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Economic integration and political accountability

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Abstract

This paper studies to what extent economic integration, or globalization, influences the accountability of politicians. Assuming that politicians are controlled by the voters through reelection rules, we analyze to what extent economic integration affects the form of those rules and the efforts made by politicians. We define economic integration by the existence of policies and shocks interdependences between countries. Then, from a political point of view, this integration is shown to be a two-sided phenomenon. Shock-interdependence allows yardstick comparison, increases political accountability and therefore efforts while policy-interdependence induces a lack of responsibility and harms the extent to which politicians can be controlled.

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1. Introduction

For now more than half a century, the world has witnessed a trend of trade globalization (see Feenstra, 1998). In 1950, the volume of foreign trade¹ of the USA accounted for 3% of their GDP whereas it is now more than 12%. This movement has been even more substantial in the European countries where the ratio of exports to GDP is now about 25% for countries like Germany or France. The analysis of the economic impact of this sharp transformation has been studied in depth by

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¹ The volume of trade is here given by exports plus imports divided by two.

economists.² What we rather aim at doing is to concentrate on the political impact of globalization. More precisely, we will see to what extent the change in the economic conditions induced by globalization influences the nature of the relationship between citizens and their government and therefore the constraints the former can impose on the behavior of the latter.

The motivation for this analysis is twofold. First, we believe that the control of governmental activities is one the main problems faced by citizens. It leads us to analyze the actual behavior of politicians as the consequence of a *contract* (implicit or explicit) with the citizens of their country. In situations where the actions really chosen by the politicians are not observable, the knowledge of the economic environment is then fundamental to assess the compatibility of those actions with the contract. The second and joint motivation for this paper originates in that, with the recent trend of globalization, the economic environment of many countries has changed. The existence of business cycles, the interdependence of policies have generated the development of economic areas of countries facing, at the same time, similar economic conditions. The objective of our paper is then to express the link between several aspects of this economic integration and the degree of control voters can have on their politicians.

We will use a specific definition of economic integration which covers many (but not all) of the features of globalization. We define economic integration by two types of interdependence: the similarity in the exogenous economic conditions between countries and the links between the actions or the policies taken by the politicians.

The first effect analyzed, called *shock-interdependence*, reflects the similarities between the economic cycles of integrated countries. For example, France and Germany (or the USA and Canada) are more likely to be in the same cycle than the USA and France. Thus, we assume that economic integration goes hand in hand with a positive correlation of shocks (see Backus et al. (1994) for empirical evidences).

The second effect taken into account, the *policy-interdependence*, encompasses two ingredients we chose to treat jointly. The first one is related to the existence of externalities between countries. The budgetary policy of Germany has a major influence on the welfare of, say, France not only because those two countries are close geographically but also because they belong to the same economic area. Similarly, the efforts made to control the quality (or security) of the goods in a country have an impact on all the countries importing these goods. The second ingredient is the dilution of policy effectiveness arising in an integrated environment. In a globalized economy, many policies lack effectiveness because of standard eviction effects.

Taking those two types of interdependence as the essential features of economic integration, we focus on the following problem. Consider an economic area with several countries. In each of those countries, a government must choose an effort level, costly and unobservable, to increase the welfare of its citizens. In fact, the

² See Rodrik (1998) for a global introduction to the economic issues induced by globalization, Feenstra (1998) for the impact on employment and wages, Neumeyer (1998) for the global welfare analysis of Monetary Union in a general equilibrium model and Corsetti and Pesenti (2001) for the study of the monetary and fiscal transmission in interdependent economies.

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