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Annex II

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PUBLIC INVESTMENTS
OF
ITALY

July 16, 1957

Department of Operations
Europe, Africa and Australasia

CONVERSION RATES FOR ITALIAN CURRENCY

U.S. \$1	=	Lit. 625
Lit. 1	=	U.S. \$.0016
Lit. 1,000,000,000	=	U.S. \$1,600,000

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ANNEX II

PUBLIC INVESTMENTS

Introduction

1. Public investments in Italy amount annually to roughly Lit. 1,100 billion (\$1.7 billion equivalent) and account for about two-fifths of total gross investment in the economy. Investment appropriations in the budget for the regular ministries, special agencies like the Cassa per il Mezzogiorno and parastatal bodies such as the railroads and highway authority, account for approximately half of total public investment. These are coordinated, if the procedure can be so described, by the usual budgetary processes and influenced by the normal economic, social and political pressures. The investments by regional, provincial and municipal administrations, which amount to just under one-fifth of the total public investment, fall in the same general category. On the other hand, the remaining 30% of the total, the investments in most public enterprises of a commercial nature, such as the far-flung activities of the I.R.I. and E.N.I. companies, are influenced by the profit expectations of managements and the possibilities of raising funds.

Budgetary Investments

2. The following table presents in summary fashion the budgetary investment appropriations for 1954/55, 1955/56 and 1956/57:

(in billions Lit.)

<u>Sector</u>	<u>Fiscal Year</u>		
	<u>1954/55</u>	<u>1955/56</u>	<u>1956/57</u>
Agriculture and land improvement	156	154	164
Transport and communications	138	141	149
Housing	72	68	72
Tourism and hotels	30	29	29
Industry	44	24	28
Public health	26	20	27
Special and emergency works	20	17	23
Vocational training and education	19	18	22
Public buildings	19	19	21
Technical and scientific equipment	19	19	20
River and flood control	18	14	13
Miscellaneous public works	<u>16</u>	<u>14</u>	<u>14</u>
	577	537	582

3. No detailed evaluation of budgetary investments has been made by the Italian authorities and because of the magnitude of the task involved none has been attempted by the Bank Mission. The information available on the physical progress of public works does not lend itself to an analysis of the costs involved and benefits derived, because of the nature of the data and the absence of adequate bench marks. Thus only broad generalizations can be made regarding the soundness of the budgetary investments in the several sectors.

4. Agriculture has been in recent years the largest single claimant for funds with a current allocation of about Lit. 164 billion. This is due to a number of factors: the national land reform program; the emphasis on agriculture in southern development; the need to carry out expensive civil works for drainage and irrigation in order to raise agricultural productivity and output to feed a growing population; and the provision of investment funds to farmers who cannot secure them through normal commercial channels.

5. These investments have on the whole proved worthwhile in terms of the objectives sought of raising productivity to increase output to feed a growing population. The bulk of public investments in agriculture in recent years has been in the south through the Cassa per il Mezzogiorno and these have been carried out effectively with a minimum of errors and waste. Investments in land reform have also been made with care and diligence although the program cannot be judged by purely economic considerations. Funds for the development of livestock, for the mechanization of agriculture, and the improvement of crops also appear on the whole to have been properly directed, if not always adequate or used to best advantage. Reforestation activities have, on the other hand, proceeded somewhat sporadically on a more or less emergency basis and have frequently assumed a work relief rather than a public works character. (A more comprehensive assessment of Italian agriculture is given in Annex I).

