Back to the long-run: the "Development Operation" as a supply-side policy by the Italian Industrial Association during the Seventies

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25 May 2016

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Abstract

The aim of this paper is to stress the proposal made by the Italian Industrial Association against the stagflation during the Seventies, labeled "Development Operation", which tried to give Italy a long-run growth path, through a strong reduction of public debt, boosting the supply-side in order to gain more productive independence; all of this in close connection with the European Community framework and in line with IMF/OECD directives. Moreover, this policy statement provided for a synthesis of different schools and joined the crowding-out debate occurring at that time in Italy.

JEL Codes: B22, B31, E65, N14.

Keywords: supply-side, Guido Carli, economic planning, crowding-out, Italian economists, oil shock.

Introduction

In the middle of the Seventies the oil shock occurred, producing a serious slump and finally generating a stagnation of economic activity. Several solutions were proposed for the European recovery, for example post-keynesian (Cornwall 1985), neo-marxian (Boyer & Mistral 1985) and also a synthesis of different schools (Tobin 1981).

The aim of this paper is to highlight the proposal made by the Italian Industrial Association (henceforth Confindustria) to give Italy a long-run growth path, through a strong reduction of public debt, boosting the supply-side in order to gain more productive independence; all of this in close connection with the European Community theoretical and economic framework.

This issue is considered worthy of attention because it inquires a little known episode of Italian economic history; moreover, the existing literature (Savona 2008[a] mainly) allows for a critical study – including the debate occurred at that time and an analysis of the economic paradigm followed by

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this proposal – over this theme. In recent years, also the recognition of a specific role of think tanks in the relationship between economic knowledge and policies has gained ground and growing interest worldwide (Cockett 1994; Mcgann 2010; Mcgann & Weaver 2000; Rich 2004). Therefore, another specific goal is to stress the features of a modern think tank born during the Seventies that, through theoretical analysis supported by econometric researches made also by Italian scholars, tried to stem and/or to advise parties, tackling politicians with technicians.

We will firstly provide an economic and historical-institutional framework of that period; we will then describe the making and the contents of the "Development Operation"; finally, we will report the debate revolving around this proposal, and why this document was rejected.

The economic scenario

In Italy, the real GDP fell down from 4% to 2% according to several estimates, the inflation rate had a trend based on "two figures", near 17%; the labor market rigidity did not allow an adjustment of factors of production by this side. Although the recession, wages increased, supported by the wage indexation mechanism. The impact was on firms' profit and investment, which found hard the adjustment of prices to costs; paradoxically, public and private monopolistic firms (which did not face competition and could rely on State aid) took advantage from the crisis because they could charge their costs on prices, but their profit did not offset the other firms' losses. Since January 1976 the balance of payments disequilibrium faced the depreciation of lira that overcame 27%, helping firms, but in the end not covering the trade gap. An inflation-depreciation vicious circle started intensifying the stagflation. Government tried to counter this situation increasing public spending to 40% and public deficit to 11% in order to stimulate aggregate demand; it forced supply side too, increasing public firms activity worsening public debt[2].

Political instability was a feature of that period; government was guided by Christian Democrats but Communists, the main opposing party that during the last polls had almost reached the majority, decided to let the former govern, aware of the crisis Italy had to face. Enrico Berlinguer (Communist party) and Aldo Moro (Christian Democrats) were the main supporters of an open door policy between their parties, the paradoxical "parallel convergences"; in 1978 the latter was kidnapped and killed by Red Brigades for his civil commitment. This was an episode of the so-called "Years of Lead", a period of socio-political turmoil in Italy that lasted from the late 1960s into the early 1980s, marked by a wave of terrorism.

For many years, what international organizations suggested as exit strategy for the crisis was:

[2] Savona P. 2008[b]; see also De Cecco M. 2008.

The prospect […] of rising unemployment, rapid inflation, and declining real income per head is by any normal standard unsatisfactory. […] in this situation the basic aim should be to restore price stability and to promote the conditions for sustainable medium-term growth of output and employment. […] this involves:

- *Bringing the oil-induced surge of inflation under control and keeping or bringing about a relationship between costs and prices sufficiently favourable to make investment worthwhile.*
- *As this is achieved, and as continuing efforts to reduce the underlying rate of inflation take effect, policies to ensure a sufficient level of activity for productive investment to be needed as well as profitable.*

Positive supply-oriented policies to improve productivity and inflation performance, and provide more jobs, through raising the share of savings and productive investment in GNP and improving the operation of product, capital and labour markets[3]

And:

Perhaps the most fundamental aspect […] is the top priority being given by industrial countries to the fight against inflation […]. The energy problem has clearly become of critical importance to the world economy […]. On the matter of supplementing the use of fiscal and monetary policies with other instruments of policy, two types of measures command attention: (a) measures to improve supply conditions and to achieve higher levels of saving and investment, and (b) measures that endeavor to keep the growth of incomes in line with the objectives of anti-inflation policies […] international cooperation is essential. This view stems from two main considerations: the present unsatisfactory state of the world economy, and the increasing interdependence of nations[4].

