

The Lira within the International Monetary System

1. The Korean War

The debate over the appropriate monetary policy for Italy revived with the outbreak of the war in Korea in July 1950 and took on a more general policy significance as a result of the arms race and the build-up of monetary reserves in some countries. The new war made dollars scarce, and the "dollar gap" was a drag on further European economic recovery. In the view of the Economic Cooperation Administration (ECA), the countries receiving Marshall Plan aid needed a powerful programme to boost output by stepping up investment, in order to reduce their continual requests for dollars.¹ The IMF, by contrast, called on the countries suffering from a dollar gap to keep consumption and investment in line with the level of output, arguing that a limit had to be set on domestic investment demand, although "investment which [would] improve the balance of payments should be continued."²

The policy recommendations of the ECA and the IMF, together with the earlier positions of the OECE and the BIS, brought the number of forums for the discussion and formulation of monetary policy proposals to four. These interventions responded to Western Europe's difficulties in emerging from the disaster of war. Despite the Bretton Woods agreements of 1944, these problems had resulted in currency devaluations affecting many countries (France in 1948, Colombia in December 1948, Britain in September 1949, and a number of other countries in the sterling area). None of the organizations cited so far had mentioned any necessity for Italy to devalue, even though, regardless of the ambiguity in which the discussions were cloaked, such a step appeared to be inevitable in the event of monetary expansion. While he saw this thrust even in the reports of the IMF,³ Luigi Federici unhesitatingly rejected it, maintaining in accord with Joan Robinson that it was "in contrast with the principle laid down at Bretton Woods" that mutual adjustment must not be attained by measures destructive to prosperity.⁴

The fact is that, towards the end of 1950, monetary affairs were marked by a disturbing uncertainty, with deplorable effects on the economy as a whole. This was due to inconsistency in the control of the money supply in different countries and the fact that each country operated in fear of falling victim to monetary manipulation by other powers. There was thus no way of defining

¹ L. Federici, "The present crisis of monetary policy principles", *Review*, V, 1 (January 1951), pp. 13 *et seq*.

² *Ibid.*, p. 15.

³ *Ibid.*, pp. 16-17.

⁴ *Ibid.*, p. 17.

this kind of economic equilibrium, in part because economic policy objectives had been radically changed, now focusing on realizable full employment, i.e. the greatest possible prosperity, while monetary conditions were viewed as the means to this end. Theoretically at least, the international economic equilibrium was no longer considered as the relation between exchange rates and prices but as a hypothetical state of affairs within which the monetary policy function was judged by its contribution to prosperity. This concept utterly ruled out any return to the gold standard.⁵

These theses of Federici's unmistakably underscore the change in economic policy ideals that was effected in the course of the Second World War. But the Korean War aggravated matters. The increase in military spending, with a generalized rise in raw-material prices, was promptly reflected in European domestic prices, with inflationary pressures that were not free of social implications; in fact, substantial wage increases were granted in many of the countries of Europe, partially if not totally offsetting the fiscal and monetary policy measures that had been taken to stabilize the price level. Thus, as raw-material prices were in dollars, the ECE proposed revaluing the European currencies to offset the rise and neutralize the impact on domestic prices and incomes. Bresciani Turrone rejected this idea both for Italy and for the rest of Europe, while acknowledging the effort to come to grips, in theory, with the fact that the world economy faced continual fluctuations and that fixed exchange rates were accordingly a serious inconvenience; flexible foreign exchange policy and the ability of the authorities to raise or lower the exchange rate as required by circumstances were much more practical.⁶

Apart from its intrinsic merits, the ECE proposal was a further signal of the problems for Europe provoked by the Korean War. Bresciani Turrone explicitly recognized that the Korean War was a turning point, the cause of serious new economic problems, confirming Italy's import dependency in that Italian inflation was not fueled by domestic monetary or credit policy but by the external sector.⁷

Italian wholesale prices, which had fallen steadily from the end of 1948 until July 1950, soared with the outbreak of the conflict. Between June 1950 and February 1951 average wholesale prices rose 23.2 per cent, but the increase was much steeper in industries dependent on imported raw materials. Textile prices rose 47 per cent, metal and engineering products 41.5 per cent, leather and shoes 76.9 per cent, but foodstuff prices increased by just 9 per cent. The impact at retail level was more moderate, the cost of living rising 12 per cent. In any event, by February 1951 the rise was halted; in the months that followed prices stabilized and then began to decline.⁸

⁵ *Ibid.*, pp. 17-19.

⁶ C. Bresciani Turrone, "Will European currencies be revalued?", *Review*, V, 4 (July 1951), pp. 267 *et seq.*

⁷ C. Bresciani Turrone, "Monetary and banking policy in Italy after the outbreak of the Korean War", *Review*, VI, 1 (January 1952), p. 5.

⁸ *Ibid.*, p. 6.

