The Peripheralization of Southern European Capitalism within the EMU

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Abstract

The paper discusses the problem of the Southern European (SE) capitalism and its difficult path into the EMU, looking at the remote causes of the crisis that hit these economies. For this reason, we consider European countries as a set of asymmetrically integrated variety of capitalism. The institutional configuration chosen by Europe to aggregate the many varieties of capitalism not only reduced the political autonomy of the single states, but effectively hindered the specific coordination mechanism of Southern European (SE) capitalism which was importantly based on state intervention as a structural element and on inflationary policies. Despite the deep market-oriented reforms this change caused both structural and macroeconomic unbalances. The aim of the paper is to integrate some principles of the variety of capitalism and the dynamics of institutional change with some insights inspired by the work of Arrighi to supply a synthetic and "alternative" perspective on the difficult role that Southern countries are experiencing in Europe.

JEL: P10; E61; R11

Key words: European integration; Models of capitalism; Centre-Periphery; Semi-peripheral countries.

1. Introduction: The difficulties of Southern European capitalism

Europe and in particular the EMU (European Monetary Union) has progressively seen the emergence of two peripheries: Former socialist countries and Southern countries. Such phenomenon became more evident with the recent crisis that in these areas had the worst impact in terms of instability. In particular, Southern European (SE) economies have experimented a thorny path into the EMU because of the difficulty to switch their inflationary regimes into some "rigorous" deflationary policy. That highlighted a fracture and some difficulty of integration between European capitalisms. The specificity of this model of capitalism, relatively to the Continent, that once allowed parallel processes of growth, today, exposed to a changed context, is producing severe difficulties.

The "narrative" of the present crisis has been framed in purely financial terms. It is said to concern public debts and banks' liquidity. Consequently, it is measured in terms of spreads on long term interest rates.[1] There is a surprising invisibility of real industrial and social damages (e.g. unemployment and the loss of production potential), which will have dramatic medium-long term effects. Consequently, the interpretation of the troubles of the euro as a problem of fiscal alignment or lack of fiscal discipline is a partial and institution-free view of European economies. We therefore propose an international political economy perspective joining the *models of capitalism* to the theory of *semi-peripheral* countries to supply a different view of the reasons behind the financial troubles of this area.[2]

The framework of *models of capitalism,* in particular that highlighting a "Mediterranean" or "Southern-European" (SE) model (Amable, 2000, 2003; Deeg and Jackson, 2007; Ferrera, 1996), can shed some light on the reasons of these troubles by focusing on this specific institutional arrangement in relation to its typical policies. The concept of *semi-peripheral* countries advanced by Arrighi (1985; 1990) and Wallerstein (1985) is also relevant[3] to understand the relationship between the specific process of institutional change and the specific economic difficulty of SE countries. The aim of this study is to connect the two theories to supply an original view of the institutional evolution of SE capitalism.

[1] The focus on finance is in part correct because, in the last twenty years, banks turned their investment from companies to families and started an absurd process of "debtors-making" in economies, which were fragile even without such incautious move.

[2] We keep Streek's definition of capitalism as "a set of interrelated social institutions, and as a historically specific system of structured as well as structuring social interaction within and in relation to an institutionalized social order" (Streek, 2010: 7).

[3] The framework of "variety of capitalism" cannot explain the dynamics of capitalism's crisis (Bruff, 2011, 2012).

The perspective proposed here is that deflationary policies have such negative impact in SE capitalism due to the weakened institutional set-up resulting from the reforms of the last twenty years. The structure of the work is the following: in section two, we expose the core-periphery problem in Europe. In section three we briefly recall the dynamic view of global capitalism proposed by Arrighi followed, in section four, by his notion of semi-peripheral country. The institutional arrangement and reforms of the SE countries will be presented in the fifth sections where an explanation of the connection between weak institutions and the crisis is proposed. The inflationary macro-dynamics of these countries will be contrasted to deflationary policies in the sixth section and some further dimensions of the present crisis are presented in the seventh. The final connection between the two perspective will be proposed in the concluding section.

2. The centre-periphery divide in the European regional system

The process of European integration has definitely reinforced the European regional system in the process of globalization, in particular after the Single Market and the adoption of the Maastricht Treaty. That has produced a partial denationalization of the member economies in different institutional domains (Sassen, 2003). However, this integration process has not been smooth and the EU, in order to enlarge the members' group, has accepted an increasing North-South divide (Gambarotto, Solari, 2009). This has introduced a weakness in the convergence process due to the difficulty to perform homogeneous policies in presence of regions with different patterns of specialization (high-tech industries vs. simple agglomeration of medium/low-tech industries, in particular in the South) (Krugman, 1990; Brülhart, 2000).

Following Krugman (1991, 1998), the increasing divergence among European regional economies can be explained observing the interaction of two factors: economies of scale and transportation costs. Low transportation cost and diminishing transaction costs caused by the EMU are determining an increasing spatial agglomeration of production inputs. Spatial clustering produces externalities like technological spillovers, labour market pooling, market size effects, and assues advantages for industrial specialization. Thus, this process of increased factors' mobility reinforces regional economic divergence and the production activity concentrates spatially to exploit economies of scale. That has also the effect of increasing regional exports and competitiveness. This core-periphery divide has been magnified by the EMU.

