

# “Insiders” and “Outsiders”: What Kind of Cohabitation?

MARIO SARCINELLI \*

## 1. Introduction

One feature of that ideal world to which economists ascribe the attributes of perfection and optimality is the presence of contracts encompassing and fully regulating the consequences and the actions of the parties in every conceivable future state (Al-Najjar 1995). The obviously anti-economic character of this sort of *modus operandi* has prompted the development of surrogates, such as political representation, delegation of management powers, and juridical interpretation. In terms of contractual foresight, the Treaty on Economic and Monetary Union is certainly no first best instance. Far from being a mere expedient, therefore, resort to interpretation is the tool for remedying insufficient contractual specifications.

The outcome of a search for a lowest common denominator of mutually acceptable positions, the document signed at Maastricht on 7 February 1992 is incomplete in a number of areas that have been spotlighted by the approach of the first key deadlines in the process of union. A major example is the position of countries that fail the initial entry exam hinging on the five convergence criteria. Article 109k leaves a good degree of indeterminacy concerning the forms of cohabitation that may be instituted between the Union's core countries and the “outsiders”, i.e. the member states accorded a temporary “derogation” from the third stage or those that will have opted out (Denmark already did and the United Kingdom is likely to do so in future).

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□ Banca Nazionale del Lavoro, Rome (Italy).

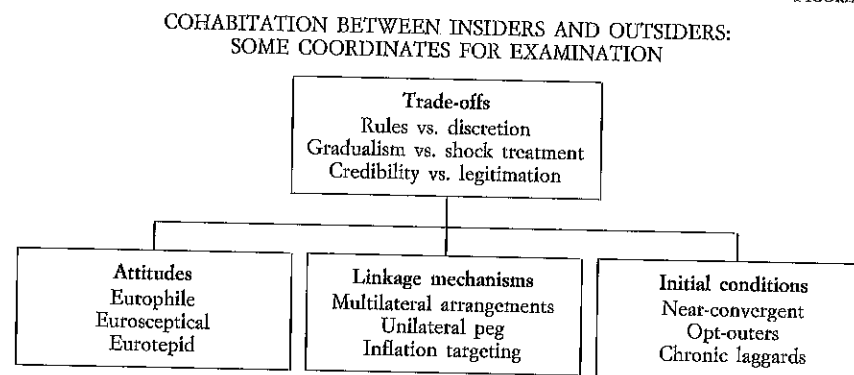
\* With the collaboration of Giovanni Ajassa.

Are the Treaty's *lacunae* such as to ineluctably undermine the chances for success, or even survival, of the process of monetary unification? In my view, they are not. The shortcomings of the Maastricht agreement must not serve as the pretext for allowing the plan for union to fail, for this would be no advantage either to "insiders" or to "outsiders" and in the long run would certainly be an undesirable outcome, in the broader context of the world economy and global politics as well. The incompleteness of the Treaty provisions necessitates further study of the most appropriate forms for the delicate stage of temporary cohabitation between the core of the Union and the countries "with a derogation".

The intention of the following remarks is to "stay on course" for the development of the European Union. The welter of positions that have shaped the debate, whose richness emerges from a reading of the essays for the present volume, testifies to the collective effort to move in that direction. From an initial reflection on the reasons why the European construction needs to be defended today, in this moment of seeming disarray, our discussion of the cohabitation between "insiders" and "outsiders" proceeds along several distinct lines of analysis. Recalling some of the fundamental dilemmas of economic policy, we examine the problem of cohabitation by seeking to match the disparate initial conditions, in terms of economic results and progress on the convergence criteria, with the differing expectations and states of mind of the various member countries. On this basis we can discuss the ways of linking "insiders" and "outsiders", through possible exchange rate mechanisms (multilateral or unilateral) between the euro and the "derogated" currencies or indirect, decentralised coordination via inflation targeting.

Though it is hard to assign a clear preference to any specific subset of combinations of options, reflection nevertheless suggests that the approach most likely to produce mutually beneficial solutions for "insiders" and "outsiders" alike will be cooperative and fairly gradual. In this way, attenuating the exclusive attention to performance and assigning appropriate importance to intrinsically common policies, the process of European integration can continue to advance.