The rise in prices worsened the terms of trade not just for Italy but for all the Western economies except Sweden. For Italy, this meant a halt to the steady improvement in the balance of trade produced since 1947 by increasing exports and a contraction of imports. Between the first half of 1950 and the first half of 1951 the trade deficit widened from \$186 million to \$280 million; this would not be without consequences.

The higher prices of imports spurred the demand for credit in dollars or sterling, depending on the country of origin, and also in lire. As Bresciani Turrone noted, since July 1950, the demand for means of payment had soared, threatening an inflationary disequilibrium, given that, in the first eight months of 1951, the index of industrial production was 17.4 per cent higher than in the year-earlier period, or about 45 per cent of the 1938 level.⁹ The imbalance did not have the effects feared, however, prices rising only 7 per cent between December 1950 and May 1951 with the rise not being due to wholesale prices. Bresciani Turrone attributed this success to the Bank of Italy, which had recommended that private banks be prudent in granting credit, refusing to lend to speculators and, in particular, to anyone interested in building up stocks of raw materials to profit from expected price increases.

To facilitate the achievement of this objective, the Bank of Italy, despite widespread protest, refused to lower the 25 per cent reserve requirement for private banks (in the form either of deposits with the central bank or of Treasury paper). To mitigate the Bank's restrictive stance, the government decided to grant industrialists an advance of 20 per cent of the value of their public procurement orders and to accord further advances in the course of public works projects up to a maximum of 80 per cent. For foreign purchases, the government decided not to resort to the banks, as in the past, but instead to turn to the Institute for Foreign Trade, which would provide the requisite foreign exchange up to a maximum of 100 billion lire. In a word, Bresciani Turrone recognized that to fight inflation the Italian government had adopted a restrictive monetary policy, not precluding direct price and investment controls in the future, if necessary.¹⁰

2. Fears of inflation

Worry over the danger of a return to the terrifying days of postwar inflation kept the monetary policy authorities and the government vigilant. To limit the requirement for dollars, intra European trade was stepped up, thanks to relations with the countries of the European Payments Union,¹¹ which had supplanted the network of bilateral agreements among the countries of Western Europe -

⁹ *Ibid.*, p. 17.

¹⁰ *Ibid.*, pp. 17-19.

¹¹ See below, Chapter III, Section 2.

for years an obstacle to European trade - with a multilateral payments system in which credit and debit positions were offset and netted.

The EPU was certainly an advance, contributing to a substantial expansion of intra-European trade, of which Italy was a major beneficiary. Between 1948, when the EPU was founded, and 1951, exports to EPU members increased from 60 to 74 per cent of Italy's total exports, and the corresponding imports from 35.4 to 55.4 per cent. Most of the surplus on trade with EPU countries was not settled but credited. Yet this system of crediting resulted in losses for Italy during these years. Before the devaluation of sterling in September 1949, Italy had been obliged to recognize the British currency's overvalued bilateral rate with the dollar (4.04 dollars to the pound), which boosted Italy's exports and impeded Britain's. The inconvertible credits that accordingly built up with the Bank of England thus depreciated sharply when sterling was devalued in September 1949 from about 2,300 to 1,750 lire. And, since Italy had issued circulating currency on the basis of the earlier parity, the devaluation resulted in an excessive supply.

Something similar happened in the second half of 1951 when France, also in substantial debit vis-à-vis Italy, devalued too. The amount of currency in circulation in Italy expanded by 126.6 billion lire between the end of 1950 and the end of 1951. By then, Italy had achieved a credit of some \$195 million, of which the EPU had repaid just \$98.3 million. At the same time, Italy had accumulated a deficit in U.S. and Canadian dollars and Swiss francs of the equivalent of \$337 million. The country thus had a surplus vis-à-vis the rest of Europe that could not be used to cover its deficit with the countries of the dollar area. If this debt was contained, it was thanks to \$280 million supplied to Italy under the Marshall Plan through the ECA.¹²

3. Slump or expansion?

At the start of 1952, the economy appeared to be on the verge of recession both in Europe and in the United States, but there was no clear, single cause for the downturn. Some observers held that what was involved was the readjustment of a number of economies following the surge of growth with the outbreak of the war in Korea. Others questioned the very existence of the recession, because in some industries expansion continued unchecked, although in others, such as textiles, there was a pronounced slump. Demand remained buoyant in some countries but showed clear signs of lagging in others. The exports of several major European countries diminished, with a perceptible deterioration of the balance of payments.

To understand the course of events and specifically the financial situation of each of its members, in March 1952 the ECE named a special committee chaired by the British economist Lionel C. Robbins and comprising, among

¹² C. Bresciani Turrone, "Monetary anomalies", *Review*, VI, 4 (July 1952), pp. 274-77.

others, Bresciani Turrone, Erich Schneider and Jacques Rueff.¹³ The committee released its report on 18 June and the work was published on 25 July as "Report by a Group of Independent Experts".

