Annals of the Fondazione Luigi Einaudi
Volume LIX, June 2025: 19-38

LUIGI EINAUDI, THE ECONOMIST AND THE HISTORIAN

Roberto Marchionatti*

ABSTRACT

This paper presents Einaudi's conception of economics. The paper is divided into two parts: the first explores Einaudi's philosophical and methodological thinking, discussing his view of the role of history and what he calls "the economist's ideals", while the second deals with his theoretical and applied economics. The resulting profile of Einaudi as economist and economic historian confirms Schumpeter's judgement that the Italian economist exemplified a profitable interweaving of historical and factual work that fertilized general economics without conflicting with theory.

Keywords: Italian Economic Thought, Luigi Einaudi, Economic Liberalism.
JEL Codes: B1, B2, B3.

Introduction

In his *History of Economic Analysis*, Schumpeter wrote that Italian economics "was second to none in 1914" (Schumpeter 1954: 855). Not only could it boast conspicuous achievements in theory, by Pareto *in primis*, Schumpeter noted, it "reached a high level in a variety of lines and in all fields of application" (*ibid.*). One of few Italian economists Schumpeter mentioned by name is Luigi Einaudi, who is applauded for his historical and factual work that fertilized general economics without conflicting with theory. In fact, he was among the leading Italian economists of the time and leader of a school, the Turin School of economics, which was an eminent expression of that period of Italian economic thought (see Marchionatti *et al.* 2013 and Marchionatti 2009). Einaudi stands between two eras in the

* Università di Torino. Address for correspondence: Roberto.marchionatti@unito.it.

ISSN: 2532-4969
doi: 10.26331/1254

history of economic thought. In the first, between the 1890s and the First World War, his thinking was shaped and achieved its first articulate vision. This period saw the systematization of marginalist-neoclassical thought at the international level,[1] and was also the golden age of Italian economic thought, as witnessed by the work not only of Pareto but also of Maffeo Pantaleoni. In the second era, between the two world wars, Einaudi's thought reached full maturity and international recognition. The period has been called the "silver age of Italian marginalism" (Faucci 2000), when significant advances in doctrine were made by numerous economists who, though internationally active, showed little openness to the new ideas – chiefly Keynes's – that were then gaining ground. This was the period when Einaudi rose to prominence.

Einaudi was thus an economist of the neoclassical school, whose contributions ranged from methodology to theoretical and applied analysis, and to public finance. His vision and doctrine were shaped by many influences: the Italian economists Cognetti de' Martiis, his mentor at the University of Turin, Pantaleoni and De Viti de Marco, the work of Marshall and Pareto (the Pareto of the *Cours* rather than that of the *Manuale*), as well as the classics, from Smith to Mill, but not Marx.[2] These influences operated on several levels. Methodologically, Einaudi's thinking is heir to the Paretian experimental method, which emphasizes that deductive reasoning must be supported by experience and observation, both statistical and historical. At the analytical-conceptual level, Einaudi's toolkit is that of neoclassical analysis; as regards his conception of the economic process, it is essentially classical-Smithian, along the lines of Marshall's analysis in Book IV of *Principles*. From this perspective, accumulation, based on savings that drive investment, is seen as a cyclical process, proceeding through market expansion, technical progress and economies of scale, in a setting where competition acts as an efficient selection mechanism. Einaudi extends earlier and contemporary economic thought in his main fields of investigation: from the analysis of the business cycle and money to the issues of public finance. Cycle theories – one of the most fertile areas of economics at the turn of the century – were one of Einaudi's earliest and most enduring interests. For the theory of money, Fisher was the fundamental influence,

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1 For an examination of the economic theory of the periods 1890-1914 and between the two world wars see Marchionatti (2020 and 2021).

2 Einaudi's position with respect to Marx was strongly influenced by the debate on Marxism that took place between 1894 and 1900 in Europe, and in Italy involved many authors, including Achille Loria, Arturo Labriola and Benedetto Croce: Einaudi found Croce's critical work to be particularly interesting (see Marchionatti 1998, and Marchionatti and Becchio 2000.

particularly his treatment of the quantitative theory of money. In the field of public finance, Einaudi continued the Italian tradition of Pantaleoni and De Viti de Marco on the one hand, and the work of Wicksell on the other.[3] Nor must we forget his relationship with Pigou, who pursued Mill's theorem of double taxation at the same time as Einaudi.[4] In the period following the First World War, between the 1920s and 1930s, the theoretical structure of Einaudi's thought was strengthened and refined through his exploration of new theoretical directions in the neoclassical area. First, the work of the neo-Austrian school, both on the methodological level and as regards its criticism of Keynes, particularly as propounded by Lionel Robbins, leader with Hayek of the London School of Economics in the 1930s, with whom Einaudi's intellectual dialog was particularly fruitful. No less significant was Einaudi's relationship with Wilhelm Röpke, a member of the German neoclassical school of economics that was stifled and dispersed with the advent of Nazism, who developed a doctrine of humanistic liberalism and of liberally oriented economic policy.[5] Lastly, it should be remembered that the history of economic thought played an important part in this phase of Einaudi's intellectual development, with his many articles on well-known economists – Smith, Galiani, Cantillon, Sismondi, Ferrara – and lesser-known figures, Italian authors especially. These articles are, as Einaudi wrote, a "wander through my library", analyzing the writings of older economists to discover their usefulness and topicality. Within this theoretical framework, and dealing with real-world problems, Einaudi's thinking unfolds.

