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ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1954

PRESENTED TO THE

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31st MAY, 1955

Excerpts from the Governor's Concluding Survey

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XII. *Excerpts from the Governor's Concluding Survey*

Gentlemen,

it is our task to draw from the figures, observations, and references contained in this Report certain conclusions which, on the basis of a summary reclassification of the numerous data, attempt to outline the fundamental facts of the economic life of our country. Devoting special attention to the financial aspects of these facts, we shall also attempt to draw from them indications capable of facilitating the course of future action, for which we ourselves are partly responsible.

This year, the studies on our economic situation have had the benefit of the remarkable contributions made in the « Survey on the economic position of Italy » submitted to Parliament and, above all, of the publication of the Programme for the « Development of Employment and Income in Italy in the Ten-Year Period 1955-1964 ». This full and scientifically conducted investigation of the problems of our economic development, carried out with a full awareness of the structural conditions of our productive system and the fundamental needs of Italian society, presents for the first time in our country a unified picture of these problems, and the final effects that any given course of action is likely to produce on the development of income and employment. One of the merits of the Programme is that it has provided a useful guide for preventing those losses which result from a failure to make use of the human, capital or material resources available in our country.

As the framework for our conclusions, we shall start with an analysis of the balance sheet of the Bank, into which are channelled the various monetary flows arising from the movements of production, domestic and foreign trade, and from public finance developments, in order that we may trace the often remote causes of these movements from the results shown in the accounts of the Bank. The credit side is divided into three prin-

principal categories of assets: loans and advances, Treasury accounts, including holdings of government securities by the Bank, and lastly, the direct and indirect financing of the official foreign exchange holdings; the debit basically shows the Commercial Banks' funds held by the Banca d'Italia in the form of demand and time deposits, and currency circulation.

The analysis of the first category of assets will permit us to show how production and trade were financed by the credit system during the year; the analysis of the second category will permit us to measure the repercussions of the management of the public finances on the balance sheet of the Bank; and finally, the analysis of the third category, will allow us to examine our position in regard to our economic and financial relations with foreign countries.

The Financing of Production and Trade.— The loans of the Banca d'Italia to Banks and Savings Banks increased by 43 milliards from December 31, 1953 to December 31, 1954; since the deposits of these banks, other than for statutory reserves, increased by only 8 milliards, there was a net increase in their borrowing of 35 milliards. This is a first indication that in 1954 the banking system was subjected to demands in excess of the resources which flowed to it during the course of the year. An analysis, though brief, of the lending and borrowing activities of the banking system will show that in 1954 it was confronted with a heavy demand which it did not find easy to meet. The volume of credit granted to the private sector by the entire credit system (Banks and Savings Banks, special institutions for credit to industry and public works, and agricultural, mortgage and building credit institutions) increased between the end of 1953 and the end of 1954 by 724 milliards, thus exceeding the increase of 712 milliards, which in itself appeared to be extremely high, registered in 1953. If the loans of the Institute for Industrial Reconstruction and the Central Post Office Savings Fund are also included, the figure for loans in 1954 rises to 861 milliards, a figure which is also higher than the 829 milliards in 1953.

Total loans of the banking system thus rose from 4,213 milliards as at the end of 1953 to 4,937 milliards as at December 31, 1954. The latter figure, considered alone, is 91 times the amount of such loans as at December 31, 1938, and is indicative of a notable participation of the banking system in the field of production; but the burden placed upon the system is measured better by the fact that, whereas national income at current prices in 1954 was 78 times that of 1938, the amount of new financial resources provided last year for the development of the economy was about 200 times that of 1938. If the comparison is made between 1954 and 1947, which was the year in which excessive credit expansion had to be arrested by certain well-known measures, and in which the price level did not differ substantially from the present level, the increase in the amount of loans was about 1.6 times.

The amounts just referred to require some comment.

To clear the ground of minor questions, and to measure as faithfully as possible the effort the banking system is making, it must be pointed out that of the 724 milliards which it supplied to the economy, 54 milliards were financed with resources obtained from the Treasury (agricultural revolving fund, Aldisio loans, ERP funds carried over). Therefore the money furnished to the private sector by the banking system on its own was 670 milliards. It also invested 161 milliards, of which 87 milliards was in Treasury Bills and other Government securities, 57 milliards in statutory reserves held on deposit at the Banca d'Italia, and 17 milliards in shares and debentures. Thus, if the additional liquidity is also included, which, though limited in amount (31 milliards), the banking system had to maintain in relation to the increased volume of deposits, the funds it had to procure during the year, from both the domestic and the international markets, amounted to 862 milliards, excluding Government assistance.

This enormous sum of money was obtained in the form of savings deposits and current accounts at Banks and Savings Banks (559 milliards), sale of debentures and interest-bear-

ing notes beyond those subscribed by the Banks and Savings Banks (144 milliards), increases in capital and reserves of Banks and long-term credit institutions (38 milliards), and increased net indebtedness in foreign currency (59 milliards). But to reach the full amount needed to cover the larger volume of lending operations, including minor items of 19 milliards, the Banks and Savings Banks had recourse, in the usual form of rediscounts on the financing of agricultural stocks, to the Banca d'Italia, which, as already indicated, had to supply 43 milliards. It should be added that the 670 milliards of 1954 corresponded to 652 milliards in 1953, 632 milliards in 1952, and only 409 milliards in 1951 and 411 milliards in 1950. For three years, therefore, the expansion of the banking system is measured at about 650 milliards a year, which exceeds that of 1950 by about 60 per cent.