6. The transportation and communications sector is the second largest claimant. With an allocation of Lit. 149 billion, railroads and highways account for more than two-thirds of this sector, with port and river improvements, the merchant marine, postal and telegraph services and civil aviation accounting for the rest. The railroad investments are designed to increase the capacity of the existing network to keep pace with anticipated growth in freight and traffic. Recourse to the budget is necessitated as a result of prevailing government policies. The requirements imposed upon the railroads that they provide preferential fares and freight rates to favored categories, that they operate uneconomical lines and that they carry numerous pensioners on their rolls, makes them run at a loss. Aside from this, the railroads are efficiently run and the administration pursues sound financial policies. In the case of highway expenditures, the greatly expanding road transport requirements in Italy have necessitated investments in improving the existing road system. A program is being worked on to create a network of express toll roads with the aid of funds from the budget. Very little of the current investment is as yet going into this network. Since the government partly owns the civil aviation companies and the telegraph services, they rely on the budget for some of their investment funds. The investments in civil aviation and in the merchant marine also appear to have been well directed and have proved helpful to the balance of payments. Construction of highways, port facilities and navigation works has on the whole proceeded satisfactorily.

7. During the past several years, the budget has helped housing construction in various forms, including contributions to subsidize the interest rate on long-term mortgages. This has stimulated a building boom with an annual construction rate of 1.5 to 1.6 million rooms. The housing built with these subsidies has been for the lowest income and the upper middle income groups. Part of the need for the subsidies may have resulted from the continued rent control over old buildings. The rent ceilings on old buildings are automatically raised annually and, if no change is made in the law, within another

four or five years the housing market may again become free. The provision of housing for the lowest income groups is likely to remain a governmental responsibility, however. Also, the government regards housing construction as an investment regulator; to be encouraged whenever total investment otherwise falls short of the needs of the economy. On the whole, the public housing program has been carried out well.

8. Public support of the tourist and hotel industries appears to have been carried out equally successfully and it has had beneficial effects on the economy in general and on the balance of payments in particular.

9. Budgetary provisions for industrial investments have been small, since most public industry is financed outside of the budget. Industrial investment in the current budget amounts to about Lit. 30 billion. This was for contributions of capital for the industrialization of the South, preliminary expenditures on a possible future atomic energy and new steel plants. In addition, several billion were invested in such sick industries as Sicilian sulfur and Sardinian coal. While no detailed appraisal was made, probably the bulk of this last investment is uneconomic and can only be justified on such social grounds as preventing complete shutdowns and unemployment. On the other hand, the funds for the industrialization of the South for a new steel plant and for nuclear power, are expected to be used on a sounder economic and financial basis.

10. The remaining fields of budgetary investments account for approximately one-fifth of the total. They cover a variety of activities, some of which are of an emergency character, and waste of investment funds in them may have taken place. In the fields of vocational training and scientific research, in spite of unnecessary duplication of facilities, many achievements have been registered. As for public health, an effective program has been carried out which suggests that on the whole the investment funds have been relatively well utilized.

11. As the above discussion indicates, budgetary investments cover a wide range of endeavor and are motivated by a variety of social, political, and economic considerations. Although on the whole they seem to have been well devised and efficiently executed, they have not escaped the normal margin of waste inherent in the formulation and execution of government budgets. Some of the economic waste has resulted from the defects in the basic legislation prompted by political or social pressures as in the case of railroads, sick industries, etc. Additional waste has frequently been caused by the emergency or ad hoc character of the public works carried out. On the other hand, the allocation of funds among the several sectors appears to have maintained a reasonably happy balance on the whole, with the result that the several sectors of the economy have continued their parallel progress without any serious interruptions because of bottlenecks in the public sector. With the recently established Vanoni Plan Secretariat it is reasonable to expect that budgetary investments may henceforth be even more closely scrutinized and better coordinated with the view of further reducing waste of scarce capital funds.

Regions, Provinces and Municipalities

12. The public investments of regions, provinces, and municipalities amount to approximately Lit. 200 billion annually. Relatively little is known about the character of these investments, not to mention the soundness and efficiency with which they are formulated and executed. Unlike the investments of the central government which are coordinated by the usual budgetary processes, the public investments of regions, provinces and municipalities are largely carried out in an autonomous manner. The only central controls exercised over these investments are indirect and of a quantitative nature. Because of the magnitude of these investments, they have attracted recently the attention of Italian monetary authorities and an attempt has been made to regulate their volume by means of credit controls. Thus, while no basis exists for evaluating the economic soundness of the investments carried out by the regions, provinces and municipalities, the fact that they are subjected to quantitative limitations would appear to impose upon them some degree of selectivity and priority determination.

