five per cent, from 684 to 900 lire.[32] Since May 1974, given a substantial deficit in the balance of payments and the impossibility of accessing the international financial markets, Italy had drawn heavily on funds made available by the International Monetary Fund for almost 900 million dollars, obtained a short-term credit from the Bundesbank for 500 million dollars and used the entire short-term credit line granted by the European Community.[33] In 1977, the Italian economy appeared to be in a "precarious" condition and the OECD and the Monetary Fund called for a stabilisation programme.[34]

By the end of the decade, it was becoming increasingly evident that Italy could not be considered a reliable partner by the major European governments and central bankers, owing to the loss of business competitiveness, high inflation, the repeated depreciation of the lira, the growing imbalances in public finance, the high unemployment rate and the intense and constant social conflict.[35] In the new, intensified phase of European integration, inaugurated in October 1977 by the then President of the European Commission Roy Jenkins, Italy was therefore in the difficult position of having to prove its credibility in order to participate fully in a monetary integration project that required convergence of economic and monetary policies.[36]

The EMS, the Bank of Italy and the choice for Europe

The prospect of creating a European monetary system, formulated by Helmut Schmidt and Valéry Giscard d'Estaing in the early months of 1978,[37] put Italy

[32] OECD, *Economic Surveys*, *Italy*, Paris, OECD, 1977, pp. 21-25. In its 1976 survey, the OECD described the Italian balance of payments position as 'fragile', since the brilliant rebalancing act of 1975 had been based on a contraction in exports rather than an adjustment to export growth, a sign of the declining competitiveness of Italian companies (OECD, *Economic Surveys*, *Italy*, Paris, OECD, 1976, p. 36).

[33] Banca d'Italia, *Considerazioni finali*, Rome, Banca d'Italia, 1975, p. 18; IMF, *Annual Report*, Washington, 1975, p. 36.

[34] See Francesco Giavazzi and Luigi Spaventa, *Italy: the real effects of inflation and disinflation*, "Economic Policy", 4 (1989), 8, p. 142.

[35] As we can deduce, for instance, from the inaccurate reconstruction — but probably faithful in its retrospective assessment — of the Italian divergence 'from the 1970s onwards' by Markus K. Brunnermaier, Harold James and Jean-Pierre Landau, *The Euro and the Battle of Ideas*, Princeton, Princeton University Press, 2016, pp. 240-241.

[36] See Peter Ludlow, *The Making of the European Monetary System*, London, Butterworth, 1982, pp. 37-55; Piers N. Ludlow, *Roy Jenkins and the European Commission Presidency, 1976-1980*, Basingstoke, Palgrave Macmillan, 2016, pp. 113-139.

[37] Eichengreen reads the proposal as a response to the growing rigidity that emerged during the decade and the void left by the end of the Bretton Woods system (Barry Eichengreen, *The European Economy Since 1945*, Princeton, Princeton University Press, 2007, pp. 282-286). A detailed reconstruction of the relations between France, Germany and Italy during Giscard d'Estaing's seven-year term can be found in Georges-Henri Soutou, *L'Italie et le "couple" franco allemand*, in *L'Italia nella costruzione europea*, cit., p. 57; more generally, Id., *L'alliance incertaine: les rapports politico-stratégiques franco-allemands, 1954-1996*, Paris, Fayard, 1996.

in the difficult position of having to develop a comprehensive convergence strategy that would be credible and free it from the "loneliness" in which Carli had found himself a few years earlier. Baffi's appointment had deeply changed the objectives and methods that the Bank of Italy was defining for itself as a central monetary authority, in particular with a view to restoring allocative efficiency to the credit market so as to make Italian companies competitive again and thus create the conditions for a non-episodic adjustment of the balance of payments and consistent stabilisation of the exchange rate.[38] However, the Bank of Italy's commitment was insufficient to restore the necessary credibility to Italy and the international commitments made by its political class that a more binding monetary integration would have imposed. It was not certain whether Italy could actually be included among the EEC members that would have formed the currency pool initially envisaged by the German Chancellor Schmidt, in the first version of which Italy was not explicitly listed.[39] Although speculative attacks also put pressure on the French franc and the British sterling, the deceleration of growth, the balance of payment deficits and the depreciation of the lira led to the assumption that Italy had entered, after the abandonment of the monetary snake in February 1973, a phase of 'slowing down of the process of integration of our economy into that of the Community'.[40]

[38] As Baffi wrote in an article published in English in *The Banker* in December 1975, and in Italian on 14 January 1976 in *la Repubblica*, titled *L'angusto sentiero dell'Italia*: '[T]he boundaries of the options that are available to politicians are narrower than in the past […] we cannot recreate the current account deficits. Nor can we pursue the balance between imports and exports through changes in the exchange rate […]. We can therefore not avoid the conclusion that the creation of liquidity by the public sector will have to be contained within limits compatible with the equilibrium condition of the balance of payments' (now in Paolo Baffi, *Economista e banchiere centrale*, edited by Federico Pascucci, Rome-Bari, Laterza, 2019, p. 99). See also Alfredo Gigliobianco, *Via Nazionale. Banca d'Italia e classe dirigente*, Rome, Donzelli, 2006, pp. 323-333; Federico Barbiellini Amidei, *Paolo Baffi, una lezione civile*, in Paolo Baffi, *Economista e banchiere centrale*, cit., pp. XXVII-XXX.

[39] Chancellor Schmidt presented the idea to British Prime Minister James Callaghan, who described it as 'an exotic idea', at a meeting in Bonn on 12 March 1978, where the Federal Republic of Germany, France and the United Kingdom were undoubtedly present. One of the effects Schmidt expected was that of 'weaken[ing] the German mark' (Margaret Thatcher Foundation, 10 Downing Street, FOI release 248745, G7 Bonn Summit, KRS [Kenneth Ronald Stowe, Prime Minister principal private secretary], "Note of Schmidt-Callaghan private dinner – EMS", 13 March 1978). Schmidt discussed this with Giscard d'Estaing and Jenkins in two meetings in February (Amaury de Saint Périer, *La France, l'Allemagne et l'Europe monétaire de 1974 à 1981*, Paris, Sciences Po Presses, 2013, pp. 148-149).

[40] This is what Carli said in May of that year: 'Italy's failure to participate in the common fluctuation of European currencies does not seem to be the cause of Italy's detachment from Europe; if anything, the opposite is true: the shadows of international and internal behaviour have suddenly been reflected on the monetary yardstick […]; the result was a slowdown in the process of integrating our economy into that of the Community' (Banca d'Italia, *Considerazioni finali*, Rome, Banca d'Italia, 1973, pp. 19-20).

The evaluation of the 'new monetary arrangements for Europe' proposed by Schmidt focused on the real exchange rate effects they would have on the currencies of the countries that were to participate in them and the related asymmetrical effects on the competitiveness of their economies. The agreement between Giscard and Schmidt initially met with resistance from Britain, whose Treasury saw it as a projection of German power.[41] The British assessment of the proposal highlighted the expected effects of the weakening of the mark on European economies, making the proposal 'not attractive' because 'we would be less competitive', while fearing that it might appear 'like ganging up with the Germans against the United States'. For Gordon Richardson, the governor of the Bank of England, 'it was not clear what would happen to the currency of the other members of the Nine, and especially to Italy; he might have it in mind to leave Italy out of any arrangement'.[42]

As is known, the EMS began to take shape and became structured during three European Council meetings,[43] held between April and July 1978: in Copenhagen on 7 and 8 April, in Bremen on 6 and 7 July, and in Bonn on 16 and 17 July. Here, the features of the new structure of European monetary cooperation and integration were clarified, and Italy managed to change its position by being considered as a country capable of participating in the agreements that had the task of providing monetary and currency stability while at the same time strengthening the growth capacities of the EEC economies in terms of progressive integration.[44] At the Copenhagen summit, the idea promoted by Giscard and Schmidt had not yet taken full shape, but at that time it did not include the lira. In Schmidt's words, closer monetary cooper-

[41] See Harold James, *Making a central bank without a state*, in *Les banques centrales à l'échelle du monde*, edited by Olivier Feiertag and Michel Margairaz, Paris, Sciences-Po Presses, 2012, p. 211. Schmidt and Giscard had different reasons, as we have seen, and their assessments differed between industry and monetary authorities in both Germany and France. The risk that large German companies in more capital-intensive sectors would lose their competitiveness as a result of the strong mark was obvious, as was the choice of France — and also Italy — to "trade" growth for stability (Marcello De Cecco, *Il Sistema monetario europeo e gli interessi nazionali*, in *L'economia politica dell'integrazione europea: stati, mercati e istituzioni*, edited by Paolo Guerrieri and Pier Carlo Padoan, Bologna, il Mulino, 1988, pp. 153-155).