Up to the introduction of the euro Aiginger and Pfaffermayr (2004) did not perceive any concentration in industrial activities. This can be explained by the still prevailing gravitational force of central regions within each nation at that time. Nonetheless, in the last decade, national centres have apparently loss their force in favour of a polycentric, but very concentrated single core area in Europe corresponding to former West Germany (plus some other urban areas). This economic core is also magnified by the political force of the German government in imposing its policies and, above all, its interpretation of the crisis (Donnelly, 2013). As a consequence, we can now start reading Europe, at least the EMU, as a single space with a centre and its many peripheries.

Many scholars and European technicians expected EMU to produce a higher integration among the EU members. This process would have been achieved through a reduction of excess volatility among EU currencies, the foundation of the single European Central Bank and the creation of a new fiscal discipline for countries, especially for those belonging to the Mediterranean area. With the Maastricht Treaty, the EU forced all the Eurozone members to restructure national economies and increase European co-ordination. This effort was strategic to face globalization and to increase competitiveness (Salvatore, 1998; Blanchard, 2004). In such new institutional context, SE countries have assumed a strong commitment planning the introduction of reforms and addressing a change of their capitalism. The traced European pathway was to increase labour market flexibility, to reduce state intervention through privatizations, to reduce the welfare state benefits and to review the spending budget. From the EU viewpoint this institutional change was the necessary constraint allowing to create a convergence between the economies of the country members and to move on a growth trajectory with higher productivity, employment and output.

However, contrary to their expectations, the South-European EMU members have become a source of instability and, definitely the new EU periphery. This claim is supported by many scholars arguing that Maastricht parameters have not driven to convergence but to a deeper structural divergence (Eichengreen, 2009; Fiorentini, Montanari, 2012). Many regions have suffered the increased competition produced by the closer European integration and by the increased market openness and flexibility, causing an outflow of strategic resources. E.g., a more flexible labour market supplies incentives to the most trained people to spatially concentrate in regions where wages are higher. Similarly, investments prefer core regions where returns are higher (or less risky) and innovation activity is supported by a more "enabling" context (Martin, 2001; Thirlwall, 2000; Krugman, 1998). Only very speculative investments venture into the South – producing further instability (e.g. real estate bubble in

Spain financed by "continental" capitals). On the other hand, the "continental" big business is harvesting the best entrepreneurial activities of the South (e.g. fashion or mechanics).
Simply put, the result of the EMU is not straightforward. The basic idea – to be more competitive in the global economy designing a more compact capitalist system – cannot be easily realized by simply adopting a single currency without fitting the co-existence of different institutional patterns and regional dynamics to the increasing complexity of the macroeconomic context. The unsurprising scenario produced by the monetary union is that of a core-periphery economic model where inequalities tend to strengthen generating illiquidity crisis in periphery (Hall and Ludwing, 2010; Dunford and Smith, 2000; Reinert, 2013).

3. The evolution of capitalism according to Giovanni Arrighi

This outcome could have been predictable whether we had followed Arrighi's model on the evolution of the world economic system. From his theoretical viewpoint, in the future, we will not see emerging a single core-periphery world capitalism with a single leader country concentrating economic and political power but, more reasonably, a plurality regional areas composed by different sets of countries (Asia, European Union, USA, Latin America, North Africa,..) – enlarging through time – able to become a diversified production and trade area in the worldwide political and economic system. This means that the North-South divide will persist both *between* and *within* regional areas in order to maintain economic and political concentration (hegemony). In fact, the North-South divide represents a persistent core-periphery configuration necessary to maintain a global hierarchy of wealth production (rich and poor economic areas). From a systemic viewpoint this means that inequalities are a basic ingredient of wealth production when the latter is based on exploitation and exclusion in the use of scarce resources (Arrighi, Silver, Brewer, 2003).
Whether we assume capitalism as a system of accumulation and supremacy, we can say that its evolution is driven by the expansion expectations of a country, aimed to maintain or to become the leader of the world economy. The hegemonic role of a country is fostered by the cooperative attitude of its partners that look for favourable political and economic agreements aimed to guarantee the national wealth production. Nowadays, this reasoning can go well for the geographical evolution of capitalism just depicted.
Historically, the organization of the world economy evolves through crises. This means that after a period of economic expansion we observe a period of over-accumulation in which capital does not find a reasonable profit rate in production investments. The increase of

capital mobility fuels the competition among countries for financial investments, both public and private with the consequence of a decreasing attitude of cooperation at the world level. However, in this way, the leading country renews its role but, historically, this kind of crises are the prelude to a structural change in the world capital organization because a deep capital redistribution arises, with a new core-pheriphery configuration (Braudel, 1984; Arrighi and Silver, 2001).

Following Arrighi (1990), during the growth of capital accumulation we can detect three different phenomena: an increase in both competition between firms and rivalry of states; an escalation of social conflicts; the rise of new power configurations in the world system's gaps, leading to some institutional and cultural hegemony. Capitalism completes its renewing cycle when the hegemonic power has completely exploited its accumulation capacity.

