

# A Culture Clash View of the Euro Crisis

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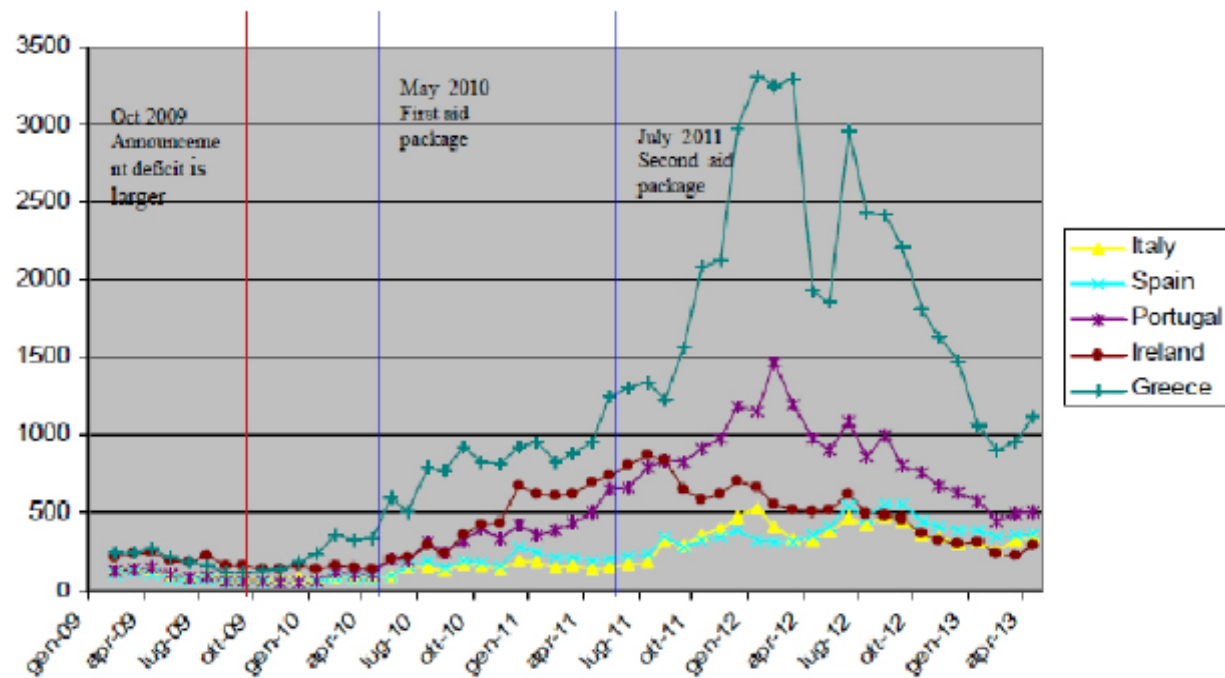
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## A mis-managed European Crisis: Why?



A political failure? Raghuraj Rajan: “Politicians are failing Europe by being forever behind the curve. Why do they find it so hard to lead?”



## Explanations so far...

- Ardagna & Caselli 2012
  - High coordination costs
  - Many countries involved
  - Different value assigned to a bailout by different countries
  - Our view: the main actor is largely Germany alone



## Our view

- EU integration is a merger of countries with different cultural norms
- Cultural clash between different shared norms: **Germany-Greece**
- Cultural clash generates inefficient economic outcomes
- How can we adjust this?
- Focus on: Idiosyncratic policies/cultures, not idiosyncratic shocks



## Our Goal: “Cultural Constraint”

- Bring “culture” into political economy
- Business cycle frequency...not only in the very long term
- See culture as a new source of frictions affecting macroeconomic outcomes
- *Deeply rooted cultural norms and beliefs are a constraint on politicians: a conformity constraint*
  - Hard for an Indian political leader to propose a bill asking firms to produce beef formula in response to a famine
- Even farsighted politicians, who preview the disaster that awaits may be unable to act

**Axel Weber: Politicians have perfect foresight of the disaster that awaits, they may have little ability to persuade voters...**



- NB: Not a model of the origin of the EU crisis: external US shock.
- A rationale for the exacerbation and procrastination of the crisis

## Before the Crisis: Potential for a Cultural Clash

### Measures of Civic Values (WVS 2000)

	Germany	Greece	Differ.	t-test
Claiming unfair Government benefits	9.00	6.96	2.04	<b>24.7</b>
Avoiding a fare on public transport	9.04	7.57	1.47	<b>19.19</b>
Cheating on taxes	8.63	7.83	0.80	<b>9.27</b>

