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Implications of European Integration for Latin American Economic Union

This paper is offered in the context of increased interest in regional cooperation in Latin America. It was stimulated by the stated aim of President Luiz Inácio Lula da Silva to create a Latin American economic union, including a single currency, and his claim in July 2003 that “The social and political conditions now are in place to launch a sustainable cycle of development. That will require the enlargement of the internal market, particularly for mass consumer goods, by integrating into it millions of excluded citizens”.²

This aim clearly is ambitious. It is more than simply extending Mercosul. It focuses on offsetting economic and social exclusion – an aim adopted by the European Project only thirty years after its initial design for a common market – and focuses on demand creation through redistribution rather than only integration of different national markets – something still only implicit in a range of EU policies. Its politics also are ambitious, not least granted that the postwar construction of Europe, from Marshall Aid and OEEC onwards, was directly supported by the then US administration, while it is less clear that a Latin American union and single currency now would be so.

In view of this it may be relevant to consider the experience – not all straightforward – of the creation of the European Economic Community and its transition to the European Union. The fact that the EU has adopted economic and social cohesion as the ‘twin pillar’ of

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² Luiz Inácio Lula da Silva (2003), “Political realism doesn’t mean we ditch our dream”. *The Guardian*, 12 July.

the Single European Act, and now adopted financial instruments for its realisation, also is of more than passing relevance. An enhanced dialogue on these issues could be more than marginally instructive.

Part 1. Principles

1.1. Latin American Structuralism and the European Project

There is a presumption that the Latin American structuralist school identified with Raul Prebisch (1949; 1959), Celso Furtado (1969; 1971) and the UN Economic Commission for Latin America, may have had something to offer in the 1960s and 70s, but is of less relevance now in the era of the WTO and liberalisation and globalisation of trade and capital movements.

This may be the case for that academic output in Latin America which has followed US economists into econometric modelling within a neoclassical framework. But it misses a wider picture, and especially how much analysis endorsed by Latin American and European political parties has been consistent with the key premises of the structuralist school.

For instance, the first major report on global development from the economic committee of the Socialist International was based on three premises: the need to recover mutual spending and trade, restructure the imbalance between private multinational and public national power, and redistribute social investment and demand as a central means of recovering mutual income and trade. The report, drafted by former Deputy Secretary General of UNCTAD, Jan Pronk and myself, and published in the names of Willy Brandt and Michael Manley, was debated in depth by the economic committee of the International, half of whose members represented Latin American parties, in a series of international meetings (Brandt and Manley, 1985; Holland, 1987a; 1988). It then was voted unanimously by the congress of the International in Lima. Its arguments were rearticulated within the same analytic framework for the Global Economy Declaration of the New York congress of the SI in 1996, and remain its official policy on development strategy (Socialist International, 1996).

In Europe, the identification of cohesion as structural, social and regional was explicit in the Spaak Report to the Messina Conference of 1956, which was the draft for the Rome Treaty. It underlay the preparatory ministerial workshop for the first Greek Presidency of the European Council in 1983, which argued the case for recovery through redistribution. The

result was the call for a New Messina Conference, echoed by the French Presidency of the Council in June the following year, which, in 1996, resulted in the inclusion of economic and social cohesion as the twin pillar, with the single market, of The Single European Act – the first revision of the Rome Treaty.

Since the early 1990s, also the link between structures of power and social and regional distribution has been central to the conceptualisation and strategy of the European Union in combating economic and social cohesion. The analytic basis of the preparatory report for Delors's 1993 White Paper on Growth, Competitiveness, Cohesion was the structural, social and spatial dimensions of markets, the need to restore a balance between public and private power, and to do so through policies for economic and social cohesion (Holland, 1993).

The coincidence between this and the Latin American structuralists was not accidental. Prebisch, Furtado, Pierre Uri (co-author of the Spaak Report) and I had been strongly influenced by the work of François Perroux,³ himself a pupil of Schumpeter, who had argued that markets embody a process of creative destruction in which competition rewards the strong and penalises the weak unless there are powerful countervailing structural, social and regional policies (Perroux, 1955; 1964; 1965). The core-periphery and dependency arguments of Prebisch, and the polarisation arguments of Perroux, also were consistent with the circular and cumulative causation and spread and 'backwash' arguments of Gunnar Myrdal, who argued that the gains from the spread of innovation and new technology would tend to be and stay in developed countries and regions, excluding the less developed from modernisation of their economic structures and social welfare (Myrdal, 1957). They also were central to the thinking of UNCTAD.⁴

Structuralist theory also is consistent with the distinction of Nobel Prizewinner Jan Tinbergen between 'negative' and 'positive' integration.

Negative integration is not doing something previously done, i.e. not having internal tariffs or different external tariffs; not having indirect barriers to trade; not obstructing free movement of capital and labour; not having independent currencies; not having independence on borrowing or budget deficits, etc.

³ Bastien and Cardoso (2003) made this point well in stressing that Perroux's early work had been published in Portuguese in the 1930s and gained considerable resonance. See further Perroux (1936).

⁴ See inter alia UNCTAD (1985), including a contribution by this author.

Positive integration is adding what was not there before, e.g. creating common bargaining on trade in international organisations; a common agricultural or industrial policy; a joint approach to macroeconomic policy to achieve expanded mutual trade and employment, etc.

Tinbergen, like the structuralist school in Latin America, realised that unless there were offsetting policies, and especially policies for social redistribution, the effect would be to consign the weaker countries and their poor to permanent exclusion from economic development and welfare. It was for this reason that he quantified and specified the official development assistance target then adopted by the UN, i.e. that the developed countries should transfer to the less developed at least 0.7% of their GDP.⁵

1.2. Negative and Positive Integration in the EU

Tinbergen's negative and positive integration distinction, entirely compatible with Latin American structuralism, also clearly is relevant directly to analysis of economic integration.

The initial experiment in the European Project, the European Coal and Steel Community, was both negative and positive: it forbade an array of actions by individual member states but also made major provisions for trades union involvement in closure decisions and unemployment compensation and retraining for the workers concerned.

The draft for the Rome Treaty – the Spaak Report for the Messina Conference of 1956 – was highly positive. It stressed that the freer working of the market between member states could aggravate structural, social and territorial disparities, and that the European Economic Community should adopt structural, social and regional policies to offset this. This was entirely consistent with the arguments of the Latin American structuralists.

But the Rome Treaty was overwhelmingly negative. It committed the six initial member states to abolish internal tariffs, abandon different external tariffs and capital controls, as well as liberalise flows of labour. Its Competition directorate from the start was powerful. The two other main common policies to which it committed the signatories were

⁵ A figure which he later was to assess to have been a considerable underestimate. See further Tinbergen (1992). Tinbergen's re-assessment is summarised in Holland (1994).

positive intervention in the case of agriculture, to protect the living standards of marginal farmers, and negative integration in the case of transport, i.e. abolishing different and especially subsidised freight rates in different countries.

In the sphere of trade, ‘negative’ integration dominated the European Project until the 1986 Single European Act, i.e. thirty years after the signature of the Rome Treaty. Common transport policy was useful but secondary.⁶ The only offsetting ‘positive’ integration institution until then was the European Investment Bank, which had a remit to promote regional development, plus the adoption from the mid-1970s of regional criteria for spending by Structural Funds. Both, however, functioned mainly through assistance for infrastructural investments rather than investment in human resources.

1.3. Stages of Integration

The European Union followed five stages of integration: (1) a common external tariff, agreed by 1968; (2) a common internal market, only secured for some non-tariff barriers by 1992, and still contentious; (3) free movement of factors of production, realised for labour within a few years but still not entirely free for some forms of capital such as banking and insurance and, again, contentious; (4) an economic union, achieved by 1968 for agriculture and transport, but much more slowly for other sectors and still with no ‘common industrial policy’; (5) policies for economic and social cohesion since the commitment of the 1986 Single European Act to both social cohesion and the internal market as the ‘twin pillars’ of the Union; and (6) monetary union, achieved more than forty years after the signing of the Rome Treaty.

Some theorists of integration claimed that the progression of these stages would be cumulative, with ‘spillover’ from one stage to the next. The evidence is different.

⁶ More secondary than it might prove in Latin America. Far more important than harmonising transport rates has been the very slow progress in constructing trans-European transport networks. Only three of eleven decided in principle at Essen ten years ago have been completed.

1.4. Ends and Means

Until the Single European Act the integration process was broadly 'negative' and seen as such by a range of vested interests. The Delors White Paper of December 1993 was the first proposal from the Commission which gave substance to the cohesion aim of the Single European Act. It set the Union the objective of creating fifteen million jobs.

The underlying rationale of the Delors White Paper (Holland, 1993) was that, with technical progress, the free working of the market could not assure sufficient job creation to avoid social exclusion, and that the jobs could be created by three main public policies: (1) investment in the trans-European transport and telecommunications networks and in health, education, urban renewal and urban environment, to be financed by new Union Bonds; (2) more labour intensive employment in the social sphere to increase employment of teachers, health and social workers, enable a reduction of school and university class size, reduce hospital waiting lists and enhance social services; and (3) the right to negotiate the incidence or reduction of working time in return for 'continuous improvement' in methods of work organisation and in the quality of public services. This is consistent with the call of the Nice European Council for 'a dynamic welfare state'.

