Maria Stella Chiaruttini[1]

Paper to the presented at the workshop

Politics and State Finance in the Peripheries of the Global Economy in Historical Perspective

University College London, 6–7 June 2018

Extended abstract

A Never-Ending Story: Public Debt and the Italian Banking Question from the Restoration to National Unification (1814–74)

Introduction

That new states are created, or kingdoms recovered, generally not by peaceful negotiations but wars, and that wars, in turn, are hugely expensive is no novelty, for historians as well as laymen. Also hardly surprising is the fact that states finance war by borrowing and raising taxes. However, fiscal changes can be so pervasive and impact so profoundly on the social and political structure of the state that over the last thirty years many political scientists and historians have devoted their efforts to studying the relationship between warfare, debt and state formation.[2] Since at least the seminal work by North and Weingast, economic historians have also explored the different paths of financial and fiscal development of modern European states, stressing the influence of this evolution on their rise or decline.[3] The archetypal comparison is that between Great Britain and France: the British political and financial revolution of the eighteenth century would prove a crucial advantage in the century-long struggle against a much larger country like France. An essential ingredient of Britain's financial revolution, as well as of its success against its continental rival, was the creation in 1694 of the Bank of England to relieve state finances, under severe strain due to the Nine Years' War. The history of early central banking in Great Britain can therefore be recounted as one of war, fiscal crisis and political change.

The same is true for Italy one century later, although the Italian case is remarkable for its absence in international banking history and the literature on fiscal states. In this paper I compare the evolution of early central banking in the two largest Italian states in the nineteenth century, namely the Kingdom of the Two Sicilies and the Kingdom of Sardinia. In both states central banking developed as a response to a severe fiscal crisis, although the different period and political context of the two crises led, in one case, to a system of public banking and, in the other, of private banking fostered by the state. When in 1860 the Two Sicilies were conquered by Piedmont-Sardinia, these two systems inevitably collided. While in most domains Piedmontese rules and institutions were simply exported to the annexed regions, the fight over the banking structure of the

[1] European University Institute, Department of History and Civilization, Villa Salviati, via Bolognese 156, IT–50139 Florence; maria.chiaruttini@eui.eu.

[2] E.g. Tilly, C., *Coercion, Capital, and European States, AD 990–1990* (Cambridge, MA, 1990); Bonney, R., ed., *The Rise of the Fiscal State in Europe, c. 1200–1815* (Oxford, 1999); Yun-Casalilla, B. and O'Brien, P. K., eds., *The Rise of Fiscal States: A Global History, 1500–1914* (Cambridge, 2012).

[3] North, D. C. and Weingast, B. R., 'Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England', *Journal of Economic History*, 49, 4 (1989), pp. 803–32; Carruthers, B. G., *City of Capital: Politics and Markets in the English Financial Revolution* (Princeton, NJ, 1996); Neal, L., *A Concise History of International Finance: From Babylon to Bernanke* (Cambridge, 2015); Rowlands, G., *The Financial Decline of a Great Power: War, Influence, and Money in Louis XIV's France* (Oxford, 2012); Stasavage, D., *Public Debt and the Birth of the Democratic State: France and Great Britain, 1688–1789* (Cambridge and New York, 2003), to name but a few works.

new kingdom dragged on for decades, being definitely ended only under Mussolini's regime with the granting of the note-issue monopoly to the Bank of Italy alone. The banking question in Italy was a particularly thorny issue due to the overindebtedness of the state, which very often verged on default in its first years of existence and was saved by the Italian banks of issue. The credit these provided enabled the government to continue its expensive policy of military aggrandisement. At the same time, however, financial emergency measures taken by the government permanently altered the banking structure of the country and rekindled regional antagonism.

From the Restoration to National Unification

In the first half of the nineteenth century both the Two Sicilies and the Kingdom of Sardinia faced bankruptcy, although at different times and for different reasons. The Napoleonic Wars and the Restoration had been particularly expensive for the Bourbons. When in 1821, a few years after coming back to power, King Ferdinand I called for an Austrian military occupation to crush constitutional uprisings, state finances nearly collapsed and were saved only by massive international loans negotiated by the Rothschilds. The attempts made by the new king Ferdinand II to redress public finances were thwarted in 1848 by new constitutional uprisings on the mainland and the overt secession of Sicily, which drained the island's resources and could be quelled only after a long and costly civil war with Naples.

