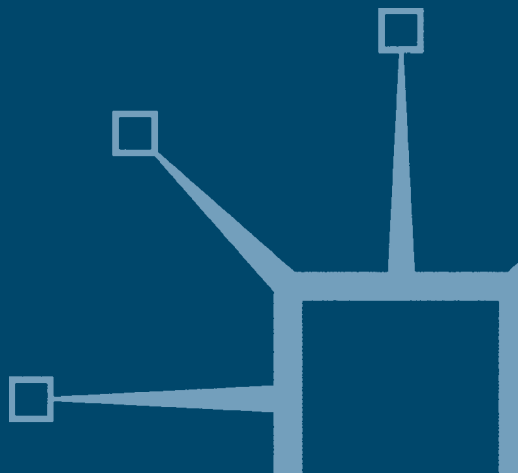


Luigi Einaudi

Selected Economic Essays

Edited by
Luca Einaudi, Riccardo Faucci and
Roberto Marchionatti



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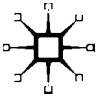
Riccardo Faucci

and

Roberto Marchionatti

on behalf of the

Ente per gli Studi Monetari, Bancari e Finanziari Luigi Einaudi



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June 2005
Rome, Italy

LUCA EINAUDI
RICCARDO FAUCCI
ROBERTO MARCHIONATTI

Editors' Introduction

*Luca Einaudi, Riccardo Faucci and Roberto Marchionatti*¹

There are several reasons for publishing a selection of Luigi Einaudi's works in English. The first is the contemporary relevance of many of his ideas, from European federalism to fiscal policy. The second is the very limited availability of Einaudi's writings in languages other than Italian, which prevents his contribution to economics and economic history from being fully appreciated in the English-speaking world.

Luigi Einaudi, economist and political figure

Luigi Einaudi (1874–1961) was a leading liberal Italian economist, economic historian and political figure.² Professor at the University of Turin, where he taught public finance, he developed several concepts typical of the Italian tradition, among which the taxation of consumption rather than income features prominently. For a few years he also taught at the Bocconi University in Milan. Several generations of economists and politicians followed his lectures and had him as their thesis supervisor regardless of their ideological views, from Sraffa to Gramsci, Gobetti, Rosselli and Togliatti.³ He edited *La Riforma Sociale*, an important academic journal, and through it conducted a continuous battle against monopolies, protectionism and the abuse of government power, especially by the liberal governments of Giovanni Giolitti.⁴ *La Riforma Sociale* was closed by the Fascist regime in 1935. To avoid censorship, Einaudi decided to study the history of economic facts and policies; he founded the *Rivista di Storia Economica* the following year.

Einaudi also played a national role and reached wider audiences as an economic columnist for leading Italian newspapers, first *La Stampa* and then *Il Corriere della Sera*, interrupting his contributions only during fascism and during his time as President of the Republic. He also served more discreetly for *The Economist* from 1908 to 1946.⁵ His academic research was always linked to the analysis of practical economic issues; it was often related to the national and international political and economic problems of his time, but

always drew on his copious knowledge of the past. He was a member of the Italian Senate from 1919 onwards, remaining one of the isolated liberal anti-Fascist figures throughout the Mussolini regime. Together with Benedetto Croce he greatly influenced the development of Italian liberalism through a long-lasting debate on the content of political liberalism and free market economic liberalism. After the Second World War, he combined the intellectual effort of rethinking the basis of democratic institutions with active participation in the drafting of the Republican Constitution and the running of the country, serving as Governor of the Bank of Italy (1945–8) and Deputy Prime Minister and Minister of the Budget (1947–8). In that capacity he developed and implemented the *Einaudi Plan*, which was intended to stabilize the lira and halt inflation, creating the conditions for stable growth and political support for the centrist governments of the time. Luigi Einaudi became President of the Italian Republic (1948–55) in time to see the beginning of the economic boom.

At the end of the nineteenth century, when a prosperous future for the Italian economy was hard to foresee, Einaudi picked up the first signals of the economic take-off in the rise of a new entrepreneurial class and the emergence of a pugnacious, but collaborative working class. These market-oriented forces were supported by a wise monetary policy that combined growth with stability. After the First World War, Einaudi acknowledged that the golden age of *laissez-faire*, free trade and stable international money was over. He objected to the new features of the economy, such as increasing State interference, a managed currency and awkward international economic relations. His faith in the excellence of *laissez-faire* capitalism did not translate into a pure individualist credo, however. Between the State and the individual there was a network of intermediate economic entities, principally based on voluntary action, whose function he praised highly. Although he identified economic liberalism with political liberalism, his vision of the 'good society' was by no means restricted to an efficient market economy. Self-government, town planning, a genuinely free press, full competition between State and private education through the abolition of the legal effects of academic diplomas, and, last but not least, a political European federation (as he was rather sceptical about a merely economic one) are the building blocks of his legacy.

Luigi Einaudi was a prolific writer in all fields. He left dozens of books and his bibliography includes more than 3,800 titles, including 1,700 economic articles for the *Corriere della Sera* alone. Einaudi's crisp and colourful style made him a classic and greatly contributed to the popularity of his writings in Italy. His style is also extremely difficult to reproduce faithfully in English, especially in view of his frequent references to examples of material conditions of life and work that are very distant from those of today. The saving habits of a Piedmontese peasant are not something we can relate to very easily.

The choice of texts to publish was far from easy, given the encyclopaedic nature of Einaudi's interests and the sheer volume of his writings. The aim that guided the editors' choice was to present his main fields of interest (money, public finance, the role of government in the economy and European economic integration) and to select the most original and representative results of his research. The more political works, which testify so effectively to his continuous commitment to a democratic society of active citizens will be published in a separate volume. In order to introduce the reader to Einaudi's practical approach to the economic problems of government, his famous article 'Know before Legislating'⁶ has been placed at the beginning of this collection.

Political and economic liberalism

The book is divided into four sections. The first is on political and economic liberalism and explores the link between the rules of the market and social and political rules. Luigi Einaudi's dynamic view of the free struggle between social forces was based on his anti-monopolistic and anti-*étatiste* approach in which conflict, together with competition, shape the best economic outcome. Such views had a strong moral and civic component in addition to the mere evaluation of their positive economic effects. An anti-socialist and anti-communist polemic was associated with an equally strong opposition to fascist and corporatist positions. Einaudi continuously challenged the 'hole-drillers' of the State budget, who prospered by calling for subsidies, asking for protection against the market and building monopolies. His decidedly free market stance was always tempered by a refusal to oppose or support any intervention of the State without looking at the specifics of the case:

In the face of concrete problems, the economist can never be an absolute free market liberal or an interventionist or socialist at any cost. From time to time he opposes protective customs duties ... he supports laws limiting work by women and children ... he is against universal socialization ... but he wants the State to consider the railways a public industry.⁷

Not only must the State intervene to protect free competition, but it must also regulate economic activity, limit inequality through taxation and public spending and provide public goods.⁸ Inequality could be reduced by making the maintenance of existing fortunes depend on the ability of the various generations of heirs to conserve and increase their capital despite substantial inheritance taxes. Einaudi also supported equality at the start of every individual's life. Opportunities, but not outcomes, had to be equitable, both in legal terms (non-discrimination) and in economic terms (grants for students and appropriate forms of social insurance). Einaudi did

not want a society of equals, which he believed would be a dead society, but a society of free men and women.

