

The Stabilization of the Italian Lira and the “quota novanta”¹

Juan Carlos Martínez Oliva

Bank of Italy

In the early years after the First World War, Italy worked to restructure its public finances and to restore the convertibility of the lira. Between 1925 and 1927, the country undertook a strenuous defence of the exchange rate in preparation for a revaluation of the lira to the level of ninety against the pound sterling (the quota novanta) sought by Mussolini. The effort was accompanied by significant reforms aimed at strengthening the banking system. Italy's international relations played a central role in achieving stabilization, facilitating the defence of the lira through access to foreign capital markets. The adoption of policies intended to mitigate the deflationary effects of the sharp revaluation marked a shift from the existing liberal approach to economic policy towards a corporative model based on greater state intervention in the economy.

1. Introduction

In order to understand Italian exchange-rate policy during the mid-1920s, when the goal of stabilizing the exchange rate of the lira against the pound sterling at ninety (*quota novanta*) was pursued, one cannot ignore the international environment in which Italy operated during that crucial period.

The First World War had seriously damaged international monetary relations, which did not improve with the conclusion of the conflict. The existing gold standard system had been suspended and every nation adopted stringent restrictions on international trade. The effects of financing the war through the issue of securities and paper currency persisted into the post-war period, fueling inflation. Exchange rates

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became extremely volatile, inexorably diverging from their pre-war parities. Trade and capital flows struggled to revive, making the need to re-establish the international monetary order even more urgent.

Most experts agreed that a return to the pre-war gold-based system was in order. However, the supporters of a return to the pure gold standard system, whose manifesto was represented by the Cunliffe Report,² clashed with advocates of a less rigid system under which gold would be used in conjunction with reserves of freely-convertible foreign currency. This gold exchange standard would lower the risk that a sudden scarcity of gold could lead to global deflation. In the end, this approach prevailed, but it only became fully established in the second half of the 1920s. Until then, the international economy was dominated by a floating-rate system characterized by high volatility, despite occasional efforts by governments to counter speculation. In the countries that adopted the gold exchange standard towards the end of 1926, the central banks were allowed to convert the national currency into gold or convertible currencies. In point of fact, however, convertibility was restricted to the latter. Given the substantial volume of pounds circulating abroad, the United Kingdom, fearing the depletion of its gold reserves, adopted the more restrictive gold bullion standard, which allowed conversion only in amounts equivalent to full bars of gold. A similar solution was adopted by the Netherlands and Switzerland. Among the great world powers, the pure gold standard was adopted by the United States and, in 1928, by France.

During the war, the large flow of exports from the United States to Europe significantly shifted the distribution of gold reserves in favour of the former. At the end of the conflict, President Wilson's promise to ensure a sufficient flow of financing to Europe so that it could continue to import American

²The report of the Cunliffe Committee on Currency and Foreign Exchanges after the War, published in the United Kingdom three months before the armistice. See Cunliffe Committee [1918]. As Giannini [2004, p. 240] notes, the Committee's position was "largely shared, in addition to political circles, by the most influential central bankers of the period, especially Montagu Norman, governor of the Bank of England, and by Benjamin Strong, the then-influential governor of the Federal Reserve Bank of New York". Many economists of the period were, however, sceptical about the benefits of the gold standard system. These included Gustav Cassel, who, initially concerned about the threat of deflation that might follow from a future gold shortage, a few years later argued that it would be possible to solve the problem by restricting the demand for gold.

goods was scaled back, starting in 1920, as the US government's policy took on a more isolationist hue. The temporary inward turn of US foreign policy encouraged the United Kingdom to lead a number of initiatives in international monetary cooperation meant to restore convertibility and to give central banks more independence from government influence. Britain's weak financial position nonetheless undermined the credibility of this ambitious design, which lacked a solid foundation of American capital.

Within the context of the effort to rebuild international monetary relations, a major issue was the advisability of re-establishing pre-war parities, in many cases at the cost of stringent internal stabilization efforts, or rather renegotiating the parities based upon existing exchange rates generated by the spontaneous movements among currencies. For many countries this second option would have involved acceptance of the extensive devaluations experienced by their currencies during the war. Although this position prevailed at the main international conferences, some countries were opposed. During the Genoa conference in 1922, the representatives of Belgium, France and Italy (represented by Treasury Minister Camillo Peano) jointly stated that the principle of maintaining the current parities would not apply to their countries.³

It was therefore impossible to reach a shared solution to the problem.⁴ The countries whose economies were gripped by hyperinflation replaced their old currencies (by now worth nothing) with new currencies whose gold parities were set on the basis of their market values.⁵ At the other extreme, nations that had successfully contained devaluation re-established their old parities, absorbing the costs that the revaluation

³ Despite the absence of the United States, the Genoa conference was the most important in a series of meetings held during the 1920s with the goal of bringing order to the system of international monetary relations; see Sayers [1976, vol. I, pp. 153-63]. As Keynes reported, the delegates of the three countries "announced, each for his own country, that they would have nothing to do with devaluating, and were determined to restore their respective currencies to their pre-war values". See Keynes [1924], p. 118.

⁴ A detailed description of the attempts to return to the gold standard is found in Mortara [1928]. For a more recent account, see Eichengreen [1996].

⁵ This was the case of, for example, Austria (1923), Russia (1923), Germany (1924), Poland (1924) and Hungary (1926), whose reserves were partially replenished thanks to loans from the League of Nations.

entailed.⁶ Belgium, France and Italy temporarily held aloof from the race to stabilization, united by the challenge of restructuring their public finances and restoring convertibility. Italy, having failed in its previous attempt at revaluation in 1919, received encouragement from the United States over the next several years to pursue the stabilization of its currency, a reflection of renewed US interest in European monetary reconstruction under its tutelage. Like many other episodes in the history of Italy's international relations, the complex vicissitudes of sterling-dollar diplomacy played a significant role in the success of stabilization, which could enjoy the support of the Federal Reserve and the major American banks. Conversely, the shifting of the centre of international finance from London to New York had an adverse impact on the United Kingdom, as it was no longer able to adequately defend its hegemony.

