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Does Economic Theory Matter in Shaping Banking Regulation? A Case-study of Italy (1861-1936)

Alfredo Gigliobianco and Claire Giordano

Abstract

We provide an assessment of the role of economic theory in orienting Italy's banking legislation over eight decades. From the unification of the country (1861) to the introduction of the 1936 Banking Act, five regulatory regimes are mapped out. Whilst market discipline and self-regulation arguments characterized the first sub-period (1861-1892), the first biting issuing-bank regulation, which inaugurated the second regime (1893-1906), was a political compromise that ignored economists' requests of a return to convertibility. The third sub-period (1907-1925) was punctuated by two banking crises: the first (1907) vindicated economists who had stressed the need of a LLR, but did not lead to any crisis-prevention regulation; the second (1921-23) confirmed – to no avail – the dangers congenital to bank-industry ties, pinpointed by some members of the profession. The following sub-period (1926-1930) was inaugurated by the first commercial bank regulation (1926) and responded to the economists' call for restricting bank competition. The 1936 regulation, which marked the onset of the approximately five-decade long fifth regime, matured in a vacuum of economic debate.

Financial crises were an important trigger in all the discussed regulatory episodes to which many players, amongst which economists, contributed with varying weights and roles according to the circumstances. Players' public and private motivations towards regulation were relevant drivers. The existing political regime is not found to have been a discriminating factor in determining the influence economic theory had on bank legislation. More important was instead the degree of authority and legitimacy that economists as a professional category displayed at the time of reforming the regulation. Finally, the desirability of economic theory actually percolating into banking laws is discussed, although the historical evidence on the matter is not clear-cut.

KEYWORDS: banking crises, banking regulation, economic theory, economists

JEL Classification Codes: B15, G28, N4

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TABLE OF CONTENTS

1. INTRODUCTION
  2. A “MIXED” REGIME BASED ON MARKET DISCIPLINE, SELF-REGULATION AND LITTLE
LEGISLATION, 1861-1892
  3. A REGIME OF STRICTER ISSUING-BANK REGULATION, 1893-1906
  4. CRISIS MANAGEMENT ISSUES AND GROWING CONSENSUS TOWARDS COMMERCIAL
BANK LEGISLATION, 1907-1925
  5. A NEW BUT BACKWARD-LOOKING REGULATORY REGIME, 1926-1930
  6. A LONG-LASTING REGULATORY REGIME WITH A TWO-FOLD AIM, 1931-1992
  7. CONCLUSIONS: REGULATION AND ECONOMIC THEORY IN ITALY, 1861-1936
- REFERENCES

1. Introduction

In this paper we assess the role of *economic theory* in shaping *banking legislation* focusing on a case-study, that of Italy from its political unification in 1861 to its 1936 Banking Act. In these eight decades, most of the country's banking legislation was introduced as a reaction to financial crises, largely banking crises, a hardly surprising fact since Italy's financial system of the time was dominated by banks, including banks of issue.¹

As is commonly accepted in the literature, banking regulation may be interpreted in the light of two competing theories: the *public interest approach* and the *private interest* (or *theory of economic regulation*) *approach*. In the first case, market failures and asymmetric information are assumed to affect the banking sector; official regulators are perceived to have the incentives and capability to correct them (e.g. Mishkin, 2001). Maximization of the social welfare function is thus attained via optimal banking regulation. Under the second framework, *public choice theory* depicts policy-makers as self-interested agents responding to political incentives, rather than as benevolent social planners (Stigler, 1971; Peltzman, 1976). In a more general framework, *political economy*, which stems from public choice, interprets regulation as a response to the demands of constituencies that pressure the government for particular policies to attain private economic gains or other goals (Pagano and Volpin, 2001; Haber and Perotti, 2008). Banking reforms are thus the product of protracted political struggles amongst different groups, acting according to their different economic interests. The combination of the latter determines the timing and content of regulation.² Besides explaining how pressure groups affect regulation, political economy also takes into account how in turn regulation shapes and entrenches political constituencies via its economic effects.

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¹ The role of economists in the law-making process has also been amply discussed in other fields other than finance (e.g. Carruthers, Babb and Halliday, 2001 on monetary policy and bankruptcy laws). The impact of financial crises on economic thought is another current topic of research: see for example Rockoff (2010), in which a careful reading of past financial crises is found to have affected Adam Smith and Milton Friedman's views on banking regulation. More in general, Dobry (1986) analyzed the definition of social groups and professions as a result of crisis episodes.

² To illustrate this point, crisis-prevention was not the only aim the Italian legislator desired to achieve, as competing interests emerged in each occasion of regulatory debate. In general, other objectives could be pursued (see Giordano, 2009 for a general framework of possible regulatory aims and tools in a historical perspective). For example, the restraint of competitive conditions in the banking sector in certain cases was seen as a means to reduce financial instability, but it was also largely favoured *per se* by incumbent banks as being a guarantee of higher rents. In some cases, regulation was designed to steer loans towards politically or socially attractive projects, sectors or firms, and, more in general, to attain a desired credit allocation.

Focusing on the role of economic theory does not automatically translate into the fact that we sponsor the public interest approach. In fact, we believe that the two approaches are complementary rather than mutually exclusive. From the public interest point of view, theory ought to be the essential tool in shaping policies. Normally, though, the latter do not reflect theory exactly. The distance between the implemented policies and what they would have been had the theory been heeded to the letter could be taken as an approximate measure of the effect of pressure groups (barring foolishness). However, this simple approach assumes that there is “one best way”, in theory, to deal with economic problems. This is clearly not the case, because in the first place not all economists agree on the same theory; in the second place, they may differ on the practical application of the same theory; in the third place, theory has little to say on the issue of revenue distribution which, instead, is relevant in designing policy of any kind.³ Besides, economists are not only the mouthpiece of theory, they are also anxious to affirm themselves (individually, rather than as a group) as competent healers of the social body, eventually as influential members of the ruling élite. Furthermore, the growing prestige of economics induces the players in the game to refer to the arguments and to the tools of the economic science in the act of fostering their interests. The development of economics therefore changes the landscape on which interest groups battle. Without entering into these theoretical disquisitions, while discussing the Italian case we will try to stress the advantages of an eclectic approach, in which both motivations, public and private, are at play.

No generally accepted definition of *economist* exists. In our story, economists are people with a professional training in economics, who exert their influence by actively using the characteristic tool-kit of the trade.⁴ According to Coats (1993, p. 403), in the United Kingdom, the second half of the XIXth century – marked by the marginalist revolution – was a watershed in the development of the modern economics profession. This was also true in Italy, with economic questions being set in the forefront of public discussions, the appearance of a demand for economic expertise from various sectors of society, the creation of university chairs and the gradual spreading of degree courses in

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³ On this point, an interesting Italian reference is the economist and later President of the Italian Republic Luigi Einaudi's work *Lezioni di politica sociale* (Einaudi, 1949), in which he anticipated in some way the contents of the two fundamental theorems of welfare economics (on the subject, see Baffigi, 2009, p. 28).

⁴ Our definition is compatible with the general definition of professions provided by Abbott (1988, p. 8): “exclusive occupational groups applying somewhat abstract knowledge to particular cases”. For concise biographies of the economists mentioned in this article see Gigliobianco and Giordano (2010).

economics, the launching of new journals and scholarly reviews devoted entirely to the subject, and the founding of professional economic associations.⁵

However, the significant issue here is not so much the professionalization of the category, but the presence of an audience in the public opinion.⁶ Economists can in fact shape beliefs if they gain an audience; to do so they need to be legitimated and acquire credibility as experts. The paper therefore also indirectly investigates in which periods the *authority of Italian economists* was firmly established in the public's mind and how the relevance of economists was maintained or altered over time.⁷ Economists' legitimacy could in fact vary over the years, which would help explain if and to what extent economic theory affected the designed banking regulation. Furthermore, if divisions amongst economic schools and doctrine were strong, or if economists were not aware of current developments in economic theory, this could undermine the profession's credibility.⁸

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⁵ More in general, Claeys *et al.* (1993) confirm the concurrence of these institutional developments in Europe, North America and Japan, although it is now accepted that institutionalization processes and disciplinary developments had distinguishing features in different countries. See Augello *et al.* (1988) for a specific discussion of the diffusion of political economy as an academic discipline in Italy, Kadish and Tribe (1993) and Middleton (1998) for similar works on the United Kingdom, LeVan-Lemesle (1986) on France, Sugiyama and Mizuta (1988) on Japan, Barber (1993) on the United States, and Waszek (1988) on Germany.

⁶ As Kadish (1993, p. 78) points out, referring to England: “[t]he story of the academic institutionalization of economics in England should not be confused with the more general issue of the development and dissemination of economic thought. Long before English universities came round to recognizing the claims of economics as an academic discipline, economic doctrines of one sort or another, and at various levels of theoretical sophistication, had become an integral part of popular perceptions of current reality”. Overall, a similar path was undertaken in Italy.

⁷ On the relevance of the legitimacy of professions, see Abbott (1988) which focuses on the dynamics and jurisdictional negotiations and conflicts through which professions over time define their vital space, or the exclusive right to capture and control the provision of specific work activities. See also Siegrist (1990) for a description of the dynamic and instable process of professionalization and Malatesta (2011) for a case-study of the development of the main European liberal professions.

⁸ For instance, in 1914 the US economists of the American Economic Association (AEA) did not set the war as a discussion topic in their forthcoming annual meeting. This blind spot was pointed out by the federal Government to which the AEA official Allyn Joung replied: “we economists [have] failed in securing the influence that we might have had largely because we have neglected to attempt to secure a concert of opinion among us on important questions...”; the solution, he believed, was to find “effective ways of bringing that opinion to a focus, and expressing it in a way to secure attention” (Bernstein, 1990, pp. 408-09). See also Coats (1964) on the role of authority in the development of British economics. Fourcade-Gourinchas (2001) has convincingly argued that domestic political structures and institutional arrangements (e.g. the transformation of higher education systems, political systems and economic systems) have in turn shaped economists' professional jurisdiction, the development of economic knowledge, and the

Italian economists were – depending on the circumstances and on their schools of thought – instigators or detractors of banking regulation. They played an especially important role in determining which issues became focal to the general public, in forging its perception of the problems to be solved and in supplying the intellectual tools by which the various issues could be handled. Besides, they contributed with other interest groups in demanding and shaping the institutional instruments to prevent banking crises. The channels via which economists could affect the design of banking legislation in the period under study were mainly two: *a)* intervention in Parliament, in Government or in technical bodies: we will call this the ‘*direct channel*’; and *b)* the writing of scientific or quasi-scientific publications on the topic: the ‘*indirect channel*’.

Italian economists in fact actively participated in economic institutions, were economic advisers and technocrats of the Governments in power, were leading figures in the debates concerning the national economic policies to be adopted and often became actual legislators or ministers (Augello and Guidi, 2003; Magnani, 2003).⁹ Therefore, economists’ proposals of credit policy and banking regulation directly influenced actual legislative outcomes (Barucci and Pavarin, 2008).¹⁰ A way to investigate this direct channel was to consult debates in Parliament, as well as publications by other political entities and institutions where economists were active.

However, when economists are wearing their politicians’ hat, they are not bound by the rules of their trade, but rather they are influenced by their political preferences. Given that when economic practitioners are also *politicians* it is difficult to decouple economic theory and political views, and hence to disentangle their separate influence on legislative outcomes, we prefer to focus on the much less studied, indirect, channel: that of economists affecting legislation via their writings. A more comprehensive analysis of the influence of economic theory on legislation requires in fact the study of sources (contemporary journals, economists’ monographs and publications, university handbooks) which shaped current beliefs on banking and regulation. From this perspective, we study how, and with which degree of cogency depending on circumstances, shifts in the paradigm of banking regulation were supported by the new developments in

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relationship between economists/economics and policy. See also, amongst many fine examples on the topic, Whitley, Wagner and Wittrock (1991), Wagner *et al.* (1991), Rueschemeyer and Skocpol (1996).

⁹ For example, in his speeches in Parliament, the economist, centre-right minister and later Prime Minister, Boselli, underlined the existence of important exceptions to the principle of economic freedom, which called for the intervention of the legislator. In his view, the definition of these exceptions was the economist in Parliament’s “mission” (Asso, 2003).

¹⁰ For the post-WWII period, see Coats (1981), which provides a comparative study on economists in the Governments of various countries, including Italy.

economic theory. It is important to underline that not only did economists contribute *ex ante*, with their writings, to the law-making process; their reactions *ex post* to enacted legislation also shaped the debate around the following legislation.

Another aspect to be considered is that economists are at the same time *citizens* and *scholars*. As citizens they cannot remain silent on matters which fall within their professional competence; but controversial economic questions usually possess important non-economic aspects and implications which the economists cannot master with sufficient competence and on which they have less right to influence public opinion.¹¹ Yet often economists take advantage of the credibility of their profession to express opinions and to tread in waters in which they should not be wading. To tackle this problem, we assumed economists were acting as scholars when writing articles in scientific journals, university handbooks and scholarly books. We therefore tended to focus on publications in relevant academic journals.¹² When referring to articles in newspapers, we were careful in drawing the relative conclusions on economic doctrine, since in this case economists could have been more likely acting as citizens and opinion-makers rather than as economists.

The analysis of how economists, with their economic ideas, theories and paradigms, influenced the design of new banking regulation in Italy via their publications ('indirect channel') is hence developed in this paper, although never setting aside the role of economists acting directly as legislators or holding key positions in the economy ('direct channel'). Moreover, the presence of other interest groups which exerted their influence on the regulatory outcomes is borne in mind throughout.

In order to better contextualise our historical narrative of the economic debate, we map out five distinct regulatory regimes under which Italy's banking sector operated, from the country's political unification in 1861 to its renowned

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¹¹ See for example Coats (1993, p. 95).

¹² The journals systematically analysed were, in alphabetical order: "Echi e Commenti," "Giornale degli Economisti," "Riforma Sociale," "Rivista Bancaria," "Rivista internazionale di Scienze Sociali" and "Rivista di Politica Economica." Note that until WWI, the journals that circulated were mainly two: "Giornale degli Economisti" and "Riforma Sociale". "Rivista internazionale di Scienze Sociali" was in fact interested in economic matters only sporadically; after 1933 it became more committed. The publication of "Giornale degli Economisti" was suspended in 1942 for political reasons; "Riforma Sociale" already in 1935. "Rivista delle società commerciali", inaugurated in 1911, changed its name in 1921 to "Rivista di politica economica". "Echi e Commenti" was a journal founded by the economist Loria in 1920 with the explicit aim to "collect and coordinate the news concerning our country, offering them directly to the public, together with comments" (Majolo Molinari, 1977, pp. 261-262). "Rivista Bancaria" was founded in 1920 by Mazzucchelli.

banking law of 1936: 1861-1892; 1893-1906; 1907-1925; 1926-1930; 1931-1980s. The sub-periods are graphically depicted in the following time-line (Figure 1), together with the indication of the main financial legislation passed and its main features relevant to our story.

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

Legend:

1865 – Code of Commerce: Enactment of company law; lack of specific regulation of commercial banks.

1874 – Minghetti Law: Number of banks of issue fixed at six; institution of a consortium of the six banks; setting of limits on the consortium's total note issuance and on that of each single bank.

1882 – Code of Commerce: Introduction of mandatory monthly balance sheet disclosure by commercial banks to the Trade Court.

1893 – Issuing-Bank Act: Number of banks of issue fixed at three; setting of limits on circulation and of metal reserve requirements; imposition of the same discount rate across banks of issue; introduction of norms on capital adequacy; list of permissible operations by banks of issue; approval of the issuing banks' chief officials by the Government.

1907 – Amendments to 1893 Act: Loosening of limits on banknote circulation.

1913 – Stock Market Law: Reversion to State, as opposed to regional or local, control over the Chambers of Commerce; outcry trading on the stock market reserved to stockbrokers; enactment of the "single capacity" principle by which stockbrokers could only act on behalf of their clients.

1926 – Bank Act: Mandatory authorization by the Ministry of Finance for the creation of a new commercial bank or branch, as well as for mergers and acquisitions; introduction of minimum capital and reserve requirements, as well as quantitative limits on credit extended to any individual client; enhanced information disclosure.

1931 – *Convenzioni*: Two secret deals between the Bank of Italy, the Ministry of Finances and the two commercial banks, Credito italiano and Banca commerciale italiana; restriction of the banks' activities to commercial bank operations in exchange for large liquidity injections from the Istituto di Liquidazioni.

1934 – *Convenzioni*: Three secret deals between the Bank of Italy, the Ministry of Finances and the three commercial banks, Credito italiano, Banca commerciale italiana and Banco di Roma; transfer of the banks' industrial assets to the Istituto per la Ricostruzione Industriale, which also took over the control of the banks; ban for banks to hold direct or indirect stakes in industrial firms.

1936 – Bank Act: Assignment of large discretionary power to the regulatory authority, the Inspectorate; ban of commercial banking activity for the Bank of Italy; segmentation of the banking sector into short-term and long-term liability institutions; reliance by short-term banks on the Inspectorate's authorization to purchase certain types of assets (i.e. industrial shares); limits on competition; enhancement of information disclosure to the Inspectorate and on-site examinations.

1947 – Amendments to 1936 Bank Act: Introduction of a functional separation between the direction of credit flows – assigned to a reorganised Committee of Ministers, CICR – and bank supervision – assigned to the Bank of Italy (the Inspectorate had been abolished in 1944).

