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Economic Theory and Banking Regulation: The Italian Case (1861-1930s)

Alfredo Gigliobianco and Claire Giordano*

Abstract

The paper provides a qualitative assessment of the role mainstream economic theory had in orienting Italy's banking legislation from its political unification (1861) to the introduction of the 1936 Banking Act. Five regulatory regimes are considered. Whilst market discipline and self-regulation arguments characterized the first sub-period (1861-1892), the debate over convertibility and limits on note issuance was intense in the second (1893-1906). The third sub-period (1907-1925) was punctuated by two banking crises: the first (1907) vindicated economists who had stressed the need of a lender of last resort *à la* Bagehot; the second (1921-23) confirmed – to no avail – the dangers congenital to bank-industry ties. The following sub-period (1926-1930) was inaugurated by the first commercial bank regulation (1926) and responded to the prevailing economists' call for restricting bank competition. The 1936 regulation, which inaugurated the approximately five-decade long fifth regime, matured in a virtual *vacuum* of professional economic debate. Overall, two key factors were found to affect the degree to which legislation drew upon contemporary economic thought: *a)* the severity of the preceding crisis; and *b)* the timing of the subsequent regulation.

JEL classification: B15, G28, N4
Keywords: banking crises, prudential regulation, economic theory

Contents

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1. Introduction[1]

In the period 1880s-1930s, most of Italy's banking legislation was introduced as a reaction to financial crises. Each crisis stressed the failure of the pre-existing regulatory regime in preventing bank failures, and affected the subsequent regulation via two channels: directly, with the actions of politicians keen to respond to public concerns and to lobbying pressures, and indirectly, through the writings of contemporary economists.[2] We focus mainly on the indirect channel by studying how, and with which degree of cogency depending on circumstances, shifts in the paradigm of banking regulation occurred alongside or were supported by the new developments in economic theory. We also try to assess how the action of other interest groups affected the ability of economists to guide legislation. The sources consulted were contemporary journals,[3] economists' monographs and publications, as well as debates in Parliament and other political *fora* where the economists were active. Actually determining the impact that economic theory had on banking regulation would have also required the analysis of other primary sources, such as private correspondence between economists and politicians: we leave this level of analysis to future investigations.

The direct and indirect channels in some cases overlapped. In fact, after the country's political unification in 1861, Italian economists were highly involved and committed, not only in disseminating economic science, but also in educating the public opinion and the political class and in livening the political debate (Augello and Guidi 2003; Magnani 2003). Moreover, as well as being polemists and opinion-makers, they actively participated in economic institutions and associations, were advisers and *tecnici* (experts) of the Governments in power, were leading figures in the debates concerning the national economic policies to be adopted and often became actual legislators or ministers.[4] Therefore, economists' proposals of credit policy and banking regulation also directly influenced actual legislative outcomes (Barucci and Pavarin 2008).

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[1] While the paper is the result of a joint effort, sections 1, 2, 3 and 4 may be attributed to Alfredo Gigliobianco; sections 5, 6, 7 and 8 to Claire Giordano.
The views expressed in this paper are those of the authors and not necessarily those of Banca d'Italia.
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[2] The impact of financial crises on economic thought is a current topic of analysis: see for example Rockoff (2010), in which a careful reading of past financial crises is found to have affected Adam Smith and Milton Friedman's views on banking regulation.

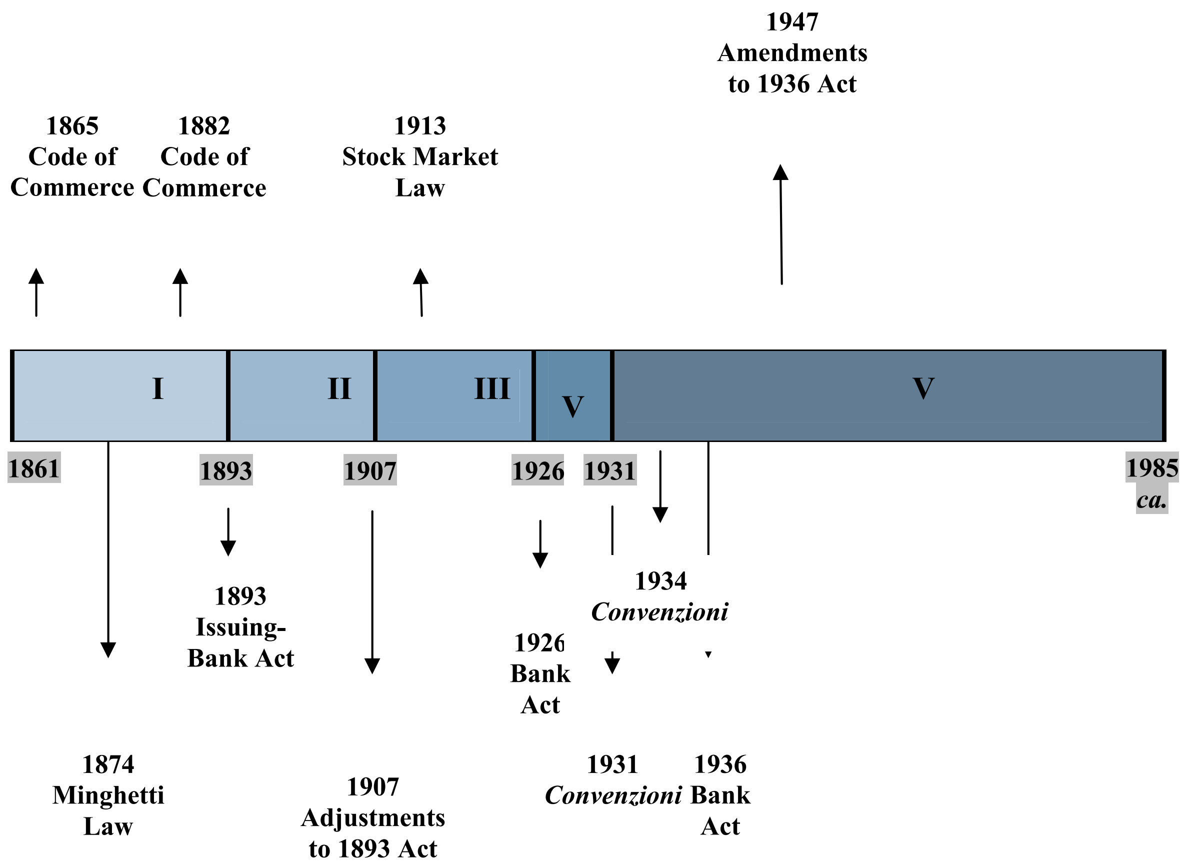
[3] In particular, the journals systematically analysed were: "Echi e Commenti," "Giornale degli Economisti," "Riforma Sociale," "Rivista Bancaria," "Rivista internazionale di Scienze Sociali" and "Rivista di Politica Economica."

[4] Just one prominent example: in his speeches in Parliament, the economist, centre-right minister and later Prime Minister, Boselli, underlined the existence of important exceptions to the principle of economic freedom, in which the legislator was called to intervene. In his view, the definition of these exceptions was the economist in Parliament's "mission" (Asso 2003).

Two main schools of economists can be tracked in Italy in the last quarter of XIXth century (some vestiges of the divide survived in the first decades of the following century): marginalists and *lombardo veneti*. The former were squarely in the European marginalist tradition, with strong and original thinking especially in the field of public finance. The latter were heavily influenced by the German Historical School, whose main *tenet* was that economic laws were not absolute, but historically conditioned; hence the importance of the State in bringing about the kind of social and economic development envisaged by the nation's leaders. The grand battle between the two schools was engaged over protectionism, especially starting from 1885; banking was another field of heated debate. Rather surprisingly, the *lombardo veneti* were politically more right-wing than their opponents: State-building was in fact the core business of the rather conservative right, while the political left was more responsive to those groups which had been left aside by the compelling necessities of unification.

We divide Italy's banking history, from its political union in 1861 to its renowned banking law of 1936, into five regulatory regimes: 1861-1892; 1893-1906; 1907-1925; 1926-1930; 1931-1980s. The sub-periods are graphically depicted in the following time-line (Figure 1), together with the indication of the main financial legislation passed.

Figure 1. Italy's regulatory regimes 1861-1980s.



Such regimes created the context for economic debate, so we found it useful to organise our paper along these lines. The first sub-period was characterized in Italy by a heated debate concerning the plurality or unification of note issuance after the creation of the Italian nation: most marginalists were in favour of plurality, while *lombardo veneti* leaned towards unification. Furthermore, the former were mainly sided against any form of issuing-bank regulation, whilst the latter were more willing to accept it in the case of unification. Market discipline (intended as the public's right to conversion of banknotes), as well as self-regulation of the banks of issue, were by them deemed as sufficient to attain overall financial stability. Yet some form of issuing-bank regulation was introduced, although laxly enforced, in 1874. The 1890s financial meltdown shifted the public opinion and led to the first truly biting issuing-bank regulation. Convertibility, however, coveted by free market economists, fell into disrepair in favour of quantitative limits on note issuance. Although a backlash of the crisis also affected commercial banks, regulation of the latter was not backed by sufficient strength (in academia and politics alike) and hence was not introduced. The 1907 crisis crowned the Bank of Italy as the nation's lender of last resort and led to some form of de-regulation of the three issuing banks in order to enhance their crisis-management abilities. The economic debate began moving towards the possibility of regulating ordinary banks, and was heightened by the 1920s crisis which underlined *i)* the dangers congenital in the procyclicality of the then dominating "mixed banks," *ii)* the problems tied to an "excessive" competition in the banking sector, and *iii)* the need to safeguard depositors. With respect to this last point, economists did not agree on the measures to be undertaken to attain this aim: banking legislation or "financial education" of the depositors were two proposed alternative solutions. The fourth regime was inaugurated by the 1926 Banking Act, an organic and comprehensive regulation for all deposit-taking institutions, which mainly curbed competition in the banking sector, a desirable outcome according to most, but not all, economists. However, the law was modelled on mixed banks as they were before WWI, *i.e.* as banks which lent long-term to industry, and not as holding companies of industrial firms, which they had turned into; furthermore, it was only loosely implemented. The 1930s banking crisis therefore immediately followed, leading to the long-lasting and pervasive 1936 Banking Act. The latter not only segmented the banking sector into two parts (short-term and long-term liability institutions), and clearly detached it from the industrial sector, but it also significantly affected bank competition, capital requirements, information disclosure and corporate governance. The role of economists was virtually nil in defining this new law, a product of the IRI brain trust, as was their reaction to the law itself. This regime lasted until the 1980s when a wave of liberalizations began and culminated in the new Banking Consolidated Act of 1993.

As a result of our analysis of Italy's regulatory history in the period 1861-1938, two key factors seem to determine whether or not, or to what degree, the post-crisis regulatory frameworks reflected or were oriented by contemporary economic theories: *a)* the severity of the crisis; and *b)* the timing of subsequent banking regulation. When crises were contained in their severity and duration, and novel legislation was introduced only after a significant time-lag, economic theory was taken into account when drawing up the new regulation. Conversely, when crises were protracted and severe, and core reforms were finalised immediately, the prevailing economists' views seemed not to be heeded. The other two scenarios (severe crisis and lagged regulatory reaction; contained crisis and immediate legislative response) never occurred in Italy in the period under study.

The paper is organised as follows. The timing and nature of Italy's financial crises in the period under study is briefly recalled in Section 2. The following Sections – one for each of the five regimes – focus on each separate crisis episode, the developing economic thought concerning banking regulation, as well as the presence of such beliefs in the novel banking laws, which are analysed in detail. Conclusions are drawn up in Section 8. Finally, the Appendix offers a concise biography of the main economists cited, which should help the reader better understand their roles.

2. Italy's financial crises (1861-1930s)

Italy's numerous financial crises after its political unification in 1861 were mainly banking crises, often accompanied or preceded by stock market turbulence. The drops in equity prices led to the volatilization of the asset side of banks' balance sheets and/or induced the withdrawal of foreign capital, thereby again affecting the banks' financial situation, in a vicious spiral. In the XIXth century, alongside the banking sector, numerous local stock exchange markets existed.[5] Initially, Genoa was the main trade centre, but the 1907 crash and the subsequent financial market regulation gave the Milan stock exchange the primacy. Yet the latter remained a small and thin market, contributing to the strong bank orientation of Italy's financial system in the period under study. In fact, the 1907 crisis destroyed "the illusion […] that the stock exchange [was] an institution able to play a functional role in the mobilisation of savings to finance [the country's] industrial development" (Bonelli 1971, p. 159). Italy's stock markets only rebounded in the second half of the XXth century. Our attention is thus limited to the banking sector, and consequently to strictly banking legislation.

Italy's first post-unification crisis was dated 1866. A combination of international events led to a financial and currency – but not a truly banking – domestic crisis. Again in 1873, the country shared in a relevant international crisis. This was mainly a stock market crisis, which did not affect the six Italian banks of issue nor the main commercial banks, but mostly hit minor banks. The 1890s meltdown was instead made up of two distinct phases (1888-1893 and 1894), the first induced by the speculative behaviour of domestic issuing and commercial banks, the second spurred on by capital flights subsequent to the international Baring crisis. The banking crisis was also accompanied by its "twin," a currency crisis. The 1907 crisis was sparked by a stock market crash, aggravated by the worldwide liquidity crunch, which caused the insolvency of the third largest universal bank of the time. The 1920s banking crisis was part of a more global post-war recession which struck many European countries, involved in their attempt to reconvert to peace-time production. In Italy, it also coincided with a period of transition to a new political regime, Mussolini's Fascist dictatorship. Finally the 1930s banking crisis was embedded in the more encompassing international Great Depression, which dealt Italy too a hard blow.

On the whole, the six financial crises considered occurred alongside or within corresponding international crises, but at the same time presented marked idiosyncratic features. The co-movement of the banking and real economy variables was considerable in two key episodes (1888-1894 and 1930s), but negligible in the other cases.

[5] The number of stock exchanges went from 6 in 1861 to 21 in 1882 (Schisani 2008).

In the period under study, at least four out of the six episodes of financial distress drove financial regulation reforms, in an explicit attempt to tackle what was perceived as being the main causes of the previous crisis and thus to prevent similar crises to occur once again.[6] Crisis-prevention was, however, not the only aim the contemporary legislator desired to achieve, as competing interests emerged, and different pressure groups dominated, in each occasion of regulatory debate. In general, other objectives were – explicitly or implicitly – pursued.[7] For example, the restraint of competitive conditions in the banking sector in certain cases was seen, also by mainstream economists, as a means to reduce financial instability; in addition, however, it was largely favoured *per se* by incumbent banks as being a guarantee of higher rents. If some rules were designed so as to favour certain categories of financial firms, other regulatory instruments were introduced in order to defend and protect the weaker counterpart of the banks, *i.e.* the depositors or investors. Finally, in some cases the State abetted banks via regulation, often coupled by moral suasion, to lend to politically or socially attractive projects, sectors or firms, and to attain a desired credit allocation. In face of this wide array of aims, legislators had a panoply of regulatory tools at their disposal, recommended or challenged by the concurrent economic theory.

In general, however, financial crises can be seen as the potentially most powerful drivers of new banking legislation, in that they affect a vast number of interest groups. We hence now move on to consider how the mentioned Italian crisis episodes created the context for new regulation to be introduced, also by affecting economists' relative positions in the ongoing debate.

3. A "mixed" regime based on market discipline, self-regulation and some legislation, 1861-1892

In 1861 the political unification of Italy was attained, whereas economic and financial integration were still far-off objectives. The contrast was particularly evident in the financial intermediation field, in which "medieval barriers" existed even between provinces.[8] The monetary confusion was solved by the Pepoli Law[9] in 1862 with the adoption of a sole currency, the Piedmontese *lira*, which supplanted the numerous currencies of the other pre-unification States. In particular, a bimetallic standard was introduced.[10] However, a series of

[6] The legislator's attempt to avoid the breakout of new crises was then always neutralised by the banking industry's ability to innovate and to adopt new business models, which were successful in circumventing the previously introduced restrictions and regulations and in bringing on new sources of risk and new bouts of financial instability. This recurring pattern has been defined as a "regulatory cycle" by Gigliobianco, Giordano and Toniolo (2009).

[7] See for example Giordano (2009) for a general framework of possible regulatory aims and tools in a long-run and cross-country perspective.

[8] Boselli, Parliamentary Acts, Camera dei deputati, 17 February 1874, reported in Asso (2003, p. 272).

[9] Law 24 August 1862, No. 788.

[10] The authors of the Pepoli reform had actually expressed a preference for a monometallic regime, but soon realised how bimetallism would favour relations with Italy's main trading partners, such as France, Switzerland and Belgium (Pepoli law proposal of 9 June 1862 in De Cecco 1990, pp. 78-79). The debate between economists – and politicians – over monometallism and bimetallism continued for over three decades (e.g. Pavanelli 1995). Supporters of the former were, among others, Boccardo, Ferraris and Pareto, whilst advocates of the latter were Rossi, Magliani, Luzzatti and, to some extent, even Einaudi. Notable exceptions were Ferrara and Martello, who were against any sort of Government intervention in monetary matters and, thus, refused the fixing of any monetary standard by law, be it gold or silver, or both (Roccas 1990).

conditions were set on the silver coins, to prevent the well-known effects of Gresham's law: the silver content in the corresponding coins was cut so as to reduce their commodity value;[11] silver was used only for small denomination coins; anyone could refuse to accept an amount of silver coins exceeding a certain threshold. However, the different silver content fixed in each country gave rise to speculation and reduced the possibility of national currencies circulating abroad (De Cecco 1990, p. 10); therefore a common monetary standard was called for. As a result, in 1865 France, Belgium, Switzerland and Italy created the Latin Monetary Union. Bimetallism was confirmed in the Union countries at a gold/silver ratio of 1:15,5.[12] Silver coin issuance was however limited. *De facto* legal tender of coins was introduced, although it was not formalised by a law in Italy.[13]

The Pepoli law of 1862, however, made no reference to banknote issuance or circulation. Until 1866, banknotes could be refused as a means of payment. Relative to issuing rights, the situation was even more intricate. Whilst six issuing banks continued to exist, as a legacy of ancient states, a forceful debate concerning unification *vs.* plurality of banks of issue opened up amongst economists and politicians. Plurality was buttressed on the theoretical grounds that, since banks of issue were pivotal to the concurrent Italian banking system, unification would have implied the creation of a monopoly in the financial sector, with all its negative implications. The model followed by the liberal economists, such as the prominent Ferrara or the promising young Rota, was the Scottish one of free banking,[14] opposed to the French one with its monolithic Banque de France. Instead, it was the Government mainly who championed unification (Polsi 1993, p. 47), in order to achieve a more effective monetary management, based on a single discount rate, and to enhance efficiency in the payments system. Also, the existence of a solid institution which could act as a guarantee for the State, for example in obtaining international loans, was considered as a desirable feature in public finance. One should note that, at this stage, the previously mentioned economic school of *lombardo veneti* was not born yet: economists were largely *laissez-faire*-oriented, in the vein of Bastiat and Say. Free banking, if largely supported by economists, was not, however, conceived as a feasible possibility in practice; hence, the political dispute was mainly between monopoly and oligopoly of the banks of issue (Cardarelli 2007).

The fragility of the new-born State, however, did not allow the central Government to swiftly defeat the powerful regional groups, each supporting the persistence and expansion

[11] The gold content of coins was of 900/1000, whereas the silver content was of 835/1000.

[12] The reason Italy continued to follow the French bi-metallic monetary system, although silver already seemed to be doomed in 1865, was largely economic. The significant use of foreign banks by wealthy Italians to intermediate their investments due to the lack of solid and trustworthy commercial banks in the newly created Italy, the large ownership of Italy's public debt by French banks, as well as the vast market for Italian exports that France represented, in fact made an independent international monetary policy for Italy impossible, for fear of retaliations (De Cecco 1990, p. 20).

[13] Other countries joined the Union in the following years. In particular, Greece, Romania, Colombia, Venezuela and Chile became members. Spain accepted the monetary system, but not the free circulation of silver coins. The Austro-Hungarian empire too began negotiating its entry, but negotiations were abruptly ended by the breakout of the Franco-Prussian war in 1870. After the French defeat at Sedan, the newly born German nation adopted the gold standard. The subsequent sales of silver by Germany, as well as an increase of silver production in the U.S., had a large impact on the price of the metal (De Cecco 1990).

