

Luigi Luzzatti and the making of the Italian monetary system

Stefano Solari*

Abstract

After unification (1861) Italy had to face a badly integrated and oddly structured financial system as well as some fragmented or lacking institutions. The financial position of the country was characterised by double deficit in public and external balance. That caused several monetary and financial difficulties. In particular, monetary and banking institutions had to be step-by-step integrated and reorganised to support economic development in this new economic space. Luigi Luzzatti has been one of the main protagonists of this process of institution building. Besides his commitment with trade tariff negotiation and a variety of initiative in industry and environmental protection, he dedicated a wide effort to monetary institutions. He was one of the main supporters of the “Latin Monetary Union”, which lasted from 1865 to 1928 and contributed to reforms dealing with the problem of the plurality of emission banks and of their control. Luzzatti also engaged in the development of “popular banks” to contribute to the structuring of the credit system from the bottom.

Jel Classification: B26, B31, E42, F33

Keywords: Luigi Luzzatti, monetary system, financial unbalances, clearing houses

Submission: 2020.09.04

Accepted: 2020.12.21

* University of Padua, Department of Economics and Management.

1. The Italian financial and monetary system after unification

In the aftermath of its political unification, the Italian financial system remained deeply decentralised and underdeveloped. Piedmont and Northern regions had a bimetallic system comparable to the French, with a value ratio between silver and gold of 1/15.5. By contrast, the Kingdom of the Two Sicilies had a silver-based monetary system, similarly to Spain and Portugal. The unification, with Pepoli's law in 1862, adopted the lira and extended the bimetallic system to the whole peninsula but kept the plurality of issuing banks. Up to that point, circulating money was metallic and coinage was free. As a consequence, the supply of money depended on the difference between metals' market prices and their official prices at coinage. The credit system was underdeveloped and not well connected.

In 1865, Italy joined the Latin Monetary Union, which was constituted thanks to a determinant effort of Belgium. It extended the French bimetallic system to Belgium, Switzerland, Italy, and Greece from 1868 (which, however, did not accept circulation of partners' coins), then Rumania, Venezuela, Colombia and Chile¹. The two-metal system was thought to avoid inflationary or deflationary pressures due to the relative supply of precious metals. Actually, it was conceived to support trade and financial relations and, thus, Italy was kept under the financial protection of the French national bank. This Union worked well up to the Sedan defeat of France in 1870; then it survived, reasonably supporting the Italian preferential trading integration with France and the French bank's financing role with regard to the Italian public debt. Therefore, Italy was financially strictly dependent on France, and that remained even after the change of military alliances in 1882 and the German financial investments in Italy (de Cecco 1990; 2003).

The macroeconomic situation of Italy was that of a typical country suffering from a double deficit, requiring costly financing. The latter was mostly found in Paris by Rothschilds, who in turn constantly affected Italian political decisions. However, severe structural problems affected the financial equilibria of Italian accounts. Italian capitals were often invested abroad, mainly attracted by the Paris financial centre. This created deficits in the capital account of the balance of payments. The same capitals were paradoxically invested in Italian government bonds and therefore financed the public debt from abroad. Banking was not well developed, and companies had to find support from foreign banks (French and British), even for discounting

¹ Austria was interested in joining, but the war of 1870 stopped this reform (Nardi-Spiller 1994).

commercial paper (de Cecco 2003). All these created strong strains on the exchange of the lira.

More generally, all institutions had to be built or renewed to support the economy of the new nation. Banks were insufficient and had insufficient reserves to assure a solid circulation. Credit was insufficient to help the development of local economies. Companies were often financed through persisting short-term credit, increasing risk for banks. Banks tended to print an excess quantity of notes, holding insufficient reserves. There was a deep uncertainty about which institution had to perform some monetary control and how.