The heavy demand for bank loans in the last three years has not been the consequence of an impoverishment of the other sources of finance. The tables on the « Flow of Savings and the Money Supply » published in our Reports show that the money collected from the public in the form of savings deposits with Banks and Savings Banks, Post Office Savings Books and Bonds, Government or Government-guaranteed securities, interest-bearing notes, shares and debentures less subscriptions by the banking system, and reserves of insurance companies, was around 600 milliards in both 1950 and 1951, rose to about 800 milliards in 1952, which was a year of great liquidity, and rose still further to 993 milliards and 1,026 milliards in 1953 and 1954, which years, however, were characterised by a credit stringency of some importance. These last two figures are more than 60 per cent higher than those of 1950/51, although they reveal only a slight increase for last year.

In the period from 1952 to 1953, however, and again from 1953 to 1954, the funds which flowed to the capital market acquired increasing importance in comparison with those which flowed to the banking system and Post Office savings banks. The size of the capital market increased from 230 milliards in 1952 to 310 milliards in 1953, and to 407 milliards in 1954, thus absorbing about 177 milliards between 1952 and 1954. This was almost

80 per cent of the increase in the total amount of deposits with Banks, which rose, as we have shown, from about 800 milliards in 1952 to well above 1,000 milliards in 1954. This fact, if it is permissible to assume what will happen in the future on the basis of what has taken place in the recent past, leads us to say that the importance of the different instruments for financing production is tending to vary, in the sense that the rôle played by the Banks is decreasing in comparison with the growing importance of the capital market. This tendency has also developed in the most important foreign countries, where every effort is made to favour it. A comparison between the last two years' «Flow of Savings and the Money Supply» reveals not only the phenomenon of the increased participation of the capital market in the channelling of savings to investments, but also the substantial equality of the volume of savings available to the Treasury in these two years for its own purposes, and for the loans of the Central Post Office Savings Fund. The total amounts involved were 311 milliards in 1953 and 322 milliards in 1954, not including the sum that went to the Treasury in the form of statutory bank reserves.

The size of the capital market can be gauged by the fact that the total issue of shares decreased from 192 milliards in 1953, to 147 milliards in 1954, while the issue of debentures, made for the most part by the long-term credit institutions, increased from 134 milliards to 156 milliards between the two years. Less duplications and placement with Banks and Savings Banks, total shares and debentures sold to the public amounted to 162 milliards in 1952, 221 milliards in 1953 and 239 milliards in 1954. The reduction of shares issued, which was of a purely voluntary nature in as much as the Inter-Ministerial committee for credit and savings authorised all increases of capital requested, is not explained by the behaviour of Stock Exchange quotations, the average index of which increased 29 per cent during the year. Therefore it can be considered that further issues could easily have been placed.

The intensity with which money had flowed to the capital market in these years when income has been rising substantially,

is explained by the fact that savers, once they have reached an amount of deposits they consider sufficient for the unforeseeable contingencies that may require them to make use of liquid funds, slow down the further accumulation of Bank or Post Office savings deposits. They turn to other forms of investment, such as Government or private securities, or, of course, to the purchase of furniture, durable consumer goods, houses, or life insurance policies. Similarly, it can be considered that enterprises, after having re-established in past years their normal degree of liquidity, placed their excess margins of financial resources in direct or portfolio investments.

Under these circumstances, it seems to be logical that it is not the first segments of savings that tend to remain outside the banking system, but rather the higher segments, and consequently it is only in respect to the latter that the amount of interest paid on deposits becomes a real incentive. That explains why the Banks decided, as of February 1954, to increase the rates paid on time deposits, into which flow the higher segments of deposits, those believed to be not urgently needed. But, even if the objective of safeguarding our credit system, which meets the permanent requirements of our country, especially the development of local economies, requires that interest on deposits be not excessive, in accordance with a principle which is carefully observed abroad even in countries favouring the utmost freedom of competition, other reasons of general interest fully confirm the desirability of such a principle.

The growth of deposits, however, should not be entrusted to an increase in the interest paid on them, but rather to an improvement in the standard of living of those who are still far removed from the credit institutions, and who have come to them in recent times only with minimal amounts. It is reassuring to observe in this connection that in the years following the monetary stabilisation, the underdeveloped regions of southern Italy and the Islands have taken part in the movement to accumulate bank deposits, with amounts which, although they seem small in absolute terms in comparison with the larger funds which flow to the banks of the North on the basis of the initial

levels, represent relatively higher increases than those obtaining in the rest of the country. Even in the field of credit, therefore, the shortening of the distances between the economy of the South and that of the North appears to be desirable, not only as a good end in itself, but as an instrument in that process of economic expansion which must also include banking activity.

The rehabilitation of the southern areas and the improvement of the well-being of the poor, as well as a limitation on the other classes in the general march towards higher consumption, are the objectives to be pursued. From this point of view, it is not superfluous to point out that while the volume of investment increased notably last year, savings channelled through the credit and capital market increased but little on the basis of the data given in our Report. The moderate change between the two years may perhaps be connected with reduced grain production; it may also be attributed to heavy building investments made by the many Italians who want to obtain homes of their own, since the maintenance of rent control prevents a rational utilisation of the building assets subject to that control.

But the level of savings which flowed to the banking system, besides being affected by the portion of savings directly invested, appears also to have been restricted by heavy increases in purchases of consumer goods (cars, household electrical appliances, etc.), as well as non-essential items (tobacco, entertainments, etc.). We do not wish to draw any conclusions from this hypothesis, other than that it is impossible to advocate large increases in consumption and in the purchase of durable goods at the expense of investment in capital goods, and at the same time to call on the credit and capital market in general for funds in excess of the resources which flow to those markets, and which are reduced by the growth of consumption. Therefore, it is obviously in the interest of the credit system that the economic development of the country should take place along the lines of the ten-year Programme, which aims at providing employment for a large number of unemployed or underemployed, thus making them potential savers. This presupposes the adoption of measures capable of ensuring that the total expansion of con-

sumption will be somewhat slower than the accumulation of income, so that an increasing flow of savings may be channelled into the banking system.

