Institute for
New Economic Thinking

Working Papers
ineteconomics.org/workingpapers

From the EMS to the EMU and…to China

Joseph Halevi*

Working Paper No. 102

September 2019

ABSTRACT

This essay deals with the EMS experience and its failure, with the Maastricht Treaty, and with the interregnum leading to the formation of the EMU in 1999. The paper highlights the position of German authorities, showing that they were quite lucid about the fundamental weaknesses inherent in a process that separated monetary from fiscal policies by giving priority to the centralization of the former. Instead of repeating the well known critiques levelled against the EMU – for which readers are referred to the unsurpassed treatment by Stiglitz, the essay highlights the splintering of Europe in the way in which it has unfolded during the 1990s and in the first decade of the present millennium. In particular the early economic and political origins of the terminal crisis of Italy are located between the late 1980s and the 1990s. France is shown to belong increasingly to the so-called European periphery by virtue of a weakening industrial structure and persistent balance of payments deficits. The paper argues that France regains its central role by political means and through its weight as an active nuclear military power centered on maintaining its imperial interests and posture especially in Africa. The first decade of the present millennium is portrayed as the period in which a distinct German economic area had been formed in the midst of Europe with a strong drive to the east with an increasingly powerful gravitational pull towards the People's Republic of China.

---

* Joseph Halevi is retired from the University of Sydney and currently professor at the International University College of Turin. josephhalevi53@gmail.com. The author is grateful for financial support for this research from the Institute for New Economic Thinking.

JEL Codes: E02, F02, F5, N14, N24

Keywords: European Monetary System, Common Market, France, Germany, Italy, Netherlands, currency depreciation, European Monetary Union

http://doi.org/10.36687/inetwp102

1. The German initiative and perspective

The European Monetary System (EMS) approved in 1978 and launched in 1979 centered on the exchange rate mechanism known by its initials as the ERM. It constituted the first formal expression of joint Franco-German initiatives and thus represented also a process of building up a de-facto economic and institutional hegemony for the two countries, where the economic benefits would accrue principally to West Germany and the political advantages mainly to France. The EMS came in the wake of the failure of the "snake in the tunnel" to stabilize exchange rates among European countries.

The new ERM, was designed to reduce exchange rate fluctuations among the participating countries. Italy, which had a much higher rate of inflation than the others, obtained a wider fluctuation band. The monetary reference was not a real currency but a virtual composite one called the *écu* in which the US $ figured prominently. Unlike Keynes' idea of Bancor, the EMS did not make any provision for alleviating the burden on the weak countries, whose currencies would come under pressure to devalue. The system was conceived to discipline precisely the weak countries whereas Keynes' Bancor idea was meant for exactly the opposite objective, namely, how not to place the whole burden on the deficit countries.

During the years of the EMS a whole set of papers and of pseudo models appeared, especially in Italy, extolling the advantages in terms of credibility of conducting macroeconomic policies with "one hand tied behind the back" (Giavazzi and Pagano 1988). Countries facing difficulties could indeed borrow by using the EMS credit lines, but the money had to be repaid in a very short span of time. The main settlement currency was the US$, thus in no way did the *écu* create new liquidity. The working of the monetary system was tilted in a strongly anti-Keynesian direction, since there was no mechanism to compel the countries with strong and persistent external surpluses to weaken their position. Thus the EMS was even worse than the 'snake' since it put a great pressure on the weak members

The EMS embraced the now nine countries of the European Economic Community (EEC), whose number rose during the 1980s to 12 following the entry into the European Community of Spain, Portugal and Greece. Initially Britain stayed out. Spain and Portugal joined the EMS in 1989, and 1992 respectively, the United Kingdom in 1990. Britain's and Portugal's experiences were very short lived as the whole system was shaken by a crisis in 1992 in the wake of German unification. Ironically the politician that started campaigning about the need for a stronger monetary system as opposed to the ineffectual 'snake' was the UK European commissioner Roy Jenkins.

Since the initiative concerning the formation of the European Monetary System came from the Bonn government it may be appropriate to start from Germany's vantage point, which is also the easiest to understand. The country's industry and banking system can be viewed as the most coherent oligopolistic system in Europe. From Paolo Sylos-Labini (1969) we know that such an economy crucially depends on external factors and not so much on endogenous Schumpeterian or Smithian forces. In the case of the United States the external impulses came, and still come from public expenditure, rather than from exports.[1] But for Germany, Japan and South Korea exports are the key. They are the main conduits for

[1]The macroeconomic role of industrial exports in a concentrated economy was understood very early by many American business figures, economists, and government officials. See (Sklar 1988, 78-85). But in an economy of the size and high level of productive capacity of the United States, capital exports - direct investment and portfolio investments - dominated over the need for exports. The same would have been true if Europe had been a single economic and political entity. The connection between exports and accumulation is best understood through a

capital accumulation. In these countries there is therefore a consistency between the oligopolistic features of their industrial structure and the macroeconomy. Indeed, in comparable countries or areas lacking such coherence, industrial exports - even if substantial - often do not act as a reliable indicator for aggregate capital accumulation.[2]

Among the large European countries, the German case is, however, singular. As argued in the preceding essays, by the end of the post-war reconstruction period the Federal Republic was on track to develop a productive capacity capable of covering very large segments of European demand. In this context, mark-up pricing policies by the leading firms require stable exchange rates which were guaranteed by the Bretton Woods system for about a quarter of a century. The Federal Republic of the 1970-90s was not yet a globally importing economy with exports concentrated on its engineering segments giving rise to an overall strong - and growing - external surplus.

With the end of the fixed parity of the Western world's monetary regime in 1971/3, Germany had to face the devaluation of the US dollar and the fluctuations of the European currencies vis à vis the Deutsche Mark. These two battle fronts appeared dangerous and not only, nor even mainly, because a lower value of the US $ would increase American industrial exports to Europe and reduce German exports to the United States. More importantly, the devaluation of the dollar affected the mark-up strategy of German firms compelling them to assess whether it was worthwhile taking a cut or developing, by means of direct investment, production lines in the United States. The downward fluctuations of the other European currencies, whose countries absorbed the bulk of the FRG exports and generated the vast majority of its current account surpluses, cannot be discussed independently from the depreciation of the US dollar. In the European theatre, the lower value of the dollar reduced the unit costs of raw materials and, although the depreciation of the US currency turned out to be lower than the increase in crude prices, it mitigated the impact of cost inflation on the operations of the big companies which, in Germany, are also the largest exporters. Such a scenario worked mostly for the oligopolistic sectors of the economy. The more competitive ones were exposed to external competition in a rather significant manner thus bearing most of the brunt of the high nominal DM policies followed since 1969 by the Government and the Bundesbank alike.

Behind all that there was the economic productivist ideology of Karl Schiller, the SPD economic minister. Evidently the validity of the strategy could not possibly depend on a continuous appreciation of the Deutsche Mark. Hence at some point in time the process would have had to be halted. It is at this juncture that, throughout the 1970s, Bonn's policy making targeted a slow rate of growth, below that of most of Western Europe. The objective was straightforward: to disinflate wages through the creation of a Keynesian form unemployment. In this way the domestic component of inflation could be held in check. Counting on the technological prowess of German firms, including the branches of the multinationals operating in the Federal Republic - such as those of the two main US automobile companies - as well as on the overall sectoral completeness of its industry,[3] the (correct) assumption was that in the austere atmosphere

---

seminal paper written by Michal Kalecki in the 1930s and reprinted in his selected essays (Kalecki 1971a, Lucarelli 2011)

[2] I would put France and Italy into this category although for different reasons.

[3] With very few exceptions, economists do not understand what sectoral coherence or completeness mean because they tend to think in terms of a purely fungible-malleable notion of production and of investment. The idea of sectoral completeness refers to the strength of the input-output matrix of an economy at the crucial level of capital goods production. My preferred theoretical reference is the fundamental work of the late Adolph Lowe (1893-1995), who, already in the early 1920s during the Weimar Republic, started to think about the structural component

of nominal revaluation, restructuring and new investments would increase productivity, well above wage rises thereby enabling a real devaluation of the German currency (Valli 1981). It was therefore a two-step strategy based on a nominal revaluation in the first instance but with the objective of a real devaluation down the road. In this context low growth and domestic price stability were crucial levers for achieving that goal. Essentially it worked throughout most of decade as shown by the relative ease with which the FRG current account absorbed the first oil price increase.

Yet one major factor tended to radically upset the German strategy, where by 'German' I mean the areas where business, and government and also union interests came together, namely those of price stability and the task to maintain and expand the current account surplus. The upsetting factor was Italy because of the Bank of Italy's policy of pursuing a strategy that combined inflation and devaluation. That was the specific way in which Italian big business and the country's central bank addressed the wave of wage increases and, in particular the virtual loss of control by management resulting from the prolonged 'Hot Autumn' strike movement. The combination of inflation with devaluation did generate a significant growth in Italy's exports, within the OECD's large countries second only to Japan's. The impact on the bilateral trade balance with Germany was in Italy's favor while the policy affected negatively France's position as well, the main pillar of the FRG economic status in Europe as a whole and not just in the EEC. Given that, at the time, France and Italy overlapped in many production lines, the de facto competitive devaluation of the Italian Lira was endangering France's trade balance both bilaterally and overall. France would not have been able to withstand the pressure coming from Italy and would have had to abandon its objective of staying close to the D-Mark. Without France, the Bonn strategy of using the EEC as a shield against the depreciation of the $ would have come crashing down. That was the real issue - hidden under the jargon of a grand European cooperation - that led in December 1978 to the formation of the European Monetary System and to the exchange rate mechanism, the ERM, within it.

Conceived in the context of a falling US dollar, the newly formed EMS served Germany's export-oriented economy and big business very well also during the years of the high dollar in the 1980s when the Federal Republic of Germany (FRG) kept piling up external surpluses. On the American trade front Germany's net position was certainly helped by the revaluation of the dollar caused by the Volcker-Reagan's high interest rates after 1979 and by the expansionary military based fiscal policies of the new Republican Administration. However Germany's net balance grew strongly also in Europe itself and in the area of the EMS (Halevi 1995). When in 1985 US interest rates started to come down, the FRG position on the American front weakened significantly but the overall surplus kept growing on account of its trade with Europe, thereby reaching an all-time high. The industrial restructuring policies adopted in the previous decade enabled the FRG to overcome the 1979 oil shock - a much sharper rise in crude

---

of the cyclical dynamics of an industrial system like that of Germany. At that time he was at the University of Kiel; his name was spelled as Adolf Löwe. After emigrating the United States in the late 1930s Lowe developed his structural theory of growth while serving as the most senior professor of economics at the New School for Social Research in New York City. In the 1950s he wrote a series of essays in the journal *Social Research* and completed his groundbreaking work in 1976 with the publication by Cambridge University Press of the volume *The Path of Economic Growth*. I was extremely lucky to know him very well during my nearly 4 year stay in New York City, teaching at the New School from the mid to the late 1970s thereby absorbing his structural theory in full. Lowe developed the most advanced form of sectoral schemes, conceptually close to, but quite different from and far more sophisticated than Marx's schemes of reproduction. Lowe showed that the crucial dynamic processes of an economy hinge on what happens *within* the capital goods sectors which, therefore, cannot be aggregated into one homogeneous investment goods sector. Hence for Lowe the term 'investment' has little meaning unless specified by sectors. This vital macro-engineering aspect of investment is ignored also by most of heterodox economists. More recently the construction by MIT and Harvard of the notion and of the related tables of complexity is perfectly understandable in both a Lowe and a Pasinetti structural framework (Harvard 2019).

prices than in 1974 - by re-establishing in 1982 the external surplus in the current account. Notably the surplus was obtained also with the oil producing countries thanks to the all-important role of the FRG machinery sectors. The expansionary military Keynesianism of the Republican administration, coupled with the high interest rate policies of the Federal Reserve, stimulated Germany's extra-European exports as much as it greatly helped exports from the rest of the EEC. However, unlike the German case, France's and Italy's export flows did not enable them to overcome the second oil shock made more acute by the rise in the value of the US dollar. Furthermore, as the FRG continued on a growth path lower than that of the rest of Europe, it could not act as a pulling factor for the other economies.

Last but not necessarily least, the rise in US interest rates had a more negative effect on the non-German part of the EEC. Indeed, the firms of the countries exhibiting a weaker external position which were also more vulnerable to the impact of the oil shock would have needed a comparatively easier access to credit in order to undertake the required restructuring. Instead, given the beginning of deregulation policies of the early eighties, financial capital became naturally attracted to US government paper exposing the greater weakness of the other countries relatively to the FRG, with the Netherlands increasingly, and successfully, glued to the FRG export oriented posture.

On the whole the EEC dependency on Germany's macroeconomic behavior increased during the 1980s but not because the FRG acted as a locomotive. In this respect, the trend of the 1970s continued in as much as Bonn's growth stayed below the European average. That decade can be divided into exactly two halves, both determined by the US stance on interest rates: from 1980 to 1985 the high US dollar prevailed, while from 1985 onward lower interest rates ruled leading to a declining dollar. The second phase had been institutionalized at the meeting of the G5 finance ministers at the Hotel Plaza in New York City held on the 22nd of September 1985, although by the time of the meeting, the Federal Reserve had been lowering interest rates for a number of months. Because of the multiple uneven impacts of the high interest rate driven dollar, the 'Europeans' had been clamoring for a realignment of US interest rates. The US too looked favorably to such a 'realignment' because of the continuing bad news on the Japanese trade front. American policy makers wished to see a substantial appreciation of the yen. The Plaza consensus was formed essentially at the expense of Japan - which was pushed onto the path of a sharp rise of the yen. In this context, it is worth pointing out that the EMS protected the FRG exports towards Europe in both phases and especially during the second one when, as the US dollar was devaluing, the ERM brought about a fixed exchange rate regime within the EMS. Germany's trade with the United States throughout the 1970s and the 1980s, was sensitive to variations in the dollar exchange rate. The decline of the dollar as of 1985 reduced the FRG net balance with the United States. Yet for Germany the second half of the 1980s produced an unprecedented overall current account surplus which was overtaken only two decades later in the years leading to the financial crisis and in those following it.

The post 1985 increase in the FRG net external balance occurred mostly in Europe and within it the largest expansion took place with the countries of the EEC. The growth of the net current account position of the FRG continued also during the three brief boom years of 1988-1990 which engulfed all of the EEC connecting with the 'Keynesian' effect on the Western part of the FRG of the absorption of East Germany (formally the German Democratic Republic – GDR) and the swelling expenditures that went with it. That boom, helped also by the fall in raw material prices and the post-Plaza decline in interest rates, was terminated in 1991 by the Bundesbank's interest rate increase based on inflationary worries allegedly arising from the absorption of East Germany. The decision of the Bundesbank ended both the FRG boom and its European-wide positive impact; it then plunged the EMS into a deep crisis which produced the European recession of 1993.

Hence, as far as Germany was concerned, by the end of the 1980s the following picture emerged. The country's economy displayed one of the lowest relative growth rates throughout the decade, likewise for the growth rate of output per person employed. It is no wonder therefore that by 1990, a boom year, FRG unemployment, as measured by the OECD criteria of the time, exceeded 7%, having peaked at 8% in 1985, as against the 3.2% figure in 1980. Just the same it would be misleading to ascribe to German capital or to the big businesses located in Germany, which are also the main exporters, an unsatisfactory behavior from the standpoint of international profitability.[4] The economic activities based in the FRG generated a growing external surplus. The trade balance on goods and services recovered from the second oil shock in 1981, resurfacing at a tiny 0.8% of GDP. By 1985 aided also by the high dollar and Reagan's expansionary budgets, the net balance climbed to 3.5%. It kept rising to 5.5% of GDP in 1990 although the devaluation of the US dollar, enshrined in the Plaza accords of September 1985, was in full swing and proceeded in earnest till May 1995.[5]

It is difficult, therefore, not to conclude that during the 1980s the FRG authorities followed a deliberate policy of internal deflation aimed at keeping domestic effective demand in a subdued state - even at the price of a fairly high rate of unemployment by West Germany's post 1960s standards - in order to support their companies' international expansion, both by means of trade as well as by means of foreign direct investment - the latter viewed as an export augmenting factor through the demand it created for German machinery. These capital goods represent the mainstay of the power of German based capital in Europe and elsewhere as well. In the period under consideration, namely the 1980s, the role of the capital goods sectors manifested itself both quantitatively and qualitatively. In point of fact it enabled the West German economy to sustain its policy induced low growth orientation by enabling systematic restructuring, given that the capital goods sectors provided the technological inputs for the rest of the economy, services and logistics included, as well as by delivering big outcomes on the foreign fronts.[6] The significant support coming from the EMS consisted in that while it brought about a tendency towards fairly stable nominal exchange rates among the participating countries, it also, and especially, entailed all along a real revaluation of the Italian Lira vis à vis the Deutsche Mark.

---

[4] External aggregate surpluses contribute to gross aggregate profits. This statement follows directly from Kalecki's economics.

