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RIVISTA DI STORIA ECONOMICA

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International Issue

PAOLO BAFFI

The Bank of Italy and Foreign Economists, 1944-53: A Personal Memoir*

Of my thirty five years at the Bank of Italy between the resumption of my post in June 1944 and my resignation as Governor in October 1979, these periods stand out in my mind as those in which a Keynesian demand boost was actively considered: 1948-49, the last nine months of 1951 (following the collapse of the Korean boom), 1958, 1964 and 1975. The present essay extends the analysis of the first two of these episodes contained in an earlier piece,¹ drawing attention to some of the cultural influences that shaped our thinking those first two times the issue was raised.

In the wake of the new Bank law of March 1936, Governor Azzolini had strengthened the Research Department of the Bank of Italy, recruiting Campolongo, De Vita, Di Nardi and myself; a number of other promising young people were assigned to the Supervision Agency. The Research Department was further expanded over the following thirteen years, and around 1948-49 its staff included accomplished scholars like Caffè, Ercolani,

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Guidotti, Masera, Occhiuto, Parravicini, Rosania, and others. Our relations were friendly, but we did not hold working seminars; and the habit of discussing the draft chapters of the Bank's Annual Report,² both among ourselves and with the Directors, was then just beginning. This paper cannot therefore speak to the views on demand management of the Department as a body (though I shall refer to it as "we"), but remains rather a personal memoir, documenting events as I remember them and as they emerge from my private papers.

I shall begin from before 1948, both to recall the problems which occupied us rather more, at the time, than the less urgent one of expanding demand, and because the turning-point of my life—the appointment to head the Research Department, and, shortly after that, the meeting with Einaudi—occurred in 1944-45.

As a student, I had had in 1931 the opportunity to hear Sir William (later Lord) Beveridge, then Director of the London School of Economics. Campolongo and I were together in London, with scholarships from the Bocconi University of Milan. I was much struck at the time by the sight of the Welsh miners tramping in single file along the edge of the sidewalk singing mournful dirges and begging pennies, and of the laid-up ships and stilled cranes in the port.

During the next five years, I reviewed various works by Beveridge and Keynes, among others, for the *Giornale degli Economisti*.

Having moved to Rome, I read Keynes's *General Theory* for the first time; but when in September 1938 Arena invited me to translate it, I was weary of translation work, and let the task pass to Campolongo (whose translation proved second to none).

While serving in the war, I took advantage of my leaves (due principally to the public loan campaigns) to reread the work. I made a long summary of it, with comments and digressions, which incorporated the interpretations of the more difficult passages that were emerging from discussions with Dominèdò, a former colleague at the Bocconi Institute of Statistics (directed by Giorgio Mortara) who was a much stronger mathematical economist than I. I later lent this thick dossier to Mario Zagari, and it was lost, with many other papers, when he was arrested for anti-fascist activities in the autumn of 1943.

Meanwhile, two further study trips to London (in 1937 and 1939) had allowed me to visit with the Overseas and Foreign Department of the Bank of England, testing and deepening my book knowledge of the City. I met Grafftey-Smith, head of the

Department, and became friends with O'Brien, future governor of the Bank.

The liberation of Rome found Grafftey-Smith, about to be promoted to Brigadier General, in the Allied Control Commission as Chief Financial Officer. Three delegates from the American armed forces (Henry Tasca, Andrew Kamarck, George Willis) had arrived at the Bank, meanwhile, and were eager for documentation on Italy. Others would also come to the Research Department with frequent requests for information: for example, Hans Landsberg of the OSS (now in Washington as Senior Fellow, Resources for the Future) and Hans Cohnsen, former assistant of Irving Fisher, of the Psychological Warfare Board. My familiarity with English, acquired over a long series of translations, and my training in statistics helped me form friendships with these men also.

With the transfer of the central administration of the Bank to the North, retirements, and impending purges, the Research Department was short of personnel at this time. As a result, and thanks also to the cordial relations I enjoyed with the Allies, I was left at the head of the Department despite my comparatively low rank. Meanwhile, a court of "justice" brought Azzolini's career to a dramatic end, just as my own would end, some thirty-five years later. His replacement in January 1945 by Einaudi, who had shown an interest in some of my writings of the 1930s, consolidated my anomalous position.

There was considerable enthusiasm for joint cultural projects with the Americans, among them a "review of reviews" and a new Carnegie Foundation series on the history of the war. The latter was discussed with Gino Luzzatto and Ugo La Malfa. The Foundation had invited Tasca to put forward proposals; but after discussions with Carnegie officials Hirschman warned us that the project was stillborn, because the Foundation was wholly preoccupied with the problem of the atomic bomb. A derivative project, a series of volumes on Italy's postwar economic problems, was instead partially realized. This project won the support of Einaudi, who entrusted it to Bresciani Turrone. The series eventually included monographs by Coppola d'Anna on reconstruction, by Medici on agriculture, by Parravicini on the banks, and by Steve on the fiscal system.⁴ My own volume, on the balance of payments, was never completed, in part because my position at the Research Department kept me busy with a number of other tasks.

I was then involved in the reorganization of the Department,

with its attendant human problems, and in the preparations for the overprinting of bank-notes or some other form of currency renewal. I was also a member of the Treasury Commission for financial reconstruction, where currency renewal was intensely debated; and I had to research, and discuss with the Allies (Tasca, in particular), a structure of multiple exchange rates that would further price stability without reducing our foreign exchange earnings.⁵

On December 19, 1944, Einaudi appeared at the plenary session of the Commission for financial reconstruction. I had never seen him before, and his physical fragility seemed almost to highlight his indomitable spirit. I later learned from his secretary, Antonio Rainoni, that he had chosen the Bank of Italy over the Embassy in Washington, in part because of the opportunity to work with the young people in the Research Department.

The wartime Beveridge Report on social insurance⁶ had been transmitted to us by the delegation which the Bank maintained in Lisbon from the end of 1940 to 1945, under the talented direction of Rinaldo Ossola. I was then reading that report, and Einaudi discussed it with me shortly after he joined the Bank. My initial collaboration with him was mainly concerned with the drafting of the Annual Report for 1943, the floating of the Soleri loan (in which Steve was much involved), and the preparations for the possible overprinting of bank-notes. Einaudi read the Report on April 18 and was deeply moved when speaking of the hoped for, imminent reunification with the North—just as Azolini, reading the Report for 1940, had been deeply moved when speaking of the first Italian casualties of the war.

I too was getting ready for the reunification. Tasca had informed me in September that I would be accompanying the Allies north; Landsberg had confirmed it, and Einaudi had released me from the day following the presentation of the Report. I was attached to a Special Force unit sent to assess the economic and monetary situation in the North. Other members of the group were Landsberg himself, and William Salant (Walter's brother, also an economist), with whom I made the trip.

We left in a jeep on April 28 and arrived in Milan on the 30th, having passed through Brescia and Bergamo, where the registers of shares and the Note Printing Department had been taken. I soon tracked down Parri, who was camped with his family in the porter's lodgings of what had been a house of detention and torture, the so-called Mournful Villa. He joined the mess of our little unit, exposing himself to the barrage of questions on the

Resistance, the economy and its prospects. Our mission lasted a month and resulted in reports sent to both Washington and Rome. During that month Einaudi and Soleri came to Milan, to prepare the extension to the North of the loan identified with Soleri's name. The technical conditions for this were fairly favorable: there was excess liquidity (especially banknotes) from suppressed inflation, which was not easily turned into investments (given the lack of raw materials, fuels, and transportation). The psychological conditions were less good. A sense of distance from Rome was in the air; but Soleri's heroic past, transparent moral honesty, and natural dignity were powerful influences, and Rome's authority was accepted through his. (The allied officers also tended naturally to accept his authority; Grafftey-Smith, in particular, grew to admire him.) Soleri was ill, and would die a few months later; yet he fought with great commitment and effect. The rate of 5 per cent was agreed to, albeit with difficulty, as the treasurer of the National Liberation Committee for Northern Italy, Pizzoni, and certain representatives of the Left said it was "too high for the social conscience of the North."

The end of the war increased the number and level of the visits to the Bank by Italian and foreign economists, and stimulated the exchange of ideas. Goldenweiser, director of the Research and Statistics Division of the Federal Reserve Board (and father-in-law of Kamarck) arrived in August 1945. He was followed by Hirschman (then in the army, and later, from the fall of 1946, with the Federal Reserve Board), who was to return several times. The other foreign scholars who came to the Research Department for brief or extended visits include Leo Pasvolksy, Barbara Ward, Elizabeth Wiskemann, Hans Staehle, Hal B. Lary, W. H. Chamberlin, Michael Kalecki, and William Welk, who wrote a report for the UNRRA on the Italian economic situation at the end of 1945.⁷ The Research Department also enjoyed at times the visits of the best Italian economists, attracted by the presence of Einaudi and, later on, of Menichella; Sraffa's, in particular, were memorable. Bresciani Turrone was the Department's guest for a time, and Benini was a habitual visitor. Del Vecchio came to see us after he had been Minister of the Treasury, and wrote to congratulate us on our work.

Thanks also to these rewarding contacts, our morale was high, and we eagerly tackled our ever increasing work load. In 1946 we drafted the Annual Reports for 1944 (which Einaudi kept very brief) and for 1945; helped the new General Manager,

Menichella, define, in cooperation with the Ministry of Foreign Affairs, the position of Italy with respect to the economic clauses of the peace treaty (the reparations, in particular), and prepared the relevant documentation. We studied the conditions and estimated the proceeds of the Reconstruction Loan, for which the banks were offered the choice between a 5% coupon and a 3.5% tax-exempt coupon. In addition, some of us at least worked with the Economic Commission of the Constituent Assembly, chaired by Demaria, for which I drafted a report on exchange controls.⁸ Meanwhile, in May inflation had picked up again, prompting a closer study of monetary conditions.

Given the number and nature of the commitments of the Department for which I was responsible, I should hardly have taken on the task of translating Beveridge's new work,⁹ as I instead did in December 1945. The translation had been started and abandoned by Felice di Falco; I took it over and finished it, with the help of Amulio Mancusi, in little more than a year. The recollection of the white-haired gentleman I had heard lecture at the London School, the discussion of his latest works (and Keynes's) with Einaudi, our fascination with the idea of full employment must have clouded my sense of priorities.¹⁰

Meanwhile Ferruccio Parri, with whom I had worked ten years earlier on the volumes the Società Edison published for its 50th anniversary,¹¹ wanted me to help set up a consortium of research centers which would provide the Allies with analyses of Italy's economic conditions. This did not come about, as the Americans considered Parri still too much of a political personality; but he founded the Istituto per gli studi di economia and *Mondo economico*.¹²

In December 1946, the board of directors of the Bank of International Settlements met again after a seven year hiatus. The two Italian members of the board were Einaudi and Menichella. Einaudi was present at the meeting, while Menichella was represented by Pietro Stoppani.

On that occasion Einaudi met Sir Otto Niemeyer, English member and former chairman of that board and, with Jacobsson, one of two most influential individuals in the BIS. At the 1906 Civil Service entrance examination, he had come in first (out of 104 candidates), ahead of Keynes. Niemeyer was sent to the Treasury and Keynes to the India Office, because the great economist to be did relatively poorly in economics and mathematics.

Einaudi and Niemeyer considered sending an Anglo-American

research mission to Italy to study and report on the situation. Niemeyer recommended the invitation of a trusted expert instead. These same options had been discussed, on board the *Queen Elizabeth*, by the Swiss banker Nussbaumer (Bankverein, Pirelli International), who favored the mission, and the Italian ambassador in London, Carandini, who favored the expert. Einaudi, who probably knew of this, chose the Carandini-Niemeyer solution. He at once invited Jacobsson, who was head of the Monetary Department at the BIS, in part perhaps because in the board of directors of that bank Italy was (and is) on equal terms with the great powers.

