

Whither Europe?

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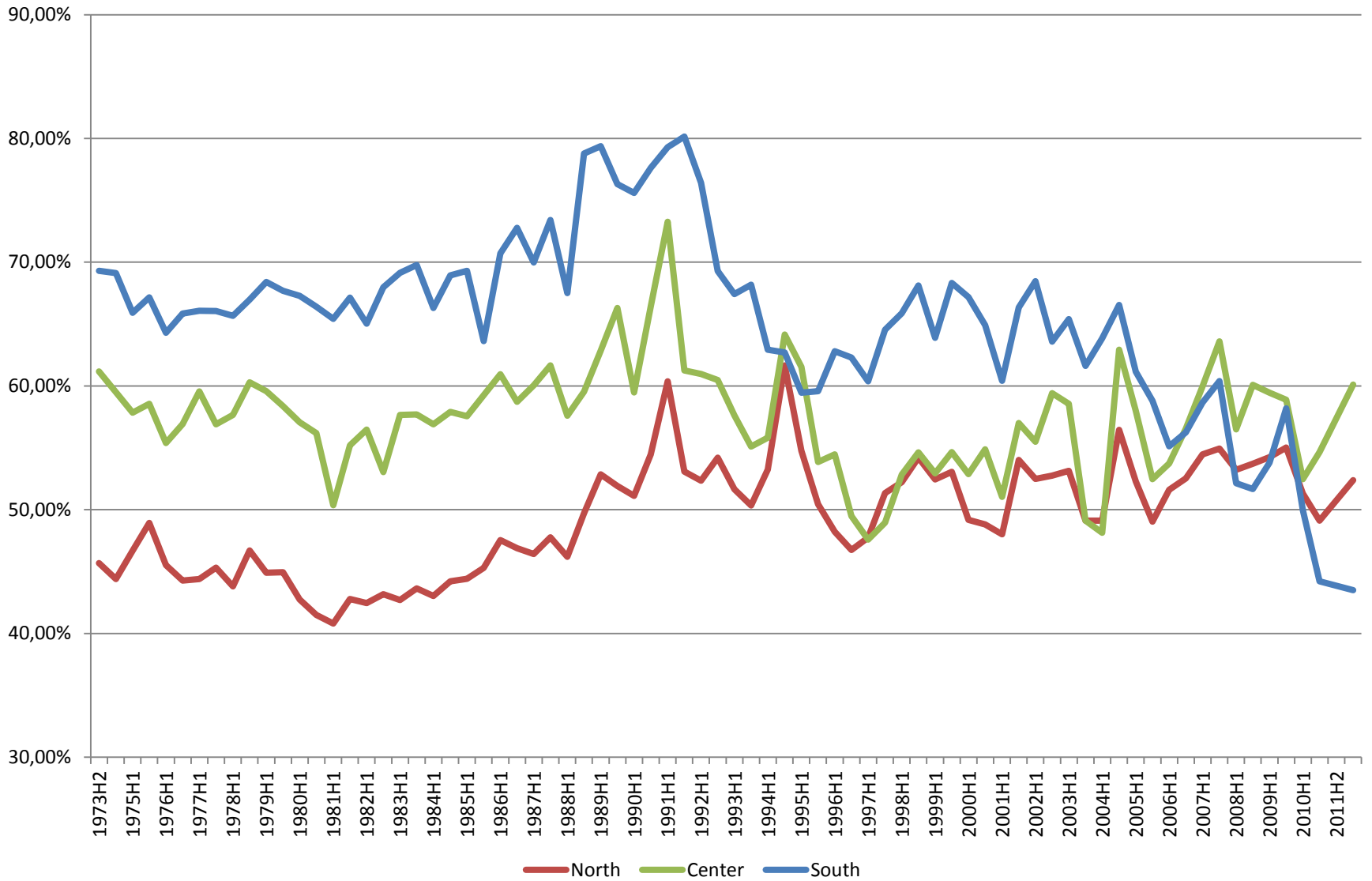
Monnet's theory

- “Europe will be forged in crises, and will be the sum of the solutions adopted for those crises.” – Monnet 1976
- "I am sure the euro will oblige us to introduce a new set of economic policy instruments. It is politically impossible to propose that now. But some day there will be a crisis and new instruments will be created." Prodi – 2001
- “The road toward the single currency looks like a chain reaction in which each step resolved a preexisting contradiction and generated a new one that in turn required a further step forward” Padoa-Schioppa (2004)