FIGURE 1



## 2. Why Europe?

Typically, economic analysis proceeds on the assumption "other things being equal". In the lively and variegated debate on future developments in the third stage of monetary union, attention often appears to have focused on technical issues of economics and finance, while the "other things" posited – rightly or wrongly – as invariant implicate our deepest-rooted and most significant social and political values. What virtually all formulations take more or less consciously for granted is the stable acquisition of the fundamental advantages deriving from the integration achieved so far. This means, for instance, the absence of military conflict between member countries in the last fifty years and the enormous economic and social benefits of the progressive dismantling of customs barriers. This is a set of "discontinued damages" and "emerging gains" (Monti in Agnelli and Cabiati 1995, p. XII) that half a century of integration has accustomed us to thinking of as a structural, immutable feature of the European landscape.

The lessons of history – including the tragic, recent events in the former Yugoslavia – should prompt reflection on the profound reasons underpinning the idea of European integration. The end of the Soviet threat has removed or at least greatly attenuated the considerations of a military order that once prompted the peoples and governments of Western Europe towards union. But at the same time it has allowed the rediscovery of the arguments raised between the

two world wars in favour of a European union. This argument is reflected in the thinking of the founder of a great Italian industrial dynasty and of an eminent economist during and immediately after the first world war (Agnelli and Cabiati 1918). In answer to the question "Why Europe?" they reply: in order to save us from ourselves, to hold off the phantoms of nationalism founded on "the principle of propagating one's own culture [...] by the sword" (Agnelli and Cabiati 1995, p. 7); not to waste an acquired set of economic and social advantages already so substantial as to represent a kind of irreversible investment (what the modern theory of contestable markets would call a "sunk cost") that can guarantee our future.

European union can serve to save the Italians from continuing with their lack of a steady, long-term foreign policy, the Germans from again falling prey to an overweening nationalism in the search for the absolute, the French from being slaves to *grandeur*, the British from limiting their links with the continent to the Chunnel (Sarcinelli 1995b). Reducing the pervasive heterogeneousness of the Old World, which was at the root of so many conflicts, is the mission of the European Union, most especially in its prospective enlargement to the East.

In this time of evident disorientation the foundations of the ideal of integration can be shored up, provided we overcome a kind of "Europeanism of the frontier", interested in the benefits of union but unprepared to shoulder the costs. And this description, unhappily, perfectly fits the case of Italy, where the feeling of being on the frontier long served as the pretext for unwillingness to sustain the full weight of the sacrifices required by Community integration. With the fall of the Berlin Wall, all discounts on the costs of union were terminated, and as the price rose Italian enthusiasm for the idea of European Union suddenly waned (Sarcinelli 1995b).

A mature, constructive approach signifies understanding that the further, quasi-federal construction of Europe is a multilateral "game" whose payoffs to the players – the potential "insiders" and "outsiders" of the Union, but also the major poles of America and Japan, and the rest of Europe – can differ greatly, depending on the degree of cooperation in designing strategy. In my own opinion, a solipsistic equilibrium in which each participant assumed the most hostile possible response on the part of the others would result in a grave, possibly irretrievable loss of welfare not just for Europe but for the entire world.

### 3. Insiders and outsiders: the rules of the game, starting conditions and expectations

Founded upon a half-century-long history of political and economic developments, European integration now faces the difficult passage to the final stage of monetary unification. In this context, the basic elements of the "game" that will be played over the next five years are clear enough: the rules, the players, the starting conditions, and the strategic expectations.

The rules determine the method for selecting the group of countries eligible for the third stage. There is now a very broad consensus among economists that compliance with the Maastricht criteria is neither a necessary nor a sufficient condition for realizing monetary union. On the contrary, some attentive scholars have emphasized that the effort to attain some of the targets may result in more pronounced deviation with respect to the others (De Grauwe 1996).

