ITALIAN CHAMBER OF COMMERCE AND INDUSTRY FOR SPAIN

TIEPOLO PRIZE 1998

Spain and Italy: the parallel development of two economies

Address by the Governor of the Bank of Italy
Antonio Fazio

Madrid, 14 December 1998

Contents

Since the fifties Spain and Italy have undergone a process of development that has been similar in several respects. In both countries economic growth has been rapid, at times tumultuous; the growth has permitted a radical transformation of the productive system, from backward to industrial and modern.

At the beginning of the fifties per capita GDP in Italy was little more than one third of that in the United States; in Spain it was about 70 per cent of the Italian level. Growth rates were high until the eve of the oil crisis; they were accompanied by sizable gains in productivity and a major improvement in living standards. In 1973 per capita GDP in Italy and Spain was respectively 91 and 76 per cent of the EU average.

From the mid-seventies onwards, the rate of increase in per capita GDP dropped in all the industrial countries. The impact of the crisis was stronger in Italy and Spain, owing to their greater dependence on imported energy, and produced serious imbalances in their external accounts. With the aim of countering the recessionary effects of the crisis, deficit spending was boosted. Between 1973 and 1990 public expenditure increased enormously in relation to GDP, from 35.4 to 53.6 per cent in Italy and from 22.4 to 43.7 per cent in Spain; public debt rose in relation to GDP from 51 to 98 per cent in Italy and from 13 to 45 per cent in Spain.

In Spain per capita GDP increased between the mid-seventies and 1990 at an annual rate of around 2 per cent, in line with the EU average; Italy achieved a higher rate, but this proved unsustainable in the years that followed. Inflation was very severe in both countries and, at close to 13 per cent, far higher than in the other industrial countries. The major contributory factor was the strong rise in wages, which caused significant losses of competitiveness, despite the depreciation of the lira and the peseta.

In Spain the second half of the seventies saw the conclusion of the long phase of political and institutional transition. Spain's economy and society suffered from the deterioration in the state of the international economy and the large number of emigrants who returned home.

Starting from a very low level in the early seventies, Spanish unemployment rose to 21.5 per cent in 1985. With Spain's entry into the European Union in 1986 and the recovery in the international economic cycle, a new phase of rapid growth began that lasted until the beginning of the nineties. It was fueled by investment, which was stimulated by the gradual modernization of the economy and the prospect of the creation of the single European market.

A crucial role was played by foreign direct investment, which Spain succeeded in attracting in large volumes: between 1985 and 1990 the inflow rose from 1.2 to 2.8 per cent of GDP; in the same period it averaged less than 0.5 per cent of GDP in Italy.

1. Spain and Italy in the nineties

In 1990 the rate of inflation in Italy and Spain was respectively 6.5 and 6.7 per cent, compared with 2.7 per cent in Germany; nominal long-term interest rates were particularly high. Italy's larger interest payments on public debt resulted in its budget deficit being almost twice as large as Spain's.

In view of the pronounced imbalance inherited from the past, the restoration of sound public finances has been a more difficult and lengthy process in Italy; action has been concentrated on the revenue side: fiscal receipts have risen in relation to GDP by 5 percentage points since the beginning of the decade. Expenditure excluding interest payments has been reduced by 3 percentage points, with most of the reduction deriving from cuts in investment and transfers to enterprises. In Spain the adjustment has been divided equally between the revenue and expenditure sides; the fiscal burden has risen by 1 percentage point. The restrictive effect on households' disposable incomes has been less pronounced.

The monetary policy conducted by the Bank of Spain and the Bank of Italy has contributed to the convergence of the two economies by bringing both actual and expected inflation down towards the levels prevailing in the other European countries with a consolidated tradition of stability. In October of this year inflation was below 2 per cent; at the end of November the long-term interest rate was 4.2 per cent, just 0.2 points above the German level; in the last week it has fallen below 4 per cent.

Spain's more favourable starting point in terms of the budget deficit and public debt, the different composition of the budget adjustment measures, the lower level of taxes and social security contributions, and the greater ability to use Community funds are the main factors underlying the faster growth of its economy in this decade. Between 1990 and 1997 GDP expanded at an average annual rate of 2 per cent, compared with Italy's 1.2 per cent. The Spanish economy will grow faster than Italy's in 1998 as well.

