funds internally".²¹ The situation was different for firms whose controlling owner was the state. Self-financing by public enterprises declined steadily and turned negative in 1981.²²

Another factor that Gnes emphasised was the dependency of firms on outside financing for more than 50 per cent of their financial needs (of which 60 per cent was medium and long-term financing). However, the proper functioning of the financial market had been compromised over the decade both by monetary instability and the pressure of the growing borrowing needs of the Treasury.²³

5. Industrial development and banks in Southern Italy

The South was also changing. Progress was mainly concentrated in non-agricultural sectors, industry in particular, while agriculture had long lost its

¹⁸ *Ibid.*, p. 260.

¹⁹ *Ibid.*, pp. 256-257.

²⁰ Paolo Gnes, "The financial structure and financing of firms: Developments and future prospects", *Review*, XXXVII, 2 (June 1983), p. 304.

²¹ *Ibid.*, pp. 305-306.

²² *Ibid.*, p. 306.

²³ *Ibid.*, pp. 306-307.

predominance. Agricultural output had fallen from 30-35 per cent of total value-added in the South in 1950 to 10-12 per cent in the 1980s. The greatest development came in manufacturing, with the building industry enjoying considerable growth as a consequence of the demand created by the reconstruction of areas devastated by earthquakes.

Nevertheless, unemployment in the South was not only twice that in the North but it looked set to rise further, given local demographic trends.²⁴ At the same time, the South could no longer be viewed as an undifferentiated mass, if it had ever been one. Sardinia, for example, was included in the vast depressed area of the South but it had special problems of its own. While the beginnings of its "renaissance" went back to 1961, the "development" policy pursued between 1961 and 1980 did not produce the hoped-for results. Employment levels were neither higher nor more stable while internal capital accumulation was not sufficiently rapid to foster and sustain self-fuelled development. The type of development that occurred, which was mainly based on the creation of industrial 'poles', was not capable of generating more widespread investment. Given its characteristics and size, the chosen industry necessarily had to tap external sources of financing and although this contributed to raising income, it worsened Sardinia's dependence on external investors. In the space of twenty years Sardinia's economic structure underwent far-reaching change. Agriculture's contribution to GDP fell to 8.9 per cent over the period, with the number of workers employed in the sector falling to 18.8 per cent of the labour force, while the contribution of industry rose to 33.9 per cent of GDP, although the number of workers in the sector only increased by 9.1 per cent. Nevertheless, per capita income in Sardinia did rise by 82.8 per cent between 1963 and 1979 in terms of constant lire, compared with 67.4 per cent for Italy as a whole.²⁵

The underdevelopment of the local economy in Sardinia and the South as a whole was blamed on the southern banking system, which was accused of being an inefficient and dysfunctional instrument. Between 1951 and 1980, deposit rates were higher in the North than in the South, but lending rates were at least 6 percentage points higher in the South. The situation did not improve with the entry of northern banks into the southern market and the consequent increase in competition. On the contrary, the differential between lending and deposit rates increased between 1970 and 1980.²⁶

Contributing to the inefficiency of the southern banking system was the poor distribution of bank branches, despite the fact that their number had

²⁴ SVIMEZ, "Recent Economic Trends in the Mezzogiorno", *Review*, XXXVII, 1 (February 1983), p. 129.

²⁵ Q. Coghe, "The Sardinian economy: from a model of consumption to a model of self-generating development", *Review*, XXXVI, 1 (February 1982), p. 124.

²⁶ F. Marzano, A. Del Monte, M. Fabbriani and R. Martina, "The southern banking system, the development of the Mezzogiorno and the entry of foreign banks into Italy", *Review*, XXXVII, 1 (February 1983), pp. 55 *et seq.*

increased considerably over the thirty years to 1980, especially those of ordinary credit banks, savings banks and mutual banks. The South was nevertheless burdened with the highest level of bad loans as well as a banking system with a low propensity to take on risk in a context in which the economic development of the areas involved should have been the focus of banking activity.

