How the institutional framework can affect the results of economic policies
Italy between economic crisis and reforms (1970-1992)

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Introduction

In their recent analysis of what they called the last "eight centuries of financial folly" Reinhart and Rogoff underline the fact that, among the vast majority of the financial crisis occurred during the last centuries, it is possible to detect a common element: the excessive increase of indebtedness involves systemic risks larger than expected during the upward phases (Reinhart and Rogoff 2009). This is partly true also for the debt crisis that the Italian government is currently facing under the pressure of both the financial markets and the European institutions.

Speaking in general terms, today's crisis is certainly related with the difficulties that the members of a monetary union find in using automatic budget stabilizers, due to the fact that they could not directly control their currency (De Grauwe 2011); it is also associated with the inability of the present Italian government to limit the rise of current public expenditures, as it is shown by the increase of the general government deficit after 2007, both in relative and absolute terms (see the graphs below), and to its political instability. But if we consider the problem of financial instability and liquidity constraints in a broader perspective we have to note that the present difficulties are not only related with the economic policies of the last years: the registered growth of public expenditures and the related growth of indebtedness are for sure central issues, but the roots of the problem reside in the past decades.

Between the end of the second world war and the beginning of the 1990s the Italian economic system gradually moved closer to the other European ones, but the political difficulties encountered by governments in pursuing growth strategies

negatively influenced that process of convergence: political weakness always negatively influences Italian development till the most recent years.

The lack of combined efforts towards development policies drove both the governments and the oppositions to consider the public administration as a mean to mediate between different interests, rather than an instrument of government. Since the years immediately after the war, when apparently the Italian governments opted for a planned economic recovery – that should have been realized through the coordination of central administrations by interministerial committees –, it was possible to find this harmful attitude towards public administration. Planning resolutions were not put into practice and the recovery relied on private enterprises, supported and controlled by means of bureaucratic procedures. Bureaucratic routines that were active also when the European Recovery Program – the so-called Marshall Plan – was launched in 1948, or when the first agencies for the growth of the southern Italian underdeveloped regions where established at the beginning of the 1950s. Routines that continued to be effective along the entire period considered in this paper.

At the beginning of the 1960s, with the establishment of the first centre-left coalitions, national economic planning seemed again a feasible way to reduce Italian economic imbalances. Nevertheless, in the subsequent decade, the failure of planning – mainly for political controversies, the summing of delays and the use of public resources for partisan political goals, in conjunction with the deep international economic crisis – led to the rejection of that large framework and to its replacement with shorter term economic and industrial policies. This evolution was for sure influenced by the world economic crisis of the 1970s: the shift from a broader focus on the socio-economic environment to a narrow, short term perspective was determined by the growing economic instability which obliged the Italian governments to reframe their policies. But it was also a consequence of the political failure of the technocratic social reform attempt pursued during the 1960s.

In this context the importance of the bureaucratic control mechanisms, cited

above, progressively grew, to such a degree that in the second half of the 1970s, when it was clear that the distortions introduced in the economic system were producing significant diseconomies, it took more or less a decade to start a reform of the system. In fact only the severe financial crisis occurred in 1992 led to some tangible effects.

The Italian case gives an interesting insight on the role played by the creation of a favourable institutional framework in determining the success of economic policies. The weakness of the institution in charge of national economic planning played, in fact, a major role in the failure of the planning process itself. In particular, the lack of a fully implemented institutional framework for national economic planning and the political uses of public resources, realized through the planning institution itself, had deep negative effects on public firms' performances. At the same time the incomplete planning system affected the private industrial sector too: during the crisis of the 1970s large-sized private enterprises benefited from the State financial aid, but this was granted without taking into consideration any development scheme, any incentive to change the strategy previously adopted.

The institutional framework among which economic planning was pursued deeply influenced its results, with relevant negative consequences on the Italian industrial system and – as it will be showed below – on the national budget and the level of public debt, with vicious effects that still today are at the centre of the political agenda.

An institutional framework for development

After the post-war recovery the Italian economic system registered a progressive integration between its institution and the political power, due to the country opening to international markets and to the instability that this implied, but also to the increasing number of political decision centres determined by the adoption of new democratic and republican institutions (De Cecco 1997). A multiplicity of interests which competed with each other and that rarely reached an agreement on

the shape that the institutional framework should have had, with deep consequences on the decision processes at the basis of public investments and public expenditures (Lavista 2010).

