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Social Capital and Economic Development in Europe

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Prologue: Trusting or Mistrusting Strangers…

At nightly twilight, a young Socialist went aboard on a small fish cutter near Lübeck. Hided under deck, where a customs inspector controlling the boat did not discover him, the 19 years old boy was shipped to the Danish coast by a friendly fisherman. Arriving on the Danish island Lolland next morning, he continued his journey on another ship to Oslo in Norway, his travel destination. The name of the young fellow, who left his homeland, was Willy Brandt.[1] As members of the ´Sozialdemokratische Partei Deutschlands´ (SPD), he and his party comrades had been running into danger more and more since the appointment of Adolf Hitler to Reich Chancellor in January 1933. That is why the SPD party leadership strongly urged Willy Brandt to leave his hometown as soon as possible and to continue the party work from now on in Norway.[2]

Two years later and more than 2600 kilometers south of Scandinavia, a young doctor from Turin, handcuffed and escorted by two police men, arrived in an old Fiat in the tiny town Gagliano.[3] Due to his opposition to Fascism, the 33-years old man was exiled to this hilly and remote area in the province of Matera or – in other words – into the middle of the Mezzogiorno. The name of this fellow was Carlo Levi and he would later write a world-famous report about his time

[1] Willy Brandt would become Federal Chancellor of West Germany in 1969 and thereby the first SPD chancellor since 1930.
[2] See Willy Brandt, Links und frei, Mein Weg 1930-1950, Hamburg 2012, pp. 66-69.
[3] Gagliano (nowadays named Aliano) is located in the province of Matera in the region of Lucania, which is usually called in the present Basilicata.

and experiences in this alien and exotic place Mezzogiorno, titled 'Christ stopped at Eboli'.[4]

Due to their resistances against German National Socialism and Italian Fascism, Willy Brandt and Carlo Levi were sharing a similar fate. Both were involuntarily forced to leave behind their homelands and to integrate into new, hitherto unknown social environments. Their (sociological) reflections about the attitudes, beliefs, habits, norms and values prevailing in these two distinct European landscapes – Southern Italy and Norway, respectively – offer first insights about the subjects of regional development and social change, the concepts of civic and political culture[5] as well as the issues of social capital, inter-personal trust and value orientations within small communities or societies.

For instance, the initial impression made by Willy Brandy upon his arrival in Norway was the honesty of its residents. He astonishingly observed in Oslo that the people do not lock the houses after leaving their homes. In addition, suitcases or bicycles, which had been left at the railway station for hours, were neither lost nor stolen. Despite the, at first glance, reserved attitude of the Norwegians towards the German stranger, they were accommodating Willy Brandt in a friendly and helpful manner.[6]

These first experiences, gained by the German immigrant, contrast sharply with Carlo Levi's observations about daily life in

[4] Cf. Carlo Levi, Christ Stopped at Eboli, London 1947, pp. 13-14.
[5] See Gabriel Almond/Verba Sidney, The Civic Culture, Princeton 1963, Gabriel Almond/Verba Sidney, The Civic Culture Revisited, London 1989 and Christian Welzel, Political Culture, in: Todd Landmann/Neill Robinson, The SAGE Handbook of Comparative Politics, London 2009, p. 299-318.
[6] See (Brandt, 1982).

Lucania. On arrival in Gagliano, the fascist major welcomed him with some practical advices about his new living place. First of all, Levi should not worry much about Malaria because "there was only a bit of [it], nothing to speak of".[7] Then, the major presented the village as "one of the richest in all the province"[8]; contrasting however with Levi's description of Gagliano as "merely a group of scattered white houses, slightly pretentious in their poverty".[9] But: Levi should be very watchful. According to the major, there were many "evil tongues" out there. He should "better trust no one".[10]

In Levi's account, everyday life in Gagliano seems to be dominated by an unhealthy combination of distrust, personal enmities among the people and strong prejudices against the peasantry. But also in the nearby town Grassano, where Levi had lived before he was relocated to Gagliano, a local army officer pictured the inhabitants as being "ambitious, thieving, dishonest, and violent".[11] In addition, ancient myths or superstitious ideas like the belief in witchcraft, dating back to premodern times, appear to still have strong effects on the behavior, the consciousness and practices of the villagers in Lucania.[12]

Even though Carlo Levi won the sympathies of the peasants after a while, the local habits and customs remained strange to the Piedmont doctor during his exile in the Italian South. In contrast to this,

[7] See (Levi, 1947, p. 20.)
[8] Ibid.
[9] Ibid, p. 15.
[10] Ibid, p. 20.
[11] (Levi, 1947, p. 30). Ibid, p. 30.
[12] Levi gives the example of a widow, whose husband was poisoned by a "peasant witch-woman […] by means of love potions'' (Levi, 1947, p. 16).

Willy Brandt was could integrate himself more easily into Norwegian civil society.

1. Introduction:

From the beginnings of European integration, regional convergence and economic, social and territorial cohesion have been central issues. European structural funds and national territorial development planning agencies like the Cassa della Mezzogiorno in Italy have been created to overcome historical regional disparities and inequalities in member states where these existed but failed to even out them. Many European countries including Belgium, France, the United Kingdom or Spain are still shaped by considerable and persistent domestic regional disparities.

Especially the long-standing North-South divide in Italy or the East-West gap in Germany after re-unification in 1990 provide striking examples of the persistence of long-established patterns of regional divergence within the same state, despite national and European attempts to alleviate those territorial disparities. Hence, European regions do not merely differ economically but also in social, cultural or institutional terms and features if we look at different outcomes in employment, criminality, health, quality of life or the government performance of local bureaucracies. Looking at regional levels of GDP per capita for the year 2010 (PP$, EU27=100), we see that the European countries are confronted with serious regional disparities, ranging from 137 (Limburg) to 87 percent (Hainaut) in Belgium, from 75 (Andalusia) to 116 (Catalonia) percent in Spain, from 65 (Calabria)

to 132 (Lombardy) percent in Italy and from 81 (Mecklenburg-Western Pomerania) to 131 percent (Baden-Wuerttemberg) in Germany.[13]

Recent decades have brought about a growing interest in the socioeconomic performance of European regions, sub-national territories and political entities, which are also associated with different levels of economic activities.[14] Consequently, this text sets out to investigate why some European regions perform ´better´ than others, even though they – as part of the same state – share the identical formal-institutional political, legal and economic framework? In other words, the following texts takes primarily the German and Italian examples to cast light on the root causes of socioeconomic disparities in Europe.

In March 1957, the European Commission aimed to ´strengthen the unity of the economies and to ensure the harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions.[15] In particular in Italy, whose Southern regions were substantially affected by under-employment and under-development, convergence and regional development had become primary policy objectives. That explains why Italy pushed for a European social policy and free labour mobility

[13] Eurostat, Regional GDP per capita in the EU in 2010: eight capital regions in the ten first places, Brussels, No. 46, 2013.
[14] Romain Pasquier, Cities, Regions and the New Territorial Politics, in: Erik Jones/Paul Heywood/Martin Rhodes/Ulrich Sedelmeier (eds.), Developments in European Politics, Houndmills 2011, p. 120.
[15] European Commission, The Treaty of Rome, Rome 25. March 1957.

within the EEC; both possibly favouring South Italy.[16] Therefore, the creation of a European Social Fund with the purpose to ´improve employment opportunities for workers in the common market and to contribute thereby to raising the standard of living´ and to ´increase their geographical and occupational mobility within the Community´ (Treaty of Rome, Article 123) was one of the results of the European Economic Community in 1957.

Article 2 of the Treaty of Rome referred to the objective of a "harmonious development of economic activities, a continuous and balanced expansion", while in the preamble the contracting parties went even further by calling for a reduction of "the differences between the various regions and the backwardness of the less favored regions." There were, however very few provisions in the Treaty for the reduction of regional disparities. Before 1975, supporting depressed regions was almost entirely a national affair. Redistributive instruments at the European level have been developed in relation to successive rounds of widening and deepening.

In the European Commission´s first attempt at European Monetary Union – the Werner Plan from 1970 - the member states accepted the need for structural and regional actions to prepare for monetary union. The Werner Plan failed, but in 1975, after enlargement to Denmark, Ireland and the United Kingdom, the European Regional Development Fund was established. Given the negligible benefit of the Common Agricultural Policy (CAP) to the

[16] Antonio Varsori, Italy´s European Policy, UNISCI Discussion Papers, p. 41-64, No. 25, January 2011.

United Kingdom, an European regional policy could provide a 'just retour' for the United Kingdom while building on the British tradition of regional policy. The successive enlargements to Greece (1981), Spain and Portugal (1986) made the need for a more substantial regional policy clearer. With the single market project regional policy became central to secure social cohesion. In the single market project, greater competition (the four freedoms) was coupled with cooperation (social, environment, and research policy) and solidarity (more opportunities for all regions). Thus in the Single European Act, regional policy was set on a firm legal basis with a new title on 'Economic and Social Cohesion'. The Treaty of Maastricht set up as most important innovation the Cohesion Fund. This was seen by many observers as a side-payment to the poorer member states in return for their agreement to European Monetary Union.

In the 1970s, Structural Funds were established by the European Commission: first the European Regional Development Fund (ERDF) in 1974/75[17]; other investment funds like the Cohesion Fund (CF) or the European Agricultural Fund for Rural Development (EAFRD) were set-up afterwards. The regional and cohesion policy of the European Union has the ´overall goal of promoting economic prosperity and social cohesion throughout the entire territory of the Union, which means the 27-member states and their 271 regions´.[18] The funds are relatively well provided with financial resources.

[17] The European Regional Development Fund is targeted towards those regions with less than 75 percent of the EU´s average level. The Cohesion Fund was established after the Maastricht Treaty. It aims at member states whose Gross National Income per inhabitant is less than 90 percent of the EU average.
[18] EurActiv, EU Cohesion Policy 2014-2020, 2011.

Between 1980 and 2006, the Structural Funds distributed approximately 382 billion Euro to lagging-behind regions or countries, implying that three-quarter of total developing aid was allocated to a quarter of the total EU population. In relation to total EU budget, spending on regional and cohesion policy from 2007 to 2013 amounted to 35.7 percent.[19]

What has been the effect of the Structural Funds on convergence and catch-up since their instalment in the 1970s? According to evaluations of the European Commission, the Structural and Cohesion Funds have been successful. An EU report has claimed that they ´not only stimulated demand by increasing income in the regions´ assisted but ´supported investment in infrastructure and human capital´ as well as ´increased competitiveness, productivity and income over the long-term´. Concerning the four ´cohesion countries´ (Greece, Ireland, Portgal and Spain), it has been pointed out that ´compared with their starting levels in 1960, all four countries can be said to have succeeded in catching-up, at least to some extent, to the EU average.[20] Yet: depending on whether ´regions´ or ´territories´ make up the observed case sample, the impact of the cohesion policy on the level of economic performance is ambiguous. According to one observation, convergence between countries was surprisingly not accompanied by the same convergence at the regional level within

[19] Ibid.
[20] Carmela Martin/Ismael Sanz, Real Convergence and European Integration: The Experience of the Less Developed EU Members, in: Empirica – Journal of European Economics, (30) 2003, p. 205-236.

countries.[21] And another concludes that ´instead of catching-up of all the poorest regions, European integration seems to have benefited mainly to the richest regions in the poorest countries´.[22]

1.1 Research Questions

The cases of the North-South divide in Italy or the East-West gap in Germany after re-unification especially highlight the existence of long-established patterns of regional divergence within the same state. In exploring the different performance of regions despite shared institutional, political, legal or economic settings, it is argued that different political and civic cultures in the specific regions induce different forms of collective action and behaviour and eventually different outcomes; eventually implying that more cohesive societies have a better social, economic and political performance than less cohesive regional societies. Concerning regional disparities in Europe, increasing evidence does suggest that social capital, social cohesion, and the quality of governance represent fundamental causes of regional development, and vice versa, the lack of it.[23]

Why do some regions perform ´better´ than others, even though they – as part of the same state – share with each other the identical formal-institutional political, legal and economic framework within

[21] Pierre Wunsch, Is the European Integration Machine Broken? In: Intereconomics – Review of European Economic Policy, Vol. 2, 2013, p. 78-83.
[22] Sandy Dall´erba/Julie Le Gallo, Regional convergence and the impact of European structural funds over 1989-1999: A spatial econometric analysis, Papers in Regional Science, Vol. 87, No. 2, 2008, pp. 219-244.
[23] Michael Keating/John Loughlin, Culture, Institutions and Economic Development: A study of eight European regions, Cheltenam 2005; Emmanele Ferragina, Social Capital in Europe, A Comparative Regional Analysis, Cheltenham 2012; Robert Leonardi, Cohesion Policy in the European Union, The Building of Europe, Houndmills 2005.

countries? Why do sub-national political entities vary across many dimensions vis-à-vis their neighbouring counter-parts? What are the reasons for the different policy performance and outcomes in socioeconomic terms across regions within the same state? And why do regional disparities tend to persist in some cases such as in the Italian South and under which circumstances regional disparities can be reduced? Can we detect a European model of successful development, based on mutual trust, social capital and cohesion? How and to which extent do European programs and development funds stimulate social capital in the targeted areas?

1.2 Research Hypothesis

The central research hypothesis is that that despite the same formal institutional incentives within the same state, the different political and civic cultures in the specific regions induce different forms of collective action and behaviour and eventually different outcomes; eventually implying that more cohesive societies have a better social, economic and political performance than less cohesive regional societies.

1.3 Research Design and Methodology

To find out which factors constitute ´root causes´ of regional development, this thesis is based on a ´most similar conditions, different outcome´ framework and involves a two-step analysis. Selecting a case-sample between 60-80 European regions (NUTS-1)

level, a cross-sectional OLS regression will be carried out. The aim is here to estimate the (relative) impact of independent variables such as social capital, quality of governance, human capital and other institutional variables on the current economic performance of European regions. In the second step, qualitative case-studies in specific regions will be done. Because of the fact that Italy and Germany experience significant within-country variation (North-South gap in Italy, East-West gap in Germany), a deeper look into the reasons for the regional disparities in both countries might be promising. The role of historical legacies and path-dependencies will be investigated, and it will be asked whether successful development policies, initiated by either the EU or the national government, can be traced back to abundant social capital and effective governance on the regional level. Can we detect a European model of successful development, based on mutual trust, social capital and cohesion? How and to which extent do European programs and development funds stimulate social capital?

2. History, Culture or Institutions? Proximate and Fundamental Causes of Development

In general, proximate and fundamental causes of long-run socioeconomic development can be distinguished.[24] In economics, variables such as capital, labor, natural resources and human capital make up the proximate sources of growth. Being the productive factors,

[24] See (Acemmoglu & Robinson, 2012) and (Acemoglu, Johnson, & Robinson, 2008).

they are included in the traditional neo-classical growth function. For example, Andalusia, Calabria or Saxony-Anhalt are poorer than Catalonia, Lombardy or Bavaria because the latter are stocked with more capital, labor and better technology than the former. However, being equipped with an abundance of factor endowments can be as much the cause as the consequence of an advanced level of development. Robert Solow had clearly made this point by stressing that ´[…] there is no solution to the inverse causation issue. The more right-hand-side variables that go into those regressions, the more they seem to me to be just as likely the consequences of success or failure of long-term economic growth, as the cause´.[25]

That is why proximate causes of growth can only make up one part of the equation. Already in 1953, the Estonian economist Ragnar Nurske stated that ´capital [is] a necessary but not a sufficient condition of progress´ before further emphasizing that ´economic development has much to do with human endowments, social attitudes, political conditions – and historical accidents´.[26] Since neo-classical growth theories cannot rationalize why resource-rich or labor-abundant developing countries or lagging-behind regions fail to catch-up with its more advanced counterparts, it is recognized that fundamental reasons for socioeconomic development need to be taken into consideration too. To sum up: While proximate development approaches focus on the productive factors (capital, labor, technology) as the main

[25] Brian Snowdon/Howard Vane, Conversations with Leading Economists, Interpreting Modern Macroeconomics, Cheltenham 1999.
[26] Ragnar Nurske, Problems of Capital Formulation in Underdeveloped Countries, Oxford 1953.

determinants of economic development, fundamental theories integrate structural, institutional and socio-cultural variables as well as ´historical accidents´ into a broader explanatory framework [27] (Acemoglu/Johnson/Robinson, 2008) and (Rodrik, 2003).

Concerning the question ´which factors can take account for these significant gaps in GDP per capita between Europe´s many regions? ´, a proximate approach would try to trace back the observed variance in GDP per capita to variances in factor endowments such as capital or labour supply. A fundamental approach would rather ask why some regions have within the same country much more capital, labour and technology at their disposal than others? The persistence of the Southern question in Italy and the failure of national (la Cassa per il Mezzogiorno) and European development funding to trigger sustainable and lasting catch-up effects has been stimulating research into the root causes of (under)-development. For Robert Putnam, Raffaella Nanetti and Robert Leonardi the Italian North-South divide is the historic legacy of the Middle Ages. He argues that the present gap in economic as well as in institutional development can be traced back to distinctions in social capital accumulation among the Italian regions. The in medieval times self-governed municipalities in Lombardy or Tuscany developed over time higher levels of social capital, including the capacity to trust and cooperate with each other, than their Southern neighbours. [28] For Michael Keating, regions as

[27] Dani Rodrik, In Search of Prosperity, Analytic Narratives on Economic Growth, Princeton/Oxford 2003, p. 1-23.
[28] Robert Putnam, Raffaella Nanetti, Robert Leonardi, Nannetti, Making Democracy Work: Civic Traditions in Modern Italy, Princeton 1993.

political actors and autonomous sub-national entities play a substantial role. He states that the relative success and failure of regions can no longer be explained by traditional factor endowments or access to markets. Rather, the political capacity of the region, and the way in which firms, governments and other social entities are organized, explains better their fortunes.[29] And the Italian sociologist Carlo Trigilia puts forward the concept of ´territory´. He argues it is a distinct „sociopolitical area with different regulation modes and different types of political mobilizations.[30]

First of all, a large body of literature has shown that institutions are key determinants of economic development and the American Economist Daron Acemoglu understands them as one of the fundamental causes of economic growth. Differences in institutions help understanding different paths of economic development and contribute to determine why certain areas reach economic prosperity and other areas do not. In second instance, an interesting new-born field of literature has proved that history matters for the economic development of an area. This literature presents the intriguing idea that modern economies are affected by past institutions even after the institutions have ceased to exist. Interestingly, past institutions can have long lasting effects on economic achievements of a country through different means.[31]

[29] Michael Keating, Thirty Years of Territorial Politics, in: West European Politics, Vol. 31, No. 2, 2008, pp. 60-81.
[30] Carlo Trigilia, Social Capital and Local Development, in: European Journal of Social Theory, Vol. 4, No. 4 2001, pp. 427-442.
[31] See (Acemoglu, Johnson, & Robinson, 2008).

Institutions that have ceased to exist can affect modern economic development through their impact on current institutions.[32] Several papers identify the origins of heterogeneity of economic achievements in certain parts of the world in colonization, proving that different colonial institutions led to different institutional outcomes in modern times.[33]

Other studies have demonstrated how past institutions can also have an effect on culture, values and beliefs. [34] This research aims at investigating whether evidence in this sense, that is, of an effect of past institutions on culture and values, can be found also in the Italian case. Robert Putnam et al. indicates the presence of a decisive discontinuity between centre and north Italy and south Italy, in terms of both economic development and institutional performance.[35] Indeed, in the 1970s all Italian regions were introduced to the same new institutional model, composed by national and local bodies, regions and provinces, but after small time new institutions showed different levels of performance. Italian local heterogeneity in terms of economic and social achievements constitutes a unique framework for research on regional development.[36]

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[32] Alberto Alesina/Paola Guiliano, Culture and Institutions, in: Journal of Economic Literature, Vol. 53, No. 4, 2015, pp. 889-944.