Niemeyer and Einaudi also considered a World Bank loan, which could be for general purposes or tied to specific projects. In the postwar years, Einaudi, and later Menichella, were eager to obtain foreign loans and to promote foreign investments in Italy, both to improve the balance of payments and to involve the experts of the lending agencies in the definition of the corresponding projects.

Jacobsson came to Rome in January 1947. There he saw Einaudi, with whom he discussed the Export-Import Bank loan, the allocation of savings between the State and the private sector, and exchange rates.

He met many other public servants, bankers, manufacturers, and politicians. My conversations with him concerned exchange rates. I felt that their premature unification would have led to political favoritism in the allocation of foreign exchange, as under fascism. It seemed best to let the market find the appropriate rates, reflecting supply and demand in the real and monetary sectors. From Bresciani Turrone he heard arguments against renewing the currency as part of a tax package. La Malfa instead criticized Corbino's policy, tying it to his ignorance of Keynes, and argued that currency renewal and a wealth tax were politically necessary to monetary stabilization. Jacobsson did not see the point of renewing the currency at that late date, and noted that it would unjustly favor those who had exported capital.

Jacobsson obtained statistical data from us and from the UNRRA, which was well informed about construction programs and the supplies of essential goods (especially wheat and coal). Molinari, former Director General of the Istituto centrale di statistica, was then with the UNRRA.

In spite of the good will of that Allied agency, which did much good in Italy, and our own, Jacobsson seems to have found it hard to grasp the reality of Italy's economic and budgetary

situation—which was admittedly veiled by the coexistence of official and floating prices and exchange rates, by the uncertainty of future public revenues from taxes and loans in the presence of galloping inflation, and by the contrasting opinions over the importance of budgetary arrears (the head of the Accounting Office, Balducci, had made them seem quite frightening, while others, including Menichella himself, had been reassuring). Perhaps as a result, on his return to Basle Jacobsson produced only an unfinished draft of a report, which he circulated only within the BIS.

The task of writing a finished report was assigned to me a few months later. I accordingly went to Basle for six weeks, and in the summer heat, went over the text with Jacobsson. The final report was widely read, and many appreciative comments were received by the Bank of Italy and the BIS, especially from American bankers.¹³ To many of them, this was the premier source of information on Italy's postwar situation; by presenting Italy's successful stabilization policy, it helped reopen credit markets to Italian borrowing.

The following September, the first mission of experts from the World Bank arrived in Rome. It was favorably disposed towards Italy, not least because its excellent Italian counterparts included Menichella (General Manager and Acting Governor of the Bank of Italy), Bresciani Turroni and Francesco Giordani, respectively Executive Director and Deputy Executive Director of the World Bank itself.¹⁴ We produced large quantities of tables and reports, borrowing the indefatigable Campolongo from Ansaldo (where he had been working for several years).¹⁵

Early in October, Rome was visited by the most important representatives of the institutions who would judge us and grant us credit: Myrdal and Kaldor of the Economic Commission for Europe; Gutt and Bernstein, respectively Executive Director and Research Director of the IMF; and Eugene Black, President of the World Bank. In Rome they met with each other, and with the highest levels of the government, the Bank of Italy, and the Foreign Exchange Office (De Gasperi, Einaudi, Merzagora, Pella, Segni, Menichella, Formentini, Carli).

The World Bank mission, which stayed two months, was followed by another organized by the IMF. The members of the latter I took to Milan, to introduce them to a number of businessmen.

On March 31, 1948, in the presence of Einaudi, still Governor, Menichella presented his first Annual Report, on which we

had worked until four a.m. But he would not publish it, for reasons unknown to me, until December. He immediately changed the date of the shareholders' meeting from March to May, in order, he said, to be better informed of what others were writing about the year in question. That did not stop our night work: late in May, we would hear the birds of the nearby Villa Aldobrandini start singing as the dawn broke.

In the fall of 1947, I was appointed to the "Commission of Eight" for the long-term (Tremelloni) plan. My concern was not in fact the plan, or even monetary policy, but rather the construction of a "national monetary account" (as I called it, by analogy to the new-born "national income account" with which it would be associated in the Annual Report) which measured the flows through the monetary and financial markets. It was probably not very well conceived, as it highlighted the change in the supply of money—clearly a backward looking approach, since additions to the monetary base enter the money supply only when prices and incomes have already risen: when the crime, as it were, has already been committed.¹⁶ A forward looking approach would rather have highlighted the banks' net free reserves, as these are the source that feeds the expansion of credit and money.

For all its possible shortcomings, the "monetary account" was a first attempt to measure financial flows on a comprehensive basis (albeit in net terms) and to identify the expansionary and contractionary influences stemming from the various sources of new monetary base (treasury, credit system, foreign sector). It thus laid the basis for an analysis of the relationships of those sources with each other and with the uses of the new monetary base. It also strengthened our relations with experts and organizations concerned with monetary flows and stimuli: Holtrop, Witteveen and others from the Netherlands, Triffin, the Federal Reserve Board (Morris Copeland and Daniel Brill), and, finally, the International Monetary Fund, which a few years later asked me to lecture on monetary analysis in Italy.¹⁷

The first "monetary account" was incorporated into the Bank of Italy's Annual Report for 1948; that was also the first to publish sectorally disaggregated statistics on bank credit.¹⁸

We felt a particular need to improve our macroeconomic information, as Italy's economic conditions seemed increasingly to warrant expanding demand.

Elsewhere, I have argued that monetary conditions ruled out any expansionary policy before 1948.¹⁹ My criticism of Corbino

at the time was the opposite of that voiced by La Malfa, recalled above: I argued that Corbino had been too quick to dismantle, in the presence of excess liquidity, the structure of incentives and restrictions that Thaon di Revel had built up to channel such excess liquidity to the State. In general, I would say, the economy was still suffering from war-induced bottlenecks and price distortions; one had to give it time to settle down before trying to alter its course.

The excess liquidity, the pent-up demand to rebuild both producers' fixed and working capital and consumers' houses and possessions produced a rapid growth spiral that was further magnified, from May 1946 to September 1947, by inflation.

Monetary policy was intensely debated in 1949-50. Of the leading thinkers and participants in that debate I had already met several times Harlan Cleveland (who had been in Rome since 1944, first with the Allied Control Commission and later with the UNRRA). Kaldor and Hirschman came several times in 1947-48. Hirschman later wrote to me commending the Research Department: he had found "the whole 'shop' animated by the same spirit of objectivity and true research which we try to cultivate at the Board."²⁰ Triffin also came, with Gutt, Chairman of the Executive Board of the IMF. And Myrdal came again early in 1949.

From the Bank I could observe, and help shape, some of the currents of opinion in Italy.

Einaudi was reluctant to admit so much as the possibility of excessive saving. He asked me for examples; but since I could adduce only the idle resources during the Depression (the 1973 oil shock was still to come), which he attributed to other causes, the proof became impossible.²¹

Jacobsson himself, to whom both Einaudi and Menichella listened, did not clearly grasp the concept of underemployment equilibrium, in which excess *ex ante* saving is eliminated by a reduction in income. His own writings, quoted below, take the fact that very few countries have been capital exporters as evidence that savings are rarely in excess supply.

I had at least partially accepted that "saving . . . is a mere residual. The decisions to consume and the decisions to invest between them determine incomes."²² But I was not entirely convinced: if the flow of savings (which are not hoarded) helps determine the interest rate, which in turn determines investment (together with the marginal efficiency of capital), then saving is also causally prior to investment.

I was also concerned that in the circumstances of the time a Keynesian expansion would run headlong into real bottlenecks; but what most made me wary of Keynes's model was the assumption of a closed economy. I found it odd that an economist raised in what was then the world's most open national economy should build, even as a first approximation, a model that ignored the balance-of-payments constraint. I wondered if he had not perhaps modeled the United States; not the world, certainly, because an economic policy requires a government. My conclusion was that the consistent application of the Keynesian model to a national economy required that one close that economy: a sinister prospect indeed for one who had experienced Fascist autarky, and naturally associated the closing of the economy with the denial of economic liberties (not to mention others) that had lowered living standards in Italy.

Menichella's natural prudence had been fed by his professional experience, and his actions now refused with equal firmness to risk either inflation or deflation.

As a young man just back from the war, he had worked in the Foreign Exchange Bureau (where he grasped the reality of destabilizing speculation). He joined the Bank of Italy in 1921, and was assigned by Stringher to the liquidation of the Banca italiana di sconto; in 1923 he moved to its heir, the Banca nazionale di credito. In 1930, the latter was incorporated into the Credito italiano, and in the following year Menichella became director of the newly constituted Società finanziaria italiana, which took over the industrial shareholdings of the Credito italiano. Three years later, with the creation of the IRI (Institute for Industrial Reconstruction), he became General Manager of the more important of its two sections—the one dealing with the liquidation of assets—and held that post until 1943.

Menichella had thus spent over two decades confronting first the financial, and then also the industrial, problems of unrecoverable credits and of businesses in crisis—problems which stemmed not only from the lack of skill and mistakes of bankers and businessmen, but also from the growing debt burden and the falling sales caused once by the deflation of 1921 and again by that of 1930-32. Mindful of speculative activities from his earliest professional experiences, and having held positions of responsibility through the stabilisation of the lira, the Great Depression, the Second World War, and the renewed inflation of 1946-47, Menichella well knew that velocity varies widely as a function of the business cycle, economic policy, and expecta-

tions. In November 1966, commemorating Per Jacobsson at the Foundation which bears his name, Menichella said that in 1947 the mistake of twenty years earlier, of "obstructing the flow of new money on to the market after a phase of sharp inflation," had been avoided." The concluding remarks of his Annual Reports often dwell on the instability of the ratio of money to national income, in Italy and abroad.

Menichella, whose recent death (July 23, 1984) we mourn, was neither a deflationist nor a monetarist in the present meaning of the term.

On the other hand, he also feared renewed inflation, especially in the late 1940s when Italy had limited international reserves, was engaged, together with its European partners, in freeing trade and returning to multilateral exchange, and was receiving a flow of foreign aid that would dwindle and finally end in 1952.

Menichella also believed that in a nation with a relatively low standard of living, as Italy had at the time, higher money incomes would largely have been translated into higher demand for goods, especially foodstuffs, the domestic supply of which was inelastic; both the price level and the balance of payments would thus have been strongly affected. Even in the 1950s he was much concerned with the harvest, as shortfalls immediately raised prices, and hence, because of widespread indexing, wages and production costs.

He was always particularly close to Saraceno and, until his fatal illness, Francesco Giordani, respectively his colleague and his president when he was at the IRI. Neither was as pessimistic as Menichella about the internal and external consequences of an expansion of demand; Saraceno had actually come up with some estimates which he discussed with Jacobsson when the latter came back to Rome in the second half of 1949.

One of their arguments was basically that, as they used to say, "the unemployed already eat." Even so, as Jacobsson emphasized, one had to make sure that the increase in employment did not so increase the wage bill as to increase the demand for foodstuffs. And there was also the argument developed by Vera Lutz in her work on Italy: namely, that the problem would arise not so much from the increased consumption of the underemployed or unemployed who found work in a factory, as from that of the family units that previously supported them.²⁴

I do not know whether Menichella ever used this subtler version of his argument with his two dear friends. On a different point they were in agreement: the need for a program of produc-

tive investment in the South. Its balance-of-payments effects were to be absorbed by a loan from the World Bank. This plan may help explain why Giordani would spend long periods in Washington as Deputy Executive Director at the World Bank, even though that post was not entirely suited to a man of his stature (he was soon to preside over Italy's Academy of Sciences). But, again as Saraceno tells us, that plan was designed to expand supply rather than to sustain demand.²⁵

In the years 1948-50 there was a flowering of studies, published only in part, on the aims, the means, the monetary effects, and the real effects of the stabilization of the lira. In this essay, I shall recall only those (by foreign scholars) which had a major impact in the Research Department, which had typically been the authors' host during their research work, and which typically prepared the Italian translations for the Governor's attention.

