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National States Sovereignty, Democracy and Global Financial Markets: the European Issue

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The relationship between financial markets, State sovereignty and democracy is a central issue in modern history.

Since the emergence of representative democratic States, national sovereignty is based on the rule of law and the sovereignty of the people: sovereignty is exercised by the people through democratic representative institutions, with a limited use of instruments of direct democracy. Consequently, the relationship between financial markets and State sovereignty came to be the relationship between finance and representative democracy. But the democratic institutions are normally contained within national borders, while financial markets are now global. The relationship between finance sovereignty and democracy has thus become highly problematic.

The Financial Markets and the Evolution of Modern Capitalism

Capitalism has broken its container several times, since its birth in Italian communal life of the thirteenth century.[1] In each case the cause of the crisis was connected to excessive growth in the power of financial markets over the State and society. Each cycle of expansion has ended in the destruction of institutions and prolonged conflict within and among States. Giovanni Arrighi in *The Long Twentieth Century* has described this

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Report presented to the Conference "The Foundations of Political Science and the Revolution of Modern Democracy", organized by the Italian Cultural Institute, New York, December 10-11, 2013.

[1] P. SHANKAR JHA, *The Twilight of the Nation State. Globalization, Chaos and War*, Foreword by Eric Hobsbawn, London, Pluto Press 2006.

development as the onset of 'systemic chaos'[2]. For his part, Fernand Braudel has characterized the result as "systemic cycles of accumulation" - intervals featuring rapid and stable expansion of world trade and production, fuelled by an extraordinary growth of the financial superstructure [3]. Such periods invariably resulted in a crisis of over-accumulation and eventual breakdown of the organisational structures, on which the previous expansion of trade and production had been based.

Is there a way to avoid crashes? A slow-down in the speed of evolution, and some important changes in the international regulations, which at the present stage of development are still penalising the long-term investment in innovation, research, infrastructure and environment, would be a way to maintain progress while avoiding chaotic social disruption. These changes may be achieved only by a strong national, supranational, and international regulation of market forces, recalibrating the relations between finance and the real economy, as well as between the market and the political choices made by democratic institutions. A new system of market regulation should parallel the establishment of an international order through a wide transfer of sovereign power from the national States to regional and international institutions.

While attempted, such a combined solution has not yet succeeded. In the wake of the current crisis, the need and the complexity of such a solution is the challenge which now confronts us.

The Institutions of the First Globalisation

The first globalisation began in the mid-eighteenth century and ended with the Great Depression of the 1930s. The second globalisation started in the 1980s, accelerated suddenly with the fall of the Berlin Wall in 1998, the Doha Round of the WTO in 1994, the great financial crisis of recent years, and is still in the making. The two phases share certain common elements, but they differ significantly in others.

According to Karl Polanyi, the nineteenth-century first era of globalisation was based on four institutions: the balance-of-power system, which assured a long phase of peace, preventing war among the great nations; the international monetary system based

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[2] G. ARRIGHI, *The Long Twentieth Century. Money, Power and the Origins of our Times, London and New York,* Verso 1994 (First Edition) and 2009 (Second Edition).

[3] F. BRAUDEL, *The Perspective of the World*, New York, Harper and Row, 1984.

on the Gold Standard; the concept of the self-regulating market; and the liberal State[4]. Two of the institutions were political (balance-of-power and the liberal State) and two were economic (Gold Standard and market ideology). Within this political-institutional framework, peace and economic development were assured for over a century. What happened in the first decades of the twentieth century, argues Polanyi, is that the mechanism of the self-regulating market turned out to be a "stark utopia". The collapse of the system produced one of the greatest economic crises in human history [5].

What kept this phase of modern capitalism functioning well for such a long time was the power of the international finance (*haute finance),* which reflected a long-standing cooperation among nation States. Some contended that the international finance was a mere tool of governments; others argued that the opposite was true, that the international finance was the real power and the guarantor of the world order. In any case, there is no question that the international finance provided the main link between the political and economic organisation of the world. Independent, but connected with single governments; independent, but connected with central banks, the international finance was not a possession of any particular nation-State. It flirted with diplomacy to grant grand peace (although favouring minor, short, and localised wars), with the only goal being to maintain the right conditions for constant accumulation of capital. It embodied the abstract concept of internationalism based on self-interest.

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[4] K. POLANYI, *The Great Transformation: The Political and Economic Origins of Our Time*, Boston, MA, Beacon Press 1957, pp. 8-11.

[5] The 1930s crisis signified the failure of the attempt to build a new world order based on free international trade and an integrated monetary system after the First World War. Kindleberger, in his seminal study of the subject, points out that, of all explanations of a world depression of such devastating intensity as that of 1929, none contains more than a grain of truth; Milton Friedman claimed that it was the consequence of some mistakes in the United States monetary policy; Samuelson argued that it was caused by a series of historical accidents; Robbins attributed it to the misuse of the gold standard; Keynes put it down to erroneous deflation; Hansen to secular stagnation; Svennilson to structural disequilibria; and so on. See: C.P. KINDLEBERGER, *The Great Depression 1929-1939*, University of California Press, Berkeley, 1986; M. FRIEDMAN and A.J. SCHWARTZ, *The Great Contraction*, Princeton University Press, Princeton, 1965; L. ROBBINS, *The Great Depression*, MacMillan, London, 1934; A. HANSEN, *Full Recovery or Stagnation*, A&C Black, London, 1938; I. SVENNILENSON, *Growth and Stagnation in the European Economy*, Economic Commission for Europe, United Nations, Genève, 1954; J. K. GALBRAITH, J *The Great Crash 1929*, Penguin, London, 1954; and P. TEMIN, *Lessons from the Great Depression*, MIT University Press, Cambridge Mass., 1996.

If we compare the first and the second globalisation, we discover that the two phases, at least in economic terms, were, in some respects, surprisingly similar[6]. While we must recognise the impressive novelty of the "Information Revolution", which has characterized the last decades, we may remember that submarine telegraph cables had connected inter-continental markets from the mid-1800s onwards. Since then, day-to-day trading and price-making were possible in almost real time in every financial centre of the world, with global bond markets and large-scale international lending growing rapidly during the period. Indeed, foreign direct investment (FDI) in 1913 amounted to 9 times world output - a proportion unsurpassed to today. Similarly import/export schedules combined a proportion of GDP that was not much greater at the beginning of the new century than in the beginning of the previous century. [7]

The present transformations in the world's economy, therefore, are not new. What is markedly different, among other things, is the increase in the size and speed of financial markets. Since 1980 the total value of financial assets has increased two and a half times faster than the aggregate GDP of all rich industrial economies. And the volume of trading in currencies, bonds and equities has increased five times faster.

The recent phase of financial capitalism, no less than its historical predecessors - from Florence's Renaissance to Britain's Edwardian era, through the Age of the Genoese and the events in Dutch history - is based "on massive, system-wide redistributions of income and wealth from all kinds of communities to capitalist agencies"[8]. In the past, redistributions of this kind engendered considerable political, economic and social turbulence.

The Return of States over Markets

The "Fin de siècle," with the *Exposition Universelle* of 1900 held in Paris, represented the apotheosis of the first globalisation. The First World War signalled the start of the crisis, which was to erupt in full force with the Great Depression of 1929.

