

Is Europe an Optimal Political Area?

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Brookings Papers on Economic Activity

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Discussion. Structure

— **Introduction. The European Union at 60!**

— **Summary and comments**

- Economic structural (convergence)
- Economic (business cycle fluctuations, crisis management)
- Institutional (EU-EZ level; national)
- Beliefs-Cultural

— **Evidence from the crisis period**

- Institutions
- Trust

— **Looking forward**

Preliminaries. European Union at 60.

- *Sui Generis* Institution
- Top-down project
- Prioritize political (rather than economic) objectives
- Incremental approach (EU Directives, EU Regulations expanding domain)
- Big ambitious Projects
 - Single Market Plan
 - Monetary unification
 - Lisbon Agenda
 - FSAP; banking union
 - Fiscal Union
- “White Paper” on the Future of the European Union

The EU Policy Approach

— “Economist” approach.

- Political, institutional, (cultural) reforms → “real” integration → Meet OCA (optimum currency area) criteria → monetary unification

— EU approach

- Some “real” convergence and homogenization → “nominal” economic criteria (inflation, deficit, debt) → monetary unification → deeper integration (incl. political, institutional, and cultural) → solidarity-identity

This Paper. [important, ambitious]

— Economic convergence

- 1980-1998. Early phase (SMP, ERM). *Yes*
- 1999-2007. Euro phase. *stopped*

— Business cycle synchronization

- Increased co-movement (especially in the “core”)

— Institutional convergence (data limitations)

- 1980-1998. Early phase (SMP, ERM). *Some*
- 1999-2007. Euro phase. *No (Divergence)*

— Cultural convergence (WVS); [unclear why needed]

- Sizable within-country heterogeneity
- Overall movement in the same direction, but at different pace.

Economic Convergence

— Successful “catch-up” phase (1980-1999)

- EU South (Greece, Portugal, Spain) and Ireland
- Transition economies in Eastern Europe

— Slow-down since euro inception

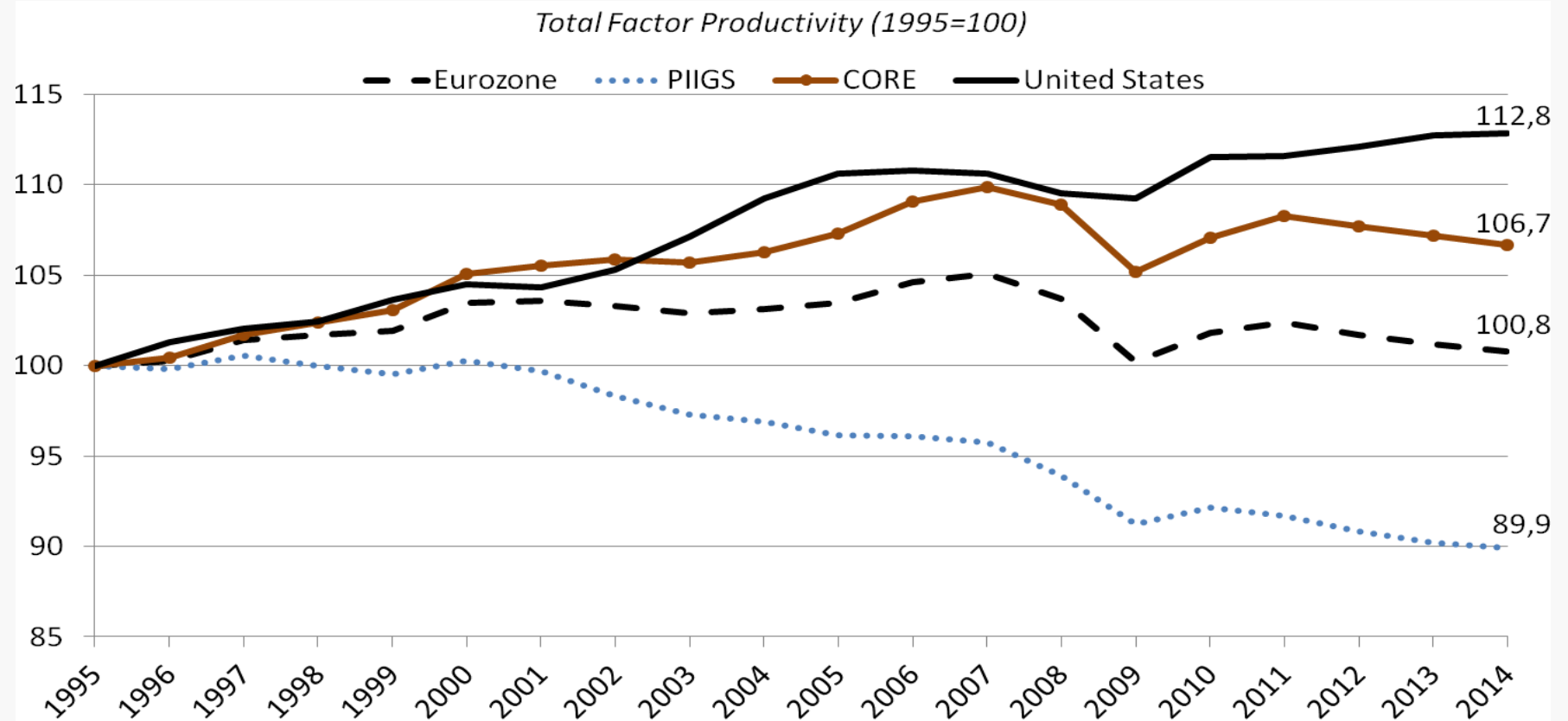
— Business synchronization

- Theoretically ambiguous effects of trade and financial integration on output synchronization (nature of shocks, type of trade, etc)
- Evidence of synchronization [counterfactual]

Economic Convergence. Looking Deeper

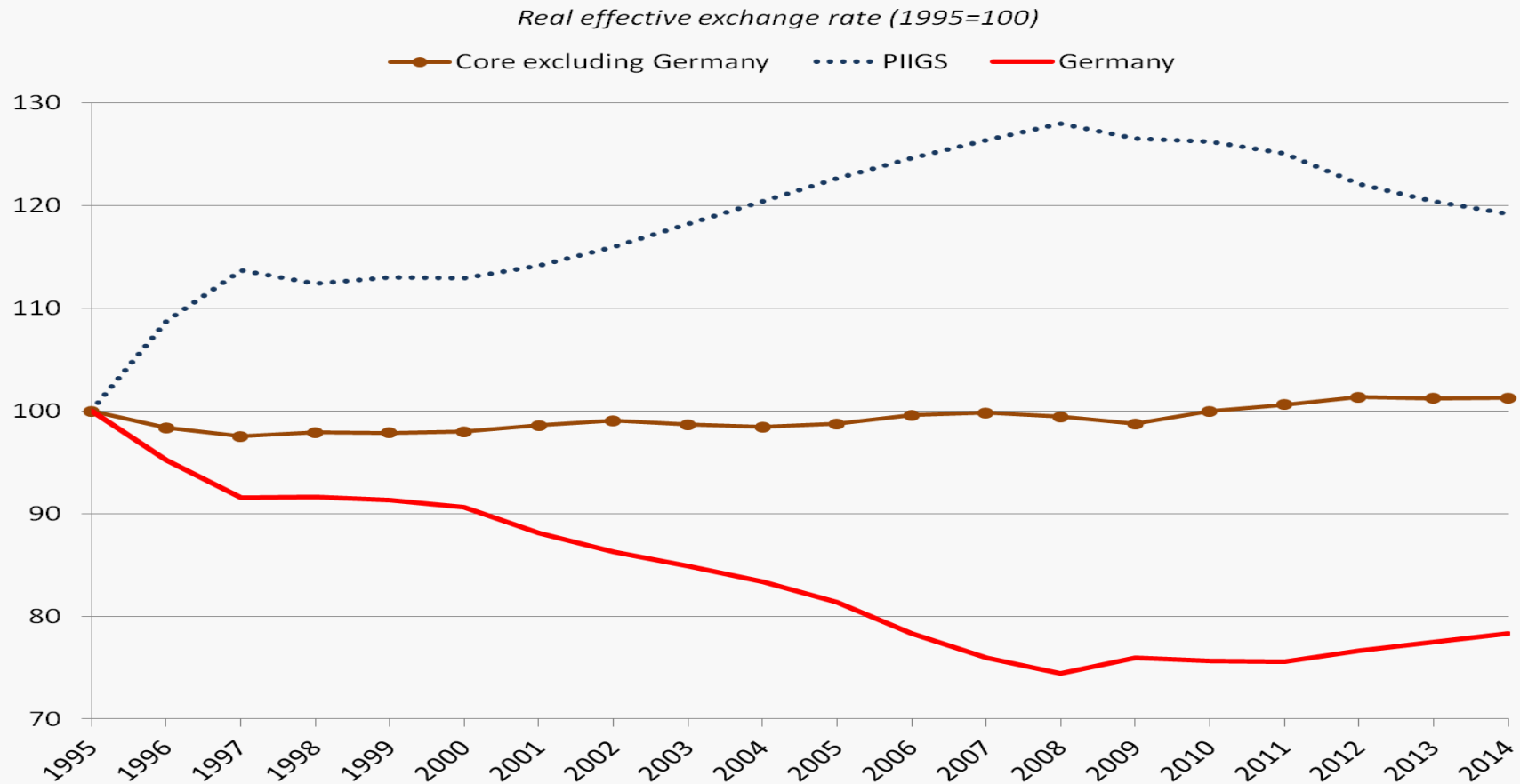
- Capital accumulation (ICT, non-ICT, infrastructure, etc)
- Human capital (education, quality of labor force, innovation)
- Labour utilization (unemployment, labor force participation)
- Total Factor Productivity
 - Misallocation across sectors. “Dutch-disease” type of syndrome [Garricano, Santos, and Villaverde, JEP 2013]
 - Misallocation within sectors. [Gopinath, Kalemli-Ozcan, Karabarbounis, and Villegas-Sanchez, QJE 2017]

TFP Divergence



Source: Micossi (2016)

Competitiveness Divergence



Source: Micossi (2016)

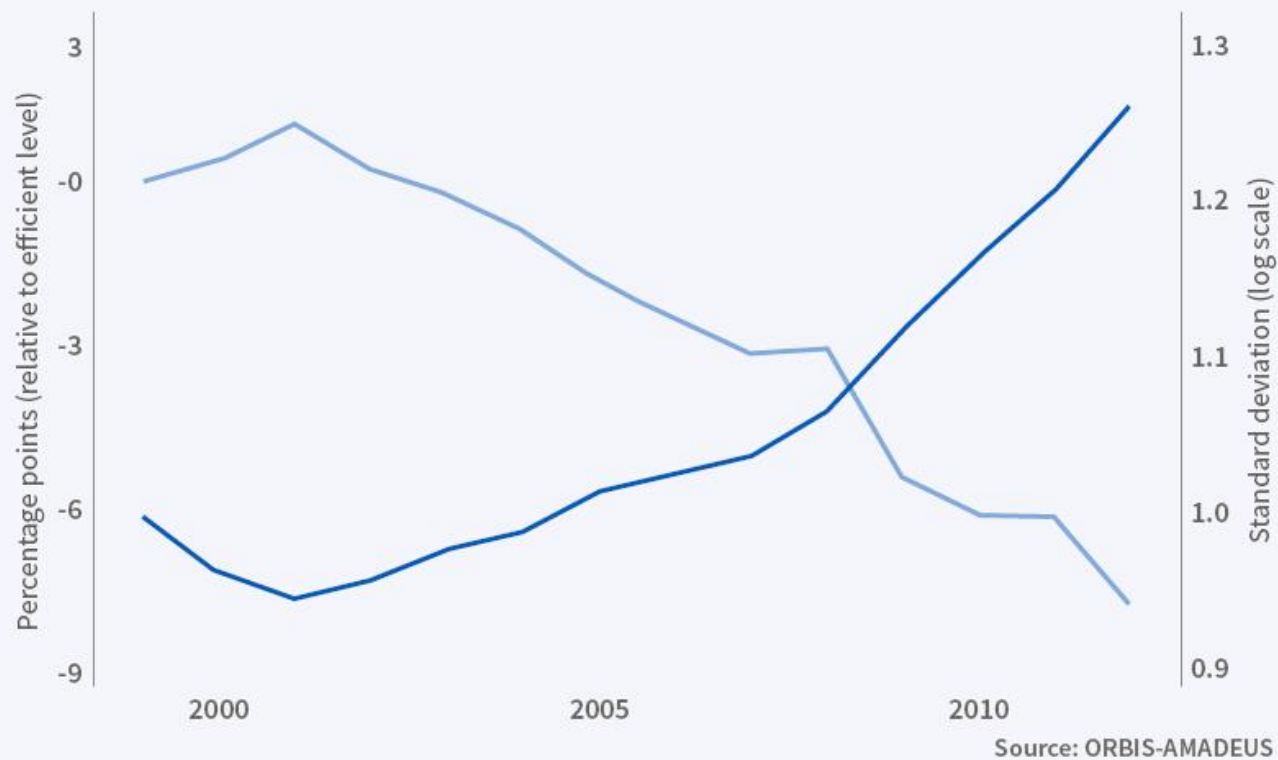
An Example

SPANISH MANUFACTURING, POST-EURO

Productivity fell as dispersion of firms' rates of return rose

Change in total factor productivity

Dispersion of the return to capital



Source: Gopinath et al. (2017)

