Far from being a factor contributing to the economic stagnation of the 1990s, the Italian banking and financial system with its structural transformation and improved performance worked and is working in the opposite direction, fostering growth. Further gains in the efficiency of the financial industry can make a significant additional contribution to raising the Italian economy’s growth potential.

Schumpeter revisited

As a general rule, finance helps to determine not only the *levels* of variables such as the capital/labour ratio, productivity and national income but also their *rates of increase*. All else being equal, the *growth* of an economy that develops or improves its financial system is likely to be considerably faster.

The financial system contributes to the quantity and quality of resources and the ways they are used by performing the following functions:¹

- clearing and settling transactions;
- pooling resources and subdividing the participation in economic initiatives;
- allocating resources, especially to firms;
- managing uncertainty and controlling risk;
- providing information through prices;
- dealing with the incentive problems that arise in the relationship between issuers and subscribers of financial instruments.

The fact that a more effective performance of these functions not only influences the economy in the broad sense but also helps to foster
growth implies a connection between these functions and variables that are decisive to growth, such as the accumulation of capital – tangible, intangible, ‘human’ – and technical progress.²

The propensity to invest, the propensity to save and the proportion of savings that is channeled into investment are all affected positively by finance as a rule, although in certain very particular conditions a more efficient financial system can lower households’ propensity to save. Thus a good financial system tends to increase the scale of capital accumulation, which continues to be seen as important in all models of growth.

No less important is the channel of technical progress. Both the theory of growth and the economics of finance and growth have assigned increasing, indeed prevalent, importance to this factor. This reflects the basic empirical pattern observed by Simon Kuznets half a century ago and confirmed by subsequent studies of economic growth in many countries, namely that the quality of resources and of their utilization is more important than their quantity in determining the wealth of nations:

> [T]he direct contribution of man-hours and capital accumulation would hardly account for more than a tenth of the rate of growth in per capita product…The large remainder must be assigned to an increase in efficiency in the productive resources – a rise in output per unit of input, due either to the improved quality of the resources, or to the effects of changing arrangements, or to the impact of technological change, or to all three.³

Finance is closely connected with all three of these factors. In particular, it can have highly productive leverage effects on organizational and technological innovation. It is no surprise, therefore, that the recent literature on growth and on finance and growth is characterized by a ‘return to Schumpeter’. For among the giants of economic theory, Schumpeter more than anyone emphasized the link between innovation and finance or, to use his own terms, between the essence of development and the essence of credit.

The mystery that some market economies develop while others with comparable resources and institutions remain mired in backwardness is increasingly explained by reference to entrepreneurship, found in the former but lacking in the latter.⁴ Differences in growth rates across time and in different places are also increasingly attributed to differences in the degree of advancement of the financial system, particularly in its capacity to select and sustain innovative firms and investment projects. This special quality of the financial system has been defined in a variety