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[6] G. ARRIGHI, *Globalization, State Sovereignty, and the 'Endless' Accumulation of Capital*, paper presented at the Conference on "States and Sovereignty in the World Economy", University of California, Irvine, Feb. 21-23, 1997.

[7] *Ibidem*, p. 1 and references therein.

[8] ARRIGHI, 1997, *op. cit.*, p. 8.

Reaction to the crisis strengthened the role of the State in the economy. Roosevelt's New Deal, nationalisation and the radical economic and social reforms attempted by the *Front Populaire* in France, fascist neo-corporatism in Italy with the birth of the IRI (Institute for Industrial Reconstruction), the 'command-and-control' Nazis' economic policy, the emergence of Keynesian economics, the birth of the public corporation, the growing role of the unions and the philosophy of the new welfare system born in the U.K., are all examples of the return to state-ownership and/or to direct State intervention in the economy. Therefore, the 20th century can be remembered as the century of the State.[9] With the advent of the Second World War, economic forces rallied around the States to combat the "state of exception" created by the conflict.

The Post-war period was characterised by the birth of mixed economies throughout Europe.[10] Protectionism, economic planning and state-owned enterprises[11] are the

[9] E. REVIGLIO, *Strong Markets, Weak States,* paper presented at the Conference *Privatization in Europe,* Accademia dei Lincei, May 16th 2002. See, E. REVIGLIO*, Privatization in Europe. A Brief History of European Capitalism in the XX Century*, Edindustria, Rome 2002.

[10] On the mixed economy see A. SHONFIELD, *Modern Capitalism*, Oxford University Press, Oxford, 1965; Id., *The Use of Public Power*, Oxford University Press, Oxford, and *In Defence of the Mixed Economy*, Oxford University Press, Oxford, 1984.

[11] The political concepts under which the systems of public enterprise were created and managed in 20th Century Europe was based on an underlying common belief: that the State should take responsibility for national industrial growth. An interventionist concept of economy began to emerge with F. LIST, *The National System of Political Economy* (1884) and John Maynard KEYNES, *National Self-sufficiency* (1933). It is based on the idea that a nation's political strength should be founded largely on the power of its own industry. It was in the collective interest to believe that if private capitalists were not able to sustain industry then the State should step in. This idea was part of a general view of the role of the State in the economy that began in the 1930s and was considered more seriously after the Second World War. One of the main arguments was that the state of infant industries in major sectors (steel and iron, telecommunications, energy, infrastructures, aerospace, defence and, in general, high technology) needed greater investments and a managerial capacity that private capitalists and the capital markets alone could not provide, especially considered the long term deferred nature of investments in infrastructures and high intensity capital sectors. It was also decided that an infringement of the liberal rules of international economy was necessary if structural conditions for the "take-off" were to arise. A certain amount of protection of new industries had to be ensured before exposing them to international competition. On economic nationalism see, F.LIST, *The National System of Political Economy*, London, 1884; J.M. KEYNES,*National Self-sufficiency*, in *The Collected Writings of John Maynard Keynes*, XXI, MacMillan, London, 1933;Shonfield, 1965; J.E. STIGLITZ, *On the Economic Role of the State*, in STIGLITZ et Al., (eds), *The Economic Role of the State*, Oxford, Basil Blackwell, 1989.

hallmarks of this long period of economic and social well-being known as the Golden Age. On the world economic front, the Cold War and the division of the globe into two large blocks contained the forces of globalisation. The European model was supported also by the United States, which considered it a defence against potential Soviet hegemony in Europe. Three are the main characteristics of mixed economy. They emerged as early as in the 1950s, but came to be defined more clearly in the 1960s. First, an all-encompassing influence of the State in the management of the economic and industrial system. Secondly, a rising concern for social conditions, which stimulated public expenditure in favour of the unemployed, education, pensions, health and transport which absorbed large quotas of public resources. Thirdly, the fact that, even in the private sector, the State could be said to control and possible intervene to adjust for market failures.

Besides, in order for mixed economy systems to be successful, the public machine supporting it had to be compatible with the principles of a modern parliamentary democracy and the democratic institutions had to be reshaped to assure a democratic governance of the new missions of the State. [12] As Shonfield puts it: "In what ways are the national democratic styles in different countries to be modified? How much of the original objective of government by popular consent can be sustained in a system in which the sphere of active government has been greatly enlarged, and is likely to become more so?". [13]

The European debate in the following decades would revolve around these questions. At the end of the 1960s the success of mixed economy systems was evident. At the time, it was thought that the programming and public management of economic, social and industrial policies was a good and successful model for the future.

Moreover, in Europe, the growth of the welfare state, which includes health insurance coverage, pensions, and other benefits, created a unique model of European citizenship.

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[12] See, in particular, F. FORTE and A. T. PEACOCK, *Public Expenditure and Government Growth*, Oxford, Basil Blackwell, 1985; J. M. BUCHANAN et Al. (eds), *Deficits*, New York, Basil Blackwell, 1987, J. M. BUCHANAN, *Public Finance in Democratic Process*, Chapel Hill, University of North Carolina Press, 1967; and R. D. IRWIN, *Public Principles of Public Debt*, Homewood Ill., Richard D. Irwin, 1958. For a discussion of the public choice theory, J.M. FERGUSON, (eds), *Public Debt and Future Generations*, Chapel Hill, University of North Carolina Press, 1964; and for a summary treatment, J. M. BUCHANAN and R.E. WAGNER, *Public Debt in Democratic Society*, Washington, America Enterprise Institute, 1967; J. M. BUCHANAN, *Cost and Choice*, Chicago, Markham, 1968.

[13] A. SHONFIELD, *Modern Capitalism*, p. 67.

The "Golden Age"

In the years immediately following the Second World War, Western economies, especially European, showed very high rates of growth.[14] This period of economic growth is known as over-performing. National diversities began to fade. The convergence of *per-capita* income and of other principal macroeconomic indicators was at once the result and the cause of broader institutional, social and cultural convergence. A very high growth rate and nearly full employment remained constant from 1945 to 1973. Poorer countries grew faster than rich ones. The cross-sectional scatter of *per-capita* input declined, thus supporting the hypothesis of a rapid convergence of European economies. It has been said: "As a result, in the early 1970s, the dispersion levels of *per-capita* income among European countries was much less pronounced that it had been a quarter of a century earlier. Moreover, the formation of core economies characterized by roughly similar standards of living was, by then, well under way". [15]

The performance in the first few years of reconstruction was exceptional due to a series of self-evident factors, such as: (1) the dimension of the damage ensuing from the war, which provided a rationale for American aid flowing into infrastructure work and technology, (2) the psychological effect of a return to enduring peace and democracy, (3) the important institutional changes which were implemented in the presence of strong national unity in each European country. Within a mere five years of the end of the war Europe recovered levels of income as high as ever experienced before the war and, during the 1950s and 1960s experienced an overall economic boom. European life started to look increasingly like its American counterpart: growth in mass consumption, decrease in poverty, low inflation, and high employment.

High growth rates in Europe were partly due to higher rates of employment in industrial sectors. This meant an increase in productivity. Towards the end of the 1950s, the demand for labour in the industrial sector was greater than the supply. Immigration,

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[14] On European economic growth theory, see N. CRAFTS, and G. TONIOLO (eds), *Economic Growth in Europe since 1945*, Cambridge University Press, Cambridge, 1996. See also, A. BOLTHO, (editor), *The European Economy: Growth and Crisis*, Oxford University Press, Oxford, 1982. The data which will follow are taken from A. MADDISON, *Dynamic Forces in Capitalist Development,* Oxford University Press, Oxford, 1991.