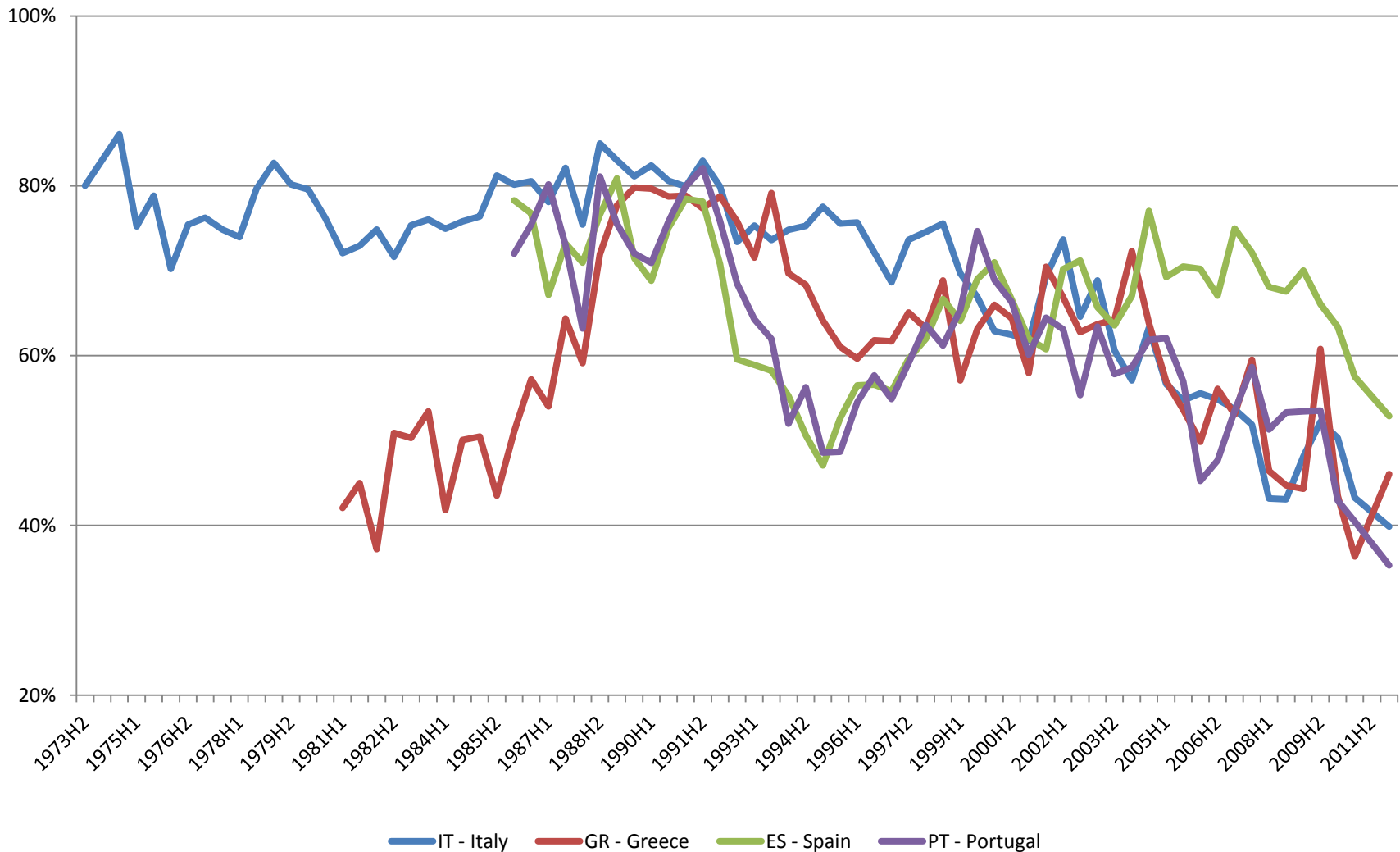
Tested by the Current Crisis

- Monnet's theory has two interpretations:
 - Crises will increase the demand for Europe and this will accelerate the unification process
 - Crises will create an opportunity to force a unification the majority of Europeans do not want
- Let's assume the first
- He wanted the crisis – he has gotten it!
- Does the demand for Europe increase?
- Let's look at Eurobarometer

EU Membership good?

