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INSTITUTIONAL AND ECONOMIC REFORM PROCESS IN EUROPE: AN HISTORICAL PERSPECTIVE

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ABSTRACT

The article compares the challenges faced by Europe in reconstructing after World War I and the new ones on similar issues encountered in 2017, after ten year of financial, economic and political crises. Such a comparison is developed not only about the reconstruction of its infrastructures, but also the political reorganization of the Continent and its Union, the reform of the European fiscal and monetary constitution, and how it deals with the twin demographic and migratory challenge. The solutions proposed a hundred years ago and their outcomes are briefly discussed, along with the possible solutions discussed today and their possible consequences.

The excessive rigidity of monetary and budgetary rules had negative influence in the reconstruction of the institutional framework in the 1920's, contributing to the end of the gold exchange standard, and today's fiscal rules must avoid an excessively restrictive bias on demand. Regulated labour migration is part of the solution of Europe's demographic problems, but it is difficult to handle. Cooperation must be reinforced in dealing with emergencies and refugees and contain irregular flows and manage expectations and fears, while fostering integration. Infrastructural investment remains weak and the Junker plan has not provided the additional push needed, because budgetary constrains remain, the complexity of the financial, legal and administrative process have become structural, and Public Private Partnerships are ultimately a more expensive way to produce public investment.

While clear cut, definitive solutions to the various problems identified appear unlikely, the endurance of the European project should not be underestimated. There is a real capacity of institutions to withstand difficulties and the commitment of the vast majority of European governments to sustain or to advance the European project and the Euro, even if a truly federalist development of Europe is unlikely and not strictly necessary.

Keywords: Latin Monetary Union, Common European Currency, European Union Reform, Europe in 1918, Infrastructures in Europe, European Immigration Policy, European Institutions. JEL codes: N14, N24, N44, B52, D72, D73, D78, E02, E58, E65, F42, F45, F53, H54, H63, J61.

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At the end of World War I Europe was facing a dramatic set of transformations and challenges, whose outcome would define the evolution of the role of the continent and the welfare of its people. The reconstruction of Europe was clearly not just the physical reconstruction of its territory, housing and infrastructures destroyed by the war, but also a demographic challenge, the choice of a new monetary system after the end of the classical gold standard, the reform of its economic system in front of the communist challenge, the re-establishement of relation between European states on sustainable, peaceful and democratic basis.

A hundred years later challenges of an even larger scope are amassing on the European horizon without solutions in sight. The Europeans have created in over sixty years a semi-federal union. They had thought that the struggle for democracy had been won for good after the fall of the Berlin wall but such hopes are now shaken by centrifugal forces, new forms of authoritarian government grow on the periphery and on the borders of Europe and new antiestablishment parties in core Europe have to prove that they can renew rather than destroy the democratic order. The central role that Europe had acquired in the world economy since the industrial revolution is waning even more rapidly than the most pessimistic forecasts of a decade ago, leaving high unemployment, growing debt and a controversial approach to the common European currency. Declining clout in foreign and military policy is the unavoidable consequence of economic decline. An underlying demographic crisis accompanies and reinforces those multiple crises, when an aging population with too few children meets its fears in front of migratory waves perceived as uncontrolled and threatening for both identity and security against terrorism.

Yet Europe is still the area with the largest share of world GDP, with leading quality of life, life expectancy, health and social protection. Its achievements cannot be measured only as a form of competition for the rate of growth of GDP when the starting point is so much higher than most of the rest of the world. Europe has to decide how to direct the development of its economy and society selecting which model of association is possible and effective in relation to the management of its institutions, economy, public finances, currency, and migration.

This contribution will explore the challenges of 1918 and 2017 in a comparative manner, recalling the solutions proposed a hundred years ago and their outcomes, along with the possible solutions discussed today and their possible consequences, with all the limitations that such an exercise has.

The political reorganization of Europe

At the end of WWI the institutional response for the reconstruction of a European future was initially led by Wilson's proposal for a League of Nations. The objective was to achieve peace through common rules, the respect of the principle of nationalities and of the rights of minorities, the expansion of democracy, through peaceful negotiations to solve controversies on territory, rearmament, war debts and war compensations.

The League of Nations was born weak, as the Wilsonian project was immediately rejected by the US Republican Party, which gained control of the Presidency and of both branches of the US Congress choose isolationism and refused to join the League. Despite the League, traditional power relationships restarted immediately in Europe, with changing alliance patterns. The peace treaties sidelined much of the Wilsonian principles, including on the attribution of guilt for the war, and the determination of reparations and war debts.

A few relatively isolated federalist voices rose to suggest an alternative, including Luigi Einaudi in Italy, who proposed in 1918 a European federation which would manage military, diplomatic and trade policies, abandoning the "deadly dogma of the absolute sovereignty" of nations [Einaudi (1918) 1948: 33], as well as Coudenhove Kalergi who started a federalist agitation through the Pan-Europa movement from 1922 onwards. Timid federalist talks started at the political level in the second half of the 1920's, after political, economic and monetary stabilization had been achieved. The French Foreign Minister and later Prime Minister Aristide Briand introduced at the League of Nations a plan to pursue a "European Union", with "a sort of federal association" (Suarez 1952) while he had reached finally an agreement with his German counterpart Steseman. These developments were halted by the death of Streseman and the beginning of economic depression in 1929. The ascent of Hitler and of other forms of hypernationalism in the 1930's (Nazis in Germany, Falangists in Spain, Fascists in Italy, Horthy in Hungary, Pilsudsky in Poland) destroyed the early developments of European unification ideals and even the most basic forms of international cooperation, leading to WWII.

The last decade (2008-2017) has produced again a crisis of the European federalist project which had developed from 1950's onwards. The last Eurobarometer of end 2016 indicated that in Italy, France and the UK only a minority of the citizens polled were optimistic about the future of the EU, even though a substantial majority of Europeans were optimistic about the future of the Union. The EU is suffering first of all a crisis of confidence, provoked by its relative economic decline, while facing the rapid economic ascent of Asian countries (not just China), loss of GDP per capita, growing inequality. The increase of unemployment from 2008 onwards has been partially reversed in most European countries but at the cost of lower wages and worsening working conditions in the present and expectations for the future. The common perception of the consequences of globalization are that it has increased inequality between European citizens within each member states, and that European firms are often losing the battle with their competitors from emerging Asia.

