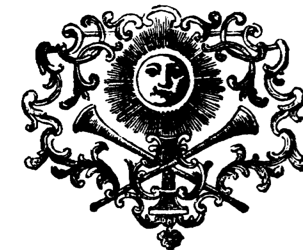
THE FEDERALIST

a political review

To look for a continuation of harmony between a number of independent unconnected sovereignties situated in the same neighbourhood, would be to disregard the uniform course of human events and to set at defiance the accumulated experience of ages.

Hamilton, The Federalist



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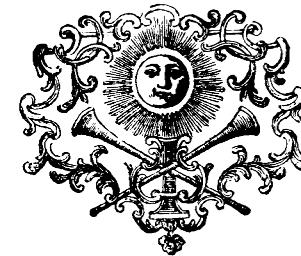
THE FEDERALIST

a political review

Editor: **Francesco Rossolillo**

The Federalist was founded in 1959 by Mario Albertini together with a group of members of the Movimento Federalista Europeo and is now published in English and Italian. The review is based on the principles of federalism, on the rejection of any exclusive concept of the nation and on the hypothesis that the supranational era of the history of mankind has begun. The primary value *The Federalist* aims to serve is peace.



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New Problems, Old Alignments

It is important to reflect upon the events which led the Italian government to the brink of a political crisis in October this year, and upon the way in which this crisis was averted, as the implications of these occurrences reach far beyond a strictly Italian context. The recent events were born of contradictions which, threatening to escalate to explosive proportions in Italy, are in fact present in all the countries of the Union as direct consequences of the logic of the process of European unification.

It is important to note, first of all, that the extremely dangerous nature of the recent political turmoil in Italy was clearly perceived by Europe's governments and media. The collapse of an Italian government, at this particular stage, would have seriously jeopardised the country's chances of entering Europe's single currency in the first-wave on January 1st, 1999. This, in turn, would have cast a shadow of doubt over the very future of economic and monetary union. Indeed, Italy's presence is essential in order to guarantee the single currency an economic basis wide enough to ensure that monetary union does not emerge as a sort of institutionalised new version of the DM area, with a French appendage. Had such a development started to look likely due to the probable withdrawal of Italy, the position of the anti-single currency camp in France, currently reduced to silence, would quickly have gained momentum, presented by the turn of events with the opportunity, through convincing arguments, to render its position acceptable to French public opinion. The fact that this crisis was averted, albeit on the basis of a compromise which has been the object of legitimate criticism, should nevertheless be recognised as an important victory.

* * *

A second important observation is that this was the first time since the start of the process of integration, that the government of a member country of the Community (or of the Union) had been threatened by a crisis on explicitly European grounds. This is an important symptom of

the fact that Europe is nearing the moment of truth. It is becoming increasingly clear that the future of European citizens is being staked on the unification of the continent and, first of all, on monetary union coming into force on schedule. It is therefore inevitable that the parasitical interests which, differently in the different countries, have prospered and continue to prosper in the shadow of an order based on division, are now coming to light, and the political forces which feed on such interests and use them as a means of working on sectors of public opinion which are fearful and ill-informed, are naturally fighting back. At the same time, however, the real nature of what is at stake is becoming increasingly apparent, heightening awareness of the benefits of European union and strengthening support for the political forces in favour of it. In view of this, the latter, with growing courage and conviction, are prompted to face up to their responsibilities and to accept the element of risk inherent in the assumption of them.

It is worth noting that the instability and the tensions which lie at the root of the events in Italy are also present in Germany and France. While it is certainly true that the institutions and the economies of these two countries are more solid than those in Italy, it is also true that certain gaps in Europe are closing: while, on the one hand, certain attitudes, irresponsible and governed by sectoral and short-term interests, continue to thrive in certain areas of the political spectrum in Italy, the country is nevertheless witnessing the development of a genuine culture of stability and the emergence of a new, modern and competent political class. Other countries, such as France and Germany on the other hand, are certainly not free from demagoguery and populism. Just think of the electoral success of the National Front and the nationalistic and anti-European attitudes which pervade the Communist party and certain sections of the democratic right and the non communist left in France, and of the populist tendency of part of the SPD and of the Bavarian CSU in Germany, as well as the prejudiced and hostile attitude towards Europe demonstrated in the new *Länder* by the successors of the former East Germany's SED. Wherever they exist, and they exist everywhere, these tensions represent a threat to the successful completion of the process of unification.

* * *

Third, and finally, it should be remarked that, in all the main European countries, the power of anti-European interests is vastly amplified by the nature of the political alignments. The fact that, even with the acknowledgement by the great majority of the forces in parliament of the need for a strict budgetary policy, Italy should reach the verge of a political crisis is symptomatic of this, as is the fact that the finance bill which provoked the unrest would in substance have been readily passed had it been possible to leave aside the logic of political alignments. The situation escalated to near crisis level because, over the question of the vote on the finance bill, the executive considered itself bound not by the opinion of parliament as a whole, but by the opinion of the majority it represents. The prime minister Mr Prodi openly refused the support of the opposition, preferring, as a pledge of his own personal sincerity and consistency, to tender his resignation.

It is important to remember that Italy has in recent times lived through a long period of compromises and dubious political bargaining which has damaged the country's reputation at international level and alienated the country's citizens from politics. In view of this, the Italian government should be applauded for its stand. And yet, the indisputable fact remains that the political system is afflicted by a serious and paradoxical dysfunction, highlighted by the recent events: Italy is on the brink of a major change, a change supported by the great majority of the political forces present in parliament, and yet the country still ran the risk of missing the EMU boat because of the opposing vote of a small wing of the majority.

* * *

In Italy, as in all the major European countries, the alignment of the political forces still reflects the contraposition of left and right which is the result of social struggles and the organisation of interests of an era long gone, one in which the division of society into classes represented the watershed in relation to which, prior to any other, political forces were required to take up their positions. Nowadays, there is a new divide: Europe now represents the decisive question on which positions should be adopted and over which divisions should emerge, and the contraposition of the pro-European majority and the minority which wants to perpetuate the national political framework cuts across the contraposition of left and right, causing divisions between and even within most parties. It follows that the position of any government intent on carrying out an effective European policy (and effective, at the present time, inevitably means unpopular) is weakened considerably by the fact that it must reckon both with the opposition, whose natural political function is to oppose, and with the anti-European faction within the majority. Germany is a particu-

larly good example of this situation.

There exists, in all mature democracies, a general awareness that problems of a constitutional nature can only be resolved through the consensus of both the majority and the opposition (or, in any case, of a large part of each). A large section of the political class in Europe shares the view that questions such as monetary union and, in more general terms, European unification, should be seen as issues of a constitutional nature. Political and monetary unification of Europe will, however, only come about if this initial awareness is developed and strengthened. European unification is a constitutional issue *sui generis*, as the march towards it affects, through budgetary laws and structural reforms, all the most important policies that the governments and parliaments are, day by day, elaborating and implementing, and this will continue to be the case for what is in political terms a long period of time. If a government asks its opponents to support government policies while still remaining in the opposition, it is, in this context, asking too much; on the other hand renouncing the support of the opposition means continually exposing the government to blackmail by the anti-European wing of the majority.

* * *

The difficulties faced by Europe are typical of all major historical changes, which often come about without really being understood by their protagonists and have to be dealt with using political instruments which, handed down from the past, are not adequate to deal with the problems of the present. However, the objective logic of the process should, in the mid-term, prevail over the logic of political alignments, even though the ways in which this occurs will vary from country to country. It is certainly possible, although improbable, that in some countries, the presence of charismatic political figures or adequate electoral systems may allow political alliances which are sufficiently solid to remain in power and, for a time, to carry on the process alone. However, this could not happen everywhere, and where it should occur, it is unlikely to prove a long-lasting phenomenon. The introduction of the single European currency will represent an important step towards unification, but the process will not end there. There will still be tensions and difficulties. The problem of stabilising monetary union through the creation of political union will arise, and widespread and strong consensus will be required for this task to be accomplished successfully. A considerable level of active popular support will be needed, and the

political forces will have to show that they are able to modify both their alliances and their contrapositions, adapting them to the nature of the epochal challenge on which the future of Europeans depends.

The Federalist

The European Government of the Economy

GUIDO MONTANI

1. *The European Union, Monetary Union and the Challenge of Globalization.*

The start of European Monetary Union in 1999 and its sustainability are continually under discussion because the future of the political union is uncertain. Added to this, the European economy has been in crisis for a long time, as witnessed by the persistently high rates of unemployment. Obviously the two phenomena are related. The crisis in the economy undermines the credibility of Monetary Union. And the uncertainty over the political future of the Union makes the consolidation of Monetary Union problematic. For this reason, political union and Monetary Union must be considered as two inseparable aspects of the same process.

When one speaks of political union one should naturally talk of the European government, of its powers and its democratic legitimacy. But the reluctance of the national governments to accept a European government is such that in debates on the future of the European economy the question is often entirely ignored. This is a mistake which undermines the foundations of much of the economic analysis. Adam Smith was able to formulate a theory of the market because over the eighteenth century, in the great European monarchies, a clear picture was emerging of the modern nation-state, founded on the distinction between political and economic power. It is in this context, that of the budding State of law, that economics was able to arise and develop as an autonomous science. In contrast, contemporary Europe presents a process in which economics has moved ahead of politics, as shown by the fact that the objectives of the internal market and the single currency were formulated without defining what political union might underpin these choices. This has led to a serious democratic deficit in Europe. Democracy is in crisis at the national level, where effective intervention is no longer possible and is

lacking at European level, where it would be possible to act.

The intention here is not to tackle the political problems concerning the building of the European Union, but to draw attention to one question: that of the need to complete the construction of the Monetary Union with a federal European government. Europe can in fact face the challenges of the twenty-first century effectively only if it can provide itself with an executive that is effective, because legitimated by the popular will. Since by its nature a government supported by popular consent cannot be subdivided into watertight compartments, the "European government of the economy" is to be understood as an important, but not exhaustive aspect of a federal Europe which, however gradually, is also to become capable of acting in foreign and security policy.

The major difficulty, when the problem of the European government of the economy is tackled, consists in the vagueness of the powers which must be entrusted to it to make it capable of acting. Criticisms are often directed at the future European Federation without any foundation. There currently seem to be two opposing conceptions of the European government. The first projects onto European level the model of the nation-state, which concentrates all the monetary and fiscal powers necessary to control the economy. A variant of this model consists of a European government with a capacity of intervention similar to that of the US government, which is a federal State, but a federal State in which, since the beginning of the century, there has been a process of concentration of resources and power which makes it similar to the national European models (especially in the management of the economy). The second model of a European government of the economy consists of an "internationalist" conception of the European economy, in the sense that the European currency would simply be a system of "irreversibly" fixed exchange rates, but the major powers of intervention in the economy would continue to remain firmly in the hands of the national governments. From this perspective, for example, unemployment is a problem which in no way concerns the European authorities of economic policy. It is the national governments which must resolve the problem. The internationalist, or confederal, conception of the European economy is defended particularly in France: President Chirac has compared the European currency to the gold standard, which France has always supported.

The hypothesis which will be considered here is that a European economic model is developing whose salient characteristics are federal in nature, and therefore can be traced back neither to the first "national"

or "centralist" model, nor to the second "internationalist" or "confederal" model. In substance, the economic model which seems to be taking shape with the European Union is that of a "post-Keynesian gold standard." The expression is perhaps not entirely appropriate, but for want of a better it may serve for a first approach. By "gold standard" it is certainly not intended to affirm that the European currency represents a return to gold. The European currency will be a token money whose reference to gold, if any, will only concern its use as an international money. However the European Monetary Union is being built on the basis of some "rules of the game" which have many aspects, such as monetary stability and financial orthodoxy, in common with those which characterized the classical gold standard of the nineteenth century. Therefore, it may prove instructive to compare the historic situation of the last century, in which the monetary and fiscal practices of the orthodoxy developed, with the current one, in which the European countries have self-imposed stringent constraints under the Treaty of Maastricht. The Monetary Union does not exhaust the programme which the European governments have assigned themselves. It is often forgotten that Monetary Union is only part of the original, more ambitious project of economic and Monetary Union. And it is precisely the economic content of the union which arouses most controversy. This is why the term "post-Keynesian gold standard" is suggested. Only at the cost of causing grave political reactions, and perhaps even the failure of the single currency, can the European Union ignore policies for employment, economic development and the environment. Keynes elaborated his proposals for economic policy in the 1930's, as a remedy for the Great Depression, in the attempt to find a "third way" between the communist system of collectivization of the means of production, and the liberal system, which deluded itself that market forces alone could cure rampant unemployment. Today, while some Keynesian proposals of economic policy, no longer current in contemporary European economies, must be questioned, it seems legitimate to maintain that the challenges of unemployment and international economic competitiveness can only be beaten if the Union adopts appropriate "post-Keynesian" interventionist instruments. As will become clearer further on, these will be post-Keynesian instruments in the dual sense that emphasis will be laid both on the need to activate interventionist policies on the supply-side as well as on demand, as Keynes did, and on the environment in which one must act — the global market — which imposes different solutions from those possible in the closed national market.

Before tackling the discussion on the most appropriate policies for the development of the European economy, it is however necessary to briefly describe the historical typologies of the two monetary systems to which continual reference must be made. The European economic and Monetary Union radically changes the panorama of the world economy. Comparison with the gold standard and the gold-exchange standard is important to establish to what extent the European currency is linked to the past and to what extent it is innovative. It is impossible to understand contemporary history unless the reasons for continuity and discontinuity are clarified.

2. *The Gold Standard.*

As is well known, the first theorization of the gold standard goes back to David Hume. Hume, contrary to what the mercantilists thought, maintained that there is an automatic mechanism of adjustment of the balance of trade. However two conditions must apply: that gold is used as a natural money of payments, and that the Central Banks, in cases where a token money is also used alongside gold, undertake not to alter the exchange rate between paper money and gold to achieve national objectives of economic policy.[1] In this case, the system of international payments does not differ from the internal system of payments, as in the case where a commodity is exchanged between inhabitants of two different provinces from the same State. Therefore, the gold standard, in what we feel is a legitimate interpretation of Hume's thought, is a system of payments which, thanks to the use of a traditionally accepted currency, cancels the difference between the internal and international market: it is the system of payments which enables the maximum integration of the world market (cf. Appendix 1).

Historically, the gold standard was set up towards the end of the nineteenth century, with characteristics other than in the model outlined by Hume. The models simply represent means to understand reality. Hume's model may therefore serve as a basis for an investigation but one must try to understand why the classical gold standard presents much more complex characteristics.

Let us begin by observing that the development of the gold standard would not have been possible without the system of equilibrium between the great European powers established by the Congress of Vienna, which gave Europe and the non-European world a very long period of peace. Only in the second half of the nineteenth century was the balance of Vienna altered by Italian and German unification. But the negative

effects of these events, which were to lead to the outbreak of the First World War, only manifested themselves slowly. On the contrary, German unification initially represented a factor of expansion of the gold standard, because thanks to the payment of war debts by France after its defeat, Germany found it convenient to adopt the gold standard, thus accelerating its spread to numerous other countries. An important factor outside Europe was the decision of the United States, at the end of the American Civil War, to return to convertibility of the dollar into gold. In those same years Russia and Japan also adopted the gold standard. Thus in the second half of the nineteenth century a genuine world market was formed, with intense intercontinental flows of commercial traffic and with a thick network of financial transactions, thanks to the adoption of a common money. Only towards the end of the century was peace in Europe brought into discussion again by increasingly aggressive nationalist policies, which led to higher customs tariffs and trade wars. Nevertheless, until the outbreak of the First World War, exports continued to grow steadily, showing that the national barriers were not as impermeable as in the years of the Great Depression.[2]

There are two important differences to be observed between Hume's model and the gold standard of the nineteenth century. The first concerns the inevitable and revolutionary development of the system of payments, founded increasingly on recourse to paper money and to substitutes for money, such as bills of exchange and cheques. These innovations facilitated and enabled the growth of commercial transactions and industrial development. As regards international relations, this change meant overcoming the simple concept of the balance of trade, to which Hume referred. Indeed, one characteristic of the international economy of the gold standard consists of the important role of movements of capital as well as goods: the frame of reference therefore becomes the balance of payments, and it is no longer necessarily true that the equilibrium of the balance of trade must be maintained in the long term. It may happen, as in the case of Great Britain, that a country has a surplus in the balance of trade compensated by a deficit in the movements of capital, if its preeminent role is that of international investor. In this situation, clearly an element extraneous to Hume's model comes into play, namely the interest rate, because movements of capital are highly sensitive to this variable. The attainment of equilibrium in the balance of payments therefore becomes a highly problematic factor: one of the great problems of the classical gold standard, on which there is a vast literature,[3] is precisely that of understanding how it was possible, in the decades

preceding the First World War, for the adjustment mechanisms of the international monetary system to guarantee an extraordinary stability of exchange rates in the presence of free circulation of goods and financial activities.