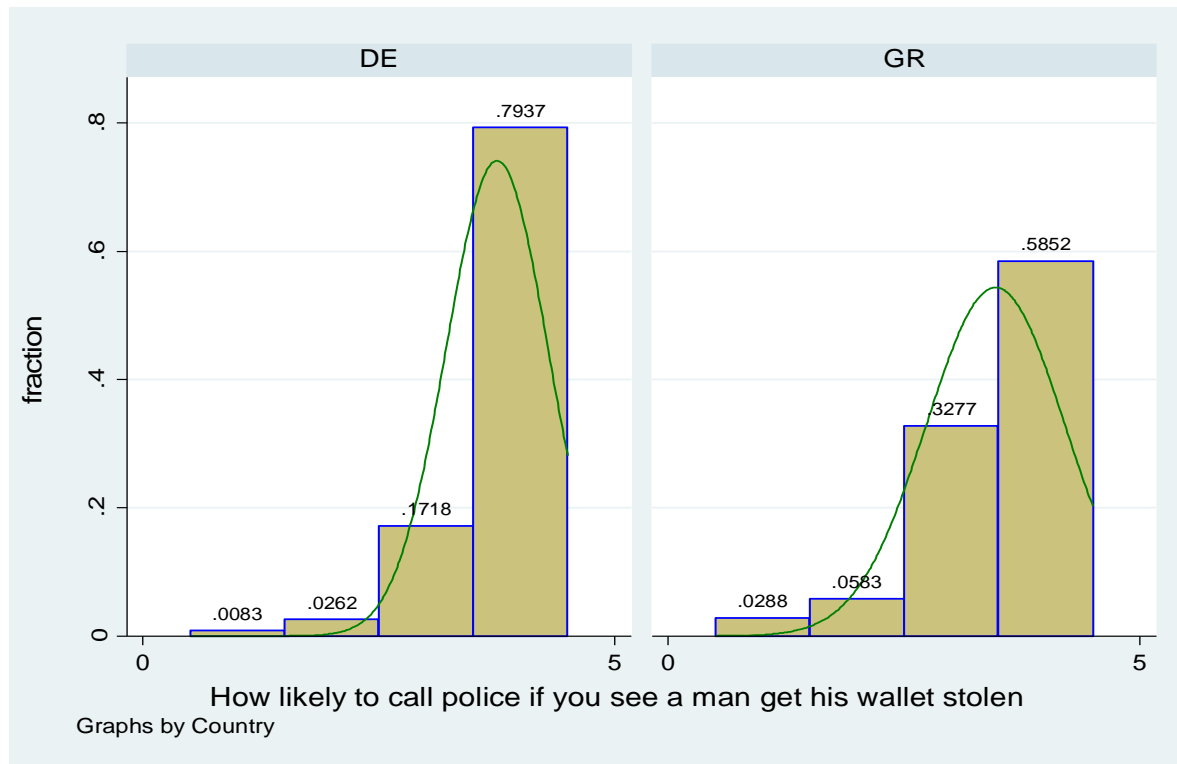
### Cultural Norms Indicators (Tabellini (2009))

	Germany	Greece	Differ.	t-test
Respect	0.71	0.52	0.19	<b>10.42</b>
Obedience	0.14	0.11	0.03	<b>2.51</b>
Control	7.25	7.00	0.25	<b>3.70</b>
Generalized trust	0.38	0.24	0.14	<b>7.58</b>

