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# The world economy and finance in 1999

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Verona, 30 January 1999

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The effects of the collapse of the Asian currencies in 1997 spilled over to the world economy in 1998; the crisis spread to Russia and other East European countries and to Latin America.

The crisis in Asia followed the sharp decline in domestic demand in Japan. The sudden change in expectations generated rapid capital outflows and currency depreciations that exceeded 50 per cent in Korea and Thailand and 40 per cent in Malaysia and the Philippines. In 1998 the Korean and Thai currencies recouped half the value they had lost. The Indonesian rupiah lost half its value in 1997 and another 20 per cent of its initial value in 1998.

The economies of Latin America withstood the wave of instability from Asia in 1997 but in 1998 were caught up in the crisis following the devaluation of the ruble. The currencies of Brazil, Mexico, Venezuela and Chile came under strong downward pressure. The speculative attack of mid-January 1999 initially focused on the Brazilian Real.

Argentina has stuck to the exchange rate fixed with the dollar under the institutional arrangement adopted for the peso. Since the devaluation of 1994, China has maintained a close link with the US currency.

The swings in share prices in the countries hit by the crisis have paralleled those in exchange rates but have generally been more pronounced.

In Japan, the stock market fell by a quarter in the last two years and has fallen further in the last few weeks; the yen first weakened then strengthened considerably in the last part of 1998. Last year the Korean stock exchange gained as much as it had lost in 1997.

The falls in the currencies and stock exchanges of Asia have been mirrored by rises in the US and European currencies and stock markets, fueled in part by the outflow of funds from Asia. Despite its high initial level, the S&P index rose by 60 per cent in the two years 1997-98. The gains on some European exchanges were even larger.

## 1. The crisis in Latin America

All the major countries of Latin America continued to run large current account deficits in 1998. Brazil's deficit grew to 4.2 per cent of GDP; the pattern in Mexico, Argentina and Chile was similar, with the deficit rising to 3.5, 4.5 and 6.8 per cent of GDP, respectively.

The ratio of Brazil's net external debt to GDP is on the order of 25 per cent. In Mexico, Venezuela and Chile the ratio is close to 40 per cent, in Argentina to 30 per cent. The debts are mainly denominated in dollars.

In the last few years these economies were marked by rapid rates of growth and lower inflation than in earlier decades. In several cases budget deficits were substantial.

In some respects there was a repeat of the experience of the Asian countries. A prolonged period of growth was financed with imports of foreign capital, mostly at short term.

In Asia the capital inflows had financed investment that in many cases exceeded 30 per cent of GDP in 1997. In Latin America, by contrast, foreign capital also financed the current expenditure of the private and public sectors; investment fell to around 20 per cent of GDP.

In the summer of 1998 the stock markets of Brazil, Mexico, Argentina and Chile had already turned bearish. Interest rates were raised steeply to defend the exchange rates.

The tensions subsequently abated, thanks in part to the reduction in US official interest rates and the approval of the stabilization plan agreed by Brazil and the International Monetary Fund. It was possible for interest rates to come down and shares recouped some of the earlier losses.

Confidence in the exchange rates and stock markets of Latin America and some Asian and East European countries was undermined in 1998 by the uncertainty surrounding the solution of Russia's financial problems and the effectiveness of Brazil's stabilization policies.

The sharp fall on the stock market at the beginning of this year and the collapse of the Real following the decision to allow it to float halved the dollar value of Brazilian shares. In the days that followed their prices rebounded, rising by 30 per cent in a single day; subsequently, however, there have been further falls in the exchange rate and share prices have gyrated.

**2. The world economy**

The slowdown in effective demand that began in Asia in mid-1997 gradually affected the rest of the world.

The Japanese economy, which had been recovering in 1996, grew by only 1.4 per cent in 1997. Growth remained rapid in North America and the United Kingdom and satisfactory in the continental European countries. It was particularly slow in Italy: 0.7 per cent in 1996 and 1.5 per cent in 1997.