Survey data showed that part of the funds raised in the South were invested by southern banks in enterprises in the Centre and North. While the northern banks' ratio of loans to deposits was greater in the South than in the North between 1961 and 1972, from 1973 onwards the situation was reversed. When the securities investment requirement and the credit ceiling were imposed, northern banks reduced their lending most sharply in the South. The retreat was a consequence of both the reduction in industrial investment in the South after 1974 compared with the rest of the country, and the decline in the value-added generated by the southern economy. In short, when the activity of northern firms in the South declined, the southern branches of northern banks used the liquidity raised in the South to finance investment in the North.²⁷

6. The 'black' economy and immigration

In 1981 the unemployment rate for Italy as a whole was 6.7 per cent, while that for the South was 12.2 per cent. At the same time, forecasts pointed towards a further decline in regular jobs and a corresponding increase in irregular work. Nevertheless, the labour market was being affected by an extraordinary development: the number of returning emigrants was increasing.²⁸ In fact, the flow of returnees exceeded that of new emigrants. But this was not the only paradox of the labour market: the number of foreign immigrants was also increasing.

Italy was caught unprepared when the western countries closed their frontiers in 1973 after years of welcoming immigrants from the Mediterranean basin and Africa. In Germany, Austria, Belgium, France, the Netherlands, Switzerland and England the rise in the price of oil together with convergent domestic factors had altered the structure of industry, with capital-intensive industries replacing labour-intensive industries, which then moved to the immigrants' home countries and the emerging economies of Asia. In the West, employment in industry fell sharply between 1973 and 1975, dropping at an annual rate of 1.1 per cent in France, 4.4 per cent in Germany and 5.4 per cent in Switzerland, while the return of immigrants to their homelands shifted the employment crisis onto these countries.

Italy reacted differently. Rather than pursuing an immigration policy aimed at protecting the domestic labour market, political considerations induced the

²⁷ *Ibid.*, pp. 61 *et seq.*

²⁸ F. Neri, "Immigration and the Italian labour market: a contradiction", *Review*, XLII, 1 (February 1988), p. 147.

country to ease the already weak restrictions on foreigners,²⁹ thus helping to worsen conditions in the labour market. At the same time, the only remedy used to assuage the discontent of Italian workers was to increase recourse to the ordinary and special wage supplementation fund, which had originally been designed as an instrument for dampening the impact of cyclical fluctuations. This helped to reduce job losses in manufacturing but only postponed a massive increase in unemployment, which was tackled mainly by offering early retirement to people in work. Between 1973 and 1983, ordinary and special wage supplementation was used to subsidize billions of work hours, which encouraged the improper use of labour by prompting firms to hire workers receiving supplementary payments, because they received relief on pension, tax and other social-security contributions.

The decentralization of production at large firms in the face of trade-union rigidity in the 1970s by contracting work out to smaller, and sometimes unregistered, firms also contributed to the absorption of such workers. Both sorts of enterprise, especially the latter, did not hesitate to hire workers receiving wage supplementation.³⁰ Irregular labour in industry peaked in the early 1980s, i.e. during the most intense period of restructuring as shown by the number of hours paid under wage supplementation and the large number of early retirements. At the same time, irregular labour in the service sector grew steadily following the second oil shock in 1979-1980, the period in which illegal immigration had reached major proportions.³¹

Obviously, black-market economic activity was not a solely Italian phenomenon. In 1978, Italy had the fourth largest black economy after Sweden, Belgium and Denmark. The underground economy also flourished, albeit to a lesser degree, in the Netherlands, France, Norway, Austria, Canada, Germany, the United States and the United Kingdom. Nor did Italy have the largest underground sector in terms of GDP: according to Vincenzo Sisto, that of the United States was even larger.³² Between 1970 and 1985 considerable submerged economic activity could be identified in textiles, clothing, hides and leather goods and footwear. It gradually expanded in the sectors of food products, beverages and tobacco products and began to spread to other manufacturing areas such as wood products and wooden furniture. There was only modest underground activity in transport equipment, chemical products and pharmaceuticals, while it appeared to be entirely absent in the areas of energy, minerals and ferrous and non-ferrous metal products. The incidence of black economic activity does not seem to have increased exceptionally over the period.³³

²⁹ *Ibid.*, pp. 143 *et seq.*

³⁰ *Ibid.*, pp. 144-145.

³¹ *Ibid.*, p. 145.

