

## Paolo Tedeschi - European Notes

### **The birth of the ECSC and ECM: effects on European economic and social development**

The European Coal and Steel Community (ECSC) was born in 1951 and including Benelux, Italy, France and West Germany. It created a common market for coal, steel, coke, iron ore and scraps: so it granted to the iron and steel enterprises of these countries a great protect market in which they could buy raw materials and semi-processed products and after sell their finished products. The ECSC abolished tariffs between the six members and so it increased the competition in the coal and iron and steel market: so the best enterprises (that is those which were able to produce goods at the best quality/price ratio) could have a greatest market and they could increase their manufacturing plants and take profit from the consequent economies of scale. So the result of the first institution European integration was an improvement of conditions of life of European people: when the prices decrease people can consume more goods and services, that is their real income increase; when the quality of goods increase people can join better goods and normally pay the same “old” price or a price which is less than the effective improvement of the quality.

The ECSC was also important because:

a) Its good results (that is the great improvement of production, productivity and sales of the iron and steel European enterprises during the first years of its “functioning”) favoured the following steps of the European integration and enlarged the number of product in the common market (in the Sixties only the agricultural products were not concerned by the principles of the ECSC).

b) It granted a gradual integration for the countries having less competitive enterprises: it was very important to avoid that the cost of integration of European markets overcame the advantage because this could obviously stop the process of integration (in fact businessmen told “Yes to Europe but not at any cost”). This explain why some markets remained temporarily protected and so enterprises had more time to renew their plants and become more competitive (for example they could specialize their production and so their sales depended on the quality and not on the price which was related to the distance from the coalmines). So Italian iron and steel enterprises and Belgian coal mines benefited of 5 years in which their markets was partially protected (that is there were tariffs on import which were progressively reduced).

c) It created an independent institution, the High Authority of the ESCS, which controlled the respect of the rules in the new European market and it could punish the unfair enterprises: this means that the countries renounced to a part of their sovereignty in favour of the European institutions. Please note that the ECSC progressively included all iron and steel products: in fact when they were very specialized the ECSC did not regulate their market. The ECSC had to control the unfair strategies concerning the not specialized products, that is the products whose sales particularly depended on the price.

Please note that the ECSC and the European Common Market (ECM) which was born in 1957 and enlarged the principles of the ECSC to other productive sectors and progressively eliminated tariffs (they were all abolished in 1968) increased the trades in Europe. From 1955 to 1969 the trades between the six increased of an average annual rate of 13% and in the same time increased from a quarter to a third of all trades made in Europe (that is including all the extra-ECM countries). In the European economic history the period 1948-1973 is called “golden age” (and in some countries people use the word “economic boom”) because the increasing of infrastructures, income and consume registered the best ratio.

Please note that, thanks to the ERP aid which had granted new technologies and the renewal of productive systems, the countries whose economic growth was more important were the West Germany and Italy: “they lost the war, but they won the peace”

### **Factors favouring the European economic development during the “golden age” (1950-73)**

a) The birth and the development of European Economic Institutions as the ECSC and the ECM and the CAP: they progressively eliminated tariffs and increased trades between European Countries. In the new wide European market it was possible to sell more goods and so factories could increase

their investments and consequently they grew up their dimensions and the productivity and reduced their unit costs;

b) The progressive liberalization of the international trade increased the level of competition and the specialization: so factories produced better goods and relation quality/prices increased; this allowed more people to purchase goods and so the sales increased and in the same time the quality of life;

c) The presence of unemployed workers who, during the '50s and the first part of the '60s accepted low wages (that is less than the value of goods they produced) and so allowed the factories to have great profits to re-invest in new equipments and machinery which reduced the cost of their products;

d) The "advantage of late comers": thanks to the ERP they received new technologies from USA paying a low cost and so they could become competitive in the brief term. This was possible because they disposed of a high level of scientific education and they also had capital for investment in new equipments, fixed and movable machinery, and technologies;

e) The low increasing of the price of the most important raw materials (particularly the coal and the petroleum); the factories could increase their demand for the raw materials (and so their production) without paying a highest price.

f) The existence of "Gold exchange standard" and the European Payment Union which maintained a low fluctuations of exchange rates and also a low level of speculation linked to currencies because investors had a great trust in the development of European economy: this favoured the international investments and particularly the development of trades making by the great enterprises having factories in several countries, that is the multinational companies;

g) The European governments decided to use internal policies favouring the factories, that is they increased investments for the development of new infrastructures and maintained a low taxation on the profits of enterprises and a low level of interest rates for financing; the European Bank of Investment particularly financed the development of the poorest regions of the European countries as the Mezzogiorno in Italy.

### **The crises of the 1970s**

a) the "oil shock" in 1973: the prices increased four times in only a year and the inflation grew up because of the very high cost of raw materials, that is the crude oil and its derivatives; a new shock oil arrived in 1979 and increased economic problems;

b) the end of the "gold exchange standard" in 1971 and the consequent increasing of the fluctuations of exchange rates: this increased the risk linked to strong variations of the exchange rates and obviously complicated and got more expensive the international trade;

c) the crisis particularly concerned the steel and the mechanic and the chemical sectors that is the industrial fields which had supported the reconstruction and the development of the '50s and '60s. The unemployment increased and the consume decreased: governments had to solve the problem of stagflation that is the increasing of inflation contemporary to the decreasing of production;

d) in some countries the governments were not able to maintain stability and so lost the international investors' trust: this increased the interest rate that these countries and their enterprises had to pay for borrowing money.