[14] White (1984) provides a thorough description of free banking in Great Britain.

of the banks of issue that had been active in the former States, so as to retain handsome seigneurage profits as well as some measure of control over credit allocation.[15] The different economic situation in the various Italian regions, especially in Southern Italy, was another reason adduced to preserve plurality. Fear of the sole bank of issue being manipulated by the State, laden with its high public debt, could have been another cause of the sluggishness of the process (Gilardoni 1922, p. 81). Finally, even the main bank of issue, Banca Nazionale nel Regno d'Italia (from now on Banca Nazionale), which had been identified by many as the future monopolistic note issuer, was not in favour of the law proposals of unification, if this implied the proposed Government nomination of its director (Onado 2003, p. 389).[16]

Free banking advocates, sided against banking regulation, emphasized the analogies between the two main banking liabilities of note issuance and of deposit receipt: a note-holder demanding conversion was akin to a depositor withdrawing his savings. Thus, since commercial banks were not regulated, banks of issue were to be similarly unfettered. Self-regulation by both issuing and commercial banks was deemed sufficient to induce their orderly conduct. An axiom advanced was that: "For a Bank never to convert, it must always be ready to convert" (Rota 1885, p. 67).[17] Different forms of self-regulation – or, as we would now say, of best-practices – were summarized by Rota: *a)* by appraising the nature of their liabilities, banks could select their assets appropriately, in order to foil maturity mismatches; *b)* when fixing the maturity of their credits, banks were also to analyse the market or industry they supplied; *c)* banks were to build up (voluntary) reserves; *d)* banks could also fine-tune their discount and interest rates, according to the market conditions. These measures applied to issuing and commercial banks alike. In particular, the consistency of the reserves could not be determined *a priori* by the banks' statute – a practice defined as "absurd" (Rota 1885, p.127) –, let alone by a law, but they were to be accumulated according to past experience. Hence, reserves could vary from bank to bank and according to the concurrent economic circumstances.[18] Similarly, the imposition of fixed interest or discount rates would mean "depriving banks of a defensive weapon" (Rota 1885, p. 128). Another form of self-regulation envisaged was the statute of joint-stock banks, which, in regulating

[15] The contention was in fact definitively solved only in 1926, when the Bank of Italy was assigned the monopoly of note issuance by law.

[16] Already in 1852, Cavour, Prime Minister of the Piedmont State, had argued in favour of having one powerful and sound bank of issue, and therefore pushed for an increase in Banca Nazionale's capitalization (Parliamentary discussion of 23 June 1852 on a law proposal of 19 March 1852, reported in De Mattia 1990, Doc. 8, pp. 192-194). Amongst the economists, Boccardo, for instance, in 1863, had also pointed to Banca Nazionale as a natural candidate to become a "bank of banks" due to the important role it had played in Italy's history (Barucci and Pavarin 2008, p. 63).

[17] It is noteworthy that such an axiom was still pronounced in the 1930s, for example by Garrone (see Strumbolo 1938, p. 52).

[18] In particular, with respect to banks of issue, de Viti de Marco (1885), a marginalist economist, excluded, as a means of guaranteeing convertibility, the 100% backing of banknotes by metal reserves, in that this would have eliminated any form of profit from note issuance. On the other hand, the total absence of reserves made conversion impossible. He thus stated that a fraction of the notes issued, variable according to the economic circumstances and to the banks' past experience, was to be backed by metal reserves, whereas the remaining part was to be invested in short-term, self-liquidating loans. In this way, if there was to be an unusual and intense demand for conversion, banks could respond first of all with their reserves and then, secondly, by reducing their credit supply, thus using the resources that were to gradually return to them. In this manner, conversion could be deferred by 3-4 months, but no more (de Viti de Marco 1885, p. 118).

their allowed undertakings, was one means of limiting the banks' risk-taking. These prescriptions intended to protect the shareholders from mismanagement, but at the same time could be indirectly beneficial for other stakeholders too. A final argument advanced by free bankers was the presumed trade-off between regulation and market discipline. In absence of regulation, in fact, banks had to gain the public's trust by proving their orderly and prudent conduct; in the presence of laws, they only had to display a formally law-abiding attitude, thus stripping the public of its "censorship role" (Rota 1885, p. 272).

The Italian post-unification economic debate, as we shall see, also partially shadowed the previous British one, with bullionists set against anti-bullionists and then with the adherents to the currency school set against those of the banking school, albeit with a temporal lag.[19] The Italian debate concerning convertibility was, however, less clear-cut; in fact, the monopoly *vs.* plurality of note issuance controversy had a more relevant political importance in Italy in this sub-period – owing, in particular, to the previously mentioned strong regional forces – and prevailed over theoretical disquisitions.[20]

In 1866, Italy suffered its first financial crisis (Conti and Scatamacchia 2009). The American Civil War had led to a shortage of raw materials in Europe and had created liquidity tensions. The 1865 international crisis and Italy's war against Austria unleashed a currency crisis and put pressure on Italian banks. Deposit withdrawals and demands for convertibility forced the latter to reduce their discounting activity in order to stem losses in metal reserves. Banca Nazionale was also asked to provide the Treasury with a consistent advance, needed for the war against Austria. In return, and to stave off a more widespread crisis, its banknotes became *fiat* money as their convertibility was suspended by legislative decree.[21] Reactions by contemporary economists were not unanimous. Even some convinced "pro-convertibility" economists, such as Ferrara, recognized the emergency of the situation and the urgency of such a law (Faucci 2003).[22] Others, such as Torrigiani, were against the measure, in that the latter credited Banca Nazionale with a *de facto* privilege in note issuance, whilst what had to be tackled and solved were instead the actual causes that had led to the abandonment of convertibility, *i.e.* the critical situation of Italy's public finances, the imbalances between reserves and note circulation, the deterioration of Italian credit on foreign markets, the lack of free competition amongst banks of issue (Augello 2003). The year 1866 thus saw the beginning of intense Parliamentary and extra-Parliamentary debates concerning Government intervention in the banking sector.

[19] Fetter (1965) provides an in-depth analysis of the British monetary debate.

[20] White (1984, p. 52) notes how even in Great Britain the monopoly *vs.* free banking question was much discussed, yet most historians of monetary thought, in developing recounts of the debates of the era, slighted this literature. White thus "undertakes to reinterpret the British currency debates in terms of the free banking question by bringing the neglected literature to light" and concludes that "free banking versus central banking was indeed the focal point of the monetary policy debates between 1820 and 1845" in Great Britain. So again, if we accept White's reading, the Italian debate shadowed the British one, albeit with a lag of approximately three decades.

[21] Royal Decree of 1 May 1866, No. 2873.

[22] However Ferrara argued that the same aim could have been attained by the Government issuing notes, without involving Banca Nazionale. He thus believed that the legislative decree was a form of Government bail-out of that particular bank, when the latter actually was not in such troubled waters (Barucci and Pavarin 2008, pp. 57-58).

In the same year, a supervisory body over all joint-stock companies (*Sindacato di controllo delle società anonime*) was created within the Ministry of Finance and later transferred to the Ministry of Agriculture, Industry and Commerce (from now on MAIC). Its mission was to oversee the firms' compliance to the law and to their statutes, with particular attention to credit institutions, yet it could not influence the firms' actual management and governance.[23] It was suppressed, however, already in 1869, with the justification that it had completely wiped out any form of market discipline by creating a dangerous and unconditional reliance on the effectiveness of Government control, thus underlining the widespread hostility towards regulation in any field.[24]

In 1873, Italy shared in what has been defined as the first significant "international crisis" (Kindleberger 1989, p. 146). It began in Vienna, and then spread to other European and American stock markets. Notwithstanding the drop in stock prices of around 30 per cent (Carriero, Ciocca and Marcucci 2003), 1873 was still a year of economic growth for Italy. The Italian stock markets were, in fact, too limited to affect industrial production. The 1873 crisis did not extend to the banks of issue (which accounted for over half of financial intermediation) nor to the two main commercial banks. Instead, it mainly hit private bankers, and saving and cooperative banks.

A year later, in 1874, the Minghetti Law[25] was passed. It was introduced to put an end to the "anarchy" in note circulation, due to the existence of three conflicting tenders: legal tender *vs.* illegal tender banknotes injected into the system by private agents and, within the legal tender class, non-convertible banknotes issued by the Banca Nazionale *vs.* (only nominally) convertible banknotes issued by the other issuing banks.[26] A related aim was to create a level playing-field for all issuing banks. This law does not seem to have been spurred on by the 1873 crisis which, as previously mentioned, did not in fact affect the banks of issue. The call for a rationalization of note circulation was, rather, a consequence of Italy's political unification and nation-building process, and of the subsequent need for monetary integration; it was not conceived as a future crisis-prevention measure. It is

[23] Head of the *Sindacato* was De Cesare, an interventionist in favour of issuing-bank unification. He was sceptical about the general public's ability to fruitfully direct its investments, hence justifying the need for State intervention. De Cesare conceived a sound banking system as made up of three non-communicating bank categories: savings banks, which received the lower classes' deposits; commercial banks, which extended short-term loans; and long-term credit institutions. Thereby, his aim was to ban the latter from deposit-taking, and to limit commercial banks' loans to short-term operations. The banks, however, responded to the *Sindacato*'s existence by introducing extremely vague and general statements in their statutes concerning the activities by them undertaken.

[24] Scialoja in fact stated: "I too believe that, in general, Government supervision on its own is powerless to avoid mismanagement of firms and hence is […] dangerous for private interests, because it leads them to believe they are protected when actually they are not […]" (Report to His Majesty on 5 September 1869 by MAIC, cited in Da Pozzo and Felloni 1964, p. 58). This was a similar argument to that of the already cited Rota (1885).

[25] Law 30 April 1874, No. 1974.

[26] The banknotes of the other issuing banks were convertible (at their discretion) in either gold or in Banca Nazionale banknotes (Art. 4, Royal Decree No. 2873 of 1 May 1866). It is clear, therefore, that Banca Nazionale was favoured relative to the other issuing banks: if they did not redeem their banknotes in gold, the latter contributed to an increase in the circulation of their main competitor's notes.

noteworthy on this point that already in 1870, before the outbreak of the crisis, an important law proposal concerning note issuance and circulation had been made.[27]

Up until the Minghetti Law, banks of issue had been regulated by their statutes, by their founding laws and, in the case of Piedmont, by a law of 1850.[28] In 1874, the number of banks of issue was blocked at six: no other entity was allowed to issue banknotes, unless a new law was passed. The six banks formed a consortium and limits were set on its total note issuance, as well as on the circulation of each single bank. Professional economists were not involved in the preparation of the law and strongly opposed it, although it was the first organic attempt to reform the banking system. Ferrara, among others, interpreted the creation of the consortium as a limitation of the freedom of credit, with negative consequences for the economy. He accused Minghetti of mimicking the British Peel Act of 1844, which had imposed monopoly of issuance,[29] and that the law would lead to an oligarchy of banks, as well as to the extension of the Piedmont system (*i.e.* the Banca Nazionale's statute and the afore-mentioned 1850 law) to all Italy, thus expunging the – more successful, in his view – Tuscan model of financial development with no State intervention. Moreover, the marginalist economists de Viti de Marco (1885) defined the Minghetti law as a contradiction in terms: "it is a monopolistic system because no new bank of issue can arise, but there are six banks of issue; it is a pluralistic system due to the existence of six banks of issue, yet no new ones can be created and they do not have the same nature nor economic power" (de Viti de Marco 1885, p. 130).[30] He also asserted that the law was not a product of a decreeing Government or of a legislating Parliament: the political institutions, in fact, had simply endorsed and legalised what the issuing banks had campaigned for (de Viti de Marco 1885, p. 133), in a situation nowadays identified as regulatory capture.

Notwithstanding the harsh opposition of the most prominent economists, banks of issue were thus, in principle, systematically regulated for the first time and on a national

[27] We are referring to the Sella-Castagnola law proposal (among others, see Galanti 2008, p. 17). If it is true that it was not the 1873 crisis that led to the first issuing-bank regulation, it instead triggered the introduction of the 1882 Code of Commerce, which supplanted the previous 1865 Code. In fact, the systematic violations of the existing financial market rules, mainly by traders of the Genoa stock exchange, were considered as the main cause of the 1873 crisis (Riva 2007). Bad regulation was considered as more damaging than no regulation at all, hence de-regulation of the stock markets was conceived as an advisable move. The stock markets were thereon disciplined by their local Chambers of Commerce, under the guidance of MAIC, whereas national rules were reduced in number. Furthermore, free entry in the stock exchange was introduced, eliminating *ex ante* controls. Baia Curioni (1995) provides a lucid description of the evolution of stock market regulation in the period under study. The 1882 Code of Commerce did, however, introduce some pieces of legislation which concerned commercial banks, that we will soon discuss.

[28] Law 9 July 1850, No. 1054, according to which banks were allowed to issue notes only if authorized by an *ad hoc* law.

[29] For those not familiar with the 1844 Peel Act, the law also established two separate departments within the Bank of England. The Issuing Department could issue notes up to the amount which was backed by Government securities in the Bank's portfolio; any additional note issuance had to be backed by gold. Instead, the Banking Department undertook the normal operations of deposit-taking and lending, in competition with ordinary commercial banks.

[30] It is noteworthy that de Viti de Marco never mentioned the word "oligopoly." Cournot (1838) and Bertrand (1883)'s models were, in fact, only just beginning to circulate in academic circles. They did, however, receive attention in the following decades in Pareto's handbooks of economics (Pareto 1897; 1906). Stackelberg's model was instead introduced much later, in 1934 (Stackelberg 1934).

basis in 1874. The Act was, however, not considered as a definitive solution to note circulation in Italy right from the start, as results from a report which preceded the law proposal in Parliament (cited in Supino 1895, p. 51). Violations of the limits set on note issuance were also the norm in the years to come. On the one hand, in fact, the law, by fixing absolute and rigid limits, did not concede the issuing banks the flexibility they needed and required in hard times. Such limits had been set by taking into account the contingent situation; prudential banks would therefore have had to issue fewer notes than the maximum admitted, to be able to handle future crises or other critical scenarios. But the banks of issue were not willing to deflate and to reduce the credit offered to their clients to such an extent. Conversely, the banks of issue, private in nature and aiming at profit-maximization, were continually biased towards increasing their note issuance. The law was punctuated by escape clauses and exceptions which the banks exploited, turning them into a common practice. The political willingness to truly enforce the issuing bank regulation was still lacking; as a result, the Minghetti Law was not biting.

What other types of banking regulation existed at the time? After the closure of the previously mentioned *Sindacato*, from 1870 commercial banks were required by a royal decree to send monthly balance sheets to MAIC which were then published. The decree was then replaced in 1882 by the rules dictated by the previously mentioned Code of Commerce. Its Article 177 imposed monthly balance sheet disclosure to the Trade Court (*Tribunale di commercio)*.[31] This was the only prescription by which the ordinary law differentiated banks – commercial and cooperatives alike – from all other firms.[32] The actual publication of the balance sheets, owing to organisational difficulties, was lagged, however, by over one year and thus suppressed any market discipline function.[33] With respect to the main categories of "special" banks, a law regulating savings banks (*casse di risparmio*) and pawn banks (*Monti di Pietà)* was introduced in 1888, therefore abstracting them from the provisions of ordinary law and from those concerning charity institutions.[34] This was actually the first regulatory law concerning non-issuing credit institutions and it introduced norms (e.g. pecuniary sanctions in the case of violations) which would later be extended to all commercial banks by the 1926 law. The point of this "special" regulation was grasped and approved of by economists. These banks were in fact aimed at collecting the meagre savings of the needy,

[31] When the various Trade Courts were abolished in 1888, balance sheets were then sent to the Civil and Criminal Courts.

[32] The reason credit institutions had greater information disclosure requirements relative to ordinary firms was the fact that their performance was believed to be subject to more frequent and larger fluctuations. Furthermore, it was necessary to periodically monitor the health of the money market as the latter affected production and national wealth (Report by MAIC in preparation for the 1882 Code, cited in Costi 2007).

[33] MAIC did not lose its recipient role, as far as joint-stock banks at least were concerned. The decree which put the Code of Commerce into effect, in fact, also required the directors of all joint-stock firms, including banks, to transmit monthly statements to MAIC for publication in the Bollettino Ufficiale delle Società per Azioni (BUSA). MAIC was to decide the form and contents of such statements. A pecuniary sanction was to be applied in the case of delays in transmission. However, the publication in BUSA turned out to be highly erratic and irregular, with no punitive measures taken. Yearly balance sheets were also to be transmitted, but the only requirement in this case was that they were to truthfully express the profits or losses registered in the previous year, and not assets and liabilities. Hence again the market discipline function was not in any way enhanced by these laxly implemented information requirements.

[34] Both categories had in fact been created as charity, rather than credit, institutions. In due time, however, they began to operate more like banks.

who were not able to exercise the market discipline necessary to guarantee the soundness of these institutions; hence the State had to intervene directly in this field.[35] So if the Minghetti banks of issue law was passed in order to discipline and reorganise monetary circulation in the newly unified State, the 1888 savings banks law was introduced as a reaction to an innovative financial business model which was developing countrywide.

Going back to the Minghetti Law, one of its articles required that within six months the Government was to present a report on note circulation and on the measures to be implemented to return to convertibility. In 1875, Minghetti acknowledged the impossibility of pursuing this goal, recognizing, for the first time, how convertibility was not the primary objective of Government action anymore, at least not in the short-term (Augello 2003, p. 104). In 1876 a left-wing Government came to power and was in favour of reintroducing convertibility. However, a law was passed only in 1881, mandating the resumption by 1883. In 1883, hence, Italy was formally on the gold standard, yet there were provisions that allowed the reserve ratio to slip below the legal minimum under specified conditions (*i.e* by paying a tax), as well as the widely accepted escape clause of suspending the convertibility of currency into gold in the event of exceptional circumstances. Furthermore, the reserves banks of issue were required to hold were two-thirds gold and one-third silver.

A widespread belief among the disciples of the currency school was that monetary stability and financial stability were intimately tied under the gold standard regime (Issing 2003; Borio 2004; Borio and Toniolo 2006). Monetary stability under the gold standard was the preservation of convertibility of a currency into gold.[36] Financial stability, on the other hand, implied the assurance that individual financial institutions could always mobilise assets – gold or assets convertible into gold – to redeem their liabilities (*i.e.* deposits) at par. Hence, convertibility to gold constituted a curb on credit expansion and a deterrent to financial imprudence. Therefore, since the quantity of gold acted as an explicit exogenous constraint on monetary authorities and financial institutions alike, prudential regulation was pointless, provided that private individuals were "financially alert." Thus, the issue of convertibility of banknotes into gold continued to be heatedly debated.[37] Currency school advocates argued that convertibility was the pivot of an orderly functioning of the money and credit market. Inconvertibility was, in fact, to be interpreted as banks of issue reneging on their debt obligations towards note-holders.[38] The underlying reasoning was the following. If issuers were not bound to redeem notes for specie, an excessive note issuance would ensue, thus fuelling commercial banks' deposits. In turn, the latter banks would over-lend, drawing on their increased deposits, and would end up financing unworthy investments. The quality of bills taken to be re-discounted would hence deteriorate, thus

[35] We will later come back to the economists' debate on the different regulatory needs of savings banks *vs.* commercial banks (see e.g. Einaudi 1913).

[36] The identification of monetary stability with price stability *per se*, *i.e.* a stable price level or a low level of inflation, is instead typical of *fiat* currency regimes.

[37] See for example "Giornale degli Economisti" of those years, known for the neoclassical views of its three main contributors, Pareto, Pantaleoni and Barone. Another source is Rota (1885), in which the author underlined the importance of a "good monetary system" (*i.e.* the gold standard regime), which, by limiting the fluctuations in the value of money and thus by minimizing risk and uncertainty, injected confidence into the system and revived credit (Rota 1885, pp. 5-7).

[38] See the note written by the directors of "Giornale degli Economisti" on the subject (de Viti de Marco *et al.* 1893).

reducing the soundness of the banks of issue and hence causing instability in the overall financial sector. Once convertibility was guaranteed, instead, no other form of regulation was deemed necessary, at least from the marginalist economists' point of view. In fact, "given convertibility, the fiduciary circulation follows the same laws as the metal circulation, hence there is no need for the Government to intervene" (de Viti de Marco 1885, p. 120), neither in limiting note issuance nor in altering the discount rate. On the other hand, banking school supporters, who largely coincided with the *lombardo veneti* economists, argued that financial crises could develop even under a regime of convertibility (Messedaglia 1876), but never went far enough as to propose regulation on non-issuing banks.[39] Banks of issue were in fact considered as the only potentially stabilizing/destabilizing force in the financial system, and hence potentially needy of regulation.

To sum up, the overarching philosophy amongst economists toward bank regulation and supervision during Italy's first regulatory regime predominantly coincided with an anti-regulation stance. Convertibility to gold, market discipline (intended as the public's right to conversion) and self-regulation of banks (via statutes, orderly conduct, voluntary reserves) were deemed necessary and sufficient for a sound financial system. Furthermore, the introduction of regulation would have necessarily crowded out market discipline and thus eliminated an effective tool of crisis-prevention. This liberal stance was also accompanied by the support of a plurality of banks of issue. The main debate in Parliament thus concerned the opportunity of having one or more issuing banks, yet political interests seemed to override economic arguments on the matter in the first three decades after Italy's unification.

4. A stricter regime of issuing-bank regulation, 1893-1906

The resumption of convertibility in 1883, backed by an international loan, increased bank reserves and kindled a large credit expansion, based on real estate security, at interest rates that did not reflect the increasing risk of lending. This was made possible by an excessively accommodating monetary stance and by the regulatory *vacuum* in which the banks operated (Fratianni and Spinelli 1997). The overheating of the economy resulted in a *de facto* suspension of convertibility already in 1887.[40] In that year, the real estate bubble began to deflate and a number of banks which had extended generous credit to the building sector ran into serious difficulties. Some of them failed, after an ill-conceived and unsuccessful bail-out attempt by Banca Nazionale.

Meanwhile, the public debate concerning the banks of issue became intense. It was inflamed by the awareness that the banks of issue had not remained aloof from the real estate bubble and had issued well over the limits set by the 1874 law.[41] The quality of their assets was also uncertain, especially since some of these banks, either because of business relations or in response to Government pressures, had largely financed the construction firms or the

[39] Messedaglia was a leader of the *lombardo veneta* school.