Interestingly for the present European situation, Arrighi argues that when production investments are less and less profitable, capitals tend to prefer mobility (and liquidity) instead of embedding in goods and services. Theoretically, with a stronger competition, firms should invest capitals in technological and organizational innovation to obtain dynamic efficiency and maintain their profit level (Schumpeter, 1934), but that works well in a closed economy. Today, given that innovation is a risky activity with a tendency to diminishing return in the short run, capital owners prefer to invest in speculative worldwide activities. The consequent financial expansion produces a world system destabilization, i.e. a crisis, because it leads to capital over-accumulation that funds the re-organization of the world economy in such a way that a new cycle of production and trade cooperation relationships, i.e. new profits, starts again. During the crisis, a "demand of hegemony" arises from dominant groups, i.e. a demand of systemic order that becomes more and more compelling when crises are very harsh. Countries, or macroeconomic regions, compete to become the new power centre and to win the hegemony in political, financial and productive relationships worldwide (or in the specific regional context).[4]

Substantially, the systemic expansion of capitalism occurs by two different processes: when the profit levels of production are high, thanks to low competition (e.g. due to new market niches or because of oligopolistic markets) we observe a *cooperative attitude* among states. This means that there is an expansion of trade and production. When profit levels in

[4] This short way of accumulation (Marx, 1962), where capital does not pass through the production of goods, normally exploits government debt as mechanism of accumulation. During crises, fiscal revenues decrease and States have not enough incomes to finance public expenditure. They consequently increase their debt position in the financial market and they compete among them to acquire liquidity. Through this kind of competition we observe a financial expansion because of the up-warding of interest rates.

production decline, capitals are disembedded and states' rivalry rises. At this stage of the accumulation process we observe an increasing *competitive attitude* among states that feeds the increase of the financial interest rates. This is the stage of financial expansion. A new hegemonic cycle begins when new political relationships among states are consolidated and the strong competition for liquidity ends.

During the previous crises of capitalism we observed the rise of some peripheral country as new player of the hegemonic power (e.g. U.S.). In this competition for leadership, countries have to show their ability to concentrate financial and military assets by creating new institutions and new firms' organization. For example, the last hegemony shift, i.e. the decline of the UK empire and the rise of USA, was based on three basic ingredients: multinationals as new form of organisation, a series of technological innovations especially for military purposes, a new institutional setup called Fordism (including also Bretton Woods, FMI, WTO). The combination of these elements in the context of the bi-polar political system carried out by the Cold War produced a massive redistribution of capitals and also the setting up of new regional areas like the European Community.

The present financial crisis, apparently, is not exactly line with this configuration. Arrighi hypothesizes some anomalies in this last crisis that should be taken into account. The first one is that the surplus accumulation is concentrated in China, possibly the emerging hegemonic state.[5] The second is that multinational enterprises modify their organization and business models quickly in order to fit changings in competition. This means that instead of financing the established hegemonic order, as the trading companies did during the XIX century British leadership, they play their strategy independently from their state of origin, so that the new emerging leadership will have a weak capacity of system re-organization. Social conflicts that historically follow transition (to adjust social costs deriving from changing distribution of wealth and to modify the position of new social groups into society) have now arisen before transition.

Today, EMU is playing a peculiar role in this dynamics, with its reluctance to supply liquidity to the system. However, it is clear that the current phase of disembedding of capitals has severely hit SE capitalism, contributing to highlight its peripheral position in the emerging configuration of capitalism. The winding-up of activities and the outflow of capitals has been particularly more intense in SE economies. Liquid capitals moved to the core of Europe, in West Germany (and some nearby urban agglomerates), where they concentrated despite the low rewards. Other capitals have taken the direction of the US (e.g. FIAT). The

[5] But it has not a military superiority and it seems that it is not interested to have it; this means that financial and military powers could be splat.

denationalization and liberalization policies of the European Commission have made this process much easier.

4. The economic profile of semi-peripheral areas

The peripheralization of SE capitalism is only a step in the above process, but it should be red within it. It is difficult to detect the processes depicted by Arrighi and the other scholars who studied centre-periphery interactions in statistical data, but many economists pointed out the same idea. Raoul Prebish (1951) proposed his *law of peripheral abandonment* in connected territories, and Gunnar Myrdal (1957) developed the idea of "cumulative causation" also for the tendency of increasing depression of peripheral areas. Then Wallerstein (1979) and Arrighi (1985) in political economy and Rokkan and Urwin (1983) in political science attempted a (still not well exploited) *territorial approach to political economy.* All of them tend to state the empirical evidence that economic development takes place in a spatially non-homogeneous way. The fundamental tendency is that developed regions attract high value activities and peripheral areas are left with less profitable processes. The same idea has recently led Erik Reinert (2013) to trace a history of this approach back to von Thünen and List. In the context of development theories, Myrdal stressed the role of institutions, in particular the rigidity of local traditional institutions, as cause of retard in development. This kind of approaches go beyond the simple industrialist model of Krugman, introducing the institutional and political dimension.

