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The Italian Economy Seen from Abroad over 150 Years

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The Italian Economy Seen from Abroad over 150 Years

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Abstract

Since it became a united country, Italy was looked at with keen eyes by foreign economists, economic historians and policy-makers. They wanted to see whether it would be possible for the economy of a country which had in the XVII and XVIII century regressed to the role of agricultural raw material exporter after having been the premier site of European industry, trade and especially finance, in the Middle Ages and the Renaissance, to redress itself and join the industrial revolution making good use of its population and territory, which gave it the potential to be among the great powers of Europe.
In this paper several instances of this are considered, focusing on foreign observers who concerned themselves with the Italian economy at different stages of its development. An attempt is made to see what influence their opinions had on Italian economic debate and Italian policy-making.

JEL classification: N13, N14
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Contents

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1. Introduction

Since it became a united country, Italy was looked at with keen eyes by foreign economists, economic historians and policy-makers. They wanted to know whether the economy of a country which had in the XVII and XVIII century regressed to the role of agricultural raw material exporter after having been in the Middle Ages and the Renaissance the premier site of European industry, trade and especially finance could redress itself and join the industrial revolution making good use of its population and territory, which gave it the potential to be among the great powers of Europe.

By what means this would happen, following which model, was particularly interesting to foreign observers. Political unification was in itself regarded as a miracle, and other declining countries, or countries which had long smarted under foreign dominion, would take Italy as the example to imitate. Several started by adopting the Italian tricolour as their flag (let us just mention Hungary and Ireland). Sionists were also keen students of the Italian experience, as the return on the scene of an ancient people after 2000 years of division as a potential modern great power may augur well for an even older people who had for even longer been subjected to loss of land, dispersal and persecution.

2. Natural and unnatural development

> Therefore, the greater part of the capital of every growing society is, first, directed to agriculture, afterwards to manufactures, and last of all to foreign commerce. This order of things is so very natural, that in every society that had any territory, it has always, I believe, been in some degree observed. Some of their lands must have been cultivated before any considerable towns could be established, and some sort of coarse industry of the manufacturing kind must have been carried on in those towns, before they could well think of employing themselves in foreign commerce.
>
> But though this natural order of things must have taken place in some degree in every such society, it has, in all the modern states of Europe, been, in many respects, entirely inverted. The foreign commerce of some of their cities has introduced all their finer manufactures, or such as were fit for distant trade; and manufactures and foreign commerce together, have given birth to the principal improvements of agriculture. The manners and customs which the nature of their original government introduced, and which remained after that government was greatly altered, necessarily forced them into this unnatural and retrograde order (Smith 2009).

Adam Smith took the Italian Republics and States since the Middle Ages as archetypal examples of “this unnatural and retrograde mode of development.” Their example had infected all the countries of Europe which imitated them. Smith was not at all surprised to see that the Italian city states had been exposed to volatility of fortune and fatal decline. He was at pains to show that their decline had not been brought about by the discovery of America. Italy’s decline had if anything preceded that event and Italy had somewhat recovered, after America’s discovery, while Spain and Portugal declined.

For my purpose in this essay it is enough to note that Smith thought that the little States of the Italian peninsula, which had experienced a meteoric rise in the early Middle Ages and a fast decline afterwards, had introduced the unnatural mode of development, avoiding what he considered the natural one, which did not depend on the vagaries and volatility of foreign commerce and plunder (the latter included in the category of primitive capital accumulation) as capital accumulation began in agriculture and proceeded to industry through reinvested savings and finally extended to foreign trade.

Adam Smith's model of natural development had a profound impact on economists and politicians all over the world. Among them were foreign students of the Italian economy, who, usually after having visited the Peninsula or having lived there for an extended period of time, reflected on Italy's decline.

Smith also influenced the Italians who engineered Italy's comeback as a political and economic power, in the middle of the XIX century. The size of the country mattered to them, because it might permit a more stable and durable growth experiment, which ought to be based on a modern agriculture affording a degree of capital accumulation sufficient to permit the installation of modern industry. Hence their strive to unite the country.

Thus, the first seventeen years of the new Kingdom of Italy saw the governing elite (La Destra storica) applying Adam Smith's "natural development" model. For them, agricultural modernization came before industrialization.

3. Industry-led development or balanced growth?

The Italian governing elites, especially after the Destra storica lost power in 1876, opted for industrialization at all costs as a necessary condition for increased international political power. David Ricardo won the day against Adam Smith. But in Italy perhaps a bit later than in other Continental European countries, Ricardian free trade gave way to protectionism as a necessary condition for industrialization. Not all foreign observers were sure it was the right choice to make. British observers, of course, advised that Italy join free trade Europe. Richard Cobden had made, earlier on in the century, a very successful tour of Italy preaching just that.

The Piedmontese adopted free trade before unification, especially to obtain capital and direct investments from France and Britain, and then extended it to the heavily protected South after unification. Cavour, ever the great realist, did not declare unilateral free trade. Rather, he signed a large number of trade treaties with the principal powers with which Italy, and before it, the pre-unification States, had or hoped to have important commercial relations.

The Southern Kingdom, a couple of decades after the Bourbon King had been removed to safety and temporary exile by Nelson's fleet to escape from revolutionary Naples, had, on the contrary, chosen the model of American protectionism, preached by Alexander Hamilton and imitated, in the German States, by Friederich List's Zollverein. This caused the enmity of the British. As the Florentine and Genoese had done in earlier centuries, their merchants had thoroughly exploited all the potentialities the Southern Kingdom offered in the way of imports and exports. In particular, British merchants had virtually monopolised the export of sulphur which was extracted, by primitive methods and with much human suffering, in the mines owned by Sicilian noblemen. Sulphuric acid was considered essential for industrialization and its price went through a veritable bubble in the early Thirties. After a few years, the bubble burst and the price declined as fast as it had risen, causing intense economic and social distress (Giura 1973).