In this paper, I will outline Einaudi's conception of economics by dividing it into two parts: philosophical and methodological work, and theoretical and applied economics.[6] For Einaudi's analysis of public finance, the reader is directed to Revelli's article in this issue.

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[3] In his 1896 essays on theoretical finance, *Finanztheoretische untersuchungen*, published in Italian by Gino Borgatta in 1934, Wicksell's treatment of the theory of qualified majority decision processes in public finance, based on the comparison between marginal utility of expenditure and marginal costs of the taxes that individual taxpayers are willing to pay, can be linked to the original contributions made by Einaudi, who drew on the Italian public finance tradition for his work in the area.

[4] Pigou dealt with the double taxation of savings in 1912 in *Wealth and Welfare*. At the same time, Einaudi discussed it in a paper (Einaudi 1911-1912: 209-213), to which Pigou devoted an extensive review in the *Economic Journal* a year later.

[5] On Einaudi and Röpke see Forte 2009: 223-238.

[6] This paper is mainly based on the *Introduction* by Marchionatti and Revelli 2024 to the *Scritti di economia e scienza delle finanze*, volumes I.2-3 of the *Edizione Nazionale delle Opere di Luigi Einaudi*, and draws on earlier work by the author, in particular Forte and Marchionatti 2012 and Marchionatti 2000.

1. Method and vision: On the nature of economic science and the ideals of the economist

Einaudi's philosophical reflections address the issues of the nature of economic science, its method and the problem of the relationship between analysis and the expression of value judgements, or the question of the importance of the economist's ideals. The theme in its broadest form is discussed in *Ipotesi astratte ed ipotesi teoriche, e dei giudizi di valore nelle scienze economiche*.[7] Economic science, writes Einaudi, is a combination of pure economics and applied economics. While the former consists in posing abstract problems and demonstrating abstract laws following the Marshallian and Paretian method of successive approximations and using theoretical schemata that sketch out the broad outlines of reality, applied economics has the fundamental task of giving economic science practical relevance by relating abstract schemata to concrete reality. Einaudi thus adopted the Marshallian-Paretian methodological vision of "using deductive logical procedures jointly with inductive logic, abstract reasoning and its empirical testing" (Einaudi 2014: 32). Einaudi considered empirical observation to be fundamental. Such empirical observation relies essentially on history – in fact, reflecting on the role of history in economic investigation was a fundamental aspect of Einaudi's method. Einaudi approached economics with a sense of history, or, as he put it (Einaudi 1936), he sought to examine facts with a "historical eye". This is what he considers the point of view par excellence:

> This is a very rare characteristic of those who have economic sense together with legal and political sense and others as well, and embraces the facts in their entirety and ignores secondary and irrelevant criteria at that point, concentrating on one or those that are significant from time to time … Unfortunately, such accomplished historians are born at a great distance from each other; but, once born, they compel everyone's admiration (*ibid.*: 155).

The next step in Einaudi's argument was to address the problem of the relationship between the economist's analytical process and the expression of value judgements. Einaudi asks: "can the economist … refrain from pronouncing value judgements?" (Einaudi 2014: 51). He rejects the idea – held by Robbins and von Mises – that economic science is value-free. Robbins's neo-Austrian approach in his 1932 *Essay on the Nature and*

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[7] The essay, originally published in 1942-1943, was translated in English in Einaudi 2014. Quotations in this paper are from this translation. For a critical edition of this essay in English see Einaudi 2017.

Significance of Economic Science meant that the economist's job begins once choices have already been made. Accordingly, Einaudi writes, Robbins's economist is a "real high priest of science": "faced with a proposition put forward by a member of the government", he "dispassionately investigates its likely effects and studies the links it will necessarily involve with other propositions and other institutions, and does not attempt to go further". His is an "enquiry into truths, not a list of councils" (*ibid.*: 64). But, Einaudi continues, "by enquiring into truths, the scholar inevitably asks himself this question: can I avoid passing judgement on the opinions, beliefs or decisions of the political classes?" (*ibid.*: 64-65). No, he replies: "we cannot set limits on the scientific approach to economic problems in such a way as to exclude value judgements" (*ibid.*: 59). Rather, the economist must "formulate moral judgements on the motives behind his own choices, decisions and private and public actions" (*ibid.*: 65): the economist cannot fail to make his choice according to his ideal of life. Einaudi's ideal of life is the liberal ideal, which he considers best able to provide an adequate answer to the problem of man's moral and material elevation: "this vision of life cannot but exert a major influence on his treatment of economic problems" (*ibid.*: 66). Starting from these convictions, Einaudi raised the question of the relationship between a society's economic order and freedom, which was to tinge his lifelong exploration of liberalism.[8]