The first sub-period was characterized by a heated discussion concerning the plurality or unification of note issuance after the creation of the Italian State: liberal economists were in favour of plurality, while Government representatives leaned towards unification. Furthermore, the former were sided against any form of issuing-bank regulation, whilst the latter were more willing to accept it in the case of unification. Market discipline (intended as the public's right to conversion of banknotes), coupled with self-regulation of the banks of issue, were by the former deemed as sufficient to attain overall financial stability. Yet some form of issuing-bank regulation was introduced, although laxly enforced, in 1874. The 1890s financial meltdown shifted the public opinion and led to the first truly biting issuing-bank regulation. However, convertibility, coveted by free market economists, fell into disrepair in favour of quantitative limits on note issuance. Although a backlash of the crisis also affected commercial banks, regulation of the latter was not backed by sufficient strength (in academia and politics alike) and hence was not introduced. The 1907 crisis crowned the Bank of Italy as the nation's lender of last resort and led to a loosening of the limits on circulation in order to enhance the main bank of issue's crisis-management abilities. The economic debate began moving towards the possibility of regulating ordinary banks, and was heightened by the 1920s crisis which underlined the dangers congenital in the procyclicality of the then dominating "mixed banks", as well as the problems tied to an "excessive" competition in the banking sector. The fourth regime was inaugurated by the 1926 Banking Act, an organic and comprehensive

regulation for all deposit-taking institutions, which mainly curbed competition in the banking sector, a desirable outcome according to most economists. However, the law was modelled on mixed banks as they were before WWI, i.e. as banks which lent long-term to industry, and not as holding companies of industrial firms, which they had turned into; furthermore, it was only loosely implemented. The 1930s banking crisis soon followed, leading to the long-lasting and pervasive 1936 Banking Act. The latter not only segmented the banking sector into two sectors (short-term and long-term liability financial institutions), and clearly detached it from the industrial sector, but it also significantly affected bank competition, capital requirements, information disclosure and corporate governance. The role of economists in defining this new law, a product of the Institution for Industrial Reconstruction (IRI) brain trust, was virtually nil, as was their reaction to the law itself. This regime lasted until the 1980s, when a wave of liberalizations began and culminated in the new Banking Act of 1993.

Each of the following five Sections focuses on a regulatory regime: the specific crisis episode, the contemporary economic thought concerning banking regulation, its impact, if any, on the novel banking laws, the economists' reactions to the new legislation. A discussion and conclusions on the link between economic theory and banking regulation in the period 1861-1930s are drawn up in Section 7.

2. A “mixed” regime based on market discipline, self-regulation and little legislation, 1861-1892

When, in 1861, the political unification of Italy was attained, economic and financial integration were still far-off objectives. The monetary confusion was solved by the Pepoli Law¹³ in 1862 with the adoption of a sole currency, the Piedmontese *lira*, which supplanted the numerous currencies of the other pre-unification States. A bimetallic standard was adopted.¹⁴

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¹³ Law 24 August 1862, No. 788.

¹⁴ The authors of the Pepoli reform had actually expressed a preference for a monometallic regime, but soon realised how bimetallism would favour relations with Italy's main trading partners, such as France, Switzerland and Belgium (Pepoli law proposal of 9 June 1862 in de Cecco 1990, pp. 78-79). The debate between economists over monometallism and bimetallism continued for over three decades (Pavanelli 1995). Supporters of the former were, among others, Boccardo, C.F. Ferraris and Pareto, whilst advocates of the latter were Rossi, Magliani, Luzzatti and, to some extent, even Einaudi. Notable exceptions were the highly liberal Ferrara and Martello, who were against any sort of Government intervention in monetary matters and, thus, refused the fixing of any monetary standard by law, be it gold or silver or both (Roccas, 1990). In 1865 France,

The Pepoli Law made no reference to the issuance or circulation of banknotes. Banks of issue were hence regulated by their charters, by their founding laws and by a Piedmontese law of 1849 (transplanted into the Italian law system), according to which banks were allowed to issue notes only if authorized by an *ad hoc* law. Whereas six issuing banks continued to exist (most of the pre-1861 banks survived the political unification), a forceful debate concerning unification *vs.* plurality of banks of issue opened up amongst politicians and economists, the latter largely *laissez-faire*-oriented, in the vein of Bastiat and Say. Plurality was buttressed on anti-monopolistic grounds. The model followed by the liberal economists, such as the prominent Ferrara or the promising young Rota, was the Scottish one of free banking,¹⁵ opposed to the French one based on the monolithic Banque de France, supported by few economists such as Boccardo.¹⁶ Instead, it was mainly the Government who championed unification (Polsi, 1993, p. 47), in order to achieve a more effective monetary management, based on a single discount rate, and to enhance efficiency in the payments system.¹⁷ Also, the existence of a solid institution which could act as a guarantee for the State, for example in obtaining international loans, was considered a desirable feature in public finance. Free banking, if largely supported by Italian economists, was not

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Belgium, Switzerland and Italy then created the Latin Monetary Union; bimetallism was confirmed in the member countries at a gold/silver ratio of 1:15,5. Refer to Barbiellini Amidei, Giordano and Luci (2011) for a chronology of Italian monetary events in the period under study.

¹⁵ Ferrara (1873) refuted the opinion that free banking necessarily led to excessive note issuance, given convertibility, by appealing to the experience in other countries, such as “the prosperous Scotland, before Peel”. Furthermore, he underlined the positive real effects of an orderly free banking system: poor in natural endowments, Scotland, “in which mankind, at the beginning of the XVIII century, designed the best or the least flawed, banking system in Europe”, “only for this reason, doubled its trade in less than twenty years”. When listing the reasons in favour of free banking, Rota (1885, p. 266) recalled how in Scotland all social classes had gained access to banks thanks to their widespread presence. Furthermore, the banks themselves had studied new types of transactions to better satisfy the needs of such a heterogeneous public, in turn increasing the efficiency of the banking sector. The Scottish case-study was therefore praised by all Italian free bankers who, in this sense, were very much influenced by Coquelin’s works on the subject, as noted also by Realfonzo and Ricci (1995).

¹⁶ Boccardo, for instance, had pointed to Banca Nazionale as a natural candidate to become the “bank of banks” in 1863, due to the crucial role it had played in Italy’s history (Barucci and Pavarin, 2008, p. 63).

¹⁷ Noteworthy are the two law proposals put forward by the Minister of Finance Sella and the Minister of Agriculture, Industry and Commerce Torelli in 1865 concerning the merger of Banca Nazionale and Banca Nazionale Toscana, and the resulting creation of a ‘Banca d’Italia’. However, both proposals were blocked at the Chamber of Deputies, given the prevalence therein of a free-banking orientation. Even Banca Nazionale was not in favour of the law proposals of unification if this implied the proposed Government nomination of its directors (Onado, 2003, p. 389).

conceived as a feasible possibility by politicians, who did not find in it any practical reward (Cardarelli 2007).

Hence, the political dispute was mainly on who would benefit from a non-competitive setting: the Government favoured monopoly on State-building grounds, whereas the powerful regional groups favoured oligopoly so as to retain handsome seignorage profits as well as some measure of control over credit allocation. The fragility of the new-born State did not allow the central Government to swiftly defeat the powerful regional groups, each supporting the persistence and expansion of the banks of issue operating in the former States.

In 1866, Italy suffered its first financial crisis, a “twin” banking and currency crisis (Conti and Scatamacchia, 2009). Banca Nazionale, the main bank of issue, was required to provide the Treasury with a consistent loan in order to finance Italy’s Third War of Independence. In return, and to stave off a more widespread crisis, convertibility of its banknotes was suspended by law.¹⁸ Reactions by contemporary economists were not unanimous. Even some convinced “pro-convertibility” economists, such as Ferrara, recognized the emergency of the situation and the urgency of such a law (Faucci 2003).¹⁹ Others, such as Torrigiani, were against the measure, in that the latter credited Banca Nazionale with a privilege in note issuance, whereas the actual factors that had led to the abandonment of convertibility, *i.e.* the critical situation of Italy’s public finances, the imbalances between reserves and note circulation, the lack of competition amongst banks of issue, had been left untackled (Augello, 2003). The year 1866 thus saw the beginning of intense Parliamentary and extra-Parliamentary debates concerning Government intervention in the banking sector.

In the same year, a supervisory body over all joint-stock companies (*Sindacato di controllo delle società anonime*) was created within the Ministry of Finance and later transferred to the Ministry of Agriculture, Industry and Commerce (from now on MAIC). Its mission was to oversee firms’ compliance to the law and to their charters, with particular attention to credit institutions, yet it could not interfere with the firms’ actual management and governance. It was suppressed, however, already in 1869, with the justification that it had completely wiped out any form of market discipline by creating a dangerous and

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¹⁸ Royal Decree of 1 May 1866, No. 2873.

¹⁹ However Ferrara argued that the same aim could have been attained by the Government issuing notes, without involving Banca Nazionale. He thus believed that the legislative decree was a form of Government bail-out, which the bank might not have actually needed (Barucci and Pavarin, 2008, pp. 57-58).

unconditional reliance on the effectiveness of Government control, thus underlining the widespread hostility towards regulation in any field.²⁰

Free banking advocates had a major role in this battle, since they were not only in favour of free entry in the market, but also sided against any other form of banking regulation. They emphasized the analogies between the two main banking liabilities: note issuance and deposit receipt. A note-holder demanding conversion was akin to a depositor withdrawing his savings. Thus, since commercial banks were not regulated, banks of issue were to be similarly unfettered. Regulation by the market and self-regulation, for both issuing and commercial banks, were deemed sufficient to induce their orderly conduct. An axiom advanced was that: "For a Bank never to convert, it must always be ready to convert" (Rota, 1885, p. 67).²¹ Different forms of self-regulation – or, in more modern terms, of best-practices – were summarized by Rota: *a*) by appraising the nature of their liabilities, banks could select their assets appropriately, in order to foil maturity mismatches; *b*) when fixing the maturity of their credits, banks were to analyse the market or industry they supplied; *c*) banks were to build up voluntary reserves; *d*) banks could fine-tune their discount and interest rates according to market conditions. These measures applied to issuing and commercial banks alike. In particular, the amount of its reserves could not be determined *a priori* by a bank's charter – a practice defined as "absurd" (Rota, 1885, p. 127) –, let alone by a law, but they were to be decided according to the bank's own experience. Hence, reserves could vary from bank to bank and according to the concurrent economic circumstances.²² Similarly, the imposition

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²⁰ Scialoja, the Finance minister who had declared the suspension of convertibility in 1866, but also economist and mentor of Luzzatti, in fact stated: "I too believe that, in general, Government supervision on its own is powerless to avoid mismanagement of firms and hence is [...] dangerous for private interests, because it leads them to believe they are protected when actually they are not [...]" (Report to His Majesty on 5 September 1869 by MAIC, cited in Da Pozzo and Felloni, 1964, p. 58). This was a similar argument to that of the already cited Rota (1885).

²¹ It is noteworthy that such an axiom was still pronounced in the 1930s, for example by Garrone (see Strumbolo, 1938, p. 52).

²² In particular, with respect to banks of issue, C. Supino (1895), a marginalist economist who however was influenced by the German Historical School, excluded the 100 per cent backing of banknotes by metal reserves as a means of ensuring convertibility, in that this would have eliminated any form of seigniorage profit, and hence could have led to the disappearance of this type of bank if not otherwise subsidised or remunerated. The opposite solution, i.e. the total absence of reserves, would instead make conversion impossible. He thus stated that a fraction of the notes issued, varying according to the economic circumstances and to the banks' past experience, was to be backed by metal reserves, whereas the remaining part was to be invested in short-term self-liquidating loans. In this way, in the case of an exceptional demand for conversion, banks could respond first of all with their reserves and then, secondly, by reducing their credit supply, hence using the resources that were to gradually return to them (C. Supino, 1895, p. 118).

of fixed interest or discount rates would mean “depriving banks of a defensive weapon” (Rota, 1885, p. 128). “The Government (...) cannot interfere with *note issuance*, because it does not know if the banknotes will *circulate*: there will be an issue if the public wants it, there will not be one if the public prefers metal to paper” (Ferrara, 1873, p. 372; italics in original). Another form of self-regulation envisaged was the charter of joint-stock banks which, by regulating their permitted undertakings, was one means of limiting the banks’ risk-taking activity. These prescriptions intended to protect the shareholders from mismanagement, but could be indirectly beneficial for other stakeholders too. A final argument advanced by free bankers was the presumed trade-off between regulation and market discipline. In absence of regulation, in fact, banks had to gain the public’s trust by proving their orderly and prudent conduct; in the presence of laws, they only had to display a formally law-abiding attitude, thus stripping the public of its “censorship role” (Rota, 1885, p. 272).

The Italian post-unification economic debate, as we shall see, also partially shadowed the previous British one, with bullionists set against anti-bullionists and then with the adherents to the currency school set against those of the banking school, albeit with a temporal lag.²³ The Italian debate concerning convertibility was, however, less clear-cut; in fact, the monopoly vs. plurality of note issuance controversy had a more relevant political importance in Italy in this sub-period – owing, in particular, to the previously mentioned strong regional forces – and prevailed over theoretical disquisitions.²⁴ It is useful to bear in mind that in the last quarter of the XIXth century two opposed schools of economists can be tracked in Italy (some vestiges of the divide survived in the first decades of the following century): marginalists and *lombardo veneti*. The former were squarely in the European marginalist tradition, with strong and original thinking especially in the field of public finance. It considered the goal of political economy to seek for and uncover abstract laws and broad generalizations for economic behaviour that would be independent from the larger historical context. Ferrara was the fore-runner of this school. The latter were heavily influenced by the Socialism of the Chair and, in some respects, also by the German Historical School, whose main *tenet* was instead that economic laws were not absolute, but historically conditioned; hence the importance of the State in bringing about the

²³ Fetter (1965) provides an in-depth analysis of the British monetary debate.

²⁴ White (1984, p. 52) notes how even in Great Britain the monopoly vs. free banking question was much discussed, yet most historians of monetary thought, in developing recounts of the debates of the era, slighted this literature. White thus “undertakes to reinterpret the British currency debates in terms of the free banking question by bringing the neglected literature to light” and concludes that “free banking versus central banking was indeed the focal point of the monetary policy debates between 1820 and 1845” in Great Britain. So again, if we accept White’s reading, the Italian debate shadowed the British one, albeit with a lag of approximately three decades.

kind of social and economic development envisaged by the nation's leaders. Among them, Luzzatti, Lampertico and Messedaglia were well known, and favoured substantive State intervention in many fields.²⁵ The grand battle between the two schools was engaged over protectionism, especially starting from 1885; banking was another field of heated debate. As Faucci (1994) points out, a common feature of both traditions in Italy was the constant attention they paid to the political, ideological and practical application of economic theory. Rather surprisingly, the *lombardo veneti* were politically more right-wing than their opponents: State-building was in fact the core business of the rather conservative right, while the political left was more responsive to those groups which had been left aside by the compelling necessities of unification.

In 1873, Italy shared in what has been defined as the first significant “international crisis” (Kindleberger, 1989, p. 146). Notwithstanding the drop in stock prices of around 30 per cent (Carriero, Ciocca and Marcucci, 2003), 1873 was still a year of economic growth for Italy as its stock markets were too limited to affect industrial production. The crisis mainly hit private bankers, savings and cooperative banks.

A year later, in 1874, the Minghetti Law²⁶ was passed in order to end the “anarchy” in note circulation, due to the existence of three conflicting tenders: legal tender *vs.* illegal tender banknotes injected into the system by private agents and, within the legal tender class, non-convertible banknotes issued by the Banca Nazionale *vs.* convertible banknotes issued by the other issuing banks.²⁷ A related aim was to create a level playing-field for all issuing banks. This law was not spurred on by the 1873 crisis which did not in fact affect the banks of issue and it was not conceived as a future crisis-prevention measure. The call for a rationalization of note circulation was, rather, a consequence of Italy's political unification and nation-building process, and of the subsequent need for monetary integration.²⁸

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²⁵ In Germany, in fact, “economics did not develop as a science for studying and explaining economic fluctuations, but as the science of how the state could influence economic fluctuations” (Hennings, 1993, translated and cited in Fourcade-Gourinchas, 2001, pp. 405-406).

²⁶ Law 30 April 1874, No. 1974.

²⁷ In particular, the banknotes of the other issuing banks were convertible at their discretion in either gold or in Banca Nazionale banknotes (Art. 4, Royal Decree of 1 May 1866, No. 2873). It is clear, therefore, that Banca Nazionale was favoured relative to the other issuing banks: if they did not redeem their banknotes in gold, they contributed to the increase in the circulation of their major competitor's notes.

²⁸ It is noteworthy on this point that already in 1870, before the outbreak of the crisis, an important, and similar, law proposal concerning note issuance and circulation had already been made, the Sella-Castagnola law proposal (see Galanti, 2008, p. 17). If it is true that it was not the 1873 crisis that led to the first issuing-bank regulation, the crisis instead triggered the introduction of the 1882 Code of Commerce, which supplanted the previous 1865 Code. In fact, the systematic

With this piece of legislation, the number of banks of issue was blocked at six. The six banks formed a consortium and limits were set on its total note issuance, as well as on the circulation of each single bank. Professional economists were not involved in the preparation of the law.²⁹ Some *lombardo veneti* economists were in favour of it (e.g. Luzzatti), whereas marginalist economists strongly opposed it. The liberal Ferrara, among others, interpreted the creation of the consortium as a limitation of the freedom of credit, with negative consequences for the economy. He accused the minister Minghetti of mimicking the British Peel Act of 1844, which had imposed monopoly of issuance,³⁰ and maintained that the law would lead to an oligarchy of banks, as well as to the extension of the Piedmont system (*i.e.* the Banca Nazionale's charter and the afore-mentioned 1850 law) to all Italy, thus expunging the more successful Tuscan model of financial development with no State intervention.³¹ C. F. Ferraris defined the Minghetti law as a contradiction in terms: "it is a monopolistic system because no new bank of issue can arise, but there are six banks of issue; it is a pluralistic system due to the existence of six banks of issue, yet no new ones can be created and they do not have the same nature nor economic power" (C.F. Ferraris, 1892, p. 197).³² Finally, it was asserted that the law was not a product of a decreeing Government or of a legislating Parliament. The political

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violations of the existing financial market rules, mainly by traders of the Genoa stock exchange, were considered as the main cause of the 1873 crisis (Riva, 2007). Bad regulation was considered as more damaging than no regulation at all, hence de-regulation of the stock markets was conceived as an advisable move. The stock markets were thereon disciplined by their local Chambers of Commerce, under the guidance of MAIC, whereas national rules were reduced in number. Furthermore, free entry in the stock exchange was introduced, eliminating *ex ante* controls. Baia Curioni (1995) provides a lucid description of the evolution of stock market regulation in the period under study. The 1882 Code of Commerce did, however, include one piece of legislation which concerned commercial banks, yet, as we shall see, it simply replaced an existing royal decree.