The new economic, political and institutional framework was carried out during the 1960s, when the opening to international markets was completed (Bottiglieri 1984) and, after a long period of controversial development, a new political alliance between the left wing of the Democratic Christian Party (DC) and the Italian Socialist Party (PSI) was signed. Nevertheless, some of its elements were already introduced at the half of the 1950s: in particular during the biennium 1955-1956 that opened up with the government's approval of a national *Income and employment decennial development scheme* and ended with the appointment of a specific ministry for public enterprises.

The document about income and employment development, the so-called *Vanoni's Scheme* (Ezio Vanoni was the DC's Budget Ministry who presented the plan to the Parliament in January 1955) aimed at overcoming the limits imposed by the strict government control over prices and exchange rates which had characterised the Italian political economy since 1947 (Baffi 1965; De Cecco 1974; Daneo 1975; Salvati 1982; Conte 1988; Zamagni 1990). Some of the DC's main representative at the beginning of the 1950s started to openly talk about a third phase of the Italian development. Criticising both the excess of free-trade and the communist system, they hoped – after the post-war economic recovery and the financial stabilization at the end of the 1940s – for a new phase based on a mix of free-market and economic planning (Bottiglieri 1984).

In 1950, with the financial aid provided by the International Bank for Reconstruction and Development, the Cassa per il Mezzogiorno – a regional development agency for the southern areas – was created (D'Antone 1997; Zamagni and Sanfilippo 1988); few years later, in 1953, Enrico Mattei, a personal and political friend of Vanoni, won the struggle to have a second financial holding for the control of state owned industrial enterprises (ENI, after IRI that had been founded in 1933); in 1954 among the DC, the party that since the end of the

second world war had held the relative majority in the Parliament, a new leadership imposed a new political strategy, aimed at increasing the influence of the party in the society, through a deeper influence of the state administrations among economic life.

What could be considered the first Italian national economic plan was designed in such peculiar political environment. The document hypothesized a 5% annual growth of national income and, assuming a constant development of the capital-labour ratio, aimed at increase by 4 million units the number of employed people, raising the income quota dedicated to productive investments. The main goal of the plan was to define the distribution of productive investments among different industrial sectors and, more in general, the percentage of national income that should have been invested in industry: part of the document was obviously dedicated to the bank sector, as the main investment vehicle, able to drive increasing quotas of national savings toward production (Ministero del Bilancio 1967a). The *Scheme* was the first sign of the changing attitude of the Italian political elite, a shift that sounded as a prelude to the new relationships that would have been established between politics and economy and between politics and the financial system during the 1960s and 1970s, when the alliance between the DC and the PSI would have become a feasible political project.

As Vanoni affirmed in 1955, presenting his document to the annual assembly of the Italian credit societies, the main banking system's task was – as in the previous years – the financial stability, but the credit institutions were now also called to "avoid the establishment of new monopoly or the reinforcement of the existing ones" and to reduce the gap between the northern industrial regions and the underdeveloped south. The bank system had to set itself some objectives in terms of credit volumes and credit distribution because its main function was to assure a "balanced development of the various economic sectors, avoiding the bottlenecks" (Vanoni 1956).

Which could have been the consequences of such position on the banking systems, in terms of controls and incentives, is quite clear. Notwithstanding the

appeal to financial stability, the approval of the *Scheme* was preceded – and followed – by a series of legislative measures that could have easily questioned financial stability itself. As it was mentioned, in 1950 the Cassa per il Mezzogiorno was established, with the law n. 298, 11th April 1953, this agency acquired shares of the Isveimer, the Irfis and the Cir, three public law credit institutions operating respectively in the continental Southern Regions, in Sicily and in Sardinia (Barucci 2008; Croce 1999).

In fact, even before the approval of the decennial plan, the formation of the centre-left alliance and the radical shift from the political framework that had been designed in the years 1947-1948, the beginning of the state intervention in the south (the so-called "extraordinary intervention") inaugurated a new era of government intervention in the economic sphere. Few years later, in 1957, the law n. 634, 29th July, confirmed this change decreeing that the state owned enterprises – organized the previous year under the control of a homonymous ministry – should have directed the 40% of their total investment and the 60% of the investments for new production facilities towards the southern regions.

