



Flash Economics

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How far can living standards diverge between euro-zone countries?

It is well known that monetary unification, by eliminating currency risk and thereby making it possible to use comparative advantages, increases the heterogeneity of the countries (regions) in a currency area.

This process of divergence in living standards began in 2010 in the euro zone, after the period during which it was corrected by capital transfers from countries with excess savings to countries with a savings deficit (due to the latter countries' growing debt).

How far can euro-zone countries' living standards ultimately diverge in the long run? The example of the United States can be used, by comparing labour mobility and the degree of federalism between the United States and the euro zone, both of which reduce the divergence of living standards.

The conclusion is that the gap in living standards (in per capita GDP) between euro-zone countries is still far from its equilibrium level.



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Monetary unification increases the heterogeneity of countries in a currency area

Monetary unification, by eliminating currency risk, allows member countries to use their comparative advantages. **As a result, productive specialisations diverge** (we can see, for example, the divergence in the size of industry, **Chart 1**). Some countries therefore specialise in sophisticated, high-end activities and others in low-end activities, and **living standards and per capita GDP diverge (Chart 2)**.

Chart 1
Value added in the manufacturing sector
(as % of real GDP)

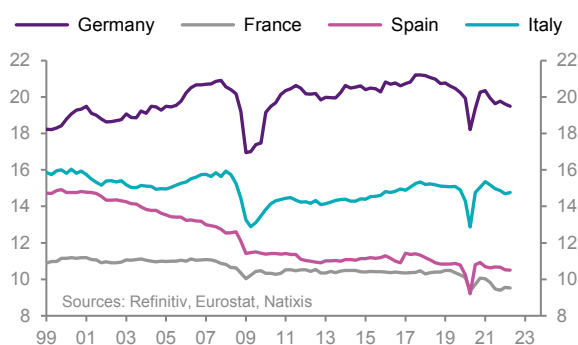
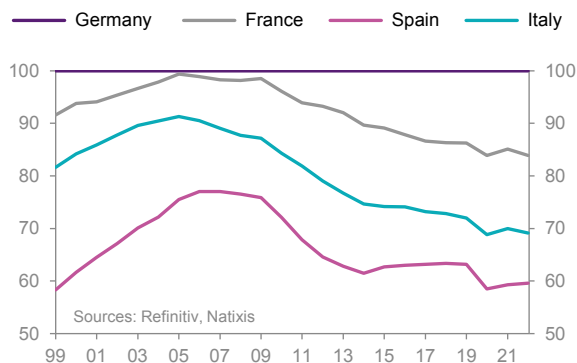
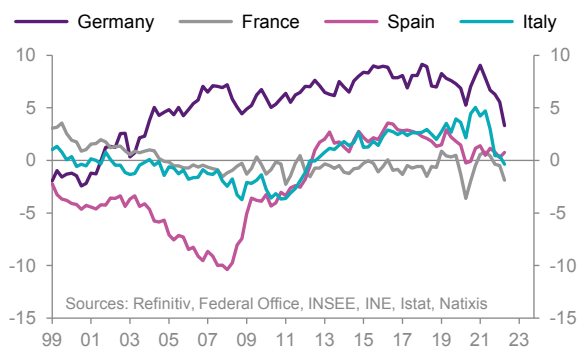


Chart 2
Per capita GDP (in EUR, as % of Germany)



This growing heterogeneity of income levels is clearly visible in the euro zone after the subprime crisis, as soon as the heterogeneity was no longer corrected by external borrowing (**Chart 3**).

Chart 3
Current-account balance
(as % of nominal GDP)



How far can the euro zone's heterogeneity go?

The widening of income gaps between euro-zone countries is bad news: it creates a risk of a break-up of the euro zone if the poorest countries see that their income levels fall relative to those of the richest countries.

How far can per capita income gaps widen between euro-zone countries?

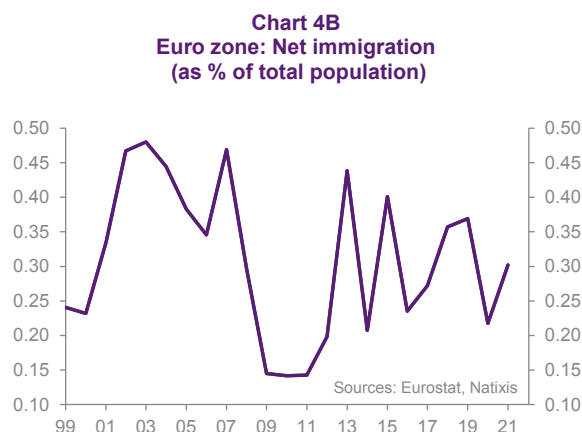
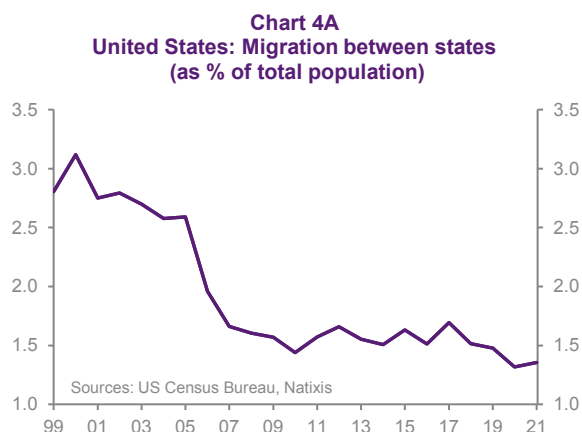
To assess this, we will compare the euro zone and the United States.