Following its protectionist strategy, which had been introduced in 1823, the Neapolitan government in 1838 chose to stabilize the slumping price of sulphur by restricting exports, limiting them by one third and auctioning the rights to the Sicilian sulphur mines, taking them away from *de facto* British control and assigning them to a newly formed monopoly run by a French company (in which the Duchess of Berry, sister of the Neapolitan King, was rumoured to have an interest).

The British government reacted, after representations were made by British merchants to their government and to their MPs, by a very open threat of naval intervention, made by Viscount Palmerston, the Foreign minister, who did not hesitate to transform it into the actual seizing of Neapolitan merchant vessels in the open seas. They were taken to Malta awaiting for the dispute to be resolved, while other ships under the Neapolitan flag were blockaded in Corfu and the commander of the British fleet was told to be ready to blockade the Gulf of Naples. This act of open imperialist bullying, an almost perfect case of gunboat diplomacy, was ordered in disregard of the British crown's legal experts' advice. It was, however, presented by Palmerston under the clothes of a doctrinary dispute between protectionists and free traders. The "objective principles of modern economic science" were wheeled out in defence of the status quo with the sulphur mines in the letter the British foreign secretary wrote to the Neapolitan King, after the latter had claimed his sovereign right to impose a monopoly on an economic activity conducted in his domains and of treating foreigners in a different manner to his own subjects.

> In countries where Government is arbitrary and despotic and subject to no responsibility or control, it may often happen that caprice, want of political knowledge, prejudice, private interest, or undue influence, may procure the promulgation of unjust and impolitic edicts, inflicting much injury upon the people of such state, interfering with the legitimate industry of individuals, deranging the natural transactions of commerce and causing great detriment to private interests and to national prosperity (published in Giura 1973).

Palmerston then proceeded to draw an essential difference between a state monopoly and one granted by a sovereign to an individual.

> No doubt royal monopolies are [...] very objectionable ways of raising a revenue. They interfere injuriously with private enterprise, prevent the full development of the natural commercial resources of the Nation, and check the consequent increase of the public revenue; but in all the countries where the science of Political Economy has been imperfectly understood, such monopolies have constituted one of the sources of income for the Crown (*ibid.*).

However scientifically and practically wrong they might be, he noted, state monopolies were not prohibited under the treaty of Commerce signed between Naples and Great Britain in 1816. But the case of sulphur was different, he affirmed, because the sulphur trade had been completely private from the start on both trading sides, and the imposition of a monopolistic restriction was a serious prejudice to the rights of British merchants and Her Majesty's government had every right to come to their help.

Palmerston made an additional didactic remark to his opponent: the Neapolitan government "appears to imagine that sulphur is an article found only in Sicily, and that

Providence has rendered all mankind dependent on that single island for a commodity which is extensively required for various uses."

Sulphur, on the contrary, is to be found in many parts of the world and the persistence of the Sicilian monopoly, Palmerston affirmed, will bring other supplies into cultivation and the price will fall. He concluded that:

> When this result is accomplished the Government of Naples may perhaps regret that it allowed itself to listen to a scheme suggested by individual cupidity, which can only be carried into effect by sacrificing the interests of the many to the avarice of the few, which violates the national faith, and which must involve the Crown of Naples in a difference with a Power, whose fleet and armies have protected and preserved for that Crown the very island where the subjects of that Power are now about to be exposed to treatment oppressive and unjust (*ibid.*).

Thus, Palmerston accused the Neapolitan crown of being scientifically backward and incorrect, politically offensive, ungrateful, and threatened that it could be also easily proven to be militarily weak compared to Britain.

The Neapolitan response was fast in coming, in a letter personally dictated and signed by King Ferdinand. There, the King showed his ire at being defined politically despotic and ignorant of economic theory. He wrote that his country did not take lessons in Political economy from anyone, least of all England, as it had been the birthplace of economists like Genovesi, Galiani, Broggia, all earlier and just as great as the most eminent economists in the world. And he stated flatly that Palmerston was also wrong in his arguments about monopoly, and that he had been contradicted even by his own legal advisers.

The ebullient and arrogant foreign secretary, however, was not to be deterred by this display of theoretical and argumentative prowess. He also had a personal axe to grind with the Neapolitan crown, as Carlo di Borbone, a cadet brother of the king, had married Penelope Smith, a beautiful Irish commoner who was Palmerston's niece; for marrying beneath his rank, Carlo had promptly been disowned by his brother and left without means of support, to fend for himself and his wife in London.

Palmerston, fired by political, ideological and personal motivations, ordered the British fleet to cruise out of Malta and seize all Neapolitan merchant vessels they found, to seize them also in Mediterranean ports, like Corfu, and finally to appear in all its persuasive strength in the Gulf of Naples. In private letters Palmerston also mentioned his determination to blockade the Kingdom of Naples altogether from the sea.

The Neapolitan government appealed to other Italian princes, to the continental powers of the Congress of Vienna, to France. It received general sympathy, and expressions of readiness to mediate, but not much else.

In the end, mediation managed to bring the dispute to a lengthy resolution. In fact, as J. Goodwin, British consul in Naples, wrote in the Journal of the Royal Statistical Society in 1842, the British had made sure that the Bourbon king would take theoretical free trade lectures seriously: "Reprisals were made upon Neapolitan commerce by the British fleet in the

Mediterranean, the result of which – wrote the Consul – was that the [monopoly] contract was dissolved by a Royal decree of 1st July, 1840."

After this ideological-military spat, the Bourbon dynasty never recovered the special relationship it had enjoyed with London. The Kingdom of Naples became, for the British, the scourge of Europe, as William Gladstone famously called it in 1850.

