

"The Italian Economy: the chance to build a new miracle"

## Preface

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*Since the early 1970s and progressively during the 1980s the Italian economy has been experimenting a subtle and perverse "model" which has expressed itself in these early 1990s in the form of the impending danger of an irreversible real and financial crisis.*

*The tenet of the model is that it is possible to deficit finance public-sector current-account spending. This results in a systematic "destruction" of savings which in turn distorts the allocation of resources, shifting them from savings to consumption.*

*In the 1970s, the great inflationary wave, the lira devaluations and above all the negative real interest rates enabled the "books to be balanced" in one way or another, shifting the responsibility for the costs incurred onto the then unaware and defenceless savers who saw a consistent part of their financial wealth "destroyed". At the start of the 1980s, however, the picture had radically changed: throughout the world inflation had fallen rapidly and was closely controlled, the exchange rate was reined back within strict margins and used to combat inflation. As a result, real interest rates became very positive, this trend was further encouraged by the need to place on the market considerable quantities of government bonds to cover the growing deficit. The public debt-interest spending-current deficit-public deficit vicious circle was therefore flanked (and worsened the already disastrous conditions of the public finances) by the growing imbalance between spending and current revenue, fuelled in the 1970s by "welfare" spending policies which it was thought did not have to be financed by increased fiscal revenues.*

*However, a "welfare" policy which aims at safeguarding and supporting employment levels when based on a current public deficit*

*which destroys savings, actually leads to an overall reduction in the number of jobs available. Recent estimates indicate that the continuing current-account deficit has, over the past twenty years, led to the loss of some 800,000 jobs, net of the increase in employment in the public sector of circa one million persons.*

*This perverse model "within" the Italian economy was hit, in late-1992 and early-1993, by a serious international economic crisis, "fuelled" by the even more serious recession in Europe, which was being slowly throttled by the high interest rates imposed by Germany. This difficult economic situation is further complicated by a serious political-institutional crisis which has already induced some commentators to talk of a "revolution Italian-style".*

*It may appear paradoxical, but the conditions engendered by the present currency crisis and recession may also provide the basis for an economic policy strategy and the consequent conduct of the social parties which could make 1993 the year of the "great opportunity".*

*To construct this opportunity, the government, central bank and social parties should formally recognise "three facts", unthinkable only a few months ago, and their behaviour should be coherent with said recognition:*

*1) there has been a strong devaluation of the lira which has not, at least for the moment, coincided or triggered an irreparable public debt financial crisis;*

*2) the inflationary dangers of the devaluation have been circumscribed by a fall in domestic demand and zeroing of cost-of-living indexation schemes;*

*3) there is significantly more room for manoeuvre than before for tackling the public deficit and debt problem, now that the lira is floating on the foreign-exchange markets.*

*All this means that the different economic-policy mix which has been discussed for years is now within reach: this mix comprises a restrictive and strict public-sector budget policy, which, after twenty five years, will produce a current surplus, and a monetary policy which is more flexible, precisely because it is "free" from the constraints of the exchange-rate and the explosive course of public deficit and debt. The objective of this policy mix is what has been preached but never practised for years: reducing consumption in favour of*

*production investment, reducing domestic demand in favour of exports so as to balance the balance of payments current account.*

*The government should therefore “finish its job” as regards the public deficit and debt. The admittedly difficult conditions of crisis regarding industry and employment should not be allowed to confuse matters, motivating an even momentary relaxation of the national budget adjustment measures.*

*The Banca d'Italia could guide a three-point reduction in interest rates as early as the coming two-three months, without necessarily waiting for approval, but certainly requesting the definition and assumption of political responsibility.*

*The social parties, companies and trade unions, constrained as they are by the present recession, should realise that their big opportunity is to aim at “quality” and not at “prices”: companies by taking advantage of the wider competitive margins created by the devaluation, maintaining their existing price lists and increasing market share, i.e., selling more at the same price, and the trade unions by seriously defending employment and rapidly improving prospects via coherent wage policy guidelines.*

*This mix of economic policy and behaviour would enable Italy once again to surprise the international markets, and demonstrate a quick capacity to recovery and above all initiate the virtuous circle that will lift the growth rate to above 3% during 1994.*

*Hence a series of miraculously concurrent circumstances, which rarely repeat themselves in any country's history, make it possible for Italy to make the great leap forward, a second miracle which will take it from the tail-end of the industrialised countries to one of the leaders. This requires but a small sacrifice on the part of those who are fortunate to have a job today, a sacrifice that will be more than compensated by improvements for those that are currently ‘outside the system’, the unemployed, in particular the unemployed youth.*

*This leap will not only bring the unemployed back into society but should also cure what have been the chronic ills of the Italian economy; high and variable inflation, imbalanced national accounts and foreign account difficulties. It is no surprise that so many pigeons can be killed with one stone as all these ills can be traced*

*back to more or less one single cause: the illusion that Italy entertained in the past that it could freely violate the law of supply and demand as it could control the labour supply and impose a real wage which approached that expected. This is no longer possible. In a country which enjoys the benefits deriving from the opening to international trade, there is a limit to the real salary which is compatible with "full employment", a limit beyond which it is not possible to avoid forced unemployment (and various other ills).*

*These are the broad lines of analysis followed by the papers in this collection which attempt to provide a contribution to the debate on the "ways out" for the Italian economy to a sound and robust upturn in both growth and employment.*

*The volume opens with three papers, by Innocenzo Cipolletta, Giuseppe Pittorino and Nadio Delai, which attempt to provide a analytical framework which sketches the structural characteristics of the Italian economy, the recent, profound changes in the political and institutional scene and those in society. The conditions, constraints, risks and opportunities which lie before the Italian economy are discussed and analysed from various points of view in the second part of the issue in the papers by Mario Baldassarri, Franco Modigliani, Luigi Spaventa, Stefano Micossi, Pier Carlo Padoan, Rudige Dornbusch and Paul A. Samuelson. The book closes with a paper by Olivier Blanchard on the parallel conditions in the French economy and a paper by Antonio Marzano on the death throes and/or resurrection of the EMS.*