This was the backdrop against which Mussolini launched his ambitious plans to stabilize the lira, which came to be known as the "battle of the lira". A vigorous defence of the exchange rate was intertwined with innovative banking reforms that introduced, among other things, reserve requirements aimed at limiting the depreciation of the lira and entrusted new control and oversight functions to the Bank of Italy. Mussolini's stabilization effort differed from other similar experiences since it was the action of one who "could exert his will", an action that could disregard consensus and, therefore, compromise. Keynes understood this. After writing in 1923 that "Signor Mussolini has threatened to raise the lira to its former value. Fortunately for the Italian taxpayer and Italian business, the lira does not listen even to a dictator and cannot be given castor oil",⁷ he later admitted that "the situation in Italy was effectively different from that of other countries and, given the existing opportunities for control, the government could have, if it had wanted to, maintained the currency at the desired levels".⁸ In fact, the revaluation, although rather large in nominal terms, was less so in real terms, and the real exchange rate returned to its level at the end of 1922, which incorporated the severe post-war depreciation.⁹ The downward pressure

⁶ Among these, Sweden (1924), Great Britain (1925), Canada (1925) and Denmark (1926).

⁷ Keynes [1924, p. 119]

⁸ Nathan to Stringher, London, 15 December 1931, in: ASBI, *Rapporti con l'estero*, cop. 146. Published in De Cecco [1993, doc. 55, p. 446].

⁹ See Cotula and Spaventa [1993, pp. 144-146].

on wages and wholesale prices imposed by the regime alleviated the consequences of the nominal revaluation, even permitting a slight improvement in competitiveness in the years that followed. Further intervention to stimulate production – essentially tax relief, subsidies and tariff protection – helped boost the economy. However, the employment of these tools, which worked as intended, marked a significant shift from the existing liberal approach to economic policy towards a corporative model based on greater state intervention in the economy.¹⁰

Although we cannot now say for certain what prompted Mussolini to choose the *quota novanta*, it is reasonable to assume that this target was designed to benefit not just the middle and working classes through its effects in protecting the value of savings, but industrialists, too, who once again had access to foreign capital and could increase their imports of raw materials and machinery. It was observed that Mussolini had a good cause in revaluing the lira, around which consensus coalesced, although he took it too far.¹¹ When the recessionary effects of the revaluation (quickly countered by the Bank of Italy) became apparent, many blamed Il Duce. However, this negative judgment must be tempered by the observation that it would have been difficult for Mussolini, just as it was for the British authorities who wanted the pound sterling revalued at its 1914 level, to have foreseen years in advance the disastrous financial crisis that, starting in 1929, destroyed the international financial order that had so painstakingly been reconstructed.¹²

2. Financial restructuring

At the time Mussolini came to power, on 31 October 1922, economists

¹⁰ As Rey writes [1978, p. 285], "This was a set of instruments that could only be adopted by a dictatorial regime. In effect, these tools performed their role correctly, but they had also established the conditions for a major change in the long term."

¹¹ Baffi [1973, p. 122].

¹² As Marcello De Cecco has remarked, before labeling the *quota novanta* as foolish, one must first establish whether Mussolini could have foreseen the horrific financial crisis that, years later, spread from the United States to shatter the world economy, and known what would have happened had that crisis been countered appropriately. See De Cecco [1993, p. 42].

and politicians unanimously agreed that the country's economic and monetary situation was grave. "The final hour has rung for the financial fortune of the nation", cautioned Maffeo Pantaleoni in the pages of *Giornale d'Italia* (12 November 1922). The poor state of the public finances remained one of the most difficult challenges, despite the earlier efforts of the Giolitti, Bonomi and Facta governments. The budget deficit exceeded 15 billion lire and the public debt generated by the huge costs of the war, although lower as a proportion of national income compared with other European countries such as France and Great Britain, had surpassed the still-substantial level of 80 billion lire, mainly in the form of short-term Treasury bills. Still to be addressed was the complex issue of settling the country's war debts with Great Britain and the United States.¹³ The problem of the convertibility of the lira followed in the rear.¹⁴

The regime change in Italy had an immediate effect on expectations. The lira appreciated, bringing it close to 20 lire to the dollar and 90 lire to the pound sterling, signaling the expectation of the markets that the new government would successfully reorganize the country's financial situation.¹⁵

Among those in the new government was Finance Minister Alberto de' Stefani, an economist who, although trained in the classical liberalism of Ferrara, viewed the state as a key driver of modernization. Following the death of Treasury Minister Vincenzo Tangorra, in December 1922 de' Stefani took on these functions as well, thereby controlling the main levers of economic policy during the first three years of the fascist regime.

De' Stefani started the job of reordering the public accounts under favourable economic conditions. The economy had begun to recover from the immediate post-war depression thanks to a boost from exports and investment in public works. The country was therefore able to balance its budget as early as 1923-24.¹⁶ Relatively accommodating

¹³ At the end of the war, Italy's debt to its allies came to about 28 billion lire, of which 11.3 billion (£404 million) was owed to Great Britain and 8.4 billion (\$1.6 billion) to the United States.

¹⁴ Gold convertibility, restored in 1902, was abandoned during the war, as in other countries.

