

**PUBLIC GOODS IN THE ERA OF
SPATIAL HETEROGENEITY
AND WEAK POLITICAL
IMPLUSE:**

Implications for the European Union

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Introduction

We should live a period of high economic theorizing:

1. The intellectual (but not institutional) collapse of Doctor Pangloss'economics: a systemic crisis
2. Theory of finance went wrong: doubts about the efficiency of markets

What should be investigated:

1. The conditions for the resilience of a “market economy”
2. A positive – as opposed to normative – theory of public policy

Synopsis

- I. Theorizing the nature, origin and impact of public goods.
- II. The European integration as the building of a series of transnational public goods.
- III. Monetary stability as a technical requisite, without clear political and democratic legitimacy.
- IV. The dangerous delegation to financiers of financial stability

I. Theorizing the nature, origin and impact of public goods

1. Quite any institutional arrangement is mixing private and public components

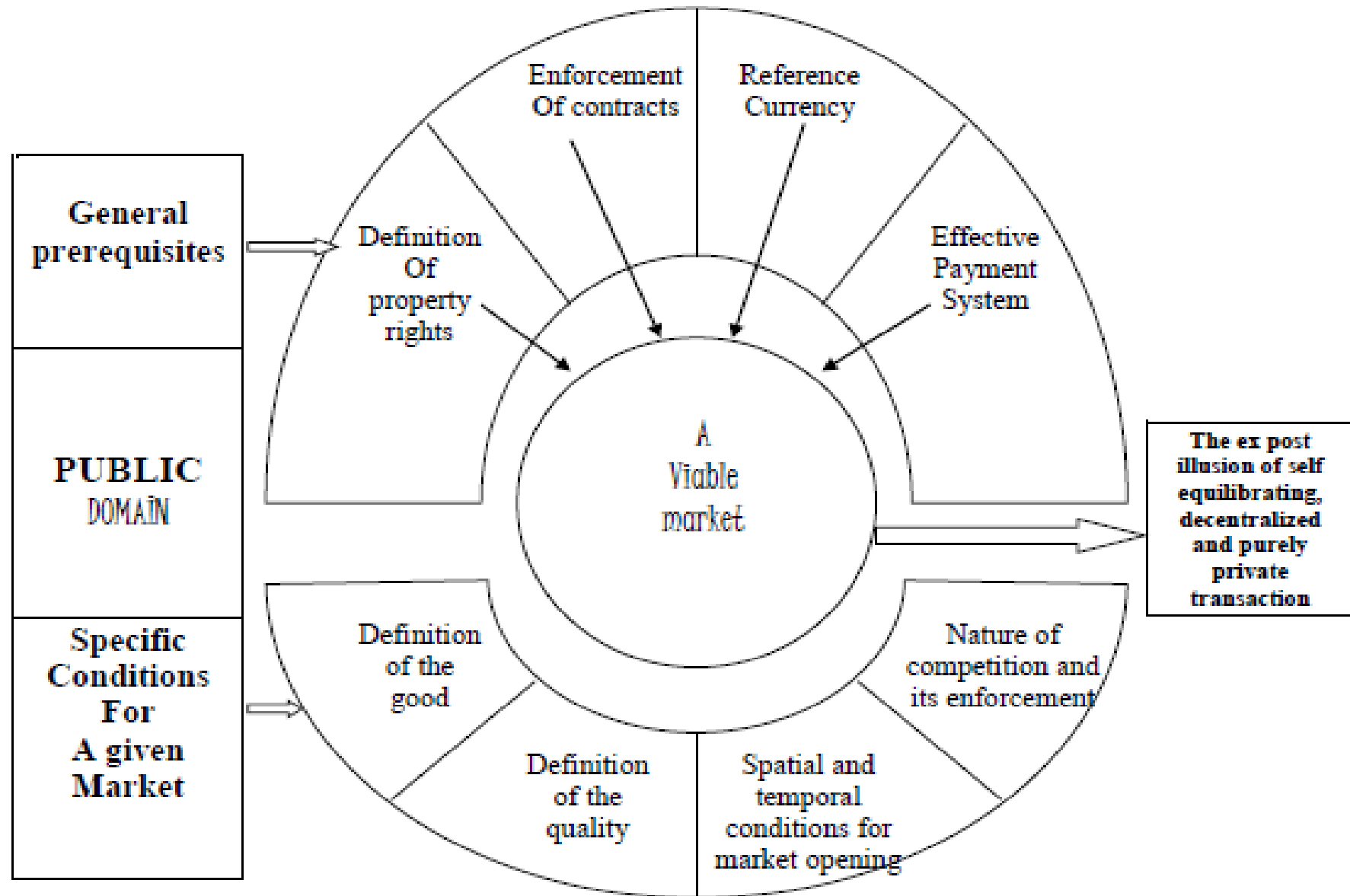
- ✓ Property rights

- ✓ The firm

- ✓ Associations and networks

- ✓ The market is socially constructed

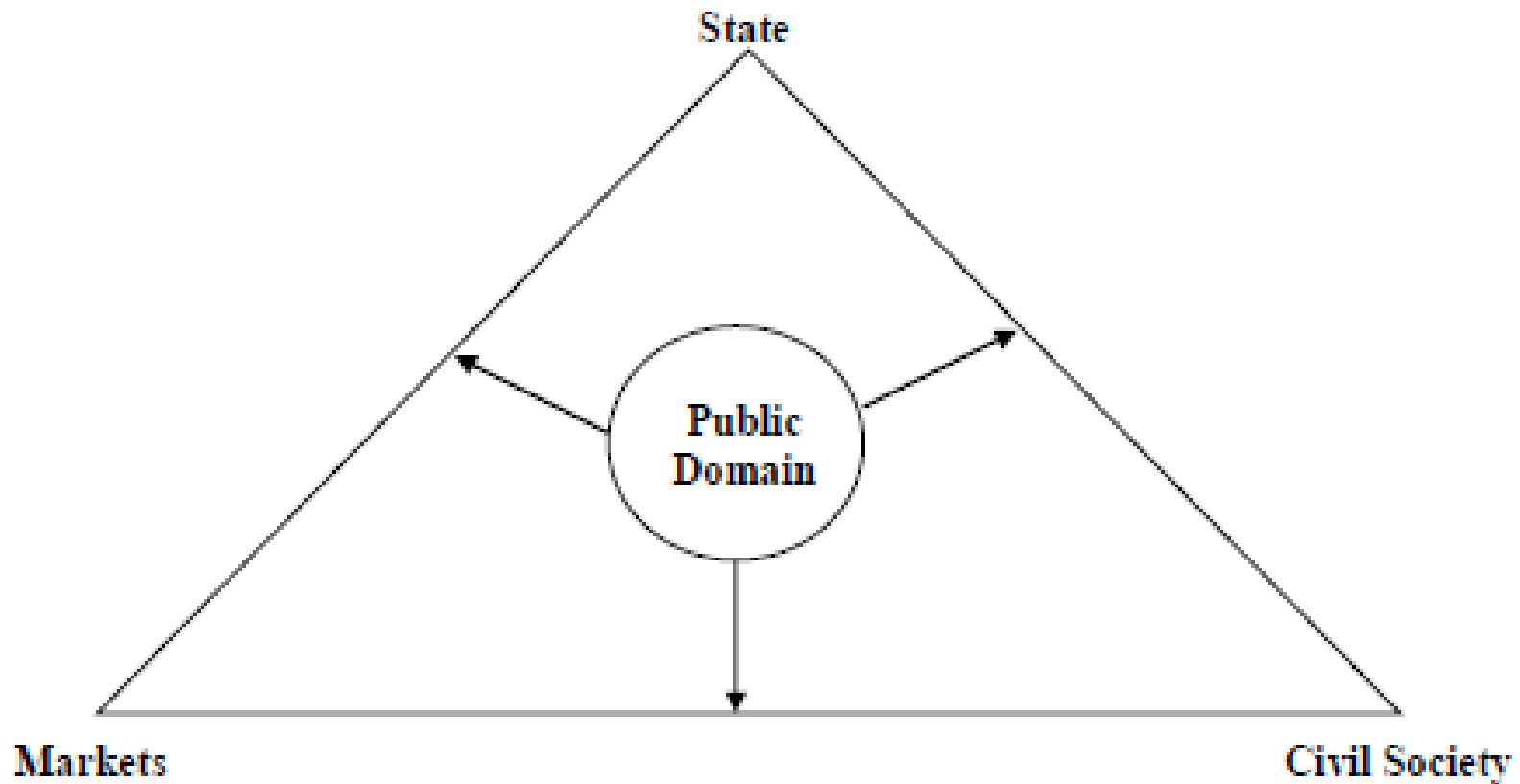
Figure 1 – The public elements of market building and functioning



2. *The public domain: in search for a definition*

✓ A general approach

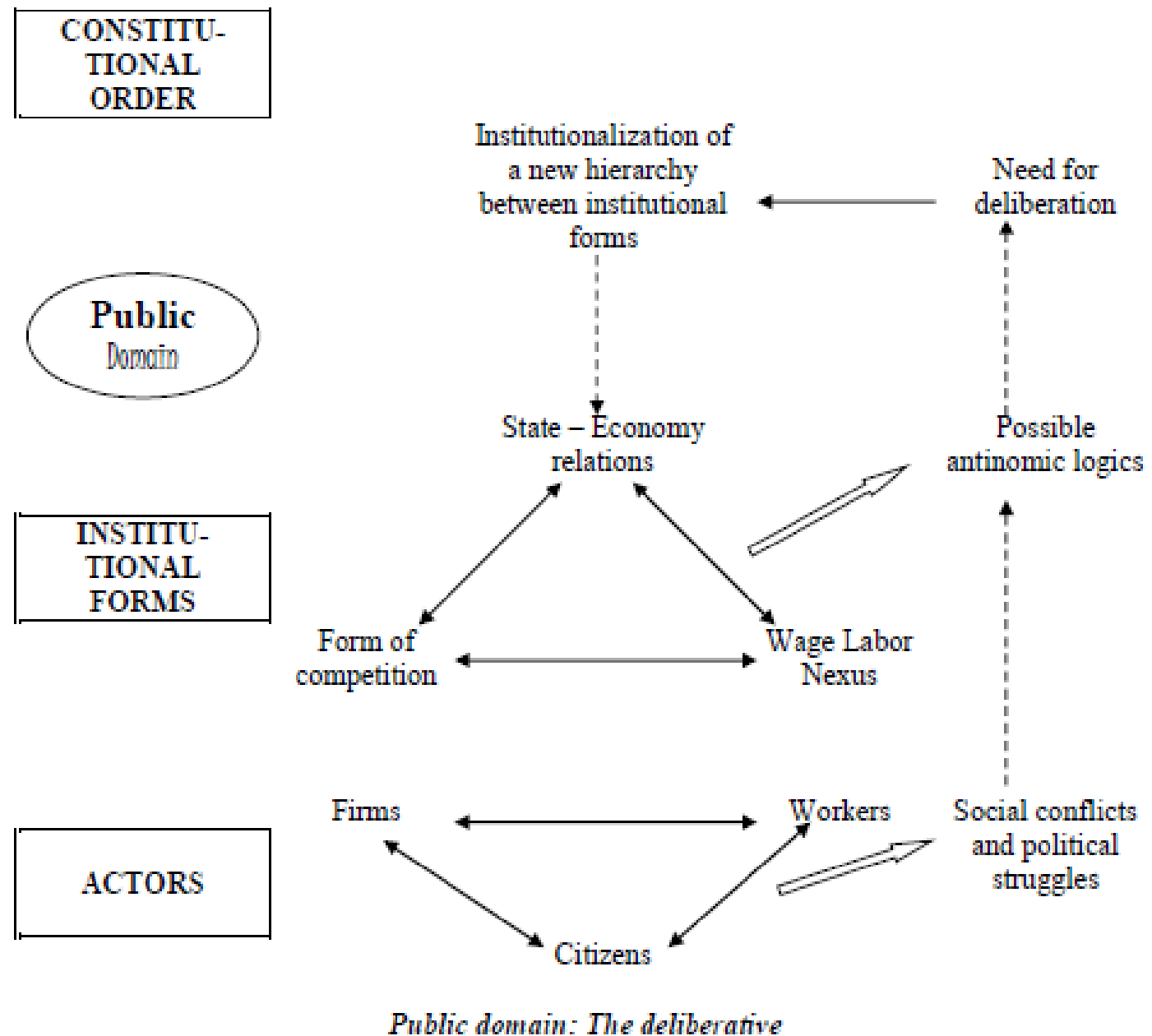
Figure 2 – A general definition of the public domain



Public domain: the deliberative arena for organizing the relationships between the Civil Society, State and Markets

✓ A “definition” within “Régulation theory”

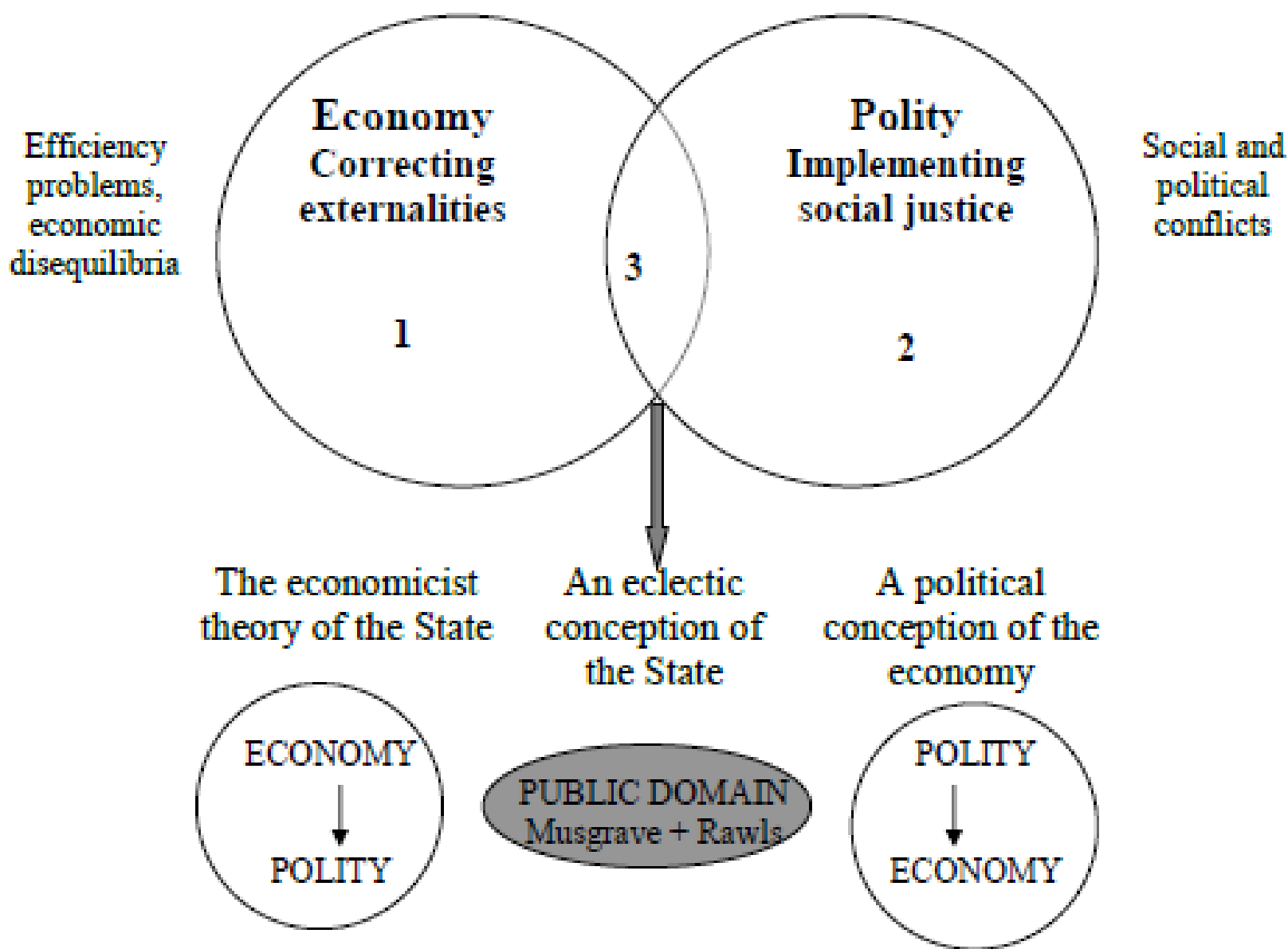
Figure 3 – The public domain within “Régulation Theory”