National governments, both centre-right and centre-left, are considered to have failed to deliver improving living standards, income and employment. The rejection of political elites by public opinion goes hand in hand with the refusal of the European project to which they have been associated and that they have governed through the European council, commission and Parliament. This new age of discontent has fuelled of anti-establishment, nationalist and anti-European movements. Their main success so far has been the popular vote in favour of Brexit in June 2016, but the growth of anti-system parties might lead sooner or later to their victory in national elections in some core countries, as they already did in Poland with Kaczynski's Law and Justice Party (PIS) and in Hungary with Orban's Fidesz. Strong anti-European parties are growing in France (Le Pen's Front National), Netherlands (Wilders' Party for freedom), Italy (Salvini's Northern League and Grillo's Movement 5 stars), Austria (Strache's Freedom Party), Germany (Alternativ für Deutschland), Sweden (Swedish democrats), Finland (True Finns), Denmark (Danish People's Party). Regardless of whether these parties will reach the government, even several mainstream parties feel the pressure and are less willing to abandon additional forms of sovereignty in favour of the Union and more often speak about the repatriation of powers from Brussels.

For several decades European integration proceeded at an irregular speed, oscillating between the proponents of a federalist view of integration, with a political pre-eminence, as viewed by the Italian Altiero Spinelli, the functionalist view of economic integration, guided by progress on the economic front, first proposed by the French Jean Monnet with the ultimate purpose of a federalist result, and the resistance of supporters of a simple integration of markets with a mere intergovernmental approach in mind, a vision embodied by the Former British prime Minister Margaret Thatcher (Armellini and Mombelli 2016: 60-65). The "ever closer union" motto, which reflected the American federalist concept of a "more perfect union" included in the second US constitution of 1787, has been attacked consistently by critics and euroskeptic. Today it should not necessarily be the guiding principle of Europhiles.

The autopilot response to crises or to the lack of progress thereof in the European project during the last 60 years has been to create new institutions to tackle any new problem or any new phase of the project. A periodical increase took place of both the areas of action of the Union (from coal in 1950, to the creation of the EEC in 1957, to the acceleration conceived during the Delors presidency of the European commission such as the Single market in 1993, Schengen in 1995, Monetary union in 1999, to the new wave of financial innovations after 2008 (such as the Banking union started in 2012), and the number of its institutions (beginning with the CECA in 1950, Commission, Council and Parliament in 1957, to numerous financial institutions after the 2008 global financial crisis, as illustrated in graphs n. 1 and n. 2 and table 1) and its members (from 6 in 1957 to 28 in 2013). The growth of EU institutions has outpaced the growth of other global supranational institutions from WWI to today, part of the process of ever more shared global governance. It is clear that the creation of institutions and the expansion to new areas of action have not followed a steady path but proceeded by waves and are becoming ever more difficult as the number of EU members makes decision making more difficult and reduces cohesion.

This approach has reached its limits. Further Institutional proliferations would be a mistake, increasing the size of European administration, already accused of bureaucratic blindness, increasing beyond sustainability the complexity of every single human activity (economic, institutional, personal). What is at stake now is not to add additional components to the list of institutions but a clearer sense of the direction for further changes in the EU, in light of the British exit, of the diverse and sometimes diverging priorities and tendencies of the original founding members (more available for further political integration), of the Scandinavian countries and of the former communist member of central and eastern Europe who joined in 2004 and 2007. The five presidents' report of 2015 was an example of how the search for continuous expansions of European roles through new agencies could go in the wrong direction, suggesting the creation of European competitiveness authorities, that would meddle with national wage bargaining processes, to keep aligned wage increases to productivity growth (European Commission 2015). At the institutional level there is a need for a substantial simplification of the institutional structure and rules. This is extremely easy to say and extremely difficult to achieve, because institutions have more functions than is commonly realized, because they defend themselves and their complexity defends them from external attempts to reform or change them.

After the shock of Brexit the discussion is divided between those who fear an implosion of the project and call for a reduced role of the Union and those who support progress towards a full federation, on the US model, as the only chance, as suggest by the Belgian liberal Guy Verhofstadt (Verhofstadt 2017: 200-201) or the Italian former President Napolitano (Napolitano 2016). A version of this view recognizes that it is impossible to drag all current EU members in this direction, particularly given the political resistance of Eastern European member states. This gives rise to proposals for a two speed Europe, suggested by German Chancellor Angela Merkel, and articulated in different ways according to the points of view. Some see a core set of countries proceeding to full political integration, composed initially by the six founding members, or by the Six plus the Iberians and the Austrians (as suggested by the former French President Giscard d'Estaing), or by the economically sound member, with the exclusion of southern Europeans with inadequate public finances (as thought by various German finance ministers. Theo Waigel in 1995 and Schäuble today). The idea of a two speed Europe calls for both a selective deepening of its policies but potentially also a selective reduction of its mandates, one of the options proposed by the Junker report in March 2017 (Junker 2017).

In their immediate reaction to Brexit, in Ventotene in August 2016, German Chancellor Merkel, French President Hollande and Italian Prime Minister Renzi agreed on a selective deepening of cooperation on defence, military issues and security. For many years the US had requested an increase in military spending by every Nato members to at least 2% of GDP, for a fair share of the defence burden and an adequate updating of military capability to new international threats. President Obama had politely but forcefully made the point repeatedly. His successor, Donald Trump, has associated the request to a much more brutal threat to set aside NATO altogether, while Putin increases pressure in eastern Europe and in the Middle East and the threat of terrorism remains high. Under such circumstances the urge for a reinforced European military cooperation is obvious but more difficult than ever given that the strongest European army, the British Army, is leaving the EU.

The proposal of a two speed Europe can be interpreted as a continuation of already existing reinforced cooperation and opt out possibilities already made possible by the Lisbon Treaty. Europe in fact has already been proceeding at different speed since the late 1970's, briefly after its first enlargement. The UK was not part of the European Monetary System from 1979 until 1990 and then joined it only to leave it in 1992, never to return. Economic and Monetary Union has not been imposed on the UK, Sweden and Denmark. The Schengen agreements on the abolition of passport controls within internal European borders has never included all Eu members (currently there are two opt out, UK and Ireland, and three awaiting entry, as Croatia, Romania and Bulgaria, are not members), while it has included non EU states (Switzerland, Norway and Iceland).