The crisis that struck in Asia in the middle of 1997 did not prevent an appreciable increase in consumption, investment and GDP in the area for the year as a whole; the exception was Thailand, where strains in the external accounts had already emerged at the end of 1996. Growth in Latin America continued at a very rapid pace in 1997: 8.6 per cent in Argentina and 7 per cent in Mexico. In Brazil the loss of competitiveness and subsequently the tensions in the financial and foreign exchange markets slowed down growth.

In 1997 world exports recorded a particularly large increase of 9.9 per cent, compared with 7 per cent the previous year. The demand of the emerging economies, still buoyant, sustained the cycle in the Anglo-Saxon countries and continental Europe.

The full force of the crisis was felt in 1998. The expansion in world trade fell to 3.3 per cent.

Growth turned sharply negative in Asia, with GDP contracting by 7 per cent in Korea, 7.5 per cent in Malaysia and 8 per cent in Thailand. The fall in imports and to a lesser extent the rise in exports inverted the sign of external current account balances for the first time in many years and generated sizable surpluses.

The crisis took on political and institutional overtones in Indonesia, where GDP is estimated to have contracted by 15 per cent. On the basis of the data available, the Chinese economy appears to have suffered only a slowdown in growth; the deceleration in the Philippines was more pronounced. Throughout the area economic activity tended to stagnate.

Partly owing to the depressed conditions in the rest of Asia, the performance of the Japanese economy continued to deteriorate in 1998. Investment contracted further, by more than 10 per cent. Signs of deflation became increasingly evident in prices, domestic demand and business expectations.

In Latin America, too, domestic demand and economic activity gradually slowed down during 1998.

The problems afflicting the Asian, Latin American and Russian economies and the improvement in their competitiveness as a result of currency devaluations adversely affected demand in the industrial countries.

The impact on domestic demand and growth was already visible in the exports of the G-7 and euro area countries.

Effective demand remained high in the United States, where the increase in domestic spending was easily financed with growing imports of saving from the rest of the world and the supply of dollars on the international market. US demand for goods helped to attenuate the crisis in Asia; it has so far prevented the economies of Latin America from declining faster.

Business confidence nonetheless waned; after rising by 20 per cent in the first quarter and 13 per cent in the second, investment slowed down further in the second half of the year.

In Japan expectations regarding the economy had already turned down in the middle of 1997.

In continental Europe business expectations deteriorated steadily in 1998. The recovery of investment that had begun in the second quarter of 1997 continued until the early months of last year; it was brought to a halt in the spring by the persistence of the crisis in Asia and its propagation to the East European transition economies and Latin America. The growth in GDP also slowed sharply before recovering slightly.

The climate of households' confidence was less negative.

According to the IMF, output in Germany, France and Italy was well below its potential level from 1993 onwards.

The current account of the balance of payments of the euro area continued to show a surplus of 0.8 per cent of the area's GDP. After rising substantially in

1997, the volume of exports slowed sharply during 1998; the volume of imports also declined markedly.

The cyclical recovery expected in the second part of this year still appears uncertain.

The low level of interest rates does not appear sufficient to trigger a widespread increase in investment. There are still no signs in the area of expectations of a vigorous and sustained recovery in economic activity in the medium term.

The uncertainty surrounding the recovery of international trade in 1999 is related to the prospect of only modest growth or even continued recession in the Asian countries affected by the crisis, the possibility of mounting difficulties in the transition economies and the halt in growth in Latin America.

Notwithstanding the sharp deceleration in economic growth in some regions, the international trade imbalances that have contributed to the abnormal increase in world finance and to the recurrent crises of recent years have not yet been corrected.

The decline in demand and economic activity in 1998 means that many Asian countries risk performing poorly again in 1999. They will continue to record large surpluses on their external current accounts. Growth in Latin America will continue, but much more slowly than last year; current accounts will remain in deficit.

The euro area still has a current account surplus; the US deficit and the Japanese surplus are still growing.