3. Two conception of the genesis of the public domain

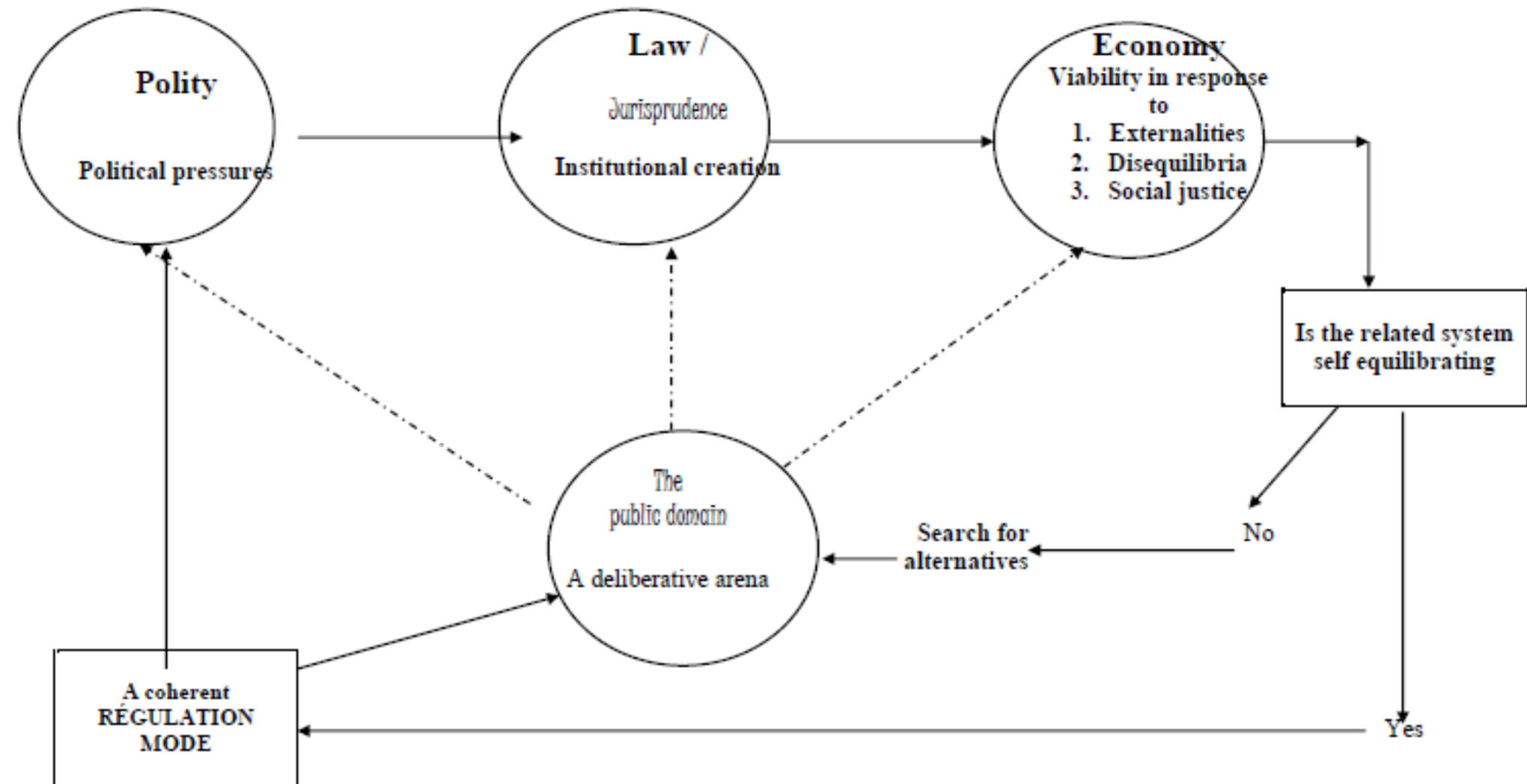
- ✓ The functionalism vision of the economist
- ✓ The outcome of a political/social process
- ✓ More actors than State
- ✓ A possible neoclassical synthesis: externalities + social justice

Figure 4 – A first definition for public domain: reconciling two contrasted visions



✓ A dynamic pattern: polity, law and economy

Figure 5 – The dynamic pattern of the public domain



Consequences :

1. The variability of the public domain across societies, according their political history
2. An evolving boundary of the public domain

4. The teaching of history: more political struggle than economic rationale

5. The public domain differs across time and between societies

✓ A complex nexus of forces and factors

Table 1 – The public domain intervention between economic disequilibria and social crises: Some examples from French history

| Features Public intervention | ORIGIN | IMPACT | RESULTING CONFIGU-RATION | TYPE OF PUBLIC DOMAIN |
|---|---|---------------------------------------|--|--|
| Law on industrial accidents | Social issue | Incentive to safer working conditions | Internalization of social costs generated by mechanization | Making security at work a public concern |
| Law on children/women work/work duration | Social issue | Incentive to labor saving innovation | More productivity led regime | Making labor a matter of public concern |
| Creation of a public central bank | Monetary / financial instability | Alteration of economic cycle | New mode of “régulation” | Money becomes a public arena |
| Compulsory education | Forging a new citizenship | More human capital formation... | ...with positive externality on growth | Arena of citizenship |
| Age of retirement | Social demand of workers | Limitation of working population | Welfare capitalism | The organization of life cycle |
| Agricultural policy | Major price / income instability | Income maintenance of farmers | Limits to pure market forces | Price formation has collective implication |
| Health insurance | Advances in medicine and collective pressures for recognition | Rise in life duration | Extended welfare capitalism with possible economic externalities | Reproduction of life is a matter of collective concern |

✓ **No fixed limits: a large diversity across brands of capitalism**

Table 2 – The frontier of the contemporary public domain: what explanatory factors?

| FACTORS STATUS | ECONOMIC | | MORAL | SOCIAL | POLITICAL |
|---------------------------|--|--|---|--|---|
| | Externalities | Major Unbalances | Shared sense of social justice | Intensity and scope of social movements | Typical function of the government |
| INSIDE THE PUBLIC DOMAIN | <ul style="list-style-type: none"> • Anti monopoly laws • Education • Innovation policy | <ul style="list-style-type: none"> • Unemployment policy | <ul style="list-style-type: none"> • Progressive income tax • Inheritance tax • Welfare systems (family, health, durability) | <ul style="list-style-type: none"> • Common agricultural policy (in Europe) • Retirement payment by welfare system | <ul style="list-style-type: none"> • Defense, Diplomacy, police • Sectors related to State prerogatives of the (arms) |
| OUTSIDE THE PUBLIC DOMAIN | <ul style="list-style-type: none"> • Environment policy until the 70's | <ul style="list-style-type: none"> • Financial instability until 1997 | <ul style="list-style-type: none"> • Unequal development at the world level (de facto, if not de jure) | <ul style="list-style-type: none"> • The international institutions reform (before Seattle) • Genetically modified organisms • Food security facing new threats | |

6. The vitality of public domain helps economic performance

- ✓ Markets assess the ex-post performance of institutional arrangements
- ✓ How democracy may help economic efficiency

7. Globalization and new technologies: two sources of public domain renaissance

- ✓ The public domain is not limited to the national territory
- ✓ The new externalities of the contemporary internationalization process
- ✓ The TIC define a new public domain

Figure 6 – The Crucial role of the political process in the building of a public domain

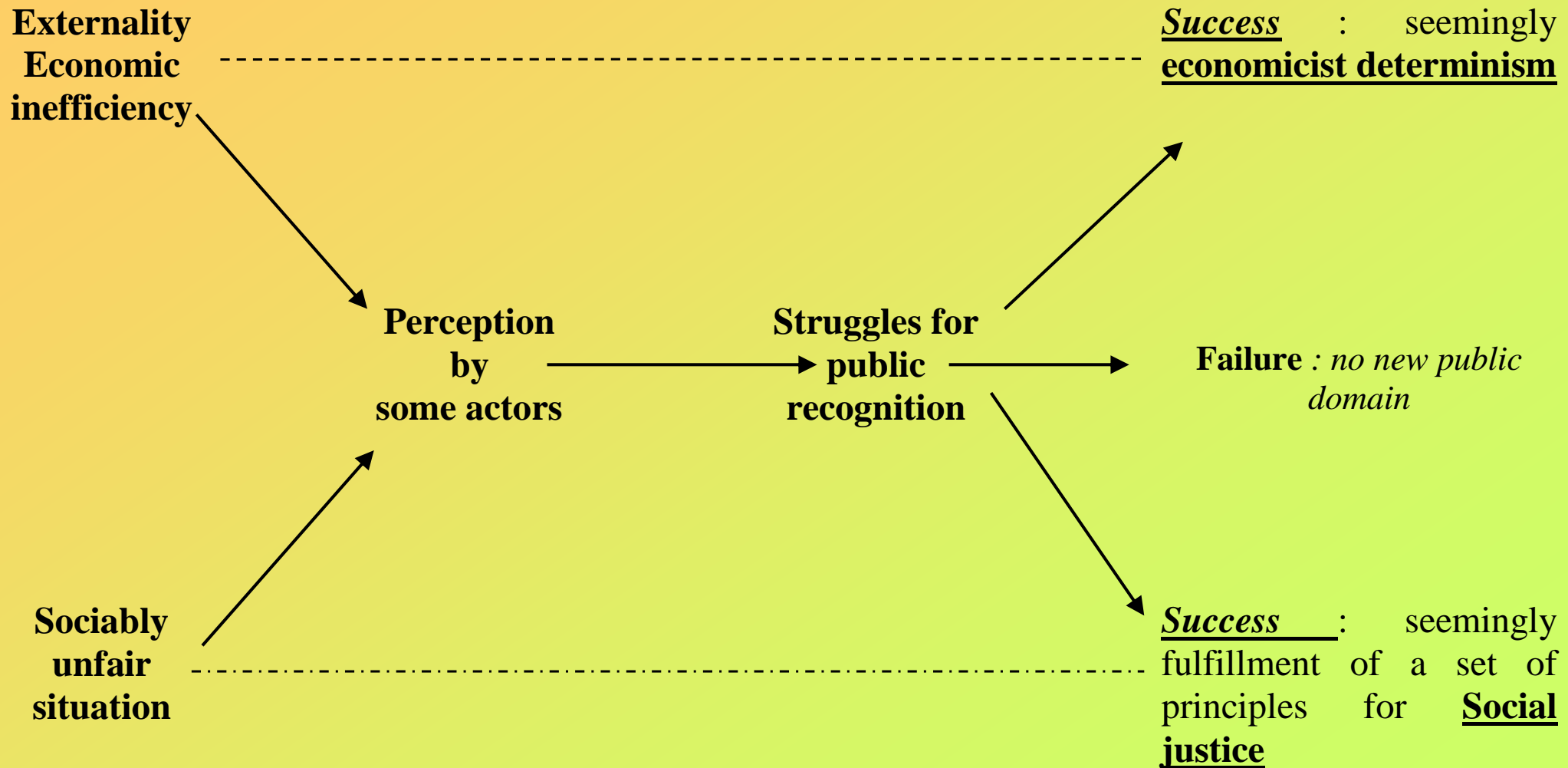


Table 3 – The four capitalisms display alternative conceptions for the public domain

| | MARKET LED | CORPORATE LED | SOCIAL-DEMOCRAT | STATE LED |
|-----------------------------|--|--|---|--|
| CORE PRINCIPLE | Solve as many problems as possible by market competition | Internalize externalities within the firm | Negotiate mutually advantageous compromises among social partners | Organize the complementarities between various domains by public intervention |
| Leading force | Innovation from private actors | The firm strategy | Social dialogue | Public administration / policy makers in charge of public interest |
| Countervailing power | Agency to control the maintenance of fair / free competition | Competition with other corporation | Foreign competition (small open economies) | Social movements from civil society / external pressures |
| PUBLIC DOMAIN | | | | |
| Main actors | <ul style="list-style-type: none"> • Diversity of professional expertise • Political fragmentation | <ul style="list-style-type: none"> • Few distribution private / public • High level administrative sector | <ul style="list-style-type: none"> • Organized interests, within a given political order | <ul style="list-style-type: none"> • Mainly the political process for government formation • Public administration acting in defense of general interest |
| Extend | <ul style="list-style-type: none"> • Role of lobbying • Shifting public domain | Rather limited within both economy and polity | Large and redesigned according to emerging problems | Large overlapping of State sector with public domain |
| Consequences | <ul style="list-style-type: none"> • Dynamism of emerging actors defending new public concerns • Extent of juridification of the public domain via the recognition of new rights | <ul style="list-style-type: none"> • Sluggish response to emerging problems • Lack of formalization / implementation of general principles | <ul style="list-style-type: none"> • Malleability of the public domain • Management by collective actors, more than | <ul style="list-style-type: none"> • Politization of the public domain • Uneven evolution of the public domain |

Figure 7 – The Information and Communication Technologies and the opening of new public domains

