

# Issues in Economic Thought

Miguel-Ángel Galindo Martín  
Cristina Nardi Spiller  
Editors

ECONOMIC ISSUES, PROBLEMS AND PERSPECTIVES

NOVA

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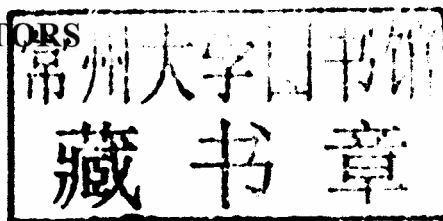
# **ISSUES IN ECONOMIC THOUGHT**

**MIGUEL-ANGEL GALINDO MARTIN**

**AND**

**CRISTINA NARDI SPILLER**

**EDITORS**



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## PREFACE

As it is well known, the present is rooted in the past. For this reason by studying the past, the authors can better understand not only some basic principles of the ideas proposed by modern economics, but also some make some recommendations to meet future economic problems of society. A huge literature has been developed on the theories and approaches of the most eminent economists. However, there is not much literature analysing contributions different from English-language on several concrete topics. For this reason, this book tries to cover this gap. In this sense, three aspects are considered: the contributions of Italian authors, Smithsonian approaches on education, growth and moral aspects, and, finally, some modern contributions.

Chapter-1- This paper concerns the appearance in Italy of economic policy as discipline, before the leading contribution of Keynes. The authors will try to show that the economic policy idea as conceived by Italian economists evolved independently from pure economics analysis or, better, it grew because the discourse on economic policy was progressively excluded from pure and applied economics. This exclusion occurred as the debate, firstly on economic art and then economic policy, gradually shifted from trade policy to state intervention in trade policy, and then to state intervention for economic growth and well-being.

Chapter-2- In the 1960s and 1970s, scholarly interest in economic fluctuations was keen. Later, attention waned, with a revival at the end of the century. After briefly outlining some of the leading contributions to this complex theme, the authors turn to the thought of certain representative Italian economists. In this context, the authors examine the approaches of Amoroso, Fanno, Menegazzi and Vito, and consider how their theories uncover new explanatory pathways. Effectively, as economic systems evolve, unexplored opportunities for enquiry may emerge from existing mechanisms or previously neglected elements. The authors are therefore convinced that these valuable theoretical contributions should not go to waste or be relegated to forgotten niches.

Chapter-3- The business cycle theory was one of the main fields of macroeconomic research developed by Italian economists in the thirties. In the post-WWII period, general interest turned towards the theory of growth in the wake of Harrod's contributions. Fanno took full part in this theoretical turn, and made an original attempt at formulating a theory of cyclical growth. One of the main aspects that he tried to express was the real and endogenous character of economic growth. From this point of view, Fanno's theory of cyclical growth is

not far off current theories of endogenous growth, in fact it is even more complete in certain aspects as it integrates the real part with the monetary part of the economic analysis.

Chapter-4- This chapter will introduce the most significant aspects distinguishing the economic thought of Costantino Bresciani-Turroni. After a brief exam of the principal point of view produced by the well-know exegete of liberal thought, the authors are going to investigate the perspective from which Bresciani-Turroni draws up his vision in relation to the concept of freedom, the role of the State in the economy, the function of social welfare and social justice and his methodological approach. To conclude the author's dissertation, the authors will illustrate a suggestive analysis concerning an expansion of economy based exclusively on loans and credits.

