ROUTLEDGE REVIVALS

The Italian Economy at the Dawn of the 21st Century

Edited by
Massimo Di Matteo
Paolo Piacentini

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To Patrizia and Flora

The Italian Economy at the Dawn of the 21st Century

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Routledge
Taylor & Francis Group
LONDON AND NEW YORK

First published 2003 by Ashgate Publishing

Reissued 2018 by Routledge
2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN
711 Third Avenue, New York, NY 10017, USA

Routledge is an imprint of the Taylor & Francis Group, an informa business

A Library of Congress record exists under LC control number: 2002043967

ISBN 13: 978-1-138-71455-7 (hbk)
ISBN 13: 978-1-315-19785-2 (ebk)

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Preface

1. Most of the essays collected in this volume are the result of the reports presented at the conference on "Enterprises, Labour Markets, and Institutions in Italy facing the Challenges of the XXI Century (University of Tokyo, 23-4 October 2001), organised as part of the initiatives of "Italy in Japan, 2001".

The editors wish to express their deep gratitude to the Institutions and individuals, who have, first, supported the initiative of the conference, and then encouraged the publication of the present volume: The Italy in Japan 2001 Foundation, The Italian Ministry of Foreign Affairs, The Italian Chamber of Commerce in Tokyo, the Italian Ministry of Higher Education and Research and the University of Tokyo.

The original aim pursued in the occasion of the conference, was that of presenting an overview of the "state" of present-day Italy through reports on a selected range of economic and social topics. We hoped, through concise presentations, to draw the attention of Japanese scholars, who, in their professional or academic activities, had an interest in comparative socio-economic analysis. To this end the reports actually presented were discussed by scholars from various Japanese Universities. However a few essays could not be discussed in Tokyo because the authors could not attend the meeting.

2. On reflecting on the aftermath of the conference we felt that the papers could be developed in order to address a wider audience.

Japan and Italy, nothwithstanding their enormous geographical distance and extremely different historical backgrounds, are both, we believe, representative of mature manufacturing economies with strong interdependences with their regional, European and Asian, contexts. They have often shared similar patterns of development, with years of high growth after a phase of reconstruction from a lost war. Nowadays, they are confronted with a broad range of structural problems, in the face of slackening growth and in the context of the international process of financial and real integration.

We did not however intend to publish a collection of essays centred on the comparison between Italy and Japan, as this has already been the object of another volume edited quite recently [*Comparing Economic Systems. Italy and Japan*, Boltho, A., Vercelli, A., Yoshikawa, H., eds, Palgrave 2001].

We wished, in fact, to introduce, and discuss, the peculiarities, and sometimes the uniqueness, of the Italian "mode" of organizing the productive and social framework. Standard country-studies, as those occasionally drafted by the research staff of international organisations, are often limited to a survey of the so called macroeconomic fundamentals and trends. These are not sufficiently informative, we believe, of the condition of a country which cannot be represented by its national averages, given the wide range of territorial differentiation in terms of income and productivity, conditions in the labour market, development of the industrial structure, and unemployment rates.

Looking back at the evolution of the Italian economy and society in the past 50 years or so, we cannot help remembering how exceptional the period between 1950 and 1970 actually was. Late comers like Italy (and Japan as well) in a few, exciting years jumped from the situation of a semi-developed and mainly agricultural society to that of a modern industrialized nation: the shift in value added and employment from agriculture to industry, the dramatic fall in unemployment, the intense urbanization process, the changing pattern of consumption are typical of those aspects that Kuznets described in an unsurpassed way.

The period of high growth ended around 1970 and the GDP growth rates never reached the previous levels again. A steady process of growth would have probably made Italy more and more similar to her partners in Europe, completing her modernization process.

In absence of such conditions the country remained, so to speak, at half way: the gap between an advanced North and a backward South (which was a feature well known to development economists and economic historians since its emergence at the birth of a unified national State in the late XIX century) did not close and even widened. Features of the growth process and aspects of this unresolved dualism are documented in the I and II Parts of the book.

Other contributions in the book (mainly in the III Part) are dedicated to another structural aspect of the Italian economy which has been paid a lot of attention by specialists in comparative industrial organisation.

Italy is characterized by an extreme fragmentation of its productive texture, with average size of plants, share of employment in the smaller enterprises, number of independent, artisan workers, which show "abnormal" levels if confronted with the figures found in other modern, industrialized economies.

The persistence of this structure over time has led to questioning the solidity of the arguments that tend to associate growth with economies of scale and increasing returns. The competitive effectiveness of this Italian industrial model, and in particular of the local networks of small enterprises ("industrial districts"), is an actual point of interest within a wider discussion on the prospects of the persistence of a plurality of "national models" of capitalism, in the face of global competition.

Successes and shortfalls in the macroeconomic and microeconomic performances, must finally be understood in the wider context of a social framework, where the conditions for the reproduction of a community and its welfare are mediated by a set of fundamental institutions of a modern society. These are not working in the same way in each country and in addition their respective role evolves over time in response to ever changing economic conditions as is witnessed by the roles performed by the family and the recent development of other non profit organizations.

Again here it can be noted that in Italy the family seems to be engaged in a wider range of activities (of economic as well as of social support, if not substitution, with respect to the State and the Market) than in other countries. Is this a peculiar feature of Italy that, as some historian has recently claimed, has marked the country over a large part of her history, making it a genetic characteristic? Could it not be that the insufficient development of other institutions called for the persistence of a relevant role of the family?

Although the majority of the contributors to the volume belongs to the economist field, in the last Part we have included essays by sociologists, working within Research Foundations, with a long standing experience in the drafting of authoritative reports on the state and evolution of the social conditions of the country. The family, the welfare system, and the so-called "third sector" are the objects of specialized contributions.

It seems to us the structure of the book reflects in a fairly good way the peculiarities of Italy as we have summarily reported, a country that, despite belonging to the G8 group, should be considered in many aspects as an outlier.

3. The ordered list of contributions intentionally follows an ideal sequence from introductive and more general presentations to more dedicated essays for specialised topics.

In the opening Part, we first include two papers aimed at presenting a historical introduction, summarizing characteristics, phases, "push' factors and limiting constraints, influencing the quantitative growth and structural changes of the Italian economy since world war II. The two papers are organized in a chronological sequence, with the first essay by Di Matteo covering the years of high growth, after the economic reconstruction and industrial take-off, broadly from 1950 to the end of the sixties while the second, by Vercelli and Fiordoni, describes the difficult path of the Italian macroeconomic developments and policies from the two oil shocks, through the years of high inflation, up to the phase of stabilisation which has culminated with a successful convergence towards the parameters and conditions of the Maastricht Treaty, in order to gain access to the EMU at its onset.

The third contribution, elaborated by Tronti et al. within the research department of the Central Institute of Statistics (ISTAT), is, on the other hand, meant to provide the reader with an essential, quantitative survey of the Italian economic structure and labour market conditions, at the onset of the XXI Century. Attention is given to the "anomalies" of the Italian case vis-a-vis comparative figures for other industrialised countries. This paper concentrates on the bulk of tables and figures for the "essential statistics" of the country, with the purpose, also, of avoiding excesses of quantitative reference to general data in the topical essays which follow.