The years of national economic planning

During the first half of the 1950s the topic of economic planning gradually entered the political debate because of the worsening of the international trade cycle registered at the end of the so-called "Korean economic boom", the favourable business trend that between the end of the 1940s and the beginning of the subsequent decade followed up the outbreak of the war in that country.

In the years 1951-1952 there was a sudden slowdown of the external demand, which remained stagnant at least for two years: the industrialists, who had profited by the "economic boom", thanks to military demand and international trade, started to worry about the opening to international markets (Petrini 2005). Those political forces, which were more responsive to the long term development of the country, rapidly understood that the main problem that had to be faced was how to raise the internal demand, instead of limit the import of goods (Craveri 1995).

Till that moment the Italian governments had drawn economic policies aiming at adapting the level of investments to the share of available savings, now they had to increase savings and to direct a growing share of them towards productive investments. They had to foster the increase of national income – that between 1951 and 1954 had grown by an average of 5% a year – designing a development plan which included a wider involvement of state owned enterprises, precisely with the aim to increase internal demand. The Vanoni's Scheme – not by chance – focussed on a series of interventions in three "propulsive" sectors: agriculture, public utilities and public works. In these fields the state intervention would have had prompt effects, because of their intrinsic nature, that made them more reactive to incentive policies, and also because of the large number of public enterprises which operated among them (Ministero del Bilancio 1967a).

In the subsequent years the *Scheme* was not enforced, but some of its forecasts come true: during the next decade the national income increased at rates even higher than expected (Nardozzi 2003). Nevertheless, the economic mechanism which led to these positive results was different from the one designed by the national plan, its basis was the external demand and – moreover – it did not solved the main sectorial and territorial imbalances.

The "economic miracle" of the second half of the 1950s increased the existing growth differentials, re-proposing at the beginning of the 1960s the same problems that were at the centre of the political debate when the first decennial development scheme was designed. The problem was clearly stated in the document that started the national economic planning policy of the first centre-left coalitions: the *Additional note* to the *Annual report on national economy* that the Budget Ministry, Ugo La Malfa (one of the main leaders of the Republican Party - PRI), presented to the Parliament in May 1962 (Ministero del Bilancio 1967b).

The document affirmed the centre-left forces' political wish to realize a more democratic government of the national economic system, but also the need for some changes less linked with political reasons. The socio-economic environment was changing: the labour disputes were increasing in numbers and in harshness

with significant effects on price level. The previous growth rate of the national economy could not assure its future development: it was necessary to implement some sort of incomes policy, as a mean to equalize salaries, but also to favour a balanced development (Berta 2009).

Economic planning, incomes policy and the nationalization of the electric industry where the three key programmatic points at the basis of the centre-left governments. Just the last one, among which only some of the participants to the alliance agreed, was realized with the law n. 1643, 6th December 1962 (Mori 1989). The first problems arose immediately after the establishment of the Cnpe, a national committee for economic planning which would have to study how to implement an economic planning system. The participants to the committee (politicians, union leaders, industrialist, experts of production, economists) did not share, in fact, a common vision of the planning process that had to be implemented. For example, some of the economists involved considered their role as prevalently "technical", others exerted pressure for a more political action (Lavista 2010); more in general, the failure of the commission had to be attributed to political divisions, that became more and more important after the political general election in the spring of 1963. The DC saw it share decreased of 4 percentage points, loosing votes in favour of the Liberal Party (PLI) which had opposed since the beginning to the alliance with the socialists and to the nationalization of the electrical industry (Craveri 1995).

The contrasts between the forces involved in the centre-left governments (DC, PSI, PRI and the Italian Social Democratic Party – PSDI) led to a reorganization of the executive and to a downsizing of its reform projects. In 1963, while the Bank of Italy took measures to reduce the credit amount (Modigliani and La Malfa 1966; Nardozzi 1979), the Ministry of the Treasury, the democratic Christian Emilio Colombo, declared that the main economic target of the new government were the monetary stabilization and an incomes policy intended merely to limit the increase of salaries (Carabba 1977).