As chairman of Confindustria since 1976 until 1980, Guido Carli tried to find a way out suggesting a new path for growth and development. He thought firms should be free from government and bureaucracy "laces", but he asked them to run a fully transparent management; moreover, rent-seeking positions, inefficient public intervention should be abandoned and firms should open themselves to national and international competition.

This was for him the only possible way to legitimate their requests to trade unions, parties and government, in a framework of economic bust, low capital accumulation, strong inflation and unemployment, excessive state aids along with crowding-out effects. Considering pluralism and

[3] OECD 1980, p. 7. Moreover, this institution pointed out that during the Seventies Italy seemed to be a good example of the general proposition that, within an open economy under fixed exchange rates, monetary policy is more effective in achieving the external goal of non-monetary movements equilibrium rather than influencing domestic policy objectives (OECD 1977).

[4] IMF 1980, p. 39-40.

competition as the main factor of economic and social development, Carli believed in firms as driving forces of innovation and growth. Instead, trade unions had to accept the idea of considering wage as a dependent variable of productivity.

Since that period the burdens on profit and wages by rent seeking positions, the helpful but inefficient expansion of State and the constraints on firms' operations, had limited Italian growth, but their negative effects were balanced, more or less, by an overall positive economic trend. The "hot autumn" wage struggle in 1969, the collapse of Bretton Woods system in 1971, and the increase of oil prices during the first half of the Seventies had stopped that positive trend.

This view was also in response to many years of economic planning that showed difficulties to pass dualism between Northern and Southern Italy[5]; according to Carli's opinion, policies in favor of Southern Italy failed due to the fact that their aim was to solve effects (employment and income) but not the cause (productivity)[6].

Carli thought that competition was the main way to exit the crisis occurring in Italy; this was the only development model which Confindustria positively considered in order to protect and guarantee wealth for Italian people.

In 1977 possibilities to reach an agreement with unions and government in order to design a development plan were offered. During that period the dispute about the *Relazione Previsionale e Programmatica* (henceforth P&P) for the year 1978[7], revolving around public spending dimension, was very significant; Confindustria suggested[8] with its estimates that public deficit could be decreased to 19 thousand billions rather than 24, whereas the latter amount created a general agreement among parties, unions and strictly Keynesian economists (the majority during the Seventies).

Confindustria sent its proposal to trade unions (with the aim of co-opting its rivals in order to submit to government a unique framework of analysis) and to its peripheral branches, in order to use the Development Operation as a policy statement for government action within "national

[5] See for example Carabba M. 1977.

[6] See Carli G. (ed) 1977.

[7] Camera dei Deputati 1977.

[8] In past years Paolo Savona (Director-general of Confindustria) had the opportunity to study crowding-out effects during Ugo La Malfa attempt to put a 7400 billions cap to public deficit; see Fratianni M., La Malfa G., Trezza B. 1975.

solidarity”[9], and to create consensus supporting the “historic compromise”[10]. The main idea of the document was the reduction of crowding-out effect produced by public spending; to increase labor demand, the growth-with-disinflation goal had to be reached by a control over labor cost dynamic and reducing unproductive public spending (especially current one), in order to liberate resources, allocating them to private investment and employment[11], finally overcoming the crisis keeping Italy within western development model (especially that of EEC).

Trade unions replied with their own document[12], based on an introduction and divided into 15 thematic points which, although partially in line with the EUR’s turn (i.e. overcoming the conception of wage as an independent variable from productivity)[13], presented a summary of profound changes to reach in economic and social policy, different from what occurred previously in our country. It considered Confindustrial scheme purely hypothetical and abstract from social reality. While this proposal did not offer quantitative analysis, it pointed out qualitative objectives to achieve; here the causality among variables did not go from labor cost to crisis via inflation and depreciation, but from the international division of labor, technological backwardness and public deficit toward crisis, whereas labor cost weighed less than half on inflation.