A democratic system had to be engineered that would combine the rule of the majority with respect for the rights of minorities, as a fundamental component of a liberal democracy. Substantial limits to the will of the majority were needed to prevent the dictatorship of the majority and the oppression of economic, political, religious or ethnic minorities. Such limits on political majorities were the respect due by the current generation to the experience of previous generations, instructed by the mistakes preceding and accompanying the fascist period.

One of Einaudi's most effective descriptions of the working of a market economy is his 'Lectures on the Market'⁹ (see Chapter 2 in this book), written in 1944 as an introductory course in economics for Italian political refugees in Swiss camps awaiting their return to a democratic Italy. The market described by Einaudi is frequently that of rural Piedmont in the early twentieth century, but it is in fact an ideal, used to give colour and life, flesh and blood, to a timeless theoretical model of the market economy. If the market is to succeed in its role of bringing about changes in the quantities produced according to the movements in prices, it has to be defended against distortions introduced by monopolies. Laws and institutions serve not only to prevent monopolistic power and unfair practices but also to temper inequalities (not eliminate them), in order to offer every individual the opportunity to fulfil his potential and advance his condition according to his talent and work.

'The Beauty of the Struggle'¹⁰ (see Chapter 3 in this book), written at the request of Piero Gobetti,¹¹ is a description, at times almost lyrical, of the pleasure brought by results achieved through hard work and by the composition of labour conflicts after harsh but free confrontations. The article must be understood not just in terms of the Schumpeterian view of unstable and ever-changing market equilibria but also in the context of the political and social conflicts in Italy in the 1920s. After a period of socialist and catholic interference with the free market, the early stages of the fascist regime were marked by an opposite but somehow similar distortion of free economic mechanisms. First, in 1919–20, the so-called 'Two Red Years', in some parts of the country socialist trade unions had imposed levels of employment or wages, while northern factories had repeatedly been occupied and temporarily managed by workers' councils, guided by the myth of the Russian revolution. Agrarian and industrial interests turned to the newborn fascist bands of blackshirts in 1920 to undermine the communist and socialist unions, associations and local governments, by violent means. Having destroyed the organization of the left and of the catholics, and having captured national government in 1922, fascism imposed a corporatist policy through fascist unions. Theoretically this was done in order to overcome differences between employers and workers in the name of the

superior interest of the nation, but in fact it served the special interests which financed and supported the rise of fascism. Einaudi was appalled by both these economic and political models: he felt

an irreducible scepticism, almost physical repugnance, with regard to benefits provided from the outside, to the well-being that it is intended to procure for workers through laws, regulations, collectivism, paternalism, the intermediation of ill-employed politicians ready to settle disputes by arbitration, by the intervention of specialists, by cutting the loaf in half; and a heartfelt approval of the efforts of those who desire to elevate themselves on their own and in this struggle, fight, falter, and rise again, learning at their own expense how to win and to better themselves.

Einaudi's ideas on economic equilibrium depended entirely on the way it had been reached and not on the level arrived at: a truly stable equilibrium could be achieved only through free and open struggle and protracted discussions between economic agents, never through the intervention of a government, a judge or an arbitrator. Even if the intervention of the latter happened to impose an optimal solution to a labour conflict or to establish an optimal price, it would be suspected by the other parties.

People must be left to bruise their heads if they are to realize they are up against a wall and that it is useless to try to butt it down. Through struggle and debate one learns how to measure the adversary's strength, to understand his reasons, to fathom the working of the system that allows both rivals to exist.

For such an equilibrium to last, it must be continuously open to new challenges and to change through confrontation between the employer, proud of the enterprise he has built, and the worker who feels the satisfaction of a job well done.

Einaudi rejected the partial view of *laissez-faire* liberalism held by Keynes. He showed that the classics and their followers had developed a more sophisticated view of the role of the State in a liberal society than the motto '*laissez-faire*' suggested. It was the Marquis D'Argenson, Jeremy Bentham and some propagandists of the Manchester School who popularized the concept, but Adam Smith and the classics never questioned the need for a measure of State intervention in the economy. Even if the number of cases in which the State should intervene according to economic theory appeared to have increased since the *Wealth of Nations*, Einaudi doubted whether the economic role of the State had actually increased in importance. He reminded the reader of all those intermediate bodies dear to Montesquieu, such as semi-autonomous authorities, local boards and charitable institutions, which are so easily forgotten but which had represented an important form of public action before the industrial era. Today, it would probably be difficult to hold such a view, but in 1925

few of the institutions and forms of State intervention known today existed. The Great Depression and corporatist forms of government in the 1930s, wartime planning and the post-war construction of the welfare state radically changed and increased the part played by the State in the economy.

Despite his misgivings about laissez-faire as a scientific principle, Einaudi believed that it could none the less be employed pragmatically. In a discerning manner it was still possible to use it as an excellent practical rule of conduct when dealing with cases outside the limited agenda of State intervention.

A further aspect of Einaudi's views is to be found in his decades-long controversy with Benedetto Croce on the respective roles and meanings of the political and ethical aspect of liberalism and the free market economic component, known as economic liberalism.¹² Einaudi's liberalism was of the British type, related to the theories of Adam Smith and the practice of Gladstone rather than to the progressive American liberals of the twentieth century, the followers of Franklin Delano Roosevelt. Benedetto Croce¹³ argued that political liberalism (*liberalismo*) was a more general concept than free market economic liberalism (*liberismo*) and that the former could flourish even without the latter. One of Einaudi's many responses was the article 'Economic Liberalism and Political Liberalism'¹⁴ (see Chapter 4 in this book). Einaudi accepted that political liberalism had a wider meaning and role than free market economic liberalism,¹⁵ but denied that the former could survive the absence of freedom of initiative and enterprise. He recognized that the laissez-faire principle did not always correspond to collective interests and was not a rational or moral rule, but insisted that freedom of thought could not be separated from the possibility to develop personal abilities through private property and the constant search for improved means of existence. The means of liberty cannot be separated from its idea. Even if a communist society happened to be more productive economically than a free market, an eventuality Einaudi firmly rejected, it would still have been impossible to reconcile it with a free political structure. In practice, although the concepts were separate, political liberalism could not exist without economic liberalism. The opposite was possible, and Einaudi cited the example of the French economy under Napoleon III, certainly oriented towards free trade and the free market, but ruled by an authoritarian government.