The Neapolitans were utterly defeated in their attempt to behave as a European power of the first rank. In economic terms, the defeat was less brutal, but the political implications of this demonstration of British imperialism were profound, for no other Italian State tried to go the protectionist way after that. Cavour pursued, as is known, free trade, in Piedmont. After his death in 1861, his political heirs extended the free trade regime to the whole of Italy, including the Southern provinces where protection had lingered on and where the effects of free trade were devastating, also induced by the new kingdom's choice of a monetary standard which over-valued the Lira.

4. Werner Sombart on Italian commercial policy

A very lucid analysis of Italy's commercial policy since unification was provided in the early nineties of the XIX century by Werner Sombart (Sombart 1896).

He had no hesitation in stating that in his view, the new Kingdom had chosen the wrong path to development by extending Piedmont's free trade to the whole of the country and that Cavour, had he lived to govern the country he had so cleverly put together, would have not done that, because he knew that what was a good policy choice for a small country like Piedmont would not be appropriate for a large and uneven one such as united Italy. Sombart provided statistics on the level of protection that existed in the various kingdoms before unification, which clearly showed that the Bourbon Kingdom was the most protected one. He remarked that Italy before unification could not adopt a custom's union like the German Zollverein, because it would have meant giving economic leadership over the whole Italian peninsula to the Austrian Hungarian government, the opposite of what the Risorgimento was about.

He provided statistics to show how the economy of the South had wilted in the years after unification, being subjected to the harsh winds of free trade. And how the whole country's imports had swollen in the same years, while exports remained stagnant.

He noted that in 1860 Italy had some industrial plants but could not be said to have an industrial sector, even in its most developed parts. He added that the shift to protectionism, in the 1870s, was gradual and did not lead, but followed, similar policy changes which were decided by neighbouring countries, in particular by France. He very perceptively remarked how close had been the integration between the economies of the two "Latin sisters," and how economically painful would therefore be for Italy the commercial war declared against France in 1887, how Italy was led into it by France's decision to abandon Napoleonic free trade in 1873, how it was also influenced by high foreign politics.

An equally perceptive set of remarks he made on Italy's decision to industrialize, under the Sinistra governments. He was convinced that the Italians had gone over to industrialization in order to affirm their national will to be a great power, in an age when industry and modernity seemed to go hand in hand and all leading countries had become industrialised. This prevalence of politics over economics seemed altogether reasonable to him. He believed that if a country stuck to "natural" economic activities dictated by geography and natural endowments, it would lose control over its own destiny, and be exposed to the vagaries of the international cycle, but that once that path was abandoned, protectionist policies required very careful planning and could easily misfire. Accordingly, he noted that the earliest duties had been imposed on foreign trade by the Italian government not to promote industry or agriculture, but mainly to boost fiscal revenues in a country where taxation was difficult to impose and manage.

When Sombart wrote his article, the great industrial spurt of the late Nineties and early XX century had not yet begun in Italy. It is with the industrialisation of the 1880s he therefore dealt. He did not have any objection to the Italian decision to provide heavy protection to the steel industry. It seemed clear to him that no industrialization effort could take place in a large country like Italy which was not based on a national steel production, even if the country did not have coal. He expressed admiration for the steel works, which were built by Stefano Breda in Terni. To him it was evidence that Italians could realize large scale state of the art projects in leading industrial sectors.

But he was too good an economist not to notice the contradiction that existed between the return of convertibility by the Lira brought about by the Sinistra government in 1882 and the negative consequences it had on the competitiveness of the Italian economy, particularly of the newly born industry. He noted that an inconvertible currency worked like protective measures and that their effect was predicated on domestic prices rising earlier and faster than domestic wages, shifting income distribution in favour of capital and against labour.

Smith, Palmerston and Sombart are excellent examples of the mix of ideology, high level economic theory and more down to earth considerations with which foreigners have traditionally approached the reality of modern Italy.

Further examples can be found in Gerschenkron's crossing of swords with Rosario Romeo on primitive accumulation, the role of German banks in Italian industrialisation and the misconceived protection of basic industries, in Vera Lutz's polemic about the Italian government's Southern industrialization policy, Andrew Shonfield's and Posner and Woolf's admiration for Italian publicly owned industry, and the more recent debate about small scale industry and industrial districts, inspired by Brusco and Becattini but made popular among world economists by Piore and Sabel and even a political science analysis of North-South difference as the one proposed by Robert Putnam. All are really looking at the different facets of the same subject, as we shall try to show in what follows.

5. Bonnefon Craponne, a contemporary witness of turn of the century Italian "Big Push"

After an early belief, shared by many foreigners and Italians, that Southern soil hid fabulous riches, and that an enlightened and efficient administration would bring them to fruition, the realization of Southern backwardness hit foreign observers as it did Italians, and advice on how to resolve the arch problem posed by Italian unification would be forthcoming from abroad for the next one hundred and fifty years. In the eyes of foreigners, the coincidence of a rapidly modernizing North and an increasingly backward South made the Italian growth experience a *Sonderweg*, a special case. Many foreign observers thought it could be solved if the Southern regions specialised in agriculture and tourism. After a much bigger case of economic renaissance, that of Germany, filled the landscape, foreigners began considering whether integration with the German empire may be better for Northern Italy than special relations with France, which had been the experience of the previous two hundred years. Northern Italy was the region involved, as it was clear that there the Italian elites would conduct their experiment of rapid industrialization.

Still, there was no widespread contemporary awareness by foreigners of the success of the Italian industrial spurt in the two decades leading to the First World War. After the war, keener observers took note of what had happened but the pre-war and wartime growth of Italy's new industrial structure was overshadowed by the more urgent problems posed by Italy's huge foreign indebtedness and by the need to reconvert the new industrial structure to the post war world economic conditions.

