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RFD 260

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

November 15, 1955

Financing Italy's Four-Year Development Plan 23 pages

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NOT FOR PUBLICATION

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Financing Italy's Four-Year Development Plan

Elinor Harris

Italy's Ten-Year Development Plan (the Vanoni Plan) envisages, over the period 1955-64, an annual rise in real national income of about 5 per cent and the elimination of chronic unemployment; external balance also is to be attained despite increased imports made necessary by the expected rise in incomes and investments. 1/

A supplementary Four-Year Plan, more modest in its goals than the original Plan, was submitted to the OEEC last spring: this Plan is considered to be the immediate working basis for the development program, and for most of the discussion in this paper. It projects an annual average rise in national income through 1958 of 4.5 per cent, rather than 5 per cent, and the reduction rather than the elimination of the structural unemployment through the creation of a million new jobs; the 1958 external deficit is to be of about the same magnitude as in 1954.

Realization of these targets, and especially the anticipated average 4.5 per cent annual increase in national income, involves a real -- and as yet unsolved -- financing problem. This problem is how best to fill the projected savings "gap," amounting to about 8 per cent of estimated gross investments through 1955-58. The "gap" arises because total projected savings from all sources, public and private, fall short of the projected investment financing needs through 1958; the gap must be closed either through cutting consumption or through bank credit expansion. 2/ However, no specific program of consumption-restraint has yet been publicly formulated. The Four-Year Plan for Economic Development merely states that, "to cover this (8 per cent) deficit, appropriate steps must be taken to mobilize the required amount from available resources which would otherwise be used for consumption, without affecting the anticipated rate of voluntary saving."

1/ The Vanoni Plan targets and the impact upon the balance of payments are discussed in detail in my paper on "Italy's External Balance and the Vanoni Plan," May 27, 1955.

2/ Some indication of the intensive savings effort required to fulfill the investment targets for 1955-58 is shown by the following comparisons: Between 1954 and 1958 gross investment is to increase by 8 per cent per annum, but consumption is to rise by only 3.5 per cent. The ratio of investment to total available internal resources is to rise from 20.6 per cent in 1954 to about 23.8 per cent in 1958. More than 40 per cent of the increase in resources expected during the period is to be devoted to investment and slightly under 60 per cent to increased consumption.

We may discuss, first, how this residual of 8 per cent of investment requirements can be reduced through increasing the rate of public and private saving from incomes; and secondly, how, once the "irreducible minimum" of bank financing is reached, its inflationary and adverse balance-of-payments impact can be dampened through credit and other controls. In this connection, we may inquire what has been accomplished through debt management and monetary policy under similar circumstances of rapid growth in the postwar years 1947-54; and which of the techniques utilized then may in the future be most effective.

1. Projected Italian Savings Through 1958

The Italian Government has computed the estimated 8 per cent "savings gap," shown in Table 1, by analyzing projected four-year trends in the sources of public and private savings. As a result of the projected 4.5 per cent annual rise in incomes, all financing sources are expected to rise on an absolute basis although some notable changes are anticipated percentagewise.

Table 1

Investment Financing, 1954 and 1955-58

	1954		1958		Total 1955-58	
	Billion lire	Per Cent	Billion lire	Per Cent	Billion lire	Per Cent
Government savings	175	7.4	200	6.2	680	5.9
Business savings (incl. depreciation in allowances)	850	36.2	995	30.8	3,755	32.7
Private savings	1,245	53.0	1,580	48.8	5,770	50.3
Foreign capital	80	3.4	80	2.5	320	2.8
Savings deficit	---	---	380	11.7	950	8.3
Total investment	2,350	100.0	3,235	100.0	11,475	100.0

Source: OEEC Council. Italian Economic Development Program, Outline of Economic Policy for the Four Years 1955-58, March 1955.

Assumptions underlying savings projections - Estimates for Government savings may be somewhat overstated; otherwise, the savings projections in the 4-year Development Plan appear to be reasonable if (and only if) certain implicit, and probably optimistic, assumptions are accepted as valid. These assumptions, which have not been spelled out in the Plan, would seem to be the following:

a) Consumer prices will remain fairly constant, or at least increase by no more than, say, the 1950-54 rate (about 4 per cent annually) so that confidence remains unimpaired and savings ratios may continue to rise; similarly, Italy's wholesale and export price levels will not rise by more than those of her competitors so that the external balance will not be more unfavorable than anticipated.

b) Domestic real incomes (monetary incomes deflated by an index of domestic prices) will be raised by the projected 20 per cent during the four-year period; and world incomes and foreign demand will rise sufficiently to permit the anticipated sale abroad of Italian goods.

c) The present highly favorable combination of internal stability plus a high rate of real economic growth will not be disturbed by serious external cyclical fluctuations, producing either inflation or deflation in Italy. In the former case, savings incentives would be dampened and savings ratios consequently lowered; in the latter case, real incomes from which savings could be realized would be reduced.

d) The Four-Year Development Plan will receive stronger support than it has recently from the Government coalition, the consuming public, and the labor unions so that the necessary legislation to implement the Plan may be enacted and executed.

Prospective savings trends - Each category of savings has been analyzed separately in the Plan, apparently based upon past trends: (see Table 1).

a) Government savings (or the excess of current revenues over current operating expenditures) are expected to rise by 13 to 14 per cent, or by 3 per cent annually; this so-called "saving" from the operating budget could then be transferred to the capital budget to be used for investment expenditures during the period. The projection assumes a rise in government current expenditures through 1958 of 22 per cent and a rise in current revenues of 31 per cent.