Some institutional reform was implemented with the Code of Commerce of 1865 and 1882 (relevant for company law) and with the Minghetti Law of 1874 that fixed at six the number of issuing banks and limited total note issuance. Monetary instability remained high, and Italy had to abandon convertibility for long time periods. In 1881, the Italian Parliament introduced a law to restore convertibility and passed the de facto Gold Standard, but the high instability of those years prevented any significant change. Effective convertibility was achieved in 1883, thanks to an international loan (partially covered by German institutions). Credit began to rise based on real estate security. However, the situation kept being unstable due to the crisis of the Paris stock exchange of 1882 and the Italian change in foreign alliances that caused trade wars with France. The result was the bank failures of 1882–84. In 1884, German capitals intervened, creating the two mixed banks *Banca Commerciale Italiana* and *Credito Italiano*.

Monetary stability remained under stress in the late 1880s with the deflation of real estate bubbles and the difficulties of Banca Romana. The Giolitti government created a new banking law in 1893 that reduced the issuing banks to three, posed limits on circulation fixing metal reserve requirements, and introduced norms on capital adequacy. At the same time, the Bank of Italy began its activity of coordination in the solution of banks' failures, and in 1894, it became the treasurer of the Public Administrations. Such a role was more clearly defined in 1907 when, after the financial crisis started in the US, the Bank of Italy effectively became the lender of last resort. At the same time, limits on circulation were relieved to help that activity. Lastly, in 1913, the Stock Market Law was promulgated to control speculation (Gigliobianco, Giordano 2012). Ultimately, the financial situation began improving in the 1890s due to the favourable economic cycle and to the emigrants' remittances (de Cecco 1990).

De Cecco (1995; 2003), Borio and Toniolo (2006), and Realfonzo (1995) remarked that both economists and technicians had a dominant view of mo-

ney close to the currency school (metallists). Consequently, monetary stability and financial stability were believed to be strictly connected. Monetary stability was seen as the preservation of convertibility into gold, and that led to a constant perception of an excess circulation of notes. The consequence was that credit was constantly limited, but that led more to speculation than to genuine credit selection. Most of the economic debate was focussed on *pro et contra* regulation, resulting in difficulty in reforming the banking system, as even economists had no clear idea of whether or how to regulate banking (Giaconi 2002). This explains why in Italian reforms, a practical approach prevailed. The right-wing politicians showed a very pragmatic approach to reforms, pointing to the resolution of problems, having in mind the viability of the economic system as well as the fragility of institutions and the precarious position in the international setting. In this sense, the statement that Luzzatti was not favourable to the use of economic theory can be explained (Giaconi 2002: 118)².

2. The scientific approach of Luigi Luzzatti

Luzzatti is fundamentally an exponent of the ethical school of political economy of the University of Padua. He is the laic follower of Messedaglia (while Lampertico and Toniolo represented the Catholic follow-up). A common feature of this stream of political economists is the continuous reflection on method and the fundamental search for a civil ethics of scientific research (in the spirit of Vico). Since his early studies, Luzzatti found inspiration in the work of Baruch Spinoza (Pecorari 2010), anticipating an open ethical position that could be accepted universally (Luzzatti 1909)³.

Today, the scientific work of Luzzatti would be classified as *Law and Economics*⁴. Actually, he has mainly been a theorist of institutional reforms, serving the development of markets of the new-born state. He did not leave any major theoretical work in political economy. However, despite his chair in Constitutional Law, he held courses in political economy, substituting Messedaglia in 1867-68 and on statistics (both in Padua and in Rome), and regularly published articles on economic matters. In these works, as well as

² See also Barucci, Pavarin, (2008), Realfonzo (1995) and Realfonzo, Ricci (1995).

³ His work *Libertà di Coscienza e di Scienza* (1909) is the most representative of this search in the spirit of Spinoza of what is common to all cultures.

⁴ In the specific domain of Constitutional Economics. He explicitly used the term “Economia Costituzionale” in the title of his 1876d paper on Swiss Central Bank.

in the way he conceived reforms, it is possible to see the influence of Messedaglia and of the ethical discourse of Romagnosi. Nonetheless, the influence of the liberal and federalist thought of Antonio Rosmini (who studied in Padua and was seen as an important point of reference in the School of Law) also left some durable imprinting.

