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Oil Deals Give Italy Energy Independence

Overall output of Italian industry fell by 2.8 per cent during October, according to the last official numbers available, following a 10.8 per cent rise between January and September. The sharp October drop is ominous, because it indicates the giving out of the Italian public sector's year-long strategy of using the depreciation of the lira for as much export-led growth as possible. Italy's economy depended on permitting the large public-sector industries to run a gigantic deficit, in an ultimately unsuccessful effort to make a rise in exports compensate for the rise in raw materials costs owing to the large January 1976 devaluation of the lira. The public sector deficit could be carried only at the expense of a contraction of private sector activity, municipal and regional expenditures, and a rate of inflation that held steady at just over 20 per cent for most of the year.

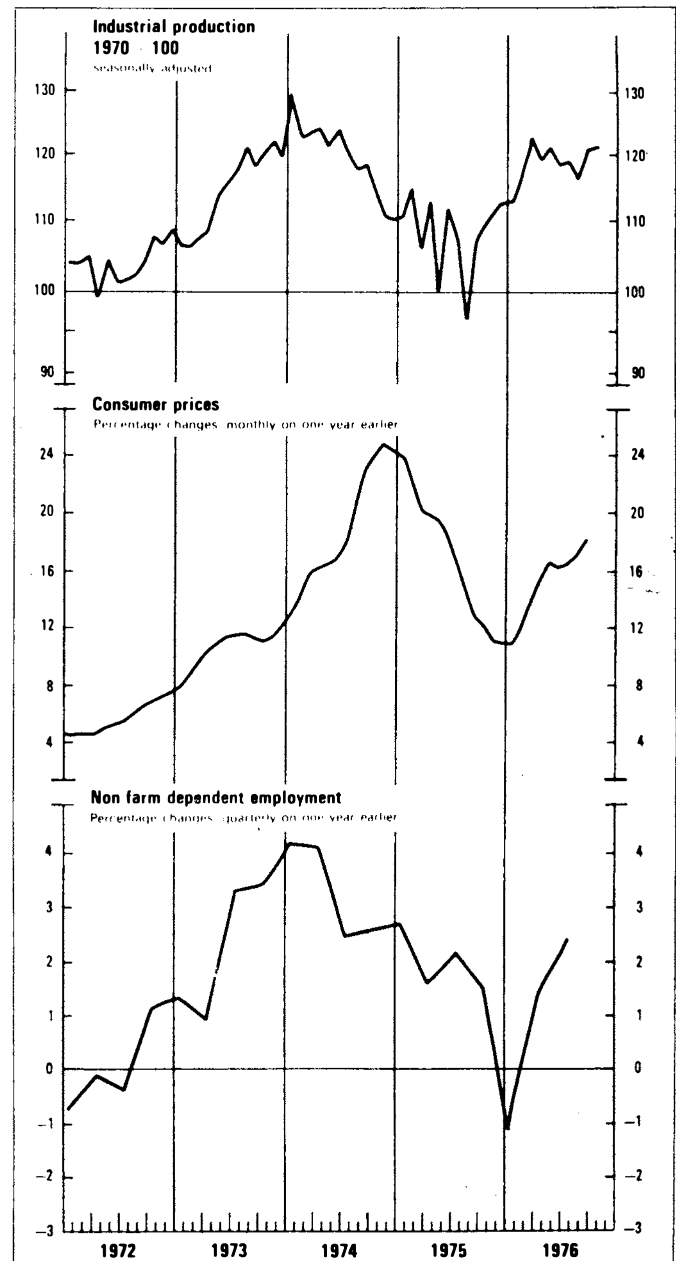
However, there are strong, if partial, indications that the Italian economy is recovering, as a result of government policies adopted in October. Statistics dated Dec. 30, 1976, for the Piedmont region, which incorporates the Turin area and the core of Italy's heavy equipment and machine tool industries, show the most rapid economic growth in Europe. Piedmont production is 10 per cent above end-1975 levels, and unemployment has fallen from 100,000 in Oct. 1975 to 63,000 in Oct. 1976 and 45,000 at present.

For the key Italian industries, concentrated in the public sector, the picture through late 1976 was heavily increased sales and heavily increased deficits. The largest public sector holding company, IRI, which controls most of the country's steel output, raised its sales to the equivalent of US $ 11 billion, with a loss of $80 million projected for 1976. However, the industries IRI represents benefitted heavily from the lire devaluation. For the latest breakdown available, Italy's balance on trade of manufactured goods (through August) yielded a surplus of $6.5 billion, against a negative overall trade balance of $3.8 billion.

In the textiles sector, the operating deficits of the key firms are projected to be considerably larger, despite a January to October improvement in output of 16.8 per cent. The textile division of the Ente Nazionale Idrocarburi (ENI), Lanerossi, is expected to run a significantly worse deficit than last year's despite rising output. Montedison's textiles division, Fisac, which exports 60 per cent of it sproduction, increased its output over 1975 by 28 per cent, but also showed an operating loss. Another Montedison textiles subsidiary, Vallesusa, required a financial injection from a combined Italian and foreign consortium.