Part II opens with the contribution by Schiattarella and Piacentini, prepared at the Fondazione Brodolini, a think tank on labour problems. According to a widespread view, that, with reference to Italy, dates back to V.Lutz's analysis, the origin and causes of a dualistic industrial structure are mainly to be found in the features and working of the labour market: segmentation and lack of flexibility resulting from a supply-side behaviour of workers are considered to be at the root of a large share of the unemployment problem and an extension of irregular jobs. The picture appears, in fact, less simple and more complex to interpret. A dualistic frame, in any case, appears to be essential in describing the structural features of the Italian labour market, not only in the sense of the traditional, territorial divide between the North and the South, but more in general, between a segment of legally and contractually protected jobs, and another segment, including the various typologies of more precarious work conditions.

As is well known the "*questione meridionale*" [The Southern question] has always been at the centre of the policy debate ever since the birth of Italy in 1861. Because of the evolving economic situation and the changing orientations of the policy makers (following Keynes' final remarks in the *General Theory*) the actions actually implemented in the attempt to solve the "*questione meridionale*" have dramatically varied over time. Franzini offers a brief description and an interpretation of such attempts over the postwar period, so that the reader can appreciate why recently a shift in the orientation of economic policy for the less developed areas has occurred. The emphasis is now centered on local, endogenous development; its policy background is briefly reviewed, within the context of a process of internal differentiation that is taking place in the South itself, between regions persistently trapped in underdevolopment and areas showing appreciable growth rates.

In the subsequent contribution, written by Barca, Director of the Department for Development and Social Cohesion Policies at the Italian Treasury, a full exposition of the targets and articulations of the new policy to be implemented in Italy, is provided. Since this approach involves the cooperation between different structures of public administration at the central and local level and private actors (firms, banks, etc), particular attention is devoted to an analysis of the institutional mechanisms designed to overcome the difficulties implicit in agreeing on contractual engagements which are necessarily set within the context of uncertainty and incomplete information.

No policy action however can be fully appreciated unless estimates, imperfect as they may be, of its quantitative effects are provided. Bollino (presently an advisor to the Ministry of Productive Activities) and Signorelli, applying a flexible production function model with spillover effects, compute the likely effects of alternative policy measures, for a disaggregated analysis of regional data.

The III part opens with an essay by Pagano and Trento who describe and interpret (on the basis of a well articulated theoretical vision) the evolution of the Italian system of corporate governance over an extended period of time. They examine the actual institutional shocks that have diversified the Italian corporate governance system from that prevailing in other capitalistic economies. In the midst of the several changes that have occurred over the past years the strong presence of families in the governance of big firms has been an important aspect of systemic continuity. This feature has not been demolished by an extensive privatization process that took place in the 1990s.

This has been paralled, as already noticed, by a widespread growth of the number of smaller firms that, although with differential patterns across the sectors, represent by now the bulk of the industrial texture of the country. The persistence of a large share of smaller firms in many areas, cannot be accounted for only by cyclical factors, but needs to be explained within a deeper understanding of the institutional and structural factors. The changing role of information and knowledge transmission among firms, central to this new phase of goods and services production and exchange, following demand evolutions of industrialized countries, lies at the heart of the interpretation put forward by Innocenti in his paper.

How successful on the international markets is this way of organizing production? Helg in his contribution concentrates on a relevant subset of the smaller firms' universe, namely, that of the "industrial districts". He carefully shows that the latter typology of industrial organization is still a driving force in the Italian export performance and contributes to a large extent to the shapening of the competitive advantage of the Italian productive system.

A process of privatization of the banking system and a dramatic increase in its concentration, has taken place in the last decade and is far from being completed. As banks still play a central role, especially for the financing of small firms, due to the relatively small importance of the Stock Market (and other pro growth financial institutions), inefficiency and propensity to discriminate are particularly damaging for firms of the South, as documented by Imbriani in his essay.

The existence of such a differentiated situation over different areas of the country, as emphasized, is probably at the root of the powerful drive towards devolution (or outright federalism) that has developed in Italy, in particular from the past decade onwards. The push towards devolution of power to local authorities is justified, by its proponents, on efficiency considerations: the control of the administration by the citizens is more effectively exercised within local communities and this makes public administrators more easily accountable. Devolution of power, if it has to be effective, entails the power of raising funds, taxation in the first place, at local level, and the autonomy in deciding the criteria of its allocation.

However owing to the very existence of differentiated growth and conditions across regions, devolution of powers could end up reinforcing a tendency towards an enlargement of the gap between richer and poorer regions, with severe consequences not only for economic growth but also for social cohesion. All this is documented at length by Filippini and Arachi in their contribution, where proposals and formulae for a system of fiscal transfers equalizing the satisfaction of a common standard of basic needs over the whole country are presented.

The central and local public authorities are increasingly confronted by expenditure constraints, also because of the clauses of the Stability Pact of the European Union and the prevailing political opinion that considers any increase in the share of public expenditure on national income to be potentially harmful as it implies a reduction in the disposable income and choice opportunities by the households. On the other hand social expenditures, given the demographic trends and other factors, can hardly be cut. In this situation, there is room for the development of the so-called Third Sector. The latter, in addition to supplementing the provision of social services, would give employment opportunities to many people willing to be engaged in activities of social utility. De Marie (Director of the Fondazione Agnelli, a think tank on economic and social problems) and Cima give a wide ranging review of the various aspects and typologies of actors within the Third Sector, from a legal, economic and social viewpoint.

The complementarity, or substitutability, of the functions performed by the family with that of other non profit institutions (the Welfare State and the Third

Sector) is one of the central themes in the multifaceted discussion, at sociological level, concerning the relevance of the family context in Italian society. These roles can be viewed from different aspects, as the family is, at the same time, a solidarity network for providing services not available on the market, a support for its old and/or sick members, a source for supplementing the income of the unemployed and for establishing connections useful for social insertion and finding job opportunities, in a segmented labour market. In his paper Toma (at Censis, a Foundation for the study of social problems) documents all these aspects.

Finally, in addition to the family and/or non profit organizations, among the institutions that shape the context within which the economic and social welfare of a country is developing, the role of the public sector cannot be overlooked. Sociologists have perhaps been among the first to declare the crisis of the Welfare State, looking at the contradictions that its function and extention have brought over the years.

Italy, again, is a peculiar case, as the Welfare State did not take a well settled form, from the point of view of coverage of functions and definition of the institutional structure, before the end of the 1970s (or even later than that). Calza Bini (former Director of IRIDISS, an Institute for the Research on the Welfare State) analyzes the range of possible contradictions between people' expectations, the changing economic environment and the constraints brought about by the process of globalization.

4. In concluding this brief outline of the volume, the editors wish to remind the reader of the general orientation followed in the selection of the topics and the tasks assigned to the contributors. Although each author obviously has his own orientation, and reference to a different "school" of economic or sociological thought, effort was requested and, we believe, was substantially maintained, in presenting informative facts and comments, seeking to reduce, as far as possible, partisan value judgements or undocumented opinions.