The idea of two speed Europe can also be interpreted as a core group of countries integrating further and leaving weaker peripheral countries behind, because they are not able to respect the full set of rules that richer and better organized countries can follow. This is a nineteenth century type of vision, that the German Finance minister Theo Waigel has been entertaining in the mid 1990's, expecting Italy, Spain, Portugal and Greece to remain outside the Eurozone. Both Prime Ministers of Spain (Aznar) and Italy (Prodi) had made it a question of national pride and national economic success to defeat such vision and accept any sacrifice in order to qualify for the Euro against expectations. Today it would be no different as far as traditional parties are concerned in southern Europe. It is completely different for new antiestablishment parties. Popular opinion would not support a policy of inclusion in the group of core countries at any cost, because a large price has already been paid in southern Europe during the last ten years.

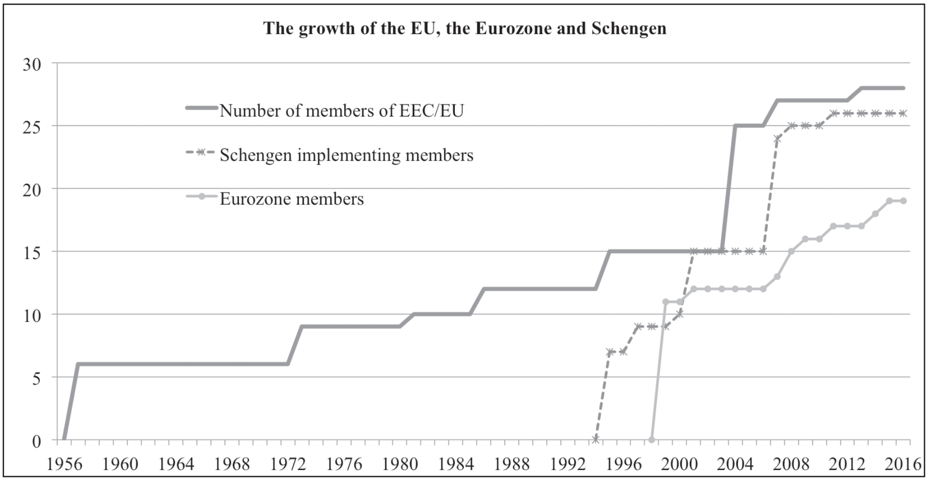
It is not sure that a reinforced official status of two speed Europe will not actually reinforce the destructive tendencies that already exist. Some countries perceive multiple speed Europe as a form of exclusion and as an act of hostility and others take advantage of it to opt out of policies they had previously been forced to subscribe to, in the name of the complete adoption of the *acquis communautaire* as a pre-condition for accession to the EU in the various enlargements between 1995 and 2013. The possible return of regional cohesion and of social and health policies to the national level highlights the fear of eastern Euroepan countries to lose European cohesion funds, one of thee main attractions of membership. Jarosław Kaczyński, the chairman of Poland's hard right PIS party, threatened that a multispeed Europe would lead to "the breakdown and in fact the liquidation of the EU in its current sense". A more chaotic situation might develop with continuously variable number of countries participating in each possible policy. Furthermore it is far from certain that the federalist impulse in the core old European countries is still strong, given that anti EU referendums are been called for by party on the rise in countries losing faith in the EU (the Front National in France, the 5 Stars Movement and the Northern League in Italy). Verhofstadt suggests, following the 1953 draft European constitution developed by the German CDU politician von Brentano, that the EU could have full members (committed to a complete political federation on the US model and immediately subscribing to the Euro, Schengen, home affairs, defence and justice, without exceptions or financial rebates), as well as associated members, essentially joining only the internal market (like Norway and Switzerland today) but with the obligation to comply to the rules and conditions of the common market.

The five alternative scenarios drawn by Commission president Juncker in May 2017 take stock of the difficulties but also the open nature of future evolutions by 2025, oscillating between reinforced cooperation, a reduction of Common European Policies under the labels of "carrying on", "nothing but the single market", "those who want do more", "doing less more efficiently", and "doing much more together" (Juncker 2017).

The difficulty in achieving a balance are such that even critics hesitate to jump off the boat, Indeed after a first round of negotiations leading to the Rome Declaration of the leaders of the EU governments and institutions for the 60th anniversary of the signing of Treaty of Rome on 25 March 2017 included more or less all the possible options, with a pledge to work towards a safe Europe with free movement, prosperity, a social Europe as well as an internal market and stronger on the global scene through partnership but also defence and security. The document was signed even the critics on the right (Poland) and on the left (Greece), even if this is guarantee for the future. It did not include a formal reference to multispeed Europe, opposed by Poland, but was referred to explicitly during the ceremony.

The Federalist idea of Europe needs to be revisited. The final destination of the European federation process is not necessarily the same as the US, German or Swiss models, but it is an original model, that we must be aware of and willing to accept without considering it necessarily a failure and an incomplete step. It was easier to build a federal state without a consolidated history behind them as the thirteen American colonies in 1787, or the German states in 1870, united by a single language and a thousand years of Germanic Confederation, or the Swiss cantons in 1848, with several centuries of looser union behind them. The EU, with a far longer history of division and diversity, with dozens of spoken languages and well established national Governments and Parliaments is not likely to be united as thoroughly as the mentioned three standard examples of federations. It is necessary to set aside the simplistic view that in the long term the only alternatives are between a breakdown of the EU or a full political union following the American model and that anything else is simply "muddling through" or waiting for catastrophy to happen. In fact the creative and ever changing third models are the only way forward while navigating between conflicting requests, Europhobia, fears and persistent popular demands of significant national policies, combined where necessary with more European collective action.

