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Original Citation:

Availability:

This version is available <http://hdl.handle.net/2318/90412> since 2016-07-04T14:41:26Z

Published version:

DOI:10.1080/09672567.2010.540346

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Journal:	<i>European Journal of the History of Economic Thought</i>
Manuscript ID:	REJH-2010-0024.R1
Manuscript Type:	Article
Date Submitted by the Author:	02-Aug-2010
Complete List of Authors:	Marchionatti, Roberto; University of Torino, Economics
Keywords:	Einaudi, liberalism, methodology, applied economics

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Luigi Einaudi's economics of liberalism

Francesco Forte and Roberto Marchionatti

1. Introduction

Luigi Einaudi (1874-1961) is one of the most representative figures in Italian post-unification history. Ranking among the major Italian economists along with other great scholars such as Maffeo Pantaleoni and Vilfredo Pareto, his field of activity was, however, not limited to economics: for almost sixty years, from the end of the 1880s to the 1950s, he was a leading figure in Italian cultural and political life. Professor at the University of Torino and at the Bocconi University of Milano, the director of prestigious journals such as *La Riforma Sociale* and *Rivista di storia economica*, a columnist writing on economic issues first for *La Stampa*, and subsequently for *Il Corriere della Sera*, the Italian correspondent of *The Economist*,ⁱ Senator of the Kingdom, and, in the later postwar period, the architect of economic stabilization as Governor of the Bank of Italy, Budget Minister and Vice-President of the Council of Ministers in the De Gasperi government, he was then elected the first President of the Italian Republic after the Constitution came into force.ⁱⁱ

Economic historiography places Einaudi in the silver age of Italian marginalism, the era that followed the golden age of Pareto and Pantaleoni, peopled by economists of great doctrinal learning, who perfected and extended the earlier breakthroughs, active on the international level but with relatively little inclination to embrace new ideas. On this basis an opinion has taken shape, and is in fact perhaps predominant today in Italy – if one excludes the judgement of Francesco Forte (1962 and 2009) who considers Einaudi one of the greatest Italian economists ever – according to which he was indeed a great national figure but an orthodox economist, of limited originality, of solid doctrinal scholarship but with a few analytical weaknesses, “whose sway over Italian public opinion was far greater than the influence exerted by any other economist before or after him”

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3 (Faucci 2000: 278. See also Faucci 1990) by virtue of the public role he held and the type of
4 message he consummately transmitted, characterized by an anti-rhetorical tone, soundness of
5 principles, and an inclination towards pedagogy. On the international level, however, the
6 importance of Einaudi's contribution to public finance and the public economy is greatly
7 acknowledged: the most representative among such judgments is that of James Buchanan (1960),
8 who in his presentation and assessment of the great Italian school of public finance indicates
9 Einaudi as one of the important contributors to the Italian tradition.ⁱⁱⁱ On the whole, from the
10 existing literature it appears that Einaudi's oeuvre has not yet found a definitive position within the
11 history of economic thought.
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24 The present study addresses this substantially unsolved question. What kind of economist was
25 Einaudi really? A neoclassical economist, certainly, but what was Einaudi's neoclassicism really
26 like? Economic orthodoxy, i.e. the dominant economic school of thought in Einaudi's day, was
27 indeed neoclassical, but if this term is taken, as is frequently the case, to mean an analysis that
28 concentrates on the optimizing behavior of perfectly rational and perfectly informed individuals in a
29 static context, and which studies the resulting equilibria, then it is by no means easy to subsume our
30 author under this heading. It would perhaps be more correct to state that he belonged to the
31 mainstream of his age, where by 'mainstream' we mean the overall body of ideas embraced by the
32 most prominent groups in the academic institutions and major journals of a given period of time.
33 Enquiry into his thought should thus be set first and foremost within the framework of the era in
34 which his ideas arose and were gradually worked out. This preliminary contextualization can clarify
35 the nature of his links to the historical background. Secondly, due credit should be given to the
36 extraordinarily broad and rich sweep of Einaudi's thought: we believe in the Einaudian idea that it
37 is imperative to discover the singularity of an author through careful reading of the texts set within
38 the historical background in which they were drawn up. In endeavouring to define Einaudi the
39 economist, and to illuminate his contribution to economic theory, we argue that the following three
40 aspects must be taken into consideration:
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1. *The influence and parentage of his thought.* Caffè (1975), recalling Einaudi on the centenary of his birth, wrote that with regard to the position Einaudi has come to occupy in his contribution to economic science, it is appropriate to take as our reference point the assessment given by Del Vecchio (1964), who stated that Einaudi can be set, in the broadest sense, beside Böhm-Bawerk, Wicksell and Fisher. Kaldor (1955), on the other hand, placed Einaudi within the Anglo-American stream, together with Mill, Marshall, Pigou and Fisher, as regards the theory of consumed income. Still others have underlined the classical-Smithian parentage of Einaudian thought (Cozzi 1975; Meacci 1998).
2. *His theoretical relation to the history.* In the view of many scholars, one of the fundamental aspects characterizing the figure of Einaudi as an economist resides in his relation with history, in the twofold sense that he composed many works on economic history, and that he addressed economics in a historical perspective. Romeo (1975: 93) is one of the many to have underlined the former aspect, stating that “among Italian twentieth-century economists, Luigi Einaudi was probably the one most open and receptive to the themes of history”. Romano (1973) has instead underlined the second aspect, pointing out that in Einaudi the economist can never be kept distinct from the historian (and, Romano adds, from the moralist). As is often the case, it was Schumpeter who was most keenly aware of this feature. In Schumpeter’s view, Einaudi’s production as an economist was representative of the commitment of those who engaged in the “historical or empirical work which in Italy made a seminal contribution to general economics and did not enter ... into conflict with theory” (Schumpeter 1954: 855).
3. *His vision.* Einaudi was a liberal thinker. How did this vision influence his approach as an economist? This is a theme that was central to Einaudi’s own reflections, pervading the whole of his life as an intellectual.

This essay is structured as follows. Section 2 deals with the state of economic thought in Einaudi’s day and the major trends that influenced his background and the development of his thought. Sections 3, 4 and 5 are devoted to Einaudi’s conception of economics: section 3 focuses on method

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3 and vision – his conception of economic science, the problem of value judgments and the liberal
4 vision -, section 4 on the fields of application – from studies on the Italian economy to reflection on
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6 the great crisis -, section 5 on the theorization of public intervention.
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10 11 12 13 14 15 **2. Economic science in the age of Einaudi and the influences on his thought**

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17 The major influences on Einaudi were, at first, Marshall and Pareto (the Pareto of the *Cours* more
18 substantially than of the *Manual*), but Einaudi was also an attentive reader of the classical authors,
19 from Smith to Mill^{iv}, in addition to the Italian economists, in particular the works by Salvatore
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Firstly, on the level of method: Einaudi adopted the experimental method, a combination of the inductive and deductive method – the approach J. S. Mill had defined as the concrete-deductive method and Pareto and Marshall developed [the Einaudian approach is a combination of the inductive and deductive method in the line of Marshall and Pareto]. This approach emphasizes that a deductive line of reasoning must be supported by adequate specific experience, where experience and observation are measures of the validity of a theoretical argument.^v Second, on the analytical plane: the appropriate tool was considered to be that of marginal analysis. Third, as regards the vision of the economic process: it was essentially still classical-Smithian, integrated with the “dynamic” parts of Marshall (in Book IV of *Principles*) and of Pareto (the chapter on economic cycles in the *Cours*). In this perspective the process of accumulation, founded on savings which drive investments, moves cyclically through market expansion, technical progress and economies of scale; the markets are competitive, where competition is seen as a dynamic mechanism *à la* Marshall in the presence of a large number of independent enterprises.

Einaudi’s main areas of investigation range from the analysis of the business cycle and money to issues concerning the public economy. The theory of the business cycle was one of Einaudi’s

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3 earliest and dominant areas of interest. In the mid 1890s, when Einaudian reflection was beginning
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5 to take shape, the international economic literature in this field was dominated by the essentially
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7 empirical work of Clément Juglar, together with the limited elaborations of the classical period (in
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9 particular the ideas put forward by J.S. Mill), and the writings of Bagehot, Jevons, and later,
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11 Marshall, as well as the internationally lesser known contribution of Pareto. These investigations
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13 were succeeded by the work of Tugan-Baranowsky on industrial crises, and the studies undertaken
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15 by Fisher, Hawtrey, Schumpeter and Mitchell. Some of these authors rank among the references
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17 that were implicitly and explicitly uppermost in the thought of Einaudi, who would thereafter
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19 devote much time to reflection on the Italian business cycle. Juglar formed a constant reference
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21 point for Einaudi from as early as the first important study carried out in the Political Economy
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23 Laboratory of the University of Turin, founded by Cognetti, which became his graduation
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25 dissertation and was later published in the *Giornale degli Economisti* of 1895-96 – “La crisi agraria
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27 nell’Inghilterra”. Among the other names that helped to mould Einaudi’s thought, mention should
28
29 be made, first and foremost, of Walter Bagehot, whose *Lombard Street* Einaudi translated into
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31 Italian in 1905, then Mill and Marshall, both of whom were educationally influential authors in the
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33 Turin *milieu*, and Pareto. Later, another work that held considerable ascendancy over the theoretical
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35 systematization of Einaudian thought on money and the business cycle was Irving Fisher’s 1911
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37 *The Purchasing Power of Money*. Fisher, together with Pigou, exerted also a fundamental impact on
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39 the theory of capital and income: Einaudi took over the concept of consumed income the American
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41 economist had formulated in 1906 in *The Nature of Capital and Income*, and acknowledged the
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43 developments of the Millian theorem of double taxation, as did Pigou^{vi}. In the field of public
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45 finance the Italian tradition of Pantaleoni and De Viti De Marco exerted a strong impact on
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47 Einaudi’s contributions; but at the same time, an affinity with Wicksell can also be perceived. The
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49 latter represented an important aspect, though not so much in the sense of helping to shape
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51 Einaudi’s thought as, rather, because of the convergence of their theories. For a considerable length
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53 of time Einaudi proceeded independently, reaching the same results as the Swedish economist. In
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3 his 1896 essays *Finanztheoretische untersuchungen*, published in Italian in 1934, Wicksell's
4 treatment of the theory of qualified majority decision-making processes in public finance, which are
5 based on the comparative assessment of the marginal utility of the expenditure and the marginal
6 costs of tax levies that tax-payers are willing to bear, can be linked to Einaudi's contributions. It
7 should be kept in mind, however, that Einaudi was developing his approach within the framework
8 of the Italian tradition.
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10 Einaudi's neoclassical theoretical structure underwent no substantial modification during the period
11 following the first world war; instead, it was reinforced and further refined through two channels.
12 On the one hand, it is worth recalling the works of the neo-Austrian strand of thought, although
13 Einaudi can in no way be described, on the methodological plane, as a neo-Austrian *à la* Mises. His
14 neo-Austrian leanings in the 1930s should essentially be read in an anti-Keynesian light. But a more
15 important influence on Einaudi in those years was that of Wilhem Röpke, an eminent exponent of
16 the German neoclassical school of economics. Röpke developed a doctrine of humanist liberalism,
17 responsive to the ethical and social values of the human person, and a doctrine of economic policy
18 with a liberal approach.^{vii} Additionally, we would argue that constant awareness of the history of
19 economic thought likewise played a fundamental role in reinforcing Einaudian thought and
20 analysis: this was a sphere to which Einaudi dedicated great attention, with many essays on well-
21 known economists - Smith, Galiani, Cantillon, Sismondi, Ferrara – and lesser known figures in the
22 history of economic thought, above all Italian authors. It was, as Einaudi himself put it, a period of
23 “wandering back and forth through my books”, during which he rejected the labels pinned on the
24 various authors and dug deep into their writings in the quest to find the true force of the authors and
25 their current relevance.^{viii}
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27 It is in this intellectual setting, directing his attention to real-world problems, that Einaudi's
28 reflection crystallized and his conception of economics became sharply defined. We will discuss his
29 views by subdividing them into three parts: methodological reflection, applied economics, and
30 public economics.
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3. Einaudi's conception of economics. Method and vision