The slowdown of the world economy is stretching into 1999.

Unemployment in Japan, although extremely low in comparison with that of other industrial countries, is rising sharply. Economic activity was still weak at the end of 1998. The support provided by monetary policy ceased to be effective a good while ago. Monetary expansion is nonetheless providing the liquidity needed by the banking system, where the quality of credit continues to decline. The rescue operation prepared by the Government provides an assurance of solvency.

It is essential that the planned massive reflation by means of budgetary policy revive domestic demand and set the economy back on a growth path this year.

It is essential, as indicated by the G-7 finance ministers and central bank governors at their meeting in Washington last October, that the growth in the United States be accompanied by a substantial recovery of domestic demand in Europe.

It was emphasized that, in order to create expectations favourable to a recovery of investment, far-reaching structural reforms are needed in the labour market and public expenditure.

The United States and Canada, Europe and Japan produce approximately half of gross world output. They have the resources, or can attract them from the rest of the world, to sustain domestic demand and strengthen economic activity. There are clear signs of a deficiency of demand, especially for investment goods, in Europe and Japan.

Only a faster rate of economic expansion in the industrial countries can prevent the world economy from stagnating and ensure a return to growth.

**3. The growth of money and world finance**

In the mid-eighties the bonds circulating in the G-10 countries, issued almost entirely by governments, amounted to $6.3 trillion, or 70 per cent of these countries' domestic product. In 1996 the stock of bonds had tripled to reach $21.7 trillion; output at current prices had doubled; the ratio had risen to 105 per cent.

The stock of shares increased faster; the value of bonds and shares rose from 116 per cent of GDP in 1985 to 220 per cent in 1996.

The growth in the quantity of money also exceeded that in output; the reduction in the income velocity of circulation was concentrated in the second half of the eighties. The rigorous monetary policies of the nineties have kept the ratio of the quantity of money to GDP in the G-10 countries unchanged at close to 60 per cent.

The picture changes, with a larger increase in liquidity, if account is taken of cross-border bank deposits. Interbank deposits and those held by non-banks grew at an annual rate of 11 per cent. According to data reported to the Bank for International Settlements, the former amounted to 21 per cent of world GDP in 1996 and the latter to 6 per cent.

Derivative products have made a decisive contribution to the increase in the liquidity of the world economy since the early nineties, when the growth in the quantity of money was brought under tighter control. Their notional value rose from 25 per cent of world output in 1990 to more than 100 per cent in 1996.

The use of derivatives increases the volume of transactions in financial assets that can be carried out with the existing money balances: the demand for and supply of securities increase by a multiple of the available liquidity. Derivatives permit more efficient risk management; but, used improperly, they entail the risk of instability for market participants.

One fundamental reason for the increase in the market value of shares has been the growth in the actual and potential liquidity of national and international financial markets.

The reduction in long-term interest rates, fostered by low inflation and the curbing of budget deficits, can also be traced to the same cause.

The abundant supply of liquidity in the markets is the consequence of the US balance-of-payments deficit and the monetary expansion in Japan, which accelerated in mid-1995 in the wake of the Mexican crisis. Following the Asian crisis large liquid balances were channeled into dollar-denominated instruments and into the European markets.

## 4. The Italian economy

The exports of the United States, Japan and the United Kingdom declined in the first half of 1998. Those of the euro area countries continued to rise, although this was largely due to France and Germany, which recorded annualized increases of respectively 3.4 and 2.8 per cent compared with the second half of 1997.

In Italy, the volume of exports contracted in late 1997 and the first few months of 1998, followed by a temporary recovery. The trend at the end of the year appears to have been downward again. Imports did not decline until the second half of the year; prices fell significantly.

The surplus on the current account of the balance of payments was equal to 2.2 per cent of GDP, as against 3.2 per cent in 1997.

The recovery in investment that had begun in the spring of 1997 faltered in 1998. Investment in construction has continued its downward trend. The pick-up in household consumption has proceeded regularly but at a pace that remains modest.