There were exceptions, however. Perhaps the most interesting among pre-war observers was Louis Bonnefon Craponne, a French silk producer based in Piedmont, who was the first chairman of the Unione industriale of Torino and later of the Confederation of Italian Industry. He published in Paris, in 1916, what can be considered perhaps the best contemporary work on the decade of rapid growth Italy experienced at the turn of the century, "L'Italie au travail," a book which had been written before the outbreak of WWI (Bonnefon Craponne 1916). The man was highly competent, a graduate of one of the elite Paris *grandes écoles*, the Haute Ecole en Sciences Commerciales, a true lover of his adopted country, a not uncritical admirer of what the Italians had managed to do especially in the ten years of what we now call the Giolittian economic miracle. His book is an extremely lively, but well documented and statistically backed description of the growth trajectory some of the most successful sectors of Italian industry experienced since unification. It included a very thoughtful chapter on la Questione meridionale, clearly inspired by a man the author thought very highly of, Francesco Saverio Nitti. He was however able to distance himself from Nitti's passionate approach to the subject.

Bonnefon started as a silk producer, closely connected to the Lyon silk market, but then moved on, to take part in the explosive boom of the Italian automobile industry in the first decade of the XX century. Naturally, his chapters on silk cocoon production, the silk industry and on the auto industry are particularly brilliant, but he is extremely well informed and informative on other sectors, such as the hydroelectric power industry.

It is only through the brilliant pen of this French *grand commis* that we get a really pulsating feeling of what must have been the heady experience of fast growth in Northern Italy in the first decade of the last century. Just by quoting production levels in the most dynamic sectors and by giving a body to those figures through extremely competent description of the production processes adopted, of the technology levels at which Italian industry was able to rise in such a short time, in sectors like automobiles, tyres and cables, hydro power, and even cotton and wool, we are able to fully appreciate the modernization of Northern Italy, its growing distance from Southern Italy, the essential role played by emigrants' remittances in the Northern miracle, the problems with the young and militant workers' unions, the pitfalls which lay in the future and which must be avoided for the miracle not to be aborted.

Bonnefon also fully understood the dualism between large and small scale industry and vividly described the self-made former workers, the well educated engineers, or upper class former cavalry officers like Giovanni Agnelli, both types of industrialists sometimes coexisting in the same sectors. He did not overlook the workers, whose recent provenance from the peasantry he stressed, because of the advantages and disadvantages that rapid social change entails, which helped to explain why such hardworking people in the end were less productive than their French, British and German counterparts. Bonnefon was a positivist living in an age of positivists and in a city where that persuasion was rife, with people like Cesare Lombroso and Angelo Mosso.

His book, in the original French edition, is very hard to find, although an incomplete copy can be downloaded from the Internet, offered by a Canadian university. A new French anastatic reprint has recently come out and, even better, an excellent translation into Italian was made and published in 1991 by the Unione industriale of Torino that Bonnefon founded, but has not been commercially distributed and is hard to find (Bonnefon Craponne 1991). For these reasons, Bonnefon Craponne is hardly a household name in Italy today. He certainly was not mentioned by either author in the Gerschenkron-Romeo debate. He does not appear in "Risorgimento e capitalismo" (Romeo 1959) nor in "Economic backwardness in historical perspective" (Gerschenkron 1962). Nor is he mentioned in the Index appended to a very important collection of essays Alberto Caracciolo put together, in 1969, under the title "La formazione dell'Italia industriale" (Caracciolo 1969). More recent works, like Castronovo's history of FIAT, (Castronovo 2005) instead make full use of the book. Bonnefon's book, however, is today known only to specialist historians, while it ought to have been among those suggested to university students of history, economics and engineering in the year of celebration of the 150th anniversary of the birth of modern Italy. His down to earth, yet vivid and scientifically cognizant prose has not aged at all in a century. Reading it calls back the enthusiasm of a decade essential to Italian economic and political history.

6. The ECA Country Study on Italy and its consequences on theory and policy-making

What to make of the Italian mixed economy, with large scale industry chiefly owned and run by the State? This occupied foreigners after the Second World War, especially during and after the Italian economic miracle. Before that, however, foreign advisers were involved in plans for the reconstruction of the Italian economy after the war and its adaptation to the new free trade environment created by the Bretton Woods Agreements. The launch of the Marshall Plan and its application to Italy gave rise to a famous dispute between the "keynesian" US administrators of the Plan and the Italian authorities, headed by the Central Bank and its then governor, the distinguished economist Luigi Einaudi, soon to become president of the Republic; the latter thought foreign financial aid should be destined to help the stabilization of the Italian currency and not to fund keynesian public works to alleviate Northern unemployment which, according to them, had structural causes. After the Marshall Plan was launched, the Economic Cooperation Administration (ECA) staff published a "country study" on Italy (ECA 1949) which was sharply critical of the Italian post-stabilization policy choices, Italian economic policy-makers cleverly managed to mobilize conservative foreign economists like Friederich and Vera Lutz, who agreed with the Italian government's set of priorities and policy sequencing. In due course the Italian authorities asked for foreign advice when Italy requested United Nations help to develop the South. Paul Rosenstein Rodan, Hollis Chenery, Richard Eckaus were consulted. That attracted foreign interest much more than what was happening to the industrialised North in the new environment of trade liberalization. The Northern "miracle" took foreigners largely by surprise, hence their interest in the mixed economy model, which had prevailed in Italy since the rescue of banks and industry in the 1930s. This model had admirers like Andrew Shonfield and Michael Posner as well as serious critics, like the already mentioned Friederich and Vera Lutz.

