GIACOMO COSTA
Università di Pisa
giacomocosta4@gmail.com

THE EUROPEAN UNION AS RECENTLY SEEN BY TWO ITALIAN ECONOMISTS

abstract

This is a review of the books on the European Union by two well-known Italian economists, Luigi Zingales and Giacomo Vaciago. It turns out there is a broad area of agreement and complementarity between them. Their treatments are summarized under the following ten headings: 1) The political genesis of the European Union; 2) the surprisingly narrow range of activities included in the present economic and monetary union; 3) the dubious validity of the "theory of forward reactions", that should guarantee the forward direction of the unification process; 4) The unsure presuppositions of the Maastricht Treaty, and the reasons why it arose the skepticism of most American economists; 5) the Italian crisis and the European paralysis; 6) Italy stands to Europe as Southern Italy to Italy; 7) Italexit? 8) What brakes the progress of the unification process? 9) What corrections to existing institutions? 10) Is there still a role for a European Federation?

keywords

European Union, European Federation, European Central Bank, Social Market Economy, Theory of Forward Reactions

Phenomenology and Mind, ISSN 2280-7853 (print) - ISSN 2239-4028 (on line)
n.8 - 2015, pp. 268-273
Web: www.fupress.net/index.php/pam • DOI: 10.13128/Phe_Mi-17752 •

0. Luigi Zingales and Giacomo Vaciago, two noted Italian economists, have recently written somewhat systematic accounts of their thoughts and researches on the European Union. The fact that they give special attention to the role of Italy in the European Union does not detract from their treatments, indeed it helps to highlight some important general problems. To a surprising extent, the two books confirm and complement each other. In what follows I will summarize those aspects of their books that may be informative or even challenging to philosophers and other general readers.

1. The origins of the European Union can be traced to the immediate aftermath of World War II. The French political leaders wanted to avoid the resurgence of German economic and military power. The projects devised by Bidault, Monnet, Schuman varied from the earlier punitive versions to the cooperative and multi- rather than bi-lateral agreements, the last of which, the European Defence Community, was an embryo of political union. Too brave! The French Parliament refused to ratify it (1952), as it had stalled the earlier proposals by its own leaders. Unexpectedly, it was the German chancellor, Adenauer, who took the initiative and hit on the winning prospect, a custom union with extra protection for agriculture to please the French: it was the Common Market. The Monetary Union is the continuation of the French effort to check German power. Mitterand saw it as the extreme device to curb the newly reunited Germany´ power and autonomy. In this realistic perspective, more congenial perhaps to Zingales than to Vaciago, the European Union is but an incident in the history of the France-Germany political relationship.

2. Many laymen complain about the European Union being merely economic. As is clear from the title of his book, Vaciago shares this concern (see also pp. 127-132). But at the moment it is not even that, argues he. A Common Market where the member countries have Gdp´s dominated, directly or indirectly, by their public sectors is altogether different from a Common Market in manufacturing. What has so far been accomplished is a satisfactory common market for industrial products and services, amounting to one third of total Gdp. The difference is important for the mechanism of improvement in the two sectors are quite distinct: competition in the former, imitation, i.e., quick adoption of the best practices, a painful and certainly not spontaneous process, in the latter. Only with the Monti Report (2010) did we become aware of this huge problem. Moreover, a monetary union without a banking union is almost ludicrous. We have been so far in a union which is “little economic and very

little monetary", argues Vaciago (p. 8). The "completion of the inner market" is a largely unfinished task.

3. The theory of forward reactions (Zingales pp. 22-24). After the defeat of his proposal of common defence, Jean Monnet decided to adopt a more gradual unification strategy, based on the premise (or theory, or assumption) that "the creation of international institutions in some sectors sets in motion a chain reaction that prompts the transfer of further functions to the international institutions, up to the final complete political union". As Tommaso Padoa-Schioppa was later to confirm, "the road to a common currency looks like a chain reaction which every step forward resolves an existing contradiction and generates a new one that, in its turn, calls for the a new step", and the Hegelian jargon is perhaps appropriate, but the "theory" not altogether convincing. As Zingales points out (pp. 23-24), it is however the working premise of European politicians and bureaucrats, and is echoed in the statement by Romano Prodi, then our *Presidente del Consiglio* (the Italian constitutional weak form of premiership), on Italy's joining the euro in December 2001: "*I am sure the euro will oblige us to introduce a new set of economic policy instruments. It is politically impossible to propose that now. But some day there will be a crisis and new instruments will be created".*