The Development Operation also opposed the Communist Party medium-term proposal carried on by Giorgio Napolitano, which pointed out more attention to public intervention in the economy aimed to introduce socialism inside society; planning should not be based on a model of growth which only considered income and production as quantitative goals, but on qualitative economic and civil improvement. The only workers’ economic austerity they admitted was for the short run, whereas in the long run they invoked mainly a moral austerity, which should mean rigor, efficiency, reliability and justice, the tool to change our development model profoundly, without restoring the

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9 Carli also proposed to trade unions the unification of economic analysis, though he had to fight against their reluctance as well as that of entrepreneurs. Nonetheless, he made the software of LUISS available to Ezio Tarantelli, adviser of Confederazione Italiana Sindacato Lavoratori (CISL), for his researches.

10 Alò C. 1977.

11 Savona P. 1994 and Savona P. 2003.

12 See Federazione nazionale CGIL-CISL-UIL 1978. This document was also published as a supplement in *Rassegna sindacale*, 24 (2): I-XVI and in *Rassegna sindacale*, 24 (8): XIX-XXX.

13 It is to remember that in February 1978 trade unions proposed a wage restraint in exchange of an economic policy that supported development and defended occupation; this change of route is known as “EUR’s turn”, due to the place where trade unions conference occurred.

old mechanisms of capitalism[14]. Two models essentially clashed: the first one where capitalism-firm determined commodities and their means of production; the second one that assumed the entrepreneur just as an official of production in order to let the supply efficient and innovative, where politics had to determine the demand for goods[15].

The Development Operation's structure and its economic paradigm

The Operation was realized by the reengineered Research Department held by Enzo Grilli, together with Paolo Savona and Jan Kregel consultancy[16]; for the first time, the estimates and forecasts on Italian economy were based on two econometric models[17]: the first edited by Massimo Tivegna with the help of Nobel Prize winner Lawrence Klein, which used objective probabilities (or frequencies); the second edited by Gabriella Chiesa under the supervision of Clifford Wymer (IMF) and Anil Markandya, which used subjective probabilities (or bayesian)[18], and it also took into account the changing behavior of market operators and the uncertainty of entrepreneurs, giving much more attention to their expectations[19].

This proposal also got back the results stressed within another research where it was highlighted that Italian public intervention was not able to boost capital accumulation and private investment;

[14] See Partito Comunista Italiano 1977; Napoleoni C. 1977; Napolitano G. 1979; Berlinguer E. 1977 and Barca L., Carandini G. (eds) 1977.

[15] See for example the essay by Rampa inside Lunghini G. (ed) 1981, pp. 125-170.

[16] It is useful to highlight the role of CSC (the Research Department of Confindustria) during Carli's chairmanship; Paolo Savona (director general of Confindustria) had the task of reengineering it because the search for consensus had to and could happen through empirical research and the collection of unbiased data. Carli knew that econometrics could not replace policy decisions and social behavior in general. However, he also knew that a choice based on analytic coherence could have a higher degree of reliability and success, where analytic coherence meant checking and doubting his opinions (see Savona P. 2008[a]; see also Dafano A. 2014).

[17] It was initially used Prometeia's model, which had a praiseworthy open-door policy toward Confindustria; this also because of the connection with Giorgio Basevi, who was within the scientific committee of the Bologna research department and gave suggestions to Gabriella Chiesa for the elaboration of her model.

[18] See Tivegna M. 1984 and Chiesa G. 1979.

[19] The Operation got back issues and analytical-statistical basis from Centro Studi Confindustria 1978; this latter was the first official report ever made by Confindustria.

the framework was that of a Ricardian view of economy, where efficient firms and productive workers fought against wastes of public and private oligopolies[20].

The document[21] pointed out several goals to reach:

- a 4,5% growth in order to increase employment outlooks, accepting a thousand billions balance of payments deficit;
- an increase in real labor cost rate always lower to the inflation rate (estimated to be 12%);
- a decrease in the cost of money up to the inflation rate;
- an increase of credit to the productive sector, which should have had the same dimension of the reversal supposed for the balance of payments (from +2000 to -1000, namely 3000 billions).

There was a convergent interpretation (between Savona and Ezio Tarantelli of CISL) on the Okun's law, that ties real growth rate acceleration with employment one, about growth rate estimate. Savona believed that 3% would have been sufficient, whereas Tarantelli opted for 4,5%. The choice went to Tarantelli's thesis, who worked in a trade union, so it could positively influence them, although this estimate was far from government's P&P 3% purpose. However, overestimating meant that it would have been always in line with the promise of 100 thousand job places creation, even if it was reached a lower goal[22].

The document then made a list of economic policy actions which entrepreneurs[23] considered necessary to overcome the crisis, based on:

- the market relation between a null real interest rate and accumulation stock;
- the multiplier effect of building spending (which involved more than 30 sectors of the economy);
- the expansive effect given by reducing public deficit at least of 5000 billion during the last part of 1977 (which went from 16450 to at least 21000);
- the making of investment in nuclear energy, transport and telecommunication sectors.