Even admitting that these arguments (for a rebuttal, see Caselli and Gomel 1996) contain a portion of truth, the criteria should nevertheless be complied with as "conventions" that are now well consolidated and representative of the political compromise on which the Maastricht construction is founded: the price to pay to convince Germany to relinquish the mark is the ascendancy at the European level of that "culture of stability" that more than any other feature has characterized the German model of the "social market economy". Even aside from this consideration, abandoning the criteria is impossible for strategic reasons; Europe's monetary future would see light under even more difficult circumstances, prompting negative expectations in the markets and lax attitudes among the less virtuous countries, both actual and potential.

The Maastricht criteria, then, must not be rejected, but they do need to be read in full and interpreted accordingly. This applies above all to the two fiscal standards, which a rigid and constrictive reading generally reduces to the achievement of ratios of government deficit and public debt to GDP of 3 and 60% respectively. Actually, however, albeit with some ambiguity and some *lacunae*, Article 104c of the Treaty allows that these standards may be deemed met even in the case of a "static" infringement of the target thresholds if there is a "dynamic" of sufficient convergence towards them. The incomplete

teness of the Treaty on these major questions leaves room for further consideration, which is necessary above all to decide how it can be judged that the speed at which a country is approaching the target levels is "sufficient". On the debt criterion, one proposal (Gros 1995) is for a rule of thumb whereby each year the overindebted country must eliminate at least one twentieth of the initial excess over the target of 60% of GDP. Another suggestion bearing on the question of interpretation is that of Thygesen (1996), which would make the cyclically adjusted budget deficit the relevant aggregate for purposes of the Maastricht criteria. This would represent a significant advance, in that it would prevent public financial adjustment from possibly colliding with the needs of cyclical stabilization, especially in view of the likely slowdown in growth in the coming years. The recent proposal of the German Minister of Finance, Theodor Waigel, for a pact for stability also indicates a certain concern over the lack of scope for countercyclical fiscal policy.

The Maastricht criteria can and should be suitably interpreted. Indeed, such interpretation is necessary to increase the number of initial participants in the third stage and attain a sort of critical mass. A strict, face-value reading of the standards would leave only a handful of countries, if any, eligible for access to the Monetary Union on its launch in 1999. And this would automatically mean deferment of the third stage to a later date, which the Treaty does not contemplate and which would have to be specified in a new agreement, possibly still more difficult to achieve.

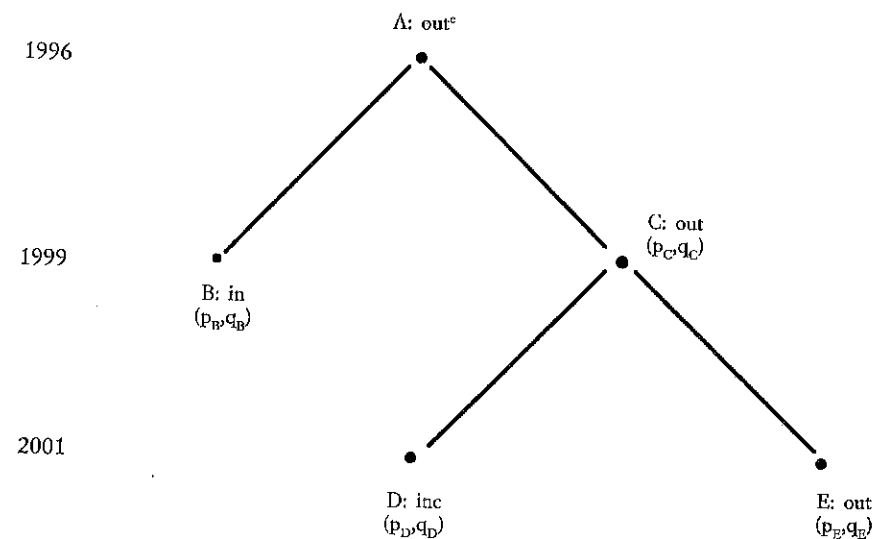
Unless we are prepared to accept a postponement, which many rightly fear could be indefinite, there is no alternative to some interpretation of the criteria. No reading, however benevolent, could possibly be such as to admit all EU member countries to monetary union at the outset. The inevitable consequence of this state of affairs is the division of the "Fifteen" into two groups: insiders (the core countries) who "pass" the entrance exam at once, and outsiders, who having been held back are to take a second exam no later than 2001.