TFP Gaps/Differentials. Looking Deeper

- Frictions in local labour, product, financial markets and banking
- National Institutions: public administration, corruption, courts, entry regulation and red tape
- Beliefs, norms, trust, etc

Institutional Gaps/Divergence

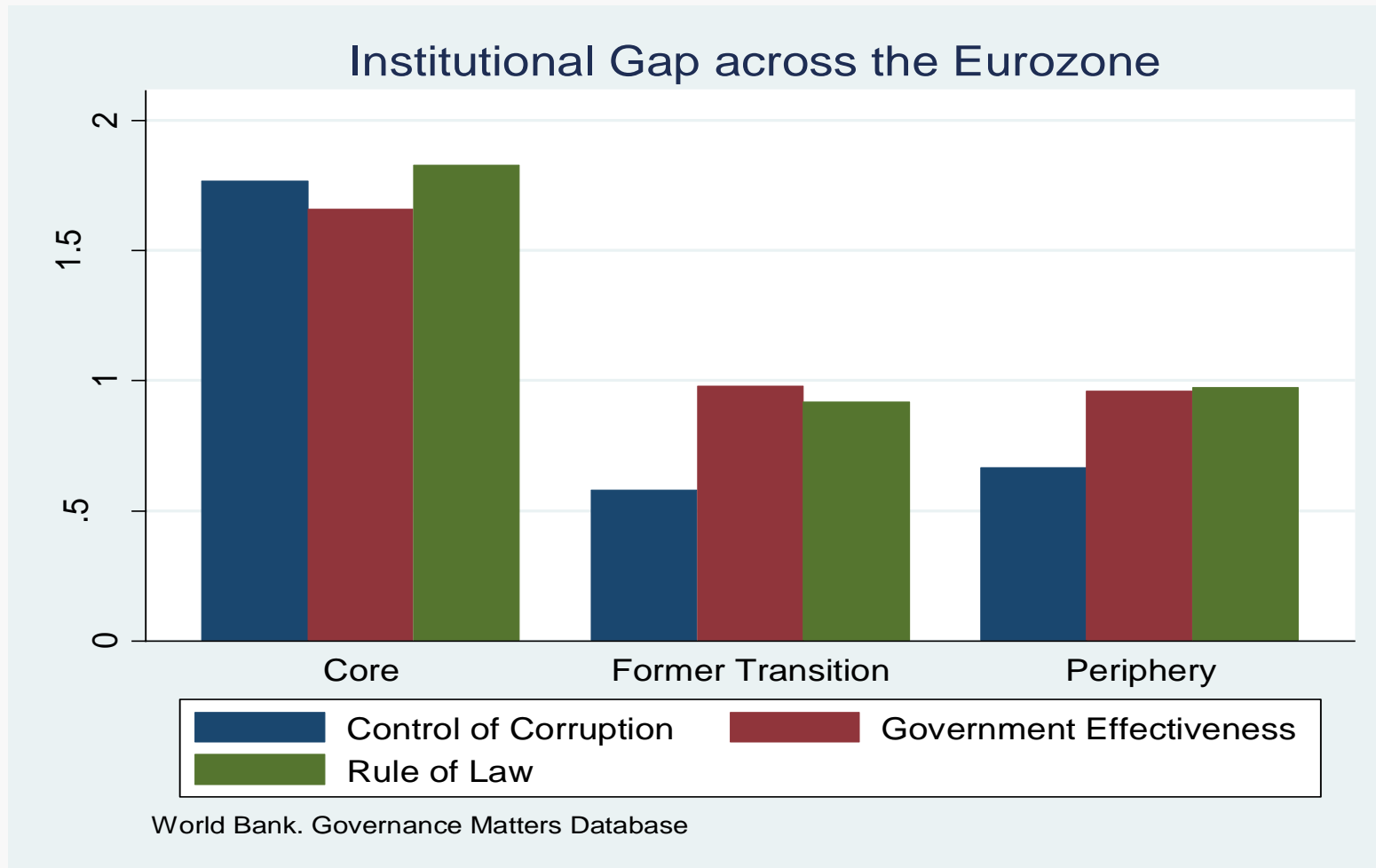
EU Institutional Arrangements

- Homogenization, harmonisation in various and expanding domains.
 - Example. Financial Services Action Plan (2000-2008; 27 Directives and 2 Regulations)

Country-level National Institutions. Results

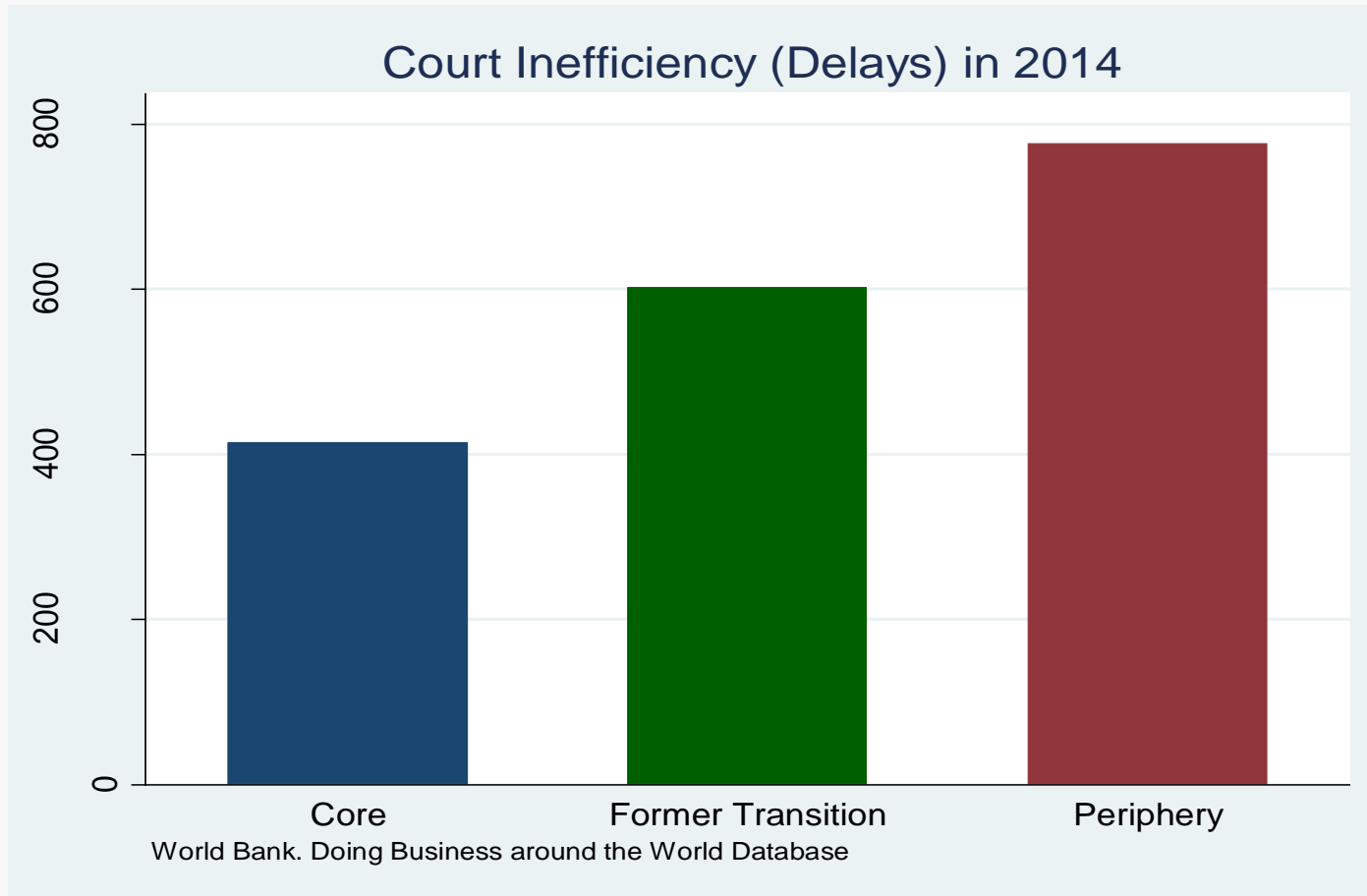
- Some convergence in 1990s
 - Periphery, reforms in banking and capital markets, liberalization in product markets
 - Transition economies in Eastern Europe
- Divergence since euro's inception

Institutional Gaps in the EU in 2014



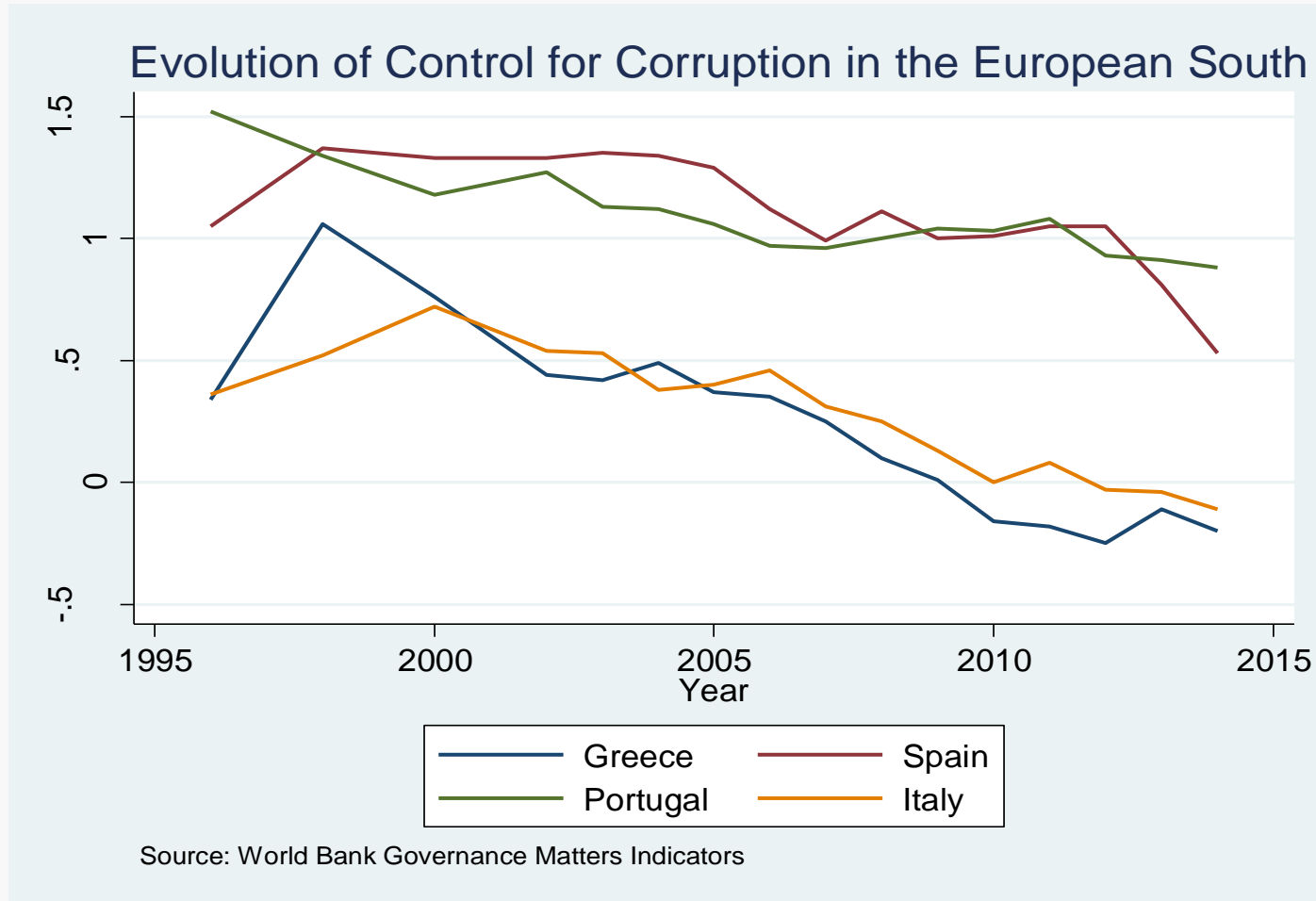
Source: Papaioannou (2016)