²⁹ Minghetti was not, in fact, an economist as we have defined this category. Gherardi (2003, p. 33) underlines how Minghetti revealed to be profoundly flattered when called "an economist" by his fellow MPs, since he was not, in truth, a member of this profession.

³⁰ For those not familiar with the 1844 Peel Act, the law also established two separate departments within the Bank of England. The Issuing Department could issue notes up to the amount which was backed by Government securities in the Bank's portfolio; any additional note issuance had to be backed by gold. Instead, the Banking Department undertook the normal operations of deposit-taking and lending, in competition with ordinary commercial banks.

³¹ Martello, follower of Ferrara, also strongly criticised the Minghetti Law, by defining it "worse than the evils it was supposed to amend" (Martello, 1877).

³² It is noteworthy that the word "oligopoly" was never mentioned. Cournot (1838) and Bertrand (1883)'s models were, in fact, only just beginning to circulate in academic circles. They did, however, receive attention in the following decades in Pareto's handbooks of economics (Pareto, 1897; 1906). Stackelberg's model was instead introduced much later, in 1934 (Stackelberg, 1934).

institutions, in fact, had simply endorsed and legalised what the issuing banks had campaigned for (C. Supino, 1895, p. 133): “regulatory capture” in today’s jargon.

Notwithstanding the harsh opposition of the most prominent economists, banks of issue were thus, in principle, systematically regulated for the first time in 1874. The Act was, however, not considered as a definitive solution to the note circulation issue.³³ Violations of the limits set on note issuance were the norm in the years to come. The law, by fixing absolute and rigid limits, did not concede the issuing banks the flexibility they needed in troubled times. Furthermore, the banks of issue, private in nature and aiming at profit-maximization, were continually biased towards increasing their note issuance. The law was punctuated by escape clauses and exceptions which the banks exploited, turning them into common practice. The political willingness to truly enforce the issuing bank regulation was still lacking; as a result, the Minghetti Law was not biting.³⁴

Apart from the rules on issuing banks, what other types of banking regulation existed at the time? After the dismantling of the previously mentioned *Sindacato*, from 1870 commercial banks were required by a royal decree to send monthly balance sheets to MAIC which were then published. The decree was then replaced in 1882 by Article 177 of the Code of Commerce which imposed monthly balance sheet disclosure to the Trade Court (*Tribunale di commercio*). This was the only prescription by which the ordinary law differentiated banks from all other firms.³⁵ The actual publication of the balance sheets by the Trade Court, owing to organisational difficulties, was lagged, however, by over one year. As a result, its market discipline function was greatly weakened.

With respect to specialised banks, a law regulating savings banks (*casse di risparmio*) and pawn banks (*monti di pietà*) was introduced in 1888, therefore abstracting them from the provisions of ordinary law and from those concerning charity institutions.³⁶ This was actually the first regulatory law concerning non-issuing credit institutions. The rationale of this “special” regulation was approved

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³³ This results from an official report which preceded the law proposal in Parliament (cited in C. Supino 1895, p. 51).

³⁴ Just to give an example, according to the 1874 law, excess circulation relative to the legal limits were to be sanctioned with a fine equal to the excess issued. But since the over-issuance of the main banks was huge (hundreds of million lire), this meant obliging them to pay up enormous amounts, which was not feasible: “according to this reasoning, the banks had to commit severe abuses to remain unpunished!” (C. Supino, 1895, p. 134).

³⁵ The reason credit institutions had greater information disclosure requirements relative to ordinary firms was the fact that their performance was believed to be subject to more frequent and larger fluctuations. Furthermore, it was necessary to periodically monitor the health of the money market as the latter affected production and national wealth (Report by MAIC in preparation for the 1882 Code, cited in Costi, 2007).

³⁶ Both categories had in fact been created as charity, rather than credit, institutions. In due time, however, they began to operate more like banks.

of by economists. These banks were in fact aimed at collecting the meagre savings of the needy, lower classes, whose members were not able to gauge the soundness of these institutions; hence the State had to intervene directly in this field.³⁷ So if the Minghetti Law was passed in order to discipline and reorganise monetary circulation in the newly unified State, the 1888 savings banks law was introduced as a reaction to an innovative financial business model which was developing countrywide.

In 1876 a left-wing Government came to power in Italy and was in favour of reintroducing convertibility, suspended since 1866. A law was passed in 1881, mandating the resumption two years later: in 1883 Italy was formally on the gold standard. A widespread belief among the disciples of the currency school was that monetary stability and financial stability were intimately tied under this regime (Borio and Toniolo, 2006). Monetary stability under the gold standard was the preservation of convertibility of currency into gold. Financial stability, on the other hand, implied the assurance that individual financial institutions could always mobilise gold, or assets convertible into gold, to redeem their liabilities (*i.e.* banknotes, deposits) at par. Hence, convertibility to gold constituted a “brake” (C. Supino 1895, p. 124) on credit expansion and a deterrent to financial imprudence. The issue of convertibility of banknotes into gold continued to be heatedly debated.³⁸ Currency school advocates argued that convertibility was the pivot of an orderly functioning of the money and credit market. Inconvertibility was, in fact, to be interpreted as banks of issue reneging on their debt obligations towards note-holders (de Viti de Marco *et al.*, 1893). Once convertibility was guaranteed, instead, no other form of regulation was deemed necessary, provided that private individuals were “financially alert”. In fact, “given convertibility, the fiduciary circulation follows the same laws as the metal circulation, hence there is no need for the Government to intervene” (C. Supino, 1895, p. 120), neither in limiting note issuance nor in altering the discount rate.³⁹ On the other hand, banking school supporters, who largely coincided with the *lombardo veneti* economists, argued that financial crises could develop even under a regime of convertibility (Messedaglia, 1876),⁴⁰ but never went far enough as to propose

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³⁷ We will later come back to the economists’ debate on the different regulatory needs of savings banks vs. commercial banks (see e.g. Einaudi, 1913).

³⁸ See for example “Giornale degli Economisti” of those years, known for the neoclassical views of its three main contributors, Pareto, Pantaleoni and Barone. Another source is Rota (1885), in which the author underlined the importance of a “good monetary system” (*i.e.* the gold standard regime), which, by limiting the fluctuations in the value of money and thus by minimizing risk and uncertainty, injected confidence into the system and revived credit (Rota, 1885, pp. 5-7).

³⁹ See also the liberal economist Majorana Calatabiano on the subject, cited in La Bruna (2003, p. 151).

⁴⁰ Messedaglia was a leader of the *lombardo veneta* school.

regulation on non-issuing banks. Banks of issue were in fact considered as the only stabilizing/destabilizing player in the financial system, and hence potentially needy of regulation.

To sum up, the philosophy amongst economists toward bank regulation and supervision during Italy's first regulatory regime predominantly coincided with an anti-regulation stance. Convertibility to gold, market discipline (intended as the public's right to conversion) and self-regulation of banks (via charters, orderly conduct, voluntary reserves) were deemed necessary and sufficient for a sound financial system. The introduction of regulation would have necessarily crowded out market discipline and thus eliminated an effective tool of crisis-prevention. Economists also supported a plurality of banks of issue. In Parliament the main debate concerned the opportunity of having one or more issuing banks, yet political interests overrode economic arguments on the matter in the first three decades after Italy's unification. Economists were heeded only when they advocated legislative arrangements (such as the absence of prudential regulation) which, being favoured by other interest groups, did not need the economists' support to be introduced.⁴¹

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

The resumption of convertibility in 1883, backed by an international loan, increased bank reserves and kindled a large credit expansion, based on real estate security. The overheating of the economy resulted in a *de facto* suspension of convertibility already in 1887. In that year, the real estate bubble began to deflate and a number of banks which had extended generous credit to the building sector ran into serious difficulties. Some of them failed, after an ill-conceived and unsuccessful bail-out attempt by Banca Nazionale.

Meanwhile, the public debate concerning the banks of issue became intense. It was inflamed by the awareness that the banks of issue had not remained aloof from the real estate bubble and had issued well over the limits set by the

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⁴¹ Noteworthy is the complaint of C. Supino who in 1895 wrote that "the [banking] principles by him expressed [cited in this Section] are all inferred from economic theory (...); it is not economists' fault if in Italy banks and legislators have acted in opposition to any scientific criterion and to any banking principle" (C. Supino, 1895, p. 123); "when examining the Italian banking policy and legislation, we find strange anomalies and strong contradictions relative to scientific teachings" (p. 128).

1874 law.⁴² The quality of their assets was also uncertain, especially since some of these banks, either because of business relations or in response to Government pressures, had largely financed the construction firms or the banks involved in the bubble, even after real estate prices had started to decline.⁴³ A scandal erupted at the end of 1892, when two left-wing MPs, Colajanni and Gavazzi, read out an official report concerning Banca Romana, one of the six banks of issue, in Parliament. The document had been written by two State examiners, Alvisi and Biagini, in 1889, had been kept secret by the Government and had later been provided to the MPs by Pantaleoni and the other “*Giornale degli Economisti*” directors.⁴⁴ It revealed not only huge bank losses, but also the illegal note issuance the bank had undertaken to remain afloat. The scandal stirred up a hornets’ nest: it prompted a new examination of all six banks of issue and speeded up the legislative process towards a new law.

The main priority was, however, to rapidly solve the thorny problem of Banca Romana, as well as to cover up the scandal which had even involved the Prime Minister Giolitti, rather than to design a new national banking system.⁴⁵ Regional interests were still strong, hence the fight for plurality of note issuance ensued. Some, among which Sonnino (soon to become Finance Minister), were in favour of the creation of a new bank, but in fact the newly established Bank of Italy was the result of a merger of three existing banks of issue (Banca Nazionale and the two Tuscan banks). The Bank of Italy was mandated to liquidate Banca Romana by acquiring its assets and liabilities. In return, it obtained the privilege of note issuance for twenty years, a reduction in circulation tax and legal tender for its banknotes for fifteen years. In this way, Banca Romana’s losses were swept

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⁴² In 1893 the economist M. Ferraris in Parliament rhetorically asked and then answered: “Where does the current state of disorder in note circulation come from? It derives from the fact that, since 30 April 1885, date in which Banca Nazionale for the first time violated the 1874 law, in 1890 we got to 260 million [lire] of illegal circulation” (M. Ferraris, 24 June 1893, cited in Giaconi 2002, p. 119). The crisis therefore rapidly outdated a point of view expressed in Rota (1885), who stated that only long-term credit institutions fed speculation and hence were to be regulated, contrarily to banks of issue and deposit-taking banks.

⁴³ It is noteworthy that in the first half of 1887 C.F. Ferraris spoke out in Parliament against the excessive note issuance which fed speculation (C. Supino 1895, p. 94), yet the Government not only did not force the banks of issue back to legality, but actually further encouraged note issuance in order to support the ailing credit institutions.

⁴⁴ Before his death, Alvisi had in fact given a copy of his report to his economist friend Wollemborg, who then passed it on to Pantaleoni.

⁴⁵ Again, we cite C. Supino: “With scientific criteria excluded or badly applied, the projects of banking reorganization [after the Minghetti Law] tended only to please and to appease the opposite interests at stake; hence one must not be surprised by their hecatomb (...); the Giolitti proposal became the 10 August 1893 law only because of the circumstances in Parliament, of the Banca Romana catastrophe and the urgency to patch things up” (C. Supino 1895, p. 131).

under the carpet as they were covered by Bank of Italy's seigniorage profits. The resulting legislation thus turned out to be a political and economic compromise, which left little room for economic doctrine.

Giaconi (2002, p. 106), in her analysis of the role of economists in contributing to the new regulation, confirms that there was "a failure of economists in Parliament" in designing the reformed banking system, in that they were "unable to exploit their role in order to disseminate in the chamber a heritage of ideas and experience which could have better qualified the letter of the law".⁴⁶ The economists present in Parliament at the time were Boselli, M. Ferraris, Luzzatti in the Chamber of Deputies, and Boccardo and Lampertico in the Senate.⁴⁷ The meetings held were very few – the new issuing bank law was passed in barely six months – and the political interests of the Prime Minister played a major role in the final outcome. Luzzatti and M. Ferraris complained that the Parliamentary Commission set up to design the new legislation was not mentally prepared to engage in its institutional mandate because it had been created for political reasons and to ratify decisions taken elsewhere.⁴⁸ Moralism and indignation against the fraudulent behaviour of the Government were the *leitmotiv* of the Parliamentary debate.⁴⁹ The economists were painfully aware of the irrelevance of their theoretical reasoning in the debate – Luzzatti refers to the use of economic theory in that context as "a political suicide" (Luzzatti, 3 July 1893, reported in Giaconi 2002, p. 118) –, given the powerful interests involved, so they set their economic theorems aside.⁵⁰ At the same time, economists realised the drama their country was experiencing – the lira was falling rapidly on the market – and accepted the proposed legislative solution as a result of the contingent situation. Boccardo adopted the principle of "better a bad law than no law" and hence made very little opposition to the proposed bill. Boselli, as President of the Commission in the lower Chamber, acted as a moderator and did

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⁴⁶ Parliamentary acts and documents are published in Negri (1989) and De Mattia (1990).

⁴⁷ Luzzatti and Lampertico were important scholars of the *lombardo veneta* school. M. Ferraris was instead a supporter of free banking in a similar vein to Ferrara, although he acknowledged the need for some sort of regulation in the banking sector (Ferraris, 1888).

⁴⁸ Luzzatti, in particular, called for a universal referendum in order to "interrogate the national conscience (...) openly and strongly, as do the English, concerning the definitive overhaul of note issuance" (Luzzatti, 27 June 1893, cited in Giaconi, 2002, p. 117), a request which was ignored.

⁴⁹ "Morality must enter [...] into the design of the [new] legislation" (Remark by Colajanni in Parliament, 2 July 1893, reported in Giaconi, 2002, p. 115).

⁵⁰ Interestingly, Colajanni was the only politician present to cite economists' thoughts. In particular, he read out in Parliament excerpts from Walter Bagehot's *Lombard Street* (Colajanni in Parliament, 4 July 1893, reported in Giaconi 2002, p. 115).

not intervene, if not sporadically and insignificantly.⁵¹ Lampertico (4 August 1893, cited in Giaconi, 2002, p. 122) summed up the situation by asserting:

Senator Barsanti, with elegant language, states that this law cannot boast to be a theoretical law; I, with cruder language, state that this law expresses our painful needs, and our painful impossibilities. Painful needs, because it was no longer possible to continue the status of things created by disgraceful actions of one of our issuing banks; painful impossibilities, because a law ordered logically around certain theoretical principles was decidedly impossible.

The new law was thus enacted on 10 August 1893. In the wake of the crisis fuelled by overlending, two issues had come to the forefront (Gigliobianco, Giordano and Toniolo, 2009): a macro issue – an excess of money circulation – and a micro one with systemic implications – the soundness of the individual banks of issue. The number of banks of issue was halved from six to three, as a result of the aforementioned merger. The macro issue was also addressed by imposing limits on circulation and metal reserve requirements. Moreover, convertibility was reaffirmed in principle, but the decree which should have set the legal framework for its application was never brought about. Limits on note circulation seem, hence, to have displaced the issue of convertibility. “Attention is transferred from the final objectives [*i.e.* convertibility] to the minute description of the characteristics of a process of currency creation which is compatible with a monetary rehabilitation” (Bonelli and Cerrito, 2003, p. 153). This was probably due to various reasons. The recent resumption of convertibility in 1883 had been followed by the credit expansion of issuing banks in that decade and to the subsequent collapse of the banking sector, a lesson too recent and harsh to be forgotten so soon. Furthermore, Italy’s political class was at the time strongly concerned with the country’s economic development: hence the decision “to not sacrifice growth prospects on the altar of the gold standard” (Bonelli and Cerrito, 2003, p. 153) by imposing the required abrupt deflation, until Italy’s economic outlook had improved. The remaining regulation was crafted to tackle the micro issue. The three banks of issue were placed, in fact, under tight Government control: the discount rate could not be changed without the Government’s assent and was to be the same for all three banks; norms on capital adequacy were introduced; the operations banks of issue were allowed to undertake were precisely listed in the law; the chief officials had to be approved by the Government; the supervisory apparatus was reinforced.

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⁵¹ See Vitale (1972) for the minutes of the Commission’s meetings.

Needless to say, free market economists, particularly those writing for “*Giornale degli Economisti*,” harshly criticized the 1893 law. The imposition of the double limit on circulation and on reserves was considered a secondary ersatz obligation, which, if arbitrarily fixed, could represent an excessive burden for the banks and which anyhow was not sufficient to guarantee the conversion of banknotes.⁵² The article of the law which imposed convertibility was not considered credible, rightly so in the light of later events. Pareto also belittled the effectiveness of Government supervision, which continued to be deemed inferior to market discipline (or “public supervision” as he defined it), still intending it as the public availing itself of its convertibility right (Pareto, 1893a; Pareto, 1893b). Finally, since shifts in the discount rate were a consequence of variations in the general equilibrium conditions, any rigidity forced upon the rate could only result in a decrease of a country’s general welfare (Pareto, 1897, p. 596). A more effective way to prevent country-specific crises, according to Pareto, was for banks of issue to invest part of their resources in good-quality foreign currency in order to guard against idiosyncratic shocks (Pareto, 1897, p. 589). Other issues, such as plurality *vs.* unity of the issuing bank or having a State-owned issuing bank rather than granting the issuing privilege to a private monopolistic bank, became of secondary importance to these economists with respect to the issue of redemption of banknotes (Pareto, 1897, p. 571; but also C. Supino, 1895, p. 120), and hence were less debated in those years.⁵³

A more moderate view was adopted by those marginalists who perceived the 1893 law as a means to safeguard note-holders *in the absence of convertibility*.