The projected government expenditure would seem low, in view of the expected growth in administrative costs and the recent wage increases granted to government employees, but the 22 per cent figure is not out of line with past experience. The projected 31 per cent increase in Treasury revenues, which compares with a rise in incomes of about 19 per cent (a ratio of 1.63 to the income rise), also is in line with past trends. 3/ However, the revenue increases in 1950-54 arose from substantial tax rate increases as well as from the growth in incomes; while the projected rise is based chiefly upon stricter enforcement of existing taxes, and, of course, upon the continued rise in personal and business incomes. 4/ Therefore, government revenues and thus "government savings" (as defined on current account) are perhaps overstated. 5/

b) Business savings are estimated to be 17 per cent higher in 1958 than in 1954, since amortization and other sinking funds are expected to rise more rapidly than replacement needs, permitting new capital formation. This projection is in line with past trends; it assumes replacements in 1958 (7.4 per cent of gross product) to be the same proportionately as in 1954 or 1950 (7.5 and 7.3 per cent of GNP, respectively).

c) Private savings are projected to rise by 5 or 6 per cent per annum, and to be about 25 per cent higher in 1958 than in 1954. This rise is also in keeping with past experience and perhaps even understated. The projected rise should result, first, from the

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3/ In the preceding four-year fiscal period (1949-50 - 1953-54) the Treasury's current revenues rose by 69 per cent, compared with a 41 per cent rise in incomes (or 1.66 times the rise in incomes) while current expenditures rose by 23 per cent.

4/ Receipts from the turnover tax alone rose by 11 per cent in the last fiscal year, against only a 5 per cent rise in incomes. It must be remembered, however, that if consumption in the coming four years is to represent a smaller proportion of the rise in incomes than formerly, the rise in indirect tax receipts will be smaller relative to the growth of incomes.

5/ In October, the Government unexpectedly announced new tax measures to provide for salary increases for government employees and for land improvement measures. New revenues will come from the following sources: (1) Additional excise taxes on lubricating mineral oils and coffee; (2) A production tax on methane gas; and (3) Increased drivers' license taxes. Relatively, the yields from these sources will be fairly small but their imposition represents some change from the Government's earlier promise not to impose new taxes nor tax rate increases.

expected 20 per cent rise in personal and business income levels, which would permit greater absolute savings even with unchanged savings ratios; and, secondly, from a continued rise in the ratio of savings to incomes, as a result of growth in confidence and the restoring of personal bank deposits, which had been destroyed by years of war and inflation.

It is true that against these factors certain trends may be working to lower savings ratios slightly (that is, the percentage saved from a given income): (1) incomes of the lower-income groups, whose consumption ratios are very high, may be increased the most percentagewise; and (2) improvements in tax administration (including greater progression in the tax structure and lessened evasion in the highest-income groups) may also produce income redistribution in favor of those having lower relative incomes and lower savings ratios.

2. The Significance of the "Savings Gap"

The resulting projected public and private savings shortfall of almost 12 per cent of 1958 investment requirements (8 per cent for the period as a whole) represents an *ex ante* concept which is statistically impossible to verify. 6/

Its statistical significance - The closest statistical approximation to the "savings gap" concept (which, however, overstates it statistically) would seem to be bank financing as a source of funds (computed yearly by the Bank of Italy) as a percentage of gross investment. This ratio was 14 per cent in 1954 as compared with 20 per cent in 1951 and 1952 (see Table 2 below).

The ratio of personal and institutional saving to gross investment, meanwhile, rose from 29 to 44 per cent. The balance of the investment financing in this crude statistical approximation would reflect government and business saving (including depreciation and replacement allowances) and foreign aid.

6/ It must be remembered that projections for savings in Table 1 probably already include some credit and monetary expansion, since they are based on past experience which included such expansion. The "savings gap" would be met by financing through the commercial banks or the Bank of Italy; such financing would mean additional monetary expansion and, *ex post*, additional monetary "savings." Thus, any attempt to measure the "savings gap" in 1951-54 through bank credit expansion probably overstates the "gap" as conceived by the Vanoni Plan authors.

The "savings gap" shown *ex ante* in Table 1 for 1958, if financed by additional bank credit expansion, will *ex post* be reflected in higher *monetary* totals for the various categories of public and private savings. Depending upon the movement of internal prices and the behavior of consumers, these higher monetary totals may or may not reflect higher *real* savings levels. Therefore, reasoning about the savings gap before the fact is rather spurious; for if the gap can be covered without inflationary consequences, then the earlier "real" savings estimates will in the final analysis be proved to have been too low, and will have to be revised upwards.

The concept of the "savings gap" may be useful in that it indicates the necessary net additional savings *effort* (as compared with past experience) or, alternatively, the *potential* new bank credit expansion involved in the implementation of the Program. It also indicates the potential threat to stability and the additional restraint on consumption which must somehow be imposed, if the necessary real resources are to be mobilized without inflation, presumably by monetary or other controls.