The second distinctive element, compared to Hume's model, is the appearance of an important player on the scene, the national Central Bank. In all the main countries which accepted the gold standard there was a slow but inevitable consolidation of the Central Banks of issue. The reasons for this process of centralization of banking activity are the following: a) the need to guarantee to the public using the circulating medium, especially paper money, the uniformity and value of the means of payment utilized; b) the need to control fluctuations of credit, to mitigate and control the economic cycle; c) the need to guarantee to the public and to the existing banking system a lender of last resort, i.e. a lender to which banks in difficulty can turn in case of serious crises of public confidence; d) the realization of a monetary policy with definite objectives, such as the maintenance of price stability; e) the possibility of guaranteeing international cooperation, by enforcing the "rules of the game", explicitly or implicitly agreed with the other national Central Banks.[4] The insertion of the Central Bank into Hume's model obviously complicates the picture, because it introduces an element of discretion into the management of movements of capital, thanks to the Central Banks' power of controlling interest rates, and therefore of facilitating or hindering international movements of capital. In cases where the Central Bank does not scrupulously observe the rules of the game of the gold standard, the mechanisms to adjust the balance of payments are by no means automatic.

The two characteristics mentioned above, which is to say the formation of a modern financial market and the development of national Central Banks, conditioned the birth and growth of the international monetary system. International investors do not move their capital at random, but on the basis of expected profit and interest rates. It is therefore entirely natural that where there is a historically consolidated financial centre, it is further reinforced, becoming the centre of gravity of the newly-forming financial market. This centre was represented by the City of London, which, thanks to more than a century of experience of the Empire, and the leadership acquired in techniques of import and export of goods and capital with the colonies, began to also function as a clearing house and lender of last resort for the international financial market. In this way, even if the role of lender was not only played by London, but

also by other important European centres such as Paris and Berlin, it was possible to compensate or finance persistent current account deficits, without having to effect drastic adjustment policies. Countries like the United States, Canada, Argentina, Australia and Russia could count on sizeable long term loans to finance their persistent current account deficits.

The preeminent position of the City in the classical gold standard has led some economists to maintain the theory that the international monetary system of the nineteenth century was in reality a gold-sterling standard, i.e. a system of payments which utilized the English sterling as a key currency of international exchanges.[5] The hypothesis has indeed some foundation because the sterling maintained its rate of exchange with gold unchanged from 1821 to 1914, and it could therefore be generally said that the sterling was a currency as good as gold. However, this interpretation seems forced. Only after the Second World War was a system of international payments established based on a national currency as the key currency. But this solution, as we shall see shortly, requires that there should be a country that dominates not only economically but also politically. The English hegemony in the last century presents characteristics different from those of the United States. The political system preceding the First World War is based on equilibrium between the great European powers and not on the hegemony of one or more great world powers, as happened after the collapse of the European system of States. France, Germany and Italy, no less than Great Britain, attempted to create Empires of their own, to guarantee a secure supply of raw materials and an outlet for manufactured goods. The City of London and the sterling fulfilled a limited hegemonic role, but only economically, because of the convenience and practicality represented by a financial centre well organized to serve international investors. But a similar role, different in the volume but not in the quality of transactions, was played by other important financial centres such as Paris and Berlin. Eichengreen correctly points out that "the pre-war gold standard was a de-centralized, multipolar system, its smooth operation was not attributable to stabilizing intervention by a dominant power."[6] The Bank of England was able to exercise the function of lender of last resort to national commercial banks, but the exiguousness of its gold reserves meant it found itself on more than one occasion in serious difficulties, and was obliged itself to resort to the help of other central national banks. In the crises of 1890 and 1907, the rescue operation of the Bank of France and the German Reichsbank, as well as other central European banks, was crucial. This

reciprocal confidence, which enabled positive cooperation between Central Banks to keep the international monetary system stable, did not diminish even in the years preceding the First World War. In substance, the gold standard was accepted spontaneously by an important group of countries which found it convenient to adhere to it for the virtues connected to the utilization of a "natural" international currency. To join the gold standard automatically brought the grant of a "good housekeeping seal of approval"[7] which could allow participating countries to enjoy lower rates of interest compared to other countries unable to offer the same guarantees of monetary stability.

In order for international monetary cooperation to function almost spontaneously, the monetary authorities had to accept common rules of conduct. Chief among these was that maintaining the rate of exchange was an economic priority, to which, if necessary, other internal objectives must be sacrificed. If a Central Bank lost gold reserves, the international market cast no doubt on the fact that sooner or later adequate and sufficient measures would be taken to keep the exchange rate stable, producing in this way the phenomenon of "stabilizing speculation", i.e. movements of capital which facilitated the process of adjustment. In short, the gold standard was a credible system because founded on a common will to cooperate. The problem of a conflict between the pursuit of stable exchange rates and a high internal rate of employment simply did not arise. Eichengreen points out that, "there was little perception that policies required for external balance were inconsistent with domestic prosperity. There was scant awereness that defense of the gold standard and the reduction of unemployment might be at odds. Unemployment emerged as a coherent social and economic problem only around the turn of the century. In Victorian Britain, social commentators referred not to unemployement but to pauperism, vagrancy, and destitution."[8] The national governments did not yet propose the realization of costly social policies, as was to happen later. The State budget represented an tiny share of the national product and the rule of the balanced budget was scrupulously observed, without this fact interfering with internal social or taxation problems.

The situation began to change only in the early twentieth century. The causes of the degradation of the international system of payments were twofold. On the one hand, the growing economic nationalism caused the introduction of customs duty and the inobservance of the rules of the game, such as the practices of sterilization, among Central Banks. On the other hand, the early claims of the workers' movement made adjustment

through lowering monetary wages increasingly difficult, while the demand for the early social security policies imposed growing taxation on the affluent classes as well as a growth in the State budget, which made observance of the rule of the balanced budget problematic. These first transgressions of the rules of the game of the gold standard were not, however, so serious as to cause its collapse. The gold standard continued to function as a "spontaneous order"[9] until the eve of the First World War. Only the outbreak of war ordained its death.

3. *The Gold-Exchange Standard.*

The gold-exchange standard is a system of international payments in which, alongside gold, the national Central Banks can hold one or more national currencies as a reserve money. The reserve moneys therefore become key currencies for international exchanges. It is a system which is often considered as a step towards overcoming the gold fetish, in that the world market could begin to function on the basis of one or more token moneys.

After the First World War, because of the monetary upheavals during the war and persistent borrowing by many governments, the return to the gold standard proved problematic. The spell was broken. It was clear that every national government had the power to make its own economy work on the basis of a simple paper standard, without promising any exchange with gold, because within the closed national system the public has no possible alternative to the forced circulation. But at international level a paper standard is not possible, because there is no supranational power able to impose a forced circulation. The Conference of Genova in 1922 for the first time recommended using national currencies, alongside gold, as reserves and for international payments. This would gain the advantage of increasing international liquidity, otherwise heavily dependent on the physical quantity of gold available and on its rate of production. In effect, the system of international payments realized in the twenties was a gold-exchange standard, even if formally the major countries, like Great Britain, the United States and France decided on a pure and simple return to the gold standard.

The fragile system of the twenties fell apart with the Great Depression. To an extent, its defects contributed to make the depression even more severe. A reserve system founded partly on gold and partly on national token moneys quickly goes into crisis if political tensions arise between governments, because confidence in the convertibility of the

currencies is lost. International liquidity thus suffers a brutal contraction, much greater than can happen with the traditional gold standard.[10] But the root causes of the collapse of the international economy go deeper. International cooperation between governments and Central Banks was never entirely restored after the war. In particular the major financial centres of London, New York and Paris acted at crucial moments not with the aim of maintaining the stability of the international economy, but primarily to pursue certain specific objectives of internal policy. There was a clear lack of a will to cooperate before the Great Depression and subsequently, when the attempt at the Conference of London in 1933 failed, because of the explicit refusal of the United States and Great Britain to discuss again the bases for a return to stable exchange rates.

The reasons for these difficulties must be explained. Comparison of two British government reports on the functioning of the gold standard, one written at the end of the First World War and the other after the Great Depression, reveals an important difference. In the Cunliffe Report (1918) one reads that where fundamental imbalances appear in overseas accounts, the Central Bank should manipulate interest rates in order to attract capital and reduce internal demand for consumer goods and investment, with consequent "slackening" of employment.[11] In the Macmillan Report (1931), which clearly shows the influence of Keynes, one of the members of the report committee, it is acutely observed that in reality the system of the gold standard by no means functioned automatically as in theory was expected. On the one hand the inflows of gold tend to be sterilized when the national authorities wish to prevent excessive expansion of credit, and on the other, credit restrictions are stopped in order to avoid deflationary effects on prices and wages. It is legitimate therefore to consider the problem of whether "adherence to an international standard may involve the payement of too heavy a price in the shape of domestic instability."[12] Then it is clearly stated that the pursuit of external and internal equilibrium are alternatives, and that in some cases one must choose.

This is the dilemma which caused the gold standard to be abandoned during the Great Depression and which the protagonists of the classical gold standard were almost entirely unaware of. After the First World War an important social turning point had been reached: the conquest of major social and political power by the labour movement. Monetary and fiscal policy could no longer be manipulated purely to maintain external equilibrium. A restrictive monetary policy caused a diminution of buying power, unemployment, and growing pressure on the wage level. An

inflationary monetary policy brought negative effects on those who lived on income from financial investments, but did not necessarily have negative effects on profits and wages because the workers were now able to defend their buying power effectively, thanks to the contractual strength of the unions, and the capitalists could maintain profit margins by raising prices. Thus in the long term inflation caused a transfer of income from the unproductive to the productive classes. Similar considerations could be made concerning the fiscal system, which was reformed radically at this time, with an increasingly important role for direct taxation and the expansion of State budgets, which took on the burden of early forms of social relief and insurance. In this case too, budgetary policy had a strong redistributive effect. In the years between the two world wars, there was therefore a complete nationalisation of monetary and fiscal policy. They became the principal instruments of government action. It was a process of centralization of the powers of economic policy which assumed different forms in communist and in capitalist countries. But the common aspect was the increased role of national power in the government of the economy. In fact, the degree of integration of the international economy between the two world wars was such that national governments still enjoyed notable margins of manoeuvre to encourage development and internal employment by autonomous policies. The end of the gold standard allowed many countries to begin effective national plans for economic recovery. And indeed, as a reaction to the Great Depression, the thirties saw an increase in internal production compared to international trade.[13] Economic nationalism had won.

The use of a national currency as a reserve money, among economic systems in which monetary policy could no longer be considered neutral for internal purposes, could therefore succeed only in a highly stable international context, with strong convergence between the economic policies of the national governments and on the basis of an absolute confidence in the national money chosen as pivotal to the system of payments. These were indeed the conditions emerging on the horizon when the new post-war economic order was planned by the United States. Indeed, the Roosevelt administration did not wait for the end of the conflict to define the rules and grand objectives of reconstruction. At the end of 1941 the United States was already beginning to open negotiations with Great Britain for the establishment of an international monetary system based on fixed exchange rates. British resistance to American claims of "universality", in other words multilateralism, which would have threatened to dismantle the system of imperial preferences and the

area of the sterling, was progressively overshadowed by the strength of the emerging world power: the United States held about 80 per cent of gold monetary reserves, their gross industrial production was approaching half of total world production and, as was seen during the war, and even more after the explosion of the atomic bomb, their military supremacy was incontestable. The Bretton Woods agreements of 1944 thus marked the beginning of a system of international payments based formally on the rules of the gold exchange standard but in fact on American supremacy. Unlike the classical gold-standard, the gold-exchange standard is by no means a spontaneous order.

Bretton Woods represents the first attempt in the history of the world economy to found an international monetary system (and successively, with the GATT, a multilateral trade system) on written rules. However, to understand how it was possible for Bretton Woods to function successfully, even if for a limited time, one must refer not only to written, but also to unwritten rules. The first important unwritten rule is that the plan drawn up at Bretton Woods would only concern the western economic area. This question was incidentally immediately settled with the USSR's refusal to ratify the agreements and Moscow's ban on countries of the socialist camp adhering. The second unwritten rule concerned final responsibility for the agreements working. Formally the signatory states committed themselves to respecting a certain parity of their currency with the dollar (with a margin of flexibility of 1 per cent more or less), while the US government committed itself to respecting parity of 35 dollars per ounce of gold. But this objective could not be obtained without the actual collaboration not only of Central Banks, but also of national governments. Unlike the classical gold standard, Bretton Woods explicitly recognised the possibility of conflict between internal objectives (full employment, price stability) and external objectives (balance of payments equilibrium, exchange rates stability), and sought to make provision for this with proper institutions: the International Monetary Fund and the World Bank. It was therefore recognized that exchange rates would not remain stable through automatic mechanisms, but only thanks to appropriate national economic policies coordinated amongst each other. The common institutions were to facilitate the attainment of this objective: the IMF through short term loans to countries with difficulties in their balance of payments, to overcome momentary imbalances, and the World Bank with long term loans at low interest rates to facilitate structural development. Both institutions had their central office in Washington, and the voice of the American government was

preponderant in their administration. Nevertheless, as soon as the Bretton Woods system was put to the test, immediately after the war, it proved inadequate. Because of the vast destruction of productive framework during the war, the European countries could not make their way back to economic recovery and international competitiveness, without which they would be unable to dismantle the pre-war protectionist apparatus and make their currencies convertible. Great Britain, urged by the US, tried to make the sterling convertible in July 1947, but the experiment failed within a few weeks. The situation was effectively summed up in the problem of the dollar shortage, i.e. in the fact that the European countries needed American products more than the United States needed European products.[14] The difficulty was overcome only thanks to the Marshall Plan of public and private aid for European reconstruction. It is calculated that from 1948 to 1951 the United States succeeded in guaranteeing Europe aid equal to 1 per cent of their gross domestic product, corresponding to around 2 per cent of the gross product of the beneficiary countries.[15] This was the beginning of a process which gradually allowed Europe to begin reconstruction and restore monetary stability, to the point of attaining convertibility. In this case, as on many other occasions which were to arise subsequently, it was clearly the American government which supported the international institutions and made them work, and it was the Federal Reserve System and not the IMF which, if necessary, acted as lender of last resort. In short, the gold-exchange standard was not a symmetrical system: some had more responsibilities than others.

Officially, the Bretton Woods agreements began to function from 1947. But, in the early years, their existence was purely nominal. The European countries were still constrained by the pre-war protectionist systems, international trade took place prevalently on bilateral bases, the international currency remained the sterling until the mid-fifties, and the Central Banks still held most of their reserves in sterling (as well as in gold).[16] Nevertheless, the political and economic stability guaranteed by the American hegemony over the entire western hemisphere was determining in creating favourable conditions for cooperation between European countries which, once started, represented in turn one of the pillars of the post-war international monetary order. Indeed, thanks to the impetus provided by the Marshall Plan, the European Union of Payments (EUP) was established, which through a clearing system stimulated multilateral trade among European countries. Later, with the Treaty of Rome, the conditions were created for full convertibility (1958) of the European currencies. Japan decide to make the yen convertible in 1964.

With the convertibility of currencies began the phase which could be called the Gold-dollar standard, because the dollar became the principle money of international trade and of Central Bank reserves.

Strictly speaking, the Bretton Woods system only functioned for little over a decade, from 1959 to 1971, when the US government was obliged to declare the inconvertibility of the dollar with gold. However, its success was considerable. The industrialized countries of the western area developed at almost twice the rate (4.9 per cent from 1950 to 1970) compared to the period of the classical gold standard.[17] Overall, the cases where the agreed rates had to be realigned because of some countries being unable to maintain equilibrium in their balance of payments, proved limited, showing that the governments participating in the agreement were respecting the economic discipline necessary to maintain the agreed exchange rates. The Bretton Woods system collapsed in 1971 for three reasons, which are closely interlinked.