The heavy demand for bank loans last year, as has been seen, did not arise from the drying-up of other sources of capital, nor, on the other hand, is it explained by the movement of prices, which remained substantially stable. The index of wholesale prices of the Central Institute of Statistics indicates a slight increase of 1.8 per cent between December 1953 and December 1954, while the index of the Chamber of Commerce of Milan, shows only a rise of 0.7 per cent—changes not appreciably different from those normally registered in countries which are considered to enjoy sufficient monetary stability. Last year was characterised by a remarkable agreement between the behaviour of our general index of wholesale prices and that of international prices, both of which increased slightly (about 2 per cent) from December 1953 to December 1954.

This seeming parallelism, however, conceals contrary movements for both foodstuffs and industrial prices: the former increased appreciably in Italy (agricultural foodstuffs in general increased by 4.6 per cent, among which livestock products increased by 12.9 per cent), whereas they dropped slightly on the international market; the latter increased abroad, and decreased, though moderately, in Italy. The contrast between the behaviour of foodstuff prices and industrial prices in Italy is greater if June 1952, is taken as the point of departure, the date to which the change in the situation following the Korean cycle is generally traced. From that time to December 1954 the Central Institute of Statistics index of wholesale agricultural food prices increased by 15 per cent; the index of the Milan Chamber of Commerce also increased, though to a smaller extent, by 6.3 per cent. During the same period, the index of domestic industrial prices as calculated by the Milan Chamber of Commerce dropped by 8.9 per cent. On the international market, however, between the same dates agricultural and food prices remained stable on the whole, but decreased noticeably (13 per cent) if the prices

of coffee, tea and cocoa are disregarded; prices of industrial raw materials also dropped by 3.4 per cent.

Such similarities and differences are also revealed if a comparison is made between the prices of consumer goods in general and those for capital goods in Italy and abroad. On the basis of re-elaborations by the Bank's Research Department of the indexes of domestic prices prepared by the Central Institute of Statistics and of international prices computed by the Confindustria, it appears that, from December 1953 to December 1954, the prices of consumer goods increased more in Italy than on international markets, whereas prices of capital goods decreased slightly in Italy and increased somewhat abroad. In relation to June 1952, prices of consumer goods increased 7.3 per cent in Italy and, conversely, decreased 2.6 per cent on the international markets; prices of capital goods decreased 13.1 per cent in Italy and increased 2.6 per cent abroad. If a comparison is made with June 1950, it is found that prices of consumer goods increased 15.5 per cent and only 1.1 per cent on the international markets, whereas prices of capital goods increased 36 per cent abroad and only 21 per cent in Italy.

Since the large investments made in these years in Italy did not cause an increase in the prices of capital goods comparable to that which took place abroad, it appears that the principal cause of this phenomenon may be found in the fact of the excess productive capacity existing in Italy after the war in many branches of industry, and in the policy of liberalisation adopted by our country. This has prevented the intense domestic demand from causing a surge in prices, since they are held in check by foreign competition. A further substantial contribution toward checking the rise in industrial prices has been made by the increase in productivity arising from the modernisation of factories which has been taking place in Italy in recent years by means, both of machinery purchased on long term under the ERP plan, and of the large volume of sterling accumulated up to 1949. This has made possible the reduction in the large discrepancies previously existing between foreign prices and Italian costs.

In the field of consumer goods, the opposing trends of domestic prices and international prices are probably explained both by the absence in several branches of production, especially in agriculture, of that unused productive capacity which existed in industry, and by an increased monetary demand not always easily met by supply, together with the lower effectiveness of the policy of liberalisation. For certain types of widely consumed foodstuffs, the policy of liberalisation has not had any real chance of being effective. In 1954, for example, about one third of the increase in the foodstuff sector in the index of the cost of living was due to the increase in the price of fruit, probably caused by a decrease of about 8 per cent in the crops. But unfortunately, besides the results of entirely natural phenomena, such as the increase in the price of certain agricultural products arising from a decreased domestic production which cannot be replaced by imports, even seasonal changes tend to consolidate through the action of the sliding-wage scale mechanism. For example, the index for foodstuffs was 4.4 per cent higher in July 1954 than in December 1953, and this increase was entirely due to a seasonal price increase in fruit and vegetables (28.2 per cent): as a result, the sliding wage scale rose 3 points in this period.

Therefore the continual concern with anything that can cause an increase in the price level, must appear to be fully justified: the increased employment of factors of production that were abundant several years ago has tended to abolish that condition which, as we have pointed out, has permitted a smaller increase in the prices of capital goods here than abroad. Thus, if the reasons which have kept the prices of our consumer goods high were to remain valid, or, what would be worse, if new ones were to be created, it would be impossible to avoid our price level from getting out of line in respect of foreign prices, and hence a deterioration from occurring in our competitive position in foreign trade.

The Financing of Government Requirements.— A second group of items in the Bank's balance sheet concerns the general

transactions with the Treasury and the Banks' holdings of Government securities. This group of items, which does not include the debts contracted by the Treasury with the Italian Foreign Exchange Control Office mainly to finance the import of machinery and commodities for Government stocks, amounted to 714 milliards on December 31, 1947 and 1,001 milliards on December 31, 1954, an increase of 287 milliards. This amount was fully covered by the increase that took place between the two dates in the Banks' statutory reserves with the Banca d'Italia, which rose from 73 milliards to 445 milliards, an increase of 372 milliards. In the same period, savings deposits at the Banks increased by 1,133 milliards and the direct investment by the Banks of their statutory reserves in government securities increased by 354 milliards.