[33] See Daron Acemoglu et al., "The colonial origins of comparative development: an empirical investigation", in: The American Economic Review, Vol. 91, No. 5, 2001, pp. 1369-1401; Sa

[34] Sascha Becker, The empire is dead, long live the empire! Long-run persistence of trust and corruption in the bureaucracy, in: The Economic Journal, Vol. 16, 2016, p. 40-76 and see (Alesina & Guiliano, 2015).

[35] See (Putnam, Nanetti, & Leonardi, 1994).

[36] Marco Almagisti, Una democrazia possible. Politica e territorio nell'Italia contemporanea, Roma 2016.

2.1 Culture and Long-Run Development

Starting with Max Weber, the search for the long-term roots of the different levels of economic development across countries and regions led many scholars to believe that the missing element in the explanatory chain is *culture*. Differing national or regional cultures – through their influence on informal and formal institutions – are supposed to be the deciding variable for the potential of a country or a region to develop economically.

But the concept of "culture" is ambiguous and it is difficult to define. Multiple definitions have been given and among the many worth mentioning a closer look will be given to Weber's work (M. Weber, 2004 [1904]) and the empirical falsification of the Weber Thesis of a 'Protestant Ethic" by Sascha Becker and Ludger Woessmann.[37]

The idea that culture and norms of behaviour may be a channel through which history can affect long-term economic development is not new. In the first years of the twentieth century Max Weber (1930), in one of the most renowned and controversial works of modern social science, "*The protestant ethic and the spirit of capitalism"*, attributed the higher economic prosperity of Protestant regions to a Protestant work ethic made of individualism and appreciation of worldly achievements.

[37] Sascha Becker/Ludger Woessmann, Was Weber Wrong? A human capital theory of Protestant economic history, in: Quarterly Journal of Economics, Vol. 124, No. 2, 2009, pp. 531-596.

Becker and Woessman respond to the sociological interpretations that Protestant ethic induced its followers to work harder with an alternative economic theory based on standard human capital models. The authors argue that Protestantism affected economic activity in Prussia by increasing education through the precept of personal reading of the Bible. In fact, Martin Luther explicitly favoured universal schooling in order to enable all Christians to read the Bible by themselves, and Protestant regions benefited of the higher prevalence of public schools. The ensuing literacy rate among Protestants was then favourable to economic activity. In order to test this hypothesis, the authors first estimate the effect of Protestantism on literacy rates using distance from Wittenberg, the epicentre of reformation, as an instrument for Protestantism. The authors obtain significant results, proving that Protestantism indeed led to higher literacy rates across Prussian countries in the nineteenth century. Secondly, economic outcomes are considered. There is a positive casual effect between share of Protestants and economic outcomes, but this effect disappears when controlling for the share of literates.[38]

Finally, a three stage least squares model is developed, using jointly relationship between distance from Wittenberg and share of Protestants, Protestantism and share of literates, literacy and economic progressiveness. The authors conclude that Weber was right in the observation that Protestant regions were economically more affluent than Catholic ones, across countries in 1900 and within Prussia in the

[38] See (Becker & Woessmann, Was Weber Wrong? A human capital theory of Protestant economic history, 2009).

second half of nineteenth century, but he was likely wrong in identifying the channel through which this pattern arises.

In order to fully understand the economic implications of a certain religious affiliation the authors choose to compare groups of minorities of Protestants and Catholics. Minority groups are likely to have a stronger adhesion to religious norms and ethics for a number of reasons: religion, along with language, history and culture, is an important element of people's identity, which may explain the willingness of minorities to defend their religious identities against the influence of the majority secondly, a minority religion's clergy works harder to preserve its followers than does the clergy of a majority religion; finally, given that following a minority religion implies continuous pressure from surrounding dominant religions, membership can be justified only if the attachment to the faith is particularly strong. Switzerland is an optimal set for the experiment, as it is a homogenous territory as regards economic conditions, and it hosts a variety of combinations of Protestant and Catholic minorities and majorities which are historically determined and with an almost perfect persistence over time. Using individual level data from Swiss census between 1970 and 2000, the authors are able to exploit the strong adhesion of religious minorities to their confessions' ethical principles to find that Protestantism is associated with a significantly higher propensity for entrepreneurship. Findings indicate that adherence to Protestant ethical principles increases the probability that an individual will be an entrepreneur by somewhat between 1,5 and 3.6 percentage

points with respect to Catholics, after controlling for many individual-level characteristics.

Furthermore, less religion-centred arguments by recent authors, especially by Roland Inglehart[39] and, in a second step, the multivariate indexes of Hofstede and Schwarz are discussed (G. Hofstede, 1988, 1980); (S. Schwartz, 1994, 1992). Finally, using broader empirical evidence from two extensive studies, the possible influence of culture on the facilitation of societal cooperation and the resulting impact on economic growth is analyzed in more detail.

2.1.1 The Definition of Culture

How can 'culture' be defined? The proposed definitions by widely cited authors hint at a broad concept that is hard to make operational and to test empirically. For example the historian David Landes, who makes far-reaching claims for the role of culture in economic history, puts surprisingly little effort into defining it. To him culture is "the inner values and attitudes that guide a population". [40] Samuel Huntington, who wrote the manifesto "Culture matters: how values shape human progress", describes culture as "values, attitudes, beliefs, and underlying assumptions prevalent among people in a society".[41] Francis Fukuyama refers to "inherited ethical habits".[42] Mancur Olson defines two different kinds of culture: on the one hand, marketable

[39] Roland Inglehart, Culture Shift in Advanced Industrial Society. Princeton 1990.
[40] David Landes, The Wealth and Poverty of Nations, Why Some are So Rich and Some so Poor, Norton 1998.
[41] Samuel Huntington, Culture matters: how values shape human progress, New York 2001.
[42] Francis Fukuyama, Trust, The Social Virtues and the Creation of Prosperity, New York 1995.

human capital and personal culture, and on the other hand public-good-human-capital and societal culture which to him is knowledge about good public policy (Olson, 1996).[43]

2.1.2 Barro's Hypothesis: Religious Faith

A different approach on the relationship between economic growth and religion is taken by Barro. In contrast to specific sectarian influences like Protestantism as proposed by Weber, he assumes that 'general religious' faith through the 'enforcement mechanism' of heaven and hell has a positive influence on the cultivation of individual traits like "honesty, thrift, willingness to work hard, and openness to strangers" (Barro, 2003, p. 1). [44]

His paper from 2001 lacks any deeper theory on how and why religious beliefs manage to influence the individual value sets on the micro level and focuses instead on proving the causality between macro level indicators of religious faith and economic growth. Though Barro can confirm earlier findings50 that economic development is negatively correlated with church attendance (holding fixed the belief in hell and heaven), he finds a positive relationship between the belief in heaven and the growth rate of the per capita Gross Domestic Product (GDP). Barro differentiates between input to the religious sector (church attendance) and output of the religious sector (the belief in heaven and hell). The data used by Barro contains the first three

[43] Mancur Olson, Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Others Poor, in: Journal of Economic Perspectives, 10, 2, 1996 pp. 3-24.
[44] See (Barro, 2003, p. 1).

waves of the World Value Survey 1981-1995, the International Social Survey Programme 1991/1998, and the Gallup Millennium Survey 1999.

In the second part of his study, Barro constructs a panel data set on economic growth rates and several additionally relevant control variables. The dependent variable (economic growth) is built by taking averages of the periods 1965-1975, 1975-1985, and 1985-1995. The data for the other variables range from 1981 to 1999. By using instrumental variable techniques, he circumvents the causality problem and tries to show the impact of religion on economic growth as a unidirectional causal relation. As instruments Barro finds the existence of a state religion, the presence of government regulation of religion, the extent of religious pluralism, and the composition of adherence among the main religions.

Catholic countries caught up and the growth rates of countries with large Catholic populations such as France, Italy, Germany, and recently Ireland and Spain outperformed countries with a Protestant majority. On the other side, Barro's results indicate that, in contrast to specific sectarian influences such as Protestantism as proposed by Weber, general religious faith through the 'enforcement mechanism' of heaven and hell might have a positive influence on the cultivation of individual traits like 'honesty', 'thrift', 'willingness to work hard', and 'openness to strangers'. If we assume that the prevalence of theses individual values can have an impact on the level of economic growth, following on from this we have to look at other, broader cultural

concepts that also deal with forms of non-religious, value-based measurements of culture.

2.1.3 Inglehart's Achievement Motivation

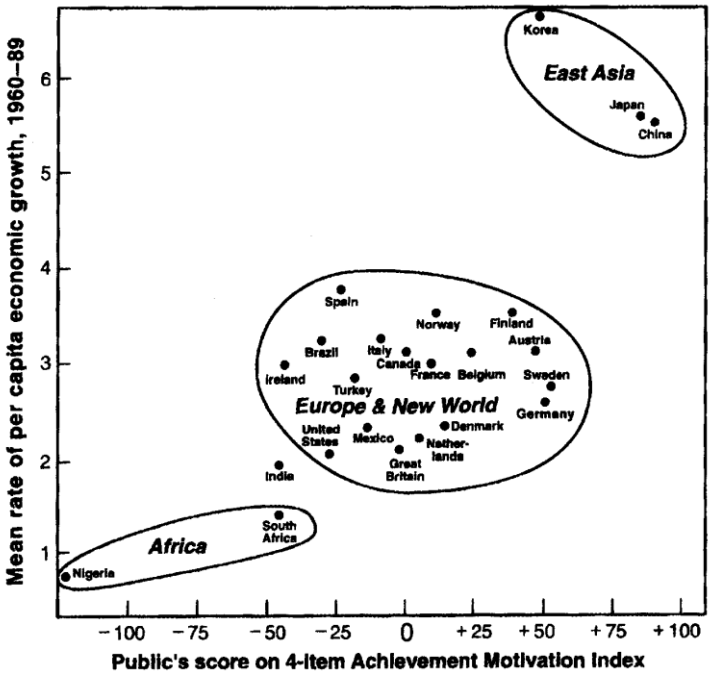
Inglehart, who continues to propagate the concept of achievement motivation as the relevant factor for long-term economic growth, extended the idea by examining the shift from materialist to postmaterialist values.[45] They claim that it is not religion, but the prevailing secular value sets of societies in respect to the achievement motive that can be made responsible for diverging patterns of economic growth.[46] This approach has the advantage of bypassing the discussion of whether these societal value sets derived from religious faith in general or were the outcome of sectarianism such as the Protestant Reformation. In the interpretation of McClelland and Inglehart, obviously nonreligious-based origins of achievement motivation can become relevant.

Following the argument that the motivation to individual achievement plays a major role in the societal development of economic growth, Inglehart constructs a four-item achievement motivation index using the second wave of the World Value Survey (Inglehart, 1996). In the 1990-1993 World Value Survey, the questions interview subjects were asked included items on attitudes towards "thrift, saving money and things", "determination, perseverance", "obedience", and "religious faith"; World-Value-Survey, 1981-2000). Inglehart uses these item variables for his analysis on the effect of

[45] (Inglehart, 1990)
[46] Ibid.

secular achievement motivation in explaining economic growth (Inglehart, 1996, p. 611).

The index built by Inglehart is constructed by adding the mentioned average sum of "thrift" (V20) and "determination" (V21) and subtracting the mentioned average sum of "obedience" (V24) and "religious faith" (V22). In order to indicate the possible relationship between achievement motivation and economic growth, Inglehart plots his achievement motivation index against the long-term economic growth rates from 1960-1989. The following figure shows the resulting scatter-plot.



In this diagram we see an obvious upward sloping trend in the relationship between Inglehart's achievement motivation index and

long-term economic growth. Furthermore, we can identify three clusters of countries: Fast growing Asia, the rather developed parts of Western Europe and the New World, and Africa, represented only by Nigeria and South Africa. India is somewhere between the New World and Africa.

On a first glimpse, the graph seems to confirm the hypothesis that a higher level of achievement motivation goes hand in hand with a higher level of long-term economic growth. A major problem with the analysis of Inglehart, however, is the timeframe he uses. The applied growth rates stem from the period before the measurement of the achievement motivation. As a result using a heuristic Granger-causality the diagram should rather be interpreted as the influence of economic growth on the formation of values prevalent in a society. Inglehart indeed devotes much of his recent research to the causation of the value shift from materialistic values to postmateralistic values in developed societies.[47]

Understood in such a way, Inglehart's ideas might hint at an important consequence of long-term economic development, but do not explain the origins of economic growth. What is required is the turning of the analysis upside down and the use of a time span measuring economic growth after the measurement of the value set of achievement motivation. A second problem for the validation of the argument is his rather small sample. Though in Inglehart's analysis Asia and Africa clearly appear different to Europe and the New World on both dimensions, a sample size of only two countries for Africa

[47] See (Inglehart, 1990).

(Nigeria and South Africa) and three countries for Asia (Japan, South Korea, and China) is too small to form the basis of generalised hypothesis-building. The third identifiable problem is the interpretation of the item "religious faith". Again, given the time span Inglehart uses, the opposite causality seems to be more likely. Secularisation could be the result of economic growth, and not vice versa. Given the methodological flaws in Inglehart's study one might be too easily willing to discard the hypothesis of the achievement motive being at the root of economic growth however. To continue the analysis, we will therefore have a deeper look at more inclusive concepts of culture that are based on multiple value-dimensions and under which the intuitively intelligible but methodologically simplistic arguments by Inglehart and McClelland can be subsumed.

2.1.4 Multidimensional Concepts of Culture

The reasons for the economic rise of the West have long been debated. Why it is that Europe and not any other part of the world began to industrialize and develop economically? Were there some special values in the European culture that allowed it to create economic growth more easily? Apart from some attempts to declare Western cultural values superior[48], there is a serious literature focusing on the specific features of Western culture, especially emphasizing its inherent economic freedom based on different forms of individualism. In order to measure the degree of individualism and economic freedom, two concepts of cultural dimensions are usually cited: Hofstede's

[48] (Landes, 1998).

pioneering work on culture and economic growth (Hofstede, 1988, 1980) and the more recent studies of Schwarz.[49] An examination of such broad-based indicators of culture, incorporating several subsets of indicators is expected to serve better in trying to explain which cultural values are of importance in respect to fostering cooperation and hence economic development.

2.1.5 Hofstede's Concept of Culture

Hofstede's framework of characterizing national cultures through four and later five dimensions has been highly influential. Although his methodology is debatable, he is still by far the most frequently cited author on culture and economic growth in the empirical literature. His major achievement was the establishment of cultural dimensions, of which he considers some to be highly important in predicting long-run economic growth. Hofstede defines five abstract dimensions under which he subsumes all cultural values and beliefs of a national culture: Power Distance, Individualism-Collectivism, Masculinity-Femininity, Uncertainty Avoidance, and Long vs. Short Term Orientation (Hofstede, 1988, 1980).

The degree of *Power Distance* describes the concerns of social inequality, including relations with authority. A high power distance indicates that an unequal distribution of power in institutions is regarded as legitimate. A low Power Distance indicates that people should have equal rights and access to power. Latin American and

[49] Shalom Schwartz, Are there universal aspects in the structure and contents of human values, in: Journal of Social Issues, Vol. 50, No. 4, 1994, pp. 19-45.

Arab countries rank high in this category while Scandinavian and Germanic countries rank low.

Individualism-Collectivism refers to the relationship between the individual and the social group. It indicates to which extent people are expected to stand up for themselves and to what extent they are expected to pursue their own goals rather than group goals. Latin America ranks low on the individualism scale and the United States ranks the highest. *Masculinity-Femininity* concerns the social implications of gender-linked behavior. More 'masculine' cultures value competitiveness, assertiveness, ambition, the accumulation of wealth and material possessions. 'Feminine' cultures place more value on relationships and quality of life. Japan is considered by Hofstede to have the most 'masculine' national culture, Sweden the most 'feminine'. According to his findings the United States and most European countries are moderately 'masculine'. *Uncertainty Avoidance* reflects cultural preferences for dealing with individual uncertainty. The more threatening uncertainty is perceived, the more value is placed on values and beliefs that are considered to provide security. Japan ranks the highest in this category, Scandinavian countries the lowest. The last dimension, *Long vs. Short Term Orientation,* has been introduced by Hofstede as the *Confucian Dynamism* dimension.

It describes a society's 'time horizon'. Societies with long-term orientation are assumed to value thrift and perseverance while rather short term-oriented societies respect tradition and instant reciprocation. East Asian nations tend to score especially high here, with Western

nations scoring low and the less developed nations even lower. In Hofstede's analysis, China attained the highest scores, Pakistan the lowest. Hofstede and his co-authors report correlations between these dimensions of national culture and long-term economic growth (Hofstede, 1988). However, the correlations found between 'Individualism' and GNP per capita, and in later works 'Confucian Dynamism' and economic growth do not by themselves prove causality as Hofstede explicitly acknowledges (Hofstede, 1988). Firstly, the same problem of reverse causality as with Inglehart's findings might be at the root of the empirical results. It could well be possible that with a higher GNP and with economic development, individualism is regarded as more important. It would then not be individualism that triggers economic growth, but economic growth that triggers individualism. Secondly, Hofstede is not controlling for other growth relevant variables such as the accumulation of physical and human capital. It might be the case that the value dimensions can explain these and are the underlying factors of influence, but without a rigorous analysis this remains a mere hypothesis.

Finally, the later inclusion of the Confucian dynamism dimension could be criticized as being data mining to fit the model to the empirical fact of fast growing East Asia. It is also unclear whether this dimension is distinct from the Individualism-Collectivism dimension. There seems to be evidence that these two are related (Johnson, 1998). Some of this criticism on Hofstede has been taken up by Schwarz who constructs a related but more precise set of cultural dimensions built on micro-level assumptions of people's individual

value sets. His work parallels that of Hofstede in constructing an exhaustive definition of culture, first at the individual level (Schwartz, 1992) and later at the macro level.[50]

2.1.6 Schwartz's Concept of Culture

Schwartz defines general human values as "desirable goals, varying in importance, that serves as a guiding principle in people's life" (Schwartz, 1994, p. 8). Using fifty-six human goals, he generates ten motivational distinct types of individual values.

Power:	Social status and prestige, control or dominance over people and resources.
Achievement:	Personal success through demonstrating competence according to social standards.
Hedonism:	Pleasure and sensuous gratification for oneself.
Stimulation:	Excitement, novelty, and challenge in life.
Self-Direction:	Independent thought and action—choosing, creating, exploring.
Universalism:	Understanding, appreciation, tolerance, and protection for the welfare of people and for nature.
Benevolence:	Preservation and enhancement of the welfare of people with whom one is in frequent personal contact.
Tradition:	Respect for, commitment to, and acceptance of the customs and ideas that traditional culture or religion impose on the self.
Conformity:	Restraint of actions, inclinations, and impulses likely to upset or harm others and to violate social expectations or norms.
Security:	Safety, harmony, and stability of society, of relationships, and of self.

See (Schwartz 1994)

[50] See (Schwartz, 1994).