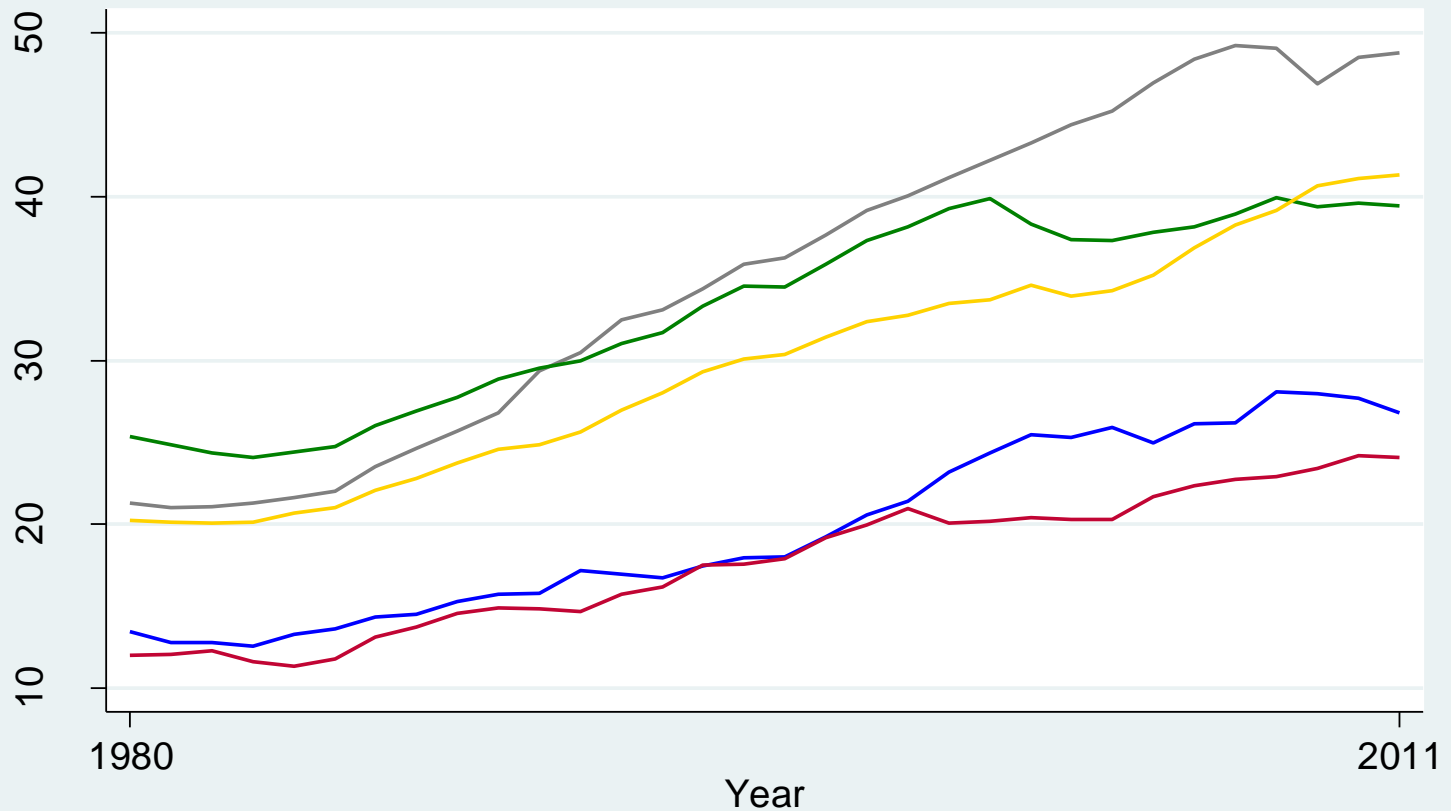


Southern Europe

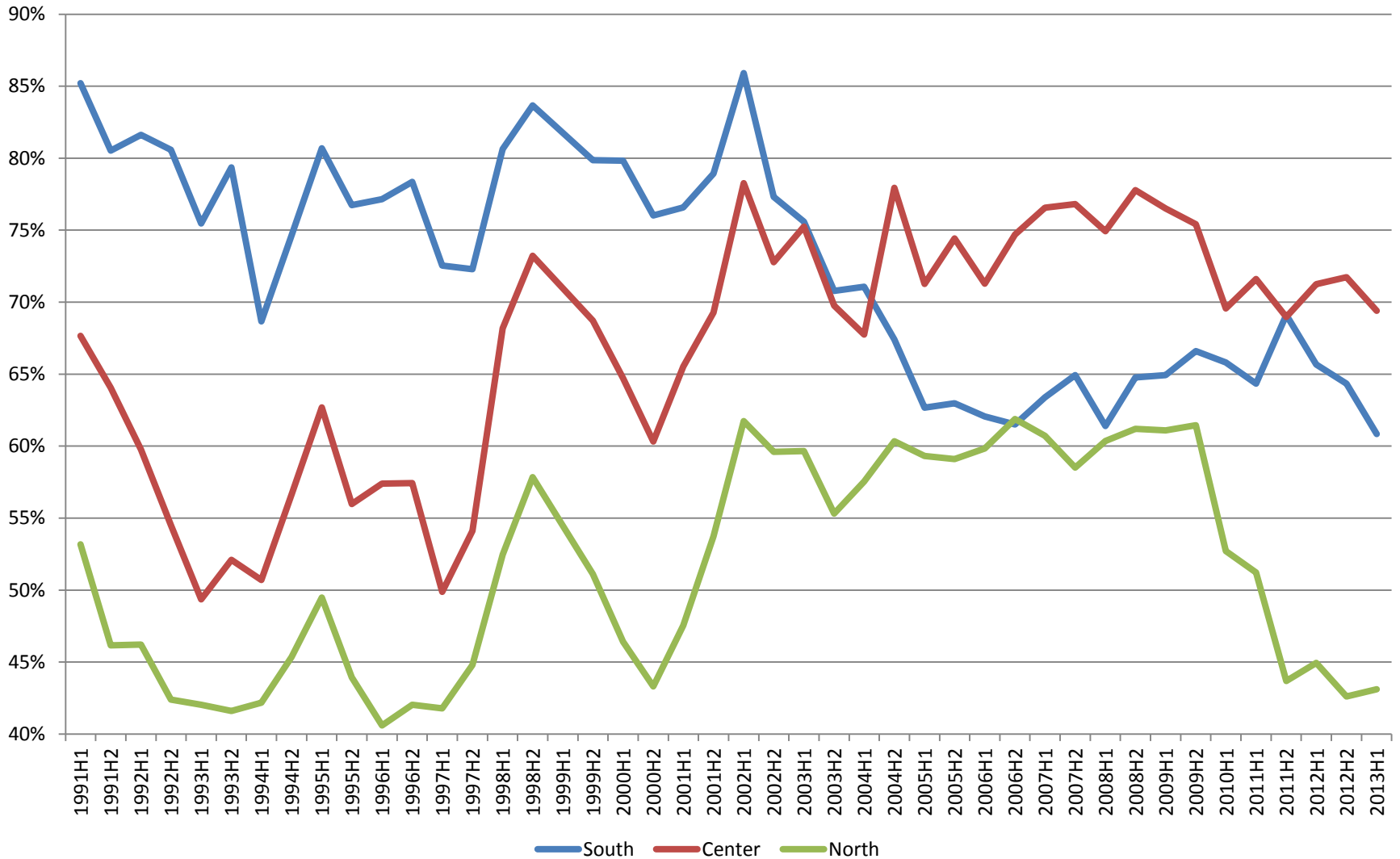


GDP/Hour Worked 1980-2011

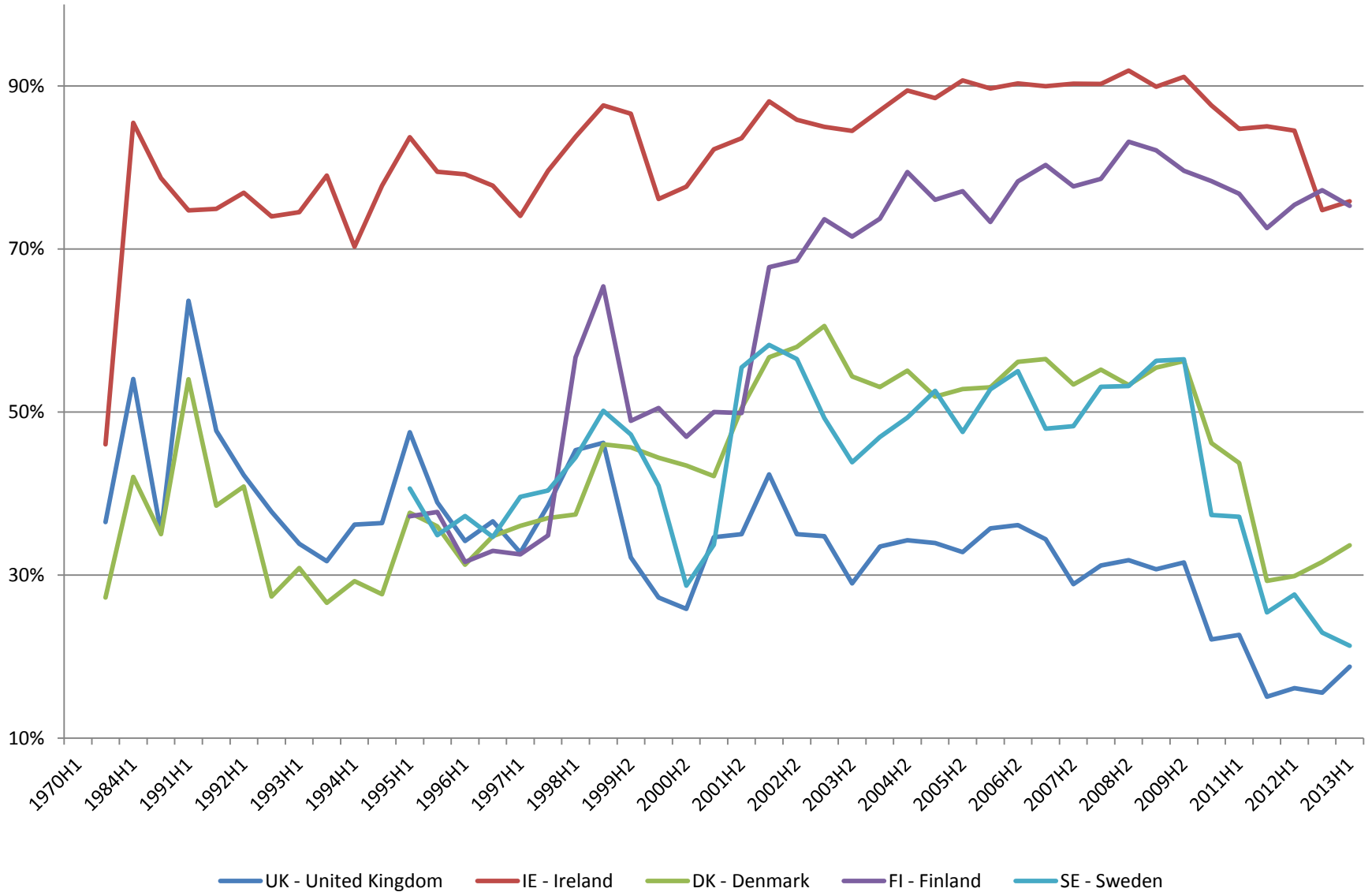
source: Penn World Tables



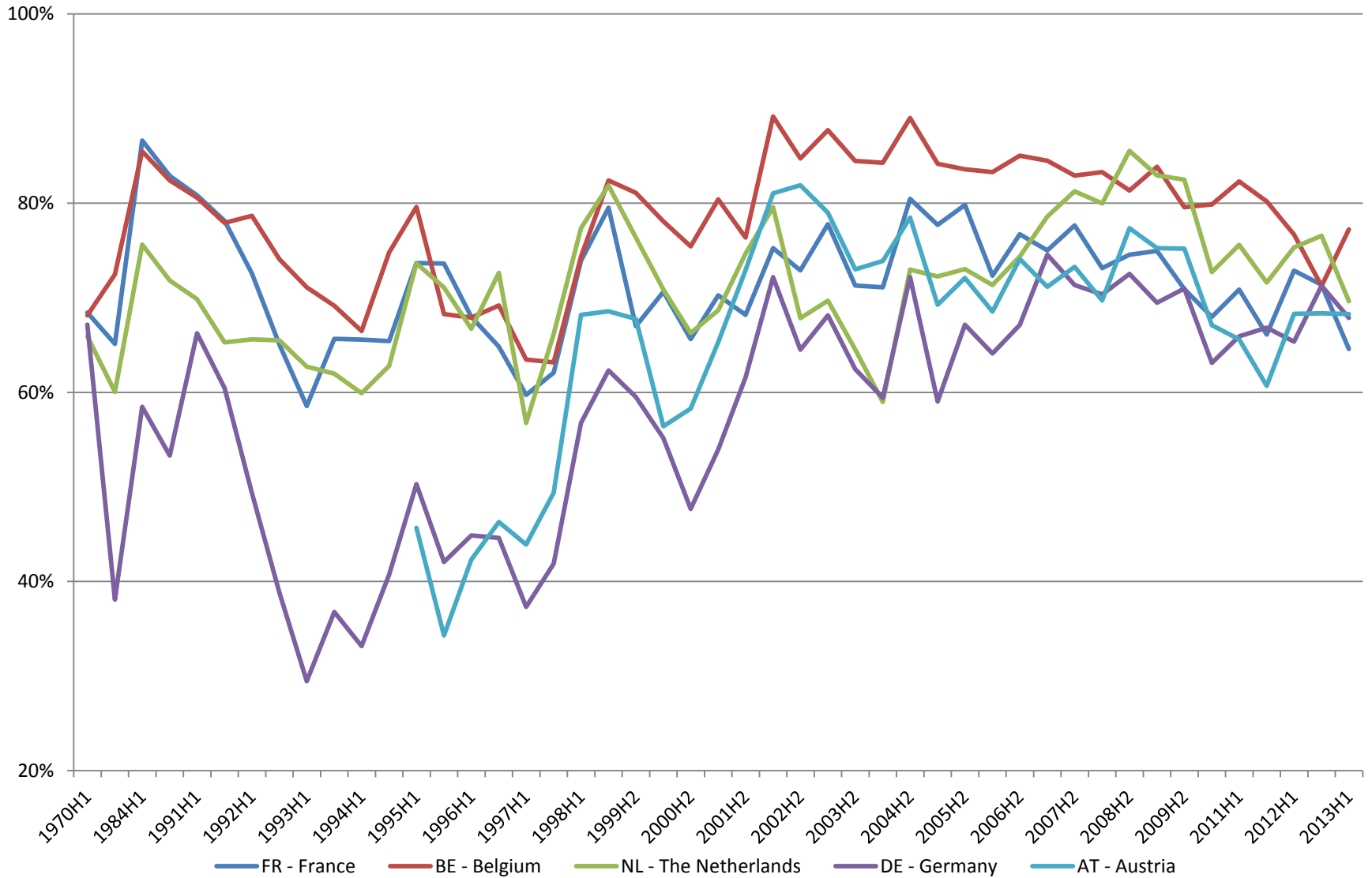
Support for the Euro