In contrast with the reasons for its appointment, the committee's report concluded that the outlook was not for depression but for expansion, the clearest sign being the high level of U.S. economic activity, because "economic conditions in the United States are known to exercise a great influence on the European situation."¹⁴

Given the good prospects for growth, the panel stressed the need to avoid any rekindling of inflation. Despite acknowledging the impact of external causes, they viewed credit policy as decisive, though this had been very largely neglected in the United States, the United Kingdom and France since the war and adopted with some rigour only in Belgium, Italy and Germany.¹⁵ Nevertheless, credit restraint was advocated everywhere. The Labour government in Britain, moreover, emphasized the need for direct state planning and control of the economy.

To make the reasons for the committee's position clear, the *Review* posed the problem explicitly and asked Bresciani Turrone himself to treat it. He had not opposed direct state control of the economy during the war and the immediate postwar period¹⁶; a war economy had to be a planned economy and planning had to continue until the economic equilibria had been restored. But eight years after the end of the fighting, with the shortage of goods now overcome and overall European output 32 per cent greater than the prewar level, as in 1951, Bresciani Turrone considered the re-establishment of market mechanisms as not only desirable but necessary. Only the free play of market forces could avoid the distortions Italy had inflicted on its economy in the aftermath of the war. Bresciani Turrone mentioned a series of direct government interventions that had upset the regular course of the economy, diminished its elasticity and curbed its growth.

The measures he criticized were: i) rent control, which resulted in an abnormal expansion of some kinds of unnecessary consumption (cinemas and cafés prospering while residential buildings tended to deteriorate); ii) the freeze on electricity prices, kept at a very low level that prevented the expansion of national hydroelectric output and made the economy vulnerable to sudden shortages; iii) the block on contract turnover for farm labourers, which impeded the adjustment of work forces to farm size and the transfer of workers to the more capably run farms; iv) the concession of a public monopoly on oil and gas production, which took a vast sector of activity out of the sphere of private enterprise; v) land reform, undertaken for social reasons in the hopes of defeating the Communist Party, which in some cases split up large farms that constituted

¹³ C. Bresciani Turrone, "Monetary policy and financial stability", *Review*, VI, 6 (November 1952), p. 463 and footnote.

¹⁴ *Ibid.*, p. 464.

¹⁵ *Ibid.*, p. 466.

¹⁶ C. Bresciani Turrone, "Free enterprises versus economic planning", *Review*, VII, 3 (May 1953), p. 185.

an organic whole and made landowners hesitant to make new investment, to the detriment of output; vi) the law requiring, for fiscal reasons, all shares to be registered, which impeded the flow of investment to the stock exchange and prevented the exchange from regaining its normal economic function.¹⁷

4. Towards the European Economic Community

In arguing the advantages of free competition, Bresciani Turrone did not totally preclude any and all forms of control and planning. He acknowledged, for example, that the programme for southern industrialization was an excellent case of planning to bring about propitious conditions for the development of economically backward areas; this was a function that the Bank for International Settlements was also intended to perform, by means of planning.¹⁸

In Bresciani Turrone's view, planning and direct government economic control also played a major role in international relations. This, for instance, was the idea behind the formation of the High Authority for Coal and Steel, whose purpose was to elicit a single market in these goods under the control of an agency endowed with extensive powers. This proposal spawned a series of others, designed to hasten the formation of Europe as a political and economic entity: for the constitution of a "green" or agricultural Community, a transportation Community, etc. However, opinions on European economic integration and the formation of a free European market differed profoundly. Two schools of thought clashed: one advocating *vertical* integration, i.e. industry by industry; the other, *horizontal* integration, i.e. through tariff reduction, the abolition of import quotas and foreign exchange controls, the establishment of currency convertibility, etc.¹⁹

This was no minor matter. Bresciani Turrone maintained that the creation of additional, specific communities would be a serious economic retreat for Europe. He recalled that one of the main postulates of economics was the interdependence of all economic variables and that it was both impossible and detrimental to imagine that an authority could set the prices not only of the controlled products themselves but also of their inputs. Furthermore, "direct controls on firms" were to be avoided. The objective of European economic integration would be better realized by monetary and credit policies, which were fully compatible with democratic institutions and with free competition. These were the policies that, together with Belgium, Italy had introduced in 1947 and that had then been adopted by the other European states, including Austria.

Apart from the choice of the method for economic unification, which would inevitably affect the individual economies, and hence Italy, the problem was that, like other countries, Italy was grappling with the repercussions of the

¹⁷ *Ibid.*, pp. 186-87.

¹⁸ *Ibid.*, p. 187.