Graph. n. 1



Graph. n. 2

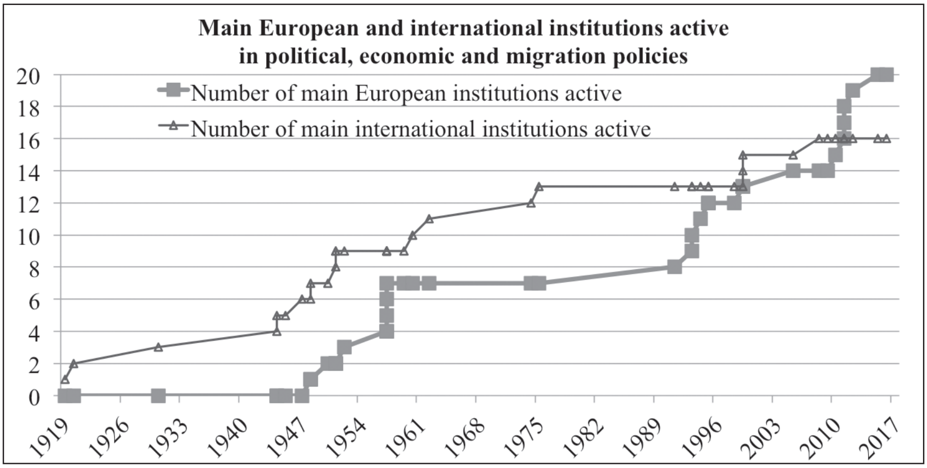


Table 1

Main European and global institutions dealing with political, economic and migratory policies created between 1919 and 2017

	Initials	Created	Ended	Total n. institutions
International Labour Organization	ILO	1919		1
League of Nations	LoN	1920	1945	2
Bank for International Settlements	BIS	1930		3
World Bank	WB	1944		4
International Monetary Fund	IMF	1944		5
United Nations	UN	1945		5
General Agreement on Tariffs and Trade	GATT	1947	1995	6
European Recovery Plan (Marshall Plan)	ERP	1948	1951	7
World Health Organization	WHO	1948		8
European Payment Union	EPU	1950	1958	9
United Nationas High Commission for Refugees	UNHCR	1951		10
International Organization for Migration	IOM	1951		11
European Coal and Steel Community	ECSC	1951		11
European Court of Justice	ECJ	1952		12
European Economic Community	EEC	1957		13
European Council,	EUCouncil	1957		13
European Commission	EUCom	1957		14
European Investment Bank	EIB	1957		15
European Parliament	EP	1957		16
European Court of Human Rights	ECHR	1959		16
Organization for Economic Cooperation and Development	OECD	1960		17
G10	G10	1962		18
Basel committee on banking supervision	BCBS	1974		19
G5-G6-G7-G8	G7	1975		20
European Bank for Reconstruction and Development	EBRD	1991		21
European Union	EU	1993		22
Single European Market	SEM	1993		23
European Monetary Institute	EMI	1994	1998	24
Schengen agreement	SA	1995		25
World trade organization	WTO	1995		25

European Central Bank	ECB	1998		25
European Economic and Monetary Union	EMU	1999		26
G20 ministerial	G20M	1999		27
Financial Stability Forum	FSF	1999	2009	28
European Agency for the Management of Operational Cooperation at the External Borders	Frontex	2005	2016	29
G20 leaders	G20L	2008		30
Financial Stability Board	FSB	2009		30
European Financial Stability Facility	EFSF	2010		31
European Banking Authority	EBA	2011		32
European Securities and Markets Authorities	ESMA	2011		33
European Authority for insurance and occupational pensions	EIOPA	2011		34
European Stability Mechanism	ESB	2012		35
European Fund for Strategic Investments	EFS	2015		36
European Border and Coast Guard Agency	EBCGA	2016		36

Reforming European fiscal and monetary constitution

At the end of WWI European countries were faced with a high inflation rate while the gold standard was suspended and uncovered paper money was depreciating the gold value of national currencies. The cost of reconstruction, the issue of war debt and indemnities repayment and of postwar slump contributed to making a monetary and financial stabilization difficult as every country followed different paths. The UK with Churchill as Chancellor of the Exchequer decided to re-evaluate the pound by about 20% to return to prewar gold parity, forcing price declines, lost output and unemployment on the way. Germany went from high inflation to hyperinflation in 1922-23, France and Italy stabilized their currencies at about a fifth and a quarter of their pre-war gold value. Existing monetary unions were the victim of this process. First the Austro-Hungarian monetary union gave way to several successor states currencies, with a fight on the distribution of new seignorage income and attempt to dump on the other members the responsibility of existing monetary circulation, while monetary conversion to new currencies was associated to extraordinary wealth taxes. The Scandinavian monetary union (SMU) was disbanded in

1920 but had ceased to exist in practice when post-war inflation caused diversified levels of depreciation for the national banknotes of the three member states, who had suspended their gold convertibility. The SMU had become an obstacle to independent monetary policy and was abandoned (Cassel 1922: 31). A similar situation happened with the Latin Monetary Union (LMU, composed by France, Italy, Belgium, Switzerland and Greece), which was abandoned in 1926, when each State had stabilized or was in the process of stabilizing its national currency at a different value from its pre-1914 gold parity, as a consequence of different costs of the war and of diversified financial decisions (Einaudi 2000). The dissolution of those monetary unions was simple because they only shared gold and silver coinage (clearly identified by issuing State) and had no common central bank, institutions or significant unpaid financial balances and the war had already broken the fixed exchange rate mechanism, so that there were no relevant additional costs for dissolution.

The attempted reconstruction of a European monetary system passed through the Genoa Conference in 1922, were the first steps were taken towards the common adoption by main powers of a gold exchange standard, based on national currencies backed by gold reserves and foreign exchange claims on gold centres (Kindleberger 1993: 324). Genoa failed to produce immediate results as pointed out by Keynes,[1] in part for the inability to settle in a sustainable manner the issue of war debts and reparations, that the French wanted to be excessively punitive and the Germans were unwilling to pay in sufficient measure but also for lack of sufficient political and central banking cooperation on monetary issues. Only by 1928 all major countries had stabilized their currencies, with new gold parities. At that point though excessively deflationary policies, followed under the gold exchange standard to sustain the exchange rate, were a central cause of the Great Depression, which began the following year (Eichengreen 1992).

In today's Europe, monetary unification includes 19 countries in a far more intense bond than was ever created by the LMU, the SMU before 1914 or the Gold exchange standard in the 1920's. The Euro, initiated together with the European Central Bank in 1998-99, has produced some of its

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[1] Keynes wrote in particular in favour of exchange rate stabilization rather than re-evaluation and deflation to return to prewar nominal values, discarding the sentimental value of "prestige", attacking the unbearable cost of raising the total claims of the *rentiers* class in terms of public debt to "intolerable proportion of the total income of the community", leaving no alternative between revolution, cancellation of public debt and extraordinary capital levy (Keynes 1922, "The Stabilization of European Exchanges. A plan for Genoa"). Keynes also criticized Genoa heavily "Never, I think, at any Conference has the intellectual standard of the official policy sunk so low. The discussions – I am limiting myself to the Russian question – seldom touched reality". (Keynes 1922, "The Genoa Conference").

promised benefits but also significant problems and a powerful opposition. Advantages include a generalized reduction in interest rates (even before the collapse of 2008-2009) and therefore massively reduced public spending on interests. The abolition of exchange rates between Euro member states had clear advantages in terms of a facilitation to exchanges in the common market, reducing exchange costs for firms and individuals, marking the end of speculative attacks destabilizing single national currencies and leading to capital flights. It also marked the end of the illusion of independent national interest rate setting, while in fact the choices of the German Bundesbank dictated every other member's decisions before 1999.

