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Excerpts from the Governor's Concluding Survey

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

Gentlemen,

The economic accounts published in ever greater numbers and with an increasing wealth of data by governments and international organisations usually present annual results with special reference to the growth in income as the principal aim of economic policy.

The reports of credit authorities may thus most usefully be coupled with those drawn up by governments if they aim at explaining how monetary policy has been or will be directed towards reconciling a high degree of utilisation—and the gradual development—of productive resources with the preservation of price stability.

The rôle which we come in this way to assign to monetary stability appears incontestable; for monetary stability is indispensable to the economic health of a nation and to the maintenance of a steady rate of expansion—it is essential, that is, for the achievement of a regular growth in income, fairly distributed among the different classes, so that those who save in monetary form are not frustrated in their expectations but share in the increase in productivity on a par with others.

Changes in World Economic Conditions in Recent Years and Monetary Policy.— During the past ten years the varying degree of success with which these two aims of income development and monetary stability have been achieved in the different phases of the business cycle has been the principal factor underlying the economic changes in western European countries and the government measures related thereto.

During the three years from 1953 to 1955 the success was almost complete. Increasing use was made of productive capacity and labour forces, and a great stimulus given to the construction of new industrial plant. But while this was happening, towards the beginning of 1955, signs of inflation began to appear in the form of widespread price increases and, in some cases, balance-of-payments difficulties. Thus, monetary authorities almost everywhere had to put into effect the first defensive measures.

During 1956 the rate of growth of production slowed down. In the second half of that year and the first half of 1957 the Suez crisis caused renewed price tension and brought about a deterioration in the balance of payments of European countries, forcing the monetary authorities to persist in their restrictive policies despite the slackening in productive activity.

In the last quarter of 1957 the European economic situation acquired features which it subsequently kept in a more accentuated form throughout 1958. Private fixed and inventory investment came to a standstill and supplies were almost everywhere in excess of domestic demand, with the result that less use was made of the increased productive capacity and a strong foreign exchange position was built up.

The balance-of-payments surpluses, which have become a feature of practically all the countries of western Europe since France adopted the well-known measures, are an indication that the recent slowing-down in the formation of income is not entirely attributable to the limitation of available resources and that, therefore, many prerequisites exist for a new economic drive. The budget for the fiscal year 1959/60, presented to the House of Commons last April by the Chancellor of the Exchequer, was, for istance, based on an evaluation of this kind. But it must be remembered that the trend in nearly all countries in the last three years has been influenced by certain basic factors, and a return to the high level of development of the years 1953/55 seems, in most cases, unlikely.

These basic factors were analysed by the Organisation for European Economic Co-operation (OEEC) in its Eighth Annual Report (published in April 1957), which contained a number of forecasts regarding the economic development of western Europe up to 1960.

Two years ago I recalled that, according to the OEEC study, the annual rate of growth of the national product in the whole group of western European countries would fall, in real terms, from 4.9 per cent in 1951-55 to 3.2 per cent in 1956-60.

Three years of this second five-year period have now passed.

Statistics published by the OEEC reveal that, in fact, the production figures for 1956-58 were, on an average, lower in the group of OEEC countries than those for 1951-55, whether measured by the yardstick of gross national income or by that of industrial production. They are even approximately in line with the forecasts made by the OEEC for the five-year period from 1956 to 1960. While the rate of growth fell off sligthly in 1956 and 1957, it was in 1958 that the most appreciable decline occurred, when the pace was very much slower than in previous years and about half as great as had been predicted by the OEEC.

With a view to studying the rôle played by monetary policy in influencing the trend of production in recent years, I wish to mention once more that the boom in production petered out in the course of 1957. In this transitional phase, because prices were still showing a persistent upward tendency and balance-of-payments difficulties were being encountered as a result both of a deterioration in the terms of trade of European countries and vast movements of short-term capital, monetary policy was still aimed chiefly at restraint.

The restrictive measures adopted culminated in the increases in discount rates made by the Federal Reserve in August 1957 and the Bank of England in September.

The phenomenon of continued price rises in periods of stagnating or declining production had already been observed during the US recession of 1953-54. In the recession of 1957-58 it was even more marked. Besides the structural factors of such movements, among which economists cite the inflation of wage costs and administered price policies pursued in conditions of imperfect competition, what influenced the behaviour of prices—particularly in Europe—was, as already mentioned, the Suez crisis.

This disassociation of the trend of prices from that of production provides further evidence of how today, more than in the past, monetary authorities often find themselves faced with complex situations, the individual elements of which appear to require the adoption of diverse—and sometimes contrary—measures.

The same lesson may be drawn from the sterling crisis that arose in the summer of 1957 following international short-term capital movements prompted by expectations of alterations in exchange rates, and in particular of an appreciation of the *Deutsche Mark*. This crisis developed when the expansion in production had ceased and while the UK balance of payments on current account was basically in surplus. As a countermeasure, the British monetary authorities not only raised Bank rate to 7 per cent but also asked the banks to reduce the absolute amount of credit outstanding.

The correct diagnosis of the nature of the crisis by the International Monetary Fund and the German authorities made it unnecessary for the British authorities to submit the economy to further deflationary pressure not justified by the level of productive activity or the position of its balance of payments on current account. The difficulties were, in fact, overcome when the British and German authorities made simultaneous and firm declarations that they intended to maintain the existing structure of exchange rates (the Germans also undertaking to lower their discount rate). At the same time a compensatory capital movement was initiated in the form of a substantial loan from the International Monetary Fund to the United Kingdom.

In 1958, while the period of stagnation continued, wage pressures diminished, and in the second half of the year, partly also owing to the fall in import prices, from which western Europe drew particular advantage, prices became stable or showed slight declines.

The trend of prices, production and stocks thus made it possible for the countries of Europe, which are mainly engaged in the processing of imported raw materials, to accumulate foreign exchange.

The End of the EPU, Convertibility and International Capital Movements.— Towards the end of 1958, as a result of the improvement in terms of trade, the expansion in foreign exchange reserves and the easing of monetary tension, the majority of European countries considered that the time had come to declare the external convertibility of their currencies and to put into effect the plan decided upon in 1955 for the termination of the European Payments Union and the implementation of the European Monetary Agreement.

Both in supporting liberalisation policies and in overcoming tensions and difficulties, the essential EPU formula, which was to furnish useful recommendations, coupled with the necessary financial aid, proved to be a realistic one and one that is still of value today, now that the experiment has been concluded.

As far as our country, in particular, is concerned, our initial indebtedness to the EPU enabled us to undertake and respect progressive trade liberalisation obligations. Subsequently there came a period during which Italy recorded substantial surpluses and consequently granted credits to the EPU—up to a maximum amount of 146.3 million dollars. From the second half of 1953 onwards Italy once more received loans from the EPU, which reached a peak of 190.4 million dollars in May 1956. In accordance with the regulations of the EPU, however, Italy's debt was later cancelled out by a series of payments to the Union. At the time of the liquidation of the EPU Italy had, in fact, a net creditor position of 6 million dollars, our bilateral credits to member countries having amounted at that date to 59 million dollars and our bilateral debts vis-à-vis other members (which we were able to pay in cash) to 53 million.