[5] In May 1995 the three major central banks of the world, namely the US Federal Reserve, the Bundesbank, and the Bank of Japan, coordinated a change in policy in order to reverse the rise of the yen which was strangling the Japanese economy.

[6] Schneilin and Schumacher (1992, p.123, reproduced in Halevi 1995, p. 260) constructed a table showing the sectoral dynamics of the FRG economy for each decade from 1950 to 1988, where the index was set at 100 in 1970. The sectors involved were mining, basic industries such as steel, cement, investment goods, durable consumption goods, food industries. Overall the highest absolute level since 1950 was reached by the investment goods industries in their 1988 index at 149, followed by the food industries at 129. As should have been expected, mining was in decline well below the 100 level of 1970 and even short of the 1950 level. Looking at the 1980-88 period, a phase of low relative growth for West Germany, the investment goods' index climbed by 22%. The food industries' index increased by 6%, while the basic industries' index rose by 5%. That of the durable consumption goods hardly budged, moving from 114 in 1980 to 115 in 1988. Thus the capital goods sector and the food industries, the latter being a part of the consumption goods sector, were the mainstay of the FRG growth after 1970. In this context, the large, both absolutely and relatively to GDP, trade surplus attained by the FRG in the late 1989, the penultimate year for West Germany's profitable stagnation decade, was mostly due to capital goods and automotive items. A more forceful analysis applied to the new conditions arising from the end of the communist led regimes in Eastern Europe was published by Elvio Dal Bosco (1992), a senior researcher of Kaleckian orientation at the Bank of Italy.

Some German economists understood pretty well how the EMS affected the relations between the FRG and the other members of the EMS (Giersch et al 1992). They saw the EMS as even superior to the Bretton Woods system because it preserved the Bundesbank's freedom of movement in that it compelled the other countries of the system to adopt the anti-inflationary position of the Bundesbank.

That the German policy was a problem for the European macroeconomy was actually understood as events unfolded. In 1990 Romano Prodi - a professor of industrial economics at the University of Bologna and, above all, a Christian Democratic politician who would become Italy's Prime Minister and then the President of the European Commission from 1999 to 2004 - wrote an important article addressing the structural nature of the German surpluses from the standpoint of companies' strategy of mergers and acquisitions (Prodi 1990). Prodi's essay is based on the correct assumption that the FRG authorities did not wish to internationalize their currency so that the financial operations of external mergers and acquisitions had to depend upon the size of external surpluses. Prodi went on to argue, in this case all too correctly, that the relative power relations within Europe would be determined by who is going to create a European wide oligopolistic system and by who would expand into Eastern Europe.

This 'who' is Germany, Prodi maintained. Thus he favored a rapid 'drowning' of the FRG into the EU through monetary union, that is, via the French strategy, the first step of which materialized in the Maastricht Treaty two years later. Prodi's analysis was rather perceptive on the issue of European oligopolies and on the FRG gravitation towards the East. Yet he totally missed the macroeconomic significance of the German surpluses for Europe and of the connected role of the EMS in relation to Italy and also, as we will see, France.

2.The EMS and Italy

The real objective of the creation of the EMS was to stop Italy, i.e. to put an end to the policy of inflation cum devaluation which amounted to a form of a systematic beggar thy neighbor attitude. Consider now that fact that from the early 1970s Italy's economic policies were basically in the hands of the central bank, Banca d'Italia, as the policy capability of successive Italian governments was rather problematic. Throughout most of the decade business managers in the major firms virtually lost control over the labor force; thus the task of providing breathing space for some kind of capital accumulation fell upon the Bank of Italy (Bellofiore 2001).The decision to combine inflation with devaluation in order to boost exports was taken as a *faute de mieux* step; it was not an eagerly sought after policy. It was the economic and political weakness in which the country found itself that led to the weak Neomercantilist line[7]. As Augusto Graziani (1989) pointed out, if the social system were to remain capitalist, business profitability would have had to be restored. The game was so successful for a while that it triggered the initiative by Germany to marshal France to form the EMS. Officially the Franco-German duo even cast doubts about the wisdom of having Italy in the EMS because it had a rate of inflation way above that of the potential members. In reality an EMS without Italy would have been meaningless.

A closer look at the Italian scene during the 1980s is therefore rewarding. Adherence to the EMS's rules entailed a systematic real revaluation of the Lira since nominal devaluation, allowed within a certain

[7] The Bank of Italy pursued a dual objective: a revaluation of the Lira against the US dollar, which would mitigate the impact of oil prices, and a devaluation against the DM which was supposed to expand exports. The policy was based on studies that showed that variations in the exchange rate of the $ impacted on 50 % of Italy's imports and on 35% of exports (Graziani 2000, p.125).

band by the rules themselves, fell significantly short of inflation (Graziani 1991). The new situation led to a widening current account deficit which the monetary authorities tackled by acting on the capital account through attractive interest rates. In this way during the whole decade Italy piled up a substantial foreign debt that was to burden the country in decades to come. In 1981 the Treasury and the Central Bank ended what was called the circuit between the Treasury and the Bank. Until then government bonds were bought as a matter of course by the Bank of Italy at a given interest rate. With the 1981 divorce (*il divorzio*, is called in Italy), the Bank of Italy aimed at reducing the purchase of bonds from the Treasury (Bank of Italy 2011).[8] It still set a ceiling on the return on new bonds and therefore intervened accordingly. Just the same the delinking from automatic financing of government bonds did occur so that the evolution of the Italian debt became increasingly dependent on speculative expectations given the prevailing inflationary environment.

This factor along with the rising external deficit helped bring about a doubling in 10 years of the ratio of public debt to national income. In Italy therefore the role of the Central Bank had been split off very early, well before anything leading up to Maastricht, from its function as a supporting and advising arm of fiscal policy. Since a similar, although historically and institutionally different, process happened in France around 1984, we may conclude that a Maastricht style mentality already existed and was not imposed on these countries from outside. The splitting of the Central Banks of both countries from their Treasuries was not even the consequence of copying from the Bundesrepublik since nothing of this sort had ever happened, not even, as we shall see, after the formation of the EMU in 1999. *Il divorzio* in Italy and *la rupture du circuit* in France emerged as internal political and economic decisions not demanded by any of the then quite limited, in terms of authority, Brussels' bureaucracy. It is also interesting to observe that politically in Italy the acceptance and the rejection of the divorce did not depend upon the particular ideologies of the political parties. The spendthrift Socialist Party of Craxi's fame was in favor, as much as the morally and economically austerian Communist Party. The latter should have known that with the *divorce* - given the new international inflationary environment and the end, with the EMS, of the phase of large devaluations - the public sector would have been saddled with rising interest payments stretching many decades into the future. Indeed, the pro-divorce position taken by the Communist Party, which although in opposition had a crucial weight in the most delicate decisions regarding the institutions of policy making, may have played a role in convincing the less enthusiastic sections of the Christian Democrats to go ahead with it.

The 1980s' Italy represents a clear example of a country where the economic trends were negative and led toward a crisis but where the trends could not be gleaned from real macro-data. To begin with, the EMS changed Italy's current account from positive to negative with grave consequences for the whole financial posture of the country. As far as behavior within the 1979-90 period was concerned, the *numbers* of the Italian economy were larger than the average of OECD-Europe, as well as the average of the EEC, of Germany and of France, in the following areas: in total and per capita GDP growth rates, in the growth of real value added in industry (in this case the Italian *number* is more than twice that of the FRG; the same applies to manufacturing with an even greater gap in favor of Italy). It also holds for real GDP per person employed, although here the gap in Italy's favor was much more limited. However, the gap widens significantly in Italy's favor when we come to the growth rate of real value added per employee both in industry as a whole, with the manufacturing subset being several times higher than Germany's.

[8] http://www.bancaditalia.it/pubblicazioni/interventi-governatore/integov2011/AREL_150211.pdf

To complete the picture, let as look at some other key macroeconomic elements. Under the guidance of the late Angus Maddison, the OECD used to produce detailed data on the growth rates of capital formation.[9] These were divided into three sets: residential, non-residential fixed capital formation, and machinery and equipment. In both residential and non-residential fixed capital formation there are strong non-productive components, definitely in the residential subset, but also in the non-residential one (example: a bank's skyscraper is mostly a speculative activity of land 'development' rather than fixed productive capital). The technological and productive orientation of investment should be found in the dynamics of the machinery and equipment subset. Here too Italy's *numbers* are larger than those of the FRG, of France, and of the EEC and OECD Europe. By contrast if we look at the rates of growth of exports and imports expressed in volumes, we notice that Italy's exports grew less while imports grew more than the average of all the reference entities. By the same token Italy's imports grew more than Italy's exports. Yet the external gap in volume terms cannot explain the crisis elements inherent in the trends of the Italian economy during the 1980s. These are to be found in the structural deterioration of the industrial sector on one hand, and in the financial burden generated by the explosion of the public debt due not to so much to wanton spending but to the interest rate charges which were an inevitable result after the *divorce* and by the need to keep the currency within the ERM band after Italy joined the EMS. At the same time however a study conducted in those years by the Bank of Italy showed - anticipating empirically the yet to be born Godley-Lavoie (2007) stock-flow consistent approach to economic accounting - that government's net expenditures entailed a significant transfer to firms, especially to the large ones, which therefore came out of the financial squeeze in which they were plunged in the 1970s (Graziani 1991). As pointed out by Graziani, the policy of combining inflation with revaluation - being a complete reversal of the pre EMS line which gambled on the connection between inflation and devaluation to foster Italy's weak Neomercantilism - was favored by the Bank of Italy in order to compel industrial restructuring as the only way to offset the real revaluation of the Lira and thereby regaining exports.

Restructuring did happen. In the 1980s and the 1990s both internationally and in Italy a whole literature sprang up on the new industrial divide as a novel form of organizational efficiency based on the clustering of small firms in industrial districts. The merit of these studies consists in that they brought out the different typologies of the small and medium-sized industrial enterprises as well as the specificities of their intra-firm relations and how they shaped the surrounding environment. The studies showed that the network of small firms is a structural phenomenon in Italy as they can reproduce themselves under changing conditions. However those works also contained a strong romantic element in that they extolled the virtues of the small firms in opposition to the stagnation and crisis of Italy's big business and its transformation into a set of weak, and often publicly subsidized, large private holdings with rent seeking orientations. No matter how appealing industrial districts may seem to the external observer, the proof of their alleged superiority over large scale industries lies in their impact on the macroeconomic aggregates as well as in their limited financial resilience.

In this respect, the late Hyman Minsky, who lived several years in the Northern Italian city of Bergamo - a major hub of industrial districts that were strongly export orientated - had absolutely no doubt about their aggregate impact.[10] Minsky believed that although the firms making the industrial districts were interesting and smart *they could not create a system valid for the industrial sector as a whole*. Indeed, attention to the surge of the small firms was raised in Italy in the mid 1970s in a book by one of the

---

[9] The OECD series is titled *Historical Statistics* and has been discontinued after 2000. Here I am using the 1960-1990 publication (OECD 1992).

[10] This account of Minsky's views is derived from a long conversation with him after one of those phenomenal conferences then regularly organized by Riccardo Bellofiore at Bergamo.

intellectual icons of Italian economics, the late Giorgio Fuà (1976) from the University of Ancona. Fuà argued that a process of internal delocalization was taking place both because of the inability of Italy's large companies to move up the technological and product ladder, as well as because of the social cleavages between management and labor. These two factors interacted thereby giving rise to the above phenomenon. The delocalization process was viewed by Fuà as marking the still underdeveloped nature of Italian industry, thus in its macro-dimension it was not considered as an innovative one. In other words, an industrial divide was indeed being created but its nature was problematical. Marcello de Cecco (2000, 2012) and Augusto Graziani (1989, 2000) corroborated the critical view put forward by Fuà decades earlier as the process got underway with de Cecco stressing the extreme financial vulnerability of the small firms.

3.1 France in the 1980s and in the early 1990s

In France the 1980s were characterized by three major austerity oriented features: (a) the beginning of the Mitterrand regime, (b) the breaking of the circuit between le Trésor and the Banque de France as Italy had done earlier, (c) the formulation of economic policies around the idea of competitive disinflation as a main characteristic of both conservative and Socialist led governments also in the following decade.

It is normally assumed that President François Mitterrand started his first mandate in 1981 with a genuine Keynesian employment objective, only to be derailed by the negative reaction of capital owners who engaged in a game of no confidence with a capital flight leading in less than two years to three devaluations of the French Franc despite the currency's status as a major component of the European Monetary System since its launching in 1979. However, the speed and relief with which the French Socialist authorities proceeded to revert to austerity - the U-turn occurred barely a year after the 1981 presidential elections - belies the story regarding the good faith of the Mitterrand presidency. Debunking the received wisdom about the latter's policies has relevance also in relation to the assessment of the euro-project which tends to be presented as a sharp - German engineered - turn toward austerity.

In this context the contributions of Alain Parguez, Emeritus Professor at the Université de Franche Comté in Besançon, are still unsurpassed. This is because Parguez brings economic theory into a historical and political framework based on knowledge of the ideological makeup of the French ruling elites and on the way in which these have adapted their own, quite stable, ideological configuration to the changing circumstances (Parguez 1998, Bliek and Parguez 2008; Parguez 2016). Indeed, whether on the 'left' or on the right, these elites see sound finance as the central pillar of the stability of the social order. The difference between the two groups is a matter of degree. The 'right' builds its position from a financial equilibrium standpoint where savings lead the investment process and any systemic budget deficit is seen as a drag on capital formation. The 'left's' view, argues Parguez, has been heavily shaped by the fact that "[t]he Marxism of the Marxists was ultra-Ricardian, holding that profits were a gain wrung from the working masses through exploitation and that public deficits created inflation, which impoverished the masses even further" (Parguez 1998, p.185). Thus in France, in relation to public finance, the right and the left positions amounted to almost the same thing. When confronted with the deficit and/or with a deficit in the social security accounts, for instance, the trade unions would argue, as witnessed by the present writer in connection with the CGT, that the remedy would have to be sought in levying taxes on 'the big fortunes,' but they would not question the view that deficits are a 'bad thing.' This conservative ideology encompasses political figures who could be pro-market or pro-planning. Such an aspect of France's economic and political culture explains quite well how people like Lionel Jospin could write Marxist articles in a Trotskyite mode and then move smoothly and rather quickly to fostering economic policies favoring financial austerity. Also the so-called "Regulationist school, which has set itself up as a heterodox alternative to mainstream economic policy making, is not in the end too distant from the financially conservative ideology ruling France.

The election of François Mitterrand to the Presidency in 1981 did however set up a clash with the Trésor since the new Socialist administration could not immediately renege on its electoral program as it had won power on a platform denouncing the Barre austerity experience of the second half of the 1970s. The beginning of the normalization can be set in February 1982 when the government established an official limit to the ratio of the public sector's deficit to GDP: it was not to go over 3%. That was exactly the ceiling enshrined in the Maastricht Treaty a decade later, yet then in the EEC there still was no talk of such a Community wide constraining fiscal rule. Understanding where the position of the Trésor originated from helps explain the extent of the change brought about by the Socialist government of Laurent Fabius and especially by his finance minister, the late Pierre Bérégovoy, during the latter's tenure in 1984-86.

The channels linking the Banque de France, commercial banks, financial institutions and also public bodies like municipalities, to the country's Treasury were given the name of circuit because they represented a circular system of guaranteed money flows to the Trésor. These institutions were required to purchase a certain amount of bonds and bills putting the public bonds market into a closed loop. Such a financing configuration came into operation upon the liberation of the country from the German occupation thereby performing an important role in the financing of reconstruction programs. As Benjamin Lemoine has pointed out in his excellent book on the subject (Lemoine 2016), by the mid-1960s high ranking treasury officials became fascinated with US capital markets and started to plan for the creation in France of a market for public debt. The infatuation was not arbitrary though, as it had its roots in the ideas of Jacques Rueff - the Richelieu of France's monetary system and the guardian of its ideological orthodoxy - who shaped the thinking of France's technocrats, whether 'left' or right, over public finances.

In 1958 the new de Gaulle government commissioned Rueff to report on the financial situation of the country (Parguez 1998). On that occasion he made a strong case for the principle that, with a given pool of savings, budget deficits would crowd out private investment while the monetization of the deficit could only be inflationary. Alain Parguez has described in detail how Rueff attacked the still existing practice of treating public capital expenditures separately from the public sector's current expenditures, arguing instead for a single unified budget in which each component had to be balanced, particularly the social security one.

On January 3d 1973, with Valéry Giscard d'Estaing as finance minister, a law was passed which prohibited the Trésor from discounting its bills at the Banque de France. The law has been considered as the first formal step in breaking up the circuit, but in reality the automatic financing channels kept operating as usual. The crunch came after the election of François Mitterrand to the Presidency in 1981. Treasury officials began linking, in a twin deficit fashion, the external current account - never particularly good for France - to the budget balance. The issue of the parity of the French Franc with the Deutsche Mark became a government obsession - a constant feature of France's finance capital - although the French Franc was deemed to be much overvalued.[11] The question of the exchange rate turned rather quickly into the psychodrama of whether to stay in the EMS or plunge the country into chaos. By late 1981 therefore the Socialist government began to work on a set of austerity measures, on setting the aforementioned

[11] Bliek and Parguez (2008) write that the view that the French Franc was highly overvalued relatively to the German currency was strongly expressed by the late Robert Eisner - one of the most distinguished US economists - who at the time was an advisor to the Mitterrand government.