Its economic significance - The "savings gap" reflects a deficiency of capital relative to labor. Italy has the problem, familiar from experiences in many underdeveloped Far Eastern countries, of excessive population growth relative to land and capital resources. 7/ In the absence of a large foreign capital inflow, this disequilibrium involves the possibility both of chronic unemployment and of chronic inflation existing simultaneously, for two reasons:

First, the *ratio of labor to capital* tends to be above the "optimum"; the "optimum" ratio of labor to capital would be one in which the factors of production are combined at the lowest total cost in the most efficient technological proportions; and in such a way that aggregate demand (both domestic and foreign) for Italian output equals the potential aggregate supply within a framework of full employment and of financial stability. The excessive ratio means that -- if labor is to be fully employed -- real wage rates must be very low and perhaps declining; or that, when real wages are not depressed sufficiently, production methods will be inefficient and

7/ At present, Malthusian downward adjustments of the labor force, through poverty and disease, cannot constitute a desirable mechanism of adjustment of labor to capital supplies although they have probably been operative to a certain extent, especially in the South; however, Italian emigration is officially encouraged, especially to neighboring countries such as France in which cultural patterns are similar. In the future, the importance of this factor *may* decline since recent demographic studies show a prospective leveling off of Italian population growth by 1970.

Table 2

The Flow and Use of Savings, 1951-54

	1951	1952	1953	1954
	(Billions of lire)			
Gross investment	2,058	2,110	2,240	2,350
Total sources of funds:	1,178.3	1,353.1	1,403.8	1,401.0
A. Personal and institutional savings:				
Savings deposits	351.1	495.1	588.7	530.3
Insurance companies	44.8	53.5	93.4	89.0
Long-term credit institutions and the capital market	196.0	229.6	310.4	406.7
Total	591.9	778.2	992.5	1,026.0
B. Bank credit expansion	405.5	435.7	349.9	328.0
C. Foreign aid	181.7	119.2	68.4	50.2
D. Other, incl. statistical adjustment	- 0.8	20.0	- 7.0	- 3.2
Total demands for funds:	1,178.3	1,353.1	1,403.8	1,401.0
A. Funds borrowed by Treasury	421.3	470.5	453.1	441.8
B. Funds borrowed by economy	757.0	882.6	950.7	959.2
	(Per cent of gross investment)			
Personal and institutional savings	28.7	36.9	44.3	43.7
Bank credit expansion	19.7	20.6	15.6	14.0

Source: Banca d'Italia, 1953 and 1954 Reports, Rome, May 31, 1954, and May 31, 1955.

present international competitive handicaps. In actual practice, the result has been more or less chronic unemployment, further reducing per capita incomes and available saving from which new capital can be created. Even today, at the height of the "boom," Italy's unemployed constitute over 10 per cent of the labor force.

Second, the nation's ratio of consumption to income (or the national average propensity to consume) is high, and for individual cases involving unemployment frequently above unity, or greater than the family's entire current income. For the nation as a whole, given its limited capital equipment, domestic demand therefore continually tends to exceed the supply of domestic goods at prevailing prices. Continued industrial reorganization or rationalization, or industrial reconversion from less to more productive industries, together with the utilization of advanced (foreign) production techniques, might result in more intensive use of available capital equipment and therefore in capital-saving; such a rise in the efficiency of the Italian productive system would, of course, raise the nation's output of goods and services and would therefore soften the inflationary impact of the high propensity to consume.

Correction of certain technical shortcomings would help to direct the available saving into the capital market and therefore into the investment stream. Savers who have indicated reluctance to invest in industrial bonds or shares have pointed out the present low yields relative to the risks involved; the wide fluctuations in share prices; the difficulties of predicting the maneuvers of the firm's management and/or of the Government with respect to the amount and distribution of profits; the lack of reliable published information necessary for accurate appraisal of a company's financial situation; and the inability of small bond- or shareholders to safeguard their own interests in company management. 8/ The recent stock market boom, although mostly confined to "name" firms and reflecting world-wide market trends, nevertheless does undoubtedly reflect some heightened interest in industrial equities and a revival of the private capital market.

8/ See Eugenio Scalfari, "The Italian Capital Market," Italy, a Financial Times Survey, May 1955, page 22. A Survey conducted by DOXA -- a reliable statistical research organization -- in 1951 indicated only 2 per cent of those questioned were willing to invest surplus funds in industrial shares, while 35 per cent preferred banking deposits, 15 per cent postal savings, 9 per cent cash, and the remainder other forms of investment. The author stresses the need, in order to attract private capital, of reforming company laws and improving the representation of small shareholders.

3. Sources of Investment Financing, 1951-54

Recent experience, especially in 1954, indicates the gradual removal of some of these technical barriers to investment of savings and, consequently, the revival of personal interest in stock and bond investments. Investment financing through the capital market and the special long-term credit institutions has more than doubled since 1951, and increased by about 100 billion lire last year alone. (See Table 2 and Appendix Table I.)

Two factors appear to be reflected in this trend: (a) a substantial reawakening of the capital market, due to the growth in real incomes and savings and the greater inclination to use savings for interest-yielding investment purposes; and (b) the attempts of the Government to supplement capital market deficiencies through the establishment of new long-term credit institutions, partially aided by public funds and guarantees. 9/

Actually, the banking system (including the Bank of Italy) supplied 14 per cent of 1954 gross investment financing requirements, slightly less than in any previous year; the resulting net monetary expansion in 1954 (9 per cent) was accordingly lower than in previous postwar years, despite the continued rise in business activity (see Appendix Table II). There was also a shift in the money supply composition from currency into deposits, and, within this category, from demand to savings bank deposits. In part, the slowing up in the rate of monetary expansion may be considered to have been effect rather than cause: this demand for the most liquid and non-interest-yielding assets, such as cash, was reduced as business firms and