One of the rules on which monetary stability is based, the limitation of advances to the Treasury on the part of the Central Bank, has therefore been observed in the last seven years. No small part of the success which the country has achieved in the monetary field has been due to the pursuit of this policy. To avoid any risks, it must firmly be maintained, all the more so because in the last three years the situation has been much less favourable than in the previous three-year period. The large amount of international aid received between 1949 and 1951 permitted the Treasury to reduce its total indebtedness to the Bank. In the last three years, on the other hand, there has been an increase in the Treasury's indebtedness, although the situation has tended to improve over the period: the size of this improvement has been only a few milliards, but nevertheless it is significant of the efforts the Treasury is making to finance the Budget deficit with voluntary contributions of savings from the market. It would be desirable to aim, if not at the total elimination of the Budget deficit, at least at containing it in such a way as to avoid any increased recourse to the Central Bank and to check the extent to which it has been necessary in past years to rely on the Commercial Banks' statutory reserves.

We realise that this is by no means an easy task. Government Expenditure has always a tendency to increase, while the Budget Revenue has already shown an appreciable advance: from a 1,000 milliards in 1947/1948, it has risen to 2,200 for the current financial year. The provisional estimates for 1955/1956 show a further increase of 250 milliards, which brings the total to 2½ times the 1947/48 level. Nevertheless there are other considerations which make us believe that it is essential further to limit the increase in the public debt used for financing budgetary and other public expenditure.

As we have said, the sums which, apart from the investments of the banking system, flow to the Treasury through the purchase of government securities and railway debentures, and through Post Office Savings Books and Bonds, have not differed much from year to year since 1948 and have fluctuated at around 250 milliards a year. The total needs, however, of the Treasury, of the Central Post Office Savings Fund and of the Railways were much greater. They amounted to 500 milliards in 1948, dropped sharply in the three-year period 1948/51, partly as a result of the use of Counterpart Funds, and rose to slightly less than 500 milliards in the more recent three-year period 1952-1954.

Although the Treasury's annual requirement of funds to be drawn from the banking system and the capital market has not appreciably altered over the period from 1948, it has nevertheless proportionately decreased in relation to the rising level of Expenditure. If we consider only the National Budget, the Expenditure of the « Administrative Budget » (*spesa di competenza*) to be covered by borrowing, which was 48 per cent in the 1947/48 Budget, decreased to 16 per cent in 1950/51, rose to 24 per cent in 1952/53 and dropped back to 16 per cent in the current financial year; the initial estimates for the year 1955/56 indicate a further reduction to 11 per cent. If instead of using the figures for authorised appropriations to measure the relationship we have brought up, we take the figures for the « Cash Budget », and also include the Central Post Office Savings Fund and the Railways, the improvement is still confirmed, the uncovered part

of expenditure dropping from 34 per cent in 1948 to 19 per cent in 1954. This was a notable advance.

But it is none the less true, that if the funds supplied directly by savers remain around 250 milliards per year, the Treasury must inevitably go to the banking system to cover its necessary requirements, a practice which in the long run might prevent the system from financing production efficiently, or might generate inflationary dangers. At the beginning of the last seven year period, these dangers were averted by the fact that heavy government demand only occurred in 1948, while in 1949 there was a strong contribution from American aid (216 milliards); in 1950 the Budget receipts exceeded those of 1948 by a figure higher than the increase recorded in payments between the two years; furthermore in 1950, in a capital market of much smaller dimensions than the present one, the first post-war issue of nine-year Treasury bonds was made, the large proceeds of which prove that not only current savings, but also savings from previous years, went into these bonds, a form of investment especially attractive to savers.

All these conditions do not exist today. American aid has been sharply reduced, and the market for government securities does not warrant the hope that larger issues may be placed than in previous years. Therefore the necessity remains of reducing Government requirements to be covered by both budgetary and extra-budgetary financing. For this reason, we cannot fail to be appreciative of the fact that the Government has consistently pursued its declared intention of reducing the Budget deficit from year to year. It has presented for 1955/56 Estimates which show a financial deficit which is 37 milliards less than the Initial Estimates for 1954/55.

Foreign Exchange Financing and Balance of Payments Problems.— The financing of the official foreign exchange holdings is carried out by the Bank both directly, and through the credits it grants to the Italian Exchange Control Office. As at December 31, 1954, the official gold and foreign exchange holdings, after deduction of the debt contracted with the European Pay-

ments Union and of minor amounts on lire and clearing accounts, amounted to \$ 891 million, which showed an increase for the year of \$ 55 million. This increase in the exchange reserves was accompanied by a notable improvement in their composition; the year closed with an increase in dollar holdings of \$ 162.3 million and, on the other hand, an increased indebtedness to EPU of \$ 33.0 million, as well as with a reduction of sterling holdings and clearing currencies amounting to \$ 73.9 million.

It should be pointed out at once that the favourable impression created by these final results is offset by the fact that they arose from the inclusion of \$ 104.3 million in FOA aid carried over from previous years, of \$ 132.5 million received during the year for off-shore purchases in Italy and of other items closely connected with the NATO military programmes. All of these receipts are of a merely temporary nature, some now being in the process of termination. It should also be pointed out that an amount of \$ 73.9 million, representing both increased indebtedness of the country abroad (the result of loan repayments to the amount of \$ 30.9 million and new loans contracted for \$ 104.8 million), and the greater utilisation of bank lines of credit, together with changes in trade debits and credits, played a part in determining the above mentioned movement of reserves. But, as we pointed out last year, it is not the behaviour of the foreign exchange reserves that should be observed for assessing the payments equilibrium with foreign countries, so much as the current items of the balance of payments. For 1954 these items showed a deficit of \$ 254 million. Here again a favourable impression is obtained from comparing this deficit with the larger ones of \$ 450 million in 1953 and \$ 596 million in 1952. Thus there has been a gradual and unquestionably substantial improvement in the last two years, which, should it be maintained, would make it possible to eliminate the deficit in a short time.