Of course, pure objectivity, even if it could be attained, might result in unattractive description. It is natural, therefore, that orientation of thought and models of reference might be guessed from the lay-out of the diverse essays. The careful, and patient, reader would appreciate, then, that the group which has taken part to the initiative of the conference and then contributed to the volume, is not homogeneous from the point of view of allegiance to some common "school" of thought, or more simply, in terms of personal inclination towards more optimistic or pessimistic points of view of the state of their own country. Some of the contributors hold operative or consulting positions within the present circumstances of the political scene in Italy; others have had similar tasks in a previous legislature, when the coalition, now in opposition, was in office.

Notwithstanding this heterogeneity, the editors have found an appreciable collaboration from the authors, in their effort to conform to the principal aim of the publication, that, of providing an informative and fact-centered survey of Italy to the foreign reader. In a period of a harshening political and social climate in the country, the editors wish to express their appreciation of this point.

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PART I
GROWTH PATTERNS AND STRUCTURAL FEATURES

Chapter 1

Italy's First Phase of Postwar Development: The Role of Aggregate Demand[1]

Massimo Di Matteo

Introduction

The aim of the paper is to offer a framework for analyzing the first two decades of postwar economic growth in Italy. The emphasis is on the role played by aggregate demand and its components in shaping the extremely fast process of economic growth that occurred in Italy during the fifties and sixties. This was accompanied by a profound process of structural change that will briefly be dealt with.

Generally the process of growth is understood as a purely supply side phenomenon along the path of Solow's model or (more recently) the new (endogenous) growth approach. I follow a different approach that merges Lewis' emphasis on the "unlimited" supply of labour with the Keynesian argument that what constrains output is effective demand. The link between the two is the existence of a wide dispersion of labour productivity across sectors of the economy: in such a situation aggregate demand drives real output. The process of growth can then be best described as a process in which labour moves from low to high productivity sectors resulting in a change in the structure of the economy.

The possibility that growth depends on demand is not wholly discarded by Solow (1997) himself, although he maintains that this possibility is uncommon:

'A more interesting question is whether a major episode in the growth of potential output can be driven from the demand side. Can demand create its own supply? The magnitudes suggest that it would be awfully difficult for a surge of aggregate demand to generate enough investment to provide the capacity necessary to accommodate it. In special circumstances it might be done, say, in an economy that has a pool of labour (rural, foreign) that it can mobilize. It might also work if strong aggregate demand can induce a rise in total factor productivity (TFP). This may be less far-fetched than it sounds, if we recognize that a large part of TFP originates not in the research laboratory, but on the shop floor, as production workers figure out how to gain a little efficiency here and a little there. The demand driven growth story sounds quite implausible to me under current conditions; but it is an example of the kind of question that needs to be asked.'

Di Matteo & Yoshikawa (2001) showed that at least in post war Italy and Japan demand driven growth was not so special. The framework that we used can be thought of as a threefold generalization of Lewis' approach. First, it is not necessary that (marginal) productivity in agriculture (the backward sector) be zero, but it can be positive. Secondly, there is a whole range of (marginal) productivities in the various branches of the secondary sector. These productivities can be ranked from the lowest to the highest. In such a situation there is therefore disguised unemployment, because if workers could be moved from low to high productivity sectors, GDP would increase: the latter is not constrained by lack of resources. Thirdly, reinvesting the profits of the industrial sector depends on the (expected) growth of demand and it cannot be assumed to be an automatic process.

Here I will concern myself with applying the demand driven "story" to the case of Italy in the period between (roughly) 1950 and 1970. This is the period when Italy grew faster than in any other period of her history, namely 5.6% on average.

This chronology may cause some uneasiness as it is commonly held in Italy that 1963 was the last year of the "economic miracle" and that a period of depression followed. On my reading of the facts (for an earlier view consistent with the present one, however, see Vaciago 1970) I disagree with the common interpretation, though of course the discussion is open as to which periodization is the most fruitful.

The paper is organized as follows. In the next section reasons are given that enable one to apply the Lewis framework to the Italian economy in the period under consideration. In the third section the pattern and evolution of aggregate demand in the period under consideration are elucidated. In the last section the turning point of Italian development in the late 1960s is interpreted.

The background

At the beginning of the fifties the Italian economy could be described (Kindleberger 1967) as a backward economy with "unlimited" supplies of labour: the large amount of population in agriculture did contribute very little to the level of output so that their productivity could be considered extremely low and well below that prevailing in other sectors of the economy (e.g. Orlando 1978).

A few data will suffice to illustrate the point. It is derived from three sources: an estimate of average (which can be considered proportional to marginal) productivity in the primary with respect to the secondary sector, unemployment figures, and migration flows. For example we observe that in the early fifties average labour productivity in "ferrous metal production" and "furniture and wood" was three and two times the corresponding value in agriculture, respectively. In line with the general point that disguised unemployment is linked to differences in marginal productivities across sectors, there was indeed huge dispersion of marginal productivity values, a fact which is contrary to the received doctrine.

It is difficult to have reliable data on migration within the country, due to intermittent revising and updating of statistical records. However we can measure the difference between two population censuses for resident population in the Centre-North and South (after eliminating the natural increase). This provides an estimate of internal migration as it is assumed that people moved from the South to the Centre North, but it is a rough one as people also moved within these large areas, e.g. from inland to coastal areas. However, in their detailed analysis, Padoa Schioppa and Attanasio (1991) rely upon this measure:

	Outflows(-) Inflows (+)	Outflows(-) Inflows (+)
	1951-1960	1960-1972
South	-1,566,000	-2,365,000
Centre North	+657,500	+1,601,000

Source: Padoa Schioppa and Attanasio (1991, p.312)

The difference between the two figures in each decade is migration abroad. On the basis of different estimates, Graziani (2000, p.73) argues that one million people moved to the North in the fifties from other parts of Italy.

Over the period 1954-1970, the unemployment rate fluctuated between 10.4% and 5% except in 1963-4 when it hit a minimum of about 4%. Unemployment figures should always be taken with care as they depend heavily on how the the survey (the first Italian survey was in 1954) is actually conducted. Before then data is available on registered unemployed and has been used and discussed by Hildebrand (1965, p.157ff) to whom we refer the interested reader.

One further element to be added to the overall picture is the share of agricultural employment, that fell continuously from 43.1% in 1951 to 20% in 1969. This indicates that about 5 million people left country areas up to 1970. This is again consistent with the existence of a large pool of labour in the primary sector that could be "mobilized", as Solow (1997) states in the passage quoted above.

All the evidence reported so far boils down to a situation of widespread disguised unemployment in Italy at least during the 1951-1970 period. The heuristic value of the concept of disguised unemployment, also in the context of recent evolution of the Italian economy, was recently reaffirmed by Graziani (2000, pp.200-1).

At the same time, northern Italy had a limited industrial sector with a bias towards heavy industries, a legacy from the fascist period. The ruling wage in industry could be interpreted as a conventional wage, somewhat higher than the "subsistence" wage (i.e. the wage received or the income earned by people on the land) to account for the cost of moving out of agriculture. In the industrial sector, where capitalistic conditions prevailed, workers were hired as long as their productivity was higher than this wage.

Here, however, comes a major difference with Lewis' original formulation: he argues that in the above conditions, a self propelled process of growth sets in, owing to reinvestment of profits generated in the industrial sector. Can one take for granted, as Lewis did, that, in the context of a backward economy, all profits (or most of them) are reinvested? In fact profits (in excess of capital replacement) could be spent on consumer goods and the equilibrium could be perpetuated without any growth occurring (although this type of equilibrium could be associated with balance of payments problems). *If* profits were reinvested, accumulation could certainly go on without any fall in profit margins as long as money wages increased at a rate lower than (or equal to) labour productivity.