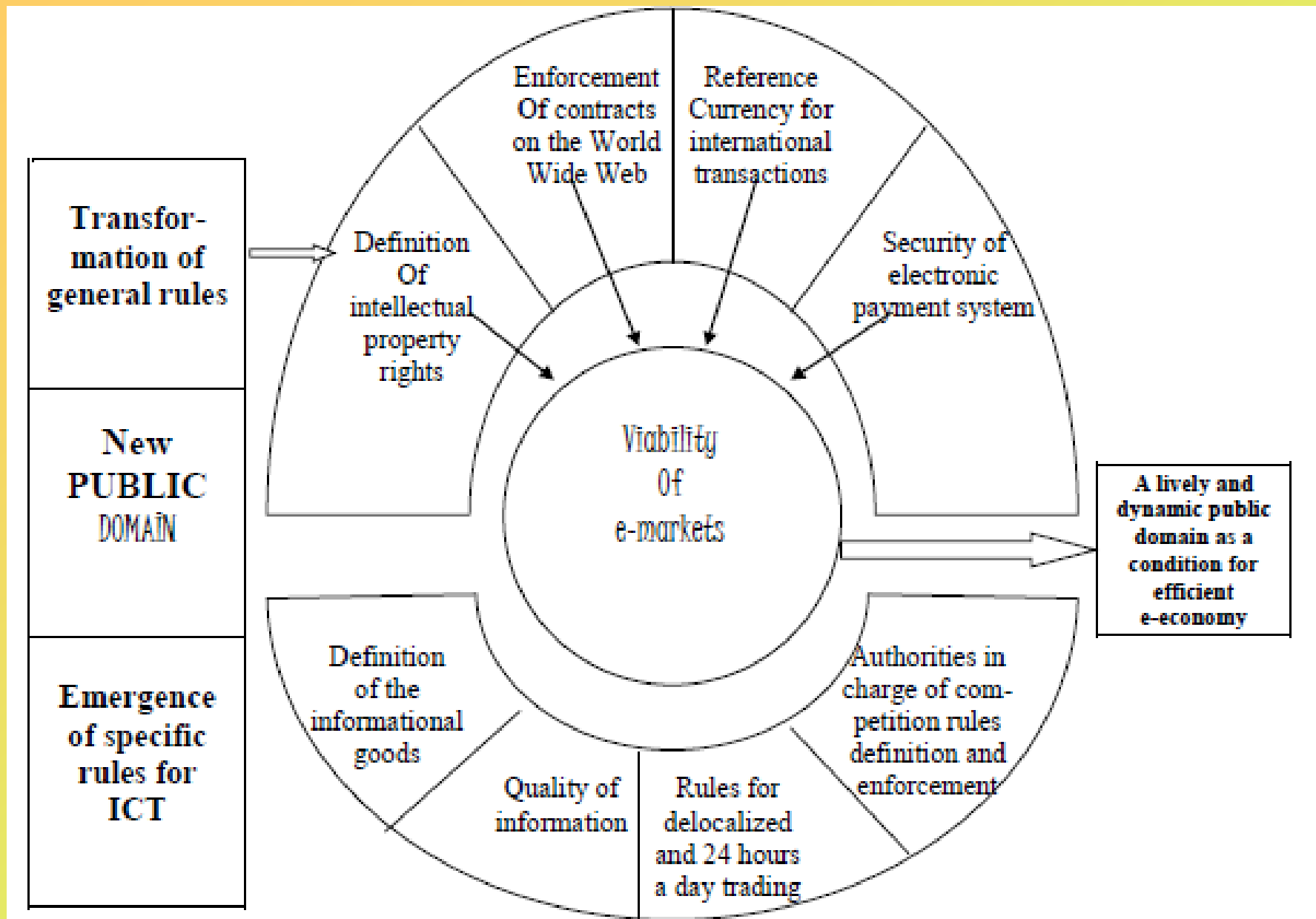
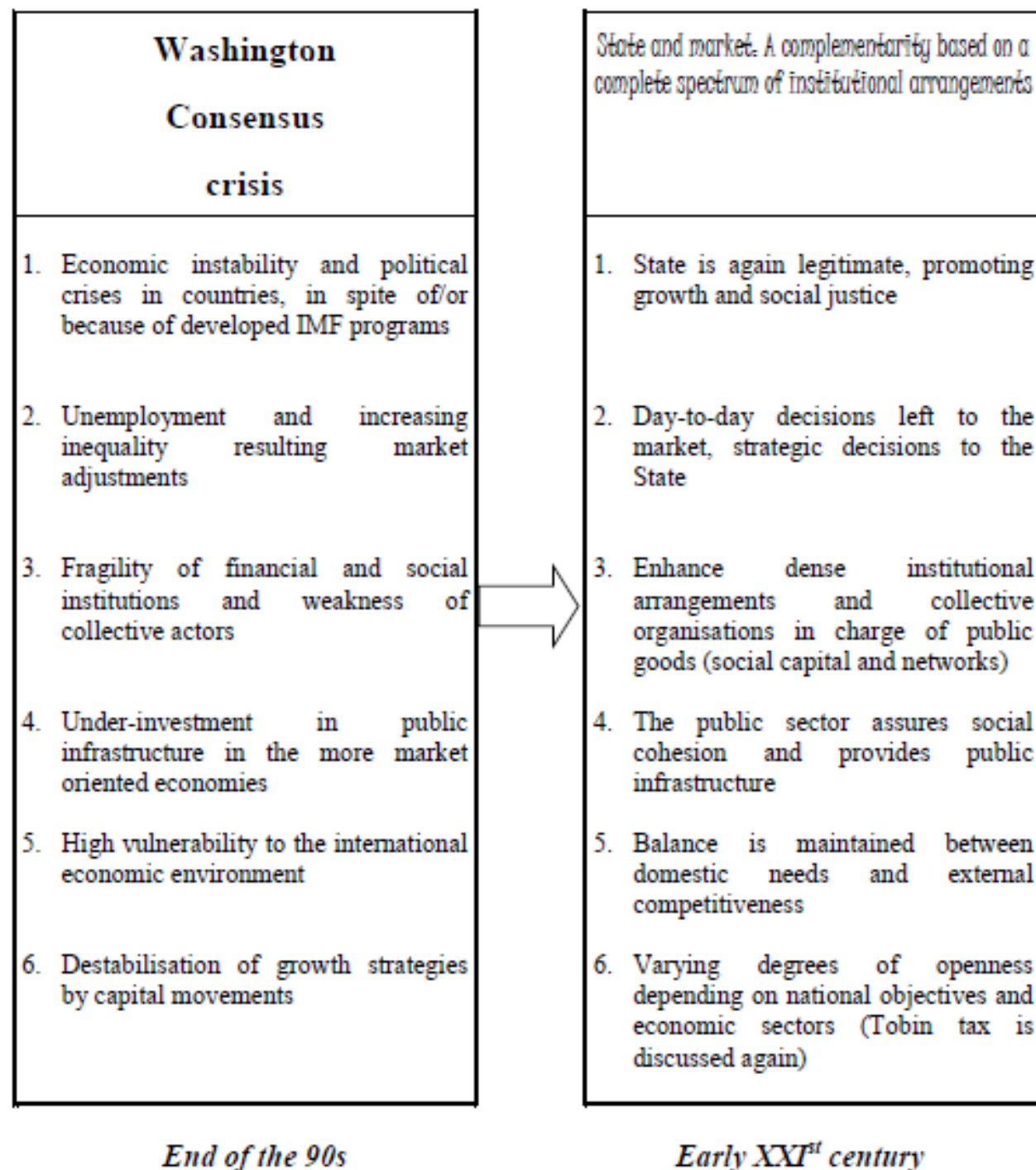


Figure 8 – From the 90s to the XXIst century: a new conception of the public domain



II. The European integration as the building a series of transnational public goods

1. A methodological issue: law or economics?

Table 4 – Two approaches to European integration

| | Law and its practices | Mainstream economics |
|-----------------------|---|---|
| Method | <ul style="list-style-type: none"> Resolution of conflicts between parties and principles, thanks to jurisprudence. | <ul style="list-style-type: none"> Formulation of a model incorporating interdependences and study of the corresponding equilibria. |
| Aim | <ul style="list-style-type: none"> Case-by-case development of jurisprudence, to preserve the legitimacy of the legal order. | <ul style="list-style-type: none"> Moving the economy towards an optimum in the allocation of resources. |
| Relation to time | <ul style="list-style-type: none"> Strong historicity, but emergence of general principles (role of the internal market). | <ul style="list-style-type: none"> Divergence of the economy from the efficiency frontier, because of unexpected events or “irrationalities”. |
| Strategy | <ul style="list-style-type: none"> Gradual establishment of principles enabling revision of the legal measures governing competences. | <ul style="list-style-type: none"> Advisory role for decision-makers so that principles resulting from economic analysis can be taken into account. |
| Effect on competences | <ul style="list-style-type: none"> Role of the judge in the delimitation of competences, on the basis of an initial, constitutional-type allocation. | <ul style="list-style-type: none"> Affirmation of the need to satisfy a principle of rationality in the allocation of resources and financial means. |

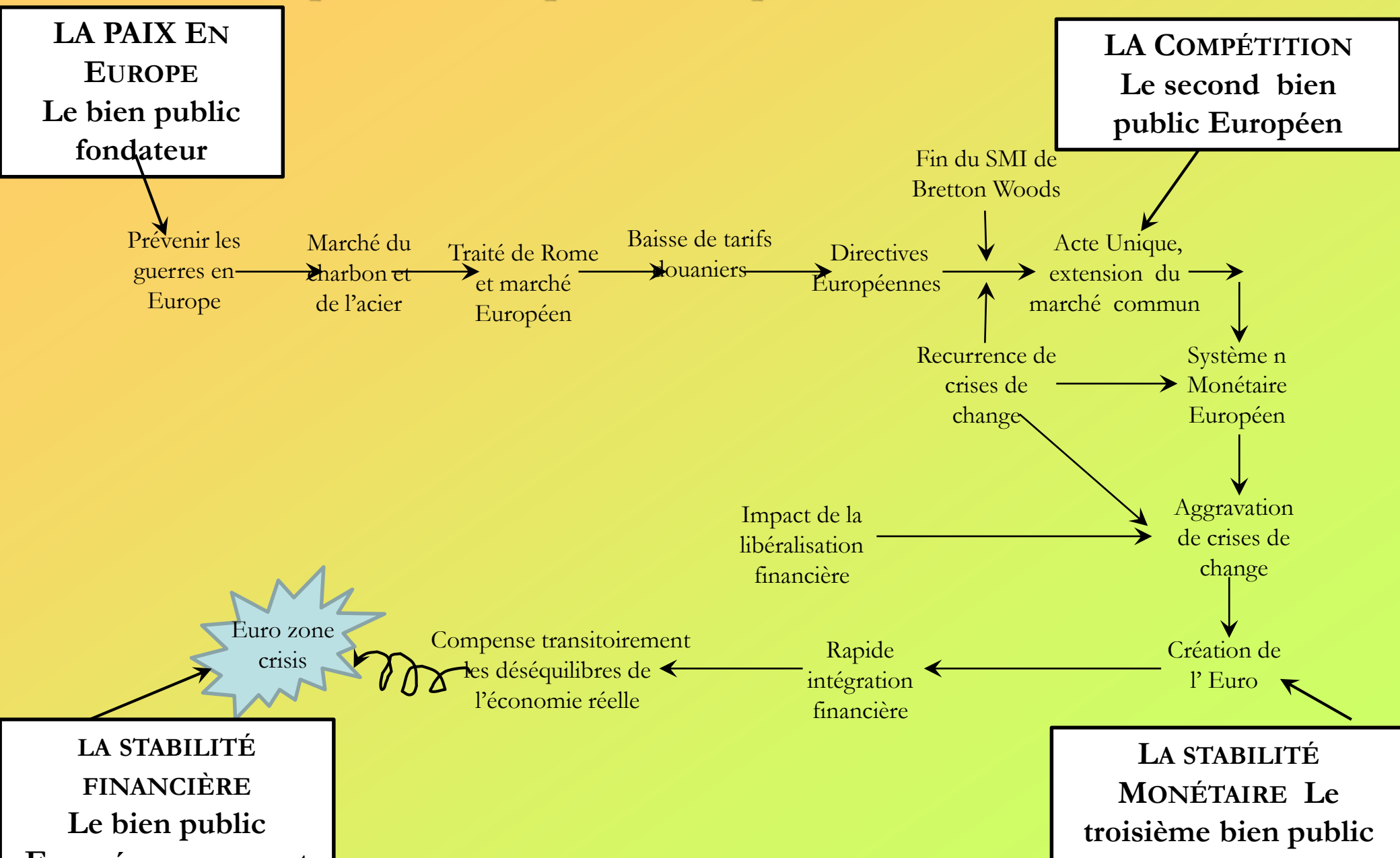
2. The normative economic approach

- ✓ The contribution of theories of public choice: clear and explicit criteria

Table 5 – Is the scale of externalities a foundation for an allocation of competences?

| Externalities | Example | Form of organisation | Consequences of recent developments as regards international integration |
|---------------|--|---|---|
| Local | <ul style="list-style-type: none"> Use of ground water | <ul style="list-style-type: none"> Clubs, single or multiple purpose inter municipal syndicates | <ul style="list-style-type: none"> Few changes |
| Regional | <ul style="list-style-type: none"> Cluster effect (e.g. Italian industrial districts) | <ul style="list-style-type: none"> Professional association or political body | <ul style="list-style-type: none"> Strengthening of certain regions in the economic and political order |
| National | <ul style="list-style-type: none"> Monetary stability Confidence in institutions | <ul style="list-style-type: none"> Central bank Constitution Government norms | <ul style="list-style-type: none"> Pooling of national sovereignty in monetary matters |
| Transnational | <ul style="list-style-type: none"> Acid rain | <ul style="list-style-type: none"> Negotiations, formation of cross-border bodies of specialist syndicate type | <ul style="list-style-type: none"> More and more frequent phenomenon |
| European | <ul style="list-style-type: none"> Large market, Technological standards, Single currency | <ul style="list-style-type: none"> European Commission or Independent administrative agency | <ul style="list-style-type: none"> Strengthening of the competition principle ECB learning as regards its relations with national European policies |
| World | <ul style="list-style-type: none"> Ozone layer, Financial stability | <ul style="list-style-type: none"> International treaty, and specialist international organisations Creation of a market in pollution rights Prudential norms | <ul style="list-style-type: none"> Difficulty in managing global public goods: conflicts of interest, absence of supranational agencies (environment) |

Figure 9 – Plus d'un demi-siècle d'intégration Européenne : construire une série de biens publics Européens en réponse à une succession de crises



✓ Distinguishing between the competence and its effects

Table 6 – From the division to the delimitation of competences

| | | | | |
|---------------|---|---|---|--|
| Treaty | { | Principles of delimitation (fundamental rules for interpreting the Treaties) laid down by the Treaty | } | Regulation of the regulation of competences |
| | | Allocation of competences (material criterion) | | Allocation of competences |
| | | Modification of Treaties | | Delimitation of competences |
| Jurisprudence | { | Principles of delimitation (fundamental rules for interpreting the Treaties) laid down by the judges | } | |