In our case, the situation is different as SE countries after the Second World War found a way to cope with institutional changes required by industrialization and achieved a good level of income. The SE countries have been included by these authors in *semi-peripheral* category and, in our opinion, they can still (or again) be included in it despite the relative catching up performed in the last forty years. The problem is that with the recent evolution of capitalism and with the EMU, the solutions for catching-up became obsolete and no more viable.

In order to fully understand what is the meaning of "periphery", we can refer to Wallerstein (1979) who argued that the world economy is structured according to centre-periphery relations. Such relations do not link nations, but they connect production processes along the international commodity chains. Core activities are those that command a large share of total surplus, peripheral activities command a minor one. Consequently, distribution is studied between nodes of a network and not between factors of production. The regional dimension is given by the fact that for institutional and political reasons, which find an economic expression in locational advantages (positive externalities and high aggregate demand),[6] core activities tend to cluster in regions that in this way are called "central regions". Core activities, like high tech ones, are rare in peripheral regions while the situation is mixed in *semi-peripheral* regions.

Selwyn (1979) has defined periphery a region suffering:

- a lack of effective control over the use of resources;
- a comparative lack of local innovation (which is imported);
- a weakness of internal linkages;
- a weakness of information flows within periphery and from periphery to centre;
- migration outflows;

These criteria remain mostly valid as well as the fact that the government of a peripheral country is required to play a more important role than that of central areas in order to counterbalance these handicaps, which is an important point face to EU policies.

Development is a process of change in composition of economic processes from low value to higher value. A country can enjoy a diffuse high level of wages if it hosts a very high share of core activities. However, the technique to achieve an increase or even to maintain a certain level of value in economic processes is related to institutions, and in particular to those that allow to defend and redistribute value in the economy.

Arrighi and Drangel (1986: 22) argued that «*by restricting or enhancing the freedom of undertaking or entering specific economic activities, states can upgrade some activities to core status and downgrade others to peripheral status affecting the core-periphery structure of the world economy*». The capability of states to control access to the most remunerative outlets of all major commodity chains, to provide the infrastructure and services required by core activities, to create a political climate favourable to capitalist entrepreneurship are often limited by the interests of ruling classes or particularistic interests of political majorities. The state in difficulty to supply real advantages to business (which would affect the distribution of political power) tend to assure a low cost of labour or some weak enforcement of rules to keep profitability high (Rangone and Solari, 2012a). Some country has succeeded in upgrading (Japan), others have succeeded partially, but constantly risk downgrading (SE countries).

In this perspective of capitalisms' evolution, the Monetary Union has (involuntarily) induced a further phase of peripheralization in SE. Arrighi and Piselli explained that «*by 'peripheralization' we understand a process whereby some actors or locales, that participate*

[6] High costs at the core, low costs but less remunerative activities in periphery.

directly or indirectly in the world division of labour, are progressively deprived of the benefits of such participation, to the advantage of other actors or locales» (Arrighi and Piselli, 1987: 687). As a consequence, countries that entered the perimeter of the core already in the 1970s as Italy (Arrighi, 1990), or in the 1990s as Spain, tend to be limited in their capability to remain in such position. Portugal and Greece are even in a worst situation having partially failed the upgrading process (in the sense of strengthening of the supply).[7]

The South European periphery is therefore more affected than central economies by the "denationalization" and the submission to the limits on governments' decision making imposed by Maastricht and by the prevailing central ideology of prices and fiscal stability.[8] The supply-side policies proposed to cope with the crisis, such as labour market flexibilization and business liberalisation, tend to worsen the situation. The deregulation of markets, in fact, tends to wipe off not only rules oriented to keep profitability high but also those responsible for reducing uncertainty, leading to difficulties in long term planning by individuals and firms. They also erase the institutions responsible for anchoring value in territories to the advantage of central regions. The overall effect is consequently a downgrading of the production specialization because the high value added productions that are highly uncertain by themselves, are crowded out by low value added and low risk activities, that tend to proliferate in the absence of alternatives (Reinert, Kattel, 2004; Reinert, 2013).

5. The Southern-European model and its institutional evolution

To better understand the position of the SE countries in the European geography, we adopt the ideal-typical institutional configuration statistically depicted by Amable (2003) as well as by some other authors.[9] The specific historical development of this institutional set-up was due to late industrialisation and to an underdeveloped culture of political freedoms. These countries experimented a late and differentiated strategy of exit from agriculture-based economy, with an accelerated industrialisation (Fuà, 1980; Rokkan and Urwin, 1983). In

[7] Portugal actually was in a best situation as a trading and financial centre, it meets some difficulties in its new EMU context.

[8] The most evident fact is that the centre can easily comply or overcome many measures taken by central institutions, while the periphery has always to justify its lack of adherence to the abstract model and it finds difficulties to object to central decisions. In this way also the adhesion to WTO was a difficult measure to stop, even if it placed a differentiated stress to European production systems. That triggered a process of slow deindustrialisation of some country (Portugal, Greece, Italy) or some rise of social costs imposed to labour (rise its precarious status) to keep existing producing units (e.g. car industry in Spain).