Institutional Gaps in the EU, cont. Legal Formalism



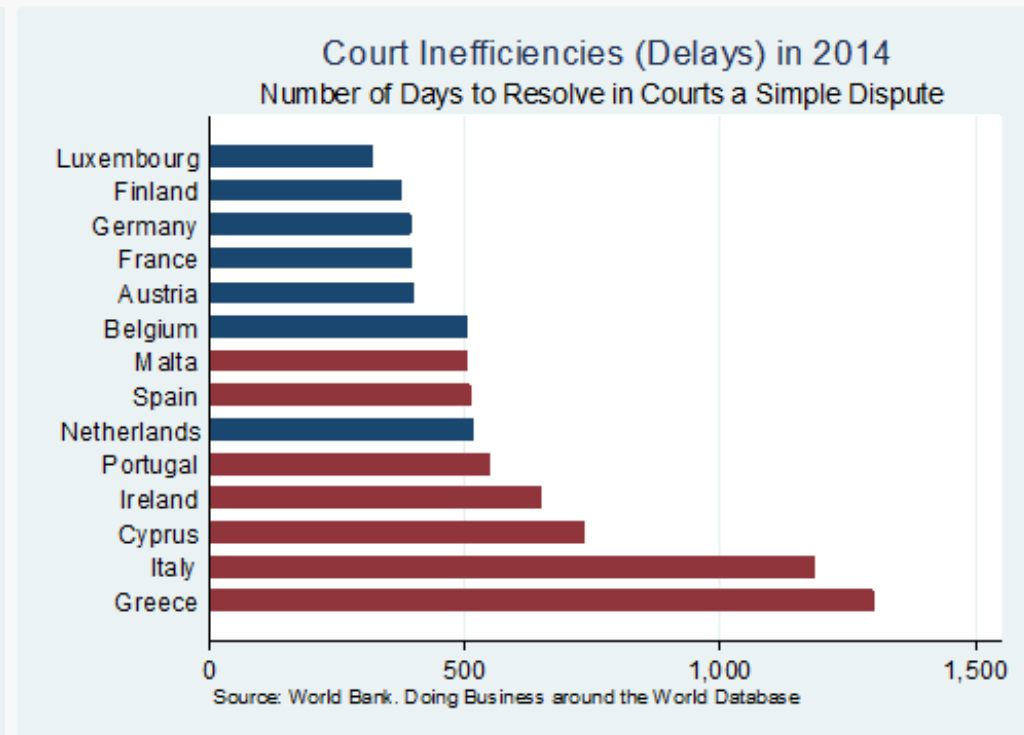
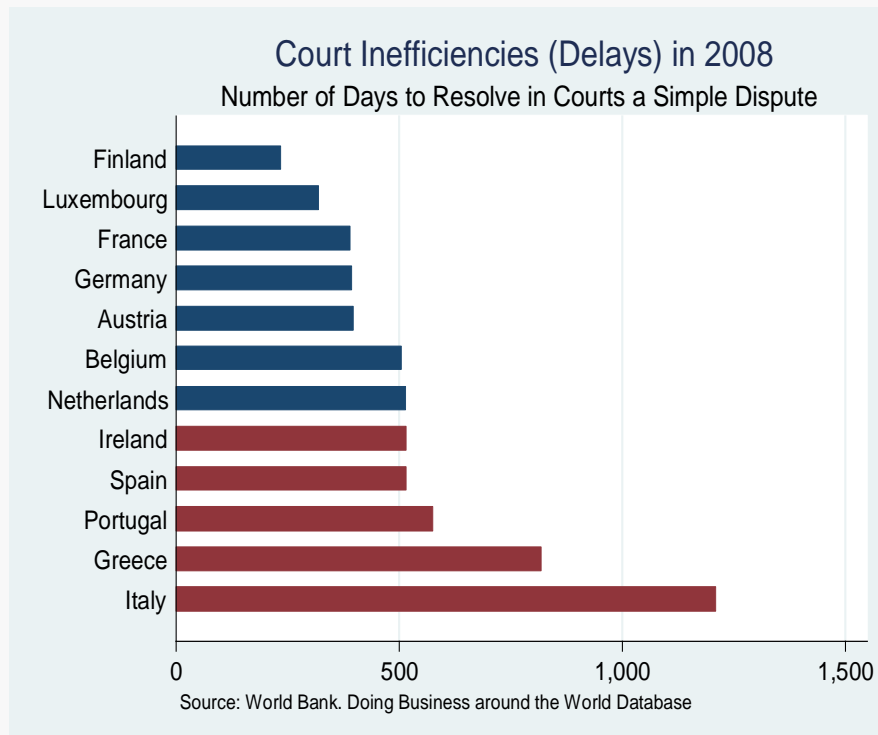
Source: Papaioannou (2016)

Institutional Divergence in the European South

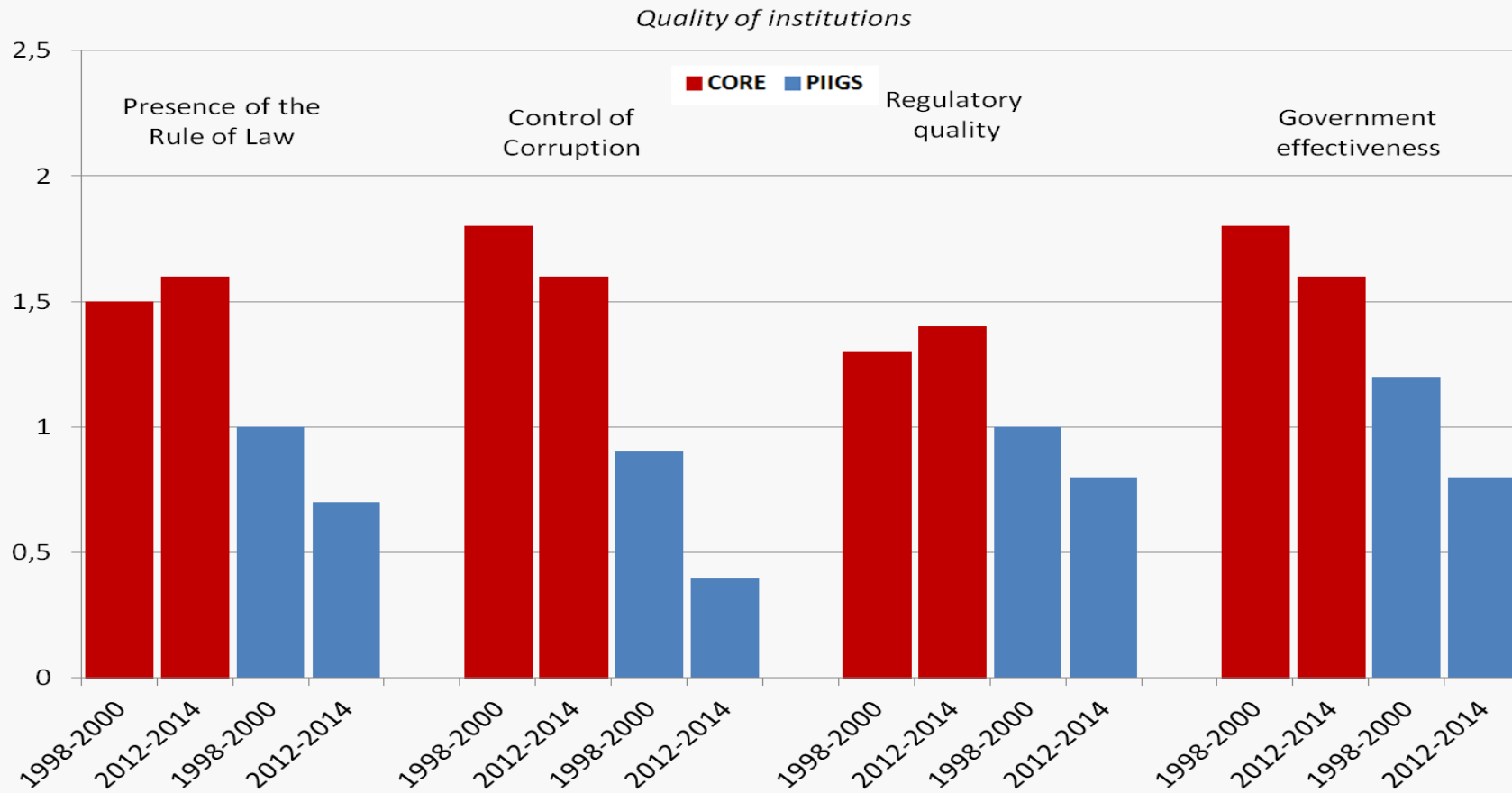


Source: Papaioannou (2016)

Legal Institutions in the EU before and after the Crisis



Institutional Divergence



Culture and Development

- **Cultural views**, role of trust, social/civic capital, beliefs, and norms [Landes, 1998; Putnam, 1994; Guiso, Sapienza, and Zingales, 2010]
- **Cultural** (ethnic, linguistic) **heterogeneity** [e.g., Alesina and La Ferrara, JEL 2005]
 - Correlation with development (opposing mechanisms); unclear overall pattern
 - Intersection of identity and heterogeneity matters [Desmet et al. 2016]
- **Institutional approaches** [Acemoglu, Johnson, and Robinson, 2005]
- **Interlinkages and common origins** [Alesina and Giuliano, JEL 2016; Tabellini, JEEA 2010]

Cultural Convergence in the EU till the Euro Crisis

Alesina, Tabellini, and Trebbi (2017)

- Limited (if any) convergence across countries
- General time trends (tolerance, secular, role of state)
- Sizable within country variation [see also Desmet, Ortuno-Ortin, and Wacziarg, 2016]
- Comparison with United States broad regions (interesting)

Conceptual Issues

- Why? Theoretical foundation (positive and negative channels)
- Crisis

Culture (Trust) and Economic Performance

— **Economic development/growth.** [Tabellini, 2010; Algan and Cahuc, 2008]

- Institutions and corruption
- Financial development
- Trade and foreign investment
- Labour market institutions
- Organizational structure

— **Determinants**

- Long-run factors; historical episodes [Nunn and Wantchekon 2011; Guiso, Sapienza, and Zingales, 2016; Putnam, 1994]
- Short-run; economic downturn [Ananiev and Guriev, 2016; Putnam, 2001]

— **Reviews.** Algan and Cahuc (2013); Guiso, Sapienza and Zingales (2011); Durlauf and Fafchamps (2005); Fernandez (2014)

The European Trust Crisis

“Europe will be forged in crises, and will be the sum of the solutions adopted for those crises.” Jean Monnet.