Maastricht-type limit on the public deficit, as well as on stopping the indexing of wages to inflation. Under circumstances in which the new government showed great readiness to learn how to 'properly manage' the economy, officials of both the Trésor and of the Banque de France kept up the pressure for the radical transformation of public financing. In the words Benjamin Lemoine:

> [by] the end of the 1981-83 episode the 'thesis of the Trésor' - that is the project of a debt based on bonds issued on the international capital markets - had been made into a natural phenomenon. *Having recourse to the market was no longer viewed as a project or as a policy choice, but as a technical necessity* (Lemoine 2016, p. 107, my translation, JH, my emphasis in italics as well).

In this context it was during the two year tenure of the ill-fated finance minister Pierre Bérégovoy, that France's public debt was fully put on the market while cutting off the automatic channels forming the circuit between the Trésor and its institutional providers. It follows therefore that starting from a post-1945 situation where the Trésor was guaranteed a constant flows of funds, by 1986 the rules had been pushed to the other extreme setting in motion the full marketization of the debt. The new framework entailed a non-reversible technical cum institutional change which made France - and, a few years later via the EMU, the whole of Europe - solidly non-Keynesianable. From this perspective France went backward also relative to the Raymond Barre period.

The fake Keynesian orientation of the Socialist-Communist government was rapidly shed as soon as difficulties began to emerge. If Mitterrand were serious about his campaign's pledge to combat unemployment, he would have addressed the financial instability by a combination of sharp devaluations of the overvalued currency and also by tightening capital controls given that banks were not owned privately and were meant to be a pillar of the promised policies on which the coalition between the Socialists and the Communists rested. In the 1980s under the stewardship of the Socialists, France became the epicenter of European austerity both in policy terms as well as in terms of institutional thinking. Throughout most of the decade the budgetary stance of the government was much tighter than that of Germany (Parguez 1998), but then, one might argue with some reason, the French macroeconomy, unlike the German one, did not have the leeway stemming from a persistent and rising external surplus. More ominous than the contingent aspect of the policies - ensuring however an official level of unemployment hovering around 10% from which the country has never freed itself - are the institutional implications of the steps undertaken in those years. The Socialists manufactured internally the framework which anticipated by several years the Maastricht-Dublin-EMU convergence criteria affecting, rather negatively, as we must now admit, most of Europe. In addition to the internal 3% deficit limit and to the breaking of the financial circuit which sustained the Trésor, the Socialist government of the first Mitterrand presidency developed the concept and practice of *competitive disinflation*, a truly dangerous idea and totally incoherent at that.

Competitive disinflation, was an obscure and purposely confusing term repeated ad nauseam by the French media during the 15 years preceding the birth of the Euro in 1999. It meant to descend to the German rate of inflation by ensuring that money wages would rise less than the domestic increase in prices; a fact which was bound to weaken both domestic demand and employment. As explained by Fitoussi (1995), in the intentions of the Socialist decision-makers even the medium term impact of the policy had to be negative in order to be successful. Monetary policy was entirely devoted to defending the nominal exchange rate with the Deutsche Mark (DM) and so was the Central Bank's interest rate on account of the stronger credibility that budgetary austerity was deemed to generate. There was no scope for employment policies. As a matter of fact the real policy entailed the creation of unemployment and underemployment since the competitive side of disinflation required firms to lay off workers in order to achieve productivity gains while demand conditions were sluggish. Only in a very distant, and unlikely, long run could employment rise again, as productivity gains by French firms were supposed to lead to a greater inroads into world markets. Fitoussi thought of the policy of *competitive disinflation* as a specifically French strategy, where more unemployment today is the condition for less tomorrow, thereby highlighting the complete incoherence of the Socialists' technocratic discourse (Fitoussi 1995). The competitive success never happened: the long run came and went with a worsening level of mass unemployment accompanied by a much deeper sedimentation of the social and territorial apartheid on which an extensive literature on social exclusion exists in France, starting with the classic work by Rosanvallon (1998).

Throughout the Mitterrand presidency and until 1999, the year of the launch of the European Monetary Union, France implemented its own austerian convergence plan. Moreover, with the signing of the Maastricht Treaty in 1992, major aspects of the criteria elaborated by the French Socialist governments of the time were effectively transferred to the institutions of the European Union (EU). The conceptually inconsistent idea of *competitive disinflation* was shared also by the right wing governments in a context in which the policies, coupled with the European dimension in which they operated, exacerbated the fluctuations of the French political business cycle. The Bérégovoy Socialist government was ousted in the legislative elections of 1986, leading President Mitterrand to appoint Jacques Chirac as Prime Minister. Yet the presidential elections of 1988 reconfirmed Mitterrand as president and he immediately disbanded the Assemblée Nationale calling for fresh parliamentary elections, which gave the Socialists a very slim plurality of votes and seats requiring a compromise with the opposition parties. The thorough defeat of the Socialists at the legislative elections of 1993 appeared to be a turning point since it was followed in 1995 by Jacques Chirac's election to the presidency against the Socialist candidate - ENA alumnus and former Trotskyist - Lionel Jospin. However, the conservatives' attempt to trim pensions and medical entitlements, and tighten working conditions, the latter mostly in the public transportation sector, led by the end of 1995 and early 1996 to a massive strike movement, the largest since 1968, which derailed government activity altogether. The government did however succeed in carrying out regressive reforms in regard to employment contracts in the private sector without substantial opposition (Amable 2017),

To retain political control and fearing another socially tumultuous third quarter in 1997, as France entered the final approach to the EMU, President Chirac called for fresh legislative elections in the Spring of that year. The results were the opposite of what the President expected. His conservative government lost to a second Socialist-Communist coalition called 'gauche plurielle' (the plural left, in which the Communist lent support to the Socialist government without participating in it) headed by Lionel Jospin.

The Socialists governed France in the crucial years leading up to the EMU, through the dotcom recession and the 9/11 events, until the catastrophic presidential election of 2002 that saw Jospin poll behind the Front National's candidate Jean Marie LePen. The government's performance and the whole idea of the 'gauche plurielle' led to the obliteration of the Communist Party largely in favor of the Front National. The virtually complete disappearance of what has been a major component of France's labor movement constituted the real first thrombosis of the French left and signaled its complete disassociation from working people. It presaged the disastrous 2012-17 experience under Hollande that led to the evaporation of the Socialist Party: Jospin had reneged on the pledge to revise the Dublin Growth and Stability Pact of December 1996, whereas Hollande failed to keep his promise to change the much harsher Fiscal Compact approved by 25 European countries on March 2 2012.

The 1986-1997 political cycle was entirely determined by the failure of austerity policies to reduce the officially reported level of unemployment which seldom dipped below 10% and normally stayed at between 11 to 12%. The cycle merged with both the creation of the European Union immediately after the signing of the Maastricht Treaty and the process of setting up the European Monetary Union that came into being in 1999. It is to this process that I will now turn.

3.2 France from the German unification to the EMU: 1990-1999

Looking at evolution of the European Union from the vantage point of France was quite a unique experience.[12] With hindsight one can almost say that that throughout the 1990s France *was* Europe. Germany absorbed the GDR and in so doing it sent shock waves economically, via the Bundesbank's increase in the interest rate which led to the crisis of the EMS regime. However the European theatrical act was being played out in full in France through the interaction between France's domestic political and economic issues and the European processes, that of the Maastricht Treaty and of the creation of the EMU.

During the 1990s France was crisscrossed by currents and tensions arising from the combined effects of the persistence of high unemployment, expanding social exclusion, and the new dimension of *l'Allemagne* (Germany) following the latter's absorption of the GDR in 1990. In this context the importance given to the Maastricht Treaty was seen essentially as a geopolitical instrument to anchor to France, with Europe's support, the reshaped Federal Republic of Germany. The Mitterrandian rhetoric spoke of la *construction européenne*, another confusing term since it dodged the question of an institutionally unified identity. The signing of the Treaty on the 27th of February 1992 was deemed a necessary but not sufficient condition to hooking Germany. The next step was to move to the formation of a European monetary union, which would prove much more difficult to attain. It was in the end achieved by putting a very reluctant Germany under heavy pressure. But more on this later. For now, it is worth revisiting the sketch made in 1997 in *The New York Review of Books* by Josef Joffe - then the foreign affairs editor of Munich's *Süddeutsche Zeitung* and later editor of the German weekly *Die Zeit* - in a well-known article that is very accurate and stands the test of time. Here is a brief summary of that all-important piece (Joffe 1997) based on an imaginary conversation between President Mitterrand and Chancellor Helmut Kohl:

> "European Monetary Union—The Movie" would have to begin with the following scene. The place is the library of the Elysée Palace, the time is about March 1990. Only three people are present: François Mitterrand, the French president; Helmut Kohl, the chancellor of soon-to-be

[12] From 1987 till the 2009 I regularly served on the faculty of the University of Grenoble and on some occasions on that of the University of Nice and of Picardie at Amiens. I was also attached to the ISMEA in Paris where Alain Parguez conducted his seminars and workshops on macroeconomics. Most of these were published in the *Monnaie et production* series of the multi-series ISMEA journal *Economies et Sociétés*. The now defunct ISMEA was an institute of mathematical and applied economics founded by François Perroux (1903-1987) after World War II. For more than fifty years it functioned as a major center of research and debate, publishing two journals, its main organ *Economie Appliquée,* and *Economies et Sociétés,* both defunct. The second journal had an innovative format since it published many parallel series each on a specific theme. Alain Parguez was the founder and editor of the series *Monnaie et production* which ran for 10 issues from 1983 to 1996. There he developed the notion of the socially constructed scarcity of money, that he termed la rareté désirée, the desired scarcity of money. It turned out to be a crucial notion in order to understand the roots of the attachment to sound finance across France's political spectrum and academic institutions (see also Parguez 2016). Of all the *Economies et Sociétés* series *Monnaie et Production* was the most important as it became a world foyer for non neoclassical monetary theory and analysis.

> reunited Germany; finally, since neither speaks the language of the other, a faceless interpreter sworn to silence.
>
> Mitterrand is in a melancholy mood. During the last few months, ever since the collapse of the Berlin Wall in November 1989, he has tried every conceivable diplomatic stratagem to stop, or at least brake, the quickening pace of German reunification. But to no avail.

In Joffe's tale Kohl tries to soothe Mitterrand who keeps silent, but then he bursts out:

> "*Bon, Helmut, c'est ce qu'on va faire*. You get all of Deutschland, if I get half of the Deutschemark."

The point of this imaginary scene is that the euro, Europe's soon-to-be common money, is a political currency. It was born out of the abrupt transformation of world politics: Moscow's capitulation in the cold war, which suddenly revealed the true power relationships on the Continent. In a few months, Germany would be "whole and free" again, as George Bush had put it. Once united, the country would also shed the ancient dependencies that had tied two thirds of it, the Federal Republic, to France.

Joffe was right then and he would be right today: the whole point of the creation of the EMU is the acquisition by France of Germany's monetary power. The rationalizations came through as a sort of learning by talking therapy providing the ideology for the EMU project. The article went on to show that the road to convergence in order to qualify for entry in the EMU were, even for virtuous countries, of an austerian nature. He also pointed out that under the Maastricht criteria policy convergence would be difficult to maintain since when confronted by an external shock policy responses would have to be different; and if countries tried to stick to the same template the system would freeze. The clinching point lies in Joffe's observation that:

> […]Europe, by plunging into monetary union, is putting last things first. It is erecting a vast structure without having prepared the indispensable foundation, a common state.[13]

Those were Joffe's words in 1997, two years before the launching of the EMU. Let us now fast forward 13 years to 2010, when the 'Greek crisis' was being taken up by the EU, the ECB and the IMF. Early that year the *Financial Times* opened its pages to a discussion of whether Greece should be bailed out along with related themes such as the creation of a European Financial Stability Facility which came into being in June 2010. The most significant contribution came from Otmar Issing, the Bundesbank's representative on the committee that formed the European Central Bank and member of its first executive board. In his words:

> It seems that quite a number of observers have forgotten what EMU is, and what it is not. The monetary union is based on two pillars. One is the stability of the euro, guaranteed by

[13] All quotes are from Josef Joffe, "The Euro: The Engine That Couldn't", *The New York Review of Books*, December 4, 1997 issue, downloaded.

> an independent central bank with a clear mandate to maintain price stability. The other is fiscal solidity, which has to be delivered by individual member states. Member countries are still sovereign. EMU does not represent a state; it is an institutional arrangement unique in history. In the 1990s, many economists – I was among them – warned that starting monetary union without having established a political union was putting the cart before the horse.[14]

The above structural fault has clearly not been remedied because it is the product of a path determined dynamics initiated by France in the 1980s which, in the wake of the end of the GDR in 1990, saw in socializing the Deutsche Mark the means to condition a supposedly expansionist Germany. Joffe did not call into question the validity of the economic logic that pushed Mitterrand - and Chirac shortly afterwards - to want to own part of the Deutsche Mark. There is simply no logic for France's macroeconomy to desire to have a Deutsche Mark like currency. Yet politically, from President Chirac to the Socialist Jospin, the end of the century events acted as a further stimulus to persevere in launching a doubtful economic construction.

At the end of the 1980s the Socialist government became absorbed by the defense of the parity with the German currency particularly when as a result of the increase in the interest rate by the Bundesbank - as an anti-inflationary move in the wake of the German unification - the currencies in the EMS (the Italian Lira, the Spanish Peseta, the Portuguese Escudo and the British Pound Sterling) came under speculative pressure and were compelled to abandon the EMS for a number of years. The EMS countries whose currencies came under pressure were all significantly in the red in their external accounts. The crisis was brought about also by the fact that in 1987 the currencies of the EMS reached virtually fixed parities. This exacerbated the current account situation in the weaker and more inflation prone countries and put pressure, as in the case of Italy, on interest rates as instruments to attract capital in order to finance the external deficit at those parities (Graziani 1991).

When the Bundesbank raised interest rates it became clear that those countries would not be in a position to sustain the additional burden. From the point of view of the current account France should have been among the weaker countries, yet because of the 'grand design' underlying *le couple franco-allemand,* the French Franc stayed roughly put and in 1993 even revalued a bit vis à vis the Deutsche Mark.

For France the consequence of all that was that the country was 'en panne,' in other words, it had stalled.[15] In terms of unemployment, above 10%, and of the social fracture, the situation was worsening and kept doing so throughout the decade. In this 'en panne' situation there emerged a panoply of political forces - from the Trotskyists, to the Communists, to the far-right National Front, but also cutting through the main conservative alliance - opposing the Maastricht Treaty. In a national referendum held on the 20th of September of 1992 the yes to the Maastricht Treaty vote obtained 51%. It was deemed to be a rather

14 Otmar Issing, "Europe cannot afford to rescue Greece", *The Financial Times*, February 15, 2010.

15 Two very different books actually managed to capture the depth of France's social crisis as well as highlighting some of its root causes. One is by what I would define as a center-right economist, Alain Cotta, *La France en panne*, Paris: Plon, 1991. The second book is by Jean Paul Fitoussi, *Le débat interdit,* Paris: Arléa, 1995. Precisely because the book has been authored by someone who always operated in highly placed institutional positions, it represents a crucial document to understand how mischievous was the strategy of competitive disinflation. It is not by chance that the title of the book translates into English as *The Forbidden Debate*.

thin endorsement. The referendum campaign was important because it focused attention on the juridical flaws of the Treaty and connected them to their implications for France in relation to its economic and social ills. The weighty critique did not come from any quarter of the 'left' but from an important figure of the section of the institutional right that rejected the Treaty. Philippe Séguin - a Gaullist and cabinet minister in the same conservative government of Jacques Chirac, which had to coexist with President Mitterrand from 1986 to 1988 - became in the public opinion the leader of the NO front. Séguin succeeded in unifying the argument about the democratic vacuum inherent in the Maastricht Treaty with the issue of the social fracture. He showed that the much-vaunted principle of subsidiarity - the view, coming from the Catholic legal tradition, that decisions are to be taken by the bodies nearest to the people most interested and affected - could not possibly make up for the formal institutional gaps in the Treaty. In very logical-legal terms, Séguin constantly hammered in the point that the Treaty was not empowering French institutions to address the country's problems. The principle subsidiarity, he maintained, could hardly be implemented as there was no mechanism designed to fill the gaps between the power shift to the EU bodies and the local powers needed to implement subsidiarity.[16]

The worsening social conditions brought about a conservative electoral victory in 1993 thereby compelling a new cohabitation between Mitterrand and the institutional right which lasted till the presidential elections of 1995. During the 1995 presidential race, Jacques Chirac exploited in a very populist manner Séguin's earlier themes about social exclusion. Lionel Jospin, the Socialists' candidate, still in the mindset of the disastrous competitive disinflation approach, countered Chirac's foxy populism with pathetic technocratic arguments. In a televised debate with his opponent, Jospin went so far as to caution against wage increases by citing possible negative substitution effects. He did it in so many unintelligible words just as unemployment was on the rise. Yet the decisive electoral victory of Jacques Chirac did not strengthen his government because it, too, was committed to austerity. The conservatives' attempt to implement it by tampering with sections of the public sector and the general public pension system led by the end of 1995 early 1996 to a massive strike wave that enfeebled the government. Thus in the Spring of 1997 President Chirac called for fresh elections that were won by the 'gauche plurielle,' the alliance between the Socialists and the Communists led by Lionel Jospin himself.