Luzzatti wrote many essays on the methodology of science with a specific interest in political economy (Luzzatti 1874; 1876a; 1876b). He expressed himself against rationalism and the search for abstract laws of economics as well as any naturalism of economic principles. He was against both mechanicism and evolutionary thought applied to society. Luzzatti's theory of knowledge is based on a bounded view of reason and on the constitutive role of uncertainty (following Bacon and Galileo, as well as Vico and Rosmini)⁵. Statistics and comparative analysis are often used to point out satisfactory ideas on how specific markets work. This is also the approach of the *Social Inquiries* of 1879 that he promoted. The connection between economic development and *incivilimento*, between ethics and politics, and between science and social change are in continuity with the legacy of Gian Domenico Romagnosi.

3. The idea of money and the foundation of popular banks

The first work of Luigi Luzzatti, *La diffusione del credito e le Banche Popolari* (1863), reprinted by Pegorari in 1997, testifies to the main interest of the author. In 1926, Luzzatti affirmed that in this first book, a *fil rouge* can be found that would characterise all his economic, social, and political ideas. It represented his guide in the years spent both as scholar and as statesman. Luzzatti affirmed that the aim of any banking reform is to avoid the usury of the rich against the poor. He thought that education and the diffusion of popular credit through cooperation could be two good instruments of civilization.

This book examines the opportunities in developing credit institutes' adoption of associative forms. Luzzatti theorised the development of specific institutions without basing it on a solid monetary theory. He looked at the work of Macleod (1885-56; 1858) with interest, and he remained attentive to all the

⁵ The mail correspondence between Luzzatti and Messedaglia repropsoed by Pecorari (2010) is fundamental to understanding the reference to Vico in the epistemology of the whole Padua School of Economics and ethics. Also the idea of "civil doctrine" and the crucial role of moral education are taken from Vico.

developments of monetary theory, although remaining favourable to contextual theorisation. He did not adhere to the currency school as the majority of economists of the time, neither did he believe that credit creates capital or wealth (a specific point of Macleod). In 1876, he was in favour of a currency backed by a metallic reserve, as suggested by Adam Smith (Luzzatti 1876c). However, metallic reserves were used to promote trust and nothing else. He supported the vision of Bagehot and referred to this later in proposing the creation of *clearing houses* and of the centralised control of monetary supply, as in the Bank of England (Luzzatti 1916). His view of credit is that it expands the effect of money, although only an accurate development of institutions is responsible for making money not idle. However, banks (not only the smaller) should federate, as in Germany, to promote stability (Luzzatti 1883b). Even the Central Bank should be a federation of banks.

Luzzatti thought that credit transfers capital and makes them liquid raising exchanges, a vision that is not at odds with the *metallist* perspective. However, he maintained that credit should be decentralised to keep capital anchored to the territory and to promote local development. Therefore, he believed that credit can have an expansionary power, and he criticised economists who understated the relevance of credit (Luzzatti 1952: 182). He believed that Proudhon's popular credit is a good idea, but gratuitous credit is impossible, as this activity should remain in the context of markets. Therefore, since credit is to be deserved, it works as a good incentive for firms.

The argument in favour of cooperative banks is predominantly based on the study of the role and the suitable form of institutions. The local associative form is fundamental. However, institutes should work on the market at market prices, which assures them the maximum freedom. Credit also has the role of moral education for people, both borrowers and investors, introducing the concept of reputation and its fundamental role in the good functioning of the market (Luzzatti 1863: 110). To grant a balanced development, these institutions should not be under the protection of the state, as it would distort markets. As a consequence, contrary to what many commentators on the role of Luzzatti have affirmed, there is no statism in his positions; he could be seen as closer to *Ordoliberalism – ante litteram*⁶. In 1910, he wrote that the role of the state is to show the way and to remove obstacles (Luzzatti 1952).