3.1. *On method of economics and the expression of value judgments*

Einaudian conception of the nature and method of economic science achieved its most accomplished expression in the *Ipotesi astratte ed ipotesi teoriche, e dei giudizi di valore nelle scienze economiche* (1942-43), which represents the culmination of a prolonged elaboration. In it Einaudi embraces the Marshallian-Paretian methodological vision of “working at the same time both with a deductive and inductive manner of proceeding, abstract reasoning and its empirical verification” (Einaudi 1942-3: 365). But the cardinal focus of his interest was the rich fruitfulness of empirical observation. The latter makes it possible to pinpoint multiple “expedients” of representation. This is exemplified by the frameworks he defines as “theoretical-historical”, depicting capitalism, state collectivism, the monopolistic state and the cooperative state:

those frameworks that stand roughly half-way between the traditional abstract extremely simplified models and the empirical models put forward to describe the law of the variation of a given phenomenon at a given time and place... They are not simplified in the manner of the abstract models and they do not claim to depict any factual state of affairs that existed empirically at a given time or place. They are, I would say, *theoretical-historical frameworks*. They present a theoretical slant in the sense that they do not claim to depict any precise moment of the unfolding of events, yet at the same time ... they seek to summarize the characteristic patterns and tendencies of patterns that genuinely existed at a certain time in history (ibid.: 369).

They are frameworks which can prove to be useful for historical investigation, and which are in any case “didactic expedients devised in order to find one’s way around in the maze of facts” (ibid.: 371). The subsequent passage of Einaudi’s line of argument addresses the problem of the relation between the work of the economist and the expression of value judgments. Einaudi raises the following question: “can... the economist [as such] refrain from passing value judgments”? (ibid.:

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3 398). Einaudi declares himself to be a supporter of the non anevaluativness of economic science,
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6 thereby expressing an anti-Misesian and anti-Robbinsian position. The neo-Austrian approach of
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8 Lionel Robbins in his 1932 book *An Essay on the Nature and Significance of Economic Science*
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10 (strongly influenced by the writings of Mises) implied that the specific task of the economist begins
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12 at the moment once political choices are made and recorded. But, Einaudi continues, “by enquiring
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14 into truths, the scholar inevitably asks himself the following question: is it possible for me to avoid
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16 passing judgment on opinions, beliefs, or decisions made by those in power in the sphere of
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18 politics?” (ibid.: 418). No, states Einaudi, adducing two types of arguments. In the first place:
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24 The economist cannot say: I will listen and record the facts; for if he listens to opinions and proposals that he regards as
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26 unfounded, he... cannot decline to offer a rebuttal by countering arguments with other arguments and to ensure that his
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28 will, which he knows to be more enlightened, becomes the will of the collective community (ibid.: 399)
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33 Secondly:

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37 He decides in favour of one or other decision for some reason he considers to be valid: the reason that is valid for him
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39 is...whatever brings advantage for everyone... Otherwise stated, the imperative of the moral and therefore also material
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41 elevation of man (ibid.: 399-400).
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46 And he concludes:

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50 There exists no plausible reason why scientific research should come to a halt when beholding ... the ideals and reasons
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52 of life, almost as if these were *untouchable* concepts...If *what follows* likewise influences the choices that have already
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54 been made, if the results of such choices and the choices themselves have an effect on the actual reasons for these
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56 choices, then how can one say: this is where science starts; and before this there is ... what? (ibid.: 401-2)
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60 The subdivision between pure economics and applied economics, he continues, has no more than practical utility. “The ifs that form the premises to the economic arguments... are drawn from

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3 reality”, which encompasses “passions, sentiment, ideals”, a reality that is “many-sided,
4 multifaceted and changeable”, and hence “exceedingly hard to investigate”. “Yet there is no
5 plausible reason why it should not form the object of an enquiry” (ibid.: 409). From this there
6 follows the conviction that “We cannot set limits on the scientific approach to economic problems
7 in such a manner as to exclude value judgments.” (ibid.: 410). In actual fact, Einaudi points out, the
8 fate of economists is inextricably bound to the type of society where men make their choices freely,
9 within the limits set by the institutions, by tradition, culture, and laws. In Einaudi’s words:

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22 To state that choices are determined by the ends men themselves have opted to pursue amounts to stating that they are
23 a function of the various and multifarious factors that make up the ends... Necessarily, if man does not wish to relinquish
24 the use of reason, he is ultimately led to formulate moral judgments on the motives behind his own choices, decisions
25 and private and public actions (ibid.: 419).

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32 He thus concludes:

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An economist who knows what rules govern a liberal or communist or plutocratic-protectionist economic society cannot
have failed to make his choice, in accordance with his ideal of life; and it is his duty to declare the reasons underlying
such a choice. (ibid.: 419-20)

What is indeed the Einaudian choice? The liberal ideal, which he believed to be the best suited to
give an adequate response to the problem of the moral and material elevation of man. Starting out
from these ideal convictions, Einaudi raised the problem of the relation between the economic order
of a society and freedom. This is the guiding thread of Einaudian reflection on liberalism, a
leitmotif that was heir to the Italian tradition deriving from Cavour, grafted on to the British
tradition: it permeated every stage of his life, interacting with the development of his economic
thought.

3.2. *The ideals of the economist*

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6 Liberalism was for Einaudi first and foremost a moral doctrine that set itself the goal of “the
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8 perfecting, the elevation of the human person” (Einaudi 1944: 65). His reflection reached its apex
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10 during the period characterized by the great crisis in western liberal thought, namely between the
11
12 late 1920s and the early 1940s. It took the form a dialogic-polemical exchange with the philosopher
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14 Benedetto Croce and John Maynard Keynes. In the dialogue with Croce, the issued focused initially
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16 on the relation between political liberalism and *laissez-faire*. Einaudi underlined that the political
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18 conception of liberalism is by no means identical to *laissez-faire*. “Those who endorse the maxim of
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20 *laissez-faire* and *laissez-passer*, almost as if it were a universal principle”, and who believe that “the
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22 free action of the individual, inspired by his individual interest, would always coincide with the
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24 collective interest”, have a religious conception of the maxim: but this, Einaudi wrote, has no
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26 justification in economic science (Einaudi 1931b: 126). *Laissez-faire*, in accordance with the
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28 Crocean view, is an inferior concept, on a subordinate level compared to the broader concept of
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30 liberalism; it is not endowed with the value of an economic principle, although one may note that it
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32 is often recommended as an “excellent practical rule”, chosen “for reasons of convenience”. But the
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34 fundamental issue that Einaudi addresses, in which the exchange of ideas with Croce takes on a
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36 polemical tone, is of a different nature: the query as to which economic order is appropriate for the
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38 exercise of freedom. Einaudi maintains that there is a conception of economic *laissez-faire* he
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40 defines as historical, “which is kindred to and almost interwoven with political liberalism, such that
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42 it becomes almost impossible to sunder the one from the other” (ibid.: 127), and this conception is
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44 founded on economic pluralism and competition. He states:
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55 Freedom of thought is necessarily connected to a certain dose of economic *laissez-faire* [...]. The historical conception
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57 of economic *laissez-faire* asserts that freedom cannot live in an economic society that lacks a varied and rich flowering
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59 of human lives, alive in their own right, independent from one another, not enslaved to a single will [...]. Man’s spirit,
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if it is free, creates a varied economy, in which there coexist private property and the property of groups, of bodies, of
state administrations, there coexist classes of industrialists, merchants, farmers, professional practitioners, artists, each