Earlier, in December 1996, the EU governments met in Dublin to sign the G*rowth and Stability Pact* which established the technical framework for the implementation of the Maastricht criteria. The pact itself was to become an integral part of a European Union more comprehensive Treaty, the approval of which was scheduled in Amsterdam in the summer of 1997. Jospin and the 'gauche plurielle' ran their election campaign with the promise to revise the Dublin pact and to stop further deindustrialization. They even vowed to support thousands of Renault workers outside France, in the Belgian city of Vilvoorde, with Jospin publicly marching with them in the front line. The Vilvoorde case was important in relation to the financialization process of the industrial sectors of the economy. In fact, the Renault management decided to shut down the plant which, though brand new as well as profitable, had been deemed to generate too low financial returns.

At this point the story of the temporary success of the Socialists - by the year 2000 a whole new strike movement against them was already in place in the public sector - intersected with, and was determined by, the actions of President Chirac vis à vis Germany regarding the high interest rate policy of the Bundesbank. For Germany the impact of the unification and of the increase in the interest rate by the Bundesbank that led to the crisis of the EMS entailed the hitherto unthinkable loss of external surpluses from 1992 to 2001. The EMS turmoil brought about a revaluation of the DM. As in the past, the Bundesbank gave priority to the anti-inflationary stance confident that, within a number of years, German firms would

[16] Today the failure of EU subsidiarity is an acknowledged fact.

implement a severe process of technological restructuring and gain in technological competitiveness. It had happened before.

In this context, the axiom of parity with the Deutsche Mark in a situation of very high unemployment increased France's exposure to foreign competition, especially from Italy, whose currency was depreciating in the wake of the latter's 1992 abandonment of the EMS. The need to keep the parity required that the Banque de France set the interest rate at a significantly higher level than that of its German counterpart. As related by the late Marcello de Cecco (1998), the situation was becoming intolerable for French companies. The theory was not working that well for Germany either, as shown by the difficulties encountered in reducing the current account deficit, the renewed balance of trade surplus notwithstanding.[17] Still from de Cecco, we learn that as soon as he was elected Jacques Chirac entrusted the shrewdest *éminence grise* of France's politics and business, namely former President Valéry Giscard d'Estaing, with the task of bringing down the Bundesbank's rates more rapidly than had been happening until then. The short-term German nominal rates had indeed been coming down since the 1992 peak of 8.5% but given the perceived weaknesses of France in terms of inflation, their decline was not strong enough to induce a fall in the French rates. A similar situation applied to the nominal long-term interest rate. The Giscard mission was also meant to exercise pressure aimed at accelerating the process towards the formation of the EMU that by the end of the first half of the 1990s appeared to be completely stuck because of a lack of German interest in it. Giscard d'Estaing managed to organize a consensus around a most ominous threat for Germany: Chancellor Helmut Kohl was told that if he did not force the Bundesbank to lower interest rates further, France would jettison the policy of keeping the parity with the Deutsche Mark. The ploy worked. It showed that Germany's position in Europe as a whole depended upon France above everything else, something that has been built into the European political economy from the years of the Marshall Plan and the EPU with crucial American input.

The reduction in interest rates caused by the change in the Bundesbank policy, the opening up of the road to the European Monetary Union, and the persistent weakness of Germany's external accounts, emboldened the Socialist government of Lionel Jospin. Jospin had gained office in 1997 when all these things were already at work. Barely a few months after its electoral victory, Jospin abandoned any pretense to renegotiate the Maastricht criteria by signing the Amsterdam Treaty which incorporated in full the Dublin stability pact. He stuck to budgetary austerity and pursued privatization programs bigger than all the previous conservative governments combined. Lastly to a delegation of the Vilvoorde Renault auto workers, with whom he earlier marched in solidarity, Jospin said that there was nothing he could do to reopen the plant. These details are not unimportant because they define the signposts of the path to disintegration of the Socialist government, whose leader, by losing to the National Front, would be excluded from the runoff in the presidential elections of 2002.

Germany's difficulties led the Socialists to believe that France had the upper hand in Europe and that, therefore, the issue of unemployment could be tackled as a technical problem by shortening working hours through the introduction of a 35 hour week while asking for greater flexibility from the unions.

[17]The German weakness lay in the service and investment income accounts - and in the permanent outflow of money repatriated by the former and the new immigrants - not in the trade account. The latter did experience a minor deficit in early 1990s but it quickly recovered. Yet its rate of expansion did not make up for the deficits in the other two components until 2002, that is three years after the launching of the Euro. Given that the 'fear of inflation' brought a reversal in fiscal and a tightening of monetary policies, the German strategies of restructuring and moving production to Eastern Europe, costly at first, led to the loss of the net investment income flows whose balance was positive and rising throughout the 1980s.

Having neutralized the official unions, the government concentrated on the flexibility side.[18] There were only some limited effects, if any. Unemployment remained higher than at the beginning of the decade but external macro data improved. Most of the improvements are to be ascribed to the easing of interest rates, to the combination of the Clinton growth and the high dollar - pushed up in order to save Japan and pressure American labor- and to the fact that Germany, by running for a while only a small trade surplus, reduced the drag that for decades its large net balances had on the rest of European effective demand. Indeed, from 1992 to the end of the decade France managed to display an overall trade and services external surplus. A rather rare period in France's postwar economic history, leading to a blind government's complacency, with its circle of commentators fantasizing about the French *Franc fort* becoming the pivot currency in Europe. On January 1, 1999 the Euro was launched. It would circulate until 2001 in the original currencies at the locked in exchange rates established in the second half of 1998.

4.1 Italy, the EMU, and the birth of a European periphery

If in the 1990s France was the hothouse from which would emerge the Europe of the single currency, Italy constituted the most significant case of a non-reconcilable asymmetry. This fact, in the light of Italy's status as the second industrial country in the EU, is in itself an indicator of the weight of the inconsistencies characterizing the architecture of European Monetary System. By the same token therefore, countries that have 'worse' features than Italy's, such as weaker industrial sectors and negative net export performances (Spain, Portugal, Greece), are farther removed from the center of the system. However if a country of the supposed core is found to be not so robust even compared to Italy, its position in the center would be mostly due to political factors. This is the case of France as shown in a magnificent book by a group of Italian economists which will be discussed further on (Celi, Ginzburg, Guarascio, Simonazzi 2018).

The 13 years of EMS rule engendered a rise in Italy's public sector's debt – a great deal of which was caused by interest payments since the primary balance moved into positive territory already at the beginning of the 1990s. The surplus in the primary balance was the EMU contradiction within Italy even before the formation of EMU. From 1991 to this very day the country has displayed one of the highest debt to GDP ratios in Europe as well as a persistent net primary balance. The latter, obtained by cutting public investment, was among the factors that prevented demand from growing at a rate which could have reduced the debt ratio to any significant extent. We know that the debt to GDP ratio has no analytical meaning (Pasinetti 1998), as indeed shown by the ill-fated research of Reinhart and Rogoff that failed spectacularly at establishing the threshold beyond which the debt/GDP ratio would begin to act negatively.

In the European framework the ratio has become relevant only as a politically selected reference on which to establish a power hierarchy between the countries acceding the Eurozone. In this context the systematically high debt to GDP ratio made Italy a weak country in its dealings with the European bodies before and after the formation of EMU. Of course, as Pasinetti pointed out, the debt burden can be lightened by lowering the interest rate. Yet the Bank of Italy lost that capacity when in 1994 it completed its 'divorce' by stopping altogether purchases from Treasury. With the signing of the Maastricht Treaty in February 1992 arose the issue of how to interpret and manage the debt along with the policies needed to embark

[18]The strikes of 1995-6 led also to the formation of independent trade unions not connected to the three big confederations known as the CGT, CFDT, FO. These new unions - SUD - operated mostly in the public sector. They opposed the Socialists' strategy of combining the 35 hours with greater flexibility and succeeded in eroding further the consensus for the Government. Yet they created no alternative to the strengthening of the National Front.

on the eventual road towards monetary union. This path was totally unknown because of the unfolding Franco-German tug of war that Josef Joffe would paint to perfection five years later.

By 1994 many informed commentators were giving up on the creation of a monetary union. After July 1992 this question merged with, and was in part superseded by, the preoccupation with how to deal with the crisis of the EMS and its possible prolonged effects on the Italian economy in years to come.

It must now be stressed that alongside the economic upheaval caused by the crisis of the EMS, Italy experienced a set of political mutations of major proportions caused by the end of the Cold War. Thus in 1992 and in the following years, the issues at stake were of an all-embracing nature pertaining both to the economic and the institutional spheres. No other country of the EEC/EU, or of Western Europe in general, faced such an array of vital challenges. Not even Germany. This is because the unification with the GDR was a decision by the FRG authorities, and so was the fight with the Bundesbank won by Chancellor Kohl to establish a sort of 1 to 1 parity between the two German currencies. Similarly, the decision to increase interest rates - thereby plunging the EMS into a crisis - was also taken by the Bundesbank in full control of its powers. In Italy, by contrast, all those things came as external shocks as it were. And given that - after the end of the Greek civil war in 1949 - Italy's political system reflected the Cold War alignments more than anywhere else in Western Europe, the shocks that were coming from the East and from the soon to be dissolved USSR, were bound to shake the country's political system to its foundations. Between 1991 and 1994, the Italian political and institutional landscape was in a process of a radical, if luckily not violent, change.

The last Parliament and Senate filled with the traditional parties that dominated Italian politics from 1948 had been elected in 1987 for a regular five year period.[19] In the legislature following the 1992 elections the Communist party was absent, having mutated a year earlier into The Democratic Party of the Left. The Christian Democrats still existed and so did the Socialists and the minor parties that always hung around the Christian Democrats. A standard center left government was formed with Giuliano Amato as Prime Minister. But the whole system was disintegrating, formally under the weight of the scandal that began by hitting the Socialist Party leader Bettino Craxi. The scandal broke when business people openly reported the practice of having to pay money to political parties for the approval of projects by the local authorities. Such a change in behavior could have happened only as the result of the end of the Cold War and of the Communist Party of Italy itself. As a consequence of the much-publicized legal investigations, by 1993 the Socialist Party all but disintegrated while the Christian Democrats too were fading rapidly.

---

[19] In the 1948 elections the Communist and the Socialist parties ran a joint ticket named *The Popular Front*. They obtained 30% of the votes while getting badly defeated by the 48% of the Christian Democrats. The real losers were the Socialists though, because in 1947 they had lost the reformist wing, which a year later ran separately as the Social Democratic Party of Italy and obtained 7% of the votes, taken entirely from the 20% that the Socialists got in the 1946 elections to the Constituent Assembly which drafted the Constitution. After the defeat, the electoral front between the Communists and the Socialists was terminated. The political alliance was kept in place, lasting till 1956 when the Communist Party supported the Soviet intervention very strongly. In the 1953 elections the two parties ran separately, increasing their joint share of the vote to 35%. From 1953 to 1991 the Italian chambers were populated by virtually the same three major political formations and their underlings such as the Liberals, the Social Democrats, and the Republicans. Occasionally and for strictly contingent reasons, marginal lists entered Parliament through the virtually perfectly proportional electoral mechanism ruling from 1946 to 1992. They vanished as easily as they appeared. In 1991, about 10 months before the end of the USSR, the Communists dissolved and mutated into the Democratic Party of the Left except for a faction that split and continued as the Party of Communist Refoundation which lasted in Parliament till the 2008 elections.

It is at this point that the figure of Silvio Berlusconi appeared on the political scene, becoming the reference point for the recycling of large segments of the previous political groupings.[20] His new Forza Italia movement made possible the jettisoning of the older parties without going through a catharsis. Furthermore, by allying his TV based movement with the National Alliance Party of neo-fascist origins, Berlusconi enabled its complete rehabilitation, making it for the first time since the country's liberation from Fascism into a legitimate partner of a constitutional government. He also brought in the newly formed separatist, as well as xenophobic towards Southern Italy and beyond, Northern League. The 1992 legislature did not survive the political maelstrom and fresh elections were called in the Spring of 1994 under a new electoral system.

Save for a minuscule leftover from the Socialist Party running with the old name PSI, which got 2% of the votes, not one of the old parties remained. The Berlusconi alliance, which included the Northern League, obtained a plurality of 42% of the votes. It was followed by the 34% share gathered by the 'The Coalition of the Progressives', set up by the Democratic Party of the Left. Among its partners were the tiny PSI, the Communist Refoundation Party, the Greens and a Catholic group stemming from the left-wing faction of the defunct Christian Democratic Party. In third position, with 15% of the votes, came a motley alliance of former Christian Democratic groupings.

Silvio Berlusconi became Prime Minister in early May 1994, but his government lasted only till the end of that year because of disagreements with the Northern League over the ongoing judicial investigations regarding kickbacks. Furthermore, the first Berlusconi budget entailed significant cuts to the financing of pensions which drew millions of protesters. Here too the Northern League had problems because most of the votes it obtained in the North were from the working class. The new Government that came into force in mid-January 1995 was headed by Lamberto Dini, a 'technical', that is not an MP, Treasury minister in the former Berlusconi administration and, more importantly, a longtime Director General of the Bank of Italy. With the support of the Democratic Party of the Left and of the Northern League, Dini formed a technical administration whose ministers were not members of Parliament.

Their main task was to push through the pension reform which they did successfully and, this time, with the approval of the main unions. Under the Dini stewardship Italy abandoned the defined benefits pension system and moved to a contributory one which later was to prove to be important in making the country acceptable for Eurozone membership. It is evident that the trade unions took a more sympathetic and conciliatory approach to the reform for political reasons since their preferred parties, the Democratic Party of the Left and the former leftwing of the Christian Democrats, supported the technical administration.

The second task of the Dini government was to take the country to early elections which, indeed, took place in the Spring of 1996. The outcome was a victory of a center left alliance called 'The Olive Tree' headed by Romano Prodi, a professor of industrial economics at the University of Bologna and an old and faithful Christian Democratic hand who in the early 1980s was entrusted with privatizing the state industrial holding IRI. The Olive Tree alliance was grouped around the Democratic Party of the Left with a coterie of minor and fleeting political formations. The Olive Tree governed the full constitutional length of the legislature till 2001 when it lost to Berlusconi again. Yet the Olive's ride in office was rough as it went through three prime ministers: Romano Prodi until the early Fall of 1998, Massimo D'Alema - the

[20] Berlusconi was not a new face in politics though. He was strictly connected to the now disgraced political leaders especially to the Socialist Bettino Craxi. An excellent analysis of the political economy of Berlusconi's businesses in the context of the Italian economy is found in Amyot (2004).

secretary of the Democratic Party of the Left which in that very year changed its name once more into the Democrats of the Left - and, from 2000 to the elections of 2001, Giuliano Amato.

In 1998 the political situation in Italy was particularly brittle. That was the year which would decide who was to qualify for entry into the European Monetary Union (EMU). Negotiations were afoot and all sort of shenanigans were happening such as Germany's inappropriate use of its stock of gold to lower the debt to GDP ratio. Indeed by the year the EMU was launched most member countries were way off the Maastricht criteria.

In the summer of 1998, the Prodi government encountered major turbulence caused by two currents. On one hand there was the Yugoslav question in Kosovo which entailed the mobilization of NATO forces leading to the military 'activation warning' of September 24. Italy's participation in the eventual NATO operation was paramount and its government had to be ready and therefore absolutely stable. It was most certainly not. On the other hand, the Communist Refoundation Party, which supported the government in Parliament, was demanding, as agreed in principle, that Prime Minister Prodi pass a 35 hour working week law identical to, that is, copied from, the Jospin law in France. The view by the 'Refoundationists' was that the high level of Italy's unemployment (11%) was due to technological factors. They did not consider the lack of investment demand as the major determinant of joblessness. Instead, they adhered to radical sociological theories whereby the demise of work and labor was a structural feature of the world capitalist system because of the ongoing electronic and computer revolution and of the end of 'Fordism.' Moreover the 'Refoundationists' were strongly opposed to the whole NATO strategy vis à vis Belgrade, though it is doubtful that they would have toppled the government on that score alone. Be that as it may, on October 7 1998, the Refoundation Party withdrew its numerically vital support to the government's budget law, thereby causing the resignation of Prime Minister Romano Prodi, who lost by just one vote.