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9/ Oldest of the industrial credit institutes is the Consorzio per Sovvenzione su Valori Industriali, founded in 1914 primarily to aid the private stock market. The Istituto Mobiliare Italiano, established in 1931 to help refinance industry in the depression and relieve the banks of illiquid investments, now finances long-term machinery and equipment purchases and improvement credits of IMI-controlled firms; these activities are financed through issuance of bonds guaranteed by the State. In addition, in 1944 and 1946, respectively, the autonomous industrial credit sections of two Southern banks of public law, the Bank of Sicily and the Bank of Naples, were established; more recently a similar section of the Bank of Sardinia was established. These sections obtain their financing either from proceeds of bonds issued by the Banks proper, which are both government-guaranteed and interest-subsidized; or from funds contributed directly by the State from the general budget. They engage chiefly in long-term investment financing of Southern industry on favorable terms.

individuals began to adjust their cash needs to the more normal requirements of a fairly stable economy. It also reflected improved profit expectations and the greater likelihood of safer and higher return from bond and share issues, reducing the desirability of non-interest-yielding assets such as cash. In actual practice, this preference was transmitted into reality through the mechanics of a shift from bank to private financing of a greater part of the economy's investment needs.

4. Debt Management and the Re-Direction of Savings

The growth of incomes and of savings incentives has raised over-all savings levels in 1951-54, and the improved investment climate has helped channel these savings into the investment stream. The Treasury, too, has utilized specific debt management techniques, involving minor short-term interest rate changes, in order to make its issues more attractive and, accordingly, to re-direct savings.

Experience in this period indicates that the Treasury may successfully mobilize personal savings without offering any rise in long-term rates if (and probably only if) the investment and general economic outlook appears to be favorable.

Substantial over-all increases in the rate level have not been considered feasible because of the increased costs to the Treasury and the probable adverse effect upon private investment and the level of employment. 10/ The official discount rate of the Bank of Italy has remained unchanged since April 1950 at 4.0 per cent; however, some upward adjustment has occurred since 1952 in the other public short-term rates while long-term bond yields have been brought down (see Appendix Table III).

The structure of interest rates in 1954 - The Treasury rate structure narrowed during 1954, that is, the differential between the longer- and shorter-term issues was reduced, as preference was registered for the longer maturities (see Appendix Table III).

Last year's lower long-term rate levels appear to reflect, on the one hand, the reduced new private share and bond offerings (see Appendix Table IV) and, on the other hand, the rise in private and institutional savings available for investment. Because of the

10/ The 1953 Annual Report of the Bank of Italy, in fact, comments with admiration upon United States monetary policies following the 1951 "accord," which have involved interest rate flexibility in both directions, but points out present impediments to use of such a policy in Italy.

relative dearth of the private issues, accordingly, the Treasury did not have to offer investors a higher rate of return in order to increase its placements outside the banking system; in fact, this result could be accomplished at a time of declining long-term Treasury yields. 11/

The 1955 rate structure - In 1955, long-term Treasury yields increased slightly while those on private bonds and stocks continued to fall, thus further narrowing the spread between public and private rates (see Appendix Table III). Thus, the spread between short- and long-term Treasury issues widened, while that between private yields and the over-all index of State bond yields narrowed. The Treasury anticipates that this fiscal year's borrowing needs will be somewhat less than those in the last fiscal year, and that progressively larger proportions of its new issues may continue to be placed outside the banking system.

The lessons of debt management in 1954-55 indicate that increasing amounts of debt may be placed with nonbank investors, thereby reducing the investment financing deficiency, if (and probably only if) the investment climate and the country's economic prospects appear favorable. Under these conditions, which prevailed in 1954-55, the Treasury's demands for funds have not even been seriously competitive with those of industrial firms and other private borrowers, who have been able to increase their financing through the private capital market and at declining interest costs.

Experience during this period also indicates that rapid economic growth and development, such as that envisaged for the future, may permit the separation of the long- and short-term segments of the rate structure in pursuit of separate policy objectives. That is, long-term public (and private) rates can be brought down, as a result of the growth of saving, while short-term rates can be varied in accordance with the requirements of debt management and monetary policy.

5. Quantitative Credit Controls and the Residual Savings Gap

"Direct" measures of consumption restraint have been considered in order to counter the over-all projected capital deficiency, including tightening of the present system of wage controls and a further extension of price controls. However, apart from all

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11/ Percentagewise, shifts in Treasury ownership in 1954 were from the commercial banking system to the public and the Bank of Italy, although the total rise in Treasury internal debt in 1954 was somewhat lower than in 1953.

economic objections, the use of both techniques will be limited by the expected unfavorable political repercussions, while introduction of compulsory savings measures (also under consideration) will be inhibited by the adverse effect on voluntary saving.

In any case, once the "irreducible" minimum of the "savings gap" is reached, the problem remains of how to dampen its inflationary impact by monetary controls. On the basis of the experience since 1947, it seems probable that this impact could be managed through indirect and other controls; however, it may be most difficult to duplicate the prosperity and stability in most of Western Europe and in the United States as well, which proved unusually favorable in recent years.

