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# **Euro: growth pains or faulty construction?**

*di Giorgio La Malfa*



The monetary unification of Europe has nearly occurred, but its future is still very much in doubt. The Euro tremors are not simply a European issue or problem. The Euro is the second largest currency in the world and world monetary and political stability depends also on its stability. These are not national or regional problems in integrated financial markets. They are global problems, actual or potential.



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**31 ottobre 2000**

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■ *L'Istituto "Ugo La Malfa" è una associazione senza fini di lucro nata nel 1980, per iniziativa e ad opera di amici e collaboratori dello statista repubblicano, con lo scopo di "promuovere, coordinare e sviluppare ricerche, documenti, studi e convegni sulla politica, le istituzioni, l'economia e la storia repubblicana", curando in particolare l'archivio degli scritti di Ugo La Malfa e la documentazione della sua attività politica e di governo.*

*La rapida trasformazione politica ed istituzionale avvenuta negli ultimi anni ha portato l'Istituto a considerare necessario affiancare a questo compito storico e memorialistico, un'attività di chiarimento e approfondimento dei problemi politici, economici e sociali che condizionano lo sviluppo civile ed il progresso dell'Italia.*

*A questo scopo è stato adottato un nuovo Statuto che così integra i compiti dell'Istituto: «a) promuovere, coordinare e sviluppare ricerche, pubblicazioni e documenti, studi e convegni sulla politica, le istituzioni, l'economia dell'Italia repubblicana e sui problemi della politica internazionale, con particolare riferimento all'integrazione europea; b) stimolare il contributo delle correnti di pensiero democratico-liberale alla ricerca di soluzioni per il migliore funzionamento dello Stato e della società italiana».*

*I soci dell'Istituto sono diciotto fra soci fondatori e nuovi associati. È stato costituito, inoltre, un Comitato Accademico composto da tredici membri che ha il compito di programmare le iniziative intese alla realizzazione degli scopi sociali.*

*Oggi l'Italia ha di fronte a sé una serie di sfide di straordinaria importanza. La partecipazione alla costruzione dell'Europa impone scelte nuove e complesse che investono quasi tutti gli aspetti della vita istituzionale, sociale ed economica.*

*Si tratta di por mano al dissesto delle pubbliche finanze, di ridefinire i modelli di governo, di riconsiderare la presenza dello Stato nell'economia, di procedere alle privatizzazioni e alla riorganizzazione dello stato sociale, di cercare strade innovative per affrontare il persistente dualismo Nord-Sud.*

*L'urgenza delle decisioni da assumere coglie però il paese in un momento particolarmente delicato: un periodo di transizione in cui al precedente pluridecennale equilibrio politico non è ancora subentrata una nuova stabile fase della vita della Repubblica.*

*Dalla consapevolezza delle difficoltà sorge per tutti un dovere di formalizzare e porre a disposizione della comunità i propri punti di vista, le proprie diagnosi, le proprie proposte: ciò vale a maggior ragione per coloro che si riconoscono nella tradizione della cultura democratico-liberale la cui storia si intreccia e quasi si immedesima con la storia nazionale.*

*L'Istituto ha l'ambizione di dare il proprio contributo al dibattito in corso con interventi rigorosi e meditati. Si tratta di un obiettivo difficile ma che, con noi, parti importanti dell'opinione pubblica ritengono necessario.*



## Ricordo di Enrico Cuccia e Guglielmo Negri

*L'Istituto Ugo La Malfa deve annunciare due perdite molto dolorose avvenute negli ultimi mesi.*

*Il 23 giugno scorso è scomparso Enrico Cuccia, socio fondatore dell'Istituto.*

*Enrico Cuccia aveva seguito, con la sua usuale discrezione, le iniziative dell'Istituto fin dalla sua fondazione dopo la morte di Ugo La Malfa. Ma negli anni più recenti ne aveva preso particolarmente a cuore l'attività e ne aveva incoraggiato il rilancio ritenendo che la crisi del sistema politico italiano, seguita alle vicende interne ed internazionali dell'ultima parte del secolo, imponesse uno sforzo particolare di "chiarimento ed approfondimento dei problemi politici economici e sociali che condizionano lo sviluppo civile ed il progresso dell'Italia", come si legge nella presentazione di questa collana di studi che egli aveva personalmente annotato e rivisto. Egli riteneva che l'Istituto fosse portatore di una tradizione politica e culturale che, nell'interesse del paese, dovesse essere continuata e coltivata.*