Although a considerable degree of de facto convertibility had already been achieved almost everywhere as a result of the introduction of various multilateral compensation arrangements and the gradual relaxation of exchange controls, the actual assumption by the various governments of the obligation to convert their currencies, at slightly fluctuating rates, for non-residents who acquire them for permitted purposes—and, in general, for current payments—was an event of the greatest importance.

Convertibility, although still hedged round with certain limitations, has, in fact, come at the end of a long period, lasting about thirty years, during which exchange controls and restrictions on the use of foreign currencies were the normal practice, whereas today such controls and restrictions are the exception in a system in which the freedom of international payments has become so widespread as to be regarded as the rule.

I know that, like all things in this world, monetary convertibility does not meet with unanimous approval and that there are still many who would prefer a system of exchange control specially adapted to protect the economies of under-developed countries against possible excessive fluctuations in international business conditions, which immediately affect such economies when currencies are convertible. In the same way, it was and still is believed that tariff protection for young industries is indispensable if a process of industrialisation is to be started.

As far as Italy is concerned, we cannot forget, however, that the shortage of basic materials for industrial processing, the heavy demand for investment capital and the need to meet an increasing proportion of the rise in income by exports of manufactured products are all factors that it would be difficult to reconcile with a discriminatory system of international payments in a world in which the prevalent tendency is, on the contrary, to settle trade transactions on a broader multilateral basis.

The existence in our country of considerable disparities between highly-advanced sectors and others that are still backward should prompt us to adopt internal measures—even more far-reaching than those introduced hitherto—to even out these disparities. But it should not induce us to prefer exchange control to convertibility, while justifying Italy's inclusion among the countries that cannot immediately remove all differences between the treatment accorded to residents and that given to non-residents in the field of financial transactions.

During the months following the adoption of convertibility studies were made and measures taken in the various countries with a view to encouraging greater trade liberalisation vis-à-vis the dollar area and freeing capital movements both within the European Economic Community and the OEEC and in the whole world.

The EPU was a system of regional economic co-operation. In return for the special facilities for settling intra-European trade transactions which the member countries obtained through it, they assumed, on the commercial plane, obligations regarding the liberalisation of imports within the framework of the OEEC. Since the termination of the EPU, differences in the method of paying for imports from OEEC countries or from the dollar area have disappeared. Consequently, a number of countries have proceeded of their own accord to raise their liberalisation percentages in respect of imports from the dollar area. In some cases (Switzerland, Belgium, Holland and Germany) the process of assimilating the two import systems is almost complete.

No one can deny that such an assimilation is in logical conformity with convertibility, nor that it furthers economic solidarity throughout the western world and actively promotes competition among the European economies. It is thus desirable that our country, too, should bring its practice in respect of imports from the dollar area into line with those of other countries.

However, the great idea that led to the establishment of the OEEC would be lost if the sole outcome of the plan for European economic integration were to be an undifferentiated removal of quantitative restrictions. We do not believe that this will happen—for two reasons: firstly, because it is laid down in the Common Market Treaty that customs duties shall also be removed, and because efforts to abolish them throughout the OEEC have not been abandoned; and, secondly, because in an area that is in many respects homogeneous and compact, like western Europe, the process of integration can be extended more easily than on a world scale to cover not only trade in commodities but also movements of persons and capital. Above all, it can help to eliminate or substantially attenuate differences in fiscal systems and social-insurance schemes and in the ways in which the state intervenes in economic life.

As far as the freeing of capital movements is concerned, the most far-reaching steps have been taken by Germany, whereas more cautious measures have been adopted by the other countries.

One of the channels through which international capital moves—and one that has been quite intensively used by several countries since the advent of convertibility—is that of security transactions, made either direct or through a great variety of investment institutions. As a result of the differentials in yield rates on portfolio investments in the various countries, capital movements of this kind have also been directed towards Italy.

We have no reason not to like such movements—or, worse, to obstruct them—just as we like, and we should even say prefer, stabler capital movements, such as foreign investment made by setting up new businesses or enlarging existing ones.

The rules governing foreign portfolio investment in Italy have often been subjected to criticism by those who would like to assimilate them with the regulations at present applied to the establishment of new enterprises or the enlarging of existing ones.

We admit that improvements can be made in this field, too. But it seems to us that it cannot honestly be denied that the afflux of foreign exchange onto the special market on which, in specific cases, all or part of the foreign exchange required for the retransfer abroad of disinvested capital or dividends may be purchased ensures that such investments receive a really favourable treatment.

Evidence of this is provided by the rates of exchange quoted on this market, which have for some time been below those applying to commercial transactions.

In particular, proof is to be found in the large purchases of Italian securities made in recent months by private individuals and foreign financial institutions which would obviously not come to Italy if they did not consider our system to be sufficiently liberal.

If such portfolio investment creates or aggravates a problem, it would seem that this consists rather in arranging for industrial enterprises to derive greater benefit from the readiness of foreigners to invest in Italy by replenishing the supply of shares through opportune increases in their capital.

For the above-mentioned reasons relating to the particular needs of the Italian economy, we do not believe that unlimited freedom should be given to the inverse movement, i.e. to Italian investment abroad. It is, however, fitting that, with the improvement in the foreign exchange reserves, the existing restrictions should be gradually relaxed. In particular, we should carry out within the prescribed time-limits our obligations under the Rome Treaty, though not refusing to avail ourselves of any facilities that this Treaty accords us because of the special development problems that exist here.

The utilisation of foreign exchange reserves for indiscriminate investment abroad could not be allowed without placing us in contradiction with ourselves.

As will be seen later on, we believe that these reserves can constitute the basis for a vast new investment drive in the near future, designed to give a decidedly positive turn to the still uncertain economic situation.

They must also, however, be used to meet the debts which we have incurred abroad (and which have played no small part in increasing the volume of our exchange holdings), as well as to cover possible disinvestment of capital that has flowed into Italy, in particular since the war.

International portfolio investments, which tend to iron out differences in interest rates on the various markets, have not yet been followed by large-scale capital movements in the form of sales of medium or long-term government securities on foreign markets. This practice was very widespread in the second half of the nineteenth century, when some countries, including Italy, placed substantial amounts of government securities on the major financial markets, such as London and Paris. In this connection it may be mentioned that the amount of Italian government securities circulating abroad towards the beginning of 1890 may be estimated (from the figures for total interest payments to foreigners at that time) at over 3 billion lire, at the then current prices. On the basis of the change in the gold price, this amount corresponds to about 650 billion lire today; on the basis of the variation in wholesale prices, it works out at approximately 950 billion. Repatriation of securities in the last ten years of the century reduced the figure by half between 1890 and 1900. If the foreign indebtedness of the Treasury and the public authorities is expressed as a percentage of the national income at various dates, it may be seen that this percentage has fallen from about 33 per cent in 1890 to barely 3 per cent today.

If we are able to maintain order in our economy and if we continue to enjoy the esteem with which foreign countries have in the past ten years regarded our ability to defend monetary stability, it will be possible to resort again to this source of capital—though only to a modest extent, for the world has certainly changed in the past eighty years. Increased consumption in the older countries of the world—and of Europe in particular—has curbed the formation of private capital which was formerly invested abroad, some of it in government securities.

Particular reserves always surround international movements of short-term funds. It is, for instance, only recently that Germany has allowed interest on foreign deposits and has permitted foreign banks to operate on the German money market.

Those whose duty it is to take decisions in this respect are influenced by past experiences and by serious considerations.