The first of these reasons was very lucidly formulated by Robert Triffin[18] back in 1959, the year in which the experiment of full convertibility of European currencies began. Triffin pointed out an intrinsic contradiction in the system of the gold-exchange standard, because the growing volume of international trade, given the impossibility of increasing gold reserves adequately, would require a growing volume of international liquidity which only the key currency would be able to provide. The country of the key currency, the United States, would thus find itself in the position of having to provide liquidity for the rest of the world, something which could only happen through a deficit in the US balance of payments (in effect, the current account surplus was compensated by the deficit in capital account). Initially, capital was leaving the United States in the form of public and private aid. Subsequently, it was a matter of direct foreign investment, especially in Europe. This situation, as Triffin correctly maintained, would in the long term become unsustainable, because it would generate a growing mistrust in the United States' capacity to maintain the convertibility of the dollar into gold. The events of the second half of the sixties fully confirmed Triffin's analysis. Partly because of the war in Vietnam, it became evident at a certain point that the American deficit was increasing not only to provide the necessary liquidity for the international system of payments, but for other aims of US foreign policy. Thus the decade afflicted by the scarcity of dollars was succeeded by a decade afflicted by the opposite: an excess of dollars, which was transformed into an unwelcome rate of inflation outside the United States.

The second reason for the crisis in the Bretton Woods system concerned the growing mobility of capital, a phenomenon which assumed huge proportions in the age of financial globalization. The Bretton Woods agreements provided for the convertibility of currency only as regards payments in current account, i.e. the trade of goods and services. The experience of the thirties had shown how destabilizing speculative movements of capital were. However, with the beginning of the phase of monetary convertibility it became increasingly difficult, especially for the American government, to prevent private capital from seeking high returns abroad. The City of London, in particular, became an especially well-equipped market for investments in dollars. Thus the Eurodollar market was born, thanks to the fact that a stateless market, not having to be subject to constraints imposed by national regulations, could offer more advantageous borrowing rates than on national markets. At that time then, an unstoppable process was set in motion towards the liberalization of movements of capital, which became even more impetuous in the eighties when, after the collapse of Bretton Woods, the flexibility of exchange rates facilitated a further liberalization of international and internal movements of capital.[19]

The third reason for the collapse of the Bretton Woods system is to be sought in the change of relative economic strength between the United States and the European Community. At the end of the sixties the Community was affirmed as the leading world commercial power, overtaking the United States. European commercial supremacy, moreover, brought a change in monetary relations. The US gold reserves diminished continuously throughout the post-war period, while those of rival commercial poles, such as the European Community and Japan, increased.[20] The relative strength of Europe was not however translated into the capacity to create a European monetary pole as an alternative to the dollar. De Gaulle, from 1965 on, protested against the United States' "exorbitant privilege" of not having to balance its own foreign accounts. According to Jacques Rueff, the gold-exchange standard had "produced the immense revolution of providing countries whose currency has international prestige with the marvellous secret of the deficit without tears, which allows one to give without taking, to lend without borrowing and to buy without paying."[21] In effect, according to Rueff, not only did the Bretton Woods system allow the United States to create an inflationary monetary base without any obligation to respect the equilibrium of the balance of payments, but, thanks to the fact that the countries in the system found it convenient to hold reserves denominated in dollars which

they could, in part, profitably reinvest in the United States market, the world monetary base necessarily ended up by expanding disproportionately. The remedy, for Rueff and De Gaulle, was the return to the gold standard. The situation became unsustainable when Germany also refused to accept the inflationary policy of the United States. In May 1971, Germany attempted to convince the other countries of the European Community to start a common fluctuation against the dollar, but because of the French resistance the German proposal was not accepted.[22] Thus began a phase of disordered monetary fluctuations, which undermined relations not only between Europe and the United States, but also among the countries of the European Community themselves.

In conclusion, the end of Bretton Woods did not represent the collapse of the international economy as had happened in the era of the Great Depression. But international monetary stability was replaced with an inflationary phase in all the industrialized countries. The collapse of Bretton Woods signified the end of American economic hegemony or, as some maintained, the transition from hegemony to leadership, because the United States were no longer able to ask the governments participating in the agreement to respect the rules of the game. International economic cooperation between countries of the Western area could continue, but only on a new basis: a system of flexible exchange rates, but whose flexibility was not to exceed limits previously agreed between the major industrialized countries. For this reason the G7 became increasingly important as an informal means of coordinating economic policies. It was also thanks to these expedients that international trade continued to grow uninterruptedly even in the era of fluctuating exchange rates. In the same way, the world capital market developed with unstoppable force, because thanks to the fluctuating exchange rates, the governments no longer had serious reasons to prevent their international flow. However, these commercial and financial movements, even if beneficial, created a situation of progressive anarchy. The national governments, including that of the United States, increasingly lost the power to control exchange rates. The dollar standard is a non-system, because the dollar now fulfils only the function of a *lingua franca*, i.e. of a conventional unit of measure for trade. But there is no longer a responsible authority of last resort to turn to in case of serious financial disorder, partly because of the enormous importance assumed by stateless finance. The world economy is out of control.

4. *The European Monetary Union as a New Gold Standard.*

The process of European monetary unification took its first steps as the Bretton Woods system was in its last throes. This is a process of regional dimensions, i.e. it concerns the formation of an international monetary sub-system which, however, possesses global potential because of the economic importance of the area concerned. It cannot be understood without bearing in mind that the technical solutions gradually adopted by the European governments were based on the need to adopt political measures which do not call into question the founding pact of the European Community. The European Community was founded in 1950, as *les premières assises de la Fédération européenne* (Jean Monnet). It is true that this political objective is rarely recalled and is not explicitly pursued but it is also true that in critical periods, where a choice was imposed between unity and division, the way of unity has always, however ambiguously, been chosen. The Treaty of Maastricht (1991), which created the single currency, but with entirely insufficient common political institutions, is a further example of the profoundly contradictory nature of the process of European unification.

For this reason, European events generate disparate interpretations, not only among commentators but among the protagonists themselves. The hypothesis discussed here is that, as the other side of the coin, the process of European unification involves the denationalization of economic policy, both monetary and fiscal. Between the two world wars, as has been seen, the major powers oriented themselves towards more or less accentuated forms of autarky. After the Second World War, with the Bretton Woods system and the other principal international economic organizations, it was accepted that economic policy should also pursue the objective of building a free world market (at least in the western area), but without calling national sovereignties into question. The project of the European currency proposed to transform an international market (even if of regional dimensions) into a genuine internal market. The Treaty of Maastricht indeed involved the establishment of a supranational Central Bank and single currency in a multinational area. As regards the exchange rate system, it is in substance a gold standard, even if, in age of token money, it is certainly no longer gold which functions as the circulating medium, but the euro.

To examine how this has been possible, let us consider three intermediate stages which the Community passed through before taking the decision to found the Monetary Union. The first consisted of the governments simply identifying the objective, in the Werner Plan (1970), but

substantially without the will to put it into practice. The second and third phase coincide with the creation (1979) and evolution of the European Monetary System (EMS), which at first bore some resemblance to a gold standard and subsequently to a gold-exchange standard, under German hegemony.

The Treaties of Rome (1957) made it possible to realize a customs union, with a common external tariff, but by no means identified the establishment of a single currency as the necessary condition to realize a genuine Common Market. Tacitly, the Treaties of Rome had considered the dollar as the European currency. However, when in the second half of the sixties the Bretton Woods system began to manifest evident signs of sinking, the European governments at the Hague Summit of 1969 decided to establish an Economic and Monetary Union. The Werner Report, approved in 1970, precisely identified the objective to be reached and its fundamental consequences for monetary and budgetary policy. "A Monetary union," the Werner Plan states, "implies inside its boundaries the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in exchange rates, the irrevocable fixing of parity rates and the complete liberation of movements of capital." This target was to be reached in the course of a decade, therefore by 1980. Moreover, the report states, "it is indispensable that the principal decisions in the matter of monetary policy should be centralized, whether it is a question of liquidity, rates of interest, intervention in the foreign exchange market, the management of the reserves or the fixing of foreign exchange parties vis-à-vis the outside world...The Community budget will undoubtedly be more important at the beginning of the final stage than it is today, but its economic significance will still be weak compared with that of the national budgets, the harmonized management of which will be an essential feature of the cohesion in the union." Finally, the report states that the creation of Monetary Union would involve a "transfers of [political] responsibility" from the national to the European level, necessitating a "centre of decision" (i.e. a government) responsible to a reformed European Parliament for overall economic policy.[23]

The real defect of the Werner Plan lay in the presumption that to start a transitory phase founded on the good will of the European governments to cooperate, was enough to gradually bring the Community closer to the final objective. No new institution, other than those already provided for in the Treaties of Rome, was initially considered necessary. The European currencies would have to gradually restrict their margins of fluctuation with regard to the dollar (which therefore continued to act as currency

of reference) until a European Monetary Cooperation Fund would be founded, embryo of the future European Central Bank.

Some of the indications in the Werner Plan were indeed put into effect after the American decision to make the dollar inconvertible and the Smithsonian Agreement of 1971, which brought the margins of fluctuation compared to the dollar to 2.25 per cent. Consequently, the European currencies would have been able to fluctuate against one another by 9 per cent, a margin considered excessively high for the Common Market, especially that of agriculture, which was based on the principle of the single price. The six countries of the Community decided therefore to restrict bilateral margins of fluctuation to 2.25 per cent more or less, so as to limit the maximum fluctuation between European currencies to 4.5 per cent. At the same time, the European Monetary Cooperation Fund (Fecom) was founded, as a clearing house between Central Banks. The snake in the (dollar) tunnel had a short life. It began to function in 1972 between the six countries, the United Kingdom and Denmark. But the latter two States abandoned the experiment immediately. In 1973 Italy came out of it and the Deutschmark and Dutch florin were revalued. In 1975 France came out, returning the same year, but withdrawing again in 1976. The snake was thus reduced to a simple Deutschmark zone.[24] In the meantime, the first and second oil crises (1973 and 1979) further aggravated the problems of the European countries, which were obliged to react individually to the increase in prices of raw materials and to difficulties in the balance of payments. In these years public borrowing began to grow, becoming chronic in the following decades. The ratio between public debt and GDP was, in 1973, close to 60 per cent in Italy, Belgium and Ireland, 70 per cent in the United Kingdom, 40 per cent in France and the Netherlands and 20 per cent in the FRG. In 1982 the same ratio rose to over 100 per cent in Belgium and Ireland, 66 per cent in Italy, and 40 per cent in Germany. Only France succeeded in keeping its borrowing to 40 per cent.[25] At the same time, inflation in some countries reached dramatic levels. Up until 1973, the differential rate of inflation in Italy, France and the United Kingdom was contained below 5 per cent compared to that of Germany. In 1980, the inflation differential in Italy and the United Kingdom rose to 15 per cent compared to Germany.[26]

The situation of monetary and financial disorder in which the European Community found itself threatened its very existence. For the first time since its foundation, intra-community trade ceased to grow. The first impulses for a political relaunch of the unification process came from the European federalists who, as well as demanding the by now imminent

direct elections for the European Parliament, called for the establishment of a European currency with which the Community could begin to change into a genuine Federal Union.[27] The European governments, however, faithful to the method of small steps, took less momentous decisions, but nevertheless significant. In 1979, between eight countries of the Community (the United Kingdom decided not to participate), the European Monetary System (EMS) came into force. Its essential characteristics were: a) a money of account was established, called ecu, composed of a basket of national currencies, weighted on the basis of their respective GDP's and intra-European trade; b) the rates of exchange of the national currencies were defined in terms of ecu (the dollar thus definitively lost the role of reference money); c) the margin of fluctuation of each currency was fixed at 2.25 per cent more or less than the central rate; d) a threshold of divergence was fixed at 75 per cent of the margin of fluctuation, in order to oblige the Central Banks and the authorities of economic policy to intervene before the extreme margin of fluctuation was reached; e) a common procedure, with which the Commission was associated, was agreed on to modify the central rates; f) a European Monetary Fund was to be established within two years; but the latter commitment was subsequently completely ignored by the European governments.

There are some characteristics of the EMS which closely recall the rules of the game of the gold standard: a) the EMS was established with the aim of creating "a zone of monetary stability" in Europe, thus protecting it from the dangerous fluctuations of the dollar. By monetary stability one must understand both stability of exchange rates and an economic policy in each country aimed mainly at fighting inflation; b) no national currency was used as a standard of measurement: instead an artificial money, the ecu, was created to act as money of reference (like gold) for the Central Banks, which were committed to keeping constant the value of the national money in terms of ecu; c) thanks to the creation of the ecu, the EMS could function as a "non-hegemonic" system, or rather as a "symmetrical" system, in the sense that no national economic policy prevailed over the others; indeed, each country had the duty to intervene when its own exchange rate approached the tolerated "threshold of divergence", either upwards or downwards; d) the tacit cooperation between the Central Banks of the gold standard in the EMS was institutionalized with precise rules of conduct concerning changes in central rates and reciprocal aid between currencies.

The initial phase of the EMS, concerning the years 1979-83, in which the inflation differentials between the European countries were still high

because of the recent oil crisis and the turbulence of the dollar, was characterized by seven realignments of central rates of exchange. But, starting from the mid-eighties, greater convergence was realized between the European economies, thanks to the reduction of inflation differentials. Par realignments became less frequent. The "single market by 1992" project thus became possible (Single Act, 1986), relaunching growth and employment. Starting in 1981 a private capital market also began to form in ecu, which was becoming established as a key currency for financial activities, thus giving visibility to the "demand" for European money. The growth of the private ecu market was sufficiently constant at the time: 5 per cent of the international market in 1985, 6 per cent in 1989 and over 10 per cent in 1991. The ecu was however not utilized to any significant extent in official transactions between Central Banks, nor in commercial transactions for the invoicing of commodities and services.[28]

The second phase of the EMS, which ended with the crisis of August 1993, when the margins of fluctuation were brought to 15 per cent more or less than central parity, began after the French government and President Mitterrand decided to abandon a policy to develop the French economy based on boosting internal demand, which would have added to the budgetary deficit and inflation. France opted explicitly, in this circumstance, for a policy of European convergence. The standard of reference therefore became the German monetary policy of the Bundesbank, which had fought inflation with greater success than the other members of the EMS. The EMS thus ceased to be a symmetrical system, if it ever had been, because, since the pursuit of a low rate of inflation had become the central aspect of economic policy, Germany could no longer be asked to increase its rate of inflation to converge towards the community average. It was no longer the ecu but the mark which became the key currency on the exchange market.[29] It could therefore be maintained that, in this second phase, the EMS became more similar to a gold-exchange standard than to a gold standard. Compared to Bretton Woods it should however be noted that the role of Germany and the mark was very different to that of the USA and the dollar. The USA could count on political, military and economic hegemony over the western world. The EMS became the area of the mark only temporarily, because the other European countries accepted the German model of monetary stability as a premise for the creation of the Economic and Monetary Union, in which the hegemony of Germany and the mark would disappear.

The political aspect of the process of European monetary integration is essential to an understanding of the events of 1992-93, which in fact led to the end of the EMS, because a margin of fluctuation of 15 per cent is a pure fiction: if it had been fully utilized it would in fact have represented a system of floating exchange rates. The EMS crisis of 1992 was very similar to that which led to the end of the Bretton Woods system. German unification had forced the Bonn government, with an exceptional issue of public debt, to support enormous investments in the Eastern Laender, and the Bundesbank to increase interest rates to contain inflation and attract foreign capital. The other countries of the EMS found themselves thus facing the necessity of either closing their borders again to movements of capital (but this would have meant refusing the first stage of Monetary Union, already approved), or considerably increasing interest rates, or, finally, devaluing their own currency against the mark and abandoning the EMS. This third path was the one followed by Italy and Great Britain. But the EMS crisis by no means led to the end of the project of Monetary Union, as implicitly maintained by those who, on the basis of pure economic logic, wanted the European countries to adopt a system of floating exchange rates, to enable national development plans.[30] For this reason, even if with growing difficulties, the process of convergence between European economies, by now precisely defined in the Treaty of Maastricht, recovered.