The report by the administrators of the Marshall Plan, titled "Italy. Country Study" which appeared in February 1949 but was written in the last months of 1948, was slender in size but it proved to be the first mover in the post-war debate about what models of economic development ought to be applied to the case of Italy, the ideal starting point of the Gerschenkron-Romeo debate. It has been condescendingly called a product of "rough Keynesianism." It certainly was keynesian to the core, but rough it was not.

Among its authors, we only know for sure there was that Richard Bissell, who later acquired a not very positive fame for having planned the unfortunate Bay of Pigs expedition against Fidel Castro's revolution. We also know that, like Bissell, the other authors were young and American.

I have already mentioned how traumatic the appearance of this report was for the Italian governing elites, who had, starting from the authoritative advice and policy-making activities of Luigi Einaudi, governor of the Central Bank, Budget minister in De Gasperi's cabinet and soon to become first full fledged president of the Italian Republic, devised a very different policy sequence to follow the stabilization of the Lira they had just brought about. De Gasperi and Einaudi had bet on the positive electoral consequences of their stopping in its tracks the inflation which had burned Italian monetary savings and the real value of the huge public debt inherited from Fascist War making. They won their bet. There were more people in favour of deflation than there were who attributed their unemployment to it. And the fact that inflation had destroyed the real value of cash earned through black market sales of all sorts of goods, like food products, did not inflame the losers into voting against the government, certainly did not persuade them to vote for the Left.

The authors of the *Country Study* reported that inflation had been initiated by the Italian authorities, when they had allowed banks to sell the large holdings of government debt they had been forced to absorb during the war and to lend the proceeds to their commercial and industrial clientele. The authorities, especially Treasury minister Epicarmo Corbino, an extremely obdurate economist who believed in free competition whatever the cost, had repealed all rules that prevented banks from freely opening new branches and competing for clients, with the result that industrial production and imports grew because pent up demand for goods but also of speculative inventory accumulation. A wild stock exchange boom also ensued, another product of easy credit.

When Corbino's influence was finally neutralised, open inflation was rampant and it took Einaudi and Menichella, who had been the first director general of IRI before the war and became governor of the Central Bank after Einaudi, to put up a joint effort to fight it back. Stabilization of the Lira was achieved at the cost of deflation, a deflation which was only mitigated by a large devaluation of the Italian currency and by special government intervention to rescue the engineering industry with subsidies.

All these aspects, positive and negative, were mentioned in a couple of brilliant articles by the young Albert Hirschman (Hirschman 1948a; 1948b), who had earned an economics degree in Trieste just before the war and had deep knowledge of the Italian economy, and who wrote just after the stabilization had been successfully performed.

Hirschman worked for the Board of Governors of the Federal Reserve. He was as a result careful with words, but he did not mince them either.

Since one of the articles appeared in the American Economic Review, the authors of the *Country Study* probably read it. Hirschman had written his papers after having spent time in Italy to gain information. There are good chances that he had met his Marshall Plan colleagues.

The *Country Study* was written in the same vein as Hirschman's articles. He had underlined the importance of the Lira devaluation for the success of stabilization. He emphasized the importance of "real" variables, like commodity prices, in dampening price rises in Italy after the autumn of 1947. And he also underlined the partial freeing of exporters' foreign exchange earnings, which had been used to import raw materials and other essential products, rather than being parked in foreign bank accounts.

The authors of the *Country Study* irked Italian policy-makers and conservative economists when they began their report by quoting the very high number of unemployed people who lived in the cities of the industrial North of Italy and affirming that increasing employment was the primary aim of economic policy. They thought that aim could not be achieved if the deflation following stabilization would be allowed to persist. A vigorous reflationary policy was mandatory also to allay the threat of Communism permanently. And they added that a massive dose of public investment was the only way of bringing it about, to substitute for weak consumption demand to be expected because of low wages and unemployment and especially for the extremely timid performance of private investment after the inflationary bubble had been successfully punctured by the authorities fast and determinate measures of mid 1947. Private entrepreneurs, wrote the *Country Study*, seemed not to have gained, after the resounding Christian democratic electoral victory of 18 April 1948, enough confidence that Communist takeover was definitively out of the picture to take out their own money and invest it in new productive capacity. In any case, private industry thought capacity utilization was still low because of the deflation following stabilization and that there was enough unused plant and machinery, not to mention workers, to supply almost any increase in demand in the immediate future.

Public investment, the *Country Study* wrote in no uncertain tones, was therefore the only way to decrease present unemployment in the North and to increase productive capacity in the less immediate future, and avoid bottlenecks which would then appear in crucial and strategically important industrial sectors. Its authors also wrote that public investment could be financed by the ample funds made available by Marshall Aid and accumulated in the special Treasury counterpart account, where the proceeds of the sales of Marshall Aid goods were deposited. This was what the ECA programme had been devised for, they added.

That is where the post-war dispute on models of development and capital accumulation began, much earlier than it was taken up by academic economists, as we recounted above. The keynesian economists of the ECA obviously had in mind a progenitor of what would later come to be known as the keynesian growth model, very similar to what Gerschenkron seemed to have in the back of his mind when he wrote his articles, some years later. Public investment to increase capacity and employ workers would be at its core. In the immediate post-war years, however, no primitive accumulation was required to realize it, unless Marshall Aid could be defined as primitive accumulation. Foreign aid replaced credit creation by German style banks which no longer existed or extraction of agricultural surplus through taxation of rich landowners or through relative price movements between industrial and agricultural goods which penalised the latter.