The terms of reference of the European Investment Bank were amended at the Luxembourg European Council to facilitate the first objective; the Essen European Council agreed the objective of more labour intensive employment in the social sector, i.e. more teachers and smaller classes in education and more workers and improved patient care in health. The Lisbon European Council also recommended the right of workers to gain a better balance of work and non-work time through Innovation Agreements.

These social objectives are ambitious, and certainly not yet realised. But the fact that they are committed as aims of the Union is central and vital to political cohesion for the European project. It is what makes it a union rather than a common market.

The Lisbon European Council re-stated the twin aims of competitiveness and full employment, and Prime Ministers Tony Blair and Durão Barroso in February 2003 called for an action programme to meet the 15 million job target within ten years. These are statements of intent. But they also are embodied both in Council decisions and in the Treaties of the Union. To the extent that they are not fulfilled, the Union is failing its own Treaty commitments.

1.5. Implications

The reason for a central role for common agricultural policy in the Rome Treaty was itself cohesion: on average one in four workers were engaged in agriculture at the time of the signature of the Treaty in 1957.

Rather than following the European model of starting with liberalisation of trade and factor movements, and only moving later to common policies, a Latin American Union could choose to move directly to defining policies evidently adding value to the member states in areas such as joint technology ventures and policies for economic and social cohesion.

This is not to neglect the importance of liberalising mutual trade in order to create economies of scale. But the concern with non-tariff policies, and the pursuit of competition policies, also could be qualified by concern for economic and social cohesion.⁷

Part 2. Politics

As is well known, the initial force for European economic union was political. At the time of the signature of the Coal and Steel Community's Paris Treaty in 1952, in the words of Robert Schuman, the aim was to seek to ensure that another war between France and Germany would be "not only morally unthinkable but materially impossible". In reality, such an agreement existed between French and German electricity companies before WW2, for power sharing on adjacent political grids. It did not stop the war. But it was respected. When the German assault destroyed sections of the grid in France, the French engineers asked for, and gained, more power from their German colleagues. Moreover, arguably, the ambition to avoid a future war between France and Germany – unlikely in any event during the Cold War – led to a 'false start' for European union. This related especially to the initial design of European institutions outlined in this paper.

⁷ See further below.

2.1. Agenda for Union

From the 1960s, there was the concern to create a sufficient internal market to be able to respond to ‘the American Challenge’ in modern and advanced technology, which influenced the economic and political strategy of France and the 2nd British application to join the then European Economic Community. This was influenced by Jean Servan-Schreiber’s thesis of the ‘American Challenge’, that without a large internal market the world’s second modern industrial power shortly would not be Europe but American industry in Europe. But the driver alone was not enough. The thesis influenced the proposal of a common industrial policy and a common European statute for companies, and that for a European Technology Community, but none of them were realised. The Internal Market achieved with much fanfare by 1992 was supposed to have been achieved by 1968.

From the seventies the political agenda was enlargement rather than deepening the Union. Progressively, this increased the number of member states from 6 to 15, including the former European Free Trade area countries, Greece and Spain. Monetary Union was more a political than economic ambition, widely considered premature when first proposed in 1972, and opposed by the Bundesbank, and much German public opinion, throughout the thirty years it took thereafter to realise. From the fall of the Berlin Wall, the political agenda again became enlargement, to include the former Soviet bloc countries of central Europe. This took some 15 years to realise – a delay which aroused considerable cynicism among the would-be Accession states, most of which were treated as supplicants rather than applicants during the negotiation period. The agenda for a Social Europe was included with the ‘social chapter’ in the Maastricht Treaty, its instruments have been well developed since, but its practice is still marginal despite economic and social cohesion being one of the two ‘pillars’ of the 1986 Single European Act.

2.2. Political Institutions

The key decision-making body in the European Project is the European Council, i.e. heads of state or heads of government. It is serviced by its own secretariat.

The initiative for policies nonetheless came from the European Commission. This was modelled on the French Commissariat au Plan, set up by Jean Monnet with De Gaulle’s

support after WW2. It had exclusive power of initiative both in proposals to the European Council and to individual Councils of Ministers for Agriculture, Transport, etc.

According to the Rome Treaty, the European Council could only amend proposals put to it by the Commission, and do so on a unanimous counter-proposal: i.e. all member states had to agree a proposed amendment to the Commission. And the Council itself was supposed to take most decisions from 1966 by a qualified majority vote (QMV). Such a vote, weighted broadly by the population of the member states, was supposed to be binding on governments in the minority on such a vote.

A European Assembly was established in due course, but initially with only advisory powers. The status of the assembly later was raised to that of a parliament. And it now has powers of co-decision with the European Council, i.e. it can vote on certain Council decisions and must give a supporting vote before they become Union policy, with the status of Union law. But, unlike national parliaments, the European Parliament cannot initiate proposals for policies to the European Council or individual agriculture, transport, industry and environment councils.

Human rights have been central to the construction of postwar Europe, not least in view of their previous abuse.

Human rights, including ethnic and gender rights, are enshrined in the new Draft Constitution for Europe. Policies to offset racial and gender discrimination are pro-active rather than reactive. The rights themselves, as well known, are subject to jurisdiction by the European Court of Justice.

The Court of Justice also was empowered to decide on disputes in areas where common policies had been agreed.

Implications

A Latin American Union could have broadly similar institutions to those of the European Union. But it should be able to gain from its actual experience and practice rather than simply replicate their formal powers. For the following reasons, including not least the initial ‘false’ start for Europe.

2.3. Federalism and Confederalism

The ‘false start’ for Europe concerned the ambition to move straight to a supranational or federal union in which member states could be minoritised by qualified majority voting. This had been acceptable enough for coal and steel by the governments which signed the ECSC Treaty at the time, but was not later for Charles De Gaulle.

Qualified majority voting (QMV) has proved completely impractical, would have undermined the authority of national parliaments and governments, was blocked by De Gaulle’s withdrawing his ministers from the European Council in 1965, and has never been carried on any issue of ‘important national interest’ since the Luxembourg Compromise of January 1966. It never is used in the European Council of heads of state and prime ministers despite key Treaty provisions to do so, such as defining broad economic guidelines for the Union.

Qualified Majority Voting

So why are the architects of a New Europe planning to replicate qualified majority voting on a major scale in the Draft European Constitution?⁸ Should a Latin American Union do so?

One argument is that the sanction of calling for a qualified majority vote can gain a higher common denominator consensus than unanimity and also speed up progress on common policies. This is open to question. QMV was not used in determining the intervention prices, quotas or levies for the common agricultural policy where ministers created a special Agricultural Liaison committee to monitor and steer Commission proposals. Even in the case of the recent moderate agricultural reform, no vote was actually called, and the reform has taken decades despite agriculture nominally being subject to qualified majority voting since the 1960s. On one of the few recent occasions on which a QMV was called and votes cast by in any Council – the Large Combustion Plant Directive during the Finnish Presidency – it failed, twice, with the German and Danish ministers doing a walk-out and no common policy being agreed. On another, the call in November 2003 on a proposal from the

⁸ The European Convention. Proposal for a Treaty Establishing a Constitution for Europe. Brussels 18 July 03 CONV 850/03

Commission to censure France and Germany for exceeding the 3% budget deficits in the Maastricht Treaty criteria for monetary union, it failed again.

The claim that qualified majority voting has helped the construction of Europe is counterfactual. De Gaulle quit the Community until gaining a national veto against qualified majority voting at Luxembourg. The veto was central to Harold Wilson's application to join the then EEC. Labour's application made the UK 'third try' more credible, thereby opening membership to most of EFTA. With the prospect of social cohesion as the 'twin pillar' of the Single European Act, continued respect for the veto also was central to Andreas Papandreu revoking the Hellenic Socialist Party's manifesto commitment to leave the European Community. Rather than qualified majority voting, De Gaulle's veto against it was vital first to maintaining a Community of Six, and then more than doubling it. Germany insisted on its own terms of reference for the creation of a European Central bank and the criteria for member states to qualify to join a single currency, i.e. a de facto veto on whether either would be realised. Then, again, the issue of which country has what share of votes in qualified majority voting obstructed agreement in December 2003 on a new Constitution for Europe, with both Spain and Poland then claiming that their share should be based on the earlier Nice European Council share, and therefore higher than that recommend in the Giscard d'Estaing Draft Constitution.

The argument for QMV that national sovereignty is outdated also is misplaced. The issue is not sovereignty but democracy. What is needed for both Europe and Latin America is a political mechanism which can reconcile national democracy with the construction of an economic and political union, and which safeguards the democratic right to consent to or dissent from specific policies, not least for smaller states.

Enabling Majority Voting

The probable answer for Europe, and worth considering for Latin America, is an Enabling Majority Vote, or EMV. Like a qualified majority vote or QMV, this would be weighted by population.⁹ Unlike QMV, however, it would bind only the member states voting for it. By not binding the minority, it would ensure that the authority of national parliaments

⁹ The weighting by population for Latin America, as for Europe, could be regressive. This would mean that larger states have more votes, but not in strict proportion to their greater population. Agreeing this balance clearly could be crucial to gaining consent of smaller states to such a union.

and governments is not undermined. It could reduce opposition to the union by respecting both the views of governments disagreeing with a particular policy and national parliaments. Unlike a QMV procedure in the European Union, which only ‘informs’ national parliaments, an EMV proposal could be voted on by them as well as the Parliament of a Latin American Union. If co-decision-making is considered desirable for a Latin American Union, the legitimacy of co-decision by its Council and the Parliament would be reinforced by respecting the rights of governments and national parliaments not supporting a proposal, especially those of smaller states.