3. The Concepts of Social Capital and Social Trust:

In principle, social capital is any set of values and relationships created by individuals in the past that can be drawn on in the present and future to facilitate overcoming social dilemmas. The externalities from the use of social capital may be positive (when a group of citizens becomes involved in civic engagement) or negative (when cartels agree on price fixing). Social capital reflects a way of conceptualizing how cultural and structural aspects of groups of individuals interact in a society. It is a synthesizing framework that can be applied when collective endeavors of individuals are critical in achieving a collective goal (Ostrom, 2002).[51]

Networks and the underlying *trust* constitute the two most basic forms of social capital. Trust and networks are a form of capital in the broad sense in that they serve as inputs to economic and political processes and therefore outcomes. Less narrowly defined concepts of social capital exist, but it is these two which are most commonly found in the second generation collective action literature incorporating heterogeneous preferences of individuals. Indeed, there seems to be a convergence in the literature towards defining social capital as social networks and their underlying trust (Dasgupta, 2000). Although it is debatable whether social capital does completely satisfy the narrow conditions for being capital that Arrow puts forward (Arrow, 2000), it is becoming the most widely used umbrella concept in the theory of collective action.

[51] See (Ostrom, A Behavioral Approach to the Rational Choice Theory of Collective Action, 1998).

3.1 Benefits of Social Capital

It seems that social scientists from various fields begin to use the concept of social capital to link their different domain's research findings on collective action. Given the infancy of the concept and the different backgrounds of the researchers, the discussion naturally has not yet reached complete consensus on how to precisely define social capital. It circles around the main catalysts of the facilitation of collective action: Trust and social networks[52]. There is less discussion on the benefits and the positive effects of social capital on a variety of relevant societal variables however. Most generally, the positive impacts which are discussed in the literature can be classified under three headings:

1. country/ region politics,
2. public sector efficiency, and
3. the resolution of market failures.

On the macro *country/ region politics* level, the widely cited Knack and Keefer look at the relationship between trust, norms of civic cooperation, associational activity, and long-term investment rates (Knack, 1997). They find that higher levels of interpersonal trust and certain norms of civic cooperation are correlated with higher rates of investment and hence economic growth. Others have examined the connection between society-wide indicators and economic policy. Easterly and Levine, for example, have shown that a measure of

[52] See for example (Arrow, 1972), (Luhmann, 1979, 1989), (Dasgupta, 1988), (Coleman, 1988), (Gambetta 1988a), (Putnam, 1993), (Fukuyama, 1995), (Knack, 1997), (La Porta, 1997), (Ostrom, 2002), (Möllering, 2006b).

"ethnic heterogeneity" is empirically associated with the adoption of bad economic policies, which they attribute to the importance of distributional conflicts and non-cooperation among ethnic groups (Easterly, 1996). Alesina additionally shows that greater ethnic fragmentation in U.S. cities leads to lower spending on productive public goods (education, roads, sewers) and is negatively related to the share of local spending on welfare (Alesina, 1999). Further entries in the country/ region-level explanation include Fukuyama's examination of trust (Fukuyama, 1995) and Huntington's summary on 'civilisational' attitudes (Huntington, 1996).

The sphere of research on social capital and public-sector efficiency is mainly driven by Putnam's work on the regional governments in Italy (Putnam, 1993). His analysis suggests that regions of Italy in which people have greater degrees of horizontal connections also have more efficient governments. He and later others have documented a close connection between the number of societal voluntary associations and the efficiency of governments. Putnam found that the more likely a region's citizens are to join football clubs and choral societies the faster, for example, the regional governments are in reimbursing health care claims. One way of understanding these results is that monitoring the performance of governments is facilitated by social capital, either directly (because the government officials are themselves embedded in the social networks), or indirectly (because the monitoring of the public provision of services is a public good which is facilitated by denser social networks). In addition, the

institutional efficiency of the public sector can also be documented in self-organized public sector projects.

In another important branch of research it is assumed that social capital in the form of trust and social networks can help overcome common market failures such as common pool resources exploitation, the diffusion of innovation, imperfect information, and insurance market problems. Ostrom's work on common pool resources, for example, suggests that the ability of local groups to cooperate plays a large role in avoiding the negative consequences of excessive exploitation or under maintenance of public assets that would result from purely individualistic behavior (Ostrom, 1990). She shows that the 'tragedy of the commons' based on short-sighted individualist behavior is only one possible outcome, and that cooperation can be a stable equilibrium in many realistic cases.

Thirdly, *imperfect information* that leads to higher transaction costs can be partially overcome by higher levels of trust and social inter-connectedness. Social linkages among parties to economic transactions may increase their ability to participate in economic transactions that involve large degrees of uncertainty about compliance. This becomes most obvious in the economy's core sector: credit. Two mechanisms could be at work here. Social capital in the form of trust could lead to a better flow of information between creditors and borrowers resulting in less adverse selection and less moral hazard. But on the other hand, social capital could also make enforcement in the form of costly recourse to the legal system redundant, either by

more ‘social control’ through networks or by the interplay of trust and trustworthiness.

3.2 Bridging and Bonding Social Capital

A number of definitions of social capital have been offered by social scientists from different backgrounds. While these definitions have some diversity, they are broadly similar and mostly draw on the concepts of trust and social networks. However, these views do express some significant nuances. On the one hand, the definitions vary depending on whether they focus on the sources or the effects of social capital. On the other hand, many authors draw on the distinction between *external* and *internal links* of individuals and groups towards others. External links – Putnam and other authors refer to ‘bridging’ forms of social capital – constitute relations an individual or a group maintains beyond his or her reference group (Putnam, 2000). Internal links – Putnam refers to ‘bonding’ social capital – constitute intensified relations within the reference group.

Edgar Grande, briding and bonding social capital in Germany

Proponents of *external/ bridging social capital* emphasize social capital as a resource to individuals or groups (organizations, communities, nations) which they can use in pursuing their individual or common group goals. Relationships and trust among individuals or groups can be used to gather and exchange information, or to build-up goodwill for future use. A famous example is Granovetter’s ‘strength of weak ties’ by which he means loose relationships. Those are

nevertheless highly valuable in job markets, for example, because they allow for cost-efficient information diffusion.[53]

The bridging view of social capital therefore can help to explain the different success of individuals and groups in their competitive rivalry. 'Better connections' are a valuable resource into which investment is possible and that hence can be inter-temporally transferred. Social capital research in sociology has been strongly influenced by network theorists and the *external/bridging* camp can be interpreted from a rationalistic point of view as functionalist approach.

In contrast to the bridging view of social capital, the *internal/ bonding* view sees social capital arising from intensified internal relations within groups. By strengthening the cohesiveness through mutual trust in a group, it is easier for that group as a whole to refer to collective action and to pursue collective goals. Social capital in this view is a resource that can be used to overcome the internal problems.

Summarizing, social capital is based on human interaction. It is thus, even more than human capital, difficult to define precisely. Though many intelligent concepts have been proposed, it seems unlikely that those in the arena of debate will be able to agree on a common definition soon. Apart from these definitional problems, it is obvious that the introduction of a new concept of capital into economic theory will not pass noiselessly. Respected scholars such as Arrow have doubted the justification in the use of the word "capital" for describing the concept (Arrow, 2000, p. 4).

[53] Mark Granovetter, The Strenght of Weak Ties, in: The American Journal of Sociology, Vol. 78, No 6, 1973, pp. 1360-1380.

In the next sections we will therefore analyzed in detail the 'capital'-qualities of social capital in order to be able to compare these to the 'capital'-qualities of physical and human capital. It will be shown that the core assumptions in the concept of physical and human capital hold for social capital as well allowing the later introduction of the concept in the growth framework created.

All forms of human-made capital are created by spending time and effort in transformation and transaction activities in order to build assets today that increase the flow of income in the future. Present consumption is exchanged for (possibly more) future consumption. While investment in physical capital is usually a self-conscious decision, human and social capital may in some instances be accumulated as a byproduct of other activities. Although obvious similarities between physical, human, and social capital exist, it is necessary to cast a glance at social capital with respect to its qualification as a form of 'capital'. In his critic of the concept of social capital Arrow puts forward three conditions of capital that have to hold when being included in the 'concept of capital' (Arrow, 2000, p. 4):

1) extension over time,
2) deliberate sacrifice in the present
3) for future benefit,
4) alienability.

Among others, using these three core aspects, all three forms of capital – physical, human, and social – shall be investigated as to which extent they can be subsumed under the 'capital'-umbrella. If we can establish

capital qualities of social capital along the lines proposed by Arrow, the inclusion of the concept into formal economic models is justifiable.

3.3 Constituents of Social Capital: Networks and Trust

Among scholars involved in the discussion, there seems to be some agreement on the main constituents of social capital (notably trust and networks), although the exact relationship between these two components still remains unclear (Schaik, 2002). A basic component of social capital, according to Fukuyama and others, is trust.[54]

On the other hand, although Putnam and his followers do not define social capital very concisely, in their view it takes the form of qualities of social relationships, e.g. norms of reciprocity and engagement in social networks.[55] (Putnam, 1993). Most of the authors, however, shy away from specifying how these two components are mutually related. For instance, is trust prior to the engagement in networks or do networks generate trust? There is an obvious *chicken-and-egg problem* in deciding which comes first: norms of trust and reciprocity without which networks cannot be created, or networks which facilitate the creation of norms of trust and reciprocity.

3.4 Social Capital as the Basis of Social Networks

The major contribution to social capital theory concerning the importance of 'trust' has been made by Fukuyama. He argues that inter-personal trust is basic for a wide variety of social relationships

[54] (Fukuyama F. , 1995).
[55] (Putnam, Nanetti, & Leonardi, 1994).

and networks to emerge in the first place. His main argument is that since trust reduces uncertainty, transaction costs are low in instances of individuals trusting each other. Following Fukuyama, interpersonal trust can be considered to be the central element to the establishment and the maintenance of networks of interaction containing social capital. Mutual trust does not only ease the cooperation between individuals but is a 'synthetic force within society' (Simmel, 1950 [1908]).

The concept of trust refers to qualities in social relationships that enhance the capacity of the participants to build and maintain social networks and thus to achieve their common interests. Important social qualities reducing uncertainty in network-building are interpersonal trust, mutual supportiveness, and shared norms and understandings. Following James Coleman, trust based on 'generalized reciprocity' is the key to social capital (Coleman, 1988). 'Generalized reciprocity' refers to a continuing relationship of exchange that is at any given time unrequited or unbalanced, but which involves mutual expectations that a benefit granted now is repaid in the future (Putnam, 1993).

According to Coleman, in a trust relationship one does something for someone else in a network not because one expects immediately ate repayment, but in the *vague expectation* that others in the network might do something in return for you in the future. Generalized reciprocity' as such involves a degree of vulnerability (Newton, 1999). The relationship with trust is clear. The trusting individual relies on the firm expectation that the others in the network

will do something in return for what one has done for them, but remains vulnerable since there are no means of enforcement. Moreover, interpersonal trust is essential in the initial creation of networks. If effort is needed to create a link between two individuals and this effort is costly to the individual establishing it while the created link benefits both, we will derive a Nash-Equilibrium when the total costs of link creation outweigh the individual benefits. A standard game theoretic equilibrium concept such as a Nash-equilibrium is therefore not suited for modelling initial network formation. If we consider a simple game, for example, where each agent announces the links he or she wishes to form and we form the links that are announced, it is a Nash-Equilibrium to have no links formed at all in case the total costs outweigh the individual benefits of link formation. Each player will announce an empty set of links since he or she (correctly) anticipates that all other players will do the same.

3.5 Social Capital and Collective Action

The late Elinor Ostrom stated in her Presidential Address to the American Political Science Association that the "theory of collective action is the central subject of social sciences".[56] Why should, as stated by the Nobel Prize winner Ostrom, collective actions and choices be the central subject of social science? Because the economic and political performance of societies - from small groups of pastoralists or

[56] Elinor Ostrom, „A Behavioral Approach to the Rational Choice Theory of Collective Action, Presidential Addrress, American Political Science Association, 1997", in: American Political Science Review, Vol. 92, No. 1 (March 1998), p. 1-22.

hunter-gatherers up to modern, post-industrial nation-states - largely depends on how the communities member manage collective tasks and duties such as mutual defense, common welfare, public infrastructure or the raising of its children.[57] The evolutionary survival of social groups, implying small tribes based on kinship up to large, complex entities, critically depends on the capacity to find solutions to collective action problems. Conversely, the failure to cooperate between each other within the same group may induce a circumstance where their evolutionary existence is at stake.[58]

One popular scientific book even claims that the presence respectively the absence of high levels of intra-group cooperation explains why some societies rise up to world domination and others collapse.[59] These groups with strong social cohesion – displaying coordination and trust to groups insiders but aggression towards group outsiders - are able to overcome collective action failures, and eventually succeed from the evolutionary point of view.[60] Hence, the dialectical relationship between peace and war, cooperation within the group and (violent) conflict between competing groups, seems to represent the dynamic course of world history since the first origins of human culture.

What is collective action, what are collective action problems and how do social groups resolve social dilemmas? "Collective action"

[57] Ibid.
[58] Those societies are labeled "failing states". Acemoglu and Robinson distinguish betweeen inclusive versus extractive institutions as key factors of long-run development. While inclusive economic and political institutions cause liberal market democracy, extractive institutions induce the opposite: namely, the persistence of autocratic rule and rentier capitalism. See (Acemmoglu & Robinson, 2012).
[59] Peter Turchin, War and Peace, and War: The Rise and Fall of Empires, New York 2007.
[60] Ibid.

is commonly defined as the "actions and behaviors taking place by a group of people in pursuit of the members´ perceived shared interests".[61] The Encyclopedia Britannica simply says that collective action occurs when a "number of people work together to achieve some common objectives".[62] Collective action of social groups is a necessary precondition for the production of public goods and the prevention of "tragedies of the commons".[63]

Despite the crucial importance of the concept of collective action in social science, Ostrom has criticized that we still lack a "behavioral theory of collective action" which is based on models of the "individual consistent with empirical evidence about how individuals make decisions in social-dilemma situations".[64] Bearing in mind all the "immense tragedies that humans have endured" which were due to collective action failures, empirical enquiry is – citing Elinor Ostrom – "essential" if we want to understand such basic questions as why "face-to-face communication so consistently enhances cooperation in social dilemmas or how structural variables facilitate or impede collective action."[65] Hence, collective action is vital in order to manage and eventually resolve social dilemmas. Social dilemmas emerge whenever "individuals in interdependent situations face choices in which the maximum of short-term self-interest yields outcomes leaving all participants worse off than feasible alternatives."[66]

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[61] Ibid, p. 12
[62] Ostrom 1998, p. 1
[63] Ibid.
[64] Ibid.
[65] Ibid.
[66] Ibid.

In a public-good dilemma, the people who would benefit from the provision of public goods like such as pollution control, law and order, security or public infrastructure find it costly to contribute and would prefer others to pay for the good instead. If everyone follows the equilibrium strategy, hence, acting rational and freeriding at the expense of the others, then the good is not provided or underprovided. However, everyone would be better off if everyone would contribute and participate.

In collective actions, the risk of free-riding is a central problem. Free-riding means gaining the benefits of a provision of common goods without contributing to the costs of it. Individual rational maximation of utility can lead to an overuse of the resource, an outcome that is collectively suboptimal and thereby non-rational. To avoid free-riding and facilitate a collective provision of a good there must be an effective solution. Garret Hardin named such a solution "mutually agreed upon coercion".

However, public choice theories and rational choice approaches assume that individuals are rational profit-maximizing actors and don not engage collectively to create public goods. For instance, Mancur Olson was very critical of the idea that groups work together in order to provide themselves with public goods by writing that "unless the number of individuals in a group is quite small, or unless there is coercion or some other special device to make individuals act in their common interest, rational, self-interested individuals will not act to achieve their common or group interests.[67]

[67] Cited in Elinor Ostrom, "Collective Action and the Evolution of Social Norms", in: Journal of Economic Perspectives, Vol. 14, No. 3 (Summer 2000), p. 137-158, p. 137.

3.6 Social and Interpersonal Trust

Any economic activity that requires agents to rely on the actions of others is accomplished at lower costs in higher-trust environments. According to Arrow, "Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence" (K. Arrow, 1972, pp. 357). Trust sensitive transactions include those in which goods and services are provided in exchange for future payment, employment contracts in which employers rely on employees to accomplish tasks that are difficult to monitor, and investments and savings decisions that rely on assurances by governments or banks that they will not expropriate these assets (H. Albach, 1980); (S. Knack, 1997); (S. Schödel, 2005). Individuals in higher trust societies spend less time and effort to protect themselves from being exploited in economic transactions. Written contracts are less likely to be needed and do not have to specify every possible contingency. Litigation may be less prevalent. Individuals in higher-trust societies are generally more likely to divert fewer resources to protecting themselves – through laywer fees, bribes, or private security services – from violations of their property rights.

Additionally, governments of societies with higher trust may be perceived more trustworthy, and their policy announcements are thus more credible. To the extent that this is the case, trust then triggers greater investment and other economic activity. Societies with high

general trust not only have stronger incentives to accumulate physical capital and to innovate, but are also likely to have higher returns to the accumulation of human capital. Where trust improves access to credit for the poor, enrolment in secondary education is higher because, unlike primary education, secondary education has opportunity costs (O. Galor, 1993). High general trust is also linked to better performance of government institutions including publicly provided education. Higher-quality schools increase the return to education (J. Coleman, 1988); (R. Putnam, 1993). Moreover, in low-trust societies, large numbers of hiring decisions are influenced by blood ties or personal knowledge and not educational credits reducing the return to the acquisition of educational credits even further (S. Knack, 1997).

Of course, trust as such is normatively neither good nor bad. Only trust that is reciprocated can unambiguously be perceived as a good thing. Evidently, the act of trusting an individual (trustee) or a group of individuals can have positive or negative consequences for the individual that trusts (trustor). Whether the trust placed pays off largely depends on the trustee's behaviour. It depends on whether the trustee reciprocates or defects, which in turn depends on his or her incentives and preferences. If those preferences include non-individualistic utility and are linked to the utility function of the trustor, the individualistic perspective can only partially help explain the concept of trust. Consequently, trust has to be studied as a *social phenomenon*. Indeed, society itself can be understood as a number of overlapping groups of individual commitment.

The definition of trust stresses the significance of other people's unobservable actions and one's expectation of them for the choice of one's own behaviour. But there is also another kind of cases in which trust in a similar sense comes into play. This is when others know something about themselves or the world, which is relevant for one's own decision to cooperate. For example, an agreement of cooperation between oneself and others may call upon these others to disclose information. But can one trust them to be truthful? How could one be sure that the information disclosed is right or not? In addition to these two definitions of trust, Luhman reserves the term 'confidence' (or lack of it) in referring to our expectations about the ability of social institutions (e.g. market mechanisms and state agencies) to function properly (N. Luhmann, 1988). It is clear enough though that the term "trust" can be extended to nearly all forms of institutions as long as disposition, motives, and incentives of the actors involved are relevant. For example, we would not trust the police as an enforcement institution, if we knew that their members were corrupt. Without trusting the police, cooperation would be less common since our trust in the enforcement of agreements of cooperation would be limited. The same applies for the civil service, the law system, and other such institutions (P. Dasgupta, 2000). Thus, trust is economically important when it enhances cooperation. However, what is the underlying link between trust, trust in institutions and finally, cooperation?