State Enterprises

13. The Italian Government owns a large share of the industrial capacity of the country which employs about 10% of the industrial labor force. Most of the government-owned firms are grouped under the holding company known as Istituto per il Recostruzione Industriale (I.R.I.). These are responsible for the generation of 26% of the country's electric power, for the operation of 60% of the national telephone equipment and for the entire radio and television network. In addition, I.R.I. plants average slightly over 50% of the iron and steel output and 12% of the value output of the engineering industries. I.R.I. is especially important in shipbuilding, where it owns 70% of all ship yards and in shipping with 67% of the national tonnage of mixed passenger and cargo vessels and 8% of cargo vessels. The investments made by all these companies, broken down by the several sectors are presented below:

(in billions of lire)

<u>Sectors</u>	<u>1954</u>	<u>1955</u>
Electric power	51.6	45.0
Telephones	30.0	42.0
Iron and steel	17.0	14.8
Shipbuilding industry	4.0	7.2
Other engineering industry	8.0	8.4
Radio-television	3.7	4.8
Miscellaneous	6.0	5.0
Total	120.3	127.2

14. The investments of the I.R.I. companies are by and large devised and carried out by the managements of the individual companies. These enjoy a high degree of autonomy and their investment activity is influenced by the profit expectations of managements, and the possibilities of raising funds. The influence of I.R.I. and the government seems to concern itself largely

with matters of social policy relating to employment rather than with investment activity. Judging by the results achieved, in the past few years both in the domestic and foreign markets, the investments have on the whole been well formulated and economically executed. There are still a number of I.R.I. companies, in the engineering sector, which were former armament producers, that are losing money and require subsidies, but their number is diminishing and with improvement in the over-all employment situation, it may soon become possible for the government to take the necessary action to eliminate the recurring losses.

15. The major state enterprise outside of the I.R.I. complex, is the state natural gas monopoly, commonly known as E.N.I. E.N.I. already produces and distributes 95% of the Italian natural gas output and is deeply involved in petroleum explorations. It owns alone or jointly with private companies, such as Standard Oil of New Jersey, and British Petroleum, over one-fourth of the refining capacity of Italy, and itself provides about one-fifth of the Italian consumption of P.O.L. products. It has recently branched out into the petrochemical field, including synthetic rubber. E.N.I. in recent years has built one of the biggest natural gas pipeline networks in the world. How much E.N.I. has actually invested is kept secret and although asked for by the Bank Mission, the data was not provided. Since E.N.I. finances itself through its current earnings, depreciation allowances and bank loans, and does not directly depend on the government, there is no way of indirectly estimating the magnitude of its investments. E.N.I. has made considerable profits from natural gas; its refining and distributing operations also appear to have been profitable. It has undoubtedly disbursed a good deal of these earnings in its oil exploration activities which have thus far proved disappointing. Because of the secrecy surrounding its financial operations, it is impossible to evaluate more positively E.N.I.'s total investment activity.

Public Investment Projections

16. The magnitude of public investments in any period is determined by a number of such variable factors as the level of savings in the economy, inflow of external capital, the state of government revenues, and the general level of economic activity. Within these limitations, however, it is possible to postulate a public investment program in terms of its likely magnitudes and composition. In line with these possibilities the Italian authorities have formulated a tentative public investment program. According to these estimates, public investment over the next three years, 1957-60 will remain at around the same level as now, Lit. 1,100 billion a year.

17. Global budgetary investments are likely to be at least maintained at their current rates and possibly somewhat increased, as the following table indicates:

(in billions of Lit.)