Luzzatti studies foreign cases of popular banks such as the Brussels Credit Union and German popular banks born in 1848. Such institutions took inspiration from mutual insurance and were in total conformity to market principles.

⁶ The correct view of Luzzatti is expressed in Romani (1994) and Gioia (2003), who saw him more attracted by British classical liberalism (J.S. Mill) than by German historicism.

The work of Schulze-Delitzsch (1855) is therefore a fundamental reference of the action of Luzzatti. He considered economic decentralisation, particularly the control of capital, of primary importance. Although some loss of efficiency may occur due to the costs of administrative activities, the gains produced by the activation of resources and enlarging markets would overcome the former. His focus is therefore always on the dynamic aspect of any issue.

Luzzatti was against the proposal expressed by liberals of abolishing laws against usury on the free credit market. This could be done only when suitable financial institutions would have been developed to assure the diffusion of credit to small businesses (1863: 102). The credit union of popular banks had to assure capitals to trade and industry, as well as to independent labourers, by the means of discounting commercial paper within the limits of solvability. The system of guarantees based on reputation, collaterals, deposits, etc. should be properly developed to make credit work. Luzzatti noted that many popular banks survived well during the financial crisis of 1857 and from that derived that they enjoyed a greater stability compared to the large banks, usually preys of speculative logics. Big issuing banks lend to big businesses, to the mighty, to the leisure class and to powerful people (Luzzatti 1952: 545, written in 1910). Luzzatti was instead interested in developing small businesses.

One year after publishing this book, in 1864, Luzzatti would be one of the founders of the first Italian popular bank, the Bank of Lodi. In 1867, he would be among the founders of the mutual popular bank of Venice and the following year, of that of Padua and later, of many others. In 1874, he would collaborate with Minghetti to elaborate on the first Italian banking law, which acknowledged and regulated the plurality of issuing banks (as demanded by liberals). It was also expected that these banks would have financed public debt. In 1875, he also supported Quintino Sella policies in favour of savings banks and the birth of post savings.

4. Luzzatti's thought and action as a statist and the painful evolution of the Italian monetary system

Luzzatti acted as a technician of the Ministry of Economic Activities from the 1870s. In this function, he was a protagonist of all treaties on commerce and of various reforms. Later, he became Minister of the Treasury (1891-92; 1896-98; 1903-05) and shortly prime minister (1910-11). He collaborated on all banking reforms and on the institutional reforms that shaped the monetary system. Over the course of time, he expressed his views about the evolving

context. Therefore, he never expressed a clear theoretical perspective, but a variety of practical positions from which we can derive his thought.

In 1880-81, he affirmed that the bi-metallic system was more stable and therefore more suitable to the actual situation of the Italian economy. Later, after the sharp devaluation of silver (due to Germany abandoning silver in favour of the gold standard), he admitted that the gold standard could be superior for controlling the supply of money, but that the bi-metallic system was still convenient, simply for neutralising the excess supply of silver (Nardi-Spiller 1994: 365). In his 1883 paper, Luzzatti analysed the different financial arrangements of Belgium and the Netherlands. The former, similarly to Italy, relied on the French central bank and on its reserves. The latter adopted gold as reserve metal and created a single monetary area with all its colonies, but it had to ration gold. It remained totally exposed to the effects of British or German financial policies. Therefore, adopting gold at that time would have caused more difficulties for Italy. Moreover, he was conscious that the *Banque de France* was also acting as lender of last resort for the Italian financial system, and maintaining status in the Latin Union meant having such external support, which was also backing most of Italian foreign trade and debt financing. Therefore, the Latin Union was beneficial to the stability of weak countries. He admitted that such a bi-metallic regime did not rely on any theoretical support, but it worked well (Nardi-Spiller 1994: 376).

