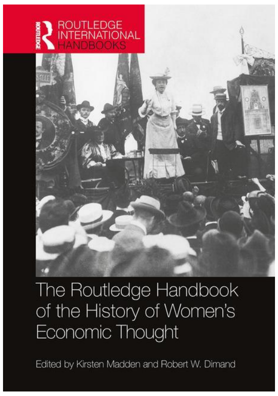

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Ursula Hicks' and Vera Lutz's contributions to development finance

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URSULA HICKS' AND VERA LUTZ'S CONTRIBUTIONS TO DEVELOPMENT FINANCE[1]

Lucy Brillant

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 some overseas students from India and other countries within the British Empire. The term "economic development" appeared for the first time in the work of LSE historians in the 1920s such as Vera Anstey and Lillian Knowles (Arndt, 1981, p. 458).[2] A fair number of economists and practitioners, who would later specialize in the field of development economics, were trained at the LSE: Colin Clark, researcher at the LSE from 1928 to 1929; Arthur Lewis in 1932; Nicholas Kaldor, assistant professor from 1932 to 1947; Albert Hirschman, student from 1935 to 1936; Ursula Webb Hicks and Vera Smith Lutz, doctoral students in the 1930s and Alice Amsden in the late 1960s. 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 monetary factors (access to liquidity, aid or external loans, and the existence of a sound financial infrastructure). It seems that a small number of scholars in the 1950s analyzed the importance of banking institutions to enhance economic growth in developing countries.

Two influential researches underlined that economic growth goes hand in hand with the development of finance (Goldsmith, 1969 and Gurley and Shaw, 1955), but their analysis was oriented to countries already developed. Ursula Hicks and Vera Lutz were two of the few scholars giving importance to money and banking issues for economic development. Hicks and Lutz can be included in a list of fifteen outstanding female researchers and practitioners in the discipline of development economics. Of note in this list are Alice Amsden, France Stewart, Nancy Birdsall, Irma Adelman and Anne Krueger (Cooley and Van Der Meulen Rodgers, 1999).

Philippe Hugon distinguished four broad periods in the evolution of development economics (2007, pp. 719–720). In the first period from 1960 to 1968, studies in economic development focused mainly on the implementation of development plans in the context of decolonization. The second period from 1968 to 1980 was marked by fights for freedom and the recognition of the Third World. The period from 1980 to 1995 was characterized by the openness of developing to international markets. In the last period from 1995 to 2007 there was a shift in emphasis with an intensification to the fight against poverty in the context of the deconstruction of liberal beliefs. Hicks' work makes an obvious contribution to the first period in the 1960s. Lutz's works both predate and extend into the first period, but are distinct: Lutz studied development characteristics of non-colonized countries (France and Italy), emphasizing the concept of economic dualism.

Some common features can be observed between Hicks' and Lutz's experiences in academics. They both earned doctorates at the LSE, and their first researches dealt with developed countries. Lutz's first academic work was about the evolution of banking practices and the birth of central banks in Western Europe and Northern America. Hicks began working on the evolution of public finance in England. These two women's interest in developing countries rose almost at the same time, in the 1950s. During her career Hicks studied a long list of countries from different regions of the world such as India, Pakistan and Afghanistan, South East Asian countries (Malaya), the East, West and Central African states such as Nigeria, and also countries such as Jamaica in Latin America. Lutz focused only on southern Italy whose development lagged markedly behind that of the north (1950, 1951, 1956, 1958, 1962a, 1962b). Hicks and Lutz show an evident interest for finance and banking issues. 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 institutions in the debate about dualism between the north and the south of Italy.

Hicks' definition of economic development appears on the first page of *Development Finance*:

> By "economic development" I simply mean growth in real income per head, while not losing sight of the fact that an increase in the gross national product is unacceptable unless it also implies some betterment of the lot of the mass of the people. Economic development has a social and redistributional as well as an economic aspect.
>
> *Hicks, 1965, p. 1*

Lutz's *A Study in Economic Development* (1962a) is limited to the case of underdeveloped regions in southern Italy. Lutz, like many observers of the time, thought that the economic performance of Italy could be improved if the gap in development between the northern and the southern regions was reduced. Emphasizing dualism as a central feature of Italian underdevelopment, Lutz indicates "the direction which the growth process would have to follow to achieve economic unification" (1962a, p. 12). Economic unification via the reduction of economic dualism and large differences in standard of living can be considered as Lutz's definition of economic development. Influenced by Hayek, she was generally skeptical of government intervention. But in the Italian case she encouraged limited policy intervention to assist the south. Her enthusiasm for policy intervention was tempered though, as previous interventions "have, however, not sufficed to remove the large disparity in levels of economic and social progress between the two geographical areas" (1962a, p. 3).