On the other hand the Euro has highlighted and not cancelled the differences in competitiveness between Euro area economies, leading to a divergence in trade imbalances. Germany actually had a current account deficit in the late 1990's because of the repeated devaluations/depreciations of many of its trade partners, while in 2015 its trade surplus reached a record 8,4% of GDP. Similar large surpluses has been developed by the Netherlands (8,6%). Italy has now a surplus as well (2,2% of GDP) but not thanks to improved competitiveness and export growth (export level in 2016 was close to the level of 2007) but because of a collapse in imports and internal demand due to the crises (Italian GDP in 2016 was 7% lower than in 2007 and industrial production was 20% lower).

In the first 18 years of existence of the Euro economic growth has decreased, per capita income has decreased in some countries and stagnated in others, unemployment rates have increased massively and now are decreasing but overall remain higher and with less job stability. A large part of these developments are not due to the Euro but to the effects of economic and financial crises and the immense increase in production and exports by Chinese and other Asian countries since 2001, when China was admitted to the WTO, which have displaced European producers and therefore hit European consumers. China moved from 7,4% of world GDP in 2000 to 17,3% in 2015 and from a surplus of current accounts from 1,7% of its GDP in 2000 to 9,9% in 2007 and reduced to 2,4% in 2016.

However the Euro played a role as well, in depressing economic growth through a generalized imposition of austerity policies from 2010 onwards as a consequence of the German and northen European reaction to the Greek debt crisis. Germany had been placed in a minority position within the G20 in the global policy response to the international financial crisis in 2008 and 2009. The concerted efforts of US president Obama and of Uk's Prime Minister Gordon Brown had created a majority coalition in favour of a large reflationary policy of support to the banking and financial system but also in support of internal demand and of investments, to stop the Great recession. After the success of that effort in stopping the recession, 2010 had produced the beginning of recovery everywhere, when Germany managed to seize control of the policy direction within the much smaller scenario of the Euro area, without Obama's influence, after Gordon Brown's defeat at the elections and after the change of priorities of the French president Sarkozy, who decided to side with Merkel. Just as in 2009 the concerted stimulus to the world economy worked to restart growth, in 2012-2014 a concerted move in the opposite direction, from stimulus to austerity in the whole European union, created a new recession in southern Europe and no growth in the northern Europe. Only in 2015 the effects of a reduced pressure of austerity started being felt. Domestic austerity cannot be compensated by an accelerated growth of exports if the main trade partners are reducing imports because they are applying fiscal austerity as well.

The main instrument to introduce a generalized austerity has been the reinforcement of the stability and growth pact. The stability pact was introduced originally to ensure the continuation of principles of sound public finances as a key condition of sustainability of a common currency (James 2012). The use of a ceiling of a maximum 60% ratio of debt to GDP and 3% deficit to GDP as central elements of a mechanism to enforce discipline have been criticized from the beginning, for example by the French Prime Minister Jospin, who campaigned against it in 1997 but was forced to accept it with the label "Stability and growth pact". The pact itself has been bended to accomodate French and German breaches to the deficit ceiling in 2003. It was tightened in 2011-2013 (through a series of measures known as Sixpack, Twopack and Fiscal Compact) after the Greek fraud on stated public accounts, reinforcing the preventive and corrective arms and introducing a debt rule, forcing countries whose debt was above the 60% threshold to reduce the excess debt above that level by a 20th every year, even if delaying its implementation for a few years. It was relaxed again, following the perception that excessive austerity was killing economic growth and fuelling political populism, with the introduction in 2015 of a "flexibility" mechanisms by the European commission under Juncker. Many German commentators complain that the rules continue not to be respected and therefore lax fiscal policies continue in some member states, without real punishment and threaten the stability of the whole edifice of EMU.

The critics of austerity on the other hand, especially the French and Italian governments, point instead to the absurd limitation of the rules, which force states to reduce public investment as well as increase taxation and therefore depress economic growth and end up increasing the real burden of debt in % of GDP instead of reducing it. The outcome so far is that after the introduction of the Euro the debt to GDP ratio has substantially increased around the Eurozone and is above 60% in all the largest EU member states.

The necessity of fiscal discipline is inescapable for countries with a difficult demographic future and low expectations in terms of future economic growth, but the debt rule is impossible to respect for countries with a high debt because it would require a substantial inflation, constant budget close to balance and an economic growth above the trend of the last fifteen years. Italy for example would require continual balanced budget, 1,5% inflation and more than 1,5% economic growth very single year for decades to respect the debt rule. It is in other words a combination which has never been achieved for decades and could be achieved only with a perfect combination of favourable circumstances, close to a miracle, hardly a rational basis for sound economic policy. It is therefore imperative to modify radically the debt rule as well as the treatment of budget deficits when they are already below the 3% threshold, in order to avoid strangling investment, consumption and economic growth.

The European Central Bank, under the leadership of Mario Draghi, has taken decisive actions to moderate the effects of credit rationing and to reduce the growing interest rates differential on government bonds between member states'. These policies have included reductions in interest rates, quantitative easing and the statement that the ECB would do whatever it would take to preserve the Euro. These actions are not sufficient by themselves to stabilize the Euro area, even if the European banking union progresses.

The perceived uncertainty on the sustainability of government debt, despite the creation in 2010 and 2012 of the European Financial Stability Facility and of the European Stability Mechanism (so-called bailout mechanisms) to support readjustment through conditional loans, has also led to the proposal of various schemes to share between member states the responsibility for national debts, in order to achieve a real convergence in the interest rates paid by every government of the Eurozone. These proposals for the issue of Eurobonds have been issued between others by Romano Prodi. However limited or cleverly articulated, such proposals have always been rejected by Germany, and have no real chance to be ever accepted before the unlikely completion of a full political and economic union. But monetary unions are like love: they are eternal, as long as they last. No country would accept to be saddled by an open ended responsibility over the debt of other countries when it cannot control the formation of additional uncontrollable debt. If the single European finance minister hypothesis is unrealistic in the current political environment, because governments will not give up tax and spending powers and Germany will never let the EU turn into a transfer union, then Eurobonds remain just as unrealistic.

