THE GREAT INFLATION IN ITALY: A POLITICAL ECONOMY VIEW

1. Introduction[1]

After experiencing a long period of price stability in the two decades following the Second World War, most industrialized countries saw an acceleration in the inflation rate between the end of the 1960s and the first half of the 1970s. This acceleration had already begun to manifest itself at the turn of the 1970s, that is to say, before the first oil shock brought about by the Yom Kippur war.

Recently, there has been a resurgence of interest in the Great Inflation debate. A vast literature on the subject, both theoretical and empirical, exists, mostly focusing on the US experience. Less attention however has been given to events in individual countries. Cross-country analyses have tended to compare countries that experienced high levels of inflation with those that did not. What appears to have attracted insufficient consideration is the fact that some industrialized countries suffered very high and particularly virulent inflation.

In this paper we seek to explain the main reasons why the Great Inflation was higher and more persistent in Italy than elsewhere. In section 1 we provide an overview of the traditional interpretations of the Great Inflation and show that these fail to explain adequately the unusually high and persistent nature of inflation in Italy.

After a brief description of these interpretations, in section 2 we highlight their critical points, particularly the fact that these hypotheses view inflation, in line with the traditional literature, as the unintentional result of policy choices (or non choices). In contrast with this position, we show how inflation, at least in certain circumstances, may be the outcome of a political exchange between interest groups and the political class. This political exchange hypothesis is illustrated in section 3.

---

[1] Although the paper is the result of a team effort, section 1 was written by G.B. Pittaluga and section 2 and 3 by E. Seghezza.

In the Conclusion we offer some guidelines for policies designed to prevent inflation.

2. Traditional explanations for the Great Inflation

Despite showing high synchronicity, the Great Inflation also took on characteristics which differed from country to country.

With reference to Italy:

a) inflation on *average* was significantly higher than in most other G6;
b) it reached *peaks* higher than in most other industrialized countries;
c) it showed greater *persistence*: disinflation occurred later than in the other G6.

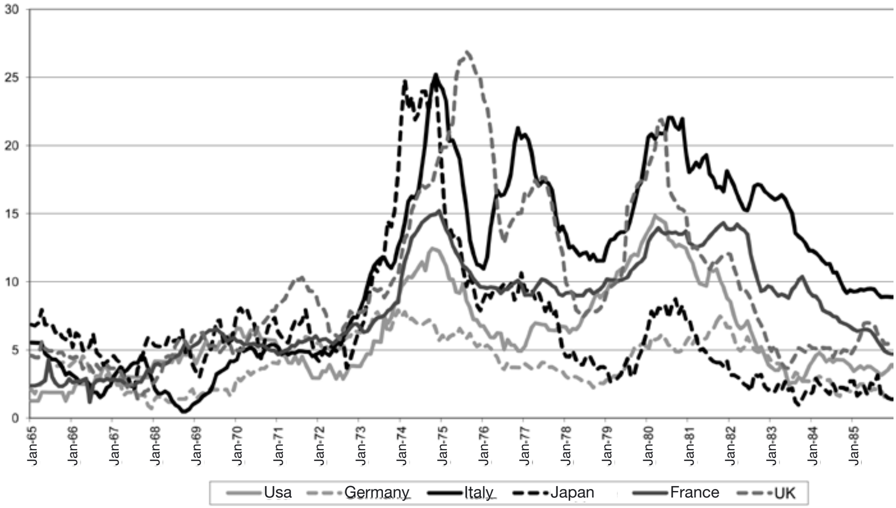
In fact, Italy had an inflation rate that was significantly higher than most G6 countries. The average annual rise in consumer prices in the 1970s in Italy was 12.3 per cent, lower only than the United Kingdom (12.6 per cent), whilst in the 1980s the annual average rise was 11.2 per cent, much higher than in any other G6 country. In Italy, moreover, the rise in prices peaked at a level higher than that recorded by other G6 countries on the back of the second oil shock in 1977. The peak reached in 1975 was second only to the level reached by the United Kingdom.

Figure 1 shows that during the 1980s inflation in Italy remained higher than in other G6 countries and decreased more slowly than elsewhere. Tellingly, at the end of the 1970s Italy's level of inflation was similar to the United Kingdom; in 1981 the growth in annual average prices in the UK had dropped to 11.9, whereas in Italy prices continued to rise at 18.0 per cent (Figure 1).