Chapter-5- In this paper the authors review and assess the contribution of Italian scholars to a number of theories of value and prices, as well as income and wealth distribution, starting from Thomas Aquinas and Ferdinando Galiani. Then the authors shall consider the classical School (Ricardo in particular) and its interpretation by Luigi L. Pasinetti in his 1960 seminal paper. The authors shall proceed, then, with a brief account of the approach to income distribution of the marginalist (or neoclassical) School, with reference to Vilfredo Pareto. But the authors shall above all concentrate on the contribution of the post-Keynesian School of income and wealth distribution, founded by Nicholas Kaldor, Richard F. Kahn, Joan V. Robinson and Luigi L. Pasinetti in the middle 1950s. The focus of their analysis was to investigate the relationship between the steady-state rate of profits on the one hand, and the saving propensities of the socio-economic classes and the growth rate of the economy on the other. It is worth noting that during these last 50 years about 100 Italian scholars operating within or outside Italy have published no fewer than 400 papers and 20 volumes in this field. The Anglo Italian post-Keynesian School of economic thought has gained a safe and sound entry in the history of economic analysis. In order to evaluate this vast scientific literature the authors divide the research program into seven specific lines: (1) the introduction of a differentiated interest rate on wealth of the classes; (2) the introduction of the monetary sector and of portfolio choice; (3) the introduction of the public sector and of the Ricardian debt/taxation equivalence; (4) the inclusion of other socio-economic classes; (5) the introduction of the micro-foundations; (6) the analysis of the long-term distribution of wealth and of the income share of the socio-economic classes; (7) other general aspects, in particular the applicability of the Meade-Samuelson and Modigliani Dual Theorem. As it may be seen, these research lines cover a wide spectrum of modern economic theorizing. Additionally they provide a bridge with alternative ways of problem-solving in economics. The references provided at the end of the paper include only part of the vast literature of this area.

Chapter-6- Nicholas Georgescu-Roegen has experienced criticism directed at the theory of the behaviour of the consumer based on the usefulness and the excessive recourse to mathematical modelling. As such, he decided to address the complexity of human nature seeking new instruments of analysis resorting to the sciences of life and thermodynamics. In the essay, the authors analyze how from this criticism the Author manages to interpret the economic process in light of the entropy that sanctions an irreversible degradation of energy, one which he also extends to matter. Georgescu-Roegen states that man for his sustenance and his esosomatic evolution uses, through the economic system, matter and energy with a low entropy on the planet. As such, the relationship between man and the environment is neither only biological, nor only economic, but bioeconomic. And the last aim of the

economic process is not to use resources and to discharge waste products into the environment, but is «the enjoyment of life».

After having examined the progressive evolution of the concept of this author and the elements of the enjoyment of life, the authors highlight how the bioeconomical approach has been easily absorbed into the Italian tradition, where the theoretical contributions of analysis of the economic and social system in its entirety are numerous in order to realize the well-being of the individual and valuing the resources of the land in which they live.

Chapter-7- Geo-economic analysis of urban territories studies the economic, social and political mechanisms that govern the organisation and differentiation of urban land use on the one hand, and the functioning of urban networks on the other. The *geography of the city* explains how economic functions, households and social groups locate within urban space, and proposes models of urban land use. The *network approach*, instead, views cities as nodes in urban systems of different scales, and analyses both the horizontal relationships (hierarchies, complementarities, and specialisations) between nodes in the network and the vertical relationships of nodes with their local *milieu*.

This dual perspective is well established in the international literature, and serves as a reference point from which to discuss the contribution of Italian geography to the study of the urban phenomenon, with special emphasis on the geography of networks and the scientific role of the Scuola di Torino.

Chapter-8- Adam Smith didn't develop his ideas about education in a chapter or in a concrete section of his work. His general research interests can be grouped into three sections: justice, moral and economics, and education can be included in all of them. In his analysis of justice, he considers that education exists in all kinds of societies and in their evolution the families, especially fathers, must be concerned about the education of their children. The reward of this effort to acquire education is that the salaries will be higher and must compensate the education expenditure. And considering an economic perspective, there is a relationship between education and the factors and variables that are growth-enhancing. In this sense, education is one element that can help to develop the division of labour's positive aspects and eliminate the negative ones. Economic advancement is achieved, among other things, through education. The main goal of this paper is to analyze all these relationships and show education's effects on those quantitative and qualitative factors, such as, division of labour, inequality, commerce, social strains, and social capital. It plays an important role in the economic growth process from Adam Smith's point of view.

Chapter-9- During the last decades, companies have been increasingly paying attention to Corporate Social Responsibility (CSR) ambits, and literature about CSR has grown exponentially. In those works it hasn't been usual to see the connection between CSR and Adam Smith's thought. Smith is seen as the father of orthodox economy. But a part of Smith's writings has been forgotten in those establishments.

The aim of this paper is to present Adam Smith as a profoundly ethical author, whose moral writings can lodge the more recent CSR standpoints. Some relations between Smith's moral thought and CSR will be established.