The persistent German oversize trade surplus and the commercial credit/debt that it creates must be corrected through an increase in investment and spending by Germany itself. Its infrastructures are aging and investment is low by German historical standards. The budget surplus created by the Merkel government is also damaging and can be spent for the mutual benefit of Europe.

Some see the exit of southern European countries from the Euro the only corrective mechanism to reestablish their competitiveness through the devaluation of a reborn national currencies and possibly also the partial repudiation of national government debts through defaults. These suggestions are just as simplistic as those proposed by the unconditional proponents of immediate and complete political union, with large fiscal transfers, Eurobonds and a single European finance Minister, but they are far more dangerous than the former. Pure Eurofederalists cannot achieve now the consensus required between at least ten countries to progress in the direction hoped for, while a single extremist government deciding to leave the Euro can produce alone a large damage. We can recall the effects of the end of monetary unions, returning to the example of the breakdown of the Austro-Hungarian monetary union after 1918 and to the Argentinian default and devalution of 2001(Argentina was leaving a currency board, a sort of self imposed unilateral monetary union with the dollar, with an exchange rate fixed "for ever"). For several year currency proliferation took place (including multiple chaotic parallel currencies), devaluation, high inflation (becoming in some case hyperinflation, as in Austria, Hungary and Germany), mass impoverishment of the population, through the growing cost of imports and the inability of wages and pensions to follow inflation, breakdown of free movement of capital, as restrictions and controls must be introduced in emergency to stop massive capital flights, limitations to individual access to savings and bank accounts (the Argentinian *corallito* of 2002), capital levies, general disorganization of the economy and plunging GDP (Schlesinger 1920, Garber and Spencer 1994). These effects could last for a limited time with some luck, but it is more likely that the effects will have a long term effect. Argentina was still battling holdouts refusing a settlement on its it debt default fifteen years later and was still denied access to international capital markets. Furthermore today in many European countries government debt is also held by national bank, pension funds and national savers and the default would threaten part of the pension and of the banking system, threatening the availability of credit. Furthermore exiting a monetary union is a very long and complex affair. It took until 1925 to conclude the liquidation of the common central bank of the Austro-Hungarian Empire, and in today's EMU financial commitments and legal complexity are a multiple of those of a hundred years ago.

Stiglitz has responded to these issues arguing that only Germany should leave the Euro, to let a new German mark appreciate and facilitate a return to equilibrium in international trade and economic activity (Stiglitz 2016). But without the attractiveness of gaining low interest rates through the association with Germany in a common currency most countries would simply not deem worthwhile the other sacrifices required to stay in a monetary union. Without Germany the rest of northern Europe would not want to be united primarily with France, Spain and Italy and EMU would rapidly disappear, with all the destabilizing consequences.

Material and Infrastructural reconstruction

The destructions of public and private housing and of infrastructure was massive around Europe at the end of World War I, but limited to specific areas where fighting had been concentrated, mainly North-Eastern France, Belgium, the Netherlands and North-eastern Italy, part of the Balkans and more limited parts of the former Austro-Hungarian, German and Russian Empires. Another substantial problem was four years of underinvestment in civilian infrastructures and spending and the necessity to demobilize war industry and war planning arrangements and organizations. The decline in economic activity due to the collapse of old existing states in central and eastern Europe, followed by post war demobilization of troops and wartime military production added to the chaos, contributing to social and political unrest and revolutions (Bolsheviks in Russia in 1917, Spartakists in Germany in 1919, Fascists in Italy in 1922, and later the Nationalsocialists in Germany) followed by counterrevolutions in some countries. It took several years to conclude the reordering of the European economy and in the second half of the 1920's the situation seemed normalized in most countries, just when the situation collapsed again from 1929 onwards.

Today the reconstruction of Europe is not primarily a physical reconstruction, given that in the last decade there was no war with material destruction on the territory of the European Union. Terrorist attacks have provoked minimal material damage and the destructions of the Balkan wars of the 1990's are distant, while the Ukrainian conflict started in 2014 is outside the EU borders. The multiple economic crises of 2008-2014 have instead left a rather heavy inheritance in terms of underinvestment (370 billion euros below the historical pre-crisis norm, according to Juncker). The private sector has reduced investment during recessions and afterwards, because of economic and political uncertainty, but also for credit scarcity, particularly in southern Europe. Public investment has not compensated the reduction of private investment. On the contrary austerity policies have led first and foremost to a decline of public investment, the easiest form of government spending that can be reduced and frozen, without being classified in government budget as protected forms of "mandatory spending" (wages, pensions, health spending, school spending, pre-existing contracts, etc.). Between 2007 and 2013 investment fell in the EU from 23,3% of GDP to 19,3%, much more than savings which declined from 22,8% to 21%. The recovery started in 2014 has not been accompanied by a return to the pre-crises levels of investment, but only to a very partial increase, especially in Southern Europe.

The consequences of such a low level of investment is a reduction of the potential growth rate in comparison to the pre 2007 potential, especially given the persistent weakness of internal demand in many EU states and the reduction in the growth of international trade and therefore of exports. Slow growth also means that the reduction of European unemployment rate has been very slow, especially concerning youth unemployment.

The response has included a policy by the European Central Bank to stabilize the macroeconomic situation by reaffirming its commitment to the single European currency, ("Do whatever it takes"), but especially a series of moves (Quantitative easing) to reduce and keep interest rates close to zero, at levels so low that many European countries had not experienced them even during the Great Depression (Euthanasia of the *Rentiers*).

At the same time the European commission launched the Investment plan for Europe, also known as the "Junker plan", launched in 2014, meant to mobilize at least 315 billion Euros of investment across the EU, by removing obstacles to investment, and by providing visibility and technical assistance. In fact the European commission was providing only a very limited amount of additional funds, intending to use existing resources and credit from the European Investment Bank (EIB) to guarantee private investment with an expected leverage factor of 15 to 1, meaning that 21 billion Euros would serve as public guarantee of the riskiest part of the investment, in order to stimulate over 3 years a total of 315 billion Euros of investment with private funds, mainly institutional investors. The EIB based European Fund for Strategic Investments (EFSI) drives the plan, using an online market place where promoters can propose and investors can seek investment opportunities worth at least 5 million Euros, the European Investment Project Portal (EIPP) and a technical unit, the European Investment Advisory Hub (EIAH). The sectors covered are consistent with the main priorities of the EU, that is energy efficiency, transport, healthcare, renewable energy, broadband infrastructure and SME's financing.