[15] N. CRAFTS and G. TONIOLO, *Economic Growth in Europe since 1945*, p. 5

mainly from poorer southern Italy and Turkey, supplied millions of workers to the more industrialized North.

The successful development of this first phase is also linked to a strong growth in investment. In its turn, investment was sustained by high levels of public expenditure. Ever growing public funds were used to invest in high-intensity capital sectors, infrastructures, education, state-sponsored social programs and public services for citizens. The money saved by firms and citizens produced lots of private savings. These savings, in turn, were invested in the productive machine.

The major European economies - France, Germany and Italy - grew faster than at the beginning of the century and expanded more intensively with shorter recessions. [16] Great Britain, notwithstanding its slower rate of growth, did better after the Second World War than during the Edwardian era of economic expansion. The United States, by contrast, grew much more at the beginning of the century than after the Second World War. America's growth rates after 1945 were lower than Europe, with worse recession cycles. [17]

According to Shonfield, two major economic reasons favoured such high rates of economic growth in western countries, to do, first, with the great expansion of international trade, and, secondly, with the construction boom of the 1950s. To these two phenomena a third must be added, which partly derives from the first - full employment, accompanied by technological innovation, favoured by public expenditures

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[16] See A. MADISON, *Economic Growth in the West*, London, Allen & Unwin, 1964. On the role of business cycles in the development of international economy see also, A. MADDISON, *Phases of Capitalist Development*, Oxford, Oxford University Press, 1982; S. A. MARGLIN, and J. B. SCHOR, *The Golden Age of Capitalism*, Oxford, Oxford University Press, 1990; and A. TYLECOTE, *The Long Wave in the World Economy: the Current Crisis in Historical Perspective*, New York, 1993.

[17] Two recession waves hit Europe between 1951-1952 and 1957-1958, respectively. Both were caused by external political conditions: the break-out of the Korean War in the early 1950s and the war over the Suez canal at the end of 1956. See M. GILBERT, *The Postwar Business Cycle in Western Economy*, in AER, May 1962. The United States suffered three recessions—in the years 1948-1949, 1954 and 1960-1961. The first two were more serious. The first (1948-1949) was largely connected to the 'rebound' of help given to the reconstruction of Europe. The second (1954), due to the 'rebound' of the Korean War, ended almost immediately, thanks to financial measures adopted by the government and by a boom in the sale of cars in 1955. The third (1960-1961) was a direct consequence of European growth being faster than the American one. The sudden, unjustified surplus of federal deficit, at a time when unemployment had exceeded 5%, was stopped. The Federal Reserve feared that the cycle of expansion at that moment was probably excessive - in other words, a self-induced recession. See OECD, *Economic Surveys, The United States*, 1961.

in high intensity industrial sectors.[18] Companies increased the rates of fixed investments in new buildings and new machines, thus causing the technological level to rise and, simultaneously, increasing work productivity.

While growth after the First World War took the form of self-sufficient economic nationalism, closed to international trade, after the Second World War the opening up of international markets and trade boosted productivity. Technology progressed and education levels rose. New sectors of industry and services became the basis of productivity.

The Oil Crisis and the Decline of the Mixed Economy Systems

At the beginning of the 1970s, a certain loss of faith in the State's ability to run the economy began to spread, or at least a loss of faith in its capacity to do it in a successful way and with good results.

One of the reason was the strong increase in public spending during the 1960s and 1970s arising from growth of the welfare state. As a consequence, the public spending/GDP ratio in the main European countries went from approximately 20% in 1950 to almost 40% in the eighties, then increasing to almost 50% at the end of the century.[19]

Now that the oil shocks were putting a serious halt to growth, the high social spending policies of the previous decade began to be seen as unsustainable. The crisis was hitting the economy as a whole, but it was especially hitting the industrial sector.[20]

So, one of the reasons the European countries decided to make a major curb on public social expenditure had to do with the governments' judgment about the limits of the taxable capacity of the nation, and with the secondary effects of the increase of public expenditure on the long term productive capacity of the economy. By the mid-1970s continental Europe feared that the resources taken away by the public sector would, in one form or another, be subtracted from the investment needed for the renewal and enlargement of industry productive capacity. To protect profits and

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[18] See J. A. SHUMPETER, *Business Cycles*, New York, McGraw Hill, 1939.

[19] V. TANZI and L. SCHUKNECHT, *Public Spending in the 20th Century: a Global Perspective*, Cambridge University Press, 2000.

[20] See, S. POLLARD, *The International Economy since 1945*, London and New York, Ruthledge, 1997.

investments, the Government was not in a condition to preserve all the benefits which had been introduced in the preceding decade.[21]

However, the rise in public spending in the period 1960-80 was the result of a wide-ranging effort to stimulate the economy as well. In 1974-76 and again in 1979 there had been a slump of unprecedented dimension since the advent of the post-war welfare state in the western world. Whether the increase can be traced back to the efforts to spend one's way out of the oil crisis, or whether if it was a secular trend, brought forwards by what Buchanan might have termed the market for political consensus, is it still an open question.

In 1977 James Buchanan and Richard Wagner published a very influential book, entitled *Democracy in Deficit: The Political Legacy of Lord Keynes*. It was a ground-breaking critical analysis of mixed economy and high public spending, and it was a major challenge to Keynesian economic policy. It appeared when the oil crisis was every day putting a heavier burden on the borrowing capacity of the State and on growing levels of

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[21] The situation is well described by Sidney POLLARD, *The International Economy since 1945*, p. 48 : "Looking back to the past twenty years, one may legitimately wonder why anyone should wish the Golden Age to come to an end, and be so eager to reverse a policy which had been so successful beyond all expectation for almost a whole generation. At an abstract, theoretical level, there were no doubt those who, with some of the disastrous experiences of hyper-inflation on the European continent in the immediate post-war years and in Latin America in mind, genuinely thought that inflation, if not curbed, would bring to an end any hope of prosperity and social peace. However, there was, in the advanced world, no sign of such hyper-inflation, and in any case, few politicians are swayed by purely abstract theory or hypothetical dangers. The cause of the reversal of the Zeitgeist may safely be sought in more mundane considerations. It is worth remembering in this context that not everyone benefited by the Golden Age. It included, let us recall, the profit squeeze, and with the decline of profit was associated a loss of power over the labor market, and over their own work force, on the part of the owners and controllers of capital. Just as Keynesianism combined some of the ideals of the Left, monetarism easily became an ideology embraced by the political Right. Apart from restoring the power of capital and management over labor, it had other desirable features from their point of view. Since, according to its teaching, inflation was best curbed by monetary means, and since it is governments which are responsible for creating money inflation by excessive borrowing which itself is due to unbalanced budgets, that is, spending more than they collected in taxes, cuts in government expenditure became a main ingredient of monetarist policy. What better element to cut than social welfare programs? It was indeed believed that it was generous unemployment benefit which allowed unions to hold up wages despite the army of the unemployed outside in the cold looking for work, The cutting back of out-of-work benefits, together with other welfare payments, would relieve the taxpayer, reduce inflationary pressure, and at the same time turn the labor market more in favor of the employer. A drive also began in almost every country to reverse the process of nationalization, by privatizing socialized enterprises. Some impetus for this was derived clearly from the somewhat doctrinaire notion that private business was always run more efficiently than any enterprise in public ownership. But it could not be overlooked that their transfer to private ownership would also increase the opportunities for making profits".

public spending. It was a call to fiscal responsibility: government should not spend without imposing taxes; and government should not expose future generations to deficit-financing of public outlays designed to provide temporary and short-lived benefits. They foresaw the coming of a new paradigm of political economy based on the concept of a more fiscally responsible State. The criticism to Keynesianism was based on the objection that the Keynesian precept of economic democracy based on public spending and balanced deficit is not efficient, since it does not restrain the spending proclivities of politicians and parties.