*Alla sua morte il mondo della politica e della finanza così come gli organi di stampa ne hanno riconosciuto la personalità straordinaria, l'acume di giudizio nelle materie economiche, la vastità degli interessi culturali e la formidabile capacità di lavoro che hanno consentito di fare della Banca che, insieme con Raffaele Mattioli, egli aveva creato nel 1946 una delle istituzioni finanziarie più solide del nostro paese e più rispettate internazionalmente. Chi, come noi, ha avuto la fortuna di conoscerlo da vicino, ha avuto modo anche di apprezzarne le qualità umane fuori del comune, la disponibilità ad ascoltare, l'inesausta curiosità intellettuale e soprattutto la passione civile che lo aveva portato a collaborare alla lotta contro il fascismo e per il riscatto dell'Italia e ne animava l'impegno quotidiano.*

*La discrezione con la quale Enrico Cuccia ha condotto la sua vita fa sì che non sia nota nella sua pienezza l'opera da lui svolta per oltre mezzo secolo ed il ruolo che Mediobanca, sotto la sua guida, ha avuto nella trasformazione industriale dell'Italia. L'augurio è che questa attività possa essere meglio riconosciuta attraverso gli studi degli storici sul dopoguerra nel nostro Paese.*

*Il 18 ottobre è scomparso repentinamente Guglielmo Negri, socio dell'Istituto e membro del suo Consiglio di Amministrazione.*

*Guglielmo Negri è stato da molti punti di vista un uomo eminente. Lo è stato come studioso del diritto costituzionale: laureato in giurisprudenza e poi in scienze politiche tra il 1949 e il 1952, aveva perfezionato i suoi studi a Oxford e ad Harvard dove era entrato in contatto con il grande pensiero politico democratico di Hamilton, Jay e Madison, raccolto nei Federalist Papers cui era tornato più e più volte nella sua lunga e operosa carriera. Lo è stato nella sua intensa attività pubblica, come funzionario esemplare della Camera dei Deputati, come Consigliere di Stato, come direttore della Scuola Superiore della Pubblica Amministrazione che sotto la sua guida energica aveva raggiunto un alto grado di qualità. Lo è stato nel 1995-96 come Sottosegretario alla Presidenza del Consiglio nel Governo Dini con la responsabilità dei rapporti col Parlamento, funzione nella quale seppe conquistare la fiducia di tutte le parti politiche per la sua lealtà ed obiettività. Lo è stato infine come uomo di alti ideali politici a cui è rimasto fedele fin dalla prima milizia nella lotta antifascista a Roma nel Partito d'Azione e poi nel Partito repubblicano al quale non ha fatto mai mancare, specialmente nei momenti difficili che sempre si accompagnano all'azione di una forza di minoranza, il contributo della sua intelligenza e del suo equilibrio.*

*Guglielmo Negri aveva una visione non contingente dei problemi del nostro paese. Considerava che l'Italia avesse intrapreso nel Risorgimento il cammino per divenire un moderno paese democratico e che, chiusa la parentesi dolorosa della dittatura che pure aveva messo in evidenza la debolezza costituzionale del nostro organismo, dovesse realizzare quel traguardo necessario. Privo di faziosità, riteneva che questo risultato potesse essere raggiunto cogliendo il meglio di quanto le diverse parti politiche potevano dare e si sforzava di cogliere tutti i segnali di una possibile convergenza nell'interesse del paese, attenuando i contrasti e ricercando ciò che poteva unire rispetto a ciò che poteva dividere.*

*All'Istituto verrà a mancare il contributo prezioso delle sue idee e della sua opera.*



# Euro: growth pains or faulty construction?\*

**di Giorgio La Malfa**

*Only the Ship of Fools is  
making the voyage this year...  
(W.H. Auden)*

● The monetary unification of Europe has nearly occurred, but its future is still very much in doubt. The Euro tremors are not simply a European issue or problem. The Euro is the second largest currency in the world and world monetary and political stability depends also on its stability. This basic connection is what prompted the US Treasury to intervene in late September just a month before the Presidential elections in support of the Euro, risking to upset what was a comfortable US position. This same argument prompted the Bank of Japan to do the same. These are not national or regional problems in integrated financial markets. They are global problems, actual or potential.