³² Vincenzo Sisto, "Macroeconomic statistics and the submerged economy", *Review*, XLI, 1 (February 1987), pp. 23 *et seq.*

Giuseppe De Rita³³ was perhaps the first to glimpse the form and importance of the black economy. His view was that the phenomenon of considerable 'black' economic activity was a stage in the development of the Italian economy, an attempt to break away from ideological and bureaucratic rigidities in order to make the economic system more flexible, freeing energy from below. He argued that it was a phase that Italy had gone through in the 1970s which had by now produced most of its more or less indirect benefits. While in the second half of the 1980s black activity continued to exist, it differed from that which had characterized the previous decade. In his view, the Italian economy would always have a certain amount of off-the-books economic activity – whether linked to sectors where restructuring did not occur, tax evasion or illegal activities – whatever the level of Italy's economic development.

7. The trade crisis of the oil-exporting countries

The oil crises of 1973 and 1979-1980 had seriously harmed industrial countries without sufficient oil resources, but the rise in the price of oil also led to increased exports of goods to the oil-producing countries. Hence the sharp rise in the weight of the developing countries, especially oil exporters, in world trade, with their overall share rising from 20 per cent in 1973 to nearly 50 per cent in 1983. However, the performance of oil producers and non-oil producers diverged during this period. Both groups increased their imports significantly until 1981. The imports of the non-oil developing countries were largely financed by the industrial countries between 1972 and 1981 so as to enable them to buy from the industrial world and continue to develop economically. Following the second oil shock, however, these countries became concerned about their growing current-account deficits, financing for which was no longer so readily available since international financial markets could no longer provide them with the liquidity they needed after the increase in oil prices, so that they were forced to reduce their imports sharply. Interest rates rose, especially in the United States, and the burden of servicing their debt became overwhelming, increasing the need to reduce imports and increase exports.

The crisis that struck the non-oil-producing countries then spread to the oil producers, which soon recorded current-account deficits as their oil exports declined, especially in 1982-1983. The rate of import growth for both categories of developing country fell to 4.5 per cent in 1982 and 3.4 per cent in 1983 as world trade generally stagnated after 1981.

³³ M. Deaglio, "Submergence in the Italian economy 1970-85", *Review*, XLI, 1 (February 1987), pp. 49 *et seq.*

³⁴ Giuseppe De Rita, "The culture of development and legacy of the submerged economy", *Review*, XLI, 1 (February 1987), pp. 9 *et seq.*

To emerge from recession and increase the volume of oil exports, the oil-exporting countries decided to lower the price of oil again: between 1983 and 1985 oil prices gradually returned to their pre-1973 levels. After reaching its lowest point in April 1983, marking the bottom of the cycle that had begun in 1973, the recession then gave way to a slow recovery. The upturn lasted for more than six years, interrupted only by a downturn in 1985, which was followed by further growth until 1989.

The recovery of 1983 was not confined to Italy alone: it involved the entire world economy, which benefited from the improvement in the industrial countries' terms of trade caused by the collapse in the price of oil.³⁵ Italy was also helped by the new incomes policy introduced between 1983 and 1984 and by the reform of the automatic wage-adjustment mechanism, a change that was adopted to tackle inflation despite its negative impact on employment and growth.³⁶

8. The restructuring of Italian industry

When the price of oil fell, Italian industry found itself in better shape in terms of costs and efficiency than it had been when the first oil crisis had burst upon it. At that time, the entire economy was just emerging from a period of social turbulence, beginning with the autumn of discontent in 1969, the breakdown in industrial relations, the coming into force of the Labour Rights Act and the abolition of differentiated wage scales between North and South. All of these events squeezed profit margins, and industry reacted – especially after the second oil crisis and through the first half of the 1980s – by accelerating restructuring³⁷ and carrying out a far-reaching reorganization, made possible in part by increasing productivity and using less expensive and more efficient factors than before.

Determined efforts had reduced costs. Automation displaced large numbers of workers and, together with new information systems, made it possible to manage warehouses and stock levels more efficiently, avoiding the costs of tying up resources in unproductive assets. External debt was reduced, profiting from the fall in interest rates after 1980. The burden of fixed costs was lightened by replacing debt with equity capital, some of which was raised through share issues. Considerable effort went into technological research or the adaptation of more complex technologies to specific production problems. To increase productivity and limit the concentration of workers in individual workplaces, the production of parts and components was decentralized. These changes required considerable capital, with the financial system in Italy coming to play a key role in the development of large industry, as it had in other countries.

³⁵ Guido Rey, "The great changes in the real economy", *Review*, XLIV, 3 (September-December 1990), p. 370.