Einaudi's thinking on liberalism can be divided into two distinct periods: from the end of the 1890s to the mid-1920s, and from the end of the 1920s to the 1940s. In the first period, Einaudi's liberalism was modeled on English liberalism, as can be seen from his *Germanofili e anglofili* (Einaudi 1916). However, the most important book of the period is *Le lotte del lavoro* published in 1924, which was especially significant because it came out during the transition from the liberal era to the fascist period. The book's content spans over twenty-five years, from 1897 to 1923, setting out the central vision of Einaudi's liberalism, which combines the fruitfulness of struggle with the positive value of labor. This was the "socialism of sentiment" dear to the youthful Einaudi. The book's short introduction, *La bellezza della lotta* – the beauty of struggle – extols this socialism of sentiment and the liberal ideals connected to it, against scientific socialism and Russian collectivism, and against fascist corporatism, which he saw as sharing a desire to stifle struggle as a factor of historical progress. In

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[8] On the concept of freedom, Einaudi's relationship with John Stuart Mill's thought is fundamental. In his introduction to the Italian translation of *On Liberty*, Einaudi 1925 writes that it is "the textbook of a fundamental truth: the supreme importance for man and society of a great variety of types and characters and of human nature's full freedom to expand in innumerable and contrasting directions".

part IV of the book, he contrasts the Bolshevik "myth" with "the ideals of labor". Here, a noteworthy section deals with the Italian publication of Goethe's letters from Naples at the end of the 18th century, where Einaudi praises the value of "labor done for the purpose of making life more beautiful". Between the late 1920s and early 1940s, years of economic, social and moral crisis in the West, Einaudi's liberalism took the form of a dialog with great intellectuals of the time, from Benedetto Croce to John M. Keynes and Wilhelm-Röpke. In the dialog with Croce, Einaudi addresses the fundamental question of what economic order promotes freedom. In an essay of 1931, *Dei diversi significati del concetto di liberismo economico e dei suoi rapporti con quello di liberalismo*,[9] Einaudi writes:

> Freedom cannot live in an economic society that lacks a rich and varied flowering of human lives, alive in their own right, independent of each other, not enslaved by a single will […]. The free spirit creates an economy consonant with itself […]. Man's spirit, if it is free, creates a varied economy … Without the coexistence of many forces animated by their own original spirit, a free society cannot exist, liberalism cannot exist (Einaudi 2006: 78-79).

In polemic with Croce, Einaudi thus rejects the idea that freedom can arise whatever the existing economic order. "Is the idea indifferent to the ways or means?" he asks rhetorically in a 1937 essay, *Tema per gli storici dell'economia: dell'anacoretismo economico* (Einaudi 1937a). While acknowledging that "no means is sufficient in itself to ensure moral freedom", Einaudi emphasizes that "there are, however, means which, by their very nature, invincibly repel the idea of freedom, and others which, on the other hand, […] tolerate and at times favor the emergence and flourishing or, at least, the extension of freedom to a larger number of men" (*ibid.*: 187). And he continues: "not all types of economic organization are equally conducive to the full liberation of the yearning, which differs from man to man, to fulfil that which is best in each of us". Not so communism, says Einaudi, "if by communism we mean […] a coercive organization of production ordered in accordance with certain tables of the law promulgated from time to time by the dominant group". Einaudi sees communism as an extreme case: when the implementation of the socialist principle is pushed beyond its limits. In one of his *Prediche inutili* published in the 1950s on liberalism and socialism (*Discorso elementare sulle somiglianze e sulle dissomiglianze fra liberalismo e socialismo*), Einaudi states that the liberal man and the socialist man are in a "fruitful and creative" contrast. Political and social stability,

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[9] An English translation of this article is in Einaudi 2006. Quotations are from this translation.

