

Monnet's Chain Reaction and the Future of European Institutional Integration: Political Economy Considerations

**Enrico Spolaore
Department of Economics
Tufts University**

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References

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Motivation

- Current events and challenges have refocused attention on the goals and limitations of European **institutional integration**.
- Critics argue that European institutional integration has gone **too far** and that the euro has failed (e.g., Feldstein 2012)
- Supporters attribute the crisis to incompleteness (a “**half-built house**”, Bergsten 2011), and ask for **more integration**: a banking union, a fiscal union, a full political union?

Europe as an incomplete house in the *Report of the Five Presidents*

- The metaphor of Europe as an **incomplete house** is echoed in the new “***Report of the Five Presidents***,” co-authored by the heads of the main EU institutions (Juncker et al., 2015).
- The Report’s central message is Europe’s economic and monetary union is “like a house that was built over decades but only partially finished” and that “it is now high time to reinforce its foundations” by moving towards a **financial union** - including the completion of the banking union and the creation of a European deposit insurance scheme - a **fiscal union**, and “finally towards a **political union** that provides the foundation for all of the above” (Juncker et al. 2015, pp. 4-5).

Monnet's Chain Reaction: Summary

- The current situation is the outcome of a long-standing European strategy of partially integrating policy functions in a few areas, with the expectation that more integration will follow in other areas, in a sort of **chain reaction** towards an “ever-closer union.”
- This gradualist strategy became the main approach to European integration in the 1950s, after the failure of a more ambitious attempt to create a defense and political community.
- The expectation was that deeper, more “political” integration would follow from integration in economic areas, in part as a result of the pressure from inefficiencies and crises associated with incomplete integration.
- From this perspective, **incompleteness** was viewed **not as a bug but as a feature**, as it was expected to lead to further integration down the road.

Successes and limits of Monnet's chain-reaction approach

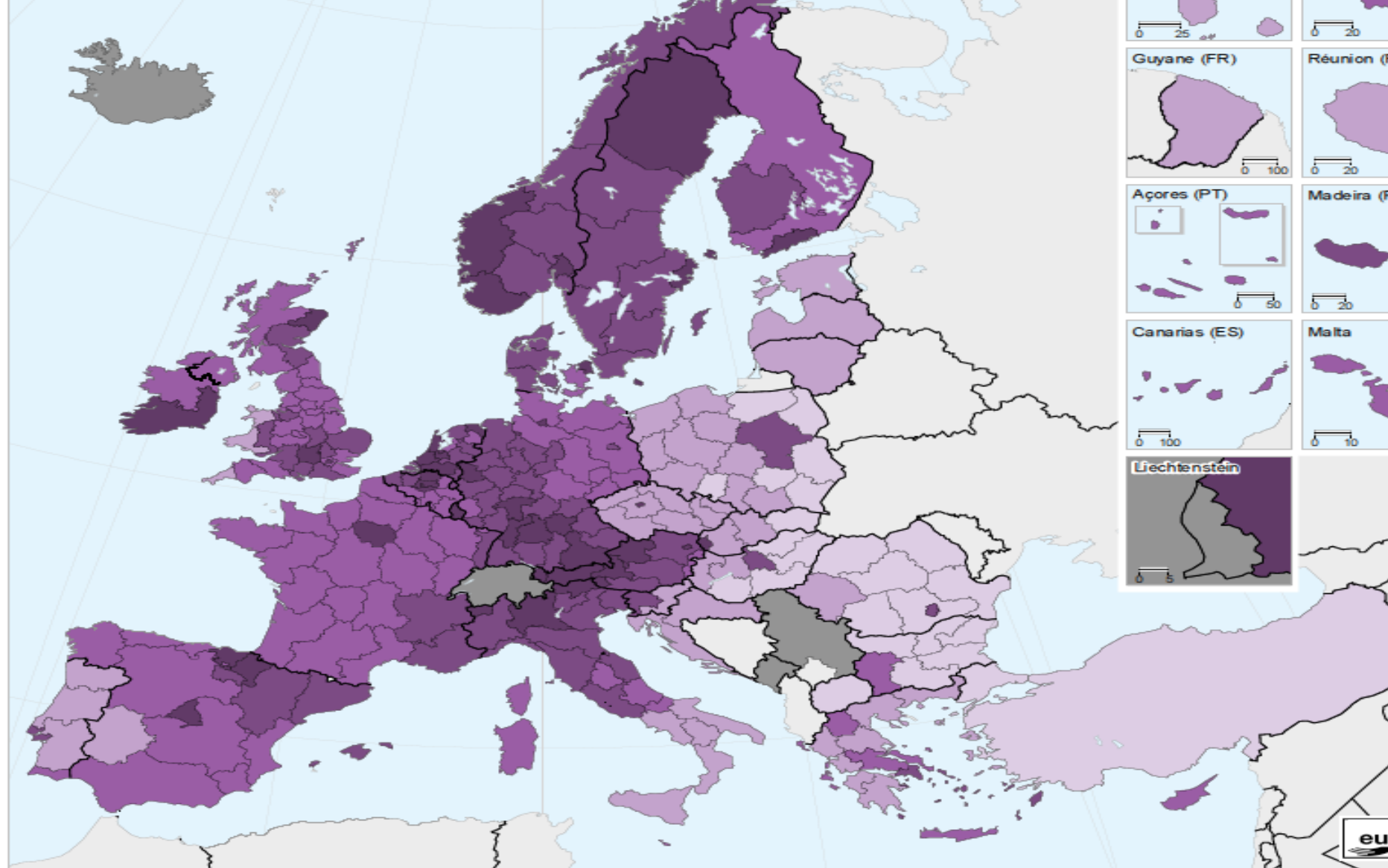
- On balance, the gradualist strategy was successful when applied to areas with **large economies of scale** and relatively **low costs from heterogeneity** of preferences and traits across different populations – for example, commercial integration.
- However, the gradualist approach, based on the **unwarranted expectation that more integration could solve the issues created by the previous steps**, and that economic integration would lead to political integration, is also at the **roots of Europe's current institutional problems**.
- Monnet's chain-reaction method has become economically and politically **too costly**, and should be replaced.