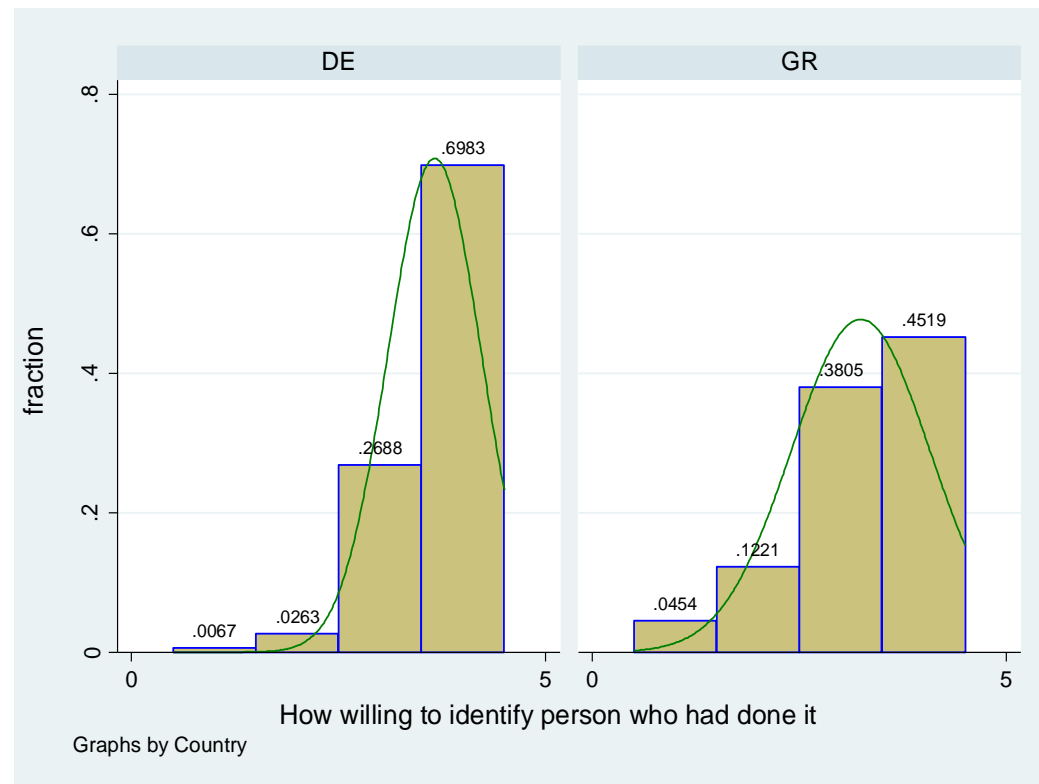


**More Responsible Behavior Among German**

## Willingness to call the police (ESS 2010)

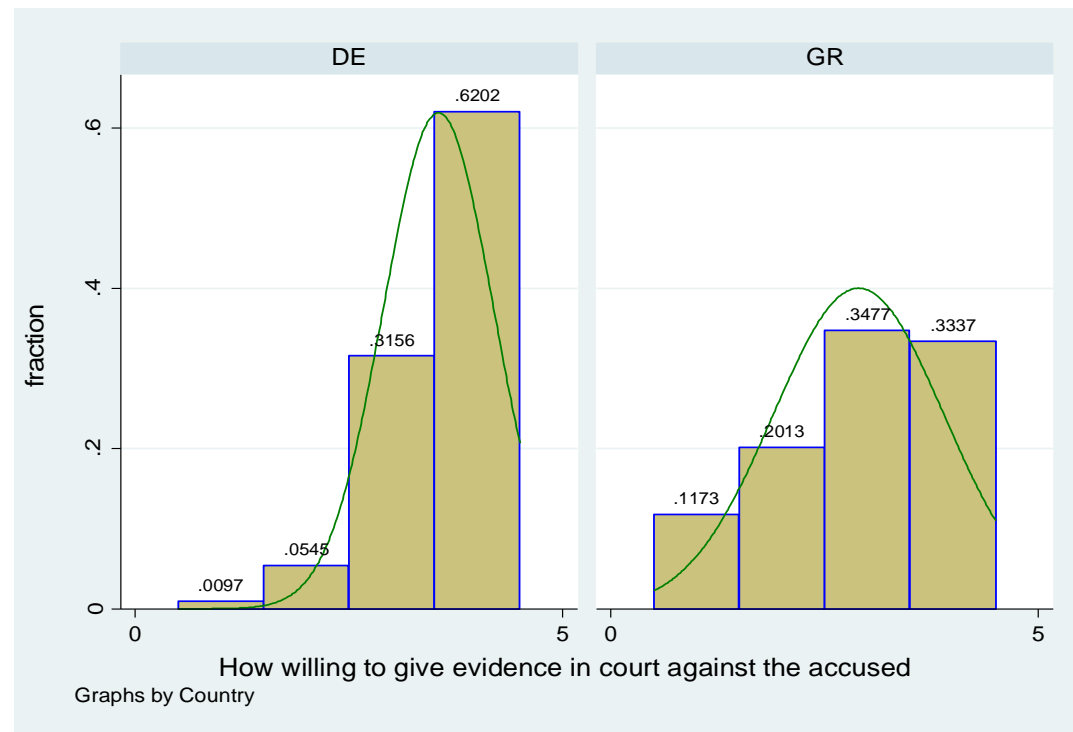


## Willingness to identify the person





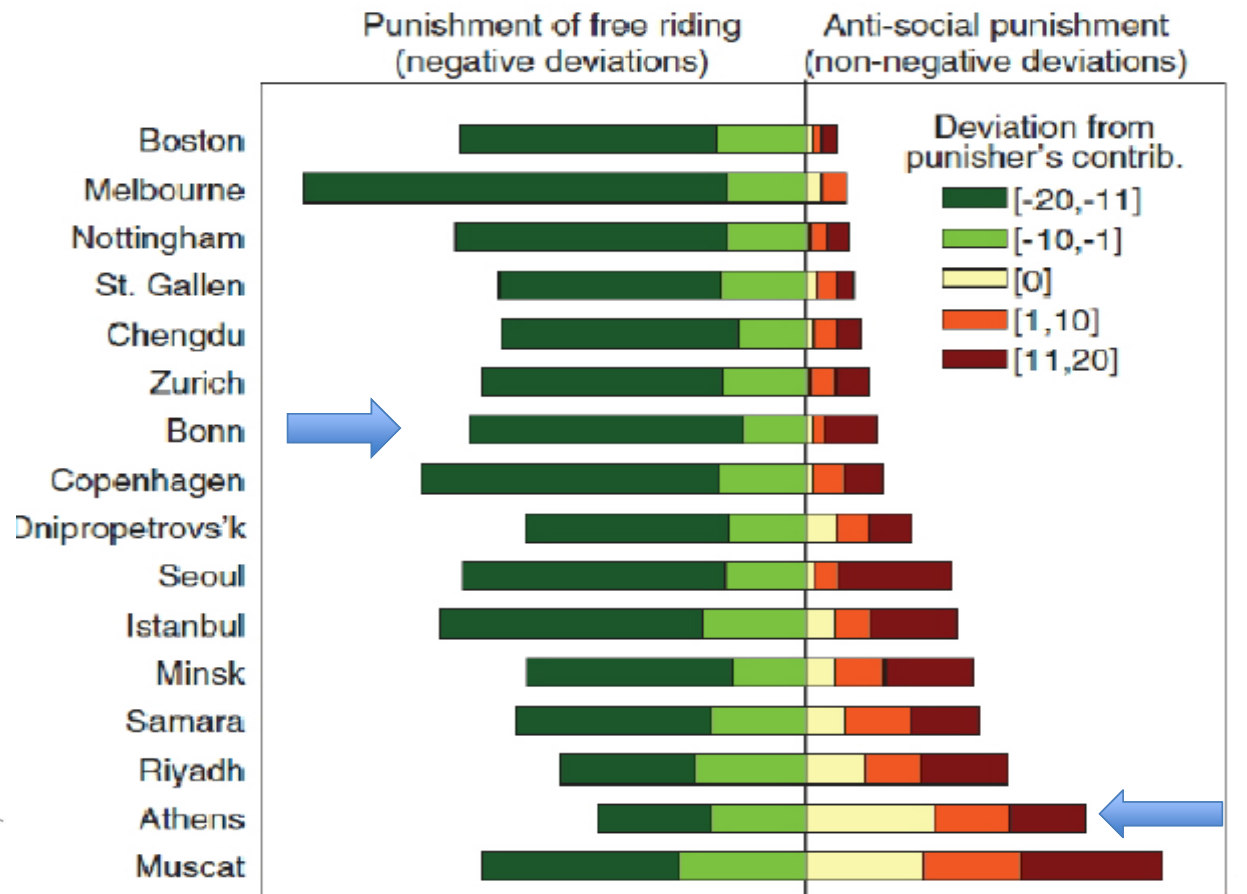
## Willingness to give evidence in court



More Willingness to Punish Wrongdoers among Germans. May be due to lack of police/court efficiency in Greece?