These data suggest that the Great Inflation in Italy was more persistent than that recorded in other G6 countries. Italy differs from the rest of the group in two fundamental ways: on one hand, Italy's persistence index was at significantly higher levels in comparison to other countries for most of the 1970s; on the other, the fall in the inflation persistence index occurred later in Italy than in other industrialized countries[2] (Figure 2).

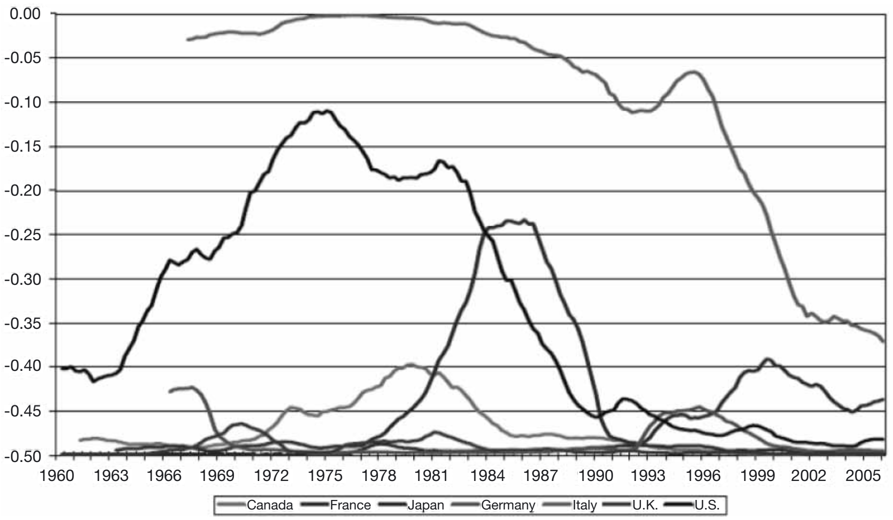
[2] See Cecchetti *et al*. (2007).

FIGURE 1 - *Inflation Rate in G6 Countries*



Source: IMF, International Financial Statistics, various issues.

FIGURE 2 - *Persistence of Inflation*



Source: Cecchetti *et al*. (2007)

Why was inflation in Italy so persistent in the 1970s and why does persistence only become significantly lower in the 1990s?

Within the Great Inflation debate, three types of explanation can be found.

The first is the so-called *bad luck hypothesis*[3], which is based on the assumption that during the 1970s industrialized economies were hit by a steady series of non-policy, exogenous shocks, primarily the increase in oil prices decided by OPEC in the wake of the Yom Kippur war.

The *bad luck hypothesis* appears not to explain satisfactorily both the intensity and the persistence of Italian inflation.

Another explanation for the Great Inflation is the *lack of commitment* view, i.e., policymakers in the 1970s had no institutional incentives to keep inflation low. The decisive cause for the Great Inflation according to this approach is therefore one of time inconsistency, first developed by Kydland and Prescott (1977) and Barro and Gordon (1983).

The importance of this type of explanation was recently emphasized by Chari *et al*. (1998), Christiano and Gust (2000), and Christiano and Fitzgerald (2003).

The more relevant criticism that can be moved to the *lack of commitment view* regards the lack of reliability of the hypothesis that the first oil shock would have significantly raised inflation expectations of individuals, forcing the central bank to adopt an accomodating monetary policy. The empirical evidence, in fact, shows that from the late 1960s to the early 1970s, in Italy, expected inflation was lower than actual inflation[4].

The third type of Great Inflation's interpretations are those that refer to the *policy mistakes view*[5].

In the 1960s and part of the 1970s the political class and most scholars attributed price rises to a *cost push* shock. This shock would have been due to trade unions increased pressure power and to wage rises above productivity[6].

---

[3] See Blinder (1982), Bruno and Sachs (1985) and more recently Blinder and Rudd (2008). Empirical support for this position can be found in Stock and Watson (2002), Cogley and Sargent (2003) and Sims and Zha (2004).

[4] See Visco (1976).

[5] See Spinelli and Fratianni (1997). This hypothesis has known a revival recently thanks to the contributions by Romer and Romer (2002), Nelson (2004a), Nelson (2004b), Romer (2005), Nelson (2006).