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[20] Carli G. (ed) 1977.

[21] Centro Studi Confindustria 1977[b].

[22] See Savona P. 2008[a], p. LI-LII.

[23] It was actually CSC estimate, but obviously the document was in the name of firms.

Another work drew up by CSC also showed the industrial sector availability to increase of 5% in real terms the investment made in 1977[24]; the effect of public spending and credit-monetary boost[25], mixed with the 16 points suggested by Confindustria, should have guaranteed growth rates able to increase production, along with positive effects on Southern Italy, and a creation of 100 thousand job places (an average in the first year of development).

It would have been a concrete turning point toward less assistentialism, to maintain Italy in the European development model framework, in order to prevent a different inflation from the rest of the world; as the other face of the same medal, it would have kept balance of payments in equilibrium along with exchange rate stability. However, at the same time, Italy should have accepted a social change directed to a growth-disinflation economic development, which would be passed mostly through a reduction of unproductive area, namely public deficit as its most direct index.

In a first step, the document predicted a cut in individual income (so a decrease in demand by this side); Confindustria suggested boosting stock cycle and to intervene in construction industry, then to operate income policies along with the expansion of credit supply to investment, only when growth rate would have been near to 4,5%. The Operation pointed out the importance to turn from consumption to private investment and to use foreign reserve in order to reabsorb balance of payments disequilibrium.

Whereas government estimates about public deficit of 28700/30000 billions, the Development Operation was harder to apply, because it required an income cut of about 10 thousand billions, in order to bring public deficit to the necessary amount in order to re-allocate resources; the recovery path of trade balance equilibrium and for exchange rate stability was fundamental, as agreed with IMF, in order to refund the debt incurred with it during the Seventies[26]. In that framework, total domestic credit begun the tool to evaluate monetary policy, because it was directly linked with the

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[24] Centro Studi Confindustria 1977[a].

[25] The relevance given to credit probably was also due to Hyman Minsky and Karl Brunner (see for example Minsky H. P. 1978 and Fratianni M. 2007); the former spent a period in Confindustria as visiting professor, the latter was the founder of the Shadow Open Market Committee at the University of Rochester, which was attended by Savona and Fratianni; as we said at the beginning of the introduction, this was in line with the attempt to have within Confederation a pluralist and open minded view of economy.

[26] As well as the 19 thousand billions public debt cap.

availability of funds for firms; it was a quantity target, instead of a price one (the latter identified by long-term interest rate)[27].

The importance given by Confindustria in fighting against public deficit was not properly about the relation between public spending and wastes, but on the specific theme of saving utilization, which kept on being absorbed by public sector instead of being used by private firms, that claimed for more share of saving. Inside the document there was also a reference to the decrease of labor cost for firms (exemption from social security contributions) that was instead financed by an increase in VAT (Value Added Tax), substantially neutralizing this gain in competitiveness through higher prices for goods[28]; nonetheless, it highlighted that the detente with unions, concerning time sheets, allowed an increase in productivity.

In the part concerning the proposal to reset the real interest rate as a form of adaptation of the same to the rate of profit, the Development Operation followed a Wicksellian approach which favored monetary interpretations of economic crisis[29]. The Swedish economist argued that the credit system (including the central bank) has the power to set the interest rate without taking into account the productivity of capital and the "natural" interest rate (where, at a given level of prices, demand for borrowed funds and supply of savings are equivalent), thus inducing changes in investment such as to cause changes in income and saving, through the cumulative processes-effective demand mechanisms that are able to vary the level of activity. According to Wicksell, banks are unable to properly use their power to set interest rates, that is, to make this rate consistent with the needs of capital accumulation; then monetary policy (i.e. the role of banks) has a function of stabilizing the economy, driving the system towards key currency countries or those in structural surplus of the balance of payments, but above all driving short and medium term expectations in order to boost development.

In summary, the Wicksellian cumulative-processes demonstrated that a fall in investment determined a more than proportional decrease in income; consequently a fall in income could decrease savings and finally investment. Here is the necessity to give back credit and self-financing

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[27] See Rossi S. 2003, p. 28-29.

[28] According to Savona, the main problem was how to shift from an assistentialistic economy to a dynamic one, the concurrent presence of inflation and deficit and how to share sacrifices appointing commitment (Savona P. 1977 and Macchi A. 1977[a]).

[29] About this Wicksellian/Northern-European monetarism see Savona P. 1978[b] and OECD 1979.

chances to the private sector in order to restart capital accumulation: within this dynamic process of disequilibrium the interest rate played a crucial role[30].

