

Ursula Hicks and Vera Lutz's contributions to development finance in the 1950-1960's

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Abstract: This paper analyses the different approaches of two well-known economists, Ursula Hicks and Vera Lutz, about development finance diverging views on the way to promote economic growth thanks to the development of financial institutions offer interesting insights. First, while researches in economics in the fifties focus predominantly on finance in already developed countries (Goldsmith, 1955 and Gurley and Shaw, 1959), Hicks and Lutz extended the analysis to low income countries and/or regions. Interested into the study of money and banking, Hicks and Lutz's researches stand also out from female economists' works not focusing much on those topics (Amsden, Birdsall, Krueger and Stewart).

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1. Introduction

The London School of Economics (LSE) seems to have occupied a special place in the emergence of development economics as a field of research. Indeed, by its openness, the LSE welcomed several overseas students from India or other countries belonging to the British Empire. The term "economic development" appeared for the first time in the work of historians, at the LSE, in the 1920s such as Vera Anstey and Lillian Knowles (as Heinz Arndt explained, 1981, p.458). A good amount of economists and practitioners, which will later specialize in the field of development economics, were trained (or studied) at the LSE: Colin Clark was a researcher at the LSE from 1928 to 1929, Arthur Lewis obtained a grant to study at the LSE in 1932, Nicholas Kaldor was an assistant professor from 1932 to 1947, Albert Hirschman studied there from 1935 to 1936, Ursula Webb-Hicks published her Phd dissertation in 1938, Vera Smith Lutz published her Phd dissertation in 1936, Alice Amsden did her Phd in 1971. Contributions focused mainly on two broad kinds of factors enhancing economic growth: the real factors (productivity, capital and land endowments and the growth of the population) and the monetary factors (the access to liquidity, aids or external loans the existence of a sound financial infrastructure). It seems that a small number of scholars in the fifties analyzed the importance of banking institutions to enhance economic growth in developing countries.

Although, in the fifties, two influential researches underlined that economic growth goes pair with the development of finance (Goldsmith, 1955 and Gurley and Shaw, 1959), the analysis remains oriented on countries already developed. Ursula Hicks and Vera Lutz belong to the few scholars giving an importance to money and banking issues for the economic development. Thanks to their contributions to development economics, Hicks and Lutz could be included in the list of Cooley and Van Der Meulen Rodgers (1999) who presented fifteen outstanding female researchers and practitioners in the discipline of development economics. In this list appears notably Alice Amsden, France Stewart, Nancy Birdsall, Irma Adelman and Anne Krueger.

We observe similarities into Hicks and Lutz's experiences in academics. They both did a Phd at the LSE, and their first researches dealt with developed countries. Lutz began

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studying the evolution of banking practices and the birth of central banks in Western Europe and Northern America, and Hicks wrote on the evolution of public finance in England. Their interest for developing countries rose in the fifties and sixties: Hicks studied the case of Nigeria, Jamaica, India and Sri Lanka, and Lutz focused only on Southern Italy whose development was lagging a lot behind that of the North (1950a, 1950b, 1951, 1956, 1958, 1962). They also shared a common interest for finance and banking theory. Hicks published *Development Finance* in 1965, and Lutz, in addition to her doctoral work on free-banking practices in 1936, discussed the role of banking institution into the debate about the dualism between the North and the South of Italy. We will however see in the forthcoming part that those authors have a different intellectual background, which drives her thought to different conclusions.

This paper does not cover all Hicks and Lutz's contributions to development economics. Hicks's several experiences within low-income countries make this task difficult². We rather chose to articulate Hicks's and Lutz's thought on the banking system to stimulate economic development, since they both contributed to development economics. About developed countries, Hicks and Lutz recognized that the creation of central bank was the result of a long experience. The main goal of central banks, notably in Great Britain after the first World War, was to stabilize and manage money in order to limit instabilities of prices and deficits of the balance of payment. In developing countries, the stakes were different. Hicks encourage the establishment of central banks in order to guide the policies of banks endowed with public funds, and also to finance public spending. Lutz did not have the knowledge and the experience of Hicks into the activity of consulting developing countries. Nevertheless, if one analyze the coherence of her writings, he/she could find some interesting elements about the role of the banking system to enhance economic development. From her doctoral dissertation, we learn that she is a partisan of free-banking practices, which discredit the utility of central banks. In the fifties-sixties, where she provided some extensive surveys on the development of Southern Italy, she thought that economic development can be accelerated by eliminating rigidities on the labor market and other market imperfections disrupting the free competitions between firms. However, the central bank and also banks occupy an important place in Lutz's analysis: to stabilize the level of price by conducting a correct monetary policy.

Our paper aims at bringing two outcomes. While researches in the field of finance in the fifties focused predominantly on the importance of financial institutions in already developed countries, Hicks and Lutz's approach offer interesting insights in history of economic thought. The plan is the following. The second part offers a bibliographical profile of Hicks and Lutz and discusses their intellectual background. The third part analyzes a convergence of thought between Hicks and Lutz on the importance of the development of a sound private banking system. Joan Robinson is integrated to this part. The fourth and fifth part stress a divergence of thought about the necessity of a central bank. While Lutz supports free-banking practices, Hicks promoted the establishment of central banks in developing countries. The six part concludes.

² In the Preface of *Development from Below* (1961) Hicks give a description of her fonctions as a civil servant in several developing countries. She stresses the various development plans conducted in different parts of Africa (Ghana, Kenya, Nigeria, Sierra Leone, Tanganyika, Uganda) and in India and Sri Lanka (called « Ceylon » in the sixties). Later in the sixties she also advised some Asian countries such as Malaya.