We Italians think back to the memorable depression of the final decade of the last century. This was undoubtedly initiated by the sudden recall of vast amounts of foreign-held short-term funds which had flowed into the country after the establishment of the capital in Rome, provoking a credit boom of exceptional magnitude, directed especially at building development in Rome and Naples.

Germany also experienced something of the inconstancy of hot money in 1931. It has been officially estimated that Germany was obliged in that year to repay, in less than four weeks, 25 per cent of the foreign short-term credits (amounting to nearly 10 billion *Reichsmark*) that had flowed into the country. The raising of the official discount rate to 10 per cent was of no avail and the inevitable outcome was exchange control, from which that country has only now freed itself.

The sterling crisis in 1949, which had to be remedied by a devaluation, and the recent crisis in 1957, which necessitated not only bold measures on the part of the British Government, but also intervention by the International Monetary Fund and the co-operation of the German Government, are further important examples of the dangers to which international movements of short-term capital expose national currencies and, with them, the economic equilibrium of nations.

The time ahead will therefore be characterised by two contrasting tendencies—towards complete freedom of international capital movements and the restoration of convertibility for residents as well, and towards greater caution, dictated by preoccupations about the inadequacy of world gold reserves and gold production.

The problem of international liquidity has been widely discussed recently in all its various aspects—including the credit potentiality of the International Monetary Fund, the gold price and the possibility of giving exchange guarantees on official foreign exchange reserves. A step towards the constitution of more adequate liquidity reserves has now been taken with the 50 per cent increase in the capital of the International Monetary Fund, which will probably have been effected by next September.

In the task of furthering investment in countries whose capital resources are relatively scarce the intervention of international institutions such as the International Bank for Reconstruction and Development and the European Investment Bank has since the war assumed—to a limited extent but on a permanent basis—the essential rôle once held by capital movements, formally at short-term but often imprudently utilised for long-term purposes.

Italy has obtained considerable funds from the IBRD for the financing of development and improvement projects in the South. The last loan, granted only recently, brings the total up to 260 million dollars, and arrangements are being made for another one (for 40 million dollars), to be used for financing the construction of a nuclear plant.

In conjunction with the last loan granted to us by the World Bank, we obtained one for 20 million dollars from the European Investment Bank, and we received a further 30 million dollars via a syndicate headed by *Morgan Stanley & Co.*—the first loan issued by Italy on the American market since the war. This loan, too, like that from the European Investment Bank, is to be used for financing industrial development in southern Italy.

Changes in the Economic Situation in Italy in Recent Years.— In the five-year period from 1951 to 1955, regarded by the OEEC in its Eighth Report as a period of marked expansion, to be followed by a period of less pronounced growth, Italy's gross national income rose by 5.3 per cent per annum in real terms, compared with an average of 4.9 per cent in the whole group of OEEC countries.

In the past three years, according to the Report on the Economic Situation in Italy, the rate of growth of our national income has been as follows: 4.1 per cent in 1956, 5.6 per cent in 1957 and 4.1 per cent in 1958—i.e., on an average, 4.6 per cent. This percentage increase was considerably greater than that shown by the OEEC countries viewed as a whole.

The average rate of growth of the national income did, in fact, fall in Italy too, compared with the rate achieved in the five years from 1951 to 1955; but the fall was slighter than that recorded in the whole group.

Whereas the rate of increase of the national income in all the OEEC countries combined was only 1.7 per cent last year, in Italy it was 4.1 per cent. The higher rate of growth in our country in 1958 was particularly influenced, however, by the favourable trend of agriculture, there having been a rise of over 11 per cent in agricultural output last year. And as far as the development of industrial production is concerned, the percentage increase here was only slightly greater than the average for all OEEC countries.

The decline in the rate of growth of industrial production (2.7 per cent, compared with 7.1 per cent in 1957) was chiefly attributable to developments in the iron and steel industry. The volume of sales in this industry was about the same in 1958 as in 1957. But in 1957 production had gone up by 13.4 per cent and had not been fully utilised, part of it having gone to increase stocks. For this reason, it was cut by 7.0 per cent in 1958. It thus seems clear that if the pace of production had been more regular the increase in 1957 would have been smaller and there would not have been in 1958 the sharp fall that had such a marked influence on the overall index of industrial production. In this specific sector of iron and steel, which has aroused the greatest concern, there has thus not been a real recession, as there has been in some countries (particularly in the United States). There is, therefore, all the more reason for not speaking of a recession in the whole industrial sector. For, despite the fall in iron and steel production and a decline in output in the textile industry, there was nevertheless an overall increase—although only one-third as great as that between 1956 and 1957.

Exports of Manufactured Products.— A further important reason for the slower expansion in industrial production last year is to be discerned in the less rapid increase in exports of manufactured products in 1958 by comparison with the two preceding years.

The greatest decline occurred in exports of textile products, which, after increasing by 17 billion lire in 1956 and more than 29 billion in 1957, fell by 25 billion in 1958, thus returning to approximately their 1956 level. Il may be noted, however, that these annual changes in textile exports were in the same direction as those recorded in the whole group of OEEC countries and that the expansion here in 1956-57 was more rapid and the decline in 1958 slightly less severe.

Among the other major commodity groups, exports from the chemical industry and, in particular, the motor-car industry expanded at an even greater pace in 1958 than the already high rate achieved in the previous year. Exports of engineering products other than motor-cars, however, showed a noticeably slower rate of progress than in 1957.

Leaving aside problems of a cyclical nature (which, however, merit the attention that is being paid to them), the fundamental requirement for the future welfare of our economy is that Italian products—and particularly manufactured products—should steadily gain ground on the world markets.

The comparative analyses made in this Report show that Italy's share in world exports of manufactured goods has grown in the last few years, which is a hopeful sign. Nevertheless, despite the undeniable progress made recently, including the considerable success of Italian firms, in competition with foreign concerns, in gaining orders for very important projects, Italy still occupies a modest position on the world markets, compared with other countries. And it must not be overlooked that some countries outside Europe are successfully joining in the fight for markets.

We believe that all possible care must be taken to ensure the further development of our exports of manufactured goods, since it is essential to the progress of the country and to the stabilisation of our balance of payments that Italy should have a variety of sources of foreign exchange income. We believe, that is, that Italy cannot entrust its economic future entirely to the development of tourism, to emigration and to the increased production of those agricultural commodities that are more easily sold abroad, essential though this is.

As to the best way of stepping-up our exports of manufactured goods, we do not deny that this presents very great difficulties. We believe that neither money nor energy should be spared in the fields of scientific education and industrial specialisation, or in the training of staff of all grades. We consider furthermore, that our taxation system should be improved, so that it does not distort the organisation of enterprises and the development of production, or handicap their competitiveness vis-à-vis foreign countries. Finally, we think that organisations for the study of foreign markets and advertising on these markets should be enlarged. We lay less stress on a further extension of the policy of medium-term export credits backed by state guarantees. These will be raised, if Parliament approves a draft law at present before it, by 150 billion lire in the current financial year, over and above the 150 billion already granted in the budget for 1959/60. But domestic saving, which is already insufficient in view of the many needs to be satisfied, should obviously not be allowed to leave the country through the operation of this special form of credit.