[42] Margaret Thatcher Foundation, 10 Downing Street, FOI release 248745, "Note of a meeting held in the Cabinet Room at 18.45 on Tuesday 4 April 1978", siglata N.L.W., 5 aprile 1978. The fact that Giscard and Schmidt wanted to limit themselves to a consultation with Callaghan can be deducted from a conversation that the British prime minister and the French president had that morning about 'the European monetary organisation' (*ibidem*).

[43] On the importance of the new level of international and regional governance associated with the meetings of the political and monetary authorities of the major economies since the early 1970s, as a response to the financial instability triggered by the end of the Bretton Woods system, and the European Council, see *International Summitry and Global Governance. The Rise of the G7 and the European Council, 1974-1991*, edited by Emmanuel Mourlon-Druol and Federico Romero, London-New York, Routledge, 2014.

[44] See Ludlow, *The Making of the European Monetary System*, cit., pp. 88-158; Mourlon-Druol, *A Europe Made of Money*, cit., pp. 164-168.

ation would be necessary to succeed in 'turning the tide'.[45] In the following weeks, the proposal was essentially interpreted as the creation of a monetary stability zone in Europe. During a meeting held at Chequers Court on 23 April, following the Copenhagen summit, Schmidt explained to Callaghan, the Chancellor of the Exchequer Denis Healey and Governor Richardson the features of the system of 'monetary relationships in Europe' in terms of a system of semi-fixed exchange rates, 'with or without Britain'. In this context, Schmidt also considered the possible participation of Italy in what was essentially a political role: '[H]e is ready to take on the risk of Italy as a burden under this scheme because he was passionately determined to do all that he could to avoid Communist governments in Italy and France.'[46]

According to Schmidt, Italy's participation in the project was therefore based on political considerations, in line with the Cold War system of international relations. Before the Bremen summit, top representatives from Britain, France and Germany conducted confidential consultations in Paris, which led to an agreement on the necessity to achieve convergence in monetary policies among the countries that would participate in the stabilisation scheme. However, the assessments of the suitability and risks of the individual economies were rather cautious,[47] in the knowledge that — as Callaghan observed — Schmidt's outline would lead to a more favourable real exchange rate for the German mark as a result of the participation of France, Britain and Italy: '[T]his would simply make the German economy even more competitive.'[48]

[45] UK NA, Kew, PREM 16/1615, "The Case for More Intra-European Monetary Cooperation. Summary of Comments made [by Schmidt] in Copenhagen on April 7, 1978", p. 7. For a reconstruction, see Ludlow, *The Making of the European Monetary System*, cit., pp. 88-94; Mourlon-Druol, *A Europe Made of Money*, cit., pp. 168-177.

[46] In any case, no one in Italy had been made aware of the scheme; at that time, it was known only to the participants in the meeting (in addition to those mentioned above, these included — on the British side — Harold Lever, Second Permanent Secretary for Overseas Finance K.E. Couzens and Stowe, and on the German side, the President of the Bundesbank Otmar Emminger, Minister of Finance Hans Matthöfer and H. Heick), the French President Giscard, the Governor of the Banque de France Bernard Clappier, Graff Lambsdorff and Schulmann The quotations can be found, respectively, in The National Archive, Kew (UK NA) and Chequers, Prime Minister's (PREM), 16/1655, Note for the record, "Prime Minister's Meeting with Chancellor Schmidt at Chequers on Sunday 23 April 1978 at 19.45", pp. 13 and 16.

[47] UK NA, Kew, HM Treasury, PREM 16/1634 "European currency arrangement. Discussions in Paris on 14 and 15 June 1978", Secret, 15 June 1978, p. 4. The need for convergence criteria in monetary policies was made explicit in a draft presented by Clappier during confidential talks with the British (*ibidem*, "Outline of a scheme by M. Clappier", point 4). The last part of the note, described as 'confidential', reports the convergence of assessment between Chancellor Healey and Monory regarding the German position: '[T]here was a danger that the Germans were using the monetary discussions to distract attention from commitments to growth.'

[48] UK NA, Kew, 10 Downing Street, PREM 16/1634, "Note for the record", "Bremen European Council Meeting record of conversation", "After dinner meeting", 6 July 1978. Callaghan's concern was consistent with the analyses that the International Monetary Fund had

A few days after the Paris talks, on 17 and 19 June, the draft was presented — at least along general lines — to Andreotti by Clappier, in Rome, and by Schmidt himself, in Hamburg, and finally to Treasury Minister Pandolfi at the meeting of the Economic and Financial Affairs Council (hereafter ECOFIN) in Luxembourg.[49] On his way back from the ECOFIN summit, Ciampi spoke with Pandolfi about Italy's options in the face of greater European integration; back in Italy, a number of documents containing analyses and proposals were quickly prepared at the Bank of Italy.[50] The first document concerned 'the credit system and the recapitalisation of companies' and was sent to the minister on 20 June; the second focused on 'the recovery from inflation' and was transmitted on 26 June; the third, sent the following day, described the 'European option as a moment of the Italian challenge'. The first document sent to Pandolfi was the likely result of an analysis carried out before the ECOFIN summit; it specified what function should be attributed to the consortia among credit intermediaries in order to facilitate the solution of the many industrial crises underway and the recapitalisation of companies, preventing their high indebtedness from putting the banks themselves at risk.[51] The second, edited by Padoa-Schioppa, was again the result of an analysis begun before the ECOFIN summit in Luxembourg and concerned total domestic credit and monetary aggregates in relation to inflation. It presented itself as an intervention in the policies deemed necessary to bring high inflation under control during the period 1979-1981.[52]

put forward in those years: the United Kingdom had often been associated with Italy because of its balance of payments deficits and reserve shortages (IMF, *Annual Report*, 1975, Washington, 1975, pp. 14 e 23), but also because of the better recovery — compared to Germany — of income in 1977-1979, despite the greater exchange rate instability (IMF, *Annual Report*, 1979, Washington, 1979, pp. 20 and 34).

[49] It is difficult to establish exactly when the stabilisation scheme was presented to the Italian government; we may assume that it happened in early June, since a relative comment was published in the *Corriere della sera* on 7 June 1978, when Schmidt and Giscard's scheme was still confidential. A general outline of the scheme was presented — in some form — to Andreotti first by Clappier during a special trip to Rome and then by Schmidt on 17 June at a meeting with Andreotti in Hamburg (Ludlow, *The Making of the European Monetary System*, cit., pp. 114-115).

[50] On 27 June, Ciampi wrote a short note to Pandolfi: 'I take the liberty of sending you a note written by Dr Masera on a subject discussed with Your Excellency during the recent trip back from Luxembourg' (AS BI, Direttorio Ciampi, file 204, folder 1, subfolder 32, letter from Ciampi to Pandolfi, Rome, 27 June 1978).

[51] The purpose of the note was emphasised in the last part: '[R]e-establishing the conditions for an autonomous development of productive activity constitutes the goal to which the action of the credit institutions must be aimed' (AS BI, Direttorio Ciampi, file 204, folder 1, subfolder 32, "Sistema creditizio e ricapitalizzazione delle imprese. Appunto inviato al Ministro del Tesoro dr. Pandolfi", 20 June 1978, p. 2).

[52] AS BI, Direttorio Ciampi, file 204, folder 1, subfolder 32, "Il 'rientro' dall'inflazione e gli indicatori monetari e creditizi. Appunto redatto dal dott. Padoa-Schioppa, consegnato dal Governatore Ministro Pandolfi", 26 June 1978, 7 pp. and a table.

