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Italy and the Political Economy of Cooperation: the Marshall Plan and the European Payments Union

by Juan Carlos Martinez Oliva

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ITALY AND THE POLITICAL ECONOMY OF COOPERATION: THE MARSHALL PLAN AND THE EUROPEAN PAYMENTS UNION

by Juan Carlos Martinez Oliva*

Abstract

Following the Second World War the Marshall Plan backed the creation of the Organization for European Economic Cooperation, which led in 1950 to the European Payments Union. Thanks to well-engineered rules, the Union fulfilled its mandate, achieving currency convertibility and trade liberalization in Europe in only eight years. This paper examines the orientations of Italian policy-makers in that early period of European cooperation. Various historical sources, including some newly released official documents, show that in those years Italy's leaders aimed at closer European cooperation and integration. They viewed cooperation as the way to institute a fair, non-discriminatory set of rules that would attenuate differences among countries; whenever possible, however, they also sought to further domestic purposes and maintain a reasonable degree of independence. Relations with the United States were particularly intense in those years, reflecting Italy's need for economic assistance and political support and the central role of the US at the early stage of European cooperation. Italy was ready to accept US hegemony as long as it guaranteed a fair payoff from cooperation.

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The United States does not wish to interfere in the domestic affairs of any country, but countries to which it extends financial aid must put their internal affairs in proper order so that such aid may be permanently beneficial.

William Clayton, March 1947

1. Introduction[1]

The history of European integration was shaped by the commitment by the United States in June 1947 to back European reconstruction with a four-year program of assistance. The Marshall Plan, as it came to be known, led to the creation of the Organization for European Economic Cooperation (OEEC), and sparked an active debate on possible ways to restore economic stability and growth. A multilateral clearing system, the European Payments Union (EPU), was put in place at the end of 1950; it also favored the removal of trade barriers, allowing real and monetary integration to proceed hand in hand. In just eight years the EPU fulfilled its mandate: the European economies adopted currency convertibility and operated thenceforth in a fully cooperative context.

The EPU was a successful transitory system that created a favorable environment for growth. Its simple but well-engineered rules were based on multilateral surveillance and commitment, which are the main building blocks of cooperation. It is an example of how good policy design can assist the smooth functioning of international cooperative arrangements. By December 1958 the historical tasks of the Union had been discharged; the newborn institutions established by the Treaty of Rome built on the EPU's legacy at multilateral institutions and a cooperative environment.

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The following abbreviations will be used below:

ACS, for Archivio centrale di Stato;
ASBI, for Archivio storico della Banca d'Italia;
ASUIC, for Archivio storico dell'Ufficio Italiano Cambi;
FLE, for Fondazione Luigi Einaudi;
FRUS, for Foreign Relations of the United States - US Department of State.

The process of European integration was particularly important for Italy, both economically and politically, but many questions concerning the policy choices of Italian policy-makers have remained unanswered until recent times. The present paper studies the orientations of Italian policy-makers with the help of newly released official documents. It examines three crucial episodes: the rebuilding of foreign exchange reserves in 1948-1949; the early implementation of import liberalization in 1951; and the termination of the EPU and the return to exchange rate convertibility in 1954-1955.

All three episodes point to the same conclusion. The Italian authorities tried to further domestic goals and maintain a reasonable degree of economic policy independence; but they also aimed at closer international cooperation and integration, particularly within Europe, and they consistently sought to create a sound multilateral setting. This distinguished Italy from countries such as Britain, which were prepared to participate in cooperation only if it posed no threat to national objectives. The Italian stance presumably reflects the expectation of benefits from fair, non-discriminatory rules that would reduce disparities among European countries. Italy's relations with the United States were particularly close in those years, reflecting Italy's need for economic assistance and careful political support. The evidence shows that Italy was ready to accept US hegemony as long as it guaranteed a fair payoff from cooperation.

2. Friendly Aid from Overseas

As 1947 began, no early end to the crisis in war-torn Europe was in sight. The program of assistance from the United Nations Relief and Rehabilitation Administration (UNRRA) was close to its end, and there was no prospect of foreign assistance. In January 1947 an Italian mission to the United States headed by Prime Minister Alcide De Gasperi submitted a set of requests to the US authorities. The results were encouraging in many respects, but in financial terms the only achievement was an Export-Import Bank loan amounting to $100 million.[2] In March there were still no signs of improvement; the heavy wartime destruction

[2] Donato Menichella, Governor of the Bank of Italy, participated in the mission. An evaluation of its results may be found in his speech at the meeting of the Italian Banking Association on January 18, 1947; see Ricossa e Tuccimei (1998), doc. 40, pp. 389-98, and also doc. 41, pp. 399-409, for a summary of the various issues

of housing and other buildings, the almost complete elimination of ships and railways, and the serious damage to industry and agriculture remained a source of deep concern.[3] Other Western European countries faced similar problems.[4] In 1947 real national product was less than half its prewar level in Germany and Austria, under 60 percent in Greece; 80 or 90 percent in France and the Netherlands, and still not up to 100 percent even in the United Kingdom and in Belgium.[5]

The situation was aggravated by the discriminatory practices and bilateral arrangements that characterized European trading and payments, a legacy inherited from the thirties and the War. The scarcity of foreign exchange reserves exacerbated bilateralism and discrimination.