[6] The mentioned interpretations of the Great Inflation make reference to some theory of inflation. However, other scholars trace the Great Inflation

The Bank of Italy also considered inflation as cost-push generated[7]. The Bank of Italy's attitude towards inflation changed since 1975, when Baffi, the new governor of the bank[8], on several occasions showed an awareness both of the monetary causes of inflation and of its negative effects on growth[9].

As inflation reflected a certain political and economic equilibrium, according to Baffi the Bank of Italy, unlike other central banks[10], did not enjoy the social consensus necessary to carry out a disinflationary monetary policy.

Even though Baffi was aware that inflation, by altering market redistributive processes, was jeopardizing growth, in the second half of the 1970s monetary policy remained accomodating.

The stance of Italy's monetary policy, also during Baffi's governorship, is synthetically illustrated by the Indicator of monetary conditions (ICM) in Figure 3. The indicator shows that the 1970s were marked in Italy by particularly lenient monetary conditions. A correction towards more a rigorous monetary policy stance began only in the early 1980s following Italy's entry in the EMS.

Even if Governor Baffi was fully aware that the lax stance was mistaken with respect to the aim of maximizing the social utility, he was also convinced that the Bank of Italy had to behave in this way, given the political and social context[11].

On the basis of what has been shown so far, we may exclude that the Great Inflation experienced in Italy was the result of monetary policy based on a flawed economic model. Logically, we can reject the *policy mistakes view* and propose instead the hypothesis that, in Italy at least, the Great Inflation was the result of political choices[12].

The oil crisis of 1973-74 undoubtedly led to a significant worsening of Italy's terms of trade. The slowing down in output

back to mistake on the empirical data taken at reference by central banks for their monetary policy decisions. See, for example, Orphanides (2002).

[7] See, for example Banca d'Italia (1974; p. 42 and p. 71). This view was shared by the large part of scholars as made clear by Guiso (1985).

[8] See Spinelli and Fratianni (1997).

[9] See, on this point, Sarcinelli (1991), Fazio (2003) and Pittaluga (2004).

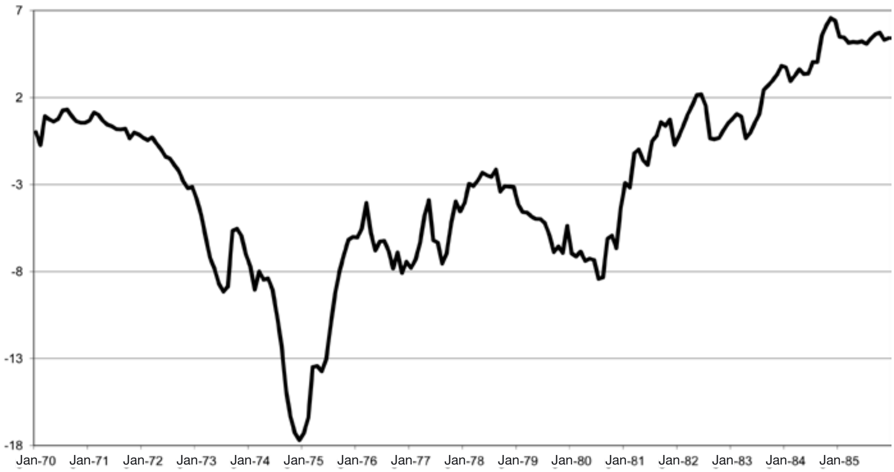
[10] See Baffi (1976; p. 212).

[11] See Baffi (1976; p. 211).

[12] A similar hypothesis regarding the United States was put forward by Meltzer (2005), Weise (2008), Levin and Taylor (2010) and even Friedman (2001).

rises triggered a conflict amongst interest groups about who should bear the effects.

FIGURE 3 - *Index of Monetary Condition*



Source: Author calculations.

An alliance between *workers* and industrialists was formed with the aim of unloading onto the *rentiers* the stabilization costs necessary to realign the balance of payments.

This alliance found its political expression in the centre-left governments in power in the late 1960s and for much of the 1970s.

> "In the mid-seventies some in this group [big business], led by Agnelli and Carli, come to the view that the country's economic problem could only be dealt with if there were a broad political consensus and specifically a modus vivendi with the Communist party and the unions" Spotts and Wieser (1987).