The dilemma concerning the possibility of a democracy without a market economy or of a market economy without a liberal democracy can be discussed in contemporary terms with reference to China. How long can a free market economy continue to develop without the liberalization of society and the political system, even when emerging from a communist system denying freedom of speech and association?

Money and banking

Luigi Einaudi's monetary and banking writings span a period of more than fifty years. They are scattered in newspapers, magazines (*The Economist*), economic journals (mainly *La Riforma Sociale*), official documents of the Bank of Italy and the proceedings of the Constituent Assembly in 1946–7. These writings analyse the most important national and international events and in large part represent a critical study of a dramatic phase in the history of the capitalistic economy, scarred by the crisis and depression between the two world wars.

Einaudi's theoretical background is that of the orthodox neoclassical economics of his time, when the doctrines of the great marginalist economists – Walras, Menger, Marshall, Pareto and Fisher – were modified, developed and enriched by the contributions of economists such as Pigou, Robertson, Hawtrey, Robbins, Mises, Hayek, Viner and Marget. Einaudi does not make any original theoretical contributions. However, his thorough analysis of facts is of great help in understanding complex economic events and in extrapolating proposals for economic policy. In his writings he can be seen as representative of the historical and factual work done in Italy, which, as Schumpeter wrote,¹⁶ really fertilized the field of economics and did not conflict with theory.

The 'equation of exchange' is the key to Einaudi's monetary thought. He explains what an 'equation of exchange' is and defends it against its critics in several articles written in the 1930s.¹⁷ He distinguishes the 'equation of exchange' from the 'quantity theory of money'. This is an important distinction, which the writers of that period often did not make. Einaudi maintains that the 'equation of exchange' is not a self-evident truth, or a truism. On the contrary, it is the result of the theoretical and empirical work of generations of economists who have made the meaning of the letters that represent the variables of the equation richer and more meaningful, such as the quantity of money in circulation (M), the velocity of circulation (V), the price level (P) and the physical volume of trade (T). In this story, according to Einaudi, David Hume made a fundamental breakthrough in the eighteenth century when he suggested the different variables were interdependent. From that time on, the equation of exchange has signified not only that prices vary as a function of the quantity of money, its velocity of circulation and the quantity of goods and services produced and exchanged, but also that the variation of each variable is a function of the contemporaneous variation of the other variables and their consequent reactions. Einaudi properly defines the equation of exchange as a 'clothes-hook' on which theoretical developments can be hung. The most complex relationships can be summarized and organized in this equation, he emphasizes. He thinks that the formulas employed in the exposition of

the equation are merely devices to enable us to bring together the principal causes which determine the value of money in an orderly way. His approach was a common one in the Marshall–Pigou tradition, to which Einaudi substantially belongs, at least as regards monetary thought.

Whereas the equation of exchange simply states that the quantity of money is one of the factors influencing prices, the quantity theory of money is a doctrine that contains one or more propositions on the importance of the quantity of money as a factor causing price variations. When the quantity theoreticians seek to quantify the influence of the quantity of money on prices, they tend to consider the velocity of circulation and the quantity of goods and services as constants. From a theoretical point of view, Einaudi is sceptical of the general cogency of this relationship. He holds it more correct to consider all the factors as variables because there are no logical reasons for considering some variables as constant in any practical situation. Einaudi's methodological proposal is this: economists should conduct systematic studies of the forces acting on the relevant variables from the analytical and empirical-historical points of view so that they can come up with the real values of these variables in the different situations. If this is not done, he judges that such research is largely a meaningless exercise. At most, he adds, the quantity theory of money can be used to explain certain great historical instances of price increases and decreases: for example, the 1550–1650, 1898–1906 and 1914–20 price increases, and the 1815–30, 1873–98 and 1920–32 price decreases. In all these cases Einaudi thought that it might be temporarily useful to consider all other factors constant in order to focus on one influential event, such as the inflow of precious metals, the abundance of paper currency or the exhaustion of gold mines. Einaudi considered the years in which he lived a period in which the quantity theory of money appeared to be 'true', at least as a first approximation – the reason why he is often considered a quantity theory economist.

According to Einaudi, the main objective of monetary policy is price stability, which ensures that variations in the value of the circulating medium cannot disturb existing contracts and expectations.¹⁸ When Einaudi was educated as an economist at the beginning of the twentieth century, the international gold standard operated smoothly to facilitate trade, payments and capital movements. Balances of payments were kept in equilibrium at fixed exchange rates by a highly automatic adjustment mechanism. Annual inflation and deflation rates were low and preserved the value of money over the long run. This state of affairs strongly influenced Einaudi's conception of an international monetary system. He considered a monetary rule such as the gold standard, which caused the money supply to vary automatically with the balance of payments, to be the best one to ensure a sound monetary system.

With inconvertible paper, on the other hand, price instability becomes a crucial problem, as historical experience showed. Einaudi faced the trau-

matic experience of the years 1914–20, when European society was shattered by a very high rate of inflation. On the basis of the lessons learned in that dramatic period, Einaudi came to the conclusion that inflation was an intolerable evil, a point he kept on making throughout his life. When he analyses the inflationary process and its effects on Italy during the First World War, he connects monetary devaluation to the increase in the note issue: ‘The political and social scenario was dominated by the paper-money printing press’, i.e., by an excessive money supply. It was ‘the main fact’ in the Italian social, political and economic history of those years. Einaudi speaks of the ‘poison introduced into Italian society by the monetary devaluation ... a moral poison that consumed society’. In fact, inflation caused the social discontent and unrest that paved the way for dictatorship in the 1920s.¹⁹ After the Second World War, first as Governor of the Bank of Italy and then as Minister of the Budget, Einaudi confronted and defeated the inflation that threatened to repeat the damage caused after the First World War.