The main argument put forward by Lewis consists in showing that in the process of growth, there will be a shift in the distribution of income towards higher saving groups: the process of growth does emanate from this pure supply side phenomenon. There are two points to this. First, as far as Italy is concerned, the share of labour income in GDP did not fall in the fifties but increased slightly from 37% in 1951 to 40% in 1961 and this can be taken as an empirical refutation of Lewis' hypothesis if, as is commonly held, wage earners have a lower propensity to save than profit receivers and secondly, it is more sensible to assume that the (share of) profits reinvested depend on the amount of demand firms expect for their products.

I think that the start of the process of growth and its continuation depend on the expectation of good prospects for aggregate demand. And indeed conditions of excess supply prevailed in Italy for many decades, as is well documented, without any prolonged growth process ever taking place: supply considerations alone can hardly be the whole story.

The dynamics of aggregate demand

One is therefore led to enquire which components of aggregate demand were actually the most dynamic in the period under consideration. Consumption was not a major dynamic force as its share in income fell continuously: it regained the 1952 figure only in 1964.

Investments and exports were the components of demand with by far the highest growth rates. Let us take them in turn.

Total investments grew faster than GDP until 1963, reaching a share of almost 30% and then stabilized at an average share of 27% for the next ten years until 1973. The pioneering analysis by Ackley (1962) stresses the role of *autonomous* investments in the agriculture and housing sectors, affected by government policy in a variety of ways (e.g. the Tupini public works bill and the Fanfani public housing plan), and in the communications and transport sectors.

As for the need of investment in residential construction, it is obvious that people relocating from South to North needed new houses. One can have a rough estimate of the number of new families by looking at the number of marriages that were 6.9 (per 1000 inhabitants) in 1951 and increased to 7.9 in 1961, levelling off at 7.5 in 1971. This information can be supplemented with the index of first nuptiality which is also a close approximation of the number of first marriages for women between 16 and 49: it has two peaks, one in 1963 and another in the early seventies and then fell continuously. This meant an increasing number of new families which, coupled with population movements, indicate an increasing demand for houses that contributed to aggregate demand evolution. The latter was also stimulated by the total increase in population that was 0.64% in the fifties and 0.42% in the sixties and declined to 0.11% in the seventies (these rates are corrected for migration).

Another indirect source of labour mobility, and therefore housing needs, is the shift of employed workers away from the agriculture sector and towards the industrial and the service sectors as mentioned above. As workers employed in agriculture were concentrated in the South and workers in the industrial sector in the Centre-North, the above is a rough indication of the population moving towards urban areas and away from rural areas. Not surprisingly, this is reflected in the pattern of residential construction (as a share of GDP) which grew very fast in the period and peaked in 1969. A similar story can be told for non-residential construction investment that also started to decrease (as a share of GDP) around 1967.

Before turning to the discussion of the pattern of foreign demand in the next paragraph, we have to remember that in this context, among the exogenous factors, we can include state-owned firms that were very active. During this period governments did not pursue a liberistic policy domestically: IRI (a state owned holding company and a legacy of the fascist period), was not dismantled but rather empowered, ENI (the national oil company) was created in 1953, an agency for infrastructure investment in the South was established in 1950 (Cassa per il Mezzogiorno) and investment projects in electricity power, steel production, telephone network, and other basic sectors were carried out (Ciocca, Filosa & Rey 1975). This reduced the possibility of bottlenecks in basic sectors that could have choked off the process and hinder a demand led growth path without at the same time directly fostering the development of Southern firms.

Following the process of external liberalization that initiated very early and was conducted very vigorously, exports too grew faster than GDP moving from an initial 5% share in GDP to 15% in 1970. However I maintain that the external component, in quantitative terms, was not the driving force of growth except for a very few years following the formation of the European Common Market in 1957. More in particular, while it is true that on average exports grew faster than any other component of aggregate demand, this however is not tremendously significant as, at that time, exports (as just remembered) were only a tiny fraction of aggregate demand. In addition net exports were consistently negative for the whole postwar period with a few exceptions (1978, 1993, 1994). And also the analysis of relative contribution to income shows that on average the value gained by exports is smaller than that got by investment.

These statements do not contradict the recognition that the external liberalisation policy (elimination of quotas, participation in OECE, etc.) was a milestone in the Italian post-war economic policy. The policy of opening up the Italian economy to foreign competition appears to have been more important in providing the right incentives to the firms than in being directly the major impulse to growth. Indeed the main effects were that of forcing firms to be more competitive on the domestic as well as foreign markets, to invest for their survival, to take advantage of being late comers by adopting the newest technology. This pattern did not spread to all sectors in an even degree: what the liberalisation policy actually did was to reinforce the preexisting dualistic structure of the Italian economy.

The Italian industrial structure was actually divided into two sectors, one characterised by more modern techniques and relatively high wages and in a position to compete with foreign firms; the other in a sheltered position with low wages and low productivity growth, mainly oriented to the sections of the domestic market immune from foreign competition. To this a territorial dualism between North (advanced) and South (backward) correspond.

Indeed it was only in a few years that exports became a relatively important factor of growth, namely after the European Common Market was established in 1957 (from that date until 1963 one could talk, if ever, of export-led growth). Then a virtuous circle set in linking exports and investments as the favourable conditions of the labour market helped maintaining competitiveness of the Italian firms which were thus motivated to increase investments (and hence productivity). Although the pace of productivity was extremely high between the birth of the Common Market and 1963, it remained on good levels for the whole period under consideration in our analysis: this performance will never be attained by the Italian economy in the following years.

Viewed in this perspective it might be then too emphatic to refer to the period immediately preceding 1963 as the "economic miracle" (as it is commonly called). It is perhaps easier to understand the reasons for the end of the period of sustained growth that however I see happening at the end of the 1960s. Those who favour 1963 as a watershed year blamed the end of the fast growth on the exhaustion of surplus labour, but this is not wholly convincing as still in 1963 there was a gross flow of migrants to other European countries of almost 100.000 workers and it has been estimated a number of 200,000 net migrants from the South to Centre North for the same year. Vaciago (1970) remarked that the 1963 episode (marked by a balance of payments crisis and a delayed but severe credit squeeze by the Central Bank) could be seen as an episode of cyclical nature, though a very important one, characterized by an outburst of workers' militancy. In any case after the 1963-4 crisis the rate of growth of GDP was still rather high (in comparison with the previous as well as the following years) and in a long term analysis is sensible to include the rest of the 1960s in the first period characterised by high growth.

Finally I briefly recollect some of the reasons why Italian entrepreneurs could have been optimist at the end of the 1940s. First the international setting: the economic policy of the USA was expansive (maybe in order to counter the communist menace) as witnessed, inter alia, by the ERP (although at first the funds were piled up to increase Central Bank reserves); there were extensive developments in multilateral exchanges within Europe; the Korean war was a favourable external shock. As for the internal environment, one recalls: the moderate policy of the communist party (accused of being too soft in defending workers' rights) whose aim was to let the country grow as only in this way the contradictions of capitalism could develop; the splitting in 1947 of the trade union movement that weakenend the workers' bargaining power within and outside the factories (to this contributed in the same year also the severe credit squeeze operated by the Central Bank to fight inflation); the giving up of the "change of currency" (with its related taxation of war profits) that reassured the country that no punitive measures would have been taken.