This chapter does not cover all Hicks' and Lutz's contributions to development economics. Hicks' many experiences in developing countries make this task quite difficult.[3] This chapter primarily narrows the focus to the role of the banking system in the process of economic development. Those economists both recognized that the main goal of a central bank, 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 payments. In developing countries, the stakes were different. Hicks encouraged the establishment of central banks to guide the policies of private banks participating in the public securities market. Lutz lacked Hicks' academic knowledge and consulting experience, but offers some interesting insights into the role of banking to enhance economic development. Beginning as early as her doctoral dissertation, Lutz is a partisan of free-banking practices, which discredits the utility of central banks. However, her view evolved starting in the late 1940s, and by 1962 she supports conservative monetary policy of the Central Bank of Italy in *A Study in Economic Development* (1962a).

The plan is the following. The next section offers a bibliographical profile of Hicks and Lutz and presents their intellectual backgrounds. The third section analyzes a convergence of thought between Hicks and Lutz on the nature of credit and its importance for the economic development. The fourth section presents Hicks' thought about the role of a central bank in developing countries. The fifth section is about Lutz's theory of economic dualism and the sixth develops her evolution of thought about central banking from 1936 to 1962. The seventh section is the conclusion of this chapter.

Bibliographical profile[4]

Hicks did her PhD dissertation at the LSE under the supervision of Lionel Robbins (1938, p. xxxvii). Even if Robbins had affinities with conservative thinkers such as Ludwig von Mises and Friedrich Hayek, it did not much influence Hicks. She was mostly influenced by John Maynard Keynes[5] and John Richard Hicks. Hicks' research specialized in the history of British public finance. She taught this course at Nuffield College (Oxford) for many years. There, Wilfred David, who did his PhD thesis under her supervision, 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" (1973, p. xiii). On Hicks' book *Development Finance: Planning and Control*, David wrote that it is "one of the best available studies of the development process from the fiscal and financial angles" (1973, p. xiv).

In a book written in Hicks' honor, David (1973) distinguished two phases in which her contributions to economics unfold. A first phase from 1938 to 1954 concerns her interest 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 identified as a pioneer with her method of cost/benefit analysis enabling a country to choose the plan that offers the greatest present value of benefits over costs. She wrote two other books on this topic (1947 and 1954). Martin Feldstein also identifies that Hicks contributed to a framework for evaluating public investment projects in developing countries using cost/benefit analysis (Feldstein, 1973, p. 4).

A second phase begins in the 1960s with Hicks' new interest in the development of developing countries. She wrote three books about economic development (1961, 1965, and 1978 with John R. Hicks), and she participated in a collective book edited by J.R. Hicks about the economic development of Ceylon (1959) where she advised the young central bank.[6] During this phase, 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.

Hicks' interests passed on through the work trajectories of her thesis advisees. Corea joined the central bank of Ceylon at its creation in 1950 as one of a group of "young recruits" (Kelegama, 2004, p. 15). He became the director of economic research from 1960 to 1965, and deputy governor from 1970 to 1973. Feldstein specialized in public finance in developed countries (1985) and Nicholas Kaldor focused on the case of developing countries (1963), in addition to his numerous contributions on economic growth.

Hicks was also a civil servant. She served as an economic adviser for the governments in the Caribbean, India, Jamaica, Malaysia, Nigeria (as part of its "advisory Commission") and Uganda. In 1965, with Margaret Hall, Hicks was one of the first women allowed to join the Oxford University Political Economy Club (FitzGerald and Heyer, 2011, p. 40). She was also one of the founders of the *Review of Economic Studies*, and managing editor from 1933 to 1961.

Lutz did her PhD dissertation at the LSE under the supervision of Friedrich Von Hayek. She did not follow an academic career like Hicks – she never occupied a position at a university. Lutz's first research, published in 1936, was on free-banking practices and questions the existence of central banks at the top of the banking system. Some write that Lutz continued Hayek's work on the evolution of money and banking; Hayek might have delegated this project when he was appointed Professor at the LSE (Huerta de Soto, 2012, p. 631). Lutz's contribution to the free-banking debate is acknowledged by several economists. Capie et al. (1995) wrote notably 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" (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 in this topic arose in the late 1970s (with Hayek's book, 1976, p. 19) and in the 1980s with the works of White (1984) and Selgin (1988). Both recognize the quality of the empirical work of Lutz's book.[7] Lutz, with her husband Friedrich Lutz, was a member of the Mont Pelerin Society.[8]