Main Analytical Concepts

- Trade-off between economies of scale and heterogeneity costs
- Costs and benefits from heterogeneity (public goods vs. rival goods)
- Endogenous heterogeneity
- Economic integration and political integration: substitutes, not complements
- Institutions and rules: complements, not substitutes

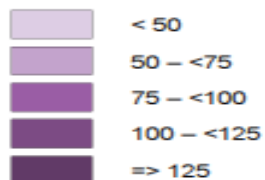
A Key Trade-off

- Public goods (legal systems, defense and security, common currency) come with **economies of scale** (benefits from a larger size)
- but those benefits must be traded against the **costs of heterogeneity** (different preferences for public policies in larger, more diverse populations)



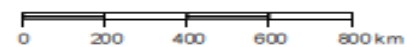
(% of the EU-27 average, EU-27 = 100)

EU-27 = 100



Administrative boundaries: © EuroGeographics © UN-FAO © T...

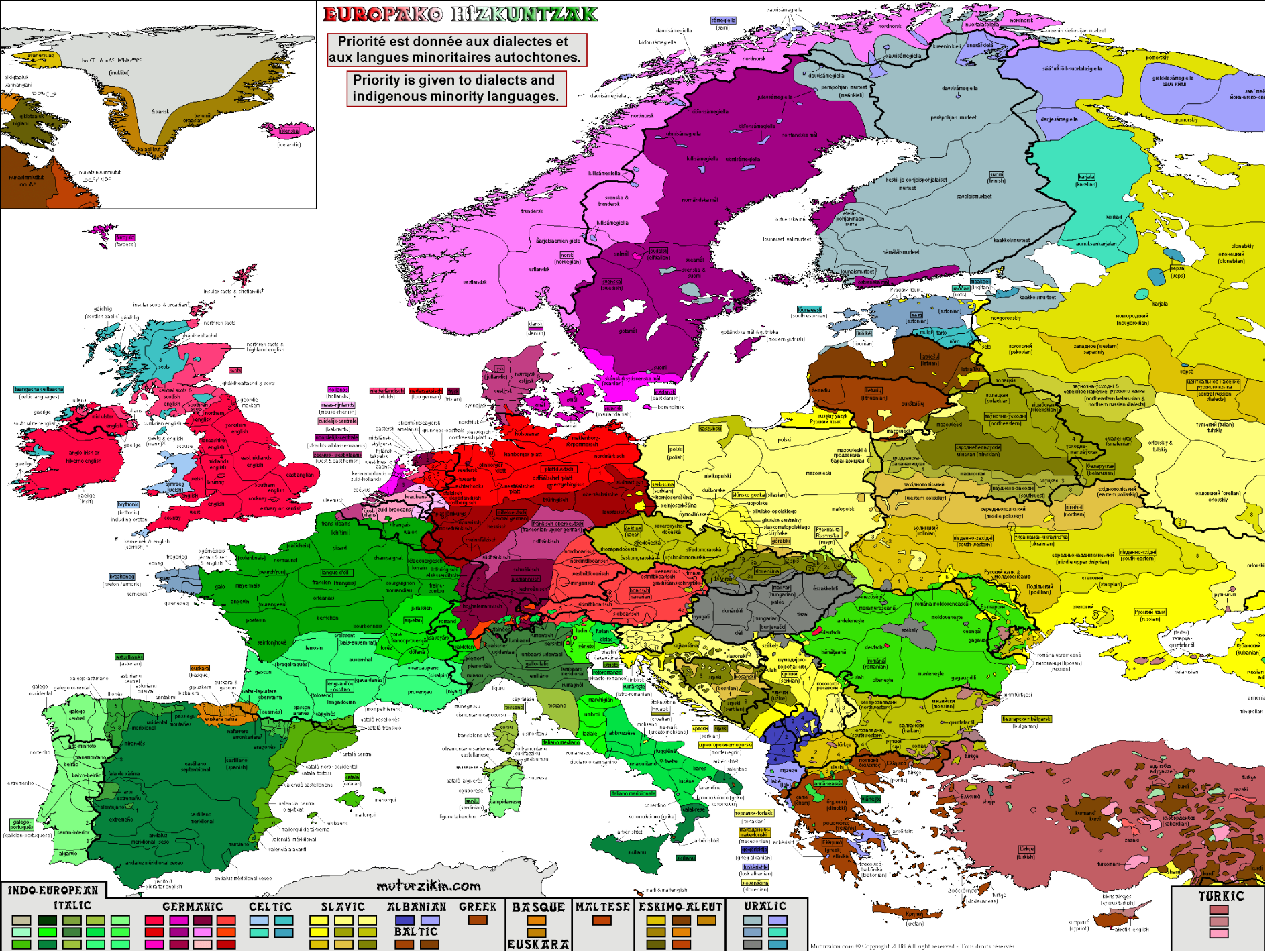
Cartography: Eurostat — GISCO, 06/2013



EUROPEAN DIALECTS

Priorité est donnée aux dialectes et aux langues minoritaires autochtones.

Priority is given to dialects and indigenous minority languages.



INDO-EUROPEAN												TURKIC			
ITALIC			GERMANIC			CELTIC	SLAVIC	ALBANIAN	GREEK	BASQUE	MALTESE	ESKIMO-ALEUT	URALIC		

The Costs and Benefits of Heterogeneity

- Large literature showing that ethnic and linguistic fractionalization and diversity affects provision of **public goods** - which are non-rival and must be shared within a jurisdiction whether one likes them or not - and **redistribution**
- E.g., Desmet, Ortuño-Ortín, and Wacziarg (2012) find that deep linguistic cleavages are good predictors of **civil conflict**, while even finer distinctions between languages matter for **economic growth** and **public goods provision**.
- In contrast, diversity comes with **benefits** when dealing with **rival** goods (trade, international conflict over territories – Spolaore and Wacziarg, 2015).

Endogenous Heterogeneity?

- Over time, couldn't a federal Europe **change political and social interactions and affect cultures and identities among Europeans**, leading to a shared identity within a “European nation”?
- 19th-century France famously turned “peasants into Frenchmen” through public policies and modernization (Eugene Weber 1976).
- This question is part of the broader debate on the persistent effects of historical/cultural traits, and the extent that culture itself can be changed by policies and institutions (e.g., see Bisin and Verdier 2010; Spolaore and Wacziarg 2013).
- Historically, nation-building and attempts to “homogenize” populations implemented by **undemocratic** rulers with an interest in reducing heterogeneity costs to maximize their own rents (Alesina and Spolaore 2003, pp. 76-78) or pursue their own preferences (Alesina and Reich 2013).
- Unlikely that **political integration** in modern **democratic nations** should lead to **cultural integration**.

The Origins of Monnet's Approach:

A Lesson in Political Realism