This new political equilibrium directly influenced the planning process: the

Economic development plan 1965-1969, presented to the Parliament during the summer of 1965, was definitively approved only two years later, with an enormous delay that made it unworkable. In fact, the 1963 round of voting and the subsequent government reshuffle marked the end of the reformist attempts (Craveri 1995; Ginsborg 1989; Giolitti 1992). The 1964 compromise, signed in order to save the parliamentary majority, was the prelude to a series of measures that in the long run stressed that mentioned use of central administration as a mean to mediate between different interests, that had partly characterised the post-war recovery. An attitude towards public administration that augmented the central role of the inter-ministerial committees, in particular after the promulgation of the law n. 48, 27th February 1967, that reformed the Budget Ministry, transforming it in the new Budget and Economic Planning Ministry, and created the Economic Planning Inter-ministerial Committee (CIPE).

The establishment of this general economic committee meant the reorganisation of the other pre-existent inter-ministerial committees but, in fact, when it was decided to abandon the project to put the CIPE under the control of the Prime Minister[1], fearing that the government could have been accused to be "technocratic", the decision process did not change so much. Economic policies were still the result of a long and complex bargaining process between the various ministers involved in the committee itself, often followed – some times even preceded – by a mediation with the unions, the representative of the industrialists and other economic powers: state owned enterprises and, moreover, the Bank of Italy.

The rejection of an heavy sectorial planning and the very long time taken by the national plans approval procedure made national economic planning ineffective. Notwithstanding its failure, the institutional framework designed for it will have had significant influences on the modality of the Italian development, in particular through the various incentives system developed over the years.

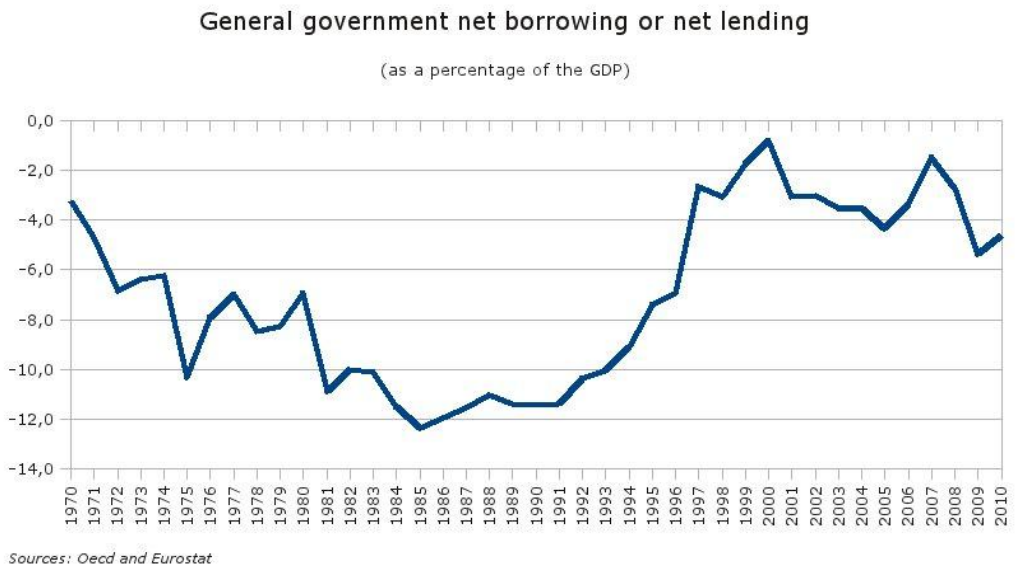
1 Following the example of other European countries and in particular the example of France (Cohen 1969; Lutz 1969; Chiarelli 1973; Cave 1981).

Along with the mentioned tendency to consider the public administration as a mean of mediation, given the absence of a general framework for the country's economic development, both the private and the state owned enterprises indiscriminately increased their leverage, using the progressively larger amount of financial resources provided by special credit institutions (Onado 2004; Conti 1999; Piluso 1999). The governments during the 1960s and the 1970s encouraged the action of this institutions, persuaded that their support to industrial firms was the only instrument available to foster economic growth. As a consequence, the special credit institutions centrality grew progressively and their action, together with the activity of the institutions created to manage economic planning, favoured the spreading of a bureaucratic vision of lending.