[40] In 1892 the Court of Turin refused to pronounce a sentence in favour or against convertibility, defining it a political matter not of its competence, and hence this sentence was interpreted as a suspension of convertibility for all banks.

[41] The crisis rapidly outdated a point of view expressed in Rota (1885), who stated that only long-term credit institutions fed speculation and hence were to be regulated, contrarily to banks of issue and deposit-taking banks.

banks involved in the bubble, even after real estate prices had started to decline.[42] The concern about the soundness of the banks of issue turned into a fraud scandal at the end of 1892, when two left-wing MPs, Colajanni and Gavazzi, read excerpts of a report concerning Banca Romana, one of the six banks of issue. The document had been written by two State examiners, Alvisi and Biagini, in 1889, had been kept secret by the Government and had later been provided to the MPs by Pantaleoni and the other "Giornale degli Economisti" directors.[43] It revealed not only huge bank losses, but also the illegal note issuance the bank had undertaken to remain afloat. The scandal stirred up a hornets' nest: it prompted a new examination of all six banks of issue and speeded up the legislative process towards a new law.[44]

The main priority was, however, to rapidly solve the thorny problem of Banca Romana, as well as to cover up the scandal which had even involved the Prime Minister, rather than to design a new national banking system. Regional interests were still strong, hence the fight for plurality of note issuance ensued. The Finance Minister Sonnino was in favour of the creation of a new bank but in fact the newly established Bank of Italy was the result of a merger of three existing banks of issue (Banca Nazionale and two banks from Tuscany). The Bank of Italy was mandated to liquidate Banca Romana by acquiring its metal reserves and assets, as well as all its liabilities. In return, it obtained the privilege of note issuance for twenty years, a reduction in the circulation tax and legal tender for its banknotes for fifteen years. In this way, Banca Romana's losses were swept under the carpet, as they were covered by Bank of Italy's seigneurage. The resulting legislation thus turned out to be a political and economic compromise, which left little room for economic doctrine.

Giaconi (2002, p. 106), in her analysis of the role of economists in contributing to the new regulation, confirmed that there was "a failure of economists in Parliament" in designing the reformed banking system.[45] The economists present in Parliament to discuss the latter were Boselli, Colajanni, M. Ferraris, Luzzatti in the Camera, and Boccardo and Lampertico in the Senate. Luzzatti and Lampertico were commonly known as leaders of the *lombardo veneta* school. Significant were the absences of Pantaleoni and de Viti de Marco, both marginalist leaders, who had not been elected in Parliament yet. The meetings held were very few – the new issuing bank law was passed in barely six months – and the interferences in the debate of the Prime Minister, with his personal interests, were numerous. Colajanni, for instance, complained that the Parliamentary Commission set up to design the new legislation was "not mentally prepared" to engage in its institutional mandate because it had been created "for political reasons" and to "ratify a decision taken elsewhere" (Colajanni 1893, p. 108). Luzzatti and Ferraris were of similar opinions. Moralism and indignation against the fraudulent behaviour of the Government were the *leitmotiv* of the economists'

[42] It is noteworthy that in the first half of 1887 Ferraris spoke out in Parliament against the excessive note issuance which fed speculation (cited in Supino 1895, p. 94), yet the Government not only did not force the banks of issue back to legality, but actually further encouraged note issuance in order to support woeful credit institutions.

[43] Before his death, Alvisi had given a copy of his report to his friend Wollemborg, who then passed it on to Pantaleoni.

[44] In January 1893 the Governor of Banca Romana, Tanlongo, was arrested.

[45] Parliamentary acts and documents are published in De Mattia (1990) and Negri (1989).

Parliamentary debate.[46] Economists were also reluctant to bring forward theoretical arguments, as the problems to be solved were believed to be political and pragmatic solutions were needed: “Is it appropriate to begin a technical discussion […]? I do not have neither the disposition nor the peace of mind to do so” (Luzzatti, 4 July 1893, reported in Giaconi 2002, p. 117). Boccardo adopted the principle of “better a bad law than no law” and hence made very little opposition to the proposed bill. Boselli, as President of the Commission in the Camera, acted as a moderator and did not intervene, if not sporadically and insignificantly. Lampertico summed up the situation by asserting: “this law expresses our painful needs, and our painful impossibilities. Painful needs, because it was no longer possible to perpetrate the status of things created by disgraceful actions of one of our issuing banks; painful impossibilities, because a law ordered logically around certain theoretical principles was decidedly impossible” (Lampertico, 4 August 1983, cited by Giaconi 2002, p. 122).

The new law was enacted on 10 August 1893. In the wake of the crisis fuelled by overlending, two issues had come to the forefront (Gigliobianco, Giordano and Toniolo 2009): a macro issue – an excess of money circulation – and a micro one with systemic implications – the soundness of the individual banks of issue. The number of banks of issue was halved from six to three, as a result of the above mentioned merger. The reduced number of banks was probably intended to be a response to both issues: the emergence of a clear leader (Bank of Italy) was seen as a decisive step towards the unification of note issuance and the control of money supply. The macro issue was also addressed by imposing limits to circulation and metal reserve requirements. Moreover, convertibility was reaffirmed in principle, but the decree which should have set the legal framework for its application was never brought about.[47] Limits on note circulation seem, hence, to have displaced the issue of convertibility, not in the monetary debate, but on practical grounds and in the legal venue. “Attention is transferred from the final objectives [*i.e.* convertibility] to the minute description of the characteristics of a process of currency creation which is compatible with a monetary rehabilitation” (Bonelli and Cerrito 2003, p. 153). This was probably due to various reasons. The recent resumption of convertibility in 1883 had been followed by the credit expansion of issuing banks in that decade and to the subsequent collapse of the banking sector, a lesson too recent and harsh to be easily forgotten so soon. Furthermore, Italy’s political class was at the time strongly concerned with the country’s economic development: hence the decision “to not sacrifice growth prospects on the altar of the gold standard” (Bonelli and Cerrito 2003, p. 153) by imposing the required abrupt deflation, until Italy’s economic outlook had improved. Finally, by not introducing any fixed monetary objectives, banks of issue apparently preserved a certain degree of elasticity in their activity, without however prejudicing their stability (Cerrito and Gigliobianco 2003, p. 102). The remaining regulation was crafted to tackle the micro issue. The three banks of issue were placed, in fact, under tight Government control: the discount rate could not be changed

[46] “Morality must enter […] in the design of legislation” (Remark by Colajanni in Parliament, 2 July 1893, reported in Giaconi 2002, p. 115).

[47] In particular, the Parliamentary Committee Report on the political responsibility of bank failures, cited in Fratianni and Spinelli (1997, p. 94), read: “[I]n present circumstances, if conversion were to be fully effective, metal reserves could run the risk of disappearing. Conversely, by not imposing such an obligation, it could be interpreted as a tacit acceptance of inconvertibility.” The latter was not a risk policymakers were ready to run. Yet convertibility was never officially reinstated in the following decades.

without the assent of the Government and was to be the same for all three banks; norms on capital adequacy were introduced; the operations banks of issue were allowed to undertake were stated one-by-one in the law (rather than in the individual bank charters); the chief officials had to be approved by the Government; and finally, the supervisory apparatus was reinforced.

The logic of the law was probably the following (Gigliobianco, Giordano and Toniolo 2009): once asset quality had been taken care of (in principle) by limitations on the kind of permissible assets, one had to worry about imperfect application of the law, hence, the capital ratio. Guaranteeing the stability of the individual banks of issue was also a motivation for prescribing a liquidity ratio, although its main justification was in the macro domain (Negri 1989, Doc. 11, p. 207). Next came the Government's veto right on the nomination of top managers and the prohibition of MPs to serve in the banks' governing bodies. These provisions were a clear response to pro-bank lobbying, which had been pervasive in the preceding years. Finally, the strengthening of supervision. The scandal of Banca Romana had severely shocked the public opinion, and a clear message had to be sent out: abundance of controls, severity of penalties.

Banks of issue had, in fact, gained a bad reputation: their managers were perceived to be at odds with the public interest and were not trusted by the political leaders who were trying to handle the crisis. Shortly after the enactment of the law, in February-March 1894, a decisive battle against the private interests operating within the Bank of Italy was engaged by Sonnino.[48] As a result, the Director General Grillo and the president of the board of directors Parodi had to leave. This also stressed the new will of the Government to end old practices of elusion and evasion of the law (Bonelli and Cerrito 2003).

Needless to say, free market economists, particularly by those writing for "Giornale degli Economisti," harshly criticized the 1893 law. The imposition of the double limit on circulation and on reserves was considered a secondary ersatz obligation, which, if arbitrarily fixed, could represent an excessive burden for the banks and which anyhow was not sufficient to guarantee the conversion of banknotes.[49] The article of the law which imposed convertibility was not considered credible, rightly so in the light of later events. Pareto also belittled the effectiveness of Government supervision, which continued to be deemed inferior to market discipline (or "public supervision" as he defined it), still intending it as the public availing itself of its convertibility right.[50] Finally, since shifts in the discount rate were a consequence of variations in the general equilibrium conditions, any rigidity forced

[48] The matter at stake was minor.

[49] In particular, limits to note circulation were opposed by Pareto, who also compared them to those set in the already mentioned British Peel Act (see note 29). Authorization had been given in Great Britain to exceed the legal limits in 1847, 1857 and 1866, in the presence of financial crises, but convertibility of banknotes into gold had been maintained. *De facto*, only in 1857 did the circulation actually increase; in the other two cases, the declared possibility of an increase in circulation was enough to stem the panic (a so-called "announcement effect"), hence proving how the English public was willing to hold banknotes, not gold. Although the Peel Act was based on "erroneous ideas" (Pareto 1897, p. 564), that is to say on limits to circulation, it was also "extremely useful" (Pareto 1897, p. 565), in that it subtracted the issuance of banknotes from the banks' power. "But laws without customs are nothing" (Pareto 1897, p. 565). Hence, Pareto concluded that if the historical experience pointed to the usefulness of limits on note issuance in the British setup, this did not in any way imply that they were suitable for Italy too, where culture, customs and praxes were different.

[50] In particular, see his columns in "Giornale degli Economisti" (Pareto 1893a; Pareto 1893b).

upon the rate could only result in a decrease of a country's general welfare (Pareto 1897, p. 596). A more effective way to prevent country-specific crises, according to Pareto, was for banks of issue to invest part of their resources in good-quality foreign currency in order to guard against idiosyncratic shocks (Pareto 1897, p. 589). Other issues, such as plurality *vs.* unity of the issuing bank or having a State-owned issuing bank rather than granting the issuing privilege to a private monopolistic bank, became of secondary importance to these economists with respect to the issue of redemption of banknotes (Pareto 1897, p. 571), and hence were less heatedly debated in those years.[51]

Other economists were instead, in favour of the law, such as for example the already mentioned *lombardo veneto* economist Lampertico, who stressed how the regulatory act was not an amnesty, introduced to repair the system after the erstwhile wrongdoings, nor had it been brought in to expand the State's control over a key sector such as the banking one: it was simply a law introduced to forestall the re-occurrence of similar crisis episodes (Gioia 2003). His position, however, was founded more on political grounds than on theoretical ones, as previously explained.

A more moderate view was adopted by those who perceived the 1893 law as a means to safeguard note-holders in the absence of convertibility. This is clear, for example, in de Viti de Marco (1898), who believed limits on note issuance to be a second-best alternative to convertibility.[52] He reasoned that, since agents were compelled to accept banknotes in their transactions, and since, in the case of denied redemption by the issuing banks, they had no right to recoupment, then banking legislation which limited note issuance was necessary. The public was also understandingly unaware of the degree of solidity of the banks of issue and was hence uneasy about holding notes; yet if such banks were subject to effective supervision, then the public would acquire confidence and would be more willing to use banknotes.[53] Hence, State intervention was necessary, first and foremost, to guarantee the orderly functioning of the payments system, and therefore was justifiable only in the case of banks of issue, not of commercial banks. Nevertheless, de Viti de Marco then stressed how State supervision could only be formal: the State could verify that the ratios imposed had been respected, but they could not monitor the actual quality of the bills in the banks'

[51] Pareto's pecking order of banking issues is not surprising, considering that in 1893 a clear signal had been sent out with the creation of the Bank of Italy, a natural-born leader with respect to the other two "follower" banks. The same opinion was held, however, by de Viti de Marco already in 1885, when he asserted that that "if convertibility exists, the structure of the issuing bank system loses much of its relevance" (de Viti de Marco 1885, p. 120); "the plurality *vs.* unification issue is not important, as is, on the contrary, a prompt and safe convertibility of notes" (de Viti de Marco 1885, p. 121).

[52] De Viti de Marco (1898) elaborated on a previous belief of his. In fact, already in 1885 he wrote that, in absence of convertibility, a continuous, rigorous and effective Government supervision was necessary: hence the introduction of limits on note issuance, of controls on the discount rate and the unification of the bank of issue. "The banking structure, in the absence of convertibility, is artificial, and the natural and spontaneous control one had with convertibility must be replaced by State control to safeguard the public" (de Viti de Marco 1885, p. 122). It is interesting to note how de Viti de Marco was a follower of the neoclassical doctrine, but took a more eclectic view with respect to banking theory (Realfonzo 1995).

[53] The reluctance of the general public to hold banknotes was not solely de Viti de Marco's impression. Supino underlined how it was natural in a prevalently agricultural country, in which economic activity was more buoyant in rural areas than in the cities as was Italy, that the main means of payment were metallic coins rather than banknotes. The latter were accepted only where transactions were numerous and frequent and where the issuing banks were known and accepted (Supino 1895, p. 9).

portfolio. Hence the preventive control by the State, essential in easing circulation and the payments system, was not as effective in guaranteeing the issuing banks' solvency (*i.e.* financial stability), in that the natural stabilizer of the economy (*i.e.* convertibility) was not activated; market discipline was, therefore, still highly relevant.

But while the banking crisis was waning, the international financial turmoil set in motion three years earlier by the Baring crisis struck Italy with a massive flight of foreign capital (October 1893 to March 1894). The two main commercial banks failed, victims to runs, and tens of local banks followed suit.[54] Either the law of 1893 did not change market expectations about the country risk[55] or it arrived too late[56] to shelter the country from international shocks. In this occasion, the banking crisis was also accompanied by its "twin," a currency crisis, with a devaluation of the lira with respect to the U.S. dollar of nearly 10 per cent between 1889 and 1894 (Ciocca and Ulizzi 1990).[57]

Surprisingly, this sudden and deep after-shock in the crisis did not elicit new significant regulatory action. Some adjustments were made to the issuing-bank law of 1893, but no lesson was drawn from the insolvency of the two largest commercial banks. A Government Committee was set up to study reforms of the existing corporate law. Its recommendations included the proposal of setting aside three tenths of the capital of joint-stock banks as a guarantee for deposits (Vivante 1895). These were not, however, translated into law; hence, the only rule specifically aimed at commercial banks in the Italian legislation remained the previously cited Article 177 of the Code of Commerce.

Inaction was due to: *1)* the fact that political energies were exhausted as new priorities emerged immediately after the crisis; and *2)* the lack of an economic or legal theory sound enough to provide a rationale for regulation beyond the realm of note issuance, the latter now widely accepted.

In 1894 the Government was in fact engrossed in dealing with the social unrest which had arisen in many parts of Italy as a result of the economic crisis. In Sicily, the *Fasci Siciliani*, proletarian organizations which demonstrated against the new tariffs and taxes imposed and against the unfulfilled promise of expropriation of the vast estates in the hands of few rich land-owners, were violently repressed by the newly formed Crispi Government (December 1893), who depicted them as dangerous conspirators against the State. Anarchists organised revolts in Tuscany for similar reasons, also declaring solidarity with the Sicilian cause. Murders and attempts on political figures' lives were another outcome of the

[54] A well-known contemporary reference is Pantaleoni (1895). He described the collapse of Società Generale di Credito Mobiliare (established in 1863) and of Banca Generale (created in 1871) as an "enormous moral bankruptcy." In general, Pantaleoni rejected the idea of bank rescues, in that he believed the greed and mismanagement of powerful politicians to be behind every banking crisis.

[55] Supino (1895) emphasized how it was not surprising that the 1893 law had no positive impact on Italy's position abroad and that the exchange rates (which inversely proxied the confidence set on a country) actually rose after the law was passed. The act was in fact, in Ferraris' words, "a sequence of good advice and hygienic prescriptions to be enforced after two, four, fourteen years" (cited in Supino 1895, p. 107).

[56] The law came into force only on 1 January 1894.

[57] Fanfani and Conti actually define the 1888-1894 crisis as a "multiple crisis" (Fanfani and Conti 2005, p. 21) in that it simultaneously affected the real estate, the banking, the exchange rate, the fiscal and the political-institutional sectors.

economic and social instability.[58] The Government reacted by declaring a state of siege in both regions, as well as by finalising three anti-anarchical laws. Meanwhile, an internal battle was going on within Parliament, with one side accusing the other of having been directly involved or of having turned a blind eye in the Banca Romana affair. It is easily understood that commercial-bank regulation was not at the top of political agenda in that moment.

With respect to the second reason (lack of economic theory),

a) Regulation addressed what was identified as having been the particular cause of the previous crisis. Overtrading by banks of issue, as well as irresponsible, if not scandalous, behaviour of their management, were blamed for the 1888-1893 meltdown, and were thus to be prevented in the future.[59] With respect to the 1894 backlash instead, Pantaleoni (1895) noted that the general public did not condemn the commercial banks and was actually hostile towards those who had made runs on the banks and withdrawn their deposits. These agents were called by the public "*ribassisti* [short sellers] and enemies of Italian credit" (Pantaleoni 1895, p. 8), while the Government and the police, who deprived the depositors of their right to be reimbursed, were seen as saviours. As for the idea of commercial bank legislation, Pantaleoni confined himself to reporting a witty note taken from Sumner: "There ought to be no laws which guarantee property against the folly of its possessors" (Pantaleoni 1895, p. 160).[60]

b) The Italian financial system of the time was dominated by the banks of issue and their potential insolvency would therefore have had a systemic impact and led to the collapse of the whole sector, a typical "too-big-to-fail" scenario. Pursuing and attaining the stability of these banks meant achieving that of the whole financial system. Furthermore, Ferraris (1892) and others claimed that the main aim of regulation was to ensure issuing banks' soundness, in order for them to be always ready to provide ample liquidity, via discounting windows and credit supply, to save the banking system when needed. Effective issuing bank crisis-prevention measures would thus guarantee effective crisis-management procedures, which in turn would prevent commercial bank crises. The positive spillover effects of issuing bank legislation thus made commercial bank regulation unnecessary.

c) The understanding of money and financial markets was incomplete, the classification of bank deposits as money was not accepted (also due to the fact that the use of

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[58] On 24 December 1983 the French President Carnot was killed by an Italian anarchist; in May 1894 an attempt to murder the Italian Prime Minister Crispi failed.

[59] For instance, Supino (1895) divided the causes of the 1888-1894 crisis into general causes (the troubled finances of the Treasury, the broken commercial ties with France, excessive speculation) and special causes (immobilisation of the issuing banks' assets, the financial hardship of the latter banks due to an increase in non-performing loans, insufficiency of metal reserves, illegal note issuance). He also acknowledged that "banks of issue gave a significant push to speculation in certain sectors and were the main cause of the crisis which followed" (Supino 1895, p. 91).

[60] Similarly, Pareto (1897) declared there was nothing wrong with commercial banks speculating "if shareholders and depositors are made clearly aware of the operations the banks are undertaking" (Pareto 1897, p. 550). On the other hand, banks of issue were rigorously to be banned from speculative activities (Pareto 1897, p. 588). With respect to commercial banks, Pareto anyhow advised to physically separate speculative banks from simple intermediaries. The former were to hold larger equity or to raise interest rates on deposits to compensate depositors for the greater risk undertaken. Not even regulation of speculative banks was by him conceived, differently with respect to Rota (see note 41).

deposits was initially not relevant in practice) and the impact of runs on commercial banks was underestimated. Deposit-taking was, thus, considered less "dangerous" and destabilizing than banknote issuance (Ferraris 1892).[61] This line of thought can be trained back to the predominance of "metallists" in Italy's economics schools (Realfonzo 1995, pp. 70-73). Ferrara, and then Martello, were the first to adhere to the idea of commodity money (*moneta-merce*) chosen by the market for its transactions due to the commodity's characteristics (*i.e.* divisibility, manageability, transportability, durability, etc.). Pantaleoni contended that money had to have intrinsic worth to be a reserve of value, due to economic agents' limited rationality, honesty and hence trust in money. Pareto too made a distinction between "true money," *i.e.* metallic money, and "false money," *i.e.* bank deposits. Barone rejected credit being able to increase the quantity of money in circulation, as it was a mere substitute of the existing metallic money; credit simply transferred savings over time (Barone 1919). Similarly Loria (1910, p. 510) wrote that "credit does not create capital, does not engender new wealth, it simply transfers wealth." Fanno (1912) too was a "metallist," as we shall later see.[62] Italian economists seemingly up until mid-XXth century had qualms about embracing the theory of credit expansion via the deposit multiplier.[63] For example, in 1934, de Viti de Marco (1934), building on his earlier 1898 work, asserted that the increase of deposits in different banks was sequential, not simultaneous, hence the increase in deposits in one bank was continually counterbalanced by the decrease in another, leading to a constant amount of deposits in the banking system as a whole. He disdainingly defined the economists who accepted the deposit multiplier theory as "modernists" (de Viti de Marco 1934, p. 70).[64]

A last interesting remark on regulation in the second half of the XIXth century is connected to some economists' belief that the variations in the balance sheets of the most important banks were indicators of the overall economic performance of their country.[65] Regulation was, thus, considered to have an impact also on "sensitive" statistical data. This

[61] De Viti de Marco (1898) considered banknotes and chèques based on deposits as alternative means of payment. They differed however in that chèques were used mainly by the more "educated" traders and not by the general public. Hence the use of chèques was in principle more conscious and prudent.