How the Junker plan has fared so far? In January 2017, one year before the targeted goal, 168,8 billion euros were potentially triggered by EFSI financing, but only 31,1 billions had been approved for EFSI financing and 21,9 billions had been signed, according to the EU-EIB-EIF, for a total of

444 transactions approved. SME were the main beneficiaries with 30% of the total, energy with 23%, while transport benefitted only from 8% of the total and social infrastructures 4% (European commission, European Investment Bank, European Investment Fund, 2017).

After the British vote in favour of leaving Europe, the Ventotene meeting on 28 August 2016, meant to show the decision by the big three (Germany, France and Italy) to proceed with European integration, also produced a commitment to stimulate quality investment in advanced sectors, to create employment, enlarging the Junker Plan. The problem however is that the outcome of high tech investment is to create net job losses, with some high income jobs added and many more lower income jobs destroyed.

In December 2016 EU Ministers have approved the extension of the EFSI until 2020 and to highway projects in all member states (initially it was limited to the 15 poorest) and to defence and security. Questions about its relevance and impact remain: the Juncker plan represents only a very small fraction of EU GDP and of EU investment and therefore will have a limited impact (far below the more aggressive and larger Obama plan of 2009). It is in part funding additional investment but mostly only finance ordinary EIB investments, already planned, without much additional value for money and effects in stimulating growth. It also suffers from typical problems associated to Public Private Partnerships, in particular it concentrates its impact in countries and regions with higher per capita income, that need it less.

Demographic and migratory challenges

The beginning of WWI created immediate movements of population. Some governments initially resorted to expulsions of immigrant workers, accusing them of being potential agents of a hostile power. The war had a disastrous effect on European population. Germany alone lost 12 million inhabitants because of WWI (1,7 million killed, 3,3 million because of reduced births, 0,5 million for increased mortality for civilian population and 6,5 million for loss of territory (Hahn 1922 and Bade 2001). The fall of birth rates in the 1930's led demographer at the times to forecast a catastrophic fall in population for the major European economies and to campaigns in favour of policies to support fertility. Movements of population restarted after the end of the war, millions of war prisoners, formerly employed as forced labour, moved back, frontiers changed, and transatlantic migration of Europeans restarted. Overall high unemployment and a generalized spread of protectionist policies (new visas, restrictions, quotas and controls) discouraged migration (Kellor 1922), such as the US quotas by origins of 1921 and 1924 against southern and western Europeans and with a total exclusion of Asians, or the Italian fascist policy of stopping emigration.

In 1900 25% of world population was living in Europe, in 2015 only 6% (Juncker 2017). Today's Europe is characterized by very low birth rates in many countries (about 1,3-1,4 children per woman in Spain, Italy and Germany), but not everywhere, as a limited number of countries have a balanced or close to balanced birth rate (France, UK, Sweden). Italy and Germany already experience a net loss of population through a negative balance between births and deaths, and only a positive net migration is preventing a downwards spiral in population. A loss of population would accelerate the decline of marginal areas (mountains, countryside, small centres) and cause a decline in GDP. Overall, in the medium to long term, the EU needs immigration to compensate low birth rates in its western part and emigration from its western members. Such a need is not necessarily immediate in countries with a high unemployment rate, (Italy, Spain and France) and is extremely difficult to explain to the public even when unemployment is low but per capita income is stagnating and populist movements point to migration as a cause of it and a threat to identity and social cohesion and to security (UK, Austria, the Czech Republic or the Netherlands).

Common European asylum policies were initially based on the 1951 Geneva Convention for the protection of refugees and developed at the European level through the Dublin convention in 1990, amended in 2003 and 2013. The Dublin regulations state that the first country where an asylum seeker lodges his claim or where his fingerprints are taken is responsible for his asylum claim. Another key European agreement was signed in Schengen and developed from the 1990's onwards, providing a common area without internal frontiers and border controls. Its initial popularity and success, accompanied common asylum policies, common rules on migrants' rights, work permits, etc. With the Amsterdam Treaty signed in 1997, some migratory policies were to be developed through qualified majorities and not unanimity. Nevertheless the right to choose who had the right to enter and settle in each country remained the domain of individual member states, except for right to free movement for work purposes, granted in 1968 to all citizens of the EEC (and then the EU). The only limitation was a transitional period of up to 7 years, that each member state can activate on its own, between the accession of new members and the full freedom of movement for work for its citizens.

The growth of asylum applications in 2013-2016 has created the largest refugee crisis since the mass movements of 1989-93 after the fall of the Berlin wall. The new crisis peaked in 2015 with over a million irregular inflows from the Mediterranean, through Greece and Italy, arriving from the crisis areas of the middle east (Syria, Irak, Afganistan) but also from Eastern and Western Africa, part likely refugees, part classical economic migrants. After an attempt by the European Commission to agree on a policy of burden sharing, with the distribution of asylum seekers across all of the EU, the most visible reaction has been the construction of barbed wire fences, walls and barriers between member states and neighbouring countries, but also within the Union and a crisis of the post war consensus on asylum rights. In fact the walls worked in diverting flows towards immediate neighbours, pushing them to close their frontiers as well, blocking large number of asylum seekers and immigrants at the frontiers, strained relations between governments and threatening a basic principle of European democracy. The EU wide quotas established in 2015 to redistribute 160.000 migrants from Italy, Greece and Hungary was also meant to show the solidarity of the whole union with the refugees from wars, in Siria and Irak, and with the frontline countries where boats unloaded thousands of migrants per day. It did not work, because eastern European members, led by Poland and Hungary, refused to accept their share of asylum seekers and the authority of the Commission to impose such decision, challenged in court. By March 2017 only a little more than 4.000 asylum seekers had been redistributed. Great political capital has been sought by anti-EU and anti-immigrant parties (the two positions often coincide), claiming that Europe was overcome by dangerous flows of undeserving foreigners and potential terrorists and that only a strong national State could form a barrier against such hostile invasions.