Secondly around 1949-50 the leading Cristian Democrats party shifted its policy emphasis away from a liberistic approach towards a social approach (concern for the satisfaction of basic needs) with emphasis on growth and employment as guiding lines for the conduct of economic policy.

Finally some entrepreneurs themselves, like Valletta (general manager of FIAT), were entusiastic about future development because they clearly saw a niche for Italian firms and products in the US dominated western economy. In my opinion all these elements established a favourable climate to the big developments that came afterwards.

Conclusions

I argue then that the process of growth could have continued provided certain favourable conditions had been maintained. This was not the case, however. In the post 1963 period looking at the surplus in the trade balance growth could have been faster (the same conclusion derives from observing the low level of capacity utilisation): the main difference with the "economic miracle" was the relatively restrictive nature of both fiscal and monetary policies and the reduction in public expenditure (as a share of GDP), in particular of the state owned firms (Sylos Labini 1974). In this context foreign demand and domestic demand went into a relation of substitution rather than complementarity and this marked a huge difference with the virtuous circle period (especially from 1958 to 1963): because of the insufficient level of domestic demand, firms were stimulated to look abroad for selling their products.

I am arguing however that the process of dualistic growth that I have recalled could have continued, provided that the modern sector had been developing so fast as to reproduce on a large scale the differential productivity and that policy had continued to be permissive. It is true that increased production in the industrial sector *for a given productivity level* tends to absorb workers and reduce the unemployed pool; at the same time however *for a given output level* in the industrial sector the increased productivity that takes place over time expels workers that go to the unemployed pool. There is a possibility that these two contrasting forces produce a situation where money wages will not increase more than productivity in the industrial sector and this gives a macroeconomic condition for stability in the growth process: in this environment unemployment can well be reduced without necessarily impairing the continuation of growth. This situation can either be spontaneously attained or reached through political consensus.

I think that a process of growth is best described by the search and implementation of new methods of production (and/or new products) that enable firms to move workers from less to more productive sectors. This process is easier when you can take advantage of being a backward country and adopting already existing techniques: it becomes more difficult but certainly not impossible when this stage is over. It is interesting to note, in this connection, that by 1970 the level of Italian GDP per capita approached that of the USA in 1950 (Maddison 1995) and the share of investment will never recover the share in GDP reached then.

To explain what actually happened in the period following the 1963-4 crisis De Cecco (1972) has a brilliant analogy by stating that firms treated different workers as different types of land and restructured labour force by concentrating demand on those who were considered to be more productive (male, experienced, etc.) and discarding others (women, very young and old workers, etc.). So it was a process of rationalization and restructuring on a very short term perspective. Here Italy missed the occasion of developing a modern economy centred on high income elastic sectors: this would have required appropriate long term policies (in education, investment in R&D, etc.) that in the 1960s were intensively talked about but not implemented (For an early lucid diagnosis and therapy, see Fuà 1965).

The end of the first period could be symbolically associated with the "hot autumn" (1969) when there was an unprecedented burst of workers' unrest and consequent wage explosion and price inflation: this was the result of both economic factors (concentration of labour demand) and political ones (reaction to the "strike of investments" and lack of structural reforms).

However the slowing down of growth was due to the end of those features of the process that I have highlighted, mainly end of reallocation process and migration with a consequent fall in the residential and non residential share of investment not compensated for by other items of aggregate investments.

Note

[1] All the statiscal data quoted in the paper without mentioning the source have been computed by the author using the data bank set up by Prometeia.

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Comment

Hiroshi Yoshikawa

1. Growth theory has gained renewed interest in macroeconomics in the past fifteen years. Theoretically, a contest between Solow's old growth model and the new endogenous growth theory has been the main battle field. Empirically, many (too many!?) cross – country regressions based on the World Bank data has been carried out.

A vast amount of literature in the field has, however, curiously left an important question untouched, namely the role of aggregate demand in the process of economic growth. This may not be surprising because in the past twenty years, the profession has minimized the role of demand even in the theory of short – run fluctuations with the Real Business Cycle theory as the culmination. I believe that this situation is very unfortunate, and that demand plays a central role not only in the short – run fluctuations but also in the long – run economic growth. It is actually not an easy task to present a theoretical growth model in which demand plays a central role, however. Aoki and Yoshikawa (2002) is such an example. There, we argue that demand – creating innovations which overcome demand – saturation is an engine of economic growth.

2. As pointed out by professor Di Matteo, demand – led growth presumes inequality of productivity among sectors / firms. Historically, the most important productivity differential lay (or lie still today in developing countries such as China) between agriculture and modern manufacturing industry. As is well known, the process of economic growth in this dual economy was analyzed by Lewis (1954). The Lewis model takes it for granted that the modern industrial sector enjoys high profitability as long as the surplus labour in the traditional sector prevents the real wages from rising, and that it keeps high investment which leads to high economic growth. However, how and what demand assures high profitability in the manufacturing sector? Where does high demand come from? Since the Lewis model actually applies not only to developing countries but also to well developed nations as Kindleberger (1967) argues, it is an important agenda to

supplement the Lewis model by demand factors. Toward this goal, the most promising approach is a careful case study.

Yoshikawa (1995, Chapter 2) showed that postwar Japanese economic growth during the 1950s and 1960s was well explained by the modified Lewis model, and that demand played a cruçial role in growth. Professor Di Matteo now persuasively shows that the similar mechanism worked also in the Italian growth. I believe that this kind of historical case study is much more productive than often lousy cross – country analyses.

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Chapter 2

The Italian Economy after the Bretton Woods Era (1971-2001)

Alessandro Vercelli
Luciano Fiordoni

Introduction

This work aims to analyze briefly the macroeconomic evolution of the Italian economy during the final three decades of the twentieth century by adopting a cyclical-growth approach that provides a few suggestive links with the co-evolution of some of the economy's structural features. Since the latter are analyzed in further detail in the following chapters, we intend to limit the analysis here to a cursory look at their interaction with the development of the economy without any attempt to provide an in-depth analysis of their determinants.

This chapter is structured as follows. A definition of periods for the Italian economy in the post-war era is given in section 2. The changes in the economy are briefly described thereafter in the following three sections dedicated to **Stagflation** (1971-1980), **Disinflation** (1980-1993) and **Integration in the Eurozone** (1993-2001). Section 6 takes a look at the origins, main features and implications of the budget instability during the eighties and of the successful fiscal consolidation of the nineties. The interaction between structural changes and macroeconomic evolution in the economy is briefly analyzed in section 7 for the whole period considered in this paper. The work ends with a few concluding remarks.

Definition of periods

It is impossible to analyze the evolution of a specific economy over three decades without providing a basic diachronic structure by means of some sort of sensible definition of periods. As usual, the definition of periods suggested here is conventional and thus risks exaggerating the principal discontinuities in the changes described. However, we believe that in this case the discontinuities so emphasized are much less arbitrary than they are normally in economics, since the structural changes of the Italian economy in the post-war period were characterized by a few relatively well-defined turning points. Such turning points may be identified by focusing on the changes in the average values of a few key macroeconomic variables throughout the succession of business cycles during the historical period considered. Therefore, we need to adopt a definition of business cycles for the second part of the last century. To this end we use the official definition of business cycles suggested by the most reliable official sources in Italy: ISCO and ISAE/BDI (see Table 1).