● The history up to now is known. The European Council, meeting in Brussels in May 1998, noted that all the conditions set in the Maastricht Treaty for the passage to the third and final phase of the European Monetary Union were met. They also decided that 11 of the 13 eligible countries (UK and Denmark having

negotiated an opting-out clause) would be included in EMU. This meant that from January 1 1999 the exchange rates of the participating countries would be irrevocably fixed and that the newly instituted European Central Bank (ECB) would be responsible for the monetary policy of the area. In other words the Euro was born, even if the circulation of Euro notes will actually begin in 2002.

● The fact that the European Union was able to strictly follow the timetable set in the Treaty for the preparation of the EMU was a cause for great optimism as to the future of the Euro. Many experts foresaw an appreciation of the Euro above the initial parity with the dollar of 1.17. It was also noted that the sheer size of the Euro area – 290 million inhabitants and a GDP as high as 80% of US GDP – together with the strength of the Euro would rapidly challenge the “supremacy” of the dollar as a reserve currency. As a matter of fact, the illusion of a “splendid” Euro was indeed short lived. At the end of

October 2000 the Euro is standing at 0,84 to the dollar some 30% below its initial parity. After insisting that the downfall of the Euro would be rapidly reversed and then arguing that markets were misreading the fundamentals and so on, the ECB and its member banks have hastily agreed with the FED and other central banks for a joint intervention in the markets to prop up the Euro. One does not know if the signal sent to the markets was one of strength and resolve or one of weakness and fear.

● The weak Euro, after a period of benign neglect in Europe, has become a problem. Many among the experts blame the ECB for being too timid in its interest rate policy. Some have surmised that the bank may have refused to sufficiently increase interest rates for fear of damaging the economic recovery now taking place in Europe, thus violating article 105 of the Treaty which mandates the Bank to concentrate exclusively on price stability. Others dispute the technical quality of the Banks' decisions. Yet, below the surface of

\* Pubblichiamo il testo di una conferenza di Giorgio La Malfa tenuta al Royal Institute of International Affairs (Chatham House) di Londra il 12 ottobre scorso. Questo stesso testo, con alcune lievi modifiche, è stato presentato a Cambridge il 13 ottobre, al SAIS della Johns Hopkins University a Washington, il 24 ottobre, all'Istituto Italiano di Cultura a New York, il 25 ottobre e alla Yale University il 26 ottobre.



technical discussions, one fundamental question is slowly emerging: Europeans start to ask themselves whether EMU and the common currency were after all such a good idea. The Danes have answered the question in the negative from outside the Euro area. Many from within are pondering it.

■ The view I have consistently held and recently formulated in an essay (*L'Europa Legata: I Rischi dell'Euro*, Rizzoli, Milano, 2000) is that at the heart of the weakness of the Euro there is a political element which was overlooked and systematically side-stepped in the long preparations of the Maastricht Treaty and in its implementation. Even today, there is a tendency to concentrate on technical explanations of the failure of the Euro, when persuasive answers cannot be provided. The reason why people tend to shy away from considering this problem is because it is feared that to discuss it would end in an impasse. The key question I am referring to is the relationship between political and monetary union, i.e. whether and how a monetary union may be made workable in the absence of a political union from which a government, set at the same level of supranationality of the ECB, is empowered to deal with economic policy questions. It is obviously a very complicated question in present day Europe, where national Governments and perhaps public opinions do not seem ready to be confronted with the general issue of moving from national states to an European federation. The outcome of the Danish referendum and the motivation for the NO vote reinforce the view that the efforts to promote the Euro as a

purely technical device to deal with monetary matters in Europe are inane.