- From the successful creation of the Coal and Steel Community and the rejection of the Defense Community, Jean Monnet and the other supporters of European integration learned a lesson in political realism (Duchêne 1992).
- **Partial integration in narrowly defined areas**, such as coal and steel, **was feasible**, while more ambitious integration in broader areas such as defense and policy coordination would meet too much political opposition.
- The Treaty of Rome of 1957 establishing the European common market no longer referred to steps “toward a federation,” but included the vaguer objective of laying the “**foundations of an ever-closer union** among the peoples of Europe.”
- A smart idea, but also at the **origin of the current problems** and predicaments.

Monnet's Chain Reaction: Positive Mechanisms

- **Learning:** as politicians and interest groups observe the benefits of integrating a few functions, they will want more. This idea is implicit in the Schumann declaration, stating “Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements.”
- **Changes in preferences and behavior:** as groups cooperate on specific functions, barriers to communication and interaction decline, bringing an “endogenous” convergence of values and norms and a demand for more integration (Karl Deutsch).

The darker side of Monnet's chain reaction

- Partial integration can lead to more integration by generating problems and crises.
- Important complementary functions are missing at each step. For Monnet and followers, such **incompleteness is not a bug but a feature**, because it creates pressure for further integration
- “*L’Europe se fera dans les crises et elle sera la somme des solutions apportées à ces crises*” [Europe will be made in crises, and will be the sum of the solutions adopted for these crises].

Jean Monnet, *Mémoires* (1976)

Monnet's method according to his collaborator George Ball

“There was a well-conceived method in this apparent madness. All of us working with Jean Monnet well understood how irrational it was to carve a limited economic sector out of the jurisdiction of national governments and subject that sector to the sovereign control of supranational institutions. Yet, with his usual perspicacity, Monnet recognized that **the very irrationality of this scheme might provide the pressure to achieve exactly what he wanted - the triggering of a chain reaction**. The awkwardness and complexity resulting from the singling out of coal and steel would drive member governments to accept the idea of pooling other production as well.”

Why Wouldn't National Politicians and Voters Anticipate the Effects of the Chain Reaction?

- **Myopia** (no weight on the future) – not very plausible
- **Asymmetric Information** (principal/agent slack): political elites and supranational agents know more than voters and national politicians – some truth
- **Democratic deficit**: European institutions (e.g., the Commission) lack full and direct democratic accountability – closer to truth?