In the Governor’s ‘Concluding Remarks’ (see Chapter 11 in this book) in the Bank of Italy’s Annual Report for 1946,²⁰ Einaudi summarizes the inflationary mechanism in a way that resembles other classical analyses of the phenomenon, such as Part I of Keynes’s *Tract on Monetary Reform*. Einaudi first notes that inflation modifies the distribution of income and wealth. It initially helps profits but hurts workers, whose incomes adjust with a lag. It also permanently affects the creditors of fixed monetary amounts. The positive effects of the redistributive change on investments – a consequence of inflation reducing taxation, improving business’s financial situations and profit receivers having a relatively higher propensity to save – gradually fade away as the negative effects prevail. Individuals’ propensity to hold money increases and the propensity to save decreases. The crucial problem is that inflation destroys the propensity to save as time passes: ‘Why save if the product of saving vanishes as far as purchasing power is concerned?’. At the same time, inflation causes currency depreciation, which produces negative effects in the balance of payments (as shown in a masterful analysis by Einaudi’s colleague and friend, Attilio Cabiati²¹). If this contagious disease is not blocked, it leads to a flight from money. ‘This is the beginning of the end’, Einaudi emphasizes. A vicious circle is created: the decreasing purchasing power of money makes it necessary to issue new notes in order to prevent the public finances from collapsing; in turn, this reduces the purchasing power of money in an endless spiral.

The essential point to emphasize in Einaudi’s analysis is the negative effect that inflation has on the propensity to save. In fact, Einaudi conceives saving classically as the pre-condition for investment and the key factor in economic development. Although he does not ignore the difference between saving and investment, he certainly underestimates it.

According to him, to the extent that inflation discourages saving, it compromises a country's long-term growth. Einaudi stresses that 'saving is a function of the confidence in the monetary unit', and as a consequence, the objective of monetary policy must be monetary stability in order to maintain a country's propensity to save. He considers monetary stability and free trade to be the conditions for steady growth. When they are lacking, the economic mechanism inevitably seizes up and comes to a standstill.

According to Einaudi, the inflation of credit during and immediately after the First World War was the cause of the subsequent crisis. The inflation-crisis link is at the core of his controversy with Keynes and Fisher on the nature of the crisis and the possible positive role of reflation in the 1930s.

In *The Means to Prosperity* (1933) Keynes maintained that the crisis and the widespread poverty in the world at the beginning of the 1930s were not due to famine or earthquake or war, or a lack of material things and the resources to produce them, but to reasons of another kind.²² Crisis and poverty came 'from some failure in the immaterial devices of the mind, in the working of the motives which should lead to the decisions and acts of will, necessary to put in movement the resources and technical means we already have' (Keynes 1971 [1933], p.335).

According to Keynes the way out could not be found by 'hard work, endurance, frugality, improved business methods, more cautious banking and, above all, the avoidance of devices' (1971 [1933] p.336). Rather, only an active economic policy could be a remedy for the crisis. This meant public works and an internationally coordinated plan to supply central banks with more reserves of international money to increase loan-expenditure. This policy would cause world prices to increase. This would be a positive factor because prices, Keynes claimed, would have to be raised in order to prevent the structure of contracts and instruments of indebtedness from breaking down. Keynes's pamphlet caused an international debate. Some economists – including the Swedish economist Gustav Cassel – agreed with Keynes; others, who were the majority at the time, disagreed or expressed doubts.

Einaudi objected to Keynes's analysis in a long article entitled 'My Plan is not Keynes's'²³ (see Chapter 10 in this book). He addressed two questions: the causes of the crisis and how to overcome it. With regard to the causes, Einaudi argued that the crisis was not due 'to a failure in the immaterial devices of the mind', as Keynes suggested. On the contrary, it was due to the effects of the war and 'the diseases it implanted into the minds of men', particularly the post-war inflation of credit, as Einaudi had already written in 1931 in two earlier essays on the crisis.²⁴ He believed that the crisis of those years was not a novelty: writing in 1932, he stated that 'the present crisis is not a new fact, strange and paradoxical'.²⁵ His view is based on his analysis of periods of prosperity and depression in the history of the capitalist economy.

In particular, Einaudi believed that the period 1914–19 and the 1920s had something in common with the post-Napoleonic crisis: in both cases the ultimate cause of the crisis was monetary. This, according to Einaudi, helped to explain the length of the latter crisis. The key factor was the cost–price disequilibrium: ‘The crisis and the lack of profits stem from the imbalances in prices, from the fact that some prices did not fall or were not left to fall; and since prices are revenues for some and costs for others, many lose and especially entrepreneurs.’

The crisis could therefore be overcome by re-establishing equilibrium between costs and prices. He believed that this could be achieved if the stocks of unsold goods were rapidly liquidated and the costs of the factors of production pushed down. This would happen sooner if the rate of interest were kept high, an opinion at that time strongly held by the economists of the Austrian School, with whom Einaudi and his group in Turin were then largely in agreement.²⁶ In this interpretation the major obstacle to the resolution of the crisis was the existence of rigidities: that is, prices fixed by law (taxes) or under long-term contracts (interest on public and private debts) or under rigid conventions among social groups (wages and salaries).

As for overcoming the crisis, Einaudi agrees with Keynes on the importance of a policy of public works because he recognizes such a policy to be ‘advantageous’ in the trough of the economic cycle. In this he conforms to classical theory, but neglects Keynes’s theoretical innovation of the income multiplier. However, Einaudi’s dissent is expressed most clearly when he holds that Keynes’s case for reflation is wrong. Keynes had written that ‘in all likelihood’ in the process a rise in prices would be followed by a rise in profits. Einaudi believed that this was not necessarily so. A rise in prices due to public works carried out through the inflation of credit, Einaudi wrote, would leave the imbalance between costs and revenues unchanged. Moreover, he argued that the sentence ‘the rise in prices recreates profits’ was true only ‘on the assumption that the public works carried out using credit push up precisely those prices that must rise to restore equilibrium’. In general, however, Einaudi noted that when there was a cost–price disequilibrium, it did not serve to create new liquidity. Einaudi considered Keynes’s proposal to raise prices artificially a hazardous method and stressed his deep disagreement and mistrust of the managed currency policy. As already emphasized in his *Riflessioni in disordine sulla crisi* (*Scattered reflections on the crisis*), Einaudi maintained that post-war monetary instability, particularly inflation, was the cause of social disorder and insisted that ‘to repeat the experiment [with paper money] today could imply the collapse of Western civilization’. Of course, Einaudi recognized that reflationists – ‘inflationists’, as he preferred to call them – claimed that reflation would be prudent, but he warned that ‘the monetary device is like trying one’s luck at Monte Carlo’: it might work but it might also revive the disorders of 1919–20.

Einaudi completed his criticism in several papers published late in 1933,²⁷ where he criticized the reflationist thesis that a rise in prices would induce savers to invest their hoarded money. Einaudi asked why people hoarded and answered that the reason was simply that savers, in *that* period, considered gold or paper money or non-interest-bearing bank deposits to be the best possible *investment*. Such behaviour was rational at times of falling prices, because the value of money rose if prices fell. Of course, if prices rise, savers may be induced to change their behaviour, but this device must not induce deposit holders to transform money into goods for fear of a monetary devaluation. As Einaudi warned, 'frightened people make mistakes, they do not overcome crises'. Einaudi stressed that in this case the choice of savers between money saving and saving in the form of real goods turned into a choice between saving and consumption, which was ultimately chosen because saving was becoming more and more disadvantageous. Certainly, Einaudi recognized, when the percentage of investment in money exceeded the level considered 'normal', alarm and anxiety would follow. In this case public works could 'break the spell'²⁸ and also be a psychological device to help the recovery.