The dramatic years which saw the disintegration of the Soviet empire and German reunification, imposed on Europe the choice between a European Germany or a German Europe.The Treaty of Maastricht (1991) sanctioned the definitive abandonment of national monetary sovereignty and the establishment of the Monetary Union, as the cornerstone of the future Political Union. The Treaty of Maastricht can therefore be interpreted as the institutionalisation of the rules of the gold standard. The acceptance of a common currency involves renouncing the utilization of the rate of exchange for beggar-my-neighbour manoeuvres, and the definitive transformation of the European market into an internal market. Moreover, the European countries did not limit themselves to accepting a whatever Monetary Union, but a union in which monetary policy pursued the primary objective of price stability. For this reason, the transition to the single currency required a "trial" period, in which the countries which, unlike Germany, had not accepted the so-called culture of monetary stability in the past, had to give proof of radical changes in certain kinds of behaviour both at institutional level and in social aspects. Finally, the Treaty of Maastricht recognizes the need for fiscal policies

to also respect some common constraints. The Delors Report, in which the objectives and phases of building Monetary Union are delineated, clearly states that national budgetary policy can generate imbalances in the entire Union through excessive deficits, and must therefore be subject to common rules.[31] The new rule is that of a balanced budget. The maximum deficit limit, 3 per cent of GDP, identified by the Treaty of Maastricht as a parameter for the start of Monetary Union, was confirmed again in the Stability Pact (Amsterdam 1997) as an absolute limit even once the Union is functioning, causing fines and special control procedures on the part of the Commission if not respected. In short, the Treaty of Maastricht establishes a symmetrical monetary system, in which the participating countries have equal powers and responsibilities; exchange rate risks are eliminated thanks to the introduction of a single currency, and interest rates will tend to be uniform (except for risk differentials) throughout the Union. Therefore, the European countries are once again observing some important rules of the game of financial and monetary orthodoxy typical of the era of the gold standard. Naturally, now that a token money, not gold, is the common money, it is necessary to fix the rules of the game in a Treaty because, without the unconditional and sacred confidence in gold, only a solemn pact and common institutions can reach the aim of maintaining unity and cohesion among numerous countries. A spontaneous monetary order in the contemporary world is no longer possible. But at this point the question arises whether a Monetary Union, based on the rules of the gold standard, represents an adequate response to the complex demands of European society and economy.

5. *Employment, Development and Subsidiarity.*

The European Monetary Union, even if similar to the gold standard, will have one important element of differentiation: the European Central Bank, responsible for issuing the single currency. It is therefore right to call it a post-Keynesian gold standard, because Keynes had criticised the gold standard for its rigidity: indeed, the quantity of money (gold and paper money convertible to gold at a predetermined rate) could not be adapted to the requirements of economic development and the economic cycle. The Treaty of Maastricht, by contrast, indicates precise priorities for monetary policy.

But there is a second sense in which the European Monetary Union could be called post-Keynesian. Monetary Union is established between countries where the practice of State intervention in the economy to favour development and employment is established. All the countries of the European Union have a welfare State which began to develop in the last century, which makes Europe an economic system with its own socio-economic identity, in which the State undertakes to fight poverty and assumes the responsibility of assuring each individual a minimum of assistance and education. But the Welfare State is currently circumscribed to the national level. The establishment of Monetary Union raises the question of the extent to which functions which before were fulfilled at national level should now be entrusted to European level. The central question is employment. Should the European level be involved in the fight against unemployment? And if so, what means (i.e. what powers) should it have at its disposal?

The answer to these questions involves obvious political implications. Some say that the European Union must not become a new Welfare State, which would end up centralizing resources and powers now held at national level. The Monetary Union, in this conception, would be nothing more than an area of free trade with a common currency. The point of view defended here is, on the contrary, that if the European nations want to maintain the standards of well-being and prosperity which they have enjoyed in the past, they must entrust some specific responsibilities for the realization of a European plan for development and employment to the European level. The principle of subsidiarity, according to which functions which cannot be fulfilled at a certain level of government must be entrusted to the next one up, must also be applied to the problem of development and employment. It is a question of understanding what the nation-states can actually guarantee their citizens and what, on the other hand, they can no longer guarantee without the intervention of a higher authority, i.e. the European government.

When one discusses a plan for development and employment it is entirely natural to take Keynesian theory as one's point of reference. However, it should be borne in mind that Keynesian thinking developed back in the thirties, in an entirely different historical context. Keynesian employment theory was conceived as the economic policy of the closed nation-state.[32] Today, the nation-state has to operate in an open international context, highly interdependent. With the single currency the European Union, while obliging the nation-states to open up more to the world economy, also provides the means to tackle the challenges of globalization. To understand the specific role of the European government, it must be specified that the economic environment in which it must act presents some characteristics which can be called post-Keynesian, in

the sense that some conditions which determined the context in which Keynesian policies were conceived in the thirties no longer apply today. There are at least three questions to examine, all in relation to the process of globalization: the relationship between monetary and fiscal policy; the relationship between monetary wages and prices; and the relationship between production and employment.

The Treaty of Maastricht and the Stability Pact impose a close relationship between monetary and fiscal policy. Monetary policy must pursue the primary objective of maintaining price stability, and fiscal policy must observe the obligation not to generate excessive budgetary deficits. This dual objective (in short: no inflation, no deficit) which the European Union made transparent with the Treaty of Maastricht is actually a general rule which the globalization of the financial market is imposing on all countries. The United States are not obliged to respect the Treaty of Maastricht, but a bipartisan agreement, accepted by both American parties in the higher national interest, takes the same direction, towards balancing the federal budget by the beginning of the next century, while the Federal Reserve System has already been following a cautious anti-inflationary policy for some time now, very similar to that required by the Treaty of Maastricht. Similar observations apply to Japan and other countries. This connection between monetary and fiscal policy is imposed by the world financial market, which considers each country by the standard of a large multinational corporation: if government borrowing becomes excessive, or the budgetary deficit exceeds a certain threshold, then lenders demand a premium on the rate of interest normally asked to borrowers. This means growing burdens on the debtor country. Inflation is considered another risk factor, which can be generated by a permissive monetary policy of the Central Bank or by an excessive budgetary deficit. All this means that the world market imposes certain constraints on national economic policy which did not exist in Keynes's day. Keynes could think of a relatively independent monetary policy, in which the Central Bank would propose the objective of reducing the interest rate until it reaches a level sufficient to stimulate investments. And if the stimulus of monetary policy was not sufficient, a more energetic fiscal manoeuvre might be considered, to increase effective demand by means of a plan of investment financed by a public budgetary deficit. This freedom of manoeuvre no longer exists. For the nation-states monetary and fiscal sovereignty have become an empty shell, and the smaller the country, the less content it has (cf. Appendix 2). Only economies of continental dimensions can aspire to relative autonomy in

an increasingly interdependent world economy. This does not mean that the monetary and budgetary policy are totally ineffective or useless: margins of manoeuvre, often important ones, do exist.[33] But the limits of some of the typically Keynesian instruments of economic policy should now be explicitly recognised. A plan for development and employment aiming at inflationary or deficit spending policies is a memory from the past. It would be like pouring water into the petrol tank of an engine. Not only would no impetus be provided, but the mechanisms would be seriously damaged.

The second post-Keynesian change which must be taken into consideration concerns the relationship between monetary wages and prices. In the thirties, in a closed nation-state one could assume, without fear of a significant difference between theory and reality, that the area of the national currency would coincide with the area of trade union organization. Trade union collective bargaining assumed a national dimension and, since wage costs represented an essential component of production costs, the level of monetary wages ended up determining decisively the general level of monetary prices. In a closed nation-state the power of the trade unions is therefore considerable: it can even influence the conduct of the Central Bank, which must adjust the monetary flows to suit the demands from workers. The trade unions' power manifested itself particularly evidently in some European countries during the years of inflation, following the collapse of Bretton Woods, when monetary fluctuations allowed a phase of relative isolation of national economies. There was then a perverse race between monetary wages and prices which seemed unstoppable, because the unions (but their conduct was tolerated and complied with by entrepreneurs and monetary authorities) attempted to anticipate inflation with demands for ever growing annual increases. In these circumstances it is difficult, and perhaps impossible, to calculate what real wage corresponds to a certain nominal wage, with disastrous consequences not only for the workers, but also for the companies and for the entire economic system. In a Monetary Union, formed by several nation-states, and open to the world market, the relationship between monetary wages and prices must necessarily change. In open market conditions, the system of real prices (i.e. the quantity of one commodity in terms of another) is decided by the system of world competition. The Central Bank of the Monetary Union, both for statutory reasons and for reasons of prudence, must pursue the objective of price stability, maintaining inflation at the lowest possible level. This allows the companies and unions to agree an incomes policy based on real data:

productivity and real wages (the Keynesian monetary illusion vanishes). In the European Union, the new "culture of monetary stability", by allowing monetary price stability and the adjustment of real wages to productivity, encourages greater flexibility in the labour market and a progressive downsizing in importance of the national level of collective bargaining. On the one hand it will become necessary to organize the labour market at European level, especially where the European dimension of companies is dominant and where the nature of the problem — for example the reduction of working hours — necessitates coordination and a European legislative framework. On the other hand, a more transparent relationship between productivity and labour cost promotes greater flexibility in the labour market, including regionalization and territorial differentiation of minimum wage levels. An employment policy, today, must therefore be based not only on demand, but also on supply. However, if the policy of making wages more flexible were pushed to its extreme consequences, this could generate in Europe, as it has in the USA, the phenomenon of working poor, i.e. the formation of a social stratum which, despite working, lives below the poverty line. Hence the reform of the Welfare State is on the European political agenda. The question is complicated by the fact that other problems are superimposed on the reform of the labour market, such as the crisis of the pensions system, caused by the aging of the population. It is certain that the old Keynesian means to fight unemployment, like the unemployment insurance funds which at one time guaranteed job stability but represented a serious obstacle to technological renewal, are no longer right for the new circumstances. The challenge of globalization imposes a flexible labour market. This does not mean, however, that the life and well-being of individuals must not be protected. The Welfare State should be reformed, not abandoned. At national level, new forms of solidarity should be sought, such as the citizen's income (articulated in a series of complementary measures like the contract of apprenticeship, loans to young entrepreneurs, etc), which should allow all to successfully enter the work market and enjoy a minimum of social services.

The third post-Keynesian situation concerns technological change. The transition from the industrial to post-industrial (or post-Fordist)[34] mode of production is under way, and the information society is becoming a reality. Keynes could conceive a stable and constant relationship, in the short-term, between effective demand and employment. Today, the technological transformation is so rapid that, even in the early phases of recovery, after a period of stagnation of the economy, any increase in production is unlikely to mean any increase in employment, because the companies' interest lies in replacing the old methods as soon as possible with automated methods, which save labour considerably. An employment policy today must necessarily be long term and favour the structural modifications necessary for the new mode of production, such as the new information technologies, the new ratios between capital and labour in the company, scientific research, education and permanent training. The technological challenge concerns all industrialised countries and does not even spare the industrializing countries, because one cannot break into the world market with antiquated productive methods. Employment policies founded uniquely on expansion of effective demand would entirely miss the mark. Economic growth, without appropriate market reforms, creates unemployment. In the last few decades, Europe has proved unable to adequately exploit the opportunities generated by the increases in productivity. Wealth is increasing, but it is distributed unequally between those fortunate enough to have a job and those, especially the young, less fortunate.

If we now return to the main question, namely if there is a policy which can only be adequately tackled at European level, and not at national level, the answer is decidedly positive. In short, the fight against unemployment must go on at all levels of government, including the local levels, but it is effective only in the context of a European plan. The causes of unemployment in Europe have been investigated by numerous studies, which converge on some decisive points: unemployment is a structural phenomenon which has assumed worrying proportions since the seventies, when it far outstripped that of the USA, where it had always been higher than in Europe. In some ways, it is a more profound and persistent crisis than the Great Depression of the Thirties. There is no single cause of the phenomenon, but a series of causes, including the rigidity of the labour market, excessive taxation and regulations which tend to exclude young people from the labour market.[35] The remedy for these problems lies in a mixture of reforms which must be realized both at national level — some governments have already made moves in this direction — and at the level of local powers, which must be put in a position to carry out an active employment policy, in collaboration with the national government and the European Union. Indeed, some social services can be offered more effectively by governments closer to the citizens and more sensitive to their needs (in this case too the principle of subsidiarity should be applied).

The European level of government is however essential when it

comes to determining what Keynes called the entrepreneurs' *state of confidence*. Investments represent the most dynamic part of effective demand and are essential to guarantee the competitiveness of the economy in the context of the world market. In Keynes's day and in a closed nation-state, a vast plan of state investment could be enough to create a state of confidence in economic recovery (the model is Roosevelt's New Deal). Today, in a situation where every government must contend with the world market and therefore with what the other governments are doing to put their own companies in a situation of advantage, a plan of public investment, especially if realized only at national level, is entirely insufficient unless part of a more complex strategy. What Keynes called "marginal efficiency of capital", in other words the profitability of investments, is by now a function which, for some strategic sectors such as information technologies, telecommunications, aeronautics, etc., depends on the possibility of establishment on the world market. The policy of offering incentives to investment has therefore become a component of government foreign policy.

The success of some free trade areas, like the NAFTA, Mercosur and the European Union itself, is explained precisely by the fact that in this way the national governments succeed in assuring their own companies a broader area than the national market as a platform to compete in the world market. Government neutrality towards the market is a liberal myth with no foundation. Even governments like that of the USA, which are often cited as models of pure liberalism, actively promote policies which can favour their own companies. The European Union has not yet succeeded in developing as effective an economic policy as that of the US and Japanese governments. To cast light on the reasons for this we shall look at the circumstances in which the Union has succeeded in creating a state of confidence sufficient to encourage a persistent phase of development of income and employment. There have only been two such phases. The first was the project of the Common Market, made possible by the Treaties of Rome of 1957. Although it was a simple project for a customs union, in the context of an increasingly open and stable world market, thanks to the American hegemony, the abolition of the customs barriers created a highly dynamic phase of intracommunity trade and investment. It should simply be noted that in the period 1960-73 the average rate of growth of the European GDP was 4.8 per cent per annum, while the unemployment rate remained at the level of 2.6 per cent, about half that of the USA. The second phase of growth, after the turbulent seventies, coincided with the project of the single European market.

Despite the fact that in the first half of the eighties the economies of the European countries were afflicted by serious problems of inflation and unemployment, the establishment of the European monetary system and the renewed confidence surrounding a common project — the objective of a "single market by 1992" thanks to the abolition of barriers to the free movement of goods, services, capital and persons — created a climate of Euro-optimism which allowed at least a temporary reversal of the European economy's tendency to decline. An estimate made on behalf of the European Commission forecast that the realization of the single market would lead to an overall increase in the rate of growth of an average 4.5 per cent of the Community GDP and the creation of 1.8 million new jobs.[36] The results did not match expectations, but from 1986 to 1990 there was indeed an annual growth recorded at 3.2 per cent, while the unemployment rate fell to 8.3 per cent in 1990, after reaching 10.8 per cent in 1985.

Since then, conditions in the European economy have only deteriorated. The phase of Euro-optimism was succeeded by that of Euro-scepticism. The wave of Euroscepticism was unleashed by the struggle for the European currency. Its origins are not to be sought in the economy, even if the dramatic crisis of the EMS of 1992 marked its beginnning. The causes of Euroscepticism are eminently political and concern the struggle between the forces of nationalism, which opposed the project of the European currency, and the pro-European forces. It is however in this context and as an integrative part of economic and Monetary Union that the "Delors Plan" for the development of the European economy and the fight against unemployment was conceived and passed. The plan, drawn up by the European Commission and contained in the White Paper, *Growth, Competitiveness and Employment. The challenges and the ways forward into the 21st century*[37] was approved by the European Council in Brussels in 1993. This, after the European Parliament project of 1983,[38] which however remained at the proposal stage, represents the second attempt to define an organic development plan for the European economy. But, unlike the European Parliament project, the Delors Plan was already formulated in operational terms, with the indication of a precise programme of European investments, sources of funding and the responsibilities to be assumed by the national governments and local authorities along with the European Commission. The Delors Plan contained an effective European response to the challenge of globalization. The construction of a European network for the exploitation of information technologies would have enabled the productivity of companies and

State administrations to increase considerably. The funding of high speed rail networks and new motorway links (particularly those between western and eastern Europe, as far as Moscow) would have given all participants in the economy tangible access to the size and enormous potential of the new European market. Finally, some innovative proposals for employment policy, such as the reduction of the labour costs associated with environmental projects, the reform of the educational system and the reduction of working hours, would have put Europe in the vanguard of experimentation with a new model of sustainable development. In short, with the Delors Plan, Europe would have succeeded in keeping step with the United States and Japan, whose governments have already promoted, in some cases effectively, measures of industrial policy (computer science, aeronautics, education, etc) which are similarly directed.

The Delors Plan, however, has so far only been realized to a minimal extent and certainly not to the extent sufficient to determine a state of confidence favourable to the recovery of the European economy. The European governments wait passively for the European economy to recover thanks to stimuli from the development of the world economy. But any recovery brought about in this way could only be another flash in the pan. The state of confidence is not to be confused with a cyclical euphoria. The fundamental problem, which Europe cannot escape, is whether the political will to face the challenge of globalization exists. The Delors Plan has not been realized, one could maintain, because rampant Euroscepticism has continually created obstacles to the monetary project and to any other advance in the building of Europe, including the Delors Plan. This analysis is correct, but incomplete. The real problem is to understand why there has been no manifestation of the will to overcome this impasse.