In his speech at Harvard University on June 5, 1947, US Secretary of State George Marshall recalled Europe's economic difficulties and promised "friendly aid." This initiative came quite unexpected, and it was initially overlooked.[6] In the days following, however, Europeans responded enthusiastically.[7] A conference was quickly organized, and the representatives of sixteen European countries met in Paris, on July 12, 1947.[8]

The main achievement of the Paris conference on European recovery was the establishment of the Committee for European Economic Cooperation (CEEC) to assess needs and resources. The Committee's draft report was submitted to the US representatives at the end of August, but proved to be a failure. The Americans, and particularly the State

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addressed by the mission. The deal was considered a success given the unfavorable premises, particularly the political situation in Italy. In his diary entry of January 3, 1947, Einaudi wrote: "Evening: Quaroni [Italian ambassador in Paris] at home. United States: they will give peanuts, 50, 100, to prevent the worst from happening. But not real help, so long as there are the Communists." See Einaudi (1993), p. 717 (my translation).

[3] Banca d'Italia (1947), p. 30.

[4] In France "115 major stations had been destroyed or badly damaged . . . We had 12,000 locomotives; 2,800 of them remained. From Paris to Lyon, Marseilles, Tolouse, Nantes, Lille, Nancy, there were no more trains. Canals, riverways, ports were unusable. Electric lines were cut. 3,000 ports had been blown up." Lecerf (1963), quoted in Eichengreen (1995), p. 18.

[5] Comitato Interministeriale per la Ricostruzione (1952), p. 38.

[6] See Kindleberger (1987), p. 29.

[7] In Marshall's words: "The plan had not been discussed with Europe in advance and Europe's prompt response represented quick foot work." Interview with George C. Marshall, October 30, 1952, Harry S. Truman Library, The Marshall Plan, Folder 7.

[8] The organization of the conference by the British and French Foreign Affairs ministers Bevin and Bidault had complicated diplomatic implications, particularly in what concerned the position of the USSR. See Martinez Oliva and Stefani (2000), pp. 144-46.

Department's economic experts, known as the "Friendly Aid Boys," severely criticized the report's plan for an ongoing external deficit and heavy reliance on American aid, estimated at $29 billion.[9] More general criticism was addressed to the inadequacy of European self-help; to the lack of commitment by single countries to domestic policy action to restore stability; and to the lack of emphasis on multilateral cooperation.[10] The "Friendly Aid Boys" found the report unacceptable and concluded that the conferees lacked the political strength to regenerate Europe. Since the Europeans were lacking realism and resolve, the State Department would have to decide unilaterally what was best for Europe.[11]

To correct the main shortcomings of the CEEC's proposal the State Department laid down a series of conditions for making the European program acceptable to the United States. These included commitment to such objectives as the recovery of production, monetary and financial stability, and the removal of trade barriers. The Europeans should also consider other sources of dollar credits to reduce the need for American assistance, implement common policies, and establish an international coordinating agency.

The final CEEC report included on this last point only a disappointingly weak provision. The new supranational organization would have very limited powers. Its role was to review the progress of the recovery program, to issue reports, and to make policy recommendations to member countries. The new institution, called the Organization for European Economic Co-operation (OEEC), managed nonetheless to free European trade from restrictions and bilateralism in ten years. Since it was clear from the outset that trade liberalization was impossible in the absence of adequate multilateral payments arrangements, the OEEC began by encouraging multilateral payments agreements.

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[9] Hogan (1987), p. 74, and Martinez Oliva and Stefani (2000), p. 157. Interesting details were recalled by George Marshall: "As implied in the speech, I insisted that [the Europeans] come with a workable plan for European recovery based on actual requirements, not what they thought the U.S. would give. For this reason I insisted that we not help Europe in the formulation of the European recovery Program. I was subjected to heavy pressure from Clayton [...], Lew Douglas and others to let them consult with the Europeans and to let them advise the Europeans on the formulation of a plan for European recovery. [...] If my recollection is correct Clayton urged the Europeans to scale down drastically their early estimate of dollar requirements to a figure which might be acceptable to the U.S. Congress." Interview with General George C. Marshall, October 30, 1952, Harry S. Truman Library, The Marshall Plan, Folder 7.

[10] Brown and Opie (1953), p. 134.

[11] See "Memorandum by the Director of the Policy Planning Staff," September 4, 1947, FRUS, 1947, III, pp. 397-405.

In March 1948 President Truman urged Congress to pass the Economic Cooperation Act, in view of the difficult economic and political situation in Europe. The Act, which was approved on April 2, instituted a $17 billion program to assist European countries "through their own individual and concerted efforts, to become independent of extraordinary outside economic assistance" within four years.[12] The European Cooperation Administration (ECA) was constituted to administer the aid and cooperate with the OEEC, which coordinated member countries' requests for vital imports.

3. Paving the way to the EPU

In the weeks following the Paris conference of July 1947 it was increasingly recognized that a multilateral payments arrangement was absolutely necessary to unlock intra-European trade. On November 18, 1947, in accordance with the Committee's recommendations, Belgium, France, Italy, Luxembourg, and the Netherlands signed the First Agreement on Multilateral Monetary Compensation. Eight European Recovery Program (Marshall Plan) countries joined as "occasional members," exempted from the regular members' obligations.[13] The results were quite disappointing, as participating countries settled only 2 percent of their overall debts.[14] The main reasons were the presence of net creditors and net debtors of the group as a whole, and the small number of full member countries.

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[12] The bill was submitted to Congress on December 16, 1947, and passed on April 2 1948. Brown and Opie (1953), p. 145. Both the American and Italian governments believed that the passage of the bill before April 18, the date of national elections in Italy, might be of crucial importance in fighting Communist propaganda.