¹⁹ *Ibid.*, p. 188.

recession following the end of the Korean War. In 1952 both the trade and the payments deficits widened considerably, and despite some improvement in exports and invisibles in 1953 the country continued to run deficits which, though smaller than the previous year, still had to be covered by U.S. aid.²⁰

U.S. aid was vital to the Italian balance of payments. As Mario de Vergottini observed, the trade deficit was no novelty in Italian economic history. In the past as well, imports had largely outweighed exports, the gap being more or less completely covered by invisible items (tourism, charters, emigrants' remittances, etc.). The difference between 1947-52 and the prewar years consisted precisely in American aid, which reduced the payments deficit to modest dimensions when not producing an actual surplus, as in 1950.²¹ De Vergottini emphasized that, whereas in 1938 invisibles had covered 55 per cent of the trade deficit, in the years from 1950 to 1952 their contribution was no more than 30 per cent (25 per cent in 1952), aggravating the payments deficit and thus making American aid all the more crucial.²²

5. Towards an Italian payments surplus

The external accounts improved markedly in 1954, however. The previous year had closed with a payments deficit of 136 billion lire, the result of an overall deficit of 281 billion less 145 billion in reimbursement for military services rendered and in economic aid. In 1954 the payments deficit came to just 21 billion lire, as a 399-billion-lire trade deficit was offset by 228 billion in receipts from tourism and remittances plus 150 billion in reimbursement for military services and in economic aid to Italy.²³ This reduction of the final deficit to just 1.45 per cent of total external spending persuaded Bresciani Turrone of the feasibility of eliminating the deficit altogether, even after the cessation of U.S. aid, and thus forging a sound payments position.²⁴ Unlike the immediate postwar years of insufficient domestic output of goods and services, these years witnessed considerable expansion of production and trade. This was shown by the fact that, despite an expansion of currency in circulation from 1,150 billion lire in 1950 to 1,580 billion in 1954 and a growth of current accounts from 1,143 to 2,183 billion, the lira held its value against the dollar at 625: precisely the rate fixed at the end of 1949.²⁵

Bresciani Turrone's prediction was duly realized. Livio Magnani reported that, even though economic aid and payment for services abroad were reduced

²⁰ C. Bresciani Turrone, "Medium-term export credit insurance and finance", *Review*, VIII, 1 (January 1954), p. 10.

²¹ M. De Vergottini, "Italy's balance of payments", *Review*, VIII, 2 (March 1954), pp. 134-37.

²² *Ibid.*, p. 139.

²³ C. Bresciani Turrone, "On the convertibility of the lira", *Review*, IX, 3 (May 1955), pp. 211-12.

²⁴ *Ibid.*, p. 212.

²⁵ *Ibid.*, pp. 216-17.

from \$73 million to \$59 million, the balance of payments swung from a deficit of \$38 million in 1955 to a surplus of \$23 million in 1956, thanks largely to increased exports.²⁶ This progress was halted in the first few months of 1957, which marked the height, in economic terms, of the Suez crisis and the closing of the Canal.²⁷ The trade deficit in the first four months of the year soared from \$230.1 million to \$358.5 million; an increase in the surplus on invisibles (tourism, charters, remittances, etc.) contained but did not offset the widening trade deficit. When the Suez Canal was reopened after six months, eliminating the extra cost of circumnavigating Africa, the situation improved considerably between May and August 1957. The balance of payments thus resumed its improvement, but reserves of gold and hard currency expanded only modestly (\$8.4 million), as the increase in exports of goods and services mainly involved countries with bilateral clearing accounts (Egypt, the Soviet Union, etc.) and non-convertible currencies.²⁸

6. Back to the dollar gap

The inconvertibility of some currencies gave rise to a delicate situation within the EPU with repercussions on the functioning of the Common Market. A group of experts, including the German economic minister Ludwig Erhard, insisted on the need for European monetary reorganization. Bresciani Turroni added that, in order to achieve this objective, it would be necessary for each country to forge a link between the exchange rate and domestic prices, so that the level of the latter and of their monetary costs reflected the effective state of the markets. Yet Europe was, indeed, far from such a situation. True, some currencies had made significant progress towards convertibility in the preceding years and were being used readily as means of payment around the world except in the dollar area (major gains had been made in Italy, too, with the "multilateral lira"), even though these currencies were also traded for dollars in the free foreign-exchange markets of Zurich and New York. But the circulation of other currencies was still limited to restricted areas.

Things changed in the course of 1957. The growing volume of German exports had generated substantial balance-of-payments deficits for the main importing countries. Thus, while the gold and dollar reserves of France and the U.K. diminished sharply, those of West Germany increased steadily. By the end of October 1957 these amounted to \$5.7 billion, \$4 billion in gold, while British reserves declined to \$1.85 billion in September.

The weakening of the British and French payments positions created serious imbalances within the EPU, with West Germany's share of total credits rising

²⁶ L. Magnani, "Italy's balance of trade and balance of payments in the first half of 1957", *Review*, XI, 6 (November 1957), p. 564.

²⁷ On the war over Suez, see S. Lucas, *Britain and Suez. The Lion's Last Roar*, (Manchester University Press, Manchester-New York), 1996.