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⁵² In particular, limits to note circulation were opposed by Pareto, who also compared them to those set in the already mentioned British Peel Act (see note 30). Authorization had been given in Great Britain to exceed the legal limits in 1847, 1857 and 1866, in the presence of financial crises, but convertibility of banknotes into gold had been maintained. *De facto*, only in 1857 did the circulation actually increase; in the other two cases, the “announcement effect” had been enough to stem the panic, hence proving that the English public was willing to hold banknotes. Although the Peel Act was based on “erroneous ideas” (Pareto, 1897, p. 564), that is to say on limits to circulation, it was also “extremely useful” (Pareto, 1897, p. 565), in that it subtracted the issuance of banknotes from the banks’ power. “But laws without customs are nothing” (Pareto, 1897, p. 565). Hence, Pareto concluded that if the historical experience pointed to the usefulness of limits to note issuance in the British setup, this did not in any way imply that they were suitable for Italy too, where culture, customs and praxes were different.

⁵³ Pareto’s pecking order of banking issues is not surprising, considering that in 1893 a clear signal had been sent out with the creation of the Bank of Italy, a natural-born leader with respect to the other two “follower” banks. The same opinion was held, however, by de Viti de Marco already in 1885, when he asserted that that “if convertibility exists, the structure of the issuing bank system loses much of its relevance” (de Viti de Marco, 1885, p. 120); “the plurality *vs.* unification issue is not important, as is, on the contrary, a prompt and safe convertibility of notes” (de Viti de Marco, 1885, p. 121).

This is clear, for example, in de Viti de Marco (1898), who believed limits on note issuance to be a second-best alternative to convertibility.⁵⁴ He reasoned that, since agents were compelled to accept banknotes in their transactions, and since, in the case of denied redemption by the issuing banks, they had no right to recoupment, then banking legislation which limited note issuance was necessary. The public was also understandingly unaware of the true soundness of the banks of issue and was hence uneasy about holding notes; yet if such banks were subject to effective supervision, then the public would acquire confidence and would be more willing to use banknotes.⁵⁵ Hence, State intervention was necessary, first and foremost, to guarantee the orderly functioning of the payments system, and therefore was justifiable only in the case of banks of issue, not of commercial banks. Nevertheless, de Viti de Marco then stressed how State supervision could only be formal: the State could verify that the ratios imposed had been respected, but they could not monitor the actual quality of the bills in the banks' portfolio. Hence the preventive control by the State, essential in easing circulation and the payments system, was not as effective in guaranteeing the issuing banks' solvency (*i.e.* financial stability), in that the natural stabilizer of the economy (*i.e.* convertibility) was not activated.

Between October 1893 and March 1894, Italy's two main commercial banks failed, victims to runs, and tens of local banks followed suit.⁵⁶ Either the law of 1893 did not change market expectations about the country risk⁵⁷ or it

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⁵⁴ De Viti de Marco (1898) elaborated on a previous belief of his. In fact, already in 1885 he wrote that, in absence of convertibility, a continuous, rigorous and effective Government supervision was necessary: hence the introduction of limits on note issuance, of controls on the discount rate and the unification of the bank of issue. "The banking structure, in the absence of convertibility, is artificial, and the natural and spontaneous control one had with convertibility must be replaced by State control to safeguard the public" (de Viti de Marco, 1885, p. 122). It is clear that de Viti de Marco was a follower of the neoclassical doctrine, but took a more eclectic view with respect to banking theory (Realfonzo, 1995).

⁵⁵ The reluctance of the general public to hold banknotes was not solely de Viti de Marco's impression. C. Supino underlined how it was natural in a prevalently agricultural country, in which economic activity was more buoyant in rural areas than in the cities as was Italy, that the main means of payment were metallic coins rather than banknotes. The latter were accepted only where transactions were numerous and frequent and where the issuing banks were known and accepted (C. Supino, 1895, p. 9). See Giordano (2011) for a quantification of the relative importance of coins, banknotes and deposits in Italy in the period under study.

⁵⁶ A well-known contemporary reference is Pantaleoni (1895). He described the collapse of Società Generale di Credito Mobiliare (established in 1863) and of Banca Generale (created in 1871) as an "enormous moral bankruptcy." In general, Pantaleoni rejected the idea of bank rescues, in that he believed the greed and mismanagement of powerful politicians to be behind every banking crisis.

⁵⁷ C. Supino (1895) emphasized how it was not surprising that the 1893 law had no positive impact on Italy's position abroad and that the exchange rates (which inversely proxied the

arrived too late⁵⁸ to shelter the country from international shocks. This sudden and deep after-shock in the crisis did not elicit new significant regulatory action. Some adjustments were made to the issuing-bank law of 1893, but no lesson was drawn from the insolvency of the two largest commercial banks. A Government Committee was set up to study reforms of the existing corporate law. Its recommendations included the proposal of setting aside three tenths of the capital of joint-stock banks as a guarantee for deposits (Vivante, 1895). These were not, however, translated into law; hence, the only rule specifically aimed at commercial banks in the Italian legislation remained the previously cited Article 177 of the Code of Commerce concerning the publication of balance sheet data.

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

In 1894 the Government was in fact engrossed in dealing with the social unrest which had arisen in many parts of Italy as a result of the economic downturn accompanying the financial crisis. In Sicily, the *Fasci Siciliani*, proletarian organizations which demonstrated against the new taxes and in favour of the expropriation of the vast estates owned by rich land-owners, were violently repressed by the newly formed Crispi Government (December 1893), who depicted them as dangerous conspirators. Anarchists organised revolts in Tuscany for similar reasons. Murders and attempts on political figures' lives were another outcome of the economic and social instability.⁵⁹ The Government reacted by declaring a state of siege in both regions, as well as by finalising anti-anarchical laws. Meanwhile, an internal battle was going on within Parliament, with one side accusing the other of having been involved in the Banca Romana affair. Commercial-bank regulation was clearly not at the top of political agenda at the time.

In terms of economic theory,

a) The regulation addressed the perceived cause of the previous crisis. Overtrading by banks of issue, as well as irresponsible or corrupt behaviour of their management, were blamed for the 1888-1893 meltdown, and were thus to be prevented in the future.⁶⁰ Relative to the 1894 backlash instead, Pantaleoni (1895)

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confidence set on a country) actually rose after the law was passed. The act was in fact, in C.F. Ferraris' words, "a sequence of good advice and hygienic prescriptions to be enforced after two, four, fourteen years" (C. Supino, 1895, p. 107).

⁵⁸ The law came into force only on 1 January 1894.

⁵⁹ On 24 December 1893 the French President Carnot was killed by an Italian anarchist; in May 1894 an attempt to murder the Italian Prime Minister Crispi failed.

⁶⁰ For instance, C. Supino (1895, p. 91) acknowledged that "banks of issue gave a significant push to speculation in certain sectors and were the main cause of the crisis which followed".

noted that the general public did not condemn the commercial banks and was instead hostile towards those who had made runs on the banks and withdrawn their deposits. These agents were called by the public “*ribassisti* [short sellers] and enemies of Italian credit” (Pantaleoni, 1895, p. 8), whereas the Government and the police, who deprived the depositors of their right to be reimbursed, were seen as saviours.⁶¹

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

c) The understanding of money and financial markets was incomplete, the classification of bank deposits as money was not accepted – also due to the fact that the use of deposits was initially not relevant in practice – and the impact of runs on commercial banks was underestimated. Deposit-taking was, thus, considered less “dangerous” and destabilizing than banknote issuance (C.F. Ferraris, 1892).⁶² This line of thought can be traced back to the predominance of “metallists” in Italy’s economics schools (Realfonzo, 1995, pp. 70-73). Pareto for example made a distinction between “true money,” *i.e.* metallic money, and “false money,” *i.e.* bank deposits. Barone rejected the idea of credit being able to increase the quantity of money in circulation, as it was a mere substitute of the

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⁶¹ Similarly, Pareto (1897) declared there was nothing wrong with commercial banks speculating “if shareholders and depositors are made clearly aware of the operations the banks are undertaking” (Pareto 1897, p. 550). On the other hand, banks of issue were to be strictly banned from speculative activities (p. 588). With respect to commercial banks, Pareto anyhow advised to physically separate speculative banks from simple intermediaries. The former were to hold larger equity or to raise interest rates on deposits to compensate depositors for the greater risk undertaken. Not even speculative banks were to be regulated according to Pareto, differently with respect to Rota (see note 42).

⁶² De Viti de Marco (1898) considered banknotes and chèques based on deposits as alternative means of payment. They differed however in that chèques were used mainly by the more “educated” traders and not by the general public. Hence the use of chèques was in principle more conscious and prudent.

existing metallic money; credit simply transferred savings over time (Barone, 1919). Similarly Loria (1910, p. 510) wrote that “credit does not create capital, does not engender new wealth, it simply transfers wealth.”⁶³ Fanno (1912) too was a “metallist,” as we shall later see. Italian economists seemingly up until mid-XXth century had qualms about embracing the theory of credit expansion via the deposit multiplier.⁶⁴ For example, in 1934, de Viti de Marco (1934), building on his earlier 1898 work, asserted that the increase of deposits in different banks was sequential, not simultaneous, hence the increase in deposits in one bank was continually counterbalanced by the decrease in another, leading to a constant amount of deposits in the banking system as a whole. He disdainingly defined the economists who accepted the deposit multiplier theory as “modernists” (de Viti de Marco, 1934, p. 70).⁶⁵

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

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⁶³ Differently to the other liberal economists, Loria was strongly influenced by the German Historical School.

⁶⁴ In 1931 Bresciani Turrone still wrote that “confusion of ideas persists” with respect to the theory of the deposit multiplier (cited in Realfonzo 1995, p. 200).

⁶⁵ Only in 1947 did another leading economist of the same school, Einaudi, start coming to terms with the credit expansion theory, yet still with some distrust. In an attempt to explain the inflationary process of 1946-47, he in fact shed light on the possible risks of inflation tied to a “new” (in Italy), yet still not widespread, type of deposits: the opening of lines of credit on which clients could draw chèques. The latter, when used, then became deposits of other agents for the same amount. This particular type of money was issued by commercial banks, not issuing banks, yet could possibly lead, if over-traded, to inflation (Einaudi 1947, reported in Barucci 2008, pp. 470-471). Einaudi, anyhow, did not consider the further developments of the deposit multiplier. The increase in deposits, of the same amount of the chèque, then could lead to a credit expansion by the deposit-taking bank and to further deposits of savings, yet he did not take into account these later stages of the process.

4. Crisis management issues and growing consensus towards commercial bank legislation, 1907-1925

Once the 1890s financial meltdown had run its course, a period of rapid GDP growth got under way, aided by abundant remittances by Italian workers abroad which contributed to the creation of large gold reserves, as well as to the nationalization of Italy's public debt, previously mostly foreign-denominated. So while convertibility was never formally declared, by 1902 the exchange rate between lira and gold had reached the old par established in 1883, and the interest rate applied to the Government debt steadily declined. Therefore, in the following decade, despite Italy being on a paper standard, the exchange rate between the lira and the franc – the main reference for policy – was essentially fixed and the government embraced fiscal and monetary rectitude, thus shadowing gold.

The pre-WWI period was also characterized by the expansion of mixed banks, which came to play a leading role in corporate finance. “The main characteristic of this period [...] is the large importance acquired by the bank *vis-à-vis* the industry: the bank has taken on the function of foundation of the industrial firm; bank capital [...] in this phase has become the propeller and at the same time the dominator of the industry” (Bachi 1914, pp. 300-301). In fact, trustees of the banks routinely sat on the boards of the main client firms; banks advised and assisted IPOs, frequently underwriting large amounts of shares to be gradually placed thereafter on the market. As a result, banks acquired relevant market-maker positions in the stock exchanges, whilst often holding consistent amounts of shares either from IPOs or as collateral for loans in their portfolios. The main banks were therefore partly responsible for the rapid increase of equity prices, which suited them well by swelling the value of their assets. Particularly impressive in this sense was the growth of Società Bancaria Italiana (SBI, established in 1898), the junior member of the big mixed bank league (the other two large banks being Banca Commerciale Italiana, from now on Comit, and Credito Italiano, from now on Credit, which had sprung up from the ashes of the two previous main *crédit mobilier* banks, that had collapsed in 1894).

In September 1907, the stock market crashed in Italy. SBI tottered on the edge of bankruptcy. The Bank of Italy, warning of the risk of contagion, persuaded SBI's two main competitors to join a consortium which extended a loan to the ailing bank. Further financial assistance was made conditional on SBI being put under control of the lenders, who would then dispose of its assets. By late Spring 1908, the crisis was overcome.

The main lessons learned from the 1907 crisis were about crisis management rather than prevention through adequate regulation, which enshrined the Bank of Italy as the agent responsible for the stability of the banking sector (Gigliobianco, Giordano and Toniolo, 2009). Both the Government and the Bank

of Italy brought home the “domino effect” argument of avoiding big bank failures which could lead to chain reactions. To prepare for the management of future crises, the Bank of Italy came to believe that more ammunition had to be added to its arsenal, in particular more flexibility was required of its liquidity management. In 1907, the Bank could act without endangering macroeconomic *equilibria* as it had large reserves – some of which supplied at the last minute by the Treasury – but circumstances could not be expected to be as favourable all the time in the future. This led to the loosening of the limits on circulation set in 1894 with a sequence of laws in 1907, 1912 and 1914.⁶⁶

It would however take another crisis for the legacy of 1907 to be translated into crisis-prevention regulatory action. Why was this? First, the traders in the Genoa stock market were identified as the main culprits of the 1907 crisis. Stock markets were believed to be in urgent need of regulation after the previous de-regulatory wave, as emerges from numerous articles of the journal “*L’economista d’Italia*”. Therefore, in 1913 a law which reorganized the stock market was passed.⁶⁷

Secondly, a large camp of economists continued to believe in the centrality of issuing banks, and hence still did not conceive the need for commercial bank regulation. An example is the main economist of the time, Fanno, who was also the promoter of Wicksell’s theories in Italy. In a 1912 article, he underlined how banknotes and bank deposits were “money,” but at the same time were not definitive means of payment. Chèques could always be presented to banks for redemption in banknotes and, in turn, banknotes could be redeemed for metal currency. Hence, the national fiduciary circulation rested entirely on the metal reserves of issuing banks (Fanno, 1912, p. 131).⁶⁸ Because banks of issue amassed these metal reserves, they were the pivot of the banking system. Credit expansion of commercial banks was not to exceed given limits with respect to these reserves. Banks of issue (and not the State) were to supervise and guarantee the respect of these limits; in case of an excess, they were to increase the discount rate (p. 132).⁶⁹ However, if an abundance of metal reserves

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⁶⁶ For a commentary of these laws see Stefani (2003, pp. 535-551).

⁶⁷ Law 20 March 1913, No. 272. The law introduced three main novelties (Siciliano, 2002): *a*) the State gained control over the Chambers of Commerce, hence reducing regional and local pressures; *b*) only stockbrokers were permitted outcry trading on the stock market, thus cutting out the other financial intermediaries; *c*) the so-called “single capacity” principle was introduced, by which stockbrokers could only act for account of their clients and not for their own. The novel organic legislation did however contain some loopholes (Schisani, 2008, p. 353): it did not regulate contangoes nor did it incorporate Nitti’s proposal to make the figures on stock market transactions public.

⁶⁸ In this, Fanno evoked Messedaglia (1876).

⁶⁹ This idea was instead already in C.F. Ferraris (1892, p. 213).

guaranteed the stability of the overall banking system in normal times, elasticity in circulation was advocated to manage crises (pp. 145-146). In other terms, banks of issue were by him considered as “the central institutions on which the overall banking system rests and gravitates, the regulators of the credit market, the ultimate line of defence to which banks turn to in case of serious difficulties” (p. 147). Therefore, although he strongly believed that metal was still the ultimate form of liquidity, Fanno was favourable to the increase of the issuing banks’ ability in providing liquidity to the banking system in the case of crises. Commercial bank regulation did not fit into this picture at any stage.

Regulation was however advocated by some economists – as summarised in Garrone (1930) – in order to eliminate distortions in the payments system, which would discourage the use of chèques. The latter aim was analogous to the one emphasized by de Viti de Marco back in 1898. At that time, the “new” medium of payment was represented by banknotes, relative to metal currency; now the “innovation” was chèques with respect to banknotes. We can thus detect a tight link between the prevailing monetary instrument and the aims of required regulation. When banknotes were the main means of payment, the safeguard of note-holders was the priority and hence regulation of issuing banks was claimed; when the use of chèques became more widespread, the protection of depositors and therefore the regulation of deposit-taking institutions were called for.⁷⁰ However, economists remained on the whole adverse to any legislation.

Some politicians were of a different opinion however. In fact, in 1908 the then Minister of MAIC, Cocco Ortu, initiated legislation aimed at protecting the small depositors of commercial banks. The latter were required to create two fire-walled sections for the separate management of “fiduciary” (or “saving”) deposits and “commercial” deposits; the former – enjoying privileges in case of liquidation – could not be used for long-term lending (Bonelli, 1971, p. 279). The proposal was, however, torpedoed by the Prime Minister Giolitti. The general impression is that, amongst politicians, the fear of blocking credit support to the expansion of the economy prevailed over the aim of safeguarding depositors. The major banks’ opinions were, thus, highly regarded even before the creation of an official bank association (Calabresi, 1996, p. 190). Stringher, general manager of the Bank of Italy, but also disciple of Luzzatti, indicated that rather than legislation what was needed was self-regulation of the banking sector, with banks themselves limiting

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⁷⁰ However, in 1912 Fanno wrote that deposit-taking institutions were still underdeveloped, due to the continuing relevance of agriculture in Italy’s economy, and hence the use of chèques as means of payment was not widespread at the time (Fanno 1912, p. 122). This argument is identical to the one adduced by C. Supino in 1895, when he explained the still meagre use of banknotes at the time of his writing (recall note 55). Finally, even in the 1930s, Mengarini (1933) still noted how chèques were used mainly in Great Britain and not in continental Europe.

their risky undertakings and thus gaining the trust (and savings) of their depositors.⁷¹ In 1913, Nitti, the new Minister of MAIC, again proposed legislation for the regulation (via obligatory reserves) and supervision (via periodic on-site examinations) of deposit-taking institutions.⁷² Einaudi rose against this proposal, defined as an interfering act of the “legislating Roman bureaucracy” (Einaudi, 1913, p. 343). He asserted that the law was aimed at “safeguarding capitalists,” in that the small and vulnerable depositors, truly in need of protection, mainly turned to savings banks or to postal saving institutions, which were already subject to regulation. The Nitti law proposal anyhow met the same fate as its predecessors.