■ In the preparatory phase of the EMU - which basically took the last ten years - it was probably feared that to state openly that monetary union entails a political union would probably prevent all progress of the Euro. So, European leaders behaved, and still behave today, as if this problem didn't exist or if it did, it could be solved in due time. But it will not. The crucial question Europe has to face is that the weakness of the Euro stems from the markets' perception that the ECB is operating in a vacuum, which prevents it from carrying sufficient authority in what it does in the conduct of monetary policy. If I am right in this, Europe must deal with the issue of political union as an extremely urgent one in its agenda. It is an issue of credibility not in the traditional sense of monetary resolve but of political legitimacy of a key institution and of the backing that it enjoys. If this will prove impossible, then I cannot exclude that the Euro construction may fall apart, not because of asymmetrical external shocks, as many US economists have predicted, but because of a key inherent contradiction. For EMU to fall apart means European countries going back to their national currencies. To this, people tend to answer that a return to national currencies is unthinkable, for it would entail a fundamental disruption of the entire European construction. Unfortunately - this is my further answer - this is no guarantee that this will not happen. When people are dissatisfied, advance knowledge of the negative consequences of their actions is not suffi-

cient argument to make them accept their present plight. I plead therefore to discuss openly this question.

■ Before going forward in the argument, it is useful to briefly review how the question of monetary union was dealt with since the inception of European integration efforts in the fifties. In the initial phase, from the treaty which established the Steel and Coal Community in 1951, to the Common Market in 1958, to the sixties, it was considered as a given that monetary unification in Europe would only occur when the basic institutions of an European state - possibly in the form of a federal state - would be in place. At that point, a European central bank would be formed to manage the common currency. It has to be borne in mind that throughout this period the Bretton Woods system was fully working so that exchange rates among European currencies were essentially fixed. There were no shocks coming from exchange rates to economic integration in Europe.

■ The need to consider the case for European Monetary integration, independently of the progress towards political union, arose by necessity when the Bretton Woods system came to be unsettled. In particular, this came after the US decision to abandon fixed exchange rates in 1971-73. At that point, the question arose whether a flexible exchange rate regime among European countries would be compatible with the ongoing effort to create a single market where people, commodities and capitals could move freely. This is the same currency problem being faced in MERCOSUR after the floating of the



Brasilian currency. The wise negative answer to this question in Europe at that time led to the Franco-German initiative of President Valéry Giscard D'Estaing and Chancellor Helmut Schmidt of the European Monetary System. The EMS was launched in 1979, with alternating fortunes. Finally, however, the EMS proved to be an unsatisfactory arrangement because of its permeability to exchange rate speculation, which was made evident by the frequent need for exchange rate adjustments. This indicated a dilemma. It was argued that free capital movements, which were growing rapidly in those years, fixed exchange rates and independent monetary policies form an impossible trio. If capital movements are free, monetary policies independently decided are not necessarily compatible with stable exchange rates. If exchange rates have to be fixed and stable in time, then either capital movements have to be checked (as was the case in the early Bretton Woods period), or monetary policies are to be strictly coordinated.

■ If monetary policies are fully coordinated, then de facto it is like having one currency and one central bank. The existence of a central bank in which all partners would share the responsibility for monetary policies can only concretely emphasize the will to do so and make matters technically easier but it is not in substance different from strict monetary coordination among different national central banks. For this reason, progress towards the construction of a European Monetary Union was slow and lacked momentum. It was a technical option. The crucial impetus towards it did in fact come

from politics, international politics at the end of the 1980s. When the Berlin Wall fell in November 1989, and the prospect of German unification was suddenly made concrete, the desire to tightly bind Germany to the European fold led France and the other continental partners to demand that Germany give up its monetary sovereignty and its symbol, the Deutsche Mark, as a sign of goodwill and a guarantee in exchange for immediate and strong support by the rest of Europe for reunification.

■ Quite by chance, in June 1988 the Hanover European Council had set up a Committee to consider the problems of monetary union in Europe. The Committee, chaired by Jacques Delors, the Chairman of the European Commission, included as members the Central Bank governors of all EU countries. Its final Report, issued in 1989, detailed a three phase approach to monetary union including the establishment of a European Central Bank. The question of the relationship between monetary and political union did come up both within the Committee and in the discussions which followed its final Report. Mr. Delors managed to sidestep it, probably because he felt that the conditions for dealing explicitly with this issue were simply not there. And in fact they were not there, in my opinion as well. The sudden emergence of the German unification issue contributed to put political union on the back burner and monetary unification on the front burner. In December 1989, the European Council, meeting after the fall of the Berlin Wall, hastily gave the green light to the Delors Plan.