The American economist, Irving Fisher, suggested reflation as a solution to the crisis in a famous article published in *Econometrica* in 1933. Fisher's proposal was based on his debt-deflation theory. If prices decline, he argues, the real value of *private* wealth increases. This implies that the liabilities of debtors and the assets of creditors increase in real terms. Debtors have a higher marginal propensity to consume than creditors. Consequently, there is a reallocation of real wealth from debtors to creditors and thus the aggregate marginal propensity to consume declines. The result of price flexibility in situations of unemployment is again a decline in consumption demand and thus a further reduction in aggregate demand and employment. Liquidation causes the price level to collapse progressively and this, Fisher believes, can shake the foundations of the economic edifice. Hence he deduces the need for reflation from his analysis.

In 'Debts'²⁹ (see Chapter 9 in this book), Einaudi agrees with Fisher that the essence of the crisis lies in the existence of debts. In his reconstruction of Fisher's analysis, Einaudi emphasizes the sequence of events preceding the deflation effect. First there are new opportunities for profitable investment that give rise to investment; then businessmen's over-indebtedness forces them to liquidate, and this causes a fall in prices; then the relative reduction of businessmen's assets due to the fall in prices and the consequent increase in the burden of debt aggravates the crisis. Einaudi recognizes that Fisher's factual analysis is correct, but he considers Fisher's remedy unacceptable. This judgement is based on an analysis of the nature of the crisis. The word 'crisis', Einaudi argues, 'must not only conjure up the idea of doing badly', but also means movement, 'passage from one equilibrium to another'. In this sense Einaudi can maintain that the eco-

conomic world has always been in crisis: 'crisis is the eternal law of a world inhabited by men, that is beings ready to invent, to be fired with enthusiasm and to imitate'. Crises lead to ruin only when 'the majority of entrepreneurs unwisely contract too many debts'. Moreover, factual analysis, Einaudi emphasizes, must distinguish between two types of crisis. On the one hand, we have 'crisis as a change in the economic mechanism triggered by changes of taste and by inventions that can satisfy new tastes or better satisfy old ones', i.e., crisis as the generator of *creative movement* – a concept that recalls Schumpeter's 'creative destruction'. On the other hand, we have 'crisis as an impediment or brake on the movement that ought to occur', hence crisis as the generator of a *destructive movement*.

According to Einaudi, the debt factor can be a condition of the first type of crisis: that is, as a condition of movement and progress. However, if too many individuals contract debts during the crisis, then this brings on the second type of crisis: that caused by 'men's mania, their imitative spirit and voracious appetite for swift gains'. This is what happened during the war and in the years that immediately followed. In this situation reflation cannot be the correct remedy. In fact, Einaudi emphasizes that the dross of the preceding cycle is not eliminated with reflation. On the contrary, the equilibrium of the past period is perpetuated, retarding adjustment. For Einaudi this is 'worse than crisis': 'The longer the period of tranquillity, the less intense the elimination of mistakes, the more frightening the collapse that ... will necessarily come.'

In 'Debts' Einaudi emphasizes the role of the central bank in preventing and solving crises. The bank of issue is responsible for preventing a salutary crisis from turning into a disaster. It should therefore intervene in the traditional and classic way taught by experience. It should discount all the good paper immediately, in order to enable commercial and saving banks to meet any demand for repayment. It should not rediscount bad paper under any circumstances. The real remedy for the crisis, Einaudi continues, lies in withholding credit or increasing its cost for imprudent people before mistakes can become dangerous. In other words, the task is to apply the brakes of the world economic machine with good timing. 'This is the art of the wise, farseeing central banker', Einaudi maintained. To do this, a central bank governor must be independent from political power: non-economic forces must not deter him from doing his duty.

In the same way, the central banker has to translate the postulate of stable currency into reality. In the late 1920s and the post-Second World War period, the stabilization of currencies was a top economic priority in Europe. Einaudi believed a fixed exchange rate regime, currency convertibility and the free movement of capital to be crucial steps in the adjustment process. In the 1920s Einaudi was deeply convinced of the need to return to gold and thoroughly analysed the Italian experience of monetary reform in the period 1927–31. In two interesting articles³⁰ he reaffirms the

importance of the stability of monetary relations and, above all, emphasizes the need for a central banker to be firm and uncompromising. The central banker 'has to look coolly at the development of a necessary crisis, which has to drive the country to the fixed aim: an established exchange rate'. The central banker must have 'strong nerves' and must not authorize bailouts, lest they slow down the process of crisis liquidation and induce businessmen to expect future help.

In this respect, Italian experience was negative, as Einaudi pointed out in many articles from the late 1890s onwards. However, there was the commendable behaviour of Bonaldo Stringher, Governor of the Bank of Italy, during the period of stabilization.

According to Einaudi, conduct such as Stringher's served to ensure sound money and a balanced budget. First, it allowed a virtuous economic mechanism to be re-established, one based on the two pillars of Einaudi's economic vision: work and saving. Second, it allowed the banking system to do its proper task: to direct savings towards profitable uses.

Einaudi wrote many articles on the banking system, including 'On other Pseudo-commercial and Pseudo-bank Containers', 'Banks with Adjectives' and 'Are there too many Banks in Italy?' (see Chapters 6, 7 and 8 in this book).³¹ According to Einaudi, the rules of behaviour of a good private banker can be reduced to just two: that 'the banker has only one duty, to his depositors, and the banker takes money from everyone, even the bad, but he gives it only to the good' and that 'The really essential point is not to make mistakes ... The mistake of mistakes in banking, the worst and biggest mistake of all, is to impose a rigid rule on oneself, or to seek to regulate bankers' conduct rigidly'. The organizational rules follow from this, according to Einaudi. Functional specialization or geographical specialization, bigness or smallness, etc., are empty formulas in themselves. Above all, bankers require independence in order to do their duty. Starting in 1924, when he commented on the possible creation of a 'fascist bank' in 'Banks with Adjectives', Einaudi severely and wisely kept on warning that:

Banking is a very difficult art, and the addition of whatever adjective to the name perhaps serves only to increase difficulties that are already exceptional in themselves ... In countries where politics and banking are less developed, even banks without adjectives may have to pay a tribute to politics ... A bank with an adjective must face another risk. The manager has to fight not only against men who are not able and not upright, but also against those who, being neither able nor upright, ask him for money on the strength of that adjective ... It is the duty of the manager of a bank with an adjective to repudiate the adjective.