Einaudi continues, is only threatened "when the limit is breached; and the liberal man foolishly denies the need for collaboration among men living in society" – Einaudi refers here to the case of the United States in the last decades of the 19th century – "or the socialist man denies men's right to live differently from the way he has declared to be obligatory" (Einaudi 1957: p. 240). At this point, the contrast "is no longer about particulars; about tendencies, about more or less state control or framing, about the limits on individuals' doings and those on the state's doings". On the contrary, the contrast is one "of principle, and insuperable". Accordingly, the communist experiment should be opposed because of its reliance on compulsion, its denial of freedom, where men "are servants of those who command". According to Einaudi, it is not the common ownership of the means of production per se, but the coercion to common ownership, that makes communism so negative. This coercion, this "forced peace of totalitarian tyranny", prevents the operation of the principle that, more than any other, makes a society prosper, economically and otherwise: the principle of the struggle (Einaudi 1957: 241). But even capitalism cannot "encourage the full liberation of the spirit": capitalism cannot do so, Einaudi writes in 1937 essay, "if by [monopoly] capitalism we mean, as tends to be the case in so much of the Western world, the regime which gives an ever-smaller number of bosses, chosen for non-economic qualities, the exclusive privilege of governing the material means of production" (Einaudi 1937a: 191). For Einaudi, the limits of communism and monopoly capitalism thus lie in the fact that they "tend to standardize and level out men's actions, resolutions and thinking" (*ibid.*). There have been moments in history – Einaudi cites the period of the medieval communes, certain decades of the 17th century in England and Holland, and the 19th century in the Western European-American world – in which "the freedom to think and write, the fervor of debate, the desire for spiritual elevation and moral perfection seemed to be on their way to becoming the property, if not of all, of a not inconsiderable number of men" (*ibid.*: 192). In those times, men created an economic order that met their needs for freedom. The idea of freedom, as Einaudi forcefully reiterates, "is not realized, does not inform the lives of the many and the most, until men … have succeeded in creating types of economic organization suited to that free life" (*ibid.*: 195), which respond to the need to choose for themselves how to secure their livelihood. This is what Einaudi calls economic liberalism.

Einaudi's economic liberalism is linked to a conception of the economy centering on the concepts of competition, labor and savings. The dispute with Keynes originated precisely from their divergent views of these issues and played out over a number of years. In 1926, Keynes published *The End of Laissez-faire*, expressing his own liberal outlook and criticism of the "old" liberalism, arguing that *laissez-faire* policies were no longer enough for the postwar economic world, and what was needed was broader state intervention in the economy. In response, Einaudi wrote that Keynes had battered down an open door, however "usefully and brilliantly" he may have written – since Einaudi denied that the *laissez-faire* principle had ever been part of the great classical economists' toolkit. Moreover, he disputed that *laissez-faire* had in fact ended, pointing to its importance "as a handy rule of practice". Einaudi criticized Keynes on two other occasions, at the beginning of the 1930s, again emphasizing that recognizing the importance of labor and the centrality of savings as the engine of growth is crucially important if the economic mechanism is to run smoothly. In a review of Keynes's essay *Economic Possibilities for Our Grandchildren*, where the English economist argued that the real crisis that the West was going through was a moral crisis, because men's ideal of life was devoid of content, all the more so because technical progress would free men from the struggle for subsistence, and the problem to be faced in the future would be that of how to occupy one's time once it was no longer necessary to work for a living, Einaudi countered that "everything on earth is precarious without labor and without savings" (Einaudi 1932a: 46). The publication a year later of Keynes's *Essays in Persuasion* was another opportunity for Einaudi to stress the importance of savings for economic development (Einaudi 1932b). According to Einaudi, even then, during the Depression, savings was the most fruitful, though not the only, way out of the crisis, and investment could only recover if savings were promoted. This difference of vision is the basis of Einaudi's anti-Keynesianism.

The dialog with Röpke spanned the second half of the 1930s and the first half of the 1940s, especially during Einaudi's exile in Switzerland. Intellectually, they found common ground in the notion of "conformable intervention", or public intervention in accordance with the economic system's inner structure and market mechanism, which underpins a liberally oriented economic policy that distances itself from the *laissez-faire* of classic liberalism. This principle is an integral part of Einaudi's conception of "good governance", i.e., his view of a liberal economic policy.

2. Theoretical schemata and concrete reality, I: The writings on economic history

For Einaudi, doing economic history meant "reviewing and rewriting the history of past events" in the light of "today's economic theory" whereby these events can be placed "in a certain perspective [and] interpreted logically" (Einaudi 1936: 156). The writings on the vicissitudes of the Italian economy are a splendid example of the theoretical fecundity of Einaudi's historical work.[10] Einaudi's interpretation of the cyclical development of the Italian economy between the 1880s and the end of the belle époque is outlined in the articles he published in *La Stampa* and *Il Corriere della Sera*, as well as in *The Economist* and *La Riforma Sociale*. Starting from his theoretical apparatus, Einaudi sets out interpretative schemata and suggestions about the variables to be investigated empirically. A fundamental influence here was Irving Fisher's *The Purchasing Power of Money*, which presented a monetary theory of the cycle. Einaudi sketches a picture of the Italian economy's cyclical development over a period of more than forty years as that of an economy whose industrial structure went from strength to strength, with especially rapid growth – the so-called "Giolitti boom" – in a period of international prosperity influenced by the spread of technological innovation in the leading sectors of industry, and fueled by the injection of capital, especially through foreign-capital banks. However, the economic cycle turned out to be slower in Italy than elsewhere, which Einaudi blamed on the country's relative economic backwardness, insufficient openness towards foreign countries and often-counterproductive public intervention. Delving into the reasons for the period's prosperity, Einaudi argues that the main driver was the increase in the gold supply, and its twofold repercussions: more capital was available internationally, thus sustaining expansion, plus a modest but steady increase in prices, business activities and expectations. Though this interpretation has aroused some perplexity among economic historians, it was supported by Fisher's theory of the business cycle, which holds that if alterations, whether real or monetary, induced during periods of transition (for example by an increase in the quantity of gold) persist, they will lead to a real effect, i.e., they will affect growth. In general, Einaudi's analysis was surprisingly modern despite the objective limitations stemming from the limited statistical resources available to him. The strength of such an analysis lies essentially in the application of a method – Marshallian in origin, as we have said – which, though apparently looser than cliometric approaches, is in fact highly sophisticated, and capable of effectively linking theoretical, statistical and historical perspectives. In the 1920s and 1930s, after the free press was abolished in Italy and Einaudi resigned from *Il Corriere*, his views on the Italian economy can be found in the articles he wrote for *The Economist*. Between 1922 and 1924, after the Fascist party had