Figure 1: Correlation between Social Trust and GDP per capita in European regions

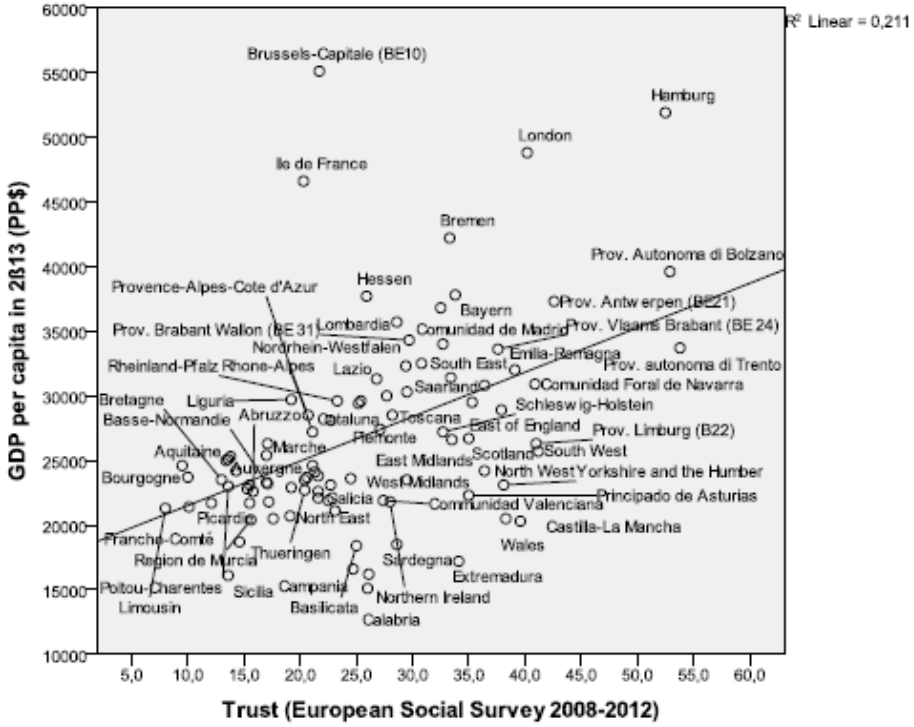


Figure 2: Correlation between Social Trust and Quality of Governance Index in European regions

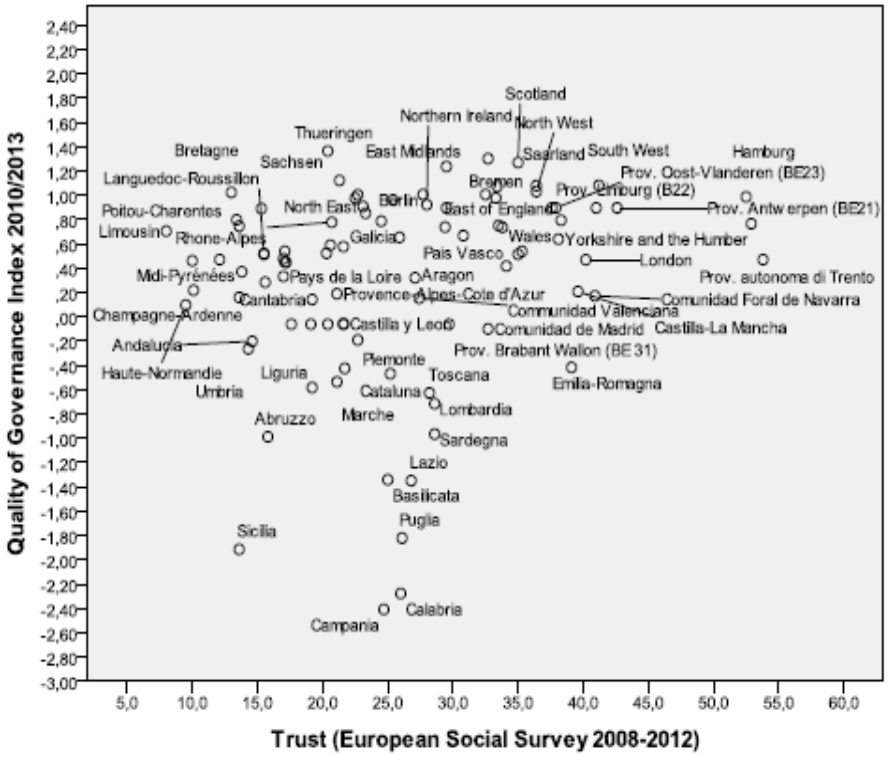
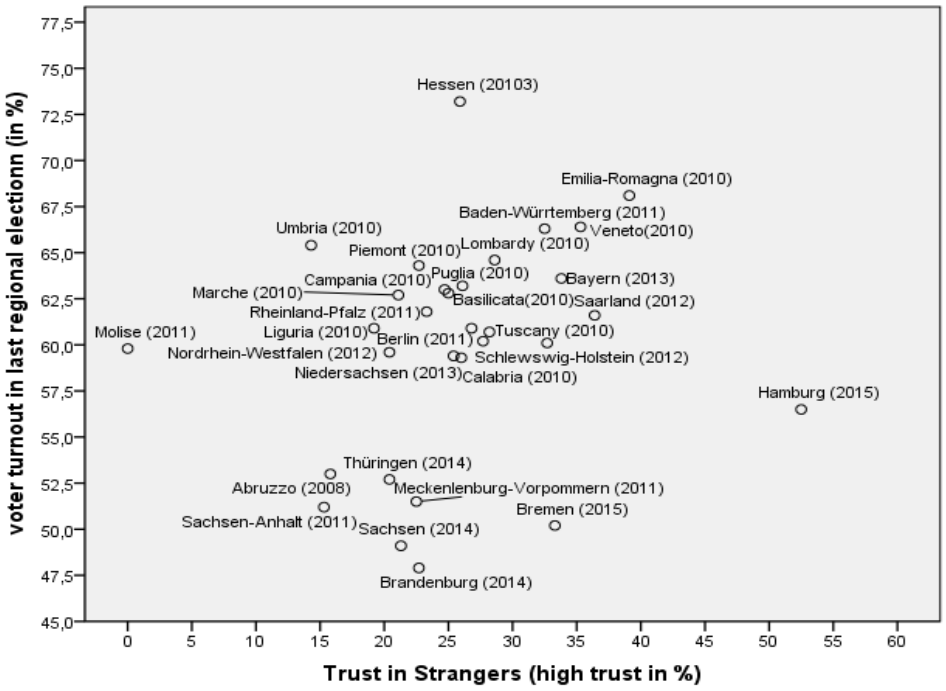


Figure 3: Correlations between social trust and voter turnout in regional elections in Germany and Italy



The following multiple regression analysis has been carried out.

Dataset: 82 European regions in six countries (Belgium, Germany, France, Italy, Spain and the UK)

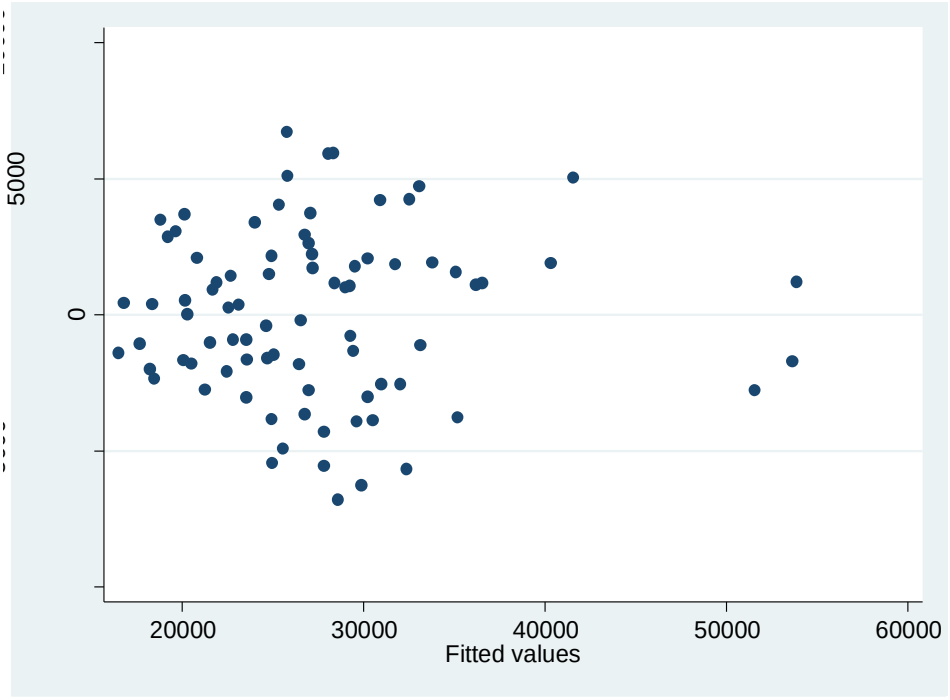
- Dependent variable: GDP per capita in 2013
- Independent variables:
- Social trust in 2000 (Question: Do you have trust in strangers, EVS2000)
- Human capital in 2000 (Percentage of persons with secondary, non-tertiary education, Eurostat)
- European Quality of Governance Index in 2011
- GDP per capita in 2000

Correlation matrix:

• pwcorr soctrst hucap QGI GDP2000 GDP2013

soctrst	hucap	QGI	GDP2000	GDP2013
soctrst	1.0000			
hucap	0.1675	1.0000		
QGI	0.2008	0.5947	1.0000	
GDP2000	0.2008	0.4335	0.2856	1.0000
GDP2013	0.3346	0.3684	0.2943	0.9064	1.0000

Testing for heterokedastizität and multi-colinearity



Multiple Regression model:

Reg GDP2013 soctrst

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. reg GDP2013 soctrst
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Source	SS	df	MS	Number of obs =	82
				F(1, 80) =	10.09
Model	572049667	1	572049667	Prob > F =	0.0021
Residual	4.5375e+09	80	56719164.5	R-squared =	0.1120
				Adj R-squared =	0.1009
Total	5.1096e+09	81	63081269.5	Root MSE =	7531.2

GDP2013	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
soctrst	240.9831	75.88129	3.18	0.002	89.97456	391.9917
_cons	19522.98	2586.827	7.55	0.000	14375.03	24670.93

reg GDP2013 soctrst hucap, beta

Source	SS	df	MS	Number of obs =	82
				F(2, 79) =	10.65
Model	1.0848e+09	2	542412257	Prob > F =	0.0001
Residual	4.0248e+09	79	50946307.8	R-squared =	0.2123
				Adj R-squared =	0.1924
Total	5.1096e+09	81	63081269.5	Root MSE =	7137.7

GDP2013	Coef.	Std. Err.	t	P>|t|	Beta
soctrst	202.2249	72.94639	2.77	0.007	.2807838
hucap	155.5949	49.04427	3.17	0.002	.3213278
_cons	11842.59	3445.481	3.44	0.001	.

reg GDP2013 soctrst hucap QGI GDP2000, beta

Source	SS	df	MS	Number of obs =	82
				F(4, 77) =	108.58
Model	4.3401e+09	4	1.0850e+09	Prob > F =	0.0000
Residual	769453915	77	9992907.99	R-squared =	0.8494
				Adj R-squared =	0.8416
Total	5.1096e+09	81	63081269.5	Root MSE =	3161.2

GDP2013	Coef.	Std. Err.	t	P>|t|	Beta
soctrst	113.3844	32.90045	3.45	0.001	.1574312
hucap	-37.18694	28.34875	-1.31	0.193	-.0767969
QGI	504.5655	524.0168	0.96	0.339	.0534142
GDP2000	.9771934	.0542889	18.00	0.000	.8928466
_cons	4520.46	1826.819	2.47	0.016	.

4. Growth Empirics and Social Capital

In conventional growth theory social capital is neglected. Although there are first signs to recognize the importance of social structure. Robert Lucas, a founder of 'rational expectations' economics, acknowledges that „human capital accumulation is a fundamental social activity, involving groups of people in a way that has no counterpart in the accumulation of physical capital" (Putnam, 1993b). Social capital capturing significant elements of social structure, norms and values, however, needs to be brought back in to renovate classical postwar growth theory. Growth theory was initially limited to the optimal saving rate and the accumulation of real capital in an economy and subsequently incorporated human capital into endogenous growth theory. But in the 1980s the sociologists Pierre Bourdieu (1980) and James Coleman (1988) have advanced the idea of social capital. The latest equipment and most innovative ideas in the hands or mind of the brightest person, however, will amount to little unless that person also has access to others to inform and to cooperate for collective, mutually beneficial action.

In this section we will briefly present previous attempts to measure social capital before we outline our own approach. Fedderke and Klitgaard (1998) provide a good overview of existing studies on economic growth and social indicators.They show how social, political and economic indicators are linked by webs of association. Economic growth is linked to levels of political and civil rights, the stability of political order, and the efficiency of public institutions. All three of these classes of variables are systematically linked with one another.

And the most general characterization of such links is that they are benevolent, with 'goods things moving together'.

Although various manifestations of 'social capital' have been invoked in numerous studies since the late 1970s the most extensive empirical research and coherent theoretical advances have come in the late 1980s and 1990s from two distinct literatures within the so-called 'new sociology of economic development', namely ethnic entrepreneurship studies (at the micro level) and comparative institutionalist studies of state-society relations (at the macro). The classic intermediary position is, of course, the de Tocquevillian one, represented most compellingly in the work of Putnam, 'Making Democracy Work' (1993), in which a vibrant civil society acts to reconcile the 'passions' of the micro level and the 'interests' of the macro.

Designating the comparative institutionalist work as 'macro' is done mainly for heuristic purposes; this work, unlike the true macro-sociological work of Braudel, Wallerstein, or Bornschier, is perhaps more accurately identified as operating at the intersection of the macro- and meso-levels (i.e., the social ties crossing the public-private divide), but we find the later term cumbersome. For our purposes, 'the macro-level' is simply short-hand for the formal business, political and social organizations of society together with its main value structure (Woolcock, 1998).[68]

[68] Michael Woolcock, Social capital and economic development: Towards a theoretical synthesis and policy framework, in: Theory and Society, Vol. 27, No. 2, 1998, pp. 151-208.

Studies analyzing micro-level social capital focus on the role networks and associations play for the development process. Social capital has also been used extensively in studies of: families and youth behaviour problems, schooling and education, community life (in physical and 'virtual' settings), work and organizations, democracy and governance and in general cases of collective action problems. The idea of social capital also trades under the name of 'intangible assets', 'social energy', 'social capability', 'sociability', 'moral resources' and '(weak) ties'.

Woolcock (1998: 193-195) gives an extensive overview over the existing, but steadily growing literature. Studies analysing microlevel social capital focus on the. The study of La Porta et al. (1997) belongs to this section of microlevel social capital. They measure the importance of social capital, understood as trust, for the performance of large organisations. This is important since it highlights an important intermediary step in the causal chain of 'more social capital is leading to more economic growth'. Data on government performance, participation in civic and professional societies and importance of large firms support the hypothesis that trust promotes cooperation. Furthermore, trust is lower in countries with dominant hierarchical religions, which may have deterred the formation of 'horizontal networks of cooperation' among people.

Studies focusing on macro-level social capital try to analy (Fukuyama, 2001)se by direct estimation the impact of specific components of social capital, like inequality, trust, democracy, etc. (civil and government social capital) on growth and investment. One of the

earlier empirical macrolevel social capital studies is from Bornschier (1989). He shows the importance of legitimacy, a component of social capital, for economic success. Putnam's already mentioned work 'Making Democracy Work' (1993) is another important contribution to the field of macro-level social capital. He analyses the 20 in 1979 new established regional Italian governments. Some of the new government proved to be dismal failures - inefficient, lethargic, and corrupt. Others have been remarkably successful, however, creating innovative day care programs and job-training centres, promoting investment and economic development, pioneering environmental standards and family clinics – managing the public's business efficiently and satisfying their constituents.

What could account for these stark differences in quality of government? Government organization is too similar from region to region for that to explain the contrasts in performance. Party politics or ideology makes little difference. Affluence and prosperity have no direct effect. Social stability or political harmony or population movements are not the key. Instead, the best predictor is one suggests that comparative economic success is influenced by the politically produced social order. Depending upon the degree of legitimacy social order is either the product of voluntary interaction of intrinsically motivated people or must be enforced by means of coercion. A multiple regression model, covering 18 Western countries over the postwar era, shows that legitimacy, understood as relative absence of mass political protest, has a positive impact on growth.

The study of Knack and Keefer (1997)[69] supplies further evidence to date that trust and civic cooperation have significant impact on aggregate economic activity. But they do not agree with Putnam (1993) who suggests that dense horizontal networks reinforce trust and civic norms. Knack and Keefer find that horizontal networks – as measured by membership in groups – are unrelated to trust and civic norms (controlling for education and income) and to economic performance. But they find that trust and civic norms are stronger in nations with higher and more equal incomes, with institutions that restrain predatory actions of chief executives, and with better-educated and ethnically homogenous populations. What is common to both recent empirical cross-country social capital studies (La Porta et al. 1997 and Knack and Keefer 1997) is that they focus exclusively on trust and civic engagement.

4.1 Social Capital and Economic Development in Italy

Which factors are responsible for the Italian North-South divide and why is the "Southern question" still there? After more than 150 years of living together in a united (nation)-state, Southern Italy´s GDP per capita only amounts to 60 percent of its Northern counterpart. Social indicators additionally indicate considerable distinctions in standard of living between the two parts of Italy. While levels of unemployment (12.6% vs. 5.3%), murder (1.95 vs. 0.75 out of 100,000 persons) or child mortality (0.41% vs. 0.29% of infants dying in the first year) are

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clearly higher in the South than in the North, the recycling rate of waste is here only half of that of the North (24% vs. 51%).[70]

The comparison of the largest Italian cities paradigmatically clarifies the socio-economic disparities between North and South. Milan is undoubtedly the most productive urban area on the Italian peninsular. With a net product around $53.000 (Real GDP per capita, $USD 2010), it is by far richer than Rome or Turin. More dramatic however is the distance between the Lombardian capital and the Southern cities Naples or Palermo whose GDP per capita only make up $22.000 and $25.000, respectively. Hence, Milan´s GDP per capita nowadays is more than double that of the two ancient cities, belonging in old times to the Kingdom of the Two Sicily's. The origins of the Southern question are closely linked to the process of Italian unification. The term "la questione meridionale"[71] was first used by the Udinese politician Antonio Billia in 1870 in order to draw attention to the disastrous economic conditions in the Mezzogiorno. Since then, travelers, writers, politicians and field-researchers have been speculating on the root causes of the "backwardness" of Southern Italy.[72]

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[70] Numbers refer to Marco Casari et al., Cooperation Hidden Frontiers, The Behavioral Foundations of the Italian North-South Divide, Working Paper, July 2014, http://www.strangers.it/papers.html.

[71] According to the official classification of the Italian National Bureau of Statistics (Istat), the Mezzogiorno consists of the following regions: Abruzzi, Molise, Campania, Puglia, Calabria, Sardegna and Sicilia. After the Congress of Vienna in 1815, the Southern regions were all under the rule of the Bourbons and belonged to the Kingdom of the Two Sicilies. The only exception was Sardegna, which was part of the Kingdom Piedmont-Sardinia.

[72] The classic text on the Southern issue was probably written by Antonio Gramsci in 1926. For Gramsci, the Southern question was primarily an agrarian and a peasant question. Naturally arguing from a Marxian point of view, he states that the "Northern

Thanks to research done by Franchetti/Sonnino (1877), Banfield (1958), Putnam (1993) and Casari et al. (2014), "social capital" has emerged as one of the major explanatory factors in the scientific quest for Southern development. It is widely assumed now that the Italian North-South divide traces back to a significant extent to differences in social capital endowments. For Putnam, the Italian North-South divide is the historic legacy of the Middles Ages. To put it simple, Putnam contrasts the self-governed city-states ("communal republicanism") of Northern Italy with the Norman "feudal autocracy" of the South. Regions with self-governed municipalities – taking for example the city-states Florence or Siena or the sea-republics Venice and Genoa – developed horizontal ties of cooperation and cohesion at the same time when vertical feudal structures dominated social life in the South for centuries. Following Putnam, the specific Southern pattern of kinship and clientelism manifested itself and eventually survived the regime change triggered by the Italian unification. Thus, the lack of adequate social capital in the Mezzogiorno may be the fundamental reason for the present deadlock situation there; being alone already sufficient for

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bourgeoisie has subjugated the South of Italy and the Islands, and reduced them to exploitable colonies". Consequently, the "Northern Proletariat" has to "emancipate the Southern peasants masses enslaved to the banks and the parasitic industry of the North". Another answer to the Southern question was provided by the Turin writer Carlo Levi. While being exiled to remote villages in Lucania (Basilicata) during Fascism, Levi was confronted with the "questione meridionale" in his daily interactions with the local population. In "Christ stopped at Eboli", Levi states that "it cannot be the state which works out the problems of the South, due to the simple reason, that all this we call the Southern question, is nothing else than the problem of the state itself". See Antonio Gramsci, "Some Aspects of the Southern Question, unfinished, October 1926", in: Quintin Hoare (Ed.), Selections from Selections from Political Writings (1921-1926), London 1978 and Carlo Levi, Christ stopped in Eboli, London 1945.

the absence of economic dynamism in the South and catch-up to the North.