[9] Bouaroudj et al. (2012) confirm the persistence of the model even after the reforms. See also Rangone and Solari (2012) for some application.

these economies the state had to assure some coordination able to sustain the industrial system of division of labour that the private economy was reluctant or unable to supply.
The economy developed in a dual way: large companies (private or state owned) in a static oligopolistic market and a very dynamic and expanding economy made of largely unregulated SMEs. Economic coordination was achieved thanks to some relevant state intervention by both specific regulation and direct investment. The latter could be seen as inefficient, but it was thanks to it that these countries recorded high growth rates and a reasonable distribution of income. Portugal actually enjoyed some high value managing activities of its Atlantic-oriented trades, but the rest of the economy experimented a slow process of development (Reis, 2010). Industrialisation was quite concentrated in a few regions in both Spain and Italy. Greece never succeeded to fully develop industry. Arrighi (1985) named these countries *semi-peripheral,* as they achieve a good level of growth but with a mix of high and low value added activities, in general framed by underdeveloped institutions and conservative social policies. Regulation and specific institutional arrangements helped to keep profitability high also in sectors that otherwise would have been exposed to high price competition.

Tab.1 Changes in the broad institutional configuration

	Standard model 1980-90	**Recent Reforms**
Labour market	Highly regulated labour market; high protection of employees	Flexibilization through increase of precarious contracts
Industrial relations	Weak institutionalization; non-collaborative industrial relations	Attempts of income policies failed
Product market	Deep regulation and control over of services	Selective deregulation
Finance	Bank-based system. Universal banks in Spain, separation in Italy	Spread of universal banking. Development of disintermediation fails
Welfare	Minimal, pension based. Universalist health care	Relative reduction of pensions. Some increase of unemployment benefits in Spain
State intervention	Wide direct property of banks, industry and public utilities; pervasive regulation and authorisation regime	Privatisation, deregulation. End of industrial policies

In order to clarify the trajectory of SE capitalism in the evolution of the UE economy, we have to trace its recent institutional change taking into account its path-dependency. We can focus on the form that this capitalism has taken after the return to democracy of three of the four countries in the 1970s and, in particular, after the adhesion of Greece to the European Community in 1981 and that of Spain and Portugal in 1986.

All Mediterranean countries previously experimented authoritarian regimes and some form of corporatism.[10] The deep role of the state in these economies was the result of industrial and banking rescues as well as of conservative regimes aiming at a forced modernization of these countries by exerting control over large concerns. The state in the 1980s was in this way proprietor of a large share of industrial groups and public utilities. Labour market was rather rigid with a high protection of labour and industrial relations remained weakly institutionalized despite several attempts to introduce "income policies" to curb inflation. Finance was bank-centred, with a large share of the banking sector politically controlled. A further major characteristic is what Ferrera (1996) called the *Southern model of welfare*, that is to say, a mix of universalist services in Health care and minimal social security mostly based on pensions, to complement the persisting role of the family and short social ties in redistribution.

When in the middle of the 1980s "liberal-progressive" forces took the lead of the European agenda, the actual privileged mechanism of governance became "system competition" and globalization. This change reduced the political autonomy of the single states, but in fact hinged the specific coordination mechanism of SE capitalism, which was importantly based on state intervention as a structural element and on inflationary pressures on aggregate demand as a redistributing as well as a propelling mechanism. Despite the intense market-oriented reforms (Rangone and Solari, 2012b), this reorganization led to some deep uncertainty and some coordination failure. The ability of institutions to coordinate the economy in a coherent way as well as their ability to keep high value activities anchored to the territory was lost.[11]

6. The painful turn from inflationary to deflationary policies

The institutional configurations of SE countries was coherent to the inflationary policy regime, that is to say, growth driven by expanding internal demand (tolerating some inflation). Such kind of expansionary strategy is well suited to the economy made of SMEs, which increase in number thanks to the expanding demand, but with low increases in productivity (horizontal growth). SE economies display a high share of employment granted

[10] See Bastien and Cardoso (2004) for a discussion of the Portugese case.

[11] Nonetheless, SE economies followed a kind of "liberal-market" model of reforms but, because of path-dependence, kept some institutional specificity relatively to the Continental capitalism (Bouaroudj et al., 2012). Institutional path dependence prevailed but with a loss of effectiveness due to the incoherent political coalitions oriented to maintain rent positions in an open context (Jackson and Deeg 2008; Amable and Palombarini, 2009).

by small producing units (Tab.2) in particular by micro-firms (1-9 labourers). This kind of production structure, fuelled by expanding demand, badly suffers the credit rationing and wage compression typical of deflationary policies. The loss of institutional coherence, described above, was also followed by a change of policy regime, which became deflationary under the guidance of the ECB. That is causing severe problems of deindustrialization due to the tough impact of the stop in the growth of internal demand and to reduced credit supply. On the other hand, large companies of SE economies tend to be fragile for the same reason of being peripheral to agglomeration economies and to hi-tech clusters and suffer from the relocation of capitals (as in the recent case of FIAT).