³⁶ *Ibid.*, pp. 339-340.

³⁷ See Chapter XVII, Section 3.

Thanks to these changes, the costs of large industry in Italy fell significantly between 1970 and 1986. Innocenzo Cipolletta showed that only Japanese industry had done better than Italy, reducing costs by 24.55 per cent over the period, compared with 16.02 per cent in Italy, 14.68 per cent in Germany and 11.96 per cent in France.⁸⁸ The reduction in the cost of imported oil created scope for an increase in imports of machinery, vehicles and chemical products, all imports that did not harm the output of similar Italian products. In fact, Italian exports of these products actually increased. In the metal products and machinery sector, for example, imports increased by 22 per cent while exports rose by 33.9 per cent. Considerable progress was also recorded in the food-products sector, where exports increased more rapidly than imports, enabling the industry to recover from the serious crisis it experienced between 1983 and 1985. By contrast, trade in textiles and clothing showed a deficit. Despite Italy's major presence in the sector, imports increased by 6.7 per cent and exports by 4.5 per cent as aggressive competition from the newly industrialized economies made itself felt. The imbalance was attributed to the contribution that Italian technology had made to the industrial development of these countries.⁸⁹

9. The decline in employment

Between 1980 and 1991 employment declined at an average annual rate of 1.6 per cent. However, most of the fall came before 1986: between 1986 and 1991 the average annual decline was only 0.3 per cent, and in 1988 and 1989 employment actually increased.⁹⁰ Italy was beginning to reap the benefits of the increase in labour productivity and the greater efficiency of production achieved over the previous decade. Manufacturing output rose significantly between 1986 and 1991, growing at an annual rate of more than 7.5 per cent in 1988. The situation changed in 1991 in the wake, triggered by the Gulf War.

International trade experienced yet another contraction, with the crisis also spreading to the Italian economy and industry.

10. The 1991 census

Conducted in a recession year, the 1991 census painted an eloquent picture of the changes that had occurred in Italy's industrial system over the previous decade, showing that firms in industry (excluding construction) with 10 or more workers employed a total of 3,999,980 people, the bulk of whom were engaged by firms with between 100 and 500 employees (875,749) and more than 499

⁸⁸ Innocenzo Cipolletta, "Italian industry in the eighties: Reflecting on the changes", *Review*, XLIV, 3 (September-December 1990), pp. 424-427.

⁸⁹ *Ibid.*, pp. 372-373.

⁹⁰ Alberto Zulliani, "Structural factors and changes in Italian firms in the light of the 1991 census", *Review*, XLVIII, 1 (January-June 1994), p. 81.

employees (1,176,564).⁴¹ In other words, slightly more than half the industrial labour force were employed in medium-sized and large firms, unlike the construction industry, which provided employment to 571,009 people, with firms with less than 50 employees accounting for 58 per cent of total employment in the sector, and firms with more than 500 employees accounting for only 11 per cent.

The census also showed that, as in other industrial countries, Italy's service sector was playing an increasingly large role in the economy, providing employment for 3,377,180 people, nearly the same as industry. The size of firms in the sector was extremely varied, however. While enterprises with more than 500 employees absorbed 39.1 per cent of total employment in the sector, those with between 6 and 9 employees, which represented 52 per cent of service firms, accounted for only 13.5 per cent of employment. The smaller firms were concentrated in the retail and wholesale trade (12.5 per cent), lodging and catering services (15.6 per cent) and business services (13.5 per cent).⁴²

The figure for business services is especially significant, as it shows how many firms had delegated certain business tasks to outside enterprises. Some 57.9 per cent of firms subcontracted payroll management tasks, while 38.7 per cent contracted out legal and accounting functions and 28.5 per cent looked to outside firms for cleaning services.⁴³

The census also showed that, in 1991, 57.2 per cent of firms accounting for 32 per cent of total employment produced for the domestic market only. Such firms generally had fewer than 50 employees,⁴⁴ while larger firms had a more balanced division of product markets.⁴⁵ Firms producing leather goods, footwear, precision equipment and furnishings showed a strong propensity to export, while those producing office machines and machinery and mechanical equipment were even more inclined to sell their products abroad.⁴⁶

11. The recovery

The effects of the recession that began in 1991 were still being felt in 1993, but, with the end of the Gulf War and the resumption of oil production and sales, the first signs of recovery could be discerned. Istat's annual report confirmed that not only had consumption increased in the second half of 1993, but income and investment had also risen in the final months of the year. The signs of recovery strengthened in 1994, although towards the end of the year some instability emerged, especially as regards prices.⁴⁷ A study by Todd G. Buchholz,

⁴¹ *Ibid.*, pp. 71-72.