Finally, the 1907 crisis also brought to the forefront the issue of Italy’s industrial development and the means for it to be soundly financed. In 1909 an article by engineer De Benedetti appeared in “Riforma Sociale.” The author suggested creating an “industrial bank,” *i.e.* a bank which had permanent relations with its client firms, that helped place their securities on the market and stabilised the prices of their shares over time. The article was preceded by the journal editors’ comments,⁷³ who were more oriented in following the Swiss example of the *Société Suisse pour Valeurs de Placement*, a sort of land bank applied to the industrial sector. In 1911 Assonime (the Association of Limited Liability Companies) rounded up the major economists and industrialists to again discuss long-term lending to the industrial sector. Monzilli (1911) reported and commented the resulting debate in a contemporary journal, “Rivista delle società commerciali.” Amongst the economists, Einaudi was against the creation of *ad hoc* industrial credit institutions, which inevitably, in his view, would favour the large firms; he contended ordinary banks, savings banks or other organizations would instead spontaneously respond to all firms’ demand for long-term credit. The liberal Cabiati too opined that ordinary banks could extend industrial loans without jeopardizing their soundness providing they formed close ties to the industries they lent to so as to successfully monitor their financial situation. He however seized the opportunity to complain about the scarce, and misleading, information published in banks’ balance sheets, from which it was not clear to which uses deposits were being directed. A legal intervention concerning mandatory information disclosure was the proposed solution to safeguard depositors. Pantaleoni believed the problem was not the rationing of industrial credit, but rather the lack of a sound social, fiscal and legal environment which hence needed to be restored. On the other side of the barricade, De Johannis

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⁷¹ Two references are Bank of Italy “Meetings of 1911” in Calabresi (1996, pp. 191-192) and Bank of Italy Report of 30 March 1912 in Bonelli (1991, pp. 39-40).

⁷² Nitti was a supporter of the German Historical School (Cardini 1993, p. 51).

⁷³ In those years “Riforma Sociale” was directed by Einaudi and the head editor was the liberal economist Prato.

favoured the creation of a specialized long-term lending institution. The meeting did not lead to any tangible results, but set the stage for the later debate on bank-industry separation.⁷⁴

One may wonder if Italian economists, in discussing the issue of industrial credit, were influenced in any way by the contemporary Austrian Hilferding's major work "Finance Capital," published in 1910, which emphasised the role of banks in directing investments, and therefore in the development path of the economy. The answer seems to be negative as no direct references appear in subsequent Italian economic articles, nor was Hilferding's work reviewed, to our knowledge, in those years. Hilferding seems to have been mostly ignored by Italian economists. This is confirmed by the scholar Pietranera who, publishing in 1961 the first Italian translation of "Finance Capital", remarked how "Hilferding is almost never cited in the non-Marxist literature and often incorrectly and superficially remembered in the Marxist-oriented one" (Pietranera, 1961, p. LXXIII). In the same direction, Fradeani and Marconi (2000a, pp. 72-73) also described the lack of interest Italian economists displayed towards Hilferding, whose work was a "forgotten contribution," due also to the fact that "there seems to exist in the best Italian scientific tradition a perfect separation between the study of real phenomena and of financial ones."⁷⁵ Italian economists did discuss the issue of bank-industry ties, yet "their contribution [was] not systematic" (Fradeani and Marconi, 2000a, p. 73) in that it reflected contingent debates arising from endemic banking crises. Fradeani and Marconi (2000b, p. 621) finally do not exclude the possibility that Italian economists were simply not aware of Hilferding's contribution to economic theory. Another relevant contribution to the contemporary discussion on the role of industrial credit and banks in the development of the overall economy was Schumpeter's "Theory of economic development", first published in 1912. However this work was appreciated and discussed in Italy with a lag of circa 15 years, when a second edition was published;⁷⁶ we will therefore delay our analysis of the Italian economists' reception of Schumpeter to a later stage of our narrative.

Going back to historical events, when WWI broke out, the expansion of industrial output was financed by the largest mixed banks. One such bank, Banca Italiana di Sconto (from now on Sconto), was created at the eve of the war by a

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⁷⁴ It is noteworthy that three sectoral long-term credit institutions were founded in the following decade: the *Consorzio di credito per le opere pubbliche* (Crediop) in 1919, the *Istituto di credito per le imprese di pubblica utilità* (Icipu) in 1924, and the *Istituto per il credito navale* in 1928.

⁷⁵ Marconi and Fradeani referred to Einaudi, Pantaleoni and Sraffa as the "best Italian scientific tradition."

⁷⁶ Only a brief and uninformative review of the first edition was written in Italy in 1912 (Grilli, 1912).

group of industrialists who had large stakes in the Ansaldo heavy industry conglomerate (Falchero, 1990). During WWI, a general moratorium on bank-deposit withdrawals pre-empted runs on the weakest banks (Toniolo, 1989, pp. 18-25). The Bank of Italy also sponsored the creation in December 1914 of a special institution (*Consorzio per Sovvenzioni su Valori Industriali*, CSVI), authorized to discount paper not eligible for direct discount at the banks of issue, in order to avoid fire sales of industrial shares by liquidity-starved banks or industrial firms (Guarino and Toniolo, 1993, pp. 197-198).

The pre-emptive supply of liquidity to the commercial banking system by the Bank of Italy reflected its changing approach to financial stability. Two main developments had taken place. On one hand, the gold standard had been abandoned at the onset of WWI. On the other, deposits were becoming a widespread form of savings. Therefore, the main source of instability was no longer the issuing banks, but the deposit banks. A shift of focus from gold to banknotes as the ultimate form of liquidity occurred. This was confirmed by the later developments in the international monetary regimes. During conferences in 1918 (Brussels) and 1922 (Genoa), the main European countries in fact expressed their willingness to restore a common monetary standard, which however was to be more elastic than the pre-WWI gold standard regime: hence the idea of creating a gold *exchange* standard. Convertibility of the lira was however postponed, also due to the emergence of other priorities (de Cecco, 2003, pp. 38-39).

The final years of WWI and the onset of the new decade were marked by a fierce struggle among capitalist groups for the control of finance. After groups formed mainly by industrialists attempted to take control of the two major banks,⁷⁷ the economic and political debate of the time focused on the *scalata alle banche* (bank takeover) issue. Many influential academics intervened, all recognizing the dangers congenital in the bank-industry liaison (Santoro, 1927, p. 33). Graziani insisted on keeping banking activities separate from industrial ones.⁷⁸ Vivante again presented his original law proposal of 1895 on joint-stock firms to protect depositors. Navarrini too called for a legal intervention to prevent deposits being used to finance one industry only. Even the liberal economist Einaudi insisted on the danger of bank specialization, as well as on the perils

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⁷⁷ In 1918 the Perrone brothers, at the helm of Ansaldo, attempted to take over the majority of Comit's shares. The aims were various: the use of the bank's copious deposits to strengthen the industrial firm's financial position, a reduction of credit to competitors to weaken them and an increase of Ansaldo's relative power in future negotiations with the Government (Sraffa 1922, pp. 180 and ff.). Industrialists Agnelli and Gualino were partially successful in taking over Credit in 1918.

⁷⁸ Graziani was an economist influenced by the German Historical School.

connected to bank clients controlling the banks. Yet his was not a call for legislation: “[t]he only effective remedies are not legislative, but concerning customs and a vigilant control by depositors, shareholders and a serious public opinion” (Einaudi, 1918).⁷⁹ Finally, Cabiati (1918) recalled, as he had already done in 1911, the impossibility of shareholders and depositors exercising market discipline, in contrast to Einaudi, due to the vague, if not misleading, balance sheets produced by banks. He thus proposed, following the example of Great Britain and France, a strict separation between deposit banks and merchant banks (*banche d'affari*) as the only solution. The former would only undertake standard banking operations; the latter could engage in security issues, the creation and support of firms, speculation.

In this context, the minister of MAIC Ciuffelli's 1918 proposal was made.⁸⁰ Deposit-taking banks were to build an independent section for deposits, subject to savings banks' regulations. Depositors were attributed a special privilege over the activities of this independent section. However, the ensuing debate was weak as the public's attention was captured by the ongoing warfare and the proposal was turned down. 1918 was also the year of the creation of a Government-sponsored bank cartel between the four main credit institutions. The main points of the cartel were the introduction of caps on deposit interest rates, of limits on branching abroad and of restrictions on loans extended to the State or to other public entities, whilst loans to industry remained unconstrained. Stringher was nominated arbiter of the potential controversies which could emerge between the four banks (Toniolo, 1989, p. 64). The cartel was continually renewed until 1927 when it was replaced by another, broader one, under the auspices of the Fascist Banking Confederation (Calabresi, 1996).

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⁷⁹ This citation is from a newspaper article, yet confirms Einaudi's thought expressed in more distinguished venues. Furthermore, Einaudi (1924b, pp. 100-101) also pondered on the importance of having able and morally integer bankers at the helm of banks:

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

⁸⁰ Ciuffelli, a politician with a technical background, was of liberal views, yet in 1917 he became minister of MAIC, which was strongly involved in the organization and control of the economy during WWI. His most famous piece of legislation, passed in 1919, concerned mandatory insurance against invalidity and old age.

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

In 1920 the regulatory debate was livened up again by the second attempt by Ansaldo to take over Comit (Sraffa, 1922). The takeover was again unsuccessful, but elicited two more law proposals in the same year, advanced respectively by Chiesa and by the economist Alessio, then Minister of MAIC. The former proposal requested an authorization from the Treasury to undertake banking activities, the introduction of Government supervision and obligatory balance sheet disclosure. The latter attributed to depositors a minimum privilege on all the property of the bank in the case of bank failure. This last proposal had little practical importance; nevertheless it is interesting to recall a speech made by Alessio in July 1920: “Significant changes in our credit system have occurred. [...] [T]he main credit institutions have modified their nature. Once they were deposit-taking institutions of commercial credit; now they are mainly deposit-taking institutions of long-term credit.”⁸¹ Some economists were thus conscious, already by the end of WWI, of the potentially destabilizing nature of mixed banking.

A ferocious critique of the Chiesa proposal in particular was made by the liberal economist Prato in “*Rivista Bancaria*,” the journal of the Italian Banking Association (ABI).⁸² Prato argued that in any developed economic environment, State intervention in the management of commercial banks seemed such “fanciful nonsense” (Prato, 1920, p. 334) to *a priori* exclude any form of discussion on the matter. Not surprisingly, the “most important teachers of the subject” (amongst which he recalled Bagehot, Mac-Leod, Ferrara) had not mentioned commercial bank regulation, but had written “everlasting pages” on the opportunity of regulating note issuance. The State was thereby not to interfere in banks’ conduct since the trust of clients was the most effective form of control, especially in the case of speculative institutions, whose depositors were financially educated

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⁸¹ Speech in Parliament made by Alessio on 28 July 1920, reported in Santoro (1927, p. 44).

⁸² “Not much knowledge of banking science is necessary to realize how the whole project, similarly to all the new restrictionist legislation, represents a laudable effort to go back centuries of economic and technical progress [...]” (Prato 1920, p. 332).

capitalists. Prato accepted the intensification of mandatory information disclosure as the only conceivable form of regulation in order to boost market discipline.

In 1921 a new banking crisis broke out. At the heart of it was the interlocking shareholding between the Ansaldo conglomerate and Sconto, as a sluggish post-war restructuring process threatened the former's solvency. Bachi's warning had turned into reality. Soon liquidation emerged as the only solution. A partial guarantee of deposits was given by the Bank of Italy through a new entity, a "Special Section" of the previously mentioned CSVI. Ansaldo was *de facto* taken over by the Government. Almost at the same time Banco di Roma suffered huge deposit losses and became illiquid. It was however provided with enough liquidity from the Special Section, with the guarantee of the newly-formed Mussolini Government, to outlive the crisis. Two successive bank failures were, in fact, considered as being excessively destabilizing for the overall economy. The economist and Finance Minister De' Stefani, inspired by Pareto and Pantaleoni, and privately encouraged by Einaudi and Cabiati, was however against these bank and industrial bailouts, one of the factors that later led to his political isolation (Marcoaldi, 1986, p. 41).

The collapse of Sconto had a much wider repercussion on the public opinion than the previously mentioned 1918 and 1920 "early warning" episodes. The closing of all the bank's branches in December 1921 had definitely caught the public's attention, as Bachi (1921, pp. 198-199) described. Sraffa (1922, p. 191) too aptly commented the reactions of all parties involved:

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

The new crisis had greatly reinforced the idea that regulation concerning banks of issue was not sufficient to attain the stability of the whole banking system. Time had come to regulate commercial banks too. The political and

economic debate covered numerous issues, of which three core ones were the following:

a) *Bank-industry separation*. The advocates of the separation in 1920 became even more convinced of their beliefs in the light of recent events. Political parties too began to take sides on the matter. For instance, the Partito Popolare already in 1922 called for a separation between “industrial banking” and “commercial banking,” which were to be subject to different legislation (Gilardoni, 1922, p. 79).⁸³ Some economists were very explicit. In his lucid analysis of Sconto’s collapse, Sraffa (1922, pp. 196-197) wrote: “The urgent necessity, if new disasters are to be avoided, is to get the industries again under the control of those whose interest it is to make them prosper.” The problem was how to attain this aim. “[E]ven if these laws [*i.e.* regulatory reforms which were being demanded] were not futile in themselves, what could be their use as long as the Government is prepared to be the first to break them so soon as it is blackmailed by a band of gunmen or a group of bold financiers?” Einaudi (1924a) again warned, as he had already done in 1918, that banks and industrial clients had to be firmly separated, since “[o]ne cannot be both master and client, judge and party” yet again, not via legal constraints, but by market discipline that guaranteed banks’ best practice.⁸⁴

b) *Over-banking and competition*. A lively discussion was engendered in the pages of the journal “Echi e Commenti,” concerning the recent institution of numerous small banks and the negative consequences brought about by cut-throat competition between them (Santoro, 1927). Arias (1923) declared that the main cause of the development of the small banks was the insolvency of Sconto which had eliminated the public’s trust in big institutions.⁸⁵ Graziani (1922) underlined the higher operating costs that the proliferation of banks and branches outside the bank cartel had led to. Loria, the director of the journal, drew a distinction between competition amongst producers and competition amongst financial intermediaries: whilst the former reduced the price of products, the latter increased it. To attract depositors, in fact, banks were forced to increase interest rates on deposits, hence raising the interest rate on loans, thus damaging the industrial sector and output. If competition then curbed the rates demanded on

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⁸³ Nonetheless, consensus was not unanimous. Gilardoni, a lawyer and an eminent member of the party, for example, discouraged new legislation on the matter (Gilardoni 1922, p. 80 and ff.).

⁸⁴ Once again this citation is from a newspaper article, but tallies with Einaudi’s overall views on the topic published in many other journals.

⁸⁵ Arias was one of the main Fascist economists, supporter of State intervention and legislator of many Fascist economic laws.

loans, the banks were forced to turn to speculation to survive (Loria, 1926). The discussion ended with a call for regulation.⁸⁶

c) *Depositors' safeguard*. Again the intellectual debate was focused on how to attain this aim. Legislation was one solution. "Financial education" of depositors was another. Deposit insurance was a further possibility. Pantaleoni (1924) was set against the regulation of deposit-taking institutions, in particular the imposition of a fixed capital-to-deposits ratio. In safeguarding deposits, it was not the capital that counted, in his view, but the type of investment the deposits had been turned into.⁸⁷ In a scathing critique he stated that, in general,

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

Similarly to what had been stated by Einaudi in 1913, in 1926 the liberal economist Flora⁸⁸ too stressed the importance of educating the Italian depositors, in order to enable them to foresee what would befall the money they entrusted to banking establishments from their very names. Einaudi again returned on the subject in 1922, this time discussing the opportunity of introducing deposit insurance, strongly conscious of the moral hazard problems underlying the issue. Testing his views against a broad array of historical evidence in Italy and in the U.S., he came to the conclusion that such an insurance would be feasible only in the case of cooperative banks and rural banks, due to their small size. He did not thus contemplate this solution for the large ordinary banks. His feeling was, in fact, that deposit insurance would not have avoided the Sconto "catastrophe" (Einaudi, 1922, p. 290). Finally, liberal economists also stressed the importance of independent economic information (e.g. newspapers) and of its vital role in bringing about market discipline.⁸⁹

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⁸⁶ Not all economists supported limits on competition in the banking sector. As we shall see, Einaudi was against such measures, as was Cabiati (1918).

⁸⁷ Similarly Cabiati (1918) had emphasized how it is not the capital-to-deposits ratio that safeguarded depositors, but the nature of the operations banks carried out. It is remarkable how the Italian economists of the time failed to see that the stock of capital signalled commitment by shareholders.

⁸⁸ See Guarino and Toniolo (1993, p. 427).

⁸⁹ Prato for example worried both about the "serene acquiescence of the press and of the public's economic illiteracy" (Prato 1920, p. 342).