¹⁵ For more on the Italian economy under fascism see, among others, Ciocca [1975], Ciocca and Toniolo [1976], Cotula and Spaventa [1993 and 2003], Rey [1978] and Toniolo [1980].

monetary conditions helped lessen the restrictive effects of the fiscal restructuring. Monetary statistics for this period show a decline in "state" money (cash certificates, Treasury bills, notes issued on behalf of the state) offset, however, by an expansion of "bank" money. As a result, average overall currency in circulation in 1923-24 was in line with the level in 1922, at about 20 billion lire.¹⁷

Nevertheless, monetary developments contained a number of hidden threats that would soon undermine this encouraging scenario. In particular, the "quality" of the money supply was deteriorating, due to the growing exposure of the Special Autonomous Section of the Consorzio Sovvenzioni to the troubled banking system. The Section, which had continued to provide advances to the Banca di Sconto during its liquidation, was the instrument used to settle the Banco di Roma affair at the end of 1923.¹⁸ The financial commitment necessary to rescue the two institutions was so great as to force the government to eliminate the ceiling of 1 billion lire originally imposed on the operations of the Section. Only in January 1924, once the banking crisis had passed, was it again prohibited from carrying out new operations, except those necessary to complete the interventions already under way. At the end of that year, bank money created on behalf of the Section came to about 4 billion lire, i.e. more than one-third of that on behalf of trade and about one-fifth of the total.¹⁹

The abundant money supply did help sustain economic growth, which in this initial period benefited from price and exchange-rate stability. The wholesale price index remained around its 1919-20 level, equal to five times its pre-war level, while the exchange rate fluctuated within a limited range: the average in 1923 and the first part of 1924 was 99.8 lire to the pound and 22 lire to the dollar.

¹⁶ De' Stefani's speeches offer more details on his financial programme; see especially de' Stefani [1922a and 1922b].

¹⁷ If the rise in bank deposits is also taken into account, liquidity actually increased. On this point, see Fratianni and Spinelli [2001, p. 281].

¹⁸ The Bank's equity investments and other fixed assets were transferred to *Società Finanziaria per l'Industria e il Commercio*, which, in turn, transferred these securities to the Autonomous Section as collateral for bill discounting. For details on the transaction see Toniolo [2003, pp. 316-320].

¹⁹ Gigliobianco [1993].

3. The lira crisis and the unification of note issue

International developments worked against the stability of the Italian lira which, like other currencies not yet formally linked to gold, was vulnerable to speculative pressures. In particular, since the lira and the French franc tended to move in tandem, an attack on one frequently affected the other.²⁰ The failure to repay loans extended by the allies also damaged Italy's credit standing on the international markets, accentuating its vulnerability. All of these circumstances, in themselves unfavourable, cannot, however, be blamed as the main cause of the weakness of the lira. This was rather a reflection of underlying economic conditions and the choices of economic policy-makers.²¹ Specifically, Italy was burdened with a large public debt whose short-term maturity required frequent refinancing.

Around the middle of 1924, inflation once again reared its head, reflecting the concomitant effects of economic recovery and expansion of the money supply, as well as the reduction in the supply of agricultural products due to the poor harvest. Between June and December of that year consumer prices rose by about 10%. Although the rise was in line with the general trend in the international economy, it created new downward pressure on the lira. As Giorgio Mortara put it:

“The poor domestic wheat harvest sparked predictable expectations of a need for substantial imports, and since in the last few months of 1924 the price of wheat in exporting markets rose rapidly, the likely foreign currency requirements also increased. The fear of a rise in the exchange rate spurred importers of wheat and other goods to rush to obtain the foreign currencies they needed, lending fresh impetus to the depreciation of the lira. Meanwhile, the attitude of the British and North American governments dispelled any hope of cancelling our foreign debts. On the contrary, it seemed they would impose onerous terms for repayment, which they demanded. This set of circumstances undermined confidence in the future of the lira.”²²

²⁰ Cotula and Spaventa [2003, p. 252].

²¹ For a more extensive analysis, see Cotula and Spaventa [1993, pp. 253-268].

The situation was exacerbated by a frenzy of stock market speculation, which saw the "participation of masses of the property-less: youths, busboys, drivers, women of every social level and virtue, who patronized the stock markets, buying thousands of shares with no funds whatsoever".²³ The effects of this state of affairs were myriad. The lira began to depreciate in November once the initial enthusiasm following the installation of the new government had waned, with the exchange rate rising to 24 lire to the dollar in January of the following year, a month also marked by false rumors of Mussolini's death.

To burst the stock market bubble, on 28 February 1925 Minister de' Stefani imposed a 25% margin requirement on securities purchases, causing prices to tumble.²⁴ That same month, the official discount rate was raised to 6% to halt the depreciation of the lira, in response to pressure from the Director General of the Bank of Italy, Bonaldo Stringher. However, the government was reluctant to take out new foreign loans to obtain the reserves needed to protect the exchange rate since, as de' Stefani publicly stated before Parliament, "Italy would once again go it alone".²⁵

The story of the lira during this period was closely linked to those of the French and Belgian francs, although the Latin Monetary Union, now

²² Mortara [1925, p. 310].

²³ De' Stefani [1966, p. 40]. The race to invest in the stock market was also fuelled by the low yields on government securities (around 4%). This was probably the reason behind the substantial failure of two long-term Treasury bond issues through which de' Stefani tried to extend the maturity of the public debt.

²⁴ The abruptness of the fall in share prices surprised both the authorities and market professionals. The banks had large stock holdings in their portfolios, held both as collateral for their loans and as investments on their own account. This prompted the four major banks (Banca Nazionale di Credito, Banco di Roma, Comit and Credit) to found Sofit, a company whose purpose was to prop up the prices of the main stocks in their portfolios. The Bank of Italy did not hesitate to extend Sofit a loan of 500 million lire. The results were disappointing and Sofit posted only losses. The episode is significant since it demonstrates how the authorities tried to "counter the effects of what was belatedly recognized as a technical error, compounding it with a second one". See Guarino and Toniolo [1993, p. 45].