Tab.2 SME relevance in the economies

	Number of persons employed	Value added
EU 27	67.1	57.6
Germany	60.6	53.2
Greece	81.9	69.6
Spain	78.7	68.5
Italy	81.3	70.9
Portugal	82.0	67.8

Source: Enterprises by size class - overview of SMEs in the EU

http://epp.eurostat.ec.europa.eu/portal/page/portal/european_business/special_sbs_topics/small_medium_sized_enterprises_SMEs

The core-periphery perspective finds an answer also to the singular German fiscal policy (Simonazzi et al., 2013). The European regional disequilibria can be interpreted in two ways: as outcome of the German culture of stability, that through restrictive fiscal policies let it gain competitiveness, and as a result of the stagnation of domestic demand. As evident in fig.1A, for all the 2000s the German macroeconomic policy remained dramatically deflationary in a way it has never experimented before. All SE economies, on the other hand, display a "normal" internal-demand-led process of growth (fig.1 B, C, D, E) – even if in the last decade it was based on increasing private debt (Orsi and Solari, 2010).

Fig.1 Growth patterns, composition of aggregate demand increase 2000-2008

A. Germany

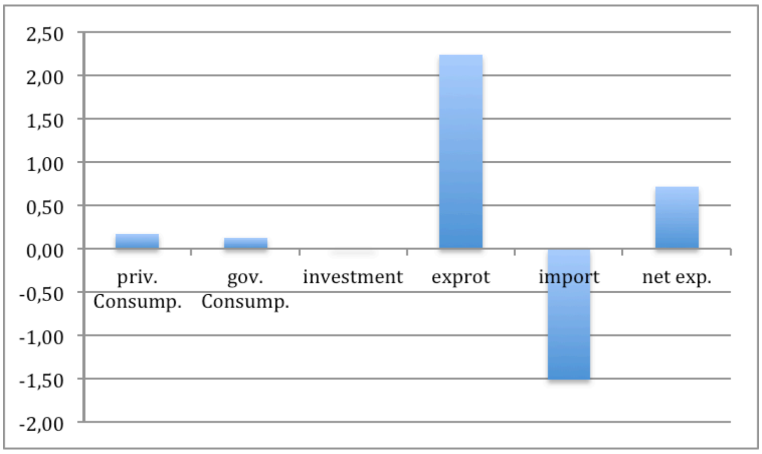
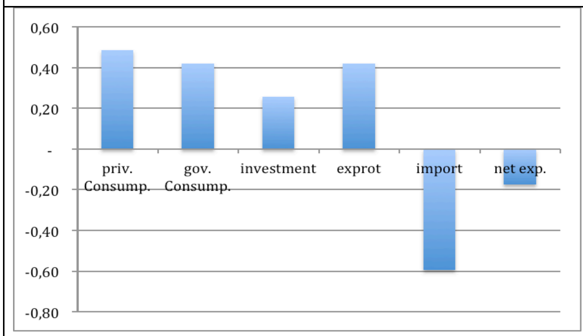
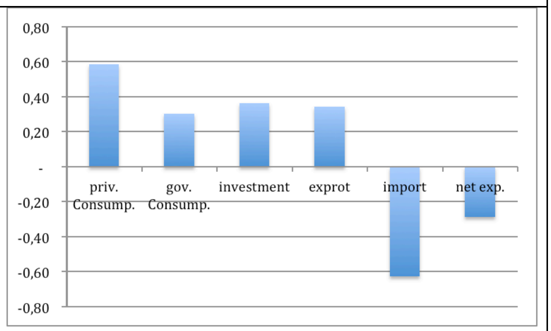


Fig.1 continued

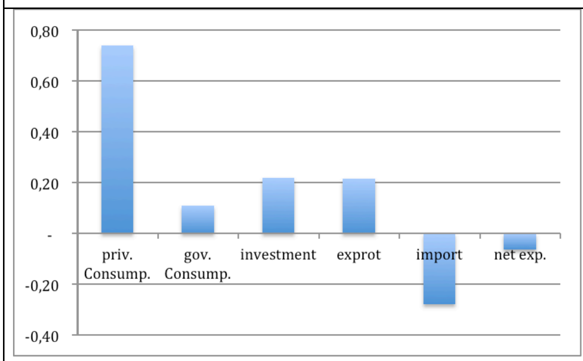
B. ITALY



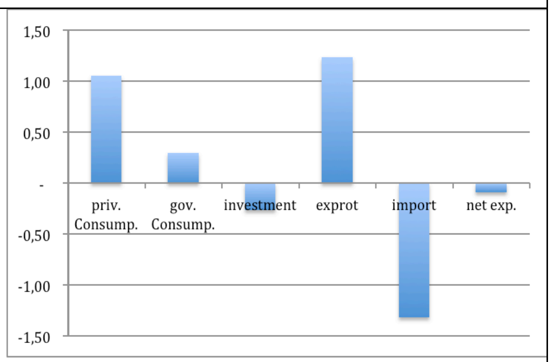
C. SPAIN



D. GREECE



E. PORTUGAL



We can simply note that such change in macroeconomic policy coincided with the introduction of the euro. Germany abandoned its income policies to adjust for unemployment - that was an increasing problem in the first part of the decade also due to unification - and was able to compensate the reduced demand with export. Therefore

Germany begun to act as a “centre”, with its strong exporting sectors, enjoying the inflow of valuable resources. On the other hand, SE economies (partially unaware of the changes, partially in difficulty to steer the economy), continued in their wage-led growth (Stockhammer and Onaran 2013) till the crisis of 2008, suffering from balance of payment deficits. Then, finally, they had to turn to deflationary policies, which cause the known depressive effect (apparently unexpected by EU) due to their production structure weaknesses.