The Impact of the Crisis on Beliefs [Algan, Guriev, Papaioannou, and Passari, 2017]

- Unemployment
- Political extremism
- Distrust towards institutions
- General trust

Data. EU Regions (NUTS)

— **Regional output, employment, and industry composition. EUROSTAT**

- 27 Countries
- 244 Regions

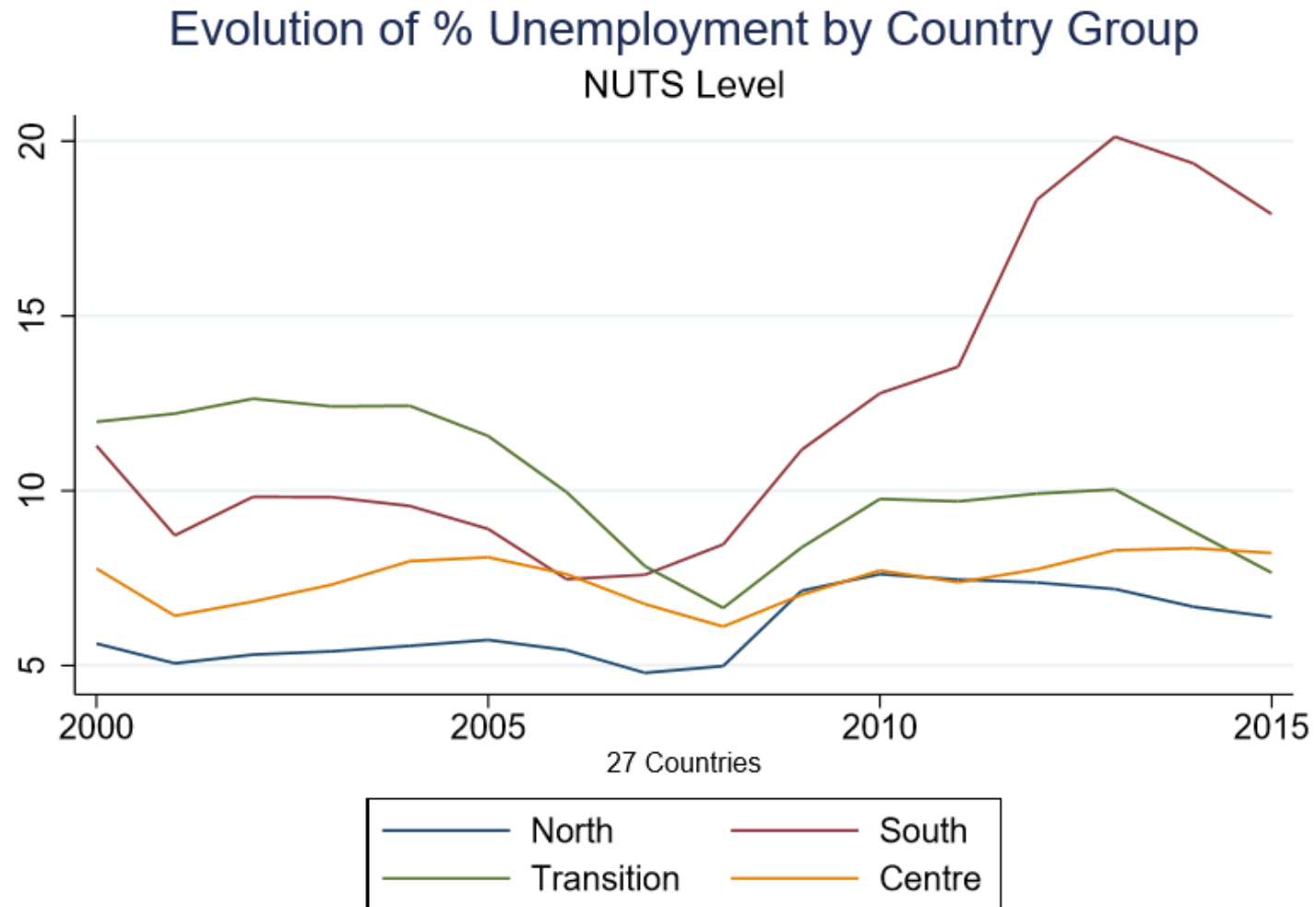
— **General trust, trust towards institutions and beliefs. European Social Surveys (ESS).**

- 24 countries
- 183 regions

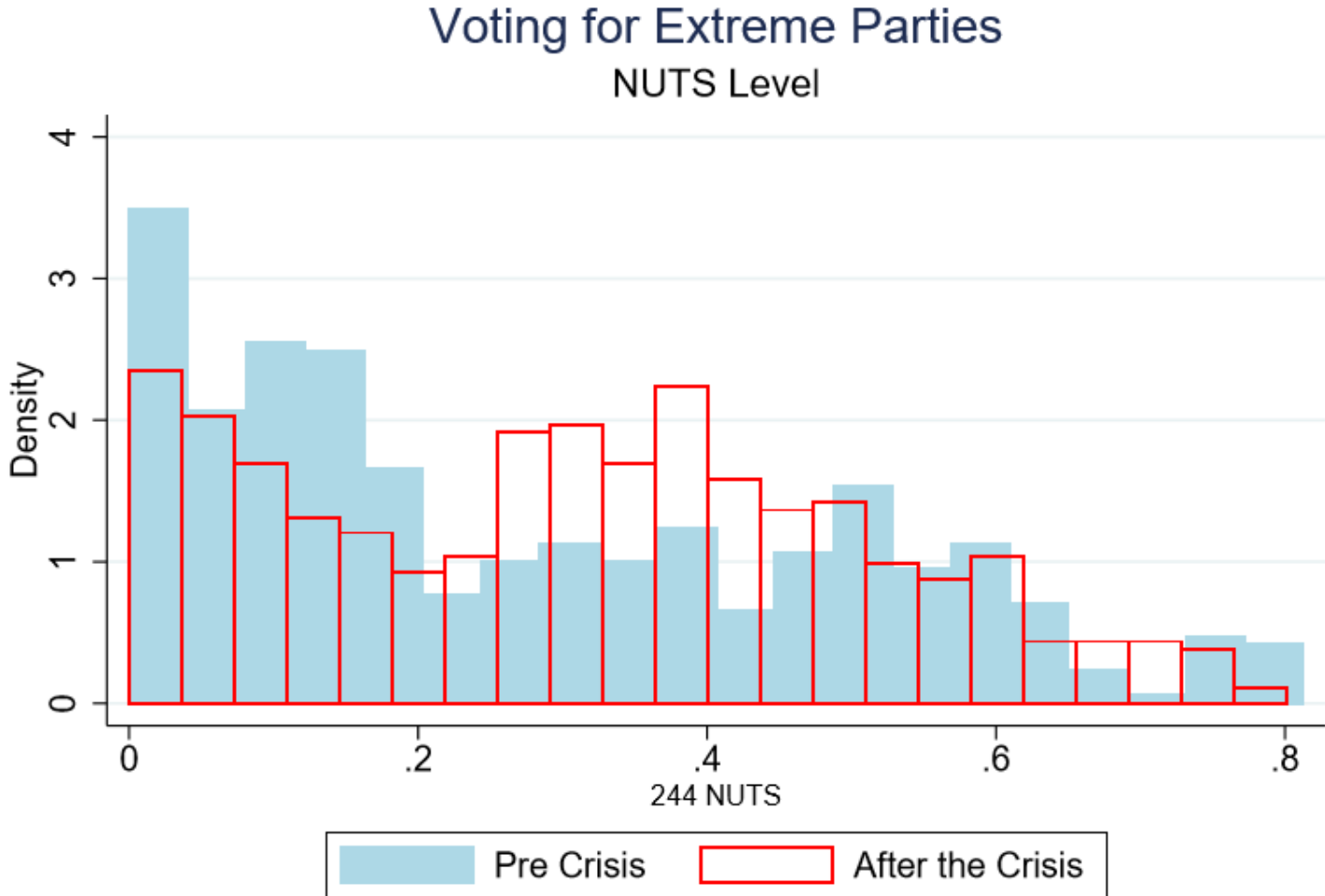
— **Electoral Data**

- National elections; country-specific sources
- Classification of political parties' orientation

Unemployment. [Source. Eurostat]

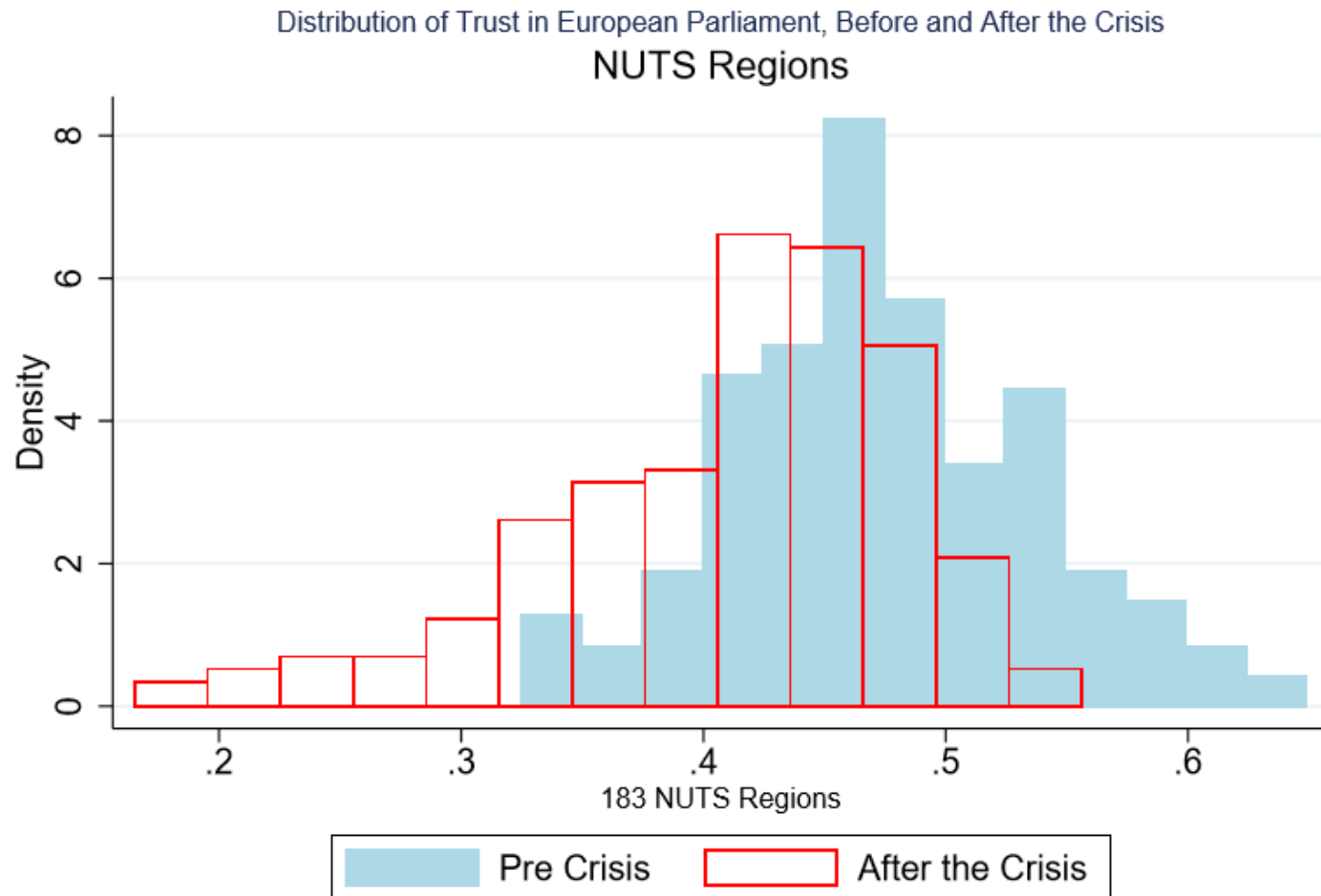


Voting for Extreme Parties. [Source. Country-Specific Electoral Datasets]



Source: National Election Sources

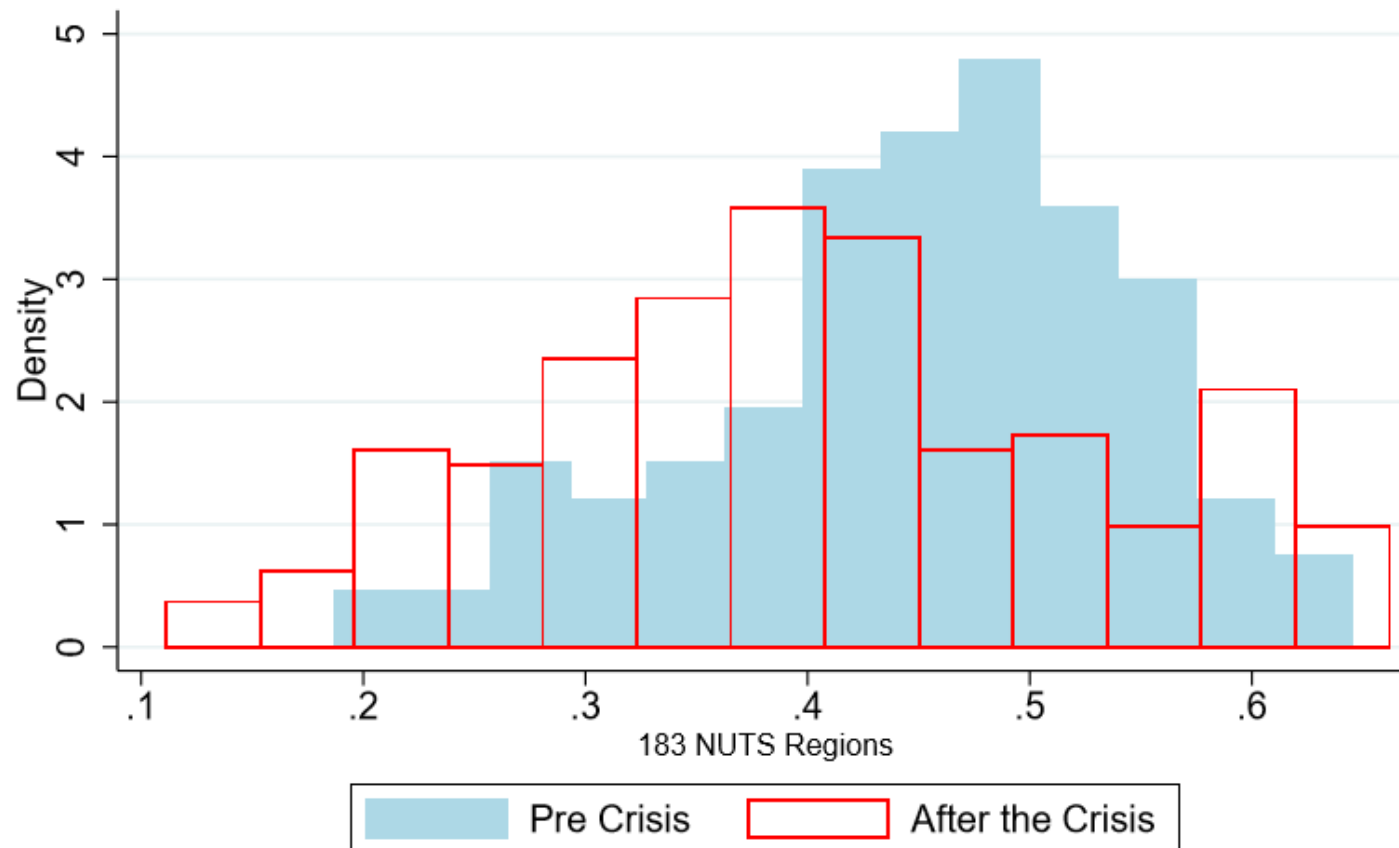
Trust towards the European Union. [Source. ESS]