Industrial production remained broadly unchanged for most of the year. Preliminary estimates for January 1999 indicate that output will be at about the same level as in January 1998.

Firms’ expectations of new orders deteriorated steadily for most of last year. Households’ confidence, though lower in the second half than in the first, remains relatively high.

Thanks to the introduction and extension of forms of flexibility in labour practices, employment has staged a recovery; the number of part-time and fixed-term contracts has increased considerably. On the basis of labour force survey data, the number of persons employed increased by 0.5 per cent on average for the year in the Centre-North and by 0.6 per cent in the South. The increase was accounted for mainly by the weakest groups, women and young people.

Given Italy’s low participation rate, however, the number of job seekers has also increased. The unemployment rate in the Centre and North declined marginally in the twelve months to October, from 7.7 to 7.6 per cent. In the South, unhappily, it increased further, from 22.6 to 23.2 per cent; youth unemployment in the region rose to a new peak.

## 5. The use of saving

Saving is the raw material of investment and growth. The large quantity generated is not all put to use domestically; it is necessary to create the conditions for it to be turned into investment to the benefit of employment in Italy.

Analysis of the balance between the formation and use of saving, in a period marked by high unemployment and sluggish investment, highlights the lack of domestic demand and, indirectly, the shortfall in competitiveness.

A succession of current account surpluses in the six years from 1993 to 1998 enabled Italy to bring its net external position into balance. A high level of foreign debt is inappropriate for an advanced industrial economy and the primary cause of continuous weakening of the exchange rate and inflation.

The achievement of a sound external position was a necessary condition for stabilizing the exchange rate and consolidating the value of the currency.

In the private sector the flow of saving declined further in relation to disposable income in 1998; its use in the domestic economy to the benefit of growth and employment remained inadequate.

The external current account surplus amounted to 45 trillion lire in 1998; in absolute terms it was in line with the figure for 1995; it was one third less than in 1996 and 1997.

A substantial part of the surplus is regularly reinvested abroad, without passing through Italy's financial accounts.

The "errors and omissions" item of the balance of payments resulted in about half the current account surplus recorded in 1996 and 1997 not appearing in the national accounts. In 1998 revenues not officially brought into the country or not recorded in the financial accounts amounted to around 50 trillion lire; they cancelled out the entire current account surplus.

Analysis of officially recorded cross-border capital movements also highlights a reduction in the surplus and the progressive emergence in 1998 of a deficit of foreign investment in the Italian financial market.

Inward investment in Italian bonds and shares amounted to 61.5 trillion lire in 1995; in 1996, owing mainly to the increased liquidity of the international market, the inflow of funds rose to 125 trillion lire. It remained at about that level in 1997 and then rose to 165 trillion last year.

Funds were attracted from abroad by the steady improvement in inflation and the consequent expectation of lower interest rates. These factors were consolidated and reinforced in 1998, *inter alia* by Italy's imminent adoption of the single currency.

Italian portfolio investment abroad has increased more rapidly. Portfolio investment outflows were substantially less than inflows in both 1995 and 1996. With the reduction in official and market interest rates, investment abroad increased; owing to the less favourable outlook for profits, inward investment tended to slow down. In 1997 there was still a net inflow of 7 trillion lire, but in 1998 there was a net outflow of 18 trillion.

The proportion of foreign securities in Italians' investment portfolios is still smaller than in other countries. The process of diversification is bound to continue.

The volume of listed shares in the Italian market is comparatively small. The alignment of Italian interest rates with those prevailing abroad is beneficial for its effects on the real economy but tends to reduce the attractiveness of the national financial market for Italian and foreign investors alike.

The presence of a large number of foreign intermediaries in Italy is highly positive considering the benefits they bring for Italian saving and their role in modernizing the market. Accordingly, we have taken a favourable view of the entry of foreign intermediaries and the additional intensification of competition within Italy. However, in the absence of profitable domestic investment opportunities, the export of saving is also facilitated. The relative weakness from which the Italian banking system still suffers in terms of size and range of business is a handicap.