4.2 Social Capital and the Mezzogiorno

However, where does social capital come from? While many studies focus on the impact of social capital on economic or institutional performance, the causes and origins of social capital are less known. That is why social capital will here be treated as the dependent variable. conceptual point of view because following Giovanni Sartori – "we simply tend to forget that *concept formation stands prior to quantification*".[73] And Lazarsfeld has noted that "[…] before we can rank objects or measure them in terms of some variable, we must form the concept of that variable". Thus, before social capital will be operationalized for the quantitative analysis, a definition of its meaning has to be provided.

A multiple linear regression analysis will be performed. In the first step, the data matrix with the variables will be constructed, and first co-relational relationships between the variables established. Then, based on a "most similar systems, different outcomes design", statistical relationships between social capital and potential explanatory variables should be examined. Arend Lijphart stressed that "comparability can be enhanced by focusing on intra-nation comparisons" due to the fact that "comparative intra-nation analysis

[73] Giovanni Sartori, Concept Misformation in Comparative Politics, in: The American Political Science Review, Vol. 64, No. 4 (December 1970).

can take advantage of the many similar national characteristics serving as controls."[74]Hence, the 20 Italian regions make up the case-sample.

The concept of social capital was first used by American economists in the 1970s to tackle the problems of black communities in urban settings.[75] Thanks to contributions made by Pierre Bourdieu (1983) and James Coleman (1988), social capital became more important in sociology in the 1980s. [76] The economist Moses Abramovitz used the phrase "social capabilities" to refer to developing countries´ capacities to adopt new technologies in the process of catch-up.[77] After Putnam´s publication on the relationship between social capital and governmental performance in the Italian regions in 1993[78], the concept was increasingly adopted by social scientists and international organizations like the World Bank or the OECD. For instance, the World Bank published a major volume on the causal nexus between social capital and economic outcomes in 2000[79]. It recognized that "social cohesion is critical for societies to prosper economically and for development to be sustainable".[80]

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[74] Arend Lijphart, Comparative Politics and the Comparative Method, in: The American Political Science Review, Vol. 65, No. 3 (September 1971), p. 682-693, here p. 689.
[75] Francis Fukuyama, Social Capital, The Tanner Lectures on Human Values, Oxford 1997, p. 378.
[76] Pierre Bourdieu, „Forms of Capital", in: J. C. Richards (ed.), Handbook of Theory and Research for the Sociology of Education, New York 1983 and James Coleman, Social capital in the Creation of Human Capital, in: American Journal of Sociology, Vol. 94 (1988), p. 95-120.
[77] Moses Abramovitz, Catching up, Forging Ahead, and Falling Behind, in: The Journal of Economic History, Vol. 46, No. 2 (June 1986), p. 385-406.
[78] Putnam (1993).
[79] Partha Dasgupta/Ismail Serageldin (eds.), Social capital, A Multifaceted Perspective, The World Bank, Washington, D.C. 1999.
[80] Mark Smith, „Social Capital", in: The Encyclopedia of Informal Education, 2000-2009, (http://infed.org/mobi/social-capital/).

According to Sartori, the "definitional requirement for a concept is that its *meaning* is declared". Therefore, what does social capital mean? The OECD conceives it as "networks together with shared norms, values and understandings that facilitate co-operation within or among groups".[81] For the World Bank, social capital is about those "norms and networks that enable collective action. It encompasses institutions, relationships, and customs that shape the quality and the quantity of a society´s social interactions".[82] Robert Putnam understands social capital as "features of organization, such as trust, norms and networks, that can improve the efficiency of society by facilitating coordinated action".[83]

However, trust, networks and civil associations are, considering Fukuyama, "all epiphenomenal" by which we mean that they only are properties or dimensions of the specific phenomenon. They do not represent the specific phenomenon - in this case "social capital" - themselves. In the words of Fukuyama, social capital is "an instantiated informal norm that promotes co-operation between two or more individuals".[84] To put it more simply, social capital means the "existence of a certain set of informal values or norms shared among members of a group that permits cooperation among them".[85] Sartori´s "ladder of abstraction" can hereby begin with a norm of reciprocity

[81] OECD, The Wellbeing of Nations, The Role of Human and Social Capital, Paris 2001.
[82] The World Bank, Social Development Department, Overview, Social Capital, (http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALDEVELOPMENT/EXTTSOCIALCAPITAL/0,,contentMDK:20642703~menuPK:401023~pagePK:148956~piPK:216618~theSitePK:401015,00.html).
[83] Putnam (1993), p. 167.
[84] Francis Fukuyama, Social capital, Civil society and Development, in: Third World Quarterly, Vol. 22, No. 1 (2001), p. 7-20.
[85] Fukuyama (1997), p. 378.

between two friends and may climb-up to "complex and articulated doctrines like Christianity or Confucianism"[86]. Generally speaking, so-called "civic virtues" such as truth-telling, the meeting of obligations and reciprocity do promote cooperation. It is rather more difficult to specify the sources of these civic virtues and to identify the conditions under which they can be created. For instance, Fukuyama points out that "families are obviously important sources of social capital everywhere". [87] While it can be reasonably assumed that societies across the world do not strongly differ with regard to the level of trust within families, the real crux concerns trust between strangers. Too pronounced family ties might obstruct cooperative behavior outside the family sphere, and thus, hamper the formation of civil associations or networks among the members of civil society. The anthropologist Edward Banfield calls this phenomenon "amoral familism". After conducting a field-study in a small village near Potenza in the late 1950s, Banfield traced back its poverty to the lack of civil associations and social cooperation:

"The book is about a single village in southern Italy, the extreme poverty and backwardness of which is to be explained (largely, but not entirely) by the inability of the villagers to act together for their common good or, indeed, for any end transcending the immediate, material interest of the nuclear family. This inability to concert activity beyond the immediate family arises from an ethos – that of "amoral familism" – which has been produced by three factors acting in combination: a high death rate, certain land tenure conditions, and the absence of the institution of the extended family."[88]

Influenced by religion, traditions, common historical experience or socioeconomic conditions, each social group differ with respect to their

[86] Fukuyama (1997), p. 378.
[87] Ibid.
[88] Banfield (1958), p. 10.

"natural" disposition to generate and accumulate a stock of social capital. Similarly to a stock of natural resources, a country or society is also equipped with a stock of social resources, which it can exploit for economic means. In this village in the Basilicata investigated by Banfield, its inhabitants fail to generate a stock of social capital that could be used for economic opportunities. As long as the material interests of the nuclear family are concerned, the individuals act rationally, work together and trust each other. When the public welfare of the whole community is at stake – say, for schooling - coordinative actions between the villagers do not develop. A surprising fact, given the small size of the village where the families must have known each other for generations!

Can the stock of social capital be changed over time? Due to the inertia of traditions, customs, morals, religious beliefs as well as socioeconomic conditions, substantial variations in the stock of social capital will properly not occur on a short-term basis. Banfield projects that the centuries-old "ethos of amoral familism" in this village in will continue to persist. But: history has shown that external shocks such as wars, natural disasters or processes of rapid modernization can trigger profound structural changes. As a result, social capital might change too. Interestingly, Banfield makes the socioeconomic conditions (high death rate, land tenure system, absence of extended family) rather than cultural factors responsible for the village´s "low-trust equilibrium'. [89] Consequently, we might expect that the stock of social capital grew during Italy´s "miracolo economico". High mortality rates and that land

[89] See Francis Fukuyama, Political order and political decay, from the Industrial Revolution to the globalisation of democracy, New York 2014, Chapter 7 (Italy and the Low-Trust Equilibrium).

tenure system perished both since the late 1950s. That is why social capital should be higher now in that village in the Basilicata.

4.3 The Operationalization of Social Capital

According to Pollock, a "conceptual definition clearly describes the concept´s properties, and it communicates the subjects […] to which the concept applies" while "an operational definition describes the instrument to be used in measuring the concept, for putting a conceptual definition into operation."[90] How can we operationalize social capital for the quantitative analysis? Basically, social capital can be distinguished into attitude (civicness, trust), behavioral (political and social participation) and structural variables (social relations in networks).

Putnam takes "civic community" and "trust" as proxies for social capital. These indicators variables record the measurement of the variable "social capital".[91] Based on survey results, Table 1 illustrates the distribution of "civic community" and "trust" in the early 1990s among the Italian regions. The Pearson correlation coefficient r accounts for 0.33 (N=20) and only indicates a moderate relationship between these variables. Hence, the behavioral variable "civic community" and the attitude variables "trust" seem not to be very linked in this data matrix. A strong distinction between North and South Italy cannot be observed too. According to this data, common people in Basilicata and Calabria trust each other more than those in

[90] Philip H. Pollock, The Essentials of Political Analysis, Washington, D.C. 2005, p. 8.
[91] Pollock 1993, p. 8.

the Emilia-Romagna. Concerning civic community, the data distribution corresponds more with Putnam´s hypothesis. The Northern and Central regions are shaped by vibrant civic life while it is significantly lower in the Mezzogiorno.

Civic Community and Trust in the Italian regions (early 1990s) Region	**Civic Community in the early 1990s**	**Trust in the early 1990s**
Piedmont	15	39.1
Aosta Valley	14	20
Lombardy	17	44.3
Trentino/Alto Adige	17	44.8
Venetia	15	50.8
Friuli	17	42.9
Liguria	17	37.7
Emilia-Romagna	18	30.8
Tuscany	17	35.5
Umbria	15.5	20.3
The Marches	15	49.3
Latium	13	27.7
Abruzzi	8	27.9
Molise	3.5	33.3
Campania	2	28
Apulia	2	29.2
Basilicata	4	33.3
Calabria	1	37.3
Sicily	3.5	28.6
Sardinia	8.5	6.3

If we transform both variables for each region into a simple composite index[92] (see next table), the following ranking of the 20 Italian regions with respect to social capital in the early 1990s emerges: Northern regions such as Venetia, Trentino/Alto Adige or Lombardy occupy the first positions of this index whereas Sicily, Apulia, Campania and Sardinia take the last places. Yet, Umbria or Molise performs worse than Basilicata or Calabria. Finally, the Marches take the second position while Aosta Valley finds itself on the 16th place.

[92] The formula is: ((xcivic community+ytrust)/2).

4.3.1 Correlations of Social Capital in early 1990s, 1991, 2000-2002

		Social capital in early 1990s	Social Capital in 1991	Social capital in 2000-2002
Social capital in early 1990s	Pearson Correlation	1	,505*	,545*
	Sig. (2-tailed)		,023	,013
	N	20	20	20
Social Capital in 1991	Pearson Correlation	,505*	1	,701**
	Sig. (2-tailed)	,023		,001
	N	20	20	20
Social capital in 2000-2002	Pearson Correlation	,545*	,701**	1
	Sig. (2-tailed)	,013	,001	
	N	20	20	20

***. Correlation is significant at the 0.05 level (2-tailed).**

****. Correlation is significant at the 0.01 level (2-tailed).**

Source: "Social capital in the early 1990s" refers to Putnam´s data on Civic Community and Trust. "Social capita in 1991" is an index, including social and political participation as well as trust, See Emanuele Felice, The Determinants of Italy´s Regional Imbalances Over the Long Run: Exploring the Contributions of Human and Social Capital, Discussion Papers in Economic and Social History, University of Oxford, No. 88 (March 2011). "Social capital in 2000-2002" is similar to Putnam´s index, taking into account association density, electoral participation and blood donation. See Roberto Cartocci, Mappe del Teosoro, Atlante del Capital Sociale in Italia, Bologna 2007.

In the socioeconomic literature several indices of social capital for specific points in time are available. In order to determine which of these is best suited for the multiple regression analysis, we correlate three different indices of social capital with each other (table 3). As can be seen, these empirical operationalization's of social capital strongly and significantly correlate with each other. The correlation coefficient r is the highest for "social capital in 2000-2002" (r=0.45*, r=0.701**), which might indicate a better measurement validity and reliability of this index relative to the others. Thus, social capital in

2000-2002 will be the dependent variable for the following multiple regression analysis.

4.3.2 The Statistical Analysis

Region	HDI in 2001	Quality of Government in 2010	former Two Sicilies	Social Capital 2000-2002
Piedmont	0.880	0.03	0	2.0
Aosta Valley	0.867	0.89	0	2.5
Lombardy	0.890	-0.51	0	2.2
Trentino/Alto Adige	0.890	0.88	0	2.7
Veneto	0.891	-0.33	0	1.5
Friuli	0.896	0.37	0	3.5
Liguria	0.886	-0.38	0	0.9
Emilia-Romagna	0.905	-0.20	0	5.3
Tuscany	0.895	-0.42	0	3.6
Umbria	0.893	-0.04	0	1.8
The Marches	0.903	-0.33	0	0.8
Latium	0.898	-1.18	1	-1.1
Abruzzi	0.888	-0.80	1	-1.5
Molise	0.888	-1.14	1	-2.8
Campania	0.857	-2.28	1	-5.7
Apulia	0.858	-1.67	1	-3.3
Basilicata	0.862	-1.17	1	-3.6
Calabria	0.855	-2.15	1	-5.6
Sicily	0.859	-1.77	1	-4.1
Sardinia	0.875	-0.78	0	0.9

Source: "HDI 2001" refers to Felice (2011). "Quality of Government in 2010" refers to Nicolas Charron/Victor Lapuente, Why Do Some Regions in Europe Have Higher Quality of Government, QoG Working Paper Series (January 2011). "Former Two Sicilies" is a (0,1) dummy variable, 1 for Italian regions which were part of the Kingdom oft he Two Sicilies prior to unification, 0 for Italian regions that were not part of Two Sicilies. See Christopher Duggan, The Force of Destiny, The History of Italy since 1796, London 2011. "Social capital 2000-2002" is the dependent variable and refers to Cartocci (2007).

Due to the limited case size of only 20 Italian regions, only three independent variables have been chosen for the quantitative analysis. Two of these are composite indices which consist of many variables; the last one is a binary dummy variable. The Human Development Index for each Italian region in the benchmark year 2001 includes

indicators of education, health and economic wealth, and is a proxy for structural modernization and the welfare of society. The index "Quality of Government" is a measure for governance effectiveness and transparency. The first edition was made for the EU in 2010. For the sake of this analysis, we assume that quality of government did not change a lot since 2002. The dummy variable "former Two Sicily's" classifies the Italian regions according to their previous membership in the Kingdom of Two Sicily's. Hence, the regression model includes one structural variable for socioeconomic conditions in the year 2001, one institutional variable which is proxy for the impact of human agency (political actors, public bureaucracy) and finally the dummy "Two Sicily's" to account for the influence of historical legacies on present outcomes (Putnam-hypothesis).

For the cross-sectional regression analysis, we estimate the following model:

> y (social capital 2000-2002)= a+b1x1 (HDI in 2001) + b2x2 (Quality of Government in 2010) + b3x3 (former Two Sicilies) + e (error value)

In order to execute the model, certain technical requirements have to be met. To begin with, the independent variables must be metric scaled and normally distributed. In addition, the independent variables should not correlate strongly with each other (autocollinearity), should not correlate strongly with the dependent variable (multicollinearity) and

should have the same degree of variance (homoscedasticity).[93] The 3 independent variables are metric-scaled and – after consideration of histograms – more or less normally distributed. To test whether the data contains tendencies of autocollinearity or multicollinearity, the Durbin-Watson test and the variance inflation factor (VIF) can be calculated. The Durbin-Watson value is 1.936 and the mean VIF value amounts to 2.64 (see appendix); indicating neither auto- nor multicoillinearity.

The multiple regression analysis:

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,959[a]	,919	,904	1,0042

a. Predictors: (Constant), Former part of Two Sicilies, HDI in 2001, Quality of Government in 2010

Table 7: ANOVA Statistics[b]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	183,105	3	61,035	60,523	,000[a]
	Residual	16,135	16	1,008		
	Total	199,240	19			

a. Predictors: (Constant), Former part of Two Sicilies, HDI in 2001, Quality of Government in 2010

b. Dependent Variable: Social capital in 2000-2002

[93] The easiest way to test for homoscedasticity is by doing a RVF-Plot. However, SPSS does not contain this option.

Table 8: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-49,425	15,686		-3,151	,006
	HDI in 2001	58,264	17,628	,296	3,305	,004
	Quality of Government in 2010	1,158	,462	,320	2,505	,023
	Former part of Two Sicilies	-3,004	,809	-,466	-3,714	,002

a. Dependent Variable: Social capital in 2000-2002

Adjusted R^2 of this model accounts for 0.904. Hence, this regression analysis may explain 90 percent of the variance of the dependent variable "social capital in 2000-2002". Taking into consideration the F value of 60.6 as well as the numbers of the degrees of freedom, the total model is highly significant. Concerning the relative impact of the 3 independent variables, the variable "former Two Sicilies" has the greatest explanatory power. "Quality of Government in 2010" is slightly more important than the "HDI in 2001" but it is less significant and has a lower t value.

Finally, this analysis largely complies with the Putnam-hypothesis. The fact whether or not the Italian regions belonged to the Kingdom of the Two Sicily's more than 150 years ago has a higher impact on its current stock of social capital than its present state of socioeconomic development or its quality of government. However, the variable "Two Sicily's" or "the South" may be too vague and allows for tautological explanations such as "Social Capital in the South is low because it is the South". It can contain many things and has to be specified: The institutional legacies created by the Bourbons

might be as important as explanatory variables as the environmental conditions, geographical distance to the markets or the pattern of land ownership and distribution in Southern Italy.

However, the established correlation between historical legacies of feudalism and current levels of social capital in the Italian regions could be even applied to the European regions. Depending on data availability, such research could be useful in detecting "root causes" of the unequal distribution of social capital among Europe´s regions.

5. The Economic Consequences of the Maastricht Treaty: From Economic Integration to Divergence?

In March 2000, European statesmen gathered in the Portuguese capital to proclaim the so-called Lisbon Strategy, which expressed an ambitious objective. By 2010, the EU would have achieved the effort to 'become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion' (Council, 2000). Writing these words 17 years later, it may be fair to argue that European economies have not become 'capable of sustainable economic growth' and presently suffer from 'less and poorer jobs and lower social cohesion'. These symptoms are due to the global financial and economic breakdown of 2008-2009, which since then has been reshaped into the European sovereign debt crisis. Public debt of the Eurozone rapidly accelerated from 71.9 percent of GDP (2007) to 100.6 percent of GDP (2012).

After the First and Second World War, European countries were faced by public debt levels of similar or even higher magnitudes but such an extreme jump of almost 30 percentage points within five years in peaceful Europe is historically unsurpassed (Wirsching, 2013). Though, the most severe and proximate impact upon peoples' lives showed up in abruptly increased unemployment - especially youth unemployment - across the European landscape.