EMU: the Chain Reaction at Work?

“[T]he 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. The steps were the start of the EMS [European monetary system] (1979), the re-launching of the single market (1985), the decision to accelerate the liberalization of capital movements (1986), the launching of the project of monetary union (1988), the agreement of Maastricht (1992), and the final adoption of the euro (1998).”
(Tommaso Padoa-Schioppa)

Incompleteness of the EMU as an (unavoidable?) “feature”

- Helmut Kohl in 1991: "It is absurd to expect in the long run that you can maintain economic and monetary union without political union."
- From the perspective of Monnet's method, such an “absurd” economic and monetary union without political union should create pressures for still more integration.
- The euro area lacked many institutions historically associated with a successful monetary union: a central bank that could really act as market maker and lender of last resort, a banking union, and a fiscal union.
- But this incompleteness could be rationalized as a natural and unavoidable feature of partial integration in Monnet's functionalist tradition

Limitations of Monnet's Chain Reaction Method

I. Overestimation of Role and Power of Supranational Institutions

- Supranational agents' ability to take autonomous decisions can only be sustained in matters where the *extent of disagreement among national governments over policy outcomes is relatively low*, like the enforcement of trade liberalization agreements. substitutes
- Success in those areas does not imply that supranational rules could also trump national interests in other areas with much *higher heterogeneity of preferences and interests*, like fiscal policies.

An Important Application: Fiscal Institutional Integration

- In general, fiscal **institutions** and fiscal **rules** are **complements**, not substitutes
- Enforcing the rules requires credible delegation of sovereignty to institutions with autonomous power.
- Applications of Monnet's chain reaction method to "fiscal integration" have relied on overestimation of the ability to enforce supranational fiscal rules while maintaining ultimate sovereignty and enforcement at the national level.

Limitations of Monnet's Chain Reaction Method

II General problem: underestimation of the costs from heterogeneity of preferences and traits.

- Successful integration is more likely to take off in areas such as commercial integration, where heterogeneity costs are relatively low, and partly offset by the benefits from diversity.
- As integration proceeds to other areas, after low-hanging fruits are picked, ***heterogeneity costs continue to increase along a convex curve.***
- At some point, those high costs become prohibitive, and the pressure from spillovers, inefficiencies and crises will no longer lead to further integration, but just to losses, and possibly even the collapse of the whole system.

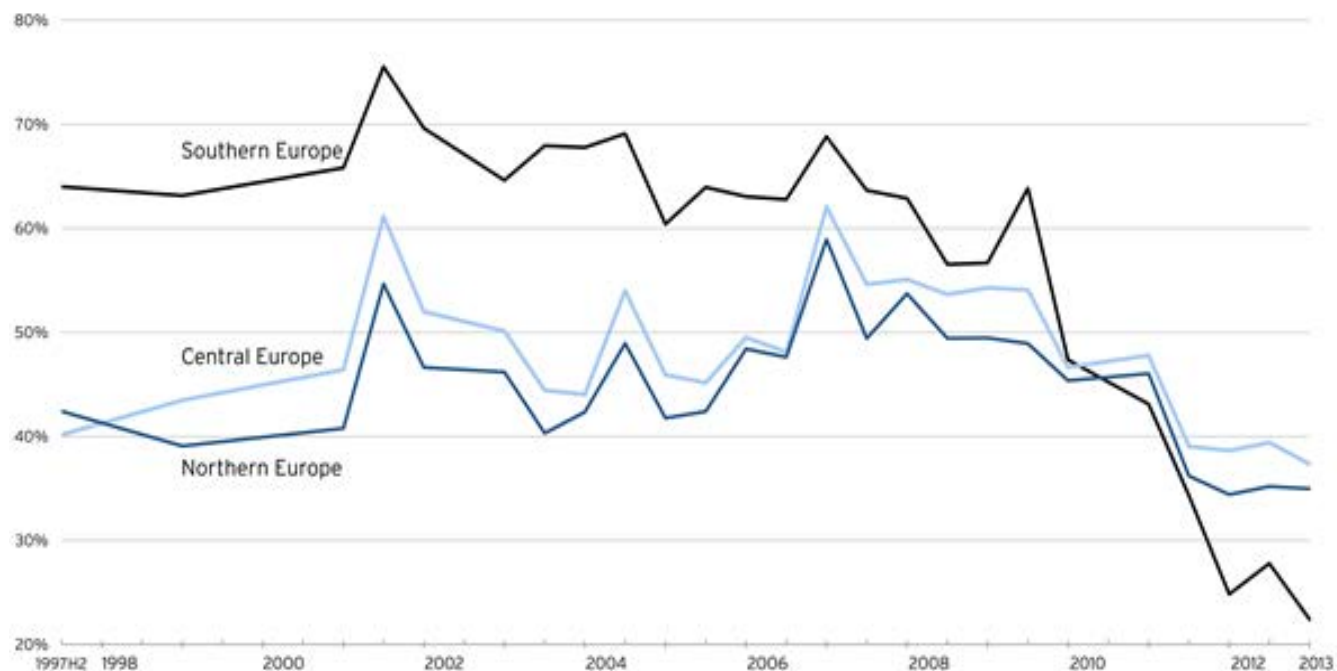
Empirical Evidence

Partial steps toward European integration have not generated more support for further steps (e.g, see Guiso, Sapienza and Zingales, 2014).