Looking at the theoretical scheme followed by the Operation, it tried to make a Keynesian post-monetaristic synthesis, according to what James Tobin and other scholars were developing in their studies:

"by far the most formidable barrier to monetary and fiscal stimulus to recovery and jobs is the risk of reacceleration of wages and prices [...] the obvious desiderata are policies to diminish the inflation risks of demand expansion and to lower the inflation-safe unemployment rate. The candidates fall into two somewhat overlapping categories: institutional reforms *and* incomes policies. *[...] Appropriately stimulative policies need not, by the way, commit any country to high budget deficits in times of prosperity because tax cuts or job-creating expenditures could be designed to terminate at a scheduled date on contingent or economic circumstances. They need not favor consumption, public or private; they could take form of tax incentives for investment or of public investment projects. they need not commit governments to larger public sectors than they desire in the long run. Whatever the national priorities of the country and its social philosophy with respect to the roles of public and private economic activity, they can be reconciled with fiscal policies appropriate to macroeconomic circumstances [...]. These require international cooperation"*[31]

The economic policy ensued in Italy until then was still inspired on a strictly Keynesian one – running a totally discretionary monetary policy – of a different type from that proposal. Given the prevailing conditions in Italian economy, the support of aggregate demand, necessary to ensure a return to full utilization of resources, especially of the labor one, had to take place through the re-configuration of public expenditure from the investment side. It was in this sense that an effective policy of supply was settled in the "Keynesian" construct, and so it was necessary to restore dignity to the functionality of fiscal policy. Recomposed in a direction of medium term development, fiscal policy could really become economic planning[32].

The debate among scholars

It seems useful to deeper underline the dispute revolving around public deficit cap, in order to stress why the Operation was denied by scholars.

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[30] Savona P. 1980.

[31] Tobin J. 1984, here pp. 92 ss. See also Tobin J. 1981. Within this framework see also Bruno M. 1984; for different approaches, respectively post-keynesian and neo-marxian, see Cornwall J. 1985 and Boyer R., Mistral J. 1985.

[32] See for example Kregel, J. A. 1985 and Savona P. 1982.

In summary, the P&P proposed a demand containment, keeping the exchange rate unchanged through the balance of payments equilibrium, together with the inflation control, in order to reach in 1978 an income growth rate of 2-3% along with a current account surplus; it also hoped in the common sense of the unions in not requiring excessive wages increases.

According to Franco Modigliani, he was concerned about the negative effects of wage indexation mechanism, crowding-out, government lack of promptness, lack of productive investment and saving, the use of inflation for income redistribution (weakening households); structural reforms in the labor market (decrease in labor cost and increase in productivity) to counter unemployment and inflation simultaneously were needed. Indeed, he positively considered the trade unions' awareness for the collaboration with Confindustria in order to draft an economic policy statement; while the Development Operation had right goals in the end (to shift resources from consumption to investment), he was skeptical about its practicality, particularly about dimension and timing of taxation. Therefore, an alternative policy had to examine the maintenance of exchange rate stability and prices moderation along with a 4-5% income expansion by a balance of payments deficit, thus raising investment and exports. Although he was aware about compatibilism among variables, in the end he was more concerned about the consequences on domestic demand, giving more flexibility to the balance of payments and public finance constraint[33].

Luigi Spaventa pointed out the fact that a 19 thousand billions cap would have inevitably needed a raise in taxes higher than Confindustria's estimates, because investment were not enough to boost growth. He agreed with Modigliani hypothesis, adding that our economic policy had to connect Italian income growth to foreign one; he also pointed out that in recent years public sector had created jobs more than industrial one and that in the years to come the latter, although it was grown at a good rate, would have created lower employment[34].

Savona argued that the acceptance of a 24 thousand billion deficit would have meant eroding even more the production base; labor cost reduction was necessary but not sufficient, it was also important to stop the monetary deficit spending practice, because it would have created unfavorable conditions to monetary equilibrium inside and outside the country. Wage indexation could not be ensured, because it was one of the most serious feature of labor cost increase; even exogenous inflationary impulses, such as rising oil prices, should not be indexed. In response to Modigliani doubts about the Operation, Savona replied that taxes should not go forcibly raised but, if that were

[33] See Modigliani F. 1978.

[34] Spaventa L. 1977.

necessary, government would have had to prepare the tools to do that in order to control inflationary expectations, thereby avoiding extreme restrictive monetary policies that would have reduced firms financing and worsened real economy[35].