### **The problems concerning the European Monetary Union**

After the elimination of all tariff in the EEC it was necessary to control the fluctuations of the currencies: only if they maintained their value it was possible to guarantee a real competition in the EEC that is to guarantee the free exportation of goods and services among the European countries. In fact if a currency devaluated it created a "financial" tariff.

Pierre Werner proposed in 1970 the creation of the EMU, but his project was not accepted by the European governments because there were two ideas concerning the way of integration. Three countries (D, NL, I) wanted to give the priority to the "harmonization" of the national economic policy (so the same inflation or the same method to use the public debt); the three other countries (F, B, L) preferred on the contrary to use the monetary policy (so the same interest rate on market money). So, to avoid that France or West Germany stopped the process of the monetary union, Werner decided to

prepare a not detailed plan: besides that it proposed a gradual plan which allowed to have more time to find an agreement and, in the same time, to verify "step by step" the effects on the European economy. Please note that Werner did not foresee the create of the European Central bank because he thought that all countries were not disposed to renounce their monetary policy.

The realization of the Werner's plan became more difficult in 1971, when US President Nixon decided that US Dollar was not convertible in gold, that is he decided the end of the Gold Exchange Standard. After the oil shock the European Governments choose a "partial solution" that is the creation of the European Monetary System (EMS).

In 1979 the European Currency Unit (ECU) was created: it was a virtual currency whose value depended on the value of the European currencies which composed it. All the European values were represented in the basket composing the ECU and their share depended on the dimension of the country and the development of its economy: so the DM (West Germany) had the greatest share and the currencies of small countries (as the Luxembourg) or of countries having more economic problems (as the Italy) had a reduced share.

The ECU allowed to control the fluctuations of currencies, that is to avoid that a country created a tariff related to the devaluation of its currency.

The creation of the Monetary Union was a gradual process because it needed the coordination of economic and fiscal and monetary and credit policies and also the possibility for the capitals to be free transferred from a European country to another one.

In 1992 the Treaty of Maastricht established the birth of both the European Central Bank (based in Frankfurt where there was the BundesBank) and the Euro, a real currency adopted by countries which were able to respect the Stability and Growth Pact for the European Monetary Union, that is the following "criteria of Maastricht": a) The annual budget deficit had to be no higher than 3% GDP (Gross Domestic Product that is the amount of goods and services produced in a year in a country); b) The national debt had to be lower than 60% of GDP; c) The inflation had to be within 1,5 points of the average inflation of the three best countries; d) The average long-term interest rates within 2 points of the average long-term interest rates of the three best countries.

In 1999 the Euro was born, but it remained a virtual currency until 2002: during three years all currencies were convertible at fixed exchange rate and this did not allow speculations.

### **Notes on the enlargement of the European Union**

The entry in 2004 in the EU of the Eastern European countries (which had been in the "soviet area of influence" until 1991) created some problems concerning the new organizations of European institution (for example to establish the number of members in the European Parliament for every country or for the regulation of the aid granted by the Common Agrarian Policy to the rural families) and particularly for the European market of labour.

Workers from Eastern Europe accepted lower wages and this reduce the real average wages in the Western Europe: besides that enterprises transferred their low and medium quality manufacturing plants in the East where the labour factor was less expensive and this increased in Western Europe the jobless (particularly among the low specialized workers). Finally many problems were related to the "Bolkenstein law" which established that people could work and/or create enterprises everywhere in Europe: in the case people made services they were subject to the labour laws of their country. This evidently created an unfair competition when services were made by people coming from the Eastern Europe where the limited contractual power of the trade unions favoured the enterprises and reduced wages and in the same time allowed the promulgation of laws giving less attention to the rights of the workers.

The existence of economies having a different resistance to the crisis did not allow to enlarge the adoption of the Euro to all countries included in the EU: Slovakia, Slovenia, Malta and Cyprus were the only countries which were able to entry in the EMU. Some other countries (the Denmark and the Baltic countries) maintained their currencies but they had fixed exchange rate with the Euro: for all the remaining countries the adoption of the Euro is not a brief term perspective.

## **From the European Payment Union to the Euro: the Development of the European Monetary Policy. Why is it so important to use a common currency for the economic development?**

Because the trade between the states with different currencies is difficult and more expensive: people and enterprise have to pay to secure their investments and trades in foreigner currencies.

In fact if one government decides to devalue or revalue its currency, there are strong and negative repercussions on the money market and on the international markets of commodities and services.

When a currency is devaluated a value tariff is created: this means that foreigner goods become more expensive than before even if their price (expressed in the currency of the exporting country) remains the same.

People travelling abroad have to exchange their funds and pay some additional fees. There is always a risk to the investors and enterprises making international trades, because the expected profit can turn into loss if the exchange rate differs significantly. To avoid any risks they have to pay an “insurance”, that is they have to buy a swap.

Foreign investors prefer to invest in a great market using a common currency, reducing the risks for their investments when transferring their funds from one member state to another. The market becomes bigger and the regional price misbalances are corrected easier when the consumers have common currency to measure the different goods and services. Besides that when people from many different countries have one common currency they build easier one common identity.

### **Before the Euro: The gold exchange standard**

It was born in 1944 in Bretton-Woods (New Hampshire – USA). It was a variation of the Gold Standard in which central bank reserves are held in gold Bullion and in reserve currencies that are convertible into gold. The new monetary system was a mixed system consisting of a cross between a reserve currency standard and a gold standard. The U.S. Dollar was convertible into gold at \$35 an ounce, and foreign exchange rates were fixed, or pegged, to the dollar (they could vary  $\pm 1\%$ ). When in 1971 the US abolished the convertibility of the U.S. Dollar into gold, all currencies could not change in gold and their exchange rates could fluctuate under the control of the national central banks which bought the too much devaluated currencies and sold the too much revaluated ones. The system worked exactly like a reserve currency system from the perspective of the non-reserve countries: however, if the non-reserve countries accumulated too much reserve currency they could demand exchange for gold from the reserve country central bank and this means that gold reserves flowed away from the reserve currency country.