The Lull in Investment Activity.— Last but not least, a third cause of the decline in the rate of growth of industrial production in 1958 was the levelling-off of fixed investment activity. This is in contradiction with the fundamental requirement of economic progress in Italy; for a more substantial annual growth in investment is needed in this country than in western European countries with a high level of employment.

It is very difficult to pass an impartial judgement on such a complex phenomenon. Moreover, contrasting versions of it have been developed and sustained with such heat that the problem has tended to be brought out of the technical sphere in which we intend to remain.

As I do not wish to take too much of your time, I shall not venture to go deeply into the problem but confine myself to making a few brief observations.

One of these, it seems to me, relates to the sector of residential construction.

Of the increase, in terms of current prices, in the country's total gross investment between 1950 and 1958, no less than 39 per cent was used for the construction of dwellings. New investment in building was, however, checked last year, although it amounted, as in 1957, to just under 1,000 billion lire. The volume of investment in building in 1958 would have been lower but for the greater contribution made in this sector by the state and other public bodies. Private individuals, in fact, appear to have devoted about 80 billion lire less to this type of investment than in 1957, which is a sign that there has been a contraction in the demand for houses from people who are in a position to acquire real estate or whose incomes enable them to pay a rent corresponding to the cost of the new buildings. It has been generally admitted in the last few years that the high rate of new building activity could not have been maintained for long. There have even been some who have considered that too great a proportion of the national income has been devoted to building, in view of the many other needs which we have to meet, particularly as regards agricultural progress and the creation of new permanent jobs in industry and elsewhere.

However that may be, it seems certain that this levelling-off in building investment (which is of great importance also from a social point of view) may necessitate special intervention by the public authorities on a much larger scale than hitherto.

Anyway, we feel it our duty to invite the land and building credit institutions in Italy to increase their activity, extending the duration of new loans or granting loans in higher proportion to the value of the real estate given as guarantee. As a result of the liquidity of the capital market it is possible today to make more mortgage bond issues.

Investment in building thus neither increased nor decreased. Investment in ships, on the other hand, declined sharply, by about 70 billion lire. This fall is, however, entirely normal at a time when the slump in freight rates after the Suez affair has laid up a substantial part of the merchant fleet.

But the fall in investment in the shipping sector must not lead us to forget that we have succeeded in building up a merchant fleet even greater than the one we had before the war, 87 per cent of which was destroyed.

Whereas investment in agriculture had gone up by 4.8 per cent in 1957, it ceased to expand in 1958. This is a very important problem and one that merits the attention that the country and the government are devoting to it.

Very difficult and very gripping at the same time, it is a problem that must be solved by large-scale finance and bold measures. Moreover, if we wish to succeed, we must draw inspiration from the ideas that have prevailed in countries which are in the vanguard in this field, such as Holland and Denmark, where the greatest spirit of co-operation exists among the producers and where agriculture is regarded as an industry in which technical education and management are essential to success.

In the meantime, it is reassuring to note that the savings banks have decided to invest in agriculture a substantial proportion of their resources, which represent, for the most part, deposits from small savers, themselves largely concerned with changes and future trends in this important sector of the economy.

As regards industry properly so called, I do not believe that anyone can deny that the various branches of the chemical industry—in keen competition among themselves—have made a good start in developing programmes based to an increasing extent on the work of highly-qualified research organisations.

And likewise the rate at which the electricity industry is carrying out its programmes cannot give rise to concern about the possible emergence of bottlenecks as a result of the probable demand for energy.

If, on the other hand, investment in the iron and steel sector has declined, it must be mentioned that in this sector a veritable revolution has been accomplished, which has undoubtedly been responsible for the far-reaching transformation of our economy since the war. Moreover, the increases in production in the last few years (21 per cent in 1954, 28 in 1955, 11 in 1956 and 13 in 1957) necessitated such an enlargement of capacity that a slowing-down was inevitable if (as did, in fact, happen) domestic and foreign demand for iron and steel products started to taper off.

Of the slower rate of development in the mechanical industry in 1958 I spoke by implication when considering the very important question of exports of manufactured products. It was this industry which I had particularly in mind when I referred to the success achieved in this field since the war, which has caused engineering products to assume the leading position among Italian exports, once held by textiles. But it is also to this industry that I alluded when I said that we still occupy a modest place among the great exporters of manufactured products.

In conclusion, I do not wish to infer that we should resign ourselves to the phenomenon of a slackness or decline, even though slight, in fixed investment, such as occurred last year. I want, however, to point out, as I did last year, that after the war—and particularly after 1953—the pace of industrial investment, though certainly less rapid than in the United States in 1955-57, was nevertheless so considerable as to render inevitable a subsequent slowing-down.

However, the unsatisfactory trend of investment in 1958, which was reflected in an attenuated form in the rate of expansion of industrial production, should not lead us to forget that, compared with the pre-war period, we have acquired—and are maintaining—a sure lead as far as the rate of growth of industrial output is concerned. With the index (excluding the building industry) standing at 231 (1938 = 100), we are, in fact, distinctly ahead even of Germany, where the index figure is 210.

Indeed, the recent slackness of investment seems rather in the nature of a pause after a period of intense activity.

In the first quarter of the current year industrial production in Italy rose by 5.8 per cent, compared with the corresponding quarter of 1958. In Germany the increase was 2 per cent and in France and the United Kingdom there was a decline.

In the consumer-goods sector, there was an increase of 8 per cent in the first quarter of this year, compared with the corresponding period of 1958, and in the sector producing materials for use in industry a rise of 13 per cent.

It would be dangerous to take these recent figures as an indication of a steadfast recovery in our industrial production and thus to believe that the fears by which we were dominated in the early months of 1958, when there were clear signs of stagnation in industrial production, have now completely disappeared.

In the same way, it would be extremely wrong if, rendered confident by the results achieved in the period from the beginning of the war until today, we were content to await developments, armed only with the belief that in the future, too, production in Italy will continue to proceed at a faster pace than elsewhere.

For one thing, there is still a considerable difference between conditions here and those in the principal countries of Europe, and scant employment and underconsumption still exist among certain classes of the population. But, quite apart from this, it is a fact that in modern economies lack of initiative can rapidly cause the pace of development to slacken or not to rise as fast as it could if all factors of production were fully utilised.

The Government's concern in this respect and the measures which it has taken and is proposing to take to help to give a decisively expansionist turn to the economy are therefore very understandable.

Monetary Policy.— Last year I said that, in order not to stem the expansion that had been going on in the first nine months of 1957, we had refrained from adopting measures that might have reduced the liquidity of the market, and in particular of the banking system.

The issue of multi-year Treasury bonds, which had amounted in each of the preceding few years to about 200 billion lire, was limited to 100 billion in 1957. Thus the Treasury, in order to meet its requirements that year, had to draw 30 billion lire from its current account with the Banca d'Italia, whereas in the previous year it had been able to pay in 45 billion. A policy was therefore adopted tending to increase the supply of money to the market, which appeared to need it. As a result of these measures and others intended to allow the banks liberal use of funds deposited with them on foreign accounts, we succeeded in curbing the pressure exerted on the primary liquidity reserves of the banks by the high rate of expansion in production and by the repercussions of the Suez crisis. By the end of the year these reserves had risen by 60 billion lire.