Lutz's interest in development economics arose in the 1950s as European countries adopted public investment plans in the aftermath of war. Lutz limited her research to the case of southern Italy and France, where she disputed the strongly held belief of others that public plans would enhance economic growth.[9] Lutz's objective was to reveal the inconsistency of public plans (Guirao and Lynch, 2015, p. 47). Lutz's views on markets and social justice appear in *Central Planning for the Market Economy* (1969). In this book she challenged the plan adopted by the French Government from 1947 to the mid-1960s to fix commodity prices (a policy of "indicative" planning). This kind of policy runs counter to her liberal philosophy, killing the spirit of entrepreneurship. To fix prices would deprive private firms from setting their own prices. Lutz supports the "Austrian view" according to which economic efficiency is improved if the decisions 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*[10]

The most famous part of Lutz's work is probably that dealing with her researches on the economic development of Italy. With Friedrich Lutz, Vera Lutz was part of a team of liberal thinkers appointed as economic experts by the Bank of Italy in the late 1940s (Baffi, 1985, as noted by de Cecco, 2011, p. 17).[11] On this topic she published one book (1962a) and several articles (1950, 1956, 1958). Those researches, notably "The Growth Process in a 'Dual' Economic System" (*Banca Nazionale del Lavoro Quarterly Review*, 1958) had a strong impact in Italy, with a direct reaction: economist Luigi Spaventa rejected Lutz's thesis (1959). Italian economist Mazzochi considered that Lutz opened the debate about the origins of dualism in Italy (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; see also Toniolo, 2013, p. 147 on Lutz's influence).

The nature of money and the development of private commercial banks

A convergence of some of the thought of Hicks and Lutz can be observed in their approach to money and credit. Both recognize that credit plays an important role in economic development. In Hicks' words, "The provision of credit for private enterprise is vital to development" (1965, p. 58). On her side, considering the effect of credit on the quantity of bank notes in circulation, Lutz wrote that "a paper currency is a desirable adjunct to a country's commercial development" (1936, p. 10).

The word "credit", both in Hicks' and Lutz's writings, has double meaning. First, it can be considered as the funds that credit institutions are willing to lend to businesses. Here, lending capacity of banks depends on the amount of savings collected from depositors. Credit also has a second meaning. It corresponds to the situation where banks respond to the demand for liquidity from businesses (Hicks, 1965, p. 58 and Lutz, 1936, p. 172). A bill of exchange – characterizing indebtedness – can also be considered as a credit. The bill of exchange represents a promise to deliver 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 B has a debt with A. The process of production can start once A accepts the bill of exchange (i.e. the indebtedness) of B. If A cannot wait to receive money at the agreed date, A can discount its bill with a bank, the bank exchanging the bill for money. Banks provide liquidity to traders who need money before the maturity date (for instance to pay their workforce).

One major problem that developing countries face is the lack of credit as defined above (Hicks, 1965, pp. 52, 57). The market for bills of exchange is weak, and the amount of savings is low. The weak development of the market for bills of exchange can be due to "lending risk", that is, the lack of confidence across merchants in their capacity to reimburse debt by maturity (Hicks, 1965, p. 58). This risk dissuades traders from issuing bills of exchange and reduces confidence in the bills market. As a result, trade decreases between merchants.

On her side, Lutz illustrated the importance of confidence in the means of exchange against which bills are convertible. She took the case of the Goldsmiths in seventeenth-century England. Goldsmith notes were certificates of indebtedness issued by banks when merchants deposited gold. Merchants could recover their gold with a simple presentation of Goldsmiths to the bank. With the spread in their use, traders became confident in the value of Goldsmiths. Those notes started to be used as money – not merely as gold certificates – with merchants accepting them as means of payment for goods (p. 11).

Another point of convergence of thought can be observed between Hicks and Lutz. They seem to agree on the fact that in occidental countries the formation of the banking and financial system is the result of a long historical process. Banking developed spontaneously without intervention of the State:

> We can roughly summarise the course of events and swings of policy in the evolution of banks of issue before 1875 under four phases. The first was a preliminary period when banks were only just beginning to emerge, and they were theoretically at liberty to form freely even if it was only because they were not yet obtrusive enough to catch the eye of the legislative authority.
>
> *Lutz, 1936, pp. 10–11*

> In an advanced country the commercial banks are far from being the only sources of credit or depositories for savings. Over the years many other institutions, such as insurance companies and building societies, have developed spontaneously.
>
> *Hicks, 1965, p. 58*

Lutz only studied the case of already developed countries, and did not express views on the development of banks in developing countries. Hicks provides interesting insights into developing economy banking in *Public Finance* (1965), where she affirms that development banks should be deliberately created. Hicks encourages the adoption of public plans in order to help countries to develop their economies. It is clear for Hicks that the quality of a plan depends on access to resources such as raw materials and an efficient workforce. Equally clear for Hicks is the need to include the impact of financing the plan in overall cost calculations (1965, p. 35). Hicks encourages countries to be financially independent, for instance by developing their own commercial credit market and by increasing private savings, in order to avoid dependence on foreign aid and loans (1965, p. 38).[12] The formation of domestic saving is necessary for independence from foreign funds. Unfortunately, this is rarely the case in most developing countries, but not because households do not save. The sense of saving is quite present in the minds of peasants in developing countries, as Hicks identifies in the case of Nigerian cocoa farmers (1965, pp. 47–48). The problem is the absence of a sound banking system which centralizes secured savings and provides these pooled funds to private merchants and to public infrastructure investment in water, roads, schools and hospitals.