Unlike Southern Italy, the fiscal situation of Piedmont-Sardinia was remarkably good until the mid-1840s. This all changed, however, in 1848, when the king was forced to grant a constitution and soon thereafter to wage war against Austria in an attempt to drive it out from northern Italy. Although Piedmont was defeated and had to pay heavy war reparations, it did not abandon its military ambitions. Under the charismatic leadership of Prime Minister Cavour, the government invested massively in rearmament, international bribery and economic development. As a result, public debt surged, but Piedmont's investments in the end paid off, since between 1859 and 1860 it was finally able – thanks to the French army and Garibaldi's expedition in the South – to unify almost the whole of the peninsula.

The Two Sicilies and the Kingdom of Sardinia pursued almost opposite policies. The former stubbornly remained an absolutist monarchy, wary of foreign influence and firmly isolationist. The latter, instead, transformed itself into a constitutional monarchy, championed the Italian cause and assiduously courted France and Britain for political and economic support to its nationalist plans. In economic and fiscal matters, the Kingdom of the Two Sicilies tried to reduce its foreign indebtedness through prolonged austerity, which, due to the need for an absolute monarchy to please its disenfranchised citizens, manifested itself in expenditure cuts rather than higher taxes. The constitutional Kingdom of Sardinia, on the contrary, was not only able to greatly increase the tax burden, but preferred accumulating substantial foreign debt in order to implement an expansionary policy of militarism and public investment in the economy.

In banking matters, however, the two countries differed less markedly, at least as regards, if not the form, the substance of the alliance between the state and its national bank. In both countries the banking system was completely overhauled in order to meet the Treasury's needs. In the South, when the Bourbons came back to power in 1815, one of their first concerns was to merge the century-old Neapolitan deposit banks into one single new entity – the Bank of the Two Sicilies – under the direct control of the Finance Minister. Thanks to the legal privileges the Bank of the Two Sicilies enjoyed, its notes soon gained wide acceptance across the whole country, which enabled the bank to use part of its metal reserves to finance, first and foremost, the Treasury. During the fiscal crisis of the 1820s the bank was still too undercapitalised to be of any help and default could be averted only thanks to the Rothschild loans. Thereafter, however, a mixture of austerity and the growing success of the state bank enabled the Bourbon government to shoulder a relative high but stable debt, whose rating on international markets was outstanding. While on the one hand a well-managed, though highly conservative, public bank effectively sustained public finances, on the other it stifled the development of private banks, unable to compete with it in terms of size and legal privileges. The absence of competitors, in turn, discouraged the Bank of the Two Sicilies from upgrading its business model or even extending its branch network. By the late 1850s, apart from its Neapolitan headquarters, it had opened only one branch on the mainland, while the two it managed in Sicily were turned into an autonomous bank after the island's secession.

In the Kingdom of Sardinia the good state of its finances until 1848 had never made the establishment of a bank of issue a priority. The first such institution was founded in Genoa as late as 1844 as a modest private bank modelled on the French departmental banks of issue. The Bank of Genoa raised to grandeur almost by chance thanks to the high costs of the First War of Independence against Austria and the impossibility for Piedmont to cover them through international loans, given the overall shortage of capital in 1848. As a last resort, the government thus borrowed from the bank five times its capital and declared its notes inconvertible. The bank, merged in 1849 with its twin sister in Turin thanks to Cavour's good offices and renamed the National Bank, would always remain a private institution. Nonetheless, after inconvertibility was lifted in 1851, the bank was still linked to the government: without any legal privileges, it could only hope to avoid the establishment of competing institutions by actively supporting Cavour's expansionary policies, increasing its capital much to the government's benefit and pre-empting regional market by developing an extensive branch network.