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3 different from the others, all drawing the material means of life from wellsprings of their own [...]. Without the
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5 coexistence of many forces, each the fountainhead of his own inspiration, there exists no free society, there exists no
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7 liberalism (ibid.: 130).
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11 Einaudi rejects the Crocean argument that freedom can reign whatever the prevailing economic
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13 order. “Are the means or tools indifferent to the idea?”, Einaudi (1937b: 135) wonders rhetorically
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15 in 1937. Einaudi underlines that “not all types of economic organization are equally suited to
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17 favouring the full liberation of the spirit that strives, in diverse ways according to the diversity of
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19 men, to fulfil that which is best in each one of use” (ibid.: 136). Communism is not suited to
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21 achieve this. Communism, as a “coercive organization of production”, is interpreted by Einaudi as
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23 an extreme case: when the limit on the implementation of the socialist principle is exceeded. In such
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25 a system men are “slaves of whoever is in command”, i.e. the tyrant. Einaudi emphasizes that it is
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27 not common ownership of the means of production in itself, but rather the coercive enforcement of
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29 such a state of affairs, that Einaudi regards as the negative phenomenon associated with
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31 communism. This coercion prevents operation of the principle which in Einaudi’s view allows a
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33 society to thrive, not merely in the economic sense, i.e. the principle of the struggle.^{ix} But not even
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35 capitalism is seen by Einaudi as suited “to favour the full liberation of the spirit”: capitalism is not
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37 suited to achieve this, “if by [monopolistic] capitalism we mean, as tends to be overwhelmingly the
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39 case in the western world, the regime where a decreasing number of chiefs, chosen for non
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41 economic qualities, are awarded the exclusive privilege of governing the material tools of
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43 production” (ibid.). The limits of communism and monopolistic capitalism reside in the fact that
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45 they “tend to set in motion total uniformity and conformity in men’s actions, men’s resolutions,
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47 men’s thought, and they destroy the joy of living, which is the joy of creating, the feeling of having
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49 fulfilled a duty, the longing for freedom, the desire to live in a society of men who are equally free
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51 to accomplish their mission” (ibid.: 143-4). There have been moments in history – Einaudi cites
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53 Athens at the time of Pericles, the period of the commune in the Middle Ages, some decades of the
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3 seventeenth century in England and Holland, and of the nineteenth century in the western
4 European-American world – in which “the freedom to think and write, the fervor of debate, the
5 desire for spiritual elevation and moral perfection seemed to be embraced, if not by all, by a far
6 from minimal number of men” (ibid.: 144). In those moments men created an economic order that
7 conformed to their need for freedom. For the idea of freedom – this is the argument Einaudi
8 forcefully reiterates – “cannot be implemented, cannot permeate the lives of many and of the
9 overwhelming majority until men, for the very same reason that led them to strive to be morally
10 free, have succeeded in creating types of economic organization suited to that free life” (ibid.: 149),
11 a freedom that can respond to the need to “choose by themselves how to earn a living”. Herein lies
12 what Einaudi defines as *liberalismo economico* – the economic order adequate to the liberal vision.
13 Einaudi’s *liberalismo economico* implies a conception of economics of the kind elaborated by the
14 thinkers who had moulded his thought, centered on three concepts: competition, work and saving.
15 The polemic with Keynes originated precisely from a discordant evaluation with regard to these
16 themes, and it made itself felt in critical appraisals at various junctures. 1926 saw the publication of
17 Keynes’ *The end of Laissez-faire*, in which the British economist expressed his criticism of ‘old’
18 liberalism, with the conviction that *laissez-faire* had become inadequate to deal with the postwar
19 economy. In it he called for more extensive state intervention in economic affairs. Einaudi (1926)
20 denied that the principle had ever been part of the scientific background of the great economists and
21 contested the view that *laissez-faire* had come to an end, bringing up the issue, as he did with
22 Croce, of the problem of the importance of this rule “as a practical rule” (ibid.: 570). On two further
23 occasions, in the early 1930s, Einaudi (1932a e b) underlined, against Keynes, that in order to
24 assure the good functioning of the economy it was crucial to recognize the importance of work and
25 the central role of saving as the engine of growth. In a long review of Keynes’ essay *Economic*
26 *Possibilities for Our Grandchildren*, in which the English economist maintained that the real crisis
27 affecting the West was a moral crisis, because men’s life was devoid of content, and even more so
28 because technical progress meant that men would no longer have to spend their time struggling with

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3 the grim task of earning a living, so that the problem to be faced in the future would be what to do
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5 with one's time in the absence of the need to work as a means of making a living, Einaudi put
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7 forward the idea, in opposition to Keynes, that "leisure is not a premise, but a consequence. If it
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9 were a premise, that is to say, if men imagined they could enjoy leisure without working, we would
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11 soon revert to poverty ... Everything is precarious on this earth without work and without saving"
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13 (Einaudi 1932a: 46). Moreover, "the scorn for those who toil and accumulate that becomes
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15 unmistakably apparent in those pages is morally unjust and historically wrong" (ibid.). Einaudi
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17 takes the side of the average man who honours his commitment to the world of work. Those who do
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19 not honour this commitment, Einaudi concludes, are "the rogues who live off other people's work,
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21 those who don't know how to build on inherited wealth" (ibid.: 47). The publication, one year later,
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23 of Keynes's *Essays in Persuasion* offered Einaudi the opportunity to counter Keynes's vision and
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25 to underline the importance of saving for long term economic development. As Einaudi saw it, even
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27 in the context of the severe crisis of that time, saving still represented the route that would
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29 definitively overcome the crisis, and investments would recover only if action were taken in favour
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31 of saving. This difference in perspective lay at the root of Einaudi's anti-Keynesianism in the field
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43 **4. Einaudi's conception of economics. Applied economics**

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49 One of the fundamental aspects of the Einaudian method, which strongly characterizes his
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51 contribution to economic science, consisted in reflection on the role of history in economic
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53 investigation and in historiographic analysis of economic facts and theories. History is, in the
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55 Einaudian approach to applied economics, the great ally of economic theory. Einaudi (1936b and
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57 1937c) tried to adopt a "historical eye" in examining the facts: this is what he considered to be the
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59 point of view *par excellence*.^x This supports the economic eye, i.e. use of the logical tool that
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economic science offers us in accounting for the facts.

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3 Here we will now examine some of the most relevant Einaudian contributions which underscore the
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Here we will now examine some of the most relevant Einaudian contributions which underscore the
profundity of the Schumpeterian judgment concerning the rich theoretical reverberations of
Einaudi's historical studies.

4.1. *Analysis of Italian economic development in the era of liberalism*

The analytical-interpretive contribution made by Luigi Einaudi to an understanding of pre-1914
Italian economic development has so far been somewhat belittled by the official historiography.
Yet on closer inspection his works reveal a solid and well-structured interpretation of the behavior
of the Italian economy during the thirty-year period that extended from the early 1880s up to the
outbreak of the first world war (see Cassata and Marchionatti 2010).

Einaudi examined the phenomenon of the cyclical development of the Italian economy by starting
out from a theoretical apparatus that encompassed both previous and contemporary reflection, in
order to derive interpretive frameworks and indications on the variables to be investigated
empirically. As noted earlier, Einaudi built his views around a classical-Marshallian vision of
economic development and a set of theories of the cycle focusing on credit and money: from Juglar
to Bagehot, Mill, Marshall, Pareto and Fisher. He could also rely on a broad and variegated
statistical base, albeit somewhat deficient on the macroeconomic plane. The data originated from a
number of sources: foreign statistical publications – in particular those of the *Economist* –, the
official Italian publications and, above all, Bachi's *Italia economica*, which appeared as a
supplement to *La Riforma sociale* from 1908 to 1921. Other empirical studies, coordinated by
Einaudi himself, then appeared, among which it is worth recalling the investigations by Jarach and
Necco on joint-stock companies and on stock market quotations, and Necco's studies on prices
from 1881 to 1913, which came out in *La Riforma sociale*. The picture of the cyclical development
of the Italian economy drawn up by Einaudi and his group is that of an economy which underwent a
prolonged period, of almost forty years, of gradual strengthening of the industrial structure of the
country, displaying a cyclical tendency defined by roughly twenty-year periods, with a particularly

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3 sharp growth spurt between 1898 and 1908, the so-called “Giolittian growth”. In Einaudi’s
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5 interpretation, underpinned from the theoretical perspective by the Fisherian theory of business
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7 cycle – which hold that as long as the causes of alteration, whether they be real or monetary,
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9 continue to be present, a real effect is brought about, that is to say, there is an influence on growth -
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11 the prosperity of the Giolittian era was made possible by the increase of gold, because this increase
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13 had a twofold repercussion: on the one hand, it was among the elements that led to a greater
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15 availability of capital on the international level, thereby sustaining the expansionary phase, and on
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17 the other, with the constant (but contained) increase in prices, it favoured the activities and
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19 expectations of industrialists and traders. Einaudi believed that the economic policies enacted by the
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21 governments of that era played only a background role, although he did not deny that economic
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23 policy could have influenced the growth rate. But what he sought to emphasize was that public
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25 intervention in Italy deformed the oscillations of the economic cycle, blunting it and prolonging the
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27 stagnation phases. His analysis of economic policy devotes considerable attention to examining
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29 protectionism, in its forms and effects. This aspect of his study represents another example of
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31 insightful combination of economic theory and analysis of data that not only confirm the theory but
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33 actually boost it. Between 1911 and 1913 Einaudi wrote a series of article against what he defined,
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35 with a term that would become famous, “the state drillers” (*trivellatori di stato*) (Einaudi 1911a).
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37 Initially coined in reference to the oil and petroleum industrialists, the term was later extended to
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39 include all those in the world of industry, above all in the iron and steel industry, who aimed to
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41 “keep going by fleecing the tax-payer”, i.e. by benefiting from public subsidies and aid designed to
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43 distort competition. In these articles (Einaudi 1911a e b, 1912 and 1913), Einaudi did not restrict
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45 himself to illustrating the economic theory of protectionism, but he also included a careful analysis
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47 of the various real cases. The most important among the protected industries in Italy was the iron
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49 and steel industry, which Einaudi soon included in a broader view of the issue, as it constituted a
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51 significant case in highlighting the damaging effect of protection on the rest of the economy. Its
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53 main consequence was that of inducing “an increase in the costs of the mechanical industries and a
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3 rise in the prices of agricultural machines and construction materials” (Einaudi 1911b: 112). More
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5 specifically, he underlined the costs faced by the mechanical industry: “the industry which should
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7 be typical of Italy, a country lacking coal and without iron ore, but endowed with a plentiful labour
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9 force that could become highly skilled and with technical personnel whose expertise and creative
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11 genius would equip them to compete with the foreigners”, yet this industry is struggling while the
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13 country is “flooded” with machines from abroad. (Einaudi 1912: 188).