Between 1923 and 1925 three “private” law proposals were published in journals by scholars. Tucci’s proposal of 1923 (Tucci, 1923) contained suggestions many of which were later adopted in the 1926 Banking Act (e.g. nominal bank shares; minimum reserve requirements; ratio between paid-up capital and deposits; limits on the credit extended to individual debtors).⁹⁰ The jurist Nicotra (1924) also supported the idea of nominal bank shares, in order to block bank takeovers by industrial firms or powerful groups. Finally in 1925 the lawyer De Gregorio stressed the need for fixed deposits-to-equity ratios (Renzi, 1938, p. 39).⁹¹

A first draft of a new Banking Act was officially prepared by the Government in September 1923 (Guarino and Toniolo, 1993, pp. 403-415). It took three more years for the law to overcome intense lobbying and to land in Parliament. Not only did the afore-mentioned free market economists still strongly argue against the desirability of “protecting depositors by law,” as just seen, but also lobbies such as the previously mentioned ABI and Assonime showed a deep anti-regulation stance. In particular, it is interesting to read the letters written by the then President of ABI, Bianchini, and by the director general of Assonime, Guarneri,⁹² in which the main reasons stated against commercial bank regulation were the following: *a)* the total adequacy of existing laws, in particular of the unification of note issuance, legally decreed in 1926, which allowed the Bank of Italy, via discounting and advances, to monitor all other banks; *b)* the impossibility of applying a uniform law to the different Italian regions; *c)* the importance of mixed banking in Italy’s economic development and, hence, the undesirability of limiting it. In the end however, the activism of Volpi, the new Minister of Finance, who had replaced De’ Stefani, contributed to the introduction of the new regulation.

To sum up, Italy’s third regulatory regime began as a reaction to the 1907 crisis with a softening of the 1894 banks of issue law: the aim was to entrust the lender of last resort, the Bank of Italy, with greater flexibility to manage future crises. A pre-emptive supply of liquidity was later perceived, during WWI, as an actual crisis-prevention tool. This new regulatory stance of increasing rather than restricting the circulation of banknotes reflected an underlying shift in the conception of the ultimate form of liquidity: notes rather than specie. Regulation

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⁹⁰ Tucci (1923) was mentioned amongst the new books on money, prices, credit and banking in the 1923 edition of “The American Economic Review” (The American Economic Review, 1923).

⁹¹ Sangiorgio and Capriglione (1986, p. 12) cite De Gregorio as an example of part of the “forward-looking” stream of the doctrine, who believed regulation had a wider scope than that of protecting depositors; it had to have the more ambitious aim, in fact, of ensuring the stability of every single bank, and hence of the whole credit system.

⁹² Guarino and Toniolo (1993, pp. 419-421 and 431-435).

of commercial banks was rejected by those economists who still maintained the centrality of the banks of issue in the overall banking system (and thus gold as the ultimate means of redemption). In contrast, some politicians called for legal intervention to protect depositors, the holders of the “new” means of payment, *i.e.* deposit currency. Law proposals, however, were defeated, although the bank-industry ties were beginning to be identified as potentially dangerous. If nothing came of these law proposals, they nevertheless indicated a significant shift in the paradigm of bank regulation, hitherto synonymous with bank of issue regulation. The 1921-23 banking crisis was the straw that broke the camel’s back. Bank-industry separation was even more vigorously acclaimed. Over-banking began to be perceived as a major problem and limits on competition were invoked. Although the main banks had already formed a cartel in 1918 which imposed insider rules, they were strongly set against State “outsider” regulation, as the ABI and Assonime documents prove. If their opposition was sufficient to delay legislative action, it could not however block it altogether.

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

A concise Banking Act was passed in September 1926, to which a more articulate one followed in November.⁹³ The new regulatory regime applied to all deposit-taking banks (including savings banks, until then falling within the realm of special legislation). A key provision of the Act was the mandatory authorization by the Ministry of Finance for the creation of a new bank or branch, as well as for mergers and acquisitions, in order to limit over-banking. The latter was in fact considered the main cause of the 1920s banking crisis (Banca d’Italia, 1929, p. 32):

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

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⁹³ Royal decrees of 7 September 1926, No. 1511, and of 6 November 1926, No. 1830.

often causing serious trouble and losses to people who placed faith in them.

Minimum capital and reserve requirements (as a share of deposits, not of assets), as well as quantitative limits on credit extended to any individual client, were introduced. The Bank of Italy, with its recently assigned monopoly over note issuance, was entrusted also with supervisory powers, via information disclosure and on-site inspections.

The number of banks dropped after the introduction of the Banking Act,⁹⁴ in a process of “gradual simplification of the banking organization, which is keenly sought by those who have at heart the safeguarding of savings” (Banca d’Italia, 1929, p. 34). The reduction, however, as we shall see, was not conceived as sufficient by many economists and by Stringher himself. Yet not all economists agreed upon this banking sector “rationalization.” Einaudi was at the forefront of this second stream of thought.

[...] [I]s it true that the adjective ‘weak’ necessarily or generally goes hand in hand with the circumstance that banks are numerous and therefore small and that the ‘strong’ banks are few and consequently large? Is it therefore beneficial for banking policy to hinder, on principle, the creation of new banks and to take a favourable view of the amalgamation or merger of existing ones? [...] Building big appears to be equivalent to building well. Hence the universal mania for cartels, consortia, trusts, giants. It is a mania and it will pass (Einaudi, 1930, p. 104).

The historical evidence of the Sconto failure and the Banco di Roma’s rescue seemed to make the over-banking view unfounded. Einaudi, who also analysed the contemporary U.S. fragmented system and the U.K. oligopolistic one, concluded that: “[i]t is not possible to proclaim dogmas in this field” (p. 107). Mergers could be an indicator of a dangerous method of managing crises in which frozen assets were offloaded onto others (*i.e.* the taxpayers). Bank cartels he deemed useful only when used to pool and share information on the creditworthiness of their customers. He admitted the fact that local bankers were more subject to concentration risks than large diversified banks, but he also attributed the failure of the former to foolishness and avarice. He thus concluded by stating the complementarity of large and small banks in the financial system

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⁹⁴ The figures show that at the end of 1927 there were 4,405 Italian banks in operation, 4,197 a year later, and 4,097 in February 1930: a reduction of 7% in 26 months (Banca d’Italia, 1930).

and hence “the 2,429 rural banks in operation in Italy appear neither too many nor too few” (p. 111).

Anyhow, the banking legislation of 1926, if not actually stillborn, was largely obsolete. Inspired by the 1888 saving banks law, it strongly reflected the 1908 and 1913 proposals, and regulated commercial banks as they existed before WWI. But the war had already changed the banking industry, as observed back in 1920 by the minister of MAIC Alessio and by the leading economists of the time. The regulation was also soft-touch, incomplete and only partially enforced. Inspections, in fact, left the larger banks largely untouched.⁹⁵ No article of the law disciplined the bank-industry linkages, except maybe the quantitative limits on credit extended to any individual client, which however were systematically exceeded by the main banks thanks to permissible exceptions envisaged in the law. Finally, nominal shares – proposed, as we have seen, by Tucci (1923) and Nicotra (1924) so as to hinder speculative manoeuvres – only became mandatory with the next set of banking legislation in 1936.

By 1929, Comit, Credit and Banco di Roma thus completed, untrammelled, their transformation into quasi-holding companies. During and immediately after WWI, as we have seen, the bank-industry bond had become much tighter due to the acquisition by banks of permanent stakes in manufacturing and utility firms. At the same time industrialists had gained some form of control over the banks. During the brief, if buoyant, cyclical expansion of 1922-25, a stock market boom, partially fuelled by the banks themselves, allowed the latter to easily extend credit to industrial companies on the security of the firms’ equity. When the stock market weakened in 1925, the banks stepped in in order to stem the falling value of equities. Unable to reverse the bear market and since most equity prices remained lower than they had been in 1925 for the rest of the decade, the banks had no alternative but to hold on to their equity portfolios (Gigliobianco, Giordano and Toniolo, 2009). Like other countries, Italy too was then strongly affected by the Great Depression. Industrial value added contracted by around one third between 1929 and 1932 (Baffigi, 2011). Confronted with deflation, which had started in 1927 with Italy’s return to the gold standard, and falling demand, industrial firms could only turn to banks for further loans in an attempt to fulfil their previous obligations and defend the value of their equity assets. Banks were forced to extend credit with equity as collateral, or to actually “convert” their credits into shares, to avoid the collapse of their indebted clients. At the same time, however, banks were hit by the withdrawal of foreign deposits.

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⁹⁵ The reluctance to interfere with the big banks was palpable. Between 1926 and 1932, 2,532 on-site examinations were conducted: 0 in the “Big Three”, 4 in national banks, 72 in interregional ones, 94 in regional banks, 270 in provincial ones and 2,092 in local ones (Banca d’Italia, 1932).

In order to stay afloat, they were obliged to turn to the Bank of Italy for financial assistance.

To sum up, Italy's fourth regulatory regime was inaugurated by the 1926 legislation concerning all deposit-taking institutions. The main instrument it relied on was barriers to entry (also via minimum capital requirements) and restrictions on branching to tackle the perceived over-banking problem, a point on which most economists agreed, but it ignored the bank-industry problem which some economists had realised, pinpointing its potential dangers. Thus, the new regulation did not reverse the process of mixed banks becoming actual holding companies; it did not hinder the banks from fuelling the 1930s financial crisis. The banks were not able to overcome their woes alone, and Government intervention was called for. As we shall see, the crisis management procedures which were implemented sowed the seeds of the next regulatory reform.

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

On 31 December 1930, the Fascist Government issued a secret decree mandating the *Istituto di Liquidazioni* (the heir of the Special Section) to offer loans and advances to a whole list of financial institutions, including Credit. This then led to a secret deal (*Convenzione*) of 20 February 1931 between the Bank of Italy, the Ministry of Finances and Credit. The latter accepted a restriction of its activities to "ordinary" (*i.e.* short-term) commercial bank operations in exchange for a large liquidity injection. Credit's industrial stakes were passed on to a financial firm. This deal is particularly relevant as it represents the first significant step towards the subsequent regulatory legislation, based on the separation between commercial and industrial banking (Gigliobianco, Giordano and Toniolo, 2009). In fact, Credit was banned from underwriting shares in industrial or real estate firms and was forbidden speculative trading in securities and real estate. In July 1931, Comit too turned for help to the Bank of Italy. In October, another *Convenzione* between Comit and the Government provided for the acquisition of the totality of the bank's industrial stakes by its financial firm, which obtained an *ad hoc* loan from the *Istituto di Liquidazioni*. Thereafter, Comit's activities too were restricted to commercial banking.

The crisis was finally settled in March 1934 by three *Convenzioni* between the State and each of the three main mixed banks (Comit, Credit and Banco di Roma). The idea was to free the latter both from their excessive debt burden towards the Bank of Italy and from their excessive credit exposure towards firms. All the industrial assets of the banks were transferred to the *Istituto per la Ricostruzione Industriale* (IRI), which also took over the control of the banks. The

banks were banned from acquiring stakes in industrial or commercial firms, directly or indirectly. The *Convenzioni* of 1934 were a significant milestone in the new re-regulation wave, in that they not only re-organized the banking sector as it had emerged from the crisis, but also contained regulatory prescriptions which inspired the 1936 legislation and which were, under this new guise, extended to all deposit-taking institutions, in an explicit intent to prevent further crises. The rescue of the three main banks was, in fact, an explicit *occasio legis* (Porzio, 1981, p. 14). IRI's "brain trust" – made up of Menichella, Beneduce, Braidotti, De Gregorio, Paronetto and Saraceno – was convinced that a successful "banking reform" had already been attained by 1934, in that the successive steps (*i.e.* the a new banking law) were "obvious" (Saraceno, 1978, p. 9).⁹⁶ Assonime was of a similar view.⁹⁷ Fascist economists, such as Fabrizi and Mengarini, were instead more cautious on the matter and preferred to talk about a reform *in itinere* (Santoro, 1981, p. 31). Jurists, on the other hand, denied legal value to the bank-industry separation principle decreed by the *Convenzioni*, principle which was only asserted later by the 1936 banking law (Santoro, 1981, p. 32), and, as we shall see, only implicitly.

The 1930s banking crisis brought home to legislators the inadequacy of the 1926 law in guaranteeing financial stability, for two reasons: *a)* the law turned out to be incapable of handling new entities, such as the mixed banks turned into holding companies, and the regulatory tools introduced proved to be unsatisfactory; and *b)* the law was also not sufficiently enforced, especially due to lax supervision of the major financial institutions. On the contrary, the crisis management and crisis resolution measures implemented in the 1930s were effective, due in particular to two main features: *a)* the (partial) secrecy with which the rescues were conducted and the pressure set on depositors not to withdraw their savings, which fended off bank runs (Toniolo, 1995);⁹⁸ *b)* a learning-by-doing process, which proved that something had been learned from the previous banking crisis of the 1920s: no big bank was, in fact, allowed to fail this time round, yet at the same time no mixed bank burdened by frozen assets was allowed to survive.

⁹⁶ Saraceno (1978, pp. 8-9) explicitly defined the 1934 *Convenzioni* an actual "reform", rather than a "rescue" or a "reorganization" of the banking sector.

⁹⁷ Assonime and industrial firms in general (represented by Confindustria) were favourable, this time round, to regulation, and in particular to the abolishment of mixed banks (Santoro, 1981, pp. 31-32).

⁹⁸ Giordano (2007, p. 40) traced the necessary conditions for such a *modus operandi*, which he acknowledged were favourably met by the Fascist dictatorship.

What precisely did the new legislation of 1936 impose on the banking sector?⁹⁹ The Act incorporated the idea of one sole regulatory authority, the *Ispettorato per la difesa del risparmio e per l'esercizio del credito*, subordinated to a Committee of Ministers, led by the Prime Minister.¹⁰⁰ Head of the Inspectorate was, however, the Governor of the Bank of Italy and, *de facto*, the Inspectorate never operated separately from the bank of issue.¹⁰¹ Large discretionary power was attributed to the Inspectorate, which could dictate instructions and decide on many regulatory issues case-by-case.¹⁰² Overall, the powers assigned were so ample that arm-twisting became very effective, enabling the institution to reach many objectives, even ones not explicitly stated in the law. The law also marked the final transition of the Bank of Italy from a bank of issue to a modern central bank, with three functions: control of money supply, last resort lending and bank supervision. Its commercial banking activity was, in fact, discontinued and its ownership was reserved to public banks and public insurance companies.

The new perimeter of regulation included two separate categories of institutions, distinguished according to the maturity of their liabilities: short-term vs. medium/long-term. The former category was regulated by Title V of the law, a dense collection of requirements and restrictions. The latter category, on the other hand, was subjected to Title VI, which simply transferred to the Inspectorate the existing regulatory and supervisory powers attributed by previous *ad hoc* laws to various regulating entities.

The tight inter-relations between deposit-taking banks and industry were pinpointed as the main cause of the 1930s banking crisis, as the “root of all evil” (Istituto per la Ricostruzione Industriale, 1937).¹⁰³ The 1936 legislation confirmed

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⁹⁹ What is commonly defined as the banking law of 1936 is actually made up of the law 7 March 1938, with amendments made by the successive 7 April 1938 law. These two laws were the result of the conversion of two legislative decrees respectively of 12 March 1936 (No. 375) and of 17 July 1937 (No. 1400).

¹⁰⁰ The previous 1926 law had in fact envisaged three regulatory and supervisory authorities: the Ministry of Finance, the Ministry of the National Economy and the Bank of Italy, the latter two in subordinated positions. See Gigliobianco, Giordano and Toniolo (2009, Appendix I) for a description of the different regulating entities in Italy's banking history.

¹⁰¹ In 1947 a functional separation between the direction of credit flows (assigned to a reorganised Committee of Ministers, CICR) and bank supervision (assigned to Bank of Italy) was introduced. The Inspectorate was abolished.

¹⁰² As Galanti (2008, p. 2) underlined, Italian banking legislation was a legislation “of principles, of allocation of powers with a proxy of regulation to the secondary legislation” of the regulating entity. This is clear in the 1936 Banking Act, but he also traces this characteristic back to the laws on banks of issue of the XIXth century.

¹⁰³ See Barbiellini Amidei and Giordano (2012) for a comparison between the “roots of all evil” in 1930s Italy and U.S., addressed by the respective legislators.

the separation between the two sectors by subjecting the purchase of certain types of assets by commercial banks to the Inspectorate's authorization. In the following years, the Inspectorate denied authorization to short-term liability banks to extend long-term loans or to purchase industrial shares. The issue of bank ownership was also not explicitly treated in the 1936 legislation. One reason was that by that time most banks were under public control, making the issue less relevant.¹⁰⁴ In order to stymie the purchase of bank shares by non-financial firms, moral suasion was used by the regulating entity.

The limitation of competition was another predominant feature of the new regulation (Gigliobianco, Giordano and Toniolo, 2009). The belief that competition was the major source of banking instability, discussed in the debate leading up to the 1926 law, was taken to extreme levels in 1936. The Bank of Italy itself believed that, after the suspension of the bank cartel in 1930, cut-throat competition between banks had been responsible for high interest rates on bank deposits, in a struggle to attract depositors in a low-liquidity market (Bank of Italy, 1932). The regulators were concerned that price competition in the market for deposits would induce banks to take excessive risk in their investments or to operate outside their core banking business, with negative effects on the stability of the banking sector.¹⁰⁵ In 1933 a blanket bank cartel was introduced by the Government fixing mandatory interest rates on deposits. The 1936 legislation not only allowed price caps, which killed interest rate competition, but denied banks other competitive tools such as free branching. Compulsory mergers and liquidations were part of further "structural regulation" (Costi, 2007, p. 59). The emphasis set on other regulatory instruments, such as capital adequacy, was thus decidedly inferior to the one attributed to the anti-competition measures. Finally, information disclosure, on-site examinations and enforcement were made more effective.

Given the totalitarian political regime at the time, to gain understanding of the role of contemporary economists in defining the 1936 Banking Act, we adopted several strategies.

i) The first one was the traditional analysis of publications in economic journals concerning banking regulation, as well as of the volumes on banking

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¹⁰⁴ In fact, the share of private banks' assets dropped from 55.6 per cent of total assets in 1927 to only 16.96 per cent in 1936 (Ferri and Garofalo, 1994, p. 138).