Variable Geometry

Enabling majority voting would mean a variable geometry union for Latin America. This case has been opposed in Europe. But, in reality, Europe already has a variable geometry.

Not all member states have joined the single currency, and only some are in the Shengen agreement which allows cross-border movement without passport or customs controls (much as free movement obtains between states in the US). Most member states do not count borrowing from the European Investment Bank against their national debt although two do. Nor do all member states have to participate in closer cooperation on mutual defence capabilities or foreign peace-keeping initiatives (Article I-40, Draft Treaty). The UK for several years did not sign up to the Social Charter on trades union rights. All are central policy issues.

Enabling majority voting would advance what the European Union calls ‘enhanced cooperation’, i.e. some member states wanting to do something together without obliging all to do so. But enhanced cooperation in the EU is an ‘add on’. Only one third of member states need to agree such a policy as Shengen for it to become a recognised Union policy. It is not central to the construction of the European Union in the manner in which policies voted by a majority of states is supposed to be.

Both by carrying a majority of states in a union and not binding the minority, an enabling majority voting procedure would command political authority. It also would open rather than close doors. Governments not initially voting for a new policy could adopt it at a

later date. The later vote could amend it by enhanced majority consent, facilitating best practice.

Implications

Enabling majority voting would be both democratic and pragmatic, while votes for policies by a majority of states would ensure direction and design for a Latin American Union. Weighting of the majority votes by population, as in the EU, could be regressive, with bigger states not claiming a strict relation to total population. But the larger the Union the stronger the case for a simple majority of member states gaining an enabling majority vote for a common policy. If a smaller number of states wished to pursue a common policy, this could be on the basis of the 'enhanced cooperation' principle already adopted by the European Union.

A variable geometry union facilitated by enabling majority voting also could accelerate joint policies. In terms of the 'stages' of integration earlier outlined, it would mean that some countries could move to higher levels of integration or joint action than others without excluding them from joining the higher stage when they were ready to do so.

Minimal 'entry' conditions for the Union would be a customs union and free trade area. Without a customs union complementing internal free trade, origin and destination problems would cause problems for the free trade area, with imports coming through the country or countries with lower external tariffs unless there were specific exceptions on social grounds, which would mean continued border monitoring for the countries concerned.

Free movement of capital and labour also probably should be adopted by the Union, with the automatic right of residence and employment for its member states.

A political gesture such as recognising Latin American Union citizenship and issuing passports in the name of the Union as well as that of member states could be considered. This measure could do as much or more for the promotion of political cohesion as formal powers for the union's institutions. A Schengen in reverse for some member states, with their agreement, also could preserve customs and passport controls, and limit rights to residence, in cases concerning drug trafficking and other criminality.

2.4. Initiating Policy

Like its preoccupation – and rejection or avoidance – of qualified majority voting, another issue on which Europe has learned slowly, and with cost in terms of delay, is who can propose Union policy initiatives.

As indicated above, according to the 1957 Rome Treaty, all European initiatives were supposed to be formulated by the Commission. But, in practice, the European Commission proved for decades to be incapable of conceiving and promoting new initiatives. Virtually the only exception was the Commission Presidency of Jacques Delors and his project for the Union to create 15 million jobs.

The Single European Act, the first significant revision of the Rome Treaty, was proposed by the European Council, i.e. heads of state and government. The single European currency was proposed by the European Council as far back as the early 1970s and gave rise to the Werner report of 1972. The decision on the terms of reference of the European Central Bank and the criteria to be met for a single currency – not more than 3% budget deficits and 60% national debt as a share of national GDP – also were political. Both were insisted on by Germany.

Three further key initiatives in the European Union in the last ten years also came from the Council rather than the Commission.

The first concerned relaxing the provisions in the Maastricht Treaty that member states would not qualify to join the single currency if their debt levels were more than 60% of GDP. Three, spectacularly, did not. Greece had a debt level nearly double this and Italy a debt over 100% of GDP, followed closely by Belgium. Maastricht allowed that countries could join the single currency if they were making significant progress or were showing significant progress to the 60% level and both countries at the time made significant efforts by postponing certain expenditures to make sure they could do so. But this was less than 2% on a debt level double that formally allowed, i.e. near 120%.

The European Council simply ignored the scale of Greek and Italian debt and allowed them into the Euro. And they were right, not wrong, to do so. The debt provision was arbitrary, monetarist in its presumption that public borrowing ‘crowds’ out the private sector, and also ignored the most basic principle of public finance, which is that you have no problem

with a given debt level provided you can service it. The Council needed to act politically to get a critical mass of member states into the Europe, and did so.¹⁰

The second major initiative preceding the introduction of the Euro was not from the Commission but a proposal put to the Council by António Guterres, then Prime Minister of Portugal: i.e. that the Union should issue its own Euro Bonds through the European Investment Bank. The conceptual framework and practical precedent were that it was through the issue of Treasury Bonds that the United States financed the New Deal and its investment and job creation programmes (Holland, 1993). The decision in principle to proceed with the issue of Euro Bonds by the EIB was taken at the Luxembourg Council.

The third major Council decision preceding the introduction of the Euro, again proposed by António Guterres to the Council, was that the areas of investment undertaken by the EIB should be extended to include health, education, urban regeneration and urban renewal. This was outlined by the Amsterdam Special Action Programme and decided on at the Luxembourg Council.

2.5. General Implications

A Latin American Union could be advised to enable the Council of Ministers to initiate proposals rather than allow a monopoly of such initiation to a Commission or Secretariat. It could both retain policy initiation for itself and allow policy initiatives to be proposed by the Assembly or Parliament of a union and an Economic and Social Committee composed of representatives of the social partners.

Neither the process of co-decision by the European Council and the Parliament nor the power of initiative was in the initial terms of reference for a European Assembly, which was limited to formulating Opinions. The EU Economic and Social Committee does not have the right to propose initiatives, but probably should do so.

Allowing for the fact that an entirely new Union needs coherence, it could be that its Council should retain the right to decision-making for some years with the request of Opinions from its Parliament and an Economic and Social Committee. But the right to make

¹⁰ As it happens, the Italian national debt also was precautionary saving. There is virtually no company provision for pensions in Italy. Most citizens buy state bonds to finance their retirement.

proposals for decision-making to the Council by a Parliament and an Economic and Social Committee reinforces pluralism without compromising coherence, as does the right of national parliaments to vote on enabling majority vote proposals and not to be bound by them.

The Draft Treaty for a European Constitution about to be considered by the Inter-Governmental Conference of heads of state and government now recognises that the European Council may propose policies on its own account. It is a late coincidence of Cartesian design and common sense.

Part 3. Economy and Environment

3.1. Competition Policy

Both competition and the chance to gain economies of scale are central to the case for creating a common market, and the powers of the Competition Directorate of the European Commission are considerable.

However, non-tariff policies such as national public purchasing and state aids to companies were not addressed by the EU until 1986 and not all resolved by 1992. Member states were concerned to avoid closures and structural unemployment, and to retain national or local instruments for promoting economic efficiency and social cohesion.

This still is the case with the support of the German government for the role of public regional banks. Also, the French government has justified its recent increases in its holdings in Alstom, its high speed train producer, on the grounds that the external effects of its closure would negatively affect both other companies and the banking system and be socially and politically unacceptable.

Balancing Public and Private Interests

The issue here, only now being confronted, is the relative balance of public and private power. The Rome Treaty was very explicit on not allowing state aids other than for regional development on the grounds that such aids would distort trade. But it said nothing on public enterprise, not least because state holdings and nationalised industries played a key role in both regional and industrial policy in countries such as Italy and France.

What has happened in competition policy since the Single European Act and the 1992 'Single Market' programme has been more concern with non-tariff barriers to trade. The result has been a tendency for the Competition Directorate to presume that public enterprise should behave like private enterprise. But the Treaty provisions are ambiguous in this regard, which is one reason why the French and German governments are resisting this interpretation.

A key related issue is externalities, as indicated by the French government's justification of its intervention to safeguard Alstom. Externalities, rather than internal profit and loss, are recognised in the infrastructure and social investment programmes of the European Investment Bank, assistance to small and medium firms through the European Investment Fund, and in the whole range of policies for public grants through the Union's Structural and Social Funds to less developed regions. Externalities in the sense that either firms or individuals may not be able to help themselves gain finance market access or access to jobs is the central theme of policies for economic and social cohesion.

Implications

Dislocation of entire sectors of activity in some member states as a result of the creation of a Latin American union would be counterproductive.

Competition policy could be shaped from the start in a manner which enabled considerable periods of transition for traditional industries, and much more concern than until lately shown in the European Union with 'positive' policies to enable traditional industries and their employees to diversify their skills and products in a manner which could both promote cohesion and avoid the dominance of 'negative integration'.