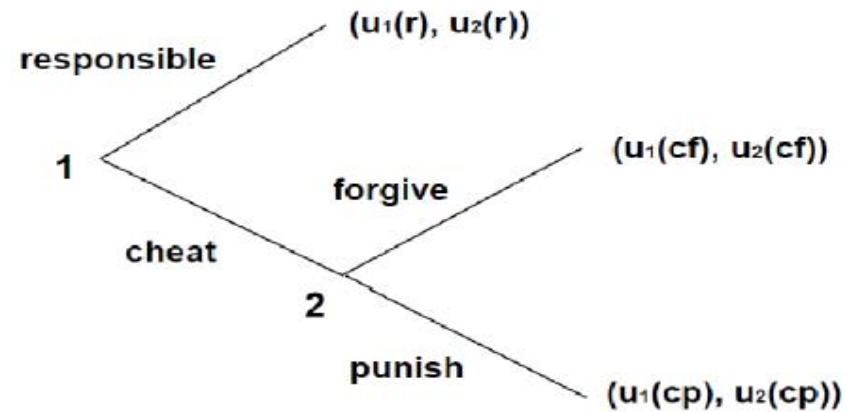
# Herrmann, Thöni & Gächter. Science (2008)



## Two Stage Punishing Game

Economy is a set of bilateral interaction between two type of players:

1. Responsible or Cheating
2. Forgive or Punish



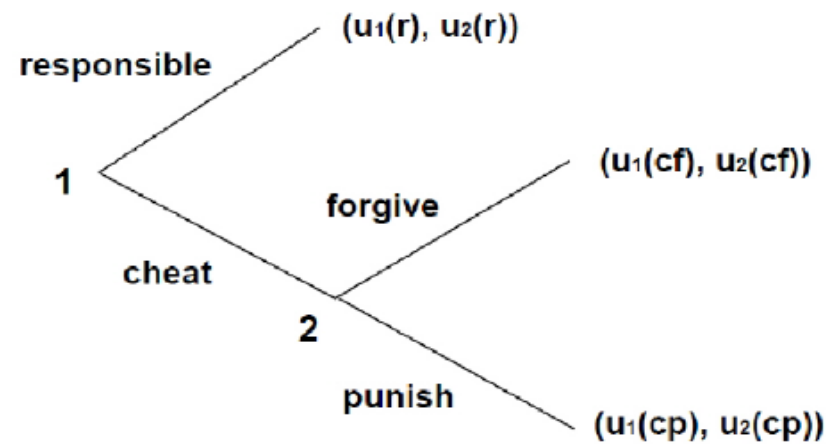
$$u_1(cp) < u_1(r) < u_1(cf)$$

$$u_2(cp) < u_2(cf) < u_2(r)$$



## Two Nash Equilibria

- $(c, f)$  (subgame perfect)
- $(r, p)$  (non-credible threat)