[13] The rules involved two types of offsetting operations, first-category and second-category compensations. As explained by Kindleberger (1984), p. 444, "The Netherlands has an export surplus of 10 with France, France a surplus of 15 with Belgium, and Belgium a surplus of 5 with the Netherlands. On this showing, a first-category compensation is possible of 5, reducing the unpaid bilateral surplus of the Netherlands with France to 5, that of France with Belgium to 10, and wiping out the Belgian gross surplus with the Netherlands altogether. Total bilateral balances after this operation have been reduced from 30 to 15. Second-category compensation would take place if France succeeded in persuading the Netherlands and Belgium to transfer 5 of the French claim on Belgium to the Netherlands against the Dutch surplus with France. This would reduce bilateral imbalances from 15 to 5. The Netherlands would agree to the canceling only if it believed that Belgium was a reliable debtor, and Belgium only if it believed that the Netherlands was no more exigent a creditor than France."

[14] The eleven countries that participated in the clearing system had bilateral debts with other participants totaling $762.1 million; clearing amounted to only $1.7 million. See Banca d'Italia (1948), p. 27 and Diebold (1952), p. 25.

A second attempt followed on October 16, 1948; it involved the whole group of the OEEC countries, whose representatives, after protracted negotiations, subscribed the First Intra-European Payments Agreement. Unlike its predecessor, the Agreement linked intra-European trade with US foreign assistance, following a previous plan devised by the Finance Ministers of the Brussels Pact powers (Benelux, Britain, and France). The key feature of the new mechanism was that the countries with a balance of payments surplus vis-à-vis other member countries should offer their surplus as a grant (drawing rights) in return for which they would get "conditional" aid from the Economic Cooperation Agency (ECA). Bilateral talks between each pair of member countries were to forecast the bilateral balances for the next year. The mechanism allowed creditors to transform their claims on other European countries into dollars, which was particularly appealing to some of them, like Belgium, but involved distortions in the net amount of goods that countries would receive from the United States.[15] In principle this system was not in contrast with the earlier orientation of the US State Department and the Congress; but it seemed more like a temporary remedy than a structural solution. It did not provide a proper incentive for countries to keep their deficits under control, it fostered bilateral trade, and it relied excessively on foreign aid.

From the start Italy opposed the use of ECA funds for intra-European payments, provoking resentful criticisms from creditor countries, such as Belgium, which expected to gain substantial advantages from the Agreement.[16] The Governor of the Bank of Italy, Donato Menichella, noted that the mechanism on which the Agreement was based did very little to enforce cooperative behavior. In his view, the lack of coordination was the main shortcoming of the agreement, which encouraged free riding rather than sound policies of external deficit reduction and monetary control.[17]

To overcome the problems associated with the bilateral allocation mechanism, the ECA proposed the full transferability among European countries of the conditional aid associated with drawing rights. This attempt to introduce a multilateral element encountered

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[15] Diebold (1952), pp. 42-46.

[16] "Relazione del sig. Gutt al Consiglio esecutivo dell'Interfund sulla situazione economica dei paesi recentemente visitati," Banca d'Italia, Servizio studi economici, Rome, September 27, 1948, ASBI, Carte Baffi, b. 30.

[17] Banca d'Italia (1948), pp. 20-21.

strong opposition by OEEC countries, and in the final compromise only 25 percent of the total resources were made transferable.

The Second Intra-European Payments Agreement, signed on September 7, 1949, contained complex provisions to deal with Belgium's expected trade surplus of $400 million, which was nearly twice its warranted dollar aid. This agreement was not a significant advance, as the more innovative proposals emerging from preliminary discussions had not won the necessary consensus. In particular, a clearing mechanism largely based on gold and credit had been proposed by Robert Triffin;[18] it was rejected by the Board of the IMF, whose attitude of discouraging the creation of a "European regional block" was influenced by the US Treasury, in contrast with the position of the State Department and the ECA.[19] Further difficulties arose in September from the devaluation of the OEEC currencies by an amount ranging from 30 percent for the pound, the guilder and the Scandinavian currencies to just 12 percent for the Belgian franc and 8 percent for the lira.[20] The devaluation dramatically altered the forecasting scenario, with significant changes in expected utilization of drawing rights as compared with the baseline. This necessitated a new agreement, in April 1950, to accommodate the positions of the debtor countries. Only modest use was thus made of compensation under the Second Intra-European Payments Agreement; the member countries clearly preferred to draw on ECA resources.

4. Coping with foreign assistance

The European Recovery Program operated through a simple mechanism. Recipient countries had to deposit, in a special fund, the national currency equivalent of the aid in dollars sold to domestic importers. The proceeds of the sales contributed to so-called "counterpart funds," whose use was subject to the approval of the ECA. The CEEC had sought assurances that the counterpart funds would not be controlled by the United States and used to undercut the ability of the national authorities to manage their economies, but

[18] At the time Triffin was with the ECA staff in Paris as economic expert.

[19] Triffin (1966), pp. 406-77 (and especially p. 440).