²⁸ Magnani, "Italy's balance", p. 562-68.

from 46 per cent in 1956 to 79 per cent in the first quarter of 1957 and 86 per cent in September, while the debtor countries had to settle 75 per cent of their liabilities in gold or dollars. Thus since, as Bresciani Turrone noted, the debtor countries could not be sure of obtaining the means to cover their debts, because they earned dollars and gold from American spending on European defence and U.S. aid, their uncertainty had driven them to contract substantial debt with the IMF and the Export-Import Bank. Thus, as in the case of France and Britain, the worsening balance of payments of many European countries was creating a new dollar gap, because some countries wanted to enjoy material prosperity beyond their means; that is, they were consuming more than they were producing, while the opposite was the case in West Germany.³⁹

Italy, too, which a few years previously had been largely in credit within the EPU, was now a debtor, but much less substantially so than France and Britain. And after peaking at \$216.2 million on 30 June 1956, the country's debt had been steadily reduced to \$22.3 million two years later.⁴⁰

Actually, Italy's overall economic position was markedly better than that of France or Britain. The country had reduced imports considerably while sharply increasing its receipts from invisibles and also improving its terms of trade. In 1958 Italy recorded a payments surplus of \$850.4 million, compared with just \$285.7 million in 1957.⁴¹ Industrial production continued to expand. To be sure, the 2 per cent rise in the industrial production index between 1957 and 1958 was much less than the 6.5 per cent expansion registered in 1956 and 7 per cent in 1957, but it was still significant, given that the pace of growth of the early fifties could hardly be maintained.⁴²

7. Monetary imbalances in the United States

The improved payments balance was not a strictly Italian phenomenon. In 1958 and 1959 all of Western Europe saw an attenuation of the monetary disequilibria that had arisen in 1957 in connection with the U.S. recession. The United States continued large-scale imports from Europe while the countervailing export flow gradually contracted.⁴³ Yet the \$2.3 billion reduction in U.S. gold reserves between February 1958 and the beginning of 1959, "the biggest drop since 1945,"⁴⁴ did not stem from the contraction of exports; indeed, in 1959 the United States ran a trade surplus of \$3 billion with Europe.

³⁹ C. Bresciani Turrone, "Monetary imbalances and paradoxes", *Review*, XII, 1 (January 1958), p. 6.

⁴⁰ L. Magnani, "Italy's foreign trade and balance of payments: Evolution and prospects", *Review*, XIII, 1 (January 1959), p. 80.

⁴¹ C. Bresciani Turrone, "Monetary panorama", *Review*, XIII, 2 (March 1959), pp. 146-47.

⁴² *Ibid.*, p. 146.

⁴³ *Ibid.*, pp. 146-47.

⁴⁴ *Ibid.*, p. 139.

What upset the U.S. balance of payments was military spending, foreign aid and credits in various forms, which totalled \$7.5 billion.³⁵ The idea that if these programmes were continued the United States risked further reduction of its gold reserves was thus not far-fetched.³⁶ If this danger were defused, the dollar would retain its supremacy intact, behind gold reserves valued at \$20 billion, or more than half of all the free world's gold reserves, against just \$15 billion in short-term debt, and not counting American foreign investment of over \$60 billion.³⁷

To keep its balance-of-payments deficit from worsening, the United States, which had so far provided some \$64 billion in aid, asked the Europeans, whose own prosperity was in part owing to this aid, to contribute to a reorganization of the international monetary situation and monetary policy. The European contribution, the Americans felt, could take the form of an end to their discrimination against imports from the dollar area and of aid to the underdeveloped countries not just in the form of exports of goods but above all in the form of exports of capital.

The American request recognized that 1958-1959 marked the definitive end of the dollar gap era, to be succeeded by a period in which the countries of Western Europe had solved their balance-of-payments problems and indeed now had surplus dollars. The central banks of Western Europe, in fact, had built up substantial reserves of dollars, so that one could now speak of "Euro-dollars". In just a decade there had been a complete reversal of the payments situation, thanks to the advancing industrialization of Western Europe, the enormous gains in the competitiveness of European vis-à-vis American products on world markets, and the achievement of currency convertibility in the late fifties.³⁸

8. Italy and the payments surplus

As the discussion on how to restore the balance of the international monetary system opened, Italy, too, found itself in the group of countries balance-of-payments surpluses. The surplus registered in 1958 significantly strengthened gold and currency reserves, which amounted to \$2.222 billion at the end of the year, compared to \$1.102 billion at the end of 1956 and \$1.372 billion at the end of 1957.³⁹ This represented an enormous expansion. By way of comparison, Britain's reserves in the autumn of 1957 amounted to just \$1.8 billion, and it took a firm restrictive policy in that year and a series of loans from the Export-Import Bank to bring them back up to \$3.215 billion in November 1958.⁴⁰ In a word, the lira was now a strong currency.

³⁵ "The problem of convertibility and international liquidity", *Review*, XIV, 1 (January 1960), p. 6.

³⁶ *Ibid.*, pp. 12-13.

³⁷ *Ibid.*, p. 12.

³⁸ *Ibid.*, pp. 17 *et seq.*

³⁹ Bresciani Turrone, "Monetary panorama", p. 147.

⁴⁰ *Ibid.*, p. 141.