The authors started from the classical pre-Keynesian view of the analogy between the State and the family or a business firm. Public budgets - just like private budgets - should maintain a surplus or, at the very least, be balanced; and deficits should be tolerated only in extraordinary circumstances. "Outlays should not exceed income, tax revenue ought to be kept up to the amount required to defray expenses". The classical Smithian theory of public financing held that a choice between tax financing and debt financing is a choice "of timing of the payments for public expenditure". With tax financing, community members pay the bill for the benefits they receive right away, and they get only what they can afford. Governments are thus judged, at election time, by what they were capable of providing during their tenures in office with only the monies they received from the taxpayers. The idea behind debt financing is that it is possible to shift the burden of higher spending onto national savings and, eventually, to place it upon future generations. Politicians, therefore, are tempted to woo public favour by increasing public spending, and if taxes do not bring in the funds to cover their political promises, they will resort to borrowing.

The second Globalisation and the Maastricht Treaty

At the beginning of the 1980s, deregulation paved the way for a gradual transformation of the financial industry. It was the end, among other things, of the Glass Steagall Act, the separation between commercial banks and investment banks, and the prelude to the financial crisis that we are experiencing today.

At the same time, a U-turn in the relationship between the State and the economy was starting to take place in the United Kingdom. The philosophy of "Small Government," the policy of privatisation of public enterprises and public services, and economic democracy under the aegis of a "Shareholders' Society" were also spreading to continental Europe and to the advanced economies of the rest of the world. Mixed

economy systems were gradually being dismantled throughout Europe and Asia. Japan, Germany, France, Korea and Italy proved to be the most resilient in this process .[22]

At the beginning of the nineties, two of the major American scholars in corporate law, Henry Hansmann and Reinier Kraakman, wrote an important essay, *The End of History of Corporate Law*, announcing the end of European, Japanese and Korean corporate ownership models, and the success of shareholder value over all other models.[23] It was the start of the extraordinary growth and development of corporate financial capitalism. At the same time, Francis Fukuyama in *The End of History and the Last Men* proclaimed that the model of the liberal State and market economy was the final destination in the history of humanity and that it would be extended to the entire planet.[24]

The fall of the Berlin Wall and the later WTO Doha Development Round, contributed to a sudden acceleration in the speed of the time of history - with much of the world acquiring the market capitalism model in various forms and at different rates. Few years after, the public policy interventions taken in almost all advanced economies to counter attack the negative effects of the financial crisis of 2008-2013, opened up a new debate on the role of public policies in a modern market economy.

The second great globalisation stage was taking off, with Internet, the digitalisation of the economy and the global connectivity, the opening of markets and the end of neo-colonialism.

In the meantime, in the EU, the Single European Act of 1987 and the Maastricht Treaty of 1992 reinforced the market based nature of the European economy[25], basically governed by the three principles: (1) free circulation of goods, utilities, people and capital; (2) a well regulated competition policy (anti-trust enforcement); and (3) limited State aid to companies. The first and last principles limit the State's activity within the market. The second limits the role of companies within the market. The last two are

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[22] M. ALBERT, *Capitalism Against Capitalism*, London, Whurr, 1993. See also, M. ROE, *Some Differences of Corporate Structure in Germany, Japan, and the United States*, in *Yale Law Journal*, 102, 1927, 1993.

[23] H. HANSMANN, and R. KRAAKMAN, *The End of History of Corporate Law*, *in Yale Law School, Law and Economics Working Paper*, 235, 2001. See also, M. ROE, *Some Differences of Corporate Structure in Germany, Japan, and the United States*, in *Yale Law Journal*, 102, 1927, 1993.

[24] F. FUKUYAMA, *The End of History and the Last Men*, Free Press, New York 1992.

[25] Although the competition and market based paradigm was already contained in the Rome Treaty (articles 101 and 103), it is only with the creation of the Single Market with the Single European Act in 1987 that stronger competition enforcement give full force to the neo-liberal foundations of the European economic constitution.

dictated by the first. Free circulation creates a single common market where an effective regulation of a fair competition is essential. A well regulated open competition, in its turn, forbids State aid to businesses if such aid can create unequal conditions among the companies acting within the community. These four conditions of circulation (goods, workers, utilities and capital) became the basis for a solid single European market. Community discipline on competition and the limitation of the State's aid to companies aimed to consolidate a free exchange policy. In their turn, the regulations on State aid have been acknowledged by the jurisprudence of the Court of Justice to be part of competition policy to the extent that they have been integrated into competition regulations.

The free-trade politics at the basis of the formation of the single European market founded on a neo-liberal theoretical paradigm supplied all the countries with a common conceptual picture. This general picture was based on the experience of the United States and Great Britain and was strengthened by the European Commission's increasing role in anti-trust policy.

At the same time the Maastricht Treaty and the road towards the Euro imposed a very severe and long term process of fiscal consolidation to most member countries. Although, from the Rome to Maastricht Treaties, the EU never imposed privatisation, but rather the liberalisation of markets[26], member States with high public debts and high welfare expenditures found themselves under a strong pressure to sell public assets to speed up the mandatory process of fiscal consolidation.

A number of factors had paved the way to the end of the system of State-owned Enterprises in the European Union: the excessive costs of social security and high public debts, the enforcement of State aid's prohibition, and more generally, a change in the theoretical and ideological framework based also on the fact that, by the end of the

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[26] Rome's Treaty leaves each country the freedom to decide on whether companies should be publicly or privately owned. But, with the advent of this freedom - and, consequentially, of competition rights and limited state help to companies – some of the principal economic reasons for the choice of public ownership seem to have faded away. However, large corporations which operate in strategic sectors and companies which own national networks and/or grids are often still under the control of the State or of public agencies. The financial crisis of 2008-2013 led, moreover, many liberal states to re-nationalize banks, insurance companies and industrial enterprises of systemic importance and has produced a rediscovery of the role of the State or of public agencies as patient shareholders and long-term investors (this point will be discussed later).

century, large enterprises were naturally ready and forced to move from a basically national to a more global dimension. In the new global arena capital markets were thought to be more effective in supporting the necessary dimensional growth and the consolidation processes which was taking place in most of key industries, through mergers and acquisitions and international strategic alliances. Lastly, the regime of competition (which includes the prohibition of State aid) reduced and transformed the European model of State intervention in the economy.