The reasons for the failure of the Delors Plan lie in the ideology of "coordination of national policies", encouraged by Delors himself.[39] According to this point of view, the approval of the European development plan, specifying the tasks to be undertaken at European, national and at local level, would be enough to obtain the necessary commitments without any substantial modification of the Union's institutions. But, as experience has shown, this is not true. A European development plan cannot be realized unless it is supported by a precise political will. This means a European government. The Delors Plan failed because the European Commission is not yet a genuine executive supported by a majority in the European Parliament and because in the Council of

Ministers, which accumulates executive and legislative powers in antidemocratic fashion, important decisions have to be unanimous. In short, the Delors Plan is a plan for government of the European economy, but it has not been realized because there is no European government. The coordination of national policies presupposes a European government. Without a European government, the national governments cannot help trying — but failing — to resolve those questions which should be tackled at European level.

The true challenge which has to be met in Europe is therefore that of establishing a European federal government. Monetary Union, without a development plan, is a body without a head. However imposing, it risks falling apart because of the tensions internal and external to the Union. The powers necessary to allow a European government to orient the European economy effectively require not only a reorganization of national governments, which can no longer claim to have the last word in matters of development and employment, but also a reinforcement of budgetary powers (see Appendix 3) at European level. Indeed, the Delors Plan also failed because of the vetoes of some national governments to raising the budgetary resources necessary to fund it.

6. *The Euro and the Reform of the International Monetary System.*

Robert Triffin bravely and lucidly denounced the grave distortion in the world distribution of wealth generated by the US monetary hegemony after the collapse of the Bretton Woods system. In the period 1969-79, after the decision to make the dollar inconvertible, world monetary reserves multiplied tenfold, thus causing a global inflationary wave. But, and here lie the major reasons for the world monetary scandal, because of its position as a debtor, the Third World was obliged to finance the industrial countries (by 270 billion dollars, at the end of 1990), and in particular the United States, which thanks to the "exorbitant privilege" of being able to pay their international debts with the national currency, were not obliged to eliminate the external deficit. For this reason, Triffin indicated the European monetary system and the creation of a European currency as the way to start a radical reform of the international monetary system.[40]

Now the question is how the creation of the European currency can help transform the current IMS (according to Triffin, International Monetary Scandal) into a genuine international monetary system, which allows the pursuit of such political priorities as the development of the

global economy and a more reasonable distribution of wealth. The creation of the European currency represents a reform of the international monetary system *de facto*, because, for the first time since the war, the dollar is obliged to contend with a currency of equal importance. The United States generate 27 per cent of world production and 18 per cent of world trade. The European Union (at 15) generates 31 per cent of world production and 20 per cent of world trade. In 1996, the proportion of overall production among industrialized countries (i.e. the OECD area) came to 38.3 per cent for the European Union and 32.5 per cent for the United States (20.5 per cent for Japan). It is calculated that once the world financial market has settled down, it will be subdivided as follows: 40 per cent to the euro, 40 per cent to the dollar and the remaining 20 per cent to the yen, the Swiss franc and other minor currencies.[41]

The mere existence of the euro on the world market may therefore create problems for the dollar. If one bears in mind that the euro can be used as a reserve money, it is immediately clear that prudent management is required in the transition from the current situation — since from 1973 to 1995 the proportion of official reserves held in yen grew from 0.1 per cent to 7.4 per cent and those in Deutschmark from 7 per cent to 14.2 per cent, while those in dollars dropped from 76 per cent to 61.5 per cent. It is a situation in which the use of the dollar as a reserve money, though less than in the past, is still more than is warranted by the importance of the American economy in world terms. Moreoever, the fact that the United States maintain a strong and persistent deficit in their balance of trade, while the European Union can count on a balance in equilibrium, suggests that the process of adjustment between the two currencies could generate dangerous tensions.

However important the problems of the internationalization of the European currency, they can be adequately tackled only if there is to be a clear point of arrival. For now, it is sometimes affirmed that the current monopolar system, founded on the dollar, could become a bipolar or multipolar system, founded on the European currency, the yen, etc, in addition to the dollar. This is still an insufficient approach to the problem. It is true that international monetary and financial systems, corresponding to habits rooted in the market, have an often surprising capacity to survive changes in the real economy, thus facilitating transitional phases. For example, the sterling continued to be used as a reserve money even when the United States, with its intervention in the First World War, had established itself as the first world power. And it was still used for years after the ratification of the Bretton Woods agreements. But what is seen

on the surface does not always reveal the profound strength of world history. The revolutionary potential of the European currency is that it could aspire to become the first world currency, supplanting the dollar as the dominant currency. Suffice to reflect that, while the area of utilization of the dollar is contracting, the area of the European currency is destined to grow considerably. The countries of Eastern Europe are now candidates to become members of the Union at the beginning of the next century. Other Mediterranean countries could follow them, including Turkey. The African countries which currently use the CFA franc will almost certainly adopt the European currency as reserve money, and indirectly also as their own currency, thus paving the way for all the countries of the Lomé Convention to follow them. Some Latin American and Asian countries are certainly interested in facilitating their trade with Europe by using the European currency. The problem of world monetary primacy is inscribed in the facts. The euro could aspire to supplant the dollar as the dominant currency on a world scale.

The hypothesis of a globally hegemonic euro, however, is not well-founded. The United States became a super power during the Second World War, with a generous military commitment in the anti-Nazi struggle, which in the eyes of their allies justified the US supremacy in the new international economic institutions. It is a very different situation for the European Union proposing itself as a new pole in world politics. Even if Europe is able to provide itself in relatively short time with its own defence, an indispensable premise for an effective common foreign and security policy, the international conditions for European hegemony (hegemony is never a purely economic fact), supplanting that of America, certainly do not exist today. At the very most one could speak of a multipolar world political system, in which not only Europe, but also Russia, China, Japan, India etc carry out a relatively independent foreign policy compared to the USA, which should therefore increasingly accept a regional role, definitively renouncing the ambitious, but irritating claim to be the "number one" of the international political system. It is therefore not reasonable to foresee a new Bretton Woods (in the sense that Bretton Woods signified the passing of the monetary sceptre from Great Britain to the USA), giving a complete outline of the architecture of a new international monetary and economic order. The hypothesis of a new gold-exchange standard founded on the euro does not appear on the agenda of world politics.

The challenge of the euro to the dollar does however pose a problem which should not be underestimated. If on the one hand there will form

geographical areas using the euro and the dollar (as well as, possibly, the yen), on the other there will also necessarily be a tendency to use a single currency in transactions of specific products. The gold standard has shown that the world market tends to seek to use a single currency. There is a precise economic reason for this tendency. Let us consider the market of the most important world raw materials, such as oil. Today the price of oil is expressed in dollars. But since a substantial share of world demand for oil may come from countries which use the euro, sooner or later the dilemma could arise whether to continue to use the dollar or to adopt the euro. Changes of this nature, on raw materials markets, can generate phases of uncertainty and speculative movements of enormous proportions. The financial markets are certainly equally sensitive to uncertainty over the currency to be used. Today the currency dominating the major world stock exchanges is the dollar. But as the volume of financial transactions in euros grows and as those in dollars correspondingly diminish, it will become easier to speculate on the prospects of the euro-dollar exchange rate (with the consequence that, if the two major world currencies have an unstable exchange rate, the entire world currency market will be unstable). As long as fluctuating currencies exist, the possibilities to exploit these fluctuations for private speculative purposes will also exist — which do not necessarily contribute to greater world monetary stability. Monetary instability produces enormous distortions in the distribution of wealth, not only because it allows speculative profits, but also because it leads entrepreneurs to employ their funds in activities which can soon prove illusory. "Many of the greatest economic evils of our time," wrote Keynes, "are the fruit of the risk, uncertainty, and ignorance. It is because particular individuals, fortunate in situation or in abilities, are able to take advantage of uncertainty and ignorance that great inequalities of wealth come about."[42] Finally, monetary instability and national divisions make it difficult, and in some cases impossible, to tax highly volatile activities, so that taxation burdens less mobile incomes.

There is only one way to rescue the international monetary system from this situation of instability, after the creation of the euro: by establishing a system of monetary cooperation on a symmetrical basis, therefore of the gold standard type, clearly signalling to the markets that the governments intend to pursue a plan of increasing monetary stability. The stability of money is the very foundation of the economic calculation; it is indispensable to the development of capitalism which, in turn, generates socially acceptable development only in contexts of stability.

International monetary reform is essential to "improvements in the technique of modern capitalism by the agency of collective action,"[43] as Keynes proposed. However, in this perspective, the major obstacle which must be overcome today concerns the process of liberalizing capital movements, which cannot be stopped without bringing into discussion the formation of an increasingly integrated and efficient world market. As regards the contemporary world economy, as Eichengreen rightly observes, "the obvious conclusion is that the trend toward a greater exchange rate flexibility is an inevitable consequence of the rising international capital mobility."[44] The high capital mobility at the time of the classical gold standard was compatible with stable exchange rates, thanks to the fact that the Central Banks and governments were not faced with dramatic problems of compatibility between external and internal equilibrium. "In a sense, the limits on the extent of democracy substituted by limits on the extent of capital mobility as a source of insulation. With the extension of electoral franchise and the declining of effectiveness of controls, that insolation disappeared, rendering pegged exchange rates more costly and difficult to maintain."[45] This observation of Eichengreen's is correct but should be completed with a second observation: flexible exchange rates are a necessary evil only until the sovereign states refuse appropriate rules of conduct.

In fixing the rules of the game of the new international monetary system, much can be learnt from the experience of European integration, during which the problem of stability of exchange rates arose in exactly the terms described by Eichengreen for the world economy. The countries of the European Union made an initial response to the problem with the Treaty of Maastricht. In other words, international monetary stability cannot be achieved separately from internal monetary stability and a sound fiscal policy. Stable exchange rates are the by-product, at least in a transitory phase, until the decision is taken to proceed to the establishment of a single currency, of the convergence of economic policies. On this basis, one can observe that the European Union and the United States are by no means practising radically divergent economic policies. As regards inflation rates and budgetary policy, they take a common course. The true difference still concerns the external US deficit and the dramatic rate of unemployment in Europe. Therefore, the common objectives of a possible agreement for a monetary reform could be the following: a) the adoption, as suggested by Robert Triffin,[46] of a system of clearing union inside the International Monetary Fund, together with an instrument of common reserve which can replace national currencies in settlements

between Central Banks of balance of payments deficits and surpluses; in this way the national currencies would lose the burden and the connected privileges of acting as an instrument of international reserve, and it would become possible to develop a private parallel market, which uses the new world currency as the unit of account, as with the ecu after the EMS was established; b) the identification of central parities between the currencies participating in the agreement, with margins of fluctuation broad enough to discourage international speculation, but with the definition of severe collective procedures for the modification of parities, with the purpose of discouraging dangerous unilateral initiatives of the beggar-my-neighbour type; c) the identification of common rules to avoid excessive borrowing.

These rules of play could initially be adopted by a small number of countries — for example, the United States, the European Union and Japan — but the initial clearing union should naturally be open to all countries wishing to join. There might soon be quite a number of these, because the need to participate in a zone of world monetary stability now represents a priority, not only for the industrialized counties, but also for the emerging countries of the Third World, (indeed, perhaps even more so for the latter, who for decades have been calling for a new world economic order, for which monetary order represents the necessary premise). This clearing union could have more substantial and lasting success than the EMS, because the greater the number of countries participating, and therefore the more substantial the volume of transactions covered by the agreement, the greater is the possibility of standing up to the force of the global economy. The EMS countries actually represented a relatively small portion of the world market, at a time of justified market scepticism as to government determination to keep the common institutions steady. Naturally, there will be a limit to the capacity of temporary measures to tackle the needs of an increasingly integrated and interdependent global market. Every temporary measure is by definition a palliative. The true solution, to which the world market itself aspires, as shown by the fundamental experience of the gold standard, is a single world currency. It is naturally impossible to foresee when the economic and political conditions will be ripe for this decisive step. But the European experience and economic theory show that the internal market is more efficient than the international market. It is therefore understandable that those who operate in the world market, from day to day, act consciously or unconsciously for the progressive elimination of all the barriers which the nation-states have artificially raised.

Before concluding, a final observation: the European Union finds itself in a crucial position to orient the policy which could lead to a world currency. Between the European Union and the United States a dynamic process can be activated, similar to that between Germany and France after the Second World War, and which represented the real motor of integration. The United States won the Cold War and represent an essential point of reference as regards the problems of world security. Similarly, France found itself among the victorious powers at the end of the war and was able to fulfil a role of European military power, the building of the *force de frappe*, which the defeated Germany was not allowed. However, in time Germany succeeded in conquering a preponderant role on the economic front. In the same way, with monetary unification the European Union is in a condition to assume a leading role on the global scene. It is therefore from Europe, in agreement with the United States, that the first initiative must come for the reform of the international monetary system. But to fulfil this role fully, the European Union cannot limit itself to entrusting its foreign policy to a Council of Ministers. The ideology of intergovernmental cooperation is not only foolish, but dangerous. If the United States wanted to entrust the major questions of world politics to a Council composed of the 50 governors of the States, whose decisions moreover must be unanimous, there would very soon be a paralysis generated in the decision-making process which would put in danger the American union itself. But the United States, in 1787, thanks to the wise decision of the original thirteen colonies, gave themselves a federal government. Today it is up to Europe to provide an equal proof of wisdom.

Appendix 1
The World as an Optimum Currency Area

From the beginning, the process of European integration has stimulated debate among economists on the relationship between market size and size of monetary area. The essential reference of this debate is the concept of an optimum currency area, elaborated by R. Mundell in 1961. Considering the problem of the choice that a country or group of countries must make with regard to the best exchange rate regime — fixed or flexible — Mundell maintains that "the problem can be posed in a general and more revealing way by defining a currency area as a domain within which exchange rates are fixed and asking: What is the

appropriate domain of a currency area?" If we consider two countries A and B, each with their own currency and with a balance of payments in equilibrium, a shift in demand from B's products to A's will cause an increase in production and employment in A, and a diminution in production and employment in B. Equilibrium can be recovered: a) if the workers dismissed by B emigrate to A, where they are taken on; b) if wages in B fall so far as to also bring down product prices to the point where it once more becomes advantageous to increase production and employment, while in country A the scarcity of manpower will make wages and prices rise so far as to reduce the excess demand. If neither sufficient labour mobility nor sufficient wage flexibility is manifested, and exchange rates between the two currencies are *fixed*, equilibrium cannot be recovered. The optimum choice is therefore that of *flexible* exchange rates: a depreciation of B's currency with regard to that of A would make A's goods much dearer and those of B less dear, thus bringing the two countries into a situation of equilibrium.

If the two countries A and B belonged to a single monetary area, with a single Central Bank, the problem would be put in the following terms: if the Central Bank wants to avoid the unemployment which was manifested in B it must favour an inflationary policy. If it wants to reduce the inflationary excess demand which was manifested in A, it must on the contrary restrict the money supply, thus causing greater unemployment in B. Mundell's conclusions are that "a currency area of either types [fixed exchange rate and single currency] cannot prevent both unemployment and inflation among its members. The fault lies not with the type of currency area, but with the domain of the currency area. The optimum currency area is not the world." But neither can the national monetary area be optimum, if regional economic imbalances arise internally. Therefore, by taking this reasoning to its extreme consequences, Mundell concludes that "today, if the case for flexible exchange rates is a strong one, it is, in logic, a case for flexible exchange rates based on regional currencies, not on national currencies. The optimum currency area is the region."[1]

This theoretical approach has stimulated a vast literature which has mainly concentrated on the comparison between Europe and the United States, where it is possible to measure, within certain limits, the advantages and the costs of a monetary area.[2] Although these studies have helped clarify some substantial differences between the American and European cases (for example, the consequences of high labour mobility in the USA and of weak interstate and interregional mobility in the European Union), the debate on the European currency, when the crucial problems of the single currency had to be tackled, has obliged economists to considerably enlarge the field of study.[3]

The major difficulty inherent in Mundell's definition lies in the implicit adoption of a political aspect of money, which is considered as a unit of measure of optimality, but in an arbitrary way. For Mundell it is crucial that money can be used to stimulate employment. But this use of monetary policy, as we have tried to argue in the text discussing the transition from the gold standard to the gold-

exchange standard, only appeared after the first world war with Keynesian thinking. To use the currency as an instrument of economic policy, in every case, there has to be a government. And if this government is to be able to choose between a system of fixed and flexible exchange rates, it must be a sovereign government. It is at this point that some irresolvable contradictions appear in Mundell's thinking. The question was already raised, at least partially, by P. Kenen in 1969. Kenen pointed out that, if the government of a certain State proposed, internally, to collect taxes in regions endowed with the power to fix the value of regional currency and change it at will, the value of the taxes collected by the Treasury would change at the discretion of the regional government. "How would taxes be collected," asks Kenen, "if a single fiscal system were to span a member of currency areas, each of them entitled to alter its exchange rate?... In which currency, moreover, would the central government pay for goods and services? Which one would it use to pay its civil servants?"[4] This hypothesis is not unreal. In 1819, in the United States, an exemplary laboratory for the history of monetary unification, the Supreme Court Justice Marshall had to intervene to oblige the State of Maryland to remove a tax on banknotes not issued internally, which would have made Maryland a sovereign monetary area. Chief Justice Marshall's decision, in which he maintained that "the power to tax implies the power to destroy," was crucial in making the United States a single currency area.[5] In short, the regional currency area is a pure illusion. The monetary area always — at least in contemporary times — coincides with the State, i.e. with a sovereign power. Only when States come apart, as happened recently with the USSR and Yugoslavia, are "regional" currency areas formed. But in this case the use of the term is improper. The reality is only that smaller States have formed. To affirm that "the optimum currency area is the region" means therefore to maintain that small States are better (from the monetary point of view) than large States. Mundell's criterion leads to absurd conclusions, because it is always possible to subdivide a State, however small it may be (like Luxembourg), into even smaller States, with specific economic characteristics.