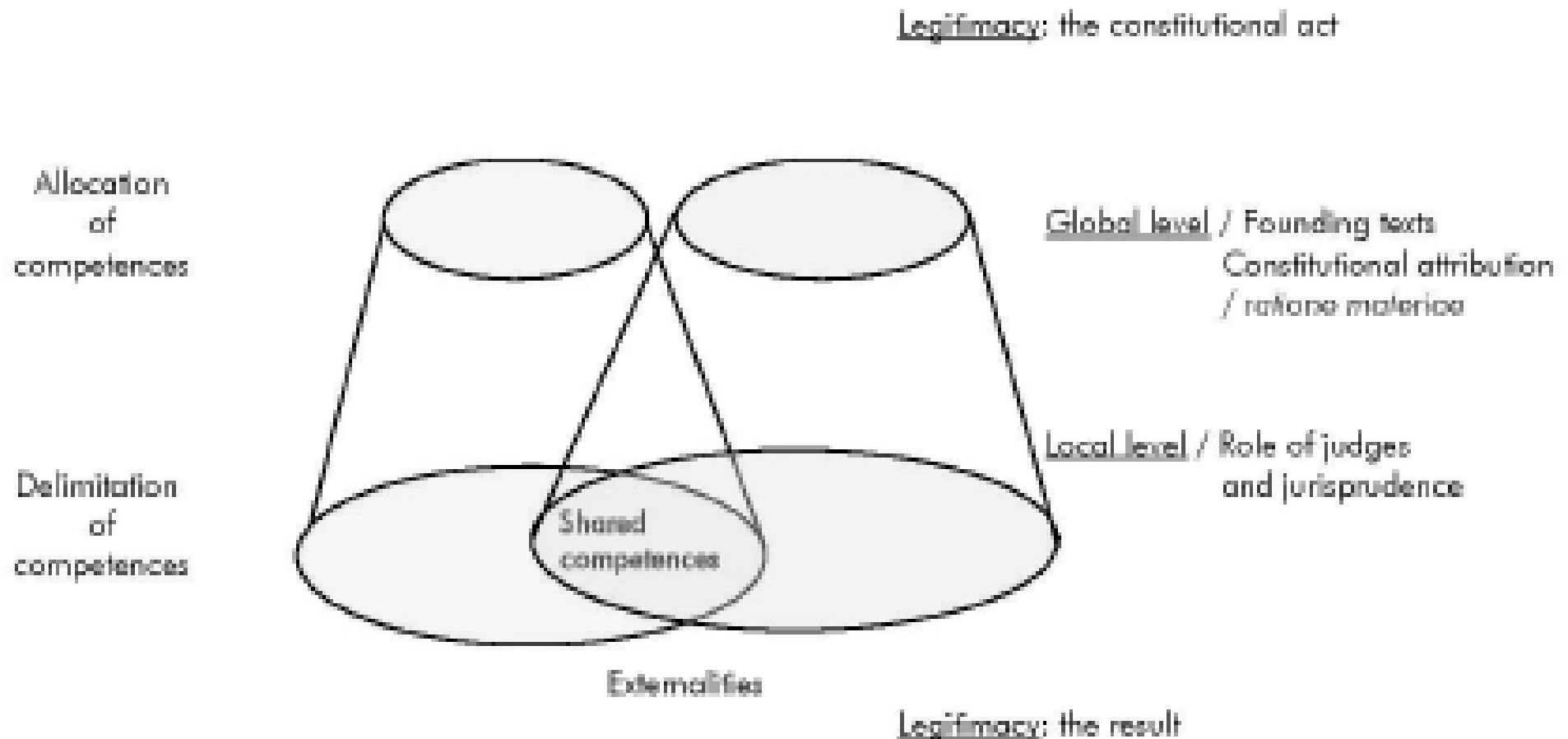
✓ Legal parallelism between Europe and the United States

Table 7 – A comparison between two jurisprudences: Supreme Court and ECJ

| Delimiting principles written into the Constitution or laid down by the Supreme Court | | Delimiting principles written into the Treaty or laid down by the ECJ | |
|---|-------------------|---|---|
| Constitution | Supreme Court | Treaty | ECJ |
| Supremacy clause | | | Direct effect (Costa vs Enel, 1974) Priority of the Community norm (Walt Wilhelm, 1969; Simmenthal, 1976) |
| Necessary and Proper clause | | Art. 308 (ex art. 235) | |
| Interstate commerce clause | | Art. 81 (competition rules) | Commission vs French Republic, 1969 |
| Reservation of competences clause | | Art. 5 (ex art. 3B) Reserved competences | |
| Loyalty clause | | Art. 10 (ex art. 5) | |
| | Cumulative effect | | Brasserie de Haecht judgement (1967) |

✓ From the allocation to the delimitation of competences: the judges role

Figure 10 – From the allocation to the delimitation of competences.
Jurisprudence as a response to externalities between domains



✓ Politics opens the prospect of various forms of federalism

Figure 11 – The spiral of Europeanization: treaty, directive, jurisprudence ... and so on

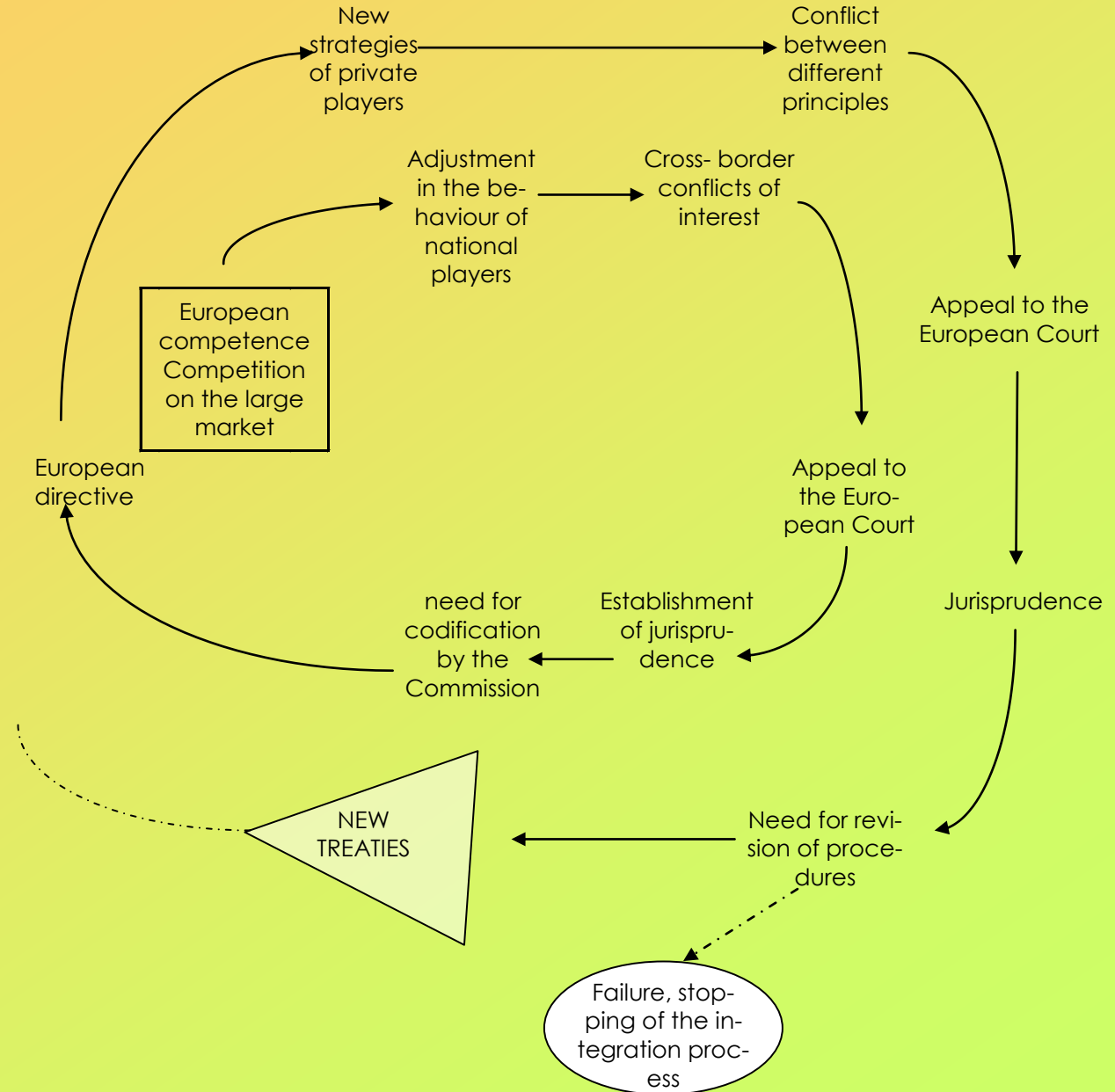
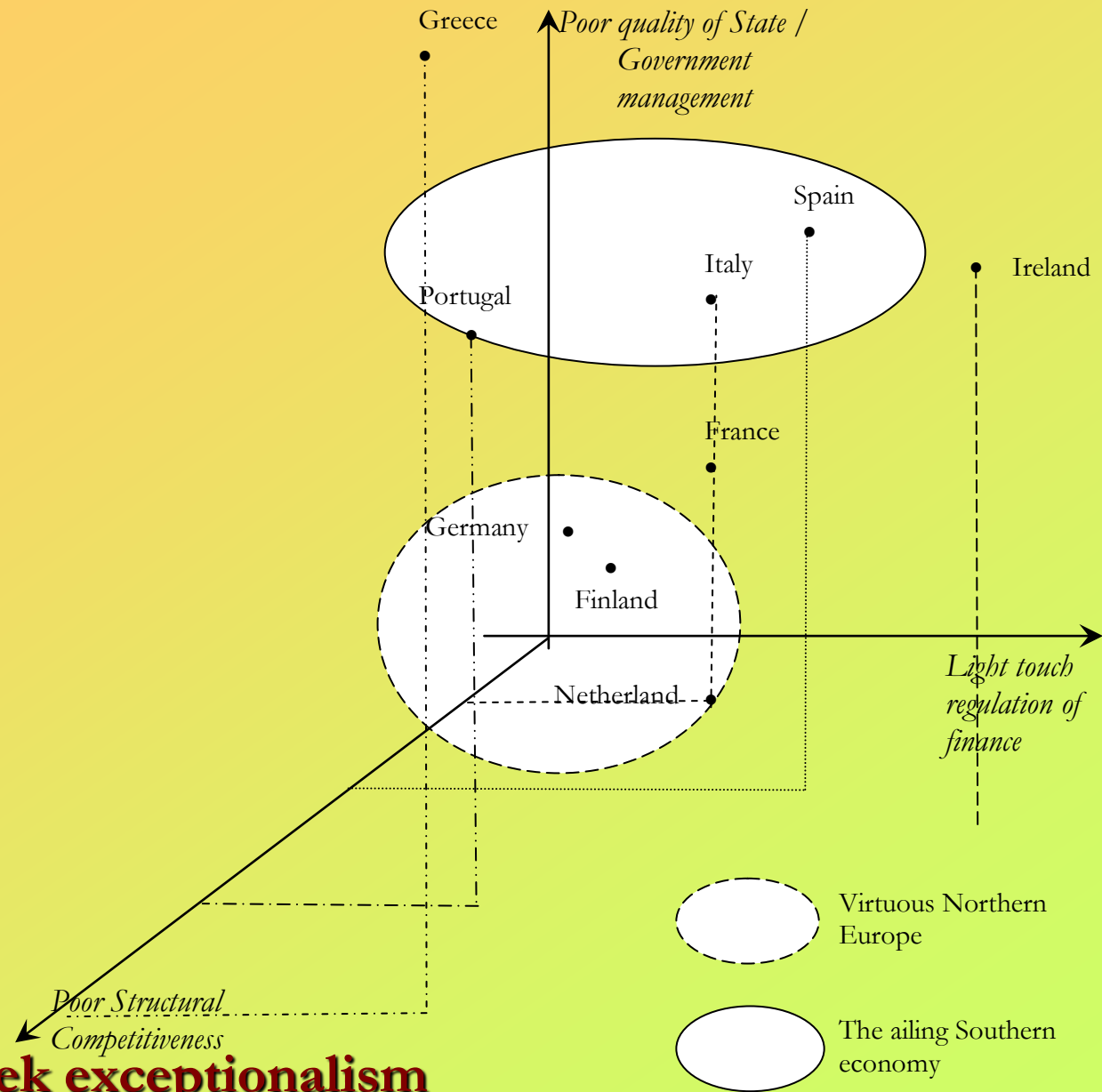


Table 8 – European integration: federalism of the third kind?

| Configuration Characteristics | Federal system | | European Union |
|-------------------------------------|--|---|--|
| | Competitive | Cooperative | Open method of cooperation |
| Competences placed in common | <ul style="list-style-type: none"> • Defence, diplomacy • Currency, internal market | <ul style="list-style-type: none"> • Defence, diplomacy • Currency, internal market | <ul style="list-style-type: none"> • Coordination of defence and diplomacy policies • Currency, internal market |
| Tax | <ul style="list-style-type: none"> • Federal and state • Wide autonomy of states under the constraint of tax competition | <ul style="list-style-type: none"> • Federal and regional • Coordination through institutional measures | <ul style="list-style-type: none"> • Exclusively national, then transfers to finance the European budget |
| Infrastructure policy | <ul style="list-style-type: none"> • Responsibility of states | <ul style="list-style-type: none"> • Responsibility of regions | <ul style="list-style-type: none"> • Responsibility of nations (although transport belongs to the Community domain) |
| Strong points | <ul style="list-style-type: none"> • Limit to the expansion of public budgets • Possibility of experimentation | <ul style="list-style-type: none"> • Maintenance of solidarity between regions | <ul style="list-style-type: none"> • Flexibility of peer control procedures • Harmonisation around common objectives |
| Weak points | <ul style="list-style-type: none"> • Risk of a race to the bottom • Possible collective under-investment | <ul style="list-style-type: none"> • Difficulty of reform • Possible brake on innovation | <ul style="list-style-type: none"> • Sometimes problematical effectiveness of the open cooperation method • Absence of a decision-making centre in the face of urgency and arbitration |

**Figure 12 – How
do the factors of
crisis differ across
the Euro-zone**



The Greek exceptionalism

France as a barycentre between North and South
Ireland victim of an unwise financial liberalisation

III. Monetary stability as a technical requisite, without clear political and democratic legitimacy

1. *From the start, a polarisation of the perception of the Euro by various social groups*

Table 9 – France: the Euro is perceived to have different consequences for various social groups.