At the same time, the expansion of the reserves increased the country's liquidity. Bank deposits grew much faster in 1958 than in the two preceding years, though the same was not true of lending, so that Italian banks now faced the problem of how to invest their surplus funds. To facilitate their placement the Bank of Italy cut its official rate from 4% to 3.5% on 7 June 1958, and made 283 billion lire in advances available, but the banks took up only 28.8 per cent of these funds.

Bresciani Turrone stressed the country's solid monetary gains but also warned of the danger to the lira on the domestic market, owing to the quickening rise in prices. The cost of living increased 5.4 per cent in the first ten months of 1958 compared with the year-earlier period. This was not the case in Germany, which limited wage increases more strictly and thus made further gains in international competitiveness.

Despite the restrictive measures adopted in 1947, in fact, Italy's traditional factors of internal inflation persisted. Since 1950 the rate of expansion of currency in circulation and means of payment had regularly exceeded that of national income growth. The automatic wage escalator (*scala mobile*), introduced by the government to adjust wages and salaries in private firms to the rising cost of living, generated inflationary pressures. Bresciani Turrone recalled that, wherever such an automatic mechanism had been employed, it had accelerated monetary inflation and increased prices; and that in the aftermath of the First World War it had been one of the main causes of currency collapse in several countries.

In his view, though, still worse trouble was brewing for Italy, with the decision to extend the *scala mobile* to civil servants. This would entail increased public spending, hence instability and a still more rigid budget. Bresciani Turrone cited the experience of the immediate postwar years as evidence of how hard it was for a central bank to assure monetary stability when the government's fiscal policy was not directed to the same objective.¹¹ The need for coordination between monetary and fiscal policy was made all the more urgent by the Treaty of Rome's provision (Article 105) that the six members of the Common Market¹² must coordinate their monetary policies; the necessity was heightened by the measures taken to achieve the convertibility of the European currencies.

The institution of the *scala mobile* was no help to Italy, as it did not exist in Germany and had been abolished in France, just as other cost of living adjustment indices had been abolished: where such arrangements continued to exist, they were less extensive than in Italy. Nor could Italy ignore the further opening to free international competition in 1957 and 1958. Following the example of West Germany and the U.K., Italy removed the last barriers still tying the country to bilateral arrangements. A decree dated 20 February 1957

¹¹ *Ibid.*, pp. 150-51.

¹² Italy, France, West Germany, Belgium, the Netherlands and Luxemburg.

made the lira convertible with currencies outside the dollar area and consequently prepared the country to deal with two currency areas: that of the dollar, where transactions were in "free lire" and the non-dollar area, based on "transferable lire". This measure, precious to Italian importers, was followed a year later by one in favour of foreigners, ending the previous rule that a foreign investor wishing to transfer income and capital abroad could use only the currency in which his original investment in Italy had been made. The decree of February 1958 accorded permission to use other currencies as well. A third decree, dated 27 December 1958, extended the convertibility of the lira to non-residents. That is, lire received by foreign residents for their exports to Italy could now be used to make payments in all currency areas. If non-residents enjoyed convertibility, however, Italians continued to be subject to restrictions set by the monetary authorities.¹³

9. The lira as a strong currency

The removal of restrictions on currency movements and of discriminatory measures concerning international trade and payments was not limited to Italy and Europe but extended to other countries as well. Accordingly, in May 1960 the IMF recognized that nearly half its members' currencies were now convertible for non-residents.

This experience proved highly positive. The exchange rates of the convertible currencies registered only modest fluctuations. Commercial banks built up foreign currency reserves, enabling them to deal directly in international markets and engage in arbitrage between currencies, thus strengthening the international payments system. In short, world liquidity increased, sweeping away the worries of previous years. France and Britain were able to repay the sizable debt they had contracted with the IMF in 1957 and 1958.¹⁴ The Fund's greater liquidity, however, was also the result of increasing individual country quotas in late 1958, and, as the World Bank had increased its capital, the financial safeguards of the Western monetary system were reinforced.¹⁵ On 30 April 1960 these reserves exceeded \$14 billion, including \$3 billion in gold and \$7 billion in the most commonly used currencies, i.e. U.S. and Canadian dollars, the Japanese yen and the main European currencies, including the lira.¹⁶

The lira had moved into the group of strong currencies thanks to Italy's balance-of-payments performance. Exports had increased rapidly, and agricultural products no longer formed a significant part of them. Now, testifying to the economic revolution that had taken place, 87 per cent of Italian exports consisted

¹³ Bresciani Turrone, "Monetary panorama", pp. 152-54.

¹⁴ "The problem of convertibility", p. 14; C. Bresciani Turrone, "Laborious progress on the road to international monetary balance", *Revue*, XV, 1 (January 1961), p. 15.

¹⁵ Bresciani Turrone, "Monetary panorama", p. 155.