$$\sum_i u_i(cf) < \sum_i u_i(r)$$



## Evolutionary games

- Consider first each economy in isolation
- Large number of expected transactions
- Pairs of individuals randomly matched: player 1-player 2
- Programmed to play one of the two pure strategies available
- $x \in [0,1]$ : the fraction of first movers programmed to play Cheat (1-x play Responsible)
- $y \in [0,1]$  : the fraction of second movers programmed to play Forgive (1-y play Punish)



## Findings 1: two steady states

- Two steady states :
- iff  $y > \bar{y}_r$  converge to all cheaters and forgivers  
(Greek equilibrium)
- Otherwise converge to a steady state with first movers all responsible and a critical mass of punishers (German equilibrium)
  - Culture is the strategy people play



## Findings 2: Monetary Union (without additional Institutions)

- Common currency: lower barriers, more cross-country matches,
- Clash of individuals of different cultures: programmed to play different strategies
- Worst possible match: Cheater-Punisher (Greek agent, German Principal): Payoff (0,0).
- No monetary union if no extra benefit
- If monetary union implies surplus creation ( $\lambda > 1$ ): **Monetary union preferred by both** provided small cultural distance between the two countries



### Findings 3: Crisis and Break-up: bad shock to lambda

- $\lambda$  is expected to be high ex-ante but subject to shocks=> monetary union preferred ex ante
- Ex-post  $\lambda$  is revealed to be low (e.g. a major crisis happens) then no union may be preferred to a monetary union
- Bad matches (0,0) have a high relative weight in welfare and so breakup may be natural outcome





## Cultural Conformity Constraint: from Agents to Leaders

- All inefficiency stems from excessive punishment
- ....punishment outcomes (0,0) prolong the crisis
- German leader sees the bad consequences of punishment but has to conform to the German culture/social norm
- => No end to the crisis, procrastination of intervention and aggravation of the crisis may=> exit only outcome
- (more micro founded model of the political constraint?)



## German Support for Greece (Politburo 2010/2011)

	Yes	No
Should Greece receive financial aid? (Feb, 2010)	33%	67%
Should Greece be given a second rescue loan? (June 2011)	36%	60%
Should other European-States support Greece? (October 2011)	42%	53%
Will Greece have to leave if it not accept EU terms? (Nov. 2011)	82%	15%
Greek bankruptcy entail consequences for Germany? (Sept 2011)	30%	68%
New government in Greece helps overcoming the crisis? (Nov. 2011, Politb)	23%	60%

Who should stay in the Euro? (July 2011,)	YES	NO
- Greece	47%	53%
- Spain	77%	23%
- Italy	73%	27%
- Ireland	67%	33%



## Evidence of German-Greek Post Crisis Resentment

### German View (Spring 2012)

	Greece	Italy	Spain	France	UK
Somewhat unfavorable	50	31	25	17	27
Very unfavorable	23	2	1	2	2
Total unfavorable	<b><u>79</u></b>	<b>33</b>	<b>26</b>	<b>19</b>	<b>29</b>

### Greek view (Spring 2012)

	France	Italy	Spain	Germany	UK
Somewhat unfavorable	28	21	14	29	36
Very unfavorable	17	10	11	49	26
Total unfavorable	<b>45</b>	<b>31</b>	<b>25</b>	<b><u>78</u></b>	<b>52</b>



..higher in Germany than among other EU countries

### French View (Spring 2012)

	Greece	Italy	Spain	Germany	UK
Somewhat unfavorable	32	26	23	11	18
Very unfavorable	22	7	6	5	5
Total unfavorable	<b><u>54</u></b>	<b>33</b>	<b>29</b>	<b>16</b>	<b>23</b>

### British view (Spring 2012)

	Greece	Italy	Spain	Germany	France
Somewhat unfavorable	33	18	14	14	21
Very unfavorable	12	5	3	7	8
Total unfavorable	<b><u>55</u></b>	<b>23</b>	<b>17</b>	<b>21</b>	<b>29</b>



## Not driven by an Anti-Mediterranean Sentiment

### Support to Libya

Should Germany support economically Libyas reconstruction? (Sept 2011, D-T)