In 1958 the policy tending to increase the liquidity of the market received a further considerable stimulus. Not only were no new 9-year Treasury bonds issued, but the excess of the Treasury's outpayments over its revenue from taxation was left available for the market, as was also the very considerable amount resulting from the conversion into lire of the balance-of-payments surplus.

As regards the former source of new liquid funds, an analysis of Treasury operations reveals that its overall requirement amounted to 286 billion lire in 1958 and was, therefore, 84 billion greater than it had been in 1957 (202 billion).

This increase occurred in spite of a reduction of 36 billion (from 208 to 172 billion) in the Treasury's budget requirement. If account were taken of the sums needed by the Central Post-Office Savings Fund (which were largely covered by postal savings), the overall Treasury requirement would amount to about 440 billion, compared with about 340 billion in 1957.

As there was a reduction in the Treasury's budget deficit, it is clear that the larger overall deficit was due to extra-budgetary requirements. It was due, in particular, to increased expenditure in respect of transactions that were only to be entered in the budget after 31st December 1958.

The overall requirement of the Treasury which, as mentioned above, was 84 billion lire greater than in 1957, would have been larger still but for the fact that in 1958 no payment was made to reduce previous or current losses incurred in connection with the management of the wheat stockpiles. Moreover, no appropriation has been made in the 1959/60 budget, in contrast to previous budgets, to settle such items.

This problem is thus becoming worse. Having already studied the subject in previous Reports, however, we do not believe it is necessary to spend more time describing it now.

Finally, the budget will have in future to meet the costs that will derive from the solution of the important question at present being discussed with the National Social Insurance Institution regarding the Government's contribution to the Equalisation Fund for disablement and old-age pensions.

The net outlay of the Banca d'Italia in respect of foreign exchange operations amounted to 583 billion lire in 1958, compared with 196 billion in 1957. Reference can be made in this respect to the analysis of such expenditure contained in the section of this Report dealing with changes in—and the probable future development of—the balance of payments.

If statutory reserves formed during the year are excluded, the flow of new liquid funds into the market in 1958, mainly as a result of Treasury expenditure and the balance-of-payments surplus, may be estimated at over 625 billion lire, of which 207 billion was held by the public (mostly in the form of notes) and by institutions other than the commercial and savings banks, while 418 billion went to swell the primary liquidity reserves of these banks, bringing the ratio of such reserves to deposits up to 10.6 per cent.

This is almost equal to the percentage reached in December 1949 and 1950. It is below the ratios attained in December 1947, 1948 and 1951, but above those obtaining at the end of each year from 1952 to 1957.

It must, furthermore, be noted that the flow of new liquidity was rather rapid, so that it was not possible in all cases for it to be reabsorbed by the normal expansion of production.

Supposing that, contrary to what actually happened, gross investment had developed at the same rate as in the five years from 1953 to 1957, it would have amounted to 3,800 billion instead of 3,546 billion. The increase of about 250 billion, even taking into account the multiplier effect on consumption, would only have been partly reflected in greater imports and perhaps also smaller exports. The corresponding rise in foreign exchange expenditure and decline in receipts would have reduced to a smaller, but still very considerable, figure the amount of foreign exchange accumulated. (Net foreign exchange earnings amounted to 850 million dollars last year as a result of the exceptionally favourable trend in the balance of payments, which was, in turn, due in particular to the lower prices paid for raw-material imports and to the reduction in purchases prompted by the determination of businesses to run down stocks, as to the greater foreign exchange receipts from tourism and the inflow of foreign capital).

Consequently, even if the growth in investment in 1958 had been in line with that in previous years, last year would still have been distinguished by a large and rapid increase in the liquidity of the market and, in particular, of the banking system, into which the major part of existing or newly-formed liquidity flows.

On the assumption just made of a larger volume of investment, the banking system would presumably have been called upon to grant a greater amount of credit. Part of the additional funds placed at the disposal of the economy would have been used to increase the note circulation. Another part would have been absorbed by additional foreign exchange requirements for the financing of imports. But an undoubtedly substantial part would have remained with the banking system in the form of deposits.

The absolute volume of the liquid resources of the banking system would have been reduced by the increase in the note circulation and in the demand for foreign exchange. However, a process of credit expansion peculiar to Italy would not have altered the trend of prices on the world markets. This would, therefore, have continued to have a depressing effect on inventory investment and on domestic prices. Thus it seems doubtful whether any measure at all adapted to the mechanism of the market could have absorbed the additional liquidity which international trends and the deficit in the government budget may be said to have virtually imposed on the Italian economy.

The greater liquidity could have been absorbed only by specific monetary measures, such as the raising of the banks' reserves or open-market sales by the Treasury or the central bank of medium or long-term government securities, which, unlike Treasury bills, are not included by the banks among their liquid resources.

Once the excess liquidity placed too rapidly on the market had been absorbed by these means, it would have been possible to supply more liquidity gradually as the need arose. New liquid funds would, in any case, have flowed onto the market as a result of the deficit in the government budget.

This would, in fact, have been the line of conduct normally adopted, had not the consequences for the country been feared, if, on top of the apprehensions roused in some sectors of our productive system by the American recession, financial difficulties had arisen in other sectors which were prepared to maintain or to increase their production and investment activity.

Thus, while, as we said a year ago, we would not have hesitated to take energetic measures if businesses, profiting from the liquidity position of the market, had exceeded the bounds of reasonable behaviour, the new liquid resources were left at the disposal of the economy, with a view also to reducing the cost of money. A reduction in the cost of money was also furthered by the lowering of the official discount rate from 4 to 3.50 per cent on 7th June 1958, and the cut of half a point in the interest rate on Treasury bills—a measure that was particularly effective in inducing the banks to seek new investment opportunities in order to lessen the impact on their earnings of the diminished yield on their substantial bill holdings.

We shall see shortly that this policy did, in fact, lead enterprises to acquire more funds than they had done in 1957, contrary to what might be deduced from the stagnation in investment activity.

As we have often stressed in the past, monetary policy is only one of the elements which promote economic development. We thus do not intend to attribute to it the merit of having prevented the slowing-down in production in the early months of last year from becoming a real recession, or of having brought about the recent recovery. What was done by the Government and state-owned institutions to step up public works, which increased by 16.5 per cent in 1958, certainly helped to sustain the economy in conditions that were taking a downward turn. But we believe that we may state that monetary policy was consistent with the Government's aims.

We must remind anyone who expected or still expects miracles that it has come to be recognised in recent times—in the light of considerable experience—that, whereas rigorous and resolute measures of monetary policy lead businesses to revise investment plans, cutting them down or postponing their execution, the relaxation of such measures may not be a sufficient incentive to bring about a rapid recovery from a state of depression.

The Formation and Use of Monetary and Financial Resources in 1958.— If the net increase in loans granted by the commercial and savings banks, special credit institutions, the Central Post-Office Savings Fund and the insurance companies, on the one hand, is added to the sums raised by enterprises through the issuing of shares or bonds or by calling up non-paid-up portions of share capital, the amount comes to 1,334 billion lire in 1958, compared with 1,174 billion in 1957. In 1958, therefore, the amount of money raised on the monetary and capital markets by the various branches of economic activity exceeded the 1957 total by 160 billion, or about 13 per cent.

From the financial point of view, 1958 was thus not characterised by any diminution in the funds raised by enterprises on the capital and money markets. This happened rather in 1957, when the amount was 184 billion less than in 1956.