2. Bibliographical profile

Hicks did her Phd dissertation at the LSE under the supervision of Lionel Robbins, as she explained in the Preface of her thesis (1938, p.xxxvii). Her researches were specialized in the history of British public finance, and she taught this course at the LSE for many years. Even if Robbins had affinities with conservative's thinkers such as Ludwig Von Mises and Friedrich Hayek, it did not influence much Hicks who had been mostly influenced by Keynes. Wilfred David who did his PhD thesis under Ursula Hicks supervision at Oxford University wrote that «one of Lady Hicks's major contributions lies in the application of the theories of fiscal policy and the financial approach to the problems of the less developed countries» (David, 1973, p.xiii). Hicks's book *Development Finance: Planning and Control* was in 1973, David wrote, "one of the best available studies of the development process from the fiscal and financial angles" (1973, p.xiv). David again, in a book written in Hicks's honor (1973), distinguished two moments in which her contributions to economics unfold. A first phase from 1938 to 1954 concerns her contributions in the history of British public finance. Her Phd dissertation *The Finance of British Government 1920-1936* (1938) is reckoned as "the first attempt by a scholar to quantify the major aspects of British public finance" (David, 1973, p.xi). Hicks is also reckoned as a pioneer with her method of the cost/benefit analysis which enables a country to choose the plan which offers the greatest present value excess of benefits over costs. She wrote three other books on this topic respectively in 1946, 1947 and 1954. From Martin Feldstein, we learn that Hicks contributed to a framework for evaluating public investment projects in developing countries (Feldstein, 1973, p.4). A second phase begins in the sixties where Hicks got interested into the development of low income countries. She wrote three books about economic development (respectively in 1961, 1965, 1978), and she participated to a collective book edited by John Richard Hicks about the economic development of Ceylon (1959) where she went to advise the young central bank (as explained by Sue Van Atta and Edita A. Tan, 21 July 1970, University of Philippines). She directed the thesis of some bright young economists at Oxford who later occupied key positions in institutions and universities: Gamani Corea, Martin Feldstein and Nicholas Kaldor. Corea made a dissertation (« Instability of an Export Economy », 1975) on the limits of policies promoting aggressive exports for small economies such as Sri Lanka. He joined the central bank of Ceylon at its creation in 1950 as a 'young recruits' (Kelegama, 2004, p.15). Feldstein specialized into the field of public finance in developed countries (1985) and Nicholas Kaldor focused on the case of developing country (1963), in addition to his numerous research on economic growth. Hicks was also a civil servant. She served as an economic adviser for the government of Caribbean, India, Jamaica, Malaysia, Nigeria ("advisory Commission") and Uganda. In 1965, with Margaret Hall, Hicks was the first women allowed to integrate the Oxford University Political Economy Club (as written by FitzGerald and Heyer, 2011, p.40).

Lutz did her Phd dissertation at the LSE under the supervision of Friedrich Von Hayek. She did not follow an academic career like Hicks, and followed an independent career. Lutz's first research work, published in 1936, was on free banking practices and questions the necessity of central banks within the economy. Some wrote that Lutz continued Hayek's work on the evolution of money and banking, who could had to delegate his project when he was appointed Professor at the LSE (Huerta de Soto, 2012,

p.631). Several economists such as Milton Friedman³, Lawrence White⁴, Selgin (1988) and Glasner (1989) congratulated Lutz's works about free banking. Lutz was also with Friedrich Lutz a member of the Mont Pelerin Society. Lutz's interest towards development economics arose in the fifties where European countries were adopting public investment plans in the war aftermath. Lutz limited her researches to the case of Southern Italy and France. Following Guirao and Lynch (2015, p.47), Lutz got interested into the plans adopted by the French government in order to reveal their inconsistency. At the time she wrote, economists were supporting public interventions, and the experience of France was giving the beliefs that those interventions was necessary to enhance economic growth⁵. Indeed, from 1947 to the mid-sixties, French government chose a policy of economic « dirigisme » rather than policies encouraging free-enterprise and competition. Some key companies (gas and electric power industries, coal mining, the main line rail way SNCF, Renault one of the biggest motor company, the Bank of France and also four deposit banks and the larger insurance companies) was nationalized in the war aftermath. Kindleberger's *Europe's Post War Growth, the Role of the Labor Supply* (1967) gives a complete picture of the five-steps of the French planning from 1947 until the mid-sixties, and directly refers to Lutz's works. In addition to nationalization, the planning also consisted in imposing productive objectives to firms in some key sectors (« indicative planning »), and it imposed also control over prices, and a policy of selective credit from commercial banks to companies, and also qualitative control on financial market (companies had to be personally allowed by the Ministry of Finance to issue fixed-interest securities). Lutz's critics concern mainly the choice of the Ministry to fix prices. Fixing prices is according to her a way to avoid uncertainty on future price at which commodities are sold, and also to coordinate individual actions. However, since price signals are a good basis for making investment decision, they should be determined freely by the market. It follows her theory of the firm (Lutz and Lutz, 1951). Lutz supports the « German view » according to which economic efficiency is improved if prices and actions of private agents are freely driven⁶. Despite two books (1965, 1969) and one chapter written in 1964, Lutz's contribution to the French experience did not receive much attention from economists (apart from Kindlergerger in 1967). However, her interpretation of the

³ Friedman wrote about a new edition of Lutz's book published in 1990 that "Vera Lutz's book remains an authoritative and accurate summary of the theoretical arguments for and against free banking, a subject that has recently received renewed attention"

⁴ About Lutz's book, White wrote in the new edition of Lutz's book (1990) mentioned in quote n°2 that « The Rationale of Central Banking is a rare classic in monetary economics. It provides still the best account available of how and why the United-States and several European countries acquired the central banks that dominate their monetary system today". White wrote also in 2014, p.8 that the issue of free banking was not extensively studied in the twentieth century with the exception of Ludwig von Mises (1928). A renewed interest have arisen with the work of Hayek (1976, p.16), White (1984), Selgin (1988) and Glasner (1989)

⁵ For instance, in 1961, Chancellor of the Exchequer Selwyn Lloyd and two years later Christopher Saunders suggested to implement similar planning policies in England. Lutz worried about this political direction (1969, p.62).