By contrast, the third document was, as Ciampi pointed out, a direct expression of the Director General's assessments of the — albeit general — currency stabilisation proposals that had emerged from the ECOFIN meeting in Luxembourg, to which Pandolfi and Ossola had initially reacted by expressing doubts about Italy's ability to keep the lira within narrow fluctuation margins (1.25), a sense of caution shared by Governor Baffi himself. The document was drafted by Rainer Masera, then head of the Research department, and in fact had a dual content: economic and political.[53] Masera's memorandum analysed the conditions of imbalance in the Italian economy and defined growth targets 'in order to achieve the full employment of factors', hence in a Keynesian analytical framework. The memorandum described the 'revival of the accumulation process, not only in physical capital, but also in the degree of preparation and capacity of workers and entrepreneurs' as a chance for the country's economy to 'adapt the production base to changes in international commodity prices'. It depicted the Italian economy as being held 'in the narrow space between the Scylla of inflation and the Charybdis of stagnation: the public sector deficit and labour costs'. If the internal constraints on growth were caused by the public debt — which increasingly consisted of current expenditure rather than investment — and the high cost of labour and related inflationary pressures, the adjustment to international market prices represented the 'external constraint' on development, measured by the balance of payments deficits and the pressure on foreign exchange rates caused by the economy's declining 'international competitiveness'. Highlighting the redistributive effects of inflationary phenomena, Masera recalled the risks of crowding out of private sector investment that the expansion of public debt entailed and the interaction between internal inflation factors and currency depreciation, whose competitive benefits were generally temporary. Finally, the memorandum described the 'strategy for a healthy and sustainable recovery', which was based on income policy ('wage increases consistent with a labour cost dynamic in line with that of the main competitor countries in international markets') and associated with an 'awareness' in the 'social body […] of the compatibility of the system'. From this perspective, 'the challenge that everyone must accept requires the chains that prevent us from moving towards conditions of accumulation, disinflationary development and reabsorption of unemployment to be broken […] it seems appropriate to propose, as the moment of the challenge, our willingness to move closer to Europe'. The interaction between domestic prices and the foreign exchange rate, which the Bank of Italy had attributed to negative dynamics in previous years, required interventions on macroeconomic variables that were largely considered 'overlapping'; in this sense, therefore, 'it

[53] Rainer Masera, who had completed a doctorate at Oxford under the supervision of John Hicks, was one of Ciampi's closest collaborators, along with Padoa-Schioppa and Pierluigi Ciocca (Gigliobianco, *Via Nazionale*, cit., p. 351).

became possible and appropriate to explicitly approach a European dimension of the global challenge'. After all, Masera's assessments were based on two facts: the marked and close interdependence of the Italian economy with those of the other members of the European Community and the importance of intra-European trade from, which the country could expect both the financial resources generated by the demand associated with exports and 'important support and assistance in the process of recovering from inflation and relaunching production'.[54]

The 'European option' described by Masera presented the progress of European integration, 'in a context of mutual reinforcement of support and commitments', as an unmissable opportunity for the stable restoration of the country's macroeconomic equilibrium; after all, if adequate choices were not implemented, even only because of the inability to make 'explicit decisions', 'behaviours and choices […] that would make it impossible for us to pursue a path of rapprochement would in themselves leave our system in a vulnerable and uncertain condition — with repercussions that could transcend merely economic values'. Masera's memorandum, then, presented the option as a "rapprochement" with Europe after almost a decade of deviation — at least macroeconomically — from the development trajectories of the core of the EEC and, in explicit terms, highlighted the political relevance of the pro-European choice, to guarantee the country's social and institutional stability. It was a matter of obtaining 'active participation' in the definition of economic and financial 'cooperation' schemes and mechanisms, to the extent that they could be corrected if they did not ensure 'satisfactory symmetry in the convergence process'. The 'global perspective' therefore required Italy to participate in the exchange rate agreements that would probably be proposed at the Bremen summit and put on the table — agreements that were expected to be able, given that initial 'scenario', to 'progressively evolve in the 1980s towards the ultimate, ambitious, but eventually necessary goal of European economic and monetary unification'. In Masera's memorandum, the aims of macroeconomic stabilisation and "rapprochement" with Europe did not end with a return to growth for the Italian economy. In this sense, the 'European option' was a 'corollary' to the 'global challenge' that nevertheless imposed unavoidable decisions and presented 'the relaunch of Italy and Europe' as events that would have to reinforce each other in a much broader political dimension, that within which

> [t]he credibility and affirmation of socially qualifying models of democracy and participation find their true expression in the ability to generate an economic system capable of devel-

[54] AS BI, Direttorio Ciampi, file 204, folder 1, subfolder 32, two versions of a note entitled "La opzione europea come momento della sfida italiana", edited by Rainer Masera, dated 23 and 26 June 1978 respectively (I am citing the longer version of 26 June).

oping and opening up, thus presenting itself as a model, and certainly not in locking itself up in solutions of stagnation and autarky.[55]

Despite the governor's reservations, the Bank of Italy was the only institutional entity that could define and motivate a strategy in the face of an economic and monetary integration plan that exposed Italy to a variety of risks, among which a balance had to be sought that would allow its effective "rapprochement" with the more solid economies of the EEC. If the adoption of rigid macroeconomic adjustment mechanisms to compensate for the loss of competitiveness suffered in the last decade entailed the risk of further instability (exchange rates) and inefficiency (production), not taking part in the monetary stabilisation project would certainly have marked the country's "marginalisation" from Europe as a set of institutions, markets and production, that is, from its political and economic articulation, favouring an even greater divergence from the areas with higher income and productivity. Although it is difficult to believe that Ciampi entrusted the economists of the Research department closest to him with the delicate task of preparing an in-depth analysis, evaluation and strategic proposal in contrast to Baffi, we can nevertheless assume that Ciampi acted with relative autonomy vis-à-vis the governor, as can be deduced from his direct relationship with Minister Pandolfi.[56]

Schmidt and Giscard's plan became clearer at the Bremen summit, and a phase of negotiations began that required an even more intense and demanding analysis and formulation of technical proposals in which the 'European option' supported by Ciampi, described as a 'courageous choice responding to sentiments that evoked the Risorgimento tradition',[57] could — at least in part —

[55] The document is divided into two sections, one containing the economic analysis and the other the political proposal, as we can deduce from the exercise of theorising the proposals that could emerge in Bremen shortly before its conclusion: 'The verification of the renewed will for renewal at the European level, guaranteeing respect for a satisfactory symmetry in the convergence process, should emerge from the forthcoming Bremen summit. In concrete terms, it should first of all manifest adherence to the principles of a concerted and gradual revival of economic activity at the European level, laying the foundations for the reabsorption of unemployment, reducing uncertainties about the development of demand, thus in itself stimulating investment and avoiding the emergence of new deficits in the current balance of payments accounts' (AS BI, Direttorio Ciampi, file 204, folder 1, subfolder 32, two versions of a note entitled "La opzione europea come momento della sfida italiana", cit., p. 8).

[56] In the documents preserved in the Archivio della Banca d'Italia, Baffi does not seem to have commented on or even only viewed and initialled (with the stamp 'Visto [Seen] Dr Baffi') Masera's note, whereas Ciampi himself forwarded it to Minister Pandolfi with the abovementioned accompanying letter.