The **European Payments Union** (EPU) was an organization in existence from July 1950, until December 1958, when it was replaced by the European Monetary Agreement. The problem was the great decreasing of the European Countries' GDP and trade was based on US dollar reserves (the only acceptable reserve currency), which Europe lacked. The bilateral payment agreements were signed between European countries with the aim of reviving international trade. But these initial agreements were founded on exchange-rate controls, which meant that authorized payments had to be made in accordance with fixed rates that matched the official value of the currencies. In addition, trade and payments had to be balanced within the credit limits set by these agreements. So the transfer of money immediately after each transaction increased the opportunity cost of trading and governments did not appreciate purchases on the international market because they reduced reserve currency. Some trade was reduced to barter and this was not acceptable during the Marshall Plan whose aim was the development of the European Economy and the trade between countries. That led to the decision in July 1950 by the Organization for European Economic Cooperation (OEEC) to replace these bilateral payment agreements by a multilateral system which could revitalize the European economy. So the OEEC created a system which accounted for trades but did not transfer money until the end of the month. This changed the landscape, from bilateral trades of necessity (trading with partners because of outstanding debts) to multilateral trades. The EPU also forced the European market liberalization (asked by U.S. government) and eliminated discriminatory trade measures (particularly the quantitative limits concerning the imported goods) and reduced protective tariffs. The EPU facilitated the

convertibility of European currencies by setting exchange rates which reflected the reality of each country's economic situation. It acted as an international clearing house, helping to compensate and balance the accounts of each European country with its neighbours. Every month, the EPU calculated a credit or debit net balance for each country in relation to the rest of the countries in the Union. A quota was set for each Member that represented the maximum that its account balance could attain. Adjustments, partially calculated in gold, were made depending on the monthly credit or debit balance of the country in question. The EPU helped to secure complete stability of exchange rates and to promote free trade amongst the Member States. Thanks to the EPU trade levels more than doubling. By its close in 1958, convertibility of currency was a possibility no longer needing government permissions, in European countries. Please note that in 1958 gold exchange standard started up definitively, so in the European Common Market, even if there were six different currencies, the trades were facilitated.

For the ECM it was important that exchange rates did not change, because this ensured the real common market without tariffs and protection. As the European countries noted that the gold exchange standard did not continue for a long term at the European Summit in The Hague in 1969, the Heads of State and Government of the European Community agreed to prepare a plan for economic and monetary union. The Werner Report was drawn up by a working group chaired by Pierre Werner, Luxembourg's Prime Minister and Minister for Finances, and presented in October 1970. The three stage plan proposed gradual, institutional reform leading to the irrevocable fixing of exchange rates and the adoption of a single currency within a decade, though it did not re-recommend the establishment of a central bank. The plan was never implemented but the end of the Gold exchange standard (1971) and the "oil shock" (1973) modified the international market of money. No currencies were convertible in gold and, after the failure of the "snake in the tunnel" (a monetary system in which all European currencies were linked to the US dollar and could not float more than  $\pm 1,25\%$ ) in 1973 the "snake in the lake" was born: this means that European currencies were not linked to the US dollar, but there were some limits to their floating concerning the other European currencies ( $\pm 2,25\%$ ).

In any case the inflation changed the value of currencies and created tariffs on the ECM.

So in 1979 the **European Monetary System (EMS)** and the **European Currency Unit (ECU)** were created. It was an artificial "basket" currency used by the member states of the ECM as their internal accounting unit. The EMS was a limited-flexible exchange rate system that defined bands in which the bilateral exchange rates of the member countries could fluctuate. The bands of fluctuation were characterized by a set of adjustable bilateral *central parities* and margins that defined the bandwidth of permissible fluctuations. This set of parities was called a *parity grid* as it defined parities for all combinations of the ECU constituent currencies. The borders of the fluctuation bands were described by the *upper intervention point* and *lower intervention point*. Typically, the bandwidths were  $\pm 2.25\%$ , with a wider margin for the Italian Lira ( $\pm 6\%$ ) (the same arrived some years later for Spain, Portugal which gave their adhesion to the EMS in 1986 and UK which participated to the EMS for a short period). When a market exchange rate reached either of these intervention points, the central banks were compelled to support these rates indefinitely through open market operations (buying of weakened currency or selling of a strengthened currency). The composition values of the ECU were fixed, while the weights fluctuated following the changes in the bilateral exchange rates

**The Maastricht criteria** - In Maastricht European Countries decided to create the European Economic Union and established five criteria that must be met by European countries if they wish to adopt the European Union's common currency, the euro. They were:

1) The inflation of no more than 1.5 percentage points above the average rate of the three EU member states with the lowest inflation over the previous year (that is the best performing ones).

2) A national budget deficit at or below 3 percent of gross domestic product (GDP) of a precedent year. If not, it is at least required to reach a level close to 3%. Only exceptional and temporary excesses would be granted for exceptional cases

3) National public debt not exceeding 60 percent of gross domestic product of the precedent year. A country with a higher level of debt can still adopt the euro provided its debt level is falling steadily. This

means that if the target cannot be achieved due to the specific conditions, the ratio must have sufficiently diminished and must be approaching the reference value at a satisfactory pace

4) Long-term interest rates should be no more than two percentage points above the rate in the three EU countries with the lowest inflation over the previous year.

