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The Rotten Heart of Europe

Bernard Connolly

'What could be more explosive than a critique by a consummate insider of the most controversial political step that Europe has taken for a generation?'

Daily Telegraph



The International
Bestseller – Updated

'There can surely be very few books about economics which make one's hair stand on end. Yet this is the effect of Bernard Connolly's *The Rotten Heart of Europe* . . . The author is the top official within the European Commission directly responsible for EMS affairs. [His] account combines extraordinary attention to detail, a broad and rigorous analysis of the effects of the ERM on Europe's economies, and a rare understanding of monetary theory.' *Wall Street Journal Europe*

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'The Brussels Commission has just suspended its senior economist, Bernard Connolly, for writing a book savaging the prospects for a common currency. There are many who now believe he should have been lauded as a prophet.' Editorial, 1 October 1995, *Observer*

'We need to ponder how our whole ruling class has turned so flabby since the fall of Margaret Thatcher . . . the story has now been bravely told by the head of Brussels' own Unit of the European Monetary System. Connolly details how the ERM was devised in their own interests by elite French bureaucrats.' Norman Macrae, *Sunday Times*

'Connolly has spun a surprisingly gripping yarn.' *Financial Times*

Bernard Connolly was born in Manchester in 1949, and studied at Oxford. He has worked on Wall Street, and for six years from 1989 was the head of the European Commission responsible for analysis of the European Monetary System and national and Community money policies. On publication of the hardback edition of this book he was suspended from his job and subsequently sacked. He is widely regarded by academics and bankers as the foremost practical expert on the interaction of politics and economics in European monetary affairs. Now an economic consultant influential in both London and New York, he is in constant demand for articles, press, TV and radio interviews and speeches throughout Europe and North America.

The Rotten Heart of Europe

The Dirty War for Europe's Money

BERNARD CONNOLLY

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Preface to paperback edition

The opportunity to write this preface to the paperback edition was granted to me by the forbearance of Faber and Faber and the lack of forbearance shown by my former employer, the European Commission. The role of my publisher is straightforward enough; but the role of the Commission perhaps needs some explaining. Even before the hardback edition was officially released, the Commission had made clear its decision to get rid of me. My crime, apparently, was serious indeed: I harboured fears that the European Monetary Union project was not quite the Heavenly City that relentless propaganda had made it out to be. 'If I had fears like that', said Jacques Santer's spokesman, 'I would resign this afternoon.'

At any rate, the Commission, after suspending me from my job as head of the Commission Unit responsible for the EMS and monetary policies, countenancing a smear campaign against me, denying me access to Commission buildings, posting photos of me at entrances to buildings and garages as if I were a dangerous terrorist bearing semtex and armalites, 'inviting' me not to leave Brussels, communicating with me through night-time visits from its little-known Security Service, and engaging in a disciplinary procedure that disregarded all the rules of natural justice, inflicted the penalty it had in effect decided five months earlier. At the end of January 1996, I was sacked.

The Commission made it plain in the formal sacking decision that it would not have granted permission for the publication of the book had I sought it. The book was, so the Commission said, a synthesis of the economic analysis I had been doing for several years as the senior official responsible for analysing – and to anyone with the Community interest at heart that must inevitably mean criticizing – the dreaded ERM and its advertised transmogrification into monetary union. In saying this, the Commission not only disregarded the duty placed on it to allow the publication of any book that did not damage the interests of the Community (how could analysis possibly do damage?) but unwittingly posed the

question of what on earth it thought I was supposed to have been doing in my job. Perhaps my sacking took on the nature of an exorcism, a ritual chasing-away of the evil forces of inquiry and discussion. At any rate, it freed me to have this preface published – something that would not otherwise have been possible, given the Commission's self-proclaimed ban on analysis. It also freed me to respond to a huge number of invitations, coming from practically every Community country and from many outside, to speak and write on the subjects the Commission most wants people to keep quiet about.