With the Kosovo operation in an advanced state of planning, NATO's top military and political brass could not possibly accept a lengthy process of negotiations between the mushrooming number of parties in order to form a new government. They also did not want the former Communist Party of Italy - which was now called Left Democrats - to be in the opposition in such a delicate phase for NATO. The government crisis got solved very quickly through the crucial contribution of two last minute formations. These were the UDR - founded by Francesco Cossiga – a former President of the Republic, and past Christian Democratic heavy-weight with an experience in the CIA-NATO led 'stay behind' networks[21] - and the 'Italian Communists,' a faction that split from the Refoundation Party allegedly in order to prevent the Berlusconi rightist alliance from regaining power.[22]

[21]Consiga's links to Operation Gladio eventually became public and played a role in his later resignation as President of Italy. The Catholic UDR (Democratic Union for the Republic) was in itself a perfect index number of the Balkanization of Italian polity and politics that followed the end of the Cold War. It was founded in the Italian Parliament in June 1998 through the gathering of parliamentarians from at least 3 different groups, two of which were Catholic, with one hitherto allied to Berlusconi, and one composite group made by people from the defunct Social Democratic and Liberal parties. It had a maximum of 27 seats out of 630. A Gattopardo group par excellence, the UDR dissolved on the 24th of February 1999, exactly one month before the start NATO's aerial bombing of Belgrade and of the then Republic of Yugoslavia. Upon the dissolution of the UDR its parliamentarians dispersed into the rest of the parties forming the government coalition thus maintaining its stability.
[22]The Party of the Italian Communists is also an example of the political system spinning out of any self-control. It was headed by the most pro-Soviet and anti-NATO faction in the defunct Italian Communist Party. Yet in 1998 it stayed in government and in so doing it supported NATO's bombings although, during the campaign, its leader Armando Cossutta traveled to Belgrade in a show of solidarity in a display of supposedly leftwing gattopardism. That small party never got more than 2% and stayed in Parliament till the 2008 elections.

It was this new constellation that guaranteed the political stability of the new Italian government in the Kosovo war. Massimo D'Alema, the secretary of the Left Democrats and the purest distillation of the nomenklatura of the old Italian Communist Party, became the Prime Minister on October 21, 1998, thus leading the country also into the EMU which came into effect of January 1, 1999. The hurdles that Italy had to go through in the eight year period from 1992 to 2000 can be seen clearly now: (a) the disintegration, that began 1991, of the political system that ruled from 1946 to 1993 entailing the Balkanization of the political parties, (b) the crisis of the EMS in September 1992, (c) the Maastricht Treaty and the more challenging path to EMU while being far away from the required parameters, (d) the Kosovo war. In these circumstances the main institution that kept the country on course was the Bank of Italy both directly, as a policy making body, and indirectly through the key personnel it provided to the Government. In the second part of the 1992-1994 legislature the Prime Minister was Carlo Azeglio Ciampi, the Bank of Italy's governor from 1979 to 1993. Likewise, the former director general of the Bank, Lamberto Dini, was the 'technical' Treasury Minister in the first Berlusconi government and, after the latter's fall, also the 'technical' Prime Minister up to the elections of 1996 and the ensuing formation of the first Prodi government. In the latter case the Treasury's portfolio was held by Ciampi as an independent; a position he kept also in the D'Alema government until elected President of the Republic in mid May 1999. It is evident that the Bank of Italy supplied both the expertise and statesmanship that political parties could no longer provide.

Let us now see how the country's economy and policies evolved in those crucial 7 to 8 years whose impact has to be gauged not just in relation to Italy but also in relation to Italy's impact on European processes. At this point I might as well anticipate that the present research has changed important aspects of the views I held in the 1990s, when I was a regular contributor to the leftwing daily *Il manifesto*. The views that I, as well as other colleagues from the editorial collective, aired vis à vis the Maastricht-EMU issues were those of a mild and innocent Keynesianism. Today I still maintain that the economics of the Maastricht Treaty have been a totally faulty construction. Joseph Stiglitz has written the best study to date on this question and there is no reason to repeat his theses; they deserve careful study (Stiglitz 2016). However, what I no longer share of my past ideas is the voluntaristic view that during the road to the EMU Italy could have avoided taking a deflationary stance. I also no longer agree with my earlier position that, failing any attempt to mitigate the macroeconomic criteria, such as choosing to stabilize the debt/GDP ratio instead of making it converge to the arbitrary 60% level (Pasinetti 1998), the country could have stayed out of the EMU so as to implement its own *Keynesianism in one country* policies. The decision to go ahead with the EMU by France and Germany corresponded to Virgil's famous statement to Dante: "vuolsi così colà dove si puote ciò che si vuole e più non dimandare" (*for this is willed where all is possible that is willed there. And so demand no more*).[23] Once the green light for EMU was given by the two countries, Italy could not have stayed out and in fact none of the original euro-six countries, with Austria now thrown in, could have opted out. This is for political reasons. The economy was supposed to adjust to those reasons, not to determine them.[24]

---

[23] This is a quote from Dante's *Divine Comedy*, Inferno, Canto III, that every high school student in Italy knows by heart. Both the Italian original and the English translation are taken from the classical Penguin edition of the Inferno of the *Divine Comedy*.

[24] Some analysts have asked whether Italy could have taken a Swedish path, and thus avoided going through the harsh deflationary process which has never really ended. Indeed, Antonio Fazio (2017), the Governor of the Bank of Italy during the negotiations for joining the EMU, recently revealed that he had major misgivings about Italy's participation in the single currency. He likened the impact of the EMU on Italy's economy to the phenomenon of Bradyseism, where through prolonged tremors the ground sinks slowly in an unstoppable manner.

With the EMS crisis of September 1992 Italy left the system - to rejoin it in 1996 - and, as a consequence, the Lira devalued sharply. By 1995 it had fallen 45% against the Deutsche Mark and 41% against the US dollar (Graziani 2002). After mid-1993 the Lira was de facto pegged against the American currency which meant that the rest of the depreciation went against the Deutsche Mark and the currencies that stayed close to it, especially the French Franc. Historically devaluation has been good for Italy's exports and so it was this time too, but, as we shall see, with some differences relative to the earlier episode of the 1970s which prompted the creation of the EMS itself. The immediate fear of the Bank of Italy and of the Government, headed by Giuliano Amato, was a flare up of inflation and further rises in interest rates. The Italian government however had already set the country on a very strong deflationary path. Two months before the crisis the Amato cabinet passed, in an emergency session held in the night between the 9th and the 10th of July, a decree-law with immediate effect involving the largest budget consolidation since the end of World War II calculated at 100 thousand billion Lires ($110 billion dollars). Other steps in that direction were a minimum tax on the self-employed and the abolition of wage indexation to inflation (McCarthy 1997). The Amato government - the last of the old Christian Democratic and Socialist alliance based on the original electoral system of 1948 - put Italy's domestic demand under such a pressure that when it left the EMS on the 16th of September 1992, hence starting the sharp devaluation of the currency, exports rose rapidly in a short span of time without going through the J-curve effect. Inflation did not rise either.

As Amato was implementing drastic deflationary policies, the political system was disintegrating around him, leading to his resignation. In April 1993 Carlo Azeglio Ciampi, until then the Governor of the Bank of Italy, was asked by the President of the Republic, Oscar Luigi Scalfaro, to proceed to form a 'technical' administration which obtained parliamentary approval. Ciampi continued the Amato policies which in fact became the blueprint for the Dini, Prodi, and D'Alema governments, all of them characterized by additional doses of restrictive labor contracts and pension reforms, budgetary austerity and, especially in the Prodi-D'Alema instances, by widespread sales of public companies, now acknowledged to have been among the worst privatizations in Europe.

When Ciampi took office in April 1993 the Lira was still falling and, contrary to widespread fear, inflation was subsiding, while exports were rising fast. By 1996 Italy attained a balance of trade surplus as a share of GDP equal to 4.9%, visibly above West Germany's 1989 post war pre-EMU peak of 4.6%. However the difference between the context of the German peak and Italy's could not be starker, highlighting the divide between strong and weak export oriented dynamics. The divide would become a structural fault in the EMU years before, and particularly after, the financial crisis now encompassing a wider

---

Although a Swedish solution might have been technically possible, the crucial difference between the two countries lies in their institutional strength. Without Italy the EMU project would have floundered. The country's exports under a weak exchange rate represented a major challenge to France and Germany. If Italy had opted out, France and Germany would have mustered all their power to reverse the decision. At that time, the Italian constitutional system could hardly have withstood the pressure The Prodi and D'Alema governments were based on ultra pro-euro forces and the newly renamed former communist party then in the governing coalition and led by D'Alema would never have wanted to appear anti-European. Complete political mayhem would have ensued with very feeble institutions given the post-Soviet vicissitudes of the country's political system. Italy simply lacked the forces able to make its constitutional framework work.

number of countries, among them the economically sizeable Spain (Celi et al. 2018). The German position in the 1980s was the result of the oligopolistic strengthening of the German industries in Europe giving Bonn - the relocation of the capital to Berlin would occur only after the unification - overwhelming institutional leverage within the EEC. As already pointed out, Germany combined its own very low growth rate, among the lowest in the EEC during the 1980s, with the absence of competitive devaluations from its EMS partners. By contrast, the competitive disinflation strategy followed by the Parisian authorities was definitely a problem for France while being inconsequential for the Federal Republic.

Then on January 1st, 1986 Spain and Portugal became members of the EEC and in June 1989 Spain joined the ERM/EMS system. The hefty flow of structural funds that these newcomers received from Brussels provided another boost to German exports. Particularly significant are the conditions under which Spain came into the ERM/EMS. As explained by Bernard Connolly (2012) in an analytically lucid form, Spain's entrance into the system highlighted the so called ERM Paradox. The country's inflation rate and balance of payment position were not 'good' in relation to the criteria underlying the EMS. Yet the Peseta moved to the upper range of the special 6% fluctuation band devised for the high inflation currencies of Italy, Spain, and, later, of Portugal and Britain, more than double the width of the band for the core countries. The Peseta became therefore an 'overvalued currency' and as consequence, paraphrasing Connolly (p.82), the glee with which German and French industrialists welcomed the Spanish government decision to join is perfectly understandable: they knew that the ERM was the mechanism by which the weaker and poorer countries were to be kept at their inferior status while shielding the stronger ones from possible competition. Connolly has also pointed out that a few years later, as the EMS was unravelling and the Spanish authorities aimed at lowering the currency, both Germany and France accused Madrid of disloyal competitive devaluation.

By contrast, Italy's strong export performance after 1992 depended solely on the Lira's sharp nominal, and this time real, depreciation. There was no institutional system around Italy, unlike the EMS for Germany in the previous decade, to sustain the export drive which turned out to be large in magnitude but rather problematic in content and in terms of its macroeconomic impact.

Let us start by examining the qualitative content of that export growth. As repeatedly mentioned by authors like de Cecco (2012) and Graziani (2002), also in this phase the country's exports were concentrated in the traditional sectors where Italy always performed well. Counter-tendencies did exist, so that in those years and in the first decade of the 21st century a number of Italian pocket multinational companies emerged. In certain branches like machine tools Italy had been ranking among the first 4 exporters, not necessarily at the same level as a producer though. However these counter-tendencies did not reverse dependency on the traditional export sectors, thereby making Italy vulnerable to competition coming from China and other Asian countries. The export drive was not firming up the country's position in world's market in terms of technological sectors. It was not halting the decline in important industries such as automobiles, although some companies were doing well in niche advanced specialized productions.

But these kinds of industries cannot act as a pulling factor in a country the size of Italy, as correctly pointed out by Hyman Minsky mentioned earlier. The same reasoning applies to the industrial districts that boomed, mostly in the Northeast of Italy, throughout the 1980s as well during the dismal 1990s, without however being able to pull the whole country up. The decline of the large companies, calculated as those with more than 500 employees, whose number has been further reduced in the wake of the financial crisis of 2007, has made it virtually impossible for Italy to stay on the forefront of technological research and development.

The comparatively minute size of the average small Italian firm prevents any substantial R&D. In today's capitalist relations conquering oligopolistic positions is essential in order not to become a peripheral player. In a framework such as that of the EU where there is a constant - mostly subterranean - multifaceted tug of war between countries and among companies, where the latter demand the support of their 'own' states also in relation to issues related to a third party, internally generated large oligopolistic companies increase the institutional weight of the country overall. Note that this implies that no successful national research strategy, which Italy certainly did not have, could substitute.

For Italy the tendency was in the opposite direction. The surge in exports, particularly strong in the three years following the exit from the EMS, was not giving added political weight to the country's industries within Europe. Export growth began to subside with the exchange rate stabilization in view of the entry into the EMU. The criteria to qualify required a two-year exchange rate stabilization period, which in fact Italy attained by increasing, as of 1996, the value of the Lira vis à vis the Deutsche Mark. Marcello de Cecco (2012) in his analysis of the historical origins of the Italian crisis, correctly emphasized that during the export boom of the mid 1990s, Italian firms did not take strategic advantage of that particular situation to consolidate the expansion of exports. Instead, argued de Cecco, they chose to raise prices, losing ground as soon as the Deutsche Mark began to depreciate relative to the Lira.

Thus during the interregnum between the crisis of the EMS in 1992 and the 1998 lock in of Euro exchange rates, Italy, unlike Spain and Portugal, which did not come out of their external deficit, exhibited an export performance relative to GDP stronger than most of the large OECD countries and better than its own performance of the 1970s, not hampered this time by two oil shocks. However the economy benefitted only superficially. Investment did not rise, the decline of the large companies continued, while official unemployment remained at a rate above 11% as at the beginning of the decade. Throughout most the 1990s the country experienced in practice an early version of the expansionary austerity thesis of Harvard's Alberto Alesina that later became a dogma through the political influence of the Bocconi business school. The deflationary policies initiated by Amato and continued by the Bank of Italy's prime ministers that succeeded him, generated a large budgetary primary surplus which, in point of fact, became Italy's major connotation in Europe to this very day. However the debt to GDP ratio kept rising because the growth of national income, due to the very deflationary policies that produced the primary surplus, could not be strong enough to reduce the interest burden on the budget. Only towards the end of the decade did the debt ratio fell somewhat in consequence of the decline in interest rates. The situation, including part of the failure to capitalize on the export drive, is to be ascribed almost entirely to the need to converge to some set of euro-compatible values in order to qualify for participation in the single currency.

Many notable and highly placed economists were aware of the inanity regarding the constraints imposed by the requirements to form the single currency. Indeed in 1998 an Italian journal, the *Banca Nazionale del Lavoro Quarterly Review,* published "An Economists' Manifesto on Unemployment in the European Union" with the opening names of Franco Modigliani, Jean Paul Fitoussi, Beniamino Moro, Dennis Snower, Robert Solow, Alfred Steinherr, and Paolo Sylos Labini (Modigliani et al. 1998). The document featured the signatures of economists as diverse as Luigi Pasinetti, Giacomo Becattini, Rudiger Dornbusch, Alan Blinder, Paul Samuelson, and James Tobin, as well as Olivier Blanchard. There was also a significant number of Italian economists and a very large contingent of academics from Spanish universities and research bodies, whereas only one signature came from Germany and, except for Fitoussi's, none from other French institutions. The authors could not certainly be considered as being against the idea of a single currency but were clearly extremely critical of the institutional form that such a project was being given by the relevant European authorities.

Rereading the Manifesto one is reminded of Tibor Scitovsky's statement (1957) at the beginning of his book on Europe, where he observed that integration must be accompanied by the common objective of full employment. Scitovsky also made the point that such a goal should have priority over monetary policies. The Modigliani manifesto constituted a severe critique of the view that supply side policies should be separated from demand-oriented ones. It denied that inflation was by then the major threat to economic stability; instead it argued that unemployment represented by far the most serious social and policy issue in Europe. At the same time it rejected the view that that was caused, in the main, by the mismatching of skills and similar phenomena, instead putting the blame for the high rate of unemployment on the absence of demand oriented policies. On the whole the manifesto was extremely moderate, if not outright conservative, since it praised the UK government's liberalization regarding workers' dismissals. It also expressed appreciation for the additional restrictions the UK government had placed on the eligibility for unemployment benefits. Likewise, the document expressed a positive view on labor market reforms in Holland which, however, ended up shoving a very high percentage of the labor force into part-time occupations (Becker 2001).[25]

The manifesto's extreme moderation highlighted the contradictions inherent in the way in which the single currency was being planned. It stands to reason to believe that many of the officials of the Bank of Italy held views close to those of the signatories of the manifesto. The Bank's research department and general directorship had excellent economists who understood Keynesian principles very well; it also had in Elvio Dal Bosco a senior official who was the foremost economic expert on Germany and had a marked Kaleckian orientation. Antonio Fazio, the former Governor of the Bank of Italy, who led the Bank's team during the negotiations towards the single currency has made, in recent seminars, several significant comments regarding that period and its immediate aftermath, acknowledging the input of the Bank's research department (Fazio 2017). He pointed out that shortly after joining the single currency the main dynamic elements of the Italian economy started to slow down markedly, notably productivity growth, exports growth and investment. Fazio also related that since in the final round of the negotiations Italy was listed as non-compliant with the Maastricht criteria he declared a readiness to issue a communiqué announcing that Italy would not join the EMU, while pointing out to the other members that it would mean a disintegration of the whole project. At which point all the other participants in the meeting capitulated and let Italy in. However what Fazio had reported can be to a large extent ascribed to the theatrics that go with the negotiations. The German authorities definitely feared Italy's devaluations both in 1978 and in 1998. As with the EMS in 1978, twenty years later the EMU would have been meaningless without Italy; it could not have functioned as a monetary set up enabling Germany to reassert its net surplus dominance in Europe.