5) (LESS IMPORTANT) Applicant countries should have joined the exchange-rate mechanism (ERM II) under the European Monetary System (EMS) for two consecutive years and should not have devalued its currency during the period.

The aim of these criteria is to maintain the price stability within the Eurozone even with the inclusion of new member states. Please note that the criteria concerning the GDP depend on the amount of GDP: in a favorable conjuncture it is possible to increase the deficit and the debt, but in a negative conjuncture a country could not respect the criteria even if it does not increase its deficit or debt. This also means that after the birth of the euro the European monetary policy depend on the choices of the European Central Bank and the country could not interfere. As the ECB followed a not expansive monetary policy to avoid the inflation the less strong countries met some difficulties: they had a strong currency which increased its value (the Euro profited of the crisis of the US dollar and become a new DM), but their economy could not support an high evaluation of the Euro. After that, as the ECB did not change its policy during the recent negative economic conjuncture, the gap between the best and the less strong European countries increased.

Please note the national governments in Europe were able to proceed with their own financial policy without regard to the neighbours' wishes and problems. If the economic cycles are not identical for every major market, it's better to have many currencies: this was the choice of the UK and Denmark. Please note that the criteria are not a dogma, it is possible to have an economic development following other figures: the EMU followed the German monetary policy. On the other hand, when two or more markets decide to proceed with identical financial policy, it's always better to have a common currency in order to facilitate the trade.

## **The European Investment Bank and the economic and social development of Italy from 1958 to the beginning of the 1970s**

Between the end of the 1950s and the beginning of the 1970s the European Investment Bank is considered to have played a major part in the process of Italy's economic development, particularly of the Mezzogiorno. The funding accorded to Italy was closely linked to the development policies that the Italian government authorities prepared on the basis of domestic factors while also consulting with the EIB, given the latter's role as a lender. Given the size of the funds allocated to the Italian projects, a check ought to be made on whether the objectives set were achieved and an assessment then carried out of the bank's role in the development of the Mezzogiorno which, it should be noted, included the islands of Sicily and Sardinia.

### **1. The factors governing Italy's privileged position where EIB loans were concerned**

The years between the founding of the EIB and the beginning of the 1970s were important in the history of both the EIB and the Italian economy.

Firstly, we have seen how the founding of a European bank responsible for financing projects to develop less advantaged regions owed a lot to Italy's urging that such a bank be set up. Once it had been successfully created, the bank was immediately placed among the institutions managing Italy's most important economic plants of the 1950s and 1960s. A system was put in place in which the intermediaries for all the funding allocated by the EIB to Italy were the Cassa per il Mezzogiorno and institutions specialising in long-term finance such as the Istituto per lo sviluppo economico dell'Italia meridionale (Isveimer), the Istituto Regionale per il Finanziamento delle Industrie in Sicilia (IRFIS) and the Credito Industriale Sardo (CIS), as well as, to a lesser degree, the Istituto Mobiliare Italiano (IMI), the Consorzio di Credito per le Opere Pubbliche (Crediop) and the Istituto di Credito per le Imprese di Pubblica Utilità (ICIPU), that is to say the largest Italian public financial institutions<sup>1</sup>.

Secondly, from 1958 to 1970 the presidents of the EIB were Pietro Campilli (from February 1958 to May 1959), then Paride Formentini (up to September 1970), both of them Italians. They supported the idea that Europe could only exist if each of its regions enjoyed economic growth and the same time they emphasised that this new institutions was not a fund but a proper bank that could 'only grants its loans or its guarantee to economically profitable projects'<sup>2</sup>, while at the same time being an instrument of European policy and, to that extent, having to make sure it coordinated its actions with the economic policies of the member States of the common market<sup>3</sup>.

Finally, not only were more than half of the loans granted by the EIB directed towards financing Italian projects during the period concerned, but it was these same loans, as well as the results obtained, that for a long time were a model for the bank's operational strategies and financial structures.

It was therefore under 'Italian management' and having been made aware of the socio-economic realities of the Mezzogiorno that the EIB learned to fulfil the double role divided for it : that of a large financial institution and that of a Community institution dedicated to regional development. Moreover, it was in its early days that it achieved the difficult balance recommended by Campilli, who emphasised at the first working meeting of the board of directors that 'in financing investment projects in which it was set up to participate, the bank does not intend to replace either the banks of the Member States of the international banking institutions, which are entrusted with the same task. It is by cooperating very

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<sup>1</sup> The Cassa per il Mezzogiorno played the role of intermediary in all the EIB's operations in the south of Italy and gave the EIB its own public institution guarantee (supplementing that of the Italian State). The purpose of Isveimer was to promote the economic and industrial development of southern Italy (excluding the Islands) , while the IRFIS financed that of Sicily and the CIS that of Sardinia. Crediop and ICIPU both aimed to finance public works by means of long-term loans. Finally, IMI was the main Italian financial institution devoted to providing long-term loans and it had already played a fundamental role in making use of counterpart funds linked to the Marshall Plan.

<sup>2</sup> *The European Investment Bank. Lecture given by Mr Paride Formentini, president of the EIB, to the Belgian Institute of Public Finance, Brussels, 26 November 1959, Brussels, 1959.*

<sup>3</sup> For president Formentini's ideas on this subject, see also 'Le développement régionale et la Banque européenne d'investissement'. Speech by Paride Formentini, president of the EIB at the conference on regional economies', Brussels, 6 December 1961, "Revue du marché commun", 1961, n°41, pp. 402-409.

closely with both sets of institutions that it wishes, by becoming a new and supplementary bank, to make its contribution to the work of European integration<sup>4</sup>. Finally, it has to pointed out that the choice of Formentini as president after Mr Campilli's brief stint was due to his experience with institution such as the Bank of Italy, the IMI and a number of companies linked to the Istituto per la Ricostruzione Industriale (IRI) – the institution controlling public sector industry. Because of the previous job, he was used to running State-controlled financial and industrial companies while at the same time having to conclude profitable loans in order to improve production and productivity and to increase employment – responsibilities that made him the most suitable candidate to manage an institution given the task of reducing the differences between European regions in terms of development.