At the end of 1947 Earl Hicks and Georges Sallé produced the report of the IMF mission.²⁶ It cast Italy's monetary policy dilemma in the usual terms, as a choice between investment-employment-inflation-foreign deficit on one hand and stability-unemployment on the other. Sure of their mastery of the material, the authors praised Italy's export-oriented exchange rate policy. After November 28, in fact, Italy adopted a sort of crawling peg, in the sense that the half of export earnings which was paid in to the Foreign Exchange Office was converted at a rate which reflected the market rates obtained by the free half. Menichella believed that "the Government does not want to establish a par value until there is a good likelihood that the established rate can be maintained without impairing Italy's exports."²⁷ The report also commended the Government for its considerable investment program for 1948 and for its prompt adoption of selective measures to support industry (especially engineering) in the post-stabilization recession. The threat to monetary stability from the indexation of wages was described in terms appropriate to the 1970s and '80s rather than to the actual course of the 1950s and '60s: "when production and the import surplus are no longer able to expand, any inflationary gap must be financed by a fall in real wages and, with the sliding scale of wage determination, and a sufficiently short interval of wage adjustment, an uninterrupted rise of prices could occur."²⁸

Hirschman used to commit the observations and thoughts prompted by his visits to Europe to extremely lucid articles and

internal reports to the Board, which were also regularly sent to us. I recall, in particular, an internal document of February 1947 on exchange control in Italy and a first, thought-provoking comparative analysis of reconstruction in France and Italy published a few months later.²⁹ In these papers Hirschman considered our exchange rate policy as the better able to achieve equilibrium in the balance of payments. He stressed that by allowing exporters to sell half their foreign exchange earnings on the free market, as we did from 1946, we had widened their profit margins at importers' expense. He recommended caution in the pursuit of orderly cross rates, sought by the IMF and by the British, at a time when the free market price of sterling was well below the official rate of \$4.03. He observed that "while it is true that even a nation's currency system cannot indefinitely remain 'half slave and half free,' it would appear better to leave it provisionally in this condition pending the creation of the bases for a system of total freedom—when the only practical alternative is a return to total regulation."³⁰

I also recall a report circulated in April 1948, and subsequently published in somewhat abridged form, on inflation and deflation in Italy.³¹ In this paper, derived from his visit to Italy late in 1947, Hirschman recognized that after the stabilization the Government had promptly taken measures selectively to assist industry, and to sustain demand by expanding the deficit component of government spending (by postponing the first due date of the wealth tax, abolishing the progressive tax on dividends, and increasing depreciation allowances). Hirschman came back to see us, on another mission, toward the end of the year.

He had contributed to the Economic Cooperation Administration Country Study published early in 1948, which was in no way critical of the policy of Einaudi and Menichella.³² This was followed in February 1949 by another, longer study, which was instead sharply critical of that policy.³³ Of the various Keynesian studies published in that period,³⁴ this was the one that most troubled those who gave top priority to maintaining monetary stability and building up Italy's international reserves, seen as preconditions for economic growth and the liberalization of trade.

Paul Hoffman, head of the ECA, prefaced this report with the statement that it represented the considered views of that Administration. The document was initially drafted at the ECA, primarily by the brothers Cleveland (Harlan and Van Buren). Upon reading that draft, the ECA mission to Rome—specifically its head, J. D. Zellerbach, and the two directors of the Programs

and Finance Divisions, Vincent Barnett and Andrew Kamarck—fought to moderate its critical tone.³⁵ Some of the views set forth in the Country Study were to reappear a few years later in Barnett's 1955 MIT Economic Development Program working paper on the Italian political situation; the Bank was among the small number of Italian institutions and individuals to receive a copy of the work.³⁶

The central thesis argued by the Country Study was that political and social stability required faster economic development, as the persistence of widespread unemployment and underemployment would produce political radicalization. The expansion of demand through a strong public investment program was not expected to be particularly inflationary, in view of the current underutilization of resources, and in any case renewed tendencies to inflation or speculation could have been held in check by administrative controls (especially on the allocation of credit). The external imbalance could have been offset by the reserves built up over the previous year and by the increase in Marshall aid that would have been forthcoming if needed.

A strong public investment program, in the context of a comprehensive plan for the investment component of national income, was justified by the timidity of private investors, the need for social overhead capital, and widespread public ownership of industry. This approach seems to reflect the Keynesian notion that the investment function must be partly socialized in order to maintain full employment. The emphasis on the deflationary effects of a savings surplus seems equally Keynesian. The Country Study seemed not to realize that the accumulation of foreign currency reflected a surplus of export earnings over current payments for imports, and that this surplus contributed to effective demand.

Exploring the danger of inflation by trial and error, as the Country Study recommended,³⁷ was hardly congenial to Menichella; but when that report came out, the recovery already under way was stimulated by investment programs (of the fifth and sixth De Gasperi governments) which probably owed something to its closely argued views.

Even though in 1949 Barnett had helped moderate the harsh judgments of the Country Study, in his 1955 study he remained critical of the Einaudi-Menichella-Pella line, which he attributed in part to the limited influence of Keynes on the Italian culture of the time. He argued, more sharply than the Country Study did, that fear of inflation made for unemployment, which in turn

created new fears and difficulties (for productivity growth, for labor mobility) in a vicious circle of stagnation. Faced with the fact of Italy's non-inflationary economic growth, Barnett refused to attribute it to what he saw as Italy's do-nothing governments, and sang instead the praises of Italy's private entrepreneurs in pages of almost poetic beauty. He spoke of the dominant influence in 1947-48 of people of a conservative disposition, and observed, with reference to De Gasperi:

One of his most difficult jobs was to mediate between the left wing of the DC, which restlessly and insistently demanded something more closely approaching a full employment policy, and the right wing which generally supported the Pella-Menichella line. One further factor, perhaps, is that most of the respected economists in Italy outside the government circles were also essentially classical and orthodox in this respect. There were relatively few Keynesians among Italian economists, at least among the older and more influential men. Hence, the anti-inflation policy was surprisingly strong with the country, resting on painful popular memories, deep convictions of the men in the key posts in government, and the blessing of academic economists.³⁸

On the economic recovery and burst of creativity which nonetheless took place, he wrote:

A most impressive fact of this post-war period must be that of the immense vitality and energy of the Italian people in the reconstruction effort. Perceptive travellers in post-war Italy have sensed the zest and spirit of a young, imaginative and ebullient society, emerging in the midst of the visual and institutional remains of the ancient and feudal civilizations. This burgeoning of youthful vigor and imagination within the physical context of past glories is one of the real fascinations of modern Italy. In the space of a few post-war years the leading artists, designers, and businessmen of Italy have established a world-wide reputation for freshness of ideas, for energetic innovation, for a willingness to pioneer. Whether it be in the building of modern apartments, the design of motor cars, the production and merchandising of sewing machines, motor scooters, typewriters, and office machinery, the styling of women's dresses, the production of literate motion pictures—whether it be in these or in many other ways, the new Italy appears as a nation with the accent on youth and a growing zest for life. It is no accident that it is the younger women in other countries who are particularly attracted to Italian hair styles and dress fashions, or that it is the younger men who respond so warmly to the lines of Italian sports cars that their design is widely imitated.

The fact is that modern Italy is a young country, with little experience in the creative force of free economic and political institutions, and that even the relatively limited extent to which the talents of the people have been liberated in these first few post-war years has released an astonishing burst of energy, imagination, and creative capacity. A tremendous reservoir of these capacities remains to be made available through a rising standard of life and a broadening of educational opportunities. The achievements of the post-war years indicate the nature of

the human potential that exists and the scope of development that could be reached if that potential were more fully utilized.

This vitality and energy—much of it as yet untapped due to the inadequacies of the new political and social institutions just beginning to emerge in the young Republic—are the best reasons for an underlying confidence in the future of democracy in Italy, and in the prospects for economic growth and development. Given a relatively stable international economic context, and a reasonable degree of comprehension and cooperation among her friends, the Italian Republic will more than fulfill the promise of these first ten years.³⁹

For Barnett, the fulfilment of this promise was in large part entrusted to the Vanoni Plan.

The roller coaster of alternating praise and criticism continued in the following months. Triffin's visit yielded a report, distributed by the IMF in March 1949, which stressed the problems in the monetary sphere, of particular concern to the Fund.⁴⁰ Partly in light of the pattern of trade, Triffin believed that the existing exchange rate correctly reflected the relative purchasing power of the lira and the dollar, while certain other European currencies were overvalued with respect to the lira. Implicitly, therefore, he assigned the burden of adjustment to those other currencies. He worried about the enduring large budget deficit, mostly financed by the banks: he felt that the coexistence (already present then) of easy credit for the State and tight credit for industry would in the long run create irresistible pressure for an easing of the restrictions introduced the previous year. He also attributed Italy's persistent unemployment to structural causes; and he concluded that it was impossible not to be deeply impressed by Italy's great progress, which exceeded "all reasonable expectations."⁴¹

J. J. Kaplan's "Economic Stagnation in Italy" appeared in May.⁴² It too was clearly Keynesian in approach. Like the 1949 ECA Country Study, Kaplan saw the strengthening of democracy as the supreme objective, and believed that it required a rapid increase in living standards and therefore in production. This in turn was to be achieved through an active investment policy and, given resource underutilisation, through an increase in consumption demand. And since Italian industry—under fascism stagnant, protected, and cartelized—had lost the habit of reducing unit costs through the expansion of the market, it was necessary not only to fight monopolistic practices but also to stimulate demand through government expenditure, sacrificing budgetary equilibrium. Only in this way would the tendency of the private sector to save more than it invested not result in

lower production. In order to achieve the objectives of the Four Year Plan presented by Italy to the OECD in the Autumn of 1948 "there must be an excess of government expenditures over receipts from all sources which equals the discrepancy between savings and private investment."⁴³

The experience of the ensuing decades confirmed the reality of the development potential which Kaplan had sensed; but it was largely realized without the public contribution he had foreseen.

Menichella replied to these criticisms, and to those from businessmen and politicians, in the conclusions to the Annual Report for 1948. A few days later he went to Basle for the annual meeting of the BIS, and, certainly not coincidentally, asked Jacobsson to return to Italy to "update" the 1947 report. He asked me to arrange visits to Italy by other eminent foreign economists; in agreement with my friend Calabresi, director of the Associazione bancaria, we invited Lutz and Lundberg under the joint auspices of that association and the Bank. (They came in 1950 and 1951, respectively.) Jacobsson came to Rome in August 1949, with Rainoni, whom Einaudi had sent to the Monetary Department of the BIS (then headed by Jacobsson), and stayed for a month.

Friedrich and Vera Lutz came to the Bank at the same time, on their own initiative. They were working on two projects, their joint study for the Princeton series, and Vera's contribution to the Council on Foreign Relations volume on *The Economics of Freedom*.⁴⁴

Neither of the two teams was Keynesian. Jacobsson was rather a Wicksellian, close to his colleagues of the Swedish school. His practical bent allowed him to grant a role to public policy; Lutz, formerly Privat Dozent with Walter Eucken at the University of Freiburg, Germany, and friend and advisor of Erhard, was instead a pure free trader. Lutz once told me that when he arrived in Princeton in 1937, the Immigration Service gave Einstein the job of examining him to see if he had any Nazi sympathies. Einstein believed in central economic planning and took the laissez-faire answers of the candidate so badly that Lutz risked failing the test. Between the mild Friedrich and the self-assertive Per there arose, during their stay at the Bank, a spirit of competition which led to some fairly tense discussions.