According to Mario Monti, splitting public and private credit had negative economic effects too, and the sole crowding-out motivation was an understatement; end-users of funds and financial intermediaries biased resource allocation. Indeed, he was concerned about a credit reduction to public sector. Therefore, it was necessary promoting and encouraging direct relations between the households' active and enterprises' liabilities with public administration. Credit to private sector could not be considered an independent variable from the deficit because it would have meant a consequent tightening of trade unions in terms of salary; perhaps the only possible solution for a deficit reduction could have been just by cutting lending to businesses, because more viable and with lower political costs. Monti proposed a third way unlike government and Modigliani, i.e. prudent fiscal and monetary policies but with the goal of remodeling labor cost per unit of output and in terms of efficient allocation of labor force, according also to Predetti and Gasparini. He added that the ultimate and most relevant task of a policy was acting on expectations[36].

Tommaso Padoa Schioppa pointed out that fluctuations in the financial and real quantities ratios occurred around long-term trends and belonged to the profound social and economic phenomena, such as income distribution, technological innovation, the transition from a self-consumption economy to an exchange one. Avoiding crowding-out was crucial because Italian economy mostly depended on firms. The important issue was whether credit measures had helped to change the fiscal and wage variables in order to pull out Italy from the path of recession, or if it had worsened our situation. He then highlighted that the sense Monti and Savona gave to this issue had in common both the awareness of this uncertainty, and the refusal of the pessimistic hypothesis; nevertheless, according to Savona the basic clause was how not to sacrifice the productive sector, whereas according to Monti credit should not nourish inflation[37].

Andreatta was broadly in line with Modigliani's recipe, and he highlighted that recovery would not have started just by investment but, at the same time, investment would have resulted only by a reduction in public spending; he also stressed to avoid firstly an anomalous negative trend in

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[35] See Savona P. 1978[a] and Savona P. 1978[c].

[36] Monti M. 1978.

[37] Padoa Schioppa T. 1978.

consumption and to an increase in taxes, because it would have biased the demand for capital goods[38].

According to Guerci our economy did not lack in investment, but in value-added one; therefore, it was necessary to replace a part of current expenditure financing them in order to avoid balance of payments deficit and inflationary pressure, as well as vain decreases in interest rates that would have not boosted properly this type of investment[39].

Onida believed that a 4,5% growth rate along with a current account surplus was entirely compatible in the medium term, as long as focusing on the reduction of labor cost and on measures that would have improved efficiency; if the maintenance of the balance of payments surplus at a higher growth rate was difficult, instead he believed that public debt net of the accumulation of the same during the oil crisis, could have been reduced at a faster level[40].

Cipolletta agreed that Italy should not resign to the growth rate expected by government but, although in line with Onida, he emphasized that a deficit of the balance of payments would have had negative consequences on the exchange rate, restricting consumption and countering growth; many proposals of Confindustria appeared to be shared by almost everyone as useful and necessary, but it was not certain whether these measures could have led to a 4,5% growth[41].

Giorgio La Malfa was rather skeptical about "Carli's expansionism", not only about the estimates regarding the relation between balance of payments and real domestic income trends, inflation forecast, government deficit for 1978; he was skeptical mainly because Confindustria correctly noted that the maintenance of an inflation rate below 12% in 1978 assumed labor cost contained within this figure. Instead, there was not the existence of an agreement among Confindustria, trade unions and government on which this issue could be addressed. Labor cost and government deficit were variables no one curbed, and it also seemed that government had never thought seriously about it[42].

Trade unions believed that Confindustria esteemed a rigid relation between the increase of productivity and a balance of payments deficit; indeed, the income policy proposed was based on

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[38] See AA.VV. 1977[b] and AA.VV. 1977[a].

[39] *Ibidem*.

[40] *Ibidem*.

[41] *Ibidem*.

[42] La Malfa G. 1977.

this assumption, not providing for a change in productive structure and in the international division of labor. Instead, this rigidity was caused by the lack of domestic supply in agricultural sector and by low provision of value added compared to purchases from abroad in the industrial one. The logic of Confindustrial document pushed towards solutions that led to the hiring of additional foreign financing of trade deficits without changing the production structure, this latter primary cause of the deficits. Confindustria considered public deficit exclusively as a parameter to change on the expenditure side, saying nothing about the adjustment of taxation on capital income and self-employed labor to employee incomes. Finally, the econometrics availed to demonstrate only the need for a reduction in labor cost as an alternative to credit supply decrease, in this way losing comprehension about the complexity and interdependencies of the real world, thus highlighting the assumptions' inaccuracy on which its schematic model laid[43].