Evolution of trust toward the European Union, arranged by geographic subdivisions of the EU 15

Share of respondents who answered *Trust/Tend to trust* to the question:

"I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you tend to trust it or tend not to trust it... The European Union"



Source: Eurobarometer surveys 1997-2013

Northern Europe: Denmark, Sweden, Finland, United Kingdom, Ireland

Central Europe: Austria, Germany, France, Belgium, The Netherlands, Luxembourg

Southern Europe: Italy, Greece, Spain, Portugal

From the BPEA paper "Monnet's Error?" by Luigi Guiso, Paola Sapienza, and Luigi Zingales

Figure 10. Change in Support for a single European market and for more European political integration, before and after Maastricht (E.U. 12) – EU 12

The two bar graphs depict the average sentiments by region in March 1992 and March 1993. The bar graph on the left depicts the share of respondents who answered *A Good Thing* to the question “Overall, what do you think that the completion of the Single European Market in 1992 will be?” in 1992 and *Advantages* to the question “Do you think that Single European Market brings more advantages or more disadvantages for (OUR COUNTRY)?” in 1993. The bar graph on the right depicts the share of respondents who answered *For* to the question “Are you for or against the formation of a European Union with a European Government responsible for the European Parliament?” Sources: EB37.0 and EB39.0. Sample: EU 12

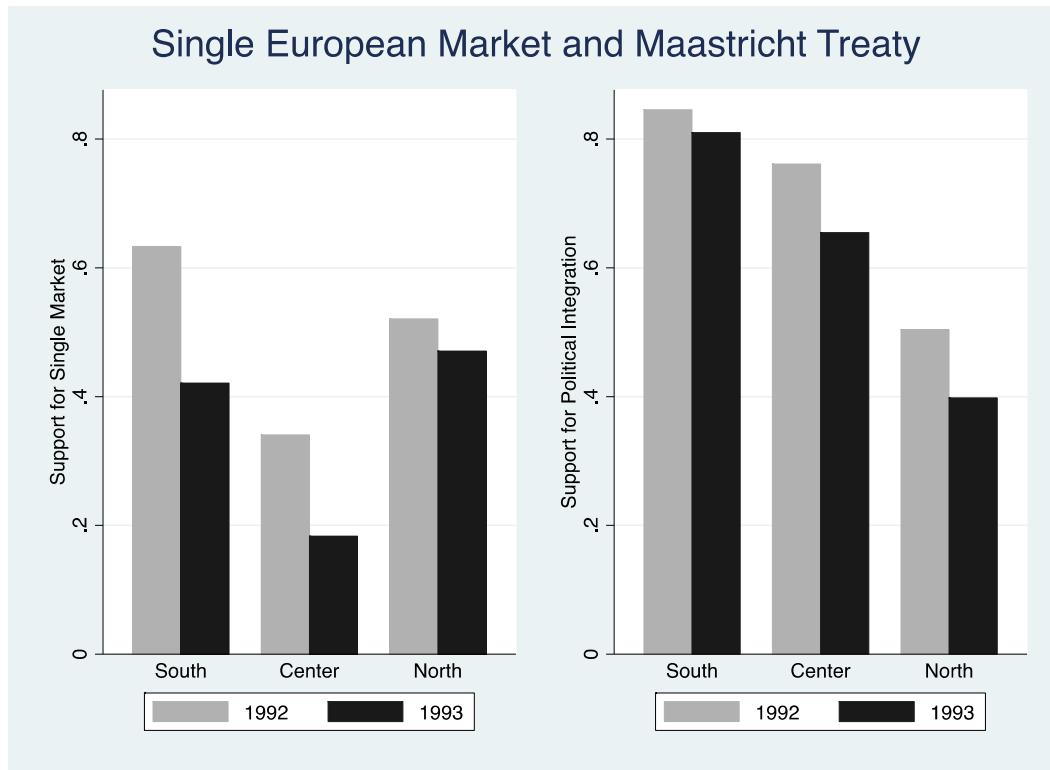


Figure 11. Change in support for further enlargements of the EU and for a single currency, before and after the 2004 Eastern European enlargement. – EU 15

The two bar graphs depict average sentiments by region in 2002 and 2005. The two graphs depict the share of respondents who answered *For* to the question “What is your opinion on each of the following statements? Please tell me for each statement, whether you are for it or against it”. In the case of the graph on the left the statement is *Further enlargement of the EU to include other countries in future years*. While in the case of the right graph, the statement is *A European Monetary Union with a single currency: the Euro*. Sources: EB58.1 and EB63.4. Sample: EU 15