[62] A notable exception is Lugli who in the late 1930s was a fervent defender of representative money (*moneta-segno*), assuming the boundless trust of financial agents (Realfonzo 1995, p. 111), in stark contrast with Pantaleoni.

[63] In 1931 Bresciani-Turroni still wrote that "confusion of ideas persists" with respect to the theory of the deposit multiplier (cited in Realfonzo 1995, p. 200).

[64] Only in 1947 did another leading economist of the same school, Einaudi, start coming to terms with the credit expansion theory, yet still unconvincingly and with some distrust. In an attempt to explain the inflationary process of 1946-47, he in fact shed light on the possible risks of inflation tied to a "new" (in Italy), yet still not widespread, type of deposits: the opening of lines of credit on which clients could draw chèques. The latter, when used, then became deposits of other agents for the same amount. This particular type of money was issued by ordinary banks, not issuing banks, yet could possibly lead, if over-traded, to inflation (Einaudi 1947, reported in Barucci 2008, pp. 470-471). Einaudi, anyhow, did not consider the further developments of the deposit multiplier. The increase in deposits, of the same amount of the chèque, then could lead to a credit expansion by the deposit-taking bank and to further deposits of savings, yet he did not take into account these further stages of the process.

[65] This view was present in Italy up until at least the 1930s. In a note of June 1935 (reported in Guarino and Toniolo 1993, Doc. 175, p. 918) for example, the Bank of Italy still underlined how its balance sheet was an essential indicator of Italy's global performance.

is clear in Sensini (1904), who was inspired by Juglar (1862). The latter's thesis was that banking activity affected population, trade, revenue, taxes, etc., and could lead to economic crises. Exogenous factors, such as bad harvests or wars, could merely aggravate them. Hence, by analyzing banks' balance sheets, one could foresee the occurrence of a new crisis.[66] However, such crises were periodic and inevitable, and therefore could only be mitigated, not avoided.[67] Sensini agreed with Juglar's interpretation of events, and averred that Government intervention could only worsen matters since the State always ended up using banks for its own purposes (Sensini 1904, p. 221); the "regulating mania of legislators" (Sensini 1904, p. 238) was therefore to be refrained. De Viti de Marco, on the other hand, entirely rejected the identification of bank behaviour as the cause of economic crises: variations in credit and banking indicators were instead evidence and consequences of a crisis (de Viti de Marco 1885, p. 194). It was a typical case of what modern econometricians would define "reverse causality."

To sum up, the 1888-1893 financial meltdown brought on the first, organic and truly enforced, issuing-bank legislation, in which economists played no part. Convertibility was not attained, but intermediate instruments consisting in limits on note issuance were used as a second-best solution. If these were not sufficient to guarantee financial stability, they could at least guarantee a smoother functioning of the payments system, by encouraging the use of banknotes as a medium of exchange, via their legal protection. Regulation of commercial banks was not deemed necessary, mainly due to the centrality of banks of issue in Italy's financial system and to the still meagre use of deposit currency. Moreover, no sound economic theory existed to justify such widespread Government control.

5. Issuing-bank deregulation and a growing consensus towards commercial bank legislation, 1907-1925

Once the 1890s financial crisis had run its course, a period of rapid GDP growth got under way, aided by abundant remittances by Italian workers abroad and tourist revenues which contributed to the creation of large gold reserves, as well as to the nationalization of Italy's public debt, previously mostly foreign-denominated. Although between 1894 and 1914 exports doubled and imports increased threefold, the revenues from these two "invisible items" stabilised the exchange rate (De Cecco 2003, pp. 19-20). So while convertibility was never formally declared, by 1902 the exchange rate between lira and gold had reached the old par established in 1883, and the interest rate applied to the Government debt steadily declined. Therefore, between 1903 and 1913, despite Italy being on a paper

[66] "On peut donc, à la seule inspection du chiffre des escomptes et de l'encaisse pendant cinq ou six années, se rendre compte du degré de proximité ou d'éloignement d'une crise. A chaque période nous retrouvons la succession des mêmes accidents: augmentation rapide du portefeuille, diminution de la réserve, épuisement de la caisse de la Banque" (Juglar 1862, p. 198).

[67] "On peut les prévoir, les adoucir, s'en préserver jusqu'à un certain point, faciliter la réprime des affaires; mais les supprimer, c'est ce que jusqu'ici, malgré les combinaisons les plus diverses, il n'a été donné à personne. Proposer un remède à notre tour, quand nous reconnaissons le peu d'efficacité de ceux des autres, n'était pas possible" (Juglar 1862, p. VII).

standard, the exchange rate between the franc and the lira – the main reference for policy – was essentially fixed and the government embraced fiscal and monetary rectitude, thus shadowing gold (Cesarano, Cifarelli and Toniolo 2009).

The pre-WWI period was also characterized by the expansion of mixed banks, which came to play a leading role in corporate finance. "The main characteristic of this period […] is the large importance acquired by the bank *vis-à-vis* the industry: the bank has taken on the function of foundation of the industrial firm; bank capital […] in this phase has become the propeller and at the same time the dominator of the industry" (Bachi 1914, pp. 300-301). In fact, trustees of the banks routinely sat on the boards of the main client firms; banks advised and assisted IPOs, frequently underwriting large amounts of shares to be gradually placed thereafter on the market. As a result, banks acquired relevant market-maker positions in the three main stock exchanges (Milan, Turin and Genoa), whilst often holding consistent amounts of shares either from IPOs or as collateral for loans in their portfolios. The main banks were therefore partly responsible for the rapid increase of equity prices, which suited them well by swelling the value of their assets. Confalonieri (1985), however, underlines how the main feature of the pre-WWI Italian universal banks was not their activity of industrial share purchases; if it is true that firms' shares became numerous in banks' balance sheets after 1907, this was initially due not to deliberate choices of asset management nor to a "sectoral strategy" (Confalonieri 1985, p. 124), but to measures undertaken to protect the banks' own interests. In this way, in fact, banks could obtain a stable demand of loans and a stable supply of deposits from a core group of businessmen.

Particularly impressive in this sense was the growth of Società Bancaria Italiana (SBI, established in 1898), the junior member of the big mixed bank league (the other two large banks being Banca Commerciale Italiana, from now on Comit, founded in 1894, and Credito Italiano, from now on Credit, created in 1895, which had sprung up from the ashes of the two previous main *crédit mobilier* banks, that had, as recalled, collapsed in 1894). Having begun its activity when its competitors had already conquered the most solid and profitable industrial clients, SBI was forced to base its business on the riskier firms.

In September 1907, reacting to a crisis in the U.S., the stock market crashed in Italy. Pressed for liquidity, corporate clients of the large banks drew on their deposits, as did members of the general public. It became clear that SBI, the weaker ring of the chain, was tottering on the edge of bankruptcy after dubious dealings it had engaged in on the Genoa stock exchange. The Bank of Italy persuaded SBI's two main competitors to join a consortium which extended a loan to the ailing bank, warning of contagion should the public lose confidence in the third largest bank in the country. Further financial assistance was made conditional on SBI being put under control of the lenders, who would then dispose of its assets. The unintended consequence for the Bank of Italy of its first large-scale lending of last resort operation was that it became involved in the management of a commercial bank. The Bank of Italy decreed that SBI was to survive; thus, its capital was reconstituted with fresh subscribers. By late Spring 1908, the crisis was overcome.

What "lessons," if any, were learned from the crisis of 1907? The main ones were about crisis management rather than prevention through adequate regulation, which enshrined the Bank of Italy as the agent responsible for the stability of the banking sector (Gigliobianco, Giordano and Toniolo 2009). Both the Government and the Bank of Italy brought home the "domino effect" argument of avoiding big bank failures which could lead to chain reactions. To prepare for the management of future crises, the Bank of Italy came to believe that more ammunition had to be added to its arsenal, in particular more flexibility was required of its liquidity management. In 1907, the Bank could act without endangering macroeconomic *equilibria* as it had large reserves, some of which supplied at the last minute by the Treasury, but circumstances could not be expected to be as favourable all the time in the future. This led to the loosening of limits on circulation with a sequence of laws in 1907, 1912 and 1914, which can be interpreted as a de-regulatory move.

It would take another crisis for the legacy of 1907 to be translated into prudential regulatory action. Why was this? First, the traders in the Genoa stock market were identified as the main culprits of the 1907 crisis. Stock markets were believed to be in urgent need of regulation after the previous de-regulatory wave, as emerges from numerous articles of the journal "L'economista d'Italia." Therefore, in 1908 a law proposal to reorganize the stock market was drawn up. However the actual law was passed only in 1913, due to the arising of other priorities in the meantime (e.g. the intervention in Tripolitania, the reform of the electoral law, etc.).[68]

Secondly, a large camp of economists continued to believe in the centrality of issuing banks, and hence still did not conceive the need for commercial bank regulation. An example is the main economist of the time, Fanno, who was also the main promoter of Wicksell's theories in Italy. In a 1912 article of his, he underlined how banknotes and deposit currency were "money," but at the same time were not definitive means of payment. Chèques could always be presented to banks for redemption (in banknotes) and, in turn, banknotes could be redeemed for metal currency. Hence, the national fiduciary circulation rested entirely on the metal reserves of issuing banks (Fanno 1912, p. 131).[69] Because banks of issue amassed these metal reserves, they were the pivot of the banking system. Credit expansion of commercial banks was not to exceed given limits with respect to these reserves. Banks of issue (and not the State) were to supervise and guarantee the respect of these limits; in case of an excess, they were to increase the discount rate (Fanno 1912, p. 132).[70] However, if an abundance of metal reserves guaranteed the stability of the overall banking system in normal times, elasticity in circulation was advocated to manage crises (Fanno 1912, pp. 145-146). In other terms, banks of issue were by him considered as "the central institutions on which the overall banking system rests and gravitates, the regulators of the credit market, the ultimate line of defence to which banks turn to in case of serious difficulties" (Fanno 1912, p. 147). Therefore, although he strongly believed that metal was still the ultimate form of liquidity, Fanno was favourable to the increase of the issuing banks' ability in providing liquidity to the banking system in the case of crises. Commercial bank regulation did not fit into this picture at any stage.

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[68] Law 20 March 1913, No. 272. The law introduced three main novelties (Siciliano 2002): *a)* the State gained control over the Chambers of Commerce, hence reducing regionalisms and local pressures; *b)* only stockbrokers were permitted outcry trading on the stock market, thus cutting out the other financial intermediaries; *c)* the so-called "single capacity" principle was introduced, by which stockbrokers could only act for account of their clients and not for their own. The novel organic legislation did however contain some loopholes (Schisani 2008, p. 353): it did not regulate contangoes nor did it incorporate Nitti's proposal to make the figures on stock market transactions public.

[69] In this, Fanno evoked Messedaglia (1876).

[70] This idea was instead already in Ferraris (1892, p. 213 ff).

Regulation was however advocated by some economists – as summarised in Garrone 1930 – in order to eliminate distortions in the payments system, which would discourage the use of chèques. The latter aim was analogous to the one emphasized by de Viti de Marco back in 1898. At that time, the "new" medium of payment was represented by banknotes, relative to metal currency; now the "innovation" was chèques with respect to banknotes. We can thus detect a tight link between the prevailing monetary instrument and the aims of required regulation. When banknotes were the main means of payment, the safeguard of note-holders was the priority and hence regulation of issuing banks was claimed; when the use of chèques became more widespread, the protection of depositors and therefore the regulation of deposit-taking institutions were called for.[71] However, economists remained on the whole contrary to any legislation.

Some politicians were of a different opinion however. In fact, in 1908 the then Minister of MAIC, Cocco Ortu, initiated legislation aimed at protecting the small depositors of commercial and cooperative banks. Banks were required to create two fire-walled sections for the separate management of "fiduciary" (or "saving") deposits and "commercial" deposits; the former – enjoying privileges in case of liquidation – could not be used for long-term lending (Bonelli 1971, Doc 34, p. 279). The proposal was, however, torpedoed by the Prime Minister Giolitti. The general impression is that, amongst politicians, the fear of blocking credit support to the expansion of the economy prevailed over the aim of safeguarding depositors. The major banks' opinions were, thus, highly regarded even before the creation of an official bank association (Calabresi 1996, p. 190). Stringher, general manager of the Bank of Italy, indicated that rather than legislation what was needed was self-regulation of the banking sector.[72] In 1913, Nitti, the new Minister of MAIC, again proposed legislation for the regulation (via obligatory reserves) and supervision (via periodic on-site examinations) of deposit-taking institutions. Einaudi rose against this proposal, defined as an interfering act of the "legislating Roman bureaucracy" (Einaudi 1913, p. 343). He asserted that the law was aimed at "safeguarding capitalists," in that the small and vulnerable depositors, truly in need of protection, mainly turned to savings banks or to postal saving institutions, which were already subject to regulation. The Nitti law proposal anyhow met the same fate as its predecessors.

Finally, the 1907 crisis also brought to the forefront the issue of Italy's industrial development and the means for it to be soundly financed. In 1909 an article by engineer De

[71] However, in 1912 Fanno wrote that deposit-taking institutions were still under-developed, due to the agricultural tendency of Italy's economy, and hence the use of chèques as means of payment was not widespread at the time (Fanno 1912, p. 122). This argument is extremely similar to the previously mentioned one adduced by Supino in 1895, when he explained the still meagre use of banknotes at the time of his writing (see note 53). In 1933 Mengarini (1933) still noted how chèques were used mainly in Great Britain and not in continental Europe.

[72] Two references are Bank of Italy "Meetings of 1911" in Calabresi (1996, pp. 191-192) and Bank of Italy Report of 30 March 1912 in Bonelli (1991, pp. 39-40). In particular, in the former, when tackling the issue of the banking sector, laws were not recommended, as they could lead to different results to those desired. "A movement in the public opinion is needed to determine a fruitful control over deposits and a lower recompense of the deposits themselves" (cited in Calabresi 1996, p. 191). The idea of introducing capital or liability ratios was not endorsed, but not entirely rejected either: "There are some who opine that the amount of deposits should be better proportioned with respect to the institutions' equity: but to introduce the right proportions one must proceed with extreme caution, by degrees and with appropriate and measured criteria" (cited in Calabresi 1996, p. 191).

Benedetti appeared in "Riforma Sociale." The author suggested creating an "industrial bank," *i.e.* a bank which had permanent relations with its client firms, that helped place their securities on the market and stabilised the prices of their shares over time. The article was preceded by the journal editors' comments,[73] who stressed how Italian banks were forced to purchase shares in industrial firms to make profits and stay afloat. Hence they were more oriented in following the Swiss example of the *Société Suisse pour Valeurs de placement,* a sort of land bank (*Istituto di credito fondiario*) applied to the industrial sector. In 1911 Assonime (the Association of Limited Liability Companies) rounded up the major economists (and industrialists) to discuss long-term lending to the industrial sector, curtailed after the 1907 crash. Monzilli (1911) reported and commented the resulting debate in a contemporary journal, "Rivista delle società commerciali." Amongst the economists, Einaudi was against the creation of *ad hoc* industrial credit institutions, which inevitably, in his view, would favour the large firms; he contended ordinary banks, savings banks or other organizations would instead spontaneously respond to all entreprises' demand for long-term credit. Cabiati too opined that ordinary banks could extend industrial loans without jeopardizing their soundness providing they formed close ties to the industries they lent to so as to successfully monitor their financial situation. He however seized the opportunity to complain about the scarce, and misleading, information published in banks' balance sheets, from which it was not clear to which uses deposits were being destined. A legal intervention concerning mandatory information disclosure was the proposed solution to safeguard depositors. Pantaleoni believed the problem was not the rationing of industrial credit, but rather the lack of a sound social, fiscal and legal environment which hence needed to be restored. On the other side of the barricade, De Johannis favoured the creation of a specialized term lending institution. The meeting did not lead to any immediately tangible results, but set the stage for the 1920s debate on bank-industry separation. It is noteworthy that three sectoral long-term credit institutions were founded in the following decade: the *Consorzio di credito per le opere pubbliche* (Crediop), in 1919, the *Istituto di credito per le imprese di pubblica utilità* (Icipu), in 1924, and the *Istituto per il credito navale*, in 1928.

One may ask if Italian economists, in discussing the issue of industrial credit, were influenced in any way by Hilferding's contemporary major work "Finance Capital," published in 1910, which emphasised the role of banks in directing investments, and therefore the development path of the economy. The answer seems to be negative as no direct references appear in subsequent Italian economic articles, nor was Hilferding's work reviewed, to our knowledge, in those years. Thus Hilferding seems to have been mostly ignored by Italian economists. This is confirmed by Pietranera when he remarked how "Hilferding is almost never cited in the non-Marxist literature and often incorrectly and superficially remembered in the Marxist-oriented one" (Pietranera 1961, p. LXXIII). Pietranera also underlined the importance of the first translation into Italian of "Finance Capital" in 1961, of which his article was an introduction, which finally allowed Hilferding's masterpiece to be disseminated in Italy. In the same direction, Fradeani and Marconi (2000a, pp. 72-73) also described the lack of interest Italian economists displayed towards Hilferding, whose work was a "forgotten contribution," due also to the fact that "there seems to exist in the best Italian scientific tradition a perfect separation between the study of real

[73] In those years "Riforma Sociale" was directed by Einaudi and the head editor was Prato.

phenomena and of financial ones."[74] Italian economists did discuss the issue of bank-industry ties, yet "their contribution [was] not systematic" (Fradeani and Marconi 2000a, p. 73) in that it reflected contingent debates arising from endemic banking crises. Fradeani and Marconi (2000b, p. 621) finally do not exclude that Italian economists were simply not aware of Hilferding's contribution to economic theory, and hence were not consciously ignoring it.

Going back to historical events, when WWI broke out, the expansion of industrial output was financed by credit lines generously opened by the largest universal banks. One such bank, the Banca Italiana di Sconto (from now on Sconto), was created shortly before the outbreak of the hostilities by a group of industrialists who had large stakes in the Ansaldo heavy industry conglomerate (e.g. Falchero 1990). It acquired the previously mentioned SBI. As long as the war lasted, a discount window opened up by the Bank of Italy ensured that liquidity never became an issue. In Autumn 1914, a general moratorium on bank-deposit withdrawals pre-emptied runs on the weakest banks and the spread of contagion (Toniolo 1989, pp. 18-25). The Bank of Italy also sponsored the creation in December 1914 of a special institution (*Consorzio per Sovvenzioni su Valori Industriali*, CSVI) authorized to discount paper not eligible for direct discount at the banks of issue. The original motivation for CSVI was to avoid the dumping of industrial equity on the market by liquidity-starved banks or industrial companies (Guarino and Toniolo 1993, pp. 197-198).

The pre-emptive supply of liquidity to the commercial banking system by the Bank of Italy reflected a different concept of financial stability to the one present in the second half of the XIXth century, based, as we have seen, if not on outright convertibility, on quantitative limits on note issuance. The gold standard had in fact been abandoned at the onset of WWI, and a parallel shift of focus from gold to banknotes as the ultimate form of liquidity occurred. This was confirmed by the later developments in the international monetary regimes. During conferences in 1918 (Brussels) and 1922 (Genoa), the main European countries in fact expressed their willingness to restore a common monetary standard, which however was to be more elastic than the pre-WWI gold standard regime. Hence the idea of creating a gold exchange standard, in which banknotes could be converted, as well as into gold, also into strong currencies, *i.e.* sterling and dollars. Convertibility of the lira was however postponed, also due to the emergence of other priorities, such as the elimination of large fiscal deficit, which in turn required a strict fiscal policy, the support of Italy's burgeoning industrial firms via a depreciated exchange rate, and the open issue of war debts (De Cecco 2003, pp. 38-39).

After a brief post-war boom, most European countries experienced quite severe, if relatively short, depressions. In Italy the banking crisis coincided with the crucial months of social and political instability that brought Mussolini to power. It was also marked by a fierce struggle among capitalist groups for the control of the largest banks and industrial conglomerates. The economic and political debate of the time thus focused on the *scalata alle banche* (bank takeover) issue (e.g. Toniolo 1989), reaching its apex in 1918.[75] Many

[74] Marconi and Fradeani referred to Einaudi, Pantaleoni and Sraffa as the "best Italian scientific tradition."