'The Theory of Imaginary Money from Charlemagne to the French Revolution'³² (see Chapter 12 in this book) is one of Einaudi's monetary essays best known outside Italy, partly because of an early translation into English. Luigi Einaudi identified what he called 'imaginary money' in pre-

Revolutionary France as a stable abstract unit of account capable of translating the differences between a multitude of real metallic currencies which circulated together, regardless of their tendency to be debased (and occasionally revalued after monetary reforms). The imaginary unit of account never existed as a real coin. Its function was that of a standard of value, an anchor of stability in a world of fluctuating values of the medium of exchange. In a different way imaginary money can be understood as a simple technical device which serves to establish the parity between gold coins and silver coins in bimetallic systems with an adjustable gold to silver ratio. Imaginary money is simply a tool to adjust the ratio through a *numéraire*, a bit like the European Currency Unit (ECU) between 1979 and 1999, whose value was based on a basket of real currencies. This solved the conundrum faced after the French Revolution by bimetallic countries which adopted the French Franc Germinal after 1803 with the 15.5:1 gold to silver ratio fixed and not adjustable. This had been the great obstacle to the orderly operation of the Latin Monetary Union (1865–1927) between France and its Italian, Swiss and Belgian neighbours, and it ultimately led to the adoption of gold monometallism instead. The abolition of all forms of imaginary money, in the name of a simple, homogeneous and rational monetary system, as embodied in France by the Franc Germinal of 1803–1927, paradoxically had created other problems, in the form of the bimetallic–monometallic quarrel and the excessive rigidity in real exchange rates and real prices. The interest of Einaudi’s contribution on imaginary money was twofold: first, it clarified the obscurity surrounding such mechanisms and the confusion felt by modern readers faced with the complexity of pre-Revolutionary European monetary operations; second, it explained why the old system, despite its complexity, had real merits and could inspire new and different ideas for solving contemporary monetary problems. For instance, Einaudi’s theory has recently been used to show how international basket currencies can be constructed.

In conclusion, money and banking was an important focus of his research, given that he was active in the years of the classical gold standard – seeing its collapse with the First World War – active in the Great Depression, in a new war and in another period of monetary and economic stabilization, in which he was a front-line practitioner. While attached to the classical quantitative theory of money, Luigi Einaudi paid a great deal of attention to the banking system and to central banking. He stressed the importance of the independence of the banking system from the political system, at a time when political expediency was moving in the opposite direction. The duty of the good banker is to maintain good management, responsibility towards shareholders and customers, away from ideologies and political influences. In ‘Noise’³³ (see Chapter 13 in this book) Einaudi argues that central bankers must use discreet moral suasion rather than changes in the discount rate, to avoid the clamour which inflates financial crises.

Luigi Einaudi's contributions to the theory of public finance

Einaudi was a major representative of the so-called Italian tradition (rather than school) of public finance.³⁴ This tradition includes Francesco Ferrara, Maffeo Pantaleoni, Antonio de Viti de Marco, Enrico Barone and Vilfredo Pareto, and their followers: Gino Borgatta, Benvenuto Griziotti, Guido Sensini, Mauro Fasiani, and others. These scholars did much to elevate the '*scienza delle finanze*', transforming it from a descriptive branch of economic and fiscal policy, as it was before 1880, to an important sector of economic and even political theory. Many of these authors corresponded with leading British and American scholars and wrote in the main scientific journals, but the Keynesian inter-war revolution obscured their thought – ideologically linked to classical liberalism – and many of them still await a reevaluation.

In his early works Einaudi did not express an unambiguous vocation towards public finance. He dealt with topics such as the British agrarian crisis, the trend of prices of agricultural products in Italy, the emigration of Italian 'human capital' to Argentina, and the rent of mines. Apart from the latter, all these writings addressed contemporary policy issues. Only one of these works concerned fiscal policy,³⁵ more specifically local taxation, which at that time (about 1902) was a very fashionable topic in Italy because several towns had socialist administrations engaged in fiscal reforms. The young Einaudi, then a left-wing Liberal with Fabian sympathies, advocated taxation of the unearned increments of urban land, not only for the sake of fiscal justice, but for economic reasons as well. Such a tax would force landowners to build houses, turning themselves from speculators into entrepreneurs. These ideas involved some considerations on the elasticity of demand for houses, which led Einaudi to reject the argument that, since the demand was inelastic,³⁶ the tax was shifted from owners to tenants.

The core of the essay consisted in the definition of the 'effects of tax'. Einaudi did not limit his research to the shifting and incidence of taxation, but also considered various kinds of markets for taxed goods (free competition and monopoly), carefully analysed from a Marshallian perspective, and he considered the divergence between the objective effects and the subjective motives which prompted policymakers to assess the tax.³⁷

Only in his subsequent works did Einaudi acknowledge that the study of the effects of taxes on economic equilibrium needed a Walrasian general equilibrium approach, but he confessed that his poor mathematical training prevented him from performing such a task as well as he wished.³⁸

In parallel with theoretical and applied fiscal studies, Einaudi produced historical studies in public finance. In 1907–8 he published two large volumes on the budget receipts of the Piedmontese monarchy during the Spanish War of Succession at the beginning of the eighteenth century and

on Piedmontese finance during the same period. Thanks to very thorough archival research (carried out with the help of his wife, Ida), Einaudi was able to show that, despite the conservation of *ancien régime* institutions, Piedmont had successfully managed its budget to meet war needs. The relationship between theoretical schemes, history and the institutional framework was from that time onwards a constant feature of his research.

His framework was mainly a free competitive economy, with the State operating as a private agent. In 1911, in his *Lezioni di scienza delle finanze*, he started from a strictly theoretical issue: that of a pure theory of 'natural' taxation, considering a State in which the delegates of the citizens had to substitute the latter in their choice of public goods. This was a branch of public economics opened by Pantaleoni's work on the allocation of public expenditure,³⁹ and based on the assumption that public finance should be approached using the analytical tools familiar in the study of the working of the private sector.

Finally, in 1912, Einaudi issued his major study on the taxation of consumed income. The theoretical framework was provided by John Stuart Mill and Irving Fisher. The former (1848) had argued that taxing of saved income would result in double taxation if the new income produced by invested savings was taxed as well. The latter (1906) had maintained that only the income destined to final consumption is true income, while all income which is not actually consumed is 'capital' and ought not to be subject to income tax.