And since the loans granted by the Central Post-Office Savings Fund and insurance companies increased in the two years together by almost the same figure (240 billion), the characteristic features of the year were not only the increase in the volume of funds acquired by enterprises, but also the pronounced shift in the proportion of demand satisfied by the capital market (which was greater) and that satisfied by the banking system (which was at about the same level).

Fresh savings drawn by businesses from the financial market, including sums obtained by the IRI and ENI and the enterprises in these groups, amounted to 271 billion in 1957 and 446 billion in 1958, which represents a rise in the latter year of 175 billion, or 65 per cent.

The additional amount supplied by the banking system, on the other hand, was almost the same as in 1957 (647 billion, as against 660 billion).

Within the banking system, however, there was also a shift. Loans granted by the special credit institutions increased by 110 billion, from 228 billion in 1957 to 338 billion in 1958, whereas loans granted by the commercial and savings banks, which had amounted to 431 billion in 1957, fell by 123 billion in 1958 to 308 billion.

If, on the other hand, it is borne in mind that in 1958 the commercial and savings banks supplied the special institutions with 102 billion (against 27 billion in 1957) through the purchase of bonds and by means of current-account credits, it appears that the real contribution of the commercial and savings banks to the financing of economic activity was only 48 billion smaller than in the previous year.

On the other hand, banks increased their holdings of Treasury bills by 340 billion lire, against 73 billion in 1957. The considerable accumulation of liquid funds by banks thus took the form predominantly of short-term financing in favour of the Treasury.

The marked expansion in capital-market activity is to be related to the ample liquidity that was a feature of the market throughout the year and, in particular, to the resultant reduction in the cost of money.

The reduction in capital-market rates, was, in fact, quite remarkable. Between December 1957 and December 1958, despite the greater volume of securities issued, the yield on debentures fell from 7.12 to 6.24 per cent; by March this year it had fallen further to 5.12 per cent and was thus 1.20 points below the level in December 1957.

Bearing in mind that the recent issues by the World Bank were placed in Germany and Belgium at 5 per cent at par, it must be admitted that the policy aimed at reducing the cost of money for long-term investment in this country has met with considerable success.

Furthermore, the latest issues by the Credit Consortium for Public Works and the IMI were made on much better terms than those obtainable in the last few years. For instance, the current IMI issue, which consists of bonds redeemable by 15 annual drawings (the average life being thus of about 9 years) has been made at 5 per cent and at the price of 98 lire for each 100 lire nominal value.

On the share market, too, there was a substantial reduction in yield rates.

From December 1957 to December 1958 these fell from 5.26 to 4.68 per cent. By March this year they had fallen further to 4.13 per cent, which means that during 1958 and to a greater extent this year industrial enterprises have been able to acquire funds at a lower cost by increasing their share capital.

These figures do not, of course, provide a measure of the total cost of the money which businesses acquire on the capital market to meet their investment requirements, since fiscal charges must also be taken into account. From this point of view, any assessment is further complicated by the considerable disparities in the taxation applied, depending on the form of finance (shares or bonds) by which the enterprises obtain the capital they need and on the nature of the organisations through which they acquire this capital when they do not have direct recourse to the market (finance companies, special credit institutions or state-owned holding companies).

This problem is an important one, both because it gives rise to discrimination within our productive system and because it creates differences vis-à-vis the countries with which we compete on the export markets. It is a problem which has become especially worthy of our attention since the coming into force of the Common Market Treaty. For this treaty envisages the abolition, or at least attenuation, of the more striking discrepancies in taxation that affect competition between the member countries.

The increase of 160 billion in the volume of money raised by the economy in 1958 is particularly significant if it is remembered that this was much greater than the growth, in money terms, in the volume of gross fixed and inventory investment (only 28 billion).

Finally, if it is borne in mind that in 1958 there was no contraction in domestic sources of finance, either in agriculture or in industry, it will be realised that the total funds acquired by productive concerns on the capital market were to a large—and certainly unusual—extent used for purposes other than investment.

Among the uses to which they were put, mention may be made, in particular, of the repayment of debts due to suppliers and the granting of longer payment terms to domestic and foreign customers.

A further part of the funds raised on the capital market was paid by businesses directly to the banks to reduce former debts, or was deposited with them on correspondence current accounts. According to an enquiry conducted by the Banca d'Italia among the commercial and savings banks, this was responsible for several tens of billions' worth of the increase in current accounts (which went up by 174 billion more than they had done in the previous year), and the bank debts of many enterprises were reduced in 1958.

The constitution of larger current-account balances with the banks or the reduction of previous debts seems, moreover, to be a normal phenomenon in a period of transition from a condition of restricted liquidity to one of abundant liquidity. In the first case the demand for money exceeds the supply, so that any funds obtained are wholly and rapidly utilised, particularly for investment. At the same time businesses try to maximise their debts to suppliers and minimise their credits to clients, both of whom are led to draw on their own liquid resources. In the second case the possibilities of acquiring money are greater than real needs for current investment. Businesses which, notwithstanding, raise additional funds by means of share and bond issues and loans may be prompted to do so either because this gives them an opportunity to cancel out excessive bank or mercantile credits to which they had resorted in years in which the capital-market rates were deemed high, or because they wish to ensure—even considerably in advance—that they will be able to make new investments when the programmes currently being carried out have been completed.

Whatever it may have been that led businesses to acquire more long-term funds in 1958 than in 1957, this does not seem to be blameworthy.

Even if their conduct was not determined by expectations of having shortly to make larger investments, the reduction of excessive bank debts, either directly or indirectly through clients and suppliers, still had the useful effect of restoring to the banking system that elasticity in providing working capital (as opposed to fixed investment) which is its particular characteristic and from which it cannot depart too far or for too long without serious consequences.

The position of the banking system has thus been eased in a variety of ways, and consequently its liquidity has considerably increased. On the one hand, the amount of new credits granted has been smaller as a result of the reduction in the cost and volume of raw-material imports or has been partially offset by the repayments received directly or indirectly from enterprises which raised money on the capital market. On the other hand, the commercial and savings banks have received larger deposits from those firms (suppliers and clients of productive enterprises) which, having acquired greater funds on the capital market, not only reduced or liquidated prior bank debts but found themselves with excess liquid funds.

Finally, it seems that last year there was a general reflux to the banking system of funds which, when liquidity was scarce, had been utilised to grant credit outside the banking system. The experience of other countries would seem to indicate that in periods of tight credit private sources of finance may tend increasingly to replace the normal banking source.

Moreover, the marked growth in the volume of savings held with the banks, in conjunction with a modest increase in new lending, was not peculiar last year to our country, where nothing was done to reduce the liquidity of the market. It occurred also in countries where some such measures had been taken. For example, in the big German banks the increase in deposits was 13.1 per cent, while short and medium-term credits actually declined (1.2 per cent).

An idea has been given above of the ways in which the greater liquidity injected onto the market by the central bank last year led to an increase in bank assets.

Savings deposits rose during the year by 16.3 per cent, or, in absolute terms, by 374 billion—from 682 billion in 1957, to 1,056 billion in 1958.

This increase, together with the expansion in the volume of money that flowed into business enterprises from share and bond issues, was also due, to a large extent, to the rise in monetary receipts in the agricultural sector, which, as has been noted, had a very favourable year, and the reduction in the expenditure of private individuals on new houses (estimated at about 80 billion lire).