From National Unification to the 1874 Banking Reform

With Unification, public debt exploded. The uncertainty surrounding the very survival of the new state, its bellicose intentions towards Rome and Venetia (still independent at the time), its growing expenses for military, administrative and economic purposes shook the confidence of international markets and required the adoption of bold fiscal measures at home. In 1859 the banknotes of the National Bank were again declared inconvertible, although initially for a short period of time. Meanwhile, in the South the Banks of Naples and Sicily (as the Bank of the Two Sicilies and its two former Sicilian branches were now renamed) were forced to keep afloat the new government with further loans. Politically speaking, the Southern banks were at a clear disadvantage with respect to the National Bank, which overtly aimed at becoming the sole bank of issue in the new country. While the National Bank was a private bank supported by the largest banking houses of the North, the Southern banks were the public banks of a defeated government and as public administrations they were left with precious little room for manoeuvre.

The weaknesses of the Southern banks were in many respects the same of the Bourbon regime. Although in purely monetary terms the South was even richer than the North, it had failed to capitalise on its strengths. Right after the Restoration the Bourbon government had set up the most powerful banking system in Italy at that time, which however remained almost unchanged until the regime's fall. The government had been as conservative in banking as it had been in domestic affairs and foreign policy. Debt was increased only to quench constitutional uprisings and the very same financial solidity of the country made 'creative financing' – and, with it, further banking innovations – unnecessary from the government's point of view. Piedmont-Sardinia, instead, had leveraged on its more modest banking system to pursue a policy of political expansion and economic modernisation. As a result, the largest Southern banks found themselves at the mercy of a foreign government and of a smaller, but more modern and dynamic, bank of issue, which hastened to open branches all over the South. Colonisation, however, was not an option for a new government whose legitimacy in the South was seriously challenged and which was embroiled in guerrilla warfare with legitimists and bandits for years. Reaching a compromise with the Southern elites was the only viable solution, also in the banking sector. Much to the regret of the National Bank, Southern banks, though downgraded, were therefore able to survive. Their survival, moreover, besides being a political necessity, perversely served the fiscal needs of the government, willing to confirm old privileges only in exchange for further loans.

In 1866 another major reform of the Italian banking system was triggered by a severe debt crisis linked to yet another military campaign. On 1 May the notes of the National Bank were once again declared inconvertible and after a few weeks Italy waged war on Austria to conquer Venetia. For many, note inconvertibility was just the final resort of an overindebted government rapidly losing its credibility on international markets and privileging the notes of the National Bank was an obvious choice, since this was the only credit institution spread across the whole country. For others, however, the National Bank had just exploited the financial weakness of the state to obtain an ‘exorbitant privilege’. Although the government tried to preserve the regional banks of issue from the attacks of a privileged bank – most notably by making their notes legal tender in their respective regions – note inconvertibility further reinforced the hegemonic character of the National Bank. Due to its debt burden, the state was unable to restore convertibility for 15 years. In 1874, regional discontent forced the government to reform the banking system once again, this time by creating a consortium of all banks of issue which would be the only institution entitled to issue inconvertible notes. By that time, however, the Southern banks could no longer hope to regain the leadership lost at the time of Unification. Bolstered by the governments of the Historical Left, more sensitive to regional claims than the Historical Right had been when leading the Unification process, they could only turn into regional champions and contribute to the inner instability of the Italian banking oligopoly.

Conclusions

The development of Italian early central banking in the nineteenth century was deeply influenced by politics and fiscal policies. The growth of the two largest Italian banks of issue, the Piedmontese National Bank and the Bank of the Two Sicilies, was largely dependent on state support and their financing of public debt, which increased manifold both in the South and the Kingdom of Sardinia since the Restoration. In the long run, however, the conservative policy of the Bourbon regime backfired, in political as well as economic terms. With hindsight, Piedmont’s high-risk strategy of military expansion, overindebtedness and financial development proved successful. The unified kingdom inherited a crushing burden of debt, which in 1866 forced the government to declare the notes of the National Bank inconvertible. This decision paved the way to the rise of the National Bank, the forerunner of the Bank of Italy, sealing the fate of the Southern system of public banking.