It also could be that public intervention to assist companies should not be disallowed from the start but judged in terms of its social effects: e.g. a cohesion exemption on grounds of public interest. This could be transitional and subject to review, for instance, within ten years, which still would be only a third as long as it took the EU to address non-tariff barriers to trade.

The cohesion clause also could avoid the presumption that there always is a coincidence between private and public interests. Private enterprise is notably averse to long-term investments, which take time to show returns, such as investment in underground

or metro systems, or long distance high speed rail links. There should be no presumption for or against public or private enterprise.

If such a cohesion public interest clause were to be introduced in a treaty for a Latin American Union, it also is possible that appeals for or against its application should be assessed by an Economic and Social Tribunal which had the professional competence to assess cost benefit analyses of the issues in question. The Tribunal could be a division of the union's Court of Justice, as could a Human Rights division.

3.2. Industry

The Failure of an EU Common Industrial Policy

For more than 40 years the European Union has failed to achieve a common industrial policy. The reasons again relate to the initial 'false start' ambition to be federal rather than confederal.

This was most clear in the proposal, in the mid-1960s, from the European Commission for a European Company Statute which would have supranational status. The Commission proposal would have meant that all companies which were multinational or transnational within the Union would pay their corporate tax to the Commission, which then, in principle, would expand its own resources for policies proposed by it to the European Council.

De Gaulle blocked this with the Luxembourg veto. Many French companies already had transnational strategic alliances or joint ventures with companies in other member states. It also was well appreciated in France that such transnational alliances were vital to assuring the global competitiveness of French companies. Alstom, the case of a current dispute between France and the Commission, and the producer of the TGV high-speed train and rolling stock, currently has only one-fifth of its employment in France. But to deny France the revenues from corporation tax paid by its companies was unacceptable. Similar reasons would readily be available to potential members of a Latin American economic union.

The Failure of a Technology Community

The 2nd British application to join the then European Economic Community was based on (1) acceptance of the Luxembourg veto on qualified majority voting in the Council and (2) the proposal of a European Technology Community which, unlike the EEC, would be open to those who wished to participate rather than bound by majority voting.

President De Gaulle vetoed this 2nd UK application on two grounds. First, that it was not clear that the UK had decisively opted for a new special relationship with Europe rather than continuing its special relationship with the US. Second, that technology joint ventures could be achieved without the formality of a Technology Community. The real reason under the second heading, however, was that the then British Prime Minister would not follow through on the initial opening made to De Gaulle that there would be technology cooperation on projects which the French at the time could only with difficulty finance: Plan Calcul, the jet fighter Force de Frappe, the Diamant satellite launcher, TGV, a bigger, cleaner and quieter Concorde II, etc.¹¹

Technology Research and Networking

An area in which a Latin American Technology Union or Technology Programme could make significant advance is in joint technology research. This is the basis of the so-called Framework Programmes, i.e. Framework Programmes on Science and Technology, within the European Union.

Since the Fourth Framework Programme there has been a provision that all projects should be networked and include at least one partner from the least developed regions in the Union (Schedule 1 Regions). This has proved one of the most effective instruments of regional development within the Union. It enables universities, research establishments or regional development agencies in the least (and less) developed regions to participate in

¹¹ I personally set this agenda and discussed it as the basis for the 2nd UK application with Louis Joxe, then French Minister of the Interior, in 1967, on behalf of Harold Wilson. Before I left Paris, De Gaulle agreed to it as the basis of a tour of European capitals by Harold Wilson and then Foreign Minister George Brown to prepare the basis for formal negotiations. But, despite requests within even the last days of the last month before they visited Paris, Wilson would not agree to specify the areas of cooperation which I had prepared rather than claim that there should first be agreement on a Technology Community and then a specific agenda. He knew that De Gaulle was likely to reject this, which suited his own UK domestic agenda. I.e. Wilson allowed me to open up the prospect of negotiations to appease the pro-European Right of the Labour Party, while allowing them not to begin to placate the anti-European Labour Party Left. Some of the detail on this is shortly to appear in the UK official history of the 2nd British application, being prepared by professor Alan Milward.

advancing the ‘innovation frontier’ of the Union. The qualification is that many of the projects only reach design stage. In the 4th Framework Programme some 800 projects never proceeded beyond prototypes and therefore never created a new small firm or new job.

The EU thereby has failed to realise one of the main objectives of networking as advocated at the time of the 4th Framework Programme, i.e. to enable small firms to gain key features of larger transnational companies without themselves needing first to become large firms.

Implications

Rather than frustrate a Common Industrial Policy by aiming to make it supranational, as the EEC did, a Latin American Union could focus it on joint development of new technology. This could be on a variable geometry basis. Or it might be known as a Technology Union.

If half or more of the member states were to agree its principles, these could be agreed by an enabling majority vote. If less than half, by ‘enhanced cooperation’. Such de facto enhanced cooperation has been the basis on which several European aircraft companies have participated in the Airbus programme, which, of course, has managed to achieve parity in sales with Boeing.

Joint technology ventures therefore would be on a variable geometry basis. The variation also could include states outside the union with relevant technology to offer, or develop, as in aerospace and satellite launching. The former Soviet ‘science cities’ have much to offer in this regard as well as in seismic protection, high temperature treatment of waste, water purification and environmental cleansing.

Joint procurement programmes would contribute to the creation of an internal market for advanced industrial and technology joint ventures. This is the basis, and precedent, on which member states of the EU can ‘opt in’ for joint Defence Development and Procurement.

In particular, a Latin American Union should seek to avoid the undue focus on research rather than development which has been evident from some of the EU’s Framework Programmes for Science and Technology. The Lisbon European Council three years ago addressed this problem by calling for more cooperation between the Commission, the

European Investment Bank and the European Investment Fund. This cooperation has just started.

If it is to achieve the aim of networking smaller and especially medium firms in different member states to help them gain transnational experience and scope, a Latin American Union would need to be much more pro-active in relating the outcome of research programmes to the development of new small and medium firms – or joint ventures by larger firms – which can prototype and market such technology. In this context, it could move sooner to equity guarantee and provision for small and medium firms than did the European Union.¹²

3.3. Agriculture

High price support for agriculture through the Common Agricultural Policy was the joint condition – with the Luxembourg veto on qualified majority voting – for De Gaulle keeping France in the EEC.

Scope and Limits of a Price Support Policy

Price support policies were understandable at the time of agreement of the policy. In the year in which the original six member states agreed the Rome Treaty – 1957 – one in four of their workforce still was employed in agriculture. A more specific production grants or income support policy would have involved a vast administrative apparatus.

Latin America could in principle agree a common price support policy for agriculture. But it will be costly and inflexible. And the ‘ratchet’ effect will be considerable.

For instance, in 1966 I was asked to advise and accompany the then economic adviser to the British Chancellor of the Exchequer, Nicholas Kaldor, to a workshop in Paris on agriculture organised by Pierre Uri, one of the three authors of the Spaak report, and a strong supporter of British entry into the then common market. The emerging view was that the initial agricultural price support levels due to be agreed within two years would be very high,

¹² See further the following section on the European Investment Fund.

but that there was a cohesion need to assure sufficient subsistence income with a minimum of dignity for 'marginal' farmers, i.e. those on the least productive land.

The common presumption also was that the working population in agriculture would reduce fast as parents stayed to gain the price and therefore implicit income support, but the young left for the towns. The emerging problem was that the young left for the towns but retained the land and therefore the right to price support for surplus produce.

Therefore, in the EU, the grandchildren of agricultural workers have become professional architects, engineers, etc. This is excellent in terms of social mobility, and would be excellent also if the same could be achieved within two generations in Latin America. But not as a justification for professionals not directly involved in agriculture to gain price support for the output of family smallholdings indefinitely.

A Latin American union might learn from European experience by distinguishing between support levels for those persons fully engaged in agriculture and those not so engaged. The policy also might relate price support for output inversely to the scale of landholdings.

With the reduction of working population in agriculture to less than 4% in the present Union of 15 member states, a production and income support policy nonetheless has become viable, and has recently been adopted.

An Income Support Policy

Arguably a Latin American Union could replicate and justify to the WTO support for farmers through a common agricultural policy modelled on the CAP, beginning with price support and then moving to a production grants and farm income support policy. This of course could be justified also by similar precedents in US support for its farmers. Argued jointly through a union, the policy would have more effect than argued singly. A union also would increase the leverage for reciprocity in liberalisation of agricultural trade with the EU.

Despite the size and share of working population in agriculture in some Latin American countries, the policy nonetheless could aim to be on the social equity basis of determining the subsistence income needed for small self-employed farmers to support themselves and their families. Unlike banking or financial services or transfer pricing by

multinational companies, there is little scope for subsistence farmers to disguise the conditions of their existence.

Besides which, as evident in most countries, rapid urbanisation attracts the young off the land and out of agriculture. The share of working population in agriculture in Latin America will continue to decline.

A Latin American Union also could pay more attention to the regional cohesion implications of a common agricultural policy than has the EU. Because the highest price support systems were for wheat, meat and milk products, this favoured the already higher income of more developed areas of the Union.

