

## Mario Draghi: The culture of monetary stability from unification to the present day

Address by Mr Mario Draghi, Governor of the Bank of Italy and Chairman of the Financial Stability Board, at the inauguration of the exhibition “The currency of united Italy: from lira to euro”, Palazzo delle Esposizioni, Rome, 4 April 2011.

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The Bank of Italy is making a twofold contribution to the 150<sup>th</sup> anniversary of the Unification of Italy. With the collaboration of numerous experts from Italy and abroad, it is sponsoring a vast research project – entitled *Italy and the World Economy, 1861–2011* – on the Italian economy’s response to the major changes in the international scenario that have taken place from the birth of the unified State to the present day. The results of this research will be presented at a conference in Rome on 13, 14 and 15 October.

For the wider public, and particularly for young people, we are inaugurating today the exhibition on *The currency of united Italy: from lira to euro*.

The thread that runs through the 150 years of Italian monetary history since unification draws together two fundamental events: the country’s monetary unification, which the newly formed Italy undertook in order to strengthen the foundations of its political unity; and, closer to our time, Italy’s participation in European monetary unification, achieved despite the lack of political unity.

This story, from the lira to the euro, illustrates a central point for all of us today – the importance of monetary stability and of a political and economic culture that recognizes its value.

Guido Carli suggested a logical path to take. “If international competition”, he wrote in 1961, “is indeed the most powerful incentive towards our country’s economic development, there can be no doubt that, in turn, its strongest pillar is monetary stability. This, too, is a lesson handed down to us through a century of Italy’s – sometimes painful – experiences as a nation state.”<sup>1</sup>

The concept of monetary stability changes with time, alongside the technological and institutional conditions that determine it. Between the 19<sup>th</sup> and 20<sup>th</sup> centuries, Italy, too, switched from a system in which money was made of, or could be converted into, precious metal to one based on purely fiat money. In the first system, monetary stability is ensured by maintaining the gold convertibility of the currency at a fixed parity. By and large, Italy managed to do this: on the eve of the First World War, despite some periods of inconvertibility, the price index was at the same level as in 1861. This stability was regarded as the natural state of things.

With the ascendancy of paper money, a radical institutional overhaul took place in the monetary field. The modern central bank came into being, and standards, rules and organizations were established to manage a currency whose value was no longer anchored to that of a metal, but instead based entirely on trust.

As early as 1839 Carlo Cattaneo warned, in his review *Il Politecnico*, that “paper money must not be issued except on behalf of the State, and that, with all the rigorousness and all the

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<sup>1</sup> Banca d’Italia (1961), *Abridged version of the Report for the year 1960*, “Concluding Remarks”, 111.

solemnity of laws and fundamental orders, its quantity must be made proportionate to needs, that is, to the volume of transactions.”<sup>2</sup>

It was not until 1893 that the Bank of Italy was founded, with the main task of centralizing the function of note issuance, which until then had been distributed among six local banks. It immediately took on the broad role of guarantor of monetary stability and centre of the financial system. In the words of Marco Fanno, it becomes “the central institution around which the banking structure gravitates and on which it is hinged, ...the body regulating the market, ... the last line of defence to activate at times of grave difficulty.”<sup>3</sup>

The suspension of the gold convertibility of banknotes during the First World War drew the attention of economists and economic policy makers directly to inflation, not in the old sense of increase in the stock of banknotes but in the modern sense of rise in the general price level. The value of money lies in its purchasing power and therefore inflation means devaluation of the currency. Keeping prices down – although still instrumental to the lira’s external convertibility – became the objective of economic policy under the new system of the gold exchange standard that prevailed after the War.

Right after the Second World War the lira fell to a thirtieth of its pre-war value as a result of a flare-up of inflation, extinguished by the monetary stabilization engineered by Einaudi and Menichella. Einaudi called for a concerted effort to avert “monetary unity’s destruction”.<sup>4</sup> The laborious task of rebuilding confidence in the currency, and thus of reconstituting savings, was pursued with courageous determination, in the belief that the defence of the currency would create a solid basis for the country’s economic recovery.

The path of international integration was followed by joining the Bretton Woods monetary system. In the 1950s Italy enjoyed a period of unprecedented monetary stability and economic growth. The exchange rate with the dollar was stable, and remained so until 1971; for the first time the rate of inflation in Italy was in line with, if not lower than, that of the other leading European countries.