Table 1 – Definition of Periods

Phases	Initial Minimum	Maximum	Final Minimum	Phases (in months)		
				Expansion	Recession	Total Cycle
I	May - 52	Sept - 57	Aug - 58	64	11	75
II	Aug - 58	Oct - 63	Jan - 65	62	15	77
III	Jan - 65	Oct - 70	Oct - 71	69	12	81
IV	Oct - 71	Jun - 74	May - 75	32	11	43
V	May - 75	Feb - 77	Dec - 77	21	10	31
VI	Dec - 77	Mar - 80	Mar - 83	27	36	63
VII	Mar - 83	Mar - 92	Jul - 93	108	16	124
VIII	Jul - 93	Nov - 95	Nov - 96	28	12	40
IX	Nov - 96	Apr - 98	Jan - 99	17	9	26
X	Jan - 99	Dec - 00	Dec - 01	23	12	35

(*) Cycle based on industrial production index (cycle-trend, 1995=100)

Source: ISCO and ISAE/BDI

In the post-war era the Italian economy never managed to avoid simultaneously monetary and real instability, apart from a very short period between the late fifties and the early sixties. Therefore the macroeconomic environment and the ensuing entrepreneurial decisions and economic policies have always been dominated by at least one of these two concerns, and often by both (particularly in the seventies). The change in the mix of these two basic types of macroeconomic instability strongly influenced the trend of all principal macroeconomic variables and the trend of economic policy, thereby suggesting well-defined criteria for the definition of periods.

Plotting the average value of unemployment and inflation for each business cycle (see Chart 1), we can identify four periods for the post-war Italian economic development:

Economic Miracle (1952-1971), a period of decreasing unemployment and absence of serious inflationary pressures;

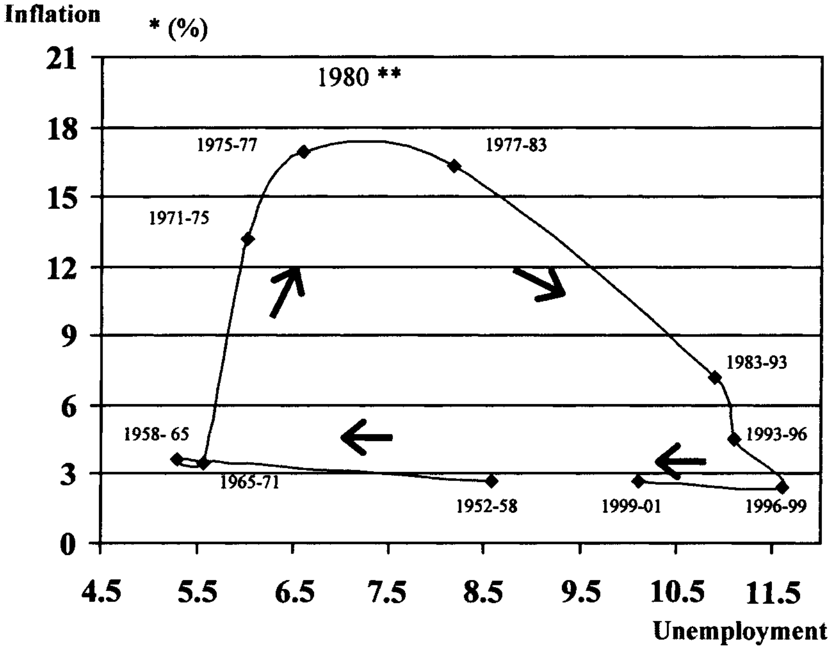
Stagflation (1971-1980), a period marked by a rapid increase in inflation and a moderate growth in unemployment;

Disinflation (1980-1993), a period of deceleration of inflation and progressive increase in unemployment;

Integration in the Eurozone (1993-2001), a period of rapid consolidation of macroeconomic stability in all its basic dimensions, and resurgence, after a 20-year period, of a trend of reduction of unemployment which however turned out to be very slow and fragile.

The boundaries between these periods coincide with those between the relevant underlying business cycles, with the only exception being the boundary between *Stagflation* and *Disinflation* (1980) that coincides with the peak of the cycle 1977-1983. In fact, from a long-term perspective, the year of 1980 happens to be the most appropriate conventional boundary between *Stagflation* and *Disinflation* since it was also the peak of the "long cycle" depicted by Chart 1.[1]

Chart 1 – The Long Cycle



(*) average values for each cycle period
(**) average values for the year

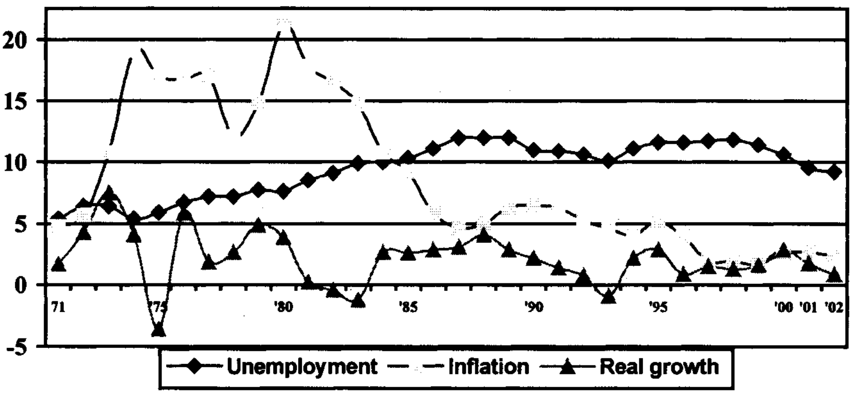
Source: Elaboration of the Authors based on ISCO-ISAE data

Since the first period was already analyzed in the preceding chapter, the analysis here focuses on the last three periods only.

Stagflation (1971-1980)

This period was marked by what might be called a "long crisis" (see Charts 1 and 2). Unlike a typical crisis of few quarters during a normal business cycle which usually paves the way to a new period of expansion without implying profound structural changes, economic instability was a dominant theme of this entire period and caused a radical structural change in the main features of economic growth.[2] It is suggestive to think of this long crisis as the crucial critical phase of the "long cycle" depicted in Chart 1.[3]