Normal people in the Community countries are clearly thirsting for knowledge about what their leaders are doing and why they are doing it; they fear they are having the wool pulled over their eyes; they suspect that hidden agendas are being implemented; they are fed up with the establishment sloganizing that has replaced analysis; they are coming to understand that the myths propagated by the supporters of EMU have no foundation; above all, they now realize that monetary union is a political project – an attempt to create a European superstate.

There are reasons for believing that the publication of this book in September 1995 played a part in opening people's eyes to the realities of European monetary politics. And it is certainly the case that events since last September have validated the book's theses and predictions. For one, the idea of monetary union as a barrier against the 'Anglo-Saxon' world has been made more explicit than ever before: in March 1996, for example, the Belgian Finance Minister said baldly that monetary union was about 'preventing the encroachment of Anglo-Saxon values' in Europe. And when it became clear even to the wilfully blind that the economic policies followed in the pursuit of monetary union were destroying jobs, not creating them, ravaging the public finances, not restoring them, devastating confidence, not fostering it, a whole slew of European politicians changed tack and proclaimed the essentially political, not economic, ambition underlying the single currency idea.

Moreover, the divisiveness of the monetary union project can no longer be hidden. There will be a European political and economic 'hard core'. Its members will be those existing countries, present and future members of the Community, that together made up the empire of Charlemagne. The southern, western and northern 'peripheries' of the Community will be tributaries of the hard core. In economic terms, they will be expected to join a new ERM, one in which they will face only burdens and responsibilities, expected to manage their policies (under surveillance) not

in their own interests, nor even in the interests of the Community, but in the interests of the hard core – to all intents and purposes in the interests of France and Germany. If they jib at this, they will be reminded that they must do as they are told. President Chirac expressed it clearly in March 1996: the union (that is, the hard core) must give itself means of ‘punishing’ those countries outside the hard core that ‘do not respect the common discipline’.

Even within the so-called hard core (whose underlying economic performance is now, as was predicted in this book, clearly deteriorating relative to other Community countries and the world as a whole) the atmosphere of mutual distrust and suspicion has become palpable. French politicians make it clear that they fear German dominance; certain German politicians, and most of all Helmut Kohl himself, warn of a return to Balance of Power politics and war in Europe if their ideas on monetary and political union are not accepted lock, stock and barrel. Yet European union can only enshrine German dominance, whether voluntary or – much more likely as far as the German people are concerned – involuntary. That is something the French élite currently seem prepared to accept, in the name of giving ‘Europe’ greater muscle against the Anglo-Saxon, Asian and Latin-American worlds. But once economic and geopolitical developments make it clearer even to French technocrats that ‘the European model’ will bring nothing more than continued economic decline and a further deterioration in the quality of political and democratic life, the new empire of Charlemagne will split asunder – and much more rapidly than its eighth-century forerunner and model.

In sum, the mask of European ‘solidarity’ has been slipping. This book shows how the reality behind the mask was always one of political and bureaucratic infighting, of national and sectional powerplays and of a ‘devil take the hindmost’ attitude far removed from the Euromyths.

During the forty years of the Pax Americana in Europe, the western half of the continent enjoyed unparalleled prosperity, stability and democratic legitimacy. In these conditions, our countries felt more at ease with one another than ever before in history. But in the ten years in which the drive to recreate the empire of Charlemagne has gathered pace, the foundations of European amity have been eroded. Europe – continental Europe, at least – is in economic disarray; political legitimacy, based on feelings of cohesion – of nationhood – within states and on the principle of ‘live and let live’ among states, is in clear and present danger; the trust between people and rulers that must underly democracy, and the trust among countries

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that must underly peace and stability, are both disappearing. None of this can be repaired if discussion and reasoned argument about European problems are treated as disloyalty and lunacy. Both those accusations have been levelled against me, usually by people who have not read the book. I leave it to readers to judge whether those charges are justified.