YES	NO
70%	27%



Due to the Greeks behavior leading to the crisis, not a  
pre-crisis German bias

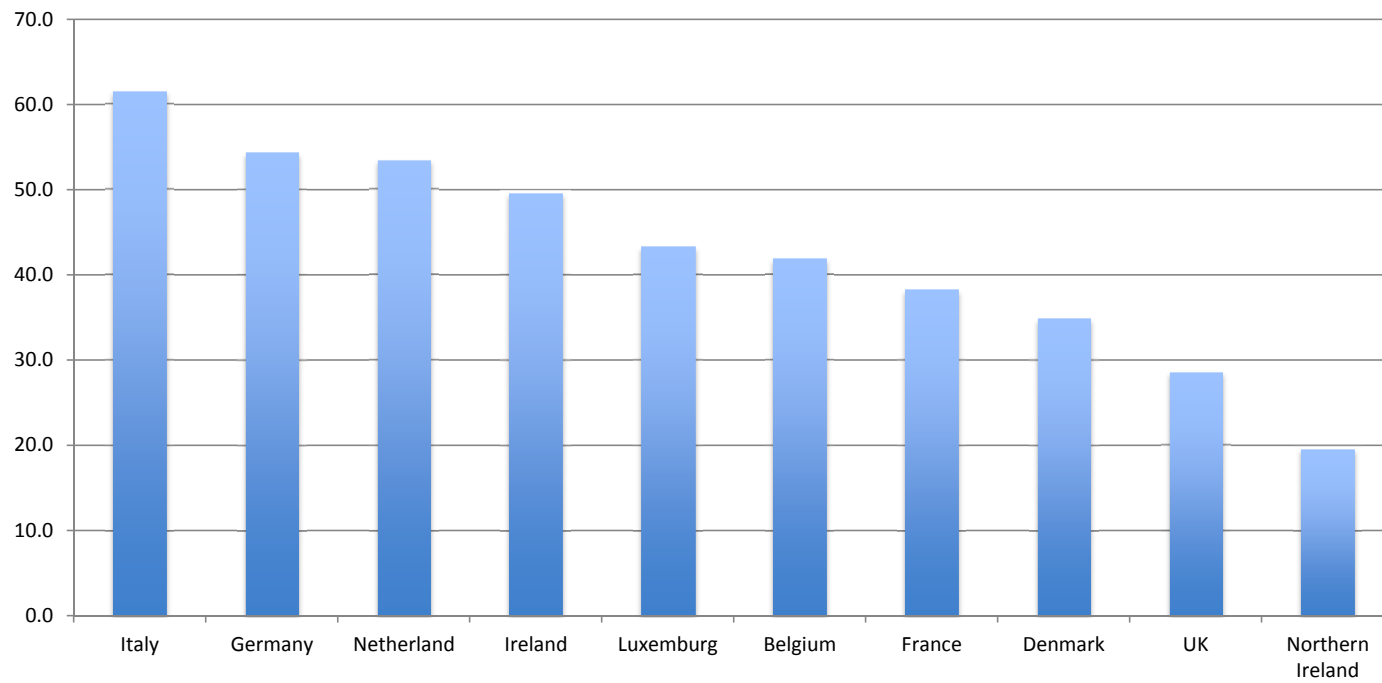
**Eurobarometer (survey data 1970-1995)**

Country receiving trust	Germans trusting a lot	Greeks trusting a lot
Greeks	<b>11%</b>	-
Germans	-	<b>18%</b>
Italians	8%	12%
Spanish	14%	21%
Portuguese	11%	17%
Irish	13%	17%
French	21%	26%
British	15%	16%
<u>Average of countries</u>	<u>16%</u>	<u>17%</u>



## No anti-Greece sentiments before the crisis

Greece Entry into the Common Market  
Fraction saying is a good thing



## Germans Support for Merkel (Politb.)

### Support for Merkel: Satisfied with Merkel's handling of the crisis?

	YES	NO
September 2011	<b>45%</b>	65%
October 2011	<b>51%</b>	49%
November 2011	<b>56%</b>	44%
January 2012	<b>63%</b>	37%
May 2012	<b>80%</b>	20%