[75] In 1917-18 the Perrone brothers, at the helm of Ansaldo, attempted to take over the majority of Comit's shares. The aims were various: the use of the bank's copious deposits to strengthen the industrial firm's financial position, a reduction of credit to competitors to weaken them and an increase of Ansaldo's relative power in future negotiations with the Government (Sraffa 1922).

influential academics intervened, all recognizing the dangers congenital in the bank-industry liaison (Santoro 1927, p. 33). Graziani insisted on keeping banking activities separate from industrial ones. Vivante again presented his original law proposal of 1895 on joint-stock companies to protect depositors. Navarrini too called for a legal intervention to prevent deposits being used to finance one industry only, hence accentuating concentration risks. Amongst the interventionists, one must hence distinguish between those economists who only fought for the safeguard of depositors and those who pushed for a more extensive control of the State over all banks.[76] Even the free market economist Einaudi insisted on the risk of bank specialization and the need to diversify and compensate risks, as well as the dangers connected to bank clients controlling the banks themselves. Yet his was not a call for legislation: "[t]he only effective remedies are not legislative, but concerning customs and a vigilant control by depositors, shareholders and a serious public opinion" (Einaudi 1918).[77] Finally, Cabiati (1918) recalled, as he had already done in 1911, the impossibility of shareholders and depositors exercising market discipline, in contrast to Einaudi, due to the approximate, if not misleading, drawing up of balance sheets by banks. He thus proposed, following the example of Great Britain and France, a strict separation between deposit banks and merchant banks (*banche d'affari*) as the only solution. The former would only undertake standard operations; the latter could engage in security issues, the creation and support of firms, speculation.

In this context, Ciuffelli's 1918 proposal was made. Both in the (previous) Cocco-Ortu and the Ciuffelli proposals, each deposit-taking bank was to build an independent section for deposits, regulated by the norms concerning savings banks. Depositors were attributed a special privilege over the activities of the independent section. However, the ensuing regulatory debate was weak as the public's attention was captured by the ongoing warfare and the proposal was turned down. 1918 was also the year of the creation of a Government-sponsored bank cartel between the four main credit institutions in order to eliminate the existing conflicts amongst the largest banks. The main points of the cartel were the introduction of caps on deposit interest rates, of limits on branching abroad and of restrictions on loans extended to the State or to other public entities, whilst loans to industry remained unconstrained. Stringher was nominated arbiter of the potential controversies which could emerge between the four banks (Toniolo 1989, p. 64). The cartel was continually renewed until 1927 when it was replaced by another, broader one, under the auspices of the Fascist Banking Confederation (Calabresi 1996).

[76] See the reference to De Gregorio further on.

[77] Einaudi (1924b, pp. 100-101) also pondered on the importance of having able and morally integer bankers at the helm of banks:

> […] [T]he banker has to know not one industry alone but all of those to which he lends, not one market but many: the storm that will reduce or wipe out the value of the paper he has discounted can come from any point of the globe. […] All prices interest him and he must monitor them all. Beyond that, he must have a thorough knowledge of the structure and balance sheet of the firms to which he entrusts money that is not his own. […] [W]ell-ordered archives, accumulated experience, executive personnel selected with a fine sieve will be useless without the prime factor of a bank's success: the right man. […] [T]he banker's duty is to entrust the money of others to able and upright men who now how to put it to work to their own advantage and repay it at the agreed time. […] If he takes pity for a moment, if he becomes groundlessly optimistic or confident, he is lost. That is, his depositors' money is lost. […] Men of this kind are extremely rare in any country. Lucky are the banks able to procure their services!

A noteworthy coeval study of the banking sector of the time, dominated by Sconto, Comit, Credit and Banco di Roma, was that of Bachi, who had already documented the rise of universal banking in Italy back in 1914. He now emphasized how the four banks were "behind all firms" (Bachi 1919, p. 167), so that depositors and clients unwittingly had become shareholders of a large number of enterprises. Furthermore, the economic and political power of these banks had intensified to such an extent that the banks of issue had lost control over the credit flows. He emphatically warned of the dangers of a potential failure of the industrial firms which would drag the banks down with them.

In 1920 the regulatory debate was livened up again by the second attempt by Ansaldo to take over Comit (Sraffa 1922). The takeover was again unsuccessful, but elicited two more law proposals in the same year, advanced respectively by Chiesa and by Alessio, the then Minister of MAIC. The former proposal requested an authorization from the Treasury to undertake banking activities, the introduction of Government supervision and obligatory balance sheet disclosure. The latter again emphasized the need for protection of depositors, however, differently with respect to the previous ones, in that it attributed a minimum privilege on all the property of the bank (not subject to mortgage or pawn) in the case of bank failure.[78] It is interesting to recall a speech made by Alessio in July 1920: "Significant changes in our credit system have occurred. […] [T]he main credit institutions have modified their nature. Once they were deposit-taking institutions of commercial credit; now they are mainly deposit-taking institutions of long-term credit."[79] Some economists were thus conscious, already by the end of WWI, of the potentially destabilizing nature of mixed banking.

A ferocious critique of the Chiesa proposal in particular was made by Prato in "Rivista Bancaria," the journal of ABI (the Italian Banking Association).[80] He argued that in any developed economic environment, State intervention in the management of commercial banks seemed such "fanciful nonsense" (Prato, 1920, p. 334) to *a priori* exclude any form of discussion on the matter. Not surprisingly, the "most important teachers of the subject" (amongst which he recalled Bagehot, Mac-Leod, Ferrara) had not mentioned the issue, but had written "everlasting pages" on the opportunity of regulating note issuance or not. The State was thereby not to interfere in banks' conduct since the trust of clients was the most effective form of control, especially in the case of speculative institutions, whose depositors were financially educated capitalists. Prato accepted the intensification of mandatory information disclosure as the only conceivable form of regulation in order to, in turn, boost market discipline.

In 1921 a new banking crisis broke out. At the heart of it was the interlocking shareholding between the Ansaldo conglomerate and Sconto, as a slow post-war restructuring process threatened the former's solvency. Sconto, which could not discontinue lending to its main client, suffered huge liquidity drainages. Bachi's warning had turned into reality. As in 1907, the Bank of Italy turned to the two largest banks in order to aid the

[78] Note, however, that even if the present and preceding law proposals called for depositor privileges of varying form, these were not contemplated in the actually enacted 1926 law.

[79] Speech in Parliament made by Alessio on 28 July 1920, reported in Santoro (1927, p. 44).

[80] "Not much knowledge of banking science is necessary to realize how the whole project, similarly to all the new restrictionist legislation, represents a laudable effort to go back centuries of economic and technical progress […]" (Prato 1920, p. 332).

troubled bank. However, the consortium materialized too late to stem the withdrawal of foreign deposits from Sconto. Soon liquidation emerged as the only solution. A partial guarantee of deposits was given by the Bank of Italy through a new entity, a "Special Section" of the previously mentioned CSVI. Ansaldo was *de facto* taken over by the Government. Almost at the same time Banco di Roma suffered huge deposit losses and became illiquid. It was however provided with enough liquidity from the Special Section, with the guarantee of the newly-formed Mussolini Government, to outlive the crisis. Two successive bank failures were, in fact, considered as being excessively destabilizing for the overall economy.

How did this banking crisis shape the public opinion, the leading economists' beliefs, the politicians views and the regulatory attitude of the authorities? The collapse of Sconto had a much wider repercussion on the public opinion than the previously mentioned 1918 and 1920 "early warning" episodes. The closing of all the bank's branches in December 1921 had definitely caught the public's attention, as Bachi (1921, pp.198-199) described. Sraffa (1922, p. 191) too aptly commented the reactions of all parties involved:

> In this uncertain situation discussions were opened with a view to reaching a definite settlement with the creditors, whereupon began the struggle between the representatives of the various interests, of whom each was trying to grind his own axe while they only agreed in striving to make the State pay the greatest possible proportion. A violent journalistic campaign was launched on the country; a parliamentary group was founded with the special aim of defending the interests of the creditors of the Banca di Sconto; the fascisti, who had always been largely subventioned by the Banca di Sconto, got up demonstrations and meetings: the creditors went so far as to threaten that if their demands were not satisfied by the Government a "general insurrection of the creditors" would take place, entailing refusal to pay taxes, withdrawal of deposits from other competing banks, and lock-outs in the work-shops.

The new crisis had greatly reinforced the idea that regulation concerning banks of issue was not sufficient to attain the stability of the whole banking system. Time had come to regulate commercial banks too. The political and economic debate covered numerous issues, of which three core ones are here briefly recalled.

a) *Bank-industry separation.* The advocates of the separation in 1920 became even more convinced of their beliefs and political parties too began to take sides on the matter. For instance, the Partito Popolare already in 1922 called for a separation between "industrial banking" and "commercial banking," which were to be subject to different legislation.[81] Nonetheless, consensus was not unanimous. Gilardoni, an eminent member of the party, for example, discouraged new legislation on the matter. Born in the wake of a banking crisis, which lay outside "ordinary" economic circumstances, such a norm was bound to be a contingent law, which could not be at the basis of a systematic economic legislation (Gilardoni 1922, p. 80). He also maintained banks should be free to choose which undertakings to engage in. Finally, in a denigrating tone, he compared the function of a regulator to that of "a press censor" (Gilardoni 1922, p. 82). In his lucid analysis of Sconto's collapse, Sraffa (1922, pp. 196-197) wrote: "The urgent necessity, if new disasters are to be avoided, is to get the industries again under the control of those whose interest it is to make them prosper." The problem was how to attain this aim. "[E]ven if these laws [*i.e.* regulatory reforms which were being demanded] were not futile in themselves, what could be their use as long as the Government is prepared to be the first to break them so soon as it is

[81] A similar opinion is stated by Flora in 1926 (Guarino and Toniolo 1993, Doc. 73, p. 427).

blackmailed by a band of gunmen or a group of bold financiers?" Einaudi (1924a) again thundered, as he had already done in 1918, that banks and industrial clients had to be firmly separated, since "[o]ne cannot be both master and client, judge and party" yet again, not via legal constraints, but by market discipline that guaranteed banks' best practice.

b) *Over-banking and competition.* A lively discussion was engendered in the pages of the journal "Echi e Commenti," concerning the recent institution of numerous small banks and the negative consequences brought about by cut-throat competition between them (Santoro 1927).[82] Arias declared that the main cause of the development of the small banks was the insolvency of Sconto which had eliminated the public's trust in big institutions. Graziani underlined the higher operating costs that the proliferation of banks and branches outside the bank cartel had led to. Loria drew a distinction between competition amongst producers and competition amongst financial intermediaries. Whilst the former reduced the price of products, the latter increased it. To attract depositors, in fact, banks were forced to increase interest rates on deposits, hence raising the interest rate on loans too, thus damaging the industrial sector and output. If competition then curbed the rates demanded on loans, the banks were forced to turn to speculation to survive. The discussion ended with a call for regulation.[83]

c) *Depositors' safeguard.* Again the intellectual debate was focused on how to attain this aim. Legislation was one solution. "Financial education" of depositors was another. Deposit insurance was a further possibility. Pantaleoni (1924) was set against the regulation of deposit-taking institutions, in particular the imposition of a fixed capital-to-deposits ratio. In safeguarding deposits, it was not the capital that counted, in his view, but the type of investment the deposits had been turned into.[84] In a scathing critique he stated that, in general,

> [t]he advocates of State interference believe that the depositor is a perfect imbecile, that bank managers are all scoundrels exempt from any legal responsibility and that bureaucracy […] is omniscient, honest and active. If depositors were truly imbeciles then regulation would perpetuate their state, whilst its absence would promptly teach them to be more circumspect (Pantaleoni 1924, p. 1305).

Similarly to what had been stated by Einaudi in 1913, Flora[85] too stressed the importance of educating the Italian depositors, in order to enable them to foresee would befall the money they entrusted to banking establishments from their very names. Einaudi again returned on the subject in 1922, this time discussing the opportunity of introducing insurance on deposits, strongly conscious of the moral hazard problems underlying the issue. Testing his views against a broad array of historical evidence in Italy and in the U.S., he came to the conclusion that such an insurance would be feasible only in the case of cooperative banks

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[82] "Echi e Commenti" was a journal founded by Loria in 1920 with the explicit aim to "collect and coordinate the news concerning our country, offering them directly to the public, together with comments" (Majolo Molinari 1977, pp. 261-262).

[83] Not all economists supported limits on competition in the banking sector. As we shall see, Einaudi was against such measures, as was Cabiati (1918).

[84] Similarly Cabiati (1918) had emphasized how it is not the capital-to-deposits ratio that safeguarded depositors, but the nature of the operations banks carried out. It is remarkable how the Italian economists of the time failed to see that the stock of capital signalled commitment by shareholders.

[85] See note 81 for the reference.

and rural banks, due to their small size. He did not thus contemplate this solution for the large ordinary banks. His feeling was, in fact, that deposit insurance would not have avoided the Sconto "catastrophe" (Einaudi 1922, p. 290). Oddly, no economist stressed the importance of independent economic information (e.g. newspapers) and of its vital role in bringing about market discipline. [86]

Between 1923 and 1925 three "private" law proposals were published in journals by scholars. Tucci's proposal of 1923 (Tucci 1923) contained suggestions which were later adopted in the 1926 Banking Act (e.g. nominal bank shares; minimum reserve requirements; ratio between paid-up capital and deposits; limits on the credit extended to individual debtors). Nicotra (1924) also supported the idea of nominal bank shares, in order to block bank takeovers by industrial firms or powerful groups. Finally in 1925 De Gregorio stressed the need for fixed deposits-to-equity ratios (Renzi 1938, p. 39).[87]

A first draft of a new Banking Act was officially prepared by the Government in September 1923 (Guarino and Toniolo 1993, Doc. 66, pp. 403-415). It took three more years for the law to overcome intense lobbying and to land in Parliament. Not only did the free market economists still strongly argue against the desirability of "protecting depositors by law," as just seen, but also lobbies such as the previously mentioned ABI and Assonime showed a deep anti-regulation stance. In particular, it is interesting to read the letters written by the then President of ABI, Bianchini, and by the director general of Assonime, Guarneri,[88] in which the main reasons stated against commercial bank regulation were the following: *a)* the total adequacy of existing laws, in particular of the unification of note issuance, legally decreed in 1926, which allowed the Bank of Italy, via discounting and advances, to monitor all other banks; *b)* the impossibility of applying a uniform law to the different Italian regions; *c)* the importance of universal banking in Italy's economic development and, hence, the undesirability of limiting it. In the end however, the activism of Volpi, the new Minister of Finance, contributed to the introduction of the new regulation.

To sum up, Italy's third regulatory regime began as a reaction to the 1907 crisis with a de-regulatory wave concerning banks of issue: the aim was to entrust the lender of last resort, the Bank of Italy, with greater flexibility to manage future crises. A pre-emptive supply of liquidity was then perceived, during WWI, as an actual crisis-prevention tool. This new regulatory stance of increasing rather than restricting the circulation of banknotes reflected an underlying shift in the conception of the ultimate form of liquidity: notes rather than specie. Regulation of commercial banks was rejected by those economists who still maintained the centrality of the banks of issue in the overall banking system (and thus gold as the ultimate means of redemption. In contrast, others called for legal intervention to protect depositors, the holders of the "new" means of payment, *i.e.* deposit currency. Law proposals, however, were defeated, although the bank-industry ties were beginning to be identified as potentially dangerous. If nothing came of these law proposals, they nevertheless

[86] Prato for example worried about the "serene acquiescence of the press and of the public's economic illiteracy" (Prato 1920, p. 342), but did not expand on the issue of public information.

[87] Sangiorgio and Capriglione (1986, p. 12) cite De Gregorio as an example of part of the "forward-looking" stream of the doctrine, who believed regulation had a wider scope than that of protecting depositors; it had to have the more ambitious aim, in fact, of ensuring the stability of every single bank, and hence of the whole credit system.

[88] In particular, Guarino and Toniolo (1993, Doc. 70, pp. 419-421; 1993, Doc. 74, pp. 431-435).

indicated a significant shift in the paradigm of bank regulation, hitherto synonymous with bank of issue regulation. The 1921-23 banking crisis was the straw that broke the camel's back. Bank-industry separation was even more vigorously acclaimed, as well as depositors' safeguard. Yet it was still not unanimous in the economic debate if actual legislation was needed or if banks' best practice, together with the financial education of depositors, were sufficient. Over-banking began to be perceived as a major problem and limits on competition were invoked. Although the main banks had already formed a cartel in 1918 which imposed insider rules, they were strongly set against State "outsider" regulation, as the ABI and Assonime documents prove. If their opposition was sufficient to delay legislatory action, it was not however strong enough to block it altogether.

6. A new but backward-looking regulatory regime, 1926-1930

A brief Banking Act was passed in September 1926, to which a more articulate one followed in November.[89] The new regulatory regime applied to all deposit-taking banks, included savings banks until then falling within the realm of special legislation, with the explicit aim to "safeguard savings." A key provision of the Act was that an authorization by the Ministry of Finance became mandatory for the creation of a new bank or branch, as well as for mergers and acquisitions, in order to limit over-banking. The latter was in fact considered the main cause of the 1920s banking crisis (Banca d'Italia 1929, p. 32):

> [t]he ease with which it was possible to receive deposits at a time of monetary inflation had driven many banks that either did not have a sufficient supply of real capital or that lacked capable management to take shape. It had also induced both old and new banks to expand recklessly in all directions, creating costly branches with the object of collecting money in the form of banknotes, even by offering high rates of interest […]. Thus in many places large sums of money flowed to banks and bankers, which ventured into speculation and tied up capital, often causing serious trouble and losses to people who placed faith in them.

Minimum capital and reserve requirements, as well as quantitative limits on credit extended to any individual client, were introduced. The Bank of Italy, with its recently assigned monopoly over note issuance, was entrusted also with supervisory powers, via information disclosure and on-site inspections.

The number of banks dropped after the introduction of the Banking Act,[90] in a process of "gradual simplification of the banking organization, which is keenly sought by those who have at heart the safeguarding of savings" (Banca d'Italia 1929, p. 34). The reduction, however, as we shall see, was not conceived as sufficient by many economists and by Stringher himself. Yet not all economists agreed upon this banking sector "rationalization." Einaudi (1930) was at the forefront of this stream of thought.

> […] [I]s it true that the adjective 'weak' necessarily or generally goes hand in hand with the circumstance that banks are numerous and therefore small and that the 'strong' banks are few and consequently large? Is it therefore beneficial for banking policy to hinder, on principle, the creation of new banks and to take a favourable view of the amalgamation or merger of existing ones? […] Building big appears to be

[89] We refer to the royal decrees of 7 September 1926, No. 1511, and of 6 November 1926, No. 1830.

[90] The figures show that at the end of 1927 there were 4,405 Italian banks in operation, 4,197 a year later, and 4,097 in February 1930: a reduction of 7% in 26 months (Banca d'Italia 1930).

equivalent to building well. Hence the universal mania for cartels, consortia, trusts, giants. It is a mania and it will pass (Einaudi 1930, p. 104).

The historical evidence of the Sconto failure and the Banco di Roma's rescue seemed to make the over-banking view unfounded. Einaudi, who also analysed the contemporary U.S. fragmented system and the U.K. oligopolistic one, concluded that: "[i]t is not possible to proclaim dogmas in this field" (Einaudi 1930, p. 107). Mergers could be an indicator of a dangerous method of managing crises in which frozen assets were offloaded onto others, *i.e.* the public, the taxpayers. Bank cartels he deemed useful only when used to pool and share information on loans to customers, so that no-one could accumulate debt beyond their solvency by borrowing from different banks which did not communicate amongst themselves. He admitted the fact that local bankers were more subject to concentration risks than large diversified banks, but he also attributed the failure of the former to foolishness and avarice. He thus concluded by stating the complementarity of large and small banks and hence "the 2,429 rural banks in operation in Italy appear neither too many nor too few" (Einaudi 1930, p. 111).

Anyhow, the banking legislation of 1926, if not actually stillborn, was largely obsolete. Inspired by the 1888 saving banks law, it regulated commercial banks as they existed before WWI and strongly reflected the 1908 and 1913 proposals. But WWI had already changed the banking industry as observed back in 1920 by the afore-mentioned Alessio and by the leading economists of the time. The regulation was also soft-touch, incomplete and only partially enforced. Inspections, in fact, mainly targeted small local banks.[91] No article of the law disciplined the bank-industry linkages, except maybe the quantitative limits on credit extended to any individual client, which however were systematically exceeded by the main banks. Finally, nominal shares – proposed, as we have seen, by Tucci (1923) and Nicotra (1924) so as to hinder speculative manoeuvres – only became mandatory after the next set of bank legislation in 1936.

By 1929, Comit, Credit and Banco di Roma thus completed, untrammelled, their transformation into quasi-holding companies. During and immediately after WWI, as we have seen, the bank-industry bond had become much tighter due to the acquisition by banks of permanent stakes in manufacturing and utility firms. At the same time industrialists sought, with varying degrees of success, to gain control of the banks. The evaluation of creditworthiness and the surveillance of potential and actual industrial clients, as well as the information flows from the industrial sector to the banking one, all deteriorated as a consequence. During the brief, if buoyant, cyclical expansion of 1922-25, a stock market boom, partially fuelled by the banks themselves, allowed the latter to easily extend credit to industrial companies on the security of the firms' equity. When the stock market weakened in 1925, the banks stepped in order to stem the falling value of equities. Unable to reverse the bear market and since most equity prices remained lower than they had been in 1925 for the rest of the decade, the banks had no alternative but to hold on to their equity portfolios (Gigliobianco, Giordano and Toniolo 2009).