Preface to the first edition

The idea for this book was born in December 1991, in Maastricht, just a few days after the name of that very agreeable, and agreeably cosmopolitan, town was besmirched by the meeting of the European Council that unwittingly spelled the end of the European Communities. I was attending a conference, at the European Institute of Public Affairs, on Europe after Maastricht. In one of the sessions, a Euroenthusiast academic gave a conventional interpretation of the history of the ERM, presenting the mechanism as a 'glidepath' to monetary union. My critical comments on this thesis apparently impressed Professor Klaus Gretschnan, the Director of the EIPA. He suggested that I should write a chapter on the ERM for a book based on the conference discussions. I agreed, and submitted a draft to the Commission authorities for clearance (I was head of the EMS, National and Community Monetary Policies Unit in the Commission). I was told that permission would not be forthcoming: evidently, any analysis that challenged the ERM orthodoxy was to be suppressed.

There the matter might have lain, but for the influence of Keith Middlemass, professor of Contemporary History at Sussex University. He was leading a multinational team researching a major work on the informal politics of the Community. Someone in the Commission hierarchy had suggested that he should consult me on the workings of the ERM. During the course of our long and enjoyable discussions, it occurred to both of us that it would be worthwhile for me to work up my draft chapter for the EIPA into a book in its own right.

This book is the final outcome of the promptings and encouragement of Klaus Gretschnan and Keith Middlemass, even if they may have expected it to be rather more academic and less political in tone. The book does have an analytical economic core. My way of thinking about economics and my confidence in the face of criticism owe a great deal to Rudi Dornbusch and Olivier Blanchard, both of MIT, the first of them German in origin, the second French. I worked very closely with them in 1983–5, when I was

secretary of the Commission's Macroeconomic Advisory Group, of which Rudi was the first Chairman and Olivier an outstandingly creative member. At that time, the Commission was more open to analysis and intellectual debate than it became once Jacques Delors had got his feet firmly under the table. Rudi and Olivier stimulated a taste for analytical rigour and intellectual adventure that I have retained even through the stifling years that began with Delors. I am sure they will enjoy the attempt in this book to make economic analysis accessible and even pleasurable to the general reader.

My interest in the *political* economy of 'Europe' was first sparked in the mid-1980s by Herbert Giersch, an immensely wise economist who was then President of the Kiel Institute for World Economics and also a member (subsequently Chairman) of the Macroeconomic Advisory Group. He was also very influential in helping me begin to get a feeling for the distinctively German way of approaching monetary questions.

Analysis need not crowd out passion: they can go very happily together, even if this combination is too often seen as 'not the done thing'. I want to thank two more distinguished economists, Alan Walters and Patrick Minford, for the determination they have shown, not without personal cost, in insisting that the endeavours of economists, even official ones, are better directed to getting things right than to doing the right thing.

So much for the origins and principles of the book. I have a great many people to thank for helping me put flesh on the bones. Not all of them can be named individually, or would want to be. I should mention, among central bankers and officials, my friends and colleagues from the Economic Unit and the Monetary Policy and Foreign Exchange Policy Sub-Committees of the Committee of Central Bank Governors of the European Communities, from the OECD's Ad Hoc Group of High Level Monetary Experts, and from the EC-EFTA Economic Council. Years of discussion, debate and argument with them, much of it over glasses of beer, have sharpened and solidified my understanding of the issues involved in what I have called the dirty war for Europe's money. In this book there are many severe criticisms of 'bureaucrats' and 'central bankers' as a caste. I want to record that many of them, as individuals, are both exceptionally able and exceptionally likeable. That judgement certainly applies to the twenty or so dear friends, whether full-time Commission officials or people on secondment from central banks or national administrations, who have worked with me in my time as head of the EMS unit in the Commission. Without their unstinting and unselfish support, the sometimes difficult personal circum-

stances of my job in an environment hostile to thought might have become impossible. While I am not necessarily sure that any of this score of people would share all the very personal political views expressed in this book, I know that practically without exception they agree with its essential economic analysis. I hope that my saying so here will not cause them harm.