The Great Convergence

The first difference, between the first and the second globalisation, is the so-called Great Convergence that will characterize the world economy in the twenty-first century.[27] The first globalisation saw European countries dominating the world economy with their system of colonial States, fully under the influence of their colonial masters. Moreover, the Soviet Union and the countries that belonged to the socialist block were not part of the capitalistic side of the world based on market economy. They were consigned to another world. Today, in the post-colonial and post-socialist era, nearly the entire globe participates in the arena of globalisation. Nearly two-thirds of the world population, mostly in Asia, is switching from self-consumption to consumption and from the closed circuit of an agricultural economy to the open source of a market economy. The world economy will then experience a huge transformation, and together with it, an exceptional demand for capital investment, open to the global financial markets.

World population will grow from seven to nine billion by 2050; in Africa alone from one to two billion; GDP should rise, in the same period, from 72 trillion USD in 2012 to about 380 trillion USD in 2060 (then growing by five times in less than four decades).[28] The fastest growing regions, according to forecasts, will be Africa (7.0%) and developing Asia (5.4%).[29] As a result, North America and Western Europe are expected

[27] F. BASSANINI and E. REVIGLIO, *Financial Stability, Fiscal Consolidation and Long-Term Investment after the Crisis*, in *OECD Journal of Financial Markets Trends*, Issue 1, 2011.

[28] OECD, *Looking to 2060: Long Term Global Growth Prospects. A Going for Growth Report*, in OECD, *Economic Policy Papers*, 3, November, 2012.

[29] See F. BASSANINI and E. REVIGLIO, *Financial Stability, Fiscal Consolidation and Long-Term Investment after the Crisis*, 2011, and sources therein.

to fall from 40% of world GDP in 2011 to just 25% in 2060, while developing Asia's share is predicted to rise from 29% to 49% in 2060. China is expected to overtake the US to become the largest economy in the world by 2020, to be, in turn, overtaken by India by 2060.

The *per capita* numbers suggest, however, that the convergence process may require several decades for completion. Looking ahead, both China and India have huge investment requirements.[30] The impact of such powerful rates of growth, urbanisation and development will place great pressure on the environment and will challenge the adequacy of natural resources on our planet. It will also represent an unusual opportunity for global financial markets.

The second difference from the first globalisation is the large increase in the cost of social expenditures (especially pensions and health care, due to aging society and rising cost of medical technology) in European countries and the rise of public debt/GDP ratios, close to and above 100%, as a consequence of the long recession and the cost of rescuing financial institutions. With the first globalisation, public spending was approximately 10% of GDP and public debt was much lower until before the war, curbed by inflation soon afterwards. Today in most Western economies public spending is close to 50% of GDP. Moreover, demographics represent a dramatic burden for the future of social spending (health and pensions). If we add to this the low rates of growth in the advanced world, especially in Europe, then the high public debt/high public spending/low growth/demographics equation becomes a nightmare for the future of these societies.

Finally, in the next ten years over three billion people, in emerging economies alone, will become the new bourgeoisie. [31] A phenomenon known as "personal empowerment". This occurrence means that competition will be increasingly based on the size of markets, made up of global players and mature competitive consumers.

The waves of financial expansion are engendered by a double tendency. "On the one hand", writes Giovanni Arrighi, "capitalist organisations respond to the over-

[30] It has been recently estimated that, to keep pace with urban population growth, China, over the next three decades, will need to build the equivalent of one New York City every year. And India, over the next three decades, will have to construct the equivalent of a city as large as Chicago every two years. MCKINSEY GLOBAL INSTITUTE, *Farewell to Cheap Capital? The Implications of Long-Term Shifts in Global Investment and Saving*, December 2010, pp. 25-34.

[31] NATIONAL INTELLIGENCE COUNCIL, *Global Trends 2030: Alternative Worlds*, Washington, 2012.

accumulation of capital over and above what can be reinvested profitably in established channels of trade and production by holding a growing proportion of their incoming cash flows in liquid form." This penchant creates what he calls the "supply conditions" of financial expansion - an overabundant mass of liquidity that can be mobilised directly or through intermediaries in speculation, borrowing, and lending.

By contrast, territorial organisations respond to the tighter budget constraints, high public debts and rising costs of the welfare state that is challenged from the slow-down in the expansion of trade and production by competing intensely with one another for the capital that accumulates in financial markets. Such a propensity creates what he calls the "demand conditions" of financial expansion. All financial expansion, past and present, is the outcome of the combined, if uneven, development of these two complementary tendencies."[32]

The Institutions of the Second Globalisation

In general, the 21st century may well be characterised by weak States in strong markets; and by new asymmetries and imbalances between the old and the new actors of global economy and their economic and political models. The lack of democratic legitimacy and accountability of the financial global players is, understandably, a troubling issue. The financial crisis has done nothing but highlight this fact.

We have seen the institutions which were at the core of the first globalisation: balance-of-power among Great Powers; the international Gold Standard; the self-regulating market economy; and the liberal State. Which are the institutions which characterise the twenty first century? Balance-of-power among Great Powers under the Bretton Woods institutions (WB, IMF, WTO, UN), the G8 and G20 (with a new entity for the regulation of financial markets, the FSB)[33]; the dollar standard under attack from

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[32] ARRIGHI, 1997, *op. cit.*, p. 7.

[33] The FSB was established after the 2009 G20 London summit as a successor of the Financial Stability Forum which was set-up in 1999 by the G7. The Board includes all G20 major economies, FSF members, and the European Commission. Secretary to the US Treasury Tim Geithner has described it as "a fourth" pillar of the architecture of global economic governance. It acts as a trans-network of national authorities, IFIs and sector specific organizations, with the objective of bridging the gap arising from national and sectoral fragmentation. If it were to remain a trans-network, much of the responsibility for implementing its decisions would inevitably rest with its member organization. Unlike the multilateral financial institutions, the FSB lacks a legal form and any formal power.. "Although the FSF evolved into the FSB, with an enlarged membership and an expanded mandate, its governance has not evolved as fast as its prominence in the current international financial system. To

the rise of the Euro and the Yuan, and the crisis of the Eurozone; the market economy, with some attempts (so far unsuccessfully) to submit it to more effective rules; the liberal State extended, however, to a much larger number of countries in the world, but by no means to all of them; a financial global industry still too detached from the needs of the real economy; and, after the great financial crisis, the search of a new role of the State within the framework of the market economy.

The balance-of-power is still dominated by the United States and its closest allies. The most widely recognised signs are the global impact of American popular culture and the growing importance of agencies of world governance, such as the IMF, the WB and the WTO, which are disproportionately influenced by the United States and its closest allies. New powers, however, are emerging within these institutions and the US hegemony is being slowly eroded. Less widely recognised, but worthy of mention, is finally the ascendance of a new legal regime in international business transactions dominated by US law firms and Anglo-American conceptions of business law [34]: in fact, a new unwritten but widely practiced *lex mercatoria* had been gradually emerging as one of the main element of the international economic integration.

The dollar-based international monetary system is still quite strong. Nonetheless, the rise of the Euro and the emerging of the Asian economies are putting strong pressure on the dollar (China and Japan hold half of foreign US Treasury bonds). Talks of a new multi-currency system are growing by the day. It may still take time before the primacy of the dollar is abraded (the dollar is still a *major yardstick* in international trade), but the "currency war" is already in the making and it may emerge as conflicting dimension in the future of global governance.[35]

The model of the liberal State, after the fall of the Berlin Wall, has been adopted by a growing number of nations, although, in most cases, the evolution from post-colonial dictatorship systems to liberal democracy may take much more time than expected. The institutional building needed for the introduction and development of liberal democratic

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reflect its expanded and still-increasing role, more modernization is needed" Brookings Institution, *The Governance of the Financial Stability Board*, Issue Paper, September 2011.