The authors of the *Country Study* also wrote that, in order to boost fixed investment in infrastructure and new industrial capacity, publicly owned industry, whose size had been greatly increased in the 1930s through the creation of IRI to rescue large scale industry and banks which owned it, should be called to play the protagonist's role, as IRI owned most of the firms capable of planning and executing large scale investment projects, to be financed with ECA funds. The *Country Study* remarked that IRI had not yet begun to plan a coordinated industrial effort such as the one now necessary for Italy to move to a fast growth trajectory, but that they ought to be asked to do it, now that resources to finance that giant effort were made available by the ECA. They thought no one in private industry had the resources and the size to replace IRI in this role.

The Italian authorities, however, did not agree with the course traced by the ECA economists in the *Country Study*. They much preferred to spend the counterpart funds in gold and foreign exchange reserve accumulation, to give once again a solid base to the Italian monetary system. Some of them also believed that Italian unemployment was not caused by a deflation-induced fall in effective demand. They thought it was structural and could therefore not be quickly reabsorbed by a demand boost to be obtained by increasing industrial capacity through fixed investment and infrastructure building.

They also feared that inflation was not permanently subdued and would be resurrected by a sudden increase in international commodity prices, leading to inventory speculation by Italian industrialists.

In the following decade, the years of Italy's economic miracle, events showed that the authors of the *Country Study* and the Italian economic authorities were both right. There had been both keynesian unemployment in Northern cities and disguised unemployment in agriculture all over Italy. The Korean War spurred another bout of speculative inventory accumulation by Italian firms and merchants, and the foreign reserves the Italian authorities had prudently piled up could be used to balance the country's international accounts.

But the war also boosted foreign demand for Italian industrial goods, and that caused employment and capacity utilization to rise without unduly pressuring wages. The low level of the Italian lira made Italian industry fully competitive with foreign producers.

At the same time, IRI firmly placed itself at the core of the new Italian growth trajectory. It managed to close the historic gap that Italy showed in integral-cycle steel production, by building, against the violent hostility of private steel makers, who used scrap iron in electric steel mills, a new steel plant in Genoa with American machinery supplied by the Marhsall Plan. American refinery equipment was also obtained to build new oil refineries and re-equip existing ones, thus helping to close another historic trade gap, that caused by coal imports. Higher value refined oil products were exported and low valued ones were burnt as fuel in the thermoelectric plants also imported from America. Moreover, IRI engaged in a huge programme of motorway construction, while ENI, the other large publicly owned firm, found natural gas in the Po valley and built a complete pipeline network to make it available to Italian industry and reduce the fuel bill Italy paid to foreigners.

Thus it was often the same men who had played down the advice of the young authors of the *Country Study*, who put the content of that advice into practice. As Gardner Ackley later remarked, there must have been plenty of keynesian unemployment in the late Forties to allow such a large and rapid supply increase in the Fifties, while millions of Italian workers had at the same time been migrating to Europe, the Americas and Australia. Full employment would finally show up, only in the North of the country, in the early Sixties, rapidly pushing up wages and causing a balance of payments crisis which Italy, now on the Bretton Woods fixed exchange rate standard, chose not to fight by devaluation.

7. Dualism in economic development

In the 1970s, David Abulafia, a distinguished Cambridge economic historian, published his work on the Italian economy of the late Middle Ages, where he showed, with considerable success, that the dualism of the Italian economy, with a developed Centre-North and an underdeveloped South, could be traced back as far as the XIV century (Abulafia 1977). This was not as far fetched as what other scholars had done before him, to show that dualism in the Italian economy dated back to classical times. Arnold Toynbee, the most extreme among them, had written that the underdevelopment of Calabria was to be attributed to the revenge the Romans had taken on its autochthonous inhabitants and the devastation they had wrought on their homeland, after the Calabrians had sided with Hannibal (Toynbee 1965).

Dualism, uneven development, is thus a concept which permeates Italian economic and social history. In our time it re-emerged in the 1950s, when a vigorous growth process finally started in the Northern part of the country, while the South stagnated and even regressed. The debate was started by an article which Vera Smith, an English economist married to the conservative German economist Friederich Lutz, published in the Banca Nazionale del Lavoro Quarterly Review in 1958 (Lutz 1958).

The couple started visiting Italy for extended periods, at the invitation of the Bank of Italy. What was the purpose the Italian authorities pursued by inviting them to work on the Italian economy, has been admirably reported by Paolo Baffi in a well known article some years ago (Baffi 1985).

In the first article, in subsequent ones and finally in a book (Lutz 1962), Vera Lutz built a model of the Italian economy characterised by some pathological features, which in her opinion caused the divergence between North and the South to come about and to persist in time.

Her articles coincided with the preliminary work for and then the launching of the Cassa per il Mezzogiorno, an institution which was Donato Menichella's creature, was inspired by Roosevelt's TVA, and was supplied with large resources to build public works and infrastructures in the Southern regions, with the declared aim of bridging the gulf that existed between economic conditions in the two parts of Italy. In the same years, the Vanoni Plan was also launched, with the aim of speeding up growth rates in the whole of Italy but in particular in the more backward regions. Foreign economists were recruited to help with both efforts.

Vera Lutz's articles had the aim of inserting doubts into the minds of the Italian governing elites, who were swinging in favour of both intervention plans, as to the soundness of their theoretical foundations.

They started from classical and keynesian premises. She, on the contrary, based her reasoning on strictly neoclassical principles.

According to her analysis, the glaring dualism which persisted between North and South as far as levels and rates of growth were concerned, was the result of one simple fact: large scale industry, mostly located in the North, was dominated by powerful unions, which imposed to the entrepreneurs much higher wage rates than the relative availability of factors of production in Italy justified. This artificial wage setting, dominated by a strong monopoly of labour resources exercised by the unions, compelled firms to use more capital intensive techniques than the ones labour availability in the economy would have suggested, thus inducing the economy to warrant a less than full employment demand for labour.