Tab.3 Labour productivity and wages increase

	Labour productivity	Wage increase	Difference	Labour productivity	Wage increase	Difference
	1995-2000	**1995-2000**	**1995-2000**	**2001-2007**	**2001-2007**	**2001-2007**
Germany	1,8	1,7	-0,1	1,6	1,5	-0,1
Greece	2,9	6,7	3,8	3,1	5,7	2,6
Italy	0,9	3,5	2,6	0,2	2,8	2,6
Portugal	3,5	5,4	1,9	1,4	2,9	1,5
Spain	0,2	2,2	2	0,7	3,2	2,5

Computation on OECD data; Annual compounded growth rate

If we adopt a double level view of the processes, regional and European, we should consider the difficult interaction between the increase of German productivity (with low wage increase) and the low SE real productivity increase with an inflationary expansion of expenditure (tab.3). The fact is that the weak SE economy requires increasing demand to feed at least the internal market and to assure the viability of the economy. That was normally achieved by letting wages expand (Stockhammer and Onaran 2013), which in the new context became impossible due to increased openness and to some insufficient productivity increase. In the integrated system that strategy caused inflation (fig.2), which further decreased competitiveness (measured by unit labour costs). Fig.3 shows the real exchange rate calculated with the use of unit labour costs. The increase of real labour costs per unit of production (therefore related to productivity) determined a fall of competitiveness of SE economies of about 30% in twelve years, and that determined the demand for “internal devaluation” by EU authorities (which in turn makes peripheralization suddenly evident).

Fig.2 Harmonised Indices of Consumer Prices (HICPs) Eurostat

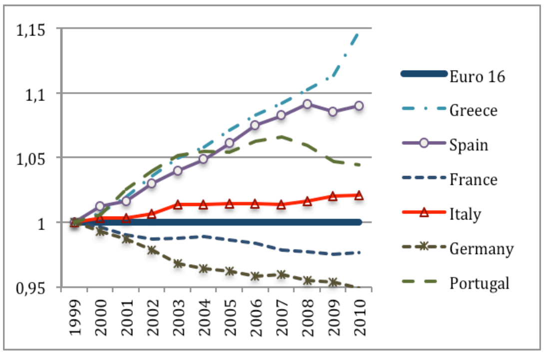
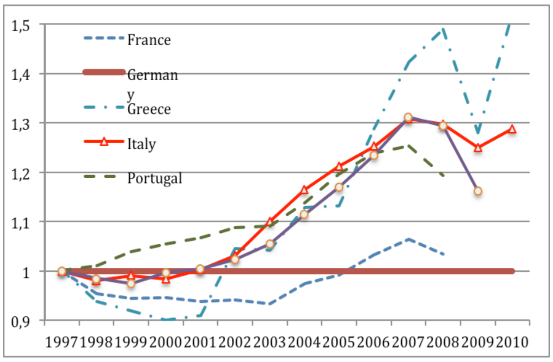


Fig.3 Real Exchange Rate Adjusted ULC (OECD) relative to the German

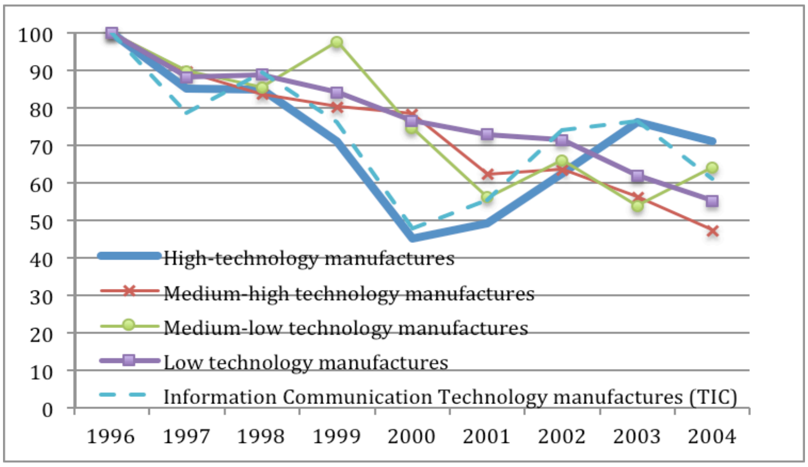


Computation on OECD data

One of the puzzling issues of this situation is why the European political process of unification left peripheral countries so exposed to external pressure (high competition on the sectors of their production specialisation). EU should have cared for the loss of compactness of European regions, but financial élites of both core and periphery were not particularly worried with this situation up to 2010. In fact, core regions reduced low and medium-tech imports from SE countries to increase them from East Europe and Asia (Simonazzi et al., 2013). After 2000 SE higher tech production export to Germany increased, but it takes many years to improve the technological profile of an economic system. Moreover, there is not room for everybody in the high-tech markets. Some core productions in SE economies have been reinforced, but the decline in value of medium and low tech production overcomes such amelioration by 5/1 (fig.6).[12] This had to be a crucial issue in the making of Europe.