Shifts of this kind in the final destination of savings draw attention to the need for channelling towards productive activity, in the most appropriate manner, savings that are now being used for purposes other than those previously considered as priorities by the vast majority of citizens (as is the case, for example, with savings formerly invested in houses by the upper and middle income groups).

Some time ago, when it was complained that an inadequate volume of savings was being invested in shares, we said that the time would come when a smaller amount of current savings would be used for purchases of flats, which had, for obvious reasons, been given priority over many other needs in past years, and that, therefore, investment in securities, as well as in durable consumer goods, would be relatively greater in future.

This time now seems to have come and it thus seems that the time has also come to accelerate the rate of share issues, which should be increased proportionately more than issues of bonds and loans.

Contrary to what might have been desired, however, bond issues or loans by productive enterprises have been greater in these last few years than share issues.

If insufficient preference has been given to share issues for reasons of a fiscal nature, there is, as we have already said, a real need to adjust the system of taxation on the forms of finance raised from outside the businesses themselves, both for internal reasons and because this will provide an opportunity at least to attenuate the differences between our system and those of foreign countries—in particular the countries of the Common Market.

The public has certainly shown a marked propensity recently for equity investment, while the supply has been limited. This state of affairs is not peculiar to Italy. In other countries, too, authoritative voices are being raised, urging industrial concerns to increase their share capital, overcoming possible delays that might arise because controlling groups fear a decline in their relative influence.

The Possibility of Encouraging a New Phase of Expansion.— As I have already mentioned, the Government has announced that it is prepared to adopt further important measures to give an effective stimulus to the recovery in production. At the same time it has confirmed its determination to safeguard monetary stability and not to lose sight of the objectives of a structural nature laid down in the Vanoni Development Plan.

We thus consider it our duty to explain why we believe that this aim can be achieved without disturbing monetary stability and to show our conviction that the credit system is ready to back a further effort in this field.

In previous Reports I have often replied to the question whether it was possible to increase the volume of investment which the country was making by saying that a limit was set to such expansion by the trend of the balance of payments.

So long as the balance of payments showed a deficit and the foreign exchange reserves remained modest, there was the risk that adverse business trends might reduce these reserves, especially if there was no system of control capable of limiting, if need be, some types of investment or consumption.

In a market economy like ours, affected by fluctuations in the other Western economies, themselves also characterised by the absence of a far-reaching system of specific controls, measures designed to step up investment could not have been adopted without running the grave risk of provoking new inflationary movements. These are to be feared and avoided everywhere, but particularly in our country, which has had a very painful experience of them and where the widespread use of the sliding-scale renders defence against inflation more difficult.

Between 1951 and 1952 a conscious move to increase investment was made when the programmes of the Southern Development Fund began to be executed in full. To prevent the additional expenditure from having an unfavourable impact on domestic prices, broad trade liberalisation measures were adopted within the EPU in October 1951 and customs tariffs were reduced.

The move was successful. In 1952, however, either owing to the increase in imports or the setback in the previously favourable trend of textile exports, the trade gap widened considerably and the current-account deficit in the balance of payments (excluding intergovernment aid), which had been 65 million dollars in 1950 and 231 million in 1951 (following the Korea crisis), rose to 586 million dollars.

The deficit was reduced in the subsequent years (450 million dollars in 1953, 277 in 1954, 245 in 1955, 226 in 1956 and 88 in 1957). In 1958 there was a fairly substantial credit balance on current account (473 million dollars), owing, in particular, to a marked reduction (from 769 to 369 million dollars) in the trade deficit.

The surplus in the Italian balance of payments last year was in line with a similar improvement in the balance of payments of western Europe as a whole.

Both were undoubtedly due largely to factors connected with the short-term economic trend. The slowing-down of the pace of production limited the demand for raw-material imports; and the consequent weakness of prices caused businesses to adopt a cautious policy in regard to stocks. Indeed there was a chain of factors all operating towards a reduction in the volume and prices of imports.

Cyclical trends in the volume and value of international trade, by their nature, work now in favour of one, now in favour of another, country. We cannot tell to what extent or how quickly prices and quantities will move again in favour of non-European countries. The volume will depend essentially on how production recovers in the developed countries. As regards prices, we do not know how the terms of trade will turn out in the long run, or how great the probable improvement in raw-material prices will be in a new phase of heavy demand.

Despite so much uncertainty, however, if we do not wish to confine ourselves exclusively to a relation of past events, we must venture to formulate some forecasts, at least in regard to the not-too-distant future.

In Italy, as abroad, the fall in the cif prices of the principal raw materials and the reduction in stocks of such materials played an important part in bringing about the surplus in our balance of payments.

Changes in world-market prices and in freight rates enabled the importers to save foreign exchange to the value of about 175 billion lire, while the reductions in the volume imported (chiefly in the textile, machinery and shipping sectors) caused the total outlay to fall by about 140 billion, so that the overall decline was equal to 315 billion lire, or over 500 million dollars.

The increases in the prices of raw materials in recent months lead us to believe that we may shortly witness a movement in the opposite direction to that which in 1958 and in the first few months of the current year caused a sharp reduction in our trade deficit. Renewed expansion in the United States will undoubtedly contribute to this.

Thus the decline that occurred from July 1958 onwards in the prices of our exports had already by the end of the year brought about a deterioration in the relationship between export and import prices, compared with the average position in 1958. Moreover, the gradual transference to the prices of manufactured products of the reductions that had taken place previously in the prices of raw materials and increased competition between exporting countries also caused a fall in export prices.

The ratio of export prices to import prices thus seems bound to settle in future at a less favourable level from our point of view than the exceptional one reached in 1958, even if, in the absence of international political complications, it is not likely to fall to the low level touched after the Suez crisis (which provoked a sharp and rapid upswing in the prices of many important raw materials, particularly fuel).

As regards the quantitative reduction in imports, this was also caused, for the most part, by factors which are, by their very nature, bound to act in the opposite direction once the economic situation changes.

As far as exports of goods are concerned, 1958 witnessed a lull after the marked expansion of 1953-57. But notable advances were still made in the motor-car industry and in the chemical, engineering and machinery sectors, as well as in services and, in particular, tourism. Total exports of goods and services, while having lost the impetus of the preceding years, thus still showed a moderate upward tendency.

In fact, if in examining the results of the current-account balance of payments in 1958 it were possible to distinguish between the effect of contingent circumstances and that of longer-term factors, it would appear that the former were of decisive importance in producing such favourable results; but it would still be evident that in the last few years the improvement was not of an ephemeral nature and that we may thus view with relative tranquillity the future development of our economic relations with the rest of the world.

Obviously this does not rule out the possibility of difficulties, even considerable ones, arising in the event of markedly adverse developments, nor does it safeguard us against a possible deterioration in the long-run position, if the pace of expansion, or the increase in the demand for money (even if inspired by considerations of a purely social nature) should be greater than the possibilities of growth in domestic supplies.

It seems, in any case, that if we are able to defend monetary stability the present amount of reserves will constitute sufficient protection against possible not-too-excessive fluctuations in the business trend.

It must not be overlooked that the far-reaching technical modernisation of domestic industry in the last few years has been such that surplus capacity is now available which will enable a growth in demand to be satisfied without giving rise to bottlenecks.