²⁵ See Asso [1993, pp. 205 *et seq.*], from which the brief quote from de' Stefani comes, spoken during an address to the Chamber of Deputies on 20 December 1924. Asso shows that, despite official statements, de' Stefani, together with Stringher, began to explore the potential of the US capital market. In January 1925, Italy agreed a first loan of €5 million with J.P. Morgan, to be followed by much larger operations with the American financial market, which are examined in more detail later.

an artefact of a distant past, was in the last year of its life. In 1925, the stabilization of the pound also stabilized the currencies of nearly all the industrial countries, as well as those of various minor nations. The exceptions were Belgium, France and Italy. International speculation therefore focused on these three countries, united in their failure to resolve the problem of their debts to the allies.²⁶ The exchange-rate problem began to concern Mussolini, who, due to its unfavourable implications for the prestige of the regime, called it "the dark cloud overhanging all of fascist policy".

In order to contain speculative pressures on the lira, the government intensified its foreign-exchange controls and its direct interventions in the foreign-exchange market. For the latter, it was also able to use a \$50 million loan from J.P. Morgan, granted in June thanks to the influence of Stringher, as the Italian authorities had advisably changed their attitude towards its foreign debt.²⁷ At the same time, de' Stefani raised the discount rate to 7%,²⁸ a level not seen since 1866, and increased the interest rate on Treasury bills. The speculators regained the upper hand, however. On 2 July, the day on which the lira crisis reached its nadir, the exchange rate against the dollar came close to 30 lire and that against the pound reached 145 lire. By contrast, the exchange rate against the French franc remained stable at around 127 lire.

The persistence of the crisis and, perhaps, the drastic nature of the measures adopted to counter stock-market speculation cost de' Stefani

²⁶ The links between the two francs and the lira are closely analyzed in Falco and Storaci [1975]. In any event, the reasons for the crisis of the lira are still controversial. Einaudi [1925], for example, tends to minimize the role of speculation, while others including de' Stefani himself [1966], emphasize it. Conversely, the role of the interallied debt problem seems to be corroborated by various sources, including a letter from Stringher to de' Stefani dated 19 May 1925, in which the Director General of the Bank of Italy refers to the results of a survey he commissioned at the Bank's main branches: "From the responses I have received, many appear to believe that the rising exchange rate has been a consequence of the pressure that, apparently, America is exercising on the nations of which it is a creditor, to force them to find a real solution to the persistent problem of interallied debt". The letter is quoted in Marcoaldi [1986].

²⁷ Mussolini decided to instruct de' Stefani to look into the possibility of a loan "before stabilization makes this impossible or possible only at a humiliating amount". See Cotula and Spaventa [1993, p. 127 and document 68, attached].

²⁸ To 6.5% on 3 June and 7% on 18 June.

his post. On 10 July 1925, Mussolini replaced him with Giuseppe Volpi di Misurata, who was considered better suited for conducting the international negotiations on debt repayment and the restoration of convertibility and who had the support of the financial community.²⁹ The former minister was accused of pursuing an "easy money" policy, when, on the contrary, he had recognized the cause prior to the devaluation of the lira as the excess supply of money, and placed the blame squarely on the Bank of Italy.³⁰ As for Stringher, who was opposed to narrowly dogmatic explanations of the link between the supply of money and its value, he revealed himself to be generally sceptical both of the alleged direct relationship between note issue and the exchange rate and the fact that supply was excessive.³¹

In order to curb the flight from the lira, Volpi resorted to no less drastic measures than his predecessor.³² In August, he introduced new foreign exchange controls on international trade in lire and, in September, intervened directly in the market to prop up the Italian currency, with the goal of fixing its level at 25 lire to the dollar. Starting in the autumn, Mussolini himself began to follow monetary developments ever more closely, to ensure himself that they would not jeopardize the success of the stabilization effort. Thus he wrote in a telegram to Stringher dated 23 October:

I read in a report from the Volta agency that, in the first ten days of September, the note issue expanded yet again by no less than 71 million, adding to the systematic increase registered over the last 30 months. You know what I think about this frightening phenomenon, which has me increasingly concerned, in part because I have not seen ... I do not

²⁹ See De Felice [1966, p. 374].

³⁰ One of the main critics of de' Stefani's monetary policy was Mario Alberti. See, for example, Alberti and Cornaro [1931]. In his defence, see Del Vecchio [1928] and Gangemi [1961]. The clash with Stringher was so heated that it is believed that he tried, in vain, to replace the Director General of the Bank of Italy with Guido Jung. The manoeuvre is said to have failed "thanks in part to the strong political support the Director General enjoyed within the fascist party". Cotula and Spaventa [1993, p. 125].

³¹ For more on this point see Cotula and Spaventa [1993] and Spaventa [1998].

³² For an examination of Volpi's measures, see Raitano [1995, pp. 298 et seq.].

want to say a reduction, but not even a pause. When I get back to Rome, I would appreciate it if would you be so kind as to explain this to me.³³

However, Mussolini soon became aware that the excessive money supply was, at the most, a contributory factor to the lira crisis and directed the government's efforts to settling the matter of its war debts, which represented the real obstacle to currency normalization. In June, the US government had already threatened that, in the absence of a solution to the war debt problem, it would have to suspend financial assistance to Italy.³⁴ In the months that followed, the US State Department blocked existing loans to Italian entities, suggesting that Italy make recourse to neutral countries. Thanks to Volpi's diplomatic skill, the issue was resolved, however. The minister, who knew the markets well, began what was to become known as the "battle of the lira" with an energetic strategy of exchange-rate intervention and moral suasion, and sometimes intimidation, with Italian industrialists and bankers. During that phase, the concept of a "theoretical exchange rate" for the lira began to emerge in Italian monetary policy, the precursor of the *quota novanta*.³⁵

Thus, when Italy sat down to negotiate with the Americans the exchange rate was enjoying a period of stability, at about 120 lire to the pound sterling. On 14 November 1925, Italy reached an agreement with Washington that enabled it to settle its debt with the United States on much more favourable terms and reopened access to the American capital markets.³⁶ The Italian government was then able to place a \$100 million

³³ The telegram was addressed to the Minister of the Interior Luigi Federzoni with a request to forward it to Stringher. The latter reassured Mussolini in a letter dated 26 October, informing him that during the second ten days of that month, the note issue had dropped by 210 million lire (followed by a face-to-face meeting with Mussolini on 2 November). However, figures now available seem to support Mussolini's view. In November, overall currency in circulation fell by just 0.6 million lire. For more details see Cotula and Spaventa [1993, p. 489, doc. 77], which also quotes the text of Mussolini's telegram.