■ The governor of the Bank of England and the UK Chancellor of the Exchequer, preoccupied by the implications of monetary unification tried to make clear that in their view the question of the monetary union could not be dealt separately from that of political union. In a speech he gave at Chatham House on January 25 1989, Nigel Lawson had stated explicitly that "Economic and Monetary Union implies nothing less than a European government...and political Union: the United States of Europe. That – he concluded – is not on the agenda now, nor will it be for the foreseeable future." (N. Lawson, *The view from n. 11*, p.910) while Mrs. Thatcher explained that the UK government interpreted the Delors Report as a descriptive not as a prescriptive statement. However, the state of disarray in the personal relations between Mrs. Thatcher, Mr. Howe and Mr. Lawson – as recounted in their memories – greatly diminished the bargaining position of the UK government and prevented it from putting forcefully enough on the table the political issue beyond EMU.

■ This was indeed a very delicate issue. Mr. Delors was probably acutely aware that the chances to promote EMU depended on claiming that monetary union did not necessarily imply a political union and viceversa. It may be worth quoting what Tommaso Padoa Schioppa – now a member of the ECB Board – who was one of the two rapporteurs of the Delors Committee and a very close ally of Mr. Delors wrote to counter Mr. Lawson's argument. He argued that monetary policy only influences the price level and that the credibility of the Central Bank



depends on its being politically independent. Thus – he concluded – “present historical circumstances allow us to take the decision to form a monetary union without or before attributing to the Community wider political responsibilities” (T. Padoa Schioppa, *L'Europa verso l'unione monetaria*, Einaudi Torino 1992, p.206-207). There is an obvious ambiguity in the statement that a monetary union can be formed without or in anticipation of political union. On general grounds, one may infer that Mr. Delors did apply to EMU the neo-functional logic of Jean Monnet, i.e. that EMU could be successful even without a political union and that the creation of a EMU could in turn provide a stimulus towards political union. What is striking is that after the early discussion, when the UK government managed to negotiate an opting-out clause, no European government went back into considering the political conditions for success of the Euro. In the 10 years period needed to draft and sign the Maastricht Treaty and to go through the preparatory phases of EMU till the launch of the Euro, there has been very little discussion of the political conditions for success of the most daring step taken by Europe in the post-war period.

■ One of the reasons for this silence was the emphasis on the Maastricht criteria and their consequences. The debate on this issue has all but monopolised the discussions on EMU until 1998, i.e. until it was too late to consider the conditions for an effective EMU once launched. In other words, after discussing ad nauseam the questions of convergence criteria and

which countries would fulfil them, there was no time at all to consider the implications of the birth of the Euro. A very interesting recent book has revealed the extent of Central Banks perplexities until the very end of Phase 2 of monetary unification. According to the reconstruction of M. Marshall (*The Bank*, London 1999) in the occasion of a Basel meeting of BIS in February 1997, the European Central Bankers openly discussed the option of postponing EMU. The question was seriously considered, although in the end no initiative was taken on it. Probably the Banks – and in particular the Bundesbank – did not want to take upon themselves the responsibility of suggesting a delay of Phase 3 of the EMU. They probably hoped that political difficulties would suggest to governments a delay and a reconsideration of the project. In turn, some Governments probably relied on the central banks to do the “dirty” job of suggesting a postponement or the cancellation of the project. In the end the decision was taken to go ahead without figuring out exactly which were the political and institutional conditions of a successful change over from national currencies to the Euro.

■ It is to be noted – and I have argued this point in my essay – that in order to avoid a discussion of the political implications and preconditions for a successful EMU, the Delors Committee and in general the European Governments adopted a convenient ad hoc theorization of the role of money and of the principle of Central Bank independence. The cornerstones of EMU are 2 articles of the Treaty – 105 and 107. The former states that “The primary

object of the ESCB shall be to maintain price stability”. The latter proclaims that in the conduct of monetary policy the ECB cannot receive nor accept any indications from European governments and institutions. This set-up obviously begs the question of what determines the level of economic activity in the Euro area. The implicit answer in the Treaty is fiscal policy neutrality and market competition: national governments are constrained in their ability to conduct an independent budget policy and have to resort to liberalization and other supply side policies to produce full employment.