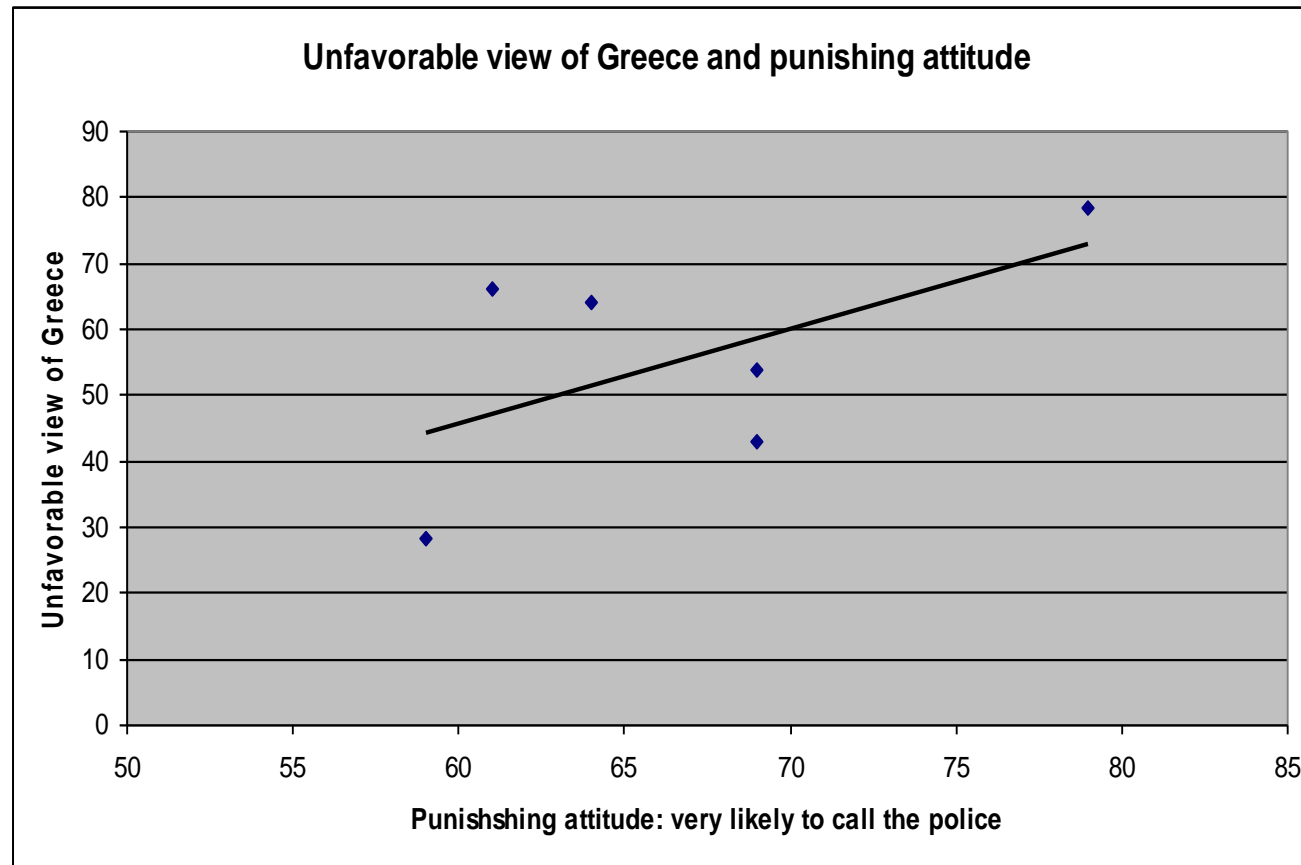
### Support for Merkel's Political Party:

Vote intentions	Christian Democrat	Social Democrat
September 2011	<b>35%</b>	28%
October 2011	<b>32%</b>	30%
November 2011	<b>34%</b>	31%
January 2012	<b>35%</b>	30%
November 2012	<b>39%</b>	30%





## Correlation (57%)



## Dealing with alternative explanations

- Higher risk of contagion in Mediterranean countries => had stronger incentives to bail Greece than Germany  
(GO) NO (Spread In Ireland decreasing early 2010)
- Germans weaker incentive to bail out Greece (compared to that of other Euro area countries) reflect a lower exposure of the German banks to the Greek sovereign debt (GO) NO (70% of total debt in D&F banks)
- Germany desire to "punish" Greece arises as an optimal strategy to discipline future moral hazard by the Greeks  
(GO) NO (should attenuate after fiscal compact)



## Fiscal Union: Central Authority

- Fiscal union eliminates independent sovereignties
- New enforcement authority endowed with a fixed probability of forgiveness  $y' > 0$
- Both leaders agree on a new institution with frequency of punishments  $(1 - y')$
- The  $y' \in (y_r, 1)$  is intermediate between German and Greek cultures:
- Greeks need to punish more, German less than home cultures prescribes
- Higher cultural difference  $(1 - y_r)$ , greater scope for intermediate policy

With cost  $C$  of lost sovereignty both countries prefer a fiscal union if  $C$  not too high and  $\lambda$  sufficiently low. Net benefit increases with cultural distance



# Conclusions

- Two general contributions
  1. Role of culture for economic outcomes:
    - Culture matters also for macroeconomic outcomes at business cycle frequency. Here through a specific channel, the conformity constraint on political leaders
  2. Interplay between culture and institutions:
    - Culture is slow moving, institutions can jump. The latter may serve to temper the consequences of cultural clashes