Question: What are likely consequences of EURO for each of the following groups?

| | Not too many problems | Transitory difficulties only | Long lasting problems | Without opinion |
|--|-----------------------|------------------------------|-----------------------|-----------------|
| Large firms 100 % | 62 | 32 | 4 | 2 |
| Younger people | 60 | 31 | 7 | 2 |
| Small and medium size enterprises | 37 | 53 | 6 | 4 |
| Retailers | 22 | 65 | 11 | 2 |
| Savers | 20 | 51 | 21 | 8 |
| People with low incomes | 7 | 49 | 41 | 3 |
| Old people | 1 | 8 | 90 | 1 |

Table 10 - How a pluralist debate led Sweden not to join the Euro

| ASSESSMENT CRITERIA | ADVANTAGES | DRAWBACKS |
|--|--|---|
| SOCIAL EFFICIENCY 1. Transaction costs 2. Short term fluctuations in exchange rates 3. Interest rates 4. Competition in the single market 5. Inflation | <ul style="list-style-type: none"> Saving 0,2 % of GDP with EMU Less uncertainty would benefit to trade and investment Lower real interest rates, similar tp the German one No more unexpected shift in national competitiveness due to exchange variations, less protectionnist pressures Given ECB strong independence, lower inflation is expected | <ul style="list-style-type: none"> Extra costs for accounting and conversion costs (probably inferior to the gains) Total uncertainty may increase (third countries exchange rate, future of national policy) In the long run, no relation between the Euro and the real interest rate Mainly valid for the financial sector, not so much product market Large efficiency effects are unlikely |
| ASSESSMENT ON SOCIAL EFFICIENCY | | Probably a positive impact for Sweden....but many other policies (tax, education, welfare) have much more impact |
| STABILISATION POLICY 6. Symmetrical and asymmetrical shocks 7. Other adjustment mechanisms <ul style="list-style-type: none"> International labour mobility Nominal wage flexibility <ul style="list-style-type: none"> Internal exchange rate changes (by shifting the tax burden) 8. Monetary policy autonomy outside the currency union 9. Macroeconomic imbalances and exchange rates 10. Fiscal policy | <ul style="list-style-type: none"> The greater credibility of ECB would allow a stronger response to a common recession Possible wage moderation Reduction in the swings in nominal and real exchange rate. The excessive deficit procedure helps in curbing down public debt Need for some transfers between countries | <ul style="list-style-type: none"> The lack of synchronisation with the core of Europe and possible asymmetric shocks are very costly for Sweden Few and small impact of the Euro per se Very difficult to increase (not observed in the US) Limited size of these adjustment compared with external exchange Less possibility to stabilise the economy Interference with the role of fiscal policy as an automatic stabiliser ...but political objections |
| ASSESSMENT ON STABILISATION | | OVER ALL NEGATIVE IMPACT <ul style="list-style-type: none"> The loss of autonomy in off setting country specific shocks is not compensated by the general expected decline in the frequency of asymmetric shocks in the EU The Euro does not make easier labour market and supply side reforms. |
| POLITICAL IMPACT 11. The role of EMU in the European integration 12. Democratic control and accountability 13. Legitimacy of a decision on the Euro 14. National influences within the EU | <ul style="list-style-type: none"> A step towards political integration Some (limited) control over ECB Report to the European Council, ECOFIN Council at the Commission Formal possibility to change the ECB's statutes by a <u>new</u> treaty Larger if the country joins the EMU ("give and take" process) and the common foreign and security policy (CFSP) | <ul style="list-style-type: none"> Strains on Unity between IN's and OUT's Conflict upon ECB policy Unpopular national policy in order to cope with EMU, specially if unemployment is high Opposition between an inter-governmental model (national parliament control) and a federal project (strengthening of European parliament) Small influence of any national parliament Euro is seen as a project for the "political and economic elite" Risk of political polarisation Time is required to organise a democratic debate ...but in any case limited influence of any single country possible opposition between national preferred policy and EU's position |
| ASSESSMENT ON POLITICAL IMPACT | | Joining the Euro increase, the country's influences within the EU, at the cost of less democratic control upon monetary policy. |
| OVER ALL ASSESSMENT <i>Small but <u>certain</u> efficiency gains, <u>reduced</u> macroeconomic imbalances but <u>less ability</u> to cope with country specific disturbances, a <u>positive</u> contribution to European political integration but possible <u>conflicts</u>. <i>"It is difficult to see that the advantages of the EMU are very substantial and unequivocal"....but a failure to implement would create acute credibility problems.</i> </i> | | |

Source: built upon Calmfors & alii (1997:305-339)

Figure 13 – Is the Euro-zone politically viable in the medium-long run? An analytical framework

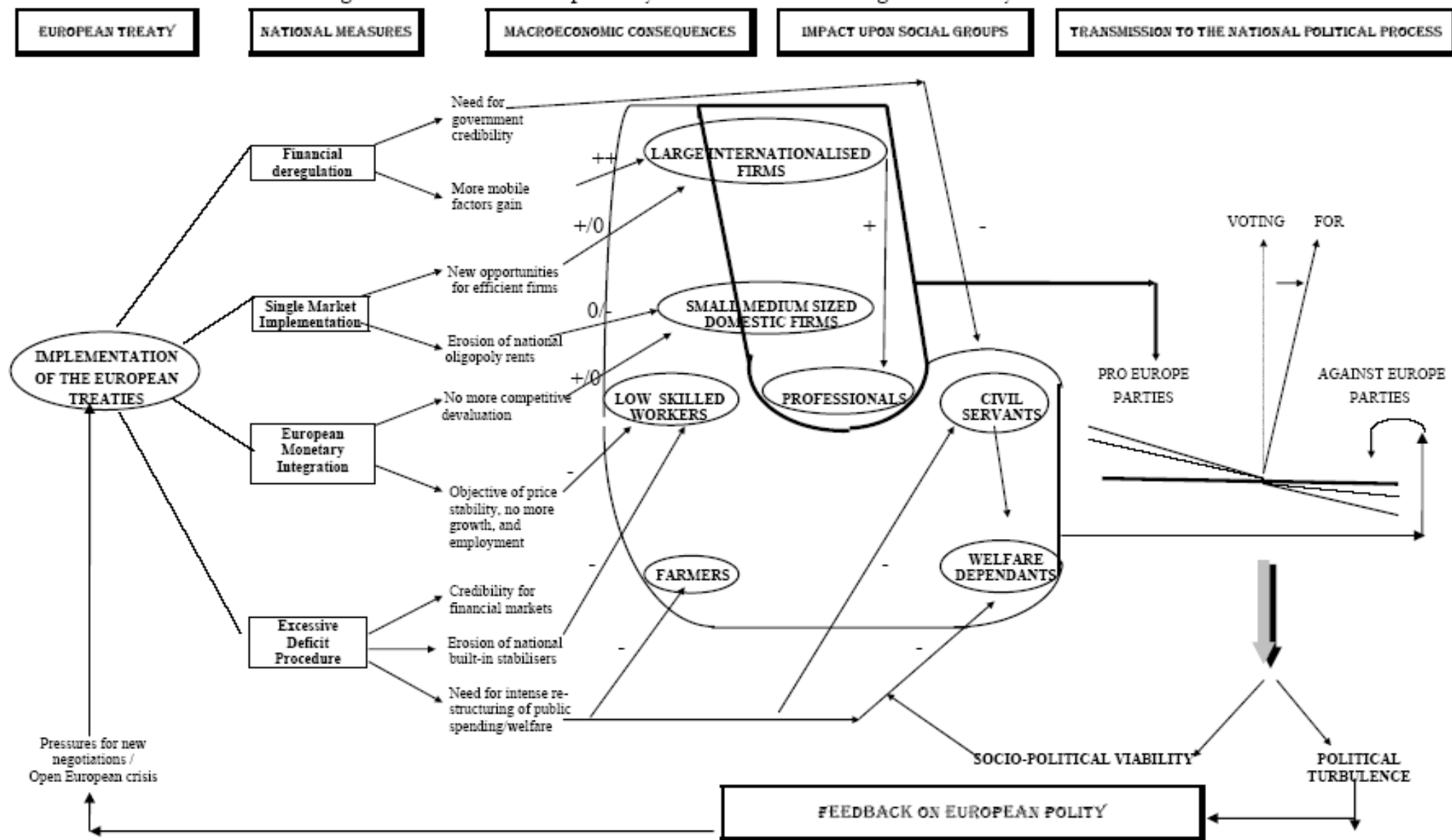


Figure 14 – Success of the Euro...or renationalisation of national policies?

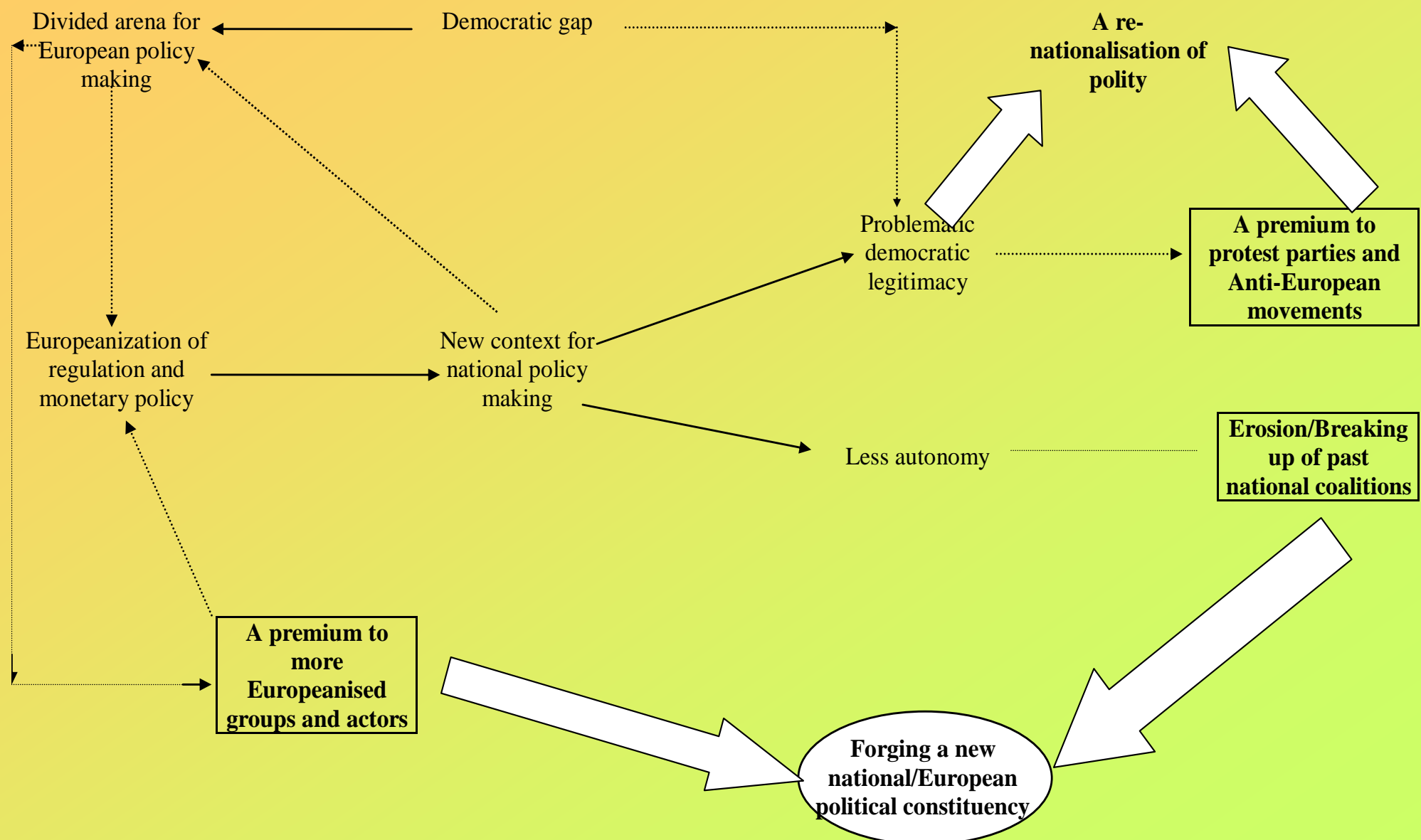
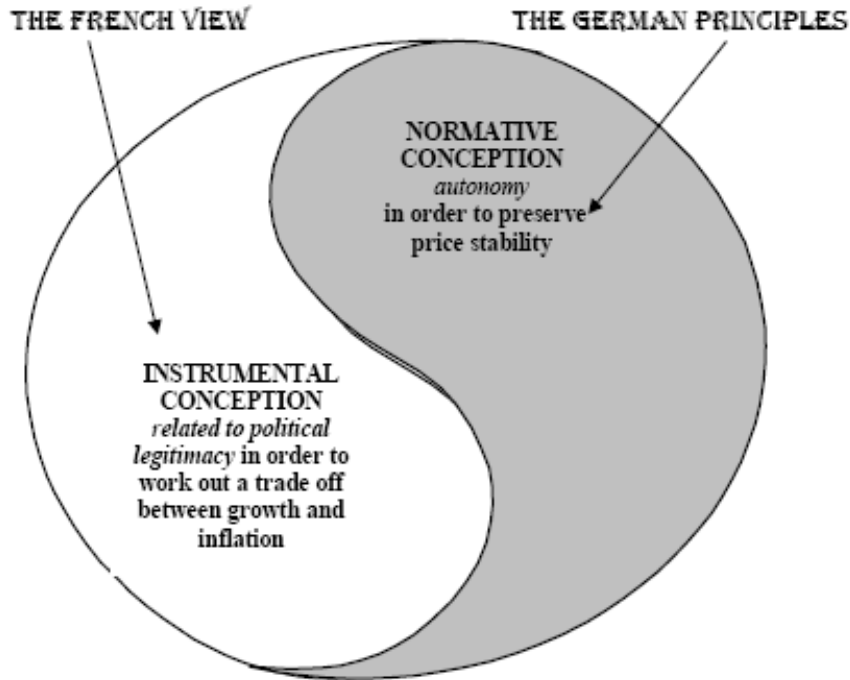
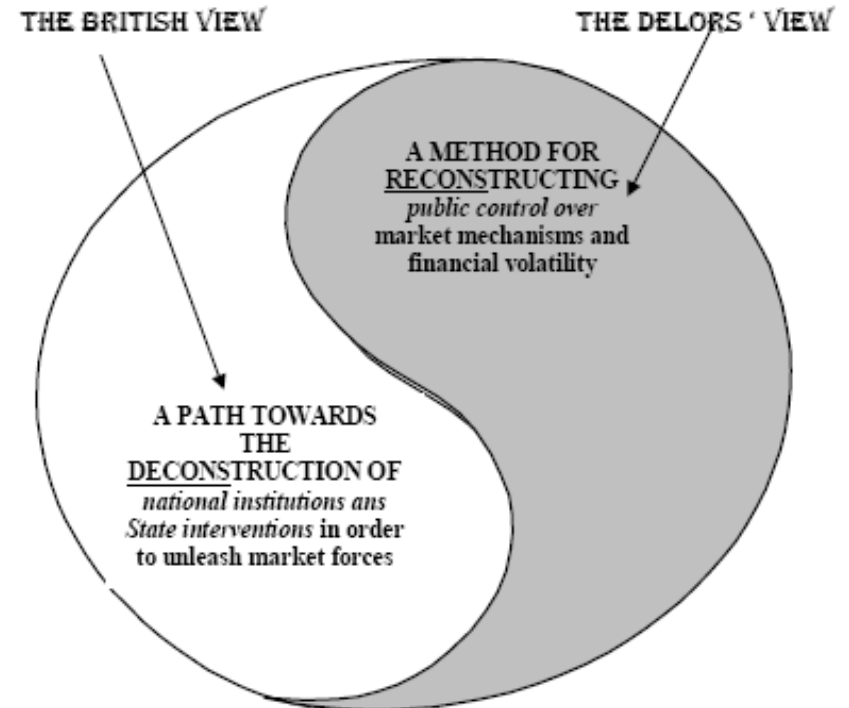


Figure 15 – The same European treaties...but conflicting visions of the dynamics it implies

1. The conception of the European Central Bank



2. The leading mechanisms for economic governance



Source: Boyer (2000)

Table 11 – The paradox of the launching of the Euro: fear in the North, enthusiasm in the South

EUROPEAN SURVEY
Early 1997

A rather enthusiast
Southern Europe

A sceptical
Northern Europe

France

70 % have a positive appraisal about Euro.
58 % consider that the benefits overcome the required sacrifices.

Germany

60 % fear Euro.

Spain

70 % have a positive appraisal about Euro.

Great Britain

58 % fear Euro...but 56 % of businessmen wish Britain to join.

Portugal

53 % are ready to financial sacrifices in order to have their country in the first wave of Euro.