[57] Ciampi's reference to the *Risorgimento* can be found in his *Considerazioni finali* for 1980, appropriately evoked in Gigliobianco, *Via Nazionale*, cit., p. 349. On his Europeanism in the years of his governorship, Ciampi himself dwells, *en passant*, in his "conversation" with Arrigo Levi: '[M]y handling of relations with foreign countries was characterised, I think I can say, by a great Europeanist drive, but also by constant attention to the global picture' (Carlo Azeglio Ciampi, *Da Livorno al Quirinale. Storia di un italiano*, conversazione con Arrigo Levi, Bologna, il Mulino, 2010, p. 134).

be reconciled with the governor's scepticism about (if not disapproval of) the method, aims and analytical perspective adopted: the Keynesian perspective of full employment of factors, the principle that the Europeanist option had to be tempered by the correction of schemes that were not compatible with the Italian economy, as Baffi would have achieved with a wider fluctuation of the lira, and the assessment that Italy would have had to make similar stabilisation and rebalancing commitments even if the country had not joined a European monetary system.[58]

The Pandolfi Plan: a strategy against the 'joilting line of decline'

At the Bremen summit, Schmidt and Giscard's plan, this time presented — albeit informally, *au coin du feu*, during an evening meeting — in more or less clear and comprehensive terms beyond the circle that had taken part in the Paris talks (the Schulmann-Clappier-Couzens group), could also be discussed outside the restricted group of heads of state or prime ministers. It was noted that in the final discussion, Schmidt assumed full leadership and emphasised that the currency stabilisation scheme was intended as a political choice for Europe as a whole, in contrast to the option of creating two currency areas within the continent:

> le nouveau système envisagé a, sur le plan politique, une double finalité. Il s'agit, d'une part, de créer […] des meilleures conditions de stabilité monétaire, lesquelles sont essentielles pour surmonter la crise économique mondiale […]. Il s'agit, d'autre part, non seulement d'aboutir à un renforcement important et réel de la Communauté mais encore d'éviter que celle-ci se devise définitivement en deux zones monétaires et en deux zones différentes au regard du bien-être des populations.[59]

After the summit, the Bank of Italy — ignoring Governor Baffi's reservations — did not hesitate to draw up a strategy document in which, leaving aside monetary reasons, it wanted to specify the underlying reasons that should have motivated Italy's pro-European choice, since Andreotti was slow to decide on the merits despite being convinced that it was fundamental for the country to confirm this choice.[60] Ever since the ECOFIN meeting in April, Governor

[58] The general Keynesian perspective does not imply that Baffi was — by training or preference — a Keynesian economist in the full sense of the word (Gigliobianco, *Via Nazionale*, cit., pp. 318-333).

[59] Historical Archives of the European Union, European University Institute, Florence, PE1-23987, "Procès-verbal de la session du Conseil Européen tenue à Brême les 6 et 7 juillet 1978", Brussels, 24 July 1978, p. 31.

[60] See Ludlow, *The Making of the European Monetary System*, cit., pp. 256-259; Daniela Preda, *Il ruolo di Giulio Andreotti nella nascita del Sistema Monetario Europeo*, in *Giulio Andreotti e l'Europa*, edited by Francesco Lefebvre d'Ovidio and Luca Micheletta, Rome,

Baffi, Treasury Minister Pandolfi and Foreign Trade Minister Rinaldo Ossola had expressed reservations about Italy's possibility of joining a fixed exchange rate system,[61] although Pandolfi had somewhat reversed his views in June. Baffi publicly reiterated the reasons for his reservations and the choices made in negotiating the agreements in his final considerations, read out on 31 May 1979. 'The establishment of the European Monetary System,' Baffi said, 'was conceived at the Bremen summit as a fundamental element of a renewed impetus for European economic and financial integration.' The macroeconomic stability thus pursued (prices and exchange rates) was understood as 'part of a common action to accelerate growth' and 'to strengthen the less prosperous economies of the Community'. From this perspective, 'the Italian position in multilateral fora and bilateral meetings […] remained more than others [probably referring to the Bundesbank] consistent with the objective of building a system capable of accommodating *all* member countries and reducing not only inflationary but also deflationary risks'.[62]

Baffi seemed to be aware of the risks implicit in the creation of a European monetary system whose features had been defined in the previous months.[63] Baffi's position was motivated by the adjustment function he assigned to the exchange rate, rather than considering it as a measure of macroeconomic discipline.[64] In Via Nazionale, the Bank of Italy's headquarters in Rome, Baffi's reservations were at least tempered by the initiatives that Director

Edizioni di Storia e Letteratura, 2017, pp. 214-219. According to Pandolfi, 'Andreotti ended up leaving the heart of the negotiation, public or confidential as it may have been, with Chancellor Schmidt to me' (*Pandolfi racconta la Germania: i miei anni con Schmidt e Kohl*, 'Eco di Bergamo', 23 September 2013). The bilateral meeting between Pandolfi, Baffi and Masera (for Italy) and Monory and Clappier on 8 September 1978 could confirm Pandolfi's version (AS BI, Direttorio Ciampi, file 204, folder 1, subfolder 62, "Incontro Ministro Pandolfi con Ministro Economia francese Monory (Villa Suardi, Bergamo, 8/9/78").

[61] Before his ministerial appointment, Ossola had frequently been involved in the creation of the post-war European payments system, in the development of the Special Drawing Rights of the International Monetary Fund and he had been, with Baffi, Director General of the Bank of Italy, from August 1975 to July 1976 (Alfredo Gigliobianco, *Rinaldo Ossola*, in *Dizionario biografico degli italiani*, Rome, Istituto della Enciclopedia italiana, 2013, vol. 97).

[62] Banca d'Italia, *Considerazioni finali*, Rome, Banca d'Italia, 1979, p. 8.

[63] In the *Considerazioni finali* read on 31 May 1979, he stated: '[I]t was emphasised that reciprocal exchange rate commitments, based on an effective symmetry of economic adjustments, had to be accompanied both by financial support, to counter speculative attacks, and by substantial aid to the weaker countries, to halt and thus overturn the perverse effects of the current redistribution of resources through the Community budget' (p. 8). The governor also explained his positions in an essay: Paolo Baffi, *Il sistema monetario europeo e la partecipazione dell'Italia*, "Thema", 1978, 2, pp. 7-19. Rinaldo Ossola expressed a similar view in *L'Italia e lo SME*, "Bancaria", 34 (1978), 8, pp. 133-143. See Fabio Masini, *A History of the Theories on Optimum Currency Areas*, "The European Journal of the History of Economic Thought", 21 (2014), 6, pp. 1025-1027.

[64] See Ivo Maes and Lucia Quaglia, *Germany and Italy: conflicting policy paradigms towards European monetary integration?*, in "Constitutional Political Economy", 17 (2006), 3, p. 195.

General Ciampi took after the Bremen summit. Ciampi's initiative, which began with the strategy document edited by Masera, fell along a peculiar fault line in Italy's state and institutional structure — that between foreign policymakers and economic policymakers — and anticipated the move towards a monetary paradigm different from the one that had guided Governor Baffi in the exchange rate issue and in joining the EMS: the monetarist paradigm.[65] The prime minister thus repaired the rift between foreign policymakers and economic policymakers, which had emerged during the negotiations that allowed Italy to join the EMS by obtaining a more flexible condition for the lira's fluctuation around parity (six per cent against 2.25 per cent for the other currencies in the system), within the foreign policy framework defined by the Cold War and by the Bank of Italy; he did so by reconciling the governor's vision of a 'symmetry of duties' between strong currencies, such as the mark, and weak currencies, such as the lira,[66] with the very first unit of that monetarist paradigm that would be partly followed by Via Nazionale in the following decade, with Ciampi as governor.[67]

Joining the EMS meant adopting convergence policies that would make Italy's European commitments credible. Between July and August, Padoa-

[65] See Paolo Baffi, *Il negoziato sullo SME*, "Bancaria", 45 (1989), 1, pp. 67-70. The reconstruction proposed here would be partly in line with the "technocratic" interpretation of the definition of the 'external constraint' proposed by Featherstone, *The Political Dynamics of the Vincolo Esterno*, cit., pp. 3-4.

[66] As Baffi argued in May 1979: 'The changes in real exchange rates that have been achieved over the last six years show how the exchange rate can play a non-negligible role in structural adjustment even in open and highly index-linked economies. The most industrialised economic systems, whose controls can be used only partially and in some cases are even blocked, need the central point represented by a degree of flexibility in the relationship between currencies. An exchange rate mechanism unable to adjust to changes in real costs would risk shifting the adjustment to the degree of economic openness of borders, especially with regard to capital flows, hence in a reductive sense of integration between economies; this must be supported by regional development policies and measured essentially in terms of freedom of transactions and only instrumentally on the basis of exchange rate certainty. Convergence is also necessary because the establishment of a regional area may damage the formation of blocs, which is especially relevant for Europe from a historical perspective. This risk would not be worth facing if the regional area did not achieve its own effective and operative internal cohesion' (Banca d'Italia, *Considerazioni finali*, Rome, Banca d'Italia, 1979, pp. 7-9). See also Luigi Spaventa, *Italy joins the EMS. A Political History*, Research Institute, Johns Hopkins University Bologna Center, Occasional Paper, June 1980, 32.