³⁴ See De Cecco [1993, pp. 56 et seq.].

³⁵ See De Felice [1966, p. 376].

³⁶ Italy was required to repay just over \$2 billion over 62 years, with no interest payments for the first five years. The United States thus waived about 50% of the debt. See Petri [2002, p. 85].

Kingdom of Italy bond issue on the American market through a consortium of banks coordinated by J.P. Morgan. The terms of the loan were not exactly advantageous,³⁷ but the issue helped foster the normalization of Italy's financial relations with the United States. This was followed by a series of other private loans to Italian companies and entities. Italy's debt to Great Britain was settled with the accord of 27 January 1926, thereby allowing the gradual restitution of its gold deposit with the Bank of England, established on the occasion of the London loan of 1916.

The greater foreign currency resources available could have been used profitably in the defense of the exchange rate. The interventions were undertaken with the help of financial innovations such as the swaps, which consisted in the simultaneous spot sale and forward repurchase of foreign exchange to avoid depletion of reserves and, especially, in order to reduce the gains of speculators by maintaining a large discount on the lira in foreign markets.³⁸ The period was, however, characterized by considerable uncertainty about the respective roles of the Bank of Italy and the Treasury. Market intervention was often uncoordinated, since the Treasury placed orders directly with the Istituto Nazionale per i Cambi con l'Estero in New York or acted through its own staff in New York or London without the knowledge of the Bank of Italy.³⁹ In fact, the Treasury tended to centralize exchange-rate intervention with itself to the exclusion of the Bank.⁴⁰

³⁷ The American authorities themselves "denounced without undue discretion the burden of the financial terms that the House of Morgan was able to impose on the Italian government". See Asso [1993, p. 240].

³⁸ For information on swap transactions, especially the technical aspects, see Santorelli [1993, pp. 355-362].

³⁹ The Bank of Italy's London representative, Joe Nathan, telegraphed Stringher: "I was told that the Italian Treasury has placed large orders to purchase lire with French Lemon & Co. Reliable rumour from the major bank circles harmful, chiefly since viewed not serious to entrust business of that nature to a firm that is not seen as a bank, but rather a quite small shipping firm". Telex from Nathan dated 12 November 1925, ASBI, Stringher Papers, 407/2.02/13, quoted by Santorelli [1993, p. 346].

⁴⁰ Santorelli [1993, p. 347] refers to a letter from Stringher to Podestà, the New York agent of the Bank of Italy, in which he states: "I would like to warn you that from henceforth orders related to the defence of the lira exchange rate will be directly placed by Finance Minister. I await your usual reports". Telex of 13 December 1925, ASBI, Rapporti con l'Estero, cart. 87.

The "battle for the lira" was supported by a healthier balance of payments than in 1925, while monetary growth was kept under tight control by the authorities.¹¹ There was a contraction in both state-generated money supply, thanks to the budget surplus, and bank money. The foreign channel of monetary base creation was blocked by stringent foreign-exchange controls. The discount rate was kept at 7%. Conditions were ripe for the government to take a number of important steps at the institutional level. The first of these was the measure to centralize the note issue with the Bank of Italy (Decree Law 812 of 6 May 1926) as from 1 July 1926. This led to a series of operations between the Bank of Italy and the two southern banks of issue, including the transfer of the liability in respect of the banknotes that the two banks had in circulation at 30 June 1926 (about 3.8 billion lire) to the Bank of Italy and their replacement with notes from the Bank of Italy.¹² The measure was essentially a formal recognition of a *de facto* situation, but it did finally put an end to a old problem.

Thanks to the various measures taken, the lira exchange rate held steady in the first four months of 1926, at around 120-121 lire to the pound (24-25 lire to the dollar). In the spring, however, international speculation against the lira and the two francs flared aggressively, coinciding with a major miners' strike in Great Britain, which forced the British authorities to tighten their defence of the pound to the detriment of other currencies. In May, the exchange rate rose above 135 lire against the pound. It soon became clear that any attempt to defend the exchange rate would be useless in the face of a speculative attack of such magnitude, and on 13 May the government duly decided to withdraw support for the lira. The abandonment of the Italian currency to market forces led to a depreciation of 25% in the space of two months. It was small consolation to witness the even steeper depreciation suffered by the French and Belgian francs.

Although fully aware of the fundamentally economic nature of the

¹¹ See Baffi [1973, p. 103].