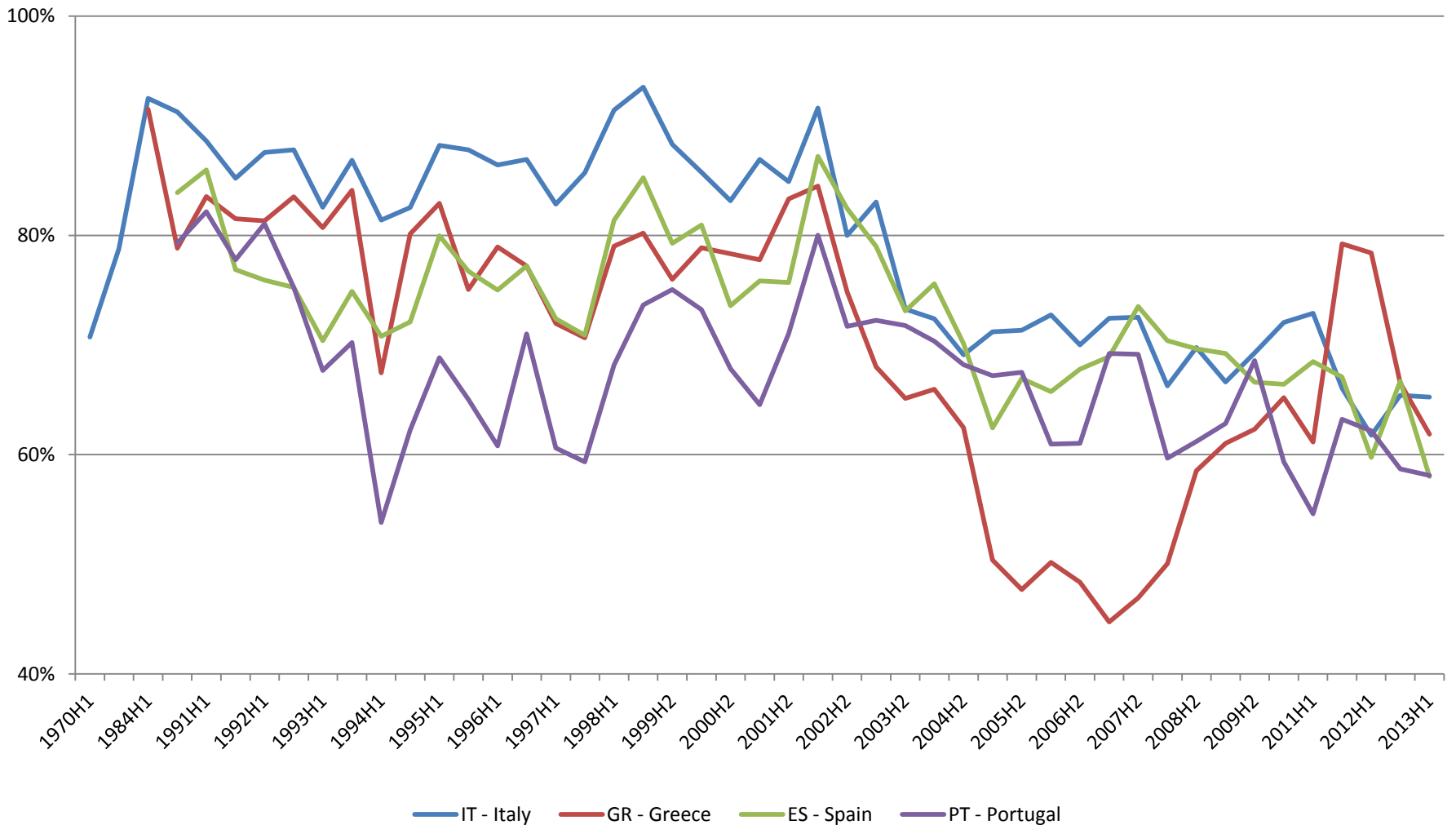
Northern Europe



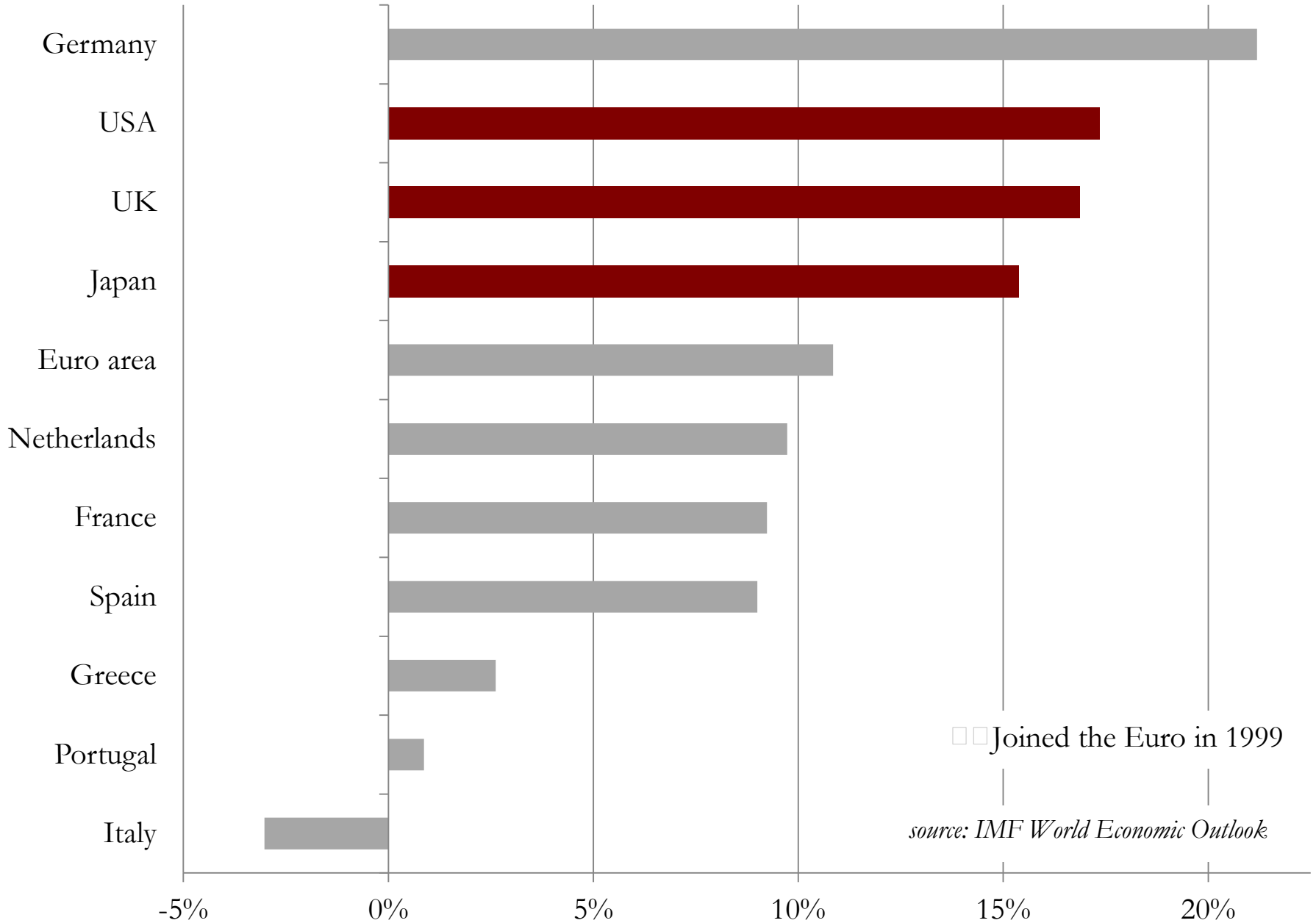
Center Europe



Southern Europe



1999-2014 Cumulative Real GDP/Capita Growth



source: IMF World Economic Outlook

Why Europe?

Political Reasons:

- To avoid future wars
- To “contain” German power
- To matter more in an international arena
- To borrow “superior” institutions (only for some)

Economic Reasons:

- To exploit economies of scale in public goods
- To create a larger and better market
- To benefit from transfers (only for some countries)

Europe Successes - 1

- The carrot for democracy and civil rights
 - Countries emerging from dictatorship were induced to accept certain rules to have access to the common market
- Compare Turkey when was hoping to enter and now.
- Carrot ends once you are in
 - Would Hungary under Orban qualify?