[20] Tew (1960), p. 168.

without success.[21] In the early stages of the program counterpart funds were used, as in Britain, to reduce the public debt. Over the whole period of the Marshall Plan, 46 percent of all the counterpart funds remained unutilized or went for debt retirement. The European countries tended to view the counterpart funds as a separate contribution from the goods granted by the US, and the ECA sometimes had to use its influence to get countries to use them for investment purposes.[22]

In the case of Italy, the counterpart funds were kept idle, rather than used for public expenditure, in order to preserve and consolidate the results achieved by the rigorous program of monetary stabilization implemented in late 1947. Those measures had certainly helped to restore market confidence and to curb inflation, but they had came under heavy criticism from the left-wing parties in the Constituent Assembly.[23] The credibility of the Government thus depended on their success. During the Annual Meetings of the Bretton Woods institutions, in September 1947, Einaudi had had the occasion to express to US Under Secretary of State William Clayton his concern about the potential political repercussions of the measures in view of the general elections scheduled for April 1948.[24]

The ECA mission in Rome, headed by James D. Zellerbach, had pressed initially for large-scale investment of the counterpart funds, but that pressure was then eased in accordance with instructions from Washington.[25] In late 1948, though, after political stability had been restored by the electoral outcome, the ECA's attitude suddenly changed again. Marshall Plan administrator Paul Hoffman[26] eager for quick results to show to Congress, started to urge a bolder investment policy on the Italian Government, while criticizing the ongoing accumulation of the reserves.[27] In his introduction to the 1949 issue of the *Country Study* on Italy, Hoffman criticized the Government's over-emphasis on curbing inflation. The

[21] Hogan (1987), p. 85.

[22] Brown and Opie (1953), pp. 243-44.

[23] That Assembly drafted the Constitution of the Italian Republic.

[24] See Martinez Oliva and Stefani (2000), p. 155, and Baffi (1965), p. 266.

[25] Martinez Oliva and Stefani (2000), p. 182.

[26] Hoffman was appointed ECA administrator by Truman at the beginning of the program and resigned on September 25, 1950.

[27] Egidio Ortona reports in his memoires the impression of growing dissatisfaction among US officials in Washington with Italian economic policy at the end of 1948. The accumulation of reserves, in particular, raised the concern that the Congress might decide to reduce ECA assistance. See Ortona (1984), pp. 270-71.

document was nonetheless weakened by debate within the ECA itself, as Zellerbach and Kamarck argued for dropping the harshest judgements.[28] For their part, the Italian authorities were extremely prudent and reluctant to disclose confidential data on Italian reserves to the US officials.[29] This secretiveness was probably counterproductive as the American representatives in Rome tended to attribute any and all increments in Italian reserves to the failure to use the counterpart funds.[30] On the other hand the National Advisory Council (NAC) and the Office of the Special Representative (OSR) acknowledged that Italy needed to accumulate reserves against possible balance of payments difficulties upon termination of the Marshall Plan, while the Council on Foreign Relations recognized the legitimacy of the Italian and Belgian use of ECA resources to build up reserves.[31]

It is thus no surprise that the Italian government initially conceived the Marshall Plan as a way to pay for imports in lire, rather than in dollars. This attitude was consistent with the twin objectives of maintaining the country's hard-won price stability and increasing foreign currency reserves. Accordingly, the counterpart funds were accumulated in a special account dedicated to that purpose (the so-called *fondo lire*).

Luigi Einaudi has left a brilliant explanation of the rationale behind the policy of reserve accumulation, pursued in 1948-1949, that yielded a reserve increase of about 600 million dollars.[32] Einaudi praised the ERP as a means to import vital goods in a situation of scarce dollar reserves. Still, the counterpart funds obtained by the government by sale of the ERP goods in the private market should not be utilized, he argued, in order to prevent unwanted increases in demand. Since the counterpart funds did not come from loans or taxes, they were equivalent to net creation of money, with dangerous implications in terms of inflation. Following the traditional specie-flow mechanism, the excess liquidity would increase prices, reduce competitiveness, and worsen the trade balance. From his own ethical standpoint, too, Einaudi maintained that "...the gift, like all the gifts, is corrupting and

[28] Baffi (1990), p.118.

[29] Asso, Biagioli e Picozza (1998), p. 126.

[30] Baffi (1990), p. 122, footnote 6.

[31] Ellis (1950), p. 511.

[32] Einaudi (1991). Einaudi's original manuscript was drafted on July 10, 1949 and first published 42 years later. For a useful introductory analysis see Ciocca and Tuccimei (1991).

damaging. In what does the damage consists? In inducing us to believe that life is easier than it is; in hampering our effort to become independent."[33]

In the summer of 1949, relations between Italy and the United States were marked by tensions and difficulties.[34] At the September Meetings of the IMF and the IBRD in Washington, Treasury Minister Pella and Governor Menichella defended their choice of rebuilding dollar reserves against criticism from a group of experts from the State Department, the ECA, and the Treasury. Menichella's main point was that the Italian economy should be prepared to withstand the repercussion of the termination of the ERP, should this occur before international equilibrium had been reestablished. He also claimed that Italy should be endowed with sufficient dollar reserves to face the schedule for foreign trade liberalization, from which Italy expected a welcome reduction in domestic prices.[35]

The Italian authorities' attitude received strong encouragement from Eugene Black, President of the IBRD, who publicly stated that countries that accumulated reserves should not be discouraged.[36] In later years, however, the war in Korea and new procedures for the administration of the Marshall Plan resulted in growing pressure by the ECA administrators, who wanted Italy to contribute more actively to the defense effort. The drastic change in their attitude became apparent when Leon Dayton, Zellerbach's successor as ECA mission chief in Rome, attacked the Italian government and industry for the insufficient expansion of investment.[37] Dayton's critique drew on the ECA's *Country Data Book* for Italy, published a few months earlier. There it was reported that, while the general conditions of the Italian economy were good, thanks to sound fiscal and monetary policies that had restored confidence and lifted the savings rate, employment and productivity growth were still unsatisfactory.[38] The subsequent debate in the US involved the Treasury and the Federal

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[33] Einaudi (1991), p. 514 (my translation).