Investment expanded in Spain at an annual average rate of 6 per cent between 1994 and 1998. Capital formation benefited not only from the large transfers from the Community budget and the fall in interest rates but also from the improvement in the climate of confidence. The results achieved to date in creating new jobs have been notable: after falling in the early nineties, the number of persons in employment has risen since the middle of 1994 by more than one and a half million; employment has increased in industry.

In Italy, employment has recovered from the low point reached in 1995 by only a little more than 200,000; in the non-farm sectors the increase amounted to 450,000 and occurred almost entirely in the services sector.

2. The labour market

The unemployment rate in Spain is now below 19 per cent, a reduction of 6 percentage points compared with the peak in 1994.

In Italy the modest increase in employment has not been sufficient to reduce the average unemployment rate; indeed, this has continued to rise, reflecting the deterioration in the economy of the southern regions. In the northern regions, by contrast, unemployment has declined.

The geographical dispersion of unemployment is more pronounced in Italy, where the problem coincides to a considerable extent with the broader question of the Mezzogiorno. Spain does not have areas with full employment, as is the case in many parts of the Centre and North of Italy.

Italy and Spain stand out from the other EU countries primarily for their low ratios of employed persons to those of working age, high proportions of self-employment and relatively large underground economies. In both countries the family plays an important role in supporting jobless young people.

The employment rate for the population aged between 15 and 64 is around 50 per cent in both countries, a figure that compares with 59 per cent in France, 64 per cent in Germany and 74 per cent in the United States. Spain's higher unemployment rate is due in part to the greater protection provided to the unemployed.

In 1984 Spain introduced a widely applicable fixed-term contract; today more than 30 per cent of total payroll jobs are of this kind. However, the high proportion of temporary employment has not grown in the last few years, which above all have seen an increase in permanent jobs.

In addition, in 1994 a start was made on rethinking the regulatory framework of the labour market with the aim of reducing the large proportion of fixed-term employment, which hinders the formation of human capital and is a cause of excessively high company turnover rates. The conditions for the termination of permanent jobs were made less onerous in 1994 and with the social pact signed in 1997; at the same time restrictions were imposed on the use of fixed-term contracts; in 1997 tax incentives were also introduced for new permanent jobs.

The increase in employment in Italy in this period was primarily in the form of part-time and fixed-term contracts. This can be attributed above all to the weak and discontinuous growth of the economy in the nineties.

3. The banking system

The action taken in Spain in the last ten years aimed at consolidating the banking system and increasing the average size of banks has brought considerable benefits in terms of profitability. In comparison with their European counterparts, Spanish banks are profitable and efficient. They have a substantial presence abroad, especially in Latin America, and are showing growing interest in the Italian market.

Significant progress has also been made in Italy in the last two years in the search for size, a necessary condition for banks to be able to compete in the global market; a start has been made on action to curb costs and broaden the range of revenue-generating activities; Italian banks in this initial phase have focused their attention on the domestic market. Following the recent consolidations, the leading Italian banks are now of a similar size to the most dynamic Spanish intermediaries.

Major Spanish banks have acquired interests in leading Italian banks. Such exchanges of equity permit the considerable scope for synergy to be exploited, both in Europe, where competition will become more intense in the coming years, and in the emerging markets.

§ — § — §

In 1997 Spain’s per capita GDP rose to 12,000 ecus, the equivalent, in terms of purchasing power, of 80 per cent of Italy’s, which was essentially in line with the average of the European Union.

During the last ten years Spain's GDP has grown faster than Italy's. The strong growth in investment has underpinned Spain's good performance as regards employment. The climate of confidence has benefited from the limited fiscal burden, the modernization of the markets for goods and services and the start made on a far-reaching privatization programme. The cooperative attitude of the social partners has been decisive.

The Bank of Spain and the Bank of Italy have pursued the fundamental objective of rooting out expectations of inflation and inflation itself. They will act to ensure the economies of our two countries are in a position to take full advantage of the opportunities offered by the single currency and the globalization of markets. Banks will have to make an important contribution by supporting the corporate sector through an efficient allocation of credit at an appropriately low cost.