Netherlands

A drastic breaking down of the acceptance of Euro.
1995 : 73 %
1996 : 46,3 %
1997 : 34 %

Italy

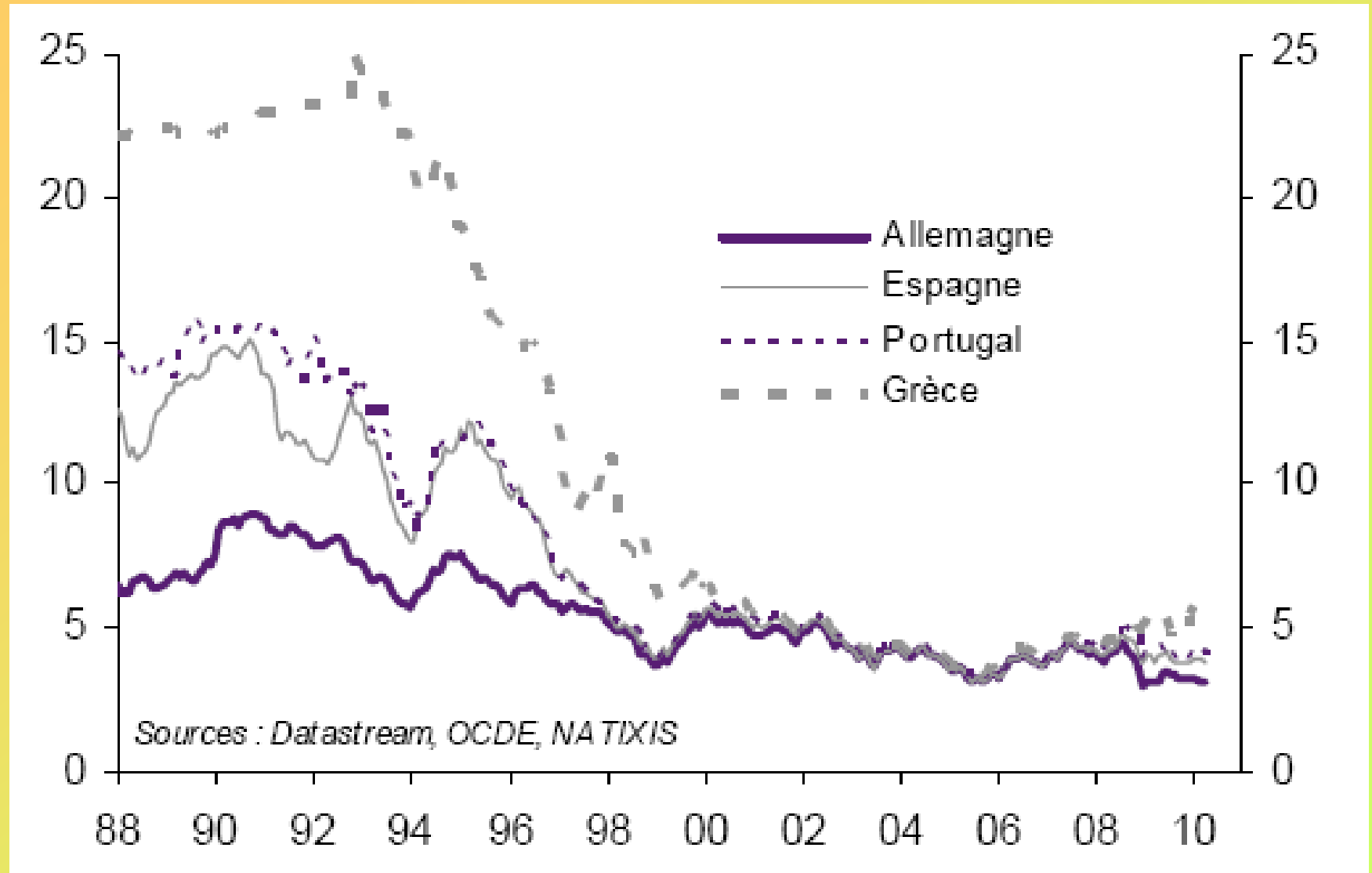
70 % have a positive appraisal about Euro.

Source: Le Sondoscope n° 129, Avril 1997, p. 70-71-73.

IV. The dangerous delegation to financiers of financial stability

- 1. The surprising appraisal by international finance: all public debts are now equivalent from Germany to Greece***

Graph 1 – A convergence of 10 years Treasury bonds interest rate

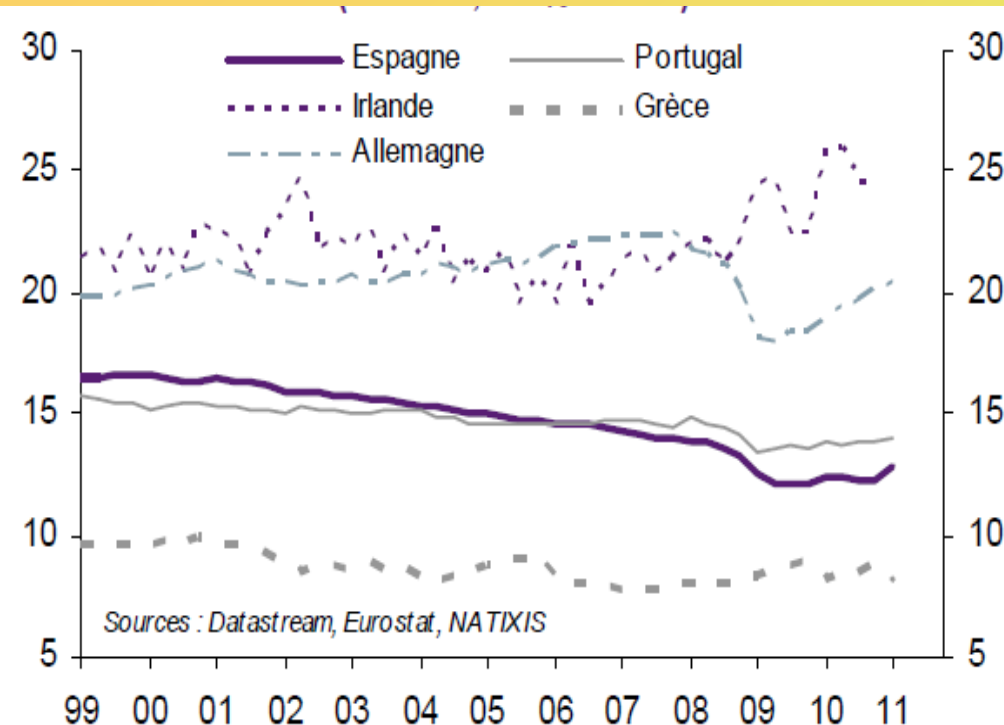


Source : Patrick Artus (2010), « Quelle perspective à long terme pour la zone euro ?, *Flash Economie*, n° 158, 12 Avril, p. 4.

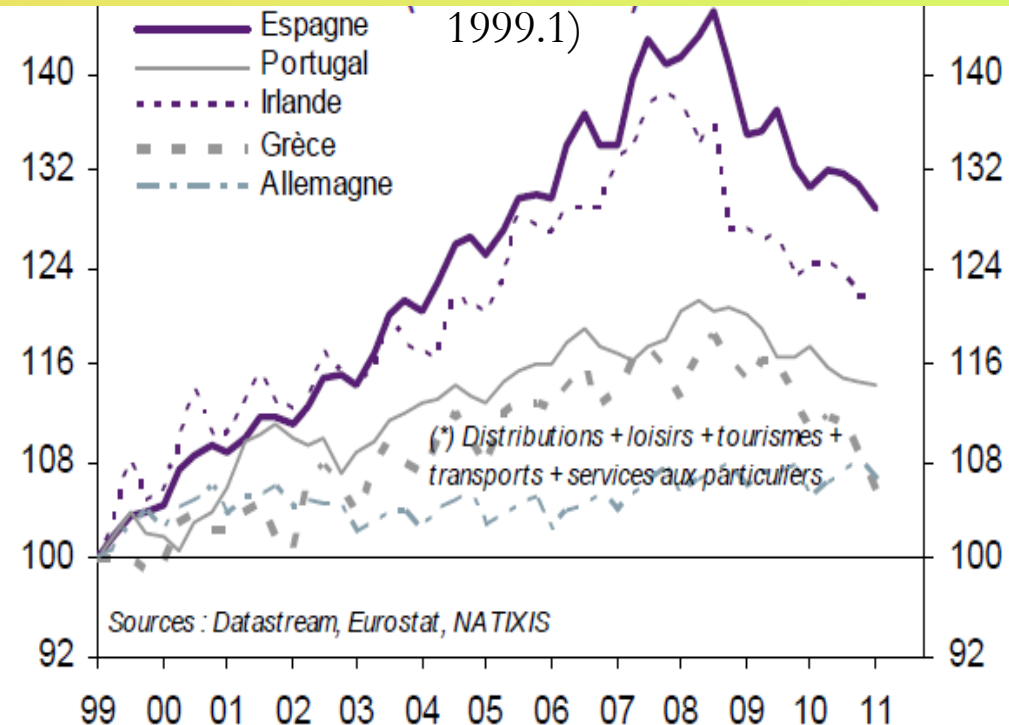
2. *Beneath nominal convergence, divergence in specialisations and domestic growth regimes: a structural complementarity accelerated by the Euro....*

Graph 2 – A deepening of intra-European specialization: manufacturing in the North, service in the South

A – Share of manufacturing in total value added



B – Employment in domestic services (100 in 1999.1)

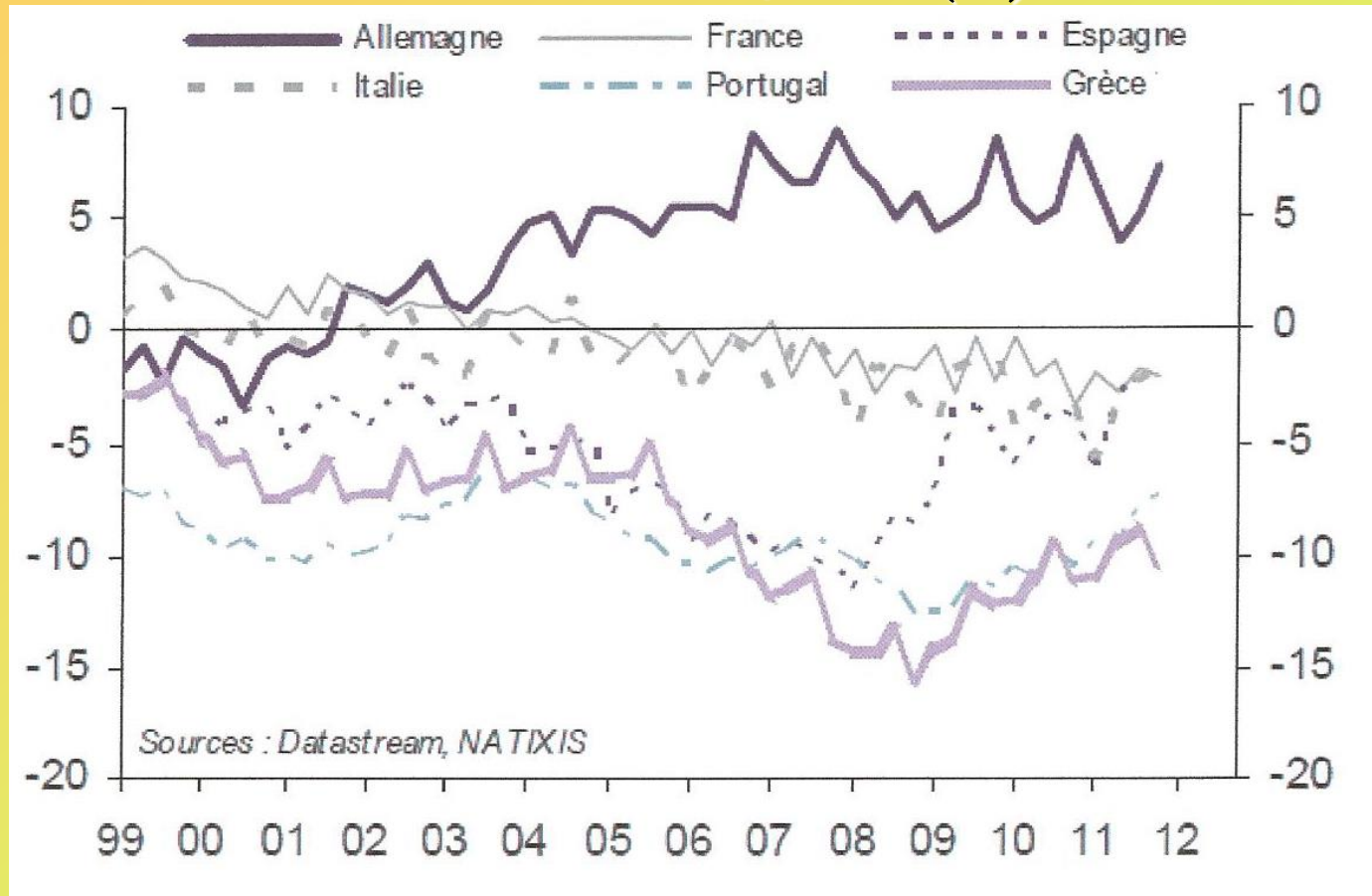


Source: Patrick Artus (2011) “Pourquoi n’a-t-on pas vu, de 1999 à 2007, les problèmes de l’Espagne, du Portugal, de l’Irlande, de la Grèce? », *Flash Economie*, n° 534, 9 juillet, p. 5.

...and a polarization of trade balance surpluses and deficits.

Graph 3 – A polarisation of external balance within the Euro zone

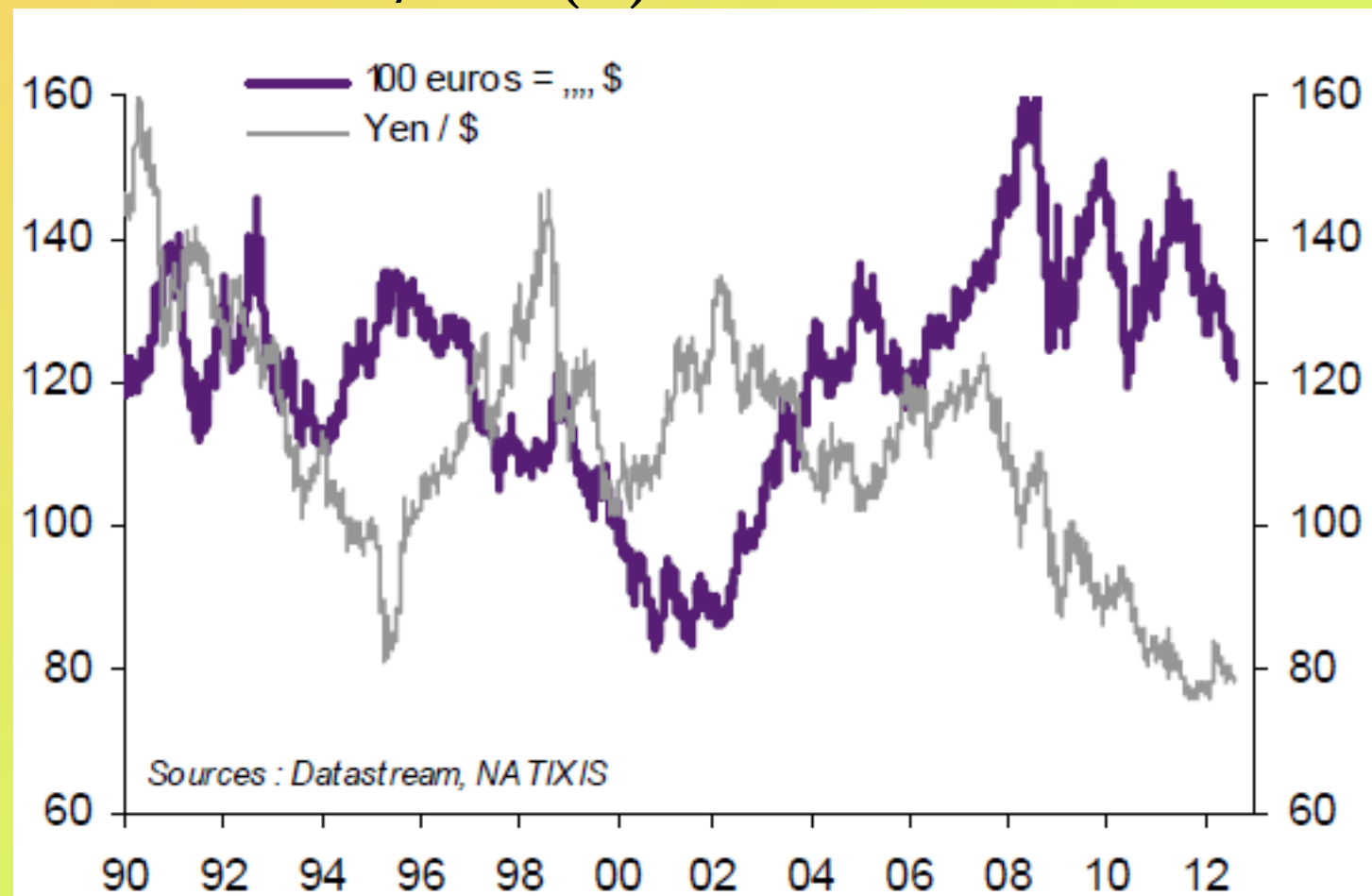
Current balance / PIB (%)



Source: Patrick Artus (2012), *Flash Economie*, n° 347, 21 mai.