[34] Ortona (1984), p. 308.

[35] Banca d'Italia (1950), pp. 254-55.

[36] Ortona (1984), p. 319.

[37] See the quotations reported in Esposito (1996), pp. 83-84.

[38] Einaudi sharply criticized that document, claiming in particular that Italian unemployment was to be attributed to the rigidities that were already apparent in the Italian labor market in the late forties, rather than to a lack of investment. See "Commenti al *Country data book* del marzo 1950," March 31, 1950, FLE, AP.i. 1950.

Reserve Board, the latter regretting the harshness of the ECA and praising the Italian concern for financial stability.[39]

A debate ensued in Italy between supporters of the current policy stance and those who feared that it would lead to a reduction in US assistance. In the months following that fear proved unfounded: on the contrary, aid to Italy was increased, as a demonstration, it was said, of the technical competence of the US experts.[40] The accumulation of foreign exchange reserves in 1948-1949 thus constituted a buffer that would help Italy over the forthcoming stages of European integration and was therefore the best strategy for internal stability and external cooperation.[41]

5. "Commitments of a revolutionary nature"

At the end of 1949 it was clear that Europe needed a better solution than the Second Payments Agreement. The ECA urged the OEEC countries to work on the issue and to design an effective multilateral clearing system together with a program to abolish trade restrictions.[42] A series of discussions followed, stimulated by the so-called Bissel proposal of December 10, 1949,[43] a package whose elaboration had taken about eighteen months, and which reflected US officials' long experience and excellent knowledge of the issues.[44]

The Bissel proposal included a number of new ideas: members should strive for long-term balance vis-à-vis the system; the entire sterling area should be included; the rules should provide an incentive for members to balance their positions; a supervisory body should be authorized to make policy recommendations to member countries; the US would help finance the system. Temporary discriminations against US exports were allowed, at least until

[39] "Politica finanziaria italiana. Federal Reserve Board." Tarchiani to Sforza, secret cable. October 17, 1950, FLE, I.3 Tarchiani Alberto 1950.

[40] Banca d'Italia (1952), pp. 320-21.

[41] Baffi (1965), p. 279.

[42] "Explanation of the Points at Issue With the British on the Proposed European Payments Union," confidential report by the ECA, Washington, April 14, 1950, FRUS, 1950, III, p. 646.

[43] Richard Bissel belonged to the group of ECA experts, and was one of Paul Hoffman's closest advisors.

[44] According to Kaplan and Schleiminger (1989), p. 369: "Few, if any, Europeans were in as good a position as ECA to absorb all the various concepts, analyse and dissect them in vigorous debate with critics, and judge the acceptability of the various notions to the critical decision-makers."

European products became more competitive. The basic rule was that net external debts could be financed using credits, up to a given level.

Britain put forward an alternative proposal whose main aim was to preserve the country's bilateral relationships. The British memo encountered severe criticism by the Americans: "We suspect that the basic reason for the British reluctance to abandon their bilateral payments system is their unwillingness to forgo the bargaining advantages and coercive possibilities which it affords. The retention of bilateral payments agreements, combined with the possibility of arbitrary, unilateral reimposition of QR's [quantitative restrictions] against individual continental countries, provide the British with the potent weapon of limiting or denying access to both the British consumer and the British producer." [45]

The British proposal provoked serious concern in Italy.[46] If that position won the day, it was thought, the European payments mechanism could become simply part of a broader network of sterling arrangements. The main preoccupation for the Italian representatives was the convertibility of Italy's sterling holdings. A repetition of the frustrating experiences in sterling-lira relations after the war, particularly in 1947-1949, was to be avoided at all costs.[47] For this reason Italian officials were prudent on their conversations with a group of American experts and members of the OEEC Secretariat and, in view of the many uncertainties still affecting the two plans, refrained from expressing a clear preference.[48]

The decisive move was made by the US Secretary of State. In a memo to the British Foreign Minister, Ernest Bevin, Marshall offered a set of safeguards to the United Kingdom: "1) If the United Kingdom suffers a significant loss of gold and dollar reserves as a result of payments to EPU, it could re-impose automatically *multilateral* quantitative restrictions, subject only to subsequent review by OEEC; 2) In the event that EPU operations should

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[45] "Explanation of the Points at Issue With the British on the Proposed European Payments Union," confidential report by the ECA, Washington, April 14, 1950, FRUS, 1950, III, p. 649.

[46] See Zecchi to Menichella, March 21, 1950, ASBI, Segreteria Particolare, pratt., b. 33, fasc. 1; "Resoconto sulla riunione interministeriale del 22.3.1950," with the attachment: "Osservazioni al nuovo memorandum inglese sul funzionamento dell'E.P.U.," Alberto Ferrari's confidential memo, FLE, Ferrari Alberto; "Conversazioni relative al nuovo Accordo Pagamenti Intraeuropei" (Cattani), Cable of the Italian delegation at the OEEC, March 22, 1950, ASBI, Segreteria Particolare, Organismi internazionali, b. 18 (provv.), Unione Europea dei Pagamenti, fasc. Q/1.

[47] See Martinez Oliva and Stefani (2000), pp. 152-56.