The return to stability has created the conditions for achieving strong and sustainable economic growth. Our countries possess the necessary resources. They will both have to make further progress in formulating policies to tackle the most serious emergency facing the European economies, the defence and creation of jobs, especially for young people.

The job emergency is at the centre of Government attention.

The forecasts for the world economy and the European economy, in particular Italy's, point to a pronounced tendency for economic activity to slow down.

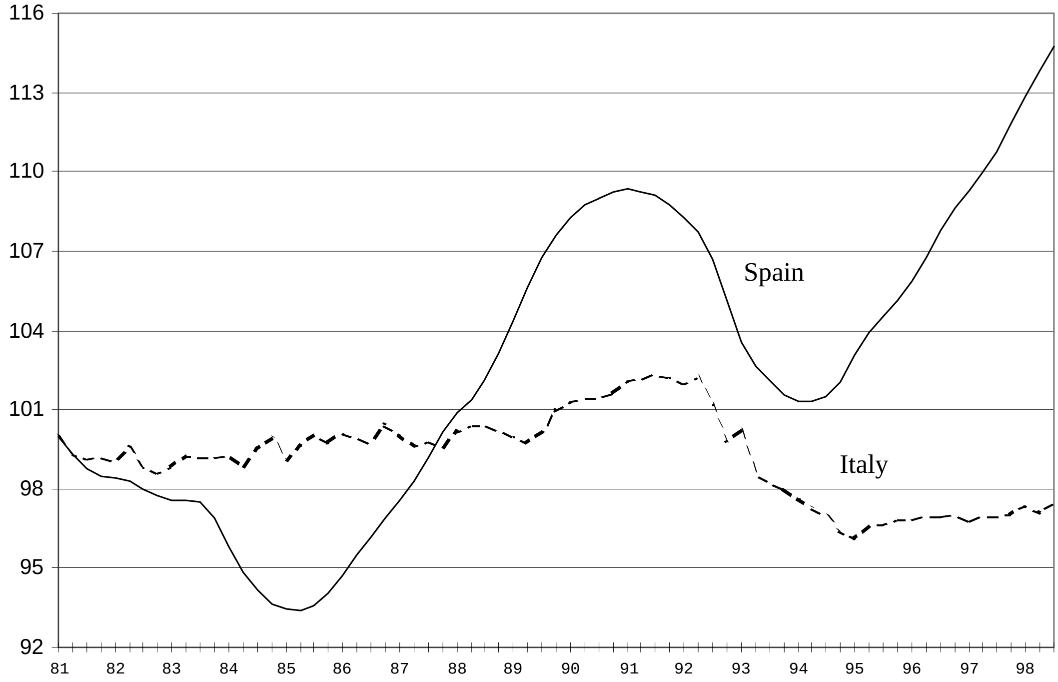
A recovery in investment is needed.

It must be the result of an economic policy and of cooperation between the social partners that, through a new incomes policy, create confidence and produce conditions favourable to the growth of enterprises and employment. These more favourable conditions must be perceived as lasting and likely to undergo further improvement in the medium-to-long term.