While in Rome, Jacobsson saw Saraceno and Giordani, who set forth their view (noted above) that an expansionary policy would have only a limited effect on the balance of payments. He also saw Menichella, who wanted the United States to guarantee

American investment abroad against political risks (including that of non-transferability); Kamarck, now representative of the Treasury at the Embassy, who rued the aggressive Keynesianism of the last Country Study; and many others. He went to see Einaudi at the Farnese palace in Caprarola, near Rome, and spoke with him about the Marshall Plan. Einaudi was shocked and outraged that the ECA should finance external deficits without regard to the economic policies which generated them, thus in effect penalizing good behavior. The idea was so foreign to his values, as well as to his sense of the proper functioning of the economic system, that he considered it deeply immoral.

Jacobsson's new report appeared in September; ostensibly an updating of the first, it was in reality an independent, substantial document.⁴⁵ The last chapter, on credit and development policies, reviews the arguments for and against an expansion of credit, with some theoretical background. Jacobsson there attributes Italy's unemployment to causes unlike those observed by Keynes when he wrote the *General Theory*:

[Keynes] concentrated all his attention on a situation in which an abundance of plant and equipment in all lines of production would so far curtail investment possibilities, and the corresponding call on funds for investment purposes, that not even a very decided reduction in the long-term rates of interest (to 3 per cent or less) would prevent a serious contraction in the volume of monetary demand and the increase in unemployment ensuing from deficiency of such demand. This, he thought, was the central problem for Great Britain and the United States—rich creditor countries in possession of unused resources of labor, material and capital but faced with a shrinkage of investments and overall demand. Obviously the situation prevailing after the second world war has been of a totally different kind: no country in Europe—with the possible exception of Switzerland—has found any difficulty in investing its own savings, at current rates of interest, within its own borders.

As may be seen from page 306 of his *General Theory*, Keynes himself was fully aware that the question of a sufficiency or insufficiency of investment possibilities was a question of fact rather than of pure theory; and, after the outbreak of the second world war, he laid very great stress, in his pamphlet *How to Pay for the War*, on the need for savings to set free the resources required for the prosecution of the war, including the new investments necessary to convert British industry to wartime production.

British economists, working in the Keynesian tradition, have insisted that the same *need for savings* continues in the post-war period. Referring to the theoretical framework built by Keynes to suit the Great Depression and to the very different case presented by him in *How to Pay for the War*, Mr. J. R. Hicks, Fellow of Nuffield College, Oxford, in the *Economic Journal* for June 1947, constructed a theoretical

framework of his own as an aid to interpreting the economic conditions in the post-war period. Hicks considers a situation in which the supply of labor will be on the increase (owing to the release of men and women from the services) but the capital equipment of the community has suffered partial destruction, while what is left of it has been gradually worn out and therefore needs renewing—which means investment. As a post-war phenomenon, consumer goods will remain in short supply for a considerable time since the equipment for a sudden increase in the production of such goods will not be available. The labor force will therefore be employed to a great extent in producing investment goods—this being a necessary preliminary to an increased output of consumer goods . . . In view of the relative scarcity of consumer goods, the demand for them must be kept down in order to avoid an increase in prices (likely to be followed by an increase in wages, and so on in a most dangerous wage-price spiral) . . .

The case of Italy clearly illustrates a state of affairs in which there is an urgent need to build up capital equipment, but where a credit expansion for such purposes would increase purchasing power in the hands of workers and others, without a simultaneous increase in the domestic output of consumer goods—and, for such a country, investment activity must, therefore, be limited by the flow of domestic savings and the volume of resources obtained from abroad.

It should, moreover, be remembered that Keynes's analysis in the *General Theory* is applied to a *closed economy*, with no real discussion of the complications arising via the balance of payments. Italy, being extremely dependent on other countries for imports of raw materials and many other goods, is not, of course, in a position to reason on the basis of a closed economy but must always consider the possible repercussions on its foreign balance . . .

[Moreover,] if . . . some factors are available only in limited supply (and others cannot serve as a substitute), expansion of monetary demand can at best increase production only up to the point where the scarcest factor is fully employed. Beyond this point, an expansion in demand will simply raise prices or create shortages without increasing production, despite the fact that there may be considerable underemployment of the less scarce factors . . .

Obviously the theoretical analysis given by Keynes in his *General Theory* postulated a case very different from that of Italy today; and there can be no doubt that, in actual fact, an increase in savings would, in Italy, be a source of greater employment, and not the *reverse*. Under the circumstances prevailing in that country, the distribution of the "unused resources" is such that they cannot serve as a basis for an immediate policy of credit expansion.⁴⁶

Just when Jacobsson returned to Basle, I went to Geneva, to attend the conference of European economists at the Economic Commission for Europe (September 9-12, 1949).

The problems discussed were the dominant ones of the time: exchange rates, the balance of payments, their relationship with monetary and fiscal policies, the transition to multilateralism, the effects of national economic planning on the international divi-

sion of labor, regional economic unions. The working sessions were chaired by Myrdal and Kaldor. The Italian contingent was made up of Travaglini, Di Fenizio, and myself. Steve was also present, as he was then working at the ECE. I did not contribute to the discussions, partly through shyness and partly because they mostly concerned the economies of central and northern Europe, which still maintained wartime controls and suffered acutely from problems that were already solved, or on their way to solution, in Italy (for example, the overvaluation of the currency, excessive liquidity from suppressed inflation, bilateralism). In the discussions, the Keynesians (T. Balogh, F. A. Burchardt, E. F. Schumacher) used what seemed to me an excessively abusive and sarcastic tone, railing, for example, against "the Holy Trinity: multilateralism—non-discrimination—convertibility" and against the attainment of equilibrium at "zero levels of activity."⁴⁷

In Italy the investment policy debate remained lively throughout 1950. It was actively stimulated by three foreign sources: the new ECA study on Italy published at the beginning of the year;⁴⁸ the ECE Survey of Europe published in May;⁴⁹ and the statements the new head of the ECA mission in Italy, Dayton, made at a press conference early in October.

The ECA study on Italy repeated, in milder form, the 1949 Country Study's criticism that Italy's monetary policy was excessively cautious. It acknowledged the inception, albeit belated, of considerable public investment programs. It asserted the need for massive investment in plant and equipment not only to increase demand but also to eliminate bottlenecks (electricity, oil, steel) and increase the competitiveness of Italian industry through an increase in capital per worker, thus improving its ability to withstand the shock of international competition in a world which was gradually opening up to foreign trade and multilateralism. The extent of aid was once again made to depend on the implementation of the desired policy.

The ECE Survey (no longer co-authored by Steve) named Italy, along with Germany and Belgium, as the three European countries in which policy was supposedly deflationary, and had aggravated structural problems: Germany and Italy, "which paradoxically have been among the most insistent in attempting to abolish internal and external controls, have thrown away, by ending rationing and relaxing import controls, two of the weapons which experience suggests are necessary in dealing with structural problems."⁵⁰

According to the Survey, these deflationary policies could

cause the disintegration of the European economy by inducing other countries to raise trade barriers, to avoid importing deflation. As Bresciani Turrone and others noted at the time, the Survey's approach was clearly Keynesian.⁵¹

Dayton's statements in October provoked a series of anxious meetings and clarifications in the higher spheres of government and the diplomatic corps, as well as a visit to Italy by Hoffman. Dayton had tied the need to invest to the need to rearm, and again criticized both the government's inactivity and the business community's passion for protection. The result was the formation of a broad opposition which went, in the newspapers, from Pella and Angelo Costa through Ernesto Rossi and Demaria to Riccardo Lombardi (but left out Gronchi and Bevione). Dayton's criticisms were in any case out of date, as the recovery had been under way for over a year, and the outbreak of the Korean war invited caution (illegal capital exports had also resumed). A well-reasoned reply to Dayton, certainly by La Malfa, appeared in the *Voce Repubblicana* on October 11.

Menichella responded to this succession of attacks in various ways. Through Giordani and Saraceno, he pushed in government circles and in Washington the special investment program for the South, which turned on the creation of the Cassa per il Mezzogiorno and the granting of a major World Bank loan. In February, a World Bank mission led by Paul Rosenstein-Rodan joined us in Rome. In the conclusions to the Annual Report for 1949, Menichella reviewed the course of stabilization. He accused his critics of misdiagnosing the Italian case, pointing out that Italy was growing faster than the rest of western Europe; and he repeated, in greater detail, the reasons against risking Italy's recently reconstituted international reserves. (Apart from the presentation of the Annual Report, Menichella was an infrequent public speaker; but he saw people privately, and converted them with the strength of his logic and the warmth of his voice. Of those who met him in my presence, only Balogh, who came in April to give a lecture, remained deaf to his charm.) Our job in the Research Department was to prepare analyses and reports, which were at times directed to the ECA.

At that time, Menichella had the support of various notable economists. Among the Italians, Bresciani Turrone stood out for his frequent, distinguished contributions;⁵² among the foreigners, I shall recall the Lutzes and E. S. Simpson.

The Lutzes had certain advantages over Jacobsson in dealing with our problems. They had greater analytical skill, and Vera

was well connected to the Research Department; she maintained personal and epistolary contacts with many of us, and dealt frequently with sector specialists as well. Her penetrating questions spurred us to further research to provide adequate answers.

Her chapter in *The Economics of Freedom* found its theoretical support in two of their works of that period.⁵³ I refer above all to Friedrich's lecture on "Wage Rates, Credit Expansion and Employment" in July 1950, published almost immediately over both the Lutzes' signatures in the journal of the Banca nazionale del lavoro.⁵⁴ He presented the United Nations Report on full employment as naive, in that it failed to distinguish among different types of unemployment and paid small attention to the relationship between prices and wages, which Keynes himself considered crucial.⁵⁵ "[It] proceeds in terms of aggregates [such as] aggregate demand, national income, aggregate investment, aggregate consumption . . .; and the relationships between the prices of different commodities, and between prices and wages, are [there] largely neglected . . . [As a result] it is an easy step to the conclusion that all that is necessary to overcome unemployment is to raise aggregate money demand."⁵⁶

This criticism of the ECE approach was further developed by Vera in the paper referred to above. Since it is easily found I shall reproduce here only the concluding judgment:

On the whole, then, we may conclude that, given the conditions prevailing in Italy—the scarcity of real capital resources, trade union policy, the tie-up between wages and the cost of living, the inflation-consciousness of the public and the need for ample dollar reserves—the Italian authorities could have done very little more than they actually did to increase employment during the last two years. They should, rather, be congratulated on having resisted pressures to jeopardize the hard-won stability of the lira, the revival of the saving habit among the public, and the winning of the confidence of potential foreign investors, for the sake of what could be at best only a small, and probably short-lived, increase in employment.⁵⁷

Simpson's article on inflation, deflation, and employment in Italy appeared towards the end of the year.⁵⁸ The author was a young English economist who died tragically shortly afterwards; at the time, he worked with Jacobsson in the Monetary Department of the BIS. Like his director, he had read Hicks and also Joan Robinson.⁵⁹ His essay presented a new model, neither classical nor Keynesian, which stressed the limited substitutability among factors of production. It condemned as inefficient both an investment policy which violated monetary stability (and thus the constraint of voluntary saving) and a policy of real wage

reduction which, in the proposed model, could “add Keynesian to structural unemployment.”⁶⁰ Noting the existence of bottlenecks (such as in energy, as had become obvious in the second half of 1949), the article expressed the belief that “the present cautious policy is as expansionary as can safely be allowed.”⁶¹ Menichella made us keep it handy for the 1950 Annual Report.⁶²

Paul Rosenstein-Rodan had grown close to Einaudi and Fasiani as a youth in Turin. In the early 1940s he moved to London to study the problems of underdevelopment. At the end of the war he became a chief economic adviser at the World Bank and enthusiastically turned his attention to Italy’s dual economy. Though close to influential Keynesians like Kaldor, he also grew close to Giordani, Saraceno and Menichella. He approved of Menichella’s monetary policy, and said as much in his recommendations to the Board of the World Bank for the approval of the loan to Italy to finance the investment program in the South.⁶³ The loan application, which reflected a Keynesian approach, was in large part prepared at Svimez by Saraceno, Ajmone Marsan and Pilloton.⁶⁴

The external debate and the presence, in February, of the World Bank mission headed by Rosenstein-Rodan directed the Research Department’s efforts to the analysis of the effects of a broad investment program. The main contributors to this research were, with Rosenstein-Rodan, Giordani and my deputy, Guidotti. Guidotti followed the real sector more than I did; having just returned from a long posting in Washington to study national income accounting, he was willing to adopt the macroeconomic approach, with which he was familiar.