[48] See Martinez Oliva and Stefani (2000), pp. 128-33.

unexpectedly result in British dollar payment obligations beyond some agreed danger point, ECA would be prepared to consider the allotment of special dollar aid to the United Kingdom from the funds expected to be appropriated specifically for EPU purposes."[49] Against the advice of the Bank of England, the British government accepted the compromise. For Italy the solution was workable, as it overcome British opposition to the use, if necessary, of Italy's sterling reserves.[50]

The final result was "a remarkably clean and simple document, embodying simple and precise commitments of a revolutionary nature, which drastically shifted overnight the whole structure of intra-European settlements from a bilateral to a multilateral basis."[51] In essence, each country's foreign position with other countries was to be reported monthly to the BIS in Basel and the offsetting claims cleared. Countries' balances were consolidated, and the resulting individual creditor or debtor positions vis-à-vis the Union were financed with credits up to a given level; when each country's quota, equivalent to 15 percent of its trade with EPU economies in 1949, was exceeded, the balance was settled in dollars or gold. A progressive settlement rule was established, involving decreasing credits and increasing gold payments as the deficit grew. A Managing Board, chaired by Guido Carli for the first two years, handled ordinary business and the special situations arising when a member threatened to exhaust its quota. Advised by independent financial experts, the Board could make policy recommendations and provide special credits and quota extensions (*rallonges*); it reported to the Council of the OEEC. EPU members were committed to the Code of Liberalization, a formal program for dismantling trade barriers; there is little doubt that the link between the payment mechanism and intra-European trade liberalization was a key to the success of the EPU, which made a major contribution to Europe's rapid postwar economic growth.[52]

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[49] Marshall to Bevin, Aide-Mémoire on EPU, Secret, London, May 11, 1950, FRUS, 1950, III, pp. 655-57.

[50] "Alcuni aspetti dell'Unione di pagamenti europei," June 19, 1950, pp. 12-13, ASBI, Segreteria Particolare, Organismi internazionali, b. 18 (provv.), Unione Europea dei Pagamenti, fasc. Q/5.

[51] Triffin (1957), p. 161.

[52] Eichengreen (1993), pp. 27, 81-96.

6. How Italy speeded up import liberalization

At the end of October 1951 Italy had nearly reached the limit of its creditor quota, equal to 205 million units of account. The most obvious remedy was some kind of export restraint, such as Belgium, Luxembourg, and Portugal had already adopted. Instead, on October 31, 1951, Foreign Trade Minister Ugo La Malfa decided to remove all quantitative restrictions to Italy's imports, with only few exceptions.[53] This measure was followed by a number of others, including a 10 percent reduction in average import duties.

Many factors affected La Malfa's bold decision. The Italian economy had embarked on an ambitious strategy of industrial development, with large scale public investment. In such conditions, according to La Malfa, freeing imports from the OEEC area would alleviate demand pressure, curb price rises, and raise living standards. La Malfa also viewed import liberalization, and the ensuing increase in competition for Italy's industrial enterprises, as the prime tool in the struggle against rent-seeking and monopolies. Lastly, he expected to ease the workload at the ministerial officials "who had to handle about three thousand new files and applications from importers every day."[54] Import liberalization promoted concern among entrepreneurs and even some government officials, but it was praised by Governor Menichella and received the support and encouragement of Treasury Minister Pella. It was also appreciated by the Managing Board of the EPU, which rewarded Italy's cooperative attitude by proposing a 100 million unit *rallonge* in its quota.

Unfortunately, serious difficulties soon emerged in connection with the new guidelines for the US foreign assistance. With the conflict in Korea, the Administration and Congress concentrated on the defense program, and for Europe the emphasis shifted from economic recovery to progress in the military build-up in the NATO countries.[55] The Mutual Security Act of 1951 gathered all the American assistance programs under a single legislative authorization, with the exception of the operations of the Export-Import bank.[56] Between

[53] The proportion of freed imports, over the benchmark year 1948, was 99,7 percent. Only a few products were excepted, one being cars. La Malfa (1955), p. 193; Fauri (1997), pp. 142-43.

[54] La Malfa (1955), p. 193.

[55] Brown and Opie (1953), p. 501, report that the dangerous implications of Western rearmament drew critical comment by the OEEC and the BIS.

[56] Brown and Opie (1953), pp. 508-09.

fiscal 1951 e 1952 there was a decrease in economic in favor of military assistance with the overall US program.[57]

Given this trend, and in view of the official American forecast of a $60 million EPU surplus for Italy in 1952-53 and Italy's weak commitment on the military front, a reduction in US assistance to Italy was clearly to be expected.[58] Encounters with American officials, in which the Italians urged the need to take account of the prospective deterioration of the balance of payments, produced no results in terms of financial assistance.[59]

The concurrent effects of the Italian liberalization at the end of 1951, and of the strong trade restrictions triggered by the balance of payments crises in France and Britain,[60] soon became apparent. In March 1952, Italy recorded the first of a series of deficits vis-à-vis the EPU. La Malfa's September meeting in Washington with Under Secretary of State Bruce was a complete disappointment. La Malfa's announcement that Italy would retract its trade liberalization in case of need, and in the absence of concrete American support, prompted only generic expressions of appreciation.[61] Further complaints on Italy's precarious situation following the French and British retreat, and the threat of reactivating import controls, also failed to produce tangible results.[62]

Italy fortunately managed to avoid such a measure, which might have had serious consequences for the credibility of European integration, but at a cost. By the end of 1953 import liberalization had returned to 75 percent in the UK and 18 percent in France. It is worth noting that in view of the external responsibilities for Italy's balance of trade

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[57] According to Brown and Opie (1953), p. 535, the figures were 76 and 24 percent in fiscal year 1951 and 62 and 38 percent in fiscal year 1952, respectively.