## 2. EIB financing in Italy

The resources allocated by the EIB to Italy until the beginning of the 1970s represented a very large part of those made available to projects of Community benefit. Most of the finds were allocated to the Mezzogiorno. However, some infrastructures was financed in the other Italian regions (whose level of the transalpine regions) in order to link the Mezzogiorno to the markets in the other countries of the Community<sup>5</sup>.

From 1959 to 1972 more than 60% of EIB lending 'to the Member State' was granted 'in favour of directly productive initiatives and general infrastructure' implemented in Italy and, in particular, in the Mezzogiorno<sup>6</sup>: thus , 43% went to infrastructures projects, mainly in order to improve communications (29%), the remainder was intended, in order of importance, for energy production and distribution (57 million u.a., or 6%), agricultural or irrigation investment in the plains of Metaponto and Ogliastro (24 million u.a. each, or 5%, in the Basilicate and Sardinia), the installation of systems distribution water from the Agri River to Pertusillo in Basilicate (2%) and tourist infrastructure in Calabria (1%).

Although, the objectives of the above projects (of which the amount was 82 million u.a.) were confined to improving standards of living in specific localities and sectors (agriculture and tourism), renovation of the transport network was the essential pre-condition for developing the whole of the Mezzogiorno – a region that is very mountainous (it includes the Apennines) and is characterised by irregular demographic distribution (with a heavy concentration of population in Campania, while in Basilicate and Sardinia are sparsely populated). This need to strengthen links between the markets of the Mezzogiorno and between the latter markets and those of the north Italy and the transalpine markets led the EIB to allocate several loans (amounting to 178 million u.a.) to the construction of 475 kilometres of motorway. These included the 'Adriatic' motorway, running from the north of Italy to Puglia, the motorway crossing the Apennines to link the Tyrrhenian and Adriatic coasts and two roads linking Messina to Patti and Catania. The renovation of the Tyrrhenian railway line linking Battipaglia (in Campania) to Villa San Giovanni close to Reggio di Calabria (port of departure for the boats crossing the Messina Straits to Sicily) was a response to these same objectives. A second track was laid and a large part of it was electrified. This infrastructure made it possible significantly to reduce the time required for transporting people and goods while increasing the competitiveness of the production plant established in the Mezzogiorno and, in particular, of the new industrial centres of Campania,

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<sup>4</sup> EIB Archives, box CL, 26/2/58-21/5/58, n°1, 160-183, 233, 420-422.

<sup>5</sup> The sources for all data provided in the following paragraphs consist of the minutes of meetings of the board of directors, board of governors and the management committee, which met in period 1958-1972, and also come from documents (memorandums and confidential reports) prepared by these bodies or submitted for their attention by those responsible for carrying out analyses. In this connection, see EIB Archives, minutes of the board of directors (from n°1 of 6 February 1958 to n° 97 of 12 December 1972) , minutes of the management committee (from n°1 of February 1958 to n°96 of 14 December 1972) ; minutes of the board of governors (from n°1 of 25 February 1958 to n°32 of 26 June 1972).

<sup>6</sup> The financing granted to Italy within the frame work of the EIB's activities in Europe in the period 1958-1972 may be seen by referring to appendix XXX, and this analysis may be placed in the more general context of these years preceding the first enlargement by reading XXX. The sources of the figures in the tables are indicated in footnote XXX. There may be some differences from informations give in the text, which covers the period from 1958 to 1972 whereas the tables only show the situation until 1970 or 1971.

Puglia and Eastern Sicily. It also guaranteed employment to many workers who, lacking professional qualifications, could not find work outside the construction sector.

Still at the infrastructure level, the EIB also funded the SIP<sup>7</sup> (telephone company) programme with a view to extending and modernising the telecommunications network in order to promote the establishment of new industrial companies and services : the 106,4 million u.a. granted by the EIB represented almost 29% of the anticipated total investment. In order to optimise the investments made in the Mezzogiorno the EIB also participated in increasing the energy available for industrial plant : it lent 57 million u.a. for the establishment of new electricity power station, representing 30% of the amount needed for the construction of five power stations (at Mercure, Taloro, Gallo, Brindisi and Salerno) having a capacity of 985 megawatts and capable of covering more than 10% of the Mezzogiorno's energy needs. Finally, in 1971 the EIB provided finance of 5 million u.a. to the SNAM gas pipeline linking the networks of the transalpine regions and of the Italy to the network in the south.

Almost 57% of the amount of the EIB's loans to the Mezzogiorno went to some two hundred industrial initiatives (including allocations on global loans) through the creation of many small and medium-sized enterprises linked to the main industrial centres formed by modern steel manufacturing and chemical installation : indeed, these two sectors together accounted for more than half of the amount allocated to industrial projects (24% in the case of steel manufacturing and 30% in the case of the chemicals industry); while a quarter of the money was reserved for the metallurgical industry, mechanical engineering and construction materials such as cement. By the middle of 1972 the EIB has concluded 141 individual loans as well as five global loans (with a total of 60 allocations), and the amount of 567 million u.a. represented just over 30% of planned fixed investment of almost 1860 million u.a.