¹² With the transfer of the banknotes, the two banks also transferred the gold and other reserves they held to partially guarantee their note issue to the Bank of Italy. The Bank also received certain assets of the two banks, such as receivables from the Treasury and the Special Autonomous Section. A highly detailed description of these measures is provided by Stringher [1926], but see also Supino [1929, pp. 254-257] and Fratianni and Spinelli [2001, pp.325-326].

monetary crisis, Mussolini was particularly concerned about its political significance, considering it a serious defeat for the fascist regime.⁴³ As he wrote to Volpi on 8 August 1926:

In December 1922, the fascist regime was faced with the pound sterling at 90 lire. The alternatives, or hypotheses, were three: the regime could still improve this rate, the regime could set it at that level, or the regime could worsen it. The third case is what occurred. This is the reason I argue, with the frankness of only the truly strong, that the regime was thus defeated.⁴⁴

The analyses of Mussolini's decision to bring the lira back to its end-1922 level are numerous and varied. The most persuasive is that Mussolini sought to ensure a lasting social peace, through policy choices that reconciled the interests of the middle and working class with those of the industrialists.⁴⁵ The very nature of the problem, rooted not just in economics but above all in politics, certainly persuaded Mussolini that the solution did not lie solely in recourse to financial measures. In this light, one cannot wonder at the emphasis in his famous Pesaro speech on 18 August 1926, whose most significant and most frequently quoted passage proclaimed:

I would like to tell you that we will conduct the economic battle in defence of the lira with the most determined resolution, and from this site to the entire civilized world I say that I will defend the lira to my dying breath, to my last drop of blood. I will never inflict on the wonderful people of Italy, who for four years have worked like heroes and suffered like saints, the moral disgrace and the economic catastrophe of the failure of the lira. The fascist regime will resist with all its might

⁴³ De Felice [1966].

⁴⁴ The quotation is reported in Baffi [1973, pp. 113-114].

⁴⁵ See both the analysis in De Felice [1966], and the correspondence between Sraffa and Tasca, reported in Sraffa [1927]. Sraffa, especially, believed that the revaluation of the lira was an attempt by fascism to conquer "the support of the middle and certain strata of the working classes". Pietro Grifone places monetary stabilization within a broader plan to achieve lasting social and political stability. In this context, Mussolini's policy would have also benefited the industrialists, by giving them renewed access to foreign capital once confidence in the lira was restored and by reducing the cost of imported raw materials and machinery. See Grifone [1971, pp. 6-58].

any attempt by our financial adversaries to bleed the country, and is determined to crush them when they are identified within. The fascist regime, from its leader to its lowliest foot soldier, stands ready to undertake every necessary sacrifice, but our lira, which is the symbol of the nation, the sign of our wealth, the symbol of our labour, our efforts, our sacrifices, our tears, our blood, must and will be defended.

Even before the dictator's words were translated into effective action, the announcement of his determination to vigorously defend the Italian currency was enough to reverse its course.⁶⁶ The exchange rate against the pound, which prior to Pesaro had deteriorated to 150 lire, strengthened to 134 lire at the start of September and fell below 120 lire in October, once the first measures were taken. As noted a few years later: "[Mussolini] *could will*, something governments could not usually do. And then subordinate all actions to his will, which did not remain an abstract proposition, but rather was translated into all possible forms of action".⁶⁷

4. Banking reform

A few days after the Pesaro speech, the government issued the first measures of the new stabilization operation.⁶⁸ Royal Decree Law 1506 of 7 September 1926 laid the foundations for quickly eliminating the "state" currency in circulation. State 25-lira notes were withdrawn from circulation, while 10-lira and 5-lira notes were replaced with silver coins. In addition,

⁶⁶ In reality the role of the Pesaro speech in the appreciation the lira remains controversial. For example, Ripa di Meana [1993] notes that the exchange rate had already been stable for a few weeks due to the positive effect of the installation of the Poincaré government in France, which caused a miraculous revival of confidence in that country and in the franc, whose links with the lira were discussed earlier.

⁶⁷ See Del Vecchio [1932].

⁶⁸ The measures were largely inspired by the suggestions of the governor of the Federal Reserve, Benjamin Strong, who met with Mussolini at the end of May. See De Cecco [1993, pp. 64-65]. On the connection between the Banking Law of 1926 and the battle for the *quota novanta* see Masera [2005, pp. XII-XIII]. In particular, Masera observes, they "can only be associated with the need, which emerged on a number of fronts, to separate the monetary creation of the bank of issue from the pressures on financing in monetary base generated by the Treasury, and with the desire to "save" the banks in crisis".

the measures also reduced the state's debt in respect of notes received from the banks of issue for loans to meet the needs of the war and post-war periods. The reduction was carried out by transferring foreign currency reserves, part of which derived from the Morgan loan, to the Bank of Italy. The corresponding notes were not withdrawn from circulation so that they remained "at the service of trade and industry".⁴⁹

Finally, the decree also set a ceiling on note issue from the Bank of Italy on behalf of trade, equal to 7 billion lire, excluding however the loans to the Treasury and to the ordinary and special sections of the *Consorzio Sovvenzioni*. They were granted an additional credit line of 1 billion lire "which should be sufficient, but not excessive, given the size of any movements, and the impact of seasonal variations or of temporary exceptional conditions of production and our activities".⁵⁰

The monetary measures were accompanied by a major banking reform aimed at protecting savings (Royal Decree Law 1511 of 7 September and Royal Decree Law 1830 of 6 November), to which Alberto Beneduce made the leading contribution. The reform was primarily intended to reduce the risk of new banking crises, but Volpi, in asking for its ratification into law, "explicitly stressed the link between this measure and a monetary policy aimed at stabilizing internal prices and the external value of the lira in view of the introduction of gold convertibility".⁵¹ The new measures substantially increased the authority of the Bank of Italy, which was given powers of supervision and inspection over banks.⁵²

However, neither the Pesaro speech nor the changes in the measures adopted in the monetary and banking field could have ensured the

⁴⁹ Stringher [1926, p. 74]. Following these measures, metallic currency in circulation reached 2.1 billion lire in September 1926, compared with 18 billion in paper currency.

⁵⁰ Stringher [1926, p. 79]. Note issue up to the normal ceiling of 7 billion lire was subject to ordinary tax of 4 per 1,000, while for currency exceeding the limit and not entirely backed by metal reserves, the rate was equal to the discount rate incremented by one third. In any event the decree established that the note issue of the Bank of Italy could not exceed 8 billion lire.

⁵¹ Guarino and Toniolo [1993, p.53].