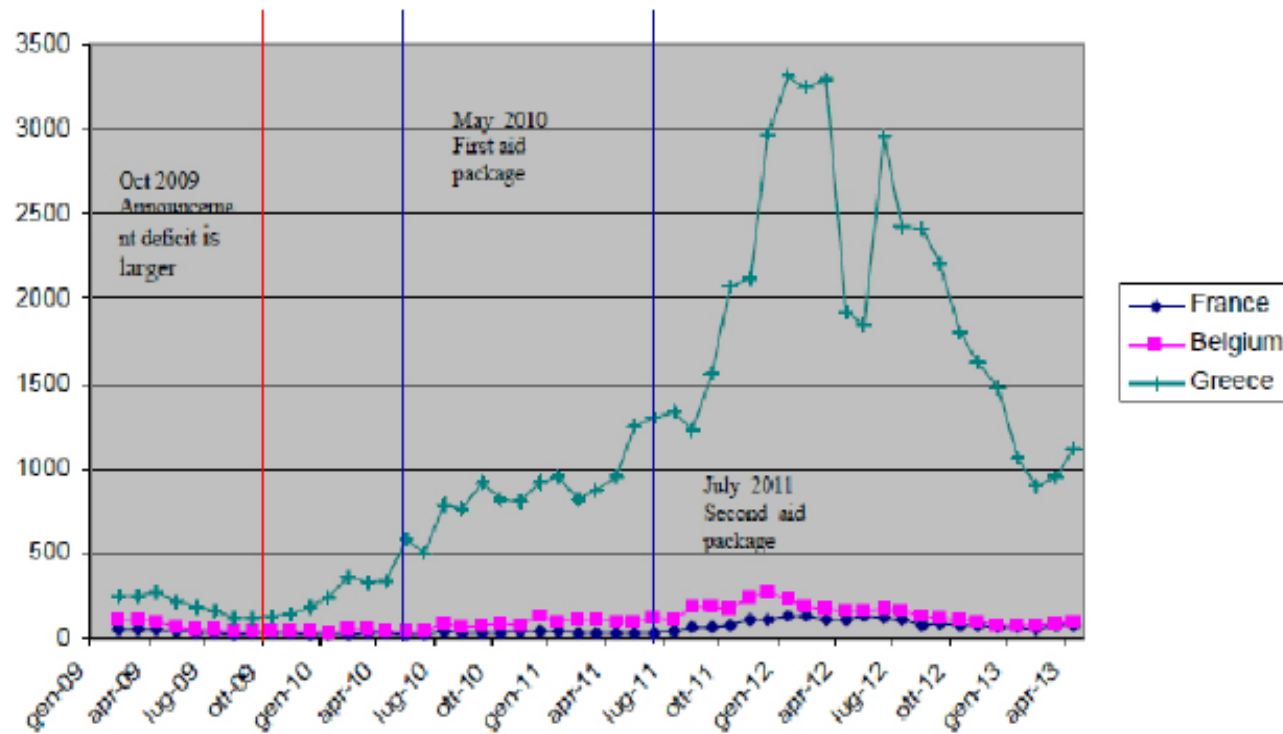


# Conclusions

- German “natural” punishing behavior clashes with Greek rule bending
- Politicians have to conform to the culture of their electorate
- The cultural clash generates inefficient outcomes
- Elimination of state sovereignty on these matters
- International Eurozone institutions that regulate “punishments”



## Differential contagion ([Back](#))



- Germans hostile opinions towards the Greeks already appear early 2010
- At the time, no risk of contagion: while Greece spread up by 300 bp, Ireland spread constant or going down, France constant until 2011

## Differential exposure to sovereign debt [Back](#)

### Claims of Germany

	Greece	Ireland	Portugal	Spain	Total PIGS
Public Sector	22.8	2.5	10.3	32.7	68.3
Total	44.4	176.9	41.0	202.4	464.8

### Claims of France

	Greece	Ireland	Portugal	Spain	Total PIGS
Public Sector	<b>30.6</b>	6.1	20.8	48.1	<b>105.6</b>
Total	<b>108.3</b>	84.8	52.0	248.2	<b>493.3</b>

bn\$. Q4 2009. Source: BIS Quarterly Bulletin.

- France and Germany

## Punishing future moral hazard [Back](#)

- Under moral hazard, Germans sentiments towards Greece should be mitigated by the introduction of the Fiscal Compact agreement (Spring of 2012)
- Under the cultural clash explanation Germans' sentiments may even amplified by the bail out packages
- Data more consistent with the latter than with the former story

### A. German View towards Greece

	Spring 2012
Somewhat unfavorable	50
Very unfavorable	23
<b>Total unfavorable</b>	<b>79</b>
	Spring 2010
Somewhat unfavorable	45
Very unfavorable	12
<b>Total unfavorable</b>	<b>70</b>



## Casual evidence

- **Thomas Wiser:** Chairmen of EU Economic and Financial Committee Committee prepares economic agenda for European Finance meetings: place where negotiations on European sovereign debt crises happen
- All the problems Europe is facing in dealing with the Greek crisis can be explained in terms of religious background:
  - Protestant (no forgiveness)
  - Catholic (forgiveness, if repent)
  - Orthodox (no need to repent to go to paradise)