Both Mill and Fisher were concerned about the negative effects of progressive taxation, since it could discourage capital accumulation. Sharing the same concern, Einaudi conceded that only proportional taxation means 'equality' or equity (intuitively, but in a questionable way, defined as that principle according to which, if 'one lira is taxed with a 10 cent tax, every other lira, belonging to whatsoever income equal, higher or lower ... must be taxed with the same 10 cent tax'⁴⁰). The theoretical implication is that the marginal utility of income is constant.

Although there were obvious difficulties in coordinating Mill's classical (objectivist) theory of double taxation and Fisher's neoclassical (psychological) definition of income, Einaudi was particularly brilliant in demonstrating that all existing fiscal systems exempted earned savings from taxation and mainly (or exclusively) hit income used for final consumption. They all respected the 'equality postulate', thanks to exemptions, deductions and other forms of qualitative discrimination. In this demonstration Einaudi's mastery of fiscal law was of great help.

The implication of his theory was that taxation should not be based on the *source* of revenue but on its final *use*, for consumption or for saving. Of course, Einaudi acknowledged that it was very difficult to ascertain how taxpayers actually allocated their incomes. But in most cases, he observed, we can fairly presume that some earned income will be allocated to

consumption and therefore will be taxed, while some will be allocated to saving. For instance, households allocate a part of their income to the necessities of life, or to maintain the purchasing power of their capital unchanged. This kind of spending was not authentically 'consumption', but 'presumed saving', which improved the capacity to work and produce and therefore had to be exempted. The income of labour deserved such fiscal treatment.

This article gave rise to a lively debate. From the point of view of practical finance policy, Einaudi was accused of excessively narrowing the basis for taxation, well below the needs of a modern State (in fact, he advocated taxes on conspicuous consumption, including horses and luxury carriages). From a more theoretical perspective, Pigou (himself a follower of the double taxation of savings doctrine) observed that the 'postulate of equality' should have been more rigorously settled. Umberto Ricci and Benvenuto Griziotti objected that the returns on the saved-invested income should be considered as 'new' income and therefore that there was no ground for a tax exemption.⁴¹

Consumption tax was only one element in Einaudi's complete theory of taxation. He laid another cornerstone of it in an article on tax amortization.⁴² As is well known, amortization takes place when capital value is diminished by a tax on its income returns. The traditional doctrine states that if a tax is general (i.e., if it is uniformly spread over all branches of production) then there cannot be amortization, because the rate of interest will also be uniformly lowered. In fact, if the tax is general, an income of 45 (after a 10 per cent tax) at the interest rate of 4.50 per cent will give a capital of 1,000, exactly as will an income of 50 at the interest rate of 5 per cent before the tax. On the contrary, if the tax is special (i.e., if it is imposed on some branches of production only, and not on the others), the rate of interest will not be lowered and amortization will reduce the capital value. In his comments on E. R. A. Seligman – the American economist whose *Shifting and Incidence of Taxation* (1898) was very well known in Italy, thanks to its translation in the *Biblioteca dell'economista* – Einaudi settled the problem in a new way. A general and uniform tax is one that does not alter the general equilibrium of the economy; in particular, it is one that does not modify taxpayers' consumption or investment habits or alter the trade-off between the different ways of employing the factors of production.⁴³ But the requisite of generality, uniformity and neutrality (used by Einaudi as synonyms) cannot depend only on the objective effects of taxation on prices and incomes. Generality is the requisite of 'a tax that weighs with equal force on incomes having equal value in the time span considered, such as to leave the *judgement* of every man unchanged with respect to every unit of income'.⁴⁴ The 'postulate of equality' is thus redefined in subjective terms.

Nevertheless, in his search for a 'neutral' tax Einaudi preferred to develop a historical-empirical approach. He therefore focused on the taxation of land, based on the cadastre, which was distinguished by being assessed not on realized incomes but on 'normal' or 'ordinary' incomes. He concluded that both the 1750 Lombardy cadastre and the 1886 Italian Kingdom cadastre were the best approximations to his 'ideal' scheme. In Einaudi's vision, a tax on land seemed to be the best model for a reform of personal taxes, since its goal was 'normal' income, based on clear-cut, objective 'economic categories': rent, profit and wages arising from its exploitation, independently of the condition of the taxpayers.⁴⁵ Einaudi's preference, therefore, was for a system of real proportional taxes even for mobile incomes.⁴⁶ He undoubtedly gave priority to efficiency over equality. In fact, entrepreneurs who gained more than the normal income were exempted from the excess part, while those who gained less were nevertheless taxed (and eventually discouraged from continuing their job). The fiscal system could therefore contribute to the formation of the economic ruling class (elite) of the country.

In order to formulate a definite verdict of 'neutrality', it is necessary for taxpayers to have some information about the effects of the public expenditure financed by the tax. It is therefore important to assess the impact of taxation on general welfare.⁴⁷ Indeed, there are some kinds of taxes whose effects are entirely negative, insofar as they either fail to give anything to taxpayers in terms of welfare (which Einaudi called 'hail-tax') or, still worse, end up financing welfare-reducing expenditure (which he called 'ransom-tax').⁴⁸ Only a tax which covers productive expenditure can properly be considered as 'economical'.

The rest of the 1919 essay was a eulogy on the benefits that State expenditure brought by promoting positive externalities (education, the environment and town planning, improved leisure, and so on). In fact, public expenditure contributes decisively to raising normal incomes and therefore to enlarging the basis for taxation. In separate essays Einaudi showed that in the past there had been authors who shared both a view of productive expenditure and the idea of the taxation of final consumption.⁴⁹

Einaudi was proud to defend such a positive view of the functions of the State. It could be imagined as relating to his early sympathies for Fabian socialism, but in fact it derived mainly from his classical Liberal beliefs. In a 1930 controversy with the fascist ideologue, Ugo Spirito, who accused the 'Liberal' economists of having neglected the role of the State, Einaudi objected that all the great economists of the past, beginning with Adam Smith, were convinced supporters of '*buongoverno*' (good government) and, therefore, of an active presence of the State in the economy.⁵⁰ Of course, he had in mind the Liberal State, not fascist corporatism, which in a subsequent essay he called 'a monster', since it pretended to interpret

the interests of the whole community while 'neglecting those of the living men that compose that community'.⁵¹