The heterogeneity of a currency area is all the greater:

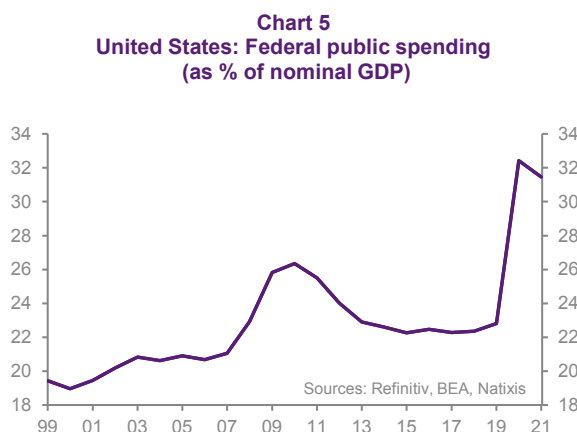
- **The lower the labour mobility between the countries in the currency area** (high labour mobility homogenises the demographics of the countries in the currency area);
- **The lower the degree of federalism** (federal transfer payments between countries correct income gaps).

However, we see that:

- **Although it has declined, labour mobility among US states is higher than labour mobility among euro-zone countries (Charts 4A and B);**



- **The degree of federalism is much lower in the euro zone (the EU budget is 1.1% of EU GDP) than in the United States (Chart 5).**



Conclusion: Heterogeneity (the size of per capita income gaps) among euro-zone countries is far from having reached its equilibrium level

As we have seen, monetary unification leads to growing heterogeneity between countries in the currency area and a divergence of their per capita income.

In the United States, the ratio is 1 to 2 for per capita GDP between the poorest and richest states (Table 1).

Table 1: United States: Per capita GDP, by state (2021, in thousands of dollars)

State	Per capita GDP
District of Columbia	229.34
New York	95.85
Massachusetts	91.82
Washington	87.55
California	85.97
Connecticut	82.76
North Dakota	82.02
Delaware	80.89
Alaska	78.27
Colorado	75.08
Illinois	74.63
Nebraska	74.50
New Jersey	73.70
Minnesota	72.27
Maryland	72.01
New Hampshire	71.76
Wyoming	71.72
Virginia	70.00
Texas	69.49
South Dakota	68.89
Iowa	67.92
Utah	67.51
Kansas	65.22
Pennsylvania	65.14
Ohio	64.23
Oregon	64.10
Georgia	64.04
Hawaii	63.19
North Carolina	62.75
Wisconsin	62.52
Nevada	61.86
Tennessee	61.23
Rhode Island	60.76
Indiana	60.68
Missouri	58.13
Arizona	57.73
Florida	57.64
Vermont	57.47
Michigan	56.93
Maine	56.81
Louisiana	55.92
Oklahoma	54.01
Montana	53.16
Kentucky	52.60
South Carolina	51.98
New Mexico	51.79
Idaho	50.65
Alabama	50.42
Arkansas	49.13
West Virginia	47.92
Mississippi	43.16

Sources: BEA, USCB, Natixis

In the euro zone, the ratio is 1 to 2.6 (Table 2).

Table 2: Euro zone: Per capita GDP, by country (2021, in thousands of dollars)

Country	Per capita GDP
Luxembourg	112.78
Ireland	84.94
Netherlands	48.84
Austria	45.37
Finland	45.36
Belgium	43.68
Germany	43.29
France	36.66
Italy	30.15
Malta	28.31
Cyprus	26.68
Spain	25.50
Slovenia	24.77
Estonia	22.58
Portugal	20.84
Lithuania	20.00
Slovakia	18.11
Latvia	17.86
Greece	17.14

Sources: Refinitiv, Eurostat, Natixis

The upper level of the per capita GDP gap will be higher in the euro zone than in the United States, since labour mobility and the degree of federalism are lower in the euro zone.

Therefore, in the future, a larger gap between the per capita income of the rich and poor euro-zone countries is to be expected.

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