Chapter-10- The notion that the quantity of money in an economy might be endogenously determined has a long history. Even so, it has never been part of mainstream economic thinking which has remained dominated by the view that the policymaker somehow controls the stock of money and that interest rates are market-determined. However, the need to design and operate a monetary policy that works for modern economies as they are currently

constructed, has led to the emergence of the so-called ‘new consensus macroeconomics’ in which it is recognised that the policymaker sets a short-term interest rate and the quantities of money and credit are demand-determined.

This chapter looks at the way in which this ‘new consensus’ is (at last) forcing a recognition, in the teaching of money, that the money supply is endogenously determined. It also shows how the authors can take this further by adding a banking sector to a model of the real economy in which the money supply is endogenously determined.

Chapter-11- The aim of this chapter is, first of all, to survey the main theoretical positions with regard to the externality problem, paying special attention to Pigou’s original formulation of external effects and to the differences between Coase and the Austro-Hayekian approach. In practice, the position of “free market environmentalism” toward pollution fits the Austro-Hayekian ideas. For this reason, in the second place and by way of illustration, the possibilities and limitations of “free-market environmentalism” viewpoint with regard to real pollution problems will be discussed.

Chapter-12- Economic growth is a central concept in the economic theory. Modern societies refer to growth as an important determinant for rising standards of living. These effects can be observed not only in more goods and services, but also in brand new products and processes. Investment in human capital is looked upon the very source of long-term, sustainable economic growth. The purpose of this chapter is to provide a brief description of the economic growth, how to analyze its measurement, and also to review briefly the main schools of economic thought that have undertaken its analysis.

Chapter-13- The aim of this chapter is to review theoretical background related to the life cycle hypothesis. The authors take into account new demographic situations, where life expectancy increases, elderly population increases, number of children decrease and, therefore, it will be necessary to consider who is going to care for elderly and dependent people. In this paper, the authors consider that savings can contribute to mitigate consequences of dependence, because people can use savings to obtain services related to dependence.

The mathematical model proposed is an extension of the life cycle hypothesis. The authors analyze Modigliani’s life cycle hypothesis and the authors use his analysis to introduce savings necessary to cover dependence; this revision will show the importance of savings and besides the authors will be able to discuss the need to finance long-term care services in the case of dependence.



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*Chapter 1*

## **MAKING A DISCIPLINE: ECONOMIC POLICY IN ITALY BEFORE KEYNES**

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### **ABSTRACT**

This paper concerns the appearance in Italy of economic policy as discipline, before the leading contribution of Keynes. We will try to show that the economic policy idea as conceived by Italian economists evolved independently from pure economics analysis or, better, it grew because the discourse on economic policy was progressively excluded from pure and applied economics. This exclusion occurred as the debate, firstly on economic art and then economic policy, gradually shifted from trade policy to state intervention in trade policy, and then to state intervention for economic growth and well-being.

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### **1. INTRODUCTION**

In the mid-nineteenth century, Angelo Messedaglia<sup>1</sup> and other scholars dealing with the question of what the state can do to increase national wealth maintained that, if a starting point existed, it should be the transformation of the then vague concept of *economic art* or *science of public administration* into a more solid and definitive discipline (Messedaglia, 1865-66, p. 15). A research programme with a strong ‘law and economics’ characterisation was drawn up to induce Italian economists to investigate the

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<sup>1</sup> Angelo Messedaglia (1820-1901) was at that time an important economist-statistician at the University of Verona.

legislative and government measures targeted on regulating private economic relationships and to augment national wealth (Messedaglia, 1920, p. 11);

and it marked out a new area of studies, which at the end of that century was named *economic policy*.

The evolution of this endeavor proceeded through conceptual stages, the first of which was the growth of trade policy studies as a consequence of the establishment of business schools (*scuole di commercio*)—the first of them being founded in Venice in 1868. Firstly, trade policy became a policy on international exchanges, duties, and customs, in a historical phase during which the state was gradually called upon to enact new interventionism in addition to its classic subsidiary functions. Only subsequently did trade policy evolve into international economic policy; that is, into an instrument for safeguarding the national interest. This introduced the last stage characterized by increasing attention towards all policies, not only trade policy, which might equally augment national growth.