Chart 2 – Macroeconomic Evolution

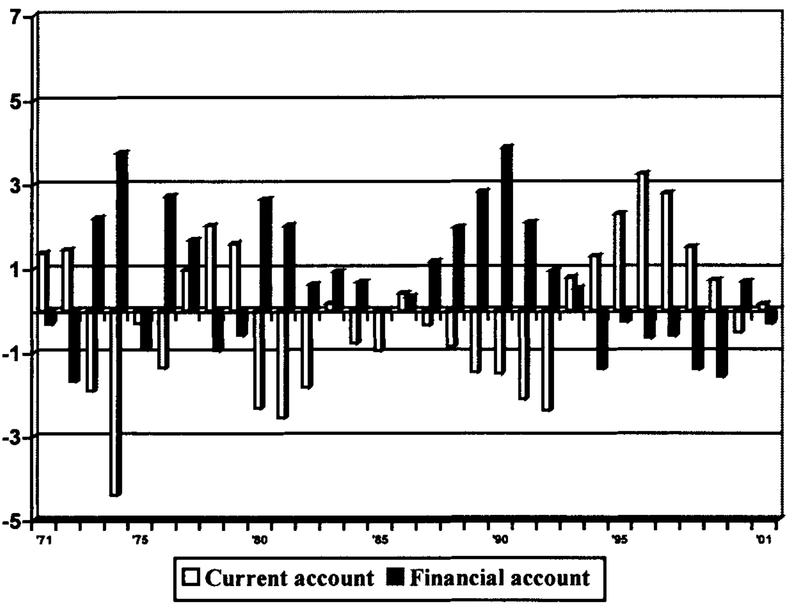


Source: Bank of Italy

With respect to the basic features of growth, this "long crisis" caused a change from an economic paradigm[4] based upon *Fordism* and *Keynesism*[5] towards a new economic paradigm based upon the progressive and systematic deregulation of markets, and the adoption of more flexible business models implying a greater role for SMEs (small and medium size enterprises). This critical phase was triggered, and initially dominated, by the intensification of the distributive conflict and by the ensuing hardening in the use of the labor force. This increased the structural uncertainty[6] of the Italian economy, contributing to the obsolescence of the economic paradigm that had presided over the so-called "economic miracle" of the fifties and sixties (further comments on these structural issues will be developed in section 7). The macroeconomic developments were profoundly affected by the structural changes mentioned above. Real growth exhibited a fluctuating pattern deeply influenced by stop-and-go economic policies (Vercelli, 1977).

The trough of 1971 was heavily affected by (i) the industrial stoppages of 1968 and 1969 (culminating in the so-called "hot autumn" of 1969 with a loss of 302 million of working hours) and (ii) the ensuing restrictive policies reacting to the inflationary pressures exerted by rapid wage rises. The easing of tensions on the labor front favored by the approval of a "workers statute",[7] and the growth of domestic consumption driven by wage increases triggered a strong recovery during 1971 and 1972. The rate of growth plummeted after the first oil shock of 1973 and then bottomed out in 1975. As a reaction public spending increased very rapidly reaching 47% of GDP by 1977 (vis-à-vis 30% of 20 years before) mainly due to the growth in current expenditures (interest payments and social expenditures[8]) rather than in capital account. After a vigorous but brief recovery in the late 1975 and early 1976, there was a new setback between late 1976 and early 1977, and then a new milder, but steadier, recovery through 1979 (see Chart 2). These sharp but short recoveries were insufficient to stop the trend towards increasingly higher unemployment, while the sharp declines in the growth rate managed to steer inflation somewhat lower from the high peak recorded in 1974 (19.1%), but not to a single-digit level. Inflation reached a new higher peak in 1980 (21.2%), after the second oil shock, convincing the authorities that a much more restrictive policy had to be introduced.

Chart 3 – Balance of Payments

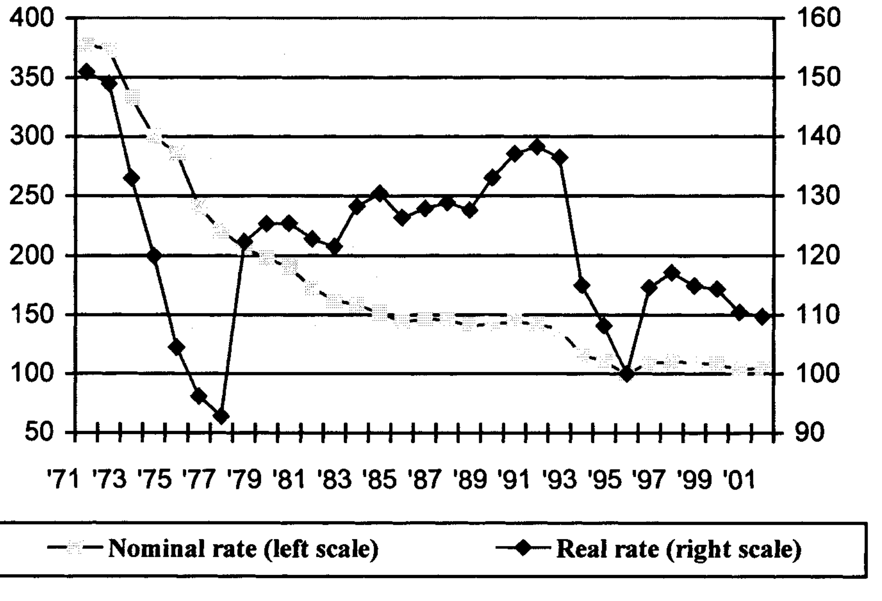


Balances as a percentage of GDP

Source: International Financial Statistics, IMF

Notwithstanding the increase in exports, in response to the expansion of the global cycle,[9] which propelled the expansionary phases of 1973 and 1976, the weight of the external constraint became increasingly evident in this period (see Chart 3) as a result of Italy's structural deficit in the energy field (due to the lack of energy sources in the country) and in the agricultural and food sectors (due to the geological and climatic features of the country). Therefore the manufacturing sector was entrusted with the difficult task of re-equilibrating the trade balance. In the seventies, this role was mainly played by light industry (textiles, fashion, shoes, ceramics, etc.) which managed to offset the growing deficits in heavy and high-tech manufacturing (for example chemicals, metallurgy, and electronics). However this peculiar model of specialization became increasingly unsustainable because of the growing contradiction between the structure of demand (which was progressively converging towards the structure of most industrialized countries) and the structure of exports (which was progressively moving away from that structure).[10] The foreign exchange policy was used as a counter-cyclical mechanism to offset the loss of competitiveness due to higher inflation, a significant degree of wage and salary indexation (because of the specific clauses contained in collective bargaining agreements), and a growing technological gap (see section 7).

Chart 4 – Effective Exchange Rates



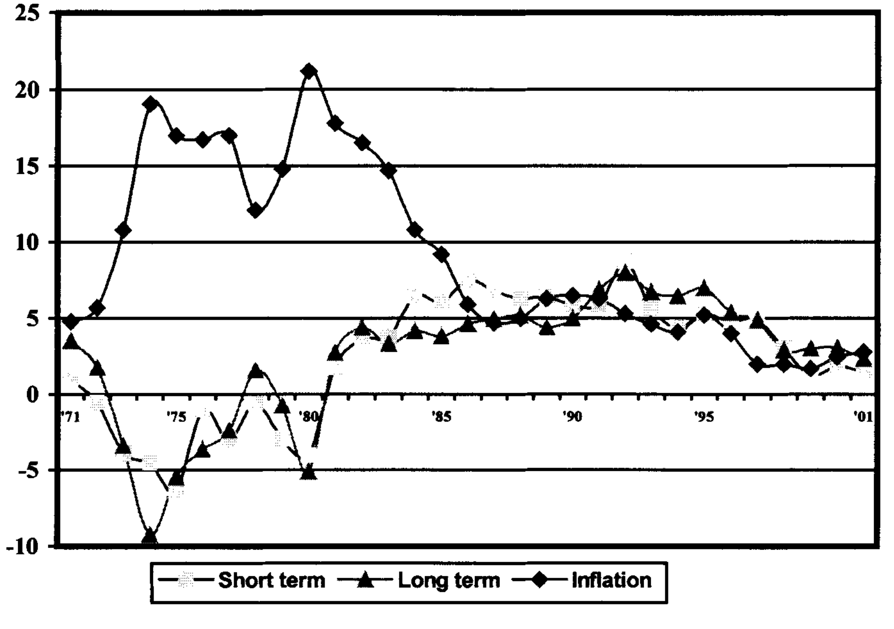
Index Numbers (1995=100)