Source: European Social Survey

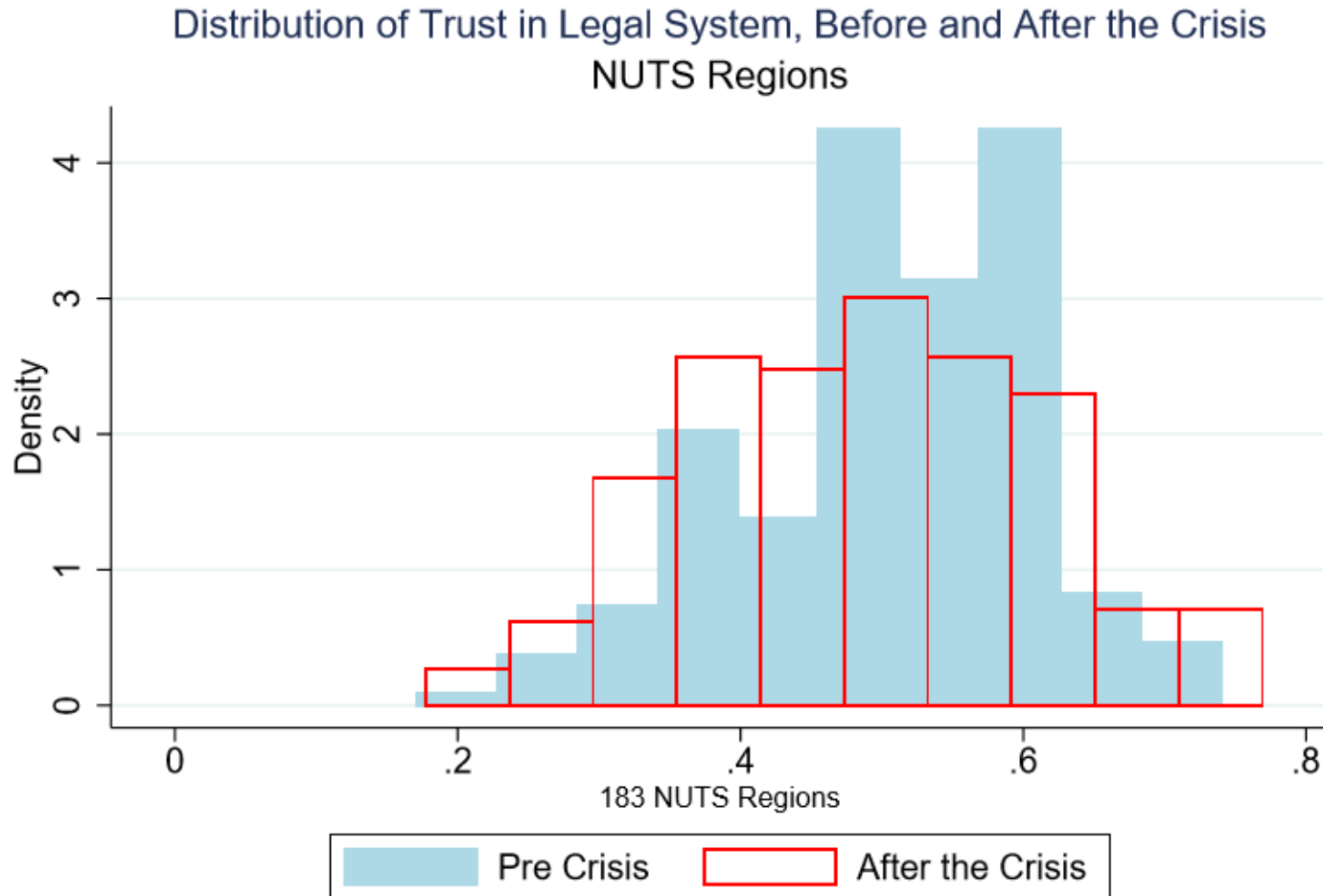
Trust in National Parliament. [Source. ESS]

Distribution of Trust in National Parliament, Before and After the Crisis
NUTS Regions



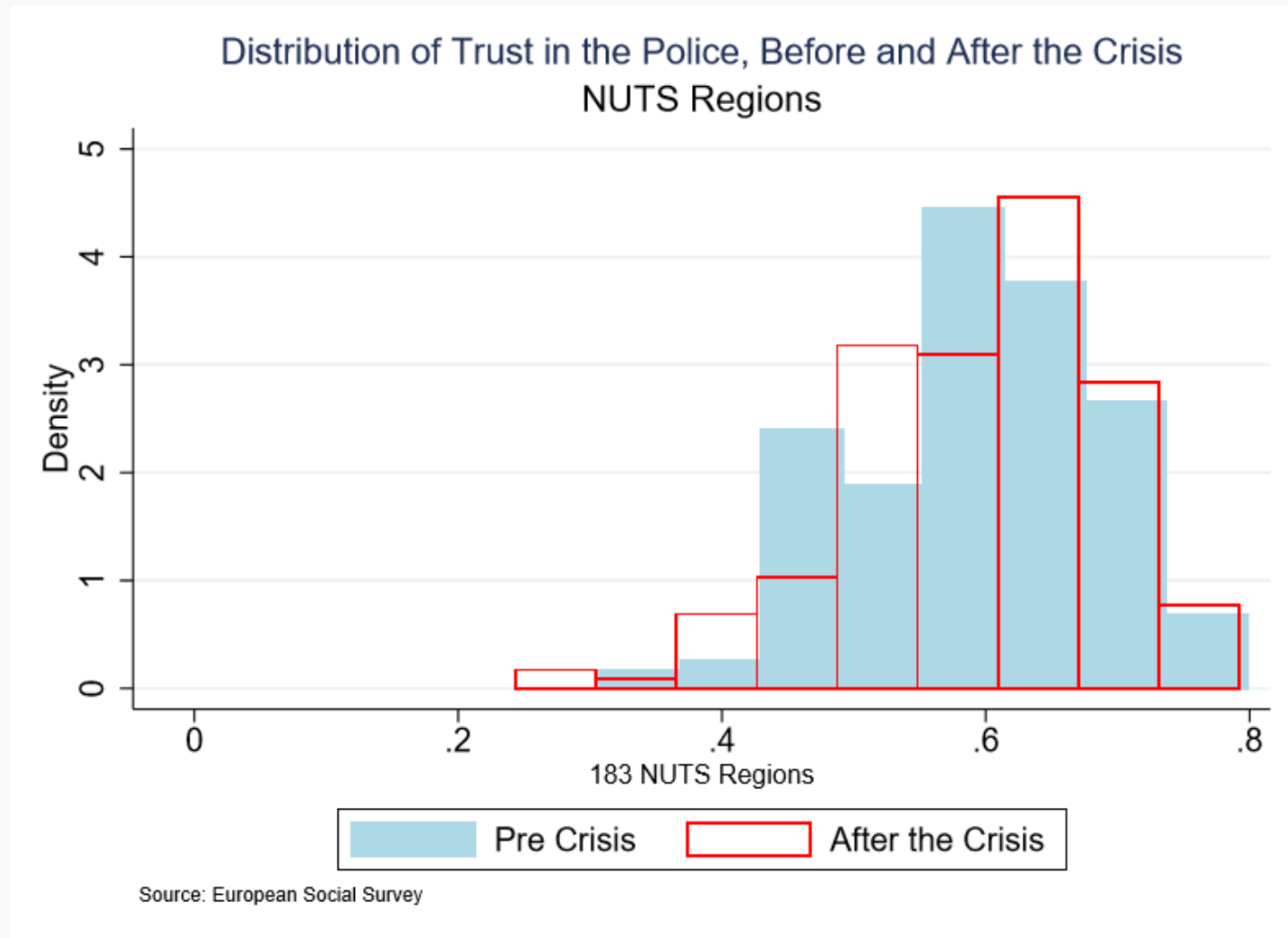
Source: European Social Survey

Trust in the Legal System. [Source. ESS]