[58] Alberto Tarchiani (Italian Ambassador in Washington), "Bilancia dei pagamenti italiana. Situazione nell'EPU. Telegramma ministeriale in data 8 aprile c.a.," 15.4.1952, ACS, Fondo La Malfa, b. 20.

[59] Martinez Oliva and Stefani (2000), pp. 304-14.

[60] On February 1952 trade liberalization was restricted to 46 percent in the United Kingdom and totally suspended in France.

[61] Ministry of Foreign Affairs confidential note, September 24, 1952, and accompanying letter of Magistrati to La Malfa, September 25, 1952, ACS, Fondo La Malfa, b. 20.

[62] For example, on March 3, 1953 the Italian Embassy submitted to the American authorities a memo, to the effect that the Secretary General of the OECD had been informed that "if U.K. and France could not find their way to revoke the restrictions which have been imposed by them and which entail such discriminatory consequences against Italy and if the creditor countries did not adopt liberalizing measures in relation to their situation, Italy might be compelled in a very near future to abandon its policy of liberalization." "Memorandum," March 4, 1953, ACS, Fondo La Malfa, b. 20.

difficulties, the country obtained special financial treatment with the EPU renewal of June 1954.

7. "Convertibility is strong medicine ..."

In June 1952, after its first two years, the EPU was renewed. It had alleviated the main problems affecting European trade and payments. Intra-European trade had expanded by more than 30 percent in real terms. Good results had also been achieved in cooperation among national authorities. However, some countries still had systematic imbalances, with surpluses or deficits regularly close to their quota threshold. Concerns about the limits of the EPU system stimulated a debate on convertibility, and the related question of trade liberalization.

By 1952, significant progress towards liberalization had been achieved, with average import liberalization above 70 percent. However, the deep-rooted structural imbalances among creditors (Germany, Belgium, the Netherlands, and Switzerland) and debtors (France, Italy, and the United Kingdom) still represented a major source of concern. A ministerial meeting of the OEEC Council was held on May 5, 1954 to deal with the differences between the two groups, but the outcome merely guaranteed the temporary survival of the EPU.[63] In the following weeks Italy worked for a financial arrangement that could alleviate its imbalances. With a deficit vis-à-vis the Union amounting to almost 123 million units, Italy requested to pay one third of that amount in gold and to settle the next part bilaterally with its creditors, Germany, Belgium, and Netherlands. A memorandum to this effect was delivered to the American authorities,[64] and after a number of informal exchanges of views,[65] it received the necessary endorsement.[66] With the EPU renewal in June 1954, Italy was granted the option it had requested. The system of *tranches* was also simplified, with the introduction

[63] Martinez Oliva and Stefani (2001), pp. 327-28.

[64] Memorandum of the Italian delegation at the OEEC, May 27, 1954, ASBI, Carte Caffè, b. 38.

[65] Cable from the Italian delegation at the OEEC, June 16, 1954, ASBI, Carte Caffè, b. 38.

[66] Cable from the Italian delegation at the OEEC, June 22, 1954, (enclosing the official answer from the US authorities, June 10, 1954), ASBI, Carte Caffè, b. 38.

of a new rule specifying 50 percent gold and 50 percent credit. This was the first significant step towards the hardening of the system.

On July 15 and 16 a Conference of the Ministers of the OEEC Council was held in London for a first review of convertibility. There was broad agreement on the advisability of a "wait and see" attitude. Italian policymakers held a number of preliminary meetings to formulate the Italian position.[67] The most momentous question from the Italian standpoint was liberalization vis-à-vis the United States. The importance of this issue was such that Guido Carli had earlier advocated a further tightening of controls on imports from the United States, provoking strong reactions by the American authorities.[68] Growing US pressure to reduce discrimination was reported by Tarchiani in late 1953. Tarchiani recommended tact to avoid possible unfavorable reactions in Congress against Italy.[69] As a matter of fact the Italian liberalization rate vis-à-vis the United States was about 10 percent, compared with the average of 80 percent vis-à-vis Italy's European trading partners. Accordingly the US share of total Italian imports was particularly low, just 10 percent, a sharp drop compared with the 25 percent recorded in 1948.[70] In 1954 Italy was not yet ready to risk convertibility and the consequent liberalization vis-à-vis the dollar area. A memorandum on the Italian position was transmitted to Washington, recalling the potential risks of an early move to convertibility,[71] such as the possible failure of liberalization among European countries, due to the deterioration of trade balances that would follow the premature opening of European markets to the rest of the world. Similar conclusions had been drawn by previous OEEC Annual Reports, and the Randall report in January 1954 had stated than no measures to end the EPU should be undertaken in the absence of a viable substitute mechanism.

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[67] "Riunione presso la Delegazione per la Cooperazione economica europea," Caffè memo, June 15, 1954; "Seconda riunione sul memorandum relativo alla convertibilità," Caffè memo, June 22, 1954; "Terza riunione per il memorandum relativo alla convertibilità," Caffè memo, June 25, 1954; "Quarta riunione per il memorandum relativo alla convertibilità," Caffè memo, June 30, 1954, ASBI, Carte Caffè, b. 36.

[68] Carli (1953), p. 474.

[69] Cable from Tarchiani on "Riorientamento della politica commerciale italiana," November 19, 1953, FLE, I.3 Tarchiani Alberto 1953.

[70] Hieronymi (1973), p. 152.

[71] See the report on the Italian memorandum drafted by Tarchiani and transmitted to Menichella by the Italian delegation at the OEEC, June 22, 1954, ASBI, Carte Caffè, b. 36.