3. An alternative explanation of the Great Inflation

No one can argue against Friedman's assertion that inflation is always and everywhere a monetary phenomenon[13]: namely, it is always the result of an excess in money supply. However, raising

[13] See Friedman (1968; p. 29).

money supply is only the conduit along which inflation is created. The reasons for inflation stem from a particular political-economic equilibrium, more precisely from choices made by government and monetary authorities as well as from the demands different interest groups make on the political class[14].

Unless we understand the fundamental reasons for this equilibrium we cannot understand the ultimate reasons for inefficient political choices or how a new political economy equilibrium may emerge and give rise to stabilization measures[15].

This means that, unlike the position offered in many cases in the traditional literature[16], inflation and deflation are not policy errors, but

> "... rational policy choices – that is, ... choices that maximized the actual objectives of monetary policy subject to the policymaker's perceived constraints" Grossman (2000; p. 2).

Models based on the 'representative agent' hypothesis neglect the redistributive aspects connected with inflation. These aspects can be picked by introducing the hypothesis of heterogeneous agents, that is agents with different forms of income and wealth.

In particular, we can model the economy[17] by supposing that there are three economic groups:

1. the *rentiers*, who hold financial wealth subject to inflationary erosion;
2. the *workers*, who hold human capital and earn wages;
3. the *businessmen*, who hold physical capital and earn profits.

The three interest groups can have a different attitude towards inflation.

This attitude depends on both the different type of income and wealth interest groups have and the institutional framework.

Since society is made up of heterogeneous agents and different

---

[14] To put it briefly, as Hirsch (1978; p. 263) observes, "... e*conomic factors, and they alone, can explain how inflation happens, but economic factors cannot explain why* ...".

[15] See, among others, Acemoglu *et al.* (2008).

[16] Exemplified by Friedman and Schwartz (1963) and more recently by Taylor (1981; 1982).

[17] This model is similar to those put forward, intuitively, by Alesina (1988) and, analytically, by Pittaluga and Seghezza (2012).

interest groups that can gain their own particular advantages from price changes, inflation and deflation become means of redistributing income.

On the social arena, interest groups struggle in order to maximize their share of national income. Inflation (or deflation), like other fiscal measures, is an instrument for carrying out a favorable distribution of income. Consequently, each interest group express different demands regarding inflation.

Along with a demand side, there is also a supply side of inflation. This kind of supply comes from political parties which, with the aim at catching power, offer protection of the interest of social groups in exchange for electoral consensus. To achieve power political parties may promote alliances amongst different interest groups.

The equilibrium situation, i.e., the adoption of certain fiscal measures and of a given level of inflation, results from the political exchange between the demand of certain interest groups and the supply of one party or a coalition of parties that have gained the electoral majority.

Therefore, in the political exchange hypothesis, the equilibrium level of inflation is the result of two kinds of competition: the competition between interest groups in the social arena for income distribution and that between political parties in the political arena for achieving power.

Suppose that wage are indexed, exchange rates are flexible and workers and businessmen are indebted.

In this stylized context (similar to that prevailing in Italy in the 1970s) the *rentiers* are adverse to inflation and favor deflation. On the contrary, *workers* and *businessmen* favor inflation because they take advantage from the inflationary erosion of their debt, while their income is not hit by the inflation. If a negative shock occurs, a struggle between interest groups rise in order to transfer the loss of output and of income due to the shock to other interest groups. Policymakers, by choosing the level of inflation, determine the result of this struggle.

4. The Italian Great Inflation in the light of the political exchange hypothesis

We saw in the previous section that alliances between *workers* and *businessmen* sought to transfer to *rentiers* the costs of adjustment made necessary by a worsening in the terms of trade. Which policy instruments were used in the actual transfer of these costs from one set of interest groups to another? Principally, the transfer of costs took place by means of the redistributive effects of inflation.

Most empirical literature on these redistributive effects focuses attention on flow variables, in particular on the redistribution of income. Few papers look at the redistributive effects of inflation on wealth, particularly of financial wealth[18]. Also the empirical studies relative to the effects of inflation on financial wealth refer mainly to the inflationist tax on cash.

Conversely from what is to be found in this literature, the present paper gives crucial importance to the redistributive effects resulting from unexpected shocks to the total stock of nominal financial assets, of which cash is but a small part. Only in recent years some papers highlighted and estimated, with reference to the United States, the process which determines a redistribution of income through the effects of inflation on financial wealth[19].

With regard to Italy, one finds that the redistribution of income induced by the inflation tax on financial wealth in the 1970s were on an impressive scale.