To sum up, parallels can be drawn on the meaning of credit in Hicks' and Lutz's thoughts. They consider that banks have the double function to provide liquidity on the market for bills of exchange, and also to collect savings. The rate of interest is the rate at which bills are exchangeable against money. Their thoughts also converge on the fact that banking systems emerged without the intervention of public authorities in most developed countries. However, their views diverge about the role of central banks.

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. In the 1950s, it was unusual to think that central banking practices were a way of promoting economic development. Most economists sought solutions from central banks for the high inflation observed in Western countries, not for reducing poverty in low-income regions of the world. Hicks, however, belongs to the few researchers who thought that developing countries require a sound banking system for sustained growth (David, 1973, p. xiii). For her, the knowledge and long experience of developed countries should serve to establish sound financial infrastructure elsewhere (1965, p. 52). She considered that in a developing country, "such institutions [central banks] are needed here and now, and so must be deliberately created" (p. 58). The central bank can be financed almost wholly out of government funds when no other source is available (p. 55). Those institutions should not be in competition with private banks, and must be capable of giving independent advice "on the basis of its own economic and statistical research" (p. 55).

Hicks presents four main roles of a central bank in developing economies, closely linked to each other. The first 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). Recall that Hicks perceived high "lending risk" in developing economies, which discourages lenders to invest in projects (p. 58). The higher the lending risk, the higher is the interest rate charged on loans. The existence of a strong banking system, supervised by a central bank, would lead to reductions in interest rates on the money market and on the market for commercial loans. It would also lead to reductions in cash hoarding, and the facilitation of funding for productive investments. Credit should develop for small and/or large businesses with the establishment of Industrial Development Corporation and an Agricultural Credit Corporation (p. 58) deliberately created by the State. Under the guidance of the central bank, these development banks implement a policy of selective credit. For instance, the central bank can encourage the banking sector to ensure low credit rates to the companies of a chosen sector: "[I]t [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).

Second, once the banking system is established, the central bank should facilitate public borrowing: "[I]t [the central bank] will have to conform to the government's general economic policy" (Hicks, 1965, p. 55). One way to reach this objective is to seek low interest rates charged on Treasury bonds, either by direct purchases of the public bonds by the central bank, or by keeping low the main lending rate from the central bank. Here Hicks had in mind an original mechanism: by announcing its policy, the central bank could promote the belief among private investors that lending rates will remain low. If investors believe this, they would be encouraged to purchase and hold long-term assets such as the Treasury bonds. The additional purchases lead to a rise in the price, and therefore decrease the interest rates of Treasury bonds.[13] This would be favorable to public finance.

A third role of the central bank in a developing economy is to encourage the formation of a private capital market. Hicks thought that the purchase of Treasury bonds could support the development of a capital market. The goal is to encourage private agents to keep their savings in the form of those bonds (which are less risky than private stock) instead of investing in a bank deposit or hoarding wealth in the form of precious metal. Agents might then become more willing to finance private stocks. Hicks had in mind the British experience, where the development of the market for Treasury bonds came before the emergence of the market for stocks:

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

> For those [developing 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. 59 fn*

Another advantage of Treasury debt dealing is more original. Hicks thought that new issue of Treasury bonds was a good thing for borrowers in capital markets, because "additional long-term debt provides extended collateral for loans" (Hicks, 1947, p. 363). If the quality of the public debt is better than the quality of the private stock, private investors have an interest in holding Treasury bonds in their portfolio. This difference in the quality of the debt is due to the powers of raising taxes by the State.[14]

A fourth role is to ensure stability in the value of money, the volatility of which is impacted by foreign and domestic factors (Hicks, 1965, p. 53). The domestic factor is the quantity of credit contracted by private businesses; if too much credit is created, money can depreciate because of the rise in prices. In order to avoid a depreciation of money, the central bank should control the money supply and impose reserve requirements on commercial banks. External factors that influence the money supply center around foreign trade. Also note that Hicks believed the central bank should form a pool of foreign currencies in order to avoid violent exchange rate fluctuations (pp. 52–53).