⁶ Lutz wrote : « The collection of information and prediction are themselves competitive activities ; and the right of individual operators to exploit their particular advantages or talents in this domain cannot be suppressed without striking at the roots of free enterprise and risk-taking » (1969, p.117) And she also wrote : « It [the « German view »] holds that all official 'programming by branch of product, even if limited to forecasting, constitutes state interference with the mechanism of business decision making and the free-enterprise because it may render business men less free or willing to do their own forecasting, make independent decisions, and assume responsibility for the consequences » (1969, p.107)

theory of “wage dualism” (to paraphrase Graziani, 1983, p.4) in Italy gave rise to reactions in the academic debate, as Ganni Toniolo explained in a recent book (2013, p.147). Her article is « Some Characteristics of Italian Economic Development 1950-1955 » (1956). Italy interested her because of the difference of economic growth between the Northern and the Southern region. As an aside, Friedrich Lutz and Vera Lutz were part of a team of conservative thinkers appointed by the Bank of Italy in order to make researches on the Italian economy, as reported by Paolo Baffi (1985, as noted by de Cecco, p.17)⁷. Lutz offers an analysis of the persistent regional differences between the North and the South of Italy by extending Arthur Lewis’s theory of dualism⁸ to the Italian case. While the Italian government was launching several public plans (like the « Vanoni plan ») aiming at reducing the differences between the North and the South⁹, Lutz explained that economic dualism in Italy was due to differences in wages between the North and the South of Italy. In the North, wages were higher than in the South because of powerful workers unions. Companies were therefore encouraged to invest in more capital-using techniques instead of recruiting labor force. In the South however, companies were much less constrained by (inexistent) workers unions so wages were lower than in the North and companies could therefore recruit more workers. Lutz’s remedy to the economic dualism in Italy was to reduce the power of workers union, and also to encourage the departure of Southern Italian workers to the North (Lutz, 1962, p.314-315)¹⁰.

3. The nature of money and the development of private commercial banks: Hicks, Lutz and Robinson

We note a convergence of thought between Hicks and Lutz about their approach to money and credit. At the early stage of the development of an economy, exchanges between traders happen thanks to the use of commercial bills (representing indebtedness between two merchants). A bill is a promise of delivery of goods against money at a future date. For instance, if a wholesaler A delivers goods to a retailer B and B promises to pay A in money at a later date then a debt or credit is created from B to A. When wholesaler A accepts the debt or credit of retailer B, goods are delivered to B. Once it is contracted between two merchants, the process of production can be launched. This is why private credit is “vital to development” in Hicks words¹¹. Lutz used presented the same idea and developed three systems of emission:

⁷ See also Maes, 2013, p.2

⁸ Spaventa gives the following definition of dualism: “Dualism is a paradox, in that a sector remains backward even though the economy as a whole is growing and the overall rates of capital accumulation and of income growth continue at a high level: growth taking place in a part of the economic system does not benefit the remainder: and the excess labour force in one sector is not absorbed by capital accumulation in the other. (Spaventa, 1959, p.201-202)

⁹ Lutz wrote « It had been a popular exercise at one time to make calculations of the total volume of public works and other investment expenditures that would be required, especially in the South, to get rid of unemployment there within a shorter or longer period » (1962, p.299)

¹⁰ Lutz wrote « If the demand for labour in the North of the country continues on the same high level, the most efficacious form of government aid to the South (...) may be financial and other assistance to workers and their families for migrating. The consequent relief of population pressure on the South may well be the factor which finally tips the balance in favour of that process of ‘autonomous’ economic development and industrialization within the area which will gradually bring the average income per head there closer to parity with that in the North. » (Lutz, 1962, p.314-315)

¹¹ The provision of credit for private enterprise is vital to development (Hicks, 1965, p.58)

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Assuming that a paper currency is a desirable adjunct to country's commercial development, we may conceive three alternative ways in which its issue may be undertaken: a) it may be subject to the exclusive control of the state; b) it may be delegated to the control of a single private institution; c) it may be left to the free competition of a large number of banks of issue (Lutz, 1936, p.10)

To analyse the creation of credit before the creation of money is characteristic of a tradition of thought in England whose precursor is Henry Thornton (1802). In the twentieth century we can consider that his disciples are Ralph George Hawtrey (1919 and 1932), John Maynard Keynes (1930, I and II) and John Richard Hicks (1989). Joan Robinson is also part of this tradition of thought, because she introduces money after the creation of credit. The nature of money is to cancel debts¹²:

Money is whatever is acceptable for discharge of obligations between members of the society concerned; the official money of a government is made acceptable by being 'legal tender' for the discharge of debts within the nation (Robinson, 1979, p.5)

Confidence on the market for bills – required for the bills to circulate – comes from the confidence between merchants in their capacity to honour their promise to reimburse their debt at a future date. This idea is presented in Lutz and Hicks's writings and also in Robinson's writings (1979, p.82). Hicks underlined that one problem dealing with the establishment of banks within certain developing countries is the high risk of bankruptcy. This risk dissuades the activity of banker and explains a high level of interest rates charged on loans (Hicks, 1965, p.58). Lutz gave an example of paper money used as money thanks to the confidence of people in it, the Goldsmiths. They were a certificate of indebtedness that banks gave once merchants deposited money. With the spread of their use, the Goldsmiths started to be used as money and people holding it could purchase good with those notes (Lutz, 1936, p.11).

One interesting thing with Robinson which link her to Hicks and Lutz is her interest into finance in developing countries. Without developing too much on Robinson, she adopted a similar approach of credit in *The Accumulation of Capital* (1956, book IV, p.226)¹³. Robinson studies an economy in which the only form of borrowing is by discounting bills (which is a debt), and the bills (or debt) comes from the private mercantile sphere. Two decades later, focusing on developing countries in *Aspect of Development and Underdevelopment* (1979), Robinson stressed the importance of banks as dealers of debts.

Indebtedness precedes the process of production, and come before the creation of money. Bills are created within the sphere of merchants. Money is used to cancel debts, and merchants exchange debts against money in order to pay for the wages of their workforce and purchase raw materials. The nature of money is therefore to cancel debts,

¹² It is often said that in Robinson's thought, the development of finance comes after the process of economic growth. Indeed, in the part entitled 'Finance' of her article "The Generalization of the General Theory" (1952), she wrote that "the supply of finance cannot be regarded as a rigid bottleneck limiting the rate of investment, but must be treated rather as an element in the general atmosphere encouraging or retarding accumulation" (1952, p.87). Finance seems to be a minor factor enhancing the capital accumulation. But if one reads her fourth book of *The Capital Accumulation* (1956) it is clear that the market of commercial bills, and the existence of banks are crucial elements to permit the accumulation of capital.