4.2 The new euro-area and pre-crisis era: general features

The creation of the European Monetary Union in 1999, institutionally terminated an important feature of economic relations within Europe, namely the recurrence of exchange rate devaluations either as a deliberate policy or as an untended consequence. Italy played a big role in this game both in the 1970s, as a deliberate policy caused by force majeure, and in the 1990s as a consequence of its inability to sustain the EMS exchange rate system upon the Bundesbank's increase in the interest rate. The lock in parities entailed also a significant revaluation vis à vis the Deutsche Mark of the currencies most negatively

[25] I do not believe that there is a symmetry between firing and hiring. If firing is made easier more pressure is put on the employees in the work process, which, in fact, can slow down or even reduce hiring.

affected by the crisis of the EMS, namely the Spanish Peseta, the Portuguese Escudo and, above all, the Italian Lira.

By contrast, after 1992, the currencies of Austria (Shilling), Holland (Guilder), Belgium (Belgian Franc) and of France (Franc), did not sway much from the German currency. Thus the monetary events of the early 1990s already showed the existence of a core and a periphery with France sitting in the former but at great pains; being part of it essentially because of Germany's determination to sustain France's membership of the core club. Indeed, with France ejected into the periphery, Europe as the overwhelming area of profitable demand (net exports) for German firms, would have become a far more problematical proposition.

Of the peripheral currencies the crucial one was the Lira because Italy, unlike Spain and Portugal, was not - as yet some might argue today - a peripheral country. The differences between Spain and Italy may help us put the issue of the new euro-regime into a more structural perspective. Although Spain experienced a remarkable industrialization after 1960, thanks to the technocratic pressure of the Opus Dei on the Franco regime that shook it from the regressive economic stance it held up to the mid of the 1950s, it very often experienced significant trade and current account deficits. When in the second half of the 1980s the Peseta and the Portuguese Escudo entered the EMS at particularly high exchange rates their external deficits ballooned. The sharp devaluation of the Peseta in the Fall of 1992 did not however represent a radical change since it only reduced size of the deficit. The Spanish economy grew quite strongly after 1995, also stimulated by a strong expansion in exports. However Spain's output has a large import content especially in relation to capital goods and other technological inputs, which was partly the cause of the weakness in the balance of trade and in the current account.

What holds for Spain is even truer for Portugal, where the EMS crisis and the fall of the Escudo brought virtually no relief at all to the external deficit as a proportion of GDP which stayed put at around 8%. We have seen already that the story for Italy was quite different. For our purposes we can draw the conclusion that devaluations helped Italy's achieve positive external balances although their impact on growth was uneven and, in the 1990s, less effective. Since Italy is the country that in terms of exports has benefitted from devaluations we can also conclude that such benefits were obtained at increasing costs in terms of technological transformations in the 1970s, as often stressed by Augusto Graziani, and with very little growth in the 1990s as remarked by Marcello de Cecco. This means that historical experience shows that devaluations are not a panacea and seldom bring about the adjustments desired by their advocates unless economic systems - on both sides of the exchange rate equation - behave exactly as required by the competitive static theoretical model. In the Italian case it is possible to say that devaluations have helped the external accounts because of the product composition of the country's exports, the demand for which tends to be price sensitive. The opposite happened with revaluation. For Portugal currency depreciation can be just as bad for the current account balance, while the Spanish case is somewhere in between but closer to Portugal's than to Italy's.

For Germany's industry and economy the picture is radically different. In relation to capital goods and intermediate products, where a solid industrial structure is required for their large-scale production, exports are not so sensitive even to significant exchange rate variations. Berlin's economy combines the oligopolistic international features of their large firms with industrial networks sustaining them. Once these networks were largely in Germany itself, branching into equivalent and/or complementary structures in Switzerland, Belgium, and Austria, extending even into the areas of the mechanical industry in Northern Italy. Today, as an outcome of a process that gathered momentum in the first decade of the millennium - in connection with preparations for EU accession by the Eastern European countries - those networks contain, as part of their value chain processes, the most important segments of the dynamic industrial sectors of Hungary, the Czech Republic, and Slovakia. In this way German industry with its extended European footprint has been capable of strengthening its position on the Old Continent, the competitive waves coming from Japan, South Korea and China notwithstanding. The capital goods and intermediate technology products emerging from the networks headed by Germany's large corporations are nested in a non-substitutable manner in the whole inter-industry dynamics of Europe, from Norway to Turkey, from Greece to Portugal. The main characteristic of the German production network is its capacity to generate technological renewal for the whole system also in the traditional metal, mechanical, and chemical industries (Storm and Nastepaad 2015). It is a productive apparatus working on an expanding scale, conceptually already depicted by Karl Marx in his production schemes in Volume 2 of *Das Kapital* but, unlike in Marx's times, based on strict oligopolistic hierarchies and on the operational awareness of the engineering and vertically integrated aspects of investment and of production. In such a context relying on exchange rate adjustments to guarantee export competitiveness is even less important than during the 1970s when Bonn's authorities pursued a policy of a controlled appreciation of the Deutsche Mark.

In fact, price is not necessarily the key element of competitiveness; it is relevant in relation to the mark-up strategies of firms which must take into account the direct, indirect, and hyper-indirect vertical chain of their network systems. In the case of Germany, it is worth mentioning that in the wake of the collapse and absorption of the GDR, the drastic fall of Germany's net merchandise exports happened in 1991 in great part as the result of the boom growth of the 1989 - 1990 years connected to events in the East. The revaluation of the DM occurred in 1992 in the wake of the impact on the EMS of the increase in interest rates enforced by the Bundesbank in order to stop the boom thereby ending the rise in domestic spending. Germany's net merchandise exports began to rise again in the very year of the revaluation and did so for the rest of decade. The difficulties of Germany's overall current account in 1990s did not arise from the revaluation of the DM per se, but rather from the adverse movements in non-factor services and in investment income. Eventually by 2002 the expansion of the net merchandise balance overcame the negative sums of the other items and Germany returned to its traditional overall external surplus, increasing it year after year. The systematic expansion of net exports until 2008 also brought back net investment income flows, representing the repatriation of parts of the profits and dividends resulting from the external investments undertaken by firms headquartered in Germany.

The formation of the single currency did widen the chasm between the periphery and the core of Europe though not via the dreaded Maastricht parameters and the Dublin Growth and Stability Pact of 1996 absorbed into the Amsterdam Treaty of 1997 and later into the problematical Nice Treaty of 2002. The widening of the gap occurred essentially through the 'asymmetric' external position of each country, with those in the core - that is Germany, Holland and Austria, with Switzerland participating in full and Sweden and Finland chipping in - siphoning off effective demand from the other countries. The reason why the weight of the 'parameters' came to naught until the Deauville 2010 beach walk of Angela Merkel and Sarkozy (Ferguson, INET 2016, Thomas Ferguson's video discussion with de Cecco and Pasinetti), was in large part due to the situation in the United States; in particular to the joint effect of the dotcom recession of 2000-01 and the 9/11 events. For reasons not completely clear to me, the year 2000 had been in most Western European countries a near boom year.[26] In France, Germany and Italy the spurt was due

[26] A reader of a draft of this paper suggested that the spurt was "due to the growth arising in the South and reacting in the North from the huge investments flowing to the south from the north, made possible by the Euro assurances about the equality of currencies?" It is quite possible that that growth, picking up from a rather disappointing decade, would have proved to be a limited flare up; we simply have no way of knowing. At any rate the US

neither to public nor to private consumption but to investment in fixed non-residential capital and to net exports. In 2001 and after, Germany and Italy were the most affected. The growth rate of the former tanked badly and did not make a noticeable recovery till 2006, barely two years before the game changer *anno domini* 2008. In Italy growth collapsed, then flattened out, picking up again in 2006 only to start heading towards a recession the year after. France, although losing steam significantly, was the only core country that did not do so badly in growth terms.

The plain fact is that, as of 2001, Germany and Italy were in, or gravitating towards, recessionary conditions, Belgium, Austria and Holland were on very low growth rates along with France, although the latter displayed somewhat higher values than the rest of the group. Germany was in the most critical position of all as it actually suffered zero growth in 2002 and an outright decline in GDP by a couple of decimal points in 2003. Frightened by the prospects of a severe recession in the teething period of the single currency, Paris and Berlin announced the suspension of provisions of the Maastricht Treaty regarding the budget deficit. Furthermore, the ECB began lowering the interest rates in earnest. This happened as Greece, a highly indebted country, yet just somewhat above the level of Belgium's debt and slightly below Italy's, was making its grand entrance into the Euro-system.

The ensuing episode of the unilateral suspension of the foundational criteria of the Euro-system is of utmost importance in order to grasp the hierarchical power relations and their working within the EU as a whole. The joint German and French unilateral decision of 2003 elicited some criticisms from smaller countries which were totally ignored. The ditching of Maastricht's rules became a fait accompli. Just as well, otherwise the Eurozone economies would have likely careened into a full recession; instead they floated around stagnation levels, picking up inconsequentially between 2005 and 2006. However that unilateral step highlighted the top-down features of EU's polity centered on Germany and France. In 2003 it did not suit either of them to follow the rules and they, consequently, broke them. In 2009 Berlin went even further by launching a massive fiscal expansion with a budget deficit equal to 5% of GDP, second only to China's. By contrast, in 2010 the Merkel - Sarkozy beach walk in Deauville produced the tightening of the rules known as the Fiscal Compact. The reasons for the reversal back to austerity, in an economic situation requiring the opposite, can be seen in the high exposure of the German and French banks to toxic structured derivatives. Indeed in the INET video conversation with Thomas Ferguson, Marcello de Cecco discussed the details of the crisis of the Landesbanken, the regional banks, and also, as remarked, by Ferguson, of the Commerzbank, prompting the German Chancellor to ask, in de Cecco's words, "everybody to chip in." In other words, every country was now required to contribute to save Germany from an eventual banking crisis at the expense of its own macroeconomic stability.

The abandonment of the Maastricht criteria by Germany and France in 2003 along with the ECB's lowering of interest rates did not do much to prevent Germany, Holland, and Italy from stagnating at very low growth rates, yet they most certainly fueled lending. If traditional balance of payment constraints - such as the amount of hard reserves held at the Central Bank - were still operational, governments would have had much greater difficulties serving as the main institutional and political conduits for interlinked private banks and financial institutions enabling them to so aggressively assault Spain, Portugal and Greece through structured lending schemes. But such constraints were already waning in the 1980s under the EMS regime. The 'divorce' between the Treasury and the Bank of Italy, as well as the breaking of the circuit linking le Trésor to the Banque de France, for instance, formally opened up the capital accounts to the financial markets. Borrowing was bound to become dependent upon the willingness to lend by any set of interconnected institutions across the globe. The combination of the suspension of the Maastricht

situation in 2001 halted the European dynamic, as much as the expansion during the Clinton years aided it in the delicate phase of the post EMS turmoil.

criteria and the lowering of interest rates did not just make aggressive intra-European lending possible, it also eliminated the perception of risk in the instruments of sovereign debt.

Although most of the lending was done through private institutions and clients - witness the low levels of public debt in Spain and Ireland before the crisis - there was one important instance in which the State acted directly as the main recipient and facilitator of the lending strategies of European financial capital, namely Greece. As explained by Christos Laskos and Euclid Tsakalotos (2013), the latter having been appointed Greece's Finance Minister after the resignation of Yanis Varoufakis in the Summer of 2015, there was no lack of willingness to partake in the financial transnationalization at the European level. The authors show very well how the PASOK led process of privatization in Greece followed a pattern parallel, both in terms of the years in which it has occurred as well as in the objectives, to that of the Socialist Prime Minister Lionel Jospin in France who, they point out, outdid all his conservative predecessors. However, they argue, Greece's private financial sector was too weak and underdeveloped not to have the State directly involved in the organization and backing of the lending operations from abroad.

During the interlude between the suspension of the Maastricht criteria and the outbreak of the financial crisis in 2007-2008, Spain, Greece, Ireland, and Finland, were the EU countries that grew most, continuing the trend they had at the launching of the single currency. For the first three, expansion was due to borrowing via the EU interrelated banks and financial institutions. This fact carried in its steps a rising current account deficit particularly for Spain, Greece and Ireland. Moreover no one seemed to be bothered by the countries with a particularly high debt to GDP ratio: Italy and Greece. Belgium which also had a high public debt ratio was a different kettle of fish for political reasons. It follows that lower ECB interest rates stimulated borrowing across the spectrum with no perception of the risk coming from the high debt countries because there was none. The dominant feature of the 2002-2007 pre-crisis period is that Germany (and the Netherlands) while hovering near stagnation, were piling up growing surpluses on the accounts of the trade deficits of Spain, Greece, Portugal and also France and Italy, which lost the surpluses of the post 1992 years.

France, which through the late 1990s experienced a rare spate of balance of trade and current account surpluses, re-entered its external deficit status in 2005. The Great Recession hit France in 2009, some ten years after the launching of the single currency. Those 10 years confirmed the economic position of the country recently christened as being in the grip of a permanent crisis from 1980 (Amable 2017). The reference is to the persistently high rate of unemployment due, in my opinion, to the systematic rejection of active demand policies as argued over the years by Alain Parguez. As the decades wore off and the country stepped into the current millennium, the price of the slow growth began to be felt via an accelerated deindustrialization. The excellent book by Celi, Ginzburg, Guarascio, and Simonazzi (2018) contains in the third chapter a precise analysis of France in the period concerned. The authors highlight the drastic fall in the ratio of manufacturing output to GDP throughout the first decade of the present millennium before the Great Recession, as against a relative stability and moderate decline in Germany. They show how France's deindustrialization and the loss of exports have been going hand in hand. The process proceeded apace with the financialization of French firms, measured in terms of their liabilities which are higher than in the German companies. Their conclusion is that France's position in the core is waning.

For Italy growth in the 1999-2007 period was dismal; just around an annual average of less than 1.5%, hampered by a very early loss, in the year 2000, of the current account surplus which kept worsening until the outbreak of the Great Recession. Italy's strength has always been in the trade balance. The latter's trade surplus began to dwindle almost immediately upon the introduction of the single currency, and then collapsed into negative territory in 2005. Despite the pitiful growth rate, the official rate of unemployment actually fell significantly both on account of bad demographics and in relation to the complete stall in the increase of labor productivity. According to the OECD Economic Outlook data (2010), labor productivity expanded over the nine years period 1999 - 2007 for a total of 0.6%, i.e. at an annual average well below 0.1%.[27] In practice, since there are firms and branches of industry where productivity is rising nonetheless, its fall was quite substantial in the vast majority of sectors. In this context, although it is true that historically Italy's exports have been sensitive to the exchange rate, the productivity crisis cannot be attributed to the single currency because it started already in the mid-1990s when exports were benefiting greatly from the devaluation of the Lira. The stall cannot be ascribed to labor militancy either since workers and unions had been rather passive for at least a decade. On top of this, in 1993 Italy's companies were handed a very generous gift by the main unions when they formally agreed with the Ciampi government to abolish the mechanism indexing wages to inflation. The abrupt and drastic deflationary policies implemented by the Bank of Italy's inspired administrations of the early 1990s - which aimed at keeping the economy on the straight and narrow to avoid, I should add, successfully, reigniting inflation as well as hoping, in vain, to halt the rise in the public debt - produced a long term catastrophic effect on technology enhancing investments. Yet this disastrous effect on productivity was made possible by the fact that Italy's industry, although large, had been, on the whole, in a weak state for a couple of decades relying on the cheapening of export prices via devaluations. Thus, after 2001 the Italian economy went into a declining mode. It staggered from one year to the next until struck by recession in 2008, being the first Eurozone country to enter the crisis.

It is evident that given the deep crisis in productive investment the strong revaluation of the Lira vis à vis the Deutsche Mark, in the approach to the exchange rates for the EMU in late 1998, did not help at all. Yet the structural causes of the decline were not connected to the launching of the EMU but rather to the long-standing crisis in the investment decision process. Compared to France, Italy did not deindustrialize at the same rate. The disease was of a different nature and displayed a different tempo. The bug of a stalling and falling productivity affected all sectors of the economy leaving very few escape routes for firms. In such a context there was no room to reabsorb even small increases in productions costs, let alone deterioration in the terms of trade. Well before the Great Recession the country was in a very vulnerable position vis à vis a possible downturn. When the latter arrived after 2008, the country became further bogged down thanks to the irresponsible austerity policies by the Monti government. Within few years Italy lost roughly a quarter of its industrial productive capacity which won't be recovered.