The end of the Bretton Woods system at the beginning of the 1970s concluded the transition from commodity money to fiat money. Troubled times ensued: international economic relations were affected by deep shocks, such as the oil crises. During this passage Italy paid a high price in terms of loss of value of the lira: double-figure inflation eroded households’ purchasing power and periodical devaluations gave only temporary relief to a productive system labouring to restore its efficiency and competitiveness.

In the following decade the decision was taken to advance the construction of the European Community through the completion of the single market and, eventually, the Economic and Monetary Union and the euro. Italy took a leading role, responding to the widespread aspiration of the nation. These prophetic words were pronounced by Carli at the beginning of the 1970s: “During Italy’s *Risorgimento* the European ideal was deeply engrained in the effort to achieve national unity, so that the two ideals were not seen as contradictory but as phases of a single process moving towards the expression of a culturally homogeneous community. Events in the last decades have given a sense of urgency to what might have seemed a utopian vision during the last century, so that the accomplishment of European unification is considered an indispensable development for the very survival of the values embodied in national ideals.”<sup>5</sup>

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<sup>2</sup> Carlo Cattaneo (1839), “Delle crisi finanziarie e della riforma del sistema monetario”, *Il Politecnico*, 1, June, 548.

<sup>3</sup> Marco Fanno (1912), *Le Banche e il Mercato Monetario*, Athenaeum, Roma, 131 and 147.

<sup>4</sup> Banca d’Italia (1947), *Annual Report of the Governor to the General Meeting of Shareholders*, “Final Considerations”, 51.

<sup>5</sup> Bank of Italy (1973), *Abridged version of the Report for the year 1972*, “Concluding Remarks”, 222.

Today, there is reason to believe that the stability of the currency and of prices depends on the expectations of economic agents. These expectations are formed on the basis of such elements as the clarity and certainty of the rules of money creation and the reliability and credibility of the institutions managing it. The establishment of a culture of monetary stability is crucial for this to become a virtuous circle.

Luigi Einaudi believed that money was a contract between economic agents and that its stability had to be built by educating them. As a young economist, in 1905 he undertook the translation into Italian of Walter Bagehot's *Lombard Street*,<sup>6</sup> the classic Anglo-Saxon text on monetary stability, certain that it would be effective also in forming public opinion. As Governor he invented the medium of the Concluding Remarks to speak to the Italians, not just to the experts. Faced with the pernicious inflation route, in 1947 he claimed it was the right and the duty of the senior management of the Bank of Italy to issue "a cry of warning", while at the same time loudly avowing that "it is a road we shall not take."<sup>7</sup>

In the last half century the Bank of Italy has indeed maintained this commitment to educate and inform with the publication of research papers by the Economic Research Department, public talks by senior management, and not infrequent contacts with universities and with the new generations. Tommaso Padoa-Schioppa explained, sixteen years ago, that a central bank contributes to monetary stability also through "a constant effort of information, education, and clarification that is part and parcel of defending the value of the currency."<sup>8</sup>

Nowadays, the central banks know that effective communication and widespread understanding of monetary matters are essential for the success of their monetary policy strategy. The Eurosystem is committed to informing the markets and the public about how it thinks, decides and acts. This is also a way of keeping price expectations stable over the medium-to-long term.

Now that monetary stability no longer hinges on the amount of precious metal available in the system, it relies on the credibility and technical expertise of the central banks. But the latter are powerless if the value of stability is not firmly ingrained in the collective consciousness.

The objective of the exhibition we inaugurate today, and of the permanent museum that will later take its place, is to help entrench this value, which is a common, founding legacy of European citizenship.

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<sup>6</sup> Walter Bagehot (1905), *Lombard Street – Il mercato monetario inglese* (translation by Prof. L. Einaudi), Utet, Turin.

<sup>7</sup> Bank of Italy (1947), *Relazione Annuale*, "Considerazioni Finali", 255.

<sup>8</sup> Tommaso Padoa-Schioppa (1995), "La sicurezza monetaria e le banche centrali", talk given at the Centro Alti Studi Difesa in Rome on 9 June 1995, published in the series *Banca d'Italia – Documenti*, 489, 9.