This paper seeks to show that the economic policy idea as conceived by Italian economists evolved independently from pure economics analysis; or, put better, it grew because the discourse on economic policy was progressively excluded from pure and applied economics. This ‘exclusion’ occurred as the debate, firstly on economic art and then on economic policy, gradually shifted from trade policy to state intervention in trade policy, and then to state intervention for economic growth and well-being.

## 2. THE FIELD OF ECONOMIC ART

In the textbooks<sup>2</sup> of the mid-nineteenth century, science and practice—that is, pure economics and economic art—were not clearly related to separate fields of economic policy. Francesco Ferrara<sup>3</sup> argued in his 1857 and 1858 academic courses that

theory and practice, science and art, must be both treated as premises to the same syllogism, as two sides and phases of the same branch of human knowledge (Ferrara, 1935, p. 618).

According to Ferrara, the strict interdependence between the two concepts of theory and art meant that they could not be treated separately. However, given the youthfulness of economic science at the time, he did not exclude a later distinction between the two fields. The relevance of Ferrara’s statements went beyond methodological disputes, because once the indissolubility between science and its applications had been posited, it was impossible to justify practices such as monopoly and protectionism by attributing them to the realm of praxis or applied economics instead of to pure theory. By rejecting any distinction between science and art, Ferrara excluded any justification of these practices contrary to *laissez-faire*.

Other contemporaries seemed cautiously interested in the distinction between rational (pure) and applied economics proposed by Pellegrino Rossi<sup>4</sup> and opposed by Ferrara. More

<sup>2</sup> The textbooks written by Italian economists constitute our main source.

<sup>3</sup> Francesco Ferrara (1810-1900) was one of the most important liberal Italian economists of the nineteenth century. He held various political offices. He promoted publication of the first series of the *Biblioteca degli Economisti*.

subtly, they differentiated between 'pure economics' and 'economic art,' where the latter did not coincide with 'applied economics.' This proposal of a sharp separation caused misgivings in Angelo Messedaglia, because

it would reduce science to a few and abstract principles [...] while it would disproportionately enlarge the field of economic art (1851, p. 30).

On the contrary,

observation and experience [...] continuously subsidize speculative science, defining its boundaries (Ibid.).

In 1874, in the introduction to his *Economia dei popoli e degli Stati*, Fedele Lampertico<sup>5</sup> wrote as follows concerning the proximity of pure and applied economics:

The sole difference is that pure theory studies general rules, while applied economics focuses on particular rules. But every type of rule is a true object of science (Lampertico, 1874, p. 73).

However, he was aware that a third field existed: *economic art*, or the set of teachings of which one makes use applying the precepts established by rational and applied economics (1874, p. 74). Thus, economic art involved *experimental* research grounded on specific knowledge of facts and conducted to achieve specific objectives. For this reason, economic art was clearly demarcated from both pure economics and applied economics.

Economists frequently resorted to categorization in pure economics, applied economics and economic art, even if it was interpreted or named in different ways. Antonio Ciccone<sup>6</sup> did not take art to be the implementation of economic rules, but rather as customs on which those economic rules are founded (1874, p. 17). Luigi Cossa<sup>7</sup> reversed applied economics and economic art, but he maintained the functional distinction between them in three areas. Moreover, he stated that

science, art (applied economics) and practice (economic art) complement each another, and it is erroneous to believe that one can take the place of another (Loria, 1876, p. 8).

Concepts such as economic art were initially introduced into the economic lexicon in order to mitigate the inconsistencies between what the abstract rules of pure economics affirmed and how they were applied, especially in trade policies. In this regard Fedele Lampertico's thought was not so distant from Ferrara's: both rational and applied economics establish the ends of economics itself, although the former is entirely abstract and the latter is historicized. Obviously, because they were grounded on the operations of the market, neither rational nor applied economics raised the question of what instruments should be used to achieve economic objectives. However, when market failures emerged, or when the state

<sup>4</sup> Pellegrino Rossi (1787-1848) taught Political Economy at College of France and Constitutional Law at la Sorbonne, Paris.

<sup>5</sup> Fedele Lampertico (1833-1906) is mainly known for his five-volume *Trattato di economia dei popoli e degli stati*.

<sup>6</sup> Antonio Ciccone (1808-1893) pursued his academic career at the University of Naples.