[10] For Einaudi's analysis of the Italian economy in the decades leading up to the First World War see Cassata and Marchionatti 2010. See also Sella and Marchionatti 2012. For the articles published in *The Economist*, see Marchionatti 2000.

gone into government, Einaudi had supported the government's economic policy, but expressed doubts – which hardened into disagreement – over the Fascists' illiberal political methods: how could one support the liberal economic policy of an illiberal government? This question soon became an unsustainable moral quandary and led to his dissociation from fascism, a decision sealed by the Matteotti murder in 1924. From then on, Einaudi's coverage of the events affecting the Italian economy appeared abroad, in *The Economist*. Between 1925 and 1929 his articles in the British journal mainly dealt with the issue of lira revaluation and deflationary policy, central themes of academic debate in Italy. Though Einaudi was cautious in his assessment of the lira revaluation and stabilization policy, several of his articles in the second half of 1927 did not fail to highlight the negative effects of stabilization. In the period following the 1929 crisis, Einaudi turned his attention to the monetary policy in defense of the lira, offering little particular criticism, and the steadily deteriorating state budget. The latter caused him growing concern, as did, internationally, creeping mercantilism and the abandonment of free trade. In the early 1930s, his attention focused on increasing public intervention and policies to rescue banks and enterprises. Here, his assessment was cautiously positive, considering these measures to be necessary at that time of great difficulty, particularly with regard to the reorganization of the banking system. By contrast, his unfavorable view of the gradual extension of the corporative system, and the consequent cartelization of the economy, was expressed through comments on the "sixth sense of the economic dictator" that aspires to replace free market competition.

3. Theoretical schemata and concrete reality, II: The contributions to international economics and monetary economics

An important part of Einaudi's work in applied economics deals with international issues relating to Italy's economic development, particularly in the Giolitti era. He focuses on two main themes: the protectionism that characterized public efforts to support Italian industry in the period, and the dynamics of the trade balance, whose deficit was a cause for concern to many. Einaudi explored protectionism extensively in the period immediately preceding the First World War, with a series of articles against what he called the *trivellatori di stato*, or "state drillers". In these articles, Einaudi combines theoretical criticism with a careful analysis of various cases. He does not deny that temporary customs barriers are sometimes advisable, but he emphasizes two points: as historical and statistical analysis shows, "what tends to happen" is that those who benefit from protection try to transform it from temporary to permanent; and that, even where a positive correlation between an industry's progress and protectionism can be found, it is necessary: *a*) to demonstrate that there is a causal link, *b*) illustrate whatever local effects it may have had on efficiency, and *c*) show that the positive effect on one industry is not accompanied, or worse, offset, by negative effects on other industries. Such "due diligence", however, is rarely performed. Einaudi concluded that, historically speaking, it is often (though not always) "impractical" to make special exceptions to the general rule of free trade, even if they are theoretically allowable. As for the balance of trade, Einaudi often emphasized that a deficit need not be a cause for concern because it could be a sign of growing demand on the part of the industrial system and consumers in a period of prosperity. This is how he interpreted the Italian situation in those years. At that time, the lira's exchange rate was constantly above parity, which most observers attributed to the trade balance deficit. Einaudi did not subscribe to this prevailing opinion, feeling that it was not sufficiently supported either by theory or statistical data. In a 1918 paper on exchange rates, trade deficits and money circulation, he discussed the determinants of the exchange rate and argued that the circulating money supply is a direct cause of exchange rate movements, since the price of a good is determined by the quantity offered and demanded, while monetary and fiscal maneuvers are indirect causes. His interpretation was taken up a few months later by Pasquale Jannaccone, who supported it with a historical and statistical analysis in a paper on the relations between international trade, foreign exchange and monetary circulation in Italy in the forty years from 1871 to 1913 (Jannaccone 1918). This paper, and consequently Einaudi's article, was rightly considered to be the origin of the monetary approach to balance of payments and exchange rates (Spinelli 1988).