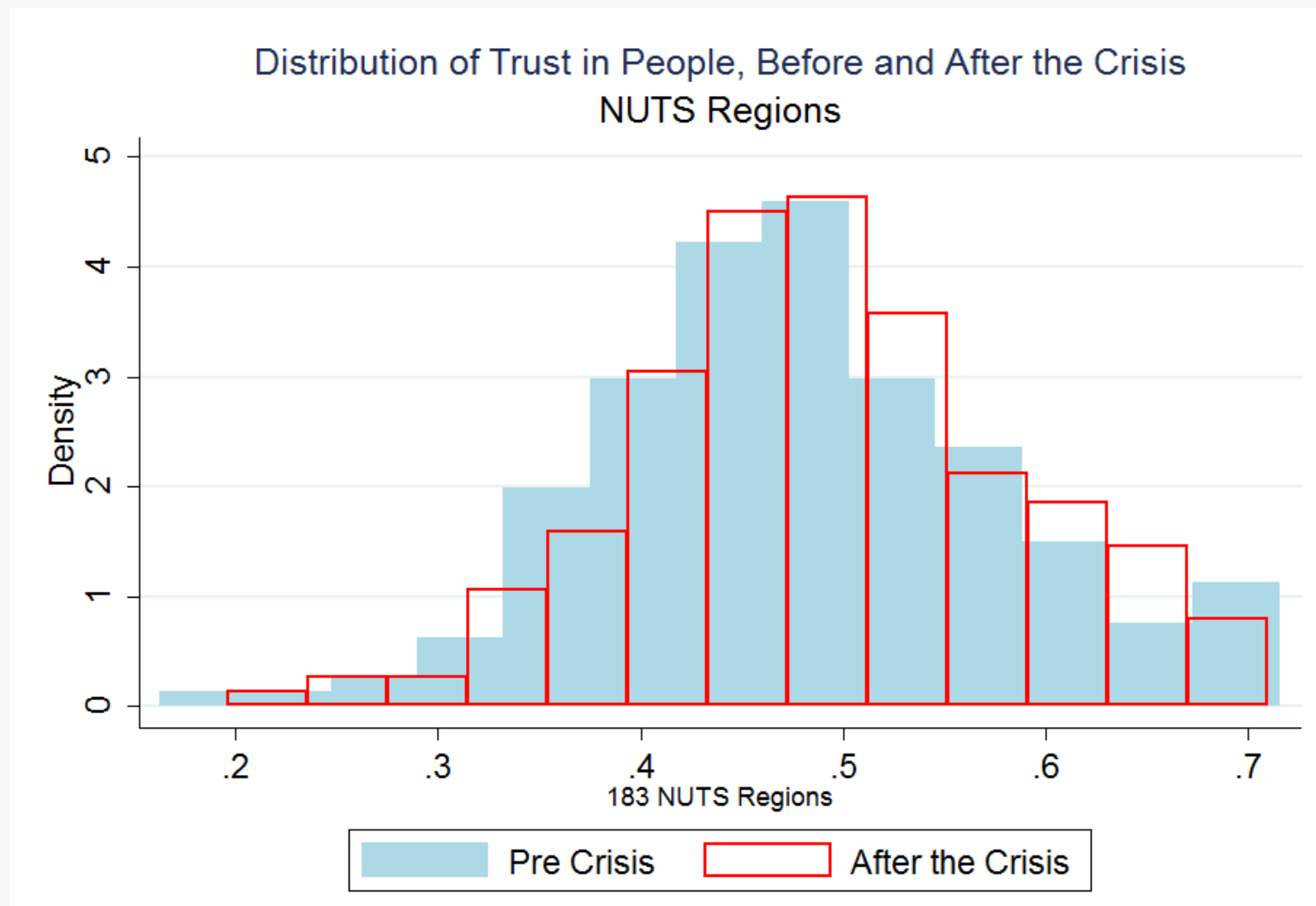


Source: European Social Survey

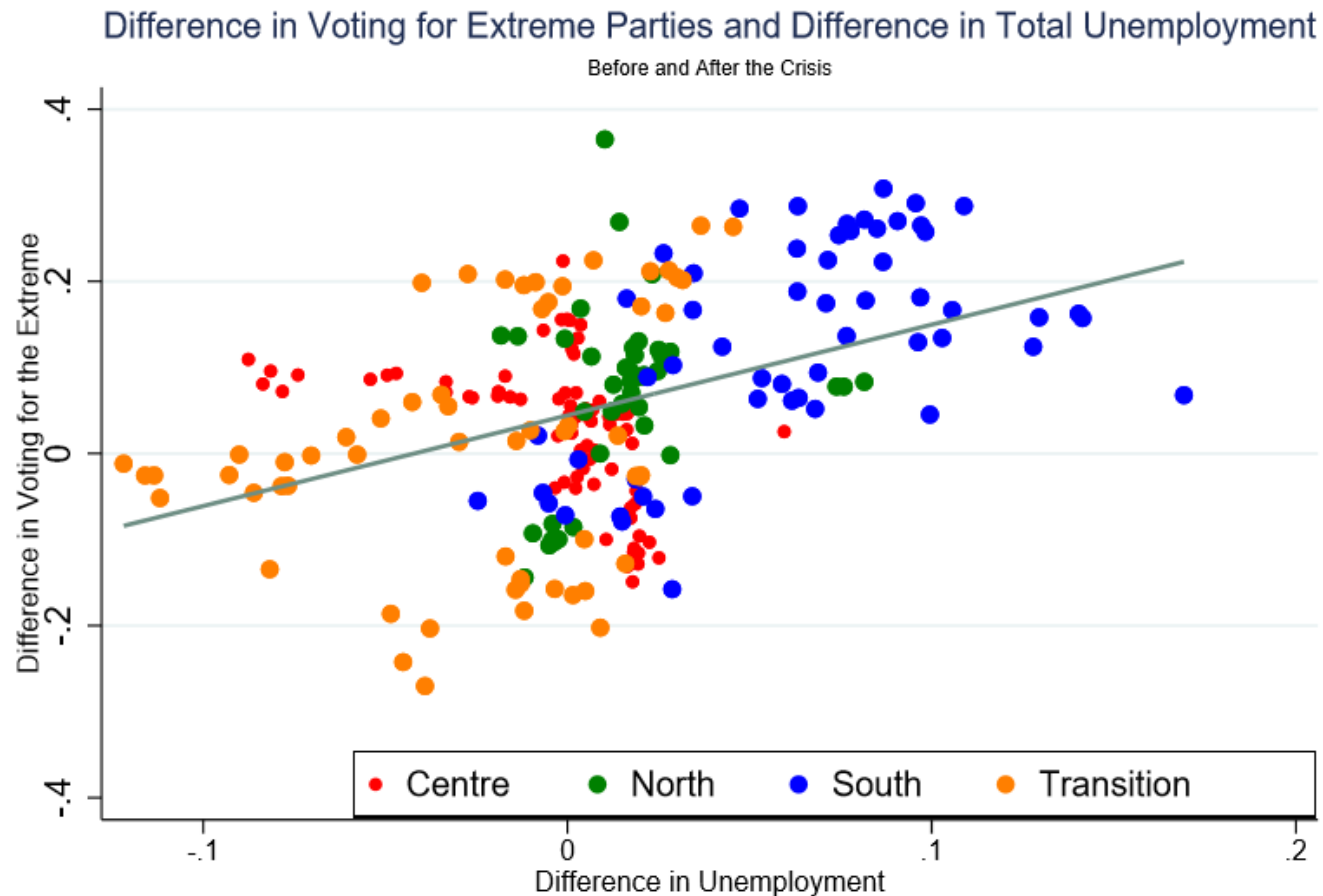
Trust towards the Police. [Source. ESS]



General Trust. [Source. ESS]



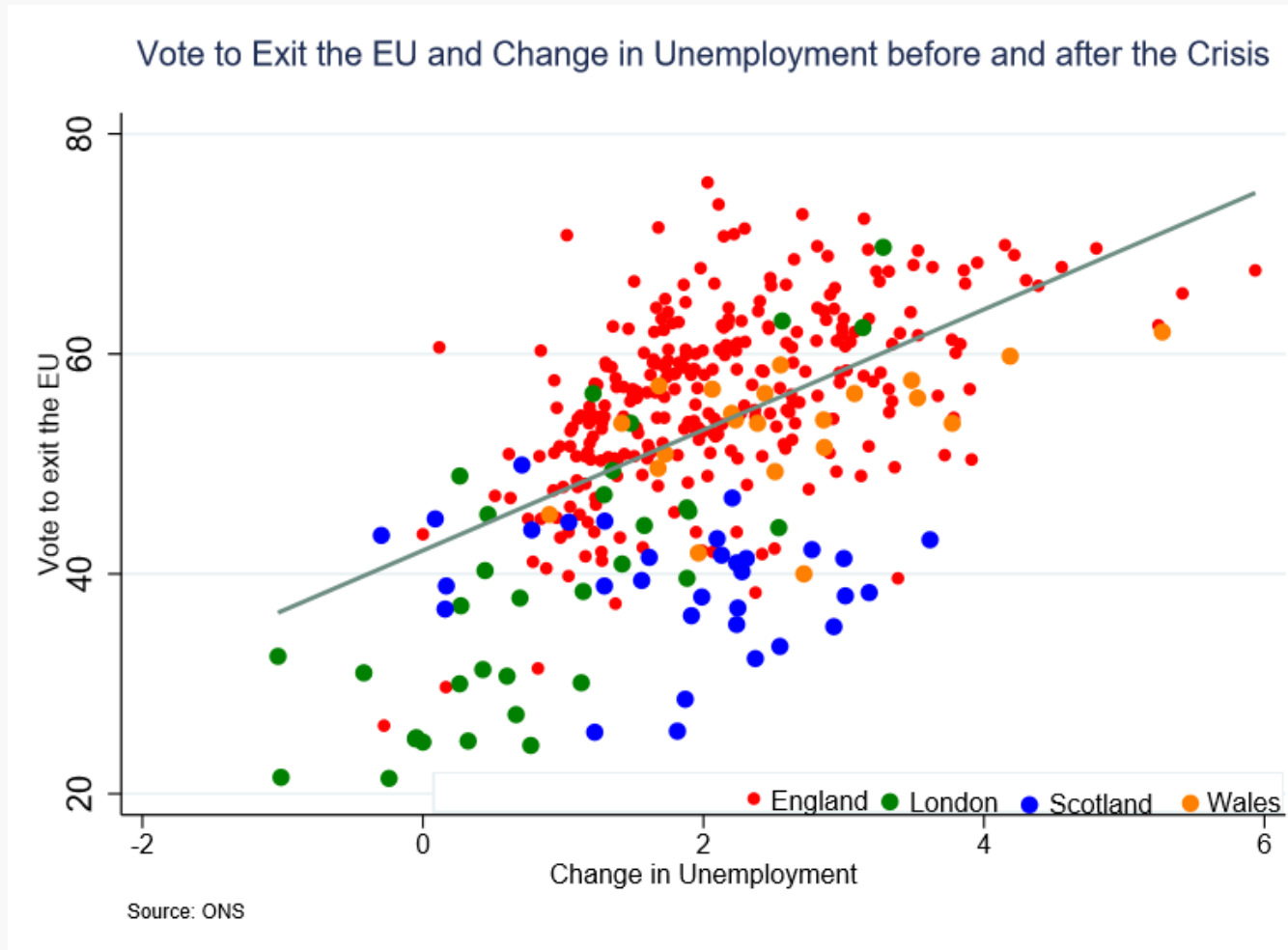
Unemployment and Extremist Voting. Before-After the Crisis



Source: National Election Sources and Eurostat

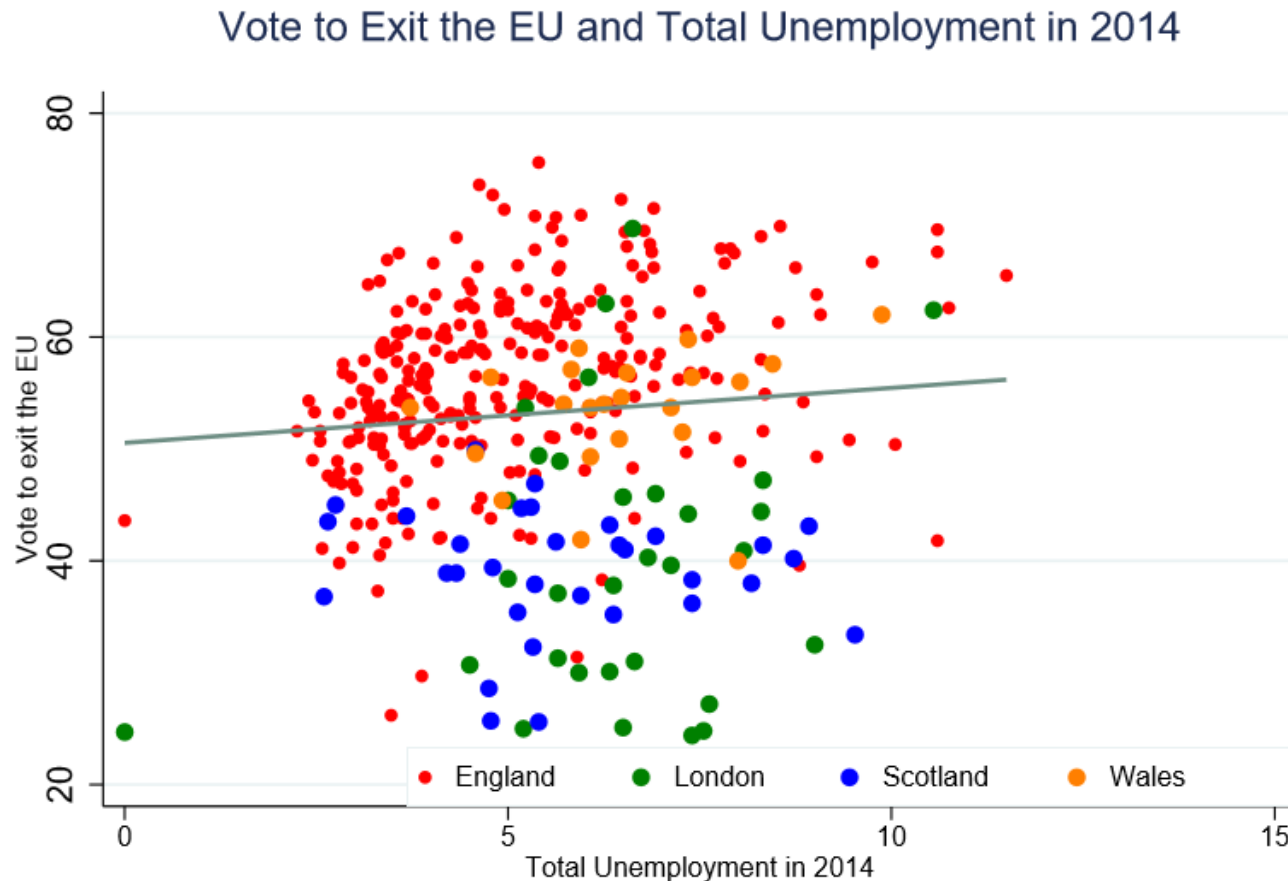
BREXIT.

