
L. Guiso, H. Herrera and M. Morelli
"A Cultural Clash View of the EU Crisis"

Philippe Weil

Conference on heterogeneity in currency areas and macroeconomic policies
European Central Bank

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Always uncomfortable about invoking heterogeneous cultures to explain policy failures:

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Always uncomfortable about invoking heterogeneous cultures to explain policy failures:

- It is often a short stretch from here to advocating isolation, secession or nationalism.

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Always uncomfortable about invoking heterogeneous cultures to explain policy failures:

- It is often a short stretch from here to advocating isolation, secession or nationalism.
- It feeds pessimism about policy making in (loosely) integrated organizations.

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Always uncomfortable about invoking heterogeneous cultures to explain policy failures:

- It is often a short stretch from here to advocating isolation, secession or nationalism.
- It feeds pessimism about policy making in (loosely) integrated organizations.
- Emphasis on the evolutionary benefits of having a population with lots of (German) punishers makes me queasy.

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Two reassuring elements, however:

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Two reassuring elements, however:

- Nothing makes the Greeks intrinsically Greek or the Germans German in the paper:

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Two reassuring elements, however:

- Nothing makes the Greeks intrinsically Greek or the Germans German in the paper:
 - ▷ Countries just happen to converge to different (multiple) equilibria.

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Two reassuring elements, however:

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 - ▷ Countries just happen to converge to different (multiple) equilibria.
 - ▷ The labels could as well be switched: Ypsilantis in Berlin, Bismarck in Athens.

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Two reassuring elements, however:

- Nothing makes the Greeks intrinsically Greek or the Germans German in the paper:
 - ▷ Countries just happen to converge to different (multiple) equilibria.
 - ▷ The labels could as well be switched: Ypsilantis in Berlin, Bismarck in Athens.
- Integration dominates isolation (thanks to $\lambda > 1$).

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Whether or not the paper offers an accurate description of the Greek-German *Kulturkampf* can be discussed forever:

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Whether or not the paper offers an accurate description of the Greek-German *Kulturkampf* can be discussed forever:

- Talking about "deeply rooted norms and beliefs" when Germans and Greeks are deep-down identical in the model but just happen to end up in different equilibria is a bit of a stretch.

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Whether or not the paper offers an accurate description of the Greek-German *Kulturkampf* can be discussed forever:

- Talking about "deeply rooted norms and beliefs" when Germans and Greeks are deep-down identical in the model but just happen to end up in different equilibria is a bit of a stretch.
- Terminology is illustrative at best: there is nothing monetary or fiscal in the monetary and fiscal unions described in the paper.

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A better way to spin the story is probably the following:

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A better way to spin the story is probably the following:

- Union dominates isolation in that it enhances payoffs to good, more than to bad, behavior...

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A better way to spin the story is probably the following:

- Union dominates isolation in that it enhances payoffs to good, more than to bad, behavior...
- ... but uniting to obtain these enhanced payoffs leads to problems/crises as long as reward and punishment are decentralized and initial steady states are different (it leads to inefficient meetings between tough German principals and Greek cheaters).

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A better way to spin the story is probably the following:

- Union dominates isolation in that it enhances payoffs to good, more than to bad, behavior...
- ... but uniting to obtain these enhanced payoffs leads to problems/crises as long as reward and punishment are decentralized and initial steady states are different (it leads to inefficient meetings between tough German principals and Greek cheaters).
- The creation of a tough central (Federal?) enforcement authority slowly eliminates these crises and leads all countries to the efficient steady state.

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- Lax or tough parents meet randomly with cheating or well-behaved kids.

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- Lax or tough parents meet randomly with cheating or well-behaved kids.
- Punishment of a misbehaving child is the least favored outcome for both parent and kid. So tough parents are not sadists who enjoy punishing, and misbehaving kids are not masochists!

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- Parents prefer dealing with a well-behaved child than having to forgive a misbehaving kid (punishing the kid is even worse).

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- Lax or tough parents meet randomly with cheating or well-behaved kids.
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- Parents prefer dealing with a well-behaved child than having to forgive a misbehaving kid (punishing the kid is even worse).
- Kids prefer misbehaving and being forgiven to behaving responsibly (being punished is even worse).

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Survival of the fittest

- If they are initially lots of lax parents, all kids misbehave and all parents become lax ("US" equilibrium).