But this is not the case. As we have been saying for several years, the balance of payments problem is the most serious one in our economy, in view of Italy's basic development require-

ments. First of all, in the more recent period, it is noteworthy that the expenditure made in 1954 for wheat purchases, as a result of the favourable crop in 1953, amounted to only \$ 24 million against \$ 114 million in 1953; thus, if the 1954 expenditure for wheat had not been cut down considerably by the exceptional harvest in 1953, the deficit on current items would certainly have exceeded \$ 300 million.

Some comparisons with the year immediately preceding the Korean war will suffice to isolate the causes, at least the immediate and most important ones, of a situation which cannot be changed in a relatively short time, or without significant consequences. In the year 1949/50 the unfavourable balance of the current items amounted to \$ 121 million. Since \$ 122 million were spent for wheat that year against only \$ 24 million in 1954, the difference between the two years is measured by a deterioration of \$ 231 million on all items of the balance of payments, excluding the purchases of wheat abroad, and by an improvement of about \$ 98 million in these specific purchases.

Looking first of all at the behaviour of the invisible items, namely all the current items which enter into the balance of payments except the movements of goods (f.o.b.), we find that there was an advance from a surplus of \$ 117 million in 1949/50 to a surplus of \$ 359 million in 1954. This was an important increase of more than \$ 242 million, of which \$ 83 million was accounted for by tourism, \$ 50 million by freight, \$ 33 million by workers' and emigrants' remittances, and 76 million by miscellaneous items. This progress was such that it would have created a balance of payments surplus, if at the same time the deficit arising from imports and exports of merchandise (again excluding imports of wheat), had not increased heavily from about \$ 128 million to about \$ 591 million in 1954, in other words, if there had not been a deterioration of some 463 millions. This deterioration was due to an increase in payments for imports of \$ 952 million which was only offset to the amount of \$ 489 million by an increase in receipts from exports. Export proceeds in fact rose from \$ 1,090 million to \$ 1,579 million, an increase of 45 per cent, between the two years under consideration.

An international comparison for the years between 1950 and 1954 based on OEEC statistics, which, unlike the above data in Italian exports, include offshore purchases and ships' stores, and represent c.i.f. values on the import side, showed that the OEEC countries as a whole, excluding Germany and Italy, witnessed an average increase in exports of 37,8 per cent, whereas 35.3 per cent was registered for Italy. Germany's improvement was 165.8 per cent; if German exports are included, the improvement for all OEEC countries, excluding Italy, was 51.4 per cent. On the other hand, imports increased between 1950 and 1954, for Italy by 72.7 per cent, wheat excluded, and by 62 per cent, wheat included, whereas they increased by only 33.8 per cent for the other OEEC countries, except Germany, which registered an increase of 70,2 per cent.

A comparison of these percentages brings out how much the state of affairs in Italy differed from that in the other principal European countries in this period. While in the field of exports the difference between our increase and the average increase for all the other countries, except Germany, is slight, in the field of imports it is extremely pronounced. Pausing for a moment on exports, we note that in the period from 1950 to 1954, Italy with an increase of 35.3 per cent stands, among the principal manufacturing countries of OEEC, in a position somewhat similar to that of Switzerland (35.9 per cent), Belgium (39.9 per cent), France (40.3 per cent), Sweden (44 per cent), above that of the United Kingdom (23.3 per cent), and below that of the Netherlands (71.5 per cent), and Germany (165.8 per cent).

A quick glance at the development of imports is sufficient to make clear the main changes that have taken place from 1950 to 1954, when, as already said, imports rose by 72.7 per cent. As regards imports of foodstuffs (excluding those of wheat, which decreased), the increased purchases of several products amounted on the whole to about \$ 135 million. This increased expenditure was offset only in part by higher proceeds from the exports of domestic foodstuffs (\$ 92 million); there remained an uncovered difference of \$ 43 million, which corresponded, more or less, to the increased expenditure on coffee, imports of which

increased between the two years under consideration by 32 per cent in quantity and 113 per cent in value. The principal economy achieved, for the reasons indicated, was in the purchase of wheat, which decreased by \$ 83 million between 1950 and 1954; but, as we have said, this saving will not be maintained in future years. All these indications show that the undeniable progress made between 1950 and 1954 in the production of foodstuffs, was neutralised by an expansion of consumption, and thus failed to bring about an appreciable improvement of the trade balance.

But the most important increases in purchases abroad between 1950 and 1954 were recorded in raw materials and in industrial goods, both for investment and for consumption. The imports of scrap iron, steel, and iron ore trebled in volume during the period. Making due allowances for prices, which in 1954 were higher than before Korea, the entire group of minerals, scrap, and products of the metallurgical industry accounted for an additional \$ 136 million of our imports, an increase which was double as much as the full total of previous expenditure. The purchase of machinery and equipment more than doubled, rising from \$ 100 million to \$ 240 million.

Moreover, despite the striking increase in the consumption of fuel oil and natural gas, the purchase abroad of coal did not decrease between the two years under consideration. Partly because of the expanding exports of refined petroleum products, the quantity of imported crude oil approximately trebled, involving an additional \$ 190 million; but if we consider only the influence of purchases abroad of crude oil and petroleum products for domestic consumption, it can be said that they increased 90 per cent, causing a deterioration of about \$ 65 million. Among the other goods usable for both investment or consumption, purchases of rubber increased 45 per cent and those of timber 70 per cent; with due allowance for prices, these two commodities accounted for an increased expenditure of \$ 72 million. Finally in textiles, domestic consumption of imported cotton and wool is estimated to have led to an increased expenditure of about \$ 80 million as a consequence of larger quantities purchased abroad (around 15 to 20 per cent) and of higher prices.

We have revealed these significant figures showing the fundamental changes that have taken place in our exports and imports over the last four years, in order to round off what has been said in the Report, and to reiterate the warning that in the present state of affairs, the short-run outlook, i.e., for the present year and perhaps also for next year, points to an increase, and not a reduction in the trade deficit. This does not merely arise from the larger purchases of wheat which are necessary this year for reasons already given.