■ I am not going to discuss here in detail contrasting views on economic policy. Given my Cambridge education, I belong to a tradition which is disinclined to accept fully a neoclassical monetarist framework. I much prefer the pragmatism behind the formulation of FED tasks as spelled in the US 1978 Humphrey-Hawkins Act: “to maintain long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices and moderate long term interest rates”. I will simply note here that to embed in a Treaty a special economic theory constitutes an excessive constraint on monetary and economic policy matters, aside from being too binding a choice in general. Things change, theories evolve and we learn. I would like also to note that, although this attitude was favoured by the climate of opinion among economists prevailing in the period, still it is somewhat peculiar that



Delors, for his personal background, would share what one could call a radical monetarist view such the one embodied in the Maastricht Treaty and the strict corollary of a Central Bank whose credibility depends solely on "isolation" from the European body politic. This must have been to him a convenient way to push the project through circumventing the thorny issue of the relationships between political and monetary union.

■ If it was a shortcut, without blaming Delors entirely or even too much for it, it was not taken without negative consequences: the weakness of the Euro, the evident uncertainties of a central bank formally insulated from European politics (yet incapable of ignoring it), the lack of a long-term confidence in the European economy (otherwise we could not explain the massive long-term capital outflows towards the US, which are credited for the downward trend in the market value of the Euro) are not marginal or inconsequential negative legacies. Avoiding the central issue of whether it is possible, and under what circumstances a monetary union can precede a political union of acceptable sort, did not avoid the consequences of the choice made, nor did it postpone them by much.

■ The weakness of the present construction has been made evident by the precipitous fall of the Euro on exchange markets and even more so by the oil market developments. There is no doubt that the increase in oil prices, compounded by the fall of the Euro vis-a-vis the dollar, is affecting price stability in the narrow definition of article 105. And yet it is

obvious that adopting a tight monetary policy in response to oil price increases could bring about price stability only through a contraction of the levels of economic activity in the Euro area. Initially, the ECB has shied away from pushing up interest rates. Under attack for failing to abide by the rules of the Treaty, the ECB argued that its prudence is due to the need of protecting European economic recovery. Now, it is acting precipitously. Thus it is evident that article 105 is not considered by the ECB neither the Gospel nor the exclusive guiding light in the conduct of monetary policies.

■ The experience of the first 20 months of the Euro is that markets perceive a vacuum around the ECB. It is now frequent to read in European newspapers comments pointing out the weakness of the institutional set-up of EMU. Apart from some extreme utterances such as those of the then German Finance Minister, Herr Lafontaine, even the more cautious French Finance Minister argued that the Euro Council should evolve into a full fledged European Treasury Minister. And in commenting the outcome of the Danish referendum, Jacques Delors has come out suggesting the need for a strong European government.

■ Thus, after all, Nigel Lawson seems to have been right in claiming that monetary and political union cannot be dealt separately: you cannot have one without the other. But I would go farther: the question has to be dealt with urgently. The longer the situation stays where it is nowadays, the weaker the Euro. The "denationalization" of money is an

illusion. Mr. Issing's – the ECB chief economist – reiterated argument (Financial Times, September 15) that the absence of a European federal state and the lack of progress in that direction is de facto a condition for the success of the Euro, not a cause of its problems, is an illusion, as markets have abundantly proven. A nearly continuous decline in Euro market values for nearly two years is a trend not a cycle. The fact that concerted action by governments to prop it up indicates that markets are sensitive to a show of political will and not to its absence. EMU cannot be successful without a political union. This is not an argument for it. But a simple reaffirmation of an obvious prerequisite.

■ Can Europe move to European Constitution? And is EMU worth a Constitution? These are important questions which would take us to a different set of considerations. I shall simply note that the conditions which made for a cohesive Europe in the postwar period are no longer there – the main one being the threat coming from the USSR. There are problems, such as the Balkans, however, where we entirely measure the consequences of the lack of Europe. I will stop here by saying that in deciding on EMU without considering the political conditions for its success, I am afraid Europe took a step which was not measured in all its implications.



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