Commercial bank financing of the "savings shortfall" (if not offset by a corresponding shift of Treasury issues from the banks to the public) results in monetary expansion. The inflationary impact of the "savings gap" will depend upon whether the creation of bank-financed investment resources is or is not counterbalanced by the additional new purchasing power and effective demand; and whether the additional monetary expansion is or is not required to support the active cash needs accompanying income growth and the public's current demands for idle cash balances, given its expectations about future economic growth and future bond and stock prices. In fact, it has sometimes been argued that the Bank of Italy since 1947-48 has not permitted the quantity of money in existence to grow fast enough, an accusation probably not borne out by the record. 12/

Monetary policy and the Vanoni Plan - Specific financial policies to close the "savings gap" under the Development Plan have not yet been formulated, but one may assume even greater future stress upon credit policy and possibly selective credit redirection as well. Budget Minister Vanoni, speaking before the Italian Bankers' Association, has rejected the notion either that the State will take over the banks' financing role or that it will pursue "easy money" policies; he stressed the need for continued elasticity in the granting of credits, insuring a flexible monetary policy, so that internal

12/ Since 1948 (and especially since 1952) monetary expansion, which was so dramatic in the years 1937-1948 of hyperinflation (a growth of 5,394 per cent), has progressively declined. In 1954 the expansion proceeded at one of the lowest rates of growth in Europe; in contrast, growth of Italian industrial production was greater last year than at any time since the immediate post-Korean boom. For a discussion of these arguments and the role of the Bank of Italy in 1947-48 see a paper of Albert O. Hirschman, Economic and Financial Conditions in Italy, December 14, 1948.

economic trends could be accelerated or retarded according to the requirements of the external balance. He emphasized that credit policies should also contribute to "even development" throughout various sectors and should help prevent bottlenecks, such as developed between 1945 and 1950.

To what extent may this policy be carried out through quantitative credit controls affecting the over-all level of bank reserves? In reply, it may be useful to examine briefly the postwar record in the period since 1947 when such controls were first put into effect.

Monetary policy in 1947-53 - Reversal of the inflationary movement in October 1947 is generally attributed in very large part to inauguration of quantitative credit and other financial controls and to the resulting shortage of cash and of bank loans. Because of credit stringency, inventories had to be liquidated and real estate and industrial shares were unloaded, which consequently were depressed in price. Business firms could not obtain sufficient credit accomodation, and were also forced by the banks to repay old debts, and consumers postponed purchases in anticipation of commodity price declines. As a result, the inflationary spiral was broken effectively, producing as an aftermath some deflation as well as some new unemployment.

Since the 1947-48 recession, however, central banking policies appear to have encouraged development of banking liquidity so that adequate bank credit might be supplied for industrial development. The discount rate has remained unchanged at a low level; the Bank of Italy has been willing to discount freely, to permit the growth of gold and foreign exchange reserves to expand the reserve level, and to accomodate Treasury needs directly when such financing appeared necessary because of current money market tightness. This policy has not been very successful in encouraging adequate private accomodation in a recession; because of the institutional framework, ample banking liquidity in the past has not assured that credit needs will be met at reasonable rates, or at all.

Even when they were extremely liquid in the recession, the Italian banks were highly selective and demanded, for all but the most secure loans, frequently prohibitive rates on medium-term loans ranging from 7 to 11 per cent. For instance, from the summer of 1951 through the autumn of 1952 the banks' liquidity ratios were steadily rising, as the result of increased Central Bank financing of Treasury deficits and European Payments Union surpluses as well as of a net inflow of deposits from the public. Yet business firms quite generally complained of lack of adequate accomodation and loan rates failed to decline appreciably. On the other hand, tight reserve positions have not prevented credit extension to high levels, as in 1954, when the economic outlook has seemed to be unusually favorable.

Monetary policy in 1954 - In 1954, the liquidity position of the banks tightened markedly, as a result of the increased rate of extension of private loans and of note circulation, and a large rise in "international aid accounts" (lire counterpart of U. S. dollar receipts). "Tied" commercial bank deposits at the Bank of Italy, reflecting chiefly compulsory commercial bank reserves, rose more sharply than at any time since 1949, while "free" reserves of the banks dropped to record low levels. Despite increasing tightness, further advances were also made in drawing down private medium-term loan rates, reflecting continued correction of the disequilibrium in the rate structure caused by years of undersaving and chronic lack of risk capital. 13/ Moreover, the volume of credits extended by the banking system in 1954 rose by 724 billion lire, somewhat exceeding the 1953 increase of 712 billion. 14/

13/ Complete data on the private rate structure are not available. However, the interest on mortgage loans contracted by private persons fluctuates between 10 and 15 per cent, to which must be added the heavy cost of drawing up the deed (a lump sum of 6 per cent), registration taxes, mortgage execution taxes, notary's fees, etc. The rates (including commissions) on mortgage loans granted by the banks are reported to be between 6-1/2 and 7-1/2 per cent and on medium-term financing (1 to 5 years) for renewal of machinery, etc., from 6.75 to 7.25 per cent; the latter are quoted by the Lombard Regional Medium-Term Credit Organization. Rates charged by Mediobanca for medium-term credits are not published but are believed to range between 7-1/2 and 8 per cent, depending on their maturity and the risk involved. See Constantino Bresciani Turroni, "Rates of Interest in Some Countries," Banco di Roma, Review of Economic Conditions in Italy, March 1955.

14/ While commercial loans rose faster last year than in 1953, domestic investments of the banks rose less rapidly than in the preceding year; however, investments abroad and in foreign exchange were accelerated. If securities placed in the compulsory reserve are deducted from bank investments, the annual increase works out at Lit. 55.1 billion for 1954, compared with 77.1 billion for 1953. Investments abroad and in foreign exchange, which had undergone little change in the preceding year, showed an increase by 35.2 billion (or over 50 per cent) in 1954.

The banks attempted to augment their reserves through increased rediscounting at the Bank of Italy. The continued gain in official gold and dollar reserves and the Bank's loans to the Treasury, too, helped the commercial banks to meet the compulsory reserves required by the growth in deposits and currency outstanding; "free" bank reserves thereby were kept from falling below what seemed an irreducible minimum. Bank of Italy advances to the Treasury rose by 80 billion lire, the biggest increase since 1948, and its government and government-guaranteed security holdings rose by 63 billion, also the biggest rise since 1948 (see Appendix Table V). The effect was analogous to that of open-market purchases designed to maintain, with no rise in long-term rates and only a small rise in short-term rates, bank reserves at the minimum working level.