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17 Einaudi does not deny that temporary protective customs barriers may at times be appropriate. But
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19 he underlines two points: namely, on the basis of the historical and statistical analysis, “what tends
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21 to happen” is that those who benefit from protection endeavour to transform it from temporary to
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23 perpetual, and further, where a positive correlation between the progress of an industry and
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25 protectionism can be found, it is necessary to: a) demonstrate its causality, b) illustrate its local
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27 effects in terms of efficiency, c) show that the positive effect in an industry is not accompanied and
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29 indeed seriously offset by negative effects on other industries. His conclusion, based on historical
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31 experience, asserts the “impracticability” – not general but widespread – of the application of
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33 particular, theoretically allowable, deviations from the general rule of free trade.
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41 4.2. *The analysis of the Great Crisis*

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43 Einaudi’s first article devoted to the world crisis was published in early 1931, a period in which
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45 there was as yet no full awareness of the seriousness of the international crisis and the overall
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47 expectation was that an upturn was not far off. He offered “a few disjointed ramblings (*riflessioni*
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49 *randagie*) on the crisis” (Einaudi 1931a: 20), arising from a monetary interpretation of economic
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51 cycles. The first aspect of the crisis he underlined was that “the economic crisis presents certain
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53 aspects that would suggest it should be viewed in the framework of what are called secular cycles,
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55 long cycles due to monetary causes. Examining the international price curves, he subdivides the
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57 period stretching from the beginning of the nineteenth century to the first thirty years or so of the
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59 twentieth century into 5 periods (1850-1873 and 1896-1920 characterized by rising prices, 1808-

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3 1850, 1873-1896, 1920-1930 with descending prices). Abundance and scarcity of gold, he argued,
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5 played a major role in these variations: scarcity in the first half of the nineteenth century and
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7 consequent drop in prices, abundance due to the discovery of gold in Australia and California in the
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9 mid eighteenth century, followed by another spell of scarcity after the mid 1870s once the gold
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11 mines had been exhausted, up to the end of the century, after which the finding of gold in the
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13 African Transvaal triggered a renewed ascent that came to an end around 1920. The subsequent fall
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15 was interrupted between 1924 and 1929, but resumed in 1929: “Where will this end?”, Einaudi
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17 could not help wondering. If the problem is stated in these terms, he reflected, it is obvious that men
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19 are likely to feel they have been left stranded at the mercy of a mysterious force, and that they will
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21 yearn to eliminate “that useless risk factor that is the variation in the purchasing power of money”
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23 (ibid.: 23). But, Einaudi went on, “there is always going to be an alternation of crises and prosperity
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25 due to other reasons” (ibid.), short cycles interspersed with long, monetary, cycles. He turned to
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27 examining the short cycles, those which “are overlaid on the long ones, and which convert the
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29 descending straight line running from 1920 to 1930 into a wavy line” (ibid.: 26). These short cycles
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31 come in two kinds: a) those due to a monetary cause: among these short cycles he listed the periods
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33 of inflation of 1898-1906, 1914-1920 and the deflationary periods such as 1920-1932 -; b) those due
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35 to non monetary causes (wars, famine, inventions), some of which show “a certain periodicity”.
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37 However, Einaudi added, “there is, I would argue, an essential difference between the long cycles
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39 and the short cycles. The former... lead to an unpredictable or highly complex solution. In the latter,
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41 the solution is certain and automatic... They are dominated by men’s mistakes” (ibid.: 27). There is
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43 only one remedy for these mistakes: “to find it, you have to turn to his lordship Mr. Price”, “the real
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45 minister of production in the modern economic world”. According to Einaudi, one can gain a rough
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47 idea of what happens both through the traditional depictions of the cycles, and also through
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49 Keynes’s theory outlined in the *Treatise on Money* (1930). In the former case the imbalance is in
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51 terms of prices; in the latter, of savings and investments. “When goods have been produced with
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53 excessive investment of capital, the price of such goods becomes lower, and this invites pessimism,
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3 driven by “bankruptcies, dishonoured bills, reduction of capital of joint-stock companies, dividends
4 not paid out” (ibid.: 28-9). The problem is that not all prices fall at the same time and in the same
5 proportion. “The worst thing involves the fixed cost elements: the interest and debt repayment
6 instalments, taxes and wages” (ibid.: 30). Wages are sticky downwards, Einaudi notes, but in the
7 long run they do go down, whereas “it is almost impossible to touch taxes”, on account of the
8 excess of public debt that weighs like a fixed cost on national income, and makes the situation very
9 burdensome for debtors. This is why the crisis persists. The Keynesian theory, which accounts for
10 the cycle and crises by referring to the saving-investment imbalance – which “hardly seems to differ
11 much from the well-known descriptions of what occurs during the economic cycles” – was, in
12 Einaudi’s estimation, capable of conveying an idea of the phenomenon, in which there is an
13 increase in the supply of short-term saving at a low rate of interest, whereas the rate remains high
14 for long-term utilizations. The essential fact, Einaudi underlines,

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34 is that normally, men live, consume, produce, engage in trading, without prior agreements... the bonds that hold this
35 world together, despite its chaotic appearance, are known as prices, interest rates, wages, profits, rents, etc. ...
36 Sometimes mistakes are made ... The relation between the value of producer goods and that of consumption goods in
37 production is different from the relation between savings and consumption in income ... There is a severe lack of
38 confidence in the future and savings are not invested ... We need to find a new price equilibrium (ibid.: 35-7).

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What is the way out of the crisis? “The transition, at a certain moment, from depression to
calmness, from calmness to an upturn, from an upturn to a strong impetus comes about through an
attenuation of pessimism and a revival of optimism” (ibid.: 39). Is it possible, today, Einaudi
enquires, to inject a spurt of optimism into businessmen? He fears it may not be: “Perhaps Keynes
is right in saying that savers who don’t buy bonds today are missing the best train. But in order for
them to act differently, it would be necessary to change people’s mindset. More than their mindset,
their nervous system, their heartbeat” (ibid.: 40).

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3 In Einaudi's view the initial cause of the great crisis was the international monetary and credit
4 inflation during and immediately after the first world war. He reiterated this argument in a note
5 (1932b), based on his analysis of the alternation of prosperity and depressions in the history of the
6 capitalist economy, in which he wrote that the current crisis was by no means a new phenomenon.
7
8 This assertion was founded on the analysis of the cycles of prosperity and depressions that had
9 affected the capitalist economy: Einaudi believed that the period from 1914-1919 and the
10 subsequent peacetime period in which things became more settled, from 1922 to 1925 (or 1922-
11 1929 "depending on the country", were similar to the periods of 1797-1815 and 1816-1819,
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27 it does not appear that the current depression ... has reached the point described by the author [the reference is to an
28 1845 book by Archibald Elson] for the prolonged season that extended from 1820 to 1842-1844. In no European or
29 American country have poverty, starvation due to famine, or social unrest reached the degree of exasperation that
30 prevailed before the revolutionary uprisings of 1848. The depression has not yet reached a duration even remotely
31 comparable to that from which the world found a way out (regardless of whether this was a coincidence or a cause) with
32 the discovery of the gold mines in Australia or California (1848). The only reason for prophesying that the present crisis
33 is likely to have a duration and thus future severe repercussions comparable to the situation in the post-Napoleonic
34 period is the suspicion that it may arise from the same root cause, i.e. a monetary cause (ibid.: 83).

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45 In particular, Einaudi felt that the 1914-1919 period and the 1920s had in common with the post-
46 Napoleonic crisis the causal role of the monetary crisis, on account of the price-cost imbalance. The
47 prices of certain goods and services had not decreased as much as might have been expected,
48 resulting in losses for entrepreneurs for whom such goods represent production inputs. Therefore
49 the solution to the crisis depends on restoring the balance between costs and prices.

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The link between inflation and the crisis is at the centre of the controversy with Keynes and with
Fisher on the nature of the crisis and the possible role of reflation in the 1930s. In *The Means to
Prosperity* (1933), Keynes argued that the crisis and poverty were due to the failure of the private

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3 decision-making process. The way out did not lie in hard work, frugality and saving and prudent
4 banking policies, but rather in an active economic policy, that is to say public works and an
5 international plan that would involve greater availability of reserves for the central banks in order to
6 enable them to increase loans in a coordinated manner: such a policy would increase world prices,
7 and positively influence the world economy.
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10 Einaudi replied to Keynes in a long article entitled “Il mio piano non è quello di Keynes”. He
11 developed his objections around two questions: the crucial factors determining the crisis and the
12 way to overcome it. With regard to the first point he argued that the crisis was due to the effects of
13 the war and the unease that had arisen in men’s minds on account of the postwar credit inflation. On
14 the second point, Einaudi agreed with Keynes that a policy of public works can be of help in the
15 quest for a way out of the crisis, although he remain sceptical on the relevance of the income
16 multiplier, but he was opposed to reflation, viewing it a highly risky policy that would not
17 necessarily be capable of achieving the objectives it set itself. Furthermore, Einaudi was of the
18 opinion that an increase in prices would not induce savers to invest money they had hoarded,
19 precisely on account of the fear of devaluation. Fisher (1933), like Keynes, had also supported the
20 argument in favour of reflation as a solution to the crisis on the basis of the debt-deflation theory. If
21 prices go down, the real value of private wealth increases, which implies an increase in real terms of
22 debtors’ liabilities and creditors’ assets. Debtors have a greater propensity to consume than do
23 creditors, and this would lead to a reallocation of real wealth from debtors to creditors, with the
24 consequence that the marginal propensity to consume would decrease. Such an outcome would, in
25 turn, induce a decline in the demand for consumption goods, aggregate demand and employment, as
26 well as a decrease in prices, accompanied by bankruptcies, and it would weaken the economic
27 structure, leading to the proposal of reflation. Einaudi (1934a) concurred with Fisher that the
28 essence of the crisis lay in the existence of debts, and that the analysis is correct but the remedy
29 unacceptable. He emphasized that the crisis also plays a positive role in the capitalist mechanism,
30 because it is the moment of transition from an equilibrium to a drive towards inventions,
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3 entrepreneurial enthusiasm and spirit of imitation. A crisis leads to ruination only when the majority
4 of entrepreneurs take on an excessive debt burden: in this case the crisis generates a disruptive
5 movement, which contrasts sharply with the type of crisis that generates a creative momentum (as
6 Schumpeter's creative destruction). The heavy burden of debt generated during the war and the
7 immediately following years had triggered a crisis of the first type: in such a case, the result of a
8 reflationary policy would merely be that of perpetuating the existing situation of indebtedness and
9 delaying the adjustment. In this context, Einaudi underlined the role of the central bank in averting
10 the crisis and preventing a restorative crisis from turning into a disaster: this was to be achieved by
11 virtue of the bank's action in slowing down the economic machine before it was too late, denying
12 credit or increasing the cost for reckless operators before their mistakes could represent a serious
13 danger. The task of the central bank, politically independent, was to act in order to guarantee a
14 stable currency and a balanced budget, that is to say, the two fundamental factors that allow the rise
15 of a virtuous economic mechanism capable of being a bulwark for the two fundamental pillars of
16 the liberal economic vision: work and saving.