The institution in charge of economic planning, through the so-called "planned bargaining" or the measures that favoured the investments in the southern regions, could in fact simplify credit authorization schemes, decreeing for example that the investment plans of a specific firm – public or private – had been designed in accordance with the national economic plan (Lavista 2010). As the governor of the Bank of Italy, Guido Carli, stressed in his 1967 annual report, subsidized credit, which had a major role in the underdeveloped areas, had distortive side effects: "subsidized credit – he asserted – on one hand suggest[ed] to the applicants that the bank [should have] automatically granted them a loan; on the other hand it induce[d] the banks to focus more on public, rather than private, interest while evaluating an investment". In other words, with subsidized credit the cooperation between banks and political authorities shifted from the consideration of general economic objectives to the consideration of particular and specific targets, inducing banks to solve contingent problems, with negative consequences for the enterprises involved and for the stability of the whole economy" (Ciocca 2008; Ciocca 1991).

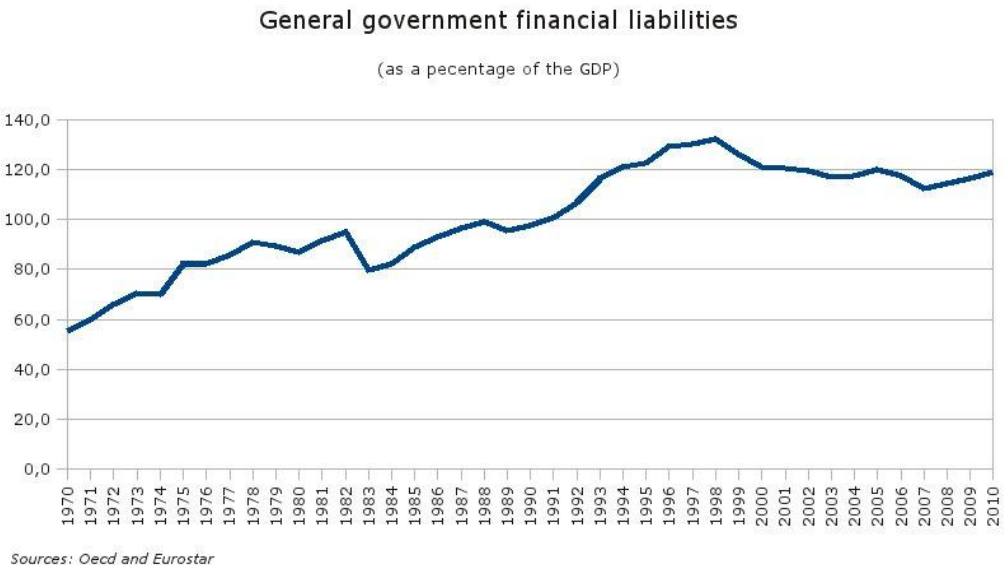
Such a system – that, notwithstanding the 1967 report, the Bank of Italy openly supported during the 1970s, through expansionary monetary policies and obliging the banks to buy pre-determined quotas of special credit institutions' bonds (Baffi

1973; Ciocca 2008; Conte 2008; Nardozzi and Piluso 2010) – could not survive the international economic crisis, due to the growing market instability, the decrease of firms' performance and the reduction of their self-financing capability and, finally, the increasing interest rates (Ciocca 2007). In addiction the failure of the reform attempts of the 1960s and the lack of any income policy determined an upsurge in trade unions activity and the consequent substitution of the income policy itself with public expenses that put extra-burned on the state's budget: in particular in the pension sector, with the 1969 shift from a contributory scheme to an earnings-related one, and in the health care sector, with the 1978 establishment of the national health care system (Craveri 1995).



The immediate effect of measures like these was the progressive public administration's deficit increase that – once again with the consent of the central bank – the governments faced through a sharp distribution of the credit total amount between the public and the private sector, imposing in 1973 some administrative measures that quickly moved large credit amounts (more or less the 60% of the total) from the private to the public sector, including state owned enterprises (Cotula 1989; Rossi 2007). Similarly, in order to satisfy the growing

needs of the central administrations, other three instruments were used: the possibility offered to the government to easily turn to overdraft financing (the government had a current account with the Bank of Italy), the so-called "inflation tax" – determined by the general increase of prices, due to the international oil crisis and to the expansionary monetary policy, and the persistence of law nominal interest rates – and the state bonds central bank's buying-in (Rossi 2007; Conte 2008).