Changes in Unemployment (2014-2007) and Leave Vote

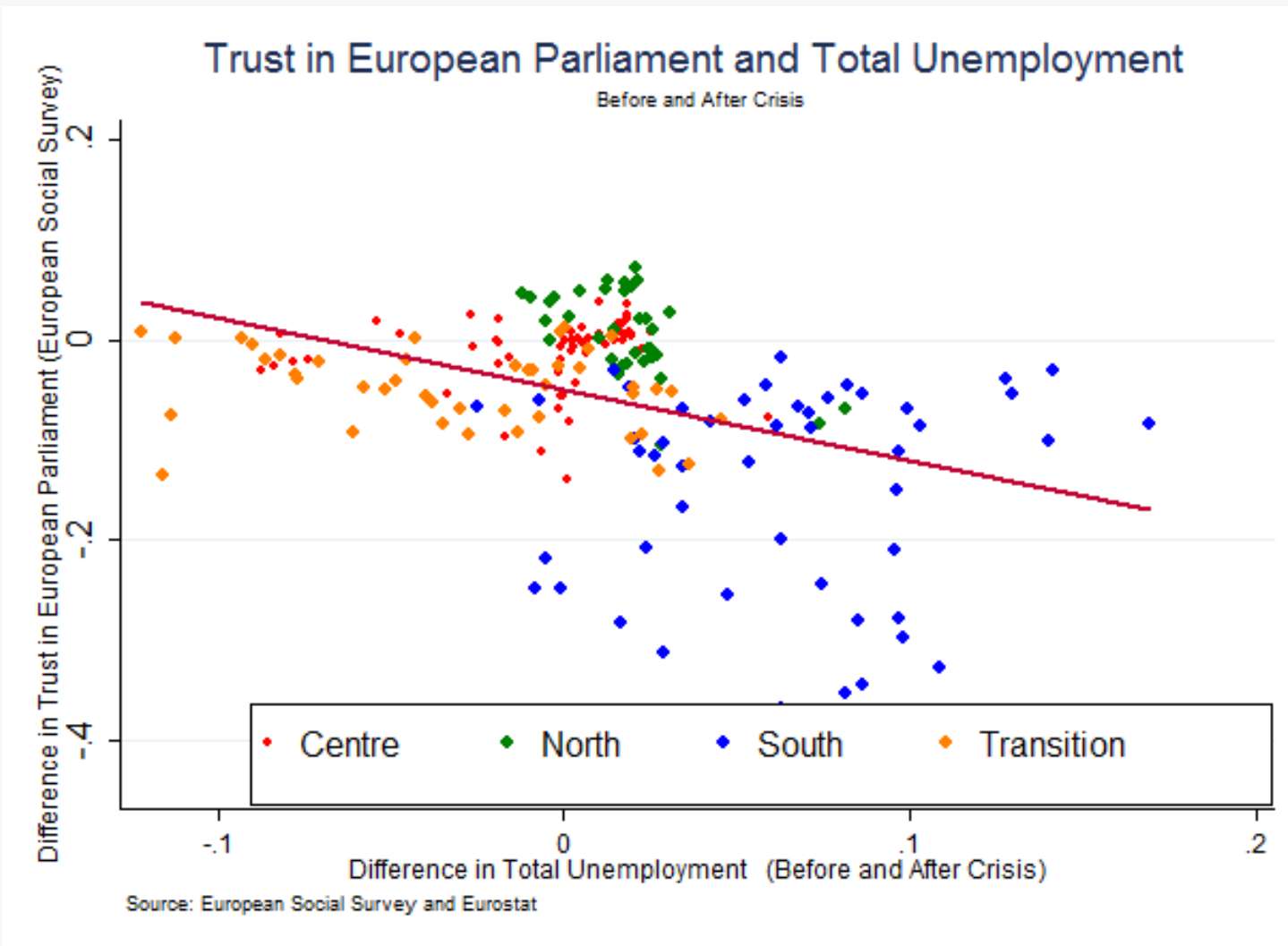


BREXIT Digression, cont.

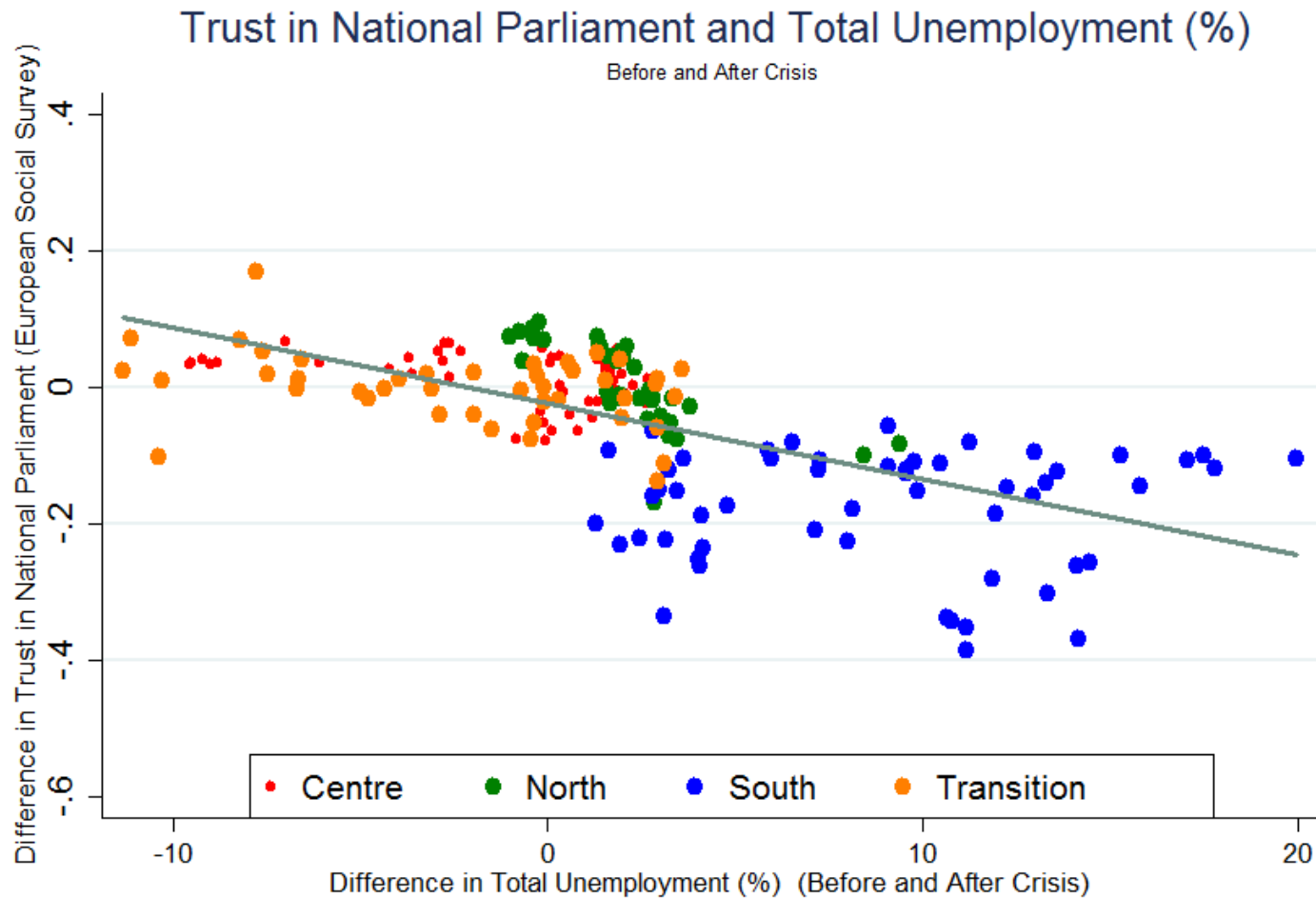
Unemployment (2014) and Vote to Leave the EU