[34] S. SASSEN, *Losing Control? Sovereignty in an Age of Globalization,* Columbia University Press., . New York 1996.

[35] B. EICHENGREEN, *Currency Wars: Perception and Reality*, DWS Institute Paper, Frankfurt, Deutsche Bank, May 2013.

systems, in countries that have had radically different political traditions and institutions, are long-term commitments. Some of the great economic powers, such as China and some Arab States, do not indicate having any intention of turning into liberal States, at least not in the near future.

The financial crisis of 2008-2013 has, moreover, questioned one of the ideological foundations of economic liberalism, the belief in the self-regulating market economy, which had been the rule of thumb since the 1980s. To avoid new crisis and to pave the way to economic recovery a change of paradigm has been invoked, especially in Europe, although little has been done so far, in terms of policy making, to introduce a real and effective regulation of the market economy.

The crisis led, moreover, many liberal States to undertaken actions in order to counterbalance the massive deleveraging process of the banking system and to give financial stability to the system (which is the condition for a sustainable and long term economic growth). As a consequence several liberal States are coming back as equity investors, either by the re-nationalization of banks, insurance companies and industrial enterprises of systemic importance, or by setting up special funds providing minority long term equity (mezzanine and guarantees) to selected firms and to infrastructure initiatives. Mostly, they have done it to complement market failures which emerged after the crisis. [36]

The historical evolution of the National State Sovereignty

[36] The new public/private instruments are based on initiatives designed to support the long term growth of potentially healthy, strategic and competitive firms, both large and SMEs, and to foster the financing of infrastructure, in a phase of prolonged "credit crunch". As historical evidence shows, this deleveraging process is likely to be long and tough. In this context, given the increased difficulty in getting loans, especially to finance long-term projects, companies need additional sources of capital to support stability and to finance investments. Moreover, there is in general in the economy a reduced investors' appetite for equity, leaving room for an "equity gap" between the amount of equities that investors will provide and what companies will need. This gap, without the necessary interventions, is intended to widen and weigh on firms' and countries' capabilities to invest and growth. This outcome, at a time when the global economy needs to deleverage in a controlled and safe way, appears to be particularly unwelcome. There is then a need for solidity, for buffers of patient capital that can absorb potential losses during shocks without seeking speculative returns. There is a need for forward-looking capital investing through the cycles even for the ultimate benefit of future generations

From a legal point of view, most national States still presumes to be strong and able enough to maintain the fullness of the national sovereignty; nevertheless, the sovereignty of national States has been eroded and undermined in many ways.

Two or three centuries ago, every national State was omnipotent within its borders, and threats to its sovereignty could only come from other sovereign States with expansionist ambitions; partial transfers of sovereignty could take place in order to forge alliances needed to contain aggressive threats from hostile States.

National sovereignty then underwent, in some States, a first process of erosion, through the spread of federal models which, to a great extent, involved the sharing of sovereign powers between the federation and the member States, including "regalian" powers such as justice, taxation and police (but usually not the power of the money): first example, the USA. However, the federal model attributes to the federal State, in any case, the role and the powers of a decision-maker of last resort (supremacy clause).

Everything started to change with the Second World War. The first steps were taken, on the political front, in the wake of the well-intentioned but unsuccessful League of Nations, especially with the creation of the United Nations and the North Atlantic Treaty Organization. They involved unions of national States in which, however, most of the privileges and the political subjectivity of the national sovereign States were preserved.

But, in the last decades, as we pointed out, along with the explosion of the forces of globalisation especially in the West, two phenomena assume increasing importance: the growth of the welfare system and its crisis and the even larger growth of global financial markets. The sovereignty of national States was therefore put under a twofold pressure represented by increasing difficulties in supporting the welfare state (with high public debt, low growth rates and worrisome demographic prospects) and the dominating force of the new multinational financial powers (global universal banks, shadow banks, ratings agencies, multilateral development banks, institutional investment funds, global private equity funds et al.): a strong erosion of most National States sovereignty in fiscal, economic, and industrial policy ensued.

Europe was the first to seek a solution to the crisis of national sovereignty with the transfer of sovereign powers to supranational unions, beginning already in the early fifties, with the creation of the European Coal and Steel Community (even if the project for a European Defence Community, which would have led to the surrender of a crucial national sovereign power, failed because of the French opposition). These institutions arose from the belief of the founding fathers (Schuman, Adenauer, De Gasperi, above all) that individual European States, by themselves, were not capable of maintaining

peace and pursue their fundamental strategic interests: an implicit admission of the crisis of sovereignty of individual European states.

During the last years of the twentieth century, globalisation placed the principle of national sovereignty even more in jeopardy. Global financial markets' players have the power to overflowing, and even to ignore national borders. Often, national governments and political forces feel forced to follow the dictates of these players even if these are contrary to the political programmes chosen by the sovereign people through democratic elections.

The reasons why many nation States are weak in the face of global markets are well known. First, financial markets players hold a large number of sovereign bonds and through this channel impose choices, even political ones, on States: the underlying principle is that "whoever owns part of your debt also owns part of your choices", that is the typical power relationship that is created between creditors and debtors. Second, markets are willing to invest as long as reforms that they believe are needed are implemented, influencing government policies on many issues, such as the fiscal policies, the regulation of the labour market, the tax burden, the welfare system, liberalisation and privatisation. Third, in democracies where have increasingly higher costs, whoever contributes to the rising costs of election campaigns (and financial markets and large corporations certainly do so) has the power to influence the democratic process of law making.

Finance utilises various tools in order to manage its power relationship over States: ratings agencies, research departments in business banks, influence and/or direct or indirect ownership of specialist and general media, direct or indirect financing of universities and research centres and/or individual commentators and, lastly, especially in developing countries, the corruption of the governments and/or public managers.[37] Finance is therefore capable to model and reshape opinions concerning the state of health of an entire nation and to impose choices on unarmed governments. Finally, multinational large corporations and finance players elude the law and the power of national States, moving in several jurisdictions and tax havens, thus escaping two of the traditional powers of sovereign States, i.e. dictating rules of law and enforce them through the courts and imposing taxes to implement democratically based policies.

Lastly, the markets have the power and the authority to move capital to countries and places where they can increase earnings. In order to be more attractive, countries, districts and cities must demonstrate that they are doing that which pleases and reassures

[37] V. TANZI, *Corruption Around the World: Causes, Consequences, Scope, and Cures*, IMF WP, 98, 63, 1998.

the markets. This type of external constraint pushes governments to implement laws which benefit the markets even if they are not always in the long-term interest of their own economies and societies.

But the globalisation was undermining the national sovereignty even more strongly with the emergence of large countries that were once underdeveloped (initially China, India, Brazil, Russia, later joined by Indonesia, South Africa, Mexico and Turkey, and within a few decades most likely augmented by Nigeria, Egypt, and Pakistan) whose population size and economic, military and political force will risk triggering the marginalisation of most of the smaller sovereign States (including virtually all the European States).