Guidotti had prepared, with Pennacchiotti, a report on the seriousness of the relative price distortions induced by inflation and on the destructive effects which it can have on employment.⁶⁵ He was, therefore, wary as none other of the dangers of an excessive stimulation of demand. But the basis of the economic arguments and of the estimates in our internal research was the Keynesian framework: the multiplier, the accelerator, the various propensities, the leakages in the circular flow, and so on.

In 1953 Rosenstein-Rodan went to MIT. He came back to Rome a year later to work with us on the Vanoni Plan. He was then working with Eckaus on the factor-proportions problem and sent us studies which attributed unemployment in underdeveloped countries and regions to non-Keynesian causes.⁶⁶

At the ECE conference in Geneva (where certain arguments had come up which would later reappear in the Survey) I had been impressed by Lundberg’s balanced and subtle contributions. Back in Rome, and with Menichella’s encouragement, I invited him to visit us. Because of various difficulties the visit took place only in April 1951, at which time Lundberg gave three lectures on different subjects and in different places.

In his lecture at the Società italiana per l’organizzazione internazionale (where Robertson, Myrdal, Lutz, and Balogh had spoken before him) Lundberg asserted that the Keynesian approach was inappropriate in conditions of inflation and full employment such as then prevailed in Britain and Sweden, and that employment goals had to be considerably reduced if one was to restore a measure of responsiveness to those economies as a step toward restoring convertibility. The lecture was published in *Bancaria* and was followed by a lively critical note by Coppola d’Anna, who considered Lundberg as revolutionary as Keynes.⁶⁷

Of the distinguished economists who frequented the Bank, the most hostile to Keynes was perhaps Ernesto Rossi, great friend of both Einaudi and Menichella. Rossi poured scorn on the very analytical tools on which we relied, even if we were very cautious when drawing practical conclusions.

Even in 1940-43, when interned in Ventotene, Ernesto Rossi had repeatedly offered Giulio Einaudi and other publishers to translate, alone or with his fellow internees, foreign language books on economics and other subjects. Among the works proposed—which Rossi justified in each case with observations on the work’s merits—there are books and essays by Beveridge, Brutzkus, Cannan, Halm, Hawtrey, Hayek, Hicks, Keynes, Knight, Mises, Pierson, Pigou, Joan Robinson, Röpke, Taussig, Wicksell, and Wicksteed. He reserved his greatest praise and agreement for Robbins (four of whose works he proposed) and for Wicksteed; the *General Theory* he recommended translating because of the stir it had caused, but he judged it “a confused and rather disingenuous book.”⁶⁸ The prevalence of authors of the classical liberal school can be explained by three reasons: one objective, one elective, and one of necessity. That is to say, it reflected the intrinsic wealth of contributions from this school of thought, Rossi’s own ideological preferences, and the need to get past the censor, who was hopefully less strict with books critical of Marxism. For example, Rossi said of Mises that “every red rag sends him into a blind rage.”⁶⁹ When proposing the translation

of *Collectivist Economic Planning* (which includes Mises's essay on economic calculation in socialism) he wrote that "its publication would surely not run into problems, since it presents a scientific criticism of communism. The book in fact demonstrates the impossibility of an adequate economic calculation and therefore of a rational allocation of the available resources among competing uses in a communist regime."⁷⁰ Rossi and his friends needed to place their translations, often prepared without a publisher's commission, in order "to earn something."⁷¹

The works which Rossi read and translated or recommended translating during his internment were clearly reflected in his proposal to Laterza in May 1950 to publish a series of ten volumes by modern English and German authors, which could be used as guides for politicians, businessmen, and union leaders. Rossi declared himself confident that President Einaudi would "give his support" to an honorary committee made up of "some of our economists who represent the continuation of the classical school in Italy (Bresciani Turrone, Jannaccone, Fanno, Amoroso, Del Vecchio)."⁷²

At the same time Rossi submitted the idea to Robbins. It was brought to my attention in June by Fuà, who told me there had been a meeting on the issue with Einaudi and some of the economists mentioned by Rossi. Fuà had promised to talk about it to Caffè, Parravicini, Sylos Labini and me.

Robbins's reply arrived in July. He began by expressing his "full sympathy with [the] desire to restore sanity and a sense of proportion in matters concerning Economics," but went on to say that, of the eleven subjects that Rossi had suggested, for three (labor market, planning, social insurance) there were no good books, while, for the other eight, those that Rossi had indicated or that he himself had been able to think of were either too old, too advanced, too specialised, or boring. Robbins said that he was "forced to the conclusion that, for the most part, you will have to get your books written."⁷³

A subsequent letter from Rossi to Bresciani Turrone reveals that even the meeting at the presidential palace had been discouraging ("the discussion did not advance the project by a single step"); nor had any proposals been received from other, younger scholars, by whom he had hoped to be helped.

Instead, the character of the series we proposed has been sharply criticized from a number of quarters. The Keynesians said that the series would give a completely false idea of what modern economic science can contribute to the solution of our problems; that it might mislead the reader by presenting as valid theories that are instead com-

pletely out of date; that it would not be fair play to use the possible contributions from banks and perhaps the name of the President for a work of a tendentious character, and so on.⁷⁴

Faced with this double negative reaction Rossi fell back on the idea of reprinting articles which had appeared over the previous thirty years in the more prominent English and American journals, perhaps rounding off the series with a volume like Wicksteed's *Common Sense* and a history of modern economic thought.⁷⁵

This less ambitious project was presented to Einaudi on July 24 at Caprarola, where I went with Rossi, Menichella, and Lutz (who had edited the volume on money in the Blakiston Series of Republished Articles on Economics).⁷⁶ But not even Lutz was encouraging: he thought that Rossi was looking for a popular anti-Keynesian literature which simply did not exist.

As a consequence, at the end of September a discouraged Rossi wrote to Einaudi: "As to the economists series we had in mind, I think there is nothing more to be done. Better to drop the project than to add to the confusion of ideas. Let's wait until fashions change and economists start using their heads again."⁷⁷

However, he had not abandoned the idea of translating Wicksteed. The idea had immediately come to him when he read the book in prison in Piacenza (1933), as he himself reports.⁷⁸ When in the fall of 1955 he received from Einaudi the introduction he had asked him for, he was delighted. But because of various problems the translation, by Paolo Vittorelli, was never published. According to Rossi's article in *Il Mondo*, publication was imminent; the two volumes were already in page proofs. But in the end the publisher withdrew: the editorial board, having examined the results of various inquiries that had been made, was forced to recognise the "lack of public interest" in the work.⁷⁹

The Korean boom ended around March 1951; production fell and then stagnated over the rest of the year, as wholesale prices eased. In the second half of the year, the deterioration of the French and English balance of trade produced in Italy, through the mechanism of the European Payments Union, a significant expansion of liquidity. The precedent of 1946, when the burst of inflation had been fed by the existing pools of liquidity, might have suggested a policy of sterilization. But, in view of Italy's stronger reserve position and of the current recession, Menichella decided only to "remain vigilant."⁸⁰ In the conclusions to the Annual Report for 1951, where this phrase appears, he was able

to give a satisfied account of the years 1948-51, in which he occasionally struck back at his critics in the ECA:

We may be allowed to note that the satisfaction with which, two years ago, we announced the achievement of the first stage on the road towards the reconstitution of our reserves of gold and foreign exchange was not perhaps in tune with a body of ideas which at the time found strong support here as abroad, and which gave a secondary role to the constitution of adequate reserves within the framework of economic and financial reconstruction. Experience since then has brought qualified opinion nearer to what has always been our position . . .

Italy has been able to meet an unfavorable balance of payments in the first phase without having to adopt drastic measures to limit the volume of purchases, as Germany was forced to do at that time and England and France successively, thanks to those policies which permitted the formation of considerable foreign exchange reserves. It is because of this that measures limiting trade, which always destroy wealth and require difficult administrative controls everywhere and in Italy in particular, have been totally avoided, and that the measures concerning credit could be limited to a reminder to the banks that they should not help, through the provision of credit, the accumulation of inventories beyond the normal needs of business . . .

I refuse to believe what one sometimes hears, namely, that we could have gained for ourselves a larger and more willing foreign assistance if, through a less energetic monetary policy and the persistence of inflation, we had maintained a larger deficit in our balance of payments. To suppose the opposite would be to offend the sense of justice and equity, as well as the competence of those who give us aid.⁸¹

One can perhaps hazard the opinion that in 1951-52 Menichella and La Malfa must have switched roles. While Menichella accepted the risk of an overhang of liquidity in order to stimulate demand in a recession, La Malfa pursued his grand design of liberalization of imports (despite the current trade deficit), without worrying that this might further reduce, in a recession, the value of the multiplier.

From the early 1950s the good health of the Italian economy and of the lira reduced the visits of Italian and foreign doctors to the Bank of Italy. Even Vera Lutz shifted the center of her Roman activities first to the Associazione bancaria (for the International Conference on Credit in 1951) and then to the Banca nazionale del lavoro and to Svimez. Meanwhile my colleagues had grown in independence and scholarly stature, developing their own networks of professional and cultural relations, and sometimes moving ahead of their director. For all these reasons my position became less central and the information I received less abundant. Even so, several distinguished foreign economists continued to keep up fairly frequent contact with the simple

research worker who remained for some years more as director of the Department. An example is provided by Dennis Robertson, who in January 1953 wrote me a letter containing a passage which illustrates his attitude to the welfare state and mentions his relationship with Keynes:

One has had to ask oneself whether it is merely the passage of time, a hardening of the arteries, the achievement of a position of security and material comfort, which has turned one who used to like to think of himself as "on the left" into one who is regarded in many quarters as a black reactionary! I hope not; for I am still at heart a "liberal" in the English rather than the Continental sense. I think I was right in my youth to be an enthusiastic supporter of the great Liberal Government of 1906-14 which laid the foundations of the "welfare state," and to be preoccupied, then and in the 1920s, with the problem of unemployment as being a much greater flaw in the economic and social scheme than had then been generally admitted. I don't seem to myself to have become a different person from what I was in those days but rather to have been driven by the exaggerations and extravagances of other people—and I cannot exempt the inspiring teacher and most kind friend and benefactor of my youth, Maynard Keynes—into seeming to have become so, because one now tries to emphasize things which have been unduly forgotten.⁸²

My testimony ends in 1953. In the ensuing thirty years, it seems to me, Beveridge has displaced Keynes. The extension of the institutions of the welfare state and, in the same vein, of some forms of protection of real wages, has so increased budget deficits as to create a permanent inflationary tension which necessarily pushes monetary policy towards containing rather than sustaining demand. Taxation, guarantees, welfare programs together prevent the realization of full employment on the official labor market despite the presence of excess monetary demand. The system appears to be headed for a terminal crisis which will once again make room for an analysis and a corpus of policy rules worked out in the conditions of great depression that characterized the early 1930s.

I ask the reader who has followed me in this review of the reconstruction years to forgive me if I have often lingered over small details. I have done this because I wished to remember the teachers, colleagues, and friends—both Italian and from overseas—with whom I shared the fears and the hopes, the efforts and the achievements of those years.