Let us now look at the other side of the European divide, at the countries with positive trade and current account balances. These tend to be grouped around Germany for reasons of economic geography, with Sweden acting as a Scandinavian industrial pole. For the 1999-2007 period Germany's growth rate too was very poor, not much above Italy's. However the overall yearly productivity growth was at least 15 times higher than Italy's which indicates how weak Italy was becoming relative to the main European partner. Germany's productivity was marginally higher than France's, but its growth rate was barely 70% of that of France. The post 1999 scenario is therefore that of a strong and dominant tendency towards stagnation if not worse. The suspension of the Maastricht criteria may have helped mitigate the tendency, but it did not turn the Eurozone ship around. Among the big countries Germany succeeded in keeping the costs of production under control and, indeed, even lowering them.

This fact is usually taken as a proof of the export competitiveness of the economy. However in an oligopolistic setting the ability to control the costs of production translates into stronger profit margins, not necessarily into lower prices. There are reasons to believe that such is the case for Germany and for the

[27] A detailed and theoretically robust study of Italy's quagmire has been provided by a crucial essay written Servaas Storm (2019) and published as the final draft of this paper was being readied.

advanced countries closely associated with the FRG, like Holland, Belgium, and Austria, to which we must add Switzerland, since it has many heavy industry and technology sectors which are fully integrated with those of Germany. For Eastern Europe the picture is different because of the still very large gap that separates their income per capita from the West. Countries like Slovakia, Slovenia, Hungary, the Czech Republic, and increasingly Poland, harbor many branches of industries which are part of Germany's productive systems and enter into them as suppliers in networks of vertically integrated value chains. In this context too their lower absolute costs of production does not necessarily translate into lower final prices.[28] Rather they help sustain the mark up on the final price coming out in the last phase of the production chain especially if (a), the chain ends in Germany, and or (b), the companies controlling the chain are multinational firms.[29]

We can now begin to evaluate what happened with the so-called surplus countries after the creation of the EMU. Well before the birth of the single currency, there were people who, starting from altogether non-conventional premises, understood the main tendencies brewing in the cauldrons of the EMS crisis and of the Maastricht Treaty. Andrew Tylecote from the University of Manchester presented in 1992 in London an excellent paper at the Post Keynesian research group of the ESRC (Tylecote 1995). In those days the arguments were still cast in terms of how to come out of an inflationary path in order to then move towards the Maastricht parameters. In this context Tylecote's paper, by going through a rather meticulous analysis of the technological features of the EU countries in terms of innovations, patents creation, etc., argued that the countries lacking a technologically adequate inner structure would be penalized in terms of real investment and productivity during the process of exiting inflation and converging towards the Maastricht parameters. Tylecote predicted that the Europe of the common currency would then be split between a periphery and a core, with Germany, the Netherlands, Belgium, and Austria squarely in the core. In the periphery he put the United Kingdom, Spain and Portugal. Interestingly and presciently, France was treated as drifting towards the periphery while Italy was described as having parts of its economy in the core. He turned out to be quite right although a bit too optimistic towards Italy since by the time his paper was published Italy was plunging into its productivity black hole.

Throughout most of the 1990s many respectable people believed that Germany had lost control over the balance of payments, which displayed negative values till 2001. The late Professor Gérard Destanne de Bernis, from the University of Grenoble and Director of ISMEA in Paris did not share that view. De Bernis, who had a deep knowledge of French and German industries, maintained that Germany's policies were oriented to the restructuring and modernizing of all of its industries, whereas France could focus only on a small number of them, mostly within the military industrial complex with less commercial viability. He argued that German companies and the authorities, often in alliance with the labor unions, were working systematically at regaining the export surplus position for the country's industries. Once the former GDR had been digested, he argued, Germany would resume the accumulation of external balances. Indeed, Germany's net merchandise balance began to recover after 1992, increasing year by year with the overall current account surplus being reconquered in 2002.

Holland is a close associate of Germany in the export surplus drive. During the 1990s the Netherlands, unlike its neighbor, did not suffer from negative current account balances. Moreover Holland, which is

---

[28] In Luigi Pasinetti's (1981) approach any reduction in the cost of production along the vertically integrated sectors translates into lower prices. This is because Pasinetti built an original natural system, which is a multi-sector modification of the Classical system of natural prices. The difference with the Classics consists in that the latter posited the formation of a uniform rate of profits, whereas in Pasinetti's natural system profit rates differ on the account of the non-uniform dynamics of technological change and of the per capita demand for each commodity.
[29] Milberg and Winkler (2013) have provided the best analysis to date of the economics of value chains.

the most industrialized service and logistic economy of Europe, displays also a strong net inflow of investment income. The Netherlands' unique strategic position in those vital sectors makes it benefit from the German trade dynamics. As of 2001 the country experienced a rise in the current account surplus in tandem with the leap forward performed by its big cousin. As a matter of fact, Holland leapt further then Germany, achieving in 2006 a pre-crisis maximal external surplus of +9.1% as a share of GDP, growing rapidly from the + 1.9% of the year 2000. The equivalent share for Germany was -1.8% in 2000 reaching a pre-crisis peak of +7.7% in 2007.

It is now possible to discuss Austria as the second component of the core German team in the Western part of the European Union. Austria has been specializing for a number of decades in sophisticated intermediate product technologies. In this process the Austrian economy benefits as a high-tech producer from direct links with German industry as well as from the transformation of the Czech Republic, Hungary, and Slovakia as areas of the industrial restructuring and relocation of German industries. In this framework the much smaller state of Slovenia functions as part of the Austrian and Italian industrial networks, having in turn significant ties to Germany with which it has a trade surplus. In the 1999-2007 period Austria's average growth was not bad, above France's 2.25%. In particular it picked up after 2003. Austria's current account balances were negative - at a moderate level though - throughout the 1990s, but after 2001 they boomed into positive territory. I do not think that the downward adjustment of the Schilling alongside the Deutsche Mark in joining the EMU was a major factor in the expansion of the net balances. In the Austrian case it is the connection with Germany and the economic restructuring in Eastern Europe that played the major roles. The last country within the EU's German inner core is Belgium. In the past it was alongside Holland the country with the closest structural relations with Germany. On the bilateral basis Belgium has not suffered from chronic deficits with Germany, often displaying a small positive balance due to the tight industrial interconnections between the two countries. These features have not gone away but Belgium's deindustrialization and financial transformation of the last thirty tears have reduced its relative weight among the countries most closely tied to Germany.

The upshot of all these considerations is that Europe shows the existence of several divergent paths and multiple stratifications among the various countries belonging to it. There is a core/periphery relation between the German area on one hand and Spain, Portugal, and Greece on the other. In these countries the accumulation of capital and the way in which it determines the respective macroeconomies takes place via external linkages based on financial borrowing. This generated a relatively high growth rate, especially in Spain and Greece, obviously accompanied by large external deficits, the main beneficiaries of which are Germany's business enterprises. These countries appear in the economy of the European Union chiefly as areas of profitable demand for the exporting countries, mainly, but not exclusively, for Germany. Then we have Italy which is not part of the periphery because it does not exhibit the same forms of dependency.

Until the mid-1990s Italy displayed the weak form of an export oriented economy as it succeeded particularly well under conditions of currency depreciation. Yet, from the late 1990s the country's economy entered into a very serious productivity crisis from which there seems to be no end in sight. Given that its exporting firms do show productivity increases and, furthermore, considering that in the Italian case additional exports are often obtained through price competitiveness, the productivity gains of the exporting firms are thereby likely to be leaked abroad by means of lower prices as theoretically explained in a general context by Luigi Pasinetti (1981). In this way the economy cannot retain internally the benefits arising from the export oriented industrial branches resulting in a growing chasm between domestic and foreign demand coming on top of the worsening divide between the Northern and Central regions and the South. Italy is the second industrial country in the Eurozone and were this situation to persist, it would represent an economic danger for the whole area and for Germany in particular.

Italy, too, is a place of net profitable demand for Germany but not as much as one may think. During the last 25 years the country's macroeconomic performance has been rather poor. The United Kingdom, for instance, has been generating a much bigger demand for Germany's products and a much larger net balance for Germany. Just the same, given Italy's rank as Germany's sixth largest export market, should the country whittle away economically, the flow of aggregate German exports would be hit rather severely unless the loss can be replaced by the sales to some extra-European destinations.

We can now turn to France and ask whether it is exiting its core status. Descriptively the definition given by Bruno Amable (2017) of France as a country in a permanent crisis since 1980 is acceptable, as is the analysis by Celi, Ginzburg, Guarascio, and Simonazzi (2018). Yet, France will not abandon its central status. The French elites and their politicians have known for decades that in terms of economic power the country is on the very edge of the core, otherwise President Mitterrand would not have used a political ploy to attempt to get hold of a chunk of the Deutsche Mark. The presence of France at the center of the European system is very important for Germany which means that France will leave the core only if marginalized by historical economic processes such as Germany's reorientation towards China and Russia. In the last section I will discuss this scenario which was briefly, but strikingly and perceptively, mentioned by the late Marcello de Cecco during the INET interview with Thomas Ferguson.

5. Germany in Europe and beyond

Since the early 1950s Europe has been the main space for German capital which, unlike that of the United States, is strongly export driven. Network systems and traditional foreign direct investment by German based companies are not meant to alter the export oriented characterization of the German economy. It cannot be otherwise: it is a built in and perhaps the most persistent feature of the tumultuous, political, military and geographical history of the country from its founding in 1871 after the battle of Sedan. In the first 13 years following the end of World War II, strictly supported by the United States and, in the in the initial seven years of peace, under a close guidance from Washington, the economy of West Germany was rebuilt, having from the start the objective of attaining an aggregate productive capacity capable of an all European outreach. In this process Germany had a number of partners, their role being dictated by their high level of development, by their own productive capacity, industrial composition and type of services. Because of geographical contiguity and historical links from Basel to Rotterdam through the Rhine, these countries could integrate very well with Germany's needs.

France, for economic more than political reasons, has not been among those partners, although in some industrial branches, like the aeronautical industry, linkages are strong. At the level of technological production France's industry is simply too different from that of Germany. The crucial divergence lies in the capital goods sector whose development in France has been problematical. In Italy some of the Northern industries in Milan, Turin, and Genova – back then the northeast was still economically rural - could integrate well with the German ones. However the country as a whole was too far behind; it needed to focus on its own development and could not therefore act as a member of a medley team. The supporting team was therefore made up of the Netherlands, Belgium, and Switzerland - the latter being a big accumulator of external surpluses even more than Holland - whose industrial and financial systems are strongly integrated with Germany's. At a later stage it included Austria as well.

The total population of these 4 countries combined has always been well below France's. At the same time their economic importance for West Germany is shown by the high share of German exports they absorb, always greater than the percentage accruing to France, which was the main destination of the Federal Republic's exports until overtaken by the USA in 2016. In the mid-1960s they absorbed nearly 30% of the total value of the FRG's merchandise exports, whereas France's share was about 13-15%. With the United Kingdom, Ireland and Denmark joining the EEC, the relative share of the group of 4 declined especially because the entry of the UK opened the floodgates of British imports from the Federal Republic. Their weight remained significant also throughout the 1980s, that is around 22%, when West Germany greatly expanded its exports to the United States. The group's share declined further with the rise of the trade with China from the 1990s to the present as well as with the momentum gained by the exchanges with Eastern Europe. By 2017 the four countries took 19% of the FRG exports which amounted to nearly 2 and half times the value accruing to the United States. Further evidence of the continuing importance of the group of four is given by the total of the combined exports to Austria and Switzerland, which exceeds the amount sold to the United States and a fortiori to France.

If we now apply Kalecki's theory that net exports constitute profits for the economy of the exporting countries (Kalecki 1971, ch. 2), the role of the group of four appears in the following manner. Taking the 1960s as the starting point of observation, Switzerland and Austria represented predominantly areas of profitable effective demand, of profit realization in Marxian terminology: Germany exported twice as much as it imported from them. With Belgium and Holland the trade export to import ratio was much lower; rarely above 1. It was 1 in the case of Belgium, and regularly less than 1 from the 1980s onward for Holland. This means that Germany's trade balance with the Netherlands had become negative, which it still is and will remain. Both Belgium and the Netherlands individually imported and exported to Germany much more than Austria and Switzerland did. The negative trade balance with Holland is not a bad economic datum. It rather means that Holland and also Belgium are fully integrated in the dynamics of capital accumulation of German companies through the product and sectoral composition of their exports to Germany. In the course of time, though, the positions of Switzerland and Austria have changed significantly relatively to that of Belgium; whereas Holland has much strengthened its role as a crucial center and crossroads for German production and globalization process.

Belgium has suffered from deindustrialization and its overall trade with Germany has slowed down relative to the other three members of the group. In this context the change in the ranking position took place after 2001 with exports to Austria passing above the level sent to Belgium. In 2017 they were 41% higher (Destatis 2018). Looking at Austria's own trade and current account dynamics we notice that throughout the 1980s and the 1990s there wasn't much to be excited about, since both were negative. As of 2002 Austria has been displaying a rising surplus, driven by the trade and services balance. The growth of the net balance has been relentless and it has resumed after the decline suffered during the 2009-2012 years. The Austrian net external position is in absolute and relative terms now greater than Belgium's. In my view the emergence of Austria as a surplus country is fundamentally connected to the process of restructuring and integration into the German led networks of the Eastern European countries, particularly of Slovenia, Hungary, Slovakia and the Czech Republic. Austria is to a large extent an advanced intermediate technology economy functioning as a high value-added hub in the network systems. It is part of the displacement towards the East of the basin within which Germany's world dynamics is being hatched out. The group of four countries is important to Germany both as a space of profitable demand and as a source of services, logistics, and advanced intermediate technologies.

Italy displays several aspects that make it a sub-section of the group mostly through the mechanical industry of the Northeast. Since the early years of the Common Market, Italy integrated rather well with

Germany's international trade system. It quickly established itself among the top trading partners and it seldom had large deficits with the FRG, instead even displaying net surpluses. After the inauguration of the Eurosystem Italy's net external surpluses dwindled and quickly turned negative, entailing a widening of the bilateral deficit with Germany. With the Great Recession, and the harsh austerity regime of Prime Minister Mario Monti in 2011-12, domestic demand collapsed to a point that imports slowed down and exports expanded, thus narrowing the gap in the trade with Germany. However the combination of economic crisis, stagnation, and productivity stagnation in which Italy finds itself tends to define its dynamic prospects as a foreign market. For instance, Germany's exports to Austria, a country of just 8.5 million people, have now reached a level which is a whisker below Italy's, whose population is 60 million, and they will probably soon overtake it. In Western Europe, the most profitable areas of realization for Germany's productions, measured in absolute terms by the net trade balances, are, in descending order, the United Kingdom where exports are three times larger than imports from the U.K., France, Spain, Austria, Sweden, Italy, and Switzerland.

For German companies Eastern Europe is the new dynamic zone, though not primarily as a net export market, except Poland, where Germany obtains a surplus close to that with Italy. Throughout the 1990s when the Eastern European countries were in the turmoil of the transition to capitalism they displayed both crisis conditions, often caused by failed shock therapies, and external deficits. In a 1992 paper given at the London Post Keynesian Research Group, I described what seemed to me a self-evident scenario:

> German industrialists, bankers and policy makers knew very well that the East is not a wasteland. In terms of technical capabilities, of the level of scientific and technical education of its population, Eastern Europe is far from being underdeveloped. It is its internal division of labour, the composition and specification of its output, which does not, as yet, suit the requirements of capitalist competition. The new situation in Eastern Europe made it possible to envisage, in the longer run, the creation of a German economic zone dependent on the FRG in relation to the transfer of technology and capital goods, but also capable of acting as a recipient of the restructuring process taking place in Germany itself (Halevi 1995, pp. 287-8).

Edged on by the preparations to join the European Union, the transformation of the Eastern countries outlined in the quotation above occurred in the first decade of the millennium with the direct involvement and planning of the major German companies and German institutions. At that time I was expecting that the nature of the dependency of Eastern Europe towards Germany would be similar to the links subordinating South Korea, Taiwan, Thailand and Singapore to Japan (Hatch and Yamamura 1996; Kriesler and Halevi 1996). I thought that Eastern Europe would inevitably develop a large trade deficit with Germany, the financing of which would require the East to run trade surpluses with the rest of Western Europe and, possibly, the United States. It did not happen that way because I did not take into account the creation of production networks and the related transformation of the FRG into a big user of these networks.

Nor did I consider a crucial difference between Eastern Europe and South Korea, Taiwan, and the other areas of Japanese economic influence in South East Asia. In East and South East Asia, during the initial stages of industrialization every single bit of capital good and technology had been imported from Japan, thereby securing afterwards a strong inflow of Japanese technological systems. Thus the countries concerned became locked into a permanent import dependency vis à vis Japan to this very day (Hatch and Yamamura 1996) which they addressed partly by means of net exports to the United States and partly, in the past though, by obtaining from Washington through various means substantial net transfers. Until China's emergence onto the trade scene, the East Asian political economy, which arose from both the Korean and the Vietnam wars, was characterized by a loop represented by net imports from Japan and net export to the United States with the latter actively sustaining the loop also at the institutional level despite the trade frictions.