On the assumption that the core group in the EMU starting gate will not be an empty set, the economic policy "game" between insiders and outsiders has already begun: the turn of this year marked the beginning of the two-year observation period based on which the roster of countries admitted to the third stage will be determined in 1998. In this context we can diagram the strategic interplay and the

possible intermediate outcomes on the basis of three points in time: the present situation, the 1999 kickoff time, and the examination of the "laggards" by the end of 2001.

THE GAME BETWEEN INSIDERS AND OUTSIDERS

FIGURE 2



Legenda:  $p_j$  = payoff for the insider (or Union core) at node  $j$   
 $q_j$  = payoff for the potential outsider at node  $j$

As the game begins in 1996, the "quality" of each country is uncertain, in that the first formal determination of insider or outsider status is not made until 1999.<sup>1</sup> The first stage of the encounter, accordingly, is a sort of introductory passage to the game itself, which will be played between in- and outsiders over the two years from 1999 to 2001. Even so, the run-up to the 1998 exam is of very considerable importance, because this stage originates the premises – in terms of the credibility of each nation's policy – necessary to determine the outcome of the second, decisive part of the match.

<sup>1</sup> The diagram in Figure 2 represents the game between a potential outsider and the core (not empty) of the Monetary Union. Starting from an initial node marked "A", the potential outsider can advance to position "B" or "C" in 1999, taking the status of insider or outsider. In the latter case, the game envisages another stage, again with these two possible outcomes: continued outsider status (node "E") or inclusion in the core (node "D"). This branching schema highlights the payoffs to the two players in each node, providing a basis on which to arrange possible equilibria.

Who will participate in the third stage right from the outset in January 1999? An exact answer to this question cannot be given in advance, but reconnoitring the initial conditions in which the fifteen members set out on the first leg of the journey towards 2001 will enable us to make a few summary but useful distinctions.

On rigorous examination as of September 1995 (EMI 1995), only Luxembourg and Germany satisfied all three Maastricht criteria.<sup>2</sup> Still, outside this "mini-core" the situations of the thirteen non-elect varied widely indeed. A simple summary measure of the degree of divergence from the criteria (Ajassa 1995) identifies a first group of "nearly convergent" countries – Denmark, the Netherlands, France and Ireland – which, if they were allowed to offset the underachievement of some standards with the overachievement of others, would be eligible for participation even now. At the other extreme are the chronic laggards, countries that like Greece and, in part, Italy, are far from the Maastricht targets on all three fronts.

From this starting position, the capacity of each member state to qualify as insider by January 1999 will depend on the policies they actually follow from now until then. Government policy options are already engaged in the complicated mediation between past commitments, the achievements of economic performance and, last but not least, the expectations and moods of the electorate (Hamau 1996). Combining these elements into a kind of summary index, we can develop three basic types of attitude: Europhile, Eurosceptical, and Eurotepid.

Though somewhat thinned with the passage of time, the ranks of the Europhiles have perhaps scored a significant, qualitative advance in their conviction. Those who now urge the necessity of proceeding along the road to integration are fully aware of the benefits but also and above all of the sacrifices it will bring. The idea that Europe can serve as a sort of orthopedic device to redress endemic individual pathologies is gradually giving way to a more mature and better balanced vision centring on an appreciation of the positive payoffs – economic, civic, and political – that continuation of the European "game" can award the players.

<sup>2</sup> At the end of the year, i.e. later than the reference date for the EMI study, Germany too would appear to be excluded from the "mini-core", with a government deficit officially estimated at 3.6% of GDP.

The concerns of the Eurosceptics centre on the possibility that the path summarily traced out at Maastricht is itself a cause of financial market instability and that the sacrifices required for admission to monetary union lack theoretical justification while imposing unacceptable social costs. For this group, then, the appraisal of the payoffs from the game of unification results in a net preponderance of costs over benefits.

Midway between the two we find the Eurotepid group, perhaps best characterized by a focus on the problem of the schedule rather than the substance of convergence on the Maastricht parameters.