In the context of the single currency the abundance of saving, which for many decades was one of the great strengths of the Italian economy, loses part of its value as a comparative advantage in fostering growth.

The new situation created by greater openness to cross-border financial flows calls in the first place for a strengthening of the efficiency and competitiveness of the banking system.

The response must be prompt and adequate in order to grasp the opportunities for growth and to finance profitable projects in Italy. We have encouraged the privatization of the banking system and the formation of groups large enough to compete more effectively in Europe.

The competition for saving at the global level depends ultimately on the growth and efficiency of the economy.

Foreign direct investment in Italy amounted to respectively 5.5 and 6.3 trillion lire in 1996 and 1997; in 1998 it rose to 6.9 trillion. Direct outward investment by Italian firms was 10 trillion lire in 1996 and rose to 18 trillion in 1997. In 1998 it amounted to 30 trillion. The Italian economy attracts considerably less foreign direct investment than France, Spain or the United Kingdom. Only Germany is more or less on a par with Italy in this respect.

In a developed economy, exports of capital by firms investing abroad are normal. In Italy, however, there are still large parts of the country where development is insufficient and unemployment very high.

Some 10 per cent of all the employment generated by Italian industry is created outside the country.

Together with the weakness of investment activity, the situation of Italy's external accounts I have described and, in particular, the balance on foreign direct investment all point to the necessity of improving the competitiveness of Italy's productive system within the global and especially the European economy.

## 6. Competitiveness

With the complete international opening of trade and capital movements and the adoption of the single currency, competitiveness is directly reflected in employment and growth.

In the new international and European context, the advantage of banking and financial systems, their ability to contribute to growth, are in large part the result of the efficient use of the funds they raise.

In an open system, however, what ultimately counts is the demand for funds; this in turn depends crucially on the conditions of employment of the factors of production, above all the profitability of the corporate sector.

In Italy, high taxation and the high level of labour costs relative to productivity in some areas hold back growth in investment and employment; they contribute to the expansion of the black economy, which harms the public finances and the efficiency of the productive system, distorts competition and has pernicious effects on the orderly life of the community.

Between 1990 and 1997 the ratio of total general government revenue to GDP rose by 6 percentage points. In 1997 the tax burden in Italy was almost one point above the European average; it was 13 and 14.5 points higher than in the United States and Japan, respectively. In 1998 the tax burden decreased by one percentage point as the result of the expiry of some temporary measures and the reduction in the yield from taxes on financial income owing to the fall in interest rates.

Public investment fell from 3.3 to 2.4 per cent of GDP between 1990 and 1997.

In a medium-term perspective, there are reforms, many of which have been initiated, that remain to be completed in order to curb current spending, above all on pensions and welfare, and to enhance the effectiveness of expenditure, especially for education and health care.

The efficiency of public services and the stock of infrastructure are not as high in Italy as they are in the industrial economies with which we compare ourselves.

It is estimated that 9 per cent of the workers in manufacturing industry are in an irregular position with respect to tax, social security and job-safety rules. In the building industry the ratio rises to 34 per cent. Irregular employment is much more widespread in the South, where in some sectors it reaches 50 per cent.

At the root of the grey economy are insufficient differentials in labour costs between areas and firms with very different levels of productivity and profitability; the phenomenon also leads to the evasion of taxes and social security contributions. Through the black economy the market tends to achieve a *de facto* closer alignment between labour costs and productivity.

The improvement of competitiveness is to be pursued by increasing the efficiency of the public sector. It is important to proceed with the full operational implementation of the legislative reforms enacted.

Frequently, the limited project development capability of local authorities and the lack of coordination with central government are far from secondary causes of the slowdown in expenditure on public investment and the failure to use the funds and resources available.