Europe Successes - 2

- Free capital movements of goods, capital and people.
- Without the EU, national lobbies would have found much easier to block free trade
- It is very important to preserve these aspects
- The potential damage created by a backlash could be very severe.

The problems with Europe

1. A centralistic approach
2. A flawed design of the euro

1) Centralistic Approach

Why? Two philosophical approaches:

- Cartesian view
 - One country – one law
 - Hyper-rational
 - Centralization/ coordination/homogenization
- Lockean view
 - Trial and error
 - Bounded individual rationality
 - Competition/imitation

Two models of Europe

1. Centralized union with the same

- Law
- Regulation

2. Confederation/federation of independent states
with different

- laws
- regulation

– The first one is prevailing

Is This View Feasible?

Difference in the EU

	Unpaid tickets	Lack of Corruption	Black economy	Days to enforce a contract	Days to receive a letter	Pisa score	% with a bachelor degree	Number of years of schooling
North	0.0	83.4	12.4	437.2	87.4	501.4	15.2	10.5
Center	2.4	76.0	10.7	421.0	112.1	501.0	13.5	10.6
South	7.7	53.8	21.4	797.0	127.6	479.5	12.5	9.9
Mean	3.4	70.4	14.9	558.5	109.2	495.4	13.6	10.3
St. Dev.	4.9	15.0	5.8	280.5	35.5	19.7	5.3	0.9
	Z-scores							
North	-0.68	0.87	-0.45	-0.43	-0.62	0.31	0.30	0.22
Center	-0.20	0.38	-0.74	-0.49	0.08	0.28	-0.03	0.30
South	0.88	-1.10	1.11	0.85	0.52	-0.81	-0.22	-0.48

Difference in the US

	Fraction population with		
	High School	Bachelor's	Proficient
	graduate	Degree	in Math
North	0.90	0.29	0.37
Center	0.87	0.28	0.33
South	0.84	0.24	0.24
Average	0.85	0.28	0.32
St dev	0.03	0.05	0.08
	Z-scores		
North	1.29	0.21	0.60
Center	0.43	0.00	0.04
South	-0.50	-0.81	-1.05

Trust in Europe

	Trust from:														
	Aus	Bel	UK	Den	NL	Fin	Fra	Ger	Gre	Ire	Ita	Lux	Por	Spa	Swe
Aus	3.56	2.83	2.89	3.22	2.90	3.29	2.70	2.98	2.32	2.93	2.66	2.95	2.13	2.65	3.53
Bel	2.95	3.28	2.91	3.18	3.18	3.07	3.07	2.84	2.60	2.93	2.64	2.82	2.66	2.73	3.23
UK	2.61	2.84	3.29	3.22	3.00	3.18	2.55	2.69	2.34	2.81	2.51	2.58	2.66	2.31	3.43
Den	2.95	3.01	3.13	3.39	3.29	3.30	2.96	2.97	2.56	2.99	2.70	2.86	2.66	2.73	3.57
NL	2.95	2.90	3.16	3.33	3.28	3.14	2.94	2.90	2.55	3.00	2.77	2.97	2.70	2.85	3.33
Fin	2.94	2.92	2.98	3.20	3.25	3.69	2.91	2.85	2.42	2.92	2.78	2.94	2.18	2.71	3.49
Fra	2.62	2.92	2.32	2.86	2.72	2.92	3.18	2.85	2.78	2.81	2.66	2.83	2.91	2.37	3.04
Ger	3.09	2.75	2.62	3.12	2.84	2.89	2.74	3.50	2.31	2.78	2.63	2.76	2.54	2.66	3.13
Gre	2.52	2.45	2.54	2.61	2.59	2.68	2.53	2.51	3.21	2.50	2.40	2.53	2.41	2.47	2.88
Ire	2.55	2.75	2.61	3.02	2.80	2.92	2.72	2.59	2.55	3.33	2.37	2.55	2.51	2.57	3.26
Ita	2.43	2.40	2.51	2.53	2.35	2.51	2.43	2.36	2.33	2.65	2.80	2.54	2.55	2.61	2.81
Lux	3.07	3.30	2.96	3.23	3.29	3.06	3.09	2.99	2.56	2.96	2.62	3.46	2.71	2.71	3.31
Nor	3.00	2.91	3.06	3.50	3.30	3.48	2.97	2.92	2.40	2.93	2.78	2.91	2.22	2.79	3.65
Por	2.50	2.53	2.74	2.67	2.74	2.67	2.59	2.48	2.60	2.65	2.32	2.56	3.29	2.51	2.97
Spa	2.58	2.59	2.47	2.66	2.64	2.61	2.68	2.66	2.71	2.64	2.64	2.65	2.59	3.32	2.86
Swe	3.05	2.99	3.03	3.41	3.34	3.35	2.99	2.99	2.51	2.92	2.89	2.98	2.24	2.84	3.59
Slo	1.98	2.17	2.49	2.51	2.43	2.53	2.22	1.80	2.27	2.52	2.10	2.06	1.79	2.27	2.79
Bul	.	2.46	2.56	2.70	2.70	.	2.49	2.16	2.05	2.60	2.32	2.39	2.47	2.15	.
Cec	2.05	2.40	2.66	2.71	2.73	2.64	2.44	2.10	2.39	2.59	2.34	2.36	2.17	2.27	2.88
Hun	2.31	2.47	2.68	2.75	2.74	2.87	2.53	2.33	2.37	2.67	2.38	2.38	2.18	2.22	2.87
Pol	2.07	2.50	2.83	2.76	2.77	2.59	2.56	1.94	2.35	2.74	2.43	2.38	2.21	2.32	2.69
Rom	.	2.52	2.59	2.65	2.70	.	2.49	2.07	2.38	2.56	2.44	2.37	2.46	2.23	.
CH	3.24	3.16	3.18	3.28	3.26	3.37	3.03	3.25	2.89	3.05	2.85	3.09	2.79	2.79	3.50
Tur	1.78	1.90	2.17	2.27	2.31	2.13	1.95	2.05	1.33	2.16	1.74	1.98	2.05	1.96	2.39