¹³ Louis Philippe Rochon devoted an interesting chapter on Joan Robinson's theory on money and credit in a book published in 2005 by Bill Gibson.

and is endogenous to the economy¹⁴. This way of considering money, very specific to the British tradition we were referring above, enables to understand the liquidity constraints of private agents and also the clearing functions of the banking system. Banks are not only considered as pools of money coming from the savings of agents, but as money creators in order to respond to the need of liquidity of private agents. Robinson presented banks as liquidity providers and wrote that the creation of money should follow the need for finance of private agents¹⁵. Hicks and Lutz emphasized also the clearing functions of banks, even if their theory of money is much less theorized than Robinson's one.

One major problem that developing countries face in order to have access to finance is the weak development and use of commercial credit according to Hicks (1965, p.52 and p.57). In *Public Finance* (1965) Hicks presents all the forms of finance that a country can use to increase its spending. Even if it is clear, for Hicks, that the quality of a development plan depends on organization's skills, access to real resources and efficient workforce, finance is as well important because it enables to measure the overall costs of a development plan (1965, p.35). A country should seek to develop his own commercial credit market in order to avoid to depend on foreign aids and loans (1965, p.38). The formation of a certain stock of saving in banks is necessary to be independent from foreign funds. Unfortunately, it is rarely the case in most low-income countries, not because households do not save (Hicks explains that the sense of saving is well present in the mind of peasants in developing countries, she gives the example of Nigerian cocoa farmers in 1965, p.47-48), but because of the absence of a sound banking system which could centralize and secure savings. Centralizing and securing funds enables to finance projects aiming at building key infrastructures for a future sustained growth (access to water, schools and hospitals and the building of roads...).

While in developed countries such as Britain or the United-States, the financial infrastructure has developed "spontaneously" over time (Hicks, 1965, p.58), developing countries do not have the same experience. Hicks thinks that the knowledge and long experience of developed countries should serve for the establishment of a sound financial infrastructure within developing countries (Hicks, 1965, p.52)¹⁶. Hicks advises those countries to "follow an aggressive policy of 'selling' banking even in remote rural areas" (Hicks, 1965, p.57). Banking practices cannot be immediately adopted without the help of public authorities according to Hicks, who wrote that "in a

¹⁴ She indeed wrote: « Notes bearing the name of a respected bank are acceptable to retailers and others entrepreneurs and so provide a medium for paying wages. The notes now circulating came into existence as the results of loans from the banks to entrepreneurs, who pay out wages in advance of receiving the proceeds of selling the goods which the workers produce. For the moment we are assuming that the only form of borrowing is by discounting bills (long-term bonds will be introduced later). A bill represents an undertaking to pay a certain sum at a specified date (say in six months' time) which is sold to-day for a sum in notes less, by the discount, than that for which the bill is drawn". (Robinson, 1956, p.226)

¹⁵ She wrote : « As national income increases, with a given pattern of habits of payments (the 'velocity of circulation of money'), there is a certain growth of the total stock of money that is required by the public. When the government and the banking system prevent the stock of money from increasing fast enough, finance is restricted, rates of interest rise and investment of all kinds is checked; when the quantity of money increases relatively to requirements, credit is easy and borrowing is stimulated" (Robinson, 1979, p.83)

¹⁶ Robinson remains silent on the necessity to encourage the creation of a sound financial infrastructure in developing countries financed by public funds. She mostly encourage the use of external funds (1979, Chapter 5)

development country such institutions are needed here and now, and so must be deliberately created” (Hicks, 1965, p.58). One reason is the high “lending risk” which discourage lenders to invest in projects (Hicks, 1965, p.58). Higher the lending risk, higher is the interest rate charged on loans. The existence of a strong banking system should permit the reduction of interest rates on loans, to avoid cash hoarding and to facilitate the funding of productive investments. Credit should be facilitate for small and/or large businesses with the establishment of an Industrial Development Corporation and an Agricultural Credit Corporation (Hicks, 1965, p.58) which would aim to promote investments in less developed regions.

In *The Rationale of Central Banking and the Free Banking Alternative* (1936), Lutz studied the evolution of the banking system since its beginning in six countries and/or regions: England, France, United-States, Canada, Scotland and Germany. From those writings – obviously not concerning developing countries – we can find interesting elements about Lutz’s general opinion about the establishment of a sound financial system. According to Lutz the development of banks in actual developed countries was the result of a spontaneous process, without interventions of public authorities (1936, p.11). In its early development the banking system was characterized by several banks being in competition, and each banks was issuing its own note; a legal tender note was not yet imposed by public authorities. Lutz was defending free competition between banks because she thought it was the best was to guarantee low rates of interest which, in turn, would encourage new investments. By issuing their own notes, banks was forced to look for the quality of their reserves and to make advances to good borrowers, and were also more exposed to bankruptcy. This risk of bankruptcy is necessary, according to Lutz, to oblige banks to be prudent in their lending activity. Lutz called it “the law of bankruptcy” (1936, p.195). There always will survive a prudent bank which will remain solvent, and this kind of bank would attract new customers. Free competition between banks is a stimulus to private investment according to Lutz.

4. Ursula Hicks on central banking practices

One original aspect of Ursula Hicks in the field of development finance deals with the task of a central bank within a low-income economy. The state of researches about central banking practices at Hicks’s times underlined the stabilizing role of central bank within developed economies (Bagehot, 1873, Hawtrey, 1932, Sayers, Keynes 1930 and 1936). Central banks had been given the task to control the money issue in order to stabilize the level of prices in most countries such as the United-States (creation of the Federal Reserve System in 1913) and Great Britain. In the fifties, it was not usual to think of central banking practices as a way to promote economic growth in low-income countries. It was the case, in the fifties in Ceylon (where Robinson, the Hickses, Oskar Lange and Nicholas Kaldor went in 1957 in order to make a survey about the economic situation of the country as explained in Dimand and Forget, 2000, p.213), Colombia and Philippines.