Vera Lutz about economic "dualism" in Italy and the failure of Keynesian budgetary and monetary policies

Lutz extended Arthur Lewis's theory of dualism (1954) to the Italian case[15] and questioned the effectiveness of public plans (such as the "Vanoni plan" launched in 1954) which were supposed to narrow dualism between the north and the south of Italy.[16] She wrote that all the efforts made by the Italian government to promote industrialization in the south – either by increasing the money supply or by investing in public funds – had been unsuccessful:

> 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.
>
> *1962a, p. 130*

In 1947, the Italian Government created an association in order to develop the south of Italy, called the SMIREV (Associazione per lo Sviluppo dell'Industria nel Mezzogiorno). From 1947 to 1957, the SMIREV voted in 340 laws aimed at raising the industrialization and living standards of the south (Lutz, 1962a, pp. 101, 122). The main purposes of policy were to allow tax relief, credit facilities[17] and grants to southern private enterprises (as presented in Chapter 6 of *Italy, a Study in Economic Development*, 1962a). In addition, the Bank of Italy and the finance of the government were closely linked: the Treasury had privileged access to the funds of commercial banks, and also it had priority over the use of the funds that were deposited by the public with the Postal Administration (Lutz, 1962a, p. 169).

The failure of public plans conducted in southern Italy is due, according to Lutz, to problems specific to Italy (1962a, p. 298). First, it is due to the high income elasticity of demand for agricultural products and the rigidity of the supply of agricultural products (1962a, p. 138); second, the level of wages was rigid because of powerful trade unions in the north (Lutz, 1950, pp. 83–84). Third, there was a difference of skills between northern and southern workers; and finally, the geographic location of southern Italy limited the competitiveness of its products (1962a, p. 135). The first and second points are considered in the next two paragraphs.

A main concern in southern Italy was the lack of spirit of entrepreneurship and the related unwillingness of farmers to modernize their production equipment.[18] Because of that, the supply of food products was inelastic to price in southern Italy (Lutz, 1962a, p. 138), and this was a major issue considering population pressure. In addition, at a national scale, the income elasticity of demand for food products was higher than the income elasticity of industrial products.[19] This created imbalanced growth between the (northern) industrial and (southern) agricultural sectors (1962a, pp. 133–137). On the basis of these observations, Lutz presented a case where the government creates additional revenue in the south, in order to reduce the gap of development between northern and southern regions (the industrial plan conducted by the Italian government from 1947). Rising income in the south would engender a rise in consumption of food and industrial products. Because the income elasticity of the demand for food produce was higher than the income elasticity for industrial produce, and also because the food supply was inelastic in the south, the price of food products would increase more than the price of industrial products. The declining relative prices of industrial goods in comparison with the prices of food products would reduce the profit rate in the industrial sector.

A solution to restore the margin of producers would be to reduce wages in the industrial sector, Lutz explained, but the workers' unions were making it impossible. Powerful workers' unions engendered higher wages in the north than in the south. Companies were therefore encouraged to invest in capital-using techniques instead of recruiting labor force. In the south, however, companies were not constrained by workers unions so wages were lower than in the north. Lutz's remedy for the economic dualism in Italy was to reduce the power of unions in the north, which would increase the demand for labor, and then to encourage (with financial assistance) the departure of southern Italian workers to the north in order to work in the industrial sector (Lutz, 1962, pp. 314–315).[20]

In an article published in the *Quarterly Journal of Economics*, Lutz expressed her view on Keynesian monetary policies. She was skeptical that these policies would encourage new investments. The stimulus can only be found in the reduction of the power of the workers' unions:

> [W]hen 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*

The two kinds of rigidities presented above – the inelasticity of the supply of food product and the rigidity to the decrease of wages – were, according to Lutz, the main factors of economic dualism in Italy. Public interventions such as expansive monetary policies or public plans aiming at industrializing the south would not enable full utilization of resources in Italy. 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, 1962a, p. 298*

An expansionary monetary policy would therefore not solve the problem of the rigidity of the supply of food products in southern Italy:

> 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, 1962a, p. 301*

According to Lutz, the State should help southern families to emigrate to the north – the only public intervention that Lutz advised. Internal migration would reduce the population pressure and the excess demand for food products in the south. It would bring additional workers to the north who could specialize into the industrial sector, knowing that "the North . . . is better situated than is the South for expanding industrial exports" (Lutz, 1962a, p. 144). Lutz saw internal migration as the best way to fight economic dualism in Italy.