Trust in the States

	Trust from people from						
	New York	East Cost	Midwest	California	Texas	Southern	Average
New York	2.97	2.88	2.71	2.83	2.60	2.56	2.76
East Cost	3.13	3.15	2.91	2.89	2.61	2.85	2.92
Midwest	3.08	3.15	3.33	3.10	2.85	2.94	3.08
California	2.76	2.94	2.69	3.18	2.68	2.59	2.81
Texas	2.59	2.97	2.95	2.87	3.39	2.93	2.95
Southern	2.89	3.00	3.04	2.76	2.80	3.05	2.92
Average	2.90	3.02	2.94	2.94	2.82	2.82	2.91

Is It Desirable?

- Somebody has to decide, but who?
- The lobbying game will be played at the European level
- It is a different game from what played in Southern Europe
- Instead of open corruption there is institutional corruption
- Northern Europe dominates this game

Two examples

- **EU law on food information to consumers**
 - Consumers want country of origin denomination
 - So does Italy
 - France and Germany no
 - The Franco – German position prevails
- **2020 target for CO2 emissions from passenger cars**
 - German government and its high-end car manufacturers have been lobbying to weaken the regulation's provisions.
 - Italy and France continuously opposed the proposed German provisions, which would provide an unfair competitive advantage for German car manufacturers.
 - Germany won

- German Green MEP Rebecca Harms said the vote closes what has been a "shameful" chapter in EU history.
- "This vote confirms what is a major pre-electoral gift for the German car industry," she said. "The final agreement, which reneged on an earlier agreement, also undermines the EU's democratic decision-making process."

2) Flawed Design of the Euro

- Eurozone is not an optimal currency area
 - Different shock
 - Low mobility
 - No Fiscal transfer
- Euro created by political will ahead of economic and financial integration process
- For some countries in Southern Europe (Italy, Greece, Portugal) as an external anchor

Borrowing Foreign Institutions

- Much of the initial consensus for Europe in Southern Europe was due to the hope of borrowing institutions from the North.
- The elite in Southern Europe wanted to be European and wanted Europe to impose to its country what they could not do by consensus.
- The myth of the foreign savior.

Is the EU the cure for failed states?

- Every organization tends to sclerosis, capture by the powerful incumbents (Olson, 1982)
- In the private sector, competition forces change
- In the public sector, if we eliminate war, what is the pressure for change?
 - exchange rate and borrowing rate was an important indicator
- For 10 years the euro has anesthetized this, favoring lack of change

- After 2010, the resurgence of the spread has created political pressure for reforms.
- Yet, the OMT mechanism has shown how this pressure can be diffused by political will
- The economic policy is decided in Frankfurt
- Democratic deficit in each country

A Creditors' Takeover

- I do not seem to like either the lack of pressure or the Frankfurt pressure, why?
- Northern Europe does not act as Connecticut acts with Louisiana
- Merkel is not elected with the Greek or Italian votes
- So her desire is not to improve Greece or Italy, but just to avoid they become a problem.

A scary analogy

- European Unification has many elements in common with Italy Unification in the XIX century.
- Both
 - were elite movements who imposed a big ideal on an reluctant and ignorant majority
 - share a centralistic view
 - imposed the rules of the North to the South
 - created a suboptimal currency area
 - had a serious democratic deficit
 - reached a Faustian pact with the local “zaibatsu”

A scary analogy -2

- At the time of Italian unification, per capita income in Sicily was similar to that of Emilia Romagna (the area around Bologna) and infant mortality in Sicily was lower than in Piedmont and Lombardy (Vecchi, 2011).
- In 1951 per capita income in Sicily was half that of Emilia Romagna
- Was unification to blame?

A scary analogy -3

- Unification is not the only cause, yet ...
- Not only was the South transformed into a protected market for the nascent industries in the North, but also public works and services in the South became a hunting ground for Northern financiers.
- The Italian army was used to protect a very feudal system in the South, which would have never resisted otherwise.

Boiling the frog?

- Worse than a crisis is a slow death
- The risk of Europe and the euro is that they provide
 - Enough force to prevent a revolt (Draghi's battalions)
 - Not enough to induce a real change
- In addition Europe provides a much easier individual exit (emigration), which reduces voice (exactly like in the South of Italy).

Euro exit?

- An exit is too costly
- Helmut Schmidt: “This is the strength of the euro: no country can leave without seriously damaging its economy”
- Yet, at the current rate of inflation any adjustment in relative prices because extremely difficult

Euro solution

1. True banking union
 - Prevents stronger countries to rescue their banks
2. Common unemployment insurance
 - Paid with European funds
3. Less deflationary monetary policy

Whither Europe?

- To survive Europe needs to focus on what it can do well
 - Common market
 - Protection of property rights and civil rights
 - Common defense
- Do not try to force an unnatural union
- Community of independent states