In *Development Finance* (1965), Hicks explains that the existence of a central bank enable to enhance economic development. This institution should not be in competition with other banks (Hicks, 1965, p.55), and must be capable of giving independent advises “on the basis of its own economic and statistical research” (Hicks, 1965, p.55). Giving credit to the stabilizing role of central banking practices in developed economies, Hicks nonetheless thought that such an institution is even more important in

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a developing country (Hicks, 1965, p.54). Insisting upon the need of institutions in the early development of countries, Hicks joined Keynes and Hawtrey who thought that the central bank can influence the level of investments and employment by announcing its future discount rate, (Keynes, 1930, I. and II, and Hawtrey, 1919 and 1932).

Hicks presented mainly three roles of a central bank.

First, it should facilitate public borrowing and manage the public debt: “it [the central bank] will have to conform to the government’s general economic policy” (Hicks, 1965, p.55). A way to encourage the expansion of particular sector of the economy is to implement a policy of selective credit. For instance, if the State wants to sustain a particular sector, the central bank can encourage banks to ensure low credit rates to the companies of this sector.

it [the central bank] should be given powers to encourage investment in particular lines by selective credit controls through the banks and through such financial institutions as insurance companies and building societies (Hicks, 1965, p.56)

Furthermore, the central bank “will have responsibility for national debt transaction” (Hicks, 1965, p.54).

A second role, closely linked to the first, is to contribute to the formation of a capital market. Hicks thought that the public debt, if managed appropriately by the central bank, can contribute to the growth of a capital market. Hicks thought that the issue of Treasury bonds could help the development of a capital market. If the central bank offer low interests on short-term borrowings, private investors would be encouraged to borrow short in order to purchase Treasury bonds. This should help to create a capital market for long-term assets, because Treasury bonds are safer assets than private stocks. If private savers are confident into the capital market, they would be more willing to invest their savings to longer term investment instead of investing in bank deposit or, worse, hoarded wealth into monetary form (coins or precious metal). Hicks had in mind the British experience, where the development of the market for Treasury bond came before the emergence of the market for private stocks:

Experience shows that government debt is a perfectly good foundation for security trading (Hicks, 1965, p.59)

For those [development countries] who have not the nucleus of a market in long-term loans will be, to start with (and perhaps for a considerable time), trading in government debt (Hicks, 1965, p.59fn)

The third role of a central bank is “to build up an internal banking structure almost from the bottom. One way of doing this is to establish a commercial bank with public funds, which will follow an aggressive policy of “selling” banking even in remote rural areas” (Hicks, 1965, p.57). Then, once the banking system established, besides making advances to private companies, it should specialize in public debt dealing. To encourage banks to purchase public debt, the central bank should allow accommodating rates to banks for those purchases. Hicks was perfectly aware about the monetary instruments which could be used in her times by the central bank. Her husband John R. Hick, with Keynes, made in the thirties a theory in which the central bank can influence long-term rates of interest – as defined as the reverse of Treasury bond’s price. John R. Hicks and Keynes advised a control over interest rates not only by using ordinary instruments – such as reserve ratios and discount rate instrument – but also by conducting open market

operations – purchases or sales of Treasury bonds. In this passage, Hicks joined clearly her husband and Keynes's thought:

whatever the future course of interest rates, no one doubts that it will be possible for the authorities to hold the long-term rate at a level well below the average of most earlier period. This will be of real assistance to private enterprise (especially for very long-term investments) as well as to the Budget (Hicks, 1947, p.362)

Given the importance to expand the public sector and its debt, the central bank should use new monetary instruments in order to manage the level of liquidity on the money market – since Treasury bonds are used as quasi-money thanks to their high degree of liquidity. Debt management – though the use of open market operations – would permit to increase government spending and also to manage the liquidity of the money market. Open market operations can affect by two ways the term structure of interest rates – as defined as the span of interest rates ruling at different maturity. First, by announcing a rise in the future discount rate at which short-term bills are exchangeable against money, the central bank impact the expectations of private investors. If these latter believe that the discount rate will effectively rise, they sell long-term bonds in order to avoid a capital loss, and invest into short-term bonds. This lead to an increase of the long-term rate. A similar effect can be obtained if the central bank announce sales of long-term bonds. Private investors would expect the price of bonds to decrease, and would sell their bonds in order to avoid a capital loss and the long-term rate would then increase. This method of influencing rates by playing on the expectations of private agents was quite new in the thirties. It is in those years that this method of liquidity control has been elaborated, especially by the Fed and the Bank of England. Hicks advised central banks to keep long-term rates at a low level in order to finance at low rates public spending. The whole thing was to make private investors believe that interest rates will remain low, thanks to accommodating monetary policy of the central bank. By announcing low short-term rates, the central bank finances private investors to purchase and hold long-term assets such as the Treasury bonds. According to Hicks, this is how the central bank can exert a downward pressure on the long-term rate, the rate at which long-term investments are financed¹⁷.

Another advantage of Treasury debt dealing is to increase confidence on capital markets. According to Hicks, the increase of the public debt has two effects. The first effect is to rise the national income. The second effect is more original and echoes a recent issue in our modern economies. It deals with the effect on the capital market's liquidity. Hicks thought that new issue of Treasury bonds was a good thing for borrowers on capital market, because "additional long-term debt provides extended collateral for loans" (Hicks, 1947, p.363). Because the quality of the public debt is better than the quality of the private debt, private investors have interest in holding Treasury bonds into their balance sheet. This difference in the quality of the debt is due to the powers of raising taxes by the State¹⁸. This issue dealing with the existence of a

¹⁷ Hicks thought, like Keynes, that the long-term rate of interest exerts a stronger influence on the level of investment than the short-term rate of interest, contrary to Hawtrey's opinion in a *Century of Bank Rate* (1938). The debate was originally opposing Hawtrey and Keynes in the thirties, who thought that the main channel of transmission of monetary policy over the productive sphere is through the long-term rate.