In his view of the Liberal-democratic State Einaudi was very close to Antonio de Viti de Marco, an economist who had to resign his university professorship in order to avoid a pledge of loyalty to fascism. In another long essay,⁵² Einaudi began by quoting the statement made by Antonio de Viti, that 'every part of income reaches its recipient as if it were already loaded by its tax debt'.⁵³ This premise descended from de Viti's theory of the State as a productive factor, and was common to both authors. As regards the definition of income, however, Einaudi took a different position from de Viti. While de Viti considered income that was actually produced to be taxable, Einaudi stressed that a tax on produced income was not a 'neutral tax', since it could not resolve the complex problems due to the different duration of productive processes and neglected the dynamics of production, considering every moment as separate from the following ones. By contrast, a neutral tax would not discourage entrepreneurs engaged in production requiring a longer time, and therefore would not cause any distortion in the employment of factors. At the end of this essay Einaudi admitted that the difference between taxing produced or consumed income was not so great, provided that the tax was levied approximately at the time of consumption.⁵⁴

After disputing the notion of produced income, Einaudi moved on to dispute that of earned income. In his 1938 book *Miti e paradossi della giustizia tributaria*⁵⁵ he exercised his wit as a pamphleteer to ridicule those he called 'tax avengers' for searching everywhere for surplus incomes to tax. The taxation of surpluses was in fact advocated by the school of Benvenuto Griziotti, a former socialist economist who Einaudi accused of being a doctrinaire since he did not consider the vagueness of the concept of earned income. If we studied the source of the surpluses, Einaudi argued, we would see that some were the result of human labour and not, strictly speaking, surpluses, while others would be found to have a non-monetary value, and the rest would be the result of State interference in the economy and would cease to exist when this interference ceased. The conclusion was that the very concept of earned income was useless.

Symmetrical to his demolition of traditional concepts of taxable income was the effort to cancel the notion of State coercion in taxation. This is a fundamental feature of Einaudi's most mature thought. For the majority of the representatives of the *scienza delle finanze*, beginning with Pantaleoni, State coercion was necessary to cover the cost of public goods. The concept of coercion was enriched by Amilcare Puviani in his theory of fiscal illusion: taxpayers fail to perceive the real need for public services and the modern State substitutes subtle deception⁵⁶ for traditional force. All these concepts looked (and really were) inspired by Machiavelli: in every historical age the lions/foxes of the ruling classes made bad use of their power by

extorting the maximum amount of wealth from the community of taxpayers. Democracy, aristocracy and monarchy – or, if we prefer, democracy and dictatorship – did not differ greatly in this sense. Einaudi reacted sharply to this pessimistic presentation. According to him, in the history of humanity there had been moments marked by cooperation between rulers and ruled. For example, in classical Athens taxes for public works and public performances (*leitourgiai*) were paid voluntarily. In *Miti e paradossi* the name of Pericles recurs more frequently than that of de Viti de Marco.

The conclusion reached by Einaudi in his almost forty years of reflection on income and taxation may seem at first sight utopian. Yet, consumption has revealed itself to be an increasingly important item of taxation, though in a different macroeconomic context.⁵⁷ Moreover, his idea of cooperation between the State and taxpayers for a transparent control of public expenditure and fiscal decentralization is very modern. Thanks to a sort of repetition of historical phenomena – or historical nemeses! – ideas that seemed old-fashioned when Einaudi formulated them, have been revived in our day.

European economic integration

Einaudi was a very early proponent of European monetary and economic unification. His proposals anticipated all the developments of the following 60 years. European federalist ideas had developed in the nineteenth century, gaining some popularity in certain key historical phases, as in 1848 and the late 1860s, but they had reached a low point during the age of imperialism preceding the First World War. In 1918 Einaudi, under the pseudonym of Junius, launched attacks in the *Corriere della Sera* against the ‘dogma of national sovereignty’ and the ‘myth of absolute independence and economic autarchy’. Not only had they fuelled the most destructive and absurd of all wars but such dogmas and myths were undermining the possibility of a lasting peaceful settlement. The League of Nations, still in the making, was already doomed because it only provided for a permanent alliance to defend a peaceful international order among fully sovereign states, but the latter ultimately maintained all the means to undertake new wars. Einaudi called for a much stronger federalist link because ‘only free nations will be able to limit each other mutually, as components of a superior State organization, to guarantee each other true security against attempts at hegemony to which in the current international anarchy the strongest state is inevitably attracted by the deadly dogma of absolute sovereignty’.⁵⁸

The long period of fascist dictatorship in Italy was not a time when such thoughts could be freely developed and expressed, but the Second World War only reinforced Einaudi’s belief in the urgency of a federalist solution to European war. Federalist ideas had been developed further during

the 1920s, thanks also to the Pan-European Movement of Coudenhove-Kalergi,⁵⁹ and culminated at the political level in the proposal made to the League of Nations in 1929–30 by the French Prime Minister, Aristide Briand. This sought to establish 'some kind of federal bond' between European states.⁶⁰ Despite further development of federalist ideas in the United Kingdom in the 1930s by Lionel Robbins, Lord Lothian and others,⁶¹ the storm of the Great Depression, the fall of Briand and his German partner, Chancellor Gustav Stresemann, had pushed federalist proposals to the background again, and they only survived in the mocking Hitlerian version of the New European Order. As soon as the fascist censorship ended with the collapse of Mussolini's regime on 25 July 1943, Einaudi reopened the discussion.⁶² As early as 1 September 1943 'Why we Need a European Economic Federation' (see Chapter 17 in this book) was published anonymously.⁶³ Only a few days later Hitler ordered the occupation of Italy, and the return to power of Mussolini. The blackshirts came to arrest Einaudi as a prominent anti-fascist and he was forced to seek asylum in Switzerland, crossing the Alps by foot at the age of 69. In Switzerland he found the example of a pragmatic confederation which helped him to develop his ideas further. 'The Economic Tasks of the European Federation'⁶⁴ (see Chapter 18 in this book) was written during the 15 months of Einaudi's Swiss exile. It was the most comprehensive study of the economic aspects of a European federation and developed the ideas of 1943 in greater detail. To provide a clear idea of Einaudi's views within the limited space available, different sections have been selected from the two texts. The arguments justifying the need for a European federation have been selected from the 1943 work, which is much more wide-ranging than the later one, while the economic tasks of the European federation are examined in greater depth in selections from the 1944 work.

Einaudi ridiculed the absolutist theories of subordinating economic phenomena to purely political ones, and the supposed need for breathing space in order to expand production and dump excess supplies on subordinate states through imperial constructions. In his view, such practices would only lead to further conflicts and the destruction of Europe. The recognition of interdependence and free, peaceful commercial competition on a cooperative footing were the only alternatives. He considered that the chief objective of a United Europe should be to prevent military conflict between fully sovereign states. However, the economic intercourse of post-Napoleonic Europe showed a strong tendency to reach global economic unification through ever-extending networks of transport and communication. A European Federation would represent the only political and economic solution accommodating such pressures without continuous national clashes in defence of anachronistic particularism.

Einaudi set out an ambitious economic agenda: free trade, free movement of people, the unification of infrastructures and a single monetary