For the smaller countries, the transfer of sovereign powers to larger political-institutional entities (regional or international) capable of counting on the international scene may become soon the only option to protect themselves against a total loss of sovereignty, and, moreover, to give to the people sovereignty a new chance: the surrender of national ultimate sovereignty in order to participate to a new shared supranational sovereignty.

This issue could be unavoidable for the European States, which, in addition to smaller size of their markets, have other handicaps towards the new emerging powers. For instance: many among these big emerging countries have economic, industrial and financial systems based on strong State aid and direct public ownership and/or intervention; their low level of public debt allows massive public interventions; in Europe, at the contrary, state aid and public direct intervention is *de jure* prohibited or strictly limited and *de facto* hindered by the high level of public debt.

The Temporal Dimension: the Need of Long-Term Investment to Support Growth

To a large extent, the problem is related to the temporal dimension of the interests involved. Markets are looking for short-term private returns, and very often operate on a short-term "bite and go" opportunistic logic, while governments have a duty to design and implement reforms that are in the long-term public interest. Thus, not infrequently governments are induced to adopt short-sighted policies, in order to please the markets, or just to attract capital, even when it is clear that these policies do not match the interests of the country.

The result has been an excessive reliance on short-term investment and a sizeable decrease in long-term investment. Long-term investments are crucial for the sustainable

future of the world economy. They have strong positive externalities for the economy and for society as a whole, and they contribute to the creation of competitive economic systems that are based on technology and innovation. Financial deregulation, beginning in the Reagan era, has favoured the creation of ever larger financial institutions with their sole mission being the accumulation of profits for shareholders and the compensation of managers for short-term increases in share value. American corporate governance systems, based on shareholders' value creation, have given strong incentive towards a short- rather than a long-term approach to banking and finance.

Financial market globalisation and the excessive liquidity which has been poured into the global financial system, have contributed materially to financial arbitrage around the world. If one can borrow money at nearly zero rates and invest it in high-yield investments, why bother with costly and time-consuming valuation of long-term projects to finance firms and investment projects in the real economy or in infrastructures?

After the crisis, which was mostly a crisis of excessive leverage, the new accounting rules (especially IAS[38] and Basel III), with the good intention of restoring stability and

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[38] The International Accounting Standards (IAS) are still dominated by the philosophy of the "mark to market" which, in many cases, penalize long-term investment as well as institutions which have business models with long-term liabilities and assets (such as Pension Funds and Life Insurance) or long-term missions of public interest (such as national and multi-lateral development banks).

In fact the key objective should be to ensure the right measurement in the right situation, or, in other words, that the measurement required for assets/liabilities conveys the right information to the users of financial statements from the entity's business model viewpoint. Therefore, requiring the same measurement method for identical assets used with different aims and contributing to future cash flows in different ways should be considered harmful to the quality of financial information. It may be more appropriate to create an additional category for financial assets that are held as investments in a medium or long-term perspective and that do not meet the definition of either the amortized cost category or the fair value through profit and loss category. The concept of "value in use" is already defined by IAS 36 – Paragraph 6 : "Value in use is the present value of the future cash flows expected to be derived from an asset". This definition could be extended to financial assets when the business model of the entity is to hold these assets for a long period. As such the key indicator of the performance measure would not be distorted by short term fluctuations of unrealized gains and losses.

The need to give more prominence to the business model was recently highlighted in the European Commission long-term investment green paper consultation. In the context of a "long-term investment activities" business model, the fair value is not the appropriate measure; it creates artificial volatility in that transitory unrealized results will not normally materialize. The IASB should define the 'business model' concept in general and recognize the 'long term investment' business model in particular. For e recent discussion on the topic see, EFRAG, ANC AND FRC, *The Role of Business model in Financial Statements*, December 2013.

Although these facts have been extensively recognized also at the institutional level (EU and G20) nothing has been concretely done so far to recalibrate the rules favoring long versus short-term investment and financing of the economy. For e recent discussion on the topic see, EFRAG, ANC AND FRC, *The Role of Business model in Financial Statements*, December 2013.

good practices in the banking industry, has forced the European banking system, which historically provided a very large part of the global long-term financing of the economy and infrastructure, to a long and painful deleveraging process.[39] This development increased the recourse by the big banks to speculative transactions in order to increase income produced by financial short-term investments, and to transfer retained earnings to increase capital (instead of asking the market for capital increases) – thereby reducing the capacity of the banking system to finance long-term investments. Long-term institutional investors, such as pension funds and life insurance companies, for their part, could take up part of the long-term needs of the economy, but even in this case regulation does not seem to adequately reflect the important potential of such interventions (see the Directive Solvency II in the EU).[40]

Pension funds and insurance companies worldwide have more than 100 trillion in assets under management. Today they invest less than 3% of their asset allocation in infrastructure.[41] Regulation could favour a substantial increase of that quota, erasing the

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[39] It is by now well known that some of new ratios (in particular, capital and liquidity ratios) imposed by Basel III penalize excessively long-term investment. See, *The High Level Group of Financial Supervision in the EU*, Chaired by Jacques de de Larosiére, Bruxelles, 2009; *A New Strategy for the Single Market. At the Service of European Economy*, Report to the President of the European Commission by Mario Monti, May 2010; the *Green Paper on Long-Term Financing in the EU*, May 2013; *The High Level Group on SME and Infrastructure Financing, Finance for Growth*, chaired by John Moran and Alberto Giovannini, December 2013; and F. BASSANINI AND E. REVIGLIO, *European Institutions and the Crisis: Investing to Grow and Compete,* English version of a chapter from the ASTRID research report: *Le istituzioni europee alla prova della crisi*, edited by G. Amato and R. Gualtieri, Passigli Editori, Florence 2013.1 In the EU, where the financial system is strongly dominated by banks over capital markets, banks have all spontaneously adopted the new regulation – which have now become mandatory under EU Directive CRD IV. In the US, on the other hand, where the financial system is strongly dominated by capital markets over banks, the application of Basel III to banks is less penalizing for long-term financing since the capital market can cover a large part of it. Moreover, the implementation of the new rules has been postponed and has been excluded for the community and the regional banks, the only ones who provide direct financing to SMEs. This fact represents an handicap for the EU versus the US and versus other national financial systems around the world which have not applied the new regulatory framework.

[40] F. BASSANINI, G. DEL BUFALO, E. REVIGLIO, *Financing Infrastructures in Europe: Project Bonds, Solvency II and the Connecting Europe Facility*, *Astrid Rassegna*, 16/2011.

[41] Source OECD (2012). Globally it corresponds to 3.4 trillion dollars, mostly invested in "unlisted equity". According to a recent research by HSBC (2012) potentially long-term institutional investors' investment in infrastructure could grow up to about $ 4.5 trillion dollars, equivalent to 5% of total asset under management. The goal is reasonable and the increase of resources for infrastructure quite outstanding in size.

significant disadvantages actually provided for long-term investment, so that investors, who have long-term liabilities, could be induce to allocate their assets in long-term assets, which are good for the economy today and bring benefit for future generations.

Conclusions: May a Sovereign Europe become the Democratic Issue?