Officials and politicians – again viewed as a caste – would no doubt like to have had the battlefield to themselves in their dirty war. Financial markets have had a habit of taking their ball away. My own insights into financial markets began to be developed during the time I spent with J.P. Morgan in New York. They have since been sharpened, I hope, by discussions with financial market economists and analysts too numerous to name exhaustively. But there is a certain number of them with whom I have had a particularly close relationship over a number of years. They have made me constantly challenge, re-examine and refine my own thinking. None of them is responsible for my opinions, and if I have still made mistakes – and no doubt I have – it is my fault, not theirs. I am thinking particularly of Derek Scott of BZW, David Bowers and John Lomax of Smith New Court, Dominique Georges of J.P. Morgan, Paris, Ignacio Ruperez of Banco Santander, Mark Brett of Capital International, Larry Kantor of Liberty Capital, Giles Keating and Sean Shepley of CS First Boston and – perhaps above all – Jonathan Wilmot, also of CS First Boston.

My agent, Bill Hamilton of A. M. Heath, my copy-editor Steve Cox and Julian Loose, commissioning editor at Faber and Faber, have, through their wise advice and friendly criticism, made this book better than it would otherwise have been.

Introduction

This book tells the true story of the Exchange-Rate Mechanism, the ERM. It is about why the mechanism is a bad thing – economically perverse and politically perverted – and why so many politicians, bureaucrats and commentators have fought so hard to hide this reality. The story of the ERM tells us a great deal about the motivation of the proponents of European monetary and political union – the European superstate. It tells us much they would prefer to keep quiet, for almost every one of the many misconceptions about Europe is embedded in the monetary mechanism that has done so much harm to us all. Even after the ERM ceased, after the market triumph of July 1993, to be a functioning economic mechanism, ‘the authorities’ did not want its true story to be told, for the myths, misconceptions and taboos that sustained the ERM are exactly those that underpin the relentless drive towards monetary union and a federal superstate in Europe.

I was once prey to some of those misconceptions. I became an official of the EC Commission in August 1978, at almost exactly the time that Helmut Schmidt and Valéry Giscard d’Estaing were finalizing the Franco-German deal that brought the ERM into being. I did not join the Commission out of any desire to ‘build Europe’, but I did believe that the Community was a useful forum for cooperation, helping to buttress friendly relations among European countries. In particular, I believed that economic coordination would bring real material benefits.

Like most mainstream economists at that time, I was sceptical about the new ERM and did not expect it to survive for long. When it did, I paid little attention, for I was not at first working on specifically monetary affairs. When I did switch to the monetary side of the Commission, in late 1986, I was responsible among other things for analysing and making recommendations about the British monetary scene. It was then, as I studied the slowly unfolding tragedy of Nigel Lawson’s obsession with the ERM, an obsession that led directly to the fall of Mrs Thatcher, that I began to

understand just how damaging the ERM was to the economies in its clutches. And I came to realize that the mechanism was part of a programme to subvert the independence – political as well as economic – of Europe's countries. Anyone who stood in the way of the European superstate had to be cut down. Mrs Thatcher was a prime target of the Eurofederalists; this book knits together strands of evidence that she was the victim of a Continental conspiracy abetted by some of her own earlier comrades-in-arms in the battle against British economic decline.

The struggle to unseat Mrs Thatcher coincided with the rebirth of plans for European Monetary Union (EMU). That period thus inevitably saw an intensification of the monetary warfare, presented as cooperation, between France and Germany that has been a persistent feature of the ERM since its inception. By the time, in late 1989, that I became head of the Commission division dealing with the ERM and monetary policy affairs, I was convinced that the mechanism, together with the EMU it was intended to produce, was a massive lie.