By contrast, an income support policy would target the poorest workers in agriculture. It would be liable to some or considerable abuse. But the social objectives should remain paramount. An individual infraction of the criteria should be subject to assessment and also understanding. In the developed countries it is common for single mothers living on state benefits to work in the informal sector. They are aware that they are breaking the rules but their aim is less to cheat than to maximise within the limits of their own capacities the welfare of their children.

Similarly, in Latin America, a major policy for income support in agriculture would be abused. This is inevitable. The question is partly by whom, and whether this is a major economic issue. In the case of systemic abuse by people professionally abusing the system on their own behalf, and therefore exploiting others, the penalties should be severe. But the key issue is to get income raised in agriculture to permit a basic or base plus level of dignity to those who work in agriculture. Indirectly, in cost benefit terms, and to the degree that income levels are raised in agriculture which encourages at least some of the young not to migrate to cities, the gains are both micro and macroeconomic.

Land Leasing

One of the main failures of liberalisation and privatisation of agriculture in the ex-Soviet Union and its satellite states was the inability to recognise the degree to which the resulting smallholdings would be economically inefficient.

By contrast, in China, after attempting collectivisation, which lowered personal motivation and efficiency, the government promoted a policy of encouraging peasants to lease their land to more efficient managers. This freed the owners to take other part-time or full-time jobs in the local area or elsewhere. It also worked for two other reasons. First, the managers bidding for the contracts had to demonstrate that they could be efficient. Second, the peasants who individually or jointly leased to others were able to retain the ownership of their land. In a country where 100 million people recently have moved out of agriculture towards local towns or cities, the significance of this cannot be underestimated. In so moving they took risks. By moving they had no right to pensioned income. They risked their own futures and those of their families by doing so. But, psychologically, they still had their land, the dignity associated with ownership, and the option of retiring to the land to survive on subsistence farming rather than producing a surplus, if all else went wrong.¹³

Latin American countries could well consider this leasing model, and its relevance, in some detail.

Priority Support for Cooperative Solutions

Also, as the close attention to these issues in the EU member states testifies, both support for income levels in agriculture and effective mechanisms for cooperative processing and distribution are essential to success.

Agricultural cooperatives are common in continental European agriculture, especially in Italy and France. These share equipment which only is occasionally used, storage and processing facilities, supervisors of quality standards, transport to markets and also brand names.

All are important. Sharing of equipment, common storage and processing, and quality control, as well as effective distribution to markets, are necessary conditions for success. But joint brand names in marketing are not the least. Lurpack is a brand name for butter found throughout the EU. Anchor is a brand name for a host of New Zealand farmers. Joint transport of commonly branded products can achieve economies of scale out of the reach of peasant farmers who otherwise only can hope to sell on local markets.

¹³ See further Zhou (2001).

Implications

First, it may be unfeasible for Latin America to move in the near future to price support policy for agricultural products simply because of the scale of the fiscal resources implied. It also may be undesirable. The ratchet effect in Europe has meant that such income support still absorbs 40% of the total budget of the European Union, despite the fact that working population in agriculture is only 4% of total working population.

Second, an income support policy, consistent with that already adopted by Brazil under the Presidency of Lula da Silva, is far preferable. It not only means an income redistribution shift to those who most need it, but also means that, as there is social progress with the young moving out of agriculture, the resources available are more focussed on the poor within it than on them.

Third, the leasing formula should be seriously considered. Farmers with an efficiency record should be able to make bids to lease land. The elderly who can no longer cope, and the young who do not wish to do so, could lease the land in this manner without risking their own minimum income, for the elderly, or their safeguard of basic income for those who may not succeed on leaving the land.

Fourth, the cooperative option should be seriously considered and developed as a joint cohesion policy for the member states concerned. It not only spreads costs for the producers. It also is more efficient for society as a whole.

3.4. Environment

The common agricultural policy in the EU has only recently taken account of the environment by undertaking to pay farmers for taking land out of production while paying them also to supervise its protection.

Preservation

A Latin American Union could be more concerned with the environment from the start. This could concern agricultural policy, but also clearly implies the issue of preservation of the rain forest. Governments elsewhere have tended to have double standards in this regard.

The rain forests oxygenate the rest of the world, but the rest of the world has tended to treat this as a free good.

Through a union with a common environment policy, Latin American states could gain leverage for an international 'environment levy' for preservation of the rain forest. Kyoto is blocked by the US at inter-governmental level but such a policy could gain significant support from individual countries, and cities, in both Europe and the US. The concept of a voluntary local 'environment levy' for rain forest countries in Latin America and elsewhere is consistent with both Kyoto 'top level' and the Porto Alegre 'lower up' action agendas.

Urban Environment

Inter-city action also is feasible in terms of the urban environment. This concerns not only emissions from power plant but also from traffic, which constitute more than half of total global emissions

In Europe, the Alternative Traffic in Towns or Alter project, launched by the UK government during the 1998 British Presidency of the European Council, mobilised 120 cities including half the capitals of the EU to support three objectives: clean renewal of their own vehicles, conversion where feasible to cleaner fuels and the introduction and progressive extension of low emission zones. The aim of the project was to demonstrate the commitment to cleaner vehicles on such a scale that producers would be able to justify their production in volume rather than as prototypes or for niche markets.

The commitment of the cities has not been matched by the institutions of the EU. The European Commission rejected funding for urban low emissions zones submitted within the Alter cities network by Athens, Barcelona, Lisbon, London and Stockholm on the grounds that these cities probably would pursue such policies without its assistance.

Brazil has been in the forefront of addressing such issues, especially in terms of alcohol from sugar cane. A Latin American Union, with a common environment policy, could include cities willing to pursue an Alternative Traffic agenda, and link with the European cities already committed to it.

Civic Globalisation

A Latin American Union could in this regard act as a catalyst not only for those of its own cities which wished to participate, but also for cities in Europe and elsewhere in the world. By so doing, it would counter corporate globalisation by civic globalisation. Again, this appears entirely consistent with the Porto Alegre agenda.

Part 4. Economic and Social Cohesion

4.1. Social Partnership

Social partnership is central to the model of the European Union. Both trades unions and industry are represented on the Economic and Social Committee. This has only consultative status, as does the Committee of the Regions and Local Government.

The Union encourages worker participation in decision-making through the Works Councils directive, which applies for larger firms. This, and the Social Charter incorporating the right to trades union representation, have been embodied in the Treaties since Maastricht, and now have been agreed by the UK government.

Also, during his Presidency of the Commission, Jacques Delors gained agreement through to so-called Val Duchesse framework that any initiative jointly agreed by the European Trades Union Confederation and the European Employers' Federation would be agreed by the Commission. This de facto widened the right of initiative in making policy proposals to include the Social Partners.

Further, the Lisbon 2000 European Council recommended the adoption of Innovation Agreements between the social partners at enterprise and organisation level. This was in the context of seeking to gain innovation in methods of work organisation or flexibility-by-consent between trades unions and management in both the private and public sectors, including public administration.

The trade-off for agreement to more flexible work practices was the recommendation of the right of workers to gain (1) negotiation of a better balance between work and non-work time, including especially the needs of families; (2) commitment to both learning from work and formal training and retraining.

Implications

A Latin American Union, unlike the EU, could give the right to an Economic and Social Committee to propose policy initiatives to the Latin American Council.

It also could match the Val Duchesse model introduced by Jacques Delors, by which the Social Partners of the union would have the right to agree policies which then would be adopted by the Latin American Council and serviced by its Secretariat or Commission.

4.2. Regional Policy

One of the key means of achieving cohesion, well recognised for decades by development economists in Latin America, and by UNECLA, and the decision to construct and move the capital of Brazil to Brasília, is the development of ‘growth poles’ to act as counters to out-migration from entire regions. The role of regional development banks clearly is central to this, as are regional development agencies fostering the growth of small and medium firms.

Regional Policy, without the title, was implicitly on the European Agenda at the time of the signature of the Rome Treaty in the form of a Protocol establishing the European Investment Bank, which had an obligation to contribute to regional development. The Bank was established on the insistence of the Italian government, which was concerned that the free movement of capital and market liberalisation would disadvantage the Mezzogiorno.

Following the Hague European Council, it was decided to establish a Regional Directorate of the European Commission. Starting from 1974, this scheduled different regions of the Union in terms of their average GDP per head and prioritised expenditures under Structural Funds for their development. The least developed regions were Schedule 1. Areas of special deprivation outside these regions were Schedule 2, etc.

The regional policy initially was concerned with infrastructure: roads, motorways, electrification, water supply and control. Where it was grant based it generated significant income and employment multiplier effects.

One of the lessons learned slowly by Europe has been that infrastructure, development banks and credit institutions are necessary but not sufficient conditions for regional development. Pro-active regional development agencies and finance to foster and support

success in small and medium firms also is vital, as is investment in the areas which most directly affect the lives of all people and their families, i.e. in health, education, urban renewal and the urban environment. This has been evident in a recent shift in focus of the activities of the European Investment Bank and the decision to establish a new European Investment Fund.

4.3. Structural, Social and Spatial Cohesion

Despite the existence from the start of the European Social Fund, it was only from the Greek Presidency of 1984, backed by the French Presidency in 1985, that the demand was made for cohesion in a wider sense to be made as central an objective for the Union as the realisation of a common market. This was embodied in the Single European Act of 1986, which made cohesion the ‘twin pillar’ of the Union with the Single Market.