## 7. The outlook

At the root of the instability and recurrent crises of the world economy is the very rapid, at times chaotic, growth of finance, inconsistent with the growth in productive activity. This has consequences for the stability of exchange rates, the purchasing power of currencies, interest rates and securities prices. It has adverse effects on the financial position of banks and intermediaries, the business cycle and employment.

The development of the international monetary system and its current configuration are the product of market forces. The institutional context does not permit quantitative limits to be set on the growth of flows. Transparent and widely accepted prudential rules for the management of intermediaries are not always applied.

The liberalization of capital movements and finance has greatly contributed to the growth of worldwide investment and saving.

The gains from the liberalization of trade in goods and services are certain at the global level and not distributed too unevenly, thanks to the operation of relative prices in response to the availability of factors. With the expansion of purely fiduciary money, there are no binding limits to quantities; monetary and financial expansion can be very uneven across the world and create tension and instability.

Monetary and financial instability is detrimental to the efficient allocation of saving and the regular growth of economic activity. It gives rise to inflation, sometimes to recessions. It can lead to an excessive concentration of financial resources in some countries and areas and an inequitable distribution of wealth, possibly producing tension and political conflict.

The experience of the decades since the collapse of the gold-exchange standard has no precedent in history.

The free circulation of capital under the gold standard took place in a context in which the growth of money and finance had an ultimate reference, a quantitative anchor in the gold reserves of governments and central banks.

The Bretton Woods system, based on the reserve currency role of the dollar, considerably increased the scope for monetary expansion and multiplication. An ultimate quantitative limit still existed. Flows of bank capital were subject to rigid rules; the International Monetary Fund adopted forms of control designed to ensure compliance with equilibrium conditions by each national monetary system.

The absence from 1971 onwards of the link between gold and the international reserve currency and the elimination, partly in response to the ideology of liberalization and the interests of multinational firms and banks, of every rule concerning the transnational expansion of credit and the transnational circulation of money meant that the growth of money and credit became theoretically unlimited. Initially, during the seventies, this resulted in a long period of rapid inflation worldwide and high interest rates and, ultimately, in a severe slowdown in the industrial economies.

The return to tighter monetary control in the eighties, first in the leading industrial economy and then in the others, led to a gradual reduction in inflation, but at the cost of a further rise in interest rates and a prolonged drag on economic growth.

International liquidity expansion continued, partly as a result of the progressive liberalization of short-term capital movements.

It was only in the nineties that more vigorous and coordinated monetary control efforts by all the industrial countries made it possible to rein in the expansion of money, at the international as well as the national level, and curb inflation.

The growth in the supply of securities continued, however; the complete liberalization of capital flows encouraged the illusion of unlimited scope for financing public sector deficits and countries' external imbalances. The market reacted to the monetary restriction by developing derivative products, which in practice act as an additional multiplier of the liquidity created by banking systems.

Financial globalization is not a zero-sum game; it brings major benefits for world economic development but it can also generate instability and substantial losses for smaller and weaker economies.

It is necessary to proceed resolutely with the action initiated by the International Monetary Fund and the World Bank to relieve the heavily indebted poor countries of a burden contracted years ago in conditions of extreme need.

The conditions exist for this relief to be completed by the end of the year 2000, fulfilling the hope expressed by the Roman Catholic Church, international organizations and prominent political personalities.

On several occasions we have insisted in the appropriate official fora on the need for the activity of the International Monetary Fund to be refocused on the prevention of crises, over and above its valid performance of crisis management, albeit in the midst of difficulties and with some failures.

Even though the external constraint is less immediately binding, in view of the greater scope for raising finance offered by the global market, it is necessary to place renewed emphasis on the external equilibrium of each country and each monetary system. The macroeconomic surveillance carried out by the International Monetary Fund under the gold exchange standard must be revived in the new institutional and market conditions.

The main causes of the crisis in Asia in 1997 and of the more recent events in Latin America were the failure to satisfy the conditions of external equilibrium and excessively rigid exchange rates of local currencies.

The crisis cannot be overcome without a recovery in the growth of the world economy supported by the domestic demand of the developed countries, as called for by the Group of Seven at its meeting last October.