4. The Treaty of Maastricht (Febr. 1992) founded the Monetary Union. As Vaciago points out (p. 23; see also Zingales, p. 178), no account is taken in the Treaty of the economic doctrine closer to its subject, the theory of optimal currency areas. This theory indicates rather stringent conditions on the member countries (for example a high degree of mobility of factors of production, including labor) for the success of a monetary union. This explains, incidentally, the position of benevolent skepticism and sometimes deep concern taken by most American economists, spanning from Milton Friedman to James Tobin. The undeclared premise of Maastricht is rather that (i) the domestic problems of a member country should not spill over to the others, and (ii) the benefits of being in the union are there for whoever is ready to reap them, i.e., is efficient, competitive, has a good public administrative and educational system, etc. The five famous "Maastricht parameters" were all dictated by (i). In particular, the last two of the five, low public budget deficit and low stock of public debt relative to nominal Gdp, were meant to relieve the Central Bank from the pressure to monetize the debt of some member country, and thus endanger the monetary stability of the whole system (Vaciago, pp 24-25; Zingales, p. 174). The Central Bank was founded on strictly German lines, i.e., on the premise that once money price stability is established, all other macroeconomic problems would take care of themselves. Thus in particular no policies or procedures were predisposed for dealing with financial or economic crises, for their happening was ruled out on principle and therefore not contemplated in the statutes. "A dangerous ideology", calls it Vaciago (p. 54). But it is more likely to have come from the famous if ever elusive doctrine of the Social Market Economy than from American neo-liberalism.

5. The Italian crisis. Italy was of course one of the main protagonists (or victims) of the recent 2010-2012 European financial crisis. To the European Central Bank, the taboo was to buy and sell bonds issued by individual member countries. "A high and increasing spread is incompatible with a logic of monetary integration and therefore signals its likely failure. Can the ECB look passively on its own demise?". Vaciago (pp. 61-62) is ready to explain the serious problem that lies at the heart of this paradox: "The financial markets signal that there is some positive probability of insolvency by Italy and Spain. These countries might therefore be compelled to exit the euro endangering the whole construction. Can the ECB prevent it in an effective way and show that it is operating in a non political manner, i.e. in the common

interest and not in the interest of only some of its members?". This is the background, Vaciago suggests, against which to set the two famous if puzzling August 2011 Trichet-Draghi letters to the Italian and Spanish governments. But this part of the story is too well known to be recalled here. Suffice it to say that Vaciago (pp. 67-70) revisits it in an illuminating way.
There is another side to the Italian crisis, of which not many people are aware, and that is a much longer run phenomenon: the almost twenty years old stagnation of productivity, in particular, total productivity (the efficiency with which all factors of production are used.) It antedates Italy's entry in the euro, and in no way can it be blamed on the euro (Vaciago, pp. 79-87, Zingales, p. 182). Vaciago devotes a whole chapter to summarizing the causes of this alarming trend. These ramify almost everywhere in the Italian economic fabric. The main culprit is the smallness and opacity of Italian firms, that makes them unable to exploit scale economies and Ict. A fascinating conjecture by Zingales (pp. 183-184) is worth mentioning: "Most of our banks do not maximize profits[...]. This holds also for the largest banks[...] not by chance their chiefs speak of the 'social responsibility' of the banking company[...]. These are banks committed to their present clients, not to finance new firms[...]. The protection of the locality, of the firms, of the friends work when the existing firms are efficient and are expanding. But when globalization changes the nature of Italian comparative advantages and calls for creative destruction, this credit structure becomes an impediment to innovation and productivity increases. If this were true, a reform in the governance of the banking sector would be the first essential step for re-starting growth".

6. Italy as the Southern Italy of Europe. Zingales offers a stimulating comparison between the Italian and the European unification processes. The similarities between the North-South divisions in the two areas are striking (pp. 144-156). The political prevalence in the South of the ill-famed *latifondists* (semi-feudal landlords) deprived the South of a true representation, with the consequence that its problems and interests were ignored and no progress was made in the first forty years of the new Kingdom. The consequence was mass emigration (5,7 million people emigrated from 1876 to 1915). But this is precisely what is happening to the whole of Italy now! "The German Chancellor, the French President do not answer to the Italian or Greek electors. They do not therefore have any interest to face the Italian or Greek problems, but to minimize and defuse them". This, observes Zingales (p. 155), removes any hope for improvement, and consigns Italy to a fate of stagnation and decay. It could be added – even if Zingales avows his preference for the sort of minimalistic approach to the European Union championed by Margareth Thatcher – that this is a powerful, indeed it is the main traditional argument in favor of political unification.

7. Italy in or out the Monetary Union? Vaciago (p. 76) observes that when discussing the Italexit option there is a preliminary question that should be posed, a question, one should add, that in fact is not only never answered, bur never asked and never conceived:

Is the Monetary Union good in itself, in the sense that it offers net benefits to its participants, and it is only their distribution among them that is unsatisfactory, or is it like a zero sum-game, in which the gains by some are matched by the losses of the others, and we Italians, by bad luck or some fault, always end up on the wrong side of the table?

Most economists of course feel that the correct answer is the first. So do our two writers: Vaciago (pp. 9-10): "The conditions for a successful integration in the European Union coincide, to a large extent, with those that would be required to ensure our children a better future even if we went back to our own currency".

Zingales (p. 159): “The solution for us and other South European countries is not to leave the European Union. That would be a regressive move. To promote true change we need to re-think the European Union, not to leave it”.
If the true long run problem of the Italian economy is to hit on a productivity increasing path, Italexit is not the solution. Our stagnation may continue if we remain in the European Monetary Union, and is much more likely to persist if exit from it is but the first step in a process of protectionist closure of the Italian economy to the whole rest of the world, as both writers fear it would inevitably happen.