⁴² *Ibid.*, p. 71.

⁴³ *Ibid.*, p. 75.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*, p. 76.

⁴⁶ *Ibid.*, p. 84.

president and chief economist of the G7 Group and Arrigo Sadun, president of the WEFA Group, showed that, following the global recession, the Italian economy began to recover strongly at the end of 1993. Industrial output rose by 6.8 per cent, a larger increase than that in Great Britain, Germany or France. The pace slowed down slightly in 1995 but remained more rapid than in the other countries. Benefiting from the depreciation of the lira and the fall in unit labour costs, exports also increased more rapidly than in any of these three countries. In fact, it was thanks to the strong performance of exports that the Italian economy was able to weather the consequences of the restrictive fiscal policy adopted by the Amato government and continued by its successors,⁴⁸ with the brief exception of the Berlusconi government. Households' purchasing power declined further, falling to below the levels reached at the end of the 1980s, which reduced households' ability to save⁴⁹ and consume. According to Buchholz and Sadun, consumption declined by 2.5 per cent in 1993, something that had not happened since the end of the second world war, not even after the oil shocks of the 1970s. Consumption returned to its already low level of 1992 only at the end of 1995. Obviously, the world economic situation was characterized by the weakness of consumption, but Buchholz and Sadun argued that it "remains more depressed in Italy than in other European countries".⁵⁰

The fall in consumption was accompanied by a deterioration in employment, which fell by 610,000 full-time equivalent workers in 1993 and 330,000 in 1994. In January 1995 total employment had fallen to 19,700,000 full-time workers, lower than the number of economically inactive working-age persons, which was calculated at 20,100,000.⁵¹ The unemployment rate rose from 11.1 per cent in January 1994 to 12.2 per cent in January 1995, while youth unemployment rose from 32.1 to 34.3 per cent. The number of unemployed averaged 2,586,000 in 1994, and the number of first-time job-seekers also increased.⁵² Unemployment increased despite the recovery in investment, which, after the sharp fall in 1992 and 1993, had begun to increase more rapidly, in spite of the restrictive fiscal stance and high interest rates.

Buchholz and Sadun argued that in those conditions it would be difficult to bridge the gap in inflation and financial stability between Italy and the other leading European economies without jeopardizing the country's already modest economic growth. And although Italy had been able to overcome the difficulties of the social tension and oil shocks of the 1970s, the challenges that it now faced were greater because "there is much less margin for manoeuvre, given the

⁴⁸ Giovanni Barbieri, "A statistical overview of conditions in Italy", *Review*, II, 1 (January-June 1995), pp. 91-92.

⁴⁹ Todd G. Buchholz and Arrigo Sadun, "The Italian economy from an external observer's point of view", *Review*, II, 2 (July-December 1995), p. 152.

⁵⁰ Barbieri, "Statistical overview", p. 93.

⁵¹ Buchholz and Sadun, "The Italian economy", pp. 153-154.

⁵² Barbieri, "Statistical overview", p. 92.

⁵³ *Ibid.*, pp. 92-93, 98.

precarious state of the public finances" and the fact that continuous depreciation of the lira would not have been compatible with monetary union. Moreover, Italy only had "a short period of time available under the timetable set at Maastricht".⁵³

A factor working in Italy's favour was that exports were rising even more rapidly than imports, which enabled Italy to maintain its trade surplus. However, the most serious concern was that the contribution of external demand to GDP growth was weakening, falling from 4.6 percentage points in 1993 to 0.3 points in 1994, thus reducing much of the positive impact of the lira's depreciation on the trade balance. At the same time, import prices were already beginning to rise.⁵⁴

The inflationary effect of expanding profit margins was considerable in industry, excluding construction, services and agriculture. Profitability improved, especially in manufacturing, which was able to improve efficiency by exploiting unused productive capacity. Nevertheless, only in 1994 did purchases of machinery and equipment begin to rise, but such investment was not yet sufficient to sustain a satisfactory pace of plant modernization and adequate growth in productive capacity.⁵⁵