Luzzatti, belonging to the right-wing party, had a pro-business view of the problems. Therefore, he considered the stability of the exchange rate fundamental. He would keep this perspective also in the 1900s, and he made up his mind that the fiscal re-equilibration would have contributed to stabilising the tensions on the exchange rate (Avesani and Spinelli 1995). In fact, most of the pressures came from the fact that the government had to rely on the financial centre of Paris for the emission of bonds, which were mostly sold back to Italian investors. Therefore, debt financing was a major source of currency exchanges. From his experience, Luzzatti developed a view of the interdependence of monetary and fiscal policies. Moreover, he remained favourable to direct interventions of the Central Bank to stabilize the exchange rate and not the interest rates.

When he became Minister of the Treasury in 1891, the banking system was close to collapse and public debt was growing fast. By 1897, the public deficit was reversed, and he became famous for his tighten fist when writing budgets. Regarding the financial system, the banking law of 1893 was proposed by Giolitti. Luzzatti was instead responsible for the laws of 1896, 1897, and the single collection of banking laws of 1910.

The main problem Luzzatti faced in 1891 was the amount of bank notes circulating in excess of metal reserves. This was thought to have an impact on the value of the lira (Pecorari 1995). As always, it had consequences on the exchange rate of the lira, and stabilising the exchange was always of primary importance for Luzzatti. Later, his idea in the act of *Risanamento della Circolazione* (25.5.1887) was obliging banks to keep 7% of reserves, which could be constituted of a variety of assets, including gold, government bonds or foreign deposits.

His attitude was gradualism, in the sense that no radical move would help the stability of the lira. The end was to move gradually out of the situation of a plurality of issuing banks and into a centralised system of control of the monetary supply. However, controlling for the drawbacks caused by the plurality of issuing banks had to be solved first by a variety of policies (Bonelli 1995). Therefore, after the law of 8 October 1893 that wended up *Banca Romana* and required the merger of issuing banks into the Bank of Italy, Luzzatti slowed down the latter incorporation to first shore up the critical situation of *Banco di Napoli* (De Rosa 1995). Luzzatti has been criticised because as the Minister of Treasury in 1891, he hid the situation about the inspections of *Banca Romana* from the Parliament (which took place two years before). In 1922, Luzzatti admitted that *Banca Romana* as well as the *Banco di Napoli* should have been wended up much earlier (Luzzatti 1922: 84). However, the situation was so entangled that drastic acts could have worsened the distrust of the lira and produced further bank-runs. Moreover, he tackled the situation of non-performing assets of these banks and of their insolvency by the means of a long-run dilution of devaluations and write-offs (Bonelli 1995).

In the case of *Banco di Napoli*, his strategy was instead to rapidly get rid of non-performing assets and to reduce circulating notes (a downsizing). To achieve this, he created the *Institute for Allowances* and conceived various operations of *creative finance* based on reciprocity. The government was helping the bank, and the latter had to invest in treasury bonds and to give a hand to solve other difficult situations, collaborating on government policies (Bonelli 1995).⁷ However, we should not forget that Luzzatti was a federalist and he was aware of the difficulties of the economy of the South after Unification. He understood that some sudden moves, such as taking decision centres away from Naples, would have meant further recessionary pressures.

Luzzatti never abandoned the idea of having a single issuing bank endowed with relevant gold reserves, following the British example. He simply

⁷ The two issuing banks of the South, *Banco di Napoli* and *Banco di Sicilia* were public bodies, contrary to the Bank of Italy.

decided to move cautiously in that direction, trying to minimise the costs of such change. In any case, he contrasted Sonnino, who aimed at further relenting this process. He favoured shifting the role of the decisional centre on monetary issues from the Treasury to the Central Bank and keeping the latter as independent as possible with regard to strategic decisions (Bonelli 1995)⁸. In this regard, he contrasted other politicians and ministers, such as Sonnino, in subtracting from the Treasury the centrality of decisions on monetary matters. The effective prominence of the Bank of Italy would be achieved with the 1903-05 ministerial experience of Luzzatti and with the nomination of Bonaldo Stringher as the general director of the bank in 1900.