Overall, Italian industry attempted to compensate for increased costs, mainly due to the rise in the cost of imported goods, through increased exports. The large deficit of the public sector and the rate of central bank money-creation represents the margin of failure of this attempt. Raw materials prices increased at a 48 per cent annual rate through the first eight months of 1976, equal to the thirty per cent depreciation of the lira plus the 20 per cent overall inflation rate.

Credit to industry increased, through the last figures available, at a 20 per cent annual rate, double the rate of growth of output. But the rise in credits is almost wholly attributable to the inflationary effects of lira depreciation, since most enterprises reduced their investment plans and hence their credit requirements. Although fi-



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gures for the deficits of state-sector industries are not available, the net increase of indebtedness of the state sector as a whole ran at an annual rate of $11.2 billion through September, or approximately 30 per cent of all state-sector expenditures. Within this overall figure, Bank of Italy handouts to state sector enterprises are estimated to make up half of the total figure, projecting from earlier Bank of Italy data.

To finance this deficit, the Bank of Italy was compelled to absorb 67 per cent of all Treasury bond issues through October 1976. This principally accounts for the rate of growth of the monetary aggregates of over 22 per cent per year.

Although complete figures are not available, industrial output seems to have followed the rule that those industries benefitted most that were in position to take advantage of the enhanced export competitiveness of the lira, including:

(Increase in output, January to October)

Textiles	16.8%
Chemicals	12.7%
Metallurgical products	7.4%
Steel	16.0%
Machine tools	3.0%

Italy's auto industry is a case in point: 1976 passenger car output rose to 1,565,000 vehicles, almost 50 per cent above the poor 1975 showing. Of total output, almost half, or 47 per cent, were exported. Most of the production and export increase occurred during the second and third quarters, after the lira depreciation had time to work into international auto markets. Ironically, Italy's largest producer, FIAT, is still showing losses. FIAT management has attributed its difficult financial position to rising labor costs, but the overall inflationary environment produced by the depreciation of the lira at the outset of 1976 is a more important factor. FIAT's holding company, IFI, will probably end 1976 with a $14 million loss, indicating the operating deficits are not a phenomenon restricted to the public sector alone.

October represented the point at which the foregoing policy of high production and high deficits could no longer be continued. Italy's trade deficits began the year at 319 billion lira ($366 million) in January. Under the "J-curve" effect of the lira depreciation, the deficit rose to a high of 708 billion lira in April ($813 million), and then fell gradually to reach a surplus of 105 billion lira ($121 million) during July. International markets are shown to have been, at least temporarily, responsive to major changes in the lira rate, over a three-month lag. But Europe as a whole began a stagnation in the third quarter and an apparent downturn during the fourth quarter of last year. International market conditions worsened, and the Italian trade balance worsened in tandem, to a deficit of 513 billion lira in September and 330 billion lira in October. Italy's deficit on account of petroleum is double the overall trade deficit, indicating the country has been in substantial surplus on its non-oil trade account.

But by October, the country's international reserves had fallen to the point that foreign exchange holdings covered no more than three months' exports, and a collapse of the lira comparable to the January 1976 run threatened. In response, the government imposed stringent foreign exchange controls, including the centralization of all foreign exchange transactions through the Bank of Italy, and a 7 per cent tax on all foreign exchange transactions. In addition, the Italian government began an extraordinary series of initiatives (see below) which resulted in considerable expansion of the country's export potential and a rapid inflow of deposits from oil-producing countries; the latest reports show Italian reserves to have risen by $1 billion since October.

Temporarily, however, the credit restriction policies which the government was compelled to take in defense of the lira produced immediate cash shortages for the state oil and chemical giant ENI, and cut cash subsidies for Montedison, which is partially state-owned. The private sector, especially small and medium-sized business, was placed in jeopardy through lending rates that esceeded 25 per cent for prime customers.

It is not possible to estimate the levels of economic activity over the fourth quarter of 1976. Two separate factors are at work: the sharp credit-austerity the Andreotti government imposed on the restrictionary side, and the prospect of expanded trade through direct government-to-government initiatives on the expansionary side.

The measures taken by the Italian government to expand the country's export potential are best illustrated by the commitment the government has made in securing enough crude oil imports from the Arab oil producing nations and the Soviet Union to guarantee both domestic consumption levels as well as to increase the exports of refined oil. Italy has either already secured or is close to securing direct state-to-state deals, bypassing multinational interference and allowing it to establish energy independence.

These state-to-state deals assign ENI (Ente Nazionale Idrocarboniaria, the state-owned oil company) the major responsibility for refining and export. The successful completion of the current Italo-Iranian and Italo-Saudi Arabian negotiations along with already standing agreements with Libya, Algeria, Iraq and the Soviet Union (see chart) would lock up in direct deals over 84 million tons — or 90 per cent— of Italy's crude oil imports.