Central banking in Vera Lutz's thought: from a rejection (1936) to an adoption for economic development (1962a)

In her doctoral work *The Rationale of Central Banking and the Free Banking Alternative* (1936), Lutz was very critical toward creation of central banks in most European countries (England, France, Germany and Scotland), and Northern America (Canada and the United States). Her advocacy of free banking was audacious in the late 1930s, where a majority of economists supported Keynesian-style monetary and budgetary policies. Lutz applauded free-banking practices, and was critical toward the creation of central banks, who, in her view, harmed the functioning of the banking system and the economy in general. The "scientific management" of money by the central bank in order to stabilize prices (Lutz, 1936, p. 190) led to "catastrophic disturbance" (p. 194). 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.
>
> *1936, pp. 189–190*

Lutz's use of "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). Lutz thought that centralizing liquidity within a central bank, and giving central bank control over the price of liquidity on the money market would not reduce monetary-induced price instability. 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*

Disappointed about the direction of banking practices coupled with frequent interventions of central banks in the early years of the interwar period (1919–1939), Lutz undertook the ambitious task of deconstructing the dominant belief that capitalism could not work without a central bank. To do so, Lutz studied the origins of central banking in capitalist economies by surveying the history of the financial structure of Canada, England, France, Germany, Scotland and the United States. According to Lutz, the establishment of central banks (except in the United States) is the result of "a combination of political motives and historical accident which played a much more important part than any well-considered economic principle" (Lutz, 1936, pp. 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, pp. 22–23). Central banks, she continues, were created to be subordinated to the State and to ease public spending.

This idea was already apparent in Bagehot (1877), quoted several times by Lutz (1936, pp. 22, 23, 123, 133). Bagehot was a British banker who became famous for his book *Lombard Street* (1877) dealing with the relationship between the Bank of England and

London's financial and money market. Lutz wrote that Bagehot supported the fact that the Bank of England's first objective in 1694 was to facilitate the borrowing of the government (1877, p. 92), and also, that "[he] continued to make frequent reference to the superior qualities of a plural banking system" (Lutz, 1936, p. 133).

Disagreeing with influential economists and partisans of central banking interventions of her time, such as Ralph George Hawtrey and John Maynard Keynes, Lutz did not think that the central bank exerts a stabilizing role in economy by controlling interest rates. History shows that attributing such power to the central bank gave rise to great monetary disturbances that harmed the economy. Lutz had in mind the special facilities granted to the State to finance public spending which had been a major cause of inflation:

> 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*

Further, to oblige banks to centralize a part of their reserve in a single supra bank renders banks less prudent. It should be the responsibility of each private bank to ensure its own solvency. Even if a big financial crisis occurs that forces banks into bankruptcy, Lutz thought that at least one prudent bank would survive the crisis – and savers could transfer any remaining solvent savings (Lutz, 1936, p. 185). The best way to encourage banking prudence is to allow the "law of bankruptcy":

> To the vast majority of people government interference in matters of banking has become so much an integral part of the accepted institutions that to suggest its abandonment is to invite ridicule. One result of this attitude is that insolvency in the sphere of banking has won exception from the rule applied in other lines of business that it must be paid for by liquidation, and it is important also to point out that since the laws of bankruptcy have almost never been strictly applied to banking we should be diffident of drawing the conclusion that actual experiences prove the unworkability of free competition in banking.
>
> *Lutz, 1936, p. 185*

Passages discussing the role of central banking in the development of a country are not easy to find in Lutz's later works. She was clearly against the privilege of Italian Government benefiting from loans from the Bank of Italy. Those loans served to create State-owned industries and to give subsidies to private industries. This was part of the development plan aimed at reducing the development gap between the north and the south of Italy. Lutz thought that those plans were ineffective at solving economic dualism.

Lutz put an emphasis on the fight against inflation. In her eyes, stable prices were an essential ingredient in development "for a recovery of personal savings, for a revival of bond markets, for a reduction in the amount of capital tied up in business hedging against rising commodity prices" (Lutz, 1962a, p. 325). In the aftermath of the Second World War, the level of commodity prices was rising in Italy. As Lutz wrote, before the stabilization of September 1947, the wholesale price level was fifty-five times higher than its level in 1938 (Lutz, 1962a, p. 297). One major cause of that rise was the note issue associated with "wheat bills" due to the Italian Government's support of high prices of wheat (Lutz and Lutz, 1950, p. 5). The Bank of Italy had to, without limit, discount bills issued by the organization pooling wheat, who purchased wheat at a price that was over twenty times the pre-war price (as explained by Masera, 1983, p. 32; see also Lutz 1962b, p. 164 and also Lutz and Lutz, 1950, pp. 5–6). In September 1947, the Government and the Bank of Italy had to find ways to stop the rise of commodity prices. Luigi Einaudi, appointed Minister of the Budget and also Governor of the Bank of Italy in September 1947, implemented a successful monetary policy of restrictive credit,[21] without reducing public spending (Lutz, 1962a, pp. 215, 297): "Professor Einaudi . . . was instrumental in carrying out these restrictive policies" (Lutz and Lutz, 1950, p. 12). Thanks to this policy, the value of the lira was rapidly stabilized, and the level of inflation was reduced in Italy.