However, if the political aspects of the currency are taken into consideration, the analysis must be broadened. Lionel Robbins did so in the Thirties.[6] According to Robbins, the cause of the international economic disorder lies in the absolute sovereignty of the nation-states, which have the power to hinder international monetary and commercial trade, to the point of provoking the extreme form of closure, i.e. autarky. The problem of the exchange regime must always be discussed in relation to the international political regime. If a situation of nationalism and struggle for supremacy prevails (as in the Thirties), there will be a situation of international anarchy and progressive disintegration of the international economic order. If a situation of convergence between the interests of the States prevails (as happened after the war in the western world, both at Atlantic and European level) then it is possible to agree a regime of fixed or pegged exchange rates. If, in a situation of convergence, the determination of some countries to realize a common currency prevails, a *new State* will be founded, a

federal State. Essentially, a currency area which springs from a unification of several currencies is never a simple sum of the preceding situations (and in this fact resides the greatest limitation of the approach of optimal currency areas), but a new situation, because there has to be a supranational political power to enable the new monetary area to form and survive. The example quoted above of Maryland is significant. A government always tends to maximize its own power, unless it is limited by a superior power. In the situation of monetary and constitutional confusion reigning in the United States at the beginning of the nineteenth-century, it seemed possible to a member state of the Federation to try to take over monetary sovereignty. If there had not been a common constitution (and a wise judge), the United States would have had fifty currencies today, and not the dollar. The fact that, in Europe, a European Monetary Union is being built without it yet becoming clear that actually a federal State is going to be built should not cause too much amazement. It depends on the historic circumstances in which the process of European unification began and developed. The United States gave themselves a constitution in 1787 and only 147 years later a single currency.[7] Europe is doing things the other way round, along a much more tortuous and incoherent path. The European Monetary Union is taking shape even before the problem of what democratic power should govern it has been resolved. But this only means that there is a democracy deficit in Europe, not that the European currency is not an essential aspect of European statehood.

These criticisms to Mundell must not prevent us from attempting a more reasonable reformulation of the concept of an optimum currency area. Today, one is more prepared than in the past to abandon an idea based on the capacity of an inflationary policy to resolve problems of unemployment. The countries of the European Monetary Union have now accepted the so-called culture of monetary stability, experience having demonstrated that in the long term inflation does not lead to higher rates of development and employment. The simplest and most reasonable criterion to define an optimum currency area could therefore be that of concentrating on the essential property of money, i.e. its capacity to serve as a medium of exchange. This property normally also includes two further functions of money, those of serving as a unit of account and as a store of value. These properties of money soon manifested themselves in the development of civilisation, and in modern times, we can observe in every case, that even when state power does not intervene, the market succeeds in creating its own money spontaneously. This is precisely the case in the use of rudimentary moneys, like shells, among primitive peoples, or of precious metals, mainly gold and silver, more recently. As the market succeeds in creating its own currency, the optimum currency area can be said to coincide with the area of trade carried out with a single monetary medium. Therefore, in an age when the markets were geographically limited to the village or to the county (as in the Middle Ages in Europe) a multitude of local moneys were established. But as trade intensified beyond the small local markets, national or even world currencies became established. This is the case of gold, which gradually became the money of world trade, with the

gold standard of the nineteenth century. In the nineteenth century the world was therefore an optimum currency area, thanks to the fact that the governments and the Central Banks, even if for a very short period, observed some "rules of the game" which perpetuated the historical function of gold of serving as a means of payment, as had happened in an age when Central Banks did not yet exist and governments did not impose the exclusive use of a national currency. Later, the nation-states claimed to divide the world market into many markets delimited by national borders. This claim of the governments to monetary and economic sovereignty, having manifested itself at a period when industrial development was already under way, coincided with the need for the market to adopt a token money (or paper money), for reasons of practicality and to more easily adapt the quantity of money in circulation to the volume of transactions. In this new situation, therefore, the system of international trade could no longer take place on the basis of a single money. But, as market interdependence once more developed on a world scale, the need for a world money became more pressing than ever. For this reason, in this essay, the model of the gold standard was adopted as a criterion for the the reform of the international monetary system, taking note that in the epoch of financial globalisation the world money can no longer be gold, but a token money whose value is guaranteed by a Central Bank. And until a world money is created, other things being equal, the most sought-after token money of trust (like gold in the past) will be that issued by the Central Bank which will manage to guarantee the lowest rate of inflation.

Appendix 2
The Cost of Monetary Sovereignty

After the classic gold standard, the need for economic stability impelled the nation-states to reinstate a fixed (or a fixed but adjustable) exchange rate system as soon as possible. A system of fixed exchange rates is possible in fact where interests (or better, reasons of State) converge sufficiently to make the participating countries accept a common discipline. The system of fixed exchange rates is therefore the expedient which brings the international system of payments closest to the ideal of world currency, even if the nation-states formally keep their monetary sovereignty.

History has however shown that a system of fixed exchange rates is very hard to form in the absence of a hegemonic country. This is the case with the Bretton Woods system, which is discussed at length in the text. It should be observed here that, in principle, a system of fixed exchange rates has a deflationary effect on the international economy. If the countries with a surplus in their balance of payments do not take adequate measures to re-establish equilibrium (accepting an increase in domestic inflation, so that it gradually becomes more advantageous to acquire foreign products), they will continue to accumulate reserves. On the contrary, countries with a deficit in their balance of payments, losing reserves, will sooner

or later be forced to take deflationary measures, reducing internal buying power to bring the balance of payments back into equilibrium. The problem is very lucidly expressed by Joan Robinson: "However great the total supply of liquidity, there will still be a deflationary kink in financial system in which every country likes to gain reserves and hates to lose them. This complaint used to be made against the old-fashioned gold standard. Our modern sophisticated arrangements are haunted by it still."[1] In short, the fixed peg system does not stop differences arising between countries with strong currencies and countries with weak currencies, nor the global effect from being deflationary because of the existing asymmetrical position.

The reference made by Joan Robinson to the gold standard which arose between the two world wars is obligatory. However, it should be observed that the accusations of many economists that the gold standard of the twenties was the principal cause of the Great Depression are unfounded. One has to distinguish between economic and political causes. That the Great Depression happened first in the United States and then, partly due to the exchange rate mechanism, transferred to other, European countries, is indisputable fact. But this does not mean that the responsibility for the Great Depression must fall entirely on the adopted system of payments. The European countries faced similar problems, even if less dramatic, in the years when the classical Gold Standard was functioning. The real problem lay in the fact that, in the thirties, the governments of countries in surplus, faced with measures which would have had to be adopted to allow external adjustment and which could have provoked internal resentment, in an international situation in which nationalist attitudes prevailed, gave way to internal pressures. The countries in deficit, lacking sufficient reserves, had no other choice than to abandon the agreed parities of their own currency and initiate the policy of competitive devaluations, thus putting in motion an unstoppable process, as each country sought to "steal" effective demand from the other countries. The fact that the Great Depression spread so quickly and widely should not therefore be imputed to the gold standard, but to the lack of collaboration between governments and Central Banks, which adopted the principles of economic nationalism instead of those of international solidarity.

The problem is once more a current one today, with European monetary unification, because some economists affirm that, with the European Monetary System (i.e. a system of fixed but adjustable exchange rates) the European countries put in motion a system of competitive deflations,[2] even if the mechanisms of transmission of deflation are different from those of the gold standard of the twenties. Some countries, like Germany, pursued a policy of financial rigour, favouring price stability over employment. To maintain the agreed rates of exchange, the other countries were forced to follow an equally restrictive policy, thus causing a situation of deflation and unemployment throughout the EMS area. For Eurosceptic economists, the remedy lay in moving from a system of fixed exchange rates to a flexible exchange rate system, abandoning monetary unification. For pro-European economists, cooperation had to be improved

unification. For pro-European economists, cooperation had to be improved between the Central Banks, in view of the establishment of the European currency.

Cooperation between European Central Banks does in fact exist, but is made tremendously difficult by the strength of the world financial market and the American economy, whose government and Central Bank are by no means bound to agree their movements with the European authorities. The remedy for this state of affairs can only be the European currency. With the European currency, not only would an automatic coordination be achieved (there would be only one rate of interest in all the countries of the Union), but that part of effective demand which today cannot show itself because of the need to keep in equilibrium the balance of payments of each European country would be freed. In short, because of the above considerations, the smaller each country is, the weaker its national currency and therefore the more open to blackmail by international finance. There are at least two most obvious costs of monetary sovereignty: higher interest rates and a "deflation" caused by the need to maintain a high volume of national reserves. National interest rates are on average higher than the European rate because the "risk" is greater if the country is relatively small compared to the world financial market. As regards reserves, it is calculated[3] that with the establishment of the European currency the countries of the Union can save over half of total monetary reserves currently possessed. This means around 4 per cent of gross Community product. Although crude, this could be the measure of effective demand which will be "freed" when the European currency is established.

These considerations also show the course which should have been taken to eliminate competitive deflation in Europe. Once it had been observed that the EMS could not function as a symmetrical system, but hegemonic, the European governments should have decided not only to establish a Monetary Union, as indeed they did at Maastricht, but to do it as fast as possible. Indeed, in 1990 the European Commission observed that "since most of the costs caused by the realization of EMU already appear in the preparatory phase of the process ..., while many of the major advantages (suppression of uncertainty over exchange rates and transaction costs) only appear in the final phase with the single currency, there is an obvious economic interest in ensuring that the transitory period is relatively short."[4] But at Maastricht the European governments decided to prolong the transitory period, whose deadline was initially set for 1994, until 1997, and in any case to put the final deadline at 1999. If the transitory phase has turned into a long and painful calvary, the responsibility is not that of the EMS or the Treaty of Maastricht, but of those who did everything in their power to delay the birth of the European currency.

Appendix 3
Fiscal Federalism and the European Budget

As with the problem of optimum currency areas, European integration has stimulated a vast literature on fiscal federalism[1] which has concentrated mainly on the comparison between Europe and the United States. However, comparison with the American experience is not entirely appropriate. The structure of the United States federal budget was formed at the time of the New Deal, in entirely different circumstances to those which are shaping the European budget. Total civil expenditure (i.e. of all government levels, excluding defence) rose from 5 per cent of GDP in 1890 to 15.5 per cent in 1940. In the post war period, they stabilized at this level until the next leap forward in the seventies. In relative terms, the percentage of the federal share rose from 21.2 in 1902, to 47.3 in 1940, to 49.8 in 1972 (the share due to the state governments and other local authorities consequently diminished).[2] It is therefore evident that the crucial years for the formation and consolidation of the US federal budget were the inter-war years, when the Roosevelt government had to combat the disastrous effects of the Great Depression. Not only did the absolute amount of public spending increase considerably, but resources were concentrated in the hands of the federal government, at the expense of the local ones.

For these reasons, the traditional theory of fiscal federalism, where it refers to the US experience, is not immediately applicable to the European case. The model elaborated by Musgrave-Oates,[3] for example, assumes that the federal government, apart from providing some public goods of general utility (like defence), must also fulfil the function of stabilizing the economy, i.e. an anti-cyclical policy with an appropriate use of fiscal and monetary policy, and the redistributive function, to guarantee a fair distribution of income. In both cases, the inheritance of the New Deal is evident. The function of stabilisation requires a budget of considerable dimensions, in order to be able to condition the state of the economy, and the redistributive function, in order to be effective, means that some important areas of the Welfare State (such as the pension and health care systems, in the case of the USA) are managed directly by the federal government.

The European fiscal system is being organized very differently to that in the US. The area of redistributive solidarity in Europe is that of the nation-state. The Welfare State was in fact formed before the process of European integration started and consolidated. It is highly unlikely that certain important items in the Welfare State, like the pension and hospital systems, should be transferred to European level today. It therefore seems possible to say that the task of guaranteeing solidarity between people belongs to the national level (and possibly to minor territorial authorities). Since these items of expenditure account for a significant proportion of the national budgets (on average 48 per cent of GDP), this explains, in part, how the European budget so far is such a modest size: 1.3 per cent of community GDP. The most substantial items on the European budget are the common agricultural policy (which still accounts for half of all allocations) and the structural funds (33 per cent). The agricultural policy, as is well-known, was wanted in particular by France at the beginning of the sixties and for a long time represented practically the only policy realized at European level. The structural policies, i.e. the policies of redressing territorial imbalances and fostering social cohesion, are on the other hand the result of pressure by countries of the Community with regional imbalances, and currently represent a model of territorial solidarity which in some cases (for example Ireland, Spain, Portugal and numerous regions of the Union) have successfully contributed to local economic development.

The problem of the appropriate size of the European budget should therefore be discussed in relation to the type of policies which the European government should develop. The MacDougall Report,[4] drawn up for the European Commission in 1977, taking the US experience as its main model, forecast that the European budget should reach circa 5-7 per cent of gross product (7.5-10 per cent including defence) in the federal phase, while in the pre-federal phase a budget of 2-2.5 per cent of gross product should be sufficient. More recently, a study group[5] reappraised the forecasts of the MacDougall Report, proposing a budget of 2 per cent of European gross product as sufficient to support the project of Economic and Monetary Union.

On the basis of these studies and the considerations in the text on the role of the European government, it seems reasonable to conclude that the future development of the European budget will depend on the realization of the following economic policies: a) although the Delors Plan did not foresee any specific increase in the Community budget, but the possibility of drawing on funds borrowed by the Community on the European financial market, a serious policy of European investment to encourage development and employment should enjoy adequate funding. The aim, as has been said, is not to directly generate employment through a European plan, (even if this beneficial effect is obviously taken into account), but to affect the state of confidence of entrepreneurs, who must be enabled to compete successfully on the global market. From this point of view the European Union should support policies for scientific and technological research with much greater conviction than evinced in the Delors Plan. A specific fund for employment, on the US mode[6], could also help those countries worst hit by the problems of unemployment. In any case, the European budget, both because of its modest proportions and because of the new directions taken by the policy against unemployment, cannot be used for anti-cyclical budgetary manoeuvres; b) greater resources should moreover be dedicated to structural policies, firstly because with enlargement to the countries of Eastern Europe (although for the first group of countries the Union will try to keep the budget unchanged) new funds will have to be found, unless contributions to the countries and regions of the Union already using it are to be diminished, and secondly because the European policies for the support of employment and for the realization of the new Welfare State will increasingly develop at local and regional level; c) finally, the Community budget will have to increase following

the decision to make foreign and security policy operational. The creation of a European defence system would also enable the establishment of a European arms agency, indispensable for the standardization of the European arms industry. In this perspective, many of the resources currently used by individual countries for development aid and diplomacy should come together at European level.

These new European budgetary commitments must be met with new receipts. New sources of income could be found in the internal market, which, by making possible the complete liberalization of the financial market, has also caused great inequality in taxation, which increasingly affects employees, and less and less the other factors of production (capital, energy and natural resources).[7] The natural remedy to this distortion caused by fiscal competition, which aggravates the problem of unemployment by making the labour factor increasingly expensive, lies in a European tax on capital and on other productive factors which avoid national taxation.

The stubborn resistance of the national governments to any increase in resources for the European budget is an obstacle which has however so far proved insuperable. Harmonization is the preferred course, in order to leave the citizens with the illusion that the national governments still take the most important decisions. The question of the size of the European budget therefore requires the definition of a constitution for the European Union, not only fiscal, but also political. The basic problem is the democratic responsibility of the budgetary authorities. Today the vast majority of decisions on expenditure and revenue are taken by a body (the Council of Ministers) which decides unanimously and which is not accountable to the European people, as is the European Parliament, but only towards each minister's own national electorate.