Similarly, in 1922, Luzzatti advised the USA on achieving the centralisation of its central bank and abandoning the money granted by treasury bonds (Luzzatti 1922: 85). He argued that Switzerland had chosen this way (federation) and achieved a strong and stable currency (Luzzatti 1922: 86).

In the last term as Minister of Treasury (1903-05), Luzzatti achieved the most famous result of his reforms: the *conversione della rendita* (restructuring public debt) (de Cecco 1990b). The result was a reduction of the interest rate from 4.5% to 3.5% with beneficial effects on the interest expenditure. This was achieved after a long negotiation, started in 1898, with French banks and, above all, with the Rothschilds. It also involved a complex action of foreign policy because it required a work of persuasion of France as well as of Germany, which wanted to have a say on international financial issues. The aim was to have the new bonds rated in the Paris stock exchange in competition with Russian debt (the other main target of investment of French financial institutions). In 1904-5, the internal conversion was achieved, where the debt was held mainly by institutions such as *Cassa depositi e Prestiti* (postal savings). In 1906, foreign bonds were also restructured (Ballini 1995). We may add that this was a symbolically important result (as well as an important achievement for Luzzatti in foreign relations), although a less relevant result in real terms as the Italian economy had much improved and the debt was already under control.

5. Against the state banker

Luzzatti was a protagonist of an exchange in 1880 that reveals much about his theoretical conception of the economic and financial constitution. This is

⁸ This process has been object of detailed studies by Bonelli and Cerrito (1994; 1999; 2000), Sanna (2018), Pecorari (2003). Luzzatti favoured competent technicians as Stringher in crucial roles of the General Direction of Treasury and then in 1900 of the Bank of Italy.

the quarrel with Quintino Sella on the “banker state” (Luzzatti 1880a; 1880b). Luzzatti admitted that the state could be the banker when in necessity or even by choice. Actually, the Ministry of Treasury, having to manage the stock of public debt and make interest payments in foreign countries, increasingly looked like a big bank. However, the problem was the *Cassa Depositi e Prestiti*⁹, which received deposits connected to a variety of regulations and paid interest on them, that is obliged to earn some profit by investing the guarded capitals. The establishment of postal savings banks (*Casse di Risparmio Postali*, 1863-1875) in connection with *Cassa Depositi e Prestiti* developed the Giro-Post Bank, which was quite useful for small savings and payments. However, in the view of Luzzatti, such postal banks should remain specialised in small credit and not engage in competition with savings banks. For this reason, Luzzatti was against the abolition, proposed by Sella, of the limits to the capitalisation of deposits of 2,000 lire or to raise it to 5,000 lire (Luzzatti 1880a: 155). Moreover, such postal accounts should not pay interests above the market level, crowding out small private competitors. The important role of *Cassa Depositi e Prestiti* was territorial redistribution of capital, a role that small banks could not perform. Private savings banks have an advantage of information on production activities of the territory relatively to larger banks (Luzzatti 1880a: 173). In summary, the danger was that postal savings banks would become a big state bank, in competition with small private saving banks, without having sufficient reserves for this task (Luzzatti 1880b: 193).

From these interventions, we understand how Luzzatti was not in favour of the extension of the state in the credit market. He was not against the complementarity of public and private activities, but he believed that the public had to intervene in useful functions that were out of reach for private initiatives. Moreover, the private-public competition could not work if public savings banks took advantage of their position (compulsory deposits and the absence of mandatory reserves) to crowd out private banks. From this debate, we also draw some hints about how Luzzatti had a systemic and structured view of how markets are arranged and of the causes of their good or bad performance.

6. The monetary peace: An international perspective

Luzzatti, as a technician of the Ministry of Economic Activities, was a protagonist of all negotiations on trade and monetary treaties that allowed

⁹ The financial institution predominantly collected postal savings and, at the time, lent them to public administrations for investments.

the Italian economy to overcome the lack of fundamental financial institutions. De Cecco (1995) argued that Luzzatti elaborated relevant contributions to the amelioration of the international monetary system. In his articles, and in those of foreign economists he let *Nuova Antologia* translate, many fundamental insights on these matters have been diffused. De Cecco also affirmed that Luzzatti had an outstanding clarity of mind and remarkably detailed information on the most specific technical aspects of the functioning of financial markets. He constantly proposed practical solutions, and he always passed from proposals to concrete political actions.