In the chemicals sectors the EIB granted 120 million u.a. (in 37 individual loans and 3 global loans allocation) to finance a number of large basic and primary chemical plants at Priolo in Sicily (Sincat and Celene), Porto Torres in Sardinia (SIR), Cagliari (Rumianca), in Sicily (ISAF) and in Puglia (Chemica Dauna), as well as financing SNIA Viscosa units for producing chemical textile fibres (in Naples and Salerno and in Paliano in the south of Latium). In the metallurgical sector, it allocated 98 million u.a. (in 4 loans) to Italsider steel producing plants in Taranto and Bagnoli (near Naples) to increase steel and cold laminates factory at Portovesme in Sardinia. Other sectors benefited from the aid given to 28 projects in the mechanical engineering field to the tune of 93 million u.a. However, the biggest loans (those to Olivetti in Marcianise and to FIAT in Bari, Lecce and Cassino totalling 62,6 million u.a.) were only put together at the beginning of the 1970s. Before that there were only two cases, the 5 million u.a. for Alfa Romeo's production of diesel engines in Pomigliano d'Arco and the 2,9 million u.a. for gearboxes and engines of Isotta and Breda in Bari. As for cement works, they benefited from nine loans amounting to 38,7 million u.a. intended to increase productive capacity and to reduce the cost of supplying raw materials to a sector considered fundamental to the development of infrastructure and housing. Finally, smaller amounts were allocated to the development of the food sector, with lending to the Dreher brewery in Massafra in Puglia, the ready-to-wear, wood, brown paper wrapping, glass, pottery, textiles, leather and rubber sectors and electrical and electronic factories closely linked to the development of the automobile industry.

With regard to the industrial groups, 30% of the total loans granted by the EIB went to companies linked to the Istituto per la Riscotruzione Industriale (IRI). These were companies whose capital belonged to the State, such as Italsider (Finsider Group), STET-SIP, the Autostrade group, Finmeccanica, SME<sup>8</sup>, Fincantieri and Italstat. Several loans were also granted to projects of other public enterprises working in the energy sector (ENEL) and the transport sector (the State railways, FS). Among private companies, the projects receiving the largest amount of funding were those presented not only by the FIAT group but also by Montedison, Olivetti, Pirelli, Italcementi, SNIA Viscosa and Rumianca-SIR, that is to say the main Italian companies.

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<sup>7</sup> The Società Ideoelettrica Piemontese (SIP) became the Società Italiana per l'Esercizio Telefonico in 1964.

<sup>8</sup> SME was the Società Meridionale di Elettricità. After the nationalisation of the electricity sector in 1962 it turned to the food processing sector while keeping its name.

In 1972, the EIB estimated that the new plants would create approximately 53000 jobs, but all the projects financed promoted economic and social development based on the creation of large scale industry situated at a distance from the large European markets. Because it was impossible to survive in such a small market – that of the Mezzogiorno – and because they had to face higher transports costs than those of their competitors, the new plants were forced either to manufacture niche products (whose high quality justified the higher price) or to achieve very high productivity in conjunction with lower labour costs (to offset the increased expense linked to obtaining supplies of raw materials and distributing the finished products). It was clear that if the industrial project did not fulfil all these conditions the loan, profitable though it might be for the EIB, did not comply with the Community objective of sustainable regional development. Moreover, the production projects financed and carried out were based on sectors such as steel manufacturing (the market for which – mature as it was – could no longer grow), mechanical engineering (dependent on the sales figures for one company – FIAT and its ability to manage the new factories, as well as to establish good sub-contracting networks) and the chemicals sector (mainly petrochemicals, heavily exposed to fluctuations in the prices of raw materials). As the monetary and energy crises of the 1970s were to demonstrate, the system concerned was insufficiently robust and could only operate within the framework of favourable economic conditions with relatively little to pay for labour, raw materials and funding together. It is not therefore surprising that as early as the beginning of 1972 the EIB pointed out that ‘the operation of eight projects [had] quit recently faced serious problems of various kinds : technical, financial or commercial’ while ‘two other small-scale companies [had] found themselves unable to operate normally once the work had been completed’<sup>9</sup>.

It should be noted that a small portion of the financing allocated by the EIB to Italian projects was used for the building of infrastructure in the north and centre of the country. This included, in particular, renovation of the railways linking Genoa to Modane (21 million u.a., improving the links between Liguria and France) and Bolzano to Brenner (5 million u.a., facilitating communication between the Po Valley and Venetia and between Austria and Bavaria) and the construction of the following motorways : the Brenner (24 million u.a. for almost 85 kms. of the northern section, the most complicated leading to the Brenner Pass); the Valle d’Aosta (24 million u.a. for more than 48 kms. linking Piedmont to the valley and, therefore, to the road via the Mont Blanc tunnel) and the ‘flower route’ (16 million u.a. to begin linking the south of France to Liguria and Tuscany). This infrastructure was aimed at promoting trade links between the transalpine countries and the Mezzogiorno, but, naturally enough, it also improved the network of communications in the north and centre of Italy.

Moreover, it has to be pointed out that the EIB also funded special interventions such as the rebuilding of plants that had sustained flood damage (for example, the Montedison premises in Châtillon) and, in collaboration with the High Authority of the European Coal and Steel Community (which supplied most of the funding) the rebuilding of the shipyards in the ports of Livorno (in Tuscany) and Monfalcone (in the Friuli). In the last two cases, the EIB granted 4,8 and 10 million u.a., respectively, supplementing the 7 million u.a. allocated to another industrial conversion operation, namely the development of sulphur mines and the production of phosphoric acid in Sicily.