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Despite these observations, Einaudi seems to endorse the interpretation of the crisis Robbins put forward in a 1934 book, which he commissioned the publishing house run by his son, Giulio Einaudi, to translate and bring out the following year. Robbins' argument, based on a neo-Austrian and Misesian theoretical structure, was that that crisis, the greatest in modern history, had been brought about by mistaken investments and an excess of indebtedness, and by actions undertaken to delay the liquidation, which only had the effect of worsening the state of affairs. Einaudi himself was likewise sceptical with regard to active public intervention. How should one proceed to bring the crisis to an end? Robbins believed – and Einaudi agreed – that it was necessary to achieve monetary stabilization and bring about a return to the gold standard, as well as to eliminate the barriers impeding international trade. Reconstitution of a gold standard system and of a market free from customs duties and protection was, in Einaudi's view, the necessary condition for overcoming the crisis. These were, as he himself clearly recognized, "traditional conclusions" – "a sound

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3 currency, honoured contracts, certainty in the future, open customs borders, or, if closed, then
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5 limited to duties of a clearly defined amount and for a specified period of time, interest rates
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7 carefully applied in a timely manner to prevent speculative frenzies”^{xi} - but, he contended, they
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9 have shown themselves to be true through centuries-old experience.
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12 13 14 15 **4.3. On Einaudi’s anti-Keynesianism**

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17 The Einaudi-Keynes relation dates back as far as the first world war. The two economists both
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19 showed an interest in each other’s positions as expressed between the wartime period and the early
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21 1920s, and at that time they were to a large extent in agreement as to what should be done. In the
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23 second half of the 1920s and in the years thereafter, their views progressively diverged, to the point
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25 that in many respects they became antagonists.^{xii} The *Means of Prosperity* is a text that marks a
26
27 notable theoretical departure of Keynes from his previous works and from orthodoxy,
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29 foreshadowing the *General Theory*. The disagreement became mainly theoretical. Einaudi was
30
31 sceptical concerning the inversion of the saving-investment relation offered by the multiplier, and
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33 reinterpreted Keynes’ argument in orthodox terms *à la* Pigou, in order to downplay the
34
35 innovativeness of the Keynesian approach. This enabled him to show himself in agreement with the
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37 public works proposal, taken as an artifice that would be useful in overcoming the troughs of the
38
39 business cycle. But Einaudi rejected the proposal of reflationary policies that Keynes and Fisher
40
41 put forward as a means of bringing the crisis to an end. It is precisely this point, namely how to
42
43 interpret the real nature of the crisis, that constituted the underlying reason for the dispute between
44
45 the two economists: whereas for Keynes the crisis besetting the period in question was due to “some
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47 failure in the immaterial devices of the mind”, for Einaudi it was caused essentially by an imbalance
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49 between relative prices – and here he denied that the general price level Keynes was considering in
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51 a macroeconomic perspective had any theoretical relevance – as a result of postwar inflation.
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53 Einaudi’s critique of Keynes on the analytical level was thus twofold. On the one hand, he offered a
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55 reinterpretation of Keynes’ theoretical innovation, giving it a more orthodox slant – and he would
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3 conduct the same operation with regard to the concept of preference for liquidity in his review of
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5 *The General Theory* (Einaudi 1939) -, and this enabled him to tone down Keynes' practical
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7 proposals. On the other hand, he advanced a counterproposal in the form of a microeconomic theory
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9 in the neo-Austrian mould, on the basis of which he could defend the rationality (and the
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11 fundamentally wise nature) of the behaviour of economic subjects, and more effectively argue his
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13 case against proposal of "managed currency", underlining its "dangerousness". This opposition also
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15 gave him the opportunity to avoid a wrangle the issue of the new theories propounded by Keynes in
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17 the *General Theory*, although, unlike some anti-Keynesian authors, he was not indifferent to the
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19 ideas of a man whose intelligence and capacity for intellectual stimulation and ability to "rub salt in
20
21 the wound" he held in admiration, despite advancing reservations in accepting Keynes' conclusions.
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23 Einaudi emphasized that the British economist offered "a typical example of the dangerousness of
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25 walking on the razor's edge", referring in this case to the Keynesian argument that "a rise in the
26
27 general price level can be of aid in recreating profit and thus in restoring an incentive for the
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29 spontaneous operation of entrepreneurs, after the first impulse of state-run public works" (Einaudi
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31 1933: 137). In Einaudi's view, the proposition that the rise in prices recreates profits "is true only
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33 under the hypothesis that public works carried out by means of credit drive up precisely those prices
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35 that have to rise in order to re-establish equilibrium" (ibid.). This derives from his *different*
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37 *conception on the nature of the crisis*. According to Einaudi,
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49 The lack of profit is not due to the fact that prices are low, but to the very different circumstance that there is an
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51 imbalance among prices ... The crisis and the lack of profit arises from the price imbalance, from the fact that some
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53 prices have not gone down or have not been allowed to go down, and since prices represent an income for some and a
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55 cost for others, many people make a loss and it is above all the entrepreneurs who make a loss. If a price rise were due
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57 to public works undertaken by means of credit inflation it would leave the disproportion between one price and another,
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59 i.e. between costs and returns, completely untouched. It might even increase the imbalance (ibid.: 138-9).
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3 Keynes had written that “very probably” during the process the increase in prices would be
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5 accompanied by an increase in profits. But Einaudi tended to underscore that this was a “non
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7 necessary” relation, reiterating his different conception of the crisis. To reinforce his assertion, in a
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9 note Einaudi refers to an essay by the Austrian economist Fritz Machlup (1933), whose arguments
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11 Einaudi fully endorsed. Machlup’s position, as outlined by Einaudi, was as follows:
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17 If it is true that the way to overcome the crisis consists in re-establishing a balance between costs and prices, which
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19 restores the possibility of a production that covers the costs with some profit left over, and further, if it is true that the
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21 more speedily unsold stock is cleared and the faster production factor and labour costs are brought down, the more
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23 rapidly price equilibrium is achieved, and, finally, if it is true that an increased discount rate accelerates warehouse
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25 clearance and a price collapse, then a rapid reduction of the discount rate is obviously a means likely to prolong the
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27 crisis. Merciful reductions in the interest rate bring relief... In short they defer the ending of the crisis (Einaudi 1933:
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29 398)
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34 Einaudi maintains that when there is an imbalance among prices, introducing an injection of
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36 liquidity “for the purpose of reaching the starting level again” is not effective, and he is doubtful
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38 that it is right to make such an attempt, because, as he enquires rhetorically, “are we sure that the
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40 level, which was balanced at the start, is still balanced now?” He thus believes it is better to “grit
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42 one’s teeth” and force loss-making producers to clear their stocks by adopting sufficiently high
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44 discount rates. Einaudi rounds off his argument by reasserting his lack of trust in action involving
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46 managed currency. The counter-proposal by reflationists, Einaudi states, is that reflation will be
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48 prudent, but, he warns them, “the monetary expedient is tantamount to trying your luck at
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50 Montecarlo”. Public works cannot adjust costs: they simply have the effect of generically increasing
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52 prices. They are “a helpful expedient to overcome standstills and the worst troughs of the economic
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54 cycle” (ibid.: 352), but they should hardly be transformed into a “panacea”. To find a way out of the
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56 crisis, it is necessary to carry out some form of re-adjustment in prices. What is needed, Einaudi
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58 recognizes, “is someone or something to break the spell”. And his admits that “public works can be
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3 one of these somethings capable of breaking the spell”, one of those “imponderable and
4
5 unknowable factors ... of the psychological mood-swing whereby men rise up from the bottom of
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7 the curve of the economic cycle and once more set off on the climb towards recovery” (ibid.).
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10 11 12 13 **5. Einaudi’s conception of economics. The general theory of conformable** 14 15 **interventions, or *Buongoverno*** 16 17

18 19 20 21 **5.1. For a general theory of conformable interventions** 22

23 In 1937, in a review article on Lionel Robbins’ *Economic Planning and international order* and
24
25 Wilhelm Röpke’s *Crises and cycles*, Einaudi (1937b) claimed that the great crisis had by now been
26
27 overcome, and he turned his attention to re-examining its causes, addressing the question as to the
28
29 possible means of preventing the current prosperity from backsliding into frenzy followed by yet
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31 another collapse. The answer, he felt, depended on a further question: “Can a cause and effect
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33 relation be found between our economic system and the exceptional severity of the past crisis?”
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35 (Einaudi 1937: 277). Here he takes up the Robbinsian concept of a “plan”, to underline the crucial
36
37 role of the political dimension. Now, Einaudi asserts, the classical economic plan, or the system of
38
39 free competition, which prevailed throughout the 19th century and the first third of the 20th, was not
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41 perfected. On the contrary:
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49 [It] is not predominantly based on *laissez-faire*. It is predominantly interventionist, protectionist, monopolistic and
50
51 restrictive. Lawmakers, overwhelmed by the enormity and complexity of the problems, believed they could solve them
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53 by wiping out the markets, the place where the prices of consumption goods and producers’ services are shaped ...
54
55 Protectionist barriers after 1870 ... Destruction of labour market flexibility ... Limits on flows of capital ... Such
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57 tendencies became accentuated with the world war ... The world that emerged from the great tragedy was no longer
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59 founded on the principle of the state as the creator of the legal *milieu*, within the limits of which men can freely engage
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in their economic activity, but rather on the entirely different principle of a state that dictates to man not so much the
limits of man’s action but its content, the manner and goals of action (ibid.: 285).