As outlined initially, in the context of the relevance to Europe of the structuralist debate in Latin America, cohesion itself also was redefined as economic, social and spatial. The conceptual framework, reflected now in the Social Fund, is that cohesion concerns what is done, by whom and where. It is not simply a matter of special programmes for lesser developed regions but central to the concept and policies of the Union. It embodies at Union level what elsewhere is widely recognised as the ‘Social Europe’ model.

This is especially the case in the new remit of the European Central Bank to promote investment in the spheres of health, education, urban renewal and urban environment. The Bank has from the start had a special remit to promote regional development, which remains. But it can undertake investment in these social spheres in any part of the Union, and is doing so.

4.4. Human Resource Development

A Social Fund was established by the Rome Treaty, but initially reactive to closures rather than pro-active in job creation. The Fund also concerned itself with training. However, experience shows that access to formal training alone is not enough to offset social exclusion. Not least, many of the socially excluded lacked school qualifications and had a negative schooling experience. Returning to classes for formal training could not overcome this.

With a more pro-active focus, following the Delors White 1993 Paper on Growth, Competitiveness and Employment, a new Objective 3 of the Structural Funds was introduced for investment in people, and especially the socially excluded. Several of these policies have merit.

Identifying Informal Skills

One of the new policies – ADAPT – sought to identify sources of employment implicit in people's own informal life experience. This meant identifying what they already could do well and seeking to extend it by 'customised' formal training, rather than training them to do something which they had never done.

The Lisbon European Council stressed the importance of lifelong learning and, as an outcome, the Union has committed itself to the principle of a European Certificate of Informal Learning which either can gain the person access to a customised training course or a recommendation for employment.

The methodology and architecture, developed by a four country prototype project led by the University of Coimbra, interviews people in an informal environment with the aim of identifying tacit knowledge, latent abilities and informal skills. These then are coded for consistency, with a resulting skills and personality assessment.

The method is robust and the outcome positive. The Hungarian Ministry of Education wants to extend it to the whole country, including Romanies, without waiting for its adoption by all member states.

The method is being applied also to revaluing informal skills – for learning-from-life and learning-from-work – in the largest bank and largest teaching hospital in Portugal. In Brazil there is strong interest from the State Government and State University of Ceará (Oliveira and Holland, 2003).

Matching Latent Demand and Informal Skills

Another outcome of the change to more pro-active human resource policies was to match latent local demand for goods and services with local informal skills. Latent demand in this sense is what people want but the local market does not deliver. The method, engaged by

the Province of Massa Carrara in Tuscany, undertook interviews with young people, people with young children, the elderly, and local hotels to identify such latent demand. For the young, it was not only sport facilities but the demand for local teams and more organised leisure facilities. For parents, it was the lack of child care facilities. For the elderly, it was assistance with household repairs, assistance in shopping or visits to a doctor, etc.

In tourism, the enquiry found that northern Europeans, in particular, were interested in walking or riding, mountain bike trails, and sailing small boats or dinghies. None of these facilities were available in the area. They now are, with the externality also that the trails connect former farm or manor houses which have been rehabilitated as small posada type hotels and restaurants. Those using the trails know that only local food and wine will be offered and provided by those with local skills in viniculture and cooking. Some six hundred jobs were created, especially for young people and mid-life unemployed, in the local area.

4.5. Redistribution and Cohesion

Redistribution is implicit in the concept of cohesion. It also is effective in generating demand.

In this context, the proposal of the President of Brazil to create markets by redistribution of demand rather than simply integration of trade is highly significant. The point that economies of scale can be achieved by creating demand by social redistribution is unanswerable. Such demand for lower but rising income groups also can in many respects be met by local rather than national or other firms, thereby in turn promoting cohesion.

And Trade and GDP Growth

But redistribution also can contribute to recovery of trade outside the local area. For instance, a redistributive policy for raising effective real income of those with less than \$1200 and \$2000 per head per year – through local health, education and employment projects – was an integral part of a report on global development for Jacques Delors in 1994 (Holland, 1994).

An econometric exercise for this report demonstrated that directly and indirectly raising incomes by such policies not only benefited the socially excluded but could over 5

years increase Latin American GDP by 15%. The policy would increase Latin American imports, but also exports to the region from the rest of the world.

Not least, reconsideration should be given, in the context of recovery by redistribution, to the degree to which most of the trade of the largest country in the region, and much trade by potential member states of a Latin American Union, is internal rather than external. Brazil, in this case, compares with the United States and the European Union, where only some 5%-6% of trade is external.

Implications

The interested member states could make both cohesion and a single market the twin pillars of a Latin American Union from the start, rather than waiting 30 years to do so, as did the European Union.

Clearly both would be objectives realised only gradually over time. A Technology Community or Union would enhance the single market. Social investment in health, education, low cost housing, sanitation and water supply would enhance cohesion. Identifying informal skills and latent demand, and matching local skills to local supply of new services, would not only increase income for the socially excluded but within the economies as a whole.

Part 5. Financial Instruments

5.1. The European Investment Bank

At more than €40 billions, EIB lending already is bigger than that of the World Bank. But it is less its size than its changing role which is significant.

Union Bonds and US Treasury Bonds

The Delors White Paper of December 1993 both recommended the 15 million job creation strategy outlined above, and that the European Union should issue its own bonds. The fact that US Treasury Bonds do not count on the debt of individual states such as California or Delaware, was the model for the Euro Bonds now issued by the EIB.

Financing Social Investment

As indicated above, the European Investment Bank, like the World Bank, operated for decades in the finance mainly of physical infrastructure projects. However, the Luxembourg European Council in 1997 remitted the EIB to invest in health, education, urban renewal, including low-cost housing, and urban development. With social security, these are the main areas of national government borrowing, investment and debt servicing. EIB finance in these areas can promote social investment led recovery. The needs are vast and the macroeconomic potential real.

As a public multilateral agency owned and controlled by the member states of the Union rather than the Commission, the EIB is highly credit worthy. It also is highly cost-effective. Being non-profit, it on-lends at a fractional administrative cost over and above LIBOR and can do so for 30 years or more. It also can finance both sides of public private partnerships, directly through its own lending and indirectly through lending to private intermediaries.

5.2. The European Investment Fund

The European Investment Fund was established as an outcome of the Delors 1993 White Paper on Growth, Competitiveness and Employment.

Venture Capital for Small and Medium Firms

The Fund offers guarantees for venture capital for small and medium firms. These operations are not yet significant in macroeconomic terms. Its total portfolio guarantees are only some €7 billion. But the Fund plays a key role, as a public institution of the Union, in facilitating the start-up and growth of small firms. Its status as a Union financial instrument has allowed it AAA rating, like the European Investment Bank.

The Fund does not directly offer equity to firms, but guarantees equity taken by other financial intermediaries. Remarkably, the Fund nonetheless is so low profile as not yet to feature in the Draft Constitution for Europe.

5.3. The European Central Bank and Monetary Union

The adoption of a ‘one size fits all’ Eurozone has been criticised as reducing German and European growth. In fact there are other reasons. But, without doubt, the Maastricht debt and deficit criteria are deflationary. The Growth and Stability Pact recently has given less growth than stability. Both France and Germany currently are in breach of these stability conditions.

Yet, as would be relevant for a single currency adopted in due course by some or more states in a Latin American economic union, because of the scale and strength of the Eurozone, the Union can fulfil policies for economic and social cohesion without provoking the foreign exchange speculation which caused the UK government in the 1960s and 1970s and France in the 1980s to put defence of the currency before social investment and welfare.

Also, in the debate on the Growth and Stability Pact in most of the press and media, it is overlooked that the European Central Bank has an obligation to support the economic policies of the member states and of the Union.

The European Council, by article 103.2 of the Treaty of Maastricht, can specify ‘broad economic guidelines’. These can include both growth and employment.

Support for Economic Guidelines

By article 105.1 – Article 1-29.2 of the Draft Constitution – the European Central Bank has an obligation to support these guidelines. It must do so without prejudice to its obligation to protect the internal and external value of the currency. But, since the Rome Treaty, and article 2 of all subsequent Treaties, the Union has been committed to achieve “continuous and balanced expansion, an increase in stability and an accelerated raising of employment and the standard of living”.

These issues are not resolved in the EU. It only is beginning to be appreciated by some member states that while the European Central Bank is the guardian of price stability, the European Investment Bank can be the safeguard of growth.

It also has taken time for it to be appreciated by some member states that borrowing by the EIB and on-lending to national investment projects makes it feasible for member states to reduce national debt and its servicing from taxation, and observe the Maastricht national

budget limits as social investment costs are transferred to a European ‘PSBR’, i.e. the current borrowing of the EIB.

Alternative Stability and Growth Criteria

Price stability is vital for Latin America. But so is growth and development. If it is to avoid a European Central Bank model of implicit deflation, compounded that encouraged by the IMF, it arguably should choose alternative criteria for a single currency.

For instance, in contrast with the mandate of the European Central Bank to balance growth and inflation, the Federal Reserve Board in the US has a responsibility to balance growth, inflation and employment. In contrast again, also, the federal government has no percentage limits for deficit or debt levels which it has to respect.