According to Eurostat data, total levels of European unemployment rose from 7.1 percent in 2008 to 10.5 percent in 2012. Yet, unemployment is very imbalanced within Europe's Single Market. It is much lower in Central and Northern Europe than in the South. In Portugal, Spain, Italy and Greece, the number of people without work has been increasing from 7.9 percent in 2007 to roughly 20 percent in 2012. Youth unemployment in these economies is between 30 and 50 percent. On the other hand, Central European countries have managed to stabilize an average unemployment level around 6.5 percent over the last years. Irish unemployment increased by 10 percentage points (2007: 4.7%, 2012: 14.8%). Inoccupation in the Nordic countries as well as in the United Kingdom has been rising to 7.7 percent. If this divergence in labor market performance within the European Union perpetuates, it may also be fair to argue that the European Union is not only 'under severe stress' (Barroso, 9 May 2013) but things are even getting worse. The centrifugal forces between Mediterranean and Central Europe, already economically active below the surface since Maastricht, have been coming into light. The Maastricht Treaty, the formation of the economic and monetary union with a single currency, has provoked non-expected effects upon the European economies. Rather than strengthening the ties between the member states (according to the coronation theory of European integration), the 'economic consequences' (Keynes, 1920) of the Maastricht treaty imply advancing divergence in economic and productivity growth between the 'North' and the 'South'. At the same time where Eastern

Europe sluggishly catches-up to Western Europe after it joined the Union in 2004, Southern Europe is falling behind.

After the ratification of the Maastricht Treaty in 1993, the European Economic Community became the European Union. The most significant outcome of Maastricht probably has been the creation of the Economic and Monetary Union which was set-up in a three-step procedure between 1990 and 1999. Since then, the member states of the EU share with each other the single market with the free movement of capital, labor, goods and services, and 19 out of 28 member states of the EU have adopted the euro. The Maastricht Treaty can be seen as a critical juncture due to the following reason: 15 German re-unification in October 1990 made a new institutional settlement necessary because it broke apart the previous established balance of power between the members of the European Economic Community. Despite growing tensions concerning the rule of the Deutsche Mark as the anchor currency of the European Monetary System in the 1980s, the four largest countries – France, Italy, the United Kingdom and West Germany – were similar to each other in population size and economic productivity.

Re-unified Germany with 82 million people certainly disrupted the existing European economic balance of power. That is why the law-makers of Maastricht attached high importance – besides the economic rationale for monetary unification - to the "decisive political influence of an external and totally unforeseen event, German reunification", which accelerated the final negotiations of the

Maastricht Treaty. How to deal with the German question? Referring to Jacques Delors, back then President of the European Commission, the construction of a federal Europe would be the "only satisfactory and acceptable response to the German question".[94] For the French government, the monetary union and the euro represented a suitable instrument to integrate, not to say to constrain, re-unified Germany into the European project. In the French logic of using European integration as the containment strategy of Germany, it made sense to Europeanize after coal and steel also the Deutsche Mark in order to break up the monetary supremacy of German's Bundesbank. In short: The Treaty of Maastricht can be mainly understood as a political response to German unification at the end of the Cold War, aiming to find a settlement for the German question and to manufacture a new social equilibrium for the European Union. It represents in particular a political bargain between France and Germany, each of whom viewed the agreement as a means of securing "vital nations interests".[95]

What have been the non-anticipated consequences of the Maastricht Treaty? The Economic and Monetary Union has obviously triggered unintentional effects on the European economies. The centrifugal forces between Mediterranean and Central Europe have been coming into light. Rather than strengthening the ties between the member states (according to the coronation theory of European monetary

[94] Michael J. Baun, "The Maastricht Treaty as high politics: Germany, France, and European integration", in: Political Science Quarterly, p. 605-624.
[95] Fabbrini 2015, p. 14-15.

integration), the economic consequences of the Maastricht Treaty induce increasing divergence between Northern and Southern Europe. Taken into account levels of unemployment, public debt and GDP per capita growth, economic disparities have been increasing sine the outbreak of the economic recession in 2008/2009. Another non-anticipated economic consequence of the Maastricht Treaty concerns the perceived economic dominance of re-united Germany compared to its European neighbors and the return of the German question.

Merton´s "error in analysis" as a key cause of "unintended consequences" strongly applies to French politicians who were fierce supporters of the quick introduction of the euro. Rather than taking control over German monetary policies, the reverse came into effect. The economic constitution of the EMU, manifested in the Stability and Growth Pact from 1997 as well as the Fiscal Compact from 2012, were framed according to German ordo-liberal and monetarist's views. The European Central Bank was modeled in line with those principles on which the independent Bundesbank was founded. Thus, the opportunities of France to influence decision-making processes concerning monetary policies seem to a lesser extent possible nowadays than before under the European Monetary System.

These centrifugal forces are further fueled by national media on both sides of the Alps. Writing with deadly pens and re-creating 'national stereotypes', publicists turn economic divergence between EU member states into a cultural cleavage between a supposed

'Northern, Protestant' and a 'Southern, Catholic' Europe. Obscure and dust history tales from Europe's past are nowadays hunted up by hot-tempered journalists, and are exploited for political ends. In fact, it is claimed that the eurozone crisis represents a 'new war of religion'. Stephan Richter, a German commentator considers 'too much Catholicism' as the root cause of Europe's crisis because it 'is detrimental to a nation's fiscal health, even today in the 21st Century'.

And Massimo Franco, political columnist for 'Corriere della Serra' seems to know that for 'average Germans' it would constitute an 'unacceptable concession to the culture of sin' if the indebted South is financed by the European Financial Stability Fund. The recent essay *'*Se un impero latino prendesse forma nel´cuore d´Europa*'*[96], which was first published in 'La Repubblica' by the Italian philosopher Giorgio Agamben, evokes the conception of a Latin Europe containing France, Italy and Spain. Equipped with the Catholic and Mediterranean traditions, this Latin Empire should resist Protestant Germany taking the role of European leadership as was suggested by the Polish foreign minister Sikorski or 'The Economist'. With regard to Agamben, German hegemony over Europe would only imply *'imposer à la majorité des plus pauvres les intérêts de la minorité des plus riches, qui coïncident la plupart du temps avec ceux d'une seule nation [, c´est Allemagne]'*.[97]

[96] Nine days later and freely translated, this article showed up in the French 'Libération' under the title '*Que l´Empire latin contre-attaque*'.
[97] Ibid.

Although historians could easily challenge such non-justified cultural statements giving explanations for the European sovereign debt crisis, these texts make a point. They highlight the crucial issue concerning the contemporary economic balance of power within the European Union. Which role should be taken by Germany, which is since re-unification by far Europe's largest economy? According to the English historian Timothy Garton Ash this *new* German question is naturally not about the difficult job of incorporating an emerging nation into the European balance of power as it had been the case after the creation of the German 'Reich' in 1871. Today's German question is rather about the similar difficult task whether or nor 'Europe's most powerful country can lead the way in building both a sustainable, internationally competitive Eurozone and a strong, internationally credible European Union'.[98]

I am going to argue that the Maastricht Treaty plays a key role in order to understand the rising economic divide between Northern and Southern Europe since the 1990s.[99] While the Treaty and its protocols contain a detailed framework for maintaining 'nominal' convergence and, eventually price stability in the *monetary* union (the so-called Maastricht criteria), the *economic* union was less specified by the law-makers at Maastricht. Rather than prescribing how 'real'

[98] Timothy Garton Ash, The new German question, in: The New York Review of Books, August 15, 2013 and Dominik Geppert, Die Rückkehr der deutschen Frage, Journal of Modern European History, Special Issue: The European Debt Crisis in Historical Perspectives.
[99] Barry Eichengreen/Andrea Boltho, 'The economic impact of European integration', in: Stephen Broadberry/Kevin H. O´Rourke (Eds.), The Cambridge Economic History of Modern Europe, Vol. 2, Cambridge 2010, p. 288.

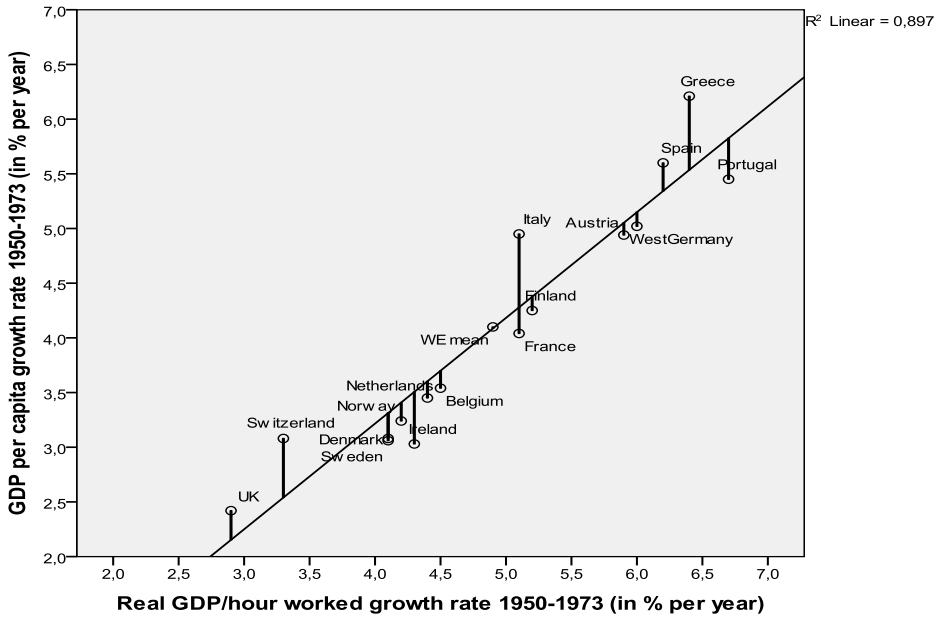
convergence could be achieved within the Union, economic coordination still belongs to the sphere of EU's *'arcana imperii'* (Bobbio, 1984). Due to increasing divergence in economic and productivity growth, which in turn affects also 'nominal' divergence, the member states of the Euro have been removing from each other for years. This will be shown in chapter two. To explore whether future economic developments are driven by continuing divergence or, at the very least, returning convergence, a simple model, in which labor mobility plays the key variable, will be presented.

5.1 Convergence and Divergence in Europe

The postwar era is known in European history as the 'Golden Age' (Hobsbawm, 1994), (Judt, 2006). Until the mid-1970s, Western Europe had run through economic development and social change on an unprecedented scale. Growth rates during this Golden Age 'broke all previous records' (Maddison, 1997). From 1950 to 1973, Western Europe's average GDP per capita growth rate amounted to 4 percent per year. By 1973, it was 2.4 times larger than afore. Real GDP per hour worked increased more, which refers to technological progress and substantial yields gained in productivity since the end of the war (Judt, 2006).

Economic and productivity growth in 16 European countries strongly correlate with each other during the Golden Age. Figure 1 indicates an almost natural linear and positive relation between the two

variables (r=0,947**), implying the hypothesis: the more productivity grows, the better the economy prospers too.[100]



Real GDP/hour worked and GDP per capita growth rate in Europe from 1950 to 1973 (in % per year), Data source: (Crafts, 2010).

The extent of economic growth ranges from 6.2 percent in Greece to 2.4 percent in the United Kingdom. Productivity growth varies between 6.7 in Portugal and 2.9 percent in the UK. Growth rates in Scandinavia were around 3 and 4 percent, respectively, while the Iberian Peninsula was passing through a boom period: average economic and productivity growth rates amounted to more than 6 percent per year. Italian GDP per capita and GDP per hour worked increased by 5 percent. France and Germany achieved economic

[100] In a simple linear regression model, the variance in growth of real GDP/hour worked would account for roughly 90 percent of the variance found in GDP per capita growth (R^2=0.897).

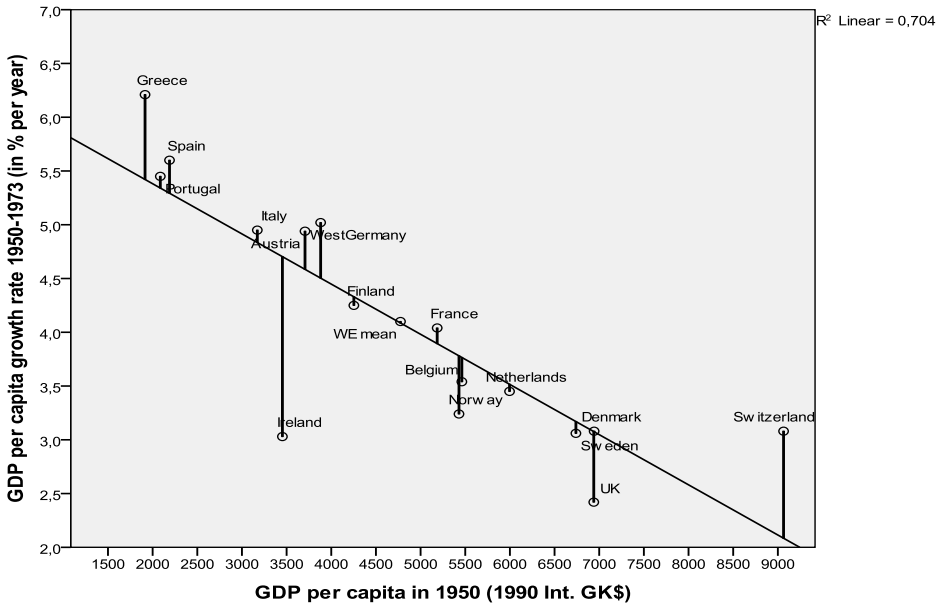
growth rates of 4 and 5 percent per year, and productivity growth in both countries was even 1 percentage point higher. Figure 1 shows a scatterplot of data points with a straight line representing the general tendency; that is the 'line of best fit'. The vertical distances between the empirical data points and the values predicted by the model are called deviations or residuals. They express over- and underestimation by the model, and thus, indicate above- and below-average growth performance of specific cases within the data set. Greece, Italy and also Switzerland do clearly overperform in comparison to the others, while Ireland could not translate its projected growth potential into reality.

While French and English historiographies think of this period as '*les trentes glorieuses'* or 'the thirty golden years', collective memories in Germany and Italy remember their '*Wirtschaftswunder*' and '*miracolo economico*', respectively. In Sweden, the Golden Age is called the 'record years'. Books such as '*Wohlstand für Alle*', written in 1957 by Ludwig Erhard, then German Minister of Economics, or Galbraith's 'Affluent Society', which came out one year later, denoted the zeitgeist of that time. Economic recovery and material reconstruction, nearly full-employment and the beginnings of social welfare gave rise to modest prosperity for the working- and middle-classes, whose vast majority could afford cars and summer holidays with the family for the first time.[101] Economic inequality not only

[101] In 1975, 15 million private cars were measured in Italy. With a population figure of nearly 55 million, almost each Italian household possessed a car, in statistical terms (Hobsbawm, 1994). And in 1967, FIAT was selling more cars in Europe than any other company, Volkswagen included. (Duggan, 2008).

diminished within society but also between the nations. While in 1950 the maximum/minimum ratio of GDP per capita was 4.7, the same ratio had been reduced to 2.7 by 1973. Erhards' slogan 'Wealth for everyone' seemed within reach on a European scale. In Germany, this optimism found its judicial expression in the 'Stability Act' of 1967 whose four aims (economic growth, price stability, full-employment and external balance) should be guaranteed by concerted action into the business cycle (Wolfrum, 2007). In Italy, the '*questione meridionale*' had become the primary policy objective. In order to develop the South, the Italian parliament adopted a 'Ten Year Plan for the Economic and Social Development of Southern Italy' in 1950. A regional programme, named 'Extraordinary intervention for the South' and its executing agency, the '*Cassa per il Mezzogiorno*' were afterwards set-up. Considered as 'the largest regional policy pursued by a western European country during the Cold War' (Felice, 2010), state-financed socioeconomic development measures in the regions south of Rome and on the Italian islands were taking place by the 1950s.[102]

[102] An impressive amount of capital was at the Cassa's disposal: The 'Fund for the South' was equipped with more than US$ 2 billion for the twelve-year period from 1950 to 1962, which then represented approximately 1 percent of total Italian national income each year. Two-fifths of the funds were invested to build up the physical infrastructure such as roads, railroads and aqueducts. Two-fifths of the available capital had been used for agricultural improvements (land reclamation and irrigation), and one-fifth was spent for agrarian reform projects and land distributions. Tourism just received a tiny sum of money (Perry, Carey, & Carey, 1955).



GDP per capita in 1950 and GDP per capita growth rate in Europe from 1950 to 1973 (in % per year), Data source: (Crafts, 2010), Maddison Project Database

Generally speaking, the Western European growth pattern from the 1950s to the 1970s largely complies with the catch-up paradigm.[103] As assumed by theory, the more backward economies of Western Europe had advanced faster than the more developed ones. Figure 2 shows that GDP per capita in 1950 and the GDP per capita growth from 1950 to 1973 do negatively and strongly correlate (r= -0,839**, R^2= 0,704). Hence, Southern Europe and West Germany, whose GDP per capita had been considerably below the Western European mean, increased much faster than wealthy Scandinavia or the UK.

[103] Due to their weak growth performance Ireland and the UK are outliers. Ireland substantially deviates from the linear trend. Theoretically, it could have grown by 2 percentage points more. On the other hand, the model is not doing justice to Switzerland. Its growth rate was roughly 1.5 percentage points higher than anticipated.

The following table gives some numbers: In 1950, West Germany or Italy had only reached 43 or 35 percent of the GDP per capita level of Switzerland, the leading nation. By 1973, West Germany or Italy arrived at 66 or 57 percent. German and Italian economic convergence to the Swiss level increased by 23 and 22 percentage points, respectively. Furthermore, the gap between Denmark and West Germany was decreased from 34 to 11 percentage points, while Italy was reducing it from 42 to 20 percentage points. Additionally, West Germany managed to draw level with the UK by 1973, while then the distance between Italy and the UK just accounted for 9 percentage points. Compared with other European laggards, the lion's share of catch-up was realized by West Germany and Italy.

European convergence and catch-up during the Golden Age (1950-1973), Data source: Own calculation based on the Maddison Project Database

Rank	Country	Index of GDP per capita convergence in 1950 (Switzerland=100%)	Rank	Country	Index of GDP per capita convergence in 1973 (Switzerland=100%)	Degree of catch-up between 1950 and 1973 (in percentage points)
1	Switzerland	100	1	Switzerland	100	-
2	Denmark	77	2	Denmark	77	-
3	UK	77	3	Sweden	74	-
4	Sweden	74	4	Netherlands	72	+6
5	Netherlands	66	5	France	70	+13
6	Belgium	60	6	Belgium	67	+7
7	Norway	60	7	UK	66	-11
8	France	57	8	West Germany	66	+23
9	Finland	47	9	Norway	62	+2
10	West Germany	43	10	Austria	62	+21
11	Austria	41	11	Finland	61	+14
12	Ireland	38	12	Italy	57	+22
13	Italy	35	13	Spain	42	+18
14	Spain	24	14	Greece	42	+21
15	Portugal	23	15	Portugal	39	+16
16	Greece	21	16	Ireland	38	-

But: despite the remarkable growth spurt that has taken place during the Golden Age, the lagging countries could hardly better themselves in the European 'world system'. Germany and Italy just improved their positions by one and two rank positions. World-system theory underlines the structural immobility of countries, being part of a historically evolved, solidified 'core-periphery hierarchy'. This is so because it is argued that the 'modern world-system is a system of stratification in which socially structured inequalities are reproduced by the institutional features of the system' (Hall & Chase-Dunn, 2006). The Irish case highlights the severity of economic competition in the international arena. Although it progressed by 3 percent per year from 1950 to 1973 - the consequence being the doubling of its GDP per capita[104] - Ireland failed to move upwards. By 1973, Ireland occupied the last place of the European rank. It reached 38 percent of Swiss GDP per capita; the same figure it had had in 1950.