In one way this is an 'inside' book. I have lived the ERM for many years. In dozens of academic conferences, hundreds of meetings and thousands of hours of discussion involving central bankers and Treasury officials I have heard every conventional argument about the ERM and EMU made and contested a dozen times. I think I can say I know what makes the ERM actors think and act as they do, both as individuals with a wide variety of faces and as faceless bureaucrats. But there is no individual 'fact' in the book that is not available to anyone with the patience to read the newspapers of this and other countries, to fillet the content of speeches and articles, to plough through official reports and publications, to gaze at the financial market screens and endure the rubber-chicken-and-warm-champagne circuit in a town like Brussels, where journalists, diplomats and officials mix and talk so freely. Indeed, it is one of the astonishing things about the ERM and EMU that what needs to be revealed is not 'the facts' but their manipulation and distortion. The more blatantly obvious the falsehood, the more insistently its perpetrators repeat it. My own decision to write this book in the way I have done was born first of incredulity at the hundreds of 'black is white' statements made about the ERM, and then of anger at the treatment given to anyone who tried to point out the lies.

The proponents of the ERM and EMU have understood perfectly well what propaganda is. To quote the political scientist and philosopher Leonard Schapiro, writing of Stalin, 'the true object of propaganda is neither to convince nor even to persuade, but to produce a uniform pattern

of public utterance in which the first trace of unorthodox thought reveals itself as a jarring dissonance.' The fanaticism of some such proponents, expressed in language akin to that of the Bolshevik cells of immediately pre-revolutionary Russia, is captured in the thoughts of John Pinder in his contribution to a conference marking the fiftieth anniversary of the Movimento Federalista Europeo:

The European federation will be created in the 1990s. It is necessary. It is possible. It is our task to ensure that it is done. Thanks to the efforts of the federalists, Europe is already in a preconstituent situation: structurally, the conditions exist for establishing the federal constitution when the political conjuncture enables the process to begin . . . Above all, we must be grateful for the historic contribution of the score of federalist pioneers who met fifty years ago in the house of the Rolliers in via Poerio 37, in order to start our struggle.

It is surely not irrelevant that for many left-wing, middle-class Britons, 'Europe' exercises a grip on the imagination similar to that of the Soviet Union on the Philby generation at Cambridge in the 1930s. Nor is it illegitimate to seek a parallel between the apologias for the Soviet Union issued by the British intelligentsia in the 1920s and 1930s, and today's wilful closing of intellectual eyes to the realities of 'Europe'. The left-wing fellow travellers of the 1930s constantly made unfavourable comparisons between Britain and the supposed paradise to the east. Today, the same is true of the British Euroenthusiasts. The head of the Commission's representative office in Britain, for instance, seems to view ceaseless denigration of his own country as the most effective way of selling 'Europe' to his fellow Britons.

Nor is it only Britain's intelligentsia that is fascinated by the secular religion of 'Europe'. Gabriel Robin, a retired French ambassador formerly close to Giscard d'Estaing and the inner circle of 'committed' French Euroenthusiasts, has recently dared to make the point in France. He writes:

The two ideologies, of Communism and of Europe, have much more in common than they [Euroenthusiasts] like to admit . . . One had its apparatchiks, the other its Eurocrats . . . Their respective credos come together [in many respects including their belief in] the inevitable withering-away of the nation-state . . . Initiates in the secrets of History, the two schools are equally convinced that they know where History is leading – towards the Promised Land. For the first, its name is the classless society, for the second, it is Europe without borders.

The techniques and modes of thought of twentieth-century secular religions have marked the attitudes of the European Establishment to the ERM 'common good' and to the 'historic inevitability' of monetary and

political union. Only the International Olympic Committee's ban on political demonstrations prevented the European Commission from spending taxpayers' money to turn the Barcelona and Albertville Olympics into flag-waving propaganda rallies. 'Europe' has been promoted, again most notably by Delors, almost as synonymous with Christendom, a counter to the supposedly pagan Anglo-Saxon worship of markets and a bulwark against decadent Anglo-Saxon culture.