Large scale industry, as a result, did not grow as fast as it might have, and labour supply was partly employed by small scale firms, which were allowed, by the relative weakness or even absence of unions from their shop floors, to pay much lower wages and ensure much worse working conditions than those prevailing in large scale industry.

The Italian economy, because of the presence of powerful unions, was therefore suffering, according to Vera Lutz, from an inadequate growth rate, a dualistic wage structure and a highly dualistic economic structure, where very capital intensive big industrial plants were surrounded by a plethora of small firms, where big industry paid higher wages than they should have, labour conditions were very different in the two sectors, and small scale firms were concentrated in the

Southern regions and in non-industrial sectors. In addition, greater industrial concentration than would have been justified by the labour supply of the country was another unfortunate result of the excess wage rates secured by the unionised labour force of the big industry sector. This led to monopoly and excess profits.

Monopolistic wage setting in the large scale industry sector thus led, according to Vera Lutz, to monopolistic prices and behaviour on the part of the entrepreneurs in the same sector. Resources were siphoned off from the rest of the economy and starved it of necessary capital.

How to get out of this dangerous impasse in which the Italian economy had been cornered by too strong unions? According to Mrs. Lutz, the answer was simple: wages in the capital intensive sector had to be kept from rising for a time long enough to allow the relative reduction of capital intensity in that sector and an increase of its growth rate so that the sector would start again absorbing labour and thus reduce the size of the backward small firm sector.

On the contrary, if wages resumed their rise in the capital intensive sector, its capital intensity would grow further and the growth rate of the whole economy would slow down, advantages of capital intensity and of high wages would be enjoyed only by capitalists and workers in the high wage, capital intensive sector. Geographical and sectoral dualism far from declining, would probably increase.

It is clear that the implications of Vera Lutz's analysis for the whole growth strategy the Italian leadership was launching aided by very eminent foreign advisors, from Paul Rosenstein Rodan to Hollis Chenery, to Harvey Leibenstein and with the help of large soft loans from the World Bank, were profound.

Had her line of reasoning been accepted, the first move on the part of Italian politicians should have been to try and break the hold the unions had on wages in the capital intensive sector.

Without this preliminary action, all attempts to increase employment levels by public works and direct investment by state industry were destined to meet only small and short lived success.

If one adds that a dualistic economy would also work, according to Mrs. Lutz, to increase agricultural prices and depress industrial prices, Southern excess supply of labour could only be relieved by mass emigration to the North, investment in employment-creating public works and even directly in new industries in the South being largely useless.

It is thus not surprising to see that Vera Lutz's articles were subjected to extremely heavy criticism on the part of economists who did not accept neoclassical theory. The first line of criticism was taken by Luigi Spaventa, then a very young and brilliant Cambridge-trained economist, alone or writing with Luigi Pasinetti (Spaventa and Pasinetti 1960) who also rose to international eminence in later years and with Gardner Ackley, an American keynesian economist, who had good knowledge of the Italian economy (he would later serve as US ambassador in Rome) (Spaventa and Ackley 1962).

Spaventa and Ackley replaced Lutz's analysis with one based on classical-keynesian theoretical premises, to which they also added the results of Sylos Labini's work on oligopoly. Their model yielded results opposite to those of Lutz's: it was oligopoly in the modern part of the economy which reduced the growth rate of the whole economy and maintained the divergence between the modern and the backward parts. A reduction of oligopolistic powers, i.e. an increase of competition in the modern part of the economy, was thus required to raise the aggregate growth rate and reduce dualism.

Other foreign economists, like Chenery and Leibenstein and especially Kindleberger, also contributed to the study of Italian dualism. Kindleberger used Arthur Lewis's analysis of development with unlimited labour supply. He attributed to the exhaustion of excess labour supplies the end of the so-called "super-growth" the Italian economy had shown in late Fifties and until 1963. Sudden and very large wage rises had stopped the virtuous circle of Italian post-war development.

His work was criticised by Italian economists who noted, for instance, that in 1963 full employment had been achieved only in Northern Italy, while unemployment persisted in the South.

Eminent foreign economists were thus working, in the Fifties and early Sixties, to explain the Italian economy's persistent dualism. It can be safely said that it was Mrs. Lutz who started the debate, and drove the discussions. And it can also be said, in retrospect, that her line of argumentation was the one which had the strongest influence on Italian public debate for years to come, in spite of the many theoretical weaknesses of her basic model. Double wage standards in different areas of the country and break up of union monopoly continue to be suggested as solutions to the dualism by which Italy is still affected, 150 years after unification.

8. Gerschenkron and Romeo on primitive accumulation and the "big push"

While the "dualism in economic development" debate raged, an equally heated one involved two eminent economic historians, Alexander Gerschenkron and Rosario Romeo: they were soon joined by other Italian and foreign economic historians and economists.

The debate focused on the role of capital accumulation in the crucial phase of economic development, which at the time was referred at as the "big push," a strong acceleration in the rate of growth of an underdeveloped country which would finally allow it to break away from underdevelopment and take a fast growth path.

More stalinist than the marxian economists whose views he challenged, though by no means a marxist himself, Romeo advanced the opinion that in the first fifteen years after unification, the Destra storica had adopted the correct approach in its attempt to bring Italy among developed countries in the shortest possible time. And that the politicians that had replaced the Destra had pursued the same strategy, whose core was the extraction of investable surplus from agriculture to shift it to infrastructure building and then to industry. This was a direct criticism of Antonio Gramsci's view of the failed agricultural revolution as the key to understanding why united Italy had not experienced a bourgeois revolution. By not distributing land to peasants, Gramsci contended, demand had not been created for industrial goods, hence slow industrial development and the very slow and timid emergence of a modern bourgeoisie.