<u>Sector</u>	<u>1957/58</u>	<u>1958/59</u>	<u>1959/60</u>	<u>1960/61</u>
Agriculture and land improvement	176	180	162	158
Transport and communications	125	121	120	115
Housing	88	80	73	71
Industry	34	41	63	82
Tourism and hotels	30	32	38	38
Vocational training and education	23	26	30	30
Public health	28	31	29	30
Technical and scientific equipment	21	21	21	21
Public buildings	18	18	17	17
River and flood control	14	14	14	15
Special and emergency works	14	10	10	10
Miscellaneous public works	<u>16</u>	<u>16</u>	<u>16</u>	<u>16</u>
	537	590	593	603

18. According to the above, it appears that agriculture is to continue as the largest single investment sector in the budget. This is justifiable on the grounds previously discussed in Paragraph 4. Within the above totals substantial increases are envisaged in land reform investments which while they contribute to the increase in agricultural output, are largely justified on social grounds.

19. The transport and communications sector investments continue to hold their second place in the capital budget, although at a somewhat lower level than during the past three years. This is largely due to a reduction in railroad investments from an average annual figure of Lit. 60 billion to roughly Lit. 30 billion annually during the next four years. The program seems to be well conceived and is likely to be efficiently executed. The chief drawbacks are likely to be the policies imposed by the government upon the railroads rather than anything inherent within their own administration.

20. Investments in the highway network are expected to increase somewhat because of the new law for the construction of express highways costing about Lit. 350 billion. The law has appropriated Lit. 100 billion for the highway construction program, with the remainder of the funds to be raised in the market. The budgetary funds are to be in the form of subsidies ranging from 24 to 34% of the total cost depending on traffic volume. The authorities which will construct and operate the superhighways are expected to fully amortize them from income from tolls, advertising, etc. in 30 years, at which time the roads will revert to the state. The program as a whole seems to be well conceived and long over-due, although some parts of it are easier to justify than others in terms of existing and foreseeable traffic requirements. The efficiency with which the program is executed will largely depend on the groups that receive the franchises and on the extent to which they are able to overcome political pressures of various localities to modify the most direct character of the roads. The Minister of Public Works believes that such pressures will be resisted and the program will not be undermined. The only other major criticism voiced concerning the highway law is that it favors public bodies over private initiatives in the award of franchises.

21. The remainder of the investments in the transport and communications sector are projected in approximately the same magnitudes as in recent years. In the field of navigation and merchant marine, some small increases are planned in investments in port works which, however, are more than offset by declining investments in ships. In the case of civil aviation, investments in air fields are optimistically expected to decline, while investments in the air fleet are to be maintained at their recent levels. Lastly, post office and telegraph investments are projected at their current rates.

22. Construction of residential housing with budgetary help is projected at somewhat declining rates. This is probably quite realistic because of the likely falling off in demand at prices at which construction can effectively be carried out even with government subsidies.

23. Budgetary investments in industry are on the other hand scheduled for very substantial increases over the next several years. This is due to a number of reasons, chief among which is the planned government intervention in the atomic energy field and the pressure on the government to intensify the industrialization of the South by loans to private industrial interests as well as the expansion and establishment of publicly-owned industrial plants. On the other hand, no further subsidies to the sick mining industries are envisaged and in the case of the mechanical industries while subsidies are to be continued at their current levels, they are expected to stand on their feet as soon as conditions permit.

24. The tourist industry is to be favored by increased budgetary investments; this is justified by the importance of tourism to the balance of payments.

25. Similarly, budgetary allocations for vocational training and education as well as for technical and scientific equipment are expected to rise gradually. These investments are justified in view of the shortages of technical and scientific personnel and the great importance of raising the levels of skills in agriculture and industry. The programming of gradual increases is wise because a more rapid crash program would run into a serious bottleneck of instructional personnel.