On the long run the steady rise of the state's deficit determined a significant growth of public debt that, if at the beginning of the 1960s represented little more than 30% of the gross domestic product, rapidly increase it share to 40% at the beginning of the subsequent decade and abundantly exceeded 80% during the 1980s (Artoni and Biancini 2003; Rossi 2007). An increase partly determined by the more and more political use of the financial resources allocated towards state owned enterprises, always more often involved in bailouts of insolvent industrial enterprises (Iri 1991), but also – and above all – by the quick widening of public services. Between 1970 and 1975 and, subsequently, between 1979 and 1985 two main cycles of public expenditures expansion followed one other: in both cases

the increase of the investment outlays was less significant than the growth of the expenditure for national debt interest rates and services like health assistance, social security and so on (Franco 1993).

Notwithstanding the progressive expansion of the state owned enterprises' system, the capital transfer towards the enterprises kept around 2-3% of the gross domestic product during both the 1970s and the 1980s (Virno 1984; Artoni and Ravazzi 1986) while, in the same years, the decentralisation of public expenditures determined by the establishment of regional governments (put in charge of the national health care system) duplicated the expenditures of local administration: from 7% of the gross domestic product in the 1970s to 14% in the subsequent decade (Morcaldo 1993).

Soon the negative consequences for the whole system became evident. The difficulties derived from the high level of indebtedness and the progressive growth of interest rates after the "Volcker shock" in 1979 stimulated a slow and controversial reform process. Always more often the national monetary authorities stressed the need to respect international obligation in order to overcome local political controversies and the incapacity of the main political forces to direct their efforts toward a shared plan of financial settlement.

The reshape of the system

The first signs of change came in 1976 when Paolo Baffi succeeded to Carli at the head of the central bank and inaugurate a tight monetary policy, persuaded that: the growth of labour cost should have followed the international trend and there should not have been any correlation between the increase in the amount of monetary base and public expenditures. This new policy clearly disavowed Carli's statements about the moral and civil obligation that had forced the Bank of Italy to finance the government's deficit and favoured the adoption of some measures aiming at increasing the pressure of taxation and tariffs. The joint action of the central bank and the first "national solidarity" government led to a slowing down of inflation rates, an essential condition to enter the European Monetary System

in 1978 (Craveri 1995; Basevi, Onofri, and Tantazzi 2001).

Joining an international monetary system meant to strictly link the national economic policy to the decisions taken by the European authorities and to the obligations derived by the process of economic integration. Two other measures confirmed, at the beginning of the 1980s, the attempt to put under control public expenditure and, moreover, to uncouple the monetary policy from the developmental measures approved by the governments. In 1981 the Bank of Italy and the Treasury decreed the so-called "divorce" between the two institutions: the central bank in the future would not have been obliged to buy the treasury bond that the Treasury would not have been able to sell on securities markets. Two years later the government started to dismantle the bureaucratic direct control over the credit system, deleting the limits to the expansion of financial investments and opting for indirect forms of control (Rossi 2007).

During the 1980s the relationships between credit and industry radically changed: from the post-war recovery till the end of the 1950s the credit system had structured itself accordingly with the extraordinary intervention in the underdeveloped regions; during the 1960s and the 1970s it had conformed itself to the not necessarily virtuous political decision that the governments took among the framework of what was improperly named "economic planning"; during the 1980s, in a very different international economic environment, it started to anticipate the reform of the Italian industry.

At the end of the 1970s the Italian governments approved a series of measure aiming at favouring industrial reengineering and groups reorganizations, clearly distinguishing between the administrative tasks of the government, both at local and central level, and the technical role of credit institutions. Notwithstanding this new approach, the political pressures weakened this tools of intervention and, moreover, reduced the chances to use them selectively. Similar results were, on the other hand, obtained by other measures approved during the subsequent decades in order to foster industrial research and technical modernization (Momigliano 1986; Prodi and De Giovanni 1990).

They were the change of the monetary policy and the transformation of the credit system, along with the favourable international economic trend, that drove the reengineering of several industrial firms and the strengthening of their financial structure. A reinforcement that, once again, occurred without any general development framework, without the design of a new industrial policy, with severe consequences on the industrial system and its specialization, that still today affect its performances (Lavista and Piluso 2001).