¹⁸ However, if the State has a high credit risk, (such as the Greek episode in Europe since 2009), private investors' confidence is lost and the public debt ceases to be liquid. Hicks made the assumption that if the State is credible, its debt is more reliable than the debt of private companies thanks to the power of raising taxes.

safe and or/ liquid asset is an important issue nowadays and is closely studied by economists¹⁹.

5. Vera Lutz about finance since her doctoral dissertation (1936) to her works as development economist in the fifties-sixties

We can divide Lutz's interest in finance into three themes. The first theme comes from her doctoral dissertation, deals with free banking practices²⁰ (1936). The second theme is about the public interventions in Southern Italy and the third concerns the role of a central bank to promote economic development.

1. Studying Lutz's doctoral work is insightful because it help to understand her subsequent works in the fifties-sixties about the development of Southern Italy. Lutz's choice to support free banking practices and critics of central banking practices was audacious in her times since the majority of economists (Keynes, Hawtrey, Robertson, John R. Hicks and Ursula Hicks) were supportive of Keynesian monetary and budgetary policies. What Lutz called "The rational of central banking" is precisely the "scientific management" of money by the central bank in order to stabilize prices (Lutz, 1936, p.190). The term "rational" must be assimilated to the "science". The central bank, in her words, should not seek to stabilize the level of prices without creating catastrophic disturbance²¹. Lutz thought that centralizing liquidity within a central bank, and given it the rights to control the price of liquidity on the money market does not permit to reduce instabilities causing prices movement. What Lutz's means by "instabilities" is close to Wicksell's definition: they are generated by discrepancies between the monetary rate (which is the interest rates charged on loans by the banking system) and the natural rate (being the profit rate of firms)²².

Disappointed about the direction of banking practices, with the growing interventions of central banks in the interwar period (1919-1939), Lutz undertook the ambitious task to deconstruct the dominant idea following which a capitalist system could not work without a central bank. To do so, Lutz tried to understand the origins of central banking in capitalists economies by surveying the history of the financial structure of Canada, England, France, Germany, Scotland and United-States. The establishment of central

¹⁹ Brunnermeier and al. (2011 and 2016) recently discussed about the need to create a safe European debt composed by a set of national bonds in fixed proportion. Called "Euro-Safe-Bonds", it could lower the exposure of banks to the risk of default of some European States.

²⁰ Lutz's contribution to the free-banking debate is acknowledged by the economic literature. Capie and al. have highlighted Lutz's contributions writing that "Vera Smith's (1936) book [...] is simultaneously one of the major studies of central banking and a sustained plea for the resumption of Free Banking" (Capie and al., 1995, p.86). This issue was not extensively studied in the twentieth century as White noted (2014, p.8), with the exception of Ludwig von Mises (1928). A renewed interest for this topic have arisen since the late seventies (with Hayek's book, 1976, p.19) and the eighties with the works of White (1984), Selgin (1988) and Glasner (1989) who all recognized the quality of the empirical work of Lutz's book.

²¹ Lutz wrote : "Out of the realization of the central bank's power to determine the volume of credit there arose the notion that it should consciously direct monetary policy along 'scientific lines'. The question then arises: What is to be the criterion of this 'scientific management'? The criterion which has so far usually been adopted, namely, that of the stability of the general price level, has been suspect in theory and just as unfortunate in practice" (, p.189-190)

²² Lutz wrote: "The most satisfactory theory yet offered in explanation of booms and depressions, however, is one which at that time was undeveloped and which finds the perpetually disequilibrating force in monetary disturbances expressing themselves in a divergence between the 'natural' and market rates of interest and between voluntary savings and real investments" (1936, p.7)

banks (except for the case of the Fed in the United-States) is according to her the result of “a combination of historical accident and political motives and historical accident which played a much more important part than any well-considered economic principle” (Lutz, 1936, p.4-5). In England for instance, pressure from politicians gave birth to the Bank of England: it “was the result of a long series of Government manipulations” (Lutz, 1936). Central banks, she continues, were created to be subordinated to the State and to ease public spending. This idea was already defended by Bagehot, known to have encouraged first the role of last resort of the central bank in 1873. The Bank of England, Bagehot explained, was founded in 1694 in order to facilitate the borrowing of the Government (1877, p.92). Disagreeing with influential economists of her time such as Ralph George Hawtrey and John Maynard Keynes, partisans of central banking interventions, Lutz did not think that the central bank could, by controlling the money rate, could exert a stabilizing role in economy. History has shown that to attribute such powers to the central bank gave rise to great monetary disturbances very harmful for the economy. Lutz had in mind the over issue of credits used to finance Government spending which can be a major cause of inflation²³, and also the monetary rule to stabilize commodity prices.

Lutz complained that free banking had never been allowed to work, because the central bank always bailed out commercial banks in situation of bankruptcy.

Centralizing reserves in the hands of a single supra bank is bad for the economy. Lutz criticized the role of lender in last resort which encourage commercial banks to take risks:

This argument [that commercial banks do not foresee the crisis and depression] is however still open to the question whether it is likely that the profits would exceed the losses, and therefore whether there would be many banks willing to lower their reserve ratios, if there were no central bank to give external aid during the crisis and the banks were always under the threat of liquidation in the case of a suspension of specific payment. The risk necessary to take in order to make the extra profits in the boom would include the possibility of insolvency (Lutz, 1936, p.185)

Even if a big financial crisis occur, making many banks into bankruptcy, Lutz thought that there will be at least one bank which would “have been capable to select their assets so carefully that they are easily realizable even in the crisis, and if their more liquid position is sufficient to retain the confidence of the public, so that instead of their having deposits withdrawn they actually receive new deposits transferred to them from other banks (Lutz, 1936, p.185). One of the main function of central bank – to bail out banks – provided by its partisans is therefore irrelevant according to Lutz.