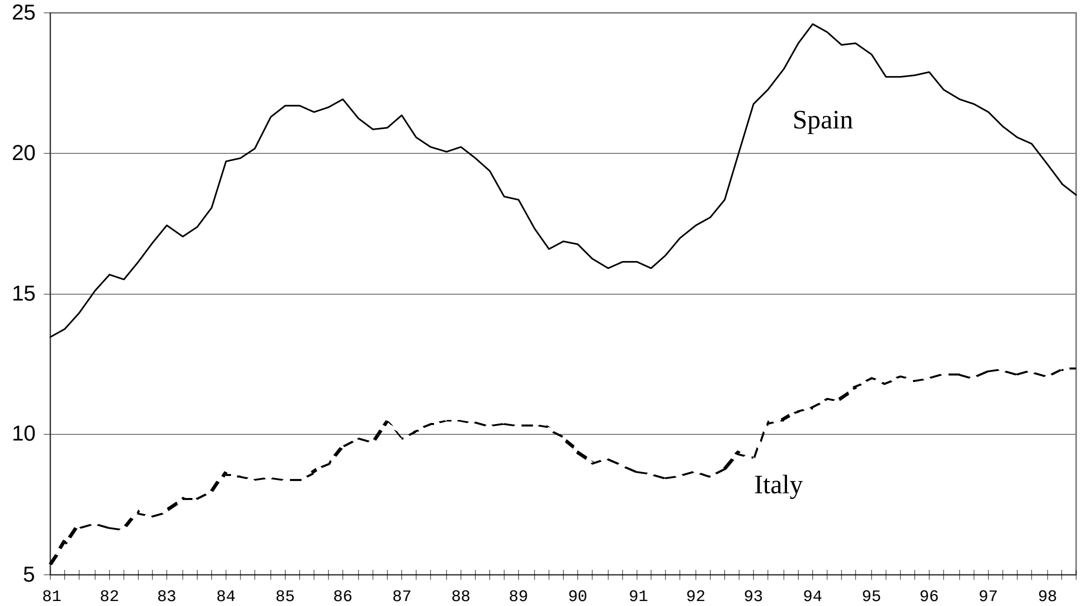
The present and potential availability of saving can sustain a higher level of investment and a faster rate of growth in economic activity; this is the only way to raise the level of employment, the ultimate measure of a country’s welfare and development.

The labour market in Spain and Italy

Total employment
(seasonally adjusted quarterly data; indices, 1981.1=100)



Unemployment rate
(quarterly data)



Sources: ISTAT and Bank of Spain.

Table 1

Main macroeconomic indicators

	1951-60	1961-73	1974-90
PER CAPITA GDP (1)			
Italy	4564	8275	12488
Spain	3123	6943	9583
EU	5442	9107	12662
PER CAPITA GDP (2)			
Italy	5.2	4.7	2.5
Spain	5.0	6.3	1.9
EU	4.1	4.0	2.0
LABOUR PRODUCTIVITY (2)			
Italy	5.8	5.2	2.2
Spain	5.1	7.0	1.7
EU	4.4	4.3	1.5
INFLATION (2)			
Italy	2.9	4.9	12.7
Spain	n.a.	6.5	12.8
EU	n.a.	4.7	8.8
BUDGET DEFICIT (3)			
Italy	-0.9	-6.5	-11.1
Spain	n.a.	1.1	-4.1
EU	0.8	-0.4	-3.5
PUBLIC DEBT (3)			
Italy	n.a.	51.3	98.0
Spain	n.a.	13.1	44.8
EU	n.a.	35.2	55.2

Sources: EU Commission and Heston-Summers (Penn World Tables, 1995).

(1) In US dollars at 1985 prices; end-of-period data.
(2) Average annual rates of change.
(3) As a percentage of GDP; end-of-period data.

Table 2

ITALY: MACROECONOMIC INDICATORS IN THE NINETIES

	1990-1997	1996	1997
GDP (1)	1.2	0.7	1.5
Domestic demand (1)	0.8	0.3	2.5
Gross fixed investment (1)	-0.4	0.4	0.6
Private consumption (1)	1.3	0.8	2.4
Inflation (1)	4.7	4.0	2.0
Budget deficit (2)	-8.3	-6.7	-2.7
Public debt (2)	115.3	124.0	121.6
Current account balance (2)	0.7	3.4	3.2

Source: Istat.
(1) Average annual rates of change.
(2) As a percentage of GDP.

SPAIN: MACROECONOMIC INDICATORS IN THE NINETIES

	1990-1997	1996	1997
GDP (1)	2.0	2.4	3.5
Domestic demand (1)	1.7	1.6	2.9
Gross fixed investment (1)	1.1	1.3	5.0
Private consumption (1)	1.7	2.0	3.1
Inflation (1)	4.7	3.6	2.0
Budget deficit (2)	-5.0	-4.6	-2.6
Public debt (2)	58.2	70.1	68.8
Current account balance (2)	-1.5	0.3	0.6

Source: Istat.
(1) Average annual rates of change.
(2) As a percentage of GDP.