Lutz's support for restrictive monetary policy seems to contradict her doctoral thesis in 1936, where she wrote against Hawtrey's monetary rule.[22] This rule aimed at stabilizing prices by controlling the quantity of money (Lutz, 1936, pp. 190–191). Such monetary policy, called "scientific management" of money by Lutz (1936, p. 190), was according to her a strong factor of "disturbance" in the economy:

> 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, pp. 194–195*

However, this apparent contradiction in Lutz's thought might not reflect a radical change in her view. One can suppose that Lutz adapted herself to a world with growing support for central banking practices, and that she found some benefits that she did not grasp while she was a doctoral student. Indeed, her view about central banking practices changed around the same time that she became interested in issues in development economics. In her writings about Italy, she clearly thought that monetary policy could favor the development of some less-advanced regions, by ensuring stability in the value of money (Lutz, 1962a, p. 325) and therefore limiting inflation which discourages agents from saving. Instead of public plans, Lutz is in favor of policies encouraging voluntary private savings, which can be used to finance projects in developing regions, such as the south of Italy:

> [T]he encouragement of voluntary private savings as a means of financing the increase in real capital resources which are necessary in order to allow the number of workers who can be employed at a given level of real wages to expand, an aim which can be reached by continuing the policy of maintaining stability of the lira.
>
> *Lutz, 1962a, pp. 83–84*

Concluding remarks

Hicks and Lutz provide contributions to the first generation of scholars who became interested in the field of development economics (Knight, 1991, p. 10). Though belonging to two different schools, both women promoted the transfer of knowledge and experience from developed to developing economies. Observing the development of banking in England (in Hicks' works), and more generally in occidental countries (in Lutz's PhD Thesis), Lutz and Hicks shared the idea that a sound banking system was necessary to ensure the proper functioning of the economy, despite an apparent opposition about the organization of such a system. Indeed, Lutz was for free banking, and Hicks for central banking. They nevertheless both considered that savings should be secured, liquidity should be provided to businesses when needed and the value of money should be kept stable by adopting relevant monetary policies.

In Hugon's fourth period of the evolution of development economics (1995–2007) there was a change in the dominant mentality supporting liberalization policies as well as knowledge transfer intended to support development. For example, Escobar (2012) denounces the practice of replicating the institutions and policies of "advanced" economies within countries where growth of domestic produce, industrialization, and mechanized, capital-intensive production in agriculture are low (p. 4). In this view, pursuing the goal of economic progress through the model of industrialized countries has caused more damage than benefit to the situation.

Lutz is less susceptible to Escobar's criticism, because, for the case of southern Italy, she did not think that public plans ("several hundreds of industrial plants," 1962a, p. 122) would help the economy to develop. She was also very critical toward plans conducted in France in the post-war period, as explained in one article and two books especially written for this issue (1964, 1965, 1969). Public plans, adopted by a majority of occidental countries after the Second World War, harmed more than helped countries by killing the spirit of entrepreneurship, and depriving economic agents from perceiving "real" signals of markets (Lutz, 1969, p. 117).

In some ways, Hicks contributed partly to the policy transfer process criticized by Escobar, although it is difficult to know how "lucrative" her civil servant functions were in the developing world.[23] However, she does not completely succumb to the Escobar critic because she never imposed a liberal model to follow. As a specialist of the evolution of British Finance from the nineteenth century until the 1930s (Hicks, 1938, 1947, 1954), her goal was to help former British colonies adapt economically with their newly gained independence. Hicks' introduction to *Development from Below* (1961) is insightful about this issue. After the war, Hicks observed an evolution of mentalities about the way to enhance economic development. It became more and more accepted that local governments had a role to play, and Hicks worked for their establishment:

> As soon as British people began to settle overseas, they set to work creating local institutions on the model of those to which they were accustomed; from these origins the democracy of the United States and of the older Dominions has grown up. That part of the expansion, and transplantation, of British local government will, however, lie, for the most part, outside our subject. Local democracy of that sort was a natural growth; no deliberate policy lay behind it . . . There is nevertheless something that is quite novel about the recent experience: what is it? . . . Since the last war local government has been regarded as a means, not only to political, but also to economic development.
>
> *Hicks, 1961, pp. 3–4*

The basis of national economic progress in Hicks' eyes, should come first by the existence of strong institutions –a local government and a central bank – which would collect public revenue, then secure and employ funds in the most efficient way. Before opening their economy to international trade, countries should be aware of the risks. Far from encouraging liberal policies, Hicks insisted on the need to be prepared to face risks of a shortage of foreign exchange or the risk of price volatility before opening the economy to international markets (Hicks, 1965).