Like other countries, Italy too was then strongly affected by the Great Depression. Industrial output contracted by 25.1 per cent between 1929 and 1932 (Toniolo 1980). The

[91] The reluctance to interfere with the big banks was palpable. Between 1926 and 1932, 2,532 on-site examinations were conducted: 4 in national banks, 72 in interregional ones, 94 in regional banks, 270 in provincial ones and 2,092 in local ones (Banca d'Italia 1932). No inspection took place in the "Big Three."

real slump had an immediate impact on the banking sector. Confronted with deflation, which had started in 1927 with Italy's return to the gold standard at an overvalued rate, and falling demand, industrial firms could hardly rely on financing out of retained profits, while at the same time they too saw the real value of their debts increase. They could thus only turn to banks for further loans in an attempt to fulfil their previous obligations and defend the value of their equity assets. It was impossible for the banks to refuse to extend credit with equity as collateral, or to actually "convert" their credits into shares, to avoid the collapse of their indebted clients. The withdrawal of foreign deposits made this strategy ever more dependent on credit from the Bank of Italy. As a last resort, the two largest banks endeavoured self-regulation by trying to solve the maturity mismatch between their short-term liabilities (deposits) and their long-term assets (stakes and credits to the industry) through the creation of *ad hoc* holding companies to which they shed their industrial stakes. This was a first timid (and voluntary) attempt to create a fire-wall between ordinary short-term lending and industrial long-term credit. It failed in that the universal banks had control over their financial firms and could not interrupt credit flows to the industrial sector. The financial firms were, in fact, a clear example of captive finance with respect to the banks that created them (Battilossi 2000, p. 332).

To sum up, Italy's fourth regulatory regime was inaugurated by the 1926 legislation concerning all deposit-taking institutions. The main instrument it relied on was restrictions on entry and dimensions, a point on which not all, but most, economists agreed, but it ignored the bank-industry problem. The law was backward-looking, soft-touch and only partially enforced. Regulation, hence, did not reverse the process of universal banks becoming actual holding companies and hinder them from fuelling the 1930s banking crisis. The banks were not able to overcome their woes alone during the Great Depression, and Government intervention was called for. As we shall see, the crisis management procedures which were implemented sowed the seeds of the future regulatory reform.

7. A long-lasting regulatory regime with a two-fold aim, 1931-1992

When the previously mentioned measures failed to solve the liquidity problem of the banks, these had no alternative but to turn to the Government which, on 31 December 1930, issued a secret decree mandating the *Istituto di Liquidazioni* (the heir of the Special Section) to offer loans and advances to a whole list of financial institutions, including Credit. This then led to a secret deal (*Convenzione*) of 20 February 1931 between the Bank of Italy, the Ministry of Finances and Credit. The latter accepted a restriction of its activities to "ordinary" (*i.e.* short-term) commercial bank operations in exchange for a large liquidity injection. Credit's industrial stakes were passed on to a financial firm at balance sheet value. This deal is particularly relevant as it represents the first significant step towards the subsequent regulatory legislation, based on the separation between commercial and industrial banking (Gigliobianco, Giordano and Toniolo 2009). In fact, Credit was banned from underwriting shares in industrial or real estate firms and was forbidden speculative trading in securities and real estate. In July 1931, Comit too turned for help to the Bank of Italy, after the withdrawal of deposits, mainly by Americans, preoccupied by the rampant banking crises in Central Europe. In October 1931, another *Convenzione* between Comit and the Government provided for the acquisition of the totality of the bank's industrial stakes by its financial firm, which obtained an *ad hoc* loan from the *Istituto di Liquidazioni*. Thereafter, Comit's activities too were restricted to commercial banking.

The crisis was finally settled in March 1934 by three *Convenzioni* between the State and each of the main universal banks (Comit, Credit and Banco di Roma). The idea was to free the latter both from their excessive debt burden towards the Bank of Italy and from their excessive credit exposure towards firms. All the industrial assets of the banks were transferred to the *Istituto per la Ricostruzione Industriale* (IRI), which also took over the control of the banks.[92] The banks were banned from acquiring stakes in industrial or commercial firms, directly or indirectly, and from financing firms that later purchased majority stakes in the banks themselves. A clear-cut separation between bank and industry, in both directions, was thus definitively attained in 1934.

The *Convenzioni* of 1934 were a significant milestone in the new re-regulation wave, in that they not only re-organized the banking sector as it had emerged from the crisis, but also contained regulatory prescriptions which inspired the 1936 legislation and which were, under this new guise, extended to all deposit-taking institutions, in an explicit intent to prevent further crises. The rescue of the three main banks was, in fact, an explicit *occasio legis* (Porzio 1981b, p. 14). IRI's "brain trust" – made up of Menichella, Beneduce, Braidotti, De Gregorio, Paronetto and Saraceno – was convinced that a successful "banking reform" had already been attained by 1934, in that the successive steps (*i.e.* the a new banking law) were "obvious" (Saraceno 1978, p. 9).[93] Assonime was of a similar view.[94] Economists, such as Fabrizi and Mengarini, were instead more cautious on the matter and preferred to talk about a reform *in itinere* (Santoro 1981, p. 31). Jurists, on the other hand, denied all legal value to the bank-industry separation principle decreed by the *Convenzioni*, principle which was only asserted later by the 1936 banking law (Santoro 1981, p. 32), and, as we shall see, only implicitly.

The banking crisis of 1931-1933 brought home to legislators the inadequacy of the 1926 law in guaranteeing financial stability, for two reasons: *a)* the law turned out to be incapable of handling new entities, such as the universal banks turned into holding

[92] Originally designed as a temporary solution to Italy's industrial problems, IRI was supposed to restructure and recapitalise the main companies that came under its wing before being newly privatized. It then became a permanent State holding of utility and manufacturing firms in 1937. To finance its activities, IRI issued bonds, guaranteed by the State.

[93] Saraceno (1978, pp. 8-9) rejected the word "rescue" (*salvataggio*), in that IRI did not just cover the banks' losses. He also refused the term "reorganization" (*risanamento*), in that IRI did not limit itself to purchasing the stakes the banks held in ailing firms. He instead defined the 1934 *Convenzioni* an actual "reform" (*riforma*), in that IRI received the stakes held in good firms too, as well as the shares in the banks themselves. As a result of this reform: *a)* the three ex-universal banks gave up all majority stakes in firms, not even of profit-making ones; *b)* the majority of banks' capital was not held by the banks themselves anymore; *c)* the banks' capital was recreated since their losses were transferred to IRI, which then settled them with the Treasury, together with those of the *Istituto di Liquidazioni*; *d)* IRI incorporated the banks' debts, as well as those of the *Istituto di Liquidazioni*, towards the Bank of Italy and liquidated them; *e)* IRI gave an impulse to the reorganization of the industrial firms under its control; *f)* IRI came to hold a capital base which allowed it to become an economic holding company; g) a new banking law, prepared by IRI was passed (Saraceno 1981, pp. 78-79). Rodano however argues that these statements by Saraceno were those of an *a posteriori* commentator, expressed decades after the actual 1930s events (Rodano 1983, p. 98).

[94] Assonime and industrial firms in general (represented by Confindustria) were favourable, this time round, to regulation, and in particular to the abolishment of universal banks, which was seen as a means to reduce the costs of long-term credit. In fact after 1936 the latter could only be extended by specific institutions with a long-term liability structure, which did not need to apply a premium against the risk of maturity mismatches, as the universal banks had instead previously done (Santoro 1981, pp. 31-32).

companies, and the regulatory tools introduced proved to be unsatisfactory; and *b)* the law was also not sufficiently enforced, especially due to lax supervision of the major financial institutions, thus resulting in a partially ineffective regulation. Some economists, however, later insisted that the 1926 law was simply badly timed, due to the outbreak of the Great Depression (e.g. Vigorelli 1936, p. 234). On the contrary, the crisis management and crisis resolution measures implemented in the 1930s were effective, due in particular to two main features: *a)* the (partial) secrecy with which the rescues were conducted and the pressure set on depositors not to withdraw their savings, which fended off runs (Toniolo 1995);[95] *b)* a learning-by-doing process, which proved that something had been learned from the previous banking crisis of the 1920s. No big bank was, in fact, allowed to fail this time round, yet at the same time no universal bank burdened by frozen assets was allowed to survive.

What precisely did the new legislation of 1936 impose on the banking sector?[96] The Act incorporated the idea of one sole regulatory and supervisory authority, the *Ispettorato per la difesa del risparmio e per l'esercizio del credito*, subordinated to a Committee of Ministers, led by the Prime Minister. Head of the Inspectorate was, however, the Governor of the Bank of Italy and, *de facto*, the Inspectorate never operated separately from the bank of issue. Separation was formally reversed in 1947 when supervisory responsibilities were again assigned directly to the Bank of Italy.[97] Huge discretionary power was attributed to the Inspectorate, which could dictate instructions and decide on many regulatory issues case-by-case.[98] Overall, the powers assigned to the supervisory authority were so ample that arm-twisting became very effective, enabling the institution to reach many objectives, even ones not explicitly stated in the law. The law also marked the final transition of the Bank of Italy from a bank of issue to a modern central bank, with three functions: control of money supply, last resort lending and bank supervision.[99] Its commercial banking activity was, in fact, discontinued and its ownership was reserved to public entities only (banks and insurance companies).

The new perimeter of regulation included two separate categories of institutions, distinguished according to the maturity of their liabilities: short-term *vs.* medium/long-term. The former category was regulated by Title V of the law, a dense collection of requirements and restrictions. The latter category, on the other hand, was subjected to Title VI, which

[95] Giordano (2007, p. 40) traced the necessary conditions for such a *modus operandi*, which he acknowledged were favourably met by the Fascist dictatorship.

[96] What is commonly defined as the banking law of 1936 is actually made up of the law 7 March 1938, with amendments made by the successive 7 April 1938 law. These two laws were the result of the conversion of two legislative decrees respectively of 12 March 1936 (No. 375) and of 17 July 1937 (No. 1400).

[97] In 1944 the Inspectorate was abolished and its faculties and powers were transferred to the Treasury. Banking supervision was, however, delegated *ex lege* to the Bank of Italy, even though the Treasury could organize its own inspections when deeming them necessary. In 1947, the ex-Inspectorate's functions were transferred directly to the Bank of Italy.

[98] As Galanti (2008, p. 2) underlined, Italian banking legislation was a legislation "of principles, of allocation of powers with a proxy of regulation to the secondary legislation" of the regulating entity. This is clear in the 1936 Banking Act, but he also traces this characteristic back to the laws on banks of issue of the XIXth century.

[99] Statement of the Confederazione Fascista dei Lavoratori delle Aziende del credito e dell'assicurazione of 1935 (reported in Cassese 1988). The monopoly of note issuance passed from being a concession of the State to becoming one of three institutional functions.

simply transferred to the Inspectorate the existing regulatory and supervisory powers attributed by previous *ad hoc* laws to various regulating entities.

The tight inter-relations between deposit-taking banks and industry were finally pinpointed as the main cause of the 1930s banking crisis, as the "root of all evil" (Istituto per la Ricostruzione Industriale 1937).[100] The 1936 legislation confirmed the separation between the two sectors, if in a rather subtle manner. Investments in industrial firms were not prohibited, but the purchase by commercial banks of certain types of assets were subjected to the Inspectorate's authorization. In the following years, the Inspectorate denied authorization to most long-term funding of the industrial sector by the regulated entities. Mixed banking, whose extreme evolution into holding companies was at the core of the 1930s crisis, was thus banned by law from the Italian financial system, as was the relapse into maturity mismatching. On this point, whilst distinguishing financial institutions according to the maturity of their liabilities, the 1936 legislation did not, however, explicitly regulate credit maturity. Except for the three ex-universal banks (bound by the *Convenzioni*), in theory, other short-term liability institutions could lend long-term. Nonetheless, *de facto* the temporal specialization was imposed by the Inspectorate's instructions. The issue of bank ownership was also not explicitly treated in the 1936 legislation. One reason was that by that time most banks were under public control, making the issue less relevant. In fact, the share of private banks in the credit market dropped from 55.6 per cent of total credits in 1927 to only 16.96 per cent in 1936 (Ferri and Garofalo 1994, p. 138). In order to stymie the purchase of bank shares by non-financial firms, moral suasion was used by the regulating entity.

The limitation of competition was another predominant feature of the new regulation (Gigliobianco, Giordano and Toniolo 2009). Free competition was, in fact, still considered as the major source of banking instability. This belief, discussed in the debate leading up to the 1926 law,[101] was taken to extreme levels in 1936. The Bank of Italy itself believed that cut-throat competition between banks had been responsible for high interest rates on bank deposits, in a struggle to attract depositors in a low-liquidity market (Bank of Italy 1932). The regulators were concerned that price competition in the market for deposits would induce banks to take excessive risk in their investments or to operate outside their core banking business, with negative effects on the stability of the banking sector.[102] In 1933 a blanket bank cartel was created by the Government fixing mandatory interest rates on deposits. The 1936 legislation not only allowed price caps, which killed interest rate competition, but denied banks other competitive tools such as free branching. Compulsory mergers and liquidations were part of further "structural regulation," aimed at defining and modelling the banking sector, leading to the emergence of "an administrated oligarchy" (Costi 2007, p. 59) of banks. The emphasis set on other regulatory instruments, such as on

[100] See Barbiellini Amidei and Giordano (2010) for a comparison between the "roots of all evil" in Italy and in the U.S., addressed by the respective legislators.

[101] Recall the articles in "Echi and Commenti" journal.

[102] See also IRI note of February 1937 (reported in Cotula, Gelsomino and Gigliobianco 1997, Doc 5, pp. 128-152) on the (rejected) "Proposal to allow ordinary credit institutions to extend medium-term credit," which stated that the increase in bank profits, consequent to limits on branching and price regulation, reduced the need for risk-taking and thus contributed to the stability of the system.

capital adequacy, was thus decidedly inferior to the one attributed to the anti-competition measures.

Finally, information disclosure, on-site examinations and enforcement were made more effective. As well as disclosure to the authorities, some form of disclosure to the public was also required.[103] The Bank of Italy, on its behalf, was still encouraging the public to become more "responsible": "Notwithstanding regulation, depositors must check the solidity of the banks they entrust their savings with" (Banca d'Italia 1931).[104] However, transparency in the 1936 legislation was basically intended as transparency towards the supervisory authorities, rather than towards the market. In commenting the 1934 *Convenzioni*, the IRI management in fact stated: "[…] another myth had fallen: the myth of bank secrecy, that secrecy that had cost the State millions and millions and which had allowed the bank directors to prevent the State from looking into banking issues",[105] confirming the nature of the transparency required.

To gain understanding of the role of economists in defining the 1936 Banking Act, we adopted different strategies.

i) The first one was the traditional analysis of publications in economic journals concerning banking regulation, as well as of the main volumes on banking, used as textbooks in universities, in the 1930s.[106] In the years prior to the introduction of the new Banking Act, but also in the ones immediately following, few interesting articles appeared, in that they all expressed a general consensus for the Fascist regime and were similar in their contents.[107] As Morelli (1984) and Cova (1999) too underline, this does not imply that banks and their regulation were deemed unimportant, rather the fact that opinions were not freely and publicly discussed in the decade under study. Two are the main reasons adduced: *a)* the official press releases, subject to controls, were the only source of information and, as we have seen, many Government measures undertaken were not made public; and *b)* most economists had acquired a prudential attitude in those years, especially when having to express opinions on State interventions. However, it is not correct to assume that all economic debate was annulled during Mussolini's dictatorship: it was, in fact, encouraged when of use to the regime.[108] Nonetheless, the written economic discussion before and after

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[103] In all forms of communication and publicity, in fact, the intermediaries had to list the capital and reserves held.

[104] This statement recalls a previous one made by the Governor Stringher to the General Assembly of the Bank of Italy on 31 May 1928, in which he stated that depositors should only turn to trustworthy institutions with a prudent and cautious management (Banca d'Italia 1928).

[105] IRI statement of 27 March 1935 (reported in Guarino and Toniolo 1993, Doc. 166, p. 853).

[106] As well as the journals mentioned earlier in note 3, the following monographs on banking theory were consulted: Garrone 1934; Fanno 1937; Renzi 1938; Landi 1939; Osio 1939.

[107] This is evident even when excluding those articles published in "regime" journals, in which rhetoric and celebrative tones reigned. See Bini (1981) for an analysis of these articles. For a general study of economic thought under the Fascist regime see Barucci (1981).

[108] An example is the Conference held in Pisa in May 1942, whose aim was to define the economic order Italy was to adopt in the case of the then probable victory of Germany in WWII. An invited discussant was, in fact, Demaria, who strongly defended economic freedom clashing with the prevailing view of corporativists and autarkists. The "Demaria scandal," as it was named, did not lead to political repercussions, since the tinge of the discussant's speech was highly predictable as his position on corporativism and protectionism had already

the 1936 banking law was extremely scanty, pointing to a marginal role covered by economists in its making and in its *ex post* justification. We here group the analysed publications into three blocks, with respect to the topic discussed (the aims of the law; the new role of the Bank of Italy; the bank-industry separation).

The declared aim of the 1936 law was not only to assign the safeguard of savings to the State ("The State is not willing to pay for other bank rescues and the control of deposits cannot be left to anonymous shareholders, but must go to the State, which represents the people"[109]), but also the control over credit flows. The 1930s regulation, in fact, had an allocative aim, as well as a stability purpose: by controlling credit, the Government could direct investment flows towards specific sectors of the economy.[110] In this sense, when it was passed, the law was defined a "corporative credit statute" (Spinedi 1936, p. 88).[111] Many were the reasons adduced by contemporary economists to regulate both deposit-taking and credit activity. On the one hand, savers had no control on the money they deposited in the banks; on the other, credit was directly related to the national economy, since its fluctuations and risks had a direct impact on interest rates. Hence, the need for State control over banks as both savings and credit were "functions of public interest" (Jacuzio, 1936, p. 405; Mazzucchelli 1936, p. 173; Supino 1936, p. 532; Osio 1939, pp. 138-139; Renzi 1938, pp. 17-18).[112] The aim of the law was thus not only to intensify the supervision of the banking sector, but also to guide and coordinate the credit activity, aligning it with the superior interests of the national economy. The Inspectorate's instructions were therefore

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been clearly expressed in a preceding article of 1941. Thus, the Fascist regime did allow economists to talk and write, but only in certain occasions and on the matters it chose to be discussed.

[109] See reference in note 105.

[110] The allocative intent of the 1936 Banking Act is transparent when reading the reports of the Corporazione della Previdenza e del Credito and of the Confederazione Fascista delle Aziende del Credito e della Assicurazione in the regulatory debate preceding the enactment of the law (see e.g. Confederazione Fascista delle Aziende del Credito e della Assicurazione (1935), "Functional and territorial distribution of credit entities" in Cassese 1988, p. 30). It can also be noticed in the statistical and economic debate on the production of banking statistics by branches of economic activity going on in the same years (see e.g. the letter written by Molinari, Director General of the National Statistic Bureau – *Istituto di Statistica* – to Baffi, then economic researcher at the Bank of Italy, of 22 September 1936, which can be found in the Historical Archives of the Bank of Italy, ASBI, Carte Baffi, 233, and of which pp. 4-5 are here of interest). A discussion may instead be opened on whether or not the 1936 Banking Act was then actually exploited to attain the desired allocation of resources in the economy, or if its potential remained unexpressed on this issue (see e.g. Baffi 1986, p. 55). Baffigi (2010) presents historiographical evidence on the subject, in connection with the foundation of credit statistics required by the 1936 banking legislation, to which we refer.

[111] Parrillo (1936, p. 572) too defined the banking reform a "first order conquest by the corporativist organization." However, although the underlying ideology of allocating credit was similar to that of corporativism, later commentators argued that "these ideas moved on a different track"; "a rigid and burocratic organization" was far from the intentions of IRI's managers; "[a]ll [of IRI's] solutions were operational in nature" (Guarino 1993, p. 166).

[112] Einaudi (1935) continued instead, in those years, to insist with his criticism of all forms of governmental regulation reducing competition and consumer choice. In general, he defined the fixing of rigid laws on bankers' conduct as the worst mistake possible. He had by then become, however, a discordant voice. See instead, in net contrast to Einaudi, Napolitano (1939, p. 694), who, continually referring to Osio (1939), emphatically declared that the days of the "doctrine elaborated by the Anglo-Judaic triumvirate Smith, Ricardo Malthus" were finally over, since the corporativist Fascist regime had gained control over credit, investments and banks.

supposed to funnel savings to the investments which were most compatible with Italy's production needs, in order to foster economic development (Jacuzio 1936, p. 407; Fantini 1936, p. 340). Not only was credit supposed to be directed towards strategic sectors, but also the quantities of production in each sector were to be controlled via credit rationing or expansion (Miceli 1936). The "social-economic utility" (Bianchini 1938, p. 931) of savings was stressed. Savings were equated to permanent and productive investments. Deposits were one type of savings, which were economically important because they became capital for public and private activities and politically important because if banks defaulted on their obligations, savers were affected and hence the State could not remain passive. Menegazzi (1936) noted how, in contrast, credit activity before 1936 depended on the monetary situation and on the contingencies of lobbying groups, who referred to axiomatic principles of banking science, and not to the needs of the nation. Panunzio (1936) emphasized how finally the State was not subordinated to banks anymore, but could actually now use the banks themselves for its own purposes. Arias (1936) underlined how the corporative economy had entered into a reconstruction phase and, via the credit channel, aimed at rationalizing production, domestic and foreign transactions. Unification of the credit function would then finally lead to the much desired economic integration of the country. Finally, Parrillo (1938) stressed how the new credit setup was indispensable to attain autarky. All the mentioned economists were also insistent in specifying how the 1936 banking reform, which led to State control over the banking sector, had not brought about a banking and industrial "statalisation" of socialist nature, which was present in other foreign countries.[113]

A general consensus in depriving the Bank of Italy of its commercial banking activities was expressed.[114] In particular, D'Albergo (1936) remarked that, by having *de facto* assigned regulatory power to the Bank of Italy, the latter could not persevere in commercial banking activities, in competition with the other banks. Its new legal form definitively separated the "Bank of Banks" (as the Governor Stringher had defined the Bank of Italy) from ordinary banks. Widespread consensus was also manifested relatively to the unification of the supervisory body, on the road to rationalization. However, Vigorelli (1936) feared that the centralization could lead to the creation of a bureaucratic mechanism, which in turn could stifle the initiative of single banks. Parrillo (1938) too was against an excessive rigidity of the system.

