Regional chasms

Economic convergence has been a cornerstone of the Eurozone project. With all members operating under the same monetary policy, it is crucial that their economies become more closely aligned, so that when shocks occur they hit countries symmetrically and can be addressed through a single policy setting. **Ominously, evidence suggests that Eurozone countries have not been converging since the formation of the current union.** First, let's look at labour markets. There are huge differences in unemployment rates across the region, with the highest reading observed in Greece (24.5%) and Spain (20.8%), standing in stark contrast with the record lows seen in Germany (4.5%). Second, the economic performance of member states since the inception of the euro has differed significantly. The Italian economy has barely grown since 2000, while the Irish economy is almost 50% larger despite a deep recession after the financial crisis. Finally, differences in productivity across countries remain very large. German GDP per capita is currently around 20% higher than the Eurozone average – almost exactly the same as in 2000. Similarly, Spanish output per person, which was 73% of the Eurozone average in 2000, has barely risen (see Chart 6).

This story becomes even worse when we look at disparities in performance at the sub-national level, which are even more pronounced. To illustrate, the most productive regions in the Eurozone, such as Hamburg and Brussels, generate around twice as much per capita output as the EU average. Out of the ten most productive regions in the Eurozone, five can unsurprisingly be found in Germany. Indeed, there are signs of a broader geographic concentration in the centre of Europe, including sections of the Netherlands and Northern Italy. The least productive regions generate between 40-50% less per person than the EU average. Seven of these regions can be found in Greece, two in France and one in Italy (see Chart 7).

The huge disparities in national and sub-national performance damage the functioning of the Eurozone. There are a number of policy steps that could help to address some of these issues. Labour mobility in the Eurozone is poor, despite the freedom of movement enshrined in European treaties. While this, in part, reflects cultural and linguistic barriers, a greater deregulation of labour markets across the region could improve flexibility. More controversially, there should be scope for fiscal transfers to help address asymmetric shocks across member states. This is a feature of well-functioning monetary unions, such as the United States. Finally, there is clearly work that needs to be done within countries. Italy provides an interesting case study. The southern "mezzogiorno" regions of Italy contracted a full 13% between 2008 and 2013, almost double that seen in the North (7%). Of the 943,000 Italians who became unemployed between 2007 and 2014, 70% were southerners. This has pushed unemployment up to 21.7%, compared a national rate of 13.6%. Finally, the employment rate in the South is lower than in any country in the European Union at 40%, with female employment at a shocking 33%. These regions are in desperate need of investment in infrastructure and human capital. Aggressive reforms are also required to boost growth and root out corruption. **If Italy is to make up the ground against some of Europe's strongest performers, it will need to narrow its own disparities first.**

Chart 6: Productivity disparities

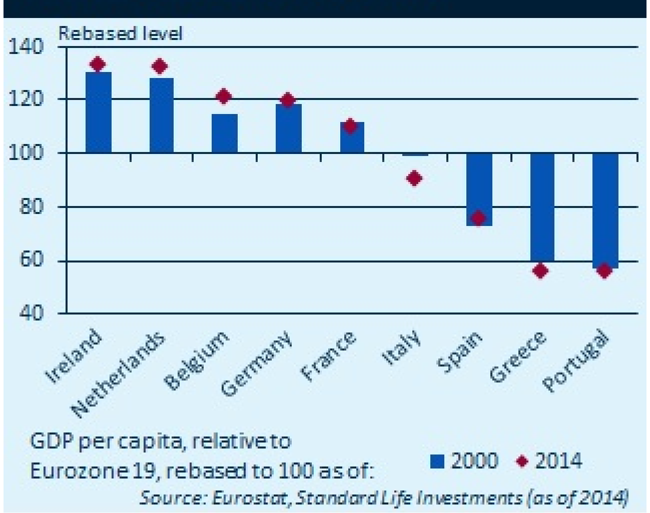

Chart 7: Laggards