⁵² See the sections on the 1926 Banking Law in Guarino and Toniolo [1993]. Very briefly, the law governed the exercise of credit business, establishing a register and introducing a licensing requirement for new banks. It strengthened capital requirements and imposed a limit, equal to one-fifth of capital, on the granting of credit lines. It also gave the bank of issue a supervisory role.

success of the "battle of the lira" on their own. The main obstacle was the massive stock of short-term public debt, whose highly liquid nature risked thwarting the stabilization effort.⁵³

The banks and the public held huge quantities of Treasury bills, the former because they could count these securities in the reserves against currency in circulation, and the latter because of the highly-liquid nature of the securities, which gave ready access to liquidity in the event of a monetary restriction. It was no coincidence that, in his report to Bank of Italy shareholders for 1926, Stringher stated: «during and after the war, the ordinary Treasury bill changed its nature and virtually became a sort of interest-bearing banknote". Redemptions of the bills grew sharply starting in 1923, so much so that new issues were systematically insufficient to cover demand for repayments. On several occasions, the Treasury found itself facing serious cash flow strains, as in July 1925, during one of the periods of greatest pressure on the lira.⁵⁴ These difficulties were, naturally, also attributable to the rigidity of nominal interest rates, which blunted the main instrument for boosting demand for securities. The government thus decreed the compulsory consolidation of short-term debt on 6 November 1926. A total of 20.4 billion lire in Treasury bills were converted into consols paying 5% not redeemable until 1936 (the so-called "Littorio loan").⁵⁵

⁵³ This was the so-called "floating" debt, basically represented by ordinary Treasury bills (BTOs), whose issuance, negligible in the pre-war period, literally exploded during the war. This phenomenon was not, however, common to all the belligerent nations. At the end of the war, the stock of BTOs accounted for 25% of the country's total public debt. In mid-1926, it represented just under 20%, equal to 17.8 billion lire. The figures cited are those given by Confalonieri and Gatti [1986, Appendix].

⁵⁴ See the letter of the Director General of the Treasury of 23 December 1925 to Minister Volpi in which the former reports on the action of the Treasury from 15 July to 20 December 1925, partially reported in De Felice [1966, p. 374].

⁵⁵ Confalonieri and Gatti [1986, especially pp. 38 *et seq.*]. Although the commentators of the regime took pains to emphasize the special nature of the measure, the consolidation of Italian debt was clearly part of the trend in similar operations carried out in other European countries, which shared Italy's problem of short-term debt. Belgium, for example, ordered the compulsory consolidation of its debt in July 1926. France suspended the issue of Treasury bills in February 1927, while Great Britain gradually extended the maturity of its debt until 1930. However, as in Belgium and France, monetary stabilization and financial consolidation were dictated in Italy by the same counterparty, namely the monetary authorities and financial institutions of the United States.

The debt consolidation functioned as "the greatest deflationary measure that could be implemented",⁵⁶ significantly strengthening restrictions on currency in circulation. Also in November, the activity of the Special Autonomous Section of the Consorzio Sovvenzioni, which had fueled the least healthy component of the money supply, came to an end. The Consorzio Sovvenzioni was made a permanent structure with independent legal status. Finally, towards the end of the year authority in foreign exchange matters was placed fully in the hands of the Bank of Italy, "the only regulator of the currency, the technical body to which the high exercise of this important function in the life of the State is entrusted".⁵⁷ However, this latter measure would be repudiated in the mid-1930s during the latest of many lira crises.

5. The "quota novanta"

After the Pesaro speech, the lira seemed to be a stable path of appreciation against the major foreign currencies. Its equilibrium level remained to be determined. The key consideration was that excessive appreciation could seriously erode competitiveness, and therefore the country's export capacity. Public opinion was deeply divided over the extent of the revaluation. On the one hand were the committed "revaluators", especially among the senators, including prominent figures such as Achille Loria, Maggiorino Ferraris and Luigi Luzzatti. These personages – some of whom supported the regime, others who opposed it – considered depreciation to be a "moral disgrace" and encouraged the government to effect a slow but steady revaluation, to a level to be determined later. On the opposing side were arrayed the industrialists, who favoured the stabilization of the lira at a level compatible with the ratio between internal and external prices, calculated at 120-125 lire to the pound sterling. Among the proponents of this view was Volpi himself. Also opposed to a steady revaluation of the lira were the banks, whose interests were closely allied with those of the industrialists. This position was authoritatively represented

⁵⁶ Del Vecchio [1932].

⁵⁷ Volpi [1928, p. 261].

by Giuseppe Toeplitz, the head of Banca Commerciale, whom the regime had already accused of speculating against the lira, a charge he vigorously denied⁵⁸. Scholarly opinion was more varied. Del Vecchio and Einaudi, especially, took intermediate positions on the issue.⁵⁹

Mussolini had not specifically indicated the size of the revaluation he sought in the Pesaro speech, but even then he had in mind the exchange rate prevailing at the time the fascists came to power, namely 90 lire to the pound.⁶⁰ And ultimately this - the "*quota novanta*" - became the level around which the new parity was set. The lira was thus revalued by more than 20% from its level in early 1926. Inevitably, stabilization of the exchange rate at that level attracted criticism from the "revaluators" and the "stabilizers" alike. For his part, Mussolini staunchly defended the decision to seek stabilization at an intermediate level, as, for example, during his address to the Chamber of Deputies on 26 May 1927, the so-called "Ascension Day Speech", in which he definitively proclaimed the objective of the *quota novanta*:

For me, history began in October 1922. If you take the high point of the pound sterling, then we have an improvement of 60 points, but if you take the average rate of 120, the improvement is only 30 points, and if you return to the time of the March on Rome, the gain is just 15, because at the time of the March the pound was trading at 105 and 110. But then, gentlemen, we had a budget deficit, we had unpaid foreign debts, a regime that was just getting finding its feet and might not have lasted very long; we had a balance of payments deficit... These concerns must end; we haven't conquered anything; we have simply retaken the positions that we had in 1922. We will call it the "*quota 90*" and at this level we expect the army to rally.