An important case study of this relationship between global financial markets and national States is that of Europe. The transfer by the Member States to the Union of important sovereign powers was made in order to safeguard peace, to gain influence on the international scene, to deal with the lack of raw materials, and to expand national markets. The economic purpose, in a liberalist format, takes precedence (disguised by time priority) over all else. For a while, the single market seemed to be the only objective of the Union, with competition being the dominant value.

The Single European Act of 1987 and the Maastricht Treaty of 1992 overturned the original relationship between State and markets. Competitive convergence set a regime of competition at the centre of the economic constitution of the Union. The monetary union was designed to be functional for the Single Market, with a central bank that has the power over the currency, but not that of printing money to support the economy and prevent attacks on sovereign debts.

The Treaty of Lisbon only put a partial brake on matter, choosing the social market economy as the model for the European economic constitution. In essence the "social market economy" believes that the State should abstain from any interference with the market (in this sense being 'liberal'). The State, which creates and supervises the "rules of the game," is considered first of all the market "regulator." The slogan is indeed "as much market as possible, as much State as necessary." Under the social market economy regime, competition is still considered a central and virtuous element of the Single Market. But the public institutions (European Union, Member States and Local Authorities) should intervene to ensure the universality of fundamental rights of citizenship (not only the rights of freedom, but also the economic and social rights). They should, moreover, intervene to create a favorable context for economic growth, prosperity and competitiveness (education, infrastructures, support to R&D, innovation and SME's, etc.), and to provide incentives for long-term investment and long-term saving.

With the crisis, a more direct intervention of the member States was permitted, even loosening the rules on State aid, for the bailout of banks, insurance companies and

industrial enterprises (even though to a lesser extent than that provided in the U.S. by the so-called Obama's Recovery Plan).[42] It was a State aid temporary rules established in response to the economic and financial crisis. The need of industrial policies, required to prevent the deindustrialization and sustain the competitiveness of the European economy, was stressed. But, in the same time the fiscal policies of (some) States were restricted (stability pact, fiscal compact), new strict interpretations of the rules on State aid were imposed albeit with exceptions not always comprehensible, and, above all, no action was undertaken to reduce the macro imbalances among the member States. These macro imbalances are the main reason for the fragility of the Euro, the reduced growth rate and the declining competitiveness of the European economy and the most immediate threat to the universality of the rights of European citizenship. No action was undertaken, moreover, to reduce the asymmetries which alter competition, so hindering a fair construction of a really homogeneous single market. Where is the level playing field, which should characterise the Single Market, when an Italian firm pays twice as much interest on credit as a German firm competing with it in the single market, and when other disparities between the two involve up to 30-40% higher costs for energy, regulation, bureaucracy, logistic, tax and pension burdens?

Therefore, the recent financial crisis produced a growing awareness that in this way Europe cannot survive, and that in any case it cannot achieve the purpose of ensuring well-being, growth, and social cohesion to European citizens. Thus, the transfer of sovereignty from the member States to the Union will not achieve the goal to recover, at a supranational level. the sovereign powers threatened by the global financial markets, by making the States even weaker in the confrontation.

That is the reason why Europe, trying to draw a lesson from the crisis, decided to move towards a banking, fiscal, economic and political union, and decided that the growth compact should balance the fiscal compact, and that it should be accompanied by policies to reduce the macro imbalances; and. For the moment, however, a definite road map has only been defined for the banking union; while for the fiscal, economic and political union we are still at the stage of good intentions. A breakthrough was created by Mario Draghi at the ECB, by the announcement of the Outright Monetary

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[42] Between 2008 and 2011, the EU Member States approved EUR 4.5 trillion (37,7% of the EU's GDP) in aid to banks. See *High Level Expert Group on Reforming the Structure of the EU Banking Sector*, Chaired by E. Linkanen, *Final Report*, October 2, 2012, box 2.2, p.21. See also, F. BASSANINI AND E. REVIGLIO, *European Institutions*, *op. cit.*.

Transactions (OTM). Another could be represented by the recent French proposal for the creation of a big budget for the Eurozone (2% of the Eurozone GDP), to be used for macro prudential objectives, for financing strategic investments and reducing the macro-imbalances between the Member States. [43]

For a long time to share national policies in a very "soft" way (such as the open method of coordination provided by the Lisbon Agenda) was considered sufficient for an intergovernmental European Union. This time is now over. Now it is clear that European Member States will not be able, by themselves, to recover their sovereign powers, which have departed for Wall Street, the City of London, and other centres of financial power around the world. They will suffer an unstoppable deterioration of their national sovereignty (and therefore also of the sovereignty of the people and of the quality of democracy) unless we quickly manage to shape a European Union capable of having its voice heard and making its own objectives count against the great powers (old and emerging) and the increasingly global, stateless market players. However, although united, Europe alone would not have this capacity and this power .

Who can do it? the UN and their satellite institutions (IMF, WB, WTO, etc)? Experience shows that they are not strong enough to do it. Or, at least, that to do it, they require more effective governance mechanisms led by a country or a group of counties with the same power held by a traditional sovereign State. The candidates are the great States with continental dimensions such as the United States, China, India, Europe, if united, and, subsequently, Brazil, Russia and Indonesia. If they agree all together they would not, in principle, lack the necessary means and powers, within the G20 and the UN, to build up a regulatory framework capable of directing the global financial markets towards the real needs of the global economy and society - to achieve the "strong, balanced and sustainable growth" that has been the central agenda item at all of the G20 meetings from Pittsburgh to Saint Petersburg. With strong agreement among them, each participant, using its powers of enforcement in its territory and its power of influence on the States of its regional area, could assure the effectiveness and efficacy of such global regulation. Thus restoring a fundamental principle, that financial regulations, except for technical details, cannot be left in the hands of non-governmental technocratic institutions which are not elected by the people and accountable to the people.

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[43] In the French proposal this budget of the Eurozone will be managed by the EU Commission and approved by the European Parliament and could be increased by the issue of European sovereign bonds. See, French Ministry of Economy and Finance, *A Single Budget for the Eurozone*, *Newsletter*, November 2013.

But at this table, where global decision-making processes could take place it is quite evident that Europe could have an influential seat only if united, with legitimate institutions fully and democratically recognized. A divided European Union will not have the necessary critical mass to weigh in on the governance institutions of the global world. Even Germany alone, with its increasingly expensive welfare system due to demographics and a general fear to include young people from other parts of the world belonging to different cultures, will not prosper alone. The European political Union requires, of course, a wide reshaping of the European constitution in order to assure the democratic representativeness of the EU institutions.

Europe must be a significant player. It has the potential of being an invaluable participant in mediating between the US, the old hegemonic super power which is determined to keep alive the "exorbitant privilege" of the dollar notwithstanding its high external debt, and the new emerging economies, with China at the top of the list.

A new multi-currency global monetary system is, at the moment, the most probable outcome. However, it will not happen tomorrow. It must be clear, and it is probably already clear to all governments in the world, that without the Euro, it will not be a *good* new multicurrency monetary global system. The Euro, as a currency, in fact, contains within itself the culture, the history, the political and economic power of Europe, which has the historical duty to be the engine and the "pedagogue" in the complex search for long-standing peaceful and sustainable global economic and social growth.

In the end, a sovereign Europe seems to be not a secondary piece in the solution of a this crucial problem, i.e. the reconciliation between people's sovereignty, democracy and global financial markets. A utopian solution? Perhaps; but the absence of a viable alternative has sometimes forced to turn utopia into reality.