Considering the amount of the financial assets held by households, inflationist erosion in the 1970s was on an average, annual basis, 8 per cent of GDP, rising to 14 per cent in 1974[20].

For most of the 1970s the redistribution effect on financial wealth through inflation was greater than that of income and property taxes[21] (Table 1).

---

[18] The better known of these contributions, in particular those by Erosa and Ventura (2002) and Albanesi (2007), put forward the view that *the poor* hold a higher proportion of currency, i.e., a form of wealth not protected from inflation, compared to the financial assets held by *the rich*. In this perspective inflation does harm *the poor*.

[19] See, in particular, Doepke and Schneider (2006).

[20] On the redistributive effects of inflation on financial wealth real value see Masera (1979), Lecaldano *et al.* (1985) and Cotula and Filosa (1989).

[21] In 1974 Paolo Baffi, at the time General Director of the Bank of Italy, pointed out in a speech held at the 'Accademia dei Lincei' that "[*If due consideration be given to monetary credits eluding the survey of financial assets and to the loss of the purchasing power of financial activities occurring during 1973, the conclusion is reached that under present circumstances inflation is a mechanism of purchasing power transfer with an importance comparable to the fiscal mechanism*.]" Translation by the authors from Baffi (1979, pp. 685-686).

TABLE 1 - *Loss of Purchasing Power of Households' Financial Wealth*

Year	Average nominal interest rate on households' financial assets	Average real *ex post* interest rate on households' financial assets	Loss of purchasing power on households' net financial assets		Pro memoria: income and property tax in percent-ages of GDP
			In billions of Italian liras	In percentages of GDP	
1971	4.8	-0.5	-2011	2.8	5.6
1972	4.6	-1.2	-3677	4.6	6.0
1973	4.5	-6.3	-7259	7.5	5.7
1974	4.5	-13.7	-17105	14.1	5.7
1975	5.5	-11.1	-9239	6.7	6.2
1976	7.4	-9.3	-21311	12.2	6.3
1977	8.7	-8.2	-14952	7.0	7.0
1978	8.1	-4.0	-16659	6.6	8.3
1979	8.0	-6.8	-33799	10.9	8.5
1980	9.0	-12.2	-45790	11.8	9.8
1981	11.1	-8.4	-46209	10.7	10.9

Source: Lecaldano *et al.* (1985).

Moreover, savers could not easily escape this expropriation of income and wealth in view of the presence of tight constraints on international capital mobility.

The incidence of the redistributive effects within the households sector is to be considered as unequal, given the high concentration of financial wealth in highest income classes. Sample data taken by the Bank of Italy reveals that at the end of the 1960s less than 8 per cent of households held almost 40 per cent of banking deposit amounts and more than 45 per cent of the outstanding securities[22], at that time remunerated through fixed interest rate. The same sample data also showed that at the beginning of the 1970s financial wealth was generally concentrated not only in the social classes with the highest income levels but in those receiving income from independent activities.

[22] See Banca d'Italia (1970).

The high concentration of financial wealth, whose large part was represented by fixed rate assets, made for a highly polarized attitude towards inflation on the part of the different interest groups. This created the conditions for a political use of money. The prolonged inflation of the 1970s had its grounds in the persistence over time of a class of income earners which could be exploited.

Who benefited from inflation?

The surreptitious expropriation of *rentiers'* resources benefited the State as well as private sector non financial enterprises and *workers*. In the 1970s Italian non financial enterprises benefited from real interest rates on bank loans close to zero, in some years significantly negative. Since bank loans represented a large share of businesses financing, this took the form of surreptitious transfers of resources to this sector[23]. Faced with a highly negative real interest rate on bank deposits, households, the main holders of these instruments, were penalized by enormous capital losses (Table 1).

The producers of tradable goods were also helped by the exchange-rate policy adopted by policymakers. In fact, the Bank of Italy flanked rising inflation with a depreciation of the nominal exchange rate and was able to maintain the real exchange rate of the lira tendentially depreciated in real terms[24]. In this context during the 1970s Italy could preserve its market share of world exports[25].

Due to the erosion of the real value of their liabilities and to the depreciation of the real exchange rate, Italian enterprises were able to absorb a marked rise of real wages. This increase favored an increase of the share of *workers*' income of GDP from 78 to 83 per cent between 1970 and 1975.