The long phase of reforms continued during the second half of the eighties, when six executives, based on new enlarged centre-left coalition (DC, PSI, PSDI, PRI and PLI) followed, one after the other. Although, the new political alliance that ruled the country until the beginning of the 1990s failed – as the continuous reshaping of the governments demonstrates – to find a synthesis between the different political view of its components (Craveri 1995).

A failure which had repercussion on the effectiveness of the policies adopted in order to reduce the continuously growing public debt. Since the general increase of interest rates, every government that ruled the country between 1985 and 1990 put the decrease of public debt at the centre of its economic agenda and committed itself to reduce primary deficit. Notwithstanding the economic growth of those years, the result in term of reduction of debt and deficit were absolutely disappointing, to the point that they risk to undermine the disinflationary policies of the Bank of Italy, ruled since 1980 by the new governor Carlo Azeglio Ciampi (Sartor 1998; Stagni 2001; Craveri 2009).

In the end, it was the deep financial crisis in 1992 that imposed a serious reform process. Along with the definition of the European monetary union, after the signing of the Maastricht treaty in February 1992, and the appearance of the first signs of the crisis of the entire Italian political system, with several investigations into corruption cases, the first of two "technical" government took office, with the aim to start a deep reform of the national economic system.

The government ruled by Giuliano Amato, a coalition between DC, PSI, PSDI and PLI which took office during the summer of 1992, was constituted with the

principal aim to correct the abuses in the state budget formulation process (Rossi 2007). A correction that was realised through huge financial manoeuvring and, after a last attempt to reorganize the state owned enterprises system with the creation of few super-holdings (Conti 1999), through the privatization of a large part of public firms (Affinito 2000; Iri 2001).

Conclusions

Since the end of the Second World War the attempt to design an economic policy to foster Italian development clashed with the lack of a wide political agreement about its characteristics, as a consequence of the deep divergences between political and social forces. As far as the design of industrial and economic policies is concerned, the main consequence of this fragmentation of the political environment was the diffused use of the public administration as a mean to mediate between different interests.

If this was true for the 1940s and the 1950s, the economic transformation of the subsequent decades, the increasing demand for political intermediation and the international crisis of the 1970s contributed to amplify the use of bureaucratic mechanisms of socio-economic regulation.

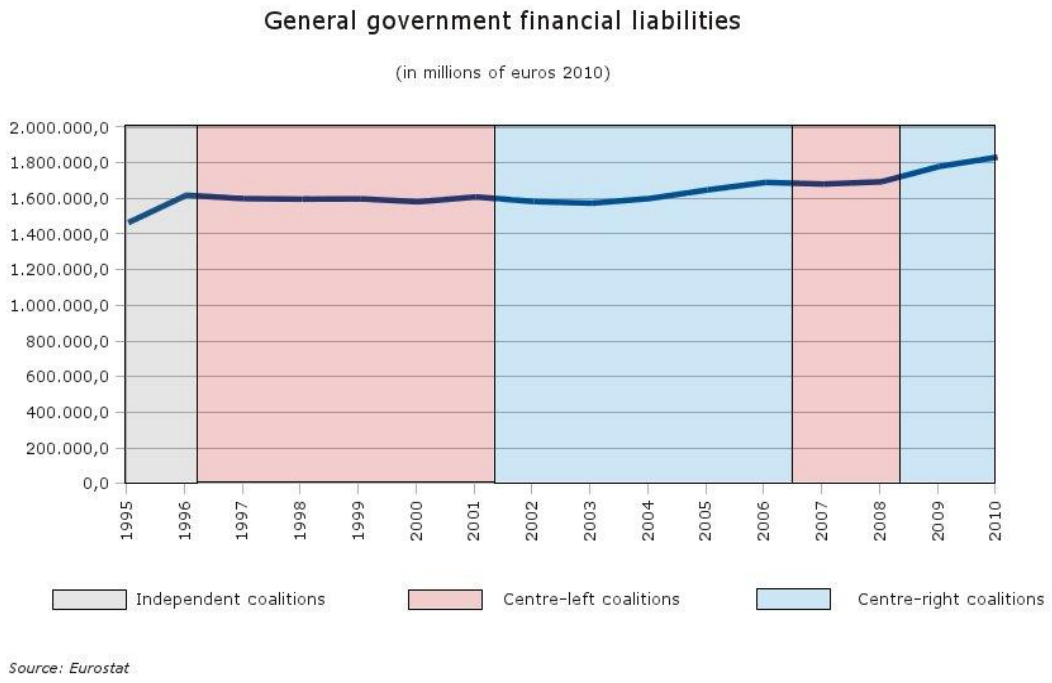
The incompatibility of these mechanisms with the development of the Italian economy in the long run induced a revision of the system of economic regulation but – as it has been showed – the process of reform took more ore less a decade to reach some tangible results.