[67] The change of paradigm was indeed more subtle during Baffi's governorship, as emerges from a text prepared by Ciampi for the hearing in the Senate, Finance and Treasury Commission, scheduled for 25 October 1978 and held the following day in the absence of Ciampi himself, who was in Brussels that day. The text contains some considerations on the importance of convergence between European economies and of the fight against both inflation and deflation that anticipate Baffi's considerations of May 1979 (AS BI, Direttorio Ciampi, file 205, folder 1, subfolder 4). The distinction between foreign policymakers and economic policymakers echoes the scheme proposed by Maes and Quaglia, *Germany and Italy: conflicting policy paradigms towards European monetary integration?*, cit., pp. 202-203.

Schioppa tried his hand at a long and detailed 'note' called 'A proposal for growth, a choice for Europe', which would eventually be presented as being 'elaborated' by Pandolfi.[68] The Pandolfi Plan, as it came to be known, picked up some of the ideas contained in the essay Padoa-Schioppa had written with Modigliani the previous year and placed them in a broader framework of economic policy proposals, inaugurating a "new" style for Italian policymakers as it defined a 'general strategy of economic policy with the precise indication of quantitative targets and operational indications on the public finance manoeuvre'.[69] The document drafted by Padoa-Schioppa had a 'strategic' target (increase in employment), a method of achievement (high and stable growth rate) and described the specific actions to be taken in the reduction of the inflation rate, in the reduction of labour costs and public finance requirements as factors of instability, in 'investments, public and private, the engine of growth'.

Padoa-Schioppa's economic policy document, which set out a strategy for adjusting to the imbalances that Italy had accumulated in the 1970s, at least since 1973, and which placed the country in an international context, aimed at creating not only a political but also — more broadly — a 'social' consensus on the objectives and the path of adjustment and growth outlined. The macroeconomic objectives for correcting the 'structural conditions' of the Italian economy, hence not just in the short term, were development, employment and stability. It was argued that the path of 'jolting line of decline' that the Italian economy had followed in the previous decade called for coherent policies that could help to correct the conditions that marked its instability 'in the technical sense of the term'; the reason given was that high inflation and high labour costs contrasted with the surplus in the current account of the balance of payments and the stable exchange rate, in a context of growing public sector debt and low growth in domestic demand, especially in the investment component. This macroeconomic framework, which was different from that of the industrialised countries with higher income to which Italy could be compared, could only be unstable, since the coexistence of such contradictory fundamentals would have resulted in a deviation, a shift towards either 'spontaneous'

[68] In the version of 22 July prepared by Padoa-Schioppa, the document was entitled 'A comparison between two decades' (AS BI, Direttorio Ciampi, file 204, folder 1, subfolder "Tommaso Padoa Schioppa", "Un confronto tra due decenni. Appunto per il Ministro Pandolfi redatto dal dr. Padoa Schioppa", 22 July 1978). The final 28-page document, complete with a statistical apparatus of 10 tables and related notes, differed in several points from the one initially prepared by Padoa-Schioppa, first of all — in formal terms — by the presence of 90 'short points corresponding to an idea'. Minister Pandolfi distributed it to the parties supporting the government on 31 August and it was published in the main newspapers the following day.

[69] In procedural terms, the document was meant 'to provide a basis for an organic and precise discussion *before* the presentation to Parliament' of the documents with which the economic policy for the following year would be defined in legislative terms. For a reconstruction of the political discussion of the Pandolfi Plan, in addition to Gualtieri's essay, see Masini, *SMEmorie della lira*, cit., pp. 35-40.

instability or a stability sought and pursued through appropriate correction policies. In recent years, the first case had repeatedly occurred in Italy in the form of a balance of payments crisis or depreciation of the lira, with a significant erosion of the competitiveness of its companies on international markets, for which currency adjustment had not proved sufficient compensation, and a correlated drop in income, employment, demand and investments. According to Padoa-Schioppa, there were two main factors of 'structural' instability on which to intervene: public finance and the high cost of labour.[70]

The first 'destabilising' factor was the deep change in public finances over the past decade, with the increase in debt and expenditure in the 'enlarged public sector': public finance contributed 'structurally' — and would have done so even more without corrective measures — to high inflation, but was not such (in terms of extent and quality) as to support, if not weakly, demand and above all investment ('very little'). Expenditure and debt increased more than the revenues, owing to the change of the original expenditure mechanism in the Treasury and the introduction of the concept of 'total requirements', which was used to manage the debts arising from the increased and multiplied transfers and from financial assets in a strict sense (typically corresponding to the commitments made by the state to government stakeholders and special credit institutions through contributions to endowment funds). The public finance scenario seemed to have been altered both by the accumulation of commitments (through the dubious practice of postponing transfers) and by the peculiar composition of expenditure, which included the share of investment (3.5 per cent in 1977 and 3.7 in 1979) as well as a higher budget deficit (4.8 per cent in 1977, 8.9 per cent in 1979).[71] The imbalance between the two components of public expenditure (current and capital) was seen as the 'primary factor of degradation of the system' and a real 'social deception' given the expected negative effects on the future provision of services. This public finance framework clashed with the financial compatibility between expected inflation, in relation to the monetisation of deficits, credit to the private sector and public needs arising from commitments made by the state and 'decentralised authorities'. In other words, a choice had to be made between the increase in inflation, a reduction in credit to the private sector and a decrease in public spending,

[70] AS BI, Direttorio Ciampi, file 204, folder 1, subfolder "Tommaso Padoa Schioppa", "Una proposta per lo sviluppo, una scelta per l'Europa", cit., points 1-8. Padoa-Schioppa's assessment was based on data presented in a table, reproduced here in the appendix: 'Comparison at a distance of ten years, 1966-1968 and 1976-1978.'

[71] It was noted that the 'hidden component' of debts in the public sector, largely determined by 'slippages' in transfers from the central state to the 'decentralised spending authorities', basically subtracted from the public budget liabilities that would later re-emerge and that as such were still qualified, albeit in the form of debts to the banking system by peripheral bodies, the national health system or state shareholdings (AS BI, Direttorio Ciampi, file 204, folder 1, subfolder "Tommaso Padoa Schioppa", "Una proposta per lo sviluppo, una scelta per l'Europa", cit., pp. 7-8).

given that public finances were generally quite inefficient because, structurally, they did not allow for a positive contribution to capital formation; cyclically, through the mechanism induced by the indexation of wages and pensions, it tended to amplify the fluctuation in prices and incomes to a more than proportional extent.[72]

The other main factor of 'structural' instability for the Italian economy was the cost of labour, the indexation of which put pressure on inflation together with the enlarged public spending. Again comparing the situation with that of a decade earlier, Padoa-Schioppa noted an increase in wages — under conditions of growth that were, however, attenuated — and a redistribution of income in favour of full-time workers in the formal sector, resulting in a 'new social order' whose preferences in terms of wage policy tended to benefit the employed at the expense of the unemployed and underemployed. High labour costs in an open economy led to a 'non-transitory' loss of competitiveness that manifested itself in a sharp decline in the balance of payments and foreign exchange, phenomena that further strengthened domestic inflationary pressures. The index-linked wage-price mechanism as a means of automatically adjusting to inflation tended to 'fix its level and propagate its impulses' without truly protecting savings and financial wealth. High labour costs thus became incompatible with investment and employment growth, protecting the workers' wages but not their financial wealth (i.e. savings), consequently reducing the productivity dynamics (and also the efficient use of existing plants). The loss of competitiveness of companies and low investment were limiting the realignment of labour costs to productivity. Hence the need for a 'course correction' of the Italian economy, policies that would change it from 'an economy of transfers to an economy of growth'. The transfer economy that the Italian economy had become was essentially a 'static' one, focused on distribution rather than economic growth. The gradual corrective actions that were proposed were a "necessary" exercise in governing the economy to promote the country's 'economic and civil growth', and the period 1979-1980 was identified as a timeframe in which to modify its evolutionary dynamics, with relevant interventions in public finance, wage policies and labour policies that would allow its flexible use. The new path to be followed was presented 'also as a choice for Europe', to which the European Council at the Bremen summit had provided an 'accelerated impetus' towards closer integration between the countries of the EEC and towards greater monetary discipline.[73]

Reducing the inflation and labour cost differential between Italy and the other EEC countries was necessary to 'stay in Europe'; it was a condition for

[72] See points 21-31 of Padoa-Schioppa's document. In the 1970s, fiscal dominance (i.e. the dependence of monetary policy on fiscal policies) was indeed accentuated (Roberto Ricciuti, *The Quest for a Fiscal Rule*, "Cliometrica", 2 (2008), 3, pp. 259-274).