Lastly, the trend of prices, which has led—and this is a new feature in the post-war period—to the downward adjustment of the sliding scale of wages for vast categories of dependent workers, is another characteristic element of the present situation.

To sum up, the foreign exchange and monetary position of the country now seems to be favourable for the promotion of a more active phase in the field of investment.

With this in view, loans have been raised abroad, even though the rapid growth in the reserves last year might have appeared to make it advisable to restrict our commitments in this sector. At the same time, monetary policy has aimed at preserving an ample volume of liquid funds for the development of investment, once the cost of money had fallen to an appropriate level, even though the maintenance of a high degree of liquidity was not and is not without certain dangers.

To what I have just said I need only add that the recovery would undoubtedly be accompanied by the necessary expansion in credit. We do not share the opinion held by some that our banking system would be timid about furthering new investments, nor are we among those who regard credit as practically the sole factor needed for a firm recovery. By this we do not intend in any way to underestimate the importance of credit, nor to belittle all that can be achieved—and has already been achieved—in reducing the cost of credit or in making it more easily available. We wish only to point out that it is impossible to confine ourselves to this one aspect of the problem.

Credit policy can certainly effect a greater or lesser increase in production; it can sharpen or blunt the peaks, correct or provoke excesses, encourage or discourage new undertakings. But decisions of the monetary authorities cannot replace those of entrepreneurs, who base their judgements on elements for the most part of a non-monetary nature, and primarily on an evaluation of probable future demand, at home and abroad, and on the conditions in which production is being developed.

What induces me to rate our credit policy among the bold—rather than among the timid—ones is the striking evidence of the spirit which has always inspired it in its actions.

In order to prove this, it is not necessary to refer to the events of more than 30 years ago. It is well known that the broad investment policy introduced at that time was accompanied by a quite unreasonable extension of bank credit, with the result that a vast inflationary process began, which the country largely discounted with the deflation from 1927 onwards.

I shall refer rather to a more recent period and to events which have taken place under the present very different system. I would point out that in the four years from 1952 to 1955, during which—through the stimulus given to the Southern Development Fund and for other reasons related primarily to the favourable international business situation—economic development continued at a very high rate, the average annual increase in the loans of the credit system rose to 744 billion lire, from the 471 billion of the previous four years (which had been the period of the feverish post-war reconstruction); it rose, that is, by over 60 per cent. In 1955, the last year of this period, the increase in the loans granted amounted to 855 billion and in 1956 it touched the highest level of annual expansion hitherto recorded, namely over 922 billion.

During the four-year period from 1948 to 1951, the commercial and savings banks had expanded their loans in favour of the economy by an average of 318 billion per annum. In 1952-55 they raised this figure to an annual average of 523 billion, and the greatest growth was recorded in 1956 (669 billion). In the second half of that year and the first half of 1957 the total amount of new deposits was used for loans, and the ratio of outstanding credits to deposits was nearly 80 per cent—a higher percentage than in any other banking system in western Europe or in the United States. If in the second half of 1957 and last year this ratio dropped several points, this was due to the exceptional injection of liquidity which the monetary authorities deliberately allowed in order to prevent a recession and to stimulate the recovery and which, as I have pointed out, was so great that it could not have been reabsorbed by the increase in production, even if this had kept up the rhythm of expansion of the best years of our economic development.

The fact that, as I have shown, the business sector acquired more funds in 1958 than it actually used for new plant is a further confirmation that the pause in investment last year was not due to credit restrictions.

If further proof were required, it would suffice to point out that the credit system responded last year to the adoption of some anticyclical measures by immediately granting new credits. For instance, the stimulus given to the public works and telephone sectors and the speeding-up of new investment by the State Railways were promptly backed by large loans from the credit system.

Moreover, there were many banks which, in the face of the increased demand from local economies and, in particular, from medium and small-sized businesses, raised their loans last year by as much as 15-20 per cent or more, compared with an overall increase of 6 per cent.

These figures are proof that the banking system has not been slow to help the small and medium-sized industries, which can satisfy their financial needs better by recourse to the commercial and savings banks than through other channels.

Credit to small and medium-sized businesses is, in fact, inevitably based on the personal qualities of the owners. In large concerns a nucleus of highly-qualified managers ensures the continuity of management, so that a change at the top does not necessarily affect the business itself. But the welfare of small and medium-sized businesses is intimately bound up with the personalities of those who direct them, and only bank managers who keep in close contact with these people can follow changes in such management with the necessary continuity and attention.

The credit granted to them is thus formally short-term, but is adapted to the needs of the businesses and the behaviour of the owners. These, therefore, know that the continuation of financial assistance is dependent on their conduct.

This is what happens in our country and in this way our innumerable small and medium-sized enterprises live and prosper.

In conclusion, I believe I may say that our economic system, profiting in particular from the current balance-of-payments situation, is in a position to sustain in the near future a further effort in the field of investment and that such an effort will be backed by the credit system. This system adequately supported economic development in the years following the war, and again in 1958, when it was appealed to, responded generously. We may thus be sure that, if a consistent impulse were given to the recovery, it would be immediately backed by the credit system. Moreover, the banks would not fail to give preference to customers with sound development programmes and would refuse, as they have done in similar cases since the war, in line with the directives of the central bank, to aid speculation on goods tending to provoke an unjustified rise in prices.

To the question posed by one of the big banks in its recent report to the annual meeting of shareholders, namely whether the slight increases registered recently in the indexes of industrial production represent the last flickers of a waning trend, or whether they are rather the triumphant sign of an irresistible upward tendency, even in adverse circumstances, I reply that it all depends on us.

Our present condition is typical of phases in which a decisive and consistent impulse given to certain public investments (schools and education in general, scientific research, roads, transport and telecommunication systems, hospitals, popular housing and, above all, agricultural improvement) could give a new impetus to industrial development and to the whole economy.

To anyone who fears lest such projects might require so much money that there will be none left for the development of directly productive ventures, I feel I must reply that fears of this kind are not founded today.

There is, it seems to me, room for both the one thing and the other.

The danger signal that would naturally lead immediately to the slowing-down of the pace of the new programmes would be given by the course of prices and, in particular, as I believe I have shown, by the trend of the balance of payments. This signal could, of course, be given the later, the more the various categories of workers co-operate by restraining their wage claims. And this could speed up, to a perhaps quite considerable degree, the progress of the country and bring about a reduction in unemployment.

I do not wish to be misunderstood. My conviction that a vast effort can be made is based, as I have repeatedly said, on the present monetary situation and on the balance of payments.

It would thus be a serious mistake to confuse a condition which might be transitory with one where current available savings are permanently sufficient to cover all our needs.

We have often observed that in leaving at the disposal of the market liquid funds designed to operate there as a stimulant to productive activity, the risks of such a policy have been calculated and accepted. It must not be denied, however, that among these risks by no means a secondary one is that inherent in the possibility that contingent circumstances may obscure the basic requirements of the country.

These requirements still today, as in the past, necessitate some restraint in consumption, in order that we may gradually meet our structural investment needs, including investment in human capital and in basic equipment. The improvement of such equipment, recognised as indispensable today even in countries with long-standing and vast accumulations of capital, seems to be all the more so in ours, where we still have great tasks of economic and social advancement ahead of us. It thus constitutes the necessary basis for further progress in our country.