<sup>7</sup> Luigi Cossa (1831-1896) was professor of Political Economy at the University of Pavia. He was associated with the reception and dissemination of the German School in Italy

conditioned (international) markets, another discipline studying those 'instruments'—economic art, subsequently economic policy—was to gain ground.

### 3. COMPARATIVE COSTS THEOREM AND TRADE POLICY

Impetus was given to the gradual constitution of economic policy as a field concerning the instruments to pursue political economy purposes by the strengthening of trade policy, which in the mid-nineteenth century consisted essentially in a policy of commercial treaties. According to many authors of that period, the general reliance on treaties to regulate exchanges between countries was one example of economic art used to push states towards free trade. By means of treaties, commercial relations among countries would approach the conditions depicted by the Ricardian comparative costs theorem, which in the meantime was becoming a fundamental principle of economic science. Trade agreements were conceived thus by Gerolamo Boccardo<sup>8</sup>, who, in his 1858 *Manuale di storia del commercio delle industrie e dell'economia politica*, described the lowering of duties by the German regions—known as Zollverein (1858, p. 352)—as a typical case of free trade achieved by means of commercial agreements. For Boccardo, the then English process of progressive abolition of customs barriers was the most advanced instance of free trade (1858, p. 358).

In the mid-nineteenth century, the signing of trade treaties was conceived in practice as an instrument of free trade, and as affirmed by Angelo Marescotti<sup>9</sup> in his *Catechismo della economia politica* (1861, p. 118), it had political implications:

The wide extension of modern international trade, the innumerable, frequent and complex relationships linking distant marketplaces have produced an important new phenomenon unknown not only to the ancients but also to the last generation. We refer to that intimate and universal solidarity unifying peoples geographically very distant from each other (Boccardo, 1858, p. 382-3).

This quotation from Boccardo introduces the crucial question of who the true protagonists of commercial relations were: markets or states? Markets, clearly, because in those years trade policy was the set of political measures aimed at bringing real exchanges closer to those described by the free trade theory.

This is a key point, because a few years after Boccardo's writings, trade policy was perceived in a very different way. Faith in the free-trade law did not change, as Cossa showed:

Originating from property rights and from equality applied to economic relationships, the laissez-faire principle contributes to spreading useful discoveries, to strengthening peace and fraternity among people, and it represents a rational complement to other kinds of progress (Cossa, 1876, p. 78-9).

<sup>8</sup> Gerolamo Boccardo (1829-1904) is mainly remembered for his four-volume *Dizionario dell'economia politica e del commercio* (1857-61).

<sup>9</sup> Angelo Marescotti (1815-1892) taught Public Economics at Bologna from 1859 to 1881.

What changed, however, was the idea that the principle could not or should not be subject to mitigation or adjustment in its real implementation. In his *Elementi di economia politica*, Cossa himself pointed out that, first, the change to free trade

should be a gradual, and not a sudden movement, suitably enforced with regard to both timing and methods; second, it must be coupled with other measures mitigating temporary drawbacks [...] affecting those industries exposed to the consequence of radical systemic changes (Cossa, 1876, p. 83).

The instrument which enabled this gradual opening of markets was once again the commercial agreement, all the more so if it included the reciprocity law. In the space of a few years, however, this accepted notion of the trade agreement changed: the latter no longer regulated market relationships, but rather state relationships.

The change in the function of this basic economic policy instrument concealed a discontinuity in the discourse on economic policy or economic art. At first sight, the focus now shifted to the subject of trade policy, namely the state. This shift was recognized by economists and scholars, but it was nothing more than a change in the image of the state and its role in international economic relations. That the issue concerned the subject of international economic relations was confirmed by Bastable (1900, p. 5), who spoke of 'international trade' as 'trade between societies' i.e. between the different social organisms which sociology assumes as its field of investigation. Pure economics attributed subjectivity to markets; applied economics and economic art did so to states; and sociology to societies. Consequently, the same trade relationships changed subject according to the disciplinary perspective, thus confirming firstly that pure economics and economic art (or policy) were progressively distancing themselves from each other, and secondly that the new state's subjectivity needed a new disciplinary field.