A senior official of the Bank for International Settlements once accused the Commission's Directorate-General for Economic and Financial Affairs of publishing propaganda in the guise of analysis. Apparently, this is what is now expected of Commission staff – they are missionaries, soldiers in the crusade for a European superstate. Every Commission official has received a blue, 'European Commission' diary (even the name is a piece of propaganda: all staff are ordered to use it even though legally the institution is still 'The Commission of the European Communities'). With the diary comes a message in three languages. It is so sacred that it is printed on a plastic insert, that it may not become crumpled or dog-eared. The plastic carries the words of João de Deus Pinheiro, member of the last Delors Commission responsible for 'information' and personnel. Combining his two areas of responsibility, Pinheiro reminds his fifteen thousand knights that: 'It is clear that staff will be more effective and enthusiastic communicators if they feel a strong sense of commitment to the goals of the Community.' Professional conscience? Remember the *auto da fê*.

Senior Commission officials have complained that 'intellectual terrorism' employed by Delors and his associates stifled any attempt at serious, open-minded discussion of European monetary issues. Even the Secretary-General of the Commission, David Williamson, in theory the most senior of all Commission officials, complained of 'the KGB [members of Delors's *cabinet*, or private office] looking over his shoulder' during the Maastricht negotiations and preventing him from doing his job professionally.

In Stalinist Russia, dissent was regarded as evidence of lunacy. In the present-day European Community, dissent does not yet warrant incarceration in brutal mental hospitals, but unorthodox thought is still a dissonance. In Britain, Enoch Powell very quickly saw the subversion of democracy implied by the ERM, yet his perspicacity was treated by enlightened opinion as further evidence of what John Major might call 'barmy' thinking. Equally early, Alan Walters saw and proclaimed the economic contradictions of the mechanism. This was an offence so heinous that even the patronage of Mrs Thatcher could not save him from the

revenge of the outraged media Establishment, led by Sam Brittan (created Chevalier de la Légion d'Honneur by a French government grateful for his enthusiastically pro-ERM stance) in the *Financial Times* and the unnamed editorialists of *The Economist* who infamously attempted to ridicule him by referring to him as 'one of the world's top three hundred transport economists'.

As we shall see, in France the long arm of the authoritarian state has pressurized dissident economists and bankers, deployed financial information programmes on international TV channels, threatened securities houses with loss of business if they questioned the official economic line, and shamelessly used state-owned and even private-sector banks, in complete contradiction with their shareholders' interests and Community law, to support official policy. French officials have bemoaned the need for elections as creating problems for the ERM. In Italy, securities houses have been 'punished' by the state for publishing accurate economic analysis that made life difficult for the lira within the system. In Denmark the central bank acted illegitimately to 'punish' banks who might conceivably have defied the Prime Minister's warnings not to finance sales of the Danish currency. In Britain the minister supposedly responsible for open government ruled that exchange-rate parities were a subject about which the government could legitimately lie to Parliament. In Germany it seems that implicit exchange controls were covertly introduced to hide the truth of the ERM's impact. In Ireland, Church leaders denounced market attacks on Ireland's ERM parity as 'unbelievably immoral'. The economics profession in Europe organized literally hundreds of conferences, seminars and colloquia to which only conformist speakers were invited; and the Commission's 'research' programmes financed large numbers of economic studies to provide the right results from known 'believers'.

In the face of this relentless and overbearing propaganda and worse, this book will attempt to expose the double myth of the ERM: that it was economically rational and beneficial, and that it was politically a symbol of friendship and cooperation. I will argue instead that the mechanism was a major reason for economic failure, for impaired political legitimacy, and for the unhappy state of affairs recently described by a German newspaper as 'the pitch-black distrust with which European Union members today regard each other'. The newspaper continues: 'This distrust is greater than when the European Community was founded 37 years ago – that is no basis for an enlarged union.'

This book treats the ERM as the field on which three battles have been

waged simultaneously. The first of those battles is between politics and economics, the expression of a bureaucratic way of thinking, an attempt to stem the tide of market forces that threatened to engulf corporatist Europe in the 1980s and 1990s. The second is between the Bundesbank, the redoubtable, unaccountable and extremely powerful German central bank, and the forces aiming to take it down a peg: France, the German government, and financial markets. The battle-ground, after a decade and a half of strife, is littered with dead and wounded: Tory radicalism; national sovereignty; capital liberalization, the Single Market in Europe, and an open trading system in the world as a whole; hundreds of thousands of firms and millions of jobs; the Italian state; trust in governments and even in the democratic system of government; the rule of law in some countries; the idea of central-bank independence as something worthwhile and practicable; the hope of economic convergence and self-reliance in the poorer members of the European Community; and the economic integration and development of Eastern Europe. And even now, when the battle of the ERM might appear to have been won by markets, for democracy and for freedom, the battle of EMU still has to be fought.