8. What brakes the progress of the European Union? What prevented and prevents the ECB from taking quick and decisive action like its American counterpart, the Fed? What slows the institution of the banking union? Vaciago (pp. 96-97) offers an interesting partial answer: “The problem that arises in a Monetary union – as yet incomplete but very interdependent in terms of credit flows – is precisely that which has so far hindered any effective solution: in the case of need, who pays? The position so often spelled out in the past years in Berlin, Frankfurt and Karlsruhe is based on two principles, hard to ignore. (i) The use of funds whenever the Treaties do not contemplate it is out of the question; (ii) in any case that a State should help another State does not have any logical basis: for the transfers among States do not respect any equity crter-siterion. It would be like asking a German worker to subsidize a wealthy Greek, or Spaniard, or Italian. Why should he agree? The transfers may become necessary in emergencies in order to avoid the worst, but will always have to be motivated with the only acceptable argument: it is of advantage to Germany and its omnipotent tax-payer. This is the daily exercise to which every ECB action must submit, otherwise it must devolve the affair to Brussels and to the European Council, where sit representatives of democratically elected governments, the only ones who can commit resource from their budgets”.
Thus it is a concern for equity that makes progress impossible. But the universal argument that inter-State transfers by their very nature defy any equity considerations quickly inadvertedly gives way to a more nationalistic concern: the deep obsessive respect the German politicians think their State owes to its citizens as tax-payers. Although the highly knowledgeable Vaciago does not notice it, this is perhaps a tacit jusnaturalistic tenet of the Social Market Economy doctrine.

9. What corrections to the existing institutions? There is no doubt that corrections are needed. Zingales (p.11) “Europe as it is not only is not workable, but it hurts particularly its Southern region, to which Italy belongs[...] the European project can be saved only if radical reforms are made in a very short time”. Let us see what reforms are suggested by our two writers.
On the financial side, what we should do is break the perverse link between State solvency, the banks’ solvency and monetary policy (Zingales, p. 174; Vaciago, pp. 55-57). In a monetary union, whenever a country (or its banks) is prey to a confidence crisis it risks entering into a vicious circle from which it cannot escape by its own devices, and therefore needs to be rescued by the ECB. But this poses a well known moral hazard problem, for it encourages reckless actions by governments and banks. This can only be alleviated by ex ante control mechanisms, as the banking union could provide, if it forbade (as the current official proposal does not) the state bailouts of banks. As long as the States are allowed to rescue their banks, the “perverse link” is re-established, and moreover the financially stronger States are in the position to confer an unfair competitive advantage to their banks.
On the real side, both our writers suggest to return to the teachings of the currency areas literature, and to introduce some automatic stabilization mechanisms in order to compensate shortfalls due to regional shocks with European funds. The more obvious candidate is

a European system of unemployment subsidies. It is not a permanent mechanism of subsidization of an area by another. As Zingales (p. 178) recalls, in 2005 it was Germany that had the highest unemployment, and in that case the transfers would have gone from South to North. The system would have the usual moral hazard problem, but no more than any national system, and could perhaps, argues Zingales (p. 179), be accompanied by a provision of cross inspections. And, it should be added, is should be protected by frauds more effectively than the Italian State has so far managed to do with its *Sistema Sanitario Nazionale* (National Health System).

A third reform concerns the institutional incentives of the Central Banks. Given its assigned inflation target of 2%, at present its costs of exceeding the target are considerable, those for falling short of it nil. This gives its operation a permanent deflationary bias that should be elimintated.

10. Is there still a role for a European Federation? There is.

Vaciago: “Seen from inside, Europe appears a quarrelsome community, where the main power is wielded by a country, Germany, which does not have either the intention or the capability to accept the responsibility to lead the Union. From outside, say from New York, or Peking, Europe takes the appearance of a “power vacuum” generated by the attitude, common to all European countries, to hope that some other of them will take the necessary decisions to which to rally themselves” (pp. 12-13); “Up to some years ago I would have said that after the monetary and hence the market unification, we should have gone on to unify what connects us to the rest of the world, i.e. foreign and defense policies. But in the light of the experience of the last twenty years, and of the problems that have arisen in the last ten, it now seems to me that the priority is now social more than economical... we should all try to redefine the model of “social market economy” that, after its inscription in the Lisbon Treaty (2010) we have all forgotten” (p. 129).

Zingales (p. 170): “Let’s delegate to the Union the tasks in which the Union has shown to have a comparative advantage, or it is easy to surmise that it will have.”

Two of these are the first two requirements for admission in the European Union: commitment to human rights and to a free competitive market economy. The third is defense, for its obvious scale economies. And from defense the whole of foreign policy may came within the competence of the Union, argues Zingales (pp. 171-172: oblivious of Margareth Thatcher’s proposal to rely for defense only on NATO and not even so negative, in this instance, on the theory of forward reactions).

The soul has not been completely extinguished. The dream continues.