¹⁰⁵ See also IRI note of February 1937 (reported in Cotula, Gelsomino and Gigliobianco 1997, pp. 128-152) on the (rejected) "Proposal to allow ordinary credit institutions to extend medium-term credit," which stated that the increase in bank profits, consequent to limits on branching and price regulation, reduced the need for risk-taking and thus contributed to the stability of the system.

used as university textbooks in the 1930s.¹⁰⁶ Before focusing on this aspect, a brief digression must be made on the evolution of economic science in Italy after WWI. If until the Belle Epoque, the two predominant schools were the marginalist and *lombardo veneto* ones, during the war a “national economy doctrine” (Cardini, 1993), a highly interventionist and protectionist approach, had developed; in the second half of the 1920s and in the 1930s, economic nationalism became corporativism, in which the key words became “direction” and “control”. The final aim was in fact to build a disciplined and controlled economy, subordinated to the superior interests of the nation. Economic science was hence not to be a set of theoretical elaborations, but a practical guide which should suggest applicable measures aimed at strengthening the national economy (Cardini, 1990, p. 379).¹⁰⁷ The institutionalisation of the corporative economy, however, was more the result of political decisions, rather than of theoretical developments (Guidi, 2000).

In the years prior to the introduction of the new Banking Act and to its conversion into law in 1938, very few interesting articles on banking appeared. Mostly, the academic literature expressed a general consensus for the Fascist regime, with few variations.¹⁰⁸ As Morelli (1984) and Cova (1999) too underline, this does not imply that banks and their regulation were deemed unimportant, rather the fact that opinions were not freely and publicly discussed in the decade under study. Two are the main reasons adduced: *i*) the official press releases, subject to controls, were the only source of information, while many Government measures undertaken were not made public; and *ii*) most economists had acquired a prudential attitude in those years. However, it is not correct to assume that all economic debate was annulled during Mussolini’s dictatorship: it was, in fact, encouraged when of use to the regime.¹⁰⁹ Nonetheless, the written economic

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¹⁰⁶ As well as the journals mentioned in note 12, the following monographs on banking theory were consulted: Garrone (1934); Fanno (1937); Renzi (1938); Landi (1939); Osio (1939).

¹⁰⁷ Interestingly, De’ Stefani in the late 1920s, from being a supporter of authoritarian liberalism, became an advocate of State intervention, as the following citation suggests: “At the beginning economic policy was called economic policy; then it became, due to liberal influences, simply economics. Maybe tomorrow it will be called administration techniques” (De’ Stefani, 1932, p. 183).

¹⁰⁸ This is evident even when excluding those articles published in “regime” journals, in which rhetoric and celebrative tones reigned. See Bini (1981) for an analysis of these articles. For a general study of economic thought under the Fascist regime see Barucci (1981).

¹⁰⁹ An example is the Conference held in Pisa in May 1942, whose aim was to define the economic order Italy was to adopt in the case of the then probable victory of Germany in WWII. An invited discussant was, in fact, Demaria, who strongly defended economic freedom clashing with the prevailing view of corporativists. The “Demaria scandal,” as it was named, did not lead to political repercussions, since the tinge of the discussant’s speech was highly predictable as his position on corporativism and protectionism had already been clearly expressed in a preceding

discussion before and after the 1936 banking law was extremely scanty, hinting to a marginal role of economists in its making and in its *ex post* justification. We here divide the analysed publications into three blocks, with respect to the topic discussed.

a) *The aims of the law.* The declared aim of the 1936 law was not only to assign the safeguard of savings to the State but also the control over credit flows. The 1930s regulation, in fact, had an allocative aim, as well as a stability purpose: by controlling credit, the Government could direct investment flows towards specific sectors of the economy.¹¹⁰ In this sense, when it was passed, the law was defined a “corporative credit statute” (Spinedi, 1936, p. 88).¹¹¹ Many were the reasons adduced by contemporary economists to regulate both deposit-taking and credit activity. On the one hand, savers had no control on their money they deposited in the banks and hence needed to be legally protected; on the other, credit was directly related to the national economy, since its fluctuations and risks had a direct impact on interest rates, and hence had to be regulated. A consensus (which excluded a staunch liberal such as Einaudi) developed on the principle that both savings collection and credit extension were “functions of public interest” (Jacuzio, 1936, p. 405; Mazzucchelli, 1936, p. 173; D. Supino, 1936, p. 532; Osio, 1939, pp. 138-139; Renzi, 1938, pp. 17-18).¹¹² The aim of the law was thus not only to intensify the supervision of the banking sector, but also to guide and

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article of 1941. Thus, the Fascist regime carefully chose the occasions and the matters on which economists were allowed to talk and write.

¹¹⁰ The allocative intent of the 1936 Banking Act is transparent when reading the reports of the *Corporazione della Previdenza e del Credito* and of the *Confederazione Fascista delle Aziende del Credito e della Assicurazione* in the regulatory debate preceding the enactment of the law (see e.g. *Confederazione Fascista delle Aziende del Credito e della Assicurazione*, 1935, “Functional and territorial distribution of credit entities” in Cassese, 1988, p. 30). It can also be noticed in the statistical and economic debate on the production of banking statistics by branches of economic activity going on in the same years (see e.g. the letter written by Molinari, Director General of the National Statistic Bureau – *Istituto di Statistica* – to Baffi, then economic researcher at the Bank of Italy, of 22 September 1936, which can be found in the Historical Archives of the Bank of Italy, ASBI, Carte Baffi, 233, and of which pp. 4-5 are here of interest).

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

¹¹² Einaudi (1935) insisted with his criticism of all forms of State regulation reducing competition and consumer choice. In general, he defined the fixing of rigid laws on bankers’ conduct as the worst mistake possible. He had by then become, however, a discordant voice. Napolitano (1939, p. 694) emphatically declared that the days of the “doctrine elaborated by the Anglo-Judaic triumvirate Smith, Ricardo Malthus” were finally over, since the corporativist Fascist regime had gained control over credit, investments and banks.

coordinate the credit activity, aligning it with the superior interests of the national economy. The Inspectorate's instructions were supposed to funnel savings to the investments which were most compatible with Italy's production needs, in order to foster economic development (Jacuzio, 1936, p. 407; Fantini, 1936, p. 340). Not only was credit supposed to be directed towards strategic sectors, but also the quantities of production in each sector were to be controlled, according to the extremists, via credit rationing or expansion (Miceli, 1936). The "social-economic utility" (Bianchini, 1938, p. 931) of savings was stressed. Savings were often equated to permanent and productive investments. If banks defaulted on their obligations, savers were affected and hence the State could not remain passive. Arias (1936) underlined how the corporative economy had entered into a reconstruction phase and, via the credit channel, aimed at rationalizing production. Finally, Parrillo (1938) stressed how the new credit setup was indispensable to attain autarky.¹¹³

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

c) *The bank-industry separation.* The intellectual debate behind the temporal and functional specialization of credit institutions was not so clear-cut. On the one side, Einaudi (1934) persevered in emphasizing the importance of bank-industry separation, yet via market discipline and banks' self-regulation. "Investment loans" were to be extended only by *ad hoc* institutions, such as IRI.¹¹⁵ He concluded by stating that "past experience will have been useful if it will give

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¹¹³ All the mentioned economists were also insistent in specifying how the 1936 banking reform, which led to State control over the banking sector, had not brought about a banking and industrial "statalisation" of socialist nature, which was present in other foreign countries. See also Landi (1939) on this point.

¹¹⁴ The Bank of Italy had instead fervently objected to the veto of direct discounting, before the approval of the law, considering it an excessive limitation of its activities (Bank of Italy note, dated June 1935, in Guarino and Toniolo 1993, pp. 915-925). The main argument adduced was the control over banks that the discounting activity gave the Bank of Italy.

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

birth to a ‘permanent’ division of labour between banks on the one hand and investment institutions on the other” (Einaudi, 1934, p. 26). Federici (1936) attempted to explain the underlying logic of the temporal specialization of banks. After the 1930s banking crisis, the average Italian saver had learnt a lesson: if she was still unable to decide whether to invest her capital in industry Alfa or in industry Beta, she was instead now able to choose between depositing her savings or buying a fixed-return bond. So, in this scenario, if bankers invested savings long-term, then they would be replacing their will to that of the savers themselves, a dangerous and unjustifiable move. Finally, Renzi (1938, p. 19) defined as a “fundamental” canon of banking orthodoxy the fact that: “the nature and the combination of a bank’s assets, in particular with respect to maturity, must correspond to the nature and combination of its liabilities.”

On the other hand, Lume defined the *Convenzioni* as a transition from a mixed banking system to an ordinary credit banking system. Banks returned to their classical activities of payments-system clearance and of support to trade via commercial credit (Lume, 1934, p. 721). He was not alone though in believing that medium-term industrial credit could be extended by commercial banks in the future, but with the necessary caution, so as not to repeat the experience of the large mixed banks. The director of Comit, Mattioli, too strongly believed in restricting banks to commercial credit activities, in order to allow the Bank of Italy an effective control over circulation, as well as guaranteeing its role of bank of banks (Minutes of Comit’s board of directors’ meeting of 12 March 1934, cited in Rodano, 1983, p. 101).¹¹⁶ Nonetheless, he was conscious of the fact that the limitation of banking activities to mere clearance was not feasible, differently to the British case where the money market was more developed and the volume of foreign trade larger.¹¹⁷ Furthermore, the three ex-mixed banks registered large credits towards IRI, which in turn financed industrial firms. Hence, indirectly, short-term bank liabilities were being used to fund long-term investments.¹¹⁸ Mattioli thus proposed, due to this *de facto* situation, to allow ordinary banks to extend some industrial credit.¹¹⁹ The idea of allowing deposit-taking banks to return to medium-term lending stirred a heated debate in 1937, with the Fascist Credit and Insurance Confederation and Assonime supporting it and some banks

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

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

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

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

and IRI against it.¹²⁰ The request by Assonime, representative of industrial capital, proved how dependent the major Italian firms were on the banking system. However, in a statement to the Bank of Italy later in 1937, Mattioli pointed out the weakness of Italy's financial system due to the total inadequacy of the existing long-term credit institutions in funding industrial firms. In particular, they were not able to engage in trust-based relationships with their clients. The banks were thus by him invited to step in and aid the creation of these relations, in order also to better appraise the firms' creditworthiness. Furthermore, banks were to be permitted to extend all credits which accompanied the production cycle, even if they were to become permanent credits.¹²¹ But, in the end, no amendment was made in this sense to the 1936 legislative decree when the law was actually passed in 1938.

ii) To gain further insight on the role of economists in contributing to the design of the 1936 Banking Act, we took a second step: we examined the documents written by who actually designed the law, i.e. the IRI braintrust, to see if any explicit or implicit references were made to economic streams of thought or to individual economists. The IRI braintrust, if we exclude its President Beneduce, was not in fact made up of trained economists.¹²² We here recall two IRI documents in particular. The first is the report presented by Menichella, then Director General of IRI, to the Prime Minister on 5 December 1933 (reported in Cotula, Gelsomino and Gigliobianco, 1997, pp. 77-124), in which we believe the spirit of the 1934-38 Italian banking reform was summarized. Government intervention was at the time deemed ineluctable, since "[t]he current situation cannot carry on: the Banks are not interested in the vital necessities of industrial firms and continue to bleed them dry to their own advantage; this will inevitably

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¹²⁰ With respect to IRI's position, we instead mention the statement made by Menichella to the Credit and Insurance Corporation in 1937: if short-term liability institutions were to go back to supplying medium and long-term credit "it is worth not only stopping at the form and authorising the extension of credits, but also looking into the substance of things and authorising even the purchase of industrial shares" (Menichella 1937, cited in Cotula, Gelsomino and Gigliobianco 1997, p. 139).

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

¹²² For instance, Donato Menichella earned his degree at a well-known Institute of Social Sciences in Florence which had the aim of training future diplomats and politicians. He later acquired great experience in directing and liquidating banks, hence becoming an esteemed *tecnico* of the banking sector. See Cotula, Gelsomino and Gigliobianco 1997 for an account of Menichella's life. Pasquale Saraceno instead studied at Milan's Bocconi University as a pupil of Italy's famous accountant Gino Zappa, who also contributed to the institution of IRI. If the framers of the Italian 1936 Banking Act cannot be defined as economists, they definitely cannot be squared into the category of corporatist economists (for example, Zappa's unmistakable anti-fascism and lack of adherence to the corporatist theories is documented in Biondi 2002, pp. 20-22).

go on until the Banks own the instruments of this bleeding: credit lines, promissory notes, financial discounts, etc.” (p. 92). A more philosophical statement follows: “[...] the Banks are not the masters of the Nation’s economy anymore, but they are only the means to exercise a particular type of credit, and not even the most important one, for the development of the productive activity of the Nation” (p. 94). Economic development was thus to become responsibility of the State. The Government intervention was to be “totalitarian,” i.e. from then onwards, banks were not only forbidden from holding shares, but they were also not to finance the capital structure of firms; “the legal form of the bank exposure cannot mask the economic nature of the exposures” (p. 106), or, in other terms, the principle of economic substance was to prevail over that of legal form. Long-term credit was assimilated to owning firms’ shares. Banks were to supply firms with the credit required by their production cycles, nothing more. Finally, the magnitude of the losses that the State incurred in rescuing the banks was the main justification for the State control over the banks, control which was to be “permanent” and “intelligent” (pp. 122-123).

What strikes the reader of the document is on one side its technical content, on the other the lack of economic theory grounding, a recurring feature in all IRI documents: not a single economist is quoted, nor any theory concerning the nature of credit or banking. Even Menichella’s report to the Insurance and Credit Corporation in 1937, which can be viewed as one of IRI’s most “theoretical” publications (IRI 1937, reported in Cotula, Gelsomino and Gigliobianco, 1997, p. 131), reads:

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

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

these bodies in the run-up to the enactment of the law, and the subsequent replies and rejections by IRI, as well as from the letter of the resulting law.¹²³

To understand the lack of any reference to economic thought in these documents, one must also consider that the decision process through which legislation advanced was now radically different from that prevailing in the preceding decades. Parliament was no longer the main arena of discussion, and public opinion was largely domesticated. Basically, the architects of a new financial order for the nation's economy had to convince one person of the viability of their ideas, and that person was Benito Mussolini. Harnessing economic theory or not depended on its usefulness in convincing the dictator: evidently Beneduce, Menichella and Saraceno, the leaders of the IRI brain trust, thought that quoting economists and their theories would not advance their cause.

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

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

¹²⁴ See Biondi (2008) for a discussion of Schumpeter's dynamic view of the firm, as a result of him using notions and reasonings not only from economics, but also from the fields of accounting and law.

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

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

With respect to the interpretation of Schumpeter's works in Italy, several articles are noteworthy. In his review of the second edition of "Theory of economic development" published in 1926, Ricci (1927, p. 659) recalled the role of banks in extending credit which was necessary to jump-start innovation and growth, but made no reference to Italy's banking system and to its newly introduced regulation, which then, in fact, did not have any growth-enhancing aim.¹²⁷ Schumpeter's volume was however translated into Italian only in 1932 – when the next banking reform was beginning to take form – and an abridged version was made accessible to the Italian public in the same year, edited by the anti-corporativist economist Demaria. It is interesting to see that the chapter referring to the role of credit (Chapter Three) was one of the parts of the book which was suppressed in order to obtain the desired condensed version, and was

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¹²⁵ Recall Einaudi (1922).

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

¹²⁷ This was the case instead of the 1936 Banking Act. Ricci was an economist who was strongly against the nationalist economic doctrine.

hence not commented. However, Fanno's outstanding article on production and credit cycles, published in 1931 in the "Giornale degli Economisti" was clearly influenced by Schumpeter's "Theory," which he explicitly quoted. In particular, Fanno referred to an "abnormal expansion of credit" by the banking system as a form of "forced savings," which, alongside the public's "spontaneous savings," were necessary to finance the production of instrumental goods and trigger the production cycle (Fanno, 1931, p. 359).¹²⁸

Schumpeter's later work of 1939, "Business Cycles" was reviewed two years later by the Italian economists, Ferrante and De Pietri-Tonelli. The former described Schumpeter's work in detail, often making connections to the theories of Italian economists, such as Pantaleoni and Fanno, but commented little on the role of bankers (Ferrante, 1941, p. 55). More interesting for our purposes is the second review, in which the author drew some explicit analogies to the Italian corporativist system.¹²⁹ Furthermore, De Pietri-Tonelli commented in detail the role of bankers. First, De Pietri-Tonelli underlined how Schumpeter noted "the inconveniences of industry controlling banks and of banks controlling industries" (De Pietri-Tonelli, 1941, p. 941), yet did not use this theoretical foothold to support the Italian banking reform. Secondly, Schumpeter rejected banks being dependent on Governments, political parties, public opinion, which would hinder them from selecting clients according to an economic rationale, but De Pietri-Tonelli hurriedly emphasized how the Austrian economist was referring to the credit control in a socialist system, and not to that of corporativism, in which credit was controlled by an appropriate regulatory body (p. 941).¹³⁰ The impression one draws is that the author had a high esteem of Schumpeter's work and aimed at disseminating it in Italy's academic circles: in order to do so, he had to emphasize its non-incompatibility with the corporativist regime. On the other hand, however, he did not exploit certain parts of Schumpeter's reasoning, such as the call for bank-industry separation, which could have given a sounder basis to the Italian banking reform.

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¹²⁸ Santarelli confirms the influence "Theory of Economic Development" had on other important Italian economists such as Del Vecchio, Demaria, Vito and stresses how all these economists, Fanno and Einaudi included, opened up "to the 'novelty' of the international debate" (Santarelli, 1984, p. 508).

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

¹³⁰ As seen in note 113, when analysing economists' articles in the main Italian scientific journals, all the authors stressed how corporativism was different from socialism.