From the combination of economics and politics, initial conditions and policy choices, legal commitments and popular moods, each of us can derive an evaluation of the results that emerge at the end of the next two years, which will produce the first separation between insiders and outsiders. From today's standpoint, however, the outcome of the first "leg" of the game cannot be thought of as independent of the mechanisms already under discussion concerning the link between in- and outsiders in the subsequent phase (1999-2001) of completion of monetary union. The succession of the two phases of play confronts each player with the problem of formulating dynamically consistent preferences and strategies. In this sense there is a profound, two-way connection between the choices that will be deemed optimal in determining the type of linkage between insiders and outsiders and the conduct of the players in the preceding phase of advance towards convergence.

#### 4. Insiders and outsiders: the mechanism of linkage

The balance struck at the start of 1999 between the EMU core countries and the countries with "derogation" is not likely to last long. The cohabitation between insiders and outsiders is a necessarily temporary experience: eventually the situation is bound to evolve towards one of the two extreme outcomes, either the laggards' catching up with the leaders or else explosive effects on the core group itself due to the chronic deviance of important outsiders. Let us turn our attention first to the latter of these two scenarios.

Under a regime of freely floating exchange rates between the euro and the outsiders' currencies, in the long run the non-inclusion of countries like Italy, the UK, Spain and Sweden would generate almost irresistible pressures on the competitiveness of the core countries. These four countries, in fact, account for 21% of Germany's exports and 20% of its imports (Spaventa 1996). The repercussions on a country like Germany of steady appreciation of the euro in real terms would risk definitively shattering the already difficult coexistence between popular legitimation and policy credibility as regards membership in the lead group within EMU.

One can counter that in the long run the nominal depreciation of the outsiders' currencies would be neutralized by higher inflation in their countries. Yet the virtuous adjustment achieved by Italy, Spain and Britain following the crisis of 1992 suggests that the transitory effects of devaluation can last for quite some time (Spaventa 1996), provoking considerable discomfort in the countries whose currencies have appreciated correspondingly. Ironically, the "near-permanence" of the competitive benefits of devaluation for the outsiders could be read as the result of at least partial endorsement of the European-style "culture of stability" that has led to such radical policy changes in Italy as, for instance, the abolition of wage indexation.

This scenario of a collapse of the core provoked by the failure of the laggards to qualify is thus strongly contraindicated for the insiders themselves. At the same time, it is easy to imagine substantial disincentives from the outsiders' standpoint too. For these countries – Italy and Sweden above all – the stakes consist most importantly, perhaps, in the high costs of the collapse of monetary union in the form of further sharp increases in the size and volatility of their risk premia on long-term interest rates (Penati and Corielli 1996). The demise of monetary union would mean the resumption of entropic tendencies, whose first targets could only be the least "stable" member countries.

On this basis it is easy to see that insiders and outsiders alike have an interest in converting transitory cohabitation into full-fledged "marriage" founded on the reunification of the laggards with the core of the Union. It should not be forgotten that Denmark is already out and the United Kingdom enjoys an opt-out clause and will probably invoke it. If the fundamentals of the Single Market, hence its permanent existence, can be threatened by exchange rate fluctuations, then

sooner or later those opting out will also have to confront the dilemma of adopting the single currency or losing the benefits of the single market. It is not credible that they will enjoy such an additional degree of freedom for ever. Meanwhile, they are no less subject to the necessity for a "linkage mechanism", which could be less transitory. Once the deleterious option of free floating is discarded, attainment of the common objective will depend in great measure on the type of linkage mechanism that is selected to bring the core and the outsiders closer. The various possibilities can be grouped into three types: a multilateral exchange rate mechanism, a unilateral peg to the euro for the countries with "derogation" (a currency board), and indirect coordination between insiders and outsiders through inflation targeting procedures.

Let us begin with the last of the three. The inflation targeting approach is founded on the premise that the simultaneous pursuit of more or less consistent disinflation objectives will contribute to virtuous cohabitation between in- and outsiders as an effective though decentralized tool for exchange rate stabilization (Dewatripont *et al.* 1995, Persson and Tabellini 1996). Fixing consumer price targets would eliminate right at the outset any incentive for competitive devaluations, which in the long run would cause inflation. Inflation targeting would also attenuate exchange rate volatility for the currencies with derogation by assuaging fears of future monetization of the outsiders' sizeable public debt.