In the monetary field, Einaudi made valuable contributions to the understanding of the complex events of the period. His deep and wide-ranging knowledge of monetary theory and its historical evolution encompassed the work of 18th-century authors, those of the Ricardian and post-Ricardian periods – from Ricardo to Tooke, Mill and Bagehot (whose *Lombard Street* he translated) – to the orthodox neoclassical theorists, Marshall and Fisher above all, who he saw as continuing in an unbroken line from their classical predecessors. His work also built on that of a number of English and American economists in the 1920s and 1930s – Pigou, Robertson and Hawtrey in particular. The key to Einaudi's monetary thinking is the equation of exchange (or quantitative equation), which he discussed in depth in a number of articles written in the 1930s (notably Einaudi 1931 and 1939). He distinguishes the equation of exchange from the quantitative theory of money, an important distinction but one that was not commonly made by writers of the time. The equation of exchange refers to the fact that the variations of each variable are functions of the simultaneous variations of the other variables and the resulting reactions. It is, Einaudi says, a "coat hanger" on which theoretical developments can be hung. Whereas the exchange equation simply states that the quantity of money is *one* of the factors influencing prices, the quantitative theory of money contains a proposition about the quantity of money as a determinant of price changes. In measuring this relationship, quantity theorists assume that the velocity of circulation and the quantity of goods and services are constant. From a theoretical standpoint, Einaudi is highly skeptical of this relationship's validity. He considers it more correct to consider all the factors as variables because, he argues, there are no logical reasons for considering some variables as constant. He believes that economists should conduct systematic historical-empirical studies of the forces at work in differing situations. In the light of such studies, he believes that quantitative theory can indeed explain major instances of rising and falling prices: when "faced with such impressive facts, we can for a moment consider the other factors as constant" (Einaudi 1939: 142).

Turning to monetary policy, Einaudi holds that its main objective is price stability, which ensures that variations in the value of the circulating medium do not disrupt contracts and expectations. From the time Einaudi trained as an economist at the beginning of the 20th century up to the First World War, the international monetary system was based on the gold standard, which facilitated trade and capital movements through a highly automatic adjustment mechanism that kept balances of payments in equilibrium at tendentially fixed exchange rates. This mechanism effectively guaranteed low rates of inflation and deflation and kept the value of the currency stable over the long run. That state of affairs profoundly influenced Einaudi's conception of the international monetary system, and he always considered the gold standard rules to be the best way to ensure a sound monetary system.[11] With an inconvertible paper

[11] Recall Einaudi's speech to the Constituent Assembly in 1947 in favor of Italy's accession to the Bretton Woods agreements. In it, he referred to the century from 1814 to 1914 as "a happy era" thanks to the gold standard. He states that "the fact that monetary unity did not depend on human will or arbitrary decisions in the happy century was that century's great good fortune", as it contributed to "unprecedented" economic growth, together with "amazing technical advances". Of the Bretton Woods agreements, he wrote that: "We can hope that the result of merging individual sovereignties into a single sovereignty will return us, at least in part, to the marvelous and delicate mechanism that had slowly come into being before 1914 and which we, with childish naivety, broke and destroyed". Between the lines, we can also sense Einaudi's fears about the new system's ability to guarantee lasting monetary stability. Einaudi's fears, like those of Keynes who farsightedly perceived the agreements' limitations,

standard, on the other hand, price instability is a major problem, as became abundantly clear in the years 1914-1920, when the European economy was ravaged by inflation. Learning from the lessons of that traumatic period, Einaudi came to the conclusion that inflation was an intolerable evil. This was to be a life-long conviction: when he analyzed the effects of currency devaluation in the years following the First World War, for instance, he spoke of the "poison" that inflation had introduced into Italian society, while after the Second World War, he successfully combated inflation, first as governor of the Bank of Italy, and then as Minister of the Budget.

In the Concluding Remarks to the Bank of Italy's Annual Report for 1946 (Einaudi 1946), he summarized the inflationary mechanism in a manner reminiscent of Keynes's *Tract of Monetary Reform*. Einaudi begins by noting that inflation changes the distribution of income and wealth: it initially helps profits, but hurts workers and people on fixed incomes. The positive effects on profits gradually pale beside the harms done by inflation, as there is a growing propensity to hold money rather than save. As Einaudi sees it, the fundamental problem is that as time passes inflation destroys the propensity to save and causes currency devaluation, which in turn undermines the balance of payments, in a vicious circle that he considered extremely dangerous. This – the threat inflation poses for the propensity to save – is Einaudi's most urgent warning, as he sees savings as the precondition for investment and the key factor for growth.