[12] The ratio of the sum of high tech and informatics exports to Germany by the SE economies to their export of medium and low tech was 0,21 in 2004 (related to fig.5).

Fig.4 Southern Europe's share in Germany's imports



Elaboration of OECD data

From this perspective, it was a European political coordination failure to proceed to a further integration without keeping a certain protection to its medium-tech producing sectors. On the one hand, German car industry and chemicals did not need trade protection as they faced no rivals (and re-localised production mostly within Europe), on the other, textiles and other medium-tech productions of SE countries have been exposed to hyper-competition. Adhering to WTO Europe has caused a sharp asymmetrical shock to its production system, leaving a wide part of its producers in a very difficult situation of competition without rules to face low-cost-of-labour (and no rights and safety standards) countries.[13] That caused a restructuring of SE economies investment in a perverse direction. Consequently, the net effect, at the European aggregate level, is the unfolding of a core-periphery model of production based on exploitation and exclusion.

Our main thesis is that also these macroeconomic dis-equilibria reveal a further dimension of an emerging and intense centre-periphery relationship between central European regions and peripheral SE regions, which is badly regulated by both European and national institutions. Unfortunately, if these centre-periphery problems are badly regulated in the present European arrangement, they would be equally difficult to smooth with a politically unified Europe. In fact, they cannot be eliminated by structural funds of cohesion policies. Moreover, industrial policies would achieve poor results if not supported by a proper institutional framework able to resist centripetal forces. The actual problem is therefore the institutional arrangement that Europe can find to assure a reasonable pattern of growth to its periphery (without ending in separation and protectionism).

[13] Obviously, that happened also for many producers of Continental European countries.

6. Conclusion: the peripheralization of Southern European countries

The Southern model of capitalism lost its typical coordination form with the implementation of the EMU (and WTO), which required the dismantling of some typical SE institution and the opening to the competition of Asian low cost of labour competitors. That has produced some evident weaknesses in these countries. From the viewpoint of the concept of semi-peripheral capitalism, the EMU and globalisation have pushed SE countries back to the periphery crowding out their (not very firm) action of amelioration of the value of productions. If on the one hand we register some increase in high value added activities, the profit margins of the majority of productions soared causing their “degradation” towards deeper peripherality.

The core-periphery model of production is an unavoidable territorial configuration in the context of globalization – as argued by Arrighi. This geographical organization is the outcome of power configurations and it changes with variations in accumulation strategy. Apparently, this process also emerged in a wide space as the EMU due to the attempts to increase productivity and competitiveness of the European production system to better compete in the global one. This model is not sustainable in the long run because the more (some kind of) deregulation is performed, the more concentration of value takes place in a few regions drying up resources in periphery. The ability of the SE to increase competitiveness to resist these tendencies is limited due to the same liberalization reforms.

The suggested framework offers a different narrative pointing out of the persistence and increase of production and wealth inequalities among the European regions.

The increasing dualism in the European geography offers an economic scenario in which peripheral countries are bearing high social costs and welfare losses while core countries could balance the present gains with an unsustainable growth regime in the long run.

In order to balance the present regional disequilibria, the peripheral countries might introduce radical institutional innovations. This could be seen as an “impossible mission” because of both territorial and political problems that have not been discussed here. Moreover, institutional arrangements are not adjustable without a minimal democratic consensus and the timing of social inertia is difficult to calculate.

At the same time, a solution to the unfolding of core-periphery dynamics in Europe is increasingly perceived as important by the Southern population, but this requires new commitment among the European countries, different from that led to the though deflationary therapy. Indeed, the introduction to deflationary policies has literally smashed the mode of growth of peripheral countries and crowded out most of business working in traditional sectors. That let arose some problem of *territorial political economy* in Europe because many regions are facing a specialization crisis without having the instruments and the help needed. This problem goes beyond the macroeconomic impact of the crisis, it concerns the expectations, motivations and well-being of all the European citizens. The consequence is that only some institutional change, jointly with precise industrial policies aiming at re-qualifying peripheral economic processes, can help to improve the present situation.

An aspect, however, emerges clearly from the analysis of the situation: the framework of the national state and the governance of the EMU based on national polities in competition is a totally ineffective device to control centre-periphery dynamics. In this context it results quite problematic that a whole set of peripheral regions are governed by states exposed to financial controls. In order to govern and to counterbalance these forces we need some more centralisation in Europe balanced with some reinforced and autonomous regional powers. This would make, on the one hand, industrial policies more effective, on the other, it would allow some redistribution. The national state is not, at this point after denationalisation, a viable solution for European regional economies.

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