Monetary policy in January-July 1955 - Available data indicate a further tightening of the banks' reserve position during the first half of 1955, chiefly as a result of the reduced indebtedness of the Treasury to the Central Bank and the rise in "international aid" or counterpart lire accounts. 15/

The failure last spring of the Bank of Italy to prevent a more-than-seasonal decline in bank "free" reserves suggests an inactive attempt by the Bank to restrain credit; the fact that it permitted discounts to rise, at no additional increase in the discount rate, however, suggests it did not wish this credit restraint to force any marked upward adjustments in the rate structure.

The effectiveness of quantitative credit controls - Consequently, it appears that Italian credit policy in the stage of business "recession," which encouraged accumulation of large amounts of "free" bank reserves in 1951-52, was not especially effective in inducing either needed credit expansion or reduced private loan rates.

Experience in the boom period of 1954 and 1955 has been most favorable, however, as it was in 1947-48. The Bank of Italy has maintained, through a mild policy of credit restraint in 1954 and 1955, sufficient pressure on bank reserves (a) to raise short-term Treasury rates and to reduce bank purchases of Treasury paper,

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15/ "Free" bank deposits at the Bank of Italy declined while "tied" deposits, or required reserves, rose substantially (see Appendix Table V). The very sharp rise in discounts and advances of the Bank of Italy, especially in April when business activity rose greatly, suggests the existing pressure on the money market and the banks' attempts to supplement their reserve funds. The subsequent decline in July in Bank advances also reflects the eased bank reserve position in that month which was partially seasonal.

and (b) to prevent rapid or inflationary private credit expansion, while permitting a moderate growth in bank credits needed to sustain the recent marked expansion in business activity.

It can be concluded that the monetary authorities have recently been fairly successful in a period of expansion in meeting their stated objectives. Thus, if one assumes the projected 8 per cent "savings gap" is a reasonable one (given the conditions outlined in Section 1), one may also assume its inflationary impact may be minimized through the quantitative controls recently used. The major present problem seems to be that the basic conditions may not be fulfilled: that is, that social and political pressures will lead to excessive wage increases or loss of confidence in the Plan, the present Government, or the economic prospects of the country generally.

6. Selective Techniques of Monetary Control

Finance Minister Vanoni has also suggested further employment of selective credit controls to divert scarce resources into the most productive uses and therefore to maximize real investment. The meaning is not clearly defined, but it would appear that "selectivity" has a slightly different connotation than might be assumed in common usage of the term. It does not necessarily mean further direct credit rationing although the possibility cannot be ruled out altogether. It may mean further resort to informal "voluntary" gentlemen's agreements among the large banks which, because of the degree of public stock ownership in the system and the limited number of strictly private banks, become almost coercive. 16/ Another type of "selectivity" would include further growth in special financial institutions to meet the problem of capital deficiencies in particular areas, in effect compartmentalizing certain demands for investment funds and certain segments of the long-term interest structure.

16/ There are six banks of public law, which are therefore quasi-public in nature, including the recently established Banca Nazionale del Lavoro and the Banco di Sardegna. Statutes of these banks must be approved by decree of the Ministry of the Treasury, which holds most of their stock, and their presidents and directors are nominated by the Minister. In addition, the Banco di Roma, the Banca Commerciale Italiana, and the Credito Italiano have been designated by Presidential decrees as banks of national interest, with the majority of their stock held by IRI. Moreover, the Bank of Italy has wide discretionary powers to intervene directly as well as indirectly in almost all phases of bank activity including their management and administration; it is therefore in a very strong position to exercise great influence on the specific types and uses of bank credits extended.

A network of special financial institutions has been established to promote development of the South and investments in basic or new industries. Not only loan, but also equity funds, have been provided from special revolving funds financed, in part, from the lire proceeds of United States dollar aid and, in part, from the general budget. Several new medium-term credit organizations of a permanent nature also have been established especially to deal with the problem of Southern development. 17/

"Compartmentalization" of important basic investment demands in this fashion provides financing needed for development and for new industries, the areas where private capital is most reluctant to flow. It also tends to lower high long-term interest costs, and therefore to reduce segments of the rate structure which most directly affect long-term investments, while still permitting quantitative credit controls to bear upon short-term rates and upon undesired or inflationary credit expansion.

7. Conclusion

The expectation of an 8 per cent "savings gap" of investment financing requirements through 1958, indicating the magnitude of the additional consumption restraint which may be required, seems to conform to recent developments. Such a gap would seem to be manageable if (and only if): (a) domestic and international economic conditions continue to be favorable, as they were in the last two

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17/ In July 1952, the Government established the Istituto Centrale per il Credito a Medio Termine alle Medie e Piccole Industrie (Mediocredito); it rediscounts bills or takes over credits or bonds relating to operations connected with the financing of medium and small industries by the special regional institutes. In Southern and insular Italy there also have recently been created three special medium-term lending institutes: Istituto per lo Sviluppo Economico dell'Italia Meridionale (ISVEIMER), Istituto Regionale per il Finanziamento alle Industrie in Sicilia (IRFIS), and Credito Industriale Sardo (CIS). Participating in their capital are both the large and small banks of each region, the Government through the Cassa per il Mezzogiorno and, in the case of Sicily and Sardinia, the two regional Governments. Loans by these three institutions are for a period of 10-15 years and finance up to 50 per cent of the total cost of individual projects. About 36 billion lire ($55 million) has been made available to these regional institutes, and thus these funds will create an investment of about 72 billion lire ($110 million) in new enterprises. ISVEIMER also has pending in September 1955 industrial credit applications for about 46 billion lire ($74 million).

years, and (b) the Vanoni Plan objectives are whole-heartedly supported by the Legislature, the Government, and above all the public.