Romeo's view was it had been exactly the failure to distribute land that had allowed the government to extract the surplus from agriculture. Who could have kept poor peasants who had come into land ownership from eating all the product they were able to produce themselves? By keeping land in the hands of the landlord class, the Italian government had been able to tax landlords heavily, because agricultural wages had not been allowed to grow. With some justification, Romeo accused the Italian marxists of not having read enough classical political economy, to have directly shifted loyalties from pre-war idealism to marxism for purely political reasons (hatred of the fascist dictatorship which had plagued Italy for twenty years). In his opinion, "primitive accumulation," a favourite expression of Italian marxists, had to be interpreted as the extraction of existing resources from a stagnant sector to invest them in a dynamic sector like industry or in indispensable public works, like the building of a railway network. The latter course was the one chosen by the Destra storica and it was a first indispensable step leading to a strategy of industrialization.

Romeo was clearly inspired by the literature on growth theory and growth models developed in those years in British and American universities, by people like Joan Robinson, Ragnar Nurkse and Arthur Lewis. But he referred in particular to the articles on Italy Gerschenkron had published in English in Italian journals.

Gerschenkron's reaction to this peculiar use of his work was ambivalent. He praised Romeo and criticised his marxist opponents. But he also reaffirmed what he considered his more important views of the Italian experience with economic development. He thought that railway building, much as it had been useful to unite the country, had been very weak as a factor of development promotion, as most of the track and rolling stock had been imported. He thus believed that the meaningful growth strategy was that initiated in the 1890s, after the great banking crisis, by replacing the failed French-type banks with German banks, which had exported to Italy their banking model and directly promoted industrial investment, as they had done in Germany. In Italy they had not managed, however, to dispose of their industrial investments as easily as they had in Germany, recovering their financial resources for another round of investment, because of the shallowness and semi-permanent state of illiquidity of the Italian stock exchange. Gerschenkron also affirmed that the industrialization policy of the 1880s, which had directly promoted the steel industry, by giving it huge resources and heavy protection, much as it might have promoted Italy's status as a great power, from the economic point of view had been mostly a waste of resources, as it had penalised the much more promising engineering industry, which had been ineffectively protected and was made to bear the costs of expensive homemade iron and steel products. Gerschenkron also criticised the choice made in the 1880s to protect the textile industry, which was hardly an innovative industrial sector.

Romeo had therefore used a partial and lopsided version of the Gerschenkron view, one which did not accept Gerschenkron's criticism of the development strategy adopted by the Sinistra governments in the 1880s. Gerschenkron told him as much in a debate they had in

Rome and in a review of Romeo's book. Unlike Romeo, he had no interest in defending the whole pre-fascist Italian governing class from marxist attacks. He based his reasoning on his own statistics of Italian GNP, which he rated were better than the ones constructed by the Italian national statistical institute, a claim which has stood the proof of time.

9. Small is beautiful, industrial districts and the "third Italy"

In the 1970s and '80s, foreign observers were definitively confirmed in the opinion that Italy was a *Sonderweg*. Not only did the divergence between North and South persist. There emerged even a "Third Italy," Italy's answer to the oil crises of 1973 and 1979, which seemed to defy and even negate world trends by promoting small scale industry and launching its products on world markets. This new historical turn received outsize interest, as foreign economists echoed the research of some of their Italian colleagues, who were studying what came to be known as "industrial districts," singing the praises of "informal horizontal integration" among small firms which did not merge but remained self standing. Foreign economists joined their enthusiastic Italian colleagues in extolling the virtues of the "Central Italian" model of balanced and non-destructive industrial growth, based on small scale firms springing up in an environment where agricultural sharecropping had prevailed for centuries and local social and political institutions existed which favoured cohesive social choices. Foreign sociologists and political scientists were eager to jump on the band wagon, some of them like Robert Putnam even going back to medieval Italy's experience with the "Comuni liberi" to explain why contemporary localised production methods based on social cohesion and cooperation had emerged in the Centre and North East regions (Putnam 1994). They contrasted this with what prevailed in the South, where Edward Banfield had several decades before found inspiration for his theory of "Mediterranean familism" (Banfield 1958).

The Third Italy model was so successfully propagandised abroad by foreign social scientists that even politicians like Bill Clinton, when he was governor of Arkansas, came to inspect it directly, visiting towns like Reggio Emilia and Modena to see their small firms and their welfare institutions, like the famous infant schools of Reggio.

10. The new Italian decline

After the end of the thirty year experience with post-Bretton Woods competitive devaluations, the Euro made it mandatory for economies like the Italian one, mostly wedded to labour intensive, technology poor goods, to control labour costs strictly and to increase productivity-enhancing fixed investment. Neither condition was respected. The marked slowing down of growth in Italy, after a previous decade of indifferent growth figures, has probably set the Italian economy on a path of steady decline, accentuated by the world crisis.

It did not take foreign observers long to notice the change: the switch from celebration to deprecation has been swift and neat. However, the countries taking the centre of the stage in the present age, the so called BRICS, have so impressed observers all over the world, that Italy's experience with the reverse phenomenon has attracted much less foreign interest, until the Italian debt crisis of 2011.

This was not just because failure finds fewer students than success. Perhaps more because, even in Europe, so many things of greater interest have happened since the turn of the new century, that Italy's plight to remain among the most developed countries in the world does not appear so notable and worthy of attention and study, especially because the decline of countries like the US and the UK is a much more important phenomenon for economists and other social and political scientists.

More attention has attracted the phenomena of the grey economy and of the criminal economy. Here, foreign economists, anthropologists and sociologists have found a very large field to plough.

It will however be some time before a Chinese Ruskin will bother to point to the abandoned factories of Prato, now enjoying a second coming with Chinese ownership and labour, as a parable in decay to warn his own country that a similar destiny may be in store for her.

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