Looking at Europe we see that the whole Eastern European trading system is centered on Germany, for imports as well as for exports. The rest of Europe appears as a residual. Between 25% to 33% of the exports of Czechia, Hungary, Poland, Slovakia, and Slovenia go to Germany. These countries, which also have a respectable growth rate, show a net trade surplus both in the aggregate and in the bilateral trade with Germany. The reasons for the difference in relation to the Japan-East Asia comparison consists in that the Eastern European countries already had an industrial base in the metal and mechanical industries which, although not in tune with the efficiency notions attached to capitalist production technologies, still shielded them from being overwhelmed by a flood of imports in the basic capital goods and mechanical sectors.

For the time being the critical role of Eastern Europe does not seem to be that of providing an export surplus area for Germany, although the area may generate net financial flows to Germany via dividends, rental payments, and repatriations of parts of profits by German companies. Countries like the Czech Republic, Slovakia, and Hungary appear rather as zones for the production of industrial inputs, as well as of big ticket items. Czechia and Slovakia are part of the German automobile and appliances industries. Hungary, which thanks to Germany has created an automotive industry that previously it did not have, is also a relocation area for production lines in appliances involving also Swedish multinationals.

In this framework Poland occupies a special place because of its size. The country is big enough not to be reducible to something like a set of company towns. After suffering from an early post-Soviet attack of shock therapy, the Eastern European mix of an experienced industrial working class, technical, educational and scientific personnel, later strengthened by EU structural funds, a crucial Keynesian spending factor, started to do its work in Poland as well. As a consequence, since 2013, following many years of trade deficits, Poland has been exhibiting an overall positive balance, although still quite negative in the bilateral relations with Germany. The leading role that Germany plays in fashioning the industrial structure of Eastern Europe, indirectly but also directly through its multinationals, determines the pace of the Eastern European countries' integration within the EU, as well as the tempo of their relations with China. Those countries are, relative to their size, big absorbers of China's exports but also high paced producers and transformers of industrial products through the web of production networks centered on Germany.

The further and more comprehensive expansion of economic ties between Europe and China - via Russia and Kazakhstan, requiring therefore the planned development of big logistical infrastructures as well as the rehabilitation of large swaths of neglected industrial areas in Russia - will occur mainly with Germany's investment and exports and with participation of the European areas functionally linked to the FRG. Although the United States and France are, respectively, the first and the second ranking export destinations for Germany (recall however that each of them imports from the Federal Republic less than the combined imports of Switzerland and Austria which total only 17.5 million people), the largest amount of the FRG overall trade is with China. Moreover Switzerland - a country tightly integrated with Germany and a producer of sophisticated products and technologies - is one of the few countries with a sizeable trade surplus with China. The German area in Europe possesses five countries among the top ten in the economic complexity index: Germany, Switzerland, Austria, Czechia, and Slovenia. Another two, Hungary and Slovakia, are not too far behind.[30] At this point the issue becomes what does Western

[30]The economic complexity index developed since 2009 by Harvard University and MIT lists countries in descending order starting from the density and layers of capital goods production and exports, which are put of the top of

Europe represent for Germany today as well as in the near future. A question to which Marcello de Cecco in the aforementioned INET conversation gave a precise and succinct answer using both arms, signifying a possible German drift away from Europe as its main economic focus - something that would have an impact also on the institutional set up of the European Union.

6. Conclusions in the vein of Marcello de Cecco

In a large single economic area the level of profits, the essential and most vital ingredient for the capitalist economy to function, depends upon gross accumulation, that is gross investment, and upon capitalists' consumption. This is nothing but Kalecki's 1933 seminal equation where profits, rather than national income, are at the center of the analysis. In this context oligopolistic relations determine the distribution of income between profits and wages. Once these are known and once the share of savings out of profit is also known, the level of income and employment will be fully determined (Kalecki 1971, ch.1; Harcourt 2006). In a small and/or medium size country profits can be buttressed by net exports and government deficits should domestic demand be insufficient to utilize existing plant and equipment at a normal level. In economies as large as the United States there isn't much room for net exports as a major source of profits. The same is true for Europe. Hence the level of profits in Europe should be essentially determined by the amount of investment and of government's net expenditure with exports being roughly cancelled out by the amount of imports.

In the last 75 years of Western European political and economic history there is nothing that points to any awareness of this question. Post 1945 Western Europe was reconstructed on the basis of export-led growth which quickly turned into viewing net exports as the principal objective of industrial strategies on a more or less permanent basis. This is true for Continental Europe, whereas Britain has-been systematically in deficit, thereby providing an important outlet for the exports of Germany, Holland, Italy, and, in a much reduced manner, of France as well. Indeed, in 2018 Germany's surplus with the United Kingdom ranked for the first time second after the Federal Republic's surplus with the United States, passing that with France.

For a number of decades after the end of the Second World War both Germany and Europe needed exports for development purposes. Obviously not everyone could achieve a net position but the attempts to expand on foreign markets led to Kaldorian dynamics: every country attempted to export more and in so doing they also imported more. The existence of institutions financed by the United States, such as EPU, enabled them, along with US transfers, to overcome the balance of payment constraints represented by the formation of German surpluses. In later phases, when US direct coverage was no longer available, the question of how to maintain net external positions by the surplus countries and by Germany in particular, became the dominant consideration in policy thinking and policy making.

This frame of mind never left European institutions and political leaders especially at the national level. European integration, economically and institutionally, proceeded throughout the last 50 years with the main participant and its closest associates viewing Europe itself as an economic space which could and should provide permanent net export outlets. Evidently this view in practice goes against integration. Wolfgang Munchau of the *Financial Times* has aptly stated that:

---

the ranking. The index is a vindication of Adolph Lowe's focus on the structure of the capital goods industry as the main guiding criterion for the analysis of dynamic processes. Reference needed

> German economic strategy is unbelievably toxic: double down on fiscal surpluses and export-led growth, frustrate EZ reforms, undermine competition policy (Munchau 2/20/2019).

That statement sums up the situation rather well because it ties together Germany's (net) export driven economic policy with its oligopolistic structure. The FRG because of its size and maximal degree of economic complexity is the only country in Europe that can force its strategy onto the Eurozone. The capacity to compete on a non-price basis because of the ingenuity of its engineers, made possible by its technological complexity, explains the unique position of Germany in the Eurozone framework (Storm and Naastepad 2015). In the Eurozone the Great Recession was caused neither by balance of payments nor by sovereign debt issues (Bellofiore, Garibaldo, Mortagua 2019; Storm and Naastepad 2016). The causes were linked to the cascading effects of the financial crisis that was occurring in the Unites States. Spain, for instance, was hit not so much on the output side but on the combined exposure to international finance of the domestic real estate and banking sectors. For Italy and Germany the cascading effects manifested themselves through the blow suffered by exports but, in the case of Germany and of France, also because of the policies followed by banks and financial institutions which blindly accumulated toxic assets on their books. In all this the public debt played absolutely no role, nor were the external deficits of Spain or of Portugal, or of Greece for that matter, the triggering factor for the European side of the crisis. However, the Eurozone plunged into the recession already weakened by a growing economic and structural division connected to a significant extent to the external accounts situation. Within two years of the crisis the splitting up of Europe started in earnest again with Germany and its area ready to benefit from the expansionary policies of the United States and, especially, from those of China. At the same time Germany, through its fiscal roughness towards the Eurozone is a major culprit in the perpetuation of the European stagnation or, at any rate, of its very limited dynamics entailing a deepening divide between the core and the newly formed periphery. This means that the rest of Europe, for the time being with the exception of Britain, where consumers' debt seems to be pulling the economy along, does not offer great vistas to Germany's and related areas' exports. It is here that de Cecco's observations become relevant. During the INET conversation he pointed out that Berlin's interest in Europe is contingent upon the share of its exports absorbed by Europe itself. The real appetites lie elsewhere, notably China. Germany, de Cecco argued, is itching to create alternatives. Should the share of German exports shipped outside Europe rise significantly above 50%, then, gestured de Cecco, "*adieu* Europe".

References

Amable, Bruno (2017) *Structural Crisis and Institutional Change in ModernCapitalism: French Capitalism in Transition,* Oxford: Oxford University Press.

Amyot, Grant (2004) *Business, the State and Economic Policy: The Case of Italy,* London: Routledge.

Becker, Uwe (2001) 'A 'Dutch Model': Employment Growth by Corporatist Consensus and Wage Restraint? A Critical Account of an Idyllic View', *New Political Economy*, 6:1, 19-43.

Bellofiore, Riccardo (2001) 'I lunghi anni Settanta. Crisi sociale e integrazione economica internazionale', in Luca Baldissarra (ed.), *Le radici della crisi. L'Italia tra gli anni Sessanta e gli anni Settanta,* Roma: Carocci, pp. 57-102.

Bellofiore, Riccardo; Garibaldo, Francesco; Mortagua, Mariana (2019) *Euro al capolinea?* Torino: Rosenberg & Sellier.

Celi, Giuseppe; Ginzburg, Andrea; Guarascio, Davide, Simonazzi, Annamaria (2018) Crisis the European Monetary Union: A Core-Periphery Perspective, London: Routledge.

Connolly, Bernard (2012) The Rotten Heart of Europe Reprint with a new introduction of the 1995 edition, London: Faber & Faber.

Cotta, Alain (1991) *La France en panne*, Paris: Plon.

Bliek, J.G.; Parguez, Alain (2008) 'Mitterrand's Turn to Conservative Economics: A Revisionist History', *Challenge* (March–April):97–108.

Dal Bosco, Elvio (1992) 'La Grande Germania fra Est e Ovest', *Rivista di Storia Economica,* **9**(3), 249-53.

de Cecco, Marcello (1998) 'Come uccidere la Germania assieme all'Euro' (How to kill Germany along with the Euro), *La Repubblica*, January 16.

de Cecco, Marcello (2000) *L'economia di Lucignolo: opportunità e vincoli dello sviluppo italiano,* Roma: Donzelli.

de Cecco, Marcello (2012) 'Una crisi lunga mezzo secolo: le cause profonde del declino italiano', *Economia Italiana,* 3: 69-92.

Destatis (2019) https://www.destatis.de/EN/Homepage.html

Fazio, Antonio (2017) Speech on the 26 of June, at the Library of the Italian Parliament at the launching of the book *Quale Europa? Crisi economica e partecipazione democratica,* edited by Vittorio Lucchese. See, in Italian: https://www.youtube.com/watch?v=iFLL2eFnmUY

Ferguson, Thomas (2016) Institute for New Economic Thinking, Video, Conversation with Marcello de Cecco and Luigi Pasinetti, https://www.youtube.com/watch?v=oPNFp66P8cE

Fitoussi, Jean Paul (1995) *Le débat interdit,* Paris: Arléa.

Fuà, Giorgio (1976) *Occupazione e capacità produttive: la realtà italiana*, Bologna: Il Mulino.

Giavazzi, Francesco; Pagano, Marco (1988) 'The advantage of tying one's hand: EMS' discipline and central bank credibility', *European Economic Review*, **32**(5): 1055-75.

Giersch, Herbert; Paqué, Karl-Heinz; Schmieding, Holger (1992) *The Fading Miracle,* Cambridge, U.K.: Cambridge University Press.

Godley, Wynne; Lavoie, Marc (2007) *Monetary Economics,* Basingstoke, U.K.: Palgrave-Macmillan.

Graziani, Augusto ed.(1989) *L'economia italiana dal 1945 ad oggi,* Bologna, Il Mulino.

Graziani, Augusto (1991) 'L'inflazione italiana degli anni ottanta', *Note Economiche,* **21**(3): 458-69.

Graziani, Augusto (2000) *Lo sviluppo dell'economia italiana. Dalla ricostruzione alla moneta europea,* Torino: Bollati Boringhieri.

Halevi, Joseph (1995) 'The EMS and the Bundesbank in Europe', in Arestis, Philip and Victoria Chick eds., *Finance, Development, and Structural Change,* pp. 233-62, Aldershot-Hants, U.K.: Edward Elgar.

Harcourt, G.C. (2006) The Structure of Post-Keynesian Economics, Cambridge, U.K.: Cambridge University Press.

Harvard (2019) *The Atlas of Economic Complexity* http://atlas.cid.harvard.edu/ (accessed 24/7/2019)

Hatch, Walter and Yamamura, Kozo (1996) *Asia in Japan's Embrace,* Cambridge, U.K., New York, N.Y.: Cambridge University Press.

Issing, Otmar (2010) 'Europe Cannot Afford to Rescue Greece', *Financial Times*, February 15.

Joffe, Josef (1997) "The Euro: The Engine That Couldn't", *The New York Review of Book,* December 4 1997 issue, https://www.nybooks.com/articles/1997/12/04/the-euro-the-engine-that-couldnt/ (accessed 29/7/2019).

Kalecki, Michal (1971) *Selected Essays on the Dynamics of the Capitalist Economy,* Cambridge, U.K.: Cambridge University Press.

Kriesler, Peter and Halevi, Joseph (1996) 'Asia, Japan and the Internationalization of Effective Demand', *Économies et Sociétés*, Série MP, No. 10: 303–322.

Laskos, Christos and Tsakalotos, Euclid (2013) *Crucible of Resistance: Greece, the Eurozone and the World Economic Crisis,* London: Pluto Press.

Lemoine, Benjamin (2016) *L'ordre de la dette*, Paris: la Découverte.

Lowe, Adolph (1976) *The Path of Economic Growth,* Cambridge, U.K., New York, N.Y.: Cambridge University Press.

Lucarelli, Bill (2011) 'German neomercantilism and the European sovereign debt crisis', *Journal of Post Keynesian Economics,* Volume 34, Issue 2, pp 205-24.

McCarthy, Patrick (1995) *The Crisis of the Italian State: From the Origins of the Cold War to the Fall of Berlusconi,* Basingstoke: Palgrave-Macmillan.

Milberg, William and Winkler Deborah (2013) *Outsourcing Economics: Global Value Chains in Capitalist Development,* Cambridge, U.K., New York, N.Y.: Cambridge University Press.

Munchau, Wolfgang (2019), https://twitter.com/EuroBriefing for Feb. 20, 2019; accessed July 30, 2010

OECD (1992) *Historical Statistics,* Paris: OECD.

OECD (2000) *Historical Statistics,* Paris: OECD.

OECD (2010) Economic Outlook, No.2, Paris: OECD.

OECD (2018) *Economic Outlook*, No.2, Paris: OECD.

Parguez, Alain (1998) 'The Roots of Austerity in France', in Joseph Halevi and Jean Marc Fontaine eds., *Restoring Demand in the World Economy*, pp.182-196. Cheltenham, UK.: Edward Elgar.

Parguez, Alain (2016) 'Economic Theories of Social Order and the Origins of the Euro', *International Journal of Political Economy,* 45: 2–16.

Pasinetti, Luigi (1981) *Structural Change and Economic Growth,* Cambridge: Cambridge University Press.

Pasinetti, Luigi (1998) 'The myth (or folly) of the 3% deficit/GDP Maastricht 'parameter'', *Cambridge Journal of Economics*, Volume 22, Issue 1, Pages 103–11.

Prodi, Romano (1990) 'The economic dimension of the new European balances', *Banca Nazionale del Lavoro Quarterly Review,* 173: 139-54.

Rosanvallon, Pierre (1998) *La nouvelle question sociale. Repenser l'E'tat providence,* Paris: Seuil.

Schneilin, Gérard; Schumacher, Horst (1992) *Economie de l'Allemagne depuis 1945*, Paris: Armand Colin.

Sklar, Martin J. (1988) *The Corporate Reconstruction of American Capitalism 1890-2016*, New York: Cambridge University Press.

Stiglitz, Joseph (2016) *The Euro. How A Common Currency Threatens the Future Of Europe*, New York, N.Y.: W. W. Norton & Company.

Storm, Servaas (2019), Lost in Deflation: Why Italy's Woes are a Warning to the Whole Eurozone, Institute for New Economic Thinking, Working Paper No. 94; https://www.ineteconomics.org/research/research-papers/lost-in-deflation

Storm, Servaas and Naastepad, C.W.M. (2015) C*risis and Recovery in the German Economy: The Real Lessons,* New York, N.Y.: Institute for New Economic Thinking, Working Paper No. 10; https://www.ineteconomics.org/research/research-papers/crisis-and-recovery-in-the-german-economy-the-real-lessons

Storm, Servaas and Naastepad, C.W.M. (2016) 'Myths, Mix-ups, and Mishandlings: Understanding the Eurozone Crisis', *International Journal of Political Economy,* 45:1, 46-71.

Sylos Labini, Paolo (1969) *Oligopoly and Technical Progress*, Cambridge, MA: Harvard University Press.

Tylecote, Andrew (1995) 'Divergent innovation and inflation as obstacles to European monetary integration', in Arestis, Philip and Victoria Chick eds., *Finance, Development, and Structural Change,* pp 180-206, Aldershot-Hants, U.K.: Edward Elgar.

Valli, Vittorio ed. (1981) *L'economia tedesca: la Germania federale verso l'egemonia economica in Europa*, Milano: Etas Libri