Taken at face value, the miraculous properties of inflation targeting make the proposal a potentially desirable approximation of the "hypothetical ex-ante optimum" (Persson and Tabellini 1996, p. 22), practicable in a system of full and explicit economic policy coordination between in- and outsiders. Unfortunately, the credibility of the decentralized equilibrium offered by inflation targeting clashes with the fact that disinflation cannot be considered the exclusive preserve of the monetary authorities (Sarcinelli 1995a). The announcement, by the central bank of a country with "derogation", of the same inflation target as the ECB does not guarantee exchange rate stability for the outsider, because actual and, more significantly, expected consumer price performance also depends on such factors as fiscal and incomes policy and on such extra-economic "disturbances" as elections with the risk of changing majorities.

On this plane of pragmatic appraisal, the inflation targeting approach is open to at least three criticisms. One is the difficulty that

the European Central Bank would have in accepting any monetary policy anchor other than the intermediate variable of the money supply, the Bundesbank's traditional M3 aggregate. A second is that the setting of a higher inflation target by an outsider could prompt expectations of a corresponding depreciation of the currency, thus slowing convergence of the laggard towards the core of the Union. Finally, there is doubt as to the effective ability of inflation targeting to defuse the incentive to competitive devaluations, in the light of our earlier reflection on Italy's experience since the 1992 crisis.

In a sense, inflation targeting magnifies the role that outsider monetary authorities would play in the process of catching up with the core countries. Diametrically opposed is the currency board approach (Basevi 1996, Gros 1996), which provides for unilateral renunciation of monetary policy making through the commitment of the laggard country central bank to create monetary base only as the contraitem of net foreign exchange inflows and to maintain a fixed exchange rate with the euro. This method requires no particular *modus operandi* of the European Central Bank and puts the entire burden on the laggard country. If Italian inflation is not a purely monetary phenomenon, then the risk, along Argentine lines, is an enormous increase in unemployment, which is structurally very high already, here as in the other potential outsiders. This sort of shock treatment in lieu of the gradual approach could prove fatal.

Together with these high social and economic costs, unilateral anchorage of the lira or other "derogated" currencies to the euro would have the Achilles' heel of poor credibility. Nor would the terms of the question be altered by the possibility of some sort of ECB facility, more or less transparent but necessarily limited, for exchange rate defence in crises. Indeed, reconsidering such experiences as the monetary cooperation provided by the Bundesbank in 1992, the markets could well judge the linkage to the euro as non-credible from the start and launch speculative attacks that could hardly be countered. The swift failure of the currency board attempt would worsen the outsiders' reputation for exchange rate un-governability and might trigger, in those countries, a social and economic delegitimation of the goal of catching up with the rest of Europe.

These considerations make it clear enough that indirect methods (inflation targeting) and unilateral solutions (the currency board) are not persuasive as credible, effective mechanisms of linkage to facili-

tate reunification with the rest of the Union. The risk, further, if each outsider took its own approach, would be conflicts not only with the core countries but with the other laggards as well. The outcome of a non-cooperative game of this sort would in all likelihood be very substantially sub-optimal: inherently unstable and with adverse repercussions on the future progress of European Union.

The necessary though insufficient condition for leading the game of European monetary unification to a better final outcome than the non-cooperative result of the typical "prisoner's dilemma" thus becomes an agreement among the laggards and a clear understanding on the rules of linkage between these and the core of the Union.

The idea of a multilateral exchange rate mechanism is warranted (Kregel 1996) by Article 109 of the Treaty of Maastricht, which empowers the Council to "conclude formal agreements on an exchange rate system for the ECU [now euro] in relation to non-Community currencies". Disregarding the formal objection that the "non-Community" label is inapplicable to such currencies as the lira and the peseta (Spaventa 1996), there remains the problem of rebuilding an EMS-style mechanism to regulate exchange rates between the core and the outsider currencies that is both effective and credible. Simply reconstituting the EMS with the euro in place of the Deutsche Mark would be possible but highly improbable, in that it would require the new-born European Central Bank to intervene, in violation of its statutory obligation to ensure price stability – an especially stringent constraint in the initial stage of building a solid anti-inflationary reputation for the new institution.