2. In an article published in 1958, and also in her book (1962), Lutz discussed the role of credit facilities in less developed regions. She studied the case of Italy and discussed

²³ Lutz wrote: “While recognizing that the maladjustments may be due, not to the specific form of the banking system, but rather to at present unresolved technical difficulties, common to any system, in maintaining equilibrium between savings and investments, or in stabilizing the effective quantity of circulating media, it seems not improbable that the tendencies to misdirection are magnified by the form of the system, in particular that part of it which entrusts the determination of the volume of credit to a single authority, between which and the Government there exist reciprocal incentives to paternalism. It is not unlikely that the bolstering up of banking systems by their Governments is a factor which makes for instability” (1936, p.7).

the efficiency of policies conducted since 1947 to reduce dualism in Italy²⁴. The economist Luigi Spaventa replied to her in the same review in 1959. In 1947 the Italian Government created an association in order to develop the South of Italy, the SMIREV (Associazione per lo Sviluppo dell' Industria nel Mezzogiorno). From 1947 to 1957, the SMIREV had voted 340 laws aiming to raising the industrialization and the living standards of the South (Lutz, 1962, p.101). The main line of the policy was to allow tax relief, credit facilities²⁵ and grants to Southern private enterprises (as presented in the Chapter 6 of *Italy, a Study in Economic Development*, 1962). In addition, the Bank of Italy and the finance of the Government was closely linked: the Treasury had privileged access to the funds of the commercial banks, and also it has the priority over the use of the funds which are deposited by the public with the Postal Administration (Lutz, 1962, p.169).

Those facilities permitted to launch several hundred of industrial plants in Southern Italy (Lutz, 1962, p.122). In Lutz's general liberal philosophy, public interventions are disincentives for private enterprise²⁶. She wrote that all the efforts made by the Italian government to promote industrialization in the South – both by increasing the money supply or by investing public funds – had not been successful:

The results achieved by more than ten years of Southern policy have, by fairly general admission, fallen short of expectations. The 'infrastructure' of industry that was built failed – in spite of additional incentives of a more directly cost-reducing kind – to attract an industrial 'superstructure' on the scale that had been anticipated. And little or no progress was made towards closing the income-gap between the two regions (1962, p.130)

Lutz did not believe that expansionary monetary policies could help to reduce the growth differential between Northern and Southern Italy. The Italian economy had special features which perpetuated its structural problems, and the central bank could not do much to reduce the dualism. According to Lutz, those features were firstly the high elasticity of the demand to income for agricultural products and the rigidity of the supply of agricultural products, secondly the rigidity of wages because of powerful trade Unions in the North (Lutz, 1950, p.83-84, quoted in Masera, 1983), thirdly the difference of skill of workers between the North and the South (Graziani offers a good illustration of this in 1983, p.15), and fourthly/finally the bad geolocalization of

²⁴ In an article published in 1958, Lutz opened a debate about dualism in Italy (as explained by Mazzocchi, 1965, p.716). De Cecco wrote that Lutz's "line of argumentation was the one which had the strongest influence on Italian public debate for years to come" (2011, p.19)

²⁵ The credit facilities concerned mainly agricultural companies. During the years 1946-1947, the price of wheat was twenty times higher than its pre-war price. The organization pooling wheat were purchasing wheat at a higher price than the price at which they could resale wheat to mills. To cover the difference, they were allowed to issue bills and banks accepted them. And the Bank of Italy had to accept to rediscounting those bills when banks asked for it (Lutz, 1962, p.163-164).

²⁶ We can find Lutz's view on markets and social justice in *Central Planning for the Market Economy* (1969). In this book she challenged the plan adopted by the French Government, which followed a policy of "indicative" planning. This kind of policy runs counter to her liberal philosophy, because it would kill the spirit of entrepreneurship. To fix prices would deprive private firms from fixing their own prices. Lutz support the 'German view' according to which economic efficiency is improved if the decision of private agents determine prices in a market economy: "The collection of information and prediction are themselves competitive activities; and the right of individual operators to exploit their particular advantages or talents in this domain cannot be suppressed without striking at the roots of free enterprise and risk-taking" (Lutz, 1969, p.117)

Southern Italy which limited its openness to international markets (Lutz explains this in 1962, p.135). In the next paragraph we focus on the first and the second point.

First. Lutz's empirical results shows that "the elasticity of the supply of food is zero" (1962, p.138), and second that the income elasticity of demand of food products is higher than the income elasticity of industrial product²⁷. On the basis of those observations, Lutz provides a model in which the growth of industrial and agricultural products is unbalanced between the two sectors (1962, p.133-137). She begins by supposing an increase in income in the North and South generated by a rise of public investments. Rising income would mean rising consumption in food and industrial products. Because the supply of food products was inelastic to income, an increase of the demand for food products would increase the price of those goods in comparison to the price of industrial goods. This distortion of the relative price engenders a "deterioration in industry's term of trade" (Graziani discussing Lutz, 1983, p.13). The declining prices of industrial goods would reduce the profit rate in the industrial sector and could decrease the number of workers since it reduces the marginal productivity and therefore the utilization of resources. If workers could be mobile (an hypothesis which was not verified in Italy in the late forties-fifties according to Lutz) they would go and look for work in the South. This would reduce the level of wages in the agricultural sector, since additional workers would be more numerous. A process of equalization of profit rate between the industrial and the agricultural sector would happen (Lutz, 1962, p.138-139 as explained in Graziani, 1983, p.13).

Second. Lutz presents the rigidity of wages as a main factor of the unbalanced growth between Northern and Southern Italy. To follow Lutz model presented previously, in order to restore the margin of producers, the fall in the price of industrial goods should be followed by a decrease of wages of industrial workers. But the trade unions, powerful in the North, constantly pressed for raising wages, and that was limiting the profits which could be gain with higher productivity. In an article dealing with the role of real and monetary factors in the determination of employment levels, Lutz indeed wrote:

when the real wage rate is fixed, a policy of monetary expansion is not much more likely to be an answer to the unemployment problem when imperfect competition prevails in the product market than when perfect competition prevails. (...) Public works likewise (...) would be of no avail unless they succeeded either in bringing about a redistribution of income of the kind described, or else in decreasing the degree of monopoly in some other manner. It appears that the only remedy adequate to the present case is a direct attack on the elements of monopoly power in both the labor and the product markets (1952, p.262)

Because of the two kind of rigidities presented above, public interventions such as expansive monetary policies or public plans were of no use to enable the Italian economy to reach full utilization of resources (employment and capacity of production).