The policy which was really implemented with a certain success is that of multilateral or bilateral agreements with transit countries, first concluded by the EU with Turkey in March 2016, and then by Italy with Lybia in January 2017. The agreement with Turkey worked in a spectacular fashion, reducing inflows in Greece from over 60.000 per month in early 2016 to less than 2.000 per months from April. After having openend German frontiers to refugees Angela Merkel worked on that agreement to contain Syrian, Iraki and Afgan refugee flows that were destabilizing even the German political scene, fuelling a rapid decline of her party (CDU) in favour of the anti-immigrant AfD. Italy instead experienced a growing inflow of sub-Saharian African economic migrants through the uncontrolled frontier of Lybia. Smugglers of human beings have grown into well organized bands of traffickers, profiting from the melting down of central government and continuous conflicts between groups and armies after the fall of Gheddafi, producing half a million landings on Italian coasts in 2014-2016. The Italian government has reached agreements with the Lybian government of Tripoli, headed by the moderate Serraj, with tribal leaders and mayors, despite the initial opposition of the other alternative government in eastern

Lybia, under the influence of general Haftar, protected by Egypt and Russia. The agreement, associated to financial aid, patrolling equipment and cooperation on camps under international supervision, started producing results at the beginning of July 2017, with a 70% reduction of inflows over four months.

The ultimate defeat of ISIS and Al Quaida and the stabilization of Lybia are the main objectives for the near future in terms o migration stabilization. The problem of the defence of human rights in Lybia remains, just as in Turkey after Erdogan's crackdown on any form of opposition.

In addition to agreements with Mediterranean countries the EU promoted in response to the new crises hotspots to identify newly arrived migrants, partnership agreements with third countries, relocation, reinforcement of external frontiers, asylum reform and struggle against human trafficking. Frontex has been reinforced and transformed in the European Border and Coast Guard Agency, launched in October 2016, and financial assistance to frontline countries has been strengthened, The management of migration has been transformed into a policy of containment, especially after the German Chancellor Angela Merkel quietly changed her policy of opening adopted in 2015, in favour of a more prudent return to more traditional forms of limited support and strong border controls.

It is often argued that irresistible migratory flows are the consequence of a continent with more than a billion inhabitants whose youth aspires to reach Europe, but these overly general statements are too vague and generic. They overestimate the will to migrate by young Africans and underestimate the cost, risks, difficulties and disappointments of migration. They also underestimate the potential efficiency of bilateral agreements between governments in reducing illegal migration to limited and acceptable numbers. The examples of the EU agreement with Turkey in 2016, and of Italy with Lybia in 2009 and 2017, Tunisia, Marocco and Albania in 1997-1999 are very telling. As long as governments remain in control of their respective countries, they have the capacity to reduce substantially outflows of people. The human cost is great, the risk of sacrificing real refugees is substantial, but the limitation of migration flows of economic migrants is far from impossible. Overall migrants landings in the Mediterranean countries of the EU declined by about 65% in 2016, despite the increase on Italian coasts. In early 2017 it is already possible to see the first signs of a decrease of the great migration fear that attacked many Europeans in 2015-2016. This is the prerequisite for a more orderly management of immigration (it will always be a bit messy in any case), in which migrants aspirations for a better life can match the European need for the contribution of a younger generation to its labour force and its society, integrating different cultures with less conflicts.

Conclusions

Today's bookstores are full of books describing why and how the European union and or the Euro will soon collapse under the pressure of today's challenges and of populist movements. Every human adventure is marked by the ambition and expectation of continual improvements, yet institutions do not get demolished if they fail to do so for part of their existence, when there is awareness that the vacuum created by their downfall would probably be far worse. There has been a longstanding tendency by Us commentators and by some Europeans to underestimate the endurance of the European project, the capacity of institutions to withstand difficulties and the commitment of the vast majority of European governments to sustain or to advance the European project and the Euro.

Throughout European history periods of great advances have coexisted with much longer periods of limited change and advance without threatening the foundation of the project. The EU can survive and remain an important force for the improvement of the life of Europeans despite its nonlinear development and the progressive relative decline of the old continent against the advance of Asia. Unlike what many like to present, we are not facing a stark alternative between an immediate threat of dissolution of the EU or instead a quantum leap to a pure federalist European Superstate with complete fiscal homogeneity and solidarity between member states, and unified political system. The EU will remain a continuously evolving compromise between a confederate intergovernmental organization mixed with some federal characters, kept alive by more compromises and adjustments, as imperfect as the real world is.

Changes need to take place, but not changes at all cost and of a predetermined nature. The EU is necessarily based on continual negociations between national needs and impulses and not a rational long term plan. Contrary to general opinion, this is a positive characteristics if you do not believe there is a predetermined place to reach. The EU was, is and will continue to be a compromise between a very strong nationalist past, which cannot be entirely cancelled, and a process of cooperation and unification to prevent inter-European destructive wars and to better withstand the storm of globalization that is progressively erasing the benefit for Europe of having initiated the industrial revolution.

There is certainly a need to find a more effective way to increase economic growth to reduce unemployment and inequality and reconstruct hope in the future for younger generations, also to facilitate a return to a more balanced demographic situation where European are not prevented from having children by poverty and fear. For that, it is not only necessary to facilitate investment, to develop a social Europe and to regulate migration so that it is the added resource that it should naturally be and not be perceived as a threat. It is also necessary to reform financial and monetary policy, reengineering the stability pact and the debt brake rule, removing its excessive propensity to austerity, to complete banking union with a common mechanism for deposit insurance and increase the cooperation in regalian maters (defence and security). Despite the migration crisis of 2015-2016 and the terrorist threat the Schengen agreement is holding because Europeans are extremely attached to freedom of movement and because more information sharing creates more security and not less.

The Latin Monetary Union underwent a phases of rules tightening in the 1860's and 1870's, after initial rules proved to be too relaxed, but ended up with excessively restrictive rules of monetary issue. European monetary policy was saved by the gold inflation that accompanied the *Belle Époque*. The excessively tight monetary rules of the late 1920's gold exchange standard contributed to Great Depression in 1929. The overdose of austerity from 2011 has produced unemployment and economic destruction and requires a new form of policy relaxation, as in the past. The search for stability against inflation and unruly deficits is necessary but must always be balanced with the awareness that without growth stability is a source of economic failure and great political disruption as a consequence.

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