The intellectual debate behind the temporal specialization of credit institutions was not so clear-cut. On the one side, Einaudi (1934) persevered in emphasizing the importance of bank-industry separation, yet via market discipline and banks' self-regulation. Industrialists were not to rely anymore on banks to fund their investments in the belief that, in case of crises and asset freezes, bank bailouts would always occur. "Investment loans" were to be extended only by *ad hoc* institutions, such as IRI.[115] He concluded by stating that "[p]ast

[113] See also Landi (1939) on this point.

[114] The Bank of Italy had instead fervently objected to the veto of direct discounting, before the approval of the law, considering it an excessive limitation of its activities (Note of Bank of Italy, dated June 1935, in Guarino and Toniolo 1993, Doc. 175, pp. 915-925). The main argument adduced was the control over banks that the discounting activity gave the Bank of Italy. It had already been criticized by IRI, for example, in 1933 (IRI 1933 cited in Cotula, Gelsomino and Gigliobianco 1997, p. 123).

[115] Einaudi was forced to accept the *de facto* situation created as a result of the crisis, and hence changed his position with respect the one held in 1911, which Monzilli (1911) had accurately summarised.

experience will have been useful if it will give birth to a 'permanent' division of labour between banks on the one hand and investment institutions on the other" (Einaudi 1934, p. 26). Federici (1936) attempted to explain the underlying logic of the temporal specialization of banks. After the 1930s banking crisis, the average Italian saver had learnt a lesson: he/she was still unable maybe to decide whether to invest his/her capital in industry Alfa or in industry Beta, but he/she was instead definitely now able to choose between depositing his/her savings or buying a fixed-return bond. So, in this scenario, if bankers invested savings long-term, then they would be replacing their will to that of the savers themselves, a dangerous and unjustifiable move. Finally, Renzi (1938, p. 19) defined as a "fundamental" canon of banking orthodoxy the following: "the nature and the combination of a bank's assets, in particular with respect to maturity, must correspond to the nature and combination of its liabilities." On the other hand, Lume (1934) defined the *Convenzioni* as a transition from a universal banking system to an ordinary credit banking system. Banks could again limit their activities to the classical ones of payments-system clearance and of support to trade via commercial credit (Lume 1934, p. 721). The economist was however aware of the existence of Italian credit institutions which surreptitiously operated as universal banks (e.g. Banco di Napoli, Banco di Sardegna, Banca Nazionale del Lavoro) to which the *Convenzioni* did not apply. But he was against the total stiffening of the system and simply stated the need to avoid repeating past errors. Lume thus seemed to fit in with a stream of economists who believed that medium-term industrial credit could possibly be extended by commercial banks in the future, but with the necessary caution, so as not to repeat the experience of the big universal banks. The director of Comit, Mattioli, too strongly believed in restricting banks to commercial credit activities, in order to allow the Bank of Italy an effective control over circulation, as well as guaranteeing its role of bank of banks (Minutes of Comit's board of directors' meeting of 12 March 1934, cited in Rodano 1983, p. 101).[116] Nonetheless, he was conscious of the fact that the limitation of banking activities to a clearance activity was not feasible, differently to the British case where the money market was more developed and the volume of foreign trade larger.[117] Furthermore, the three ex-universal banks registered large credits towards IRI, which in turn financed industrial firms. Hence, indirectly, short-term bank liabilities were being used to fund long-term investments.[118] Mattioli thus proposed, due to this *de facto* situation, to allow ordinary banks to extend some industrial credit.[119] The idea of allowing deposit-taking banks to return to medium-term lending was later object of a heated debate in 1937, with the Fascist Credit and Insurance Confederation and Assonime supporting it and some banks (amongst them, Comit) and IRI against it.[120] The

[116] See also Galea (2008, p. 593) on Mattioli's position in this debate.

[117] "Notes and proposals concerning the reform of the banking system," letter by Mattioli to Beneduce, president of IRI, cited in Rodano (1983, p. 105).

[118] This reasoning was a bit far-fetched, since the bank credits towards IRI, created as a result of the rescues, represented a much larger amount than the market value of the credits they had towards industries prior to the bail-outs.

[119] Letter by Mattioli to Beneduce mentioned in note 117, cited in Rodano 1983, p. 108.

[120] To analyse Mattioli's position see the letter by him to Alessandro Parisi, head of the Confederation (published in Porzio 1981a, Doc. 6, pp. 330-331). With respect to IRI's position, we instead mention the statement made by Menichella to the Credit and Insurance Corporation in 1937: if short-term liability institutions were to go back to supplying medium and long-term credit "it is worth not only stopping at the form and authorising the extension of credits, but also looking into the substance of things and authorising even

request by Assonime, representative of industrial capital, proved how dependent the major Italian firms were on the banking system. However, in a statement to the Bank of Italy later in 1937, Mattioli pointed out the weakness of Italy's financial system due to the total inadequacy of the existing long-term credit institutions in funding industrial firms. In particular, they were not able to engage in trust-based relationships with their clients. The banks were thus by him invited to step in and aid the creation of these relations, in order also to better appraise the firms' creditworthiness. Furthermore, banks were to be permitted to extend all credits which accompanied the production cycle, even if they were to become permanent credits.[121] However, notwithstanding this debate, no amendment was made in this sense to the 1936 legislative decree when the law was actually passed in 1938.

ii) To gain further insight on the role of economists in contributing to the design of the 1936 Banking Act, the second step taken was to look at the regulatory process from a different perspective – that of the main driver of the 1936 bank legislation – to see if any explicit or implicit references were made to economic streams of thought or to individual economists. We here recall two IRI documents in particular. The first is the report presented by Menichella, then head of IRI, to the Prime Minister on 5 December 1933 (reported in Cotula, Gelsomino and Gigliobianco 1997, Doc. 3, pp. 77-124), in which we believe the spirit of the 1934-38 Italian banking reform was summarized. Government intervention was deemed ineluctable, as "[t]he current situation cannot carry on: the Banks are not interested in the vital necessities of industrial firms and continue to bleed them dry to their own advantage; this will inevitably go on until the Banks own the instruments of this bleeding: credit lines, promissory notes, financial discounts, etc." (IRI 1933, reported in Cotula, Gelsomino and Gigliobianco 1997, p. 92). The economic development of the nation was not in the universal banks' hands anymore: "[…] the Banks are not the masters of the Nation's economy anymore, but they are only the means to exercise a particular type of credit, and not even the most important one, for the development of the productive activity of the Nation" (IRI 1933, reported in Cotula, Gelsomino and Gigliobianco 1997, p. 94). Economic development was thus to become responsibility of the State. The Government intervention was to be "totalitarian," i.e. from then onwards, banks were not only forbidden from holding shares, but they were also not to finance the capital structure of firms; "[t]he legal form of the bank exposure cannot mask the economic nature of the exposures" (IRI 1933, reported in Cotula, Gelsomino and Gigliobianco 1997, p. 106), or, in other terms, the principle of economic substance was to prevail over that of legal form. Long-term credit was assimilated to firms' de facto ownership. Banks were to supply firms with the credit required by their production cycles, nothing more. Finally, the magnitude of the losses that the State incurred in rescuing the banks was advanced as the main justification for the State control over the banks, control which was to be "permanent" and "intelligent" (IRI 1933, reported in Cotula, Gelsomino and Gigliobianco 1997, pp. 122-123).[122]

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the purchase of industrial shares" (Menichella 1937, cited in Cotula, Gelsomino and Gigliobianco 1997, p. 139).

[121] Letter by Mattioli to Azzolini, Governor of the Bank of Italy of 23 August 1937, in Rodano 1983, p. 118.

[122] Not dissimilar were the adjectives later used by Renzi (1938, pp. 16-17), who stressed the need for "an assiduous supervision and a homogenous and organic legislation" in the banking sector.

What emerges clearly when reading the document, is its highly technical content, which reveals no economic theory grounding, a recurring feature we found in all IRI documents. Even Menichella's report to the Insurance and Credit Corporation in 1937, which can be viewed as one of IRI's most "theoretical" publications (IRI 1937, reported in Cotula, Gelsomino and Gigliobianco 1997, Doc.5, p. 131), reads:

> The language that IRI uses in this report might not be scientific, as it might not respond to the traditional classifications that in this subject exist in the doctrine; yet we believe that it is founded on a sufficiently clear vision of how the productive process works in the current phase of development of the Italian economy and hence adheres pragmatically to situations well known to men of action such as those that sit in the Corporation.

It thus seems quite clear how the IRI environment brushed aside, in the name of pragmatism and urgency to act, any existing economic theory concerning banks, and set up their auto-referential doctrine. The 1936 Banking Act was thus entirely an "in-house product" of IRI. Its directors had in fact handled the final rescue operations and, thanks to the experience thus acquired, possessed "clear ideas" on the problems concerning Italy's banking sector (Santoro 1981, p. 56) and how to handle them and prevent them from occurring again in the future. Ministries and *Corporazioni* were marginal actors in the design of the new regulatory framework, as can be seen from the reports and proposals made by these bodies in the run-up to the enactment of the law, and the subsequent replies and rejections by IRI, as well as from the letter of the resulting law.[123]

iii) The total lack of formal economic rationale in the 1936 banking law may be surprising if we consider the fact that in Italy many theories were circulating which could have been aptly bent and exploited to justify the law's pervasive prescriptions. It is noteworthy, in fact, that in the 1920s and 1930s the theory of economic cycles and crises, developed abroad by Hayek, Schumpeter, Robbins, Fisher etc., was followed and discussed in Italy. The debate also involved the role of financial intermediaries. Some authors, such as Hayek, noted the negative role of banks which financed investments, forcing the level of the interest rate down: a crisis would ensue when interest rates returned to their "normal" level. Others, on the other hand, viewed the essential, and positive, role of banks. For instance, Schumpeter emphasized how banks could extend credit to innovative entrepreneurs and enable them to produce their "innovations" and hence contribute to the growth of the overall economy: trust – and not savings – was the engine of innovation.[124] The first, "negative" stream could have been used to justify a drastic reduction of power of the banks in the economic system. The second, "positive" stream could have provided the theoretical grounding for a clear-cut distinction between banks and industrial firms, or even for State intervention in the banking sector (given the key role of banks in orienting investment). Our third strategy was thus to analyse reviews and critiques in Italian economic journals of a selected sample of these foreign authors and their theories, to gain understanding of *a)* the degree of awareness Italian economists had in the 1920s-1940s of modern economic theories; and *b)* their possible use of them to justify or criticise the 1936 banking law. We

[123] See Cassese (1988) for a collection of reports by the various corporations and Guarino and Toniolo (1993) for useful documents concerning the Ministries and the main banks.

[124] For a recount of the influence Hayek and Schumpeter had on the Bank of Italy environment and, in particular, on Baffi, see Gigliobianco and Massaro (2010).

here report a selection of interesting articles which led us to draw our final conclusions on the role of intellectual undercurrents in designing the 1936 banking law.

Einaudi (1934) laid out an impressive critique of Fisher's "The debt-deflation theory of economic depressions," published in "Econometrica" in 1933. The former stressed the importance of the role of shrewd bankers in rationing credit to "imprudent" agents in boom phases to avoid triggering the debt-deflation process carefully described by the American economist. This type of *ex ante* credit rationing was considered a preferable alternative to Fisher's *ex post* reflation solution. According to Einaudi, therefore, in the 1920s, central banks should have intervened by modifying discount rates and by carefully selecting the paper to be discounted, discarding the poor quality one. "Bad" banks should have been left to fail in the 1920s, together with their clients and depositors, in order to send a signal and thwart any further excessive debt- and risk-taking. Had these simple prescriptions been followed, the panic would have soon ended and no major crisis would have broken out. Again Einaudi's sensitivity to the moral hazard issue emerges.[125] Indirectly and implicitly, this article may be seen as a criticism of the 1920s bank rescues in Italy: Banco di Roma, for example, was bailed out in 1923 only to become object of the 1934 rescue. However, if in the previous decades Einaudi's liberal views had counted somewhat, in the 1930s his appeals were disregarded. Big banks were not, in fact, allowed to fail, although "bad."[126]

With respect to the interpretation of Schumpeter's works in Italy, several articles are noteworthy. In his review of the second edition of "Theory of economic development" published in 1926,[127] Ricci (1927, p. 659) recalled the role of banks in extending credit which was necessary to jump-start innovation and growth, but made no reference to Italy's banking system and to its newly introduced regulation, which then, in fact, did not have any growth-enhancing aim.[128] Schumpeter's volume was however translated into Italian only in 1932 – when the next banking reform was beginning to take form – and an abridged version was made accessible to the Italian public in the same year, edited by Demaria. It is interesting to see that the chapter referring to the role of credit (Chapter Three) was one of the parts of the book which was suppressed in order to obtain the desired condensed version, and was hence not commented. However, Fanno's outstanding article on production and credit cycles, published in 1931 in the "Giornale degli Economisti" was clearly influenced by Schumpeter's "Theory," which he explicitly quoted. In particular, Fanno referred to an "abnormal expansion of credit" by the banking system as a form of "forced savings," which, alongside the public's "spontaneous savings," were necessary to finance the production of instrumental goods and trigger the production cycle (Fanno 1931, p. 359).

Schumpeter's later work of 1941, "Business Cycles" was reviewed in the same year by two Italian economists, Ferrante and De Pietri-Tonelli. The former described Schumpeter's work in detail, often making connections to the thoughts of Italian economists, such as

[125] Recall, for example, Einaudi (1922).

[126] Einaudi was still able to write quite freely in the 1930s thanks to his international standing. He was, in fact, correspondent for "The Economist" from 1908 to 1946. However, in 1925 he was forced to resign from "Il Corriere della Sera," and the journal "Riforma Sociale" he directed was closed down in Spring 1935. Furthermore, Faucci (1986) maintains that since 1934 Einaudi's international correspondence took on an aseptic tone.

[127] A brief and uninformative review of the first edition was written by Grilli in 1912.

[128] This was the case instead of the 1936 Banking Act.

Pantaleoni and Fanno, but commented little on the role of bankers (Ferrante 1941, p. 55). Of greater interest for our purposes is the second review, in which the author drew some explicit analogies to the Italian corporativist system.[129] Furthermore, he commented in detail the role of bankers in Schumpeter's thought. First, bankers were to posses the qualities necessary to be able to judge the creditworthiness of clients, a point that De Pietri-Tonelli declared was always put forward in Italy in occasion of the introduction of any new banking regulation (De Pietri-Tonelli 1941, p. 941).[130] Secondly, the reviewer underlined how Schumpeter noted "the inconveniences of industry controlling banks and of banks controlling industries" (De Pietri-Tonelli 1941, p. 941), yet did not use this theoretical foothold to support the Italian banking reform. Furthermore, Schumpeter rejected banks being dependent on Governments, political parties, public opinion, which would hinder them from selecting clients according to an economic rationale, but De Pietri-Tonelli hurriedly emphasized how the Austrian economist was negatively referring to the credit control in a socialist system, and not to that of corporativism, in which credit was controlled by an appropriate regulatory body (De Pietri-Tonelli 1941, p. 941).[131] The impression one has when reading this review is that the author had a high esteem of Schumpeter's work and aimed at disseminating it in Italy's academic circles, by emphasizing its non-incompatibility with the corporativist regime. On the other hand, however, De Pietri-Tonelli did not exploit certain parts of Schumpeter's reasonings, such as the call for bank-industry separation, which could have given a sounder basis to the Italian banking reform.

Our conclusion on the 1930s is that economic theory was not called upon in the design of the new banking legislation for three different reasons. *A)* The purely "corporativist" economists lacked the knowledge of economic theory, the vision and the theoretical sensibility to do so and thus limited their articles to technical disquisitions aimed at eulogizing the regime's actions. *B)* Some, more cultured, economists were well aware of the economic debates going on in the international *fora*, and in fact did not refrain from ably commenting them. Yet they were not willing to use them to the regime's advantage. The examples of Fanno and De Pietri-Tonelli are poignant. *C)* Finally, the anti-regime liberal economists were mute, either because of personal choice or because of rejection of their articles by scientific journals or because of actual persecution. The overall result is that Italian economists were practically absent in the making and the commenting of the 1930s regulation.

To sum up, the 1930s *Convenzioni* led to the abolishment of universal banking and set the scene for the extensive 1936 banking law, which had a two-fold aim of safeguarding savings and controlling credit flows. A vast range of regulatory tools was adopted and great discretion was assigned to the sole regulatory entity, the Inspectorate and then the Bank of Italy, which was also deprived of its commercial banking activity. Little however can be extrapolated from contemporary journals with respect to the Italian economists'

[129] "In the case of the so called bilateral monopoly, the example of the entrepreneur's monopoly and that of the trade union is made [in Schumpeter's work]. This is a similar case to that of corporativism, that we believed to have studied from a political point of view, when in fact in reality, as we have shown, it is an economic and a political economy problem […]" (De Pietri-Tonelli 1941, p. 940).

[130] We recall Einaudi's frequent references to the characteristics bankers were supposed to possess.

[131] As we saw before, when analysing economists' articles in the main Italian scientific journals, all the authors stressed how corporativism was different from socialism.

contributions and reactions to the 1936 Banking Act, although it emerges that the relevant economic theory was known to at least some of them. Yet the law was a product of the IRI brain trust, which elaborated its own pragmatic "doctrine" and did not refer to any leading economic theory.

The 1936 law lived well beyond the crisis it had triggered from, survived the political changes that followed the Second World War and held steady until the late 1980s. Right from the start, it was admitted that the banking reform could be retouched, due to the future inevitable structural changes in the economy: "the only immutable principle in reforms is the possibility of them being retouched in the future" (Banca d'Italia 1938). Yet, the 1936 law was only marginally amended in the half century to come.[132] The fact that the Act matured in the IRI environment and hence was not expression of the regime then in power, the general loss of confidence in market forces after the 1929 crash, as well as the great discretion attributed to the regulatory body which gave the banking system an adequate degree of elasticity, were some of the reasons, highlighted by the literature, of the "long life" of the 1936 law (Giordano 2007, pp. 61-62; Galea 2008, pp. 589-591). We could add that the lack of inputs by economists to the law, and the dearth of reactions after its enactment, may have contributed to its insulation from theoretical debate, and thus to its endurance.

In guaranteeing financial stability, the Banking Act, however, sacrificed competition, thus leading to inefficiency (e.g. De Cecco 1968; Albareto and Trapanese 1999, pp. 120-133), compounded by the extensive public ownership of the banks. Also, the straight-jacket imposed on the banking system probably contributed to the underdevelopment of the Italian financial system in the following decades, by stifling financial innovation. The dominant paradigm based on the primacy of financial stability was, however, strongly entrenched in the academic circles, as well as within the regulatory environment, up until the 1980s. This was accompanied by a general consensus from all parties in the financial field – Treasury, Bank of Italy, commercial banks, large debtors, households, as well as economists themselves – for a non-competitive banking system. We ought not to forget that in Italy a general antitrust law was introduced only in 1990.[133]

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[132] For example, the Economic Commission of the Constitution Assembly set up in 1946 stated "In harmony with the criteria that inspire the current banking law (criteria that, even with respect to the current economic conjuncture, we believe must remain unchanged) [industrial] credit must be extended by special institutions, clearly separated from the ordinary credit ones and authorized to collect funds corresponding to the maturity of their assets" (Ministero per la Costituente 1946, p. 217). Special sections of deposit banks, which made loans to industry, had also been created in the preceding years (*Sezione di credito speciale del Banco di Napoli*, *Sezione di credito speciale del Banco di Sicilia* and *Mediobanca* as a product of the three ex-universal banks). "Strict laws have to be dictated for such institutions to eliminate the danger of interference between the management of ordinary credit and that of industrial credit, in order to preserve the integrity of the guiding principle of the current banking law confirmed and honed by experience" (Ministero per la Costituente 1946, p. 237). The functional and temporal specialization of Italian credit institutions was hence maintained in the post-WWII Italy, as well as all the other prescriptions of the 1936 Banking Act. The only immediate amendments to the law were the one concerning the abolishment of the Inspectorate, as anticipated in note 97, and a decree of 1946 which subjected the just mentioned medium and long-term credit institutions established after 1936 to the more restrictive regulation of short-term credit institutions. Some even argued that the Art. 47 of the 1948 Italian Constitution (which reads "[t]he Republic encourages and safeguards savings in all their forms; disciplines, coordinates and controls the exercise of credit") vested the 1936 Banking Act and its subsequent amendments with a constitutional value (e.g. Merusi 1981).

[133] Law 10 October 1990, No. 287.