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5 It follows that “if the liberal plan, which even before 1914 was only partially functioning, and
6 which as early as the wartime period was replaced by other plans that became an enduring
7 substitution ... such plans being characterized by the state operating through men who took orders
8 from the state itself”, then “what happened after 1914 can hardly be attributed to the operation of
9 the liberal plan” (ibid.: 285-6). In Einaudi’s eyes, this justified a renewed proposal of a liberal plan.
10 His argument was that the economic problem in general, and in particular the problem of
11 attenuating the violent disruption induced by the crises, could be more successfully addressed with
12 a liberal plan, or, as Einaudi preferred to put it, a “conformable plan”. This term, introduced by
13 Röpke, was a “technical” term that evoked no particular meaning of its own, but served to indicate
14 all economic policies “that are compatible with the existence of a market”. Such policies not only
15 require “a complex of legal rules suitable for regulating the market and a state organization
16 appropriate for producing goods and services that private initiative would not produce or would
17 produce badly”, but they must also ensure that the rules are “compatible with the legal institutes that
18 are commonly called the *laissez-faire* system”, for instance rules to regulate the stock market, the
19 laws on working hours and the minimum wage, or those regulating and limiting monopolies”
20 (Einaudi 1937b: 287). Here Einaudi introduces the theme which occupied a central position
21 throughout his life and achieved its most original systematization in the ten-year-long reflection
22 extending from the mid 1930s to the mid 1940s, namely the theory of *Buongoverno* (*Good*
23 *Government*). With this expression Einaudi refers to a theory aimed at defining policies compatible
24 with the existence of a market economy, and aimed at “maximize” collective welfare: in our view
25 the expression is the most fitting to define his theory of economic policy. This is the period that saw
26 the publication of the supporting pillars of the Einaudian construction: the essays on the taxation
27 system contained in the second edition of the *Miti e Paradossi della giustizia tributaria* (1940), the
28 *Lezioni di politica sociale*, completed in 1944-45 but published in 1949, and which concern his
29 model of the welfare state, the essays that appeared in *La Rivista di Storia Economica* between
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3 1937 and 1942 on money and the various types of economic systems and the principle of freedom,
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5 which arose, as we have seen, partly from interaction with the ideas of Croce and partly from his
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7 reflection on the work of Röpke, and finally the 1943 and 1944 essays on the European economic
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9 federation.
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12 13 14 15 **5.2. The foundations of the theory of Buongoverno**

16 17 18 19 20 *5.2.1. Freedom of competition and the industrial policy against monopolies*

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22 Einaudi's economic liberalism had nothing to do with the motto that "everything goes". He realized
23
24 that if the market is left to itself, it can destroy free competition and create monopolies and
25
26 unacceptable inequalities, which undermine its ideal significance *and* efficient functioning.
27
28 Consequently, there is a need for a public intervention^{xiii} designed to remove the obstacles that
29
30 hamper the functioning of free competition. The competitive mechanism acts efficiently only if
31
32 competition comes about in the framework of shared rules and limits. That is to say, rules must be
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34 established, and economic agents must be free to operate provided they abide by these rules.
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36 Charting the boundaries of economic action (such boundaries being equal for all people, objectively
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38 fixed and not arbitrary), i.e. "establishing the framework": this, Einaudi asserts, is what constitutes
39
40 the method of liberalism. It is a method "forever provisional, since the rules laid down by the law
41
42 are the fruit of experience and must be revised with every new experience" (Einaudi 1959: 222), yet
43
44 it must be considered the best on the basis of empirical and historical evidence. One of the crucial
45
46 aspects of this programme is the battle against monopolies, both public and private. Monopolies, in
47
48 Einaudi's estimation, represent the most pernicious danger looming over the economic world. In a
49
50 competitive market, Einaudi explained in his *Lezioni di politica sociale*, producers are content "to
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52 earn what [is] necessary to induce them to risk their savings as well as funds they have borrowed
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54 from banks and to induce them to organize and run businesses" (Einaudi 1949: 20), whereas
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56 producers in a monopoly market "net huge additional gains, no longer due to the *merit* of working,
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3 organizing and risking, but due instead to the *demerit* of having swept the field clear of competition
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5 or of having come to ... an agreement with their competitors to extort money from the consumers”
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7 (ibid.). The battle against monopolies “must be considered as one of the main goals of the
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9 legislation in a state where the rulers’ concern is to ensure the welfare of the majority of citizens”
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11 (ibid.: 21). Accordingly, one of the essential elements of a liberal economic policy is

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17 A determined battle against all those in the world of industry, trade, banking, landownership who have sought success
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19 by taking advantage of privilege, natural and artificial monopolies, customs protection, prohibitions on the setting up of
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21 new industrial plants that would compete with their own factories, stacked patents – deadly for real inventors - or high
22
23 prices guaranteed by the state (Einaudi 1943: 8-9).
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28 The battle against monopolies should be waged by “abolishing excise duties, restrictions and
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30 prohibitions and imposing public disclosure by means of “court proceedings and by the compulsory
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32 splitting up of monopolies into competing enterprises” in the manner of the antitrust system of the
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34 United States (Einaudi 1959: 229).
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41 *5.2.2. The principles of ‘equality of starting points’ and of ‘elevation from below’, or on the*
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43 *social policy of the liberal state*
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47 The market mechanism “works with admirable perfection” but “it is an impassive economic tool,
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49 insensible to justice, morals, charity, all of which are human values” (Einaudi 1943: 182). Can the
50
51 advantages associated with free markets be made to coexist with the desire for social justice? In his
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53 *Lezioni* Einaudi dwells at length on an individualistically based welfare state, intentionally
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55 contrasting it with the model Beveridge had draw up in Britain in those same years. The Beveridge
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57 plan was grounded on the principle of guaranteeing a minimum income whenever the vicissitudes
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59 of life leave a person without an income or means of earning a living, an approach which could,
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Einaudi felt, dampen the incentive to work and was not immune from the reproach of paternalism.

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3 What Einaudi himself sought to propose was a model that would be consistent with liberal ideal.
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5 “Men’s ideals with regard to the distribution of wealth”, Einaudi noted, “range from the extreme
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7 case of absolute equality to that of absolute inequality” (Einaudi 1943: 51). The extreme solutions
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9 are “the precursors of tyranny”, synonymous with “loss of freedom”, and intermediate solutions are
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11 thus to be preferred. This opened up the potential for social economic legislation: here “action is
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13 undertaken in the sense of endeavouring to bring the starting points closer together, insofar as
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15 possible, and it is enacted in two directions: one is that of lowering the peaks, the other that of
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17 upwards elevation from below” (ibid.: 52). In developing his model of the social constitution of the
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19 liberal state, Einaudi puts forward five arguments (ibid: 117 and ff):
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24 a) The liberal principles of individual freedom and competition require a social structure based on
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26 the greatest possible reduction of inequality of starting points and on reduction of excessive
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28 concentrations of wealth, the so-called concept of “chopping off the peaks”. The first of these two
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30 goals is to be achieved by means of public expenditure and the second mainly by a progressive
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32 income tax and an inheritance tax. It should be noted that these two principles allow better selection
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34 on the market, defined by Einaudi as the selection of the “elects” from among the universal sphere
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36 of men, thereby furthering the improvement and increase of human capital, but in order to achieve
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38 such an aim, unrestricted public education open to all citizens is an essential prerequisite.
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43 b) The risks encountered in the economic contest make it necessary to assure coverage, that must be
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45 borne by the entire community, of the guarantee of a minimum living standard so as promote the
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47 social cohesion that underpins the development of a competitive economy. This is the basis of old-
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49 age pensions and medical treatment, the two pivotal elements of the Einaudian system of social
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51 expenditure, the one in the form of social insurance, the other of public expenditure.
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55 c) The lack of foresight that may at times lead men to engage in foolhardy behaviour should be
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57 corrected by the imposition of obligations, which bring an advantage to those involved, such as
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59 insurance against accidents in the workplace.
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3 d) There are cases in which the benefit accruing to private individuals generates a social advantage,
4 such as social intervention in favour of child-bearing and the family.
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8 e) Cases of blameless indigence and poverty call for action that is restricted to bringing an
9 advantage to those in need, according to the liberal principle of the ethical value of freedom.
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13 14 15 5.2.3. *The optimum tax, or on the taxation policy of the liberal state*^{xiv} 16

17 Taxation is a necessary condition for the state to be able to provide public services, Einaudi wrote in
18 *Miti e paradossi della giustizia tributaria*. To the extent to which taxation is the means through
19 which the state creates new values, a tax does not signify destruction: on the contrary, Einaudi
20 underlined, “by virtue of taxation the state creates the legal and political *milieu* in which men can
21 organize, invent and produce” (ibid.: 196). A tax designed according to this framework is defined
22 by Einaudi as the *optimum tax*. This definition was the culmination of prolonged theoretical
23 reflection dating from as early as the first decade of the twentieth century, which led Einaudi to
24 conceive of several types of tax: taille-tax, hail-tax, and the economic, or optimum tax, the one that
25 characterizes the state as a production factor, increases the efficiency of existing resources and
26 favours accumulation. His numerous contributions to the theme of taxation built up a scheme,
27 outlined in *Miti e paradossi* (1940), the book he regarded as his real treatise on the general
28 principles of public finance, and in the *Saggi sul risparmio e l'imposta* (1958). A tax is optimum if
29 it increases the efficiency of resources, that is to say, if “it creates the conditions whereby the
30 revenue necessary to maximize the economic power of society – and this implies the power of the
31 state as well – can be obtained with the least possible friction and the greatest possible immediacy”
32 (Einaudi 1940: 19). The optimum tax is neutral, not in the sense of not interfering with the
33 economy, as this is unfeasible, but in the sense that it involves no dirigiste ends that would distort
34 the competitive process. In other words, the optimum tax is a tax conforming to the competitive
35 market system. Any interferences that represent an impediment to the optimum tax are removed by
36 solutions such as taxation of normal income, no taxation of capital gains, exemption from tax of
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3 income sent to savings. Thus the only aim of the tax is to collect the fiscal price of public services,
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5 which means that the state obtains from the tax the remuneration due for its contribution to
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7 production of the social income. Such a tax, distributed by means of objective and general criteria,
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9 finances expenses that can serve to reduce inequalities of starting points for low income subjects,
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11 and to protect blameless subjects who find themselves facing excessive difficulty in the economic
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13 contest. It is an economic tax in that it finances expenses that are functional to the competitive
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15 system. The first maxim to which it must conform is respect for the rule of subjective equality
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17 between sacrifice and satisfaction of the public needs of individuals. This calculation, which in
18
19 actual fact is approximate, is essential to distinguish the economic tax from the “*taille* tax” which
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21 “takes a large amount away from citizens and returns very little to them”.(Einaudi 1940: 203).
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27 The principle of equality of treatment that defines a tax as “just” is an aspect of the Einaudian
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29 model of the cooperative state that is instrumental to the market: it can be construed as a limit on
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31 the discriminatory interference of the state in the personal sphere and on the market. But, it should
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33 be borne in mind, the principle also protects the various freedoms of the individual. In addition to
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35 being “just”, the tax must also be objective. This implies that income tax must be levied on normal,
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37 or ordinary, income. In other words, “the tax is not designed to seek out the actual truth on the gains
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39 and losses of individual tax-payers, but rather to explore what is the level of income that ... a
40
41 normal entrepreneur would manage to obtain” (ibid.: 455). This is the crux of the Einaudian theory
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43 on the market-conformable tax, the supporting pillars of which are, firstly, non taxation of capital
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45 and of capital income, secondly, taxation of income only to the extent that it is consumed, because
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47 income sent to saving is a capital that will generate future income but it is not, in itself, to be
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49 considered as income. In building his theory Einaudi drew inspiration from the history of economic
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51 thought: he turned his attention to the arguments proposed by the Italian economists of earlier times
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53 who had underlined that a tax system in which taxes were based on average income potential could
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55 act as a considerable boost to progress; additionally, he offered an original re-examination of the
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3 idea that savings should be exempt from tax, treated in the beginning by John Stuart Mill and later
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5 by the Cambridge School economists.
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10 5.2.4. "Sound currency" and free markets, or on the international liberal order