¹ P. Baffi, "L'evoluzione monetaria italiana dall'economia di guerra alla convertibilità (1935-1958)," in my *Studi sulla moneta* (Milan, 1965), pp. 225-315. For complementary information see also my "Il problema monetario italiano sullo scorcio del 1944," *ibid.*, pp. 133-76; "Memoria sull'azione di Einaudi, 1945-1948," *ibid.*, pp. 177-93; "Giorgio Mortara e la Banca d'Italia," in my *Nuovi studi sulla moneta* (Milan, 1973), pp. 123-38; "Ideali, scelte e metodi di lavoro," in Ente per gli studi monetari, bancari e finanziari "Luigi Einaudi," *Moneta, dualismo e pianificazione nel pensiero di Vera Lutz* (Bologna, 1984); "Le idee economiche di Angelo Costa," *Nuova Antologia*, 119 (aprile-giugno 1984), pp. 116-23.

² Banca d'Italia, *Adunanza generale ordinaria dei partecipanti* (annual).

³ J. M. Keynes, *The General Theory of Employment, Interest and Money* (London, 1936); in Italian, *Teoria generale dell'occupazione, dell'interesse e della moneta*, translated by A. Campolongo (Turin, 1971).

⁴ F. Coppola d'Anna, *La ricostruzione economica e il suo finanziamento* (Milan, 1946); G. Medici, *L'agricoltura e la riforma agraria* (Milan, 1946); G. Parravicini, *L'ordinamento bancario e l'attività creditizia* (Milan, 1947); S. Steve, *Il sistema tributario e le sue prospettive* (Milan, 1947).

⁵ See Baffi, "Il problema monetario."

⁶ United Kingdom, *Social Insurance and Allied Services. Report by Sir William Beveridge* (London, 1942).

⁷ W. Welk, "Brief Survey of the Italian Economy" (United Nations Relief and Rehabilitation Administration, Geneva, 1945). Antonio D'Aroma, who was special assistant to Einaudi in 1947-48, remembers that there were many other distinguished foreign economists who visited the then Governor. Only those who had close relations with the Research Department are mentioned here.

⁸ [P. Baffi,] "Regime delle valute. Il controllo dei cambi in generale e in Italia," in Ministero per la Costituzione, *Rapporto della Commissione Economica presentato all'Assemblea Costituente*, part III, vol. 1 (Rome, 1946).

⁹ W. Beveridge, *Full Employment in a Free Society* (London, 1944); in Italian, *Relazione sull'impiego integrale del lavoro in una società libera*, translated by P. Baffi and F. Di Falco (Turin, 1948).

¹⁰ As is apparent from his introduction, Beveridge prepared his volume in competition with the government White Paper on the same subject, United Kingdom, *Employment Policy*, Cmd. 6527 (London, 1944). According to Michael Dealtry (economist at the Bank for International Settlements), "Tom Wilson says that by the time it came to preparing the Full-Employment White Paper, the Civil Service was thoroughly fed up with Beveridge. When it was learned that he was writing a report on employment policy which was clearly intended to rival the Government's own impending White Paper, all civil servants were forbidden to provide him with any assistance, even in a personal capacity" (M. G. Dealtry to the author, Oct. 5, 1983). Thomas Wilson is the author of "Policy in War and Peace: The Recommendations of J. M. Keynes," in A. P. Thirlwell, ed., *Keynes as a Policy Adviser* (London, 1982). On our fascination with the idea of full employment see P. Saraceno, "Keynes e la politica italiana di piena occupazione," *Banca Toscana. Studi e informazioni*, 6 (settembre 1983), pp. 7-32.

¹¹ G. Mortara, ed., *Nel cinquantenario della Società Edison* (Milan, 1934).

¹² Libero Lenti, who participated in these initiatives with Parri, describes them as follows:

"The government headed by Ferruccio Parri was formed on June 21, 1945. Some weeks afterwards . . . Parri suggested that I organize a consortium of the research departments of the main companies in Milan in order to help the government gather and process data . . . [But] I knew that milieu very well, [and]

immediately expressed my scepticism about the project . . . We fell back on the idea of creating an autonomous center, the Istituto per gli studi di economia (ISE), which might later develop along the lines of the original idea . . . [With] the fall of the Parri government on December 10, 1945 . . . it was no longer possible to speak of a research department in close contact with government circles. We decided therefore to widen the scope of the ISE and consult for the private sector as well. Parri, less involved in politics, . . . took over the presidency of the ISE with an executive board made up of extremely important personalities, such as Einaudi, Menichella, Vanoni, Tremelloni, and others . . . At that time statistical material was particularly lacking. Because of this we decided to issue, as an ISE publication, a monthly bulletin, *Congiuntura economica*, which I directed . . . This bulletin came out in independent form until September 1956; thereafter it appeared, until December 1973, as a supplement to *Mondo economico*. The first issue of *Congiuntura economica* appeared with an introduction by Parri in which he explained the aims of the ISE; its structure, which was to remain virtually unchanged, also reflected Parri's objectives . . . Over time we realised that the ISE could do its job better through a weekly economic journal . . . In 1946 a group of scholars had begun the publication of a fortnightly review, *Negotia*, edited by Silvio Pozzani. In 1951 it was decided to continue publishing it, but with the name *Mondo economico*" (L. Lenti to the author, Sept. 12, 1984).

¹³ Bank for International Settlements, *Italy's Economic and Financial Position in the Summer of 1947* (Basle, 1947).

¹⁴ Menichella became Acting Governor when Einaudi became Minister of the Budget in May 1947. Einaudi remained as Governor until his election to the Presidency of the Republic in May 1948.

¹⁵ Ten years earlier, he had been the principal author of the second and third volumes of Banca d'Italia, *L'economia italiana nel sessennio 1931-1936* (Rome, 1938). To complete their 1,900 pages, he worked so hard and so long, day and night, as to fall ill.

¹⁶ Pierluigi Ciocca writes:

"The use of the term monetary 'base' with reference to the 'monetary account' of 1947 brings up again the question of the origins, and the diffusion, of the concept in Italian economic literature. W. F. Crick, 'The Genesis of Bank Deposits,' *Economica*, 7 (1927) pp. 191-202, is a definitive clarification of the subject and was not overlooked by the sharper Italian scholars and technicians. However, even before its appearance, it is possible to find in Italian literature obvious traces of the term and above all of the concept. An analytically developed formulation is offered, for example, by Marco Fanno in the second part of the volume on *Le banche e il mercato monetario* (Rome, 1912). A merit of Fanno's treatment is the close link which he established between the monetary base, the individual and total supply of loans and deposits by the banks, and the demand for bank loans and deposits by businesses and families. 'A given relationship normally exists in every country between the quantity of metallic currency (that is, the whole of the first part of the circulating medium) and the quantity of bank deposits. Therefore, as the first part of the circulating medium varies, so do deposits, and in the same proportion. Deposits, therefore, are a function not only of the rate of interest, but also of the first part of the medium of exchange. But the supply of loans corresponding to a given cost structure depends on the relationship between the rate of interest and the quantity of deposits. Therefore, if the quantity of deposits changes independently of the rate of interest, as the relationship between the rate of interest and the quantity of deposits changes, so too will the relationship between costs and the supply of loans . . . At identical costs, or, equivalently, at an identical discount rate there corresponds, from this point on, a different supply from that which held previously; and the supply curve as a function of the discount rate, while retaining the same shape as before, is moved from its initial base. Which means that the supply changes not only as a function of the discount rate, but also as a function of the quantity of deposits corresponding to a given rate of interest. But this quantity of deposits changes

as a function of the quantity of metallic currency in the country. And therefore the offer of loans is indirectly a function of the quantity of this metal money or, equivalently, of the first part of the circulating medium. Letting d represent the quantity of deposits mentioned above, s the discount rate, Od the supply, we can say that: $Od = f(s, d, \dots)$ (pp. 261-63, emphasis added)" (P. Ciocca to the author, Sept. 9, 1984).

¹⁷ P. Baffi, "Monetary Analysis in Italy," *IMF Staff Papers*, 5 (Feb. 1957), pp. 316-23.

¹⁸ The collection of these statistics had started in 1936; see Baffi, "Giorgio Morara."

¹⁹ Baffi, "L'evoluzione monetaria."

²⁰ A. O. Hirschman to the author, Nov. 17, 1948.

²¹ At least one other person was asked the same question about the possible excess of saving: Federico Caffè, also at this time of the Research Department of the Bank of Italy. In December 1953, Einaudi wrote him a letter in which he asked: "to know the existing bibliography on a point of fact:

i) in what historical periods has it happened that the economic system has effectively produced or has had the tendency to produce the excess indicated above?

ii) are there writings (books or essays) in which the above-mentioned tendency is illustrated?

iii) are there studies about this subject which refer to the period of the great crisis around 1930?

iv) with the same question in mind, have other periods been studied?

v) is there a literature in which people have studied the frequency with which the tendency for savings to exceed possible uses occurs, when compared with the possible opposite excess of uses as against savings produced?" (L. Einaudi to F. Caffè, Dec. 21, 1953).

Sergio Steve observes that:

"it is not well enough known that Keynes used the idea of available saving, as a means of financing recovery, only in his early writings on Depression policies ('A Programme of Expansion,' 1929). When he had the use of the multiplier he completely abandoned that idea" (S. Steve to the author, June 24, 1983).

Steve's reference is to the title of the fourth essay of the second part of Keynes's *Essays in Persuasion* (London, 1931). In his *Collected Writings* the essay is in volume 9 (London, 1972), under the title "Can Lloyd George Do It?"

²² Keynes, *The General Theory*, p. 64.

²³ D. Menichella, "Per Jacobsson and Monetary Development in Italy 1946-1947," in Per Jacobsson Foundation, *The Role of the Central Banker Today* (Washington, D.C., 1966), p. 14.

²⁴ V. C. Lutz, *Italy: A Study in Economic Development* (Oxford, 1962), p. 138.

²⁵ Saraceno, "Keynes," pp. 8-9.

²⁶ E. Hicks and G. Sallé, "Report of the Mission to Italy" (International Monetary Fund, Washington, D.C., 1947).

²⁷ *Ibid.*, p. 2.

²⁸ *Ibid.*, p. 10.

²⁹ A. O. Hirschman, "Exchange Control in Italy" (Board of Governors of the Federal Reserve System, Washington, D.C., 1947); [A. O. Hirschman,] "France and Italy: Patterns of Reconstruction," *Federal Reserve Bulletin*, 33 (April 1947), pp. 353-66.

³⁰ Hirschman, "Exchange Control," p. 16.

³¹ A. O. Hirschman, "Inflation and Deflation in Italy," *American Economic Review*, 38 (Sept. 1948), pp. 598-606.

³² Economic Cooperation Administration, *Country Studies-Italy* (Washington, D.C., 1948).

³³ Economic Cooperation Administration, *Italy. Country Study* (Washington, D.C., 1949).

³⁴ For example, United Nations, *National and International Measures for Full Employment* (New York, 1949).

³⁵ The paper I presented at the Florence conference suggested that Barnett might have been the author of the Country Study. Barnett himself writes:

"With respect to my relationship to the February 1949 Country Study, I feel I must correct one wrong impression that the draft conveys. While it is flattering (or not, depending on your point of view) to be considered as the 'presunto autore' of that document, such is not a very close approximation of the fact. It was first drafted at ECA Headquarters in Washington, by the people on the 'country desk.' While they certainly drew upon the cables, memoranda, analyses, and other communications from the Mission in Rome for which I was principally responsible, the form, content, and general tone of the first draft were determined in Washington. The people primarily responsible there were Harlan Cleveland and his brother Van Buren Cleveland.

When the draft was sent to the Mission for our comments and suggested revisions, it caused considerable concern. It is no exaggeration to say that the Chief of the Mission, J. D. Zellerbach (later Ambassador to Italy), was incensed. He considered the criticism of Italian government policy to be extreme, unfortunately worded, and probably counterproductive. Zellerbach was a Republican, of the liberal wing of the party, but by no means a Keynesian or a 'New Dealer.' While he hoped the Italian government would take more aggressive steps to spur growth and reduce unemployment (which he regarded as a severe political threat to Italian stability), he by no means undervalued the importance of containing inflation and keeping the lira stable and strong.