When the question of democratic accountability is tackled, it will become thinkable to assign even a proportion of personal taxation to the European level.[8] Indeed, in a democratic system, every level of government must assume the responsibility of realizing certain policies and, to this end, of asking for the necessary resources. As Alexander Hamilton observed, speaking about the American Constitution, in a federal system the power of taxation must be considered "a concurrent power." The political and electoral debate will establish how many of the resources available for public expenditure must be assigned to the various levels of government.

NOTES

[1] On this interpretation of the thinking of Hume see. G. Montani, *L'economia politica e il mercato mondiale,* Bari, Laterza, 1996.

[2] Cf. R. Cameron, *A Concise Economic History of the World From Paleolithic Times to the Present*, Oxford University Press, Oxford, 1989, ch. XI; and A. G. Kenwood and A. L. Loughed, *The growth of the international economy, 1820-1980*, London, George Allen & Unwin, 1983, chap. 6 and 7.

[3] On this question see the *Introduction* to the volume: B. Eichengreen (ed.), *The Gold Standard in theory and history*, New York and London, Methuen, 1985. Concerning changes during the nineteenth century, in relation to the century of Hume, Robert Triffin observes: "The term gold standard could hardly be applied to the period as a whole, in view of the overwhelming dominance of silver during the first decades, and of bank money during the latter ones. All in all, the nineteenth century could be far more accurately described as the century of an emerging and growing credit-money standard, and of the euthanasia of gold and silver moneys, rather than as the century of the gold standard" (cf. R. Triffin, "The myth and realities of the so-called gold standard", in *Our international monetary system: yesterday, today and tomorrow*, New York, Random House, 1968, p. 21.

[4] The functions of the Central Bank listed here are those illustrated by V. C. Smith, *The rationale of Central Banking (1936)*, Indianapolis, Liberty Press, 1990, chap. XII.

[5] Cf. A. Walter, *World power and world money*, London, Harvester Wheatsheaf, 1993, chap. 4.

[6] B. Eichengreen, *Golden fetters*, New York and Oxford, Oxford University Press, 1992 p. 5.

[7] This theory is persuasively discussed in M. D. Bordo and H. Rockoff, "The Gold Standard as a 'Good Housekeeping Seal of Approval'", in *The Journal of Economic History*, vol. 56, n. 2, June 1996.

[8] B. Eichengreen, *cit*., p. 6.

[9] The idea of spontaneous order was elaborated by F. A. Hayek (especially in, *Law, Legislation and Liberty*, London, Routledge & Kegan Paul, 1982), but Hayek keeps the field of reference to the internal order (the nation-state in other words) and never extends it to the international order.

[10] Cf. R. Nurske, *The gold-exchange standard* (1944), now in B. Eichengreen (ed.), *The Gold Standard in theory and history*, *cit*., pp. 201-25.

[11] Cfr. Eichengreen (ed.), *The Gold Standard in theory and history*, *cit*., p. 171.

[12] Cfr. Eichengreen (ed.), *The Gold Standard in theory and history*, *cit*., p. 194.

[13] B. Eichengreen observes, "Depreciation was the key to economic growth. Almost everywhere it was tried, currency depreciation stimulated economic recovery. Prices were stabilized in countries that went off gold. Output, employment, investments, and exports rose more quickly than in countries that clung to their gold parities", (B. Eichengreen, *Golden fetters*, *cit*., p. 21). In addition, Kenwood and Loughed (*The growth of the international economy*, *op. cit*., p. 221) point out that in the period 1913-37 production in developed countries increased by 22 per cent, pro-capita product increased by 13 per cent, while international trade increased only by 11 per cent in total, but dropped by 3 per cent in terms of pro-capita product.

[14] On these events, see H. James, *International monetary cooperation since Bretton Woods*, New York and Oxford, Oxford University Press, 1996, chap. 2 e 3.

[15] This information is taken from B. Eichengreen and M. Uzan, *The Marshall Plan: Economic effects and implications for Eastern Europe and the former USSR*, London,

CEPR, Discussion Paper n. 638, 1992.

[16] Cf. M. D. Bordo, "The Bretton Woods international monetary system: A historical overview", in M. D. Bordo and B. Eichengreen, *A retrospective on the Bretton Woods system.* Lessons for international monetary reform, Chicago and London, The University of Chicago Press, 1993, pp. 47-49.

[17] Cf. A. G. Kenwood and A. L. Lougheed, *The growth of the international economy, cit.*, p. 306.

[18] R. Triffin, *Gold and the dollar crisis*, New Haven, Yale University Press, 1960.

[19] On the process of liberalization of capital and on its consequences for economic policy, cf. J. R. Shafer, "Experience with controls on inter-national capital movements in OECD countries: solution or problem for monetary policy?" in S. Edwards (ed.), *Capital controls, exchange rates, and monetary policy in the world economy*, Cambridge, Cambridge University Press, 1995.

[20] On US reserves cf. M. D. Bordo, *The Bretton Woods international monetary system, cit.*, p. 39, fig. 1.10.

[21] J. Rueff, "Le problème monétaire de l'Occident" (1961), in *L' âge de l'inflation*, Paris, Payot, 1963, p. 134.

[22] Cf. H. James, *International monetary cooperation since Bretton Woods, cit.*, pp. 214-6.

[23] Office of publications of the European Communities, Luxembourg, November 1970.

[24] On these aspects cf. D. Gros and N. Thygesen, *European monetary integration*, London, Longman, 1992, pp. 16-7.

[25] These data are taken from J-M. Daniel, A. Gubian, H. Harasty, "Finances publiques en Europe. Un blocage généralisé?" in *Entre convergenges et intérêts nationaux: l'Europe*, (ed. J-P. Fitoussi), Références OFCE, Paris, 1994, pp. 334-5.

[26] See D. Gros and N. Thygesen, *European monetary integration, cit.*, p. 31.

[27] The federalist initiative is documented in the volume (ed. by the Movimento Europeo and by the Movimento Federalista Europeo), *L'unione economica e il problema della moneta europea. La moneta come elemento di divisione o di unità dell'Europa*, Milan, Franco Angeli, 1978.

[28] On the functioning of the EMS and on the market of the ecu see D. Gros and N. Thygesen, *European monetary integration, cit.*, chap. 3 e 6.

[29] On the role of Germany in the EMS cf. M. Artis and N. M. Healy, "The European Monetary System", in *The economics of the new Europe. From Community to Union*, (ed. N. M. Healey), London and New York, Routledge, 1995.

[30] This opinion was very popular among English-speaking economists. See for example P. Minford, "The lessons of European monetary and exchange rate experience", in *Capital controls, exchange rates, and monetary policy in the world economy*, (ed. S. Edwards), *cit.*

[31] *Report on Economic and Monetary Union in the European Community*, Luxembourg, 1989, §§ 16, 27, 30.

[32] I have discussed the historical and cultural limitations of Keynesian theory in *L'economia politica e il mercato mondiale, cit.* 33. See the considerations on the positive effects of Keynesian policy in P. Krugman, *Peddling prosperity*, New York, W. W. Norton and Company, 1994.

[34] For a deeper discussion of this problem cf. G. Montani, *L'economia post-industriale e il mercato mondiale*, Giappichelli, Turin, 1989; for a pessimistic view of the process of automation cf. J. Rifkin, *The end of work. The decline of the global laborforce and the dawn of the post-market era,* Berkeley, Putnam's Sons, 1995.

[35] On these problems see for example A. Lindbeck, "The West employment problem", in *Weltwirtschaftliches Archiv*, 1966, Vol. 132 (4); G. Alogoskofis, C. R. Bean, G. Bertola, D. Coehn, J. Dolado and G. Saint-Paul, *Unemployment: Choices for Europe*, London, CEPR, 1995; e J. Michie and J. G. Smith, *Unemployment in Europe*, London, Academic Press, 1994.

[36] Commission of the European Communities, *The European Challenge 1992. The Benefits of a Single Market*, Luxembourg, 1988.

[37] Commission of the European Communities, Luxembourg, 1993.

[38] Cf. M. Albert, *Un pari pour l'Europe. Vers le redressement de l'économie européenne dans les années 80*, Paris, Editions du Seuil, 1983.

[39] See J. Delors, *L'unité d'un homme*, Paris, Editions Odile Jacob, 1994, pp. 292-7; and, more recently, the document *Reflections and proposals for a new model of development*, presented by J. Delors at the Congress of European Socialists at Malmô, 1997.

[40] R. Triffin, "The IMS (International Monetary System ... or Scandal?) and the EMS (European Monetary System ... or Success?)", in *BNL Quarterly Review*, n. 179, 1991.

[41] Cf. C. F. Bergsten, "The dollar and the euro", in *Foreign Affairs*, July/August1977. The other statistics quoted were obtained from the European Commission Report, *External aspects of Economic and Monetary Union,* Brussels, February 1997.

[42] J. M. Keynes, "The end of Laissez-faire", in *Essays in persuasion*, London, Macmillan, 1931; now in *The Collected writings of J. M. Keynes*, Cambridge, The Royal Economic Society, 1972, vol. IX. p. 291.

[43] J. M. Keynes, *ibidem*.

[44] B. Eichengreen, *Globalizing capital. A history of the international monetary system*, Princeton, Princeton University Press, 1966, p. 191.

[45] B. Eichengreen, *ibidem*.

[46] R. Triffin, "The IMS (International Monetary System ... or Scandal? and the EMS (European Monetary System ... or Success?)", *cit.*

Appendix 1

[1] R.A.Mundell, "A theory of optimum currency areas", in *The American economic review*, 1961, pp. 657-65.

[2] Among the studies and reviews on the subject, I limit myself to citing: L.Bini-Smaghi and S.Vori, *Rating the EC as an optimal currency area: Is it worse than the US?* Banca d'Italia discussion paper, 1993; O. Bofinger, "Is Europe an optimum currency area?" in A. S Steiherr (ed.), *30 years of European monetary integration. From the Werner Plan to EMU*, London and New York, Longman, 1994; D. Gros, *A reconsideration of the optimum currency area approach. The role of External shocks and labour mobility*, Brussels, Center for European policy studies, 1996.

[3] Cf. For example Chap.1 of M. Emerson and Ch. Huhne, *The ECU Report,* London, Pan Books, 1991, in which the approach of optimal currency areas is explicitly rejected (M. Emerson is the economist who coordinated the working group which drew up the report *One market, one money,* for the European Commission).

[4] P. B. Kenen, "The theory of optimum currency areas: An eclectic view", in R. A. Mundell and A.K. Swoboda, *Monetary problems of the international economy*, Chicago, The University of Chicago Press, 1969.

[5] On the episode quoted and, in general, on the US experience as a model by which to inspire the European monetary project, see the intelligent review by L. B. Lindsey, member of the Board of Governors of the Federal Reserve System, in *Auszüge aus Presseartikel*, Deutsche Bundesbank, May 1996.

[6] For an exposition of the thinking of L. Robbins I refer the reader to my essay *L'economia politica e il mercato mondiale, cit.*
[7] As L. B. Lindsday, cit., maintains, not until 1934 did the Federal Reserve System have the full powers of a Central Bank.

Appendix 2

[1] J. V. Robinson, *The new mercantilism*, Cambridge, Cambridge University Press, 1966, p.15.
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Appendix 3

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[3] Cf. W. E. Oates, *Fiscal federalism*, New York, Harcourt Brace Jovanovich, 1972, chap. 1.
[4] D. MacDougall et al., *Report of the study group on the role of public finance in European integration*, Luxembourg, European Community, 1977.
[5] "Stable money, sound finances. Community public finance in the perspective of EMU", in *European economy*, n. 53, 1993.
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CHANGE OF METHOD IN EUROPEAN INTEGRATION: A CONSTITUTION INSTEAD OF DIPLOMATIC TREATIES

The intergovernmental conference to revise the Treaty of Maastricht — success or failure? Success, say some, mindful of the always-valid diplomatic rule that Germany only takes part in successful conferences, and that the result is always precisely what Germany has already long been striving for ... such diplomatic formulae aside, however, the question arises of how to measure success or failure. Considering the possibilities of a diplomatic conference — was Maastricht II a success in this respect? Measured against treaty changes at earlier events of this nature — was it worth the effort this time? Measured against the actual challenges of the next few years and especially the extension to the east — did the IGC make the EU fit for "Agenda 2000"? Measured against the objectives of a European federal political community — did the revision make decisive progress in this direction?

It appears, independently of the outcome of the IGC in detail — and one of its problems is precisely that the results lie in the detail — that not only one result or another, but also the method for continued European unification is to be considered. For some time now there have been increasing murmurs that the "Jean Monnet method" has no future. Others in contrast, precisely in view of the limited possibilities of each individual IGC, speak of the inevitability of an "evolutionary development" of the treaties. What conceivable and appropriate ways are there to make the European Union what it should be: a *res publica* accepted by the citizens of Europe, to shape the European future?

First one should remember that Jean Monnet's "method" was itself an alternative to another, failed attempt at European unification. When Jean Monnet submitted his concept to the French Foreign Minister Schuman in April 1950, it was almost a year after the Hague congress — next year will be its fiftieth anniversary. May 1948 saw the failure of the revolution-

ary attempt to create a European Federation at a stroke, through an act of will by the statesmen responsible. The non-governmental European associations which had started this attempt had to give up the initiative.

The alternative to the immediate realization of the "United States of Europe" called for by Churchill, was initially discussed and developed in the Parliamentary Assembly of the newly-founded Council of Europe, before Jean Monnet made it into a practicable, politically feasible and achievable project. The formula developed in the Council of Europe was threefold: first there had to be a genuine common European political authority, an institutional core or motor; secondly, this was to have genuine power, so the realization of its decisions could not be once more subject to the goodwill of any one member state, but must be directly valid law; thirdly, this power should be limited to a few sectors, and thus be acceptable to the member states.

A political authority with genuine power, but limited competences — for Jean Monnet and Robert Schuman this alternative became the standard, albeit with an additional dynamic, an ulterior motive: the initially limited competences should gradually be extended, more and more areas of policy should be added, so that in the end there should indeed be a European federation concerned with all European functions — and not only with the few acceptable to those states clinging to their sovereignty.

This integration strategy, disregarding differences of detail, has been the standard until today, until Maastricht and Maastricht II, and in fact "evolutionary development of the Treaties" means nothing else. Indubitably the "Jean Monnet method" has even been extremely successful, despite some setbacks (like the failure of the European Defence Community in 1954). Indeed, success is the problem of this integration strategy today. Its success has brought it to the limits of its capacity.

A glance at the development of the European treaties illustrates this observation. Alongside the first "European Community", which in accordance with the Council of Europe formula remained limited to two areas, coal and steel, other treaties were added with further competences: the European Atomic Community, which — admittedly with little success — was to exploit nuclear energy and other new forms of energy and technology for Europe; and the European Economic Community (EEC), particularly with the internal market project and associated common policies, such as competition and foreign trade, right up to the final consequence of the single market and single currency.

In the Single European Act there were already four parts to the treaty,

or part treaties, which were now for the first time brought together under the mantle of one treaty: "European (foreign-) political cooperation" was added. With the Maastricht treaty, the book of European treaties was again enriched by new chapters: "cooperation in justice and home affairs" was added, and the protocols gained so much substance and meaning — for example the statute of the European Central Bank is contained here — that they are due the rank of a special part treaty. Instead of the six treaties or part treaties one can also, greatly simplifying, distinguish "three pillars": economic, foreign and security policy, and justice and home affairs.

The rule with all the major changes was that the existing treaties were completed and extended, new treaties or new parts were added to them — but they were never put together, united and integrated to make one single treaty text. Thus was formed a complex mountain range of differently organized treaties and parts of treaties with widely differing decision-making procedures. The Jean Monnet method finally reached its goal, by Maastricht at the latest, in one respect: the emergence of a European political system which can actually attend to almost all European functions, and which to a certain extent covers all political fields which have European dimensions.

Jean Monnet has reached its goal — so where is the problem? The problem is the existence of a European *res publica* which is not public. A multitude of, in themselves, extremely complicated treaties cannot be the basis on which citizens and political system relate to each other — in as far as this political system claims to be democratic (or at least to want to become so). Basic to our European understanding of a legitimate political system is the notion of popular sovereignty, of the people, the citizens, as the source of political power. And the agreement which commits the citizen and the political system to the transfer and exercise of political power is normally — and nowhere is this in doubt — a constitution.