²⁷ Lutz wrote a full chapter on the agricultural sector. The rigidity of supply of agricultural product rested on the low productivity of the agricultural sector due to a lack of equipment. Another explanation is the reluctance of peasants to use modern method production and also the population pressure in the South: "Often lack of capital o lack of knowledge may stand in the way of this and other types of progress. Over a great part of Southern agriculture, however, other limitations exists. There are connected partly with irremediable physical conditions, and partly with the present excessive population pressure" (Lutz, 1962, p.169)

One reason is that “there never had existed in Italy any pre-constituted balance of capital equipment commensurate in size and composition with a situation of full or near-full employment of labour, just as there never had existed that proportion of skilled to unskilled labour which corresponds to such a situation [of a previous state of full utilization of resources]” (Lutz, 1962, p.298). Moreover, an expansionary monetary policy would not solve the problem of rigidity of the supply of food product in Southern Italy, which Lutz quoted as one major cause of the imbalanced growth between the North and the South (Lutz, 1962, p.301)²⁸.

3. Passages discussing the role of central banking in the development of an economy are not easy to find in Lutz’s works. She criticized such the privilege of the State to benefit from advances facilities from the Bank of Italy (which served to increase public investments in Southern Italy)²⁹. Lutz however congratulated the conservative monetary policy (the stabilization plan was attributed primarily to Einaudi and Menichella, as Masera wrote, 1983, p.44) which enabled to limit the growth of commodity prices while public spending was increasing (Lutz, 1962, p.215 and also p.297). In a chapter written on Western central banking practices, Lutz indeed wrote that “credit controls – meaning the amount that the central bank allows the banks and saving banks to borrowing the form of ‘ordinary discounts and advances – has been the strictest” (Lutz in Sayers, 1962, p.172). This permitted to stabilize the level of prices. Lutz’s view evolved since her doctoral dissertation. In 1936 she was against Hawtrey’s monetary rule presented during the Genoa Conference in 1922 (Hawtrey, 1923, p.61), aiming at stabilizing prices by controlling credit by varying short-term rates of interest (Lutz, 1936, p.190-191). Lutz called such policy (of controlling the level of price) a “scientific management” of money (1936, p.190) and a strong factor of “disturbance” in the economy. Discussing the monetary situation in the twenties and early thirties Lutz wrote:

There is not much doubt that the present banking system is actively responsible for disturbances... it seems to be an indisputable fact that the major fluctuations come from changes in the amount of cash provided by the central banks... fluctuations, while not being entirely eliminated, would be much reduced under free banking. And it is undoubtedly true that such a system is much less capable of monetary manipulation than a system of central control(Lutz, 1936, p.194-195)

The capacity of the central bank to stabilize the level of prices is crucial for developing Southern Italy because it is an essential ingredient “for a recovery of personal savings, for a revival of bond market, for a reduction in the amount of capital tied up in business hedging against rising commodity prices” (Lutz, 1962, p.325).

²⁸ Lutz wrote: “As was observed in earlier chapters, the process of providing, within a near future, the necessary increase in the supplies of the higher-quality foodstuffs and of other goods must be a highly complex one, depending on many more things than monetary policy” (Lutz, 1962, p.301)

²⁹ Lutz wrote: “This is consistent with the thesis fended in her doctoral dissertation following which central banks are used to ease the finance of the Government: “it seems not improbable that the tendencies to misdirection are magnified by the form of the system, in particular that part of it which entrusts the determination of the volume of credit to a single authority, between which and the Government there exist reciprocal incentives to paternalism. It is not unlikely that the bolstering up of banking systems by their Governments is a factor which makes for instability (1936, p.7)

6. Concluding remarks

Hicks and Lutz can be considered as development economics: Hicks made significant contributions on the systems of taxations for the public finance and the development plans in low income countries and Lutz studied the way to promote development in Southern Italy. They belong to the first generation of scholars who got interested into this field, preceding the contributions of prominent economists such as Irma Adelman (University of California, Berkeley), Nancy Birdsall (Yale University) and Anne Krueger (University of Wisconsin), who entered the field in the seventies (as explained by Cooley and Van Der Meulen Rodgers, 1999). The respective academic careers of Hicks and Lutz were different. Hicks had an academic experience as a lecturer (at Nuffield College, Oxford), and she had also been a civil servant in several African countries and also in Jamaica, India and Malaysia. Lutz's experience as economic adviser had not been as rich as Hicks's one. Her lonely experience was to be adviser of the Bank of Italy in the late forties.

Belonging to two different schools, Hicks and Lutz provided very different visions on the role of institutions, and on solutions to achieve economic development. As a member of the Mont Pelerin Society, Lutz defended liberal theories. She gave her support to the liberal post-war policies in Italy, notably the decrease of agricultural subsidies and limits on the increase in industrial wages (1950a, 1950b). Even if Lutz seems to have abandoned her thesis on free banking (1936) in the forties-fifties, she continued to express her views on money and banking in a few writings. First, during an international credit conference held in 1951, Lutz criticized strongly the accommodating monetary policies of Western central banks. Central banks were financing public spending, and Lutz advised to stop the central bank subordination to the Government. Only the Bank of Italy, which Lutz congratulated, was aiming at stabilizing the level of prices. About the development of Southern Italy, Lutz did not believe that an expansive monetary policy could help because of numerous rigidities on the labour market and the productivity of the agricultural sector. By contrast, Hicks had been rather influenced by the Keynesian School. She saw expansionary monetary policies, coupled with public spending, as necessary to enhance economic growth. She thus encouraged the creation of development banks receiving public funds. In addition, developing countries should establish a central bank and a sound banking system in order to secure savings and increase investments.

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