In that forum a start was also made on studies and actions aimed at reforming the working of the international monetary system.

The creation of a European currency that is common to eleven countries is a major event for the stability of world finance.

The ground was prepared for the single European currency by the stabilization the participating countries carried out in the nineties. Inflation was tamed but the rigidities and competitive weaknesses of Europe’s economies also emerged clearly.

The monetary stability that has been regained can and must provide the basis for a new phase of growth; appropriate economic policies and consistent behaviour by employers and workers can produce new confidence in the ability of Europe’s economies to achieve rapid and sustainable growth.

Structural policies are required in all the countries of the area to reduce the rigidity of public expenditure on current account, allow an easing of the tax burden and introduce elements of flexibility in a labour market that still responds to the logic of closed economies.

The measures are needed in order to bring down the high rate of unemployment and to give, through the vigour of the productive economy, greater force to the single European currency.

Money is largely the product of credit granted to private productive activity. Its strength depends not only on the prudent management of interest rates and quantities but also on the prosperity of the economy and the quality of lending.

Where currencies are firmly anchored to productive activity, the setting of objectives for exchange rates appears logically extraneous to the system.

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The halt in the growth of the emerging economies and financial instability have led to a worldwide slowdown in economic activity that is tending to carry over into 1999.

In Italy the structural problems of the public finances, the large public debt and the level of the competitiveness of the financial system and the economy influence investment and employment.

The adjustment of the public finances, intensified from 1993 onwards, the cooperation between employers and the unions, and the restrictive stance of monetary policy from 1995 to 1997 made it possible to recoup the serious fall in the value of the lira and to root out both expectations of inflation and inflation.

Italy's re-entry into the ERM and the restrictive fiscal policy of the last two years have consolidated the results of the stabilization.

Partly owing to the efforts required to reduce the budget deficit, the Italian economy grew at an annual average rate of 1.2 per cent in the period 1996-98, or about half as fast as the German and French economies. The problems in the world economy contributed to growth in 1998 being much slower than expected. There is the risk that the trends of demand and output in the last part of the year will lead to unsatisfactory results for 1999.

The large volume of saving available, of which a part flows abroad in the absence of profitable investment opportunities within Italy, and the unemployed labour force reveal the plentiful availability of resources for a return to rapid growth.

Expectations must be modified, the climate of confidence improved.

Determined progress must be made, by means of extraordinary measures where necessary, in the reform of the working of the machinery of government by improving the efficiency and efficacy of the procedures. The plans for reviving investment in the South must be implemented, construction sites must be opened. The level of transport and water supply infrastructure must be raised. The funds and credit available at Community level must be utilized to the full. The process will gain from improvements in the project development and decision-making capability of local authorities, in part as a result of advances along the federalist-oriented path indicated in the proposed reforms of the Constitution.

The medium-term policy of achieving equilibrium in the size and composition of the budget must be perceived by the market and business as a certainty. Tax competition is bound to intensify in Europe in the coming years; it will result in investment tending to be concentrated where the tax regime and the social environment conditions are most favourable and the cost of labour lowest.

In the context of Europe and the global economy, flexibility in the conditions governing the supply of labour is necessary in order to enhance competitiveness; it can help to support and increase employment both in large firms and in small and medium-sized enterprises.

The broad consensus on the two sides of industry on the definition of the recently signed social pact can provide the foundation for a new incomes policy, for a lasting reduction in unit labour costs where unemployment is highest and illegal work most common, to the point of becoming the norm. If flexibility brings increased and more stable employment, the dignity of workers is defended and the participation in productive activity widened.

The lofty issues concerning the orientation and development of society lie within the sphere of politics. What is needed is an underlying stability in the country's institutions and in society based on convictions that are shared by all. The objective of more rapid growth, increased employment and better prospects for the young is universally accepted. It can serve as a reference point, without detracting from the debate that is inherent to democracy, for strengthening the social and political fabric.