In the context of a tendency to over-restrictive policy on the part of the European monetary authorities, the ECB's unwillingness to extend unlimited support in defence of the outsiders' currencies would threaten the new ERM with a repetition of the dramatic failure of 1992. One way to overcome this obstacle would be the institution of "conditional" mechanisms of monetary cooperation (Wyplosz 1996) in which foreign exchange support from the European Central Bank would depend on the deviant country's submission of annual convergence programmes. The combination of a *binding* commitment to adjustment by the outsider and *unlimited* support by the European monetary authorities should suffice to deter self-fulfilling expectations of devaluation and the consequent speculative attacks.

Can the market always and in every circumstance be expected to consider the multilateral commitments undertaken within a "conditional" ERM as credible? In my judgement, unfortunately, the answer cannot be in the affirmative. The poor reputation acquired during the years of crisis for the EMS counsels a less ambitious solution.

Possibly recouping room for discretionary policy at the expense of rules, a viable multilateral mechanism of linkage between in- and outsiders might consist of an "observation band" for nominal exchange rates between the euro and the outsiders' currencies.<sup>3</sup> In this framework the protracted depreciation of any currency below the permissible fluctuation band should be a matter of common concern to the Union and lead to measures decided on *case by case*, depending on the extent of the deviance, on the currency involved, as well as on the credibility of the constraining, yearly programs of adjustment. This would deprive speculators of a predetermined point of attack. It would make policies more important than performance. Hopefully such policies should be Union-inspired.

## 5. Conclusions

Can European monetary unification successfully negotiate the complicated passage of cohabitation between insiders and outsiders? On the basis of the foregoing considerations, our response is a qualified yes.

Viewing future developments from the standpoint of the present, the single currency "game" appears to be structured in two stages – the run-up to the 1999 deadline and the subsequent cohabitation between insiders and outsiders – that are distinct but inextricably connected. Any number of paths may lead from the present state of affairs to the final stage of the "game". Much narrower, by contrast, is the range of options whose ultimate outcome will be a

<sup>3</sup> Instead of hinging the "observation zone" on the nominal exchange rate, it could be built with reference to the real exchange rate. Such a constraint would be gladly accepted by the insiders, since on a weighted average basis it is supposed to stem any outsider's gain in competitive advantage, but would have the defect of making for continued inflation in the outsider's economy, retarding its convergence, and playing against catching up with the insiders. Of course, all this holds if sooner or later inflation follows exchange rate depreciation ...

higher equilibrium in which the salvation of the idea of European Union is the source of mutual benefits for all concerned. In this framework, for a likely laggard like Italy, the only conceivable winning strategy is one that combines a credible present commitment to adjustment and convergence with the future operation of viable multilateral arrangements governing exchange rates between the euro and the "derogated" currencies, so that the outsiders can be gradually brought into the core of the Union.

Given the variety and the interdependency of the choices facing us, the incompleteness of the Maastricht Treaty could turn out to be a virtue rather than a defect, enabling policy makers to respond better to problems as their outlines are clarified. With an appropriate mix of rules and discretionary powers, the *lacunae* of the contract for monetary union can be overcome first by interpretation and then by integration, on condition that the cooperation and credibility displayed in action prove deeper and more solid than those so far set to paper.

The history of monetary unions in the XIX century also suggests that a powerful common geopolitical or foreign policy interest is the best guarantee of success (de Cecco 1996). In constructing the European Monetary Union political motivations certainly outweigh narrowly economic ones (Montesano 1996), and in any event they are essential to advancing the Old World towards a quasi-federal configuration. The Intergovernmental Conference about to open in Turin must trace out the evolution of the Union in such quintessentially political domains as defence and foreign affairs, respond to the requests for enlargement, especially to the East, and begin to adapt the institutions and rules of the Union to the exigencies of the XXI century.

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