[73] AS BI, Direttorio Ciampi, file 204, folder 1, subfolder "Tommaso Padoa Schioppa", "Una proposta per lo sviluppo, una scelta per l'Europa", cit., pp. 11-18.

'remaining in a new [monetary] system', where a flexible exchange rate would not have offered reliable guarantees and there was no alternative to rejecting a 'special monetary status' because of the economic and political implications: '[I]f we failed, the damage of inflation and unemployment would be enhanced by the economic, political and cultural damage of a relationship with Europe that would be precarious to the point of relegation. But if we succeed, our situation will be strengthened and secured.'[74] The political nature of the "proposal" was perfectly clear to Padoa-Schioppa, as he wrote in the concluding remarks, locating its 'condition of feasibility in the social consensus' that would be obtained from the 'credibility and acceptability of the project offered to the country'; following an analytical framework that was close to the typically Keynesian theory of full employment, he mentioned 'greater social equity' as the aim of a 'major collective commitment', in the option between 'chosen sacrifices and imposed sacrifices' in order to have a 'more evolved, more just, more self-confident society'.[75]

EMS membership and the call for 'symmetrical mechanisms' of adjustment

In the following months, the Bank of Italy's participation in the technical fora (Monetary Committee, Committee of Governors and Economic Policy Committee) continued, as did the analyses and evaluations by the Research department in accordance with the framework set out by the governor, but under the coordination and impetus of Ciampi.[76] At the beginning of October, Reiner Masera and Salvatore Zecchini prepared a new note for Minister Pandolfi on the 'European monetary system', in which they stated, first of all, that Italy's theoretical membership was the result of an assessment of the 'net benefits' derived from the prospects of greater integration of intra-EU markets and a larger market for Italian companies, and from the creation of 'extensive financing mechanisms' capable of saving the lira from recurrent speculative

[74] See paragraph 61, quoted here almost in full (AS BI, Direttorio Ciampi, file 204, folder 1, subfolder "Tommaso Padoa Schioppa", "Una proposta per lo sviluppo, una scelta per l'Europa", cit., p. 19).

[75] AS BI, Direttorio Ciampi, file 204, folder 1, subfolder "Tommaso Padoa Schioppa", "Una proposta per lo sviluppo, una scelta per l'Europa", cit., p. 26, points 81-83. One of the main critics of the proposal elaborated by Padoa-Schioppa was Federico Caffè, with whom he had a bitter correspondence (Alberto Baffigi, *L'integrazione europea come questione di social choice nel pensiero di Federico Caffè*, in "Ricerche di storia economica e sociale", II (2016), 1-2, pp. 183-208).

[76] See, first of all, the note preserved in AS BI, Direttorio Ciampi, file 204, folder 1, subfolder 49, "Alcune considerazioni sul prossimo triennio. Appunto inviato al Ministro del Tesoro on. Pandolfi", 1 August 1978 (also on tax policies and labour costs). Ciampi's role emerges — even only indirectly — from the concentration of documents in the Direttorio Ciampi archive of the AS BI rather than in the Baffi papers.

attacks that — with the depreciation of the currency — reinforced domestic inflationary tensions. However, both the authors of the note and the Bank of Italy were aware that the EMS would impose short- and long-term 'constraints' on the country's economy. During the negotiations, the Italian representatives therefore adopted a non-monetarist approach that insisted on certain principles in the construction of the new system: i) it had to be configured as 'realistic' and 'durable', unlike the monetary snake, taking into account the differences between the nine economies of the EEC, at the cost of provoking foreseeable effects of instability on the entire international monetary system, on the prospects for further integration in Europe and on individual European economies; ii) "all" the currencies of the EEC had to be included in order not to accentuate the differences between the various economies; iii) there should be no targets for competition with other currency areas (the implicit reference was to the dollar); (iv) adjustment burdens had to be distributed equally between deficit countries (Italy and France) and surplus countries (Germany) in the event of a deviation from parity; (v) a substantial flexibility in the fluctuation margins had to be maintained; and (vi) the system should rely on broad 'financial arrangements' with a view to the establishment of a European monetary fund.

A compromise solution was found, as often happened as a result of the multilevel structure of the EU governance system; the latter envisaged fluctuation margins on a bilateral basis, with reference to a European Currency Unit (hereafter ECU) as a basket of the currencies of the nine member countries (currency pool), and adjustment procedures (yet to be defined) in the case of a currency deviating from the ECU, which would in any case have affected the economic and monetary policies of the member states.[77] The Italian objective was essentially to create a system that would not be exposed to speculative attacks as a result of asymmetries arising from the participation in the adjustment of the exchange rates of individual currencies to the monetary centre of gravity, the ECU, asymmetries between economies with significant disparities in their respective external positions and domestic inflation rates. Along the lines indicated by Baffi, the technical solutions should have 'ensured concrete symmetry and convergence in the adjustment processes of the economies of the Community countries'. In this sense, the 'external constraint' could realistically be accepted, as it would allow for sufficiently wide margins of deviation so as not to deprive Italy, but also Ireland and Great Britain, of the possibility of using the exchange rate as an adjustment.[78] If inflation was Baffi's main concern, there was an awareness that the monetary system would also have

[77] The competing hypothesis suggested that the ECU was the European Unit of Account.

[78] This explains the 'harmonious cooperation now established between Italy and the United Kingdom over ECC questions' (UK NA, Kew, FCO 33/4046 f3, Alan Campbell, HM Ambassador at Rome, "Italy: Annual Review for 1978", confidential, 15 January 1979, p. 7).

to predict the opposite phenomena; for example, in the event of adjustment, it would have to 'prevent […] the system from leading to a deflationary trend'. In other words, although the Bank of Italy was inclined to accept a monetary arrangement involving measures to realign prices and labour costs to the levels of the Mark currency areas, it insisted on the need to adopt equally important measures to encourage the convergence of income and productivity in the 'less prosperous' economies: a 'greater homogeneity in the levels of development of the national economies' would be the most certain condition for the duration of the EMS.[79]

Zecchini and Masera's note of October 1978 was perhaps a clarification of Padoa-Schioppa's 'proposal for growth'; to some observers, the latter actually suggested a compression of demand that placed the pro-European choice in a growth and convergence perspective,[80] given that the policies to recover from inflation were to be associated — with 'no less effort', for surplus countries like Germany — to policies supporting domestic demand and external capital flows that would move the 'savings surpluses' of the 'more prosperous' economies towards the less wealthy economies (i.e. those with lower per capita income) through transfer policies, with the EEC's regional and social funds and European Investment Bank loans. Padoa-Schioppa's recovery programme as described in the Pandolfi Plan was therefore explicitly linked, in the 'not easy negotiations', to the creation of symmetrical mechanisms of economic policy (transfers and demand stimulus in higher income countries, which would favour the exports of lower-income countries and their convergence) and monetary policy (equal opposition to inflation *and* deflation).[81]

During the negotiations, the Italian position insisted on the symmetry of economic and monetary policies and the need for transfers to support real convergence as a condition for a stable and lasting European monetary system.[82]

[79] AS BI, Direttorio Ciampi, file 205, folder 1, subfolder 20, Zecchini and Masera, "Sistema monetario europeo. Appunto inviato al Ministro del Tesoro dr. Pandolfi", 9 October 1978, *passim*. Zecchini and Masera's note was clearly in line with Baffi's assessments of the resilience of a European monetary system that would rely on the convergence of real economies rather than on monetary variables (Gigliobianco, *Via Nazionale*, cit., pp. 324-326).

[80] This was the case with the influential economist Federico Caffè, who criticised Padoa-Schioppa's document in various interviews (Baffigi, *L'integrazione europea come questione di social choice nel pensiero di Federico Caffè*, cit., pp. 185-194).