The inflation-crisis link is at the heart of the controversy with Keynes and Fisher on the nature of the Great Depression and the role of reflation in the 1930s.[12] According to Einaudi, the great crisis was originally triggered by the international monetary and credit inflation during and immediately after the war. This was stated in a 1932 article (Einaudi, 1932c), where he argued that the current crisis was nothing new, citing the alternating periods of boom and bust that had marked the entire history of capitalism. Einaudi believed that the root cause of the current crisis was monetary, due to the price-cost imbalance, so that overcoming the crisis depended on

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unfortunately proved to be well-founded, although the international economy was to enjoy a new "happy era" for over twenty-five years before the system eventually collapsed.

12 The Einaudi-Keynes relationship dates from the years of the First World War. The two economists expressed similar positions on economic issues between then and the early 1920s. From the second half of the 1920s onwards, their positions gradually moved farther apart and became in many ways antagonistic. On the relationship between Einaudi and Keynes see Marchionatti 2000 and 2017. Einaudi's relationship with Fisher began in 1911, when he sent Fisher a positive review of his book *The Purchasing Power of Money* written by Borgatta and published in *La Riforma Sociale*. Fisher responded by involving Einaudi in a plan to set up an *International Commission on the Cost of Living* that Fisher was trying to establish to analyze the causes of rising prices.

re-establishing equilibrium. Einaudi considered it illusory to think that the solution to the crisis lay in elaborating some kind of plan.[13] By contrast, Keynes in *The Means to Prosperity* of 1933 maintained that the crisis and poverty resulted from the failure of private decision-making. The remedy was not to be found in hard work, frugality and savings, and prudent banking policies, but in an active economic policy, i.e., in public works and an international plan that would make more reserves available for central banks to enable them to increase lending in a coordinated manner: such a policy would increase world prices and boost the international economy. Einaudi replied to Keynes in a long article entitled *Il mio piano non è quello di Keynes*, "My Plan is not Keynes's".[14,15] He marshalled his arguments around two issues: the determinants of the crisis and the way out of it. Regarding the causes, he repeated his contention that the crisis was due to the effects of the war and postwar credit inflation. As for the second point, Einaudi agreed with Keynes that a policy of public works could help in overcoming the crisis – Einaudi saw public works as a useful expedient for climbing out of troughs in the economic cycle. However, he was skeptical about the relevance of the income multiplier, and he was adamantly opposed to reflation, as a very risky policy that would not necessarily be able to achieve its goals.[16] Furthermore, Einaudi argued that an increase in prices would not have induced savers to invest money they had hoarded, precisely because

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[13] As Einaudi wrote in a mid-1932 article, *Piani* (Einaudi 1932d): "Everyone makes plans and everyone makes mistakes in making them. The present crisis, no different in this from past crises, does not stem from not having made plans in the past; but from having made them wrong. From 1914 to 1918 in one respect, from 1918 to 1928 in another, everyone made plans … Then it was seen that … many plans were wrong; and now, with the usual logical inconsistency of men, new plans are invoked". Einaudi took aim at the creators of plans and "trappings" in an article published in the autumn of the same year, *Bardature della crisi* – Trappings of the Crisis (Einaudi 1932e). By "trappings", Einaudi meant the creation of industrial consortia, regulations on competition, bailouts, duties and quotas, and constraints on capital movements. These trappings, Einaudi argued, interfere with the operation of the price mechanism, increase costs, prevent marginal firms from being weeded out, stand in the way of innovation, lead to capital flight, and so forth. Recovering from the crisis, Einaudi argued, also depended on eliminating these trappings.

[14] An English translation of this article is in Einaudi 2006.

[15] The young Italian economist Carlo Pagni entered the controversy, writing Einaudi a letter to which he attached an article of his own. It was published together with Einaudi's reply (Einaudi 1933b). Einaudi returned to the subject again a few months later (Einaudi 1933c).

[16] Einaudi believed that Keynes offered "a typical example of the dangerousness of walking straight ahead on the razor's edge", arguing that "to recreate profits and hence restore, after the initial impulse of state-financed public works, the incentive for the spontaneous operation of entrepreneurs, it is desirable to raise the general prices level" (Einaudi 2006: 131). Einaudi held that the proposition that rising prices recreate profits "is only true on the assumption that public works carried out using credit push up precisely those prices that must rise to restore equilibrium" (*ibid.*: 133).