26. A slight increase in public health investments is also programmed and is justified on the grounds of the need to raise the standards of sanitation, especially in the South. Investments in river and flood control works are to remain at their current levels. On the other hand, special and emergency works are expected to decline because of the more permanent investments already carried out to control natural hazards. Some decline in investments in public buildings is also anticipated and this may be regarded as a favorable development. However, these savings will be taken up by somewhat higher commitments in the category of miscellaneous public works.

27. Thus on balance the investment program in the budget for the next four years is largely a continuation of the investments carried out during the past several years with the outstanding exception of investments in atomic power and intensification of investments in the South, particularly in the steel industry. The fields of agriculture, including land reclamation and particularly irrigation, as well as transport, both railroads and highways, represent areas in which the assistance of external capital might prove useful.

28. No projections are available of the regions, provinces and municipalities. Their investments are likely, however, to continue at approximately current rates or somewhat lower if the monetary authorities consider it desirable to further squeeze the credit available to them.

29. The investment program of the state enterprises in the I.R.I. group for the period 1957-1960 is contained in the following table:

(in billions of Lit.)

	<u>1957-60</u>	<u>Average Annual</u>
Electricity	325	81
Iron and steel industry	163	41
Telephone	120	30
Milan to Naples superhighway	112	28
Mechanical industry	70	18
Civil aviation	53	13
Shipbuilding industry	34	8
Radio and television	19	5
Miscellaneous	<u>16</u>	<u>4</u>
	912	228

According to I.R.I. this program represents the maintenance of the proportional role that I.R.I. plays in the Italian economy. Thus in the case of electricity which represents the largest investment, I.R.I. investments are expected to increase its output by about 7% annually; i.e. at approximately the projected rate of growth in national demand. The same is true in the iron and steel industry where I.R.I. expects to maintain its share at about 50% of the national output by constructing new capacity based on imported iron ore especially in the South. The same is intended in the case of telephone service, the demand for which grows by 8 to 9% annually.

30. In order to achieve these goals, however, I.R.I.'s industrial investments are indicated at an average annual rate of Lit. 200 billion as against only Lit. 127 in 1955. There is reason to believe that I.R.I.'s share in some of the sectors at least would increase, depending of course on what was being done in the interim by the private interests. Approximately Lit. 190 billion of the above Lit. 800 billion I.R.I. expects to finance by ploughing back its own resources. I.R.I. will also require Lit. 112 billion from the market for the Milan to Naples superhighway which it has undertaken to handle, in addition to the Lit. 63 billion contribution from the budget for this venture.

31. E.N.I., which it will be recalled, furnished no data covering its past investment, proposes to invest Lit. 200 billion during 1957-60, 80% of which will be covered by its own resources. (This provides some indication of its past investments). This program includes large sums for gas and petroleum exploration, extension of the natural gas pipeline network, an increase in refining capacity and completion of the petrochemical factory for the production of fertilizer and synthetic rubber in Ravenna. In addition to this

program and subject only to availability of funds, E.N.I. also proposes to enter the atomic energy field and to build another petrochemical factory. Although the management of E.N.I. is aggressive and may be expected to press its needs to carry out its investment program as well as to enter the field of nuclear energy, it is unlikely that E.N.I. will get much financing outside of its own resources.

Conclusions

32. Making allowance for human errors as well as for political and social pressures, the public investment seems on the whole to have been adequately formulated and executed. Waste in the public sector does not appear to have been abnormal or more than customary in most countries. Investment in agriculture, transport, electricity and other utilities, housing, tourism, and vocational training has contributed to the strengthening of the economy.

33. The projected investment continues in broad outlines the activities of the past. As previously mentioned, the projected program is highly tentative and its execution will depend on a number of factors, not the least of which is the state of public finances and the inflow of external capital. It is reasonable to expect that some adjustments will take place in the program and that with the recent creation of a Ministry of State Participations, the industrial investments may be better coordinated, although there is the danger of greater political interference in the affairs of state-owned industry.