In the beginning the European community development set in motion by Jean Monnet certainly did not need a constitution; right up to the 70's one could argue over whether the European Communities were not simply a functional association between several interested states, which required no legitimation beyond the parliaments of the member states. But a European Union with a common market and a common currency — and hence, on the whole, a common economic policy — with a common foreign and security policy and close coordination, in part even a common justice and home affairs policy, has without doubt become

such a complete political entity that it at the very least resembles a state. And certainly there can no longer be any doubt that the citizens of Europe are affected by the use of political power through this system to such an extent that they rightly can and should demand another basis for this power than the sketchy range of treaties.

Precisely because the method of gradual integration has now fulfilled its original remit, of Europeanizing political power, there has to be a change of method. This is no criticism of the method of intergovernmental conferences, nor of those who have negotiated the treaties so far. On the contrary: the change of method comes into question only at this point, when the path of intergovernmental conferences has achieved everything that could be achieved this way — and that is a result to be proud of: a whole, complete, state-like political system that is Europe. It is this which now, for the first time, requires a constitutional order — and such an order cannot be created through an "evolutionary development" of the treaties through continued intergovernmental conferences.

"45 years striving for the European constitution" — this was the title of Walter Lipgen's still-valuable annotated collection of documents back in 1986. The demand for a European constitution is by no means new, since (as is well-known) it was raised even before the beginning of gradual integration. In the current situation this has advantages and disadvantages: one advantage is that talk of the European constitution no longer sounds revolutionary, but habituation brings the disadvantage that its notorious lack of success draws the good-natured smile accorded to harmless talk, removed from reality.

This is a disadvantage because the demand for a European constitution today has a sharpness hitherto unknown in the whole history of European unification. The question is now acutely current and must rid itself of the image of harmless dreams cut off from reality. The sharpness with which European Union resolutions are everywhere discussed, the dramatic drop in support for "Europe" speak for themselves. And the argument often brought into play, that disputes over European resolutions are a good sign, because in this way the EU does after all prove its quality as a directly functioning state-like system, only speaks all the more for the constitutional order.

Now there is another reason why the demand for a change of integration method, from intergovernmental conferences to a constitution-building process, is no longer quite so revolutionary: the change of method has already begun. The various beginnings need only be brought together and completed. Secondly the change of method must be formally

made into a principle — and not just executed casually, half-unconsciously. Thirdly, suitable means must be demanded, if negotiation in reflection and other diplomatic groups cannot lead to the goal of an understanding between citizens and Europe. The following considerations are dedicated to these three aspects — already recognizable beginnings, their systematization, and the means to realize them.

The method of simply stringing together otherwise independent treaties was breached for the first time in 1965, when the institutions of the then existing three treaties were put together, merged. This trend became clearer however only with the Single European Act, which in 1985 placed a unitary mantle around the treaties. And finally the treaty concerning the European Union, the Treaty of Maastricht, is a fresh summary of the treaties and parts of treaties going beyond the Single Act. The unifying function of the EU Treaty is undoubtedly symptomatic of the insight that unless they were bound together in some way, the multiplicity of treaties and part treaties would fall apart. But in the case of the Treaty of Maastricht it can also be seen that the bond was only created "in some way", and in fact is still haphazard. This is no organic fusion of the treaties, but merely an exercise on paper.

The second indication of a change of method, away from integration through the gradual extension of competences, is the fact that, quite openly, no new EU-competences were to be created through the IGC. This was the first time this applied to the further development of the treaties: the Maastricht treaty itself still added to the European Community such important elements as Economic and Monetary Union, turned European Political Cooperation into the Common Foreign and Security Policy, and established Cooperation in Justice and Home Affairs. With Maastricht II, at least for some time and generally speaking, the 47-year-old rule that any change in European integration treaties opened up new areas of policy, had become obsolete.

Another maxim has taken the place of this rule: the treaties are not to be extended, but simplified and made more efficient. Simplified by reducing the many complicated decision-making procedures to a few less complicated; made more efficient by pushing back the rule of unanimity and by the possibility of making more far-reaching decisions in a smaller circle, without allowing one or a few states to hold it back — a possibility which under the concept of "flexibility" has become the central to the question of reform.

The end of the extension of competences, the search for simplification and increased efficiency are clear signs of a change of method. Admit-

tedly the successes are minimal, because the new method is being pursued by the old means — but more of this anon.

The third starting point for the "creeping" change of method is the growing significance of the principle of subsidiarity in the European Union. This is decisive evidence of a way of dividing power between the states and Europe that is quite different from the past. The Jean Monnet method consisted of taking a few areas of policy over into community responsibility, while the others, the majority, remained with the states — a kind of vertical division of powers. The principle of subsidiarity on the other hand demands a horizontal division of powers: in various policy areas both the EU and the states are involved in policy formation, in various forms of voting and cooperation.

This subsidiarization of the European Community began long ago, basically with the foundation of the EEC, in which the states, through the Council of Ministers, received greater power to cooperate in policy-making than had been the case in the ECSC. Generally speaking it is a rule (with exceptions) that the later areas of policy to be made community responsibilities show a lesser degree of integration than those added earlier: in the EC-area the degree of integration is higher than in the CFSP (Common Foreign and Security Policy), and it is higher in the CFSP (which in any case harks back to the ECP (European Political Community)) than in Justice and Home Affairs etc. All this shows that in any case the method of gradual integration has long departed from the simple schema of the gradual transfer of competences, but is oriented rather according to cooperation between the state and Union levels based on the principle of subsidiarity.

This means however, whether or not the advocates of the subsidiarity principle are aware of it, that a federal principle has become the standard of EU development. For the principle of subsidiarity presupposes fundamentally federal structures, above all the existence of various, organically-connected political levels. On the other hand, one might conclude that the Jean Monnet method was not all that federalist after all. It tended rather towards European centralization, although initially of only a few selected areas of policy. With the growing number of these policy areas however the demand for "federalization" did indeed arise, and with the rising significance of the principle of subsidiarity it is in part answered.

The various treaties and parts of treaties are (admittedly in an unsatisfactory fashion) already grouped together and are no longer wholly disconnected; the competences of the EU have basically spread to all areas of policy of European dimension; and the rule of division of

power between the states and Europe is today less of an "us and them" situation, but cooperation organized according to the principle of subsidiarity and hence (pre-)federal. With this the demand for a change in the method of gradual integration is already to a large extent answered by reality — admittedly no other method has taken its place, but a process that is at best pragmatic, but more often aimless.

The change of method, the necessity of which has already been proved in reality, must be made a principle, and a new method put in place of the old. That is the fundamental task of integration policy at this time of change and crisis.

For this there have to be new means. Intergovernmental conferences cannot mastermind this transformation. Governments are on the whole not the right point of departure for the new task: European society, the European peoples, the citizens of Europe, must come into play, and not only as addressees of government, commission or parliamentary information campaigns, but as independent agents, taking the European unification process into their own hands. The initiative for the future shape of Europe must come from the non-governmental arena of civil society.

Once again: this is not fundamental criticism of the integration process so far and its negotiation leaders. On the contrary — they have done their bit, and to expect diplomats and officials to develop a European constitution would be to disregard their duties and competences. No, a constituent force must grow out of society, through the engagement of the social forces organized in unions and elsewhere.

Naturally a legitimate representation of the people or of the European peoples should then be charged with the actual formulation of the constitution. This cannot be undertaken in society itself, but must be brought out of the non-governmental into the institutional area. The only candidate for this task is the European Parliament, for which it is nothing new. It is simply a question of resuming the draft constitution already worked on in Parliament. The European Parliament is after all the bridge between European citizens and "their" Europe, it is the "people's representative" which must take on the issue of the constitution.

By definition one cannot say beforehand what kind of constitution this should be: after all, it is supposed to grow out of the engagement of European civil society. The notion of a "constitution" is therefore intended merely to represent a fundamental agreement between the citizens and Europe, which may take various forms.

It should however include three essential declarations: first, the

European Union must make a commitment to human, basic and citizens' rights and acknowledge the goals which the European citizens set for it. Secondly, it must clearly specify in which areas of policy the European Union can, should and may be active; and whether and how it must cooperate with the member states in these areas. Here the subsidiarity principle applies. And thirdly, such a fundamental contract should make clear to an interested citizen where, how and by whom decisions are made, or in other words: the institutional structure and the process of decision-making must be agreed between the citizens and political Europe.

As already sketched out, this demand is simply the consequence of long existing beginnings: of the timid attempts to condense and collate the treaties, of the transfer of competences (to a great extent already established, and of the growing significance of the principle of subsidiarity. The European Parliament is there to take up the task. The citizens of Europe are dissatisfied enough with the European Union that they might — should such a change not take place — withdraw their consent entirely.

The demand for a European constitution was always justified, but never urgent. Thus it could be accepted in principle and yet remain without effect. Today the demand is urgent. The governments, diplomats and officials have taken European integration so far that it must now, as a fully-developed, state-like system, modern and federal in character, be handed over to the citizens of Europe to receive its legitimation from them. Now is the time when Europe needs a new fundamental agreement between citizens and politics.

Hartmut Marhold

NATO-RUSSIA PACT AND ENLARGEMENT OF NATO

Paris was the venue, on May 27th this year, for the signing of an agreement between the Russian government and NATO member countries based on a document denominated the "Founding Act" which was presented by the international press as a turning point in the framework of international security. This followed the American decision to enlarge NATO, allowing it to embrace several eastern European countries (the Czech Republic, Poland and Hungary, postponing the eventual admission of other countries to a future date), a project for a long time opposed but ultimately accepted by Russia in the framework of its new relations with the military alliance.

Looking at its main points, the agreement signed in Paris establishes that "NATO and Russia should not regard each other as the enemy" and, on the basis of this, that they "intend to develop a strong, stable and lasting relationship of collaboration...Taking as a starting point the principle that the security of all the states within the Euro-Atlantic community is indivisible, NATO and Russia will work together to help to establish common and global security in Europe" on the basis of shared principles and aims, in other words a) democracy, pluralism, respect for human rights, market economy, b) renunciation of the use of force, c) mutual openness over defence policies and military doctrines, d) prevention of conflicts through peaceful means, in line with the principles of the UN and the OSCE, and e) support for peace-keeping operations authorised by the UN security council or conducted under the responsibility of the OSCE.

In order to put all this into practice, a NATO-Russia joint permanent council has been set up — defined by the Act as a body of consultation, cooperation and, as far as possible, of joint decisions, to improve security through a greater level of trust. But "the act makes clear that Russia has no veto over alliance decisions and NATO retains the right to act independently when it so chooses" (White House press release, 27th May, 1997). The council will also provide the setting for debates on arms control, nuclear security, and on prevention of the spread of nuclear, biological and chemical weapons. As a means of counterbalancing this enlargement of NATO, the agreement also includes an undertaking on the part of the alliance not to install nuclear arms on the territory of the new member states and not to increase conventional forces on European soil (an undertaking also made by Russia) but rather, ensuring their integra-

tion and interoperability, to employ them to the best end.

The role to be played by each of the partners within this council is defined vaguely and interpreted differently by the two essential parties to this agreement (the USA and Russia). The only line that Yeltsin can take, faced at home with strong opposition to enlargement of NATO from nationalist and communist quarters, is to stress the active role that Russia is once again taking in European and in world affairs. "The document says" affirms Yeltsin "that decisions [of the council] are only taken on the basis of consensus...If Russia opposes any decision, that decision will not be taken. This is of capital importance" (*Le Monde*, 16th May, 1997). Clinton on the other hand has, through a spokesman, declared that NATO has made no fundamental concession, pointing out that while Russia has acquired "a voice" within the organisation it "does not have the power of veto."

All these declarations reflect in some way the normal tactical games characteristic of international relations in which each state, regardless of the degree of power it wields in the world, tends to focus on its national pride, stressing the importance of its own role. Going beyond this, however, in order to evaluate the significance and the limits of this agreement, we need to question whether it serves to weaken the logic of *raison d'Etat*, a logic which is fundamentally conservative and can only be superseded if, on the basis of substantial reciprocal interests, it is first imprisoned in a global plan of evolution.

The limits of the "Founding Act" can best be appreciated by drawing a comparison with the political climate and projects of the Gorbachev era. A superficial reading of the principles embraced in the Act reveals that they contain many of the words uttered and written by Gorbachev and Reagan at the time of the turning-point in relations between the two superpowers (democracy, collaboration, reciprocal openness, trust, and so on); at that time, however, the atmosphere in which a new world order was gradually taking shape was so vastly different from the current atmosphere that it even proved possible to lay aside, in part, what we earlier called tactical games. Against the "mad logic" generated by (and, at the same time, the consequence of) the nuclear deterrent strategy, a theory evolved which was both realistic and, to some degree, revolutionary as it was based on the recognition of world interdependence and of the need to adapt thinking and political projects to the new reality which had finally emerged. Many of the words spoken by the two statesmen seemed to belie Einstein's agonised declaration that freeing the power of the atom had changed everything except our way of thinking, and that we had been

set adrift towards a catastrophe the like of which had never been seen before.

Following the failure of Gorbachev's policy and the collapse of the Soviet Union, many were quick to accuse Gorbachev of being over ambitious, naive and politically inept, when he had, in fact, shown himself to be an extremely far-sighted individual. While remaining attached to the conservative logic of "collaboration" between states, that phase of international relations was strongly characterised by the emphasis placed on the need to manage a transitional phase towards a new power situation, and it is precisely by considering the *evolutionary trend of the power situation* that the potentialities inherent in a given political framework can be assessed.

The projects of the Gorbachev and Reagan era were not to succeed, however, and the new world political framework, which has moved from bipolarism to "monopolarism" is now seen to be extremely difficult not only to manage (the USA alone cannot shoulder all the problems which exist: old and new, global and regional), but also to modify. The "evolutionary trend of the power situation" that we talked of earlier can, indeed, be activated only in the presence of effective poles of power, that is, states which are prepared to take on the responsibility for implementing a given policy, and which have sufficient strength to lend credibility to their statements of principle and to the projects they expound: either politics is all about the shouldering of responsibility, or it means the generation of chaos.

The logic of economic and technological development is leading to the creation of a global society that can no longer be managed by individual states. This is particularly true as regards the problem of security which can be addressed only through a programme of reform which targets the UN and renders it more democratic. If this proves not to be the direction taken, the role of a military alliance like NATO, very precisely defined during the cold war, will, as is already occurring, become less and less clearly defined. The organisation is indeed tending to extend beyond the realm of its military functions to take on a political role, the epicentre of this organisation being the sole survivor of the two superpowers. In the power vacuum created by the disappearance of the old world order which, although it had to be overcome, nevertheless provided a relatively stable framework of reference, it comes as no surprise that, as regards the question of security, NATO has become the magnet which continues to attract new states looking for something to cling on to in their bid to escape the drift towards chaos. For different reasons, it is also no surprise

to see Yeltsin seeking, also through the pact with NATO, to regain credibility as a political interlocutor, thereby using the façade of the role assigned to the country to disguise Russia's weak and isolated position.

The need for stability induces states, quite rightly, to seek points of aggregation, but there is no order in the way this is done. This lack of order, or confusion, arises from the fact that, as they seek to tackle the issues upon which stability itself is founded (security, economic development, democracy), the states have as points of reference international bodies, reproduced at local and world level, which have no "political soul", and which, starting with their specific roles and competencies, (in the economic and security spheres), tend to take on functions of "government" without, however, having the legitimacy or means to do so. In fact these bodies represent, in the final analysis, the framework not so much of a common management of these problems as of the definition, or redefinition of the role of individual states within the world; they reflect the balance of world power, or rather the game of *raisons d'Etat* and are thus slaves to a mechanism which they have been created to overcome. These considerations provide a starting point from which to analyse the processes of aggregation currently in progress and the question to be asked is whether or not these processes are moving in the direction of new state-based forms of power distribution, that is, whether or not they indicate an evolutionary change in the power situation in the world, a change which may, in the short term, make it possible to produce a multipolar order and, in the long term, create the conditions necessary, through a world federation, to bring about a real and effective world government.

From this point of view, besides failing to contribute to a modification of the world order, no prospects are offered to new members by the enlargement of NATO and the association of Russia. All that has happened is that the new member states have been given the right to come under the protective umbrella of the hegemonic power and Russia is given the dubious honour of still being accepted as an interlocutor.

The framework and outlook will be quite different if the process of European unification culminates in the formation of a federation: a new and responsible political subject will enter the picture and all those countries which form part of it, including eastern European countries, will no longer be down-trodden members of an alliance dominated by a superpower, but able, instead, to contribute democratically to the building of their own future and the future of the world.

Nicoletta Mosconi

ABOUT THE AUTHORS

HARMUT MARHOLD, General Secretary of the German Council of the European Movement.

GUIDOMONTANI, National Secretary of the Movimento Federalista Europeo, Professor of International Economics, University of Pavia.

NICOLETTA MOSCONI, Member of the Central Committee of the Movimento Federalista Europeo.

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