5. Conclusion

The prevalent reinterpretations of the Great Inflation formulated in recent periods attribute the inflationist acceleration of the 1970s mainly to the fact that policymakers at the time based themselves on 'mistaken' economic ideas, above all the traditional Phillips curve.

[23] On this aspect see Fanna *et al*. (1989; p. 108).

[24] See Giavazzi and Spaventa (1989).

[25] This share passed from 6.3 per cent in 1970 to 7 per cent at the end of the 1970s.

However, the Great Inflation lasted too long to be considered the outcome of behavioural mistakes. In other words, given the price dynamics over several years, it is inconceivable to think that the policymakers did not ask themselves about the validity of their economic models.

This paper is an attempt to reply to this question with the *political exchange* hypothesis. In economic systems with a high polarization between creditors and debtors there are interest groups with different preferences towards inflation, that is to say, different demands for inflation. Each interest group exerts pressure for their own preferences, and consequently, their own interests to prevail. Those who are on the side of the political supply try to give a reply to the inflation demands. There are thus parties or coalitions which formulate inflation offers in an attempt to bring together interest groups with similar preferences with regard to inflation. The parties or coalitions that command a majority of a country's citizens impose their choices regards to inflation and fiscal measures and at the same time try to consolidate their power by enlarging the spectrum of the interest groups favored by these choices.

It follows that the prevailing inflation rate in a given economy is primarily the result of a political exchange.

In this perspective, the persistence of Italy's Great Inflation can be attributed to the alliance between *businessmen* and *workers* which on the political arena was represented by left wing government coalitions[26]. Since these interest groups were protected from inflation, the former through the flexible exchange rate and the latter through the sliding wage scale, they favored an ample redistributive process by means of inflation to the detriment of those holding financial assets, i.e., the *rentiers*. The monetary authorities, in particular the Bank of Italy, starting from the governorship of Baffi, were aware of the high costs of inflation and of the fact that the economic policy being pursued was based on an erroneous model, but they were impotent in the face of a coalition between center and extreme left parties and the alliance between the interest groups in power at the time.

The Italian experience suggests that inflation processes are more probable and more intense where interest groups are strongly polarized and where some of these groups are protected, for instance

[26] More precisely by centre-left governments which for a brief period from 1976 to 1979 were supported by the Communist Party.

by forms of indexation, from inflation, whilst other groups have no such protection.

It follows that high inflation can be prevented by restricting the degree of polarization of interest groups in terms of inflation exposure.

Giovanni B. Pittaluga
Università di Genova, Dipartimento di Scienze Politiche, Genova, Italia

Elena Seghezza
Università di Genova, Dipartimento di Economia e Metodi Quantitativi, Genova, Italia

REFERENCES

Acemoglu D., S. Johnson, P. Querubin and J.A. Robinson (2008), "When does Policy Reform Work? The Case of Central Bank Independence", NBER Working Paper No. 14033.

Albanesi, S. (2007), "Inflation and Inequality", *Journal of Monetary Economics*, 54(4), 1088-1114.

Alesina, A. (1988), *The End of Large Public Debts*, in: F. Giavazzi, L. Spaventa (Eds), "High Public Debt: the Italian Experience", Cambridge University Press: Cambridge.

Baffi, P. (1976), *Concluding Remarks*, in: "Report for the Year 1975", Banca d'Italia: Rome.

Baffi, P. (1979), *Il risparmio in Italia, oggi,* in: F. Cotula, P. De Stefani (Eds), "La politica monetaria in Italia: istituti e strumenti", il Mulino: Bologna.

Banca d'Italia (1970), Indagine sui bilanci delle famiglie italiane, Roma.

Banca d'Italia (1974), Relazione Annuale sul 1979, Roma.

Barro, R.J. and D.B. Gordon (1983), "Rules, Discretion and Reputation in a Model of Monetary Policy", *Journal of Monetary Economics*, 12(1), 101-122.

Blinder, A.S. (1982), *The Anatomy of Double-digit Inflation in the 1970s*, in: R.E. Hall (Ed.), "Inflation: Causes and Effects", University of Chicago Press: Chicago.

Blinder, A.S. and J.B. Rudd (2008), "The Supply Shock Explanation of the Great Stagflation Revisited", NBER Working Paper No. 14563.

Cecchetti S., P. Hooper, B.C. Kasman, K.L. Schoenholz and M.W. Warson (2007), "Understanding the Evolving Inflation Process", Presentation at the US Monetary Policy Forum, Washington: D.C.