Why did this shift from market to state occur? Economic growth could be ensured by markets and states, the latter by means of protectionism. Governments found new rationales for intervening in markets because they seemed to yield inferior outcomes. Moreover, as a consequence of state intervention to regulate international exchanges, trade policy was transformed into a policy for a community progressively identified with the state. It was no longer a policy for markets. Shortly afterwards, in 1907, Luigi Fontana-Russo<sup>10</sup> wrote:

Now, speaking of trade policy, we mean that international exchanges occur between states and not between markets (Fontana-Russo, 1907, p. 13).

In the last decades of the nineteenth century, economic policy largely signified state intervention hinged on trade policy, although this was no longer purported to ensure solely the well-being of individuals, families, economic classes, but also the well-being of society as a whole, that is, of the state (Fontana-Russo, 1907, p. 13). This statist wave did not imply mercantilist resurgence; rather, it was the first symptom of the subsequent subjugation of trade policy to national economic objectives. This occurred when trade policy, and not just international exchanges, was seen as a source of national wealth.

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<sup>10</sup> Luigi Fontana Russo was Professor of Trade Policy and Customs Law at the Regio Istituto Superiori di Studi Commerciali.

This evolution increased the then unclear difference between pure theory of international exchanges and trade policy. Economic art was no longer the field in which instruments to achieve pure economics objectives were devised. A passage in Pantaleoni's *Principii di economia pura* stressed that the implementation of Ricardian theorems in international exchanges concerned applied economics without any interest for us pure theoreticians (Pantaleoni, 1894, p. 215 note 1). The theory of international trade should be applied to markets; trade policy concerned state relationships, and was thus gradually excluded from pure economics. Two areas of research were emerging: the first on theories, and the second on policies.

### 3.1. On International Exchange Theory

Before the free trade-protectionism debate is investigated to explain the market/state shift, it may be useful to outline how textbooks incorporated the theoretical research embodied in the Ricardo-Mill comparative costs theorem.

Generally speaking, the Ricardian theory of comparative costs was the framework of almost all textbook sections on international trade. If free trade had advantages, they were depicted by the above-mentioned theorem. Barone wrote that:

apart from its rudimentary form, which ignores many circumstances, and apart from a slight imprecision deriving from its focus on the concept of production cost and its neglect of utility or demand, Ricardo's reasoning was exact, and the comparative costs theorem has been widely confirmed by experience (Barone, 1915, p. 112).

At most, some integration or adjustment could be made to the theorem.

The manuals bear traces of the broadening of analytical scope due to the Marshallian curves of reciprocal demand illustrated by Maffeo Pantaleoni<sup>11</sup> in his *Principii* (1894, p. 236 ff.). In this regard, Augusto Graziani<sup>12</sup> (1913, p. 141), when discussing the case of country monopolistic production, emphasised the reciprocity of demand, which contradicted the rule that the current value of imported and exported goods was based only on costs. In general, both supply and demand would influence international price-making:

We cannot exactly speak of international normal value as the point on which market values converge, but we can assert that the change of international values determined by reciprocal demand ranges between boundaries fixed by the country's comparative costs (Graziani, 1913, p. 143).

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<sup>11</sup> Maffeo Pantaleoni (1857-1924), graduated in law at Rome and then pursued his academic career at several universities, among them Macerata, Geneva, and Rome. He was also Deputy (1901-04) and Senator (1923-24) in the Italian Parliament. Besides his well-known and influential 1889 *Pure Economics*, he wrote on public finance, banking, economic dynamics, and social topics.

<sup>12</sup> Augusto Graziani (senior) (1865-1944) taught Political Economy and Public Economics at Naples University.



Vilfredo Pareto,<sup>13</sup> in both the *Cours d'économie politique* and the *Manuale di economia politica*, argued for the difficulty of applying a subjective notion of production cost to international trade. This could be done by envisaging a production cost as a sacrifice—a concept comparable to that of utility or ophelimity—although the problem of extending it to a country or community persisted (Pareto 1964a, p. 210-12). Among the other issues mentioned by Pareto were the different currencies used in international exchanges and the inclusion of transportation costs in price-making. For these various reasons, Pareto preferred a comparative costs theorem founded on the notion of price instead of cost.

According to a purely economic approach, protection consists of nothing more than a specific application of the Ricardian theorem. This viewpoint is clearly expressed in Pareto's *Manuale* and Barone's *Principi di economia politica*. By contrast, if an applied perspective is adopted, protectionism is the *main* policy problem.