In previous years a survey has been carried out by our Research Department of the effects of liberalisation on imports. The continuation of the survey for 1954 shows that imports of products freed from quota restrictions in October 1951 were not appreciably greater than those of 1953. This confirms the inference made in previous Reports that the expansion of Italian imports can only very partially be attributed to the liberalisation voluntarily carried out within OEEC. This policy has, rather, exerted its greatest influence by preventing domestic prices from rising excessively. Hence it appears that the considerable deterioration that took place during the past four years in the volume of liberalised imports should primarily be attributed to the expansion of investment and consumption which characterised the development of the Italian economy in this period. For what it may be worth, it must also be remembered that the percentage increase in the volume of imports over the four-year period was much greater than the percentage increase in Italy's real income.

We have no doubt, therefore, that the further economic development we are aiming at will require an increased volume of imports: indeed it may be said that the latter will determine the former, since the economic strength of our country depends upon its increasing participation in international trade, rather than upon restrictive practices. For this reason we have been pleased to see that the lines along which the ten-year economic development Programme will be carried out contemplate a considerable expansion of our international trade, and reject all measures which are inspired by protectionism. Such measures would

inevitably lead, sooner or later, to a contraction or to an inadequate increase in the country's real income, despite any benefit that they might give to particular sectors of economic activity or to particular groups of producers.

The efforts we have made in the past four years, to modernise our industrial equipment and to apply in agriculture improved techniques, have been made in a climate of competition determined by the policy of liberalisation adopted some three years ago. The hardships included in this policy have been made tolerable by increased productivity, while further, but perhaps more important, easing of the effects of foreign competition arose from the wide assistance given by the Government to the southern regions through the Cassa per il Mezzogiorno. The policy of developing investment and consumption in the formerly neglected regions of the South has kept demand at a high level. This has enabled all the productive sectors, even those most exposed to foreign competition, to increase production, and hence to reduce costs. Thus we have had the salutary experience, for the first time for many years, of plunging into the cold bath of international competition, and of having to produce at increasingly reduced costs, though perhaps we have had to run the risk of freezing, and of having to retire precipitously to the warmth of protectionist and discriminatory practices, the inseparable companions of distress.

The merit, by no means small, is not ours alone. It can be attributed to a large extent to the growth of international co-operation in the post-war period, which in the case of Italy took the form both of the substantial and decisive aid furnished by the United States and also of our participation in the joint action taken in Europe through OEEC. Without American aid the reconstruction and modernisation of our industrial equipment would have been extremely difficult: without the perseverance of OEEC in holding together at the highest level the economies of Western European Countries, restraining national egoism and protecting and promoting reciprocal trade, American aid would perhaps have been less effective or would merely have been a temporary relief: upon its termination, it would not

have been possible to approach the solution of the fundamental problems of our economy, as is now feasible. It is our firm conviction that we are on the right road, that we have already covered a considerable distance, that we cannot stop or turn back without harming what has been so painfully accomplished. This gives us the courage fully to state our opinion that it is still imperative for the assistance to be maintained which has been granted to us in recent years by international co-operation. Our concern is a part of the well-grounded feeling shown abroad lest certain concrete forms of this co-operation should be weakened by the adoption of measures, such as currency convertibility, which however desirable in themselves might nevertheless weaken international co-operation and the instruments by which it has been promoted and strongly maintained in recent years.

Italy has largely benefited from the sympathetic consideration of her problems shown in the international sphere. In the last few weeks a new demonstration of confidence has been given us by the International Bank for Reconstruction and Development, which has granted a loan of \$ 70 million for carrying out specific development projects in the South, thus bringing the total of its assistance to Italy to \$ 90 million. Furthermore in the last financial year we were able to reach with several European countries funding agreements for debts contracted with the EPU. In particular, last year as well as this, the Swiss market has shown us a favourable disposition by granting loans to some of our most important firms; in addition we have also been able partially to renew a line of credit granted to us by the Export-Import Bank in 1947. In all these carefully negotiated transactions, we have been able to satisfy our lenders as to the high credit standing of our country; Italy has always honoured its international financial obligations.

A promising prospect is also held out for the development of foreign investments. It is the intention of our Government that they should be favoured and protected, and this is shown by the bill on foreign investments recently submitted to Parliament. This bill provides for full freedom to transfer both profits and capital while reserving these advantages for capital

which directly assists either in the creation or in the expansion of new productive units. Little in fact would be gained by the entry of foreign capital in the form of mere portfolio investments, subject to rapid displacement.

The inflow of such capital might lead to many unfulfilled expectations as well as to serious economic mistakes. At the same time, we would have to be prepared to face sudden outflows and therefore we would have to keep correspondingly high liquid reserves. Indeed we have already received from various sources, and may yet receive in the future, a sizeable amount of loans and capital investments. These are both additions to the volume of domestic savings, which are by themselves insufficient to sustain a strong development of production, and also a means of covering the balance of payments deficits without impairing our exchange reserves.

But as we have pointed out before, we would not be sincere if we did not repeat that in the case of Italy unified long-term international action seems both indispensable and justified. The need for continued reliance on considerable international assistance is shown by a number of factors: the size of the balance of payments deficit, its persistence, the impossibility of reducing imports which in fact show a tendency to expand in many sectors, the spreading crisis in textile exports to underdeveloped countries, and above all the knowledge that a policy of economic development tends of itself to increase imports and to curb exports. Fortunately, the ten-year programme has not underestimated this need, which was translated into a series of requests when it was submitted to OEEC. These requests were based on the evidence supplied that the need for assistance is temporary since the effort necessary to overcome unemployment is also temporary, and they were justified by our intention to slow down the increase in consumption in order to be able to devote larger amounts of the additional income to investment.