Chari, V.V., L.J. Christiano and M. Eichenbaum (1998), "Expectations Traps and Discretion", *Journal of Economic Theory*, 81(2), 462-492.

Christiano, L.J. and T.J. Fitzgerald (2003), "Inflation and Monetary Policy in the 20th Century", *Economic Perspectives*, First Quarter, 22-45.

Christiano, L.J. and C. Gust (2000), "The Expectations Trap Hypothesis", *Economic Perspectives*, Second Quarter, 1-39.

Cogley, T. and T.J. Sargent (2003), "Drifts and Volatilities: Monetary Policy and Outcomes in the Post WWII U.S.", University of California at Davis Working Paper No. 35.

Cotula, F. and R. Filosa (1989), *La contabilità nazionale e i conti finanziari. Flussi reali e finanziari*, in: F. Cotula (Ed.), "La politica monetaria in Italia", il Mulino: Bologna.

Doepke, M. and M. Schneider (2006), "Inflation and Redistribution of Nominal Wealth", *Journal of Political Economy*, 114(6), 1069-1097.

Erosa, A. and G. Ventura (2002), "On Inflation as a Regressive Consumption Tax", *Journal of Monetary Economics*, 49(4), 761-795.

Fanna, A., F. Papadia and G. Salvemini (1989), *Attività e passività finanziarie degli utilizzatori finali delle risorse in Italia,* in: F. Cotula (Ed.), "La politica monetaria in Italia", il Mulino: Bologna.

Fazio, A. (2003), *Paolo Baffi, studioso della moneta e governatore,* in: P. Baffi "Le origini della cooperazione tra le banche centrali. L'istituzione della Banca dei Regolamenti Internazionali", Laterza: Bari.

Friedman, M. (1968), Inflation: Causes and Consequences, Asia Publishing House: New York.

Friedman, M. and A.J. Schwartz (1963), A Monetary History of the United States, 1867-1960, Princeton University Press: Princeton.

Giavazzi, F. and L. Spaventa (1989), "Italy: the Real Effects of Inflation and Disinflation", *Economic Policy*, 4(8), 133-171.

Grossman, H. (2000), "The Political Economy of War Debts and Inflation", NBER Working Paper No. 2743.

Guiso, L. (1985), *Il dibattito sull'inflazione italiana negli ultimi quindici anni*, in: "Contributi all'Analisi Economica", Servizio studi della Banca d'Italia: Roma.

Hirsch, F. (1978), *Conclusion: the Ideological Underlay of Inflation,* in: F. Hirsch, Goldthorpe J.H. (Eds), "Political Economy of Inflation", M. Robertson & Co.: London.

IMF, International Financial Statistics, various issues.

Kydland, F.E. and E.C. Prescott (1977), "Rules rather than Discretion: The Inconsistency of Optimal Plans", *Journal of Political Economy*, 85(3), 473-492.

Lecaldano, E., G. Marotta and R.S. Masera (1985), "Households' Saving and the Real Rate of Interest: the Italian Experience, 1970-1983", Temi di discussione del Servizio Studi Banca d'Italia n. 47, Banca d'Italia: Roma.

Levin, A. and J.B. Taylor (2010), "Falling behind the Curve: A Positive Analysis of Stop-start Monetary Policies and the Great Inflation", NBER Working Paper No. 15630.

Masera, R.S. (1979), Disavanzo pubblico e vincolo di bilancio, Edizioni di Comunità: Milano.

Meltzer, A.H. (2005), "Origins of the Great Inflation", *Federal Reserve Bank of St. Louis Rewiew*, 87(2), 145-176.

Nelson, E. (2004a), "The Great Inflation of the Seventies: What Really Happened?", Federal Reserve Bank of St. Louis Working Paper No. 2004-001.

Nelson, E. (2004b), "Monetary Policy Neglect and the Great Inflation in Canada, Australia and New Zealand", Federal Reserve Bank of St. Louis Working Paper No. 2004-008A.

Nelson, E. (2006), "Ireland and Switzerland: The Jagged Edges of the Great Inflation", Federal Reserve Bank of St. Louis Working Paper No. 2006-016A.

Orphanides, A. (2002), "Monetary Policy Rules and the Great Inflation", *American Economic Review*, 9(2), 115-120.