[81] AS BI, Direttorio Ciampi, file 205, folder 1, subfolder 20, Zecchini and Masera, "Sistema monetario europeo", cit., pp. 12-13. Ciampi wrote to Pandolfi about the difficulties in the negotiations and the division between the two groups of countries, sending him a note on 9 November about the meeting of the EC's Economic Policy Committee on 6 November (AS BI, Direttorio Ciampi, file 205, folder 1, subfolder 20, letter from Ciampi to Pandolfi, 9 November 1978; "Resoconto dei lavori condotti in seno al Comitato di Politica Economica della CEE in merito ai 'concurrent studies' nell'ambito del negoziato per il nuovo sistema monetario europeo", 8 November 1978).

[82] AS BI, Direttorio Ciampi, file 205, folder 1, subfolder 20, "Memorandum italiano presentato al Comitato di Politica Economica, 2 November 1978; *ibidem*, subfolder 16, "Misure

However, the Italian position, as it was presented by the Bank of Italy, was essentially that of Governor Baffi and Minister Pandolfi, who were aware of the rigidity of the Italian economy resulting from the high public debt and the wage indexation system. Prime Minister Andreotti, aware of the political dimension of Schmidt's proposal, was nevertheless cautious at the bilateral meeting in Siena in early November. According to Renato Ruggiero, Andreotti's diplomatic adviser at the time, Schmidt was particularly skilful in 'concentrating his own political onslaught' on the Italian prime minister and dismissing, 'almost contemptuously, the technical arguments' of Baffi and Pandolfi. According to Schmidt, monetary stability was a precondition for greater investment and trade within the European market and, in the absence of a stabilisation mechanism, all EEC member states would have suffered from external and internal imbalances by 1985, while Baffi's and Pandolfi's reservations were not such as to justify the lower growth expected for the economies of the European Community as a whole. Schmidt's persuasive strategy was essentially centred on the downgrade risks that Italy would face: 'Those who rejected the EMS would sink to a second rank within the Community. If Italy rejected it, she should become like Greece or Turkey.' Andreotti confirmed to Schmidt that Italy, as a founding country, continued to view the creation of Europe as a 'top priority, but wanted an EMS that strengthened and did not split the Community', a risk that was indeed latent in a scheme that reduced the margins of adjustment through the exchange rate and did not contemplate transfers of resources to the less wealthy countries, according to the concerns expressed by Baffi and Pandolfi, which was also why they insisted on British participation.[83] While Schmidt did not rule out, along with Andreotti, the possibility of resource transfers between the EMS countries,[84] the commitments that the German monetary authorities effectively made to this end were nevertheless understood to be non-binding, as the Chancellor agreed with the Bundesbank's president, Otmar Emminger, a few weeks after the meeting in Siena; the Bundesbank's intervention in the foreign exchange market through credit lines to support currencies in difficulty — as far as provided for in the

economiche parallele", notes sent by Governor Baffi and the Bank's Director General to Minister Pandolfi, 6 December 1978.

[83] The reconstruction Ruggiero gave the British ambassador in Italy in strict confidence ('not playing any of it back to non-British (including Italian) officials. Other wise [*sic*] his own position will be damaged gravely') is preserved in UK NA, Kew, PREM, 16/1637, telegram from the British Embassy in Rome, 2 November 1978.

[84] Schmidt had accepted the principle that the monetary reform scheme was 'associated with growth and a transfer of resources' in Bremen, during confidential talks with Giscard and Callaghan. Schmidt 'said that the relationship between monetary reform and resource transfer would be similar to that between the IMF and the World Bank' (UK NA, Kew, 10 Downing Street, PREM 16/1634, KRS [towe], "Note of a conversation between the Prime Minister, President Giscard and Chancellor Schmidt on the monetary reform in the Rathaus, Bremen, on 6 July 1978 at 18.20", Confidential, p. 1).

agreements — would in reality be non-binding and left to the central bank's discretion even if the government was unable to formalise an intention that was openly at odds with international commitments.[85]

Italian resistance was eventually overcome, not only by the introduction of a wider fluctuation band for the lira,[86] but also because of the moral suasion by Padoa-Schioppa and Modigliani, who softened the reservations nurtured in Via Nazionale.[87] From the outset, the strategic choice to participate in the EMS was motivated by two strong arguments: firstly, Andreotti's government intended to make decisions that were consistent with the strengthening of European integration processes, within the system of alliances defined in the 1950s; secondly, Andreotti and Pandolfi were aware that by joining the EMS, hence 'with the solidarity of the community', Italy could have been more successful in pursuing its objectives of fighting inflation, stimulating economic growth and reducing unemployment.[88]

However, in May 1980, the new Governor Ciampi highlighted the difficulties that had emerged during the first year of the EMS, in particular the fact that 'disagreements about the role of the Community budget and the implementation of reforms agreed in principle had not been settled', with unsatisfactory effects on the hoped-for convergence between the EEC economies. While the exchange rahospites had held up well, despite the lira's wide fluctuations within the bandwidth, Ciampi claimed that the original 'intention of leading the [EEC's] budget in a direction more attentive to reducing income gaps between

[85] This is the reassurance Schmidt gave the Bundesbank leadership: 'I must say to you openly that I have quite severe misgivings about a written specification of this sort, a written specification of the possibility of an at least temporary release from the intervention. Let us first of all assume that it appeared tomorrow in a French or Italian newspaper. What accusations would the newspapers then make in editorials against their own Government who got themselves mixed up with such a dodgy promise with the Germans. A Government which promised them to intervene in the framework of certain rules of the game, but internally put in writing its intention to be able to do otherwise if need be. In the matter itself I agree with you, gentlemen, but I deem it out of the question to write that down. In the matter it is yet the case that there has been a beautiful saying the world for two thousand years: *ultra posse nemo obligatur*' (Bundesbank Historical Archive, Frankfurt, N2/267, Council meeting with Chancellor Schmidt, 30 November 1978). English translation by the Margaret Thatcher Foundation.

[86] See Mourlon-Druol, *A Europe Made of Money*, cit., pp. 246-250. On the Italian involvement in European integration, see Francesca Fauri, *L'Italia e l'integrazione economica europea*, Bologna, il Mulino, 2001, pp. 171 and onwards.

[87] Modigliani in particular attached great importance to the article, written but not signed — for reasons of expediency — with Padoa-Schioppa, *I pro e i contro per l'Italia*, "Corriere della Sera", 1 December 1978 (Franco Modigliani, *Avventure di un economista*, edited by Paolo Peluffo, Rome-Bari, Laterza, 1999, pp. 245-248).

[88] See Preda, *Il ruolo di Giulio Andreotti*, cit., pp. 223-229. On the necessity of joining the EMS to achieve the inflation target, see Barry Eichengreen and Andrea Boltho, *The economic impact of European integration*, in *The Cambridge Economic History of Modern Europ*e, edited by Stephen Broadberry and Kevin O'Rourke, Cambridge, Cambridge University Press, vol. 2, pp. 284-285.

regions, more incisive in influencing production potential and ultimately more appropriate for providing support for lasting monetary stabilisation' had not been put into practice.[89]

Conclusion

European monetary integration, as Mourlon-Druol has pointed out, is a complex process that depends on the plurality of dimensions — political, economic and cultural, national and transnational, governmental and non-governmental — in which the actors who were, and nowadays are, involved in it operated.[90] The creation of the EMS and the seed of the future common currency, the ECU, was the outcome of a particularly complex process of learning and interaction between institutional and non-institutional actors, between governments and transnational bodies, between economic interests, political projects and cultures (and not only the technical projects of economists and central bankers). In that process, Italy — having been excluded from the early stages of launching and defining the project — first of all had to reaffirm its credibility as a candidate and could only enter the negotiating phases after an initial draft of a European monetary system had been outlined on the initiative of Giscard and Schmidt. The Bank of Italy's Director General Ciampi, and some of the economists close to him, especially Masera and Padoa-Schioppa, played a crucial role in building the country's credibility and the strategic decision to join the EMS. This group was part of interconnected transnational epistemic communities (i.e. central bankers, economists),[91] which redefined the post-Keynesian economic paradigms with which the systemic shocks of the stagflation years were dealt with and from which the fiscal and monetary policy lines emerged that guided the choices of the following decade.[92]

[89] Banca d'Italia, *Considerazioni finali*, Rome, Banca d'Italia, 1981, pp. 15-16. The problems of the incompleteness of the EMS fully emerged when, in the early 1990s, European integration gave rise to what Padoa-Schioppa called the 'irreconcilable quartet': free trade, fixed but adjustable rates, unrestricted capital mobility and (relative) autonomy of monetary policy (Tommaso Padoa-Schioppa, *Lo SME: una visione di lungo periodo*, in *Il Sistema monetario europeo*, edited by Francesco Giavazzi, Stefano Micossi and Marcus H. Miller, Rome-Bari, Laterza, 1993, pp. 371-387).