Our conclusion on the 1930s is that economic theory was not called upon in the design of the new banking legislation for four different reasons. *A)* The purely “corporatist” economists lacked the knowledge of economic theory, the vision and the theoretical sensibility to do so and thus limited their articles to technical disquisitions aimed at eulogizing the regime’s actions. *B)* Some, more cultured, economists were well aware of the economic debates going on in the international *fora*, and in fact did not refrain from ably commenting them. Yet they were not willing to use them to the regime’s advantage. The examples of Fanno and De Pietri-Tonelli are poignant. *C)* The anti-regime liberal economists were silent, either because of personal choice or because of rejection of their articles by scientific journals or because of actual persecution. *D)* The IRI brain-trust could easily have gained access to economic theory, but was so confident of its practical supremacy that it did not take any step in that direction. The overall result is that Italian economists were practically absent in the making and the commenting of the 1930s regulation.

To sum up, the 1930s *Convenzioni* led to the abolishment of mixed banking and set the scene for the extensive 1936 banking law, which had the two-fold aim of safeguarding savings and controlling credit flows. A vast range of regulatory tools was adopted and great discretion was assigned to the sole regulatory entity, the Inspectorate and then the Bank of Italy. Little however can be extrapolated from contemporary journals with respect to the economists’ contributions and reactions to the 1936 Banking Act, although it emerges that the relevant international economic theory was known to at least some of them. The law was a product of the IRI brain trust, which elaborated its own pragmatic “doctrine” and did not refer to any leading economic theory.

The 1936 law lived well beyond the crisis it had triggered from, survived the political changes that followed WWII and held steady until the late 1980s. Right from the start, it was admitted that the banking reform could be retouched, due to the future inevitable structural changes of the economy: “the only immutable principle in reforms is the possibility of them being retouched in the future” (Banca d’Italia, 1938). Yet, the 1936 law was only marginally amended in the half century to come.¹³¹ The fact that the Act matured in the IRI environment

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¹³¹ For example, the Economic Commission of the Constitution Assembly set up in 1946 stated “In harmony with the criteria that inspire the current banking law (criteria that, even with respect to the current economic conjuncture, we believe must remain unchanged) [industrial] credit must be extended by special institutions, clearly separated from the ordinary credit ones and authorized to collect funds corresponding to the maturity of their assets” (Ministero per la Costituente, 1946, p. 217). Special sections of deposit banks, which made loans to industry, had also been created in the preceding years (*Sezione di credito speciale del Banco di Napoli*, *Sezione di credito speciale del Banco di Sicilia*), as well as Mediobanca, constituted by the three ex-mixed banks. “Strict laws have to be dictated for such institutions to eliminate the danger of interference between the

and hence was not direct expression of the regime then in power, the general loss of confidence in market forces after the 1929 crash, as well as the great discretion attributed to the regulatory body – which gave the banking system an adequate degree of elasticity –, were some of the reasons, highlighted by the literature, of the “long life” of the 1936 law (Giordano, 2007, pp. 61-62; Galea, 2008, pp. 589-591). One may add that the Banca d’Italia was also very much in favour of the legislation as it was, since it attributed ample powers to it. One must recall however that the central bank did not act alone in the banking sector, as the above-mentioned Committee of Ministers (CICR), which set out general guidelines concerning credit activity, also operated throughout these years.

In guaranteeing financial stability, the Banking Act, however, sacrificed competition, thus leading to inefficiency (de Cecco, 1968; Albareto and Trapanese, 1999, pp. 120-133), compounded by the extensive public ownership of the banks. Also, the straight-jacket imposed on the banking system probably contributed to the underdevelopment of the Italian financial system in the following decades, by stifling financial innovation. The dominant paradigm based on the primacy of financial stability was, however, strongly entrenched in the academic circles, as well as within the regulatory environment, up until the 1980s. This was accompanied by a general consensus from all parties in the financial field – Treasury, Bank of Italy, commercial banks, large debtors, households, as well as economists themselves – for a non-competitive banking system. We ought not to forget that in Italy antitrust legislation was introduced only in 1990.¹³²

To conclude, economists did not pick up the debate on the 1936 Banking Act for many decades. Only in the mid-1980s the climate started to change. Some claimed that the 1936 Banking Act did not state the aims of the law and gave an excessive discretionary power to the authorities, which was at odds with the need of transparency in regulation (Visentini, 1986). Others deemed it still valid, although economic theory had much changed. To give just one example, research promoted fifty years later (Caranza, Frasca and Toniolo, 1986) underscored the

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management of ordinary credit and that of industrial credit, in order to preserve the integrity of the guiding principle of the current banking law confirmed and honed by experience” (Ministero per la Costituente, 1946, p. 237). The functional and temporal specialization of Italian credit institutions was hence maintained in the post-WWII Italy, as well as all the other prescriptions of the 1936 Banking Act. The only immediate amendments to the law were the one concerning the abolishment of the Inspectorate, replaced by the Bank of Italy, and a decree of 1946 which subjected the just mentioned medium and long-term credit institutions established after 1936 to the more restrictive regulation of short-term credit institutions. Some even argued that the Art. 47 of the 1948 Italian Constitution (which reads “[t]he Republic encourages and safeguards savings in all their forms; disciplines, coordinates and controls the exercise of credit”) vested the 1936 Banking Act and its subsequent amendments with a constitutional value (e.g. Merusi 1981).

¹³² Law 10 October 1990, No. 287.

evolution of monetary theory in the five decades after the introduction of the law, which however did not lead to a questioning of the act. In the 1930s, the belief that banks had to be regulated because of the monetary nature of their liabilities (deposits) and because of the possibility of unlimited expansion which introduces instability into the financial system, had dominated. In the 1960s Tobin's "new view" had rejected the assumption of banks being any different from other financial intermediaries (Tobin, 1963, p. 410). All financial intermediaries had the purpose of satisfying simultaneously the portfolio preferences of borrowers (who wished to expand their real assets beyond the limits of their own net worth) and lenders (who wished to hold part of their net worth in assets of stable money value with negligible default risk). Hence, financial intermediaries' assets were borrowers' obligations, whereas financial intermediaries' liabilities were lenders' assets. There is simply differentiation, amongst different types of financial intermediaries, in the products offered to the two groups of customers. Caranza, Frasca and Toniolo (1986) resorted to the later developments of monetary theory to again affirm the special nature of banks, but this time due to their assets and not to their liabilities as in the 1930s literature: banks, by extending loans and owing to the close relationship with their customers, signal the creditworthiness of certain clients and hence produce information for the market (Goodhart, 1986). The scholars therefore concluded that:

In face of the distinctive feature of banking, both burdens (regulation; restriction of activities) and guarantees (lending of last resort) of banks are equally specific. They are envisaged by the current legislation. Neither theoretical developments, nor those of markets and financial instruments, nor the commitments undertaken with the European Economic Community suggest a change in this legislation (Caranza, Frasca and Toniolo, 1986, p. 31).

Yet liberalization pressures from the European Economic Community did actually contribute to the softening of the 1936 Act and to the introduction only a few years later in 1993 of the new Banking Act, the law which is still in force today.

7. Conclusions: regulation and economic theory in Italy, 1861-1936

In the wake of a *financial crisis*, it is natural for the regulatory pendulum to swing in the direction of those who demand more or stricter regulation. The players in

such junctures are many: savers, politicians, financial lobbies, borrowers, jurists, regulators and, naturally, economists. In these conclusions we thereby summarise the main drivers and actors involved in the definition of Italy's four main prudential regulation laws from 1861 through to the 1930s, together with a brief reminder of the actual regulatory outcomes. What results clearly is that economists as scholars had in mind the maximization of social welfare, via the prevention of disruptive and painful banking crises, which could be attained by an array of solutions proposed by them (market discipline, financial education, regulation, self-regulation), but the gap between theory and policy was inevitable, also given the interplaying of many interest groups. Disentangling the *public* and *private motivations* towards regulation is extremely hard, but what emerges from our historical narrative is that both were relevant drivers in Italy's first seventy years of banking regulation.

After the country's political unification, the first financial crisis that triggered an actual shift in banking regulation was that of 1888-1893. In fact, the loosely regulated banks of issue, engaged in overtrading and risky loans to the construction industry, were perceived to be responsible for the crisis. The severity of the crisis thus drummed up support for strict regulation of the banks of issue, in order to prevent illegal note issuance and fraud in the future: the banks were therefore merged, downsized in their commercial business and tightly regulated by the 1893 banking law. The main priority was however to solve the problem of Banca Romana's liquidation and hence to settle with its shareholders and creditors in an orderly manner. Political interests were evident, since the scandal which had erupted undermined the credibility of the State itself. This explained both the prompt regulatory response to the crisis, with the defeat of the lobbies of the issuing banks at risk of disappearing (which had been active until the very last), and the fact that the 1893 law turned out to be a political compromise between the remaining banks of issue, the new Bank of Italy and the Government. This balancing, and sometimes convergence, of interests of these players can be seen when reading the text of the law itself. It did not in fact introduce convertibility, favoured by economists, but feared both by the banks and by the Government, but only limits on note issuance. It did not unify note issuance, yet the Bank of Italy immediately emerged as a designated leader in the issuing-bank league and the two Southern banks were kept alive for a few more decades mainly for political reasons. Economic theory, which championed free banking (except for the *lombardo veneti* economists) and convertibility (with no exceptions), was thus largely disregarded.

Financial instability re-emerged in 1907, this time with commercial banks as the main actors. The 1907 de-regulatory law of the banks of issue, which focused on lender of last resort arguments, was widely accepted by the main Italian economists, who acknowledged Bagehot's teachings, albeit without

quoting him.¹³³ The opposition to any commercial bank regulation was strongly voiced by most economists who won the day. It took in fact another crisis in the wake of WWI for a new banking law to regulate commercial banks in 1926. The latter was centred on setting significant limits on competition in the banking sector, which were by then strongly supported by most economists. There was instead very little debate on the capital ratios, also introduced by the law, since they were considered mainly banking technicalities. Economists generally considered them as undesirable rigidities imposed onto the banking system. Finally, bank-industry separation, called for by some economists, was instead not introduced. Although this first banking legislation, whose main contents were on the whole bolstered by most economists, was passed in 1926, financial lobbies were then successful in steering its enforcement away from the current practices at least of the big banks.

Italy's mixed banks then became illiquid (insolvent under certain conditions) in 1929-30, threatening the stability of both the financial system and the real economy. The ensuing regulatory wave originated from the need to prevent the recurrence of financial crises which – in the view of the IRI brain trust – stemmed from the close interlock between banks and industry. Since the banks were very weak, IRI was able to curb their influence by confining them to the funding of firms' working capital, and to expel them from the decision processes concerning investment thereafter. The 1936 Banking Act attained the much acclaimed bank-industry separation, but with no reference whatsoever to the main economists' proposals on the matter: simply, the rules contained in the deals signed during the bailouts percolated into legislation. IRI was the new protagonist of Italian economic life, both through the ownership of firms and through a privileged access to the bond market, with implicit State guaranty. The Act of 1936 matured entirely in the IRI environment, which deemed itself to be "self-sufficient" and did not need to refer to any particular economic theory. Economists on the other hand were not able – in the case of the corporativists – or willing – in the case of the other economists – to buttress the law with their knowledge of the modern economic doctrine. The politicians (at that time the Fascist regime) backed the very pervasive regulation designed by the *grands commis* entrusted with the management of IRI and were only too happy to accept it when it was actually finalized, hoping to be able to use the law as a means for directing credit according to priorities set by themselves. The regulator (*i.e* the Bank of Italy) rapidly learned to appreciate the vast powers which had been put at its disposal. The borrowers organized in associations were mainly large firms (Assonime from 1910, Confindustria from 1919): if they had been against the

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¹³³ Interestingly, it was Einaudi who in 1905 first translated "Lombard Street" into Italian.

1920s Government “interference” in the banking sector, in the 1930s they looked favourably to the idea of disbanding the large mixed banks.

In two cases – 1893 and 1936 – the banking regulation introduced was later perceived as having overshoot its aim of effective crisis-prevention, and was subsequently downscaled. As for the 1893 law, corrections were made in the following two decades, so that the regulatory framework for the banks of issue remained heavy, but compatible with the lending of last resort activity. As a result, some of the more profit-oriented shareholders of the banks of issue reacted by shifting towards mixed banking, more rewarding in terms of revenues and business relations. On the contrary, in the years after 1936 the only significant regulatory move was towards de-bureaucratization – the Inspectorate was abolished – rather than actual de-regulation. The Bank of Italy and the political authority maintained that the whole panoply of instruments was needed, even if some were never used. The strongest motivation for not re-privatising the banks was that in Italy financial capitalists as such did not exist,¹³⁴ thus implying that the private banks, in one way or another, would fall in the hands of industrialists, which was anathema.¹³⁵ At the same time, the dense regulatory landscape meant that no capitalist could be attracted in the field, and in fact private capital lost most of its relevance. As a result, demand for de-regulation was suppressed in its cradle. It was only in the 1980s that financial innovation and liberalization emerged: this new phase led to bank privatizations and to new legislation which was summarized in the banking law of 1993.

The existing *political regime* does not seem, hence, to have been a discriminating factor in determining the influence economic theory had on bank legislation: both in the liberal Italy and in the Fascist Italy, in fact, economists were not heeded. Although it must be specified that in the 1890s economists spoke out before, but also after to criticize the enacted law, whereas in the 1930s they were not allowed to do so freely.

This point takes us back to the issue of *Italian economists’ authority* raised in Section 1. In the second half of the XIXth century, economists’ growing involvement in academia was a significant channel of legitimacy. Authority was

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

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

also decreed by the numerous presence of economists in Parliament until WWI.¹³⁶ Similarly to what was occurring in France and Germany, the institutionalization of economics was orchestrated by the State in the process of its own building.¹³⁷ 1893, the year of the banking law, was possibly however too early on in the institutionalization process of the economics discipline for economists to be entirely heeded. Certainly, economists had a weaker drive in this occasion than the other social actors, especially banks and politicians, whose profits or re-election were at stake. Furthermore, the theoretical divide between Italian marginalist and *lombardo veneti* economists could have weakened the professions' influence. Finally, one may add that the ineffectiveness of economic thought in orienting legislation in this period also depended on the *failure of economic theory* in understanding what truly needed to be regulated: hence, the missed chance of introducing commercial bank regulation in 1894.

At the eve of WWI Italian economists were numerous and well established both as scholars and as public figures. The minor severity of the 1907 and the 1920s banking crises probably explained the limited urgency to pass new banking regulation relative to the 1890s and 1930s episodes. This gave regulators time to appraise proposals from all parties involved. The long law-making process which ended in 1926 thus saw economists at the forefront, campaigning against harmful competition in the banking sector. Their "alliance" with the main bank of issue, the Bank of Italy, on this issue gave economists an extra foothold on which to stand in their policy recommendations, which were mostly taken into account by the new law.

However with the strengthening of the Fascist regime, the legitimacy of the economics profession began to falter, since the quality of the category as a whole deteriorated. The relationship with the State of economists who did not explicitly adopt positions of consent or submission became conflict-ridden, to the point that they lost the State's support or were actually persecuted. Universities

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¹³⁶ Interesting figures are presented in Augello and Guidi (2003). 34 economists were elected in the two chambers in the period under study; the presence of economists was increasing over the years (p. XXXI). To better gauge the dominance of economists in Parliament, Augello and Guidi (2003, p. XXXVII) suggest a comparison with similar professions (i.e. university professors of other disciplines): economists on average were over twice more numerous than doctors and nearly five times than engineers. Finally, economists' average participation in Parliament lasted 21 years (p. XLII).

¹³⁷ Abbott (2005) suggests in fact that States actually constructed themselves also owing to the effort made by key emerging professions to establish their own space. Intellectual professions have helped building modernity by using the instruments of knowledge and expertise, and mediation between State and society. Similarly, in modern times, European professionals are becoming important players in the building of Europe as a supranational political entity (Evetts and Dingwall, 2002). Other relevant works on the globalization of professions are Dezalay (1992), Dezalay and Garth (1996), Dezalay and Garth (2002a), Dezalay and Garth (2002b).

were very much impoverished with the exit of many talented academics.¹³⁸ Within the economics profession, there was therefore a progressive empowerment of Fascist/corporativist economists, among which many were crassly ignorant and were unable to unleash existing – but to them unknown or ignored – theoretical justifications to support the 1936 banking reform. There were also competitive challenges from other professions, which attempted and succeeded to penetrate the economists' field in those years, in particular jurists, technocrats and politicians. In fact, the framers of the 1936 Banking Act were not economists, as defined by us, but rather *tecnici*. Since they had to convince Mussolini, and not Parliament or the public opinion, of the viability of their ideas, it is not surprising that they deemed unnecessary to delve into theoretical disquisitions.

One final point: is it *desirable* that economists influence regulation? The Italian historical case-study shows mixed, and overall insufficient, evidence to draw conclusions on this point. In the two cases in which economic theory was not regarded, over-regulation ensued. It had to be expensively corrected soon after in the first episode and bore costs on the economy for decades in the second. However, the 1926 Banking Act, which heeded the main views expressed by contemporary economists, was not able to prevent a new bout of financial distress only a few years later. The 1907 episode finally shows that economists sometimes have good ideas – in this case, deregulating banks of issue – but lack daring in that they did not propose, as opposed to their foreign partners, to regulate commercial banks.

We have not extended our analysis to the (liberal) legislation introduced in the early 1990s in Italy. It could be shown, though, that it incorporated large portions of contemporary economic thought, and that economists played a primary role in designing it. This fact fits well with our analysis so far, in that the legislative process of the 1980s and of the 1990s was not conducted through the urgent needs of banking crises: it was rather the result of a domestic practical and intellectual evolution, much aided by the new international and especially European framework, which led to a strong consensus on the opportunity of deregulating and liberalising the banking sector. But this could be the object of fresh, future research.

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¹³⁸ See for example Zunino (2005) for a general discussion of the relations between the regime and the scholarly world under the Fascist and Nazi regimes, Finzi (2003) for an assessment of the impact of the racial laws on Italian universities, Romani (1997) for a case-study of Italy's Bocconi University under Fascism.

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