Crowding-out issue played a key role in those years[44]; indeed, Confindustria later examined it in depth, considering firms' self-financing and purchasing power one of the main fields it wanted to study better[45]. In general, the problem highlighted was that a combined presence of four factors – 1) medium term deficit expectation durability; 2) prevalence of public aggregates on global credit and financial flows; 3) stronger crowding-out expectation related to domestic and international instability; 4) the increase of transfers to firms – made public sector conduct move toward two directions: on the one hand, boosting inflation through home money stock creation; on the other hand, to a capital stock reduction and the restriction of development chances of Italian economic system, along with a consequently present and expected loss in investment goods profitability.

In countries like Italy for example, where the foresight of public budget imbalance seemed entrenched, the expectation of a permanently limiting action performed by that sector could affect private real saving availability; so it could have significantly affected expectations about the real cost of saving available in the future. Therefore, a budget that required an extended use of private savings would have become a predictable cause of "drain" of real private credit, and a source of non-transitory increase in the level of real interest rates in the economy.

Given the same expectations, this fact constituted a fall in the rate of return on investment (or an increase in the minimum rate of return required) that inevitably resulted in a corresponding fall in its implementation. In this sense, if anticipated by economic agents, public debt might affect the

[43] See Bordini M. 1977.

[44] See for example Cristini G., Tullio G. 1976.

[45] See Savona P., Tivegna M. 1977.

production capacity at the same time that it would manifest. In other words, public debt bonds (or, in general, the non-monetary financing of deficit) was found to be equivalent to a substantial taxation of capital, causing that the most significant and lasting impact of public deficits' persistence had to be identified on the supply side rather than on the aggregate demand[46].

Overall, it was estimated that the public deficit had determined a reduction in production capacity of at least 20% from 1966 to 1978; considering the expansion of the deficit occurred from 1978 onward, the overall impact on the growth of aggregate supply, net of the effects of the second oil shock, had probably been 50% higher (a destruction of growth in production capacity of 1.5 percentage points per year on average)[47].

In conclusion, that dispute highlighted the opinion of Franco Modigliani against Paolo Savona's public debt cap and the thesis of Mario Monti about State as a "shadow banker" which did not crowd-out, but financed production. Nevertheless, although Modigliani carried on a strong critique on wage indexation, he was an opinion leader and Confindustria lost its battle, furthermore political and economic thought was generally imbalanced to the left wing in a Keynesian sense; Luigi Spaventa and Mario Monti of Centro Torre Argentina finally agreed with Modigliani's 24 thousand billions cap[48].

Concluding remarks

The technical quality of this document showed the level reached by the Research Department of Confindustria, so as thinking about it as a long-run economic plan to overcome the oil shock, in line with IMF recommendation[49], and in line with decentralized market planning that other European countries were achieving; more precisely, it was a programming method according to which the programmer not replace the market, but aims to orient it by defining the "economic" and/or "social" value assigned to goods and services; finally, the programmer steers the use of resources and, therefore, the structure of the production process mainly through the purchase of final products on

[46] This research was also based on the credit-money-real economy transmission mechanisms highlighted in Brunner, K., Meltzer, A. H. 1972.

[47] See Karnosky D., Fornasari F. 1980.

[48] See for example Fiori G. 1977.

[49] Macchi A. 1977[c].

the market. In this way, the most important function of the market, that is to say the price making, remains untouched as a tool to guide choices[50].

Confindustria stressed the incoherence of P&P 1978 because this document would have determined a deflation of industrial activity, diminishing credit to firms through public debt; instead, the Development Operation pointed out the relevance of private production as a driving force able to generate employment, implicitly highlighting the theme of neoclassical "compatibilism" among variables of political economy, at that time very significant within the economic debate[51]. These were the main P&P's inconsistencies stressed by the Operation:

- an increase in taxation was needed to avoid a public debt higher than 19 thousand billions, otherwise the effect would have been to crowd-out credit for productive sector;
- with the expectation of a higher public deficit and not by intervening on cost-push inflation, monetary deceleration would have led to a reduction in credit supply and/or to an increase of its cost;
- with higher-than-abroad labor cost, exchange rate stability would have involved (in order to guarantee international market quotas) a contraction of gross profit on exported goods and an increased demand for credit by productive firms, due to a lack in self-financing. Therefore, the decrease of cost-push inflation was based on a deflation of productivity.

However, the proposal of 19 thousand billions deficit was considered unfounded on logical basis and blamed as a conservative policy; the thesis of 24 thousand billions gained more consensus among the majority of economists (exclusive of a few laissez-faire economists, such as Veniero Del Punta) and politicians; it had a less difficult goal to reach in terms of growth and public spending cut, and it would have resulted in less economic austerity, although many future researches and workshops (organized by CEEP, Centro Torre Argentina and Bank of Italy too) will have mostly supported Confindustria assumption[52].