We have much appreciated the work OEEC has so far performed in the interest of European co-operation, and we have, in addition, a special Italian interest in maintaining the institution in its full duties and functions. We are therefore, con-

cerned that the policy of economic co-operation between the Western countries should not be changed, that it should be strengthened along the lines the OEEC has endeavoured to promote in recent years.

Bearing these considerations in mind, it seems appropriate to bring up the very important problem of international economic and monetary co-operation, on which decisions are anxiously expected. It may be recalled that after the war, the countries of Western Europe had to face first of all the urgent task of reconstruction; later, in the atmosphere of co-operation created by the Marshall Plan, they attempted to establish a system of trade and payments less narrow than that which had prevailed in the decade between the great depression and the second world war. This system had been the result of the disintegration of the classic order which had been based on freedom of trade both from quantitative restrictions and from restrictions on the convertibility of currencies. The benefits that this order had brought before the first world war explain the anxiety with which, thirty years ago, the European countries attempted to restore it, without having first carefully measured their own forces or ascertained whether the old conditions under which it had operated were still in existence.

However, the men who faced the task of monetary reconstruction after the second world war had the unfortunate experience of the collapse of the old system fresh in their minds. It is true that the classic order is incompatible with the ends of autarky and war toward which the policy of the European countries headed in a rapid succession of painful events between 1930 and 1935. But even more than to the ill will of men, that collapse appears to have been due to the fact that the fundamental mechanism of the system, such as the flexibility of prices and wages, and the movement of capital, had failed in a rigid economy, or had shown that it tended towards accentuating rather than correcting the incipient disequilibria.

Between the two wars and after the second one, the extreme reaction to that negative experience, shown in certain policies and doctrines, was to deny *in toto* the trinity of multilateralism,

convertibility, and nondiscrimination. But a more moderate line, and one more compatible with technical conditions and with the general political and economic situation, has prevailed in Europe in recent years, thanks in part to the particular inter-relationships established, through ERP, between the methods of settling trade and the requirements of aid redistribution, which the granting of bilateral drawing rights, and their subsequent multilateralisation permitted.

Within EPU which comprises Western Europe and the vast areas associated with European currencies, more than 60 per cent of world trade is settled on a multilateral basis, although the participating currencies are not convertible into dollars. The mechanism of automatic credits which has given stability to the system, although it is endowed only in part with the stabilising virtues assigned in the classic schemes to the international movement of capital, is nevertheless removed from the risks of a market disturbed by heavy waves of speculation and panic such as those witnessed between the two wars. It has constituted the indispensable prerequisite to a substantial return to forms of multilateral settlement in the situation of scarcity of exchange reserves characteristic of the European countries in 1947/48. Developments in recent years have been inimical to the continuance of this regional system of payments in Europe and the associated areas, partly because some of the objective, generally valid, reasons for its establishment have since weakened, chief among them the scarcity of reserves and the overvaluation of European currencies, and partly because the pressure of national interests of different kinds has generated within EPU centrifugal forces which might well in the near future lead to its dissolution.

The criticisms directed from most sides at the present system are inspired by reasons as diverse as are the attributes of the system of convertibility which it is sought to create. The leanings of the British are obviously influenced by the wish to restore the traditional position of sterling as the great currency for settlement in international trade, and for London the function of world centre for trade in merchandise, freight, insu-

rance, bankers' acceptances, foreign exchange, and gold. These requirements suggest that sterling should be given the full measure of transferability that is compatible with the protection of foreign exchange reserves and the maintenance of an orderly system of exchange rates. An important advance in that direction was undoubtedly made in March of last year when the transferable account and the bilateral account areas were substantially unified. But the innovation gave impetus, in Zurich, New York, and other centres, to the market for transferable sterling, in which the holders of such sterling can sell it for dollars by taking a moderate discount which varies according to the market situation. With the decision adopted in February by the British authorities to intervene in that market, even in the direction of supporting the rate of transferable sterling with sales of hard currencies, a system of « imperfect convertibility » was established, which, however, is the prelude to the final system which must result from the declaration of convertibility, and in which the problem of the exchange rate will be posed. Two elements of importance in the choice between a fixed rate and a limitedly fluctuating rate seem to be the favourable experience that the United Kingdom made between 1932 and 1939 in operating the Exchange Equalisation Account, and the preference of Anglo-Saxon economists for a fluctuating rate.

As a counter-weight, on the Continent a clear preference has been shown for a system of fixed rates, both by economists and the officials responsible for the management of exchange control. Certainly in this attitude there is also involved the consideration that the European countries hold large balances in the two main currencies, whether to cover the normal requirements of trade or to find remunerative investments for a part of their reserves, and they are accordingly more exposed to the risks of rate fluctuations. This is one of the reasons behind the desire of the creditor countries of continental Europe to retain EPU as a clearing mechanism, operating at fixed exchange rates, and enjoying an exchange rate guarantee in cases of changes of parity. On the other hand, the functioning of the Union has meant for these countries the granting of

credit which they are reluctant to extend beyond the limits already reached.

For our part, Italy, as a debtor country, does not have specific reasons for opposing the interests of the great currencies and of the countries which are structurally creditors in the European area. We must, however, point out that, after the successful results obtained in the fields of recovery in production and internal financial stability, the liberation of trade and currencies became a natural guiding line for OEEC activity. But, as we noted last year in this Report, it is the progress in the liberation of trade that gives meaning to the progress already achieved in the direction of convertibility which could only be an empty façade if it were to be supported by quantitative restrictions, however nondiscriminatory they might be.