The prospects for the realization of the Iranian and the Saudi Arabian imports are good. It is interesting here to look at the two deals in greater detail. The Dec. 29 *El Moujahid* announced the signing of the deal between the Iranian state owned oil company NOIC and ENI (which has been under negotiations for nearly a year). The ENI-NOIC agreement stipulates that ENI's extensive refining and distrbution facilities in Europe, excluding Italy itself, and the Third World will be taken over by a joint (50-50) ENI-NOIC company. This means the immediate injection of $100 million of Iranian capital into the Italian economy. NOIC has agreed to directly supply 4 to 5 million tons of crude oil per year to the new company. A direct deal of another 14 million tons per year to Italy is also being mooted. Furthermore, ENI president Pietro Sette has scheduled a trip to Iran this month. Sette is expected to discuss the additional 14 million ton export as well as to arrange for NOIC to take Italian industrial

ENI GROSS CRUDE OIL IMPORTS (IN MILLION TONS)					
	1973	1974	1975	1976	1977 (proj.)
Libya	4	4	8	12	12
Iraq	20	19	19	15	15
Algeria					5
USSR	3	—	3.3	4.5	5
Iran					(20)
Saudi Arabia					(27)
Total	27	23	30.3	31.5	84

exports in barter for crude oil.

The prospects for the Saudi Arabian deal are as promising. The Dec. 31 issue of the Journal of Commerce announced that Italian Trade Minister Rinaldo Ossola and top-level ENI officials are discussing plans to have the Saudis buy out and take over the operations of the multinationals — Exxon and Mobil — in Italy. (Both multinationals have been fielding the rumor that they intend to abandon the Italian market). The Saudis could in return guarantee 27 million tons of crude oil in direct deals for export to Italy yearly.

Oil exports represent only one — albeit it is a determining — factor of the Italian government's overall economic policy. The FIAT-Libya deal announced Dec. 2 is a paradigm scheme for future agreements. The FIAT-Libya deal was constituted by Libya's purchasing of 10 per cent of FIAT stock, worth $300 million. FIAT in turn will be constructing auto and commercial vehicle production plants in Libya for export to the Third World.

An executive member of the Libya Arab Bank in Rome on Dec. 4 lauded the deal stating that Libya does not merely look for financial operations but for investments, but saw the deal as opening up to continued multilateral arrangements with Italy in many different fields. The official Libyan communique issued Dec. 3 stated that the Libyan participation means a close cooperation as the first step towards a new international economic system based on development and not exploitation.

Since the signing of the FIAT-Libya deal, enthusiasm has been voiced by other developing countries as well as the Soviet Union to escalate multilateral agreements. On Dec. 16, ENI's chemical subsidiary, SNAM Progetti announced plans for the construction of a fertilizer plant in India which would be funded with Soviet loans. The fertilizer plant will be located at Trombay and will cost $45 million.

Dec. 20, the weekly *Tempo Illustrato* announced a four-way agreement between the Soviet Union, FIAT, Libya, and Algeria for the construction of an auto plant in Algeria.

Signals of a Boom

There are already economic indications that promises of increased exports foreshadow an economic "boom" in Italy — based on real production.

This is already being seen in the so-called mini-eco-boom which the Italian press is reporting for the Piedmont region. The Piedmont region (Turin) traditionally regarded as the economic "bellwether" region in Italy is showing signs of recovery — based on increased exports. The leading Piedmont daily *La Stampa* reported Dec. 30 that industrial production for 1976 in the region was up by 10 per cent compared to industrial production figures for 1975.Underemployment for 1976 is down in the region by 55.5 per cent as compared to 1975. Unemployment figures for Oct. 1976 showed unemployment down. In Oct. 1975 there were 62,767 unemployed; Oct. 1976 about 45,000.

There are presently two factors which corroborate the optimism concerning Piedmont. The two industries of Piedmont — FIAT and Comau (a consortium of machine tool companies) are both working at full capacity. Whereas FIAT has signed the deal with Libya, it has not yet begun implementation of the deal. Comau on the other hand has begun to fill orders particularly for the Soviet Union. Comau president Vincenzo Buffa commenting immediately after the signing of a $132 million contract with the Soviet Union stated on July 9, 1976, "Just last June the machine tools balance closed negatively ... but the situation is changing for the better. Contacts with the Soviet Union, Poland, and the internal market have put us back up there."

Expecting a real recovery, based on expanded exports of autos, tractors, and machine tools, the Italian government has taken measures to insure the maintenance of a skilled workforce in Piedmont, injecting major amounts of money to increase employment in the services (tertiary) sector to insure that skilled workers will not emigrate. A Piedmont regional government proposal sees the creation of 124,000 industrial jobs over the next four years.