### **3. What was the impact on the social and economic development of Italy?**

It is impossible to measure the impact of the projects carried out with the aid of the EIB finance. Indeed, the impact of new infrastructure on an industrial centre is shown by an increase in revenue which is not confined to the value of newly produced goods and the salaries paid to new employees. Rather, account has also to be taken of the introduction of other production and service activities closely linked to the project funded. Indeed, many projects carried out in the Mezzogiorno related to plant managed from the north of Italy, meaning that a portion of the income generated in the new industrial centres was ‘accounted for’ in the net product of the North. Moreover, the EIB always acted

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<sup>9</sup> For the projects financed by the EIB in the Mezzogiorno and the problems encountered during their implementation, see in addition to the sources in note XXX, the EIB Archives, ‘La banque et les problèmes du Mezzogiorno et de l’industrie italienne’, Etudes économiques, n° 158, 14 September 1972, pp. 44-87.

in cooperation with other financial institutions such as the Cassa per il Mezzogiorno, so only a portion of the investments depended on the resources provided by the bank.

In order to know what this portion was, the impact obtained would have to be allocated in accordance with the percentages of participation in the project, something that cannot be done in the absence of information relating to the effective role of the loan granted. (It would be necessary to know whether the project could have been carried out without the EIB's contribution and how much it would have cost to have replaced this contribution with that of another financial institution). What is more, a number of projects provided for technical cooperation between European companies (for example, Alfa Romeo and Renault), which enabled the two firms concerned to increase their know-how and the quality of their products. These were real advantages, but not quantifiable ones. Finally, although the failure of a project and its promoter's difficulties in reimbursing the loan did not involve any risks for the EIB (given the guarantee provided by the Italian State), the fact that resources had been allocated to an unreliable project signified a faulty use of the EIB's resources and damaged other, non-financed, projects and more generally the whole of the European economic system.

It may in any case be pointed out that the production structure of the Mezzogiorno had undergone significant changes by the beginning of the 1970s.

Thus, there were more jobs in industry than in agriculture (with 32% of workers being employed in the former and 31,5% in the latter), and there were almost 8% fewer employees than there had been at the beginning of the 1960s (-36% in agriculture, +9.5% in industry, +18.5% in the service sector). 'Per capita' income had increased by 62,5%, bordering on the 51% recorded in the regions of the north and centre of Italy. Gross product increased by 71% (+44% in agriculture, +109% in industry, +65% in the service sector), but general productivity and industrial productivity still represented 71% of those of central and northern Italy. This means that, although EIB lending in support of the plants of the Italian Government had been used to create new industrial centres and improve infrastructure, it had not made it possible to reduce the differential that existed in relation to the rest of Italy, which, in the same period, had benefited from a level of economic growth that was among the best in the common market. By referring to the objectives laid down when it was founded, the EIB was particularly active in financing all projects whose specific aim was regional economic development, but the overall results were not those anticipated by the founding fathers of the institution. With regard to the period analysed in this XXXX book then, the economic growth of the Mezzogiorno did not attain the levels enjoyed by other European regions. A principal reason for this was that, although large enterprises were created, there was no socio-economic fabric capable of supporting them. Few bosses and entrepreneurs had come from the region. Moreover, bad planning in terms of time scales meant that the new industrial centres were unable to benefit from new road infrastructure straight away. (The cost of putting such infrastructure in place was then increased, and it was difficult in due course to create an effective network of clients). Furthermore, the growth in 'per capita' income was also linked to emigration, which continued during the 1960s, removing from the Mezzogiorno not only lower-qualified people but also the best technicians and graduates, who were attracted by the higher income offered by firms in the north.

Naturally enough, the results obtained in the Mezzogiorno depended mainly on the specific limits of the development projects devised by the Italian Government. The EIB simply made its financial contribution and therefore had only limited responsibility. In many cases it even refused to allocate money to operations of a kind that did not help develop the regional economy or in connection with which no documents were available to enable a judgement to be made on whether the project concerned could be carried out effectively. Among the situations in question were those in which either there were already firms in existence producing similar goods or in which the market available, or again, the company concerned might be a commercially run steel-manufacturing operation that did not therefore offer adequate technological guarantees. The EIB also indicated to the Italian authorities that a number of projects, 'while not in major difficulty [were] quite badly delayed' and that 'in the majority

of cases a considerable increase in costs [was to be] noted and, often, delays in completing works<sup>10</sup>. These remarks concerning the higher costs resulting from the delays brought about by Italian bureaucracy and from underestimating the technical difficulties connected with certain items of infrastructure (for example the bridges and tunnels for the motorway in the Apennines) did not make much impact, however. There were a number of cases in which the EIB allocated resources to industrial projects of doubtful benefit (particularly in the eyes of the research department economists and member states lending department staff who were responsible for appraising the projects). This leads one to suspect that pressure from Italian economic and political circles led to overestimates of the profitability of a number of projects, causing EIB managers to 'forget' the bank remit, which was to use its resources to best effect in pursuit of effective and sustainable economic development. The EIB was in fact alert to the 'realpolitik' characteristic of all the Community organisations in the international (and mainly Italian) political context of the 1960s and early 1970s. In calculating the profitability of certain investments, account was also taken of the 'electoral' advantages guaranteed to an Italian Government having to come to terms with the largest Community party of the Western world. In the connection, it has to be noted that the EIB bore no responsibility for the development of industrial plant that did not take account of the problems associated with the pollution and with safeguarding the environment. In the 1960s there was indeed still no research into sustainable development (especially in Italy).