The position of Luzzatti on international financial institutions is that the origins of the monetary and financial crisis could be understood only by adopting an international perspective (Luzzatti 1922: 9). The solution to such crises is to be found in international arrangements and not in local initiatives, and this is particularly true for less developed economies. Therefore, international conferences are quite important for reaching a common understanding of problems, as well as for monitoring the situation. Issuing banks are an old institution unable to supply good answers to a new crisis. In particular, Luzzatti referred to the 1907 collapse of US financial markets, which had a tough impact on Italian markets. If the USA had a single central bank, it would have controlled the crisis much better. On the contrary, the financial shock was internationally transmitted through Europe and had the worst effects in less developed financial markets.

Luzzatti clearly stated that the solution was a system of international banks able to assure reciprocal credit and form foreign investment portfolios in gold as collateral. As early as 1883, he advised the National Bank of Italy to use foreign-based portfolios, and as a minister, he raised gold investments in British treasuries. He always held a position against the hoarding of gold. Above all, he aimed at eliminating the “disastrous travelling of gold” for payments (Luzzatti 1922). Luzzatti always observed the techniques used by other fragile countries to manage their financial institutions to derive some good hint for Italy. In the 1870s, he carefully studied how Belgium defended its gold reserve, keeping it invested in interest-bearing accounts of foreign banks or in bills of exchange. The problem of small countries was having the necessary reserves to counterbalance the movement of capital, attracted by the more favourable investment conditions of foreign financial centres.

At the *Institut de France* – where he took the place left free by Gladstone – Luzzatti proposed to develop an international payment system based on clearing houses and mutual cooperation in absorbing monetary imbalances. He would get back on this theme at Villa d’Este in 1915 and in Paris in 1916. He maintained that the development of international trade and finance would bring

new instability, given that speculation also increases with them and the architecture of the international financial system supported speculators. No state or central bank dares to cool down the economy when business goes well and the late and local intervention of issuing banks is therefore helping speculation instead of offsetting it. To find some permanent solution to these problems, during the First World War, he proposed a project of a “*conférence Internationale pour la paix monétaire*”. Such a proposal was appreciated by both Great Britain and France, but they had no immediate interest in performing the needed reforms because, as central financial centres, they enjoyed benefits from the underdeveloped international institutional arrangement.

Luzzatti argued that we needed an international monetary system able to manage solidarity of the profit of all. He insisted that “all commodity and financial markets are jointly liable in good and bad times, more in bad times than in the good ones” (Luzzatti 1922: 20)¹⁰. Therefore, it is the interest of all to take part in a system able to regulate monetary interactions (offsetting imbalances). He thought that a major cause of the crisis could be identified in the defects of national treasuries and central banks, or in the badly framed relationships between states and central banks that worsened the financial instability, as happened in 1907. Mutual lending, compensating credits and debts as well as having foreign reserves in gold and reciprocal current accounts to stabilise the exchange rates and wipe-off speculation, would favour growth. Lastly, introducing an ethical point, he affirmed that solidarity is also due to guilty actors.

Toutes les sociétés humaines liées par la loi de la solidarité sont obligées d’aider les faibles, *même coupables*, par égoïsme plus encore que par altruisme, parce que les effets des maux d’autrui, sous la forme de l’habitation malsaine, de l’ivrognerie, comme des crises financières ou autres, vont rayonnant sur les habitants des maisons salubres, sur les sobres, et sur l’épargne du peuple prévoyant (Luzzatti 1908/1922: 21).