But from the obstacles OEEC has encountered to the liberalisation of trade from quantitative restrictions, one draws the impression that an awareness of the difficulty of proceeding further on the road to liberalisation is not unconnected with the movement toward convertibility; and that the difficulty is due, at least in some cases, to the opposition of vested interests, or the desire to use the remaining quantitative restrictions as a means to negotiate reductions of import duties on the part of other higher-tariff countries. The shifting of the principal effort of liberalisation from trade to currency, if it occurred before the process of liberalisation of intra-European trade were carried to completion, might exert secondary effects even more harmful to the economic integration of Western Europe. If, in fact, serious balance of payments difficulties arose as time went by, the retreat from convertibility could no longer be halted at a position such as that of transferability within the regional circuit represented by the EPU, the halfway house between the extremes of bilateralism and convertibility. The result would therefore mean the resumption of open or concealed forms of bilateralism, against which, if experience is a guide to the future, the efficiency of universal agencies such as GATT is smaller, since the degree such institutions can attain effective co-operation and acceptance of a common discipline, does not bear comparison

with what can be accomplished in a homogeneous and compact area such as Europe.

These are the concerns and preoccupations by which we are influenced, convinced as we are by our recent experience that trade restrictions and bilateralism, in addition to being open to censure in themselves, would be especially harmful to Italy because of her vulnerability in large sectors of her export trade. This trade is exposed to the protective measures of other countries, which can only be eliminated at the cost of great sacrifices. Therefore we still believe that every effort will be made by America and the major European countries to ensure that the process of multilateral intra-European trade, which has been the really new feature of the post-war period, and which to many appears to be the most effective step so far taken towards European unification, should be preserved in its full vigour.

Should this endeavour require further economic support, or should it delay the time when West European trade is settled only on a world basis, we believe that the additional waiting would not be sterile, because the work which really lasts is that which is carried through to fulfillment, and certainly not that which is broken off, even if at a fairly advanced stage.

Gentlemen,

If one studies the increase in production among the nine major European countries associated with OEEC, Italy occupies second place after Germany on the basis of progress made in 1954 compared to the situations in 1950 and 1953; Italy again occupies second place, this time after Norway, if the comparison is made with 1938 or with the year of maximum pre-war production. We believe that Italy can point with just pride to these results, which give the measure of the success of the effort made and which seem to us to corroborate the statement we made at this meeting a year ago, that never in its history has our country shown such great economic progress as in recent years.

Our last year's annual Report was mainly concerned with the developments which accompanied the intensive growth of productive activity, and we paid particular attention to credit expansion, which can at times promote speculation rather than a sound productive process; to the behaviour of prices, which by their instability can jeopardise the efforts made to increase production; to the influence exerted on the capital market by Treasury requirements, which by competing with private needs, may lead to increases in the rates of interest, and hence to an increase in the costs of production; to the difficulties in the balance of payments, which under certain conditions, can set an insuperable limit to productive expansion. These four problems have to be considered above all others in our Bank's annual Report so that we can establish whether economic development is taking place without distortions and without endangering monetary stability.

We believe that we have shown on the basis of actual data that in 1954 the credit expansion, although it promoted and accompanied a heavy increase in production, did not exceed the dimensions of 1953; that, as in 1953, it was held within bounds and did not provoke an inflation of prices or an unhealthy accumulation either of stocks by producers or of finished products by consumers. It can, therefore, be stated that the monetary stability was not jeopardised by the intensive efforts made.

We have also shown on the basis of a thorough analysis that the Budget position, considered from the extent to which it had to lean on the capital market in order to meet the deficit, improved somewhat last year, in both the « administrative » and the « cash » Budgets; and that considered from the same standpoint, the structure of the Budget was much better balanced than the Budgets for the years immediately preceding the second world war, which witnessed cash deficits of around 30 per cent of expenditure. These deficits, by their size, required a large direct and indirect assistance by the Central Bank to the Treasury, and set in motion the inflationary movement which was accelerated by the even larger deficit of the war years.

Among the factors which have been responsible for the improved management of our public finances since the war, we should certainly count the lesson we have learned from this past experience, and also the existence of more favourable conditions arising from the opening up of international trade channels. The improvement can be measured by the fact that the deficit now stands at about 16 per cent of total expenditure, half the pre-war figures. But we have still had to point out that the high level of public expenditure and the urgent needs of the private sector of the economy called for a further determined advance along the road towards a balanced Budget. As far as the structure of the Budget is concerned we should never forget the need of not sacrificing investment expenditure, which directly produces income, for the sake of expenditure which only leads to an expansion of consumption.

Finally, we have pointed out that even in the less favourable aspect of our economic development, namely in the behaviour of the balance of payments, the deficit on current account was smaller in 1954 than in the two preceding years, even if the savings arising from lower wheat imports are disregarded. We have remarked that the volume and the composition of our foreign exchange reserves notably improved in the course of the year, but we also pointed to the fact that the deficit was covered last year, as in previous years, only through the help of American aid, to which offshore purchases have recently been added. We have, therefore, stated our firm conviction that in the near future we shall not be deprived of the understanding shown for our determined efforts during the period of reconstruction and of the assistance granted to us since the war through international co-operation. This favourable attitude has been very recently confirmed by many acts of sympathetic support, now that the phase of development which started in 1950 with a programme of extensive public works in the South, is in full swing.

We may conclude on the basis of the facts we have been describing, that the efforts made so far have been planned and carried out with due respect for the need to have a balanced

development if lasting results are to be obtained. This balanced development has undeniably benefited both the activities of business firms which have been able to expand and reorganise in a favourable economic environment, and also individuals who have enjoyed a higher and more continuous level of employment. The effects of the increased productivity of the economic system have brought about an appreciable growth of consumption, which has been spread throughout the community and especially among the working population.

But the tasks which await us are still larger. The efforts envisaged for the coming years are indeed substantial, and will require considerable sacrifices. It is true that future action will have the advantage of taking place in an adequately balanced economy which is already expanding: thus further progress will be made easier, and the time required for its achievement will be shortened. Nevertheless we should not forget that any strengthening of the effort already being made increases the strain on the economy. This requires even greater attention and vigilance in every branch of economic activity in order to maintain the desired degree of flexibility which will permit us to cope with any distortions that may arise, without thereby compromising the process of our development.