they feared devaluation.[17] Fisher, like Keynes, had also come out in favor of reflation (Fisher 1933) as a solution to the crisis on the basis of his debt-deflation theory. If prices fall, the real value of private wealth increases, which means that debtors' liabilities and creditors' assets increase in real terms. As debtors have a higher propensity to consume than creditors, there is a reallocation of real wealth from debtors to creditors. Consequently, the marginal propensity to consume would drop. In turn, there would be a decline in the demand for consumer goods, aggregate demand and employment, and a fall in prices, accompanied by bankruptcies. All this would shake the economy to its foundations, hence – Fisher maintains – the need for reflation. In a 1934 article entitled *Debiti*[18] – debts – Einaudi concurred that the essence of the crisis lay in the existence of debts, writing that the diagnosis is correct but the remedy unacceptable. Here too, the assessment is based on the nature of crisis: echoing Schumpeter, Einaudi emphasizes that crises also have a positive role in the capitalist mechanism, as transitions from one equilibrium to another driven by the spirit of innovation. Crisis leads to ruin only when the majority of entrepreneurs contract too much debt: in this case, the crisis generates destructive rather than creative movement. The enormous burden of debt generated during the war and the years immediately thereafter had brought a destructive crisis. Here, Einaudi argued that reflation would have perpetuated the existing situation and delayed the adjustment. While critical of Keynes and Fisher, Einaudi agreed with the interpretation Lionel Robbins set out in a 1934 book, *The Great Depression*, an Italian translation of which Einaudi commissioned and published 1935, adding a foreword of his own. Robbins's stance, based on a neo-Austrian theoretical framework, was that the greatest crisis in modern history had come about because of mis-investments and excessive debt, plus measures to delay liquidation that had only made matters worse. Robbins, like Einaudi, believed that the way out of the crisis lay mainly in monetary stabilization and returning to the gold standard, as well as in removing barriers to international trade. As Einaudi acknowledged, these were "traditional conclusions" – "a sound currency, honored contracts, certainty about the future, open customs borders or,

[17] More generally, Einaudi's article outlines a critical approach to Keynes, on the one hand reinterpreting Keynes's theoretical innovations in an orthodox light – later, he would do the same for the concept of preference for liquidity in his review of *The General Theory* (Einaudi 1939) – which enabled him to scale back Keynes's practical proposals. In addition, he set out a neo-Austrian microeconomic theory of the crisis as a counterproposal to Keynes, defending the rationality (or, as he wrote, the underlying wisdom) of the behavior of economic subjects and arguing against "managed currency".

[18] An English translation of this article is in Einaudi 2006.

if closed, limited only by duties of a clearly defined amount and for a specified period of time, interest rates applied in a timely manner to prevent speculative frenzies" (Einaudi 1935: 11) – "traditional", he maintained, but shown to be true by centuries of experience.

Towards the end of the 1930s, Einaudi considered the crisis to be over, and in a review of two books by Robbins and Röpke he asked what could be done to ward off another collapse. His answer was that the economic problem in general, and in particular the problem of mitigating the violence of crises, can best be solved by a liberal plan, or as he preferred to call it – adopting a term introduced by Röpke – a "conformable plan". "Conformable" referred to economic policies that are compatible with the existence of a market and not only require "a set of legal rules for regulating the market and a state organization capable of producing goods and services that private initiative would not produce or would produce badly", but are "compatible with institutions that are not commonly said to be liberal" (Einaudi 1937b: 286), such as stock exchange regulations, laws on working hours and minimum wages, and laws to regulate and limit monopolies. Einaudi thus introduced the theme that was to occupy him for the ten years between the mid-1930s and mid-1940s: the theory of *Buongoverno*, or Good Governance, perhaps the most fitting encapsulation of his theory of economic policy.[19]

Concluding remarks

Our profile of Einaudi as an economist and economic historian confirms Schumpeter's judgement that the Piedmontese scholar exemplified a profitable approach to historical and factual work that fertilized general economics without conflicting with theory. Einaudi's "historical eye" gave him an amalgam of logic (i.e., economic theory), intuition and wide knowledge of facts – qualities that Keynes, in his biographical essay on Marshall, said were required for the highest form of economic interpretation. At the same time, a comment Einaudi made about Smith (Einaudi 1953) applies equally well to himself: Smith, Einaudi wrote, harbored three souls within his breast: the souls of the moralist, the historian and the economist, and all three were always brought to bear on the problems he set himself. As did Smith, Einaudi the moralist posed the problems that Einaudi the historian and economist sought to understand and solve. He thus possessed qualities and ways of proceeding that bring him close to the great

[19] This is the subject of Federico Revelli's paper in this issue.

economists of the history of economic thought, whose lessons he learnt to the fullest. These qualities are shown in the many facets of his thinking: his reflections on the economist's method and vision; his work in economic history, international economics and monetary economics, as well as in his interpretation and suggested remedies for the Great Depression, where he did not shrink from challenging the leading economists of the day. In all of this, he was able, as Schumpeter put it, to fertilize general economics. Moreover, his work on the history of economic ideas – though undiscussed here – sought not only to understand the economic thought of the past but also to develop new ideas. Einaudi was well aware of the importance, and indeed the necessity, of the history of economic thought in the training of an economist who is not merely the unwitting user of uncritically accepted technical baggage. His contributions as a historian and economist highlight his ability to interpret the economic movement in its highest form: Einaudi has given us an articulate presentation of a lively and rich liberal vision, penetrating critiques of crucial episodes in the history of capitalism – which are still appreciated and discussed today – and a brilliant example of the application of a rigorous yet flexible method of analysis: this may be his most lasting legacy in economics, alongside his ability to translate his thinking into effective action.

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