Implications

In terms of financial instruments and institutions it should be evident that there are precedents in the roles of the European Investment Bank, the European Investment Fund and the terms of reference of the European Central Bank which are relevant to consideration of similar financial institutions and agencies by a Latin American Economic Union.

Granted the degree to which the prospect of such a union advancing to a single currency for some member states is an issue for the longer term, the changed role of the European Investment Bank and the relatively new European Investment Fund may be of particular interest. Both already play significant roles in policies for growth, competitiveness and cohesion, as intended in the design of the Delors 1993 White Paper.

Notably, it is accepted by the IMF that member states’ drawings from the European Investment Bank need not count on their national debt. This provision predated the establishment of a single currency.

The same could be the case for a Latin American Investment Bank whose principal members, as in the case of the EIB, would be the member states of the Latin American Union. While its role would complement that of the Inter–American Development Bank, it could take its own initiatives in areas such as investment in health, education, urban renewal and the urban environment.

A Latin American Investment Bank could parallel the EIB in both funding Trans-Latin American (telecommunications and transport) Networks and investments in health, education, urban renewal (including low-cost housing, sanitation and power supply) and urban environment.

Part 6. Monetary and Fiscal Policy

6.1. Monetary Policy and Development

As a public multilateral agency, there is no reason in principle why a Latin American Investment Bank modelled on the EIB should not be able to grant loans for such social and infrastructural investment, long-term, and at low interest rates.¹⁴

The point is simple but clearly also central to avoiding the inhibition of investment, not least in industry, but also in housing, by high interest rates in individual countries which have liberalised their foreign exchange but not satisfied foreign exchange markets. A Latin American Investment Bank also does not depend on parallel or prior creation of a single currency.

What it could depend on is governments being prepared to make finance for such an EIB modelled Latin American Investment Bank available as its equity capital and as loan capital.

Normally, multilateral institutions do not call on member states actually to pay equity or reserve capital up front. The presumption is that it is there if needed, on call. Also, in the case of the EIB, it is not governments which provide the finance. Its credit rating, like that of the EIF, is sufficient for the Bank to attract private investment funds from the market, not least from pension funds.

In the case of a Latin American Investment Bank, it nonetheless would be open to the union both to fund the equity capital and a share of the on-lending.

The presumption of the US administration may be that there is no case for such a new institution in view of the existence of the Inter-American Development Bank. But the

¹⁴ The EIB can lend for up to thirty years and do so, as a nonprofit-making public institution, at a fractional administration cost.

presumption of other multilateral financial institutions could be different. The World Bank could advocate the case. IDA could be involved. This could especially be the case in the degree to which they recognise the counterpart of the commitment of the member states of the union to co-finance both development and social cohesion.

Otherwise, the European Union also could itself choose to act in co-financing the Bank, or, at less direct cost, guaranteeing a share of its equity. This would considerably increase the feasibility of the Bank achieving the kind of credit rating needed to attract private sector purchase of its bonds.

6.2. Differential Interest Rates

Differential interest rates are widespread throughout the developed countries. Among the clearest examples are the interest rate incentives given by many or most regional development agencies to small and medium firms or interest rate reductions on borrowing for larger firms choosing to locate in development areas.

Fiscal discounts much greater than interest rate reductions have been given by most European governments in the form of regional development grants. For instance, the Cassa per il Mezzogiorno gave regional investment grants of 20% or more, with a Protocol permitting this in the Rome Treaty. France has given such grants. Britain did so up to 40%. This is nearly double what the differential between current Brazilian interest rates and those feasible for a Latin American Investment Bank could be.

There may be a question of the opportunity cost for national governments of making investment funds available to a Latin American Investment Bank rather than placing them on its own higher interest earning financial markets. But, though likely to occur, the question is marginal to the main case. A national government placing such funds would both need borrowers at the higher interest rate and face the same exchange rate risk as has caused interest rates to be higher nationally in the first place.

6.3. Fiscal Policy

The term fiscal policy is loosely used by economists claiming more precision than other social scientists. It sometimes includes interest rate policy. In this section the term is used in the original Latin sense of taxation.

Differential Taxes

The main point in this context is well appreciated by specialists but less evident to the public. There is no need for an economic union to harmonise all taxes.

This is evident in the United States, where local taxes differ considerably between states. These differentials also have a role in regional development. Delaware attracts some companies because its corporation tax is low. New York can charge higher corporation taxes because most companies wish to have offices in New York.

State taxes in the US also vary considerably. Lower income states charge less. Higher income states charge more. The Union has not disintegrated, nor been inhibited, because of differentials in corporate and local taxation.

The same goes for indirect taxes such as value added tax. These vary widely in the European Union without threatening the single currency or consumption. Again, there is a regional and cohesion factor. Value added tax can be higher in higher income countries than in lower income countries.

6.4. Monetary and Fiscal Policy and a Single Currency

The key criteria for a single currency are macroeconomic. No group of states can consider monetary union if the main economic indicators are seriously divergent. Such indicators include deficits, debt, inflation and exchange rates. These in turn are dependent on both stability and growth. But they also have to be understood in the context of both growth and stability.

The Maastricht Criteria

The Maastricht criteria insist on a 3% national limit to national budget deficits. The Commission some three years ago actually recommended ‘balanced budgets’, i.e. zero deficits.

This reasoning is monetarist. It presumes that public spending drains or ‘crowds out’ the private sector and that only stable money supply can counter inflation. ‘Crowding out’, explicitly endorsed by the European Commission, implies that there is a given sum of finance available for investment and that, if government takes it by tax and invests, this will crowd out the investment which the private sector otherwise would have undertaken. But this concept, again derived from Friedman, is far too simple. In particular, it

- focuses on the supply of money rather than the level of demand;
- ignores that private savers are averse to long-term investment with delayed returns;
- neglects the multiplication of private contracts, income and profits from public investment;
- presumes that economies already are operating at full employment.¹⁵

The Misplaced Rationale

The monetarist presumption against public borrowing and expenditures in the Maastricht criteria therefore presumes full employment and neglects the role of public recycling of savings into investment, or public spending, in promoting income, profits and employment in the private sector. This is the circularity of income and expenditure through multipliers, stressed by Keynes and denied by Milton Friedman. And the facts are on Keynes’s side. For instance, in health, there is not a hospital built, an operating theatre equipped, a ward serviced, or a drug prescribed which is not constructed, equipped, serviced or proscribed mainly or exclusively by private enterprise. Investment in health, or education, or urban renewal overwhelmingly generates income and profit for the private sector.

Borrowing to invest was the basis of modern economies. Investing savings was the basis of the Florentine development of modern banking. If all investment had to be financed from retained earnings, there could be no credit mechanism enabling expansion.

¹⁵ See further “Money and Monetarism”, ch. 7 (281–329), in Holland (1987b).

Borrowing to invest also was how the US democratic administration was able to finance the New Deal. If the New Deal had been financed by taxation rather than bond issues, this would have deepened the slump of the early 1930s before a recovery could have been achieved. Since savings are high in a recession, but investment demand low, savers have no outlet for investment unless a private sector recovery occurs spontaneously, or the governments offer bond issues which can finance public investment programmes.

6.4. Rigidity and Recession

For a monetary union to give itself rigid limits to budget deficits and debt is to risk recession. Both Germany and France recently have risked this not only for themselves but for the rest of Europe. Both are in excess of the Maastricht 3% budget and 60% debt limits. Both are in a head-to-head collision with the European Commission's rigid interpretation of the criteria.

If the European Union cannot exploit the new financial instruments at its disposal, and especially the fact that EIB borrowing and investment is not counted on national debt by 13 of its 15 member states, it could enter a decade of deflation as just witnessed by Japan. With a downturn in the US economy, this could condemn the world to the worst depression since the early 1930s.

Inflation

Latin America has had problems of hyperinflation. But so has Europe. Germany was subject to hyperinflation twice: after both the first and second world wars. The hyperinflation under the Weimar Republic, with mass unemployment in the early 1930s, were principal causes of the National Socialist seizure of power.

The second hyperinflation was after WW2, with a collapsed civil economy rather than growth. Growth only recovered with the combination of currency reform, the introduction of the Deutschmark, and the vast infrastructure and urban renewal programmes made possible by Marshall Aid.

Currency Stabilisation and Redistribution

The postwar 1948 currency reform in Germany also was redistributive. Reichsmarks could only be exchanged for Deutschmarks up to a given limit. Recent Germany monetary Union also was redistributive. The parity exchange of Ostmarks for Deutschmarks was not justified by any criterion of purchasing power parity. The decision, like that to create the European Union itself, was political. And, like the exception allowed to Greece, Italy and Belgium on debt nearly double the Maastricht criteria, justified.

Counterpart Funds and Investment

The difference between the first and second German currency reforms, after the war and after the fall of the wall, nonetheless were very clear. The 1948 currency reform was accompanied both by funds directly available through Marshall Aid in dollars, and indirectly through the counterpart funds by which Germany multiplied the effectiveness of that aid in local currency by up to a factor of 10 – similar to or better than normal banking debt-reserve ratios.

6.5. Deficits, Borrowing and Investment

The terms and conditions of monetary and fiscal policy for a single currency in the European Union already are under strain, are not being met by key countries, and may need to be revised.