3. The ambiguous blessing of Euro credibility: its appreciation puts at risk the competitiveness of many national economies

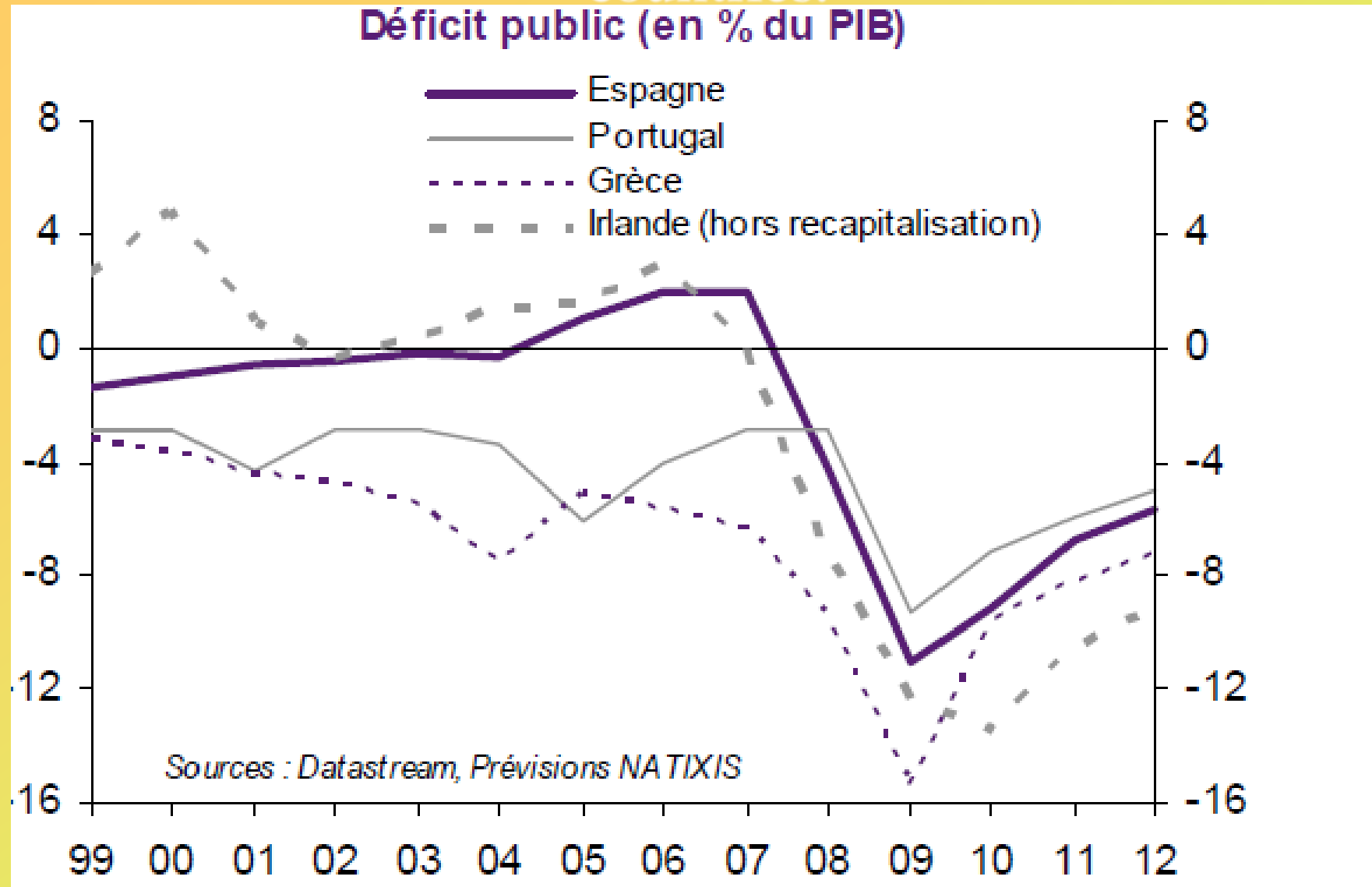
Graph 4 – The evolution of Euro/dollar/yen exchange rates. Current balance / PIB (%)



Source: Artus (2012), Flash
marchés n° 535, page 6.

4. The consequences of the subprime world crisis: a brutal wakeup call by international finance in response to the deterioration of public finances...

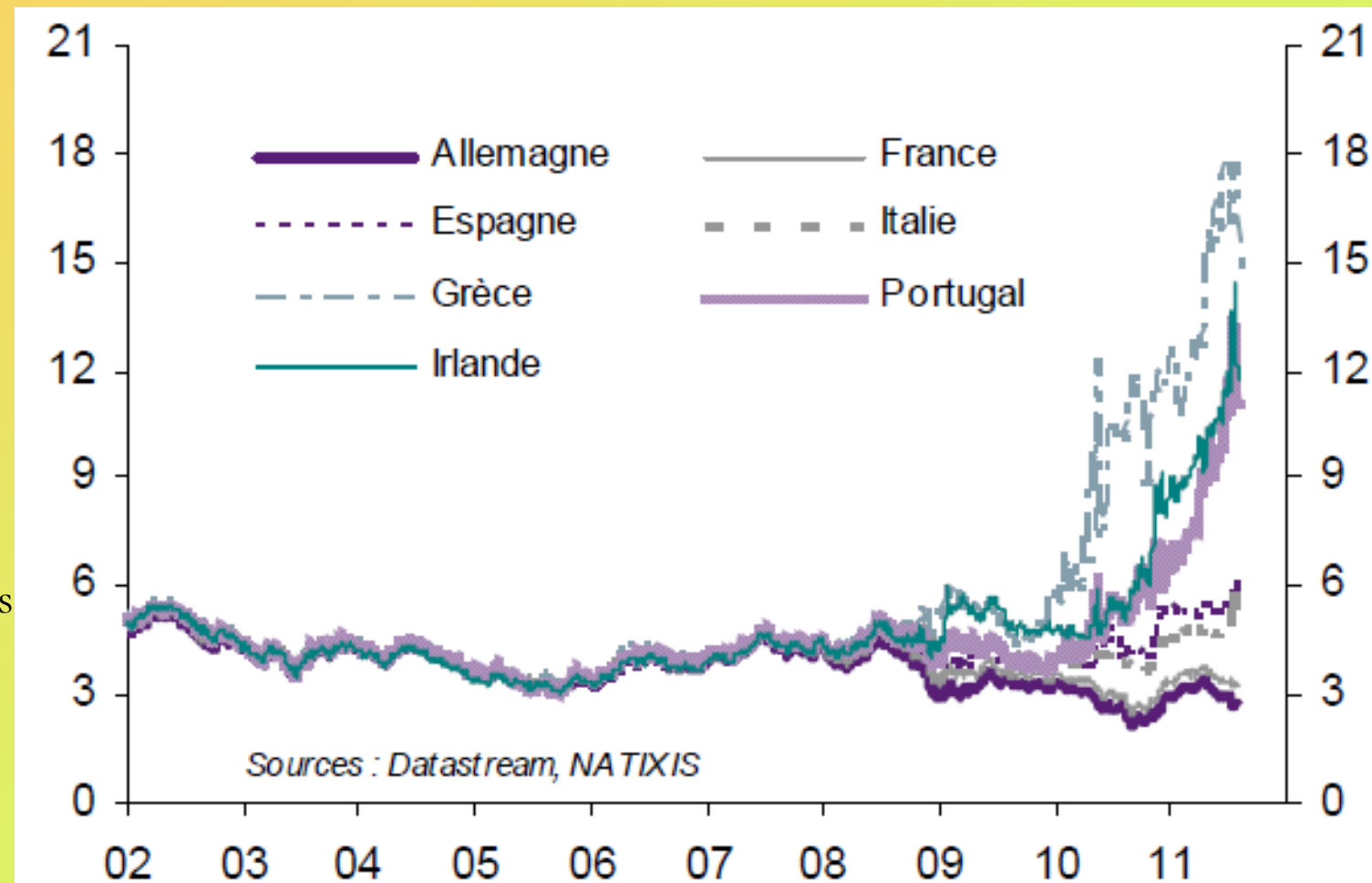
Graph 5 – The deepening of public deficits after 2008: selected countries.



Source : Artus Patrick (2011), L'introduction du fédéralisme dans la zone euro : les avantages et les risques, *Flash économie*, 18 avril 2011, numéro 284, p. 7.

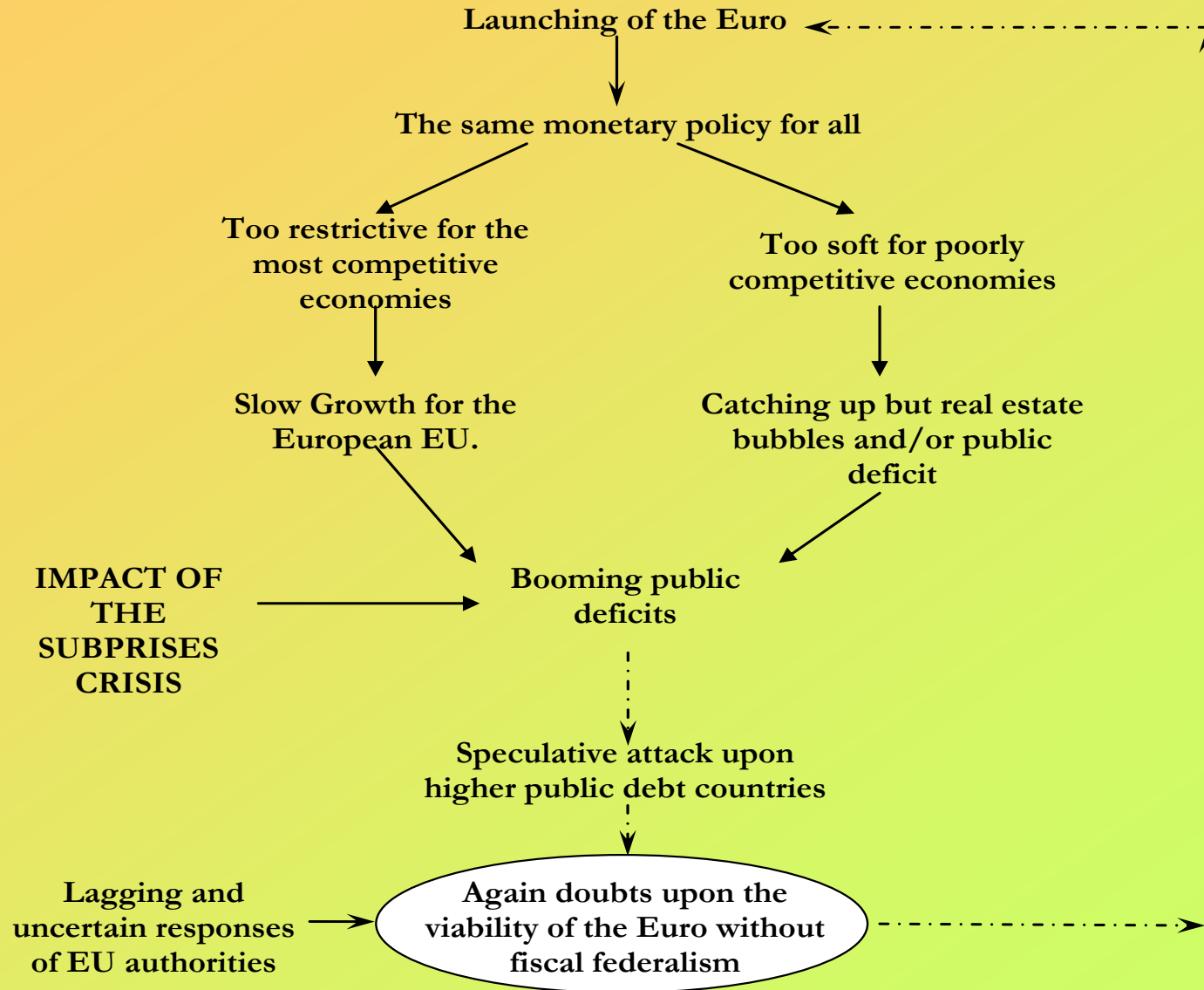
... With the explosion of the refinancing costs of public debt for Greece, Portugal, Ireland

Graph 6 – The brutal explosion of the cost of refinancing of public debt of Southern Europe economies

