Is Europe an Optimal Political Area?

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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
  • 1999-2007. Euro phase. stopped

— Business cycle synchronization
  • Increased co-movement (especially in the “core”)

— Institutional convergence (data limitations)
  • 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

Total Factor Productivity (1995=100)

Eurozone, PIIGS, CORE, United States

Source: Micossi (2016)
Competitiveness Divergence

Real effective exchange rate (1995=100)

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

Institutional Gap across the Eurozone

Core
Former Transition
Periphery

Control of Corruption
Government Effectiveness
Rule of Law

World Bank. Governance Matters Database

Source: Papaioannou (2016)
Institutional Gaps in the EU, cont. Legal Formalism

Source: Papaioannou (2016)
Institutional Divergence in the European South

Evolution of Control for Corruption in the European South

Source: World Bank Governance Matters Indicators

Source: Papaioannou (2016)
Legal Institutions in the EU before and after the Crisis

Institutional Convergence
Institutional Divergence

Quality of institutions

- Presence of the Rule of Law
- Control of Corruption
- Regulatory quality
- Government effectiveness

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Institutional Convergence
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]
Trust towards the European Union. [Source. ESS]
Trust in National Parliament. [Source. ESS]
Trust in the Legal System. [Source. ESS]

Descriptive Analysis

Distribution of Trust in Legal System, Before and After the Crisis

NUTS Regions

Source: European Social Survey
Trust towards the Police. [Source. ESS]

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

Source: European Social Survey
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

Vote to Exit the EU and Change in Unemployment before and after the Crisis

Source: ONS
BREXIT Digression, cont.

Unemployment (2014) and Vote to Leave the EU

Vote to Exit the EU and Total Unemployment in 2014

Source: ONS
Unemployment and Distrust in the European Parliament
Unemployment and Distrust in National Institutions

Trust in National Parliament and Total Unemployment (%)

Before and After Crisis

Difference in Trust in National Parliament (European Social Survey)

Difference in Total Unemployment (%) (Before and After Crisis)

Source: European Social Survey and Eurostat
Unemployment and Distrust in National Courts
Unemployment and General Trust

Trust in People and Total Unemployment (%)

Source: European Social Survey and Eurostat
Unemployment and Role of Immigration in the Economy

Belief that Immigrants are Good for the Economy and Total Unemployment
Before and After Crisis

Difference in Belief that Immigrants are Good for the Economy (European Social Survey) vs. Difference in Total Unemployment (Before and After Crisis)

Source: European Social Survey and Eurostat
Unemployment and Role of Immigration in Cultural Life

Belief that Country’s Cultural Life is Enriched by Immigrants and Total Unemployment Before and After Crisis

Difference in Belief that Country’s Cultural Life is Enriched by Immigrants (European Social Survey)

Source: European Social Survey and Eurostat
## Trust. 2sls Estimates. Before-After the Crisis

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### Panel A. 2SLS Estimates

| Share of construction          | -0.2158      | -2.0522**             | -0.8896***          | 0.1637              | 0.3908           | -1.1718**         |
|                               | (0.1823)     | (0.2798)              | (0.0500)            | (0.2326)            | (0.1717)         | (0.3502)          |

### Panel B. "Reduced-Form" Estimates

| Change Unemployment            | -0.1240**    | -0.8031**             | -0.3104             | 0.0240              | -0.0226          | -0.4630*          |
|                               | (0.0131)     | (0.1855)              | (0.2329)            | (0.1212)            | (0.0244)         | (0.1946)          |
| First-Stage F-score           | 38.79        | 38.79                 | 38.79               | 38.79               | 38.79            | 38.79             |

### Panel C. OLS Estimates

- First-Stage F-score: 38.79
- Initial Industry Shares: Yes
- Observations/Regions: 122
- Countries: 24

Unemployment and Trust/Beliefs

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)