The messages back and forth between ECA Washington and the Rome Mission got so hot and heavy, and even acrimonious, that the Cleveland brothers were sent to Rome to help work out the differences.

My role—and the role of others in the Mission (including the Finance Division Director, Andy Kamarck)—was largely in the direction of tempering the criticism and moderating the language in the original draft. The Country Study of 1949, as it finally appeared, was a collaborative effort, in which many took part. It would be historically inaccurate to portray me as the 'presumed author' or even the 'principal author.' I did, however, at that time share the view that a more vigorous investment program could and should be undertaken, well within the boundaries of any serious threat to rekindle the inflationary cycle. Large scale unemployment and underemployment, along with a great deal of unused productive capacity (especially industrial), led me to conclude that inflation was a lesser threat—at least in the short run—than the political extremism being fueled by unemployment and economic stagnation. But I don't think I ever undervalued the destructive potential of inflation if it indeed were to come about. So it was a matter of judgment, not scientific precision, as to what the total level of investment (and the composition of that investment) ought to be in order to reduce unemployment, strengthen political stability, and at the same time avoid or contain inflation. The Country Study sought to encourage the Italian government toward some entrepreneurial risk-taking on behalf of increasing employment, while the government seemed to be stressing prudence born of the scars of Italy's historical experience with inflation. I believe now, and I think I believed then, that it was an honest and understandable difference of emphasis.

I think one has also to understand that this whole discussion took place in the context of an aid program and the political realities in the United States. When the net effect of granting substantial sums of dollars (over \$600 million in the first year for Italy—a not inconsiderable sum) to fill a presumed 'dollar gap' was in fact to increase the gold and dollar reserves in Italy, it became difficult to use the rationale that dollars were crucially needed to finance imports or productive

investment. Congress was understandably cynical when those arguments were presented in its committee hearings the next time around. Moreover, if the aid was used mainly to import cotton and petroleum products and other commodities, rather than for productive equipment of one sort or another, it was difficult to demonstrate that the aid was going to have any kind of multiplier effect or was going to have any impact on employment-producing investment. So the political dynamics, both in Italy (unemployment, stagnation, and the rising strength of the Left) and in the United States (that aid should be used to restore the productive capacity of the country, not to accumulate reserves) reinforced and perhaps even determined the choice of economic rationale. The Country Study in its first draft, and possibly even in the final version, may have stated the case for an aggressive investment policy a bit too strongly, and may have made its criticism of government concern with inflation a bit too severe. But it was a policy document, not an academic exercise, and it was intended to have some impact on the direction that future policy might take. As an aside, at a later period Ezio Vanoni did indeed take the attack on unemployment as the prime goal of Italian economic policy, and the *Piano Vanoni* did indeed reflect much the same kind of thinking that motivated the Country Study" (V. M. Barnett, jr., to the author, Aug. 12, 1983).

At the time of the Country Study Franco Mattei was the most direct Italian counterpart of the officials of the ECA mission. He provides an account of the course of the relationship of the Italian bodies with the mission, and of the latter with Washington which squares with Barnett's account and enriches it with certain suggestive touches. Mattei writes:

"The first head of the economic office of the ECA in Italy was Dayton (who then came back as head of the mission), with Victor Sullam as his second. Dayton was a hard man . . . In innumerable meetings I had to bear his heaviness with patriotic patience. One example. We had a pressing requirement for P.A.s [Procurement Authorizations] for cotton, which were difficult to justify with the data we could provide from the pre-war time series or from the declarations of those concerned. Dayton kept screaming at me, 'No statistics, no cotton.' . . . Neither he nor I knew or had understood that entrepreneurs had immediately discovered the highly profitable opportunity of importing cotton in dollars under the ERP plan and exporting the products to the sterling area (at least until September 1949, when sterling was forced to devalue). It was in this way that substantial sterling reserves were built up . . .

Dayton was transferred elsewhere and Vincent Barnett replaced him . . . [Before the ERP] the few available dollars had been tied to the purchase of fundamental goods like grain. We did not yet ask ourselves the big questions about macro-economic equilibria and about strategies for the use of the much more massive aid which was about to be given to us (this happened at the beginning of 1948). 1948 was, therefore, a year of great changes in the structures and in the personnel (as well as in the problems). When the Country Study for 1949 began to be drafted, there was within the American administration, both in Italy and in Washington at the various 'Italian desks,' an 'Italian lobby' or better, a lobby of people who knew Italy and were very keen to work on Italian questions . . . We might say that they were all 'scholastic Keynesians.'

It was not just a lobby but also a mutual aid society. For example, if the ideas of one of their number in Rome were not accepted, the same ideas would reappear from Washington via the constant personal communications between them . . .

[The 1949 Country Study] was born more from that lobby than from Barnett . . . [There was] a confrontation between the American representatives and the Italian government over the creation and then over the utilisation of the lira fund . . . Admittedly, the lira fund, administered by the Italian political and bureaucratic systems, had become rather baroque in its choices, procedures, delays . . . Dayton kept on repeating that with the lira fund we didn't know how to do anything except 'rebuild church steps and cemetery walls'; and it certainly

wasn't easy to make them accept the Fanfani housing plan, with its element of lottery.

But, besides all this, the running of the lira fund implied a macroeconomic fact which was obvious to everyone. The lira fund, as it was gradually built up, destroyed monetary base (as we afterwards learned to call it); and paradoxically it destroyed it the more, the more we received raw materials and goods given to the Italian economy, the more real supply grew without a balance-of-payments constraint.

As far as the tone of the 1949 Country Study goes, two factors, which I would call bureaucratic factors, had a great influence, and, according to my ways of interpreting things, assume great importance in the historical explanation of certain events.

The first is that it was bureaucratically difficult to explain to the people in Washington, who in turn had to explain things to Congressmen, that it was necessary to take dollars out of the pockets of American tax-payers to give them to Italy which didn't need them, to the point that her currency reserves continued to increase . . .

The second 'bureaucratic' fact was that the less Italy spent, the less would have been her slice of ERP aid, and all those concerned with Italian affairs would have become less important . . .

I confess that I was not enthusiastic about Menichella's insisting that the first thing to do was to ensure bread for the Italians, not least because—if I remember rightly—the problem had already been substantially resolved by the end of 1948. Would that we could have increased our requirement by increasing our requests for wheat!" (F. Mattei to the author, July 5, 1983).

On the American position during these years and on the issues raised by Barnett and Mattei, Andrew Kamarck writes:

"In the summer of 1944, I was transferred from the Finance Sub-Commission to General O'Dwyer's staff to serve as his economic adviser. General O'Dwyer was in charge of the whole of the economic and financial side of the Allied Control Commission. In the autumn, he returned to the United States and after a short delay I was ordered to join him. Essentially what we were involved in was persuading the US government that Italy should no longer be treated as an occupied former enemy but more as a liberated area. This meant that the former economic and financial controls should be dismantled. Consequently, neither O'Dwyer nor I returned to Italy and I went on to the Allied Control Council for Germany.

On the Marshall Plan period, there are a few nuances that I remember. In the first year, as you indicate, there was a problem with a few people in Washington who wanted to apply Keynesian remedies to an inapplicable situation. There is a great difference between an economy in deep cyclical depression where insufficient demand has left idle capital resources and an economy where the idle capital is structurally ill-adapted to produce the goods that a free civilian economy needs. (In Occupied Japan the attempt on the part of MacArthur's staff to carry out such 'Keynesian' remedies did plunge Japan into an acute inflation.) By the middle of the second year, however, I was becoming convinced that the process of reconversion in Italy had gone so far that some measures of demand stimulation could be undertaken. I so indicated to Ferrari-Aggradi, Vanoni and Menichella. Menichella was persuaded to loosen credit somewhat on the promise that I had secured from Washington that if such measures were taken, the amount of aid allocated to Italy would be increased by some definite amount. (I do not remember the amount, probably over a hundred million dollars.) In the event, aid *was* increased but not by the promised amount. I remember Menichella jokingly reproving me on the matter" (A. Kamarck to the author, Oct. 23, 1984).

⁵⁶ V. M. Barnett, jr., "The Italian Political Situation" (Economic Development Program, Italian Project, Center for International Studies, MIT, Cambridge, Mass., 1955). Barnett writes that the study "was circulated to the Bank and a number of other Italian friends and colleagues . . . [It reflects] respect and admira-