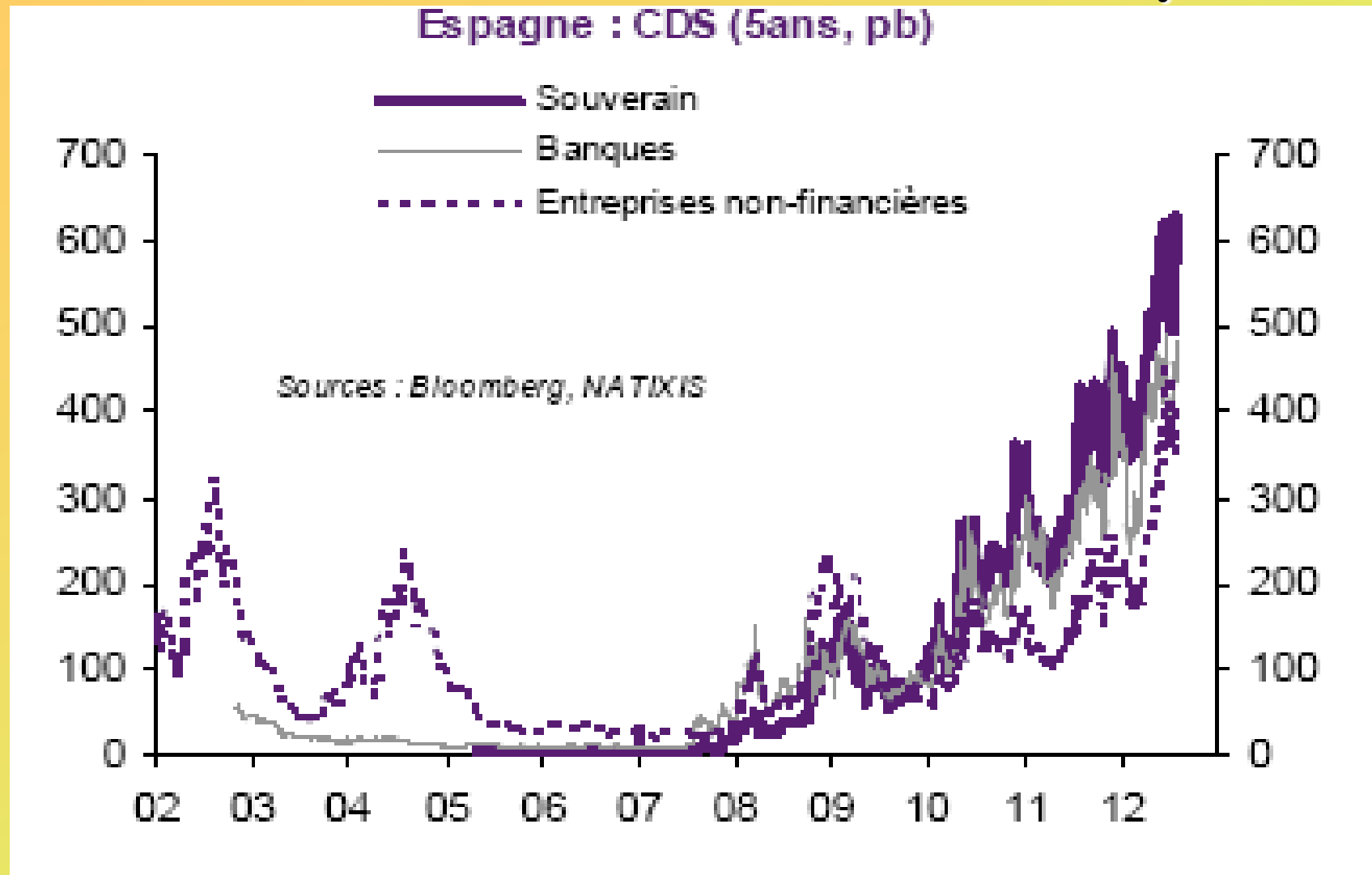


Source: Artus Patrick (2011),
“La crise de la zone euro nous
apprend beaucoup sur le
fonctionnement des Unions
Monétaires ; l’euro est-il
sauvé?”, *Flash Economie*, n°
599, 9 août, p. 5.

Figure 16 – Financial speculation reveals some of the institutional unbalances of European governance

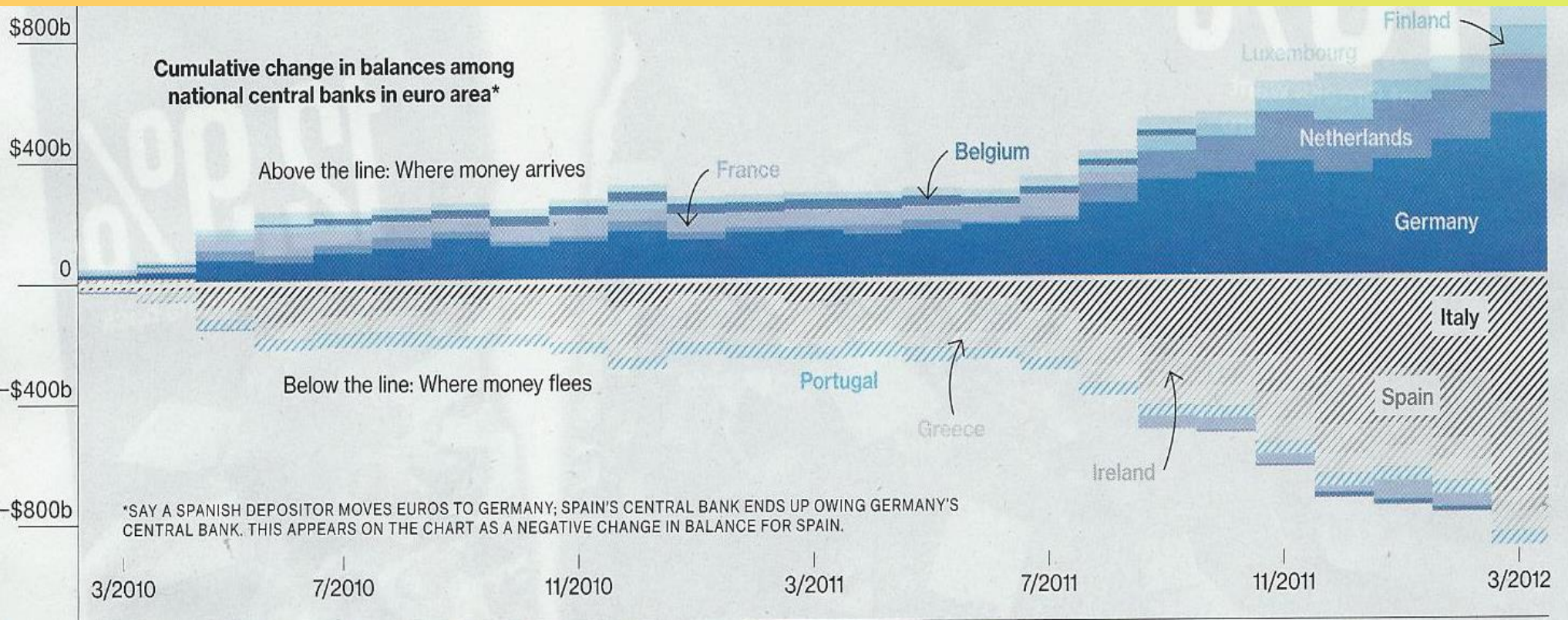


Graph 7 – An evidence of the systemic crisis: the perverse spill over between bank and State credibility



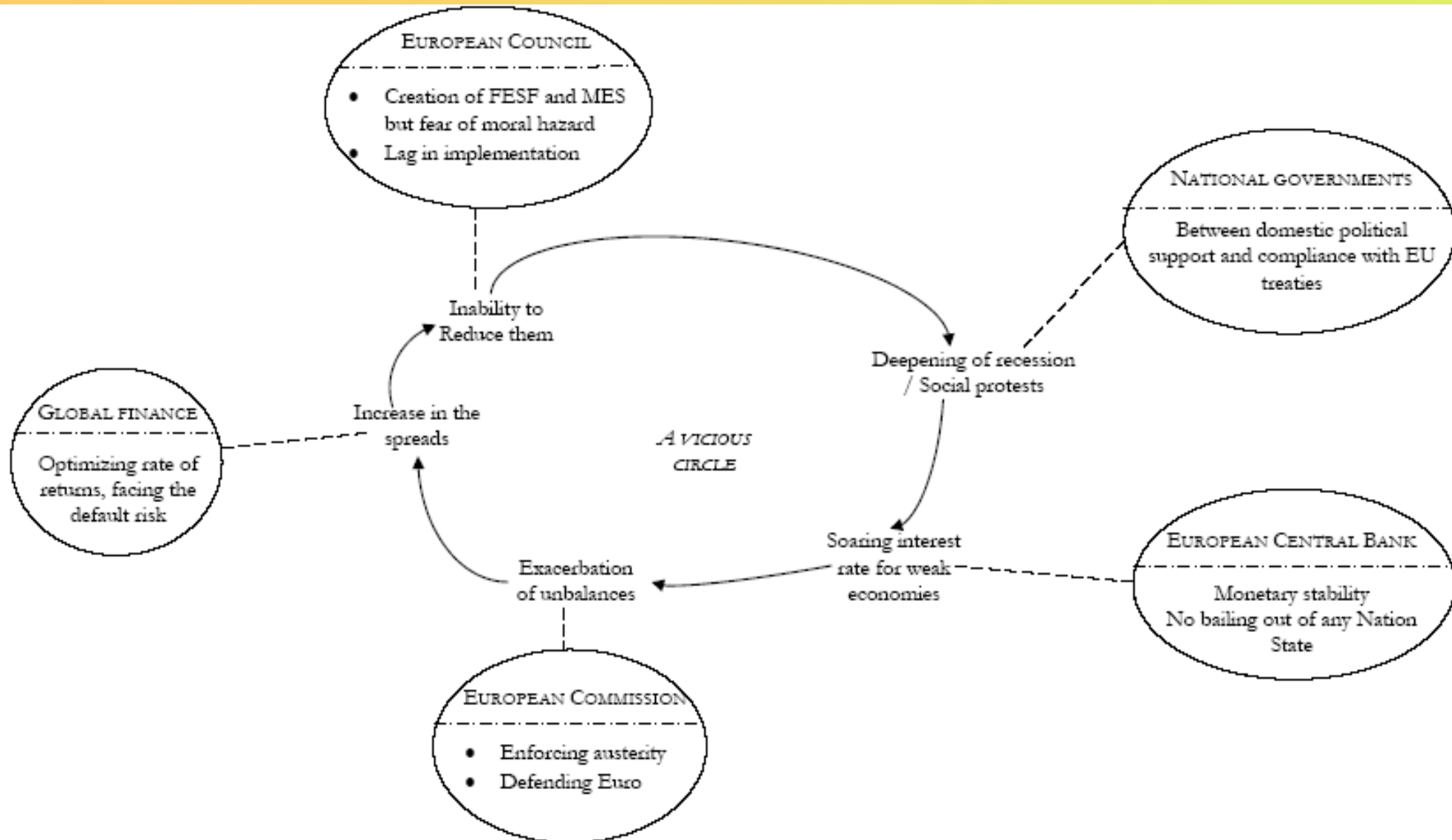
Source: *Eco Hebdo*, n° 30, 27 juillet 2012, p. 6. Figure 11 – The self defeating process of financialisation: from Lehman Brothers to the Euro-zone crisis

Graph 8 – The financial mobility against the viability of the Euro-zone



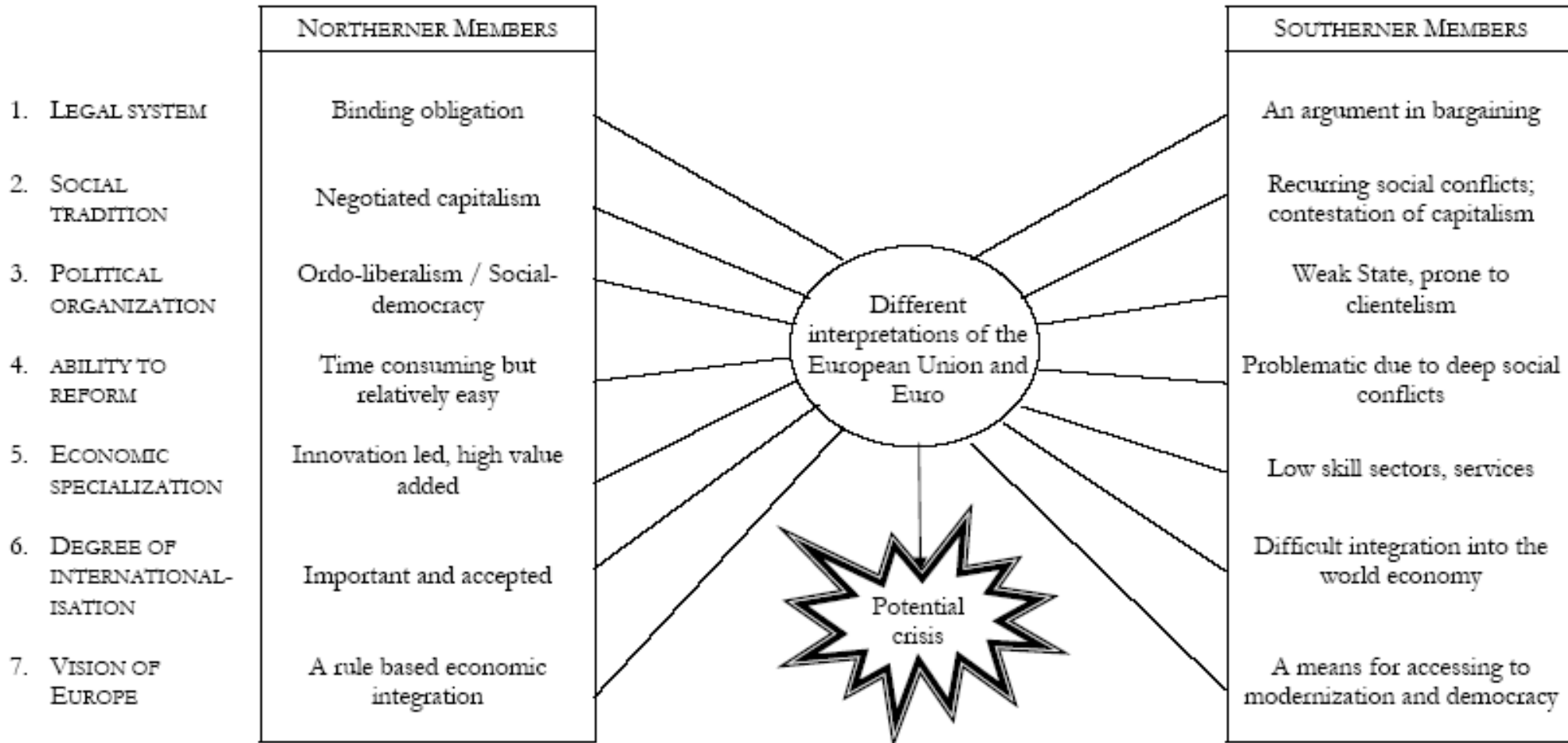
Source: Euro crisis, Bloomberg Businessweek, may 21-27, 2012

Figure 17 – The muddling through in the Euro-zone: the consequence of the conflict between the objectives and interests of a web of actors



5. The increasing danger of a North / South grand divide

Figure 18 – The North / South divide is an obstacle to the building of new federalist institutions



CONCLUSION

C1. Since a market economy is not self equilibrating, its viability is up to the coherence of **a set of public goods**, embedded into organizations, rules, norms and institutions.

“ I have never known much good done by those who affected to trade for the public good”, Adam Smith (*The wealth of Nations*, p. 168)

C2. Public goods may be conceived as corrections to economic externalities but they cannot be generated through the interactions of individually rational economic agents, since this requires social and political processes in order to aggregate heterogeneous, beliefs, interests and representations. They may fail recurrently (Climate change).

C3. Public goods emergence might be motivated by sentiments of social justice but they are not a sufficient condition: history suggests that social struggles, political intermediation and legislations are necessary.

C4. The public goods operate at quite **diverse levels** (local, industrial, national, continental and global) and **spatial heterogeneity** is frequently an obstacle to their implementation (Banking federalism in the EU).

C5. Public goods tend to become **complementary** as shown by the evolution of the European integration, but political science and standard economic theory rarely recognize this interdependency.

C6. This framework delivers the following diagnosis about the origins of the Euro crisis:

- The intellectual confusion between two public goods: monetary and financial stability
- A technocratic approach to economic institution building, applied to a highly political monetary regime
- An illusory confidence in the efficiency of financial markets, as an alternative to collective monitoring

C7. How to reconstruct a relevant macroeconomic theory? By taking seriously a socioeconomic analysis of the core public goods of capitalist economies.

**Thanks for your attention
and patience**

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