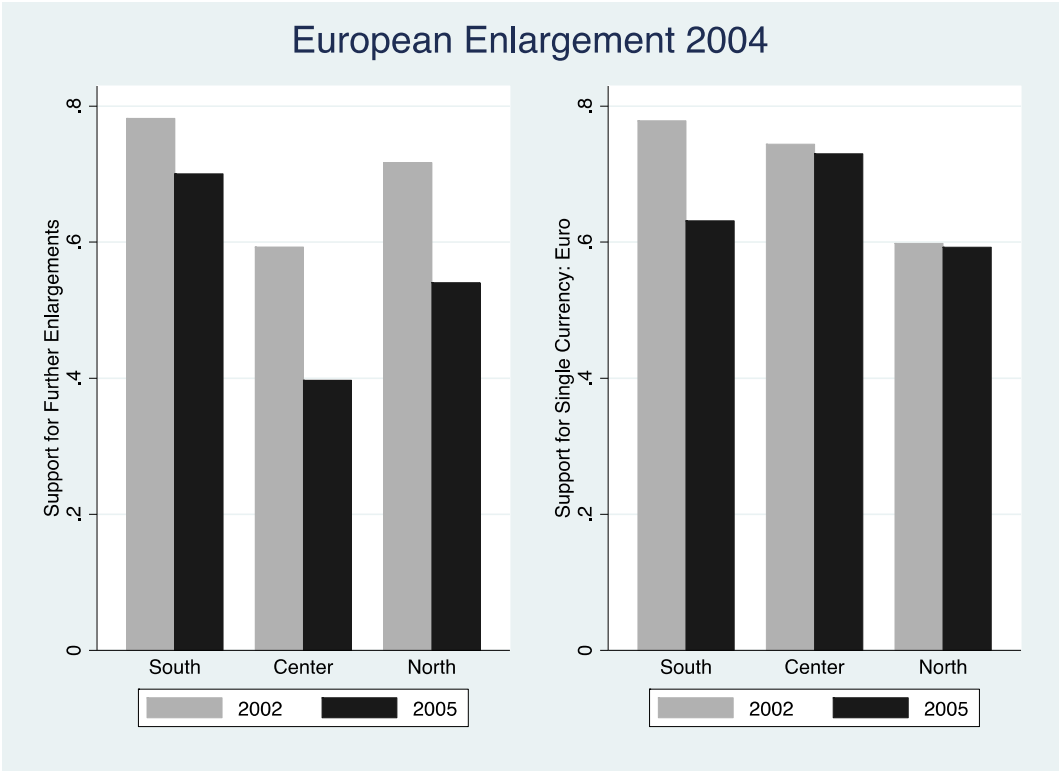
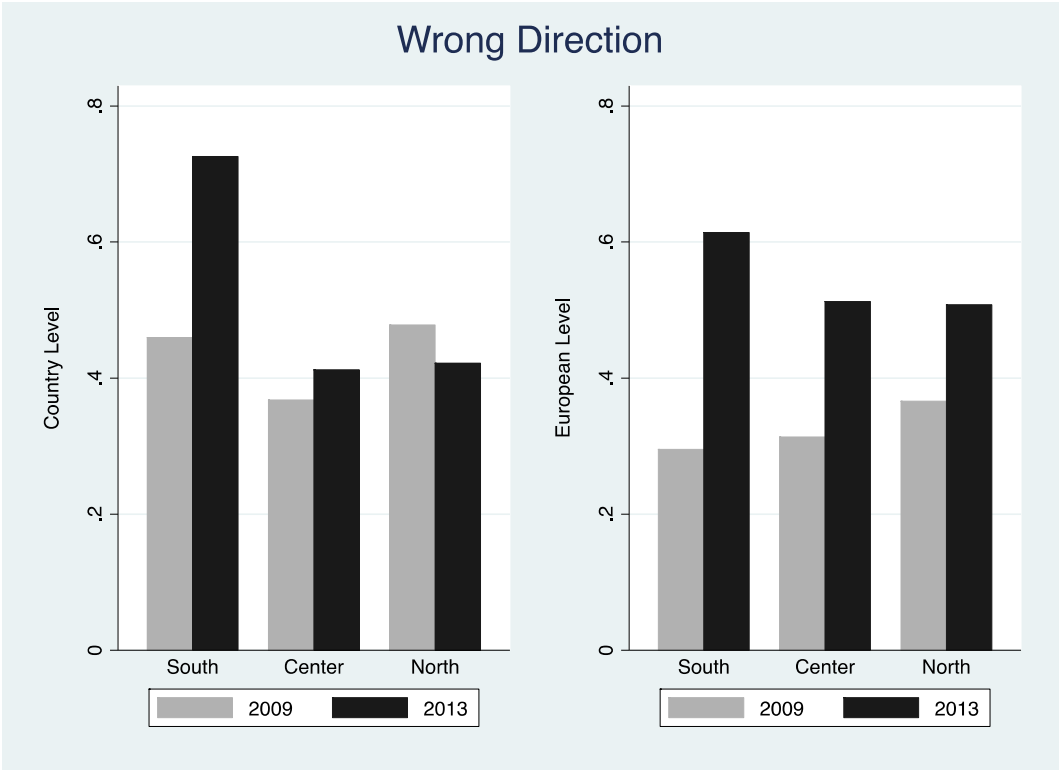


Figure 16. Change in perception of general direction before and after Eurocrisis. – EU 15

The two bar graphs depict sentiments by region in 2009 and 2013. The bar graph on the left depicts the share of respondents answering *Wrong Direction* to the question “At the present time, would you say that, in general, things are going in the right direction or in the wrong direction, in our Country?” The bar graph on the left depicts the share of respondents answering *Wrong Direction* to the question “At the present time, would you say that, in general, things are going in the right direction or in the wrong direction, in the European Union?”