8. Conclusions: regulation and economic theory

Italy's regulatory legislation history from 1861 to the 1930s can be summarized in the following manner. After the country's political unification, the first financial crisis that triggered an actual shift in banking regulation was that of 1888-1894. In fact, the loosely regulated banks of issue, engaged in overtrading and risky loans to the construction industry, were perceived to be responsible for the crisis. They were therefore merged, downsized in their commercial business and tightly regulated by the 1893 banking law, with the belief that financial stability would follow sound circulation and macroeconomic equilibrium. While the latter was remarkably attained in the years up to 1914, financial instability re-emerged in 1907, since part of the credit market previously covered by the banks of issue was now conquered by pro-cyclical mixed banks. It took another crisis in the wake of WWI for a new banking law to regulate commercial banks in 1926. By then, the war and the stock market boom and bust of 1922-25 had largely transformed the mixed banks into holding companies with extensive permanent stakes in the manufacturing and utility industry. It was this new type of banks which became illiquid in 1929-30 threatening the stability of both the financial system and the real economy. The ensuing regulatory wave originated from the need to prevent the recurrence of episodes of bank illiquidity which spread to the real economy due to the close interlock between banks and industry. It then went beyond bank-industry relations in regulating the system and providing regulators with wide, largely discretional, powers.

In two cases – 1893 and 1936 – the amount of banking regulation introduced was later perceived as having overshot its aim of effective crisis-prevention, and was subsequently downscaled. As for the 1893 law, corrections were made in the following two decades, so that the regulatory framework for the banks of issue remained heavy, but quite compatible with the lending of last resort activity. As a result, some of the more profit-oriented shareholders of the banks of issue reacted by shifting towards mixed banking, more rewarding in terms of revenues and business relations. On the contrary, in the years after 1936 the only significant regulatory move was towards de-bureaucratisation – the Inspectorate was abolished – rather than actual de-regulation. The Bank of Italy and the political authority maintained that the whole panoply of instruments was needed, even if some were never used. The strongest motivation for not re-privatising the banks was that in Italy financial capitalists as such did not exist,[134] thus implying that the private banks, in one way or another, would fall in the hands of industrialists, which was anathema.[135] At the same time, the dense regulatory landscape meant that no capitalist could be attracted in the field, and in fact private capital lost most of its relevance. As a result, demand for de-regulation was suppressed in its cradle. It was only in the 1970s with the collapse of the Bretton Woods system, the spreading of the eurodollar and the reappearance of episodes of bank failures that the soundness of the 1936 arrangements began to be questioned, also by the economists. It

[134] "Italy has never had a class of financiers lovers of Banks, that is to say willing to invest their money in bank shares and to manage the banks in order to gain the greatest dividend from their shares; only industrial groups in Italy, in different periods, have shown an interest in becoming bank shareholders […]" (Menichella 1937 in Cotula, Gelsomino and Gigliobianco 1997, p. 171).

[135] To avoid such a menace, Menichella got to the point of asserting "It would be of great use, according to my opinion, to give the Bank of Italy direct control over banks" (Menichella 1937 in Cotula, Gelsomino and Gigliobianco 1997, p. 183).

took another decade for financial innovation and liberalization to emerge: this new phase led to bank privatizations and to a new banking law in 1993.

In the wake of a financial crisis, it is natural for the regulatory pendulum to swing in the direction of those who demand more or stricter regulation. The players in such junctures are many: the savers; the politicians; the financial lobbies; the borrowers; the economists and the jurists; sometimes the regulators. In the four banking crises we focused on (1888-94, 1907, 1921-23, 1929-34), the savers were never given a genuine voice of their own in how to resolve matters, via specific associations for instance. The politicians reacted promptly in the first case, because the scandal which had erupted undermined the credibility of the State itself: they defied and won the banking lobbies which had been active until the very last. In the 1907 and 1921 cases, a political decision did not emerge from a somewhat confused debate: the lobbies, aided by some economists, were successful in steering legislation where it was unable to bite into the current practices of the big banks. In 1931-38 the politicians (at that time the Fascist regime) backed the very pervasive regulation designed by the *grands commis* entrusted with the management of IRI and were only too happy to accept it when it was actually finalized, hoping to be able to use the law as a means for directing credit according to "national" priorities. The would-be regulators (*i.e* the Bank of Italy) in the 1920s were not pro-regulation in that their main stance was to encourage market discipline. On the contrary, in the 1930s, the regulators rapidly learned to appreciate the vast powers which had been put at their disposal. The borrowers organized in associations were mainly large firms (Assonime from 1910, Confindustria from 1919). If they were against the 1920s Government "interference" in the banking sector, in the 1930s they were in favour of the proposed reforms of abolishment of the large universal banks.

What about the economists' role in Italy's regulatory history? The severity of the 1888-1893 crisis drummed up support for strict regulation of the banks of issue, in order to prevent illegal note issuance, frauds and scandals. The main priority was to solve the problem of Banca Romana's liquidation and hence to settle with its shareholders in an orderly manner. Political interests were evident, and the 1893 law turned out to be a political compromise between the remaining banks of issue, the new Bank of Italy and the Government. This balancing of interests can be seen when reading the text of the law itself. It did not in fact introduce convertibility, but only limits on note issuance. It did not unify note issuance, yet the Bank of Italy immediately emerged as a designated leader in the issuing-bank league and the two Southern banks were kept alive for a few more decades mainly for political reasons. Economic theory, which championed free banking (except for the *lombardo veneti* economists) and convertibility (with no exceptions), was thus disregarded. The 1907 de-regulatory law of the banks of issue, which focused on lender of last resort arguments, was widely accepted by the main Italian economists, who acknowledged Bagehot's teachings, albeit without quoting him. The opposition to any commercial bank regulation was strongly voiced by most economists who won the day, as a banking law was introduced only nineteen years later, after another severe crisis episode. The 1926 legislation concerning all deposit-taking institutions was focused on setting significant limits on competition in the banking sector which were by then strongly supported by most economists. Bank-industry separation, called for by some economists, was instead not enforced. There was extremely little debate on the capital ratios, introduced by the law, since they were considered mainly as banking technicalities. If they were discussed by economists, they were considered in negative terms as undesirable rigidities introduced into the banking system. Finally, the 1936 Banking Act took into account the much acclaimed bank-industry separation but as a consequence of the path opened up by the *Convenzioni* and by the crisis management procedures, and with no reference whatsoever to the main economists' proposals on the matter. The law matured entirely in the IRI environment, which deemed itself to be "self-sufficient" and did not need to refer to any particular economic theory. Economists on the other hand were not able – in the case of the corporativists – or willing – in the case of the other economists – to buttress the law with their knowledge of the modern economic doctrine.

The existing political regime does not seem, hence, to have been a discriminating factor in determining the influence economic theory had on bank legislation: both in the liberal Italy and in the Fascist Italy, in fact, economists were not heeded. Although it must be said that in the 1890s economists spoke out, before but also after to criticize the enacted law, whereas in the 1930s they were not allowed to do so freely. Hence, whereas the *ex ante* contributions to the design of the new regulation were minimal in both episodes, the *ex post* reactions to the two laws were very different. Furthermore, one may add that the ineffectiveness of economic thought in orienting legislation in these two episodes also depended on the "failure of economic theory" in understanding what truly needed to be regulated: hence, the missed chance of introducing commercial bank regulation in 1894 and the inability of the corporativist economists to unleash existing – but to them unknown or ignored – theoretical justifications to support the desired banking reform.

So did economic theory orient the main crisis-driven banking laws in the period 1861-1930s? A glance at Table 1 may help find some patterns and draw some conclusions. Column 1 considers the key banking crisis episodes of the period under study.[136] Column 2 reports a measure of the "cost" of each crisis, *i.e.* net losses shouldered by public institutions to rescue banks as a percentage of GDP of the year indicated in brackets.[137] Colum 3 recalls the banking regulation introduced as a response to the crisis. Column 4 reports an approximate time-lag between the end of the crisis and the introduction of the new legislation. The 1907 crisis immediately led only to some fine-tuning crisis-management rules for issuing banks between 1907 and 1914, but no organic crisis-prevention response to the commercial bank failures was formalised. In the 1930s, on the other hand, the 1933 *Convenzioni* are considered a core reform in themselves which then imbued the 1936, more pervasive, law. Hence the computation of the respective regulatory delays.

[136] The 1866 crisis is thus excluded as it was mainly a currency crisis with no major bank failures.

[137] The source is Carriero, Ciocca and Marcucci (2003).

Table 1. Severity of banking crises and timing of the regulatory response in Italy, 1861-1938

Crisis years	Output loss as % GDP (of year expressed in brackets)	Banking regulatory response	Time-lag before introduction of new law
1888-1893	6% (1888)	1893 law	< 1 year
1907	0.2% (1907)	1926 law	19 years
1921-23	2.7% (1921)	1926 law	3 years
1930-33	8% (1930)	1933 *Convenzioni* and 1936 law	< 1 year

Source: see text

In Italy's historical experience it thus seems that *a)* the severity of the banking crisis and *b)* the timing of the regulation were both key factors in determining the degree to which the subsequent regulatory framework reflected contemporary economic theories. When the crisis was less severe and legislation was passed after a greater time lag, as in 1907 and in the 1920s, economic thought mattered and affected the regulatory legislation in a more significant manner. When, instead, the crisis was more severe and widespread, and regulatory action was taken immediately, as in 1893 or in the 1930s, economists' opinions were largely disregarded and political or simply other vested interests prevailed. It is not a coincidence that in both these cases over-regulation was the result.

Appendix
Concise Biographies[138]

Alessio, Giulio (1853-1940). Professor of Public economics and Political economy at the University of Padova, he became member of the Camera in 1897. He was Minister of Mail and Telegraphs under Nitti in 1919-1920, Minister of MAIC under Giolitti in 1920-1921, and of Justice under Facta in 1922.

Arias, Gino (1879-1940). Professor of Political economy in the Universities of Genoa, Florence and Rome, he became MP in 1934. He then emigrated to Argentina due to the enforcement of the racial laws in Italy.

Bachi, Riccardo (1875-1951). As director of the Bureau of Labour of MAIC from 1904 to 1908, he edited a Bulletin of statistical surveys on labour issues. In 1908 he became director of the MAIC library and produced an annual survey of different aspects of the Italian economy. He became Professor in 1910 and taught at the Universities of Macerata, Parma, Genoa and Rome. He is also known for the "Bachi price index."

Barone, Enrico (1859-1924). Expert in military history, once he abandoned his military career, he became chair in Political economy at the Advanced Institute of Economics and Commerce in Rome, which later became the Faculty of Economics and Commerce. He worked with Pareto and Pantaleoni for "Giornale degli Economisti" from 1894 onwards and also wrote for "Riforma Sociale."

Bianchini, Giuseppe (1876-1970). He was the first director of the Italian Banking Association (ABI) created in 1919, where he stayed on until 1933. President of the National Confederation of Credit from 1926 to 1935, he founded and directed "Rivista Bancaria" until 1935. Member of the Camera from 1929 to 1939, he was appointed Senator in 1939.

Boccardo, Gerolamo (1829-1904). Professor at the University of Genova from 1860, Senator in 1877, he directed the sixth edition of "Nuova Enciclopedia Italiana" (1875-88). He was the author of publications in economics, finance and geography.

Boselli, Paolo (1838-1932). In 1871 he became the first Professor of Public finance in Italy at the University of Rome. Centre-right member of the Camera between 1870 and 1921, he was also Minister of Education (1888), of Agriculture (1893), of Finance (1899-1900). Prime Minister from June 1916, he resigned in October 1917 due to the defeat of the Italian army at Caporetto. In 1921 he was appointed Senator. He was also President of the *Istituto Storico Italiano* (Italian Historical Instituite).

Bresciani Turroni Costantino (1882-1963). He was Professor of Statistics and Political economy at the Universities of Pavia, Palermo, Bologna, Milan and Cairo (during Mussolini's dictatorship years). President of Banco di Roma in 1945, he became executive director of the Bank of International Settlements between 1947 and 1951. In 1953 he was appointed Minister of Foreign Trade. He wrote for "Corriere della Sera" from 1946 until the year of his death.

[138] The sources for this section were various volumes of the Collana Storica della Banca d'Italia, Laterza, Roma-Bari and of Istituto della Enciclopedia Italiana.

Cabiati, Attilio (1872-1950). He was Professor at the Universities of Genoa and Bocconi, Milan. He wrote for “Giornale degli Economisti,” “Riforma Sociale” and “La Stampa” and directed the financial part of “Rivista Bancaria.”

Cavour, Camillo Benso conte di (1810-1861). Member of the Camera in 1848-1849, he was Minister in 1850-1851 and then Prime Minister from 1852 to 1859 and in 1860-1861. He founded the journal “Il Risorgimento” in 1847.

Chiesa, Eugenio (1863-1930). Representative of the Republican Party, he was member of the Camera from 1902 to 1926, when he left the country due to his opposition to fascism.

Cocco-Ortu, Francesco (1842-1929). Member of the Camera from 1876 to 1925, he was Minister of MAIC between 1897-98 and 1906-09.

Colajanni, Napoleone (1847-1921). Member of the Camera from 1890 to 1924, he was one of the Radical MPs who denounced the Banca Romana scandal in Parliament. Professor of Statistics at the Universities of Palermo and Naples, he founded the journal “Rivista Popolare.”

D'Albergo, Ernesto (1902–1974). He was Professor at the Universities of Bologna, Ferrara, Rome, Siena and Trieste. He was also President, from 1952 to 1974, of the *Associazione Nazionale dei Tributaristi Italiani* (ANTI), which was created to offer scientific support to the fiscal reforms of the country.

De Cesare, Carlo (1824-1882). General Secretary of Finance in Naples, he maintained this title after Italy’s unification. Member of the Camera, he later became general inspector of the banks of issue (1967-1970), counsellor of the *Corte dei Conti* (Audit Court) in 1870 and Senator in 1876.

Demaria, Giovanni (1899-1998). Professor and then dean of the University of Bocconi, Milan, he became director of “Giornale degli Economisti” from 1938. After WWII he was appointed President of the Economic Commission of the Costituente.

De Pietri Tonelli, Alfonso (1883-1952). He was Professor from 1920 at the *Istituto superiore di economia e commercio* in Venice.

De Viti de Marco, Antonio (1858–1943). Professor at the Universities of Macerata, Parma and Rome, he directed the "Giornale degli economisti" together with Maffeo Pantaleoni. He was also member of the Camera from 1900 to 1921, in particular as representative of the Radical Party officially founded in 1904.

Einaudi, Luigi (1874-1961). Professor at the Universities of Turin and Bocconi, Milan, he directed the journal “Riforma sociale” from 1902 to 1935. In 1936 he founded and directed “Rivista di Storia economica.” He also wrote for “La Stampa” and “Il Corriere della Sera.” He was appointed Senator in 1919. Governor of the Bank of Italy (1945-1948), he was also Minister of the Budget and MP for the Liberal Party. He was President of the Republic of Italy from 1948 to 1955.

Fanno, Marco (1878–1965). He was Professor of Political economy at the Universities of Sassari, Cagliari, Messina, Parma and Padua from 1920 to 1958. His main field of research was credit, money and economic cycles.

Ferrara, Francesco (1810-1900). He was Professor of Political economy at the Universities of Turin and Pisa. Member of the Camera, he became Minister of Finance in 1867, and was appointed Senator in 1881.

Ferraris, Carlo Francesco (1859-1924). He was the first Professor of Science of administration at the University of Pavia. He became Minister of Public Works in 1905 and was appointed Senator in 1913.

Flora, Federico (1867-1958). He was Professor of Public finance at the Universities of Catania and Bologna. President of Banca Popolare di Bologna from 1918 to 1945, he was also Senator from 1934.

Garrone, Nicola (1877-1959). Professor at the University of Rome from 1926 to 1952, he directed the "Enciclopedia Bancaria" in 1942.

Graziani, Augusto (1865-1944). Professor of Public economics and Political economy, at the Universities of Siena and Naples, he was also member of the *Accademia dei Lincei*.

Guarneri, Felice (1882-1955). He was the director of the research department of Confindustria (Association of Industrialists) from 1920 to 1935. Between 1920 and 1925 he was also general secretary of Assonime (the Association of limited liability companies), and then became director until 1935. Minister of the Exchange and Currency, he was also President of the Banco di Roma from 1940 to 1944.

Lampertico, Fedele (1833-1906). Professor of Political economy at Padua University. Member of the Camera between 1865 and 1870, he was designated Senator in 1873. As an MP, he was constantly involved in financial matters.

Loria, Achille (1857-1943). He was Professor of Political economy at the Universities of Siena, Padua and Turin and directed "Echi e commenti" from 1920 until 1928. He was appointed Senator in 1919.

Luzzatti, Luigi (1841-1927). He was Professor of Constitutional law in Padua. In 1871 he was elected member of the Camera. He was Treasury Minister in 1891-92 and 1896-1898, 1902-05 and 1906, and Minister of Agriculture in 1909. Prime Minister from March 1910 to March 1911, he was appointed Senator in 1921.

Magliani, Agostino (1824-1891). Member of the Corte dei Conti, he became Senator in 1871. He was Minister of Finance three times between 1879 and 1889. He was one of the founders of the Adam Smith Society in Florence.

Martello, Tullio (1841-1918). He was the founder of "Revue d'Economie, d'Histoire et de Statistique" in 1869. He was Professor at the Universities of Padua and Bologna.

Mattioli, Raffaele (1895-1973). He directed "Rivista Bancaria" from 1920 to 1922 and became President of the *Istituto italiano di studi storici* (Italian Institute of Historical Studies) in Naples after Benedetto Croce's death. Managing Director of Banca Commerciale Italiana from 1933, he was appointed President in 1960 and resigned in 1972.

Menegazzi, Guido (1900-1987). He was Professor of Financial and political economics at the Universities of Cagliari, Bari, Pisa, and Verona.

Menichella, Donato (1896-1984). General director of IRI from Jaunary 1933, he resigned in November 1943. General Director of the Bank of Italy from April 1946, he was Governor from August 1948 until August 1960.

Messedaglia, Angelo (1820-1901). He was Professor at the Universities of Pavia, Padua and Rome. Right-wing member of the Camera from 1866 to 1883, he became Senator in 1884.

Nitti, Francesco (1868-1953). Director from 1894 of "La Riforma Sociale," he was Professor at the University of Naples. Member of the Camera from 1907, he became Minister of MAIC under Giolitti (1911-14) and of the Treasury under Orlando (1917-19). He was Prime Minister from June 1919 to June 1920. In 1945 he became member of the Costituente.

Osio, Arturo (1890-1968). Nominated director of *Istituto nazionale di credito per la cooperazione* (National institute of cooperative credit) in 1925, he was successful in converting the failing bank into Banca Nazionale del Lavoro, which he directed until 1942. In 1950 he founded and directed Banca Romana.

Pantaleoni, Maffeo (1857-1924). He was Professor at the Universities of Camerino, Macerata, Venice, Bari, Naples, Genoa, Pavia and Rome. Member of the Camera for the Radical Party from 1901, he was appointed Senator in 1923.

Panunzio, Sergio (1886-1944). Journalist and political scientist, he was member of the Italian Socialist Party, and became one of the main collaborators of Mussolini.

Pareto, Vilfredo (1848-1923). Director general of the *Società delle ferriere italiane* (Italian Railway Corporation) from 1880, in 1894 he became Professor of Political economics at the University of Lausanne, substituting Léon Walras. From 1890 to 1905 he contributed regularly to "Giornale degli Economisti."

Prato, Giuseppe (1873-1928). Director of "Riforma Sociale" from 1908, he was Professor of Political economics at the Universities of Turin, Genoa and Bocconi, Milan.

Ricci, Umberto (1879-1946). Professor at the Universities of Parma, Pisa, Macerata Bologna and Rome, he then taught at the Universities of Cairo and Istanbul. At the International Institute of Agriculture he organised the statistics on world production and was one of the leading economists of the League of Nations.

Rossi, Alessandro (1819-1898). Entrepreneur, he was elected member of the Camera in 1866 and Senator in 1870. He founded the *Associazione Laniera Italiana* (Italian Wool Association) in Rome in 1877. In 1902 he was appointed "Cavaliere del Lavoro."

Rota, Pietro (1846-1875). Economist, he became Professor at the University of Genoa. His main field of study was banking.

Saraceno, Pasquale (1903-1991). He was part of the IRI brain trust from 1933 and in 1946 founded Svimez, the Association for the Development of Industry in Southern Italy. He was Professor at the Universities of Milan and of Venice.

Scialoja, Antonio (1817–1877). He became Professor of Political economics in 1846 at the University of Turin. He became Minister of MAIC in 1848 and Minister of Finance in 1860. He then held numerous other positions under the following Governments and, in particular, declared inconvertibility of the lira in 1866 as Minister of Finance.

Sraffa, Piero (1898-1983). He was Professor at the Universities of Perugia and Cagliari. He left Italy in 1927 and became lecturer of Economics at Cambridge University. From 1939 he was Professor at Trinity College.

Supino, Camillo (1860-1931). He was Professor of Political economics at the Universities of Messina, Siena and Pavia.

Torrigiani, Pietro (1810-1885). He was Professor of Political economic at the Universities of Parma and of Pisa. Member of the Camera, he was appointed Senator in 1879.

Vigorelli, Remo (1893-1977). He was one of the founders of the Partito Popolare Italiano. He was also a banker and Professor at the University of Milan.

Vivante, Cesare (1855-1947). He was Professor of Commercial law from 1898 at the Universities of Parma, Bologna and Rome. The proposal for the new Code of Commerce in 1921 was named after him.

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