With these considerations in mind, Budget Minister Ezio Vanoni argued that convertibility should be achieved through the process of European cooperation, and cautioned against its premature implementation. Vanoni reaffirmed the Italian view that the removal of trade barriers against the United States did not require convertibility and proposed, with little success, that OEEC adopt a common list of liberalized imports from the Western Hemisphere. In this effort to separate convertibility and free trade, thus keeping the EPU alive, Italy was strongly supported by the Foreign Operations Administration, the successor of the Mutual Security Agency, disbanded on August 1, 1953.[72] The Administration's belief that a gradual hardening of the EPU was the most viable route to convertibility made it a natural advocate of the Italian position.[73]

In January 1955 the Managing Board of the EPU resumed discussion of the future of the system. Some countries, including Italy, wanted to maintain the existing rules, while others supported a further hardening of the system, with a reduction of credit in favor of gold settlement, and even an escape clause for countries adopting convertibility; Belgium, the Netherlands, and Switzerland in particular called for raising the share of settlement from 50 to 75 percent. Other issues included the requests of Italy and Norway for *rallonges* of 100 and 30 million units of account, respectively.[74] In February, France and Germany shifted their position to endorse tougher rules. A compromise of 65 percent was suggested by the Chairman, von Mangoldt, but it was rejected.[75]

In the following months the procedures for the next renewal of the EPU were not resolved, due to the opposition of Italy and Norway. Threatened by a quota exhaustion before June, due to its growing cumulative deficit, Italy decided to approve, subject to an additional *rallonge* of 100 million units of account, 60 percent to be settled in gold.[76] In mid-April, the

[72] Banca d'Italia (1954), pp. 57-60.

[73] See "Problema della convertibilità," Ministry of Foreign Affairs cable, April 30, 1954, ASUIC, Relazioni con l'Estero, Unione Europea dei Pagamenti, sc. 3, fasc. ministero Affari Esteri; "Rinnovo dell'EPU - proposta italiana," permanent Italian delegation at the OEEC cable, June 22, 1954, (enclosing is a copy of the official US answer, June 10, 1954), ASBI, Carte Caffè, b. 38.

[74] "Rinnovo EPU 1955-56," permanent Italian delegation at the OEEC, January 22, 1955. ASBI, Carte Caffè, b. 39.

[75] "Rinnovo dell'EPU e trasformazione del sistema per passare al Fondo Europeo," permanent Italian delegation at the OEEC cable, February 24, 1955, ASBI, Carte Caffè, b. 39.

[76] "EPU e Fondo Europeo," permanent Italian delegation to the OEEC cable, April 1, 1955, ASBI, Carte Caffè, b. 39. The episode had previously puzzled some scholars interested in the EPU. For example Dickhaus states: "This

Board proposed even more favorable terms, consisting in a special two-year loan, of 50 million units, which Italy accepted.[77] On May 14 the Board approved the arrangement and submitted its proposal to the OEEC Council for the formal decision.[78]

By fighting to maintain the EPU Italy reaffirmed the principle vividly illustrated in Menichella's description of convertibility as "strong medicine, which cannot be prescribed without risks to every patient."[79] The final approval of the amendments to the EPU displays Italy's spirit of compromise. The special loan was not actually drawn upon, but helped to reinforce and protect the stability of the system. The following year it was prolonged until June 30, 1958, in view of the solidity of the Italian commitment within the EPU.[80]

The EPU was terminated quite unexpectedly, at the end of 1958, following the enormous improvement of economic and financial conditions in Europe. A strong effort was required of France, in particular, which involving severe financial consolidation, a 15 percent devaluation, and the completion of France's obligations on trade liberalization.[81]

When told that France was ready to endorse the move to convertibility Menichella gave his full support to the imminent decision to end the Payments Unions.[82] The EPU had provided support for trade liberalization and been effective in overcoming the strains and difficulties that emerged over the years; but its era had clearly come to and. A new period was beginning with new opportunities and new challenges.

The termination of the EPU almost certainly caused some regret for the Italian authorities over the loss of a functioning institution with no valid replacement. However, this was certainly mitigated by the enormous economic and political achievements Italy had

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Italian attitude seems peculiar especially if one remembered that only few months before, in summer 1954, the Italian Government had strongly opposed convertibility and had urged the retention of EPU." Dickhaus (1997), p. 194.

[77] "Rinnovo dell'EPU e Fondo Europeo. Caso dell'Italia," permanent Italian delegation to the OEEC cable, April 19, 1955, ASBI, Carte Caffè, b. 39.

[78] "Rinnovo dell'EPU - credito speciale all'Italia," permanent Italian delegation to the OEEC cable, May 17, 1955, ASBI, Carte Caffè, b. 39.

[79] Banca d'Italia (1954), p. 377 (my translation).

[80] OECE A(56)23, "Communiqué de la Presse," Paris, June 29, 1956, ASBI, Carte Caffè, b. 40.

[81] Martinez Oliva and Stefani (2000), pp. 366-68.

[82] Kaplan and Schleiminger (1989), p. 316 mentioned a meeting in Rome between John M. Stevens, the Bank of England representative at the BIS, and Menichella, Carli and Baffi. On the mission of Stevens see "promemoria

made in Europe in the short space of just a few years, thank to its unflagging commitment to European cooperation and integration.

della Segreteria Particolare del governatore (Cantuti)," December 22, 1958, ASBI, Segreteria Particolare, pratt., b. 497.

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