It should be stressed that, at the end of 1922, the pound had depreciated

⁵⁸ See on this issue the letter from Toeplitz to Volpi dated 10 December 1927 reproduced in Cotula and Spaventa [1993, doc. 120, pp. 657-658]. Credito Italiano was also accused of conspiring against the government's monetary policy.

⁵⁹ For a description of the various positions held on revaluation, see Baffi [1973].

⁶⁰ This is made clear in the correspondence between Mussolini and Volpi reported in De Felice [1966], and especially in the previously cited letter from Mussolini to Volpi of 8 August 1926.

by about 5% from its pre-war parity, to which it returned in 1925, which implies that the revaluation of the lira against gold required by the *quota novanta* was in fact smaller than that against the pound alone. On the other hand, if left to market forces, the lira would probably have appreciated above the *quota novanta*. Until January of that year, intervention in the market by the monetary authorities were relatively mild, leaving room for a slow, gradual appreciation. In the subsequent months, upward pressure intensified. When the pound fell below 90 lire in June, intervention was increased to stabilize the exchange rate in line with the government's objective.

The Italian authorities were especially active in engineering a decline in prices and wages consistent with the new parity, an effort facilitated by the nature of the regime, a factor that distinguishes the *quota novanta* policy from stabilization attempts in other countries. Downward pressure on prices and wages was exerted using every possible channel, from state and public bodies in general to the labour unions and the state-controlled press. The impact was greatest on wages and wholesale prices, less so on retail prices, which were more rigid.⁶¹

Once the exchange rate was stabilized at the *quota novanta* level in practice, it was necessary to give the policy statutory force, which came with Royal Decree Law 2325 of 27 December 1927. The new gold parity of the lira, the so-called "new gold lira", was set at 0.07919 grams of pure gold, 70% lower than the 0.290322 grams before the war. The ratio corresponded to an exchange rate of 92.46 lire to the pound sterling, 19 lire to the dollar and 3.66 lire to the French franc. In addition to setting the new official exchange rate, the measure sanctioned the restoration of convertibility and thus the adoption of the gold exchange standard for the Italian currency.

At the same time, the Italian authorities secured \$75 million in new credit from the major foreign banks of issue, under the auspices of the Federal Reserve and the Bank of England, as well as \$50 million from a group of major private international banks led by J.P. Morgan. The support of the international financial community was sought "both to strengthen

⁶¹ On this aspect, see Fratianni and Spinelli [2001, pp. 301-303] and the literature cited therein.

the ability to defend the fixed exchange rate, and because ... it signified cordial collaboration and international approval of the decisions taken by the government".⁶²

To complete the task of putting the country back on a sound monetary footing, the measure of 27 December contained numerous other important provisions. The government appropriated the valuation gain on the Bank of Italy's reserves produced by the new parity and used it to repay its remaining debt of 4.2 billion lire to the Bank. On its part, the Bank of Italy undertook to gradually withdraw the notes related to the debt from circulation. Stricter capital requirements were imposed on the bank of issue: it was now required to maintain a 40% reserve, from which government securities were excluded, backing not only the note issue but also any other sight liabilities of the ^{Bank}.⁶³ The available reserves were, however, amply sufficient: in December 1927, they amounted to 55.5% of the Bank's sight liabilities. Commenting on the task of restoring monetary health, Stringher wrote:

There seems to be no doubt that, with the reserves it has available, the Bank of Italy may calmly face the end of non-convertibility, pursuant to the provisions of the Decree Law of 21 December. ... The old lira, although its purchasing power was necessarily reduced – but by much less than the amount that it long had to suffer, due to the exchange rate, with frequent, ruinous fluctuations – will continue in its office, as if nothing had happened, without changes that could generate unfavourable repercussions caused by psychological reactions rather than the real action of economic and social events.⁶⁴

6. Conclusion

In June 1928, a new agreement between the government and the Bank of Italy became law. Among other things, it loosened the restrictions

⁶² Consiglio dei ministri [1928, p. 152].

⁶³ In the past the "other sight liabilities" could have been covered by state-issued notes. Based on the new gold parity, the reserves were equal to 57% of notes and other debts subject to coverage.

⁶⁴ Stringher [1928, p. 213].

on the note issue of the Bank.⁶⁵ Also in June, the position of Governor of the Bank of Italy was created. The position naturally went to Bonaldo Stringher, who ceded his post as Director General, a job he had held for twenty-eight years, to Vincenzo Azzolini. On Christmas Eve 1930, Stringher died and Azzolini became the second Governor of the Bank of Italy.

The lira remained convertible until 1934, while the exchange rate of 90 lire to the pound sterling was maintained until 1936, with the help of strict controls on commercial and foreign-exchange transactions. However, as early as 1930 a surge in speculation depleted reserves, which contributed to the devaluation of the pound in 1931. The worsening of the global economic crisis and the collapse of international monetary cooperation then plunged the world into protectionism and centralized control over the economy.

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⁶⁵ Royal Decree 1377 of 17 June 1928. It partly transposed a previous secret agreement between the government and the Bank of Italy, which had restricted the note issue to 17.5 billion lire (excluding, as usual, advances to the Treasury). The decree abolished the previous limits but did not establish new ones. However, it can be presumed that the ceiling of 17.5 billion remained in force. In any event, the restriction was never a factor owing to the decrease in currency in circulation until the mid-1930s, after which the ceiling was permanently eliminated from the legislation governing the Bank of Italy. On these and other aspects of the legislative changes regarding the bank of issue between the two wars, see Appendices I and II to the Introduction in Cotula and Spaventa [1993].

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