The third battle is even more titanic; it has gained in intensity since the fall of the Berlin Wall and the longed-for collapse of the Yalta carve-up of Europe. It is the battle for control of the European superstate, in which French technocrats confront German federalists, both sides claiming to fight under the banner of Charlemagne. The 'collateral damage' from this battle lies mainly in the future, but it could be ghastly. Whether Britain can avoid it is a major question of the final section of this book.

My central thesis is that the ERM and EMU are not only inefficient but also undemocratic: a danger not only to our wealth but to our freedoms and, ultimately, our peace. The villains of the story – some more culpable than others – are bureaucrats and self-aggrandizing politicians. The ERM is a mechanism for subordinating the economic welfare, democratic rights and national freedom of citizens of the European countries to the will of political and bureaucratic élites whose power-lust, cynicism and delusions underlie the actions of the vast majority of those who now strive to create a European superstate. The ERM has been their chosen instrument, and they have used it cleverly.

The first part of this book analyses the history of the ERM from its inception to the signing of the Maastricht Treaty. It describes how the ERM confidence-trick worked for so long, and how – despite the economic damage it was inflicting on most of its members – it came to be hailed as a

motor of economic progress and political reconciliation. The analysis stresses the paradox that, while the ERM during that period was increasingly seen as outstandingly successful, giving impetus to the forces that produced the treaty, it in fact was running counter to all the economic objectives of the Community: monetary stability, a levelling up of productivity and living standards, high employment, sound public finance, free trade and the Single Market, the liberalization of capital movements and a harmoniously competitive world economic order. To mask this paradox, the champions of the mechanism ingeniously invented a series of superficially attractive economic fallacies. These fallacies will be exposed.

The first part also describes how the cloak of ERM 'cooperation' masked ferocious political in-fighting within and between the countries participating, or thinking of participating, in the mechanism. Particular attention is given to the combination of economic mismanagement by the Treasury and the Bank of England and conspiracy within the Tory party and European Establishments that ultimately toppled Mrs Thatcher. I also emphasize the growing divergence during this period about monetary issues – all appearances to the contrary – between France and Germany that now threatens the whole future of the European Community.

The second part of the book chronicles the collapse of the narrow-band ERM between Maastricht and the great market assault of July 1993. The emphasis here is on explaining how the interplay of economic forces, political events and personal motivations laid bare the economic contradictions and political hypocrisy of the mechanism, allowing markets to discover, after fourteen years of succumbing to illusionism, that the Emperor indeed had no clothes. I explore the role of Helmut Schlesinger, Bundesbank President in the critical 1991–93 period and one of the very few heroes in a landscape overpopulated by villains. A central argument of this part of the book is that Schlesinger was able to manoeuvre German monetary policy, aided by economic developments and market power, until ultimately the monetary pretensions of France were laid bare with such starkness that Helmut Kohl could no longer resist German popular indignation with the French assault on Germany's monetary sovereignty.

The final part of the book describes the remarkable tenacity with which the proponents of EMU have clung to their ambitions despite the collapse of the ERM and a lack of popular support that even the Commission has had to admit to. How great is the danger that EMU will go ahead? And what damage would it do to Britain, Europe and the world? Those are the questions with which the book ends. But if answers are to be given, the

book must begin with an exploration of the motives of the proponents of the ERM. 'L'Europe se fera par la monnaie, ou elle ne se fera pas' – 'Europe will be created via a currency or not at all' – wrote Jacques Rueff in the 1950s. As we shall see, that maxim motivated the fathers of the ERM, Valéry Giscard d'Estaing and Helmut Schmidt. Why?

PART ONE

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