Doubts concerning whether optimum use was made of a few large loans ought not however to disguise the real impact of the EIB's interventions on improving living and working conditions in the Mezzogiorno. Thus, between 1963 and 1970, the regions that had received most funding doubled their productivity (in the cases of Sardinia and the departments of Southern Latium) or increased it significantly (Campania, Puglia and Sicily), while regions such as Calabria, Molise and Basilicata, having benefited from less finance, recorded lower economic growth during the same period. It is true that these regions were ideally located, but it must be stressed that no industrial project was financed in the last two cases, which demonstrates an undeniable link in terms of cause and effect between EIB finance and improvement in living conditions. With regard to the amounts allocated between 1959 and the beginning of the 1970s, the EIB financed 30% of the planned investment for the projects it approved. Most of the projects were large ; indeed, 20 factories received a total amount of 321 million u.a., that is to say more than 57% of the industrial loans granted in the Mezzogiorno. In addition, the EIB granted 34500 u.a. per job created (more than 85000 in steel works, almost 62000 in cement works and more than 50000 in chemical works), compared with the 25000 u.a. granted by the other Italian financial institutions which concentrated on initiatives characterised by a limited amount of capital, within the framework of projects aimed at the economic development of the Mezzogiorno. The positive impact on employment and on net regional product of such an input of funds for investment in infrastructure and industrial plant could hardly be slight (and this in spite of decisions that sometimes were risky). It is not therefore surprising to note at the beginning of the 1970s an increase in private consumption in the Mezzogiorno that was up by 78% on that of the 1960s (with, in particular, +56,5% recorded for food products, +99% for clothing, + 129% for consumer durables and + 214% for forms of transport).

Bearing in mind as well the fact that from 1968 the EIB extended its intervention to include small and medium-sized enterprises by implementing global loans, it is possible to appreciate how important its activities were. By supporting large scale projects, it on the one hand enabled other Italian financial institutions (that did not benefit from State Guarantees) to spread the risks over several projects; hence a reduction in interest rates that in conjunction with the tax facilities granted by the State made investments in the Mezzogiorno more profitable. On the other hand, in allocating almost a third of the funding to new infrastructure and industrial centres, it charged lower interest rates than those current on the global capital markets. Indeed, even though the EIB applied rates linked to those at which it acquired its resources on the markets, its presence covered such a large portion of the total investment that it reduced the effective demand for money from the Italian financial institutions. It remains the

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<sup>10</sup> With regard to the delays in carrying out projects and the increase in their costs, see EIB Archives, 'La banquet et les problèmes du Mezzogiorno et de l'industrie italienne', op.cit., pp. 80-81.

case that, given the volume of loans concluded, even if the overall results were not always the best in terms of projects actually carried out, especially with regard to the development model followed, the EIB's contribution was crucial as it permitted lower-cost investment, freeing resources for the development of the Mezzogiorno.

The impact of EIB finance in the other regions of Italy must also be added to these initial spin-off effects. The money used to modernise the railways and build infrastructure such as the motorways of northern and central Italy – referred to above – promoted exchanges between the transalpine countries and the Mezzogiorno, but the main benefits were concentrated in the north and centre of Italy, which reduced transport cost connected with introducing products to European markets. Industrial enterprises, as well as agriculture in the Po Valley and tourism, came into contact with the transalpine countries, improving their competitiveness and attracting investment. Paradoxically, what a number of EIB loans could not achieve in the Mezzogiorno was fully achieved in already developed regions using smaller amounts representing only a small portion of the total fixed investment. In this way, the clientele not only of the big industries of the north-west but also the small and medium-sized enterprises of the north-east and the centre was extended to include clients from the transalpine markets, so contributing to the great success of Italian products within the common market. In the same way, improvements to transport encouraged the arrival of German tourists and therefore the development of seaside resorts situated on the northern coasts of the Tyrrhenian Sea and the Adriatic and on the Alpine coasts of Venetia, Trentino and Lombardy.

Finally, it is necessary to emphasise what the measures taken to benefit the Mezzogiorno represented for the EIB itself. During the early years of its activity the EIB allocated most of its financial resources to the Mezzogiorno, in that way closely linking its own success of the projects financed. Moreover, analysis of the problems and needs of the Mezzogiorno (the very poorest region of the Community and the one with the most complex socio-economic environment) taught the EIB's managers to coordinate their activity with the other national financial institutions and to evaluate the effectiveness of the projects submitted to them while taking account of all the factors linked to the bank's institutional role. It was indeed in the Mezzogiorno that the bank experienced for the first time the difficulty of choosing projects designed to promote sustainable development in the least advanced regions, while as far as possible resisting pressure from the Italian State. The latter, which had contributed to the EIB's capital, wanted to obtain short-term results and, for obvious electoral reasons, to bring about above all a reduction in unemployment.

The EIB's activity, right from its founding until the early 1970s, proved to be integrally linked to the funding of projects in Italy and in particular in the Mezzogiorno, which was the least advanced region of the Community. The bank allocated of its resources to the Mezzogiorno and learned to manage loans granted in partnership with the main Italian financial institutions, in particular the Cassa per il Mezzogiorno. It contributed almost a third of the overall financing intended for the social and economic development of this region, obtaining positive results in terms of improved living conditions and reduced unemployment, while the model of industrialisation chosen by the Italian Government (based on the creation of large-scale basic industry) proved to be too exposed to fluctuations in the prices of raw materials, as well as being heavily weighed down by transport costs, increased in the light of the competition existing within the common market. Finally, the loans intended to modernise or create infrastructure in central and northern Italy, enabling the Mezzogiorno to be linked to the transalpine markets, undeniable proved to be successful. However, it was mainly the companies situated in the Po Valley and in the coastal areas to the north of the Adriatic and Tyrrhenian Seas that benefited most.