Sources: EB72.4 and EB81.0. Sample: EU 15



Economic integration does not necessarily lead to political integration

- International cooperation and political integration can be viewed as ***substitute*** ways to lower barriers to trade.
- If two regions can already agree to reduce their trade barriers with each other while remaining independent, they are going to obtain ***smaller*** additional gains from trade if they also form a political union with a unified domestic market (Alesina and Spolaore, 1997, 2003; Alesina, Spolaore and Wacziarg, 2000).
- The example of the German customs union (*Zollverein*), often mentioned in this respect is misleading, because the main force behind commercial integration was political integration pushed by Prussia's military power (Gilpin, 2001).

Figure 5. Scatterplot of the Detrended Number of Countries Plotted Against the Detrended Trade to GDP ratio (Without Sub-Saharan Africa - 1870–1992)

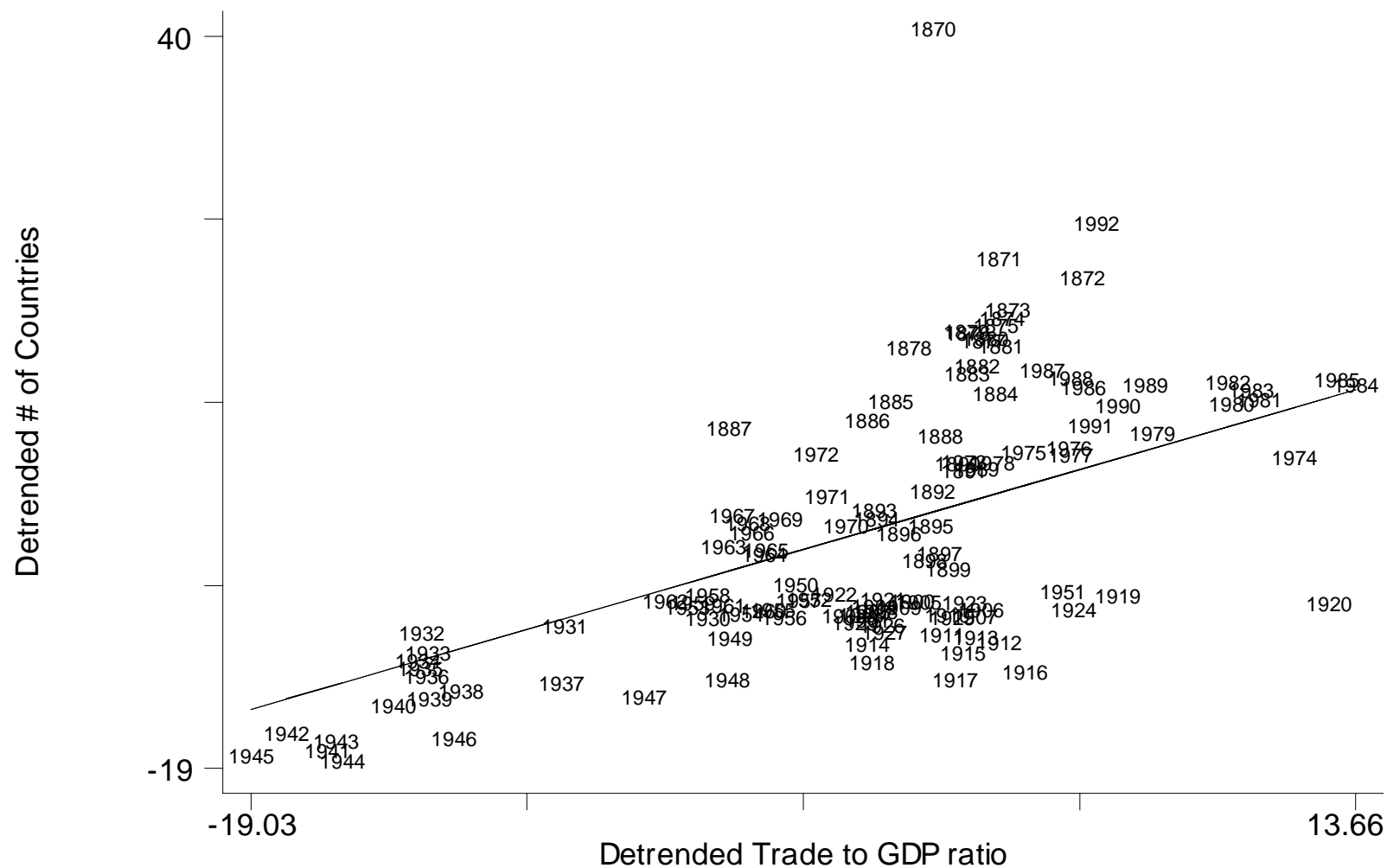
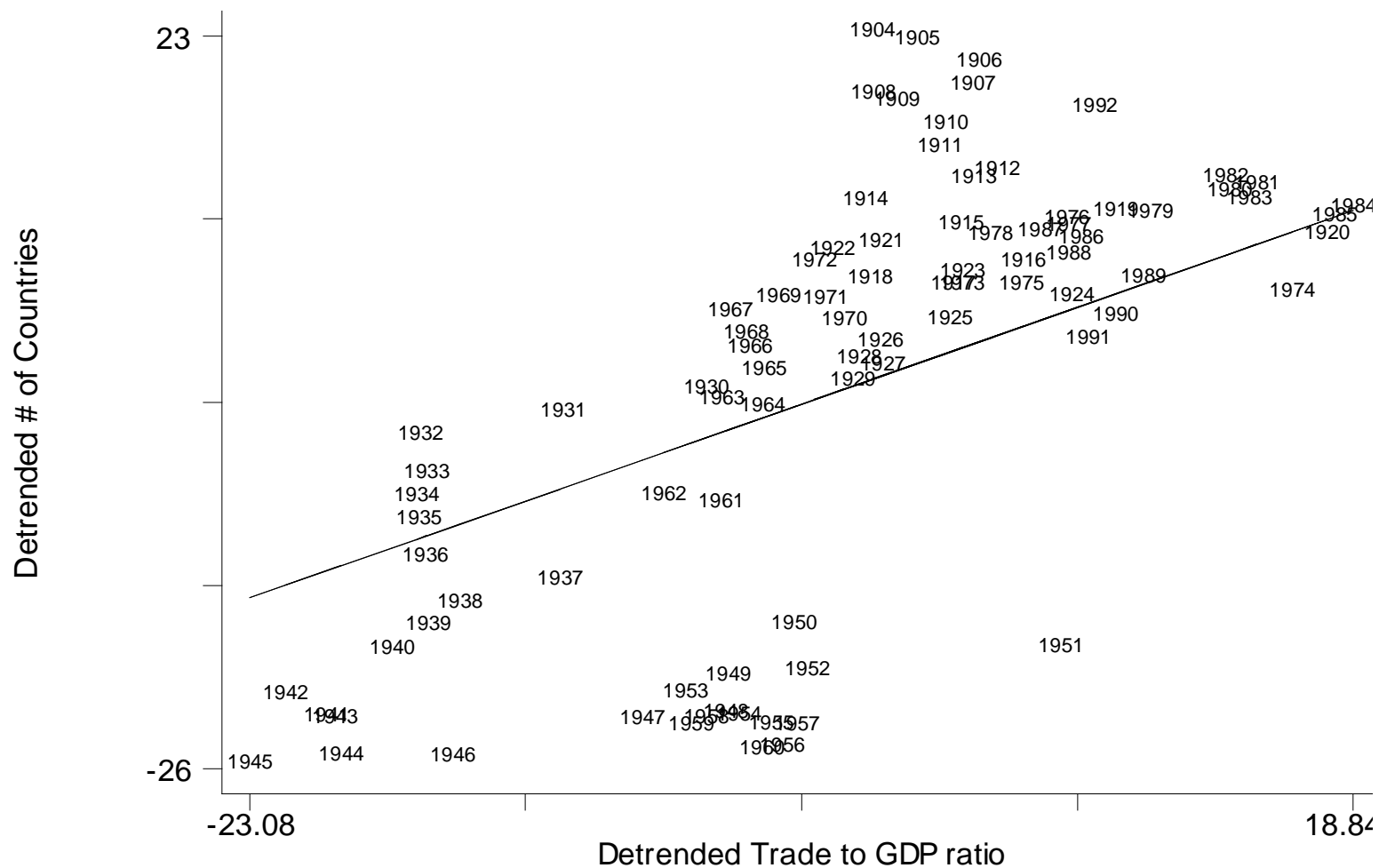


Figure 4. Scatterplot of the Detrended Number of Countries Plotted Against the Detrended Trade to GDP ratio (With Sub-Saharan Africa - 1903–1992)



Incompleteness as a bug after all

- The chain-reaction approach does not anticipate that heterogeneity costs and constraints can become binding and stop the process for good.
- Followers of this approach are therefore prone to setting up **incomplete and inefficient arrangements**, relying on the **overoptimistic expectation** that such inefficiencies can always be addressed at a later stage through additional integration.

Ending on a (moderately) positive note

- European institutional integration greatly beneficial when applied in areas with relatively ***low heterogeneity costs and large economies of scale***, such as the formation of the single market. There is still potential for progress in such areas - e.g., financial integration.
- Fiscal and political integration are obviously much more challenging because of much higher political heterogeneity of preferences and traits among the 28 member states.
- Sustainable progress much more likely, and less costly, if pursued by ***abandoning the chain-reaction's approach***, and focusing on ***reforms that make economic and political sense by themselves***, not as “steps” towards an “ever-closer union.”