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12 At the time when Einaudi trained as an economist, the functioning of the international economic
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14 system rested on open markets and the gold standard. The gold standard governed international
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16 trade and international movements of capital, the balance of payments in the different countries was
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18 maintained in equilibrium at more or less fixed exchange rates by virtue of an adjustment
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20 mechanism characterized by pronounced automatic responses, inflation and deflation rates were low
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22 and consequently the value of money remained stable over the medium-long term. This order was at
23
24 first severely undermined and then shattered by the events of the 1920s and 1930s. In the Einaudian
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26 interpretation inflation lay at the root of the crisis and the social unrest that ensued after the first
27
28 world war, threatening to bring down the whole of western society. As far as Italy was concerned,
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30 the inflationary experience of the period from 1914 to 1920 heightened Einaudi's assessment of
31
32 inflation as an intolerable ill, a poison that ate into the fabric of Italian society and ushered in the
33
34 Fascist dictatorship. How was the economic world to be reconstructed after the terrible experiences
35
36 of the prolonged crisis and the new world war? For Einaudi once again the liberal plan could form
37
38 the basis for reconstruction, re-establishing rules like the gold standard that would be able to assure
39
40 automatic variations in the money supply in relation to the balance of payments, together with
41
42 freedom of trade. Furthermore, in Einaudi the reflections of a scholar were brought to bear on the
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44 practical approach of a man of action, when during the postwar period he found himself called upon
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46 to influence the economic choices of the new state and to guide monetary policy as the Governor of
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48 the Bank of Italy and as Budget Minister.
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54 His theoretical reflection, which he had developed through his analysis of the post-1929 crisis, was
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56 subsequently enriched with historical-theoretical studies that were published in the period between
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58 1936 and 1940, appearing above all in *La Rivista di storia economica*. Here he focused principally
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3 on the role of monetary stability in the market economy. The core of this investigation is a
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5 justifiably celebrated essay on the theory of “imaginary money” or money-of-account (Einaudi
6
7 1936a), a theme that belonged to a distant historical past, but re-analyzed in the light of the
8
9 monetary problems facing the Italian economy during the time in question. Einaudi enquired into
10
11 the monetary practices of a millennium ranging from the age of Charlemagne up to the French
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13 revolution, directing his attention to the theoretical debates that had arisen in the context of such
14
15 practices.^{xv}

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18 Einaudi discusses the idea that money-of-account could take on the role of stabilizing the general
19
20 price level on the international scene. In this sense his essay can be seen as a contribution to debate
21
22 on the new postwar international system. In the immediate postwar period the problem of monetary
23
24 stability basically arose, first and foremost, in connection with the decision as to whether Italy
25
26 should undersign the July 1944 Bretton Woods Agreement, and subsequently, in connection with
27
28 choices concerning domestic monetary policy measures. Addressing the Constituent Assembly in
29
30 March 1947, Einaudi made a passionate speech in favour of Italian participation in the Agreement.
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32 At the beginning of his speech he recalled the period between 1814 and 1914, a “blissful century”
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34 that was characterized by the “myth of gold”:

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43 Before 1914 we lived through a blissful period which I fear will never be the same again. The century between 1814
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45 and 1914 was a parenthesis in the history of the world, a parenthesis the likes of which we of the present generation and
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47 perhaps of many generations to come will probably no longer experience. One of the characteristic aspects of that
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49 blissful century was the myth of gold, or rather, as I would prefer to call it, the magic of gold. If the person speaking
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51 were a grandmother, instead of an economist, and she wanted to tell her grand-children all about what things used to be
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53 like before 1914, ... she would certainly say: once upon a time there was a magician, ... who actually kept watch over
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55 men and prevented them from engaging in wrongdoing.

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59 The availability of gold, Einaudi pointed out, did not depend on the “will of men” but on pure
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chance, which “brought gold to light”. Thus it was a force extraneous to the affairs of men, and it

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3 had the effect of making the quantity of gold increase or decrease. Furthermore, Einaudi argues,
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5 “the fact that in the blissful century the monetary unit was extraneous to human will or power was a
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7 blessing for that era”, contributing to the rise of an economic development “such as had never been
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9 seen before”, together with “amazing technical progress”. It was a blessing, according to Einaudi,
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11 because by preventing deliberate action on the circulating mass, “the myth of gold” constituted a
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13 sort of economic-moral force that compelled men to be honest. “[The myth of gold] had the effect
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15 that honesty ... had miraculously become a rule of action that not even men in government could
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17 fail to abide by”. It was an era, Einaudi went on, where as a result of the monetary honesty that
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19 depended on the mythical gold magician, international trade exchanges of goods and men were
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21 easy”. But
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29 In 1914, men imagined they peep inside this mechanism, almost as if it were a toy; they wanted to see how this
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31 mechanism, this so carefully contrived and exquisitely delicate clock mechanism, really worked... and they broke it,
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33 and in its place they set up what was later called managed money, money that is no longer left to mere chance, no
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35 longer left to arbitrary events, no longer left to fortuitous discovery of gold mine; all of these concepts were things from
36
37 the past, they were all things that had to be suppressed, because man’s will, man’s wisdom – not chance – should
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39 dominate over the market as well. We have seen what it means to have the wisdom of man taking the place of chance
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41 we don’t even know any more ... whether there still exists a monetary unit.
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45 In this situation the Bretton Woods Agreement, Einaudi believed, did not represent a return to the
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47 age of gold and a return to a currency that would be independent of the human will: the Agreement
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49 “is, however, something that is worth more than the will of the individual states”.
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54 It is the replacement of the will of the individual states by a common will of those govern the various states and who, by
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56 becoming part of a single body, will regulate and will have to regulate this matter... We do not know whether the
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58 results will match our expectations, name the desire for stability of the purchasing power of money... We can hope that
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60 the transfusion of individual sovereignties into a single sovereignty will usher in a result that allowing us to return, at

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least partly, to the aforementioned amazing and exquisitely delicate mechanism that slowly took shape prior to 1914 and which we, with childish *naïveté*, broke and wrecked.

Bretton Woods system leads to the re-opening of the markets:

By undersigning the monetary agreements we are entering into today, we will have relinquished monetary sovereignty. This will signify that frontiers will once more be opened to the circulation of goods and the circulation of men.

Monetary order founded on a sound currency and free markets: on this basis the two pillars of the liberal economic vision can henceforth be refounded, partial and imperfect though their functioning may be in the framework allowed by the accord.

Participation in the new world order would make it necessary to engage in an operation of domestic economic policy in order to combat inflation, as the latter triggers devaluation of the currency, with consequent adverse effects on the balance of payments and instability in commercial and financial relations. If not addressed, this could jeopardize freedom of trade and lead to damaging domestic effects. In his *Final Considerations* for 1946, which Einaudi likewise read in March 1947 in his capacity as Governor of the Bank of Italy, he analyzed the inflationary mechanism and its effects. It modifies the distribution of income and wealth, and although it initially boosts profits it also damages wages, as there is a delay in income adjustment, and it has adverse consequences for those on fixed incomes. The positive effect that the redistributive change brings for investments little by little begins to fade when countered by the predominance of negative effects, and this in turn increases the propensity to hoard money and reduces the propensity to save. The crucial problem is that inflation destroys the propensity to save, in Einaudi's vision, an essential condition for investment. By discouraging saving, inflation puts long-term development at risk. Saving, Einaudi underlines, is a function of trust in the monetary unit, so that the central aim of monetary policy must be that of price stability in order to support the propensity to save. It is therefore hardly surprising that in Einaudi's view the main aim of monetary policy should be price stability, to be