## 4. TRADE POLICY BETWEEN FREE TRADE AND PROTECTIONISM

The changing conception of trade policy from market to state relationships can be better understood by investigating a subject recurrent in almost all the economics textbooks of the late nineteenth/early twentieth century: the free trade/protectionism debate. This involved four main topics: infant industry; national economies; the resurgence of protectionism; and comparison between liberal and protectionist systems. These topics are indicative of the increasing awareness among Italian economists that trade policy did not fall within the domain of pure economics, but rather within an undefined field different even from applied economics.

### 4.1. Infant Industry

The infant industry theory is relevant to our purposes here because it was used to demonstrate the fallaciousness of a theoretical treatment of protectionism.

Free trade and the corresponding rejection of protectionist policies were mitigated when countries had to deal with infant industries. This softening of liberalism did not convince everyone, however. Pareto admitted in his *Manuale* that protection could be useful to safeguard infant industries; but he equally acknowledged that there were no examples of infant industries which had renounced such protection when they had matured. Although stating that infant industry should be protected in its early phases so that it can learn from its own experience—the Mill-Bastable<sup>14</sup> dogma, a legacy of Listian thought—may be acceptable in abstract, it reveals its fallaciousness in practice:

All industries born under protection have always demanded even more protection, never renouncing it (Pareto, 1964b, p. 322).

<sup>13</sup> Vilfredo Pareto (1848-1923) is considered one of the founders of the general economic equilibrium approach. See in particular his *Cours d'Economie Politique* (1896-97), *Manuale di economia politica* (1906) and *Trattato di sociologia generale* (1916).

<sup>14</sup> The term is taken from M.C. Kemp (1960, p. 65-67).

Infant industry protection should therefore be undertaken very cautiously, owing to the risk of its becoming permanent, not temporary.

Similar arguments were developed by Pasquale Jannaccone,<sup>15</sup> whose 1915 *Lezioni di economia politica* expressed all his scepticism concerning renunciation of the advantages of protectionism by infant industries:

The metaphor of rising and developing industry does not correspond to reality because it is not easy to recognize when the industry can do without protection, also because the individual firms belonging to an industry are at different stages of development and of competitiveness. Thus, protectionism is invoked by those firms that are in less favourable conditions (Jannaccone, 1915, p. 510-11).

According to these authors, the infant industry theory was confuted in practice.

Emilio Nazzani<sup>16</sup> put forward similar views. In his *Sunto di economia politica* he wrote:

The right of a country to protect its own industry is admissible only when it is temporary and is useful to acclimatize a particular industry in one country (Nazzani, 1921, p. 140).<sup>17</sup>

However, it is very difficult to reduce or to abolish a duty once it has been established, because of the opposition of interest groups advantaged by the duties (1921, p. 141).

On a theoretical level, the protection of infant industry gave rise to more doubts than certainties. Italian economists were not convinced by the then more advanced theoretical explanation of protectionism. Put simply, they conceived infant industry as nothing more than an ordinary protectionist measure; and protectionism did not admit to theoretical explanation because, as we shall see in the next section, it had a historical characterization.

## 4.2. The Specificity of National Economies

To return to Pareto, he seemed inclined to grant an autonomous field to applied economics, if not to economic policy. Notwithstanding his reservations about the infant industry theory, he recognized the difficulty of judging a priori the effect of either protectionism or free trade, even by comparing countries adopting different regimes, and this because of the many other circumstances distinguishing the countries. The effects on each country of either protectionism or free market are necessarily different:

It is erroneous to cite the United States' prosperity as an example of the usefulness of protectionism, or the United Kingdom's wealth as a proof of the usefulness of free trade (Pareto, 1964b, p. 329-30).

This statement justified the creation of an autonomous discipline which analysed each national case individually. Nor did international exchange theory appear immune to criticism. The fact that Pareto made use of the notion of 'exchange value' instead of 'international

<sup>15</sup> Pasquale Jannaccone (1872-1959) taught Statistics and Political Economy at the University of Turin.

<sup>16</sup> Emilio Nazzani (1832-1905) focused his studies on the classic theory of value.

<sup>17</sup> Nazzani's book, *Sunto di Economia Politica*, went into its 16th edition in 1921. The first edition was dated late 1870s.