Source: International Financial Statistics, IMF

The Lira exchange rate was cleverly maneuvered in order to obtain a slow but progressive depreciation vis-à-vis the German Mark, the currency of the main market for Italian exports, while avoiding a depreciation vis-à-vis the US dollar, i.e. the currency of most Italian imports. This helped to keep substantial equilibrium in the balance of payments since an increase in the price of imports was immediately apparent in that balance, while an improved competitiveness of exports had a lagged impact. In addition, the combination of such exchange rate policy with a restrictive budgetary policy, especially after the 1976 cyclical rebound, succeeded in reducing the inflationary pressures and produced a current account surplus for the period 1977 until the second oil shock in 1979.

During this period, real interest rates were negative (see Chart 5) with long-term rates falling to -10% in 1974, when inflation reached one of its peaks. A new minimum was reached in 1980 (-5%) as a consequence of imported inflation following the second oil shock. However the new restrictive policies inaugurated with Italy's joining the EMS in 1979 (though within a larger band[11]) not only caused a progressive increase in real interest rates, that ended up having a considerable impact in the subsequent period, and a tendential appreciation of the lira (see Chart 4) but also led to a long period of disinflation.

Chart 5 – Real Interest Rates

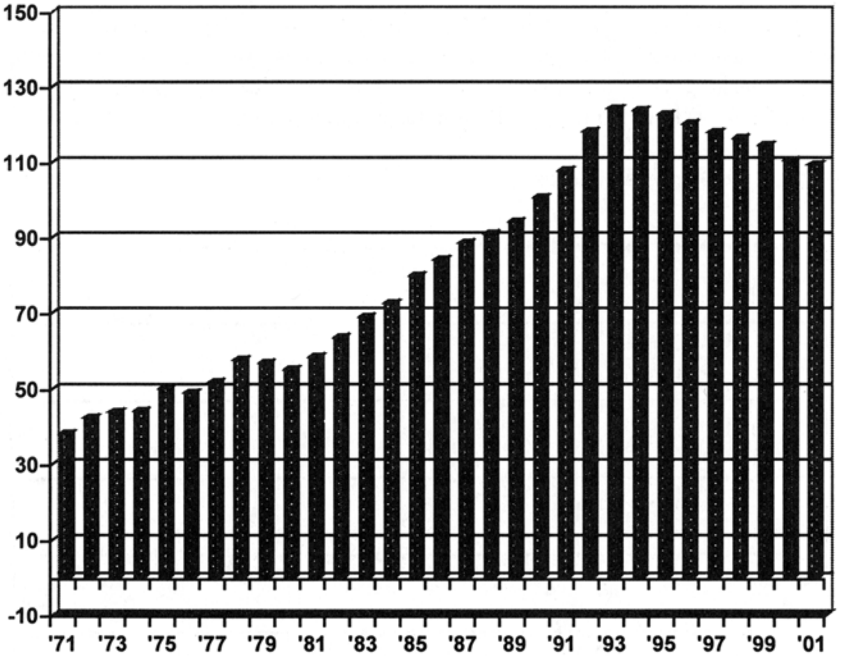


Source: International Financial Statistics, IMF

Disinflation (1980-1993)

This period was marked by the ongoing deceleration of inflation accompanied by a progressive increase in unemployment (see Charts 1 and 2). The disinflationary effects of a very restrictive monetary policy were somewhat offset by a permissive policy of deficit spending. This was reflected in the simultaneous increase in real interest rates (see Chart 5) and public debt (see Chart 6).

Chart 6 – Public Debt



Stock as a percentage of GDP

Source: International Financial Statistics, IMF

At the beginning of the decade, the major industrial economies had to deal with the effects of the second oil shock. The reaction of the Western economies was mostly unilateral and uncoordinated: some countries stimulated the inflow of petrodollars (this was the case in the UK), others tried to increase the exports by devaluating their currencies (Japan) or to reduce the imports of oil (Germany). In most countries, including the U.S., interest rates were raised to attract foreign capital. Such action eventually led to the debt crisis of emerging countries and the U.S. stock exchange crash of 1987.

In Italy, the restrictive monetary policy and the ensuing appreciation of the lira caused a profound structural change in the economy and in particular in the manufacturing sector. The organizational, technological and financial structure of the firms was re-engineered in order to assure a higher level of flexibility. The same drive towards flexibility happened in the industrial relations and in the management of the labor force. Domestic prices were affected to a lesser extent by imported inflation, deficit spending, the growing cost of capital, and the increase in the price of public services, while the effect of the indexing mechanism was progressively weakened.[12] The accumulation of productive capital slowed but the economic efficiency of investment increased in consequence of a shift towards more flexible forms of investment. This process was consistent with innovation in the productive process but was inconsistent with product innovation, especially in the high-tech sector which needs long-term investment in R&D and in new plants, and this eventually enhanced the technological gap between Italy and other industrialized countries.

At the same time, the financial system embarked on a process of change that decentralized a few crucial categories of financial decisions giving more weight to competition and redistributing in a more efficient manner the financial risks, but increasing the fragility of the financial system.[13] In addition a reduction in inflation was accompanied by an increase in the budgetary instability (see Chart 6 and section 7).

The fall in growth, which hit a low in 1983, pushed unemployment over the 10% level. By 1987, the disinflationary process had succeeded for the first time in steering the inflation rate under the threshold of 5% although only at the cost of a more than 12% level of unemployment (Chart 2). The last part of the period (1988-1991) was marked by a moderate expansion that succeeded in cutting the unemployment rate at the cost of a limited rebound in inflation. However the real rate of growth, after hitting almost 5% in 1988, kept decelerating until it turned negative in 1993. These figures may be reconciled by taking into account the strong increase of the unofficial economy during this period; this increase reduced the rate of effective unemployment but was obviously not reflected in the official statistics.

Through 1987, there were various realignments in the lira central parity within the EMS; such realignments tended to make up for the progressive loss of Italy's competitiveness abroad and favored the containment of the current account deficit. From 1987 to 1992, the lira was realigned only once (in 1990) when it entered the smaller band of fluctuation. On the whole, the Italian lira appreciated in real terms during the period (see Chart 4). The growing external deficit from 1987 to 1992 (Chart 3) forced the authorities to further increase the interest rates up to 1992 (Chart 5). The downside effects were the creation of huge internal and external deficits. Considering the policy of deficit spending together with the restrictive monetary stance and resulting high interest rates, the sustainability of public debt was increasingly jeopardized. In the eighties, the public deficit expanded at an annual average rate exceeding 10% of GDP. Also alarming was the ensuing increase in the foreign debt that went from a negligible value of 1979 to 15% of GDP ten years later (see section 6).