¹⁶ Bresciani Turrone, "Laborious progress", pp. 6-7.

of industrial goods.⁴⁷ However, the expansion of exports had not righted the balance of trade, which continued to run a deficit, but this was not considered grounds for concern in that the increase in imports involved raw materials, stocks of which were virtually depleted in 1958, and machinery, indicating that Italy was engaged in restructuring its manufacturing plant. Lastly, imports helped hold down domestic prices at a time when demand for goods and services was stimulated by abundant liquidity.⁴⁸

Despite the growth of the tourist industry, whose foreign exchange earnings rose from \$137 million to \$182.4 million in mid-1960, the surplus on invisibles was not enough to offset the substantial trade deficit, so that the overall balance-of-payments surplus contracted from \$268 million to \$91 million. Meanwhile, however, while foreign investment in Italy slackened, Italian investment abroad increased, confirming the buoyant growth of Italian industry and the progress of the economy as a whole. Further evidence of the latter was the continuing payments surplus, albeit reduced from around \$465 million in mid-1959 to \$152 million in mid-1960.⁴⁹ Bank deposits increased further between 1958 and 1960, and monetary liquidity, though in decline, was still robust in mid-1960. In fact, thanks to the substantial reserves of the Bank of Italy, additional types of imports from the dollar area were liberalized, so that 93 per cent of such imports were now free of restrictions, as well as 99 per cent of imports from the OEEC countries.⁵⁰

10. The U.S. payments deficit and the revaluation of the German mark

Italian and European economic growth corresponded to a period of recession in America. The United States recorded another substantial payments deficit in 1960, due not to economic causes but to government spending abroad and private overseas investment.⁵¹ The resulting disturbance of the international monetary system mobilized central banks and experts. A series of meetings and

⁴⁷ The transformation began in 1948. In the years through 1955, foodstuffs accounted for around 16 to 18 per cent of the total imports, while finished goods and industrial raw materials rose from 37.1 to 62.4 per cent of the total. Even in these early years, exports of fruit, vegetables and other food products declined in relative importance, while that of finished goods (metal and engineering products, chemicals, rubber, artisanal products, etc.) rose to over 50 per cent of total exports in 1955; auxiliary materials, such as petroleum products, also gained in importance. These changes on both the import and export sides clearly indicated the course of the economic transformation under way, testifying in particular to the rising standard of living and the revolution in productive activity. See M. Mazzantini, "Il commercio italiano con l'estero", in *L'economia italiana nel decennio 1947-1956, Review*, special tenth anniversary issue, 1957, pp. 142-49.

⁴⁸ Bresciani Turrone, "Laborious progress", p. 7.

⁴⁹ *Ibid.*, pp. 7-8.

⁵⁰ *Ibid.*, pp. 8-9.

⁵¹ C. Bresciani Turrone, "Some recent monetary experiences", *Review*, XVI, 1 (January 1962), pp. 6 et seq.

discussions resulted in monetary cooperation agreements, but no measures were taken to overcome the problems affecting international liquidity and to reform the system. Yet plans for reform were neither few in number nor slight in significance. The *Review* recapitulated no fewer than eleven projects, drafted by Zolotas, Triffin, Bernstein, Maxwell-Stamp, Baloch, Heilperin, Jacobson, Hirsch, Posthuma, Monnet, and Maudling. All called for reorganization of the IMF except Posthuma, who assigned a decisive role to the central banks, and Monnet, who called for the creation of a European Monetary Fund, to which the central banks of the six founder members of the Community would transfer a part of their gold and foreign exchange reserves.

The Fund so formed would, in Monnet's view, be used to provide credit to all countries, including non-members.⁵² Many scholars maintained, however, that the problems of international liquidity and convertibility could not be permanently solved by monetary manipulation; that is, either by raising the price of gold from \$35 to \$50 an ounce, as some had suggested, or by introducing flexible exchange rates, or by internationalizing reserves. Both these objectives could be attained by integrating America and Britain into the European economic process and supplying more substantial aid to the developing countries.⁵³

The novelty in Europe since 1958 was not just the Italian balance-of-payments surplus but the massive, and mounting, West German surplus. With economic expansion, West Germany was accumulating payments surpluses. Now, at the urging of the Americans, whose interest in reducing their own payments deficit was pressing, Germany should have tried to encourage investment abroad. But after years of restrictive monetary and credit policy, with a high discount rate, West Germany sought to attain the desired objective by cutting the discount rate in November 1960. Meanwhile the United States lowered its own discount rate to spur domestic growth, just as large quantities of gold were leaving the country.

It is almost superfluous to add that the German objective was not attained. German businessmen proved reluctant to step up investment abroad. And failing to achieve their purposes with the interest rate cut, on 4 March 1961 the West German authorities revalued the Deutsche Mark. Although this breached the fixed exchange rate system ruling the West since 1958 when external convertibility of the European currencies was introduced, it helped Germany to foster imports and reduce exports by the effect on domestic prices.⁵⁴

Italy, like West Germany, could not remain indifferent to its mounting balance-of-payments surplus. Foreign exchange receipts progressively swelled central bank reserves and the country's liquidity, which led to tight liquidity in

⁵² "The problem of international liquidity", *Review*, XVI, 1 January 1962), pp. 6-9.