- ration for my good friend De Gasperi as well as Giuseppe Pella, and for the functioning of CIR and its staff-headed by another good friend, Mario Ferrari Aggradi" (V. M. Barnett, jr., to the author, Aug. 12, 1983). An abridged version appeared as *The Italian Political Situation in the Spring of 1954* (Cambridge, Mass., 1954); see also his "Competitive Coexistence and the Communist Challenge in Italy," *Political Science Quarterly*, 9 (June 1955), pp. 230-57.
- ³⁷ Economic Cooperation Administration, *Italy. Country Study*, pp. 3, 35.
- ³⁸ Barnett, "The Italian Political Situation," chap. 1, p. 18.
- ³⁹ *Ibid.*, Conclusion, pp. 1-3.
- ⁴⁰ R. Triffin, "Italy's Progress in 1948" (International Monetary Fund, Washington, D.C., 1949).
- ⁴¹ *Ibid.*, p. 19.
- ⁴² J. J. Kaplan, "Economic Stagnation in Italy?" (Yale Institute of International Studies, New Haven, 1949).
- ⁴³ *Ibid.*, p. 22. See Organisation Européenne de Coopération Économique, *Rapport Intérimaire sur le Programme de Relèvement Européen* (Paris, 1948), vol. 2, pp. 563-664.
- ⁴⁴ F. A. Lutz and V. C. Lutz, *Monetary and Foreign Exchange Policy in Italy* (Princeton, 1950); V. Lutz, "Italy."
- ⁴⁵ Bank for International Settlements, *Economic and Financial Problems of Italy in the Summer of 1949* (Basle, 1949).
- ⁴⁶ *Ibid.*, pp. F6-F9. See also J. M. Keynes, *How to Pay for the War* (London, 1940); J. R. Hicks, "World Recovery after War: A Theoretical Analysis," *Economic Journal*, 57 (June 1947), pp. 151-64.
- ⁴⁷ In Balogh's favor one should remember that in 1944 he had pleaded for the fixing of non-punitive exchange rates in liberated territories. T. Balogh, see "Fixing Exchange Rates in War," *Oxford Bulletin of Statistics*, 6 (April 8, 1944), pp. 73-76, and my *Studi sulla moneta*, pp. 159-61.
- ⁴⁸ Economic Cooperation Administration, *Italy. Country Data Book* (Washington, D.C., 1950).
- ⁴⁹ United Nations, Economic Commission for Europe, *Economic Survey of Europe in 1949* (Geneva, 1950).
- ⁵⁰ *Ibid.*, p. 71.
- ⁵¹ C. Bresciani Turrone, "Two Contrasting Opinions Regarding Italian Economic Policy," *Review of the Economic Conditions in Italy*, 4 (Sept. 1950), p. 358.
- ⁵² Most of these appeared in the *Review of the Economic Conditions in Italy* (which collected his leading articles from 1947 to 1962 in a special issue, Dec. 1964) and the *Corriere della sera*.
- ⁵³ [V. Lutz,] "Italy: Economic Recovery and Development," in H. S. Ellis, *The Economics of Freedom* (New York, 1950), pp. 299-365.
- ⁵⁴ F. A. Lutz and V. C. Lutz, "Wage Rates, Credit Expansion and Employment," *Banca Nazionale del Lavoro Quarterly Review*, 3 (July-Sept. 1950), pp. 171-80.
- ⁵⁵ *Ibid.*, p. 171; the reference is to United Nations, *Measures for Full Employment*.
- ⁵⁶ *Ibid.*
- ⁵⁷ V. Lutz, "Italy," p. 361.
- ⁵⁸ E. S. Simpson, "Inflation, Deflation and Employment in Italy," *Review of Economic Studies*, 17 (1949-50), pp. 203-25.
- ⁵⁹ Hicks, "World Recovery after War"; J. Robinson, *Essay on Marxian Economics* (London, 1947).
- ⁶⁰ Simpson, "Inflation," p. 220.
- ⁶¹ *Ibid.*, p. 222.
- ⁶² On this point, Sir John Hicks writes:
"It is not surprising that it was Simpson who drew your attention to my 'World Recovery after War' paper; for he had been a pupil of mine. Ursula was then editing the *Review of Economic Studies* and I remember arranging the publication of his paper.
What a disaster it was that he was cut off like that! I realize, after reading you, that it was a personal disaster for me; for if he had survived, I would certainly have resumed my contacts with Italy much sooner than I did. As it was, I had practically no contact with Italian economists after 1933, when I came to Italy with introductions from Rosenstein, and met Einaudi, del Vecchio and Marco Fanno, until 1958 when I met Sylos Labini at a conference in Corfu, and then of course things really started up when Rainer Masera came to work with me in Oxford. I now see why it was that he came!
I have given my 'World Recovery' paper a prominent place in the second volume of my *Collected Essays*, for I am still quite proud of it. Maybe it was the most useful thing I have ever done. I always hoped that it might be useful, and now I know that at least in one case it was. This is immensely cheering" (J. R. Hicks to the author, July 15, 1983).
- ⁶³ Rosenstein-Rodan's general attitude was one of great sympathy for problems of Italian development and finance, and of careful awareness of the limits to the effective use of expansionary demand policies. For example, on the occasion of a study mission in Italy in 1955 for MIT which had our economic development as its subject, he brought to our attention a study of Prof. R. S. Eckaus, who was with him, on "The Factor Proportions Problem in Economic Development" (Economic Development Program, Italian Project, Center for International Studies, MIT, Cambridge, Mass., 1954); see also R. S. Eckaus, "The Factor Proportions Problem in Underdeveloped Areas," *American Economic Review*, 45 (Sept. 1955), pp. 539-65. I showed Eckaus's 1954 paper to the General Manager, Formentini, with the following comment:
"The conclusions constitute a criticism of the Keynesian (or pseudo-Keynesian) position according to which unemployment is essentially due to insufficient demand and can therefore be eliminated with an expansionary monetary policy. They show, in fact, that in underdeveloped countries unemployment derives at least in part from a) limitations of a technological nature which prevent the adoption of production processes which require large doses of labor and small doses of capital (labor-intensive), both because production processes require certain rigid proportions of the two factors, and because, in the case of elastic combinations, the marginal productivity of labor falls to zero beyond a certain point; and b) the structure of wages which, because of union pressure, remain at high levels, which induce a level of mechanisation incompatible with full employment, given that the availability of capital within the country is insufficient for that" (memorandum from the author to P. Formentini, April 27, 1955).
- ⁶⁴ Svimez, *Effetti economici di un programma di investimenti nel Mezzogiorno* (Rome, 1951).
- ⁶⁵ S. Guidotti and A. Pennacchietti, "Inflazione e disoccupazione" (Banca d'Italia, Rome, 1949). See also S. Guidotti, "Moltiplicatore" (Banca d'Italia, Rome, 1950).
- ⁶⁶ See above, note 63.
- ⁶⁷ E. Lundberg, "Inflazione e difficoltà nelle bilance dei pagamenti dei Paesi europei," *Bancaria*, 7 (marzo 1951), pp. 259-64; F. Coppola d'Anna, "Disoccupazione, inflazione e rigidità economiche nel pensiero di Erik Lundberg," *Bancaria*, 7 (agosto 1951), pp. 327-31.
- ⁶⁸ E. Rossi to G. Einaudi, n.d. (forwarded by A. Rossi, Oct. 28, 1942).
- ⁶⁹ *Ibid.*
- ⁷⁰ E. Rossi to G. Einaudi, July 1, 1942. The reference is to F. A. Hayek, ed., *Collectivist Economic Planning* (New York, 1935).
- ⁷¹ E. Rossi to G. Einaudi, n.d. (forwarded by A. Rossi, Oct. 28, 1942).
- ⁷² E. Rossi to F. Laterza, May 29, 1950.

- ⁷³ L. Robbins to E. Rossi, July 20, 1950.
- ⁷⁴ E. Rossi to C. Bresciani Turrone, July 28, 1950.
- ⁷⁵ P. Wicksteed, *The Common Sense of Political Economy* (London, 1946).
- ⁷⁶ F. A. Lutz and L. W. Mints, eds., *Readings in Monetary Theory* (New York, 1951).
- ⁷⁷ E. Rossi to L. Einaudi, Sept. 22, 1950.
- ⁷⁸ E. Rossi, "Prefazione al trattato di economia del Wicksteed," *Il Mondo* (28 novembre 1961), p. 11.
- ⁷⁹ Statement by N. Pozza to G. Fois, reported in G. Fois to the author, April 11, 1983.
- ⁸⁰ Banca d'Italia, *Adunanza generale ordinaria*, 1951, p. 312.
- ⁸¹ *Ibid.*, pp. 306, 310, 320-21.
- ⁸² D. H. Robertson to the author, Jan. 19, 1953. Sylos Labini writes about this letter, and about certain of the personalities and themes of this article:
- "My note on the Keynesians, published in 1949 in the English edition of the journal of the Banca nazionale del lavoro, was a rather impudent and impertinent note. However, I don't disown the substance of it for two reasons: 1) because the central critical point—that money cannot be wholly considered as an exogenous quantity—still seems valid to me; 2) because that note was much appreciated by Ernesto Rossi and marked the beginning of a close relationship with him. . . . After having had Schumpeter as supervisor at Harvard—in 1948-49—I succeeded in having Robertson as supervisor at Cambridge, where I went with a Stringher scholarship in the academic year 1950-51. In both cases the assignment of the supervisor corresponded to wishes which I myself had expressed. At that time I was concentrating on the study of the business cycle. Considering the historically changing character of the business cycle, the study of purely abstract models seemed to me unsatisfactory. It seemed to me necessary to combine theoretical study with empirical analysis, and it was partly for this reason that I had asked to have those two exceptional supervisors. Robertson was particularly struck by my request, given that—with his label (totally unfounded and unjust) of 'black reactionary'—there were very few students, either English or foreign, who asked to have him as supervisor. His amazement increased when he learned that I was considered to be a left-winger and that I had chosen him, and not, as might have seemed more natural, Joan Robinson, with whom, in any case, I established a good relationship. I remember that Robertson expressed to me the very concepts which he wrote in the letter—there are hints in the same sense in one of his articles, in which, instead of the expression 'black reactionary' he uses the other, 'baleful Bourbon.' When Robertson came to Rome I introduced him to Ernesto Rossi" (P. Sylos Labini to the author, July 29, 1983).

The reference is to P. Sylos Labini, "The Keynesians (A letter from America to a friend)," *Banca Nazionale del Lavoro Quarterly Review*, 2 (Oct.-Dec. 1949), pp. 238-42. Robertson took part in the First International Conference on Credit, held in Rome in November 1951, where he also met the governor, Menichella. On Keynes's positions in respect of the problems of the post-war and on his relations with Robertson, Edward Bernstein writes (from the Brookings Institution):

"Keynes changed his mind about the likelihood of a postwar depression during the discussions on the International Monetary Fund. . . . When Keynes wrote his proposal for a Clearing Union, he leaned to this pessimistic view of the postwar world. After Bretton Woods, however, Keynes came to believe that the dollar payments problem would be solved by expansion in the United States. I believe his conversion came at a dinner that Keynes gave to Walter Gardner and me in 1943. At this dinner, Keynes predicted that there would be a flight from the dollar after the war because of fear of a post-war depression. I presented my reasons for believing there would be no recession. . . . [Robertson] was a U.K. Treasury representative in Washington during the war and I dealt with him

constantly on Treasury matters. The technical problems that arose in the preliminary discussions on the International Monetary Fund were referred to him and to me to settle. We never had any difficulty in reconciling our views. We both had trouble with Keynes, although on different issues, because he regarded any disagreement with him as a sign of ignorance. I did not realize until I read the Keynes Paper how deeply he resented my opposition to the Clearing Union proposal" (E. M. Bernstein to the author, Nov. 30, 1984).

On the conflict with Keynes, Bernstein writes in a further letter:

"The reference in my letter is to volume XXV of the Keynes Papers, pp. 344-49 and 360-64, particularly the last page. The facts are as follows.

On September 24, 1943, the U.S. and U.K. groups held a meeting at the U.S. Treasury to discuss the remaining points for an agreed statement on the postwar monetary institution. White was ill and I was the spokesman for the U.S. group. Keynes opened the meeting by saying that the United Kingdom was prepared to accept the U.S. proposal, subject to some changes, but wanted to rewrite the plan for the institution in terms of the *unitas*, the unit of account that was included in the White proposal. In the Keynes note of the meeting this is item II, *Monetization of the unitas*.

I was afraid that in the process of rewriting by Keynes we would end by having his plan for a Clearing Union in the guise of a stabilization fund. I replied to Keynes by saying that if the United Kingdom accepted the U.S. proposal, why did it have to be rewritten in terms of *unitas*. Because, Keynes said, the White Plan is written in Cherokee. I tried to make light of the point by saying that if it seemed to be in Cherokee, it was because the braves of Wall Street understood the language. Keynes then became personal and insulting in his remarks about my narrow-mindedness. I did not reply, but suggested that we proceed with the agenda. After the meeting Robertson and Robbins thanked me for my restraint.

Keynes explained my opposition to his proposals by attributing it to my pride of authorship, although in fact the plan was White's and I told Keynes that on a number of occasions. In the note, page 364, Keynes says of me: '[The] chap knows every rat run in his local ghetto, but it is difficult to persuade him to come out for a walk with us on the high ways of the world.' The truth is that it was Keynes who had the greatest pride of authorship. He and White sometimes talked rudely to each other, but I was always polite and respectful to Keynes.

It is true that I was chiefly responsible for formulating the U.S. view on the Clearing Union. Our opposition was two-fold. While there was a limit on each country's debit balance of *bancor*, there was no limit on the obligation of a country to accept settlement of its balance of payment in *bancor*. Thus, the United States could have been confronted with financing about \$25 billion of balance of payments deficits in the early postwar years. In the White Plan, the U.S. obligation to finance the payments deficits of other countries was limited to the subscription to the Fund. Our other objection was that the Clearing Union implied that each country would maintain exchange controls, support the exchange rates of other members by buying their currencies in its own exchange market, and the monetary authorities of the surplus countries would then present their accumulations of the currencies of the deficit countries for settlement through the Clearing Union. No doubt, the Clearing Union could be written in such a way as to give the United States a limited obligation to finance the deficits of other countries and to make each country primarily responsible for supporting the exchange rate for its own currency. That is probably what Keynes meant when he said that he accepted the U.S. plan but wanted it rewritten in terms of the *Unitas*. Presumably, the use of the term *unitas* instead of *bancor* was designed to satisfy our pride.

It is interesting to note that after the United States and the United Kingdom had agreed on the Joint Statement of Experts on the Establishment of an International Monetary Fund, Keynes stated in the House of Lords that 'the new plan . . . [is] in some respects . . . a considerable improvement on either of its parents.' And he added that with the new agreement 'there is no longer any need for a new-fangled international monetary unit. Your Lordships will remember how

little any of us liked the names proposed—bancor, unitas, iolphin, bezant, daric and heaven knows what.'

I should add that after Bretton Woods, Keynes was very appreciative of what I did. Note particularly his reference to the report on Bretton Woods that I wrote for the Senate Committee on Banking and Currency" (E. M. Bernstein to the author, Jan. 12, 1985).

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