Notes

1 This paper was presented in May 2017 at the European Society for the History of Economic Thought (ESHET) organized at the University of Antwerp. I would like to warmly thank Kirsten Madden (editor) without whom this chapter would not have this present form. I also thank very much Robert Dimand (co-editor with Kirsten Madden), and Farida Kahn (discussant) for their insightful help. I am also grateful to Nicolas Barbaroux, Harro Maas and Nathalie Sigot for their discussion during the session. This paper was also presented to the seminar of the LEDi in April 2017, I which to thank all the participants (Ludovic Desmedt, Jean-Luc Bailly, Xavier Bradley, Jimmy Lopez) and the PhD students present there (Emmanuelle Leturque).

2 Dr. Sheetal Bharat identified that Vera Anstey and Lillian Knowles were instrumental in coining the phrase "economic development". This term appears in the title of their respective books entitled *The Economic Development of the British Overseas Empire* (London: George Routledge and Sons, 1924) and *The Economic Development of India* (London: Longmans, Green, 1929).

3 In the Preface of *Development from Below* (1961) Hicks gives a description of her functions 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 1960s). Later in the 1960s she also advised some Asian countries such as Malaya.

4 The bibliographical profile for Ursula Hicks draws on material out of Jacobsen (2000).

5 Hicks wrote that Keynes's *General Theory* was a major source of inspiration for her work. About John Richard Hicks, she was very supportive of the *Social Framework* (1946).

6 As explained by Sue Van Atta and Edita A. Tan (July 21, 1970, University of Philippines).

7 "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" (Lawrence White, writing on the back cover of Lutz (1936) [1990]).

8 The Mont Pelerin Society is a think tank founded by Hayek in 1947. It gathers politicians, economists and thinkers who advocate freedom for individuals, enterprises and markets. Milton Friedman, Maurice Allais and James Buchanan were members of the Mont Pelerin Society.

9 In 1961 Chancellor of the Exchequer Selwyn Lloyd, and two years later Christopher Saunders, suggested implementing planning policies in England. Lutz worried about those political directions (1969, p. 62).

10 Despite authoring two books (1965, 1969) and one chapter written in 1964, Lutz's works about the French economy did not receive much attention from economists (except Kindleberger, 1967).

11 See also Maes, 2008, p. 2

12 Irma Adelman assessed the effectiveness of foreign aid in Greece in a paper written with Chenery in 1966. Like Hicks, Adelman encourages limiting the reliance on foreign aid.

13 This method of influencing rates by playing on the expectations of private agents was discovered in the 1930s, and presented by Keynes (1930, I and II, and 1936) and also by John R. Hicks (1939).

14 However, if the State has a high credit risk, private investors lose confidence and the public debt ceases to be liquid. Hicks assumes the State is credible: its debt is more trustworthy than the debt of private companies thanks to the power of raising taxes.

15 Arthur Lewis is credited with contributing the idea of economic dualism in the context of economic development, without explicitly coining this term. Italian economist 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.
>
> *1959, pp. 201–202*

Lutz did not claim explicitly that her researches were influenced by Lewis's theory. There is only one reference to Lewis in footnote 13, p. 137 in Lutz (1962a). Spaventa however wrote that she extended Lewis's theory to the Italian case in earlier works (1959, p. 203).

16 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.
>
> *1962a, p. 299*

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

18 Lutz raises these issues, quoting Professor Rossi Doria:

> Professor Rossi Doria has devoted many of his writings of recent years to the task of presenting – in the new light of modern techniques – the hard realities of the situation in the Mezzogiorno as, in his present view and that of many others, they still remain. His general conclusion is that, even allowing for the improvements that modern science and engineering have made possible, the pessimism of Fortunato was substantially justified. . . . Often lack of capital or 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 exist. These are connected partly with irremediable physical conditions, and partly with the present excessive population pressure.
>
> *Rossi Doria,* 10 anni di policia agrarian nel Mezzogiorno, 1958, *p. xviii, in Lutz, 1962, p. 169*

19 "It seems probable, then, that the condition of zero elasticity of supply of food, in the face of a rise in industrial productivity due to investment, will have one of the following consequences" (Lutz, 1962a, p. 138).

20 Lutz wrote:

> If the demand for labour in the North of the country continues at 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, 1962a, pp. 314–315*

21 Lutz 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, 1962b, pp. 171–172).

22 This rule was presented during the Genoa Conference in 1922 (Hawtrey, 1923, p. 61).

23 Quoting Rahnema (1991), Escobar underlined that working as planners, civil servants or experts for the government of developing countries was a "lucrative industry" (2012, p. 46).

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