5.2 Forging the Golden Age: Economic Growth and the Role of Labor

The economic boom in Europe lasting up to the first oil crisis in October 1973 dates back to a number of factors. With reference to (Crafts & Toniolo, 1996), (Eichengreen, 1996) and (Maddison, 1997), backlog effects induced by the war, high rates of savings and investments, liberalization of international trade (GATT, ECSC), and wage moderation resulting from the 'postwar settlement' were major contributions to the onset of the Golden Age. While acknowledging

[104] According to the '70/g' rule, a variable, which yearly grows by the factor g, will double itself in '70/g years'. Hence, GDP per capita that advances by 3 percent per year will be doubled after 23.33 years (70/30=23.33), (Samuelson & Nordhaus, 2009).

that it was driven by the interaction of multiple causal factors, the key role of labor should be still taken into account; a fact which was as early as 1967 pointed out by the economist Charles Kindleberger. Influenced by the Lewis model of unlimited labor supply [105], Kindleberger argued that cheap labor, migrating from the agricultural South to the industrial North - within Europe as well as the home country - was the main driving force of economic growth in France, Germany, Italy, Spain or Switzerland. By keeping industrial wages down, the abundance of labor ensured steady growth (Kindleberger, 1967) and (Temin, 2002). And inversely, the weak growth record of Belgium or the UK traced back to their resistance to immigration (Kindleberger, 1988).

Before scrutinizing those above mentioned factors in more detail, does empirical evidence support Kindleberger's labor-hypothesis? Figure 3 (next page) depicts a bivariate correlation between net migration from 1950s to the 1970s (in percent of total population) and GDP per capita 1973 (1990 Int. GK$). The Pearson correlation coefficient amounts to r=0.734** (R^2=0.538), suggesting a proximate impact of foreign workers on Europe's Golden Years. By 1973, Germany had received with 12 percent in relation to its population size - measured in average population between 1950 and

[105] Formulated in order to explain economic change in 19th century Britain or in developing countries, Lewis' model assumes two sectors (agriculture and industry) in an open economy and an exogenously given unlimited supply of labor available at a subsistence wage. Induced by higher wages paid in industries, workers are shifting from agriculture to industry but wage rates in each sector – due to the unlimited labor supply - remain constant. Capital formation will raise the share of profits in national income. Only those people who migrated from agriculture to industry receive higher salaries (Kindleberger, 1988), (Lewis, 1954).

1973 - the greatest number of immigrants. Switzerland attracted the second largest inflow of immigration (11 percent of total population). Foreign workers even amounted to a quarter of total Swiss labor force, fueling its economic growth. France and Sweden were also stocked with relative high shares of foreign workers. Growth in Sweden was fostered by cheap Finnish laborers (320.000) and internal migration. 250.000 Swedish migrated from the countryside to the city in the 1950s. The French economy benefited from immigration from Southern Europe and the Maghreb, including the 1 million pieds-noirs who settled in France after Algerian independence in 1962.

Countries of emigration were mainly situated in Southern and Southeastern Europe and Northern Africa. Portugal (-22 %), Algeria (-15%) and Yugoslavia (-8.5%) were especially shaped by significant outflows of people. The fact that there is still a strong correlation between net migration in 1950-1973 and GDP per capita in the year 2010 (r=0.54*) points at the long-term macroeconomic legacy of migration flows: the more workers migrated to one country, the higher is its GDP per capita today.

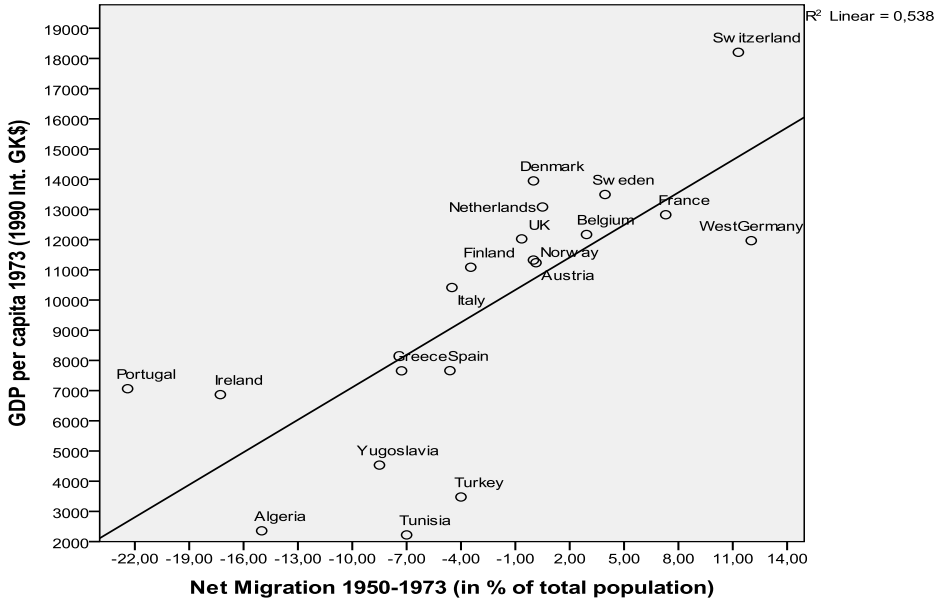


Figure 4: Net emigration 1950-1973 (in % of total population) and GDP per capita 1973 (1990 Int. GK$), Data source: (Fischer, 1987), Maddison Project Database

As shown in (Eichengreen, 1996), multivariate regressions suggest that high rates of savings and investments played an important role. The aspect that net investments were nearly twice as high in the 1950s and 1960s than in previous or later periods both demonstrates the considerable postwar needs of reconstruction and the accumulating demand for capital in new business areas, like in the case of automobiles or consumer goods. [106] By referring to the Western German and Italian cases, European integration promoted their economic expansion. [107] While the European Coal and Steel

[106] With regard to (Eichengreen, 1996), investments in Western Europe had risen from 10 percent in 1920-38 to 17 percent in 1950-1970.

[107] But the long-term and macroeconomic welfare effects of the European project remain controversial (Eichengreen & Boltho, 2010). ECC participation seems not to be related with GDP per capita growth between the 1950s and 1970s. After computing a dummy

Community reduced coordination problems in trade, foreign exchange was additionally fostered by the creation of the customs union in 1957. Italian trade with EEC countries increased from 23 percent in 1955 to over 40 percent in 1965 (Duggan, 2008). And by 1971, 40 percent of German's exports were traded within the European Economic Community (Jaeger, 1988). With regard to **(**Varsori**,** 2011**)**, Italian participation to the EEC was 'almost a vital stimulus to the country's rapid economic growth and to its social transformation and modernization.'[108]

However, investments or foreign trade do only translate directly into welfare gains if these are founded on 'social capabilities' by which domestic 'political, commercial, industrial and financial institutions' are meant (Abramovitz, 1986). Or, as (Nurske, 1953) had formulated: 'Economic development has much to do with human endowments, social attitudes, political conditions – and historical accidents'. According to the Estonian development economist, 'capital is a necessary but not a sufficient condition of progress'.[109]

That is why the 'postwar settlement' is part of the equation. Out of tripartite pacts between trade unions, employers and governments, neo-corporatist models of industrial relation had emerged on the

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variable (EEC membership=1, EEC non membership=0), EEC membership did not correlate with GDP per capita growth in the Golden Age. This might be due to the unbalanced data distribution (5 EEC members, 11 EEC non-members).

[108] (Varsori, 2011).

[109] The here pursued emphasis on labor as the key factor ignores a little the important role of capital. Yet, it may be assumed that labor was relative to capital the scare productive factor in the postwar era. In fact, the above noted expansion of investment underlines the availability of capital while the extent of labor migrations refers to the mismatch between labor supply and demand.

European landscape. They were based upon the underlying principle that in exchange for self-imposed wage restraint by the unions, employers assured the re-investments of profits (Temin, 2002). In 1952, the German '*Betriebsverfassungsgesetz*' was adopted that guaranteed workers' participation in decision-making and the right to elect to one-third of a company's supervisory board. In return, the newly created '*Betriebsräte*' (working councils) within companies were henceforth legally bound to cooperative behavior in relations with employers. Instead of calling out on strike, disputes should be settled through agreements of mutual consent (Müller-Jentsch, 2011). Italy's legacy of conflictual industrial relations, dating back to deep divisions between capital and labor, had made collective bargaining more difficult.[110] It was replaced by direct government intervention in wage setting (Toniolo, 1998).

Despite all that, labor abundance and productivity might have been crucial in performing the postwar economic miracles of Germany and Italy. For instance, (Duggan, 2008) has written that the most important factor behind Italy's performance was its 'reservoir of cheap labor'. And with regard to (Woller, 2010), low-wages in Italy 'were certainly a precondition for the economic growth and especially the booming exports'. Regarding the German case, high- and low-skilled labor immigration from Eastern and Southern Europe was of critical

[110] The *‚apertura a sinistra'* policy, conducted in the 1950s and 1960s by Fanfani and Moro, can be understood as the political attempt to overcome the traditional cleavage between capital and labor. The centre-left coalition of Moro and Nenni, formed in the end of 1963, was the first government with socialist participation since 1947 (Woller, 2010).

importance (Abelshauser, 2004) and (Wehler, 2008). Table 2 portrays the development of productivity (GDP/hour worked) and industrial wages in both countries between 1950 and 1973. Characteristic for modern economies, a positive relationship between labor supply and wage rates can be observed (Malanima, 2011).

	West Germany		Italy	
	GDP/hour worked	Industrial Wages	GDP/hour worked	Industrial Wages
1950	100	100	100	100
1960	193	200	156	124
1966	259	237	246	173
1973	373	300	355	280

Table 2: Growth of GDP per hour/worked and industrial wages in West Germany and Italy (index points in %), Data source: GDP/ hour worked refers to (The Conference Board, 2014). For German index of industrial wages see (Wehler, 2008). Italian data is based on (Malanima, 2008). Absolute data has been transformed to the index (industry, real wage rates masons 1950=1).

In Western Germany, wages had accelerated more quickly than in Italy. Within ten years, German wages doubled implying that they had risen slightly more than productivity. By 1950, industrial wages in Italy – because of slow growth of real wages - only increased by the factor 1.24. Till 1962, real wages annually went up by only 2 percent; that was well below the annual acceleration of productivity by 5 percent (Woller, 2010). Besides, unemployment had hardly improved in the 1950s. In 1959, Italy counted 2 million unemployed persons; the same number as ten years ago. First in the 1960s, when unemployment was considerably reduced, wages started to climb, and multiplied by

280 percent in 1973. It was similar in Germany where industrial earnings tripled from 1950 to 1973.

Yet, wages and salaries advanced less than productivity although the economic boom regions required huge amounts of workers. Apart from the policy of wage moderation, the abundance of labour, fuelled by migration, can account for the retarded increment in earnings. More than 5 million people, about 10 percent of Italy's population, migrated to other countries between 1946 and 1963.[111] Internal migration looked like a true job exodus. Estimates concerning the period 1955-1971 speak of roughly 9 million Italians leaving their homes in order to find work. Most of those came from the Mezzogiorno, and headed towards the North, particularly to the industrial triangle Genoa – Milan – Turin (Woller, 2010), (Duggan, 2008). By 1967, 1.1 million people lived in Turin; an increase of 155 percent in the FIAT city as against the previous decade. Half of its population originally came from the South. Between 1951 and 1971, Southern Italy passed over 2 percentage points of its population to Northern and Central Italy (Hertner, 1987).

Germany has been the country of destination for refugees from Eastern and labor migrants from Southern Europe since the end of World War Two. The German 'Wirtschaftswunder' was greatly enhanced by high- and low-skilled migrants. By 1950, 8.3 million refugees and displaced persons, accounting for 18 percent of total

[111] Switzerland attracted with 1.5 million much more immigrants than Germany where 500.000 Italians entered. Higher Swiss wages could be the main reason for this (Woller, 2010).

population, had moved to West Germany. Until 1960, it had risen to 13.8 million; almost a quarter of total population came from the East (Herbert, 2001). Between 1952 and 1963, approximately 20.000 engineers, 7.500 doctors and 1.000 university professors moved from East to West Germany, representing a transfer of human capital from East to West in the magnitude of 30 billion DM (Wehler, 2008). The uneven urban development of Cologne (West Germany) and Leipzig (East Germany) further illustrates the unilateral exchange of human capital. In 1960, Leipzig's population size (618.000) was a little bigger than Cologne's (595.000). From 1950 to 1980, Cologne grew by the factor of 1.63. On the other hand, Leipzig lost 10 percent of its inhabitants (Fischer, 1987).

Despite such an influx of people, growing concerns on a potential labor shortage prompted the first bilateral agreement on labor recruitment between Germany and Italy in 1955. After the construction of the Berlin Wall in 1961, West Germany concluded labor agreements with Greece and Spain (March 1960), Turkey (October 1961), Portugal and Tunisia (March 1964), and Yugoslavia (October 1968). By 1973, when recruitment was stopped, 2.6 million foreign workers, 12 percent of total labor force, were employed in Germany (Wehler, 2008).

But in contrast to the Lewis framework, foreign workers did not hamper the escalation of wages in West Germany where the trade unions successfully claimed same payment. Concerning Italy, the wage differential between the Mezzogiorno and the industrial triangle motivated internal migration, thereby causing structural change, urbanization, and side-effects. The more people rushed to the North,

the less manpower remained in the South. During the 19th century, the Mezzogiorno had been characterized by the abundance of labor and the scarcity of capital. At this juncture in the 1960s, when the Fund for the South made capital available for the first time, labor paradoxically became there the scare productive factor (Woller, 1998).

To conclude: it has been demonstrated that labor supply (extensive growth) and labor productivity (intensive growth) were mains reasons for the economic miracles in West Germany and Italy from the 1950s to the 1970s. While not being alone sufficient, labor migration was certainly a necessary precondition for Europe's Golden Years (Judt, 2006). By relying on the Lewis model of unlimited labor supply, it has been shown that considerable labor migration, from the Mezzogiorno to the industrial triangle, from other countries to West Germany, took place from the 1950s to the 1970s. But: as just indicated, this transfer of labor and human capital might have occurred at the expense of the originating country or region, implicating that modern, industrial areas were by far better off than remote, agricultural ones.

5.3 Root Causes of Economic Development

Proximate and fundamental causes of long-run development are distinguished. While proximate factors focus on productive factors (capital, labor, technology) as the main determinants of economic development, fundamental theories integrate cultural, environmental, institutional and social-structural variables as well as 'historical accidents' into a broader explanatory framework (Acemoglu, Johnson, & Robinson, 2008) and (Rodrik, 2003).

Historically evolved divisions between Wallonia and Flanders in Belgium, Andalusia and Catalonia in Spain, Calabria and Lombardy in Italy or between Mecklenburg-Western Pomerania and Baden-Wuerttemberg in Germany demonstrate the existence of unequal patterns of regional development on the European continent. According to Eurostat data on regional GDP per capita in 2010 (PP$, EU27=100), the member states of the European Union are confronted with serious domestic socioeconomic disparities, ranging from 87 (Hainaut) to 137 (Limburg) percent in Belgium18, from 75 (Andalusia) to 116 (Catalonia) percent in Spain, from 65 (Calabria) to 132 (Lombardy) percent in Italy and from 81 (Mecklenburg-Western Pomerania) to 131 percent (Baden-Wuerttemberg) in Germany (Eurostat, 46/2013). The economic gap naturally becomes more dramatic when the richest regions make up points of references. While GDP per capita in Hainaut, Andalusia and Mecklenburg-Western Pomerania is between 61 and 64 percent relative to Limbourg, Catalonia and Baden-Wuerttemberg, Calabria is a special case. Its GDP per capita is only half of this of Lombardy.

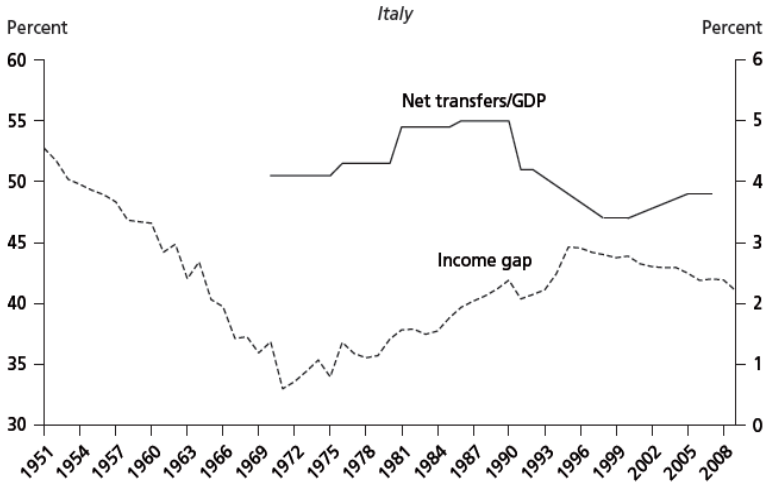
Which factors can take account for those significant gaps in GDP per capita between Catalonia or Lombardy? To put it simple, Andalusia or Calabria are poorer than Catalonia or Lombardy because the latter are stocked with more capital, labor and better technology than their Southern fellows. However, equipped with an abundance of factor endowments can be as much the cause as the consequence of a high level of development. Robert Solow clearly makes this point by stressing that the 'fundamental reason why I am dubious about it is that there is no solution to the inverse causation issue. The more right-hand-side variables that go into those regressions, the more they seem to me to be just as likely the consequences of success or failure of long-term economic growth, as the cause' (Snowdon & Vane, 1999). Hence: Instead of tracing back the observed variance in GDP per capita to variances in factor endowments, the fundamental question we should ask reads like this: Why have some regions within the same state much more capital, labor and technology at their disposal than other regions?

History is here part of the game. Concerning the Italian North-South gap, (Putnam, 1994) argues that the different levels of wealth are the outcome of historic distinctions in social capital among the Italian regions. While it was quite low in the Southern Two Kingdoms of Sicily, the self-governed municipalities and city-states of Emilia-Romagna, Lombardy, Tuscany or Veneto developed higher levels of social capital including civic virtues like cohesion, cooperation and trust, eventually benefiting their long-term economic performance. Innovative field studies in four medium-sized Italian cities, recently

undertaken by researchers from the 'Strangers Project', indeed found significant variances in levels of behavior. They conclude that 'the ability to cooperate is stronger in the North than in the South' (Bigoni, Bortolotti, Casari, Gambetta, & Pancotto, 2015). While a high degree of cooperation might be a pre-condition for business activity, the issue of inverse causation again influences the interpretation of the results. Low levels of cooperation in the Sicilian city of Ragusa or the Calabrian city of Crotone could be the outcome as well as the cause of their low-income. Finally, data provided by (Daniele & Malanima, 2008) show that levels of GDP per capita in North and South Italy were almost similar when Italy unified in 1861. By 1882, the year of Garibaldi's death, North-South divergence can hardly be discovered in GDP per capita terms. Only in the years prior to the First World War, when Northern industries took-off, North-South divergence speeded up from the economic point of view.