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Survival of the fittest

- If they are initially lots of lax parents, all kids misbehave and all parents become lax ("US" equilibrium).
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Survival of the fittest

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Remark

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Remark

- The world described in the paper is one in which there is no central domestic authority in either country. Punishment and forgiveness are the sole result of private behavior. No central enforcement mechanism, no police, no courts — either in the US (where they would help) or in Germany (where they are useless in the long run).

Survival of the fittest

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Remark

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- Why is this relevant? Because fiscal union is modeled as the creation of a centralized enforcement mechanism!

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Mixing two populations, one with only misbehaving kids and only lax parents ("US"), the other one with only dream kids who never need to be punished ("DE"), suddenly puts in contact bad kids (who were never punished) with tough parents (who never had to punish):

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- Bad for those rotten US kids unlucky enough to meet a tough German parent, but good for US parents happy to who meet a nice German kid: positive effect on the US overall only if enough German parents are lax!

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- Tough Germans parents unhappy to mingle with Greeks as they don't enjoy punishing miscreants.

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Hence no voluntary ("monetary") union unless it enhances utility in some other way.

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- "Monetary" union is described as enlarging by a factor λ the payoff of responsible actions (NB: nothing monetary about that union... just no central enforcement mechanism).

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Conclusion

- "Monetary" union is described as enlarging by a factor λ the payoff of responsible actions (NB: nothing monetary about that union... just no central enforcement mechanism).
- If λ is high enough, both countries will be initially happy to join BUT things might go awry for the Germans (convergence of the union to a US equilibrium!) if the combined initial proportion of German laxists and Americans (all laxists!) is too high.

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- On top of this, the union is strained if λ turns out low ex post.

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- On top of this, the union is strained if λ turns out low ex post.
- Add to this a "fiscal" union, or rather a union with tough centralized enforcement.

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- On top of this, the union is strained if λ turns out low ex post.
- Add to this a "fiscal" union, or rather a union with tough centralized enforcement.
- This eliminates crises and leads both countries slowly to the efficient steady state.

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- Assumption that, outside of a (fiscal) union, countries have no centralized enforcement authority is bothersome.

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- Assumption that, outside of a (fiscal) union, countries have no centralized enforcement authority is bothersome.
- With national enforcers y' , population dynamics of first-mover cheaters x and second-mover forgivers y would be, in each country before integration, governed by:

$$\begin{aligned}\dot{x}/x &= (1-x)(y' - \bar{y}_r)u_1(cf) \\ \dot{y}/y &= x(1-y')u_2(cf)\end{aligned}$$

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- So $y \rightarrow 1$ as soon as $x_0 > 0$; and $x \rightarrow 1$ if $y' > \bar{y}_r$ (weak national law enforcement) or $x \rightarrow 0$ if $y' < \bar{y}_r$ (strong national law enforcement).

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- So $y \rightarrow 1$ as soon as $x_0 > 0$; and $x \rightarrow 1$ if $y' > \bar{y}_r$ (weak national law enforcement) or $x \rightarrow 0$ if $y' < \bar{y}_r$ (strong national law enforcement).
- Same results as in the fiscal union but each country might have a different institutions (a different y').

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- Now integrate the two populations into a "union" but keep separate national enforcers with different degrees of toughness $1 - y'_{GR} < 1 - y'_{DE}$.

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- Now integrate the two populations into a "union" but keep separate national enforcers with different degrees of toughness $1 - y'_{GR} < 1 - y'_{DE}$.
- Two ways to proceed depending on where punishment occurs: jurisdiction of the principal or of the agent?

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- Now integrate the two populations into a "union" but keep separate national enforcers with different degrees of toughness $1 - y'_{GR} < 1 - y'_{DE}$.
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- Introduce a supranational enforcer: how does it compare with national enforcers? As tough or tougher than the toughest?
- Confederation v. federation?
- Much easier...

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- A fun and elegant paper

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- Terminology (monetary, fiscal) is slightly misleading.

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- The main point is about the benefit of supranational law vs. domestic law.

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- A fun and elegant paper
- Terminology (monetary, fiscal) is slightly misleading.
- The main point is about the benefit of supranational law vs. domestic law.
- The point would be stronger if the comparison was *not* made with national entities devoid of any domestic legal system