In this case, the problem of mobilizing sufficient saving and reducing bank-financed investments to levels where they will not constitute a serious inflationary threat, may be solved. Personal savings and their flow into the capital market may then be expected to grow steadily, as they did in the period 1951-54. Moreover, experience with debt management in 1954-55 indicates that a favorable investment climate, generally associated with economic growth and stability, is conducive to non-bank financing of Treasury requirements, without necessitating a rise in interest costs. Finally, experience with the use of quantitative credit controls indicates that under these conditions any inflationary pressures resulting from bank financing of the remaining "irreducible minimum" savings gap may be dampened so as not to upset basic internal financial stability.

Appendix Table I

The Flow of Savings and the Money Supply in 1951-54 1/
(Variations during the year; Billions of lire)

Items	1951	1952	1953	1954
Demands for Funds:				
A. Funds borrowed by the Treasury from:				
Banks, savings banks & banking associations	99.4	145.7	142.0	155.5
Central Post-Office Savings Fund	65.6	76.3	87.3	8.9
Insurance companies	3.6	5.7	4.1	8.2
Long-term credit inst. & capital market	69.5	58.5	77.7	149.8
Foreign aid	216.7	142.5	74.0	19.7
Other accounts at the Banca d'Italia	(-33.5	41.8	46.4	109.0
Italian Foreign Exchange Control Office	(		21.6	- 9.3
	421.3	470.5	453.1	441.8
B. Funds borrowed by the Economy from or through:				
Banca d'Italia	- 17.3	- 3.1	35.1	13.9
Banks, savings banks & banking assoc.	325.8	590.8	549.8	486.3
Central Post-Office Savings Fund	52.7	100.1	93.9	108.1
Insurance companies	41.2	47.8	89.3	80.8
Long-term credit inst. & capital market	126.5	171.1	232.7	256.9
Italian Foreign Exchange Control Office	221.9	- 25.1	- 50.1	13.2
Foreign aid	6.2	1.0	---	---
	757.0	882.6	950.7	959.2
	1,178.3	1,353.1	1,403.8	1,401.0
Sources of Funds:				
A. Personal and institutional savings:				
Savings deposits	191.7	292.0	302.8	338.1
Other bank accounts	51.9	36.5	102.1	75.9
Post-Office savings	107.5	166.6	183.8	116.3
Insurance companies	44.8	53.5	93.4	89.0
Long-term credit inst. & capital market	196.0	229.6	310.4	406.7
	591.9	778.2	992.5	1,026.0
B. Bank credit expansion:				
Banca d'Italia current accounts and cashier cheques	- 3.8	6.3	- 6.2	0.3
Banks' current accounts & cheques	271.5	323.6	287.4	236.5
Post Office current accounts	10.8	9.8	- 2.6	0.7
	278.5	339.7	278.6	237.5
C. Miscellaneous				
Foreign aid	181.7	119.2	68.4	50.2
Cash and available balances	0.4	6.3	3.5	1.6
Circulation of Banca d'Italia Notes	126.6	89.7	67.8	88.9
	308.7	215.2	139.7	140.7
D. Unexplained residual	- 0.8	+ 20.0	- 7.0	- 3.2
	1,178.3	1,353.1	1,403.8	1,401.0

1/ Excluding loans and investments in foreign currencies and current accounts in foreign countries.

Source: Banca d'Italia, 1953 and 1954 Reports, Rome, May 31, 1954 and May 31, 1955.

Appendix Table II

A. National Income and the Money Supply

(1949 = 100)

	National income	Notes and coins	Cashier cheques and cheques	Current correspondence and ordinary accounts	Total money supply
1950	110.0	109.5	94.1	117.4	112.3
1951	126.4	120.8	99.3	136.0	126.7
1952	132.5	134.5	104.2	169.7	149.4
1953	143.0	142.1	108.6	201.3	168.2
1954	152.1	152.0	112.5	224.3	183.9
Annual rate of increase between 1949 and 1954 (per cent)	9	9	2	18	13-1/2

B. Distribution of Money Supply

(Billions of lire)

End of period	Money supply, total	Currency in circulation	Demand deposits	Savings bank deposits	Postal savings deposits 1/
1950	2,522	1,113	1,409	1,076	689
1951	2,919	1,226	1,693	1,274	796
1952	3,374	1,315	2,059	1,594	963
1953	3,720	1,383	2,337	1,959	1,147
1954	4,036	1,473	2,564	2,468	1,205

1/ Includes Postal Savings Bonds.

Note: Money supply comprises currency in hands of public (i.e., excluding that held by other banks) and deposit money at the Bank of Italy (i.e., non-government domestic-owned deposits), at other deposit banks, and at the postal savings banks.

Source: Banca d'Italia, 1953 and 1954 Reports, Rome, May 31, 1954 and May 31, 1955.