In the end, the case of Italian economic planning demonstrates how important is the establishment of a favourable institutional framework in order to implement a successful policy of economic reforms: in the near future, but also in the long run, because of the existence of a strong institutional path dependence.

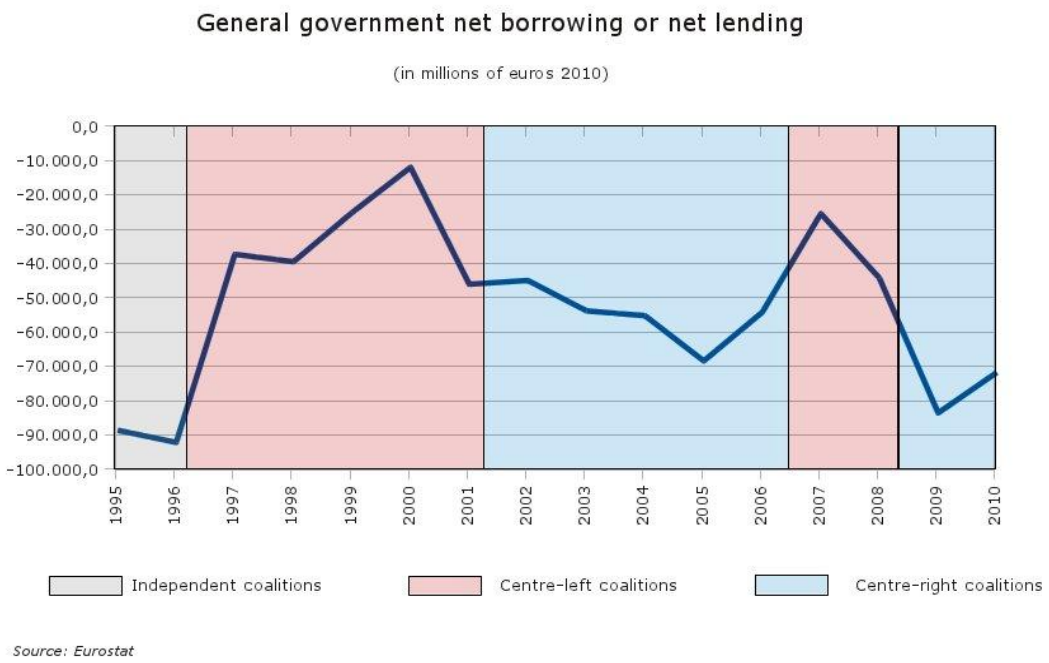
The Italian case proves to be significant also in this perspective. After the reforms launched in 1992 and the radical political transformation induced by the numerous corruption investigations and trials carried out at the beginning of that decade, the institutional environment did not change so deeply. The election system after a

long political debate shifted from proportional to uninominal representation, but the institution in charge of the design of political economy were not radically transformed: the CIPE still exists today and the bargaining between economic ministries is still an important part of the decision process that led to productive investments.

Not by chance, while the country registered flat growth rates for more or less a decade, public debt – after a period of slowdown – continued to growth both in relative and absolute terms.



A phenomenon that is possible to explain considering the mentioned institutional path dependence mentioned above and also the political weakness of the coalitions that ruled the country in the second half of the 1900s and in the 2000s.



As it is possible to see in the graph above both the centre-left and the centre-right coalitions found difficulties to pursue the reform process started at the beginning of the 1990s. The centre-left government, strongly committed to reduce public debt and deficit reached significant results during their first years of government, but this efforts were rapidly dispersed when the coalition itself began to disrupt and the risk of new general election became concrete.

On the other hand, centre-right coalitions were for sure more solid in terms of parliamentary majority. Nevertheless, often pursuing particularistic and opportunistic interest, they regularly increased the amount of public expenditures, favouring the growth of public deficit and debt that are at the basis of the today financial crisis.

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