The beginning of the 1990s saw many changes in the corporate sector. Both during expansion (1989-1990) and recession (1992-1993) there was a tendency towards concentration in firms with more than 200 employees, which absorbed smaller firms. This development was most pronounced in the distributive trades and business services, but a considerable decline in employment occurred in any sector in which this trend took place. In contrast to the early 1980s, the 1990s were characterized by the vertical integration of an increasing proportion of firms, which sought to provide production-related services in house. At the same time, the beginning of the decade also saw greater use of new processes, especially in manufacturing, with innovations being introduced by fully one third of industrial firms with more than 20 employees, accounting for 62 per cent of employment in the sector and 71 per cent of sales. Giovanni Barbieri, a senior manager at Istat, noted that 63 per cent of firms introducing innovations made changes in both processes and products, 20 per cent altered processes only and 17 per cent modified products only.⁵⁶

Agriculture began to be affected by the new Common Agricultural Policy in 1994. Small farms were penalized and the composition of output changed. Barbieri noted that "there is a general trend towards reducing farm output, with possible effects on Italy's future ability to meet domestic demand with internal production". There was a considerable reduction in the output of orchards and vineyards, increases in cereals, vegetables and similar products and stable livestock output. Although agricultural output remained unchanged in value

⁵³ Buchholz and Sadun, "The Italian economy", p. 154.

⁵⁴ Barbieri, "Statistical overview", p. 94.

⁵⁵ *Ibid.*, p. 95.

⁵⁶ *Ibid.*, pp. 95-96.

terms, employment in the sector continued to decrease, with the number of full-time equivalent workers falling by 7.3 per cent in 1993 and a further 3.8 per cent in 1994.⁵⁷

The progress made between 1993 and 1994 was not enough, however, to make up the ground lost during the recession of 1991-1993. As a result, GDP growth over the ten years from 1985 to 1994 fell compared with the previous period, a decline that would worsen in 1995 and 1996.⁵⁸

12. The "Southern question" at the turn of the millennium

The 1991 census confirmed the worsening of the North-South divide.⁵⁹ It is not that incomes in the South failed to rise: with regional GDP growing at a rate of 2 per cent, the area was expanding at the same pace as the Centre and North. However, it should have been growing considerably faster if it was to bridge the gap. Guido Rey calculated that the South's trade deficit increased from 22.3 per cent of regional GDP in 1980 to 26.4 per cent in 1987, while per capita income was still only 57.4 per cent of that in the North, despite the major investment in the area, with the situation worsening as the South's population continued to grow.⁶⁰

A distinguishing feature of the South's slower growth was the continuing weight of agriculture in its output structure. In the North construction accounted for 5.2 per cent of GDP, compared with 8.3 per cent in the South. A similar disparity existed in non-market services (9.7 per cent compared with 17 per cent), despite the fact that the overall share of the service sector in the economy was identical, at about 46.6 per cent. The difference in industry, however, was even larger and more difficult to remedy, with a share of 37.7 per cent in the North and barely 17.5 per cent in the South.⁶¹

The situation did not improve in the years following the census. The economic recovery after 1993 did not touch the South. While growth in the North was 2.6 per cent in 1994, in the South it was less than 1 per cent, and many commentators argued that the divergence would continue, especially because the outlook for growth was linked to the areas' scope for increasing exports, which only the industrialized North could hope to do.⁶²

⁵⁷ *Ibid.*, pp. 96-97.

⁵⁸ Rate of GDP growth (%) in a selection of European countries

	1975-84	1985-94
Italy	3.1	2.1
Germany	2.2	3.7
France	2.4	2.2
U.K.	1.7	2.2

Source: Buchholz and Sadun, "The Italian economy", p. 155.

⁵⁹ Zuliani, "The 1991 census", pp. 71-73; Antonio Pazio, "Development policies for the Italian South", *Review*, XLV, 3 (September-December 1991), pp. 305 *et seq.*, 313; Mariano D'Antonio, "Economic policy for Southern Italy: Continuity, conservation, innovation", *ibid.*, pp. 401 *et seq.*

⁶⁰ Rey, "The great changes", p. 374.

⁶¹ *Ibid.*, p. 373.