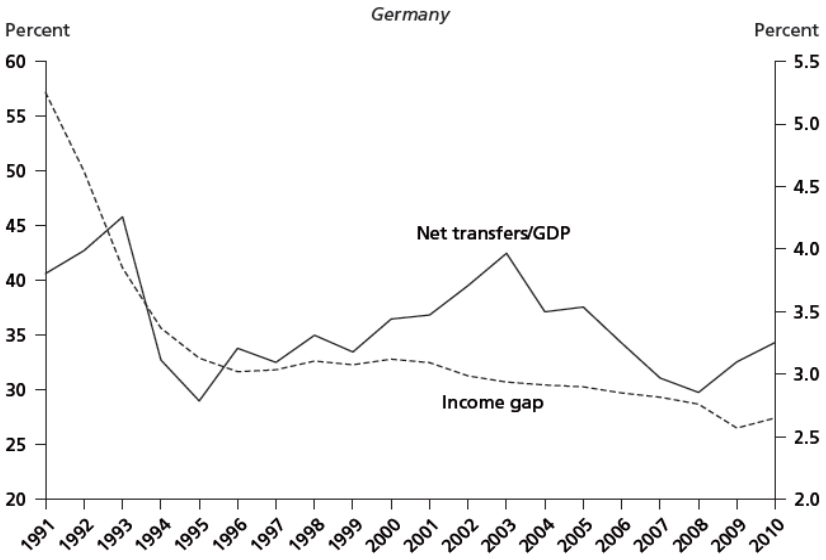
5.4 A model of intra-regional divergence: Germany vis-à-vis Italy

Figure 5 Regional policy in Italy: Income gaps and fiscal transfers



Net transfers to Mezzogiorno as percentage of GDP and per capita income gap (1951–2009).
Source: Vittorio Daniele, Paolo Malanima (2007); Istat.

Figure 6, Regional policy in Germany: Income gaps and fiscal transfers



Net transfers to East Germany as percentage of GDP and per capita income gap (1991–2010).
Source: Arbeitskreis VGR der Länder: Bruttoinlandsprodukt, Bruttowertschöpfung in den Ländern und Ost-West-Großraumregionen Deutschlands 1991 bis 2010; ifo Dresden.

In 1949, 19.1 million people lived in East Germany. By 1990, East Germany's population decreased to 15.52 million. During the last 41 years, Eastern Germany had passed over 20 percent of its population size to the West. After reunification in October 1990, emigration has not stopped. In the last twenty years, 1.6 million East Germans (10 percent of total inhabitants) have been heading for the West. Most of these migrants are high-skilled, and 60 percent are younger than 30 years old (Kröhnert, 2010). As far as recent data is concerned, East German productivity makes up 79 percent of total productivity, East German unemployment is almost twice as big and (Inneren, 2012). While East Germany might not have 'become a new Mezzogiorno'

(Boltho, Carlin, & Scaramozzino, 1997), East-West convergence temporarily seems to have reached a stop (Streeck, 2013).

In Italy, convergence took place until the outbreak of the first oil crisis. From 1950 to 1973, the Mezzogiorno caught-up by 18 percentage points (from 48 percent to 66 percent of Northern GDP per capita). While levels of education and health are now Northern GDP per capita (Daniele & Malanima, 2008) and (Iuzzolino, Pellegrini, & Viesti, 2011). Despite the high transfer of capital and developing aid from West to East, from North to South - both countries invested roughly 4 percent of national GDP per year - Eastern Germany and the Mezzogiorno could not draw level with their Western and Northern counterparts. Apart from small 'islands of industrialization' (Lewis, 1954) in the relevant regions, economic policies to generate self-sustained growth have been failing so far and deep regional inequalities remain (Streeck, 2013).

Despite of key endogenous factors inhibiting economic development in the Mezzogiorno and East Germany, their backlog may be the effect of the following pattern: Due to several reasons including higher input of technology or an asymmetric shock, we assume that capital tends to favor regions that have a technology lead while labor (human capital) tends to move to areas with the best career potential.21 If the growth conditions in region A (West Germany, North Italy) are better than in region B (East Germany, Mezzogiorno), the curve of region A may shift upwards while the curve of region B remains at the same level. The expectation of a persistence of this development induces the situation where the expected returns on labor

and capital are higher in A than in B. Gaining momentum, labor and capital starts to flow from B to A. Hence, the already existing economic gap between A and B is cumulatively reinforced (Molle, 2006). Governments may take countermeasures. They will implement developing policies for region B. Governments can easily generate public funds and investments, thereby substituting the lack of private capital in region B. But it is more difficult to compensate for the shortage of labor. Taking into consideration labor mobility, aging populations and falling birth-rates across Europe, we can assume that supposed unlimited labor supply is no longer in place. Therefore, labor will probably be the scarce productive factor relative to capital. If employees (=human capital) act rational, they will certainly go to Region A where salaries are higher. Consequently, a mismatch between capital and labor occurs in region B.

In Mundell's optimal currency theory, such a situation, in which the productive factors shift from one country to another, is the result of an asymmetric demand shock. In order to rebalance the emerged disequilibrium between the affected and non-affected country, factors of production would unilaterally transfer to the non-affected country, factors of production would unilaterally transfer to the non-affected country and eventually recreate equilibrium (Mundell, 1961) and (Persson & Sharp, 2010). While labor mobility theoretically serves as a kind of equalization mechanism in a currency union, its possible negative side effects for the sending country are excluded in Mundell's optimal currency model. Although asymmetric shocks in a currency union should be less frequent, the macroeconomic dynamics of

competing nation-states within a monetary union may indeed (Grauwe, 2007).

The fact that region A and B are part of the same economic system, sharing with each other the single market, the free movement of capital and labour, and a common currency makes the situation for B not easier. If B were a sovereign economic unit with its own national currency, it would devalue it and provoke export-led growth. In this way, lower prices in region B would compensate for its low wages, thereby attracting foreign labor and human capital. With the loss of the exchange rate mechanism, this option is no longer available. Apart from the 'painful process of adjustment' (Grauwe, 2007), which other economic strategies could be executed by region B in order to reverse the loss of labor?

5.5 The European North-South Divide

The Maastricht Treaty was put into force in November 1993. 11 countries originally entered into the European Monetary Union in January 1999. The euro was introduced two years later. What were their effects upon convergence and cohesion? Naturally, an evaluation of the Maastricht Treats is dependent upon the specific point in time. (Geary, Germond, & Patel, 2013) remind us that the 'past is always contingent upon the present. the present. Ten, or even five years ago, assessments of the Treaty might have been radically different than it is today. In the view of the late Tommaso Padoa-Schioppa, one of the euro's architects 'convergence is economically desirable *per se* rather than a necessary condition for (Padoa-Schioppa, 1994). For the

European Commission, the euro has been a ‘clear success’. Published prior to take--off of the economic crisis in 2008, the report ‘EMU@10’: successes and challenges after 10 years of Economic and Monetary Union’ lists the major achievements of the euro. Among them are macroeconomic stability, the fostering of economic, monetary and financial integration, job-creation and real convergence (Directorate-General, 2/2008).

Yet, the Directorate-General for Economic and Financial Affairs admits that ‘catching-up processes have been somewhat slower in EMU than outside it’ (Ibid.). (Buti & Noord, 2009) notice ‘persistent differences in economic performance between countries in a medium-term frame’. Germany and Italy in particular have ‘experienced markedly weaker growth than the average’ (Ibid.). (Christodoulakis, 2009) argues that the ‘evidence in support for convergence is fading away after the EMU was initiated in 1999. Rather, a process of divergence in per capita GDP is underway’, which is accompanied by ‘unprecedented current account deficits in the Southern European countries (Ibid).

(Bongardt & Torres, 2013) write that former cohesion countries in South Europe began to ‘diverge (or, in the case of Italy or Portugal, continued to diverge) with respect to the Eurozone core countries in terms of real GDP growth’ (Ibid). (Eichengreen & Boltho, 2010) assess that ‘significant divergences in economic performance have emerged’. While countries such as Finland, Ireland, or Spain have been growing rapidly until 2009, Italy and Portugal stagnated (Ibid). In order to reflect on the issue whether the Eurozone is driven by growing

convergence or divergence, table 3 portrays two series of GDP per capita for the benchmark years 1990 and 2010.

The Maddison Project Database does not contain data of the euro member Luxembourg. That is why the Penn World Table 8.0 was included too. Both series do strongly correlate (r=0.823**), demonstrating their congruence with each other. The GDP per capita in 1990 and 2010 of the specific Euro countries was indexed to the Euro-12/11 countries mean (=100).

	Penn World Table 8.0 (GDP per capita in 2005US$GDP)			Maddison Project Database (GDP per capita in 1990 Int. GK$)		
Country	1990	2010	Change in 1990-2010 (in percentage points)	1990	2010	Change in 1990-2010 (in percentage points)
Euro-12/11 mean	100	100	-	100	100	-
Luxembourg	152	175	+23			
Netherlands	116	116	-	116	119	+3
Germany	112	103	-9	107	101	-6
Austria	107	106	-1	114	118	+4
Belgium	104	98	-6	116	115	-1
France	101	89	-12	119	105	-14
Italy	101	83	-18	110	91	-19
Finland	99	96	-3	113	114	+1
Ireland	84	126	+42	79	108	+29
Spain	80	78	-2	81	82	+1
Greece	69	69	-	67	72	+5
Portugal	65	62	-3	73	70	-3

Data source: Own calculation based on Penn World Table 8.0 and the Maddison Project Database. Index was computed with the formula: (GDP per capita of 'respective country'/GDP per capita 'EU-12/11 countries mean')*100.

What do the figures of table 3 reveal? In 1990, the majority of the EU-12/11 countries had higher levels of GDP per capita than the respective value of the Euro-12/11 countries mean. Luxembourg is by far the

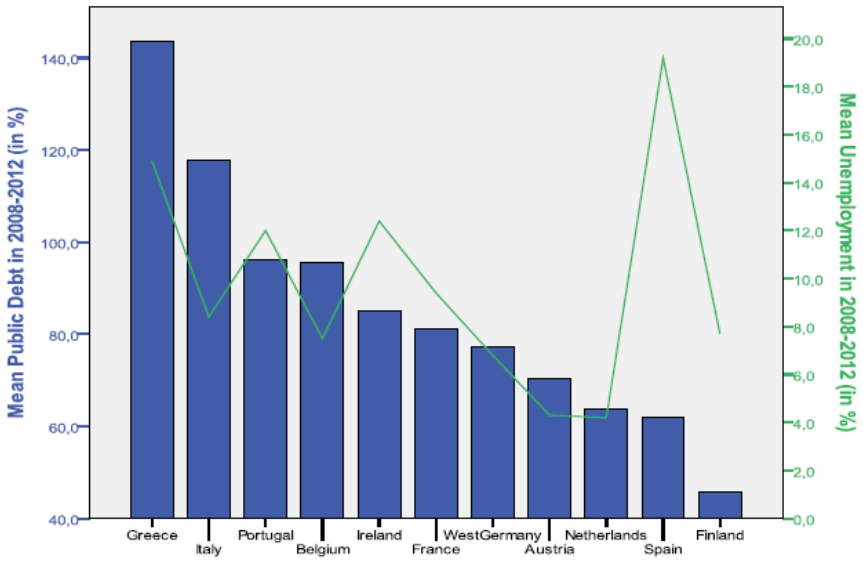
richest Euro member, followed by the Netherlands. Portugal, Greece, Spain and Ireland had performed below the Euro-12/11 mean. Finland, France and Italy constitute ambiguous cases. In the Penn World Table, they are situated just above or below the arithmetic average. In the Maddison series, their GDP per capita in 1990 was clearly higher than the average value. Taken into account economic performance since 1990, the case sample splits-up in three parts. Ireland and Luxembourg are in the first group. They notably performed well, both profiting from the abundance of financial services. The second group consists of countries such as Austria, Belgium, Finland, Germany and the Netherlands. Those kept the same level or have slightly improved in economic terms.

Southern Europe and France are in the last group. While Portugal, Spain and Greece regressed a bit, France and Italy are plainly losing ground. In both series, their minus amounts to 12-14 and 18-19 percentage points, respectively. In the Penn series, the number of Euro countries dropping below the EU-12 mean rose from 5 (1990) to 7 (2010). In particular, France and Italy have been falling behind. In the Maddison dataset, 4 countries are situated below the Euro-11 average. Up until now, modest divergence in terms of GDP per capita development among the Euro members can be observed. Colin Crouch made a similar prediction ten years Colin Crouch made a similar prediction ten years ago when he stated that '(…) it is generally agreed that one consequence of monetary union, at least, in the medium-term, will be to produce considerable divergence in the economic progress of different regions' (Crouch 2000). Bearing in mind the persistence of

recession, it can be reasonably assumed that GDP per capita divergence will gain weight.

Expressed in terms of unemployment and public debt, economic disparities have considerably increased among the Euro-11 countries. Figure 4 displays mean public debt and unemployment from 2008 to 2012. Levels of public debt range from 144 percent in Greece to 46 percent in Finland. Unemployment varies between 4.3 and 19.2 percent. Both variables have been advancing for years. Public debt is especially high in Greece (143%), Italy (118%), Portugal (96%) and Belgium (95%). The highest unemployment is presently found in Spain (19.2%), Greece (14.9%), Ireland (12.4%) and Portugal (12%). If this divergence in labor market performance within the European Union perpetuates, it may be fair to argue that the European Union is not only ‘under severe stress’ (Barroso, 9 May 2013) but things are getting worse.

Figure 7: Public debt 2—8-2012 and unemployment 2008-2012 (mean values in %) in the Euro-11



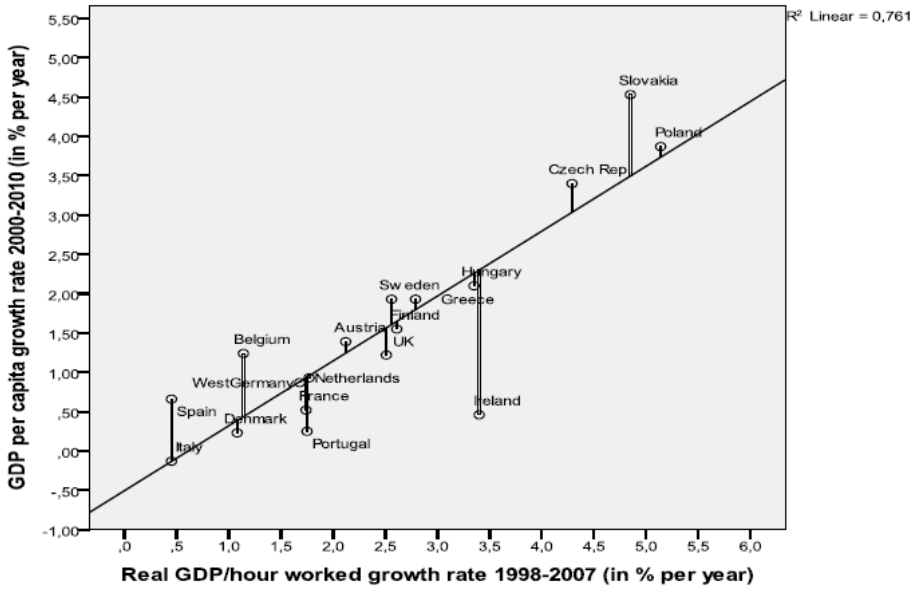
Data source: Eurostat database.

Generally speaking, the weak economic performance can be explained by a decline in productivity and competiveness. Referring to (Buti & Noord, 2009) 'divergences in productivity growth and unit labour costs developments have proved persistent'. (Grauwe, 2007) finds the 'emergence of large divergences in competitive positions of members of a monetary union'. By reducing the relative unit labour costs as the consequence of a policy of wage moderation, Germany bettered its competitive position. On the contrary, Greece, Ireland and Italy saw their unit labour costs rise relative to the others because wages accelerated faster than productivity. Hence, these states underwent a loss in competitiveness since 2000 (Ibid.). However, (Boltho & Carlin, 2013) insist that this tendency is due to 'divergences in behavior'

meaning the 'lack of discipline and excessive borrowing by the public sector' in Portugal or Greece.

The previous parts have established a causal relationship between economic and productivity growth during Europe's Golden Age. Does the same pattern also apply when the recent period is considered? Figure 5 compares economic growth in 2000-2010 and GDP/hour worked in 1998-2007. The Pearson correlation coefficient r equals to 0.872** (R^2= 0.761, N=18). Both variables are still positively linked except that the correlation would be reduced if the East European countries (Czech Republic, Hungary, Slovakia and Poland) were excluded.

Figure 8: Real GDP/hour worked 1998-2007 and GDP per capita 2000-2010 growth rates (in % per year)



Data source: Own calculation based on the Maddison Project Database and the OECD http://stats.oecd.org/Index.aspx?DataSetCode=PDYGTH. Growth rates were computed with the formula: Y= ln ((GDP per capita year x1/GDP per capita x2)/number of years))*100

Corresponding with the catch-up paradigm, the new member states from East Europe performed above average. Central and Southern European countries with the notable exception of Greece - did underperform. In fact, Greece had the highest economic growth in the Eurozone; eventually culminating in the economic crisis. Italy was the country with the lowest GDP per capita growth in the case sample. It endured a negative growth rate of -0.13 percent. Other euro members like Portugal, Ireland, France, Spain, Germany and the Netherlands had low growth rates under 1 percent. To conclude: Monetary integration did obviously not succeed in preventing growing divergence in the Eurozone. According to the locomotive theory of European integration, an early introduction of the common currency should have facilitated the coalescence of the Eurozone. Instead, the European periphery 'had suffered from large asymmetric shocks in comparison to Europe's core (Boltho & Carlin, 2013)'. Monetary integration might have played a positive role but the benefits – for example, in the form of low interest rates - of the euro were not large enough to offset the decline in competitiveness and productivity experienced by countries like France or Italy.

In March 2000, European statesmen gathered in the Portuguese capital to proclaim the so-called Lisbon Strategy, which expressed an ambitious objective. By 2010, the EU would have achieved the effort to 'become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion (Council, 2000). Reading these words 17 years later, it may be fair to argue that the

European economies have not become ‘capable of sustainable economic growth’ and presently suffer from ‘less and poorer jobs and lower social cohesion’.

Newspapers have recently reported that 1 million people have been migrating to Germany since 2011. On the other hand, immigration to Italy dropped by 30 percent between 2007 and 2011. Prior to the outbreak of economic crisis in 2008, the ‘periphery’ (Greece, Spain, Ireland, Italy and Portugal) experienced immigration. Since that time, migration flows have been changing. At the moment, ‘core countries’ (Belgium, Germany, France, Sweden and UK) are receiving immigrants from South and Southeast Europe (Holland & Paluchowski, 2013). Does this trend suggest that economic relations in the Eurozone reshape into the elaborated model where Northern Europe (=region A) takes over labour from Southern Europe (=region B), while South Europe may receive Northern capital as part of so-called bank bailouts?

Convergence between countries was surprisingly not accompanied by the same convergence at the regional level within countries (Wunsch, 2013). The difficulties of intra-regional development, experienced by Germany and Italy, confirm this assessment. The lack of intra-regional catch-up in Germany and Italy is aggravated by migration flows from East to West, from South to the North. It has been shown previously that labor migration was a key driving force of previous European economic development. It can be inversely argued that emigrating human capital and the decline in labor productivity represent main reasons for the North-South divide in

Europe. Empirical evidence suggests that austerity policies do probably not work in crisis-ridden states. They might be effective in cutting public expenditures and budget deficits but they have failed so far in stimulating business activity or the economic cycle. Neither public debts nor unemployment have been reduced in the wake of austerity policies. On the contrary, key economic indicators are deteriorating in Greece, Spain or Portugal. The severity of recession does not inevitably induce the situation where ‘’Southern Europe is turned into a greater Mezzogiorno’’ (Wunsch, 2013). Nonetheless, the present situation highlights the urgent necessity to explore how and by which means convergence within and between countries can be realized in the framework of a single currency setting.

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