Appendix Table III

Interest Rates on the Money and Capital Markets

Description	1938 1/	December 1952	December 1953	December 1954	June 1955
Bank of Italy:					
Demand deposits	0.50	0.50	0.50	0.50	0.50
Time deposits	0.50	2.50-4.25	1.50-4.25	1.50-4.25	1.50-4.25
Rediscounts	4.50	4.00	4.00	4.00	4.00
Advances	4.50	4.00	4.00	4.00	4.00
Banks and Savings Banks:					
"Ordinary" current accounts	1.50	0.50	0.50	0.50	0.50
Savings deposits: Demand	2.00	1.00	1.00	1.25	1.25
Time	2.50-3.00	1.50-2.00	1.50-2.00	2.50-4.00	2.50-4.00
Small savings deposits	2.50	1.50	1.50	1.50	1.50
Special time deposits	—	3.00	3.50	4.00-	4.00-
Current corresp. accts: Demand	1.50	0.50	0.50	0.50-3.00	0.50-3.00
Time	2.50-3.00	1.50-2.00	1.50-2.00	2.50-4.00	2.50-4.00
Open credits	5.63-6.25	6.00-7.50	6.00-7.50	6.00-7.50	6.00-7.50
Advances	5.00-5.75	4.75-7.00	4.75-7.00	4.75-7.00	4.75-7.00
Discounts	5.00-6.13	5.25-6.75	5.25-6.75	5.25-6.75	5.25-6.75
10-12 month Treasury bills	5.26	4.36	4.17	4.17	4.17
Interest-bearing Post Office bonds	5.00	4.50-5.25	3.75	3.75	3.75
Consolidated bonds	5.40	5.27	5.45	5.40	5.50
Redeemable bonds	5.66	6.22	6.61	6.41	6.46
Treasury bonds	5.29	6.02	6.28	6.23	6.37
Government Bonds	5.45	6.03	6.31	6.23	6.36
Debentures issued by institutes specialising in industrial loans	5.72	7.05	7.21	7.15	7.06
Debentures issued by institutes specialising in industrial mortgages	5.47	6.76	6.76	6.67	6.60
Industrial debentures	6.12	6.81	6.77	6.45	6.31
Total, debentures	5.71	6.95	7.06	6.99	6.90
Shares	5.11	5.54	6.21	5.04	4.75

1/ Averages for the period.
Source: Banca d'Italia, 1953 and 1954 Reports and Bolletino, May-June 1955.

Appendix Table IV

Total Issue of Securities since 1948 1/
(Billions of lire)

	1938	1948	1949	1950	1951	1952	1953	1954
Consolidated, redeemable and multi-year State Treasury bonds 2/	0.2	- 11.6	- 29.2	191.5	114.8	124.7	192.8	211.5
Communal and provincial governments	---	0.9	0.9	---	---	5.6	---	---
Long-term credit institutions	1.0	61.1	47.3	72.1	55.2	127.9	139.2	127.7
Institute for industrial reconstruction 3/	---	---	---	---	---	55.6	21.8	27.9
Industrial shares 4/	1.7	94.9	104.6	65.5	81.4	107.0	191.6	147.3
Industrial debentures 5/	---	15.5	86.3	30.0	4.3	11.9	8.3	- 3.7
Total	2.9	160.8	209.9	359.1	255.7	432.7	553.7	510.7

1/ Actual proceeds of issues, less amounts repaid.

2/ 16.9 billion of 5% nine-year Treasury bonds, 1962, transferred to the Italian Foreign Exchange Control Office in return for the financing of special imports from the sterling area, are excluded from the total of bonds issued in 1954; as also bonds amounting to 3 billion of the Funded Redeemable 5% Loan, issued as land reform compensation.

3/ Ordinary debentures only.

4/ The amount of money absorbed by the issue of shares, including commissions and expenses, according to the figures of the Banca Commerciale Italiana.

5/ Excluding convertible debentures whose amounts are already included under shares.

Source: Banca d'Italia, Report for the Year 1954, Rome, May 31, 1955.

Appendix Table V

Assets and Liabilities of the Bank of Italy

(Billions of lire)

Items	1945	End of period 1952	1953	1954	1st half 1955	July 1955
Assets:						
Gold and foreign exchange	0.5	47.0	67.2	76.7	75.0	77.9
Discounts and advances	15.4	333.7	380.0	421.3	384.4	363.1
Government securities	68.9	250.1	282.8	345.2	362.4	376.2
Advances to Treasury	446.5	584.3	599.2	679.1	619.2	672.9
Miscellaneous loans 1/	12.4	728.8	686.6	695.1	706.5	727.2
Other assets 2/	51.0	37.1	43.8	37.5	29.2	30.9
Total assets	594.7	1,981.0	2,059.6	2,254.9	2,176.6	2,248.1
Liabilities:						
Note circulation	382.1	1,381.5	1,449.3	1,538.4	1,427.7	1,507.5
"Tied" deposits 3/	124.2	360.2	389.9	448.3	474.2	486.3
Other deposits & sight liabilities	60.2	79.4	72.4	79.5	76.2	82.5
Treasury deposits	20.5	25.4	—	—	—	—
Treasury international aid 4/	—	12.3	6.7	37.2	52.8	32.4
Other liabilities	6.8	120.4	139.3	149.2	143.1	136.9
Capital and reserves	0.9	1.8	2.0	2.3	2.5	2.6
Total liabilities and capital accounts	594.7	1,981.0	2,059.6	2,254.9	2,176.6	2,248.1

1/ Chiefly advances to the Italian Exchange Office for the purchase of foreign exchange.
2/ Includes cash other than gold, "earmarked" gold held abroad, property and furniture, etc.
3/ Principally required reserves of the commercial banks.
4/ The lire counterpart of dollar aid receipts.

Source: Servizio Studi Economici, Banca d'Italia.