The mid-1990s saw the full emergence of the harmful consequences of abandoning the southern industrialization policy in 1973,⁶³ when the South's economy began to deteriorate as a result of the world recession triggered by the fourfold increase in oil prices, the crisis involving state-controlled enterprises, the growth of the public debt, especially after 1969 (and even more so after 1973) and, finally, the difficulty of reconciling the special intervention of the Southern Italy Development Fund with the planning activity of the ordinary statute regions created in 1972.⁶⁴ Another factor was the extension of the government investment incentives created for the South over the years to all the regions. This was the case of Law 1329/1965, which subsidized the purchase of foreign and domestically-produced machinery by providing for the discounting of bills at concessionary rates and guarantees for the supplier's trade credit. The only difference between incentives granted in the North and those in the South was the size of the reduction in interest rates, which was 5 percentage points in the Centre and North and 8 points in the South. However, between 1980 and 1993, only 9 per cent of the amounts disbursed as subsidies went to the South, although the share did rise in 1994 to 13 per cent, equal to 337 billion lire out of a total of 2,538 billion. Another case was Law 346/1982 on the Fund for Technological Innovation. As Bruno Jossa pointed out, only 6 per cent of a total of 8,900 billion lire went to the South between 1983 and 1993. In 1994, spending for the South was only 35 billion lire compared with 446 billion for Italy as a whole.

Other examples abound. Of the 55 billion lire in subsidies granted in 1993 and the slightly more than 9 billion disbursed in 1994 under Law 399/1987, which, like Law 696/1983, was designed to encourage small and medium-sized firms to purchase advanced machinery, only 0.5 per cent went to southern firms. The benefits to the South of Law 317/1991 for small and medium-sized enterprises were only slightly greater. Only partly implemented between 1992 and 1994, subsidies granted under the law to the South came to only 7 per cent of the total of 1,114 billion lire disbursed. The change in policy for the South stands in even sharper relief if we consider that the share of aid that went to the South from the former Southern Italy Development Fund, the Ministry for Industry and the Italian Industrial Credit Institute gradually declined from 61 per cent in 1971-1979 to 50 per cent in 1980-1987, while the region's share of project financing fell from 55 per cent to 35.6 per cent between the two periods.⁶⁵

⁶³ Vincenzo Apicella, "Il Mezzogiorno e la ripresa economica", *Economia italiana*, 2 (May-August 1995), p. 279.

⁶⁴ Until the beginning of the 1970s, as long as the southern economy was growing more rapidly than that in the North, the external economies of the South also increased more rapidly. Bruno Jossa, "Credit and economic development in Southern Italy", *Review*, II, 2 (July-December 1995), pp. 198-199.

⁶⁵ *Ibid.*, pp. 181-182.

⁶⁶ *Ibid.*, pp. 193-194.

As regards capital grants and the laws for the industrialization of the South, it almost goes without saying that the large firms of the North and Centre benefited the most. Jossa correctly pointed out that the figures show a "shift of public transfer payments from Southern firms to medium-sized and large companies in the rest of Italy", with "little change in [the share] allocated to the small enterprises of the North and a fall in that for Southern firms of every size".⁶⁶ Only some of the figures provided by Jossa have been reported here, but the others do not belie the picture that we have drawn. On the contrary, they only confirm the shift in industrial policy in favour of the North and Centre. And yet the South cannot do without the stimulus of special incentives: as long as assistance was reserved exclusively or mainly to the South, it played a decisive role in promoting the industrialization of the region.

The European Community also intervened on behalf of depressed areas. Beginning in 1975, the EEC provided aid for the development of backward regions, but it was primarily with the approval of the Single European Act in 1985, which introduced funds for economic and social cohesion into the Treaty establishing the European Community, the subsequent reform of the Structural Funds and the "reform of the reform" empowered by the Maastricht Treaty, that the Community took an independent position with regard to regional development. Unfortunately, not all regions were equipped to plan and promote development projects. In fact, the least active and capable regions were precisely those most in need of the Community assistance. In 1994 and 1995, a variety of infrastructure projects could not be initiated because the matching Italian co-financing could not be found. Despite unemployment of more than 21 per cent, more than a trillion lire in financing could not be used, part of which was irretrievably lost once deadlines for submitting projects had passed.⁶⁷

⁶⁶ *Ibid.*, p. 195.

⁶⁷ *Ibid.*, pp. 190-192.