Pittaluga, G.B. (2004), *Il governatorato di Paolo Baffi (1975-1979)*, in: Biblioteca della Nuova Antologia "Governare la moneta. La Banca d'Italia da Einaudi a Ciampi", Fondazione Spadolini Nuova Antologia, Polistampa: Firenze.

Pittaluga, G.B. and E. Seghezza (2012), "The Role of Rentiers in the Stabilization Processes of the Twenties", *European Economic History Review*, forthcoming.

Romer, C. (2005), "Commentary on Meltzer", *Federal Reserve Bank of St. Louis Review*, 87(2), 177-186.

Romer, C.D. and D.H. Romer (2002), "The Evolution of Economic Understanding and Postwar Stabilization Policy", NBER Working Paper No. 9274.

Sarcinelli, M. (1991), "Governor Baffi's Monetary Policy", *Banca Nazionale del Lavoro Quarterly Review*, 179(12), 513-535.

Sims, C.A. and T. Zha (2004), Were there Regime Switches in US Monetary Policy?, Center for Economic Policy Studies, Princeton University: Princeton.

Spinelli, F. and M. Fratianni (1997), A Monetary History of Italy, Cambridge University Press: Cambridge.

Spotts, F. and T. Wieser (1987), Italy. A Difficult Democracy, Cambridge University Press: Cambridge.

Stock, J.H. and M.W. Watson (2002), "Has the Business Cycle Changed and Why?", NBER Working Paper No. 9127.

Taylor, J.B. (1981), "Stabilization, Accommodation and Monetary Rules", *American Economic Review*, Papers and Proceedings, 71(2), 145-149.

Taylor, J.B. (1982), "Establishing Credibility: a Rational Expectations Viewpoint", *American Economic Review*, Papers and Proceedings", 72(2), 81-85.

Taylor, J.B. (2001), "An Interview with Milton Friedman", *Macroeconomic Dynamics*, 5(1), 101-131.

Visco, I. (1976), *Misura ed analisi delle aspettative inflazionistiche: l'esperienza italiana*, in: "Contributi alla Ricerca Economica", Banca d'Italia: Roma.

Weise, C. (2008), "Political Constraints on Monetary Policy during the Great Inflation", MPRA Paper No. 8694.

ABSTRACT

The prevalent reinterpretations of the Great Inflation formulated in recent periods attribute the inflationist acceleration of the 1970s mainly to the fact that policymakers at the time based themselves on 'mistaken' economic ideas, above all the traditional Phillips curve. However, the Italian Great Inflation lasted too long to be considered the outcome of behavioural mistakes. Besides, the monetary authorities, in particular the Bank of Italy governor Baffi, were aware of the high costs of inflation, but they were impotent in the face of the inflationary preferences of society. The high level and the persistence of Italy's Great Inflation can be attributed to the choice of policymakers supported by an alliance between interest groups protected from inflation, in particular between *workers* and *businessmen*. These interest groups favored an ample redistributive process by means of inflation to the detriment of those holding financial assets, i.e., the *rentiers*.

Keywords: Great Inflation, Interest Groups
JEL Classification: E31, E52, E65

RIASSUNTO

La Grande Inflazione in Italia: un'interpretazione alla luce della political economy

Le interpretazioni prevalenti della Grande Inflazione formulate nel periodo recente attribuiscono l'accelerazione inflazionistica degli anni Settanta in gran parte al fatto che i policymaker del tempo si basarono su idee economiche "sbagliate", in particolare sulla curva di Phillips tradizionale. Tuttavia, la Grande Inflazione italiana durò troppo a lungo per essere considerata il risultato di errori di comportamento delle autorità monetarie. Queste ultime, inoltre, in particolare il governatore della Banca d'Italia, Baffi, erano dichiaratamente consapevoli degli alti costi dell'inflazione, ma erano impotenti rispetto alle preferenze inflazionistiche della società. Il livello elevato e la persistenza della Grande Inflazione italiana possono essere attribuiti alle scelte dei policymaker, sostenute e sollecitate da un'alleanza tra gruppi di interesse protetti dall'inflazione, in particolare da lavoratori e imprese. Questi gruppi di interesse favorirono un ampio processo redistributivo attraverso l'uso dell'inflazione in modo da traslare i costi di aggiustamento dello shock petrolifero sui detentori di attività finanziarie, i *rentiers*.