Unemployment and Distrust in the European Parliament

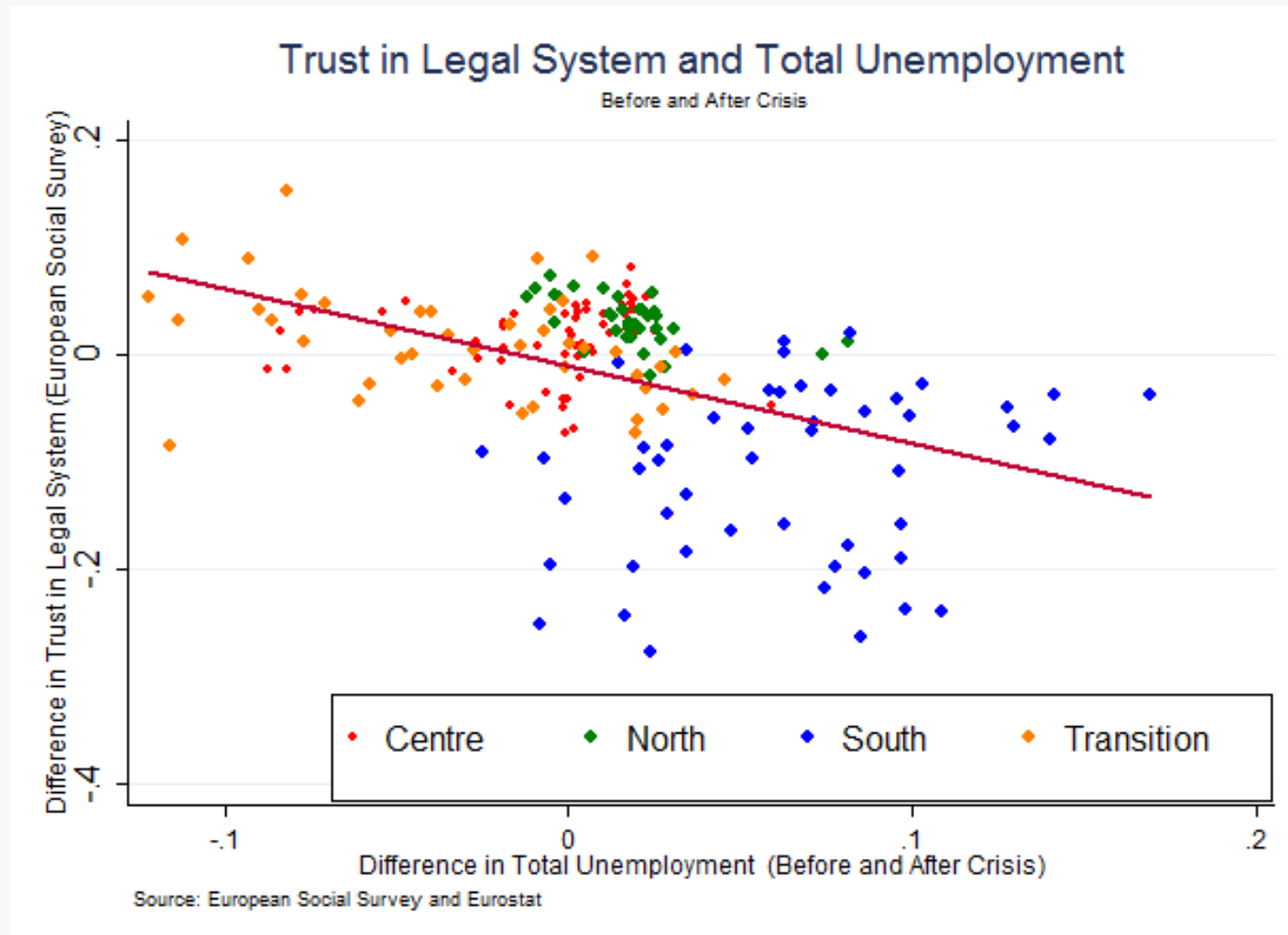


Unemployment and Distrust in National Institutions

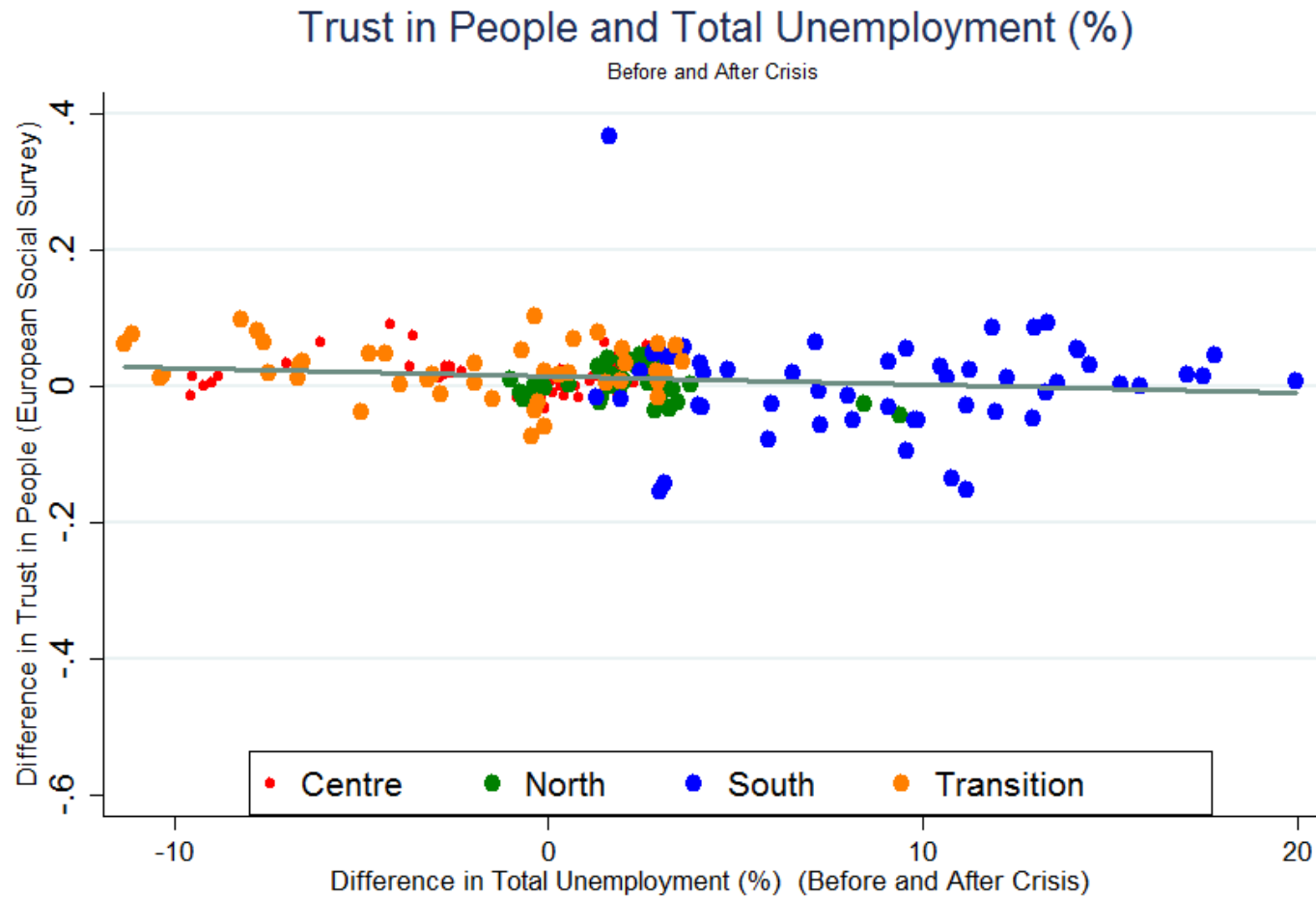


Source: European Social Survey and Eurostat

Unemployment and Distrust in National Courts

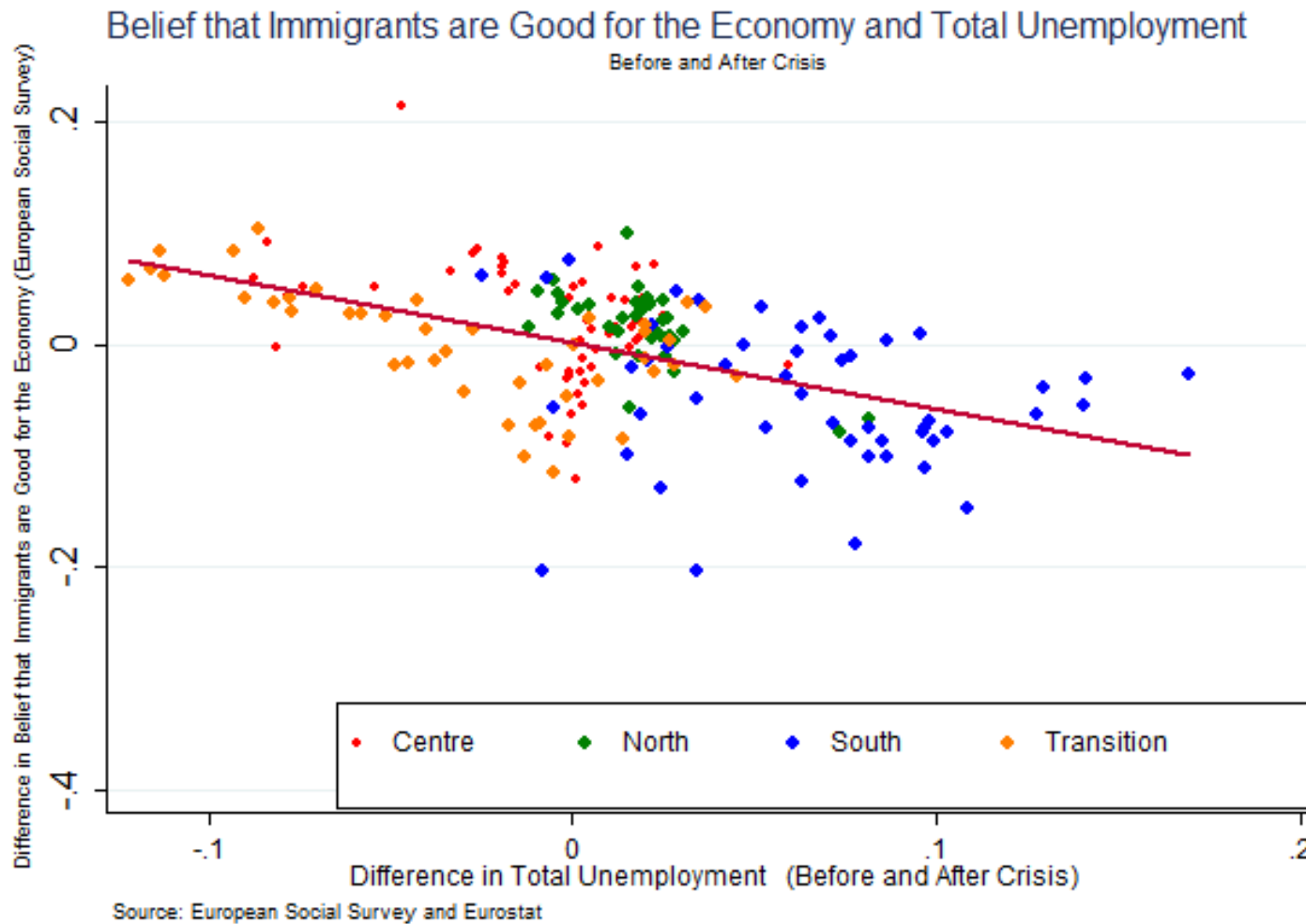


Unemployment and General Trust

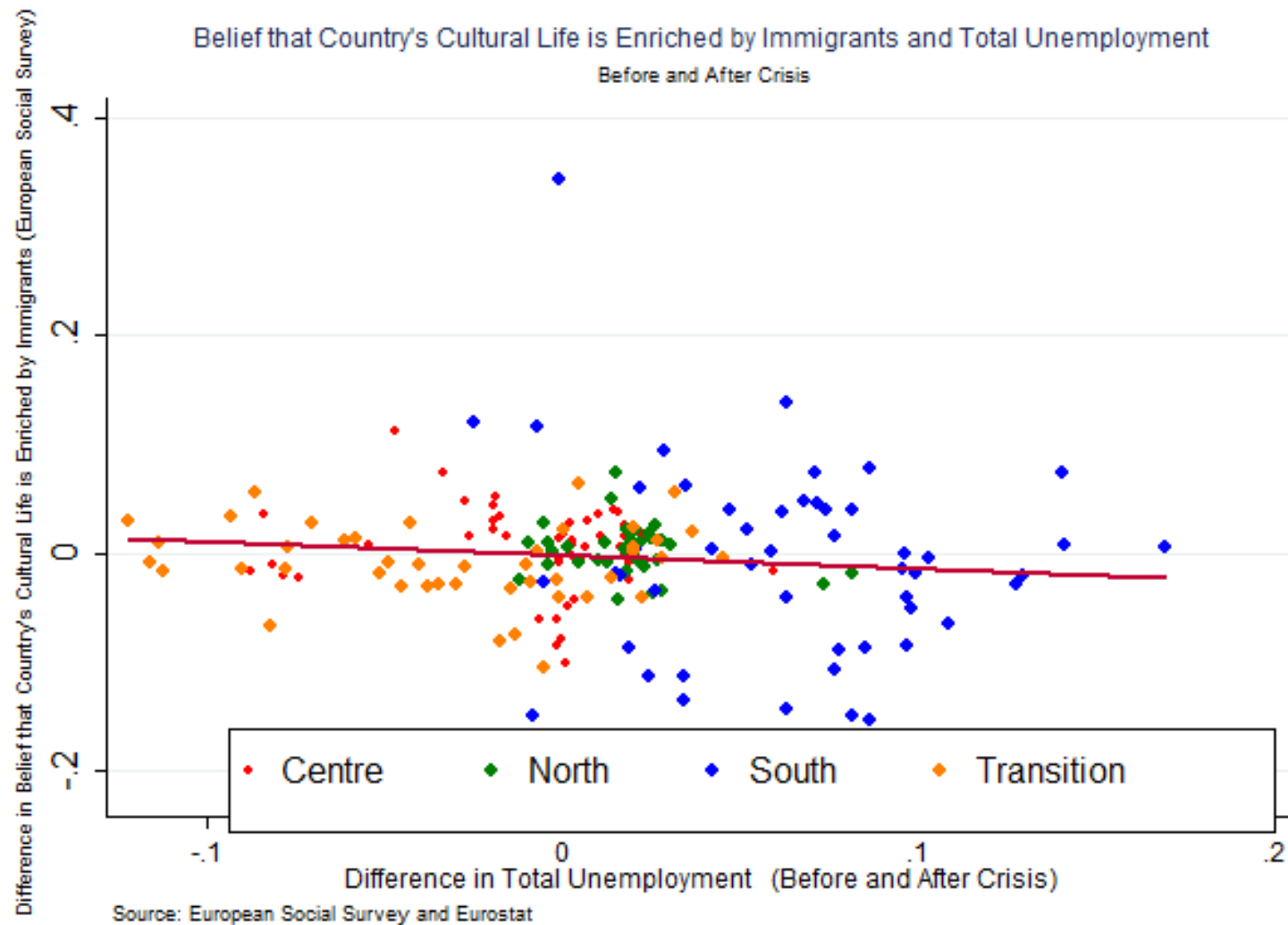


Source: European Social Survey and Eurostat

Unemployment and Role of Immigration in the Economy



Unemployment and Role of Immigration in Cultural Life



Trust. 2sls Estimates. Before-After the Crisis

Change (before-after crisis) in	Trust People	Trust Nat. Parliament	Trust EU Parliament	Trust United Nations	Trust Nat. Police	Trust Legal System
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A. 2SLS Estimates						
Change Unemployment [standard error]	-0.1234 (0.1137)	-1.1022*** (0.0831)	-0.4778*** (0.0903)	0.0879 (0.0906)	0.2099** (0.0832)	-0.6294*** (0.1022)
Panel B. "Reduced-Form" Estimates						
Share of construction [standard error]	-0.2158 (0.1823)	-2.0522** (0.2798)	-0.8896*** (0.0500)	0.1637 (0.2326)	0.3908 (0.1717)	-1.1718** (0.3502)
Panel C. OLS Estimates						
Change Unemployment [standard error]	-0.1240** (0.0131)	-0.8031** (0.1855)	-0.3104 (0.2329)	0.0240 (0.1212)	-0.0226 (0.0244)	-0.4630* (0.1946)
First-Stage F-score	38.79	38.79	38.79	38.79	38.79	38.79
Initial Industry Shares	Yes	Yes	Yes	Yes	Yes	Yes
Observations/Regions	122	122	122	122	122	122
Countries	24	24	24	24	24	24

Summary. Alesina, Tabellini, and Trebbi (2017)

1. **Economic convergence and business cycle synchronization**
2. **Institutional convergence**
3. **Focus on beliefs, norms, and culture.**
 - Compare with economic convergence
 - Compare with cultural convergence in the US
 - Emphasize importance of **identity!** (**solidarity**)

‘Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity.’

Robert Schuman (1950). EU White Paper (2017)

Europe. Moving Forward

- **Economic convergence** (anaemic recovery from the crisis)
- **Banking Union** (some steps)
- **Fiscal Union** (divide)
- **Further integration in security, defence.**

- **Institutional Union**
 - Deepen integration
 - Promote well-being
 - Homogenize beliefs (in the long-run)