⁵³ *Ibid.*, pp. 5-6.

⁵⁴ Bresciani Turrioni, "Some recent monetary experiences", pp. 8-10.

other countries, especially some Common Market partners. The resulting imbalance threatened to undercut foreign demand, so the Italian government decided to inject liquidity into the international market. In November 1959 the leading Italian banks were accordingly authorized to repay their debts to foreign banks and invest in the international money market as well as to channel funds into bank deposits abroad.⁵⁵

11. Western Europe supports the dollar

Along with West Germany, the Netherlands also revalued, leading many observers to predict imminent revaluation by Switzerland, France and Italy as well. To allay fears of further international monetary disarray, at the meeting of the BIS in Basel in March 1961, the central bank governors of Belgium, France, Italy, the Netherlands, Sweden, Switzerland, the United Kingdom and West Germany declared that no more revaluations were in store and pledged to neutralize any speculative movement.

In another effort to deter speculative attacks, the Americans reached an agreement with the Western industrial nations to acquire convertible foreign currency for use in the foreign exchange markets. The central banks and/or governments of Switzerland, France, the Netherlands, Belgium, Canada and West Germany plus the BIS thus lent the equivalent of over \$820 million to the U.S.⁵⁶ Italy, through the Italian Foreign Exchange Institute, opened a line of credit for the United States of 150 billion lire, against lira-denominated U.S. Treasury paper.⁵⁷

A third agreement, finally, was reached at the third meeting of the International Monetary Fund in Vienna in September 1961. The Fund would be endowed with additional resources, whose amount was set at the Paris

⁵⁵ F. Masera, "Recent developments in the Italian balance of payments", *Review*, XVI, 6 (November 1962), p. 500.

⁵⁶ Specifically (in millions of dollars):

October 1961	Swiss government	46
January 1962	Italian government	25
March 1962	Italian government	50
March 1962	Bank of France	50
May 1962	Bank of England	50
June 1962	Bank of the Netherlands	50
June 1962	National Bank of Belgium	50
June 1962	Bank of Canada	250
July 1962	Swiss National Bank	100
July 1962	BIS	100
August 1962	Bundesbank (W.Germany)	50
		821

Source: "The problem of international liquidity", p. 9.

⁵⁷ Masera, "Recent developments", pp. 505-506. Bear in mind that the price of monetary gold of \$35 per ounce, fixed at Bretton Woods, was still in effect.

meeting of finance ministers in December 1961 at \$6 billion, divided between Western Europe, Japan and the U.S.⁵⁸

The Paris agreement gave the IMF the means to defend the balance of payments of the countries under speculative attack. But there was no shortage of observers who felt that the agreement was an emergency measure. Other measures were suggested to ensure a fully functioning international monetary system, including a return to the gold standard, a guaranteed price for the dollar, the creation of a superbank to take over the reserves of all the central banks.⁵⁹ But all, for one reason or another, were considered unsuited to the objective. Pragmatically, it was concluded that the best course was to rely on the institutions and instruments already in being.⁶⁰

The dollar's troubles were not over, however. There were attacks on its stability in the autumn of 1960, on the eve of the presidential elections, at the end of 1962 and again in 1963. The U.S. payments deficit increased to a total of \$8.5 billion in the years 1960-62, and the earliest provisional figures for 1963 showed a further rise to \$3.5 billion for that year alone. In part the deficit had been covered by short-term borrowing and in part by IMF resources. Meanwhile U.S. gold reserves, which had stood at \$24.4 billion in 1948, dropped to \$15.5 billion at the end of 1963. And as \$12.5 billion was frozen by law to back domestic currency, scarcely \$3 billion was left to meet short-term debt, which had risen from \$7.6 billion in 1948 to over \$20 billion, 30 per cent of it with private parties and the rest with central banks (mainly in Europe) and international agencies.

To be sure, this debt was guaranteed by American overseas investment, which had now increased to \$62 billion,⁶¹ but this was longer-term investment that could not be mobilized to meet short-term obligations. Nevertheless, even though U.S. external liquidity had diminished by some \$26 billion since the end of the war, the dollar ran no serious risk. It overcame not only the revaluation of the DM and the guilder but also the speculative attacks against the pound, the devaluation of the Canadian dollar, the Berlin crisis and the Cuban missile crisis, and the crisis in British relations with the European Economic Community. The IMF continued to recognize that both sterling and the dollar were sound, strong currencies.⁶²

* The quotas, in millions of dollars, were as follows:

US	2,000
UK	1,000
W.Germany	1,000
France	550
Italy	550
Japan	250
Canada	200
Netherlands	200
Belgium	150
Switzerland	100

Source: "The problem of international liquidity", p. 140.

⁵⁸ "The problem of international liquidity", pp. 11-14.

⁵⁹ *Ibid.*, pp. 14-16.

⁶⁰ "The international monetary problems", *Review*, XVIII, 1 (January 1964), pp. 7-8.

⁶² *Ibid.*, p. 14.