[90] See Mourlon-Druol, *A Europe Made of Money*, cit., pp. 3-11.

[91] See John Singleton, *Central Banking in the Twentieth Century*, Cambridge, Cambridge University Press, 2011, pp. 191-221; Frédéric Clavert and Olivier Feiertag, *Les banquiers centraux et la construction européenne*, "Histoire, Économie et Société", 30 (2011), 4, pp. 3-9.

[92] In Padoa-Schioppa's case, that experience opened the door to an appointment at the DRII of the European Commission in Brussels, between 1979 and 1983, a position he interpreted from a Europeanist as well as a professional and political perspective, as he wrote in a note when he returned to the Bank of Italy: "[J]e considère que dans les matières qui intéressent la DGII, ces traits se ramènent a deux concepts: nécessité d'une construction progressive de l'Europe; valeur centrale de la professionnalité" (quoted in Papadia, *Tommaso Padoa-Schioppa*,

The definition of an initial, albeit unfulfilled, coherent policy to fight inflation, rebalance public finances and boost productivity through the Pandolfi Plan allowed Italy to regain credibility in the central and final stages of the negotiations for the creation of the EMS. In this way, despite the considerable differences between Carli and Baffi, an attempt was made to realign the investment-maximising paradigm on which monetary and fiscal policies had hitherto been based with the emerging neo-monetarist paradigm that had motivated Schmidt's anti-Keynesian currency stabilisation proposal.[93] Between June and October 1978, Baffi's justified reservations about the lira's entry into the EMS — an option essentially dictated by political reasons, according to Prime Minister Andreotti — caused an invisible crack in Via Nazionale: a difference of assessment, and perhaps vision, between Governor Baffi and Director General Ciampi and the economists who defined and technically argued for the pro-European choice also in terms of an external constraint based on a new meaning for Italy as an open economy.[94] The emphasis was now placed on the quasi-legal nature of the European constraint in terms of membership and with respect to the inflation and public finance targets contained in the agreements of the EMS, and not simply on the policies and mechanisms for correcting balance of payment deficits, as had been understood until then.[95]

Reconstructing the strategic choice and the context in which the Pandolfi Plan was developed allows us to specify the genesis, the rationale behind and the economic objectives of the 'European option' exercised by Italy in a frame-

cit., p. 186). In a functionalist logic, à la Jean Monnet, Padoa-Schioppa would later work alongside Jacques Delors, as secretary of the Committee he chaired, in the development of the euro (Fabio Masini, *Tommaso Padoa-Schioppa: EMU as the Anchor Stone for Building a Federal Europe*, in *Architects of the Euro*, edited by Kenneth Dyson and Ivo Maes, Oxford, Oxford University Press, 2016, pp. 193-211).

93 Schmidt's intolerance of Keynesian policies is well-known (see, among others, Matthias Waechter, *Helmut Schmidt und Valéry Giscard d'Estaing: Auf der Suche nach Stabilitat in der Krise de 70er Jahre*, Bremen, Temmen, 2011).

94 This difference can add to the reading offered by Franco Spinelli and Michele Fratianni, *Storia monetaria d'Italia*, Milano, Mondadori, 1991, pp. 687-689. Baffi's opposition to joining the EMS is also documented in Emmanuel Mourlon-Druol, *A new monetary system in a changing polity. Central banks, the ECC and the creation of the European Monetary System*, in *Les Banques centrales et l'État-nation*, edited by Olivier Feiertag and Michel Margairaz, Paris, Sciences-Po Les Presses, 2016, pp. 568-569.

95 The balance of payments and foreign exchange rates constituted, as noted above, an external constraint that was well-known to central bankers and economic policymakers. The external constraint outlined by Padoa-Schioppa in the Pandolfi Plan, consistently with the structure of the EMS, moved towards exchange rate constraints related to public finance and to the fiscal dominance phenomena that still characterised monetary policy in Italy; in other words, it was transformed into a fiscal policy constraint that the so-called divorce between the Bank of Italy and the Treasury in July 1981 would formally recognise. The classic external constraint related to the balance of payments accounts and foreign exchange rates remained unchanged towards the rest of the world, meaning that it had an economic and not a "legal" nature, as defined by Guido Carli in the early 1990s.

work of powers divided between foreign policymakers and economic policymakers, and to better understand the specific value of the 'external constraint', used for the first time to justify the 'European option' as an intellectual *and* political product of the Via Nazionale technocracy in its original formulation. In the specific definition given by Masera, and soon also — albeit more generally — by Padoa-Schioppa, the 'external constraint' would have existed even if Italy had remained outside the EMS, as a 'global challenge' and a balance of payments constraint that conditioned the growth prospects of the country's economy.[96] However, if from that perspective the external constraint acted at least in part independently of the Bundesbank's monetary policy decisions, the external constraint — redefined in this way — would have acted as a "quasi-legal" treaty constraint, albeit in asymmetrical terms, as Schmidt admitted in order to absorb Emminger's reserves, a constraint hinged on inflation targets in relation to public finance.[97] A reduction of the adjustment margins through the exchange rate — which Baffi still believed could be achieved — would necessarily have involved compensating for the effects of adjustment policies without devaluation by increasing public debt, to the point of running the risk of a fiscal crisis, which led to Italy's exit from the EMS in 1992.[98]

Translated by Andrea Hajek

[96] This consideration was expressed in Modigliani and Padoa-Schioppa, *I pro e i contro per l'Italia* (Modigliani, *Avventure di un economista*, cit., pp. 246-247).

[97] Perhaps the links between interest rates and fiscal policy can explain the subsequent disagreement between Modigliani and Padoa-Schioppa on the economic policy to be adopted: loosening budget constraints and rebalancing balance of payments accounts, for the former, or the sharp correction of public debt, for the latter (see the letters the two economists wrote in 1993, published in *Franco Modigliani. L'impegno civile di un economista*, edited by Pier Francesco Asso, Siena, Fondazione Monte dei Paschi di Siena, 2007, pp. 183-185).

[98] This could also explain the divergence in the 1980s between inflation and public debt as described in Giavazzi and Spaventa, *Italy: the real effects of inflation and disinflation*, cit., pp. 133-171.

Appendix
Comparison at a distance of ten years, 1966-1968 and 1976-1978

Table 1 - Average of data for the two three-year periods in question; figures in italics are average for the 1976-1977 period. (1): Annual rates of increase; (2): GDP deflator; (3): In industry excluding construction; (4): At constant prices; (5): Consistency at the end of December of the balance of the external position of the Bank of Italy-UIC and credit companies

		1966-1968	*1976-1978*
Growth (1)	of GDP in quantity	6,4	3,3
	of GDP in prices (2)	3,2	16,9
	of the cost per employee	8,46	18,65
Unemployment	listed in unemployment register	1,1 mln	*1,5 mln*
	hours of unemployment benefits	87,73 mln	*263,5 mln*
Distribution	share of employee income	56,7	*70,4*
Accumulation	fixed investment: GDP (3)	20,6	16,9
	investment in machinery and equipment: GDP	7	7,4
Foreign Trade	imports: resources (4)	12,5	16,8
	exports: resources (4)	13,3	20,2
Assets	external position (5)	811 bn	*–7,7977 bn*
	public debt	15,986 bn	*92,584 bn*

Source: AS BI, Direttorio Ciampi, file 204, folder 1, subfolder "Tommaso Padoa Schioppa", "Una proposta per lo sviluppo, una scelta per l'Europa", cit., p. 29.