Deficits

Deficits need to be understood and acted on in cyclical context. There is discussion in the EU now whether the 3% deficit limits should not be relaxed in the event that an economy has been threatened with low, slow or negative growth for a given period of time. It would be better for any union to be able to recognise and react to indications of a trend to recession and take joint action to avoid it, factoring this into its criteria for deficits. Otherwise, over rigid criteria will simply be ignored, or lead to confrontation and then still be ignored by larger states, as was the case in the EU in November 2003, when a vote was called and lost in the economic and finance ministers Council ECOFIN on a Commission proposal that they should reduce their budget deficits. At the time of enlargement to a union of 25 member states on 1

May 2004, six of the previous 15 member states of the Union were being challenged by the Commission on their budget deficits.

Debt

Debt also should be understood in context. A high national debt may indicate irresponsibility. Or, as in the case of Italy, it may represent precautionary savings by individuals who have no corporate pension scheme. For the state it is borrowing. For the individuals it is investment.

Such an investment criterion, both for individuals and for member states, could be factored into debt criteria for a Latin American state to qualify for a single currency. Certain categories of investment could be excluded. These could in particular include long-term investment in social programmes for health, education, housing and urban renewal.

Borrowing to Invest

Especially, a Latin American Union should use the precedent of US Treasury Bonds to justify borrowing for investment by a union Investment Bank. Such borrowing does not count on the debt of member states in the US and is not counted on national debt by 13 of the 15 present member states in the EU.

Bonds issued by a Latin American Investment Bank could be subscribed by other development banks and by the EU through the European Investment Bank. As with dollar backed Marshall Aid, this would increase their credit rating and make it possible to increase their investment, income and employment multipliers through counterpart funds.

Part 7. Planning the Future

7.1. General Economic Guidelines

Reference has already been made to the fact that, by Treaty, the heads of state and government through the European Council can set guidelines which the European Central Bank is obliged to fulfil without prejudice to its responsibility to maintain and internal and external stability of the Euro.

These economic guidelines are debated by the European Parliament, the Committee of the Regions and Local Government, the Economic and Social Committee, and the Social Partners in the first half of each year, and a similar procedure engaged in the second half of the year for guidelines on Employment.

But the formulation of the recommendation on the guidelines then is by the economy and finance ministers of the union, the ECOFIN, rather than by the European Parliament. The recommendation to adopt or reject the guidelines then goes to the European Council of heads of state and government, which formally should not take account of or seek to reconcile alternative proposals. This ensures a brake on growth and a lower priority for employment than for price stability.

7.2. Medium-Term Economic Policy

Such a formulation of the economic policy guidelines for the Union by ECOFIN is informed by the opinion of an Economic Policy Committee. But this is a long way removed from the Medium Term Economic Policy Committee set up in 1964 by Robert Marjolin.

Marjolin was the senior Vice President of the first Commission. He had formerly been Jean Monnet's deputy when Monnet was the first Head of the postwar Commissariat au Plan. Marjolin then became head of the OEEC, the Organisation for European Economic Cooperation, which was the body set up to administer Marshall Aid. He later headed its transition to OECD by the inclusion of the US, Canada, Japan and other non-European countries.

At the Commission, Marjolin invented the Medium Term Economic Policy Committee, for which there was no provision in the Rome Treaty. He composed it of representatives of the national planning commissions of France, Italy and Belgium, and economics rather than finance ministries of other countries. He invited and succeeded in gaining Langer, the German Under-Secretary of State for economics, to chair the committee. He as Vice President of the Commission and two other Commissioners were members of this committee composed predominantly of representatives of member states.

7.3. Consistency

What Marjolin aimed to achieve with the committee was the translation of the French indicative planning model to the EEC. And, for its first report, he succeeded.¹⁶

Although for most postwar Germans, after Speer, plan was a four letter word, Langer came to learn that French planning was no so different in practice from postwar German allocation of Marshall aid through the Credit Institution for Reconstruction, which, working through the banks, set priorities for allocation of resources to key sectors.

The committee echoed the original 'positive integration' approach of the 1956 Spaak Report which had been the blueprint for the creation of the EEC, but not reflected in the mainly negative integration agenda of the Rome Treaty. Like Spaak, it also stressed the importance of structural, social and regional policies to offset the inequalities likely to be increased by liberalisation of trade and factor movements.

One of the main lessons learned by the members of the MTEPC was the need for consistent forward planning. For instance, each found that each country planned to export more to the others than they planned to import. The fact that OECD could have told them as much was by then irrelevant. They needed to be with and confront forward planning issues to realise this inconsistency and adjust to it.

7.4. Coordination

One of the striking features of the Medium Term Economic Policy Committee as established by Marjolin is the manner in which it reflects the kind of forward perspectives role-played in Latin America by the United Nations Economic Committee for Latin America (UNECLA). But, as with the marginalisation of OECD with the creation of the EEC, a Latin American Union would be well advised to ensure a policy committee similar to the MTEPC, composed of representatives of member states.

Doing so could facilitate the central issue of policy coordination. In the EEC, this was proposed by the Commission in its preface to Marjolin's first report. The concept was rejected by the French government and the looser term 'confrontation' or comparison adopted instead.

¹⁶ European Commission (1996). Premier Programme de Politique Economique à Moyen Terme. Brussels.

The issue echoes the ambition of the Commission to go for ‘supranational’ solutions rather than pragmatic outcomes. In the Draft Constitution for Europe, the stronger ‘coordination’ of national policies has been adopted without rejection by any member state. And, apart from the need to gain coherence in direction for 25 rather than 15 member states, this may be with good reason.

After Marjolin’s retirement from the Commission, the second and third reports from the MTEPC became less action focussed and more like OECD working party reports. Then, when confronted by the September 1973 quadrupling of oil prices, the member states failed to adopt a coordinated reaction. Rather than mutually change their economies down a gear, each slammed on the brakes and cut domestic demand to make room for the higher cost of oil imports. As a result, they mutually reduced each others’ trade and pushed their economies into recession.

Also, medium-term planning as a mechanism of cooperation from this point was quietly interred. The ceremony was symbolised by changing the name of the Medium Term Economic Policy Committee into the Economic Policy Committee. Rather than this being composed, as under Marjolin, by senior economy ministers, these were replaced by officials. The political driver was lost.

Nonetheless, medium-term policy objectives were later regained in the form of ‘pluri-annual programmes’. Virtually every area of Union policy has one. But whether there is public participation in their formulation, and debate, is another matter. Most of them are formulated in unscrutinised committees of the European Commission.

7.5. Democratising Decision-Making

Rolling Annual Debate

If a Latin American Economic Union is to be able to gain cooperation on ends such as employment and cohesion rather than opt only for means such as liberalising trade and factor movements, it could well seek to replicate the main procedures by which the economy of the EU, and its employment objectives, have been debated in the first and second half of each year by the main Union institutions, i.e. the European Parliament, the Committee of the Regions and Local Government, the Economic and Social Committee, and the Social Partners

– and the Economic Policy Committee. The Draft Constitution would change this to triennial debate which, for democratic accountability, clearly would be a regressive move.

Accountability

This process in the EU is known as ‘surveillance procedures’. The term was coined because the rolling debate was to inform the surveillance of the conditions for monetary union. But it makes no sense to the wider public who hardly know that it is happening. If polled on which European institution employs such procedures they probably would opt for Interpol.

Where monitoring rather than ‘surveillance’ would be useful would be in paralleling the EU principle of National Action Plans to follow through on union level agreement on economic policy and employment objectives, matched also by performance indicators and benchmarks, including social indicators. In terms of combating poverty and exclusion this is entirely consistent with UNDP programmes.

Participation by National Parliaments

Unlike the EU, which does not include national parliaments in this rolling debate, the time schedule is such that the initial proposals for medium-term economic and employment policy also could be debated by national parliaments with proposed amendments. The role of the parliament of the union then could be to amend, accommodate, or reject such amendments.

The process would deepen rather than diminish democracy. Certainly, at a higher level, it would be consistent with the principles of the Porto Alegre ‘participatory budget’ process. French regional planning since the 1980s has allowed the same. The Ministry of Finance and Economy makes available its proposals for regional budgets to the regions for debate and recommendations of change.

Choice on Alternatives

Unlike the EU, also, it could be that a Latin American Union would opt for the annual recommendations on medium-term economic and employment policy to be made by the economy ministers and employment ministers to the council of heads of state or government. In the EU this would be entirely feasible. The European Council is serviced by its own extensive secretariat. The options could be considered in time for choice rather than simply acceptance, or rejection, of an ECOFIN equivalent.

Stability, Growth and Cohesion

A Latin American Union undoubtedly would adopt provisions for a single currency that its central bank should both preserve the internal and external stability of the currency. But it also could be well advised to ensure that the bank also is committed to support the economic guidelines determined by the council of heads of state or government.

But, if the Council of a Latin American Union is to be more effective than the EU in avoiding recession by 'autopilot', it also could ensure both that its criteria for a single currency (1) exempt certain agreed categories of long-term investment, including social investment; (2) allow for deficit criteria to accommodate the current economic cycle; (3) ensure that the counterpart to the safeguard of stability offered by the central bank is available to it through an investment bank as the guardian of growth and cohesion.

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