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3 pursued by an independent and self-governing central Bank, in order to guarantee that variations in
4 the value of the currency do not disrupt trade, contracts and expectations. When Einaudi was
5 appointed governor of the Italian Central Bank, the Italian economy was experiencing an extremely
6 difficult period. In his *Final Considerations* for 1946 he sounded the alarm concerning the risks
7 involved in an excessive supply of money. The monetary measures enacted in the autumn of 1947,
8 which became known as the “Einaudi line”, made it possible to stabilize prices without exerting an
9 unfavourable effect on economic growth, thanks also to a moderately expansionary fiscal policy and
10 a selective public enterprise financing policy.^{xvi} The aim of the measures was to give families and
11 enterprises accurate price signals, in order to ensure the functioning of market mechanisms to
12 stimulate saving, which is, as described above, a function of trust in the currency unit. Monetary
13 stability on the domestic front and on the international level: these were the two goals to be
14 achieved as a means of moving towards a development mechanism that would not be short-lived.
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16 The restored liberal order would then allow full exploitation of technical-organizational progress
17 and the broadest extension of the market. In this perspective, Einaudi also became aware of the
18 inadequacy of closed national states. This links the problem of the international economic order to
19 Einaudian political reflection on the crisis of the nation states and, further, to the proposal of a
20 federal government as a more appropriate institutional solution. The core of these ideas is to be
21 found in two articles, *Per una Federazione economica europea* (1943), and *I problemi economici*
22 *della Federazione europea* (1944), written in his period of exile in Switzerland. It is in these articles
23 that Einaudi built up what has been defined as his theory of the global market (Forte 2009),
24 founded on the discussion of the Smithian theorem on division of labour and extent of the market,
25 and developed his theory of the federal government, that is to say, his thoughts on the model of a
26 supranational federal democratic state which would make it possible to seize the opportunities
27 offered by a world-wide market, or at least a great unified market. The European federation
28 represents a ‘second best’ of the supranational state, the theoretical optimum being constituted by a
29 world government. In effect, the project of a federal government takes into account the drive
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3 towards amplification of the market, reconciling it with the broadest possible political dimension,
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5 while recognizing that the world government model is utopian not only for political and cultural
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7 reasons but also because it would imply the existence of excessively large organizations, which
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9 would be subject to pronounced organizational-bureaucratic diseconomies of scale.
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12 13 14 15 16 **6. Concluding remarks**

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18 The profile we have delineated portrays an Einaudi who, as an economist, belongs to the
19
20 neoclassical school - where by this term we refer above all to the synthesis of thought achieved in
21
22 the closing years of the nineteenth century and in the early twentieth century by authors such as
23
24 Marshall and Pareto – as far as his method and conceptual structure is concerned. At the same time,
25
26 marked classical components can also be noted, following in the footsteps of Smith. Such
27
28 components involve the vision of the economic process and the *laissez-faire* and liberal conceptions
29
30 of which Einaudi was the bearer.
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34 But this profile seeks above all to highlight the originality of Einaudi as a man and Einaudian
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36 thought, building on the judgement given by Schumpeter and exploring the way Einaudi's thought
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38 shows itself capable of evolving in the face of constantly changing facts, while maintaining the
39
40 structure of his theoretical foundations, ideals and framework of reference substantially unchanged.
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44 In this sense, labels may be helpful in providing a guide to his work, but that which truly counts is
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46 the man as he emerges from his writings, his singularity.
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50 Above and beyond the question of labels, we would argue that two aspects should be underlined in
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52 the endeavour to provide a synthetic overview of the qualities of Einaudi as an economist.

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54 The first consideration can be put forward with regard to a famous article by Keynes. In his
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56 biographical essay on Marshall (1924), Keynes wrote that Marshall possessed many of the qualities
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58 that make an economist great – a master-economist. In particular, he possessed “the amalgam of
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60 logic and intuition and the wide knowledge of facts, most of which are not precise, which is
required for economic interpretation in his highest form” (Keynes 1924 and 1933: 176note). It is

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2
3 fair to state that Einaudi's "historical eye" had precisely this quality, of combining economic logic
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5 and vast knowledge of facts and events.
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8 The second consideration stems from a judgement on Smith given by Einaudi himself (Einaudi
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10 1953). With regard to the history of classical economics, Einaudi states that three souls dwelt
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12 within Smith's breast: the soul of the moralist, the historian and the economist, and that the three
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14 souls were consistently kept together in the English economist's enquiry into an array of problems.
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16 Analogously, in Einaudi the moralist addressed problems the historian and the economist sought to
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18 understand and solve.
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22 Einaudi thus possessed the qualities and the manner of proceeding of the great economists of the
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24 past. But Einaudian understatement in the manner of presenting his positions and interpretations, his
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26 style of argument – likewise partly taken over from Marshall - have perhaps overshadowed the
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28 great economist he was, if he is viewed through the somewhat short-sighted eye of the
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30 contemporary economist. But an economist capable of interpreting economic movement in its
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32 highest form – this indeed he was.
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38 **Acknowledgements**

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43 A first version of this paper was given at the conference on 'Luigi Einaudi nella cultura, nella società e nella
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45 politica del Novecento', Torino, Fondazione Luigi Einaudi, April 16 and 17, 2009.
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48 We thank the participants at the conference for their comments.
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NOTES

ⁱ Einaudi's articles on Italian newspapers have been partly republished in Einaudi (1959-1965).

Einaudi's articles in *The Economist* have been republished in Einaudi (2000).

ⁱⁱ For the biography of Einaudi see: R. Faucci (1987).

ⁱⁱⁱ Fundamental contributions to this issue have been made by Forte (1962 and 2009). See also: Meacci (1998), Fausto (2003 and 2008) and Medema (2005).

^{iv} He addressed also the issue of Marx's economics towards the end of the century. Between 1894 and 1900 an extensive debate had developed in Europe on Marx and Marxism. In Italy the debate saw the participation of an extensive range of authors, among whom Benedetto Croce and Antonio Graziadei (See Marchionatti 1998, and Marchionatti and Becchio, (2000). According to Croce Marx's conception of economics, which he reduced to the two theories of the transformation of values into prices and the "nature of profit in surplus value" was "substantially wrong". Croce disagreed with the interpretation offered by Graziadei, who studied the nature of profit independently of value. Einaudi (1898) looked favourably on the contributions of Croce and Graziadei. With regard to Croce, he expressed a general appreciation of the contribution to the critique of Marxism, considering Croce's assessment to be among the most important in Europe. As far as Graziadei was concerned, Einaudi appreciated the analysis given by Graziadei in which the latter refuted Marx's prediction concerning the tendency towards a decline in the rate of profit and the final crisis of capitalism; Einaudi also appreciated Graziadei's "historically unbiased" judgement of the function of capitalism as reducing rather than increasing poverty, and looked with interest on his theory of profit. Ten years or so later, Einaudi forcefully declared "the death of socialism in the world of ideas", his assessment now no longer attenuated by the more sympathetic leanings he had felt towards the practical action of socialists in the early years of the century.

^v On Pareto's method and its similarities with Marshall's see Marchionatti and Gambino (1997).

The similarities between Marshall and Pareto on method includes: a) the limitation of deductive reasoning unsupported by specific experience (see Appendix C of Marshall's *Principles*) and Pareto's emphasis on the legitimacy of abstractions as long they do not lose their experimental character; b) the caution in using mathematics: this point is well known as regards Marshall, but scarcely emphasised in Pareto – but see for example Pareto's "Considerazioni sui principi

fondamentali dell'economia politica" (*Giornale degli Economisti*, May 1892, now in Pareto 2007, edited by R. Marchionatti and F. Mornati).

^{vi} Pigou dealt for the first time with the theory of double taxation of income – and incorporated it into his theoretical system – in 1912 in *Wealth and Welfare*. At the same time Einaudi discussed the question in *Intorno al concetto di reddito imponibile e di un sistema di imposte sul reddito consumato*, to which Pigou dedicated an extensive and positive review article one year later in the *Economic Journal*. On the diffusion of Fisher's theories in Italy between the late nineteenth and the early twentieth centuries see Pavanelli (2006).

^{vii} On Einaudi and Ropke see F. Forte, *Einaudi e Ropke. Interventi conformi ed economia sociale di mercato*, in Forte (2009).

^{viii} The majority of these essays are republished in Einaudi 1953.

^{ix} The principle of struggle was first discussed in "La bellezza della lotta" (1923), a paper written at the request of Piero Gobetti. It is a description of the pleasure brought by results achieved through hard work and by the composition of labour conflicts after harsh but free confrontations.

^x Einaudi writes that it is a rare characteristic displayed "by someone who possesses at one and the same time an economic sense as well as the sense of law and politics and of other aspects as well, and who encompasses the facts in their entirety and neglects the criteria which as regards that particular point are secondary and irrelevant, concentrating on the element or elements which are significant at various times" (Einaudi 1936b: 155).

^{xi} See: L. EINAUDI, *Preface to L. ROBBINS, 1934*, pp. 10-11. See also the review of *Economic planning and international order* by the same English economist (L. EINAUDI, 1937).

^{xii} On the relation between Einaudi and Keynes see: Forte (1962) and Marchionatti (2000).

^{xiii} The argument is concisely but brilliantly stated in Einaudi (1943).

^{xiv} A fundamental essay on this subject is Forte (1962b). The essay is the proslution by Francesco Forte in November 1961 upon his appointment to the Chair of Public Finance of the University of Turin, to which he had been appointed as the successor of Luigi Einaudi, upon the official indication of Einaudi himself.

^{xv} Central to his investigation was the contribution made by Galiani to discussion of the issue, and the role that money-of-account, as a standard of value, could play in achieving the aim of stabilizing purchasing power. Money-of-account served to allow the functioning of a system based on a plethora of currencies and sundry metals, through the establishment a given official relation between money-of-account and minted money, and inasmuch as it was purely a unit of account, the risk of manipulation that affected real coined currencies was avoided. Indeed, as Einaudi himself stated, money-of-account could perfectly well have enabled the universal bimetallic system to

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function quite satisfactorily, yet in actual fact its functioning was disappointing and inadequate on account of the sluggishness in responding to the variations in the commercial exchange rate of the different metals, thereby leading to in the defect noted in Gresham's Law. Einaudi suggested two possible solutions to this disadvantage: a) the solution proposed by Galiani, who argued that instead of imposing a compulsory rate of exchange, cried up or cried down, on the various types of money, the currencies should instead simply be assigned a agreed price, that is to say, a price that would be valid in the absence of any convention to the contrary; b) the solution proposed by Einaudi himself, involving ad hoc use of seignorage, i.e. of the gap the bank of issue establishes between the intrinsic metal value of coins and their legal tender status. Einaudi also highlights the abuses money-of-account concretely lent itself to, as it could mask operations whereby coins were shaved or clipped at the behest of princes, or modifications of the relation between real metallic coin and the lira-of-account; such manipulations were deceitful in the short term and led to lack of certainty, and over the long term they were extremely damaging.

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^{xvi} In this regard see: F. Forte, *Teoria monetaria e stabilizzazione della lira. Einaudi ministro del bilancio e governatore della Banca d'Italia*, in Forte (2009).