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[50] As for example the experience of Federal Republic of Germany (*Finanzplan*) and the French one (*Programmes d'action prioritaires*), followed by the *V European Community medium-term plan*, which had the aim to reduce foreign dependence and inefficient use of resources by boosting investment and productivity. The OECD pointed out that, following the increasing relevance of microeconomic analysis, decentralized planning had become the backbone of public intervention in industrialized countries with a market economy (see OECD 1983[a] & 1983[b]).

[51] About this debate see Bini P. 2013. See also Macchi A. 1977[b].

[52] About these themes see for example Masera R. 1979; Arcelli M., Valiani R. 1979; Monti M., Siracusano B. 1979; Cavazzuti F. 1979; Banca Commerciale Italiana 1983; Grilli E. 1983; the records within 1981's *Rivista di politica economica*, 71 (12), on the issue "Public spending and Italian economy".

Indeed, it was stressed that, on the side of real crowding-out there was little fiscal illusion, so Italy had a large presence of negative expectations over public spending; debt-financed spending generated high interest rates (via monetary feedback) and it had negative consequences on expectations, acting within a permanent indebtedness framework and, moreover, it had bad consequences on wealth; aggregate supply was tightened, so it could not completely follow the impulses given by an increase of aggregate demand. On the side of financial crowding-out, it was noted that bank financing to private sector was more flexible and able to adapt to firm necessities over time, whereas public financing through transfers was not and could not be able to do it, due to its collective interests; public intervention created credit rationing and increased the price of bank financing, and this effect was stronger when public debt was financed by households through government bond purchasing; it was irregular and not continuous, badly influencing outlook about firms' budgets. Last but not least, *stop and go* policies were the cause and the effect of increasing deficit; these type of policies negatively affected private investment, and tried to compensate this latter through public spending.

It is to say that Spaventa, Monti and Padoa Schioppa together with Bank of Italy later helped minister Pandolfi to write a medium-term plan, which should have been the economic policy of government within the "historic compromise", aiming at the stabilization of the economy; it looked for public debt and labor cost reduction for disinflation purposes[53]. This is to say that the Development Operation had the opposition of many economists who at that time defended free market, public finance rigor and more laissez-faire.

The Italian National Council of Economy and Labor (CNEL) evaluated Pandolfi's Plan, stressing that the Operation made by Confindustria was coherent in terms of macroeconomic variables to take under control and into account, in terms of statistical basis, in terms of assumptions. Confindustrial paradigm accepted the coexistence between market and State, because market, if left alone, did not allow full employment; moreover, labor was considered an asymmetric factor over capital, so it had to meet more market rules, it had to be less constrained to bureaucratic burdens[54].

Furthermore, the Operation was pulled alongside to the Statute of the Firm (a forerunner competition law) and entrepreneurs strongly disagreed with this choice; they refused competition and free market, they did not want Communist party inside government, substantially denying the "historic compromise".

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[53] See Ministero del Bilancio e della Programmazione Economica 1979.

[54] Consiglio Nazionale dell'Economia e del Lavoro 1979, p. 115 ss.

Overall, the critiques addressed to this project were mainly two: the impossibility to reach a social agreement, due to its profound innovative way of considering it; the shift from consumption to investment was unrealistic in front of the inefficiency of public administration, and due to the actual propensity to invest despite the level of real interest rate[55].

It was pointed out that the Operation was unfortunately fell down in one of the worst periods Italy had ever seen and that there was a lack of the main speaker: government. Nevertheless, Confindustria had the merit to strongly stress the problem of production and growth, searching for the removal of barriers to it, highlighting the problem of income distribution[56].

Anyway, an agreement was never reached, especially because many irreconcilable paradigms were fighting. Apart from the proposal examined, maybe this lack of foresight and the scope of public debt led Italy to accept an "external constraint"[57] and stricter ties within Maastricht Treaty framework; indeed, nowadays public finance still burdens on Italian economic development[58].

In the early Eighties, many scholars who worked inside Confindustria joined the Ministry of Budget and Economic Planning, and, together with minister Giorgio La Malfa, tried to propose again a supply-side policy based on decentralized market planning in order to modernize our country, similar to what it has been analyzed, but this is another story.

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55 Editorial 1978.

56 Guerci C. M. 1978.

57 For a useful study on these Italian economic issues see Ciocca P. 2007.

58 Salvati M. 2000; see also Rossi S. 2003, where the author labels the second half of the Seventies as a period of "aborted stabilization".

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