He would re-propose this initiative on monetary peace in 1916 at the *Conférence Internationale du Commerce*. He would still insist on the need to develop some international clearing houses. He saw them as a mechanism for automatically reducing the opportunities for speculation by stabilising the exchange rates: the abstract laws of the market do not work in the short run, and speculation takes advantage of this fact. He insisted that small issuing banks teach us what should be done: federate to build an efficient system of

¹⁰ “Tutti i mercati economici e finanziari sono solidali nel bene e nel male. Più nel male che nel bene”.

payments. First, a system of international money transfer has to be constituted; then a clearing house for compensation between banks is to be set up; lastly, banks could cash in their foreign assets. He insisted that the example of the functioning of post offices is to be replicated on a larger scale.

Unfortunately, Luzzatti admitted that The Netherlands was the centre of speculation and Great Britain had little interest in modifying the international arrangement due to the positional advantage it had. Actually, in 1920, France and Great Britain also began to suffer from exchange rate instability, having lost their centrality. Luzzatti had much before that moment understood the instability that the deregulated system of the US would have brought to the European monetary system. He also understood that the new polycentric international arrangement would have led to a new run to gold, subtracting it from the mechanism of international adjustment. A compensating mechanism between countries gaining and losing monetary reserves due to the movements of capital was a necessary institution to be built (de Cecco 1995). Moreover, he also asked that countries give up monetary policies enacted with objectives of political and economic dominion¹¹. Therefore, in 1921, Luzzatti could have reaffirmed the need for restructuring the international trade and financial space, but he was too old to be an active promoter of the solution.

7. Luzzatti as a money doctor in times of uncertainty

In the aftermath of the unification (1861), Italy had to face a badly integrated and oddly structured financial system as well as some fragmented or lacking institutions. The financial position of the country was characterised by a double deficit in public and external balance. This caused several monetary and financial difficulties. In particular, monetary and banking institutions had to be step-wisely integrated and reorganised to support economic development in this new economic space. Luigi Luzzatti had been one of the main protagonists of this process of institution building. Besides his commitment to trade tariffs' negotiation and a variety of initiatives in industry and environmental protection, he dedicated a wide effort to monetary institutions.

Luzzatti was not a theorist of monetary economics, but he developed a competent view of how the economy works and principles of policy-making that united ethics and economic expertise. He knew what to do, applying the

¹¹ De Cecco (1995) argues that the same reasoning will be repropounded by Keynes at the end of the Second World War.

Baconian kind of contextual knowledge, starting from how things effectively work.

He was one of the main supporters of the “Latin Monetary Union,” which lasted from 1865 to 1928 (thanks to the indulgence of France). He also contributed to reforms that dealt with the problem of the plurality of emission banks and of their control. The management of the lira was quite problematic due to several strains due to both the bad integration of the economy and the underdevelopment of the banking system. Luzzatti acknowledged the subordinate position of Italy in the financial system and the helpful hand of France that assured continuous support to the new state. Therefore, he moved cautiously from this situation, trying to avoid shocks to the economy. His attitude was gradualism, in the sense that no radical move would help the stability of the lira, rather a gradual move out of the situation of a plurality of issuing banks and into a centralized system of control of the monetary supply. He particularly tried to help the development of credit by diversifying the banking system in a way that stimulated peripheral development as well as the stability of the whole system.

Luzzatti thought that the application of abstract liberal principles would have led the actual economy astray. His liberalism was practical, with a pro-business attitude, aware of the role that the correct institutional set-up plays in achieving viable market conditions. From trade treaties to banking reforms, he always conceived of viable reforms that could help to achieve a more resilient economy that could afford international competition. The international economy was always the reference point for his decisions, even when he was perfectly aware of the deficiencies of international financial institutions. In this regard, Luzzatti developed a view of the necessary direction of reforms of the international financial institutions that anticipated what effectively was, in part, achieved later. However, in his view, much emphasis was placed on a horizontal collaboration of central banks, made of reciprocal obligations of stabilization, that would become a central point also in the view of Keynes, and that still is partly unachieved. To Luzzatti, this project was without any doubt the result of his federalist beliefs.

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