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Towards a European Division of Labour: Do Europe's Crises Highlight Structural Challenges to Sustainable Economic Growth in the Eurozone?

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The financial and economic crises of the last few years in many Southern Eurozone countries are generally studied individually, without reference to other such crises in the region. In this note, we argue that they may also be approached as symptoms of an underlying structural challenge facing the EU economy. In many ways the relationship between northern and southern Eurozone countries seems remarkably similar to typical economic centre–periphery relations, yet without the harmonizing role that a national government could play. The occurrence and combination of crises seems to be indicative of what one would expect from the adverse effects of centre–periphery relations among countries. Unfortunately, this would imply that the crises we are currently seeing are likely to continuously reoccur in the near future to the detriment of sustainable economic growth and political-economic stability in Europe.

Introduction

Several southern EU countries have been experiencing financial and economic challenges for quite a while now. First the Greek financial crisis was making headlines, then concerns about the debt of Italy, Spain, and Portugal, rising (youth) unemployment in some of those countries, and a general inability to compete with northern EU countries, came to the fore. Mostly, these challenges were addressed without reference to each other. For example, the means to deal with the Greek financial crisis – forcing banks to hold 9% of their capital in reserve, installing a €1000 billion emergency fund, setting up a tight budgetary supervision role for the European Commission, and cutting Greece's debt in half – are situated within the

context of financial markets and national policy. This is understandable. Such challenges may have a variety of country specific causes. Failing tax collection, poor policy choices, and an inability or unwillingness of politicians to convince the populace of the need for budget cuts (and acceptance by the latter) may all have domestic reasons.

We could, however, also approach these various financial and economic challenges in southern Eurozone countries as symptoms of a bigger, underlying structural challenge facing the EU economy rather than individual crises. If so, the occurrence and combination of crises seems to be indicative of what one would expect from the adverse effects of centre–periphery relations among countries. Unfortunately, this would imply that the crises we are currently seeing are likely to continue to occur in the near future, to the detriment of sustainable economic growth and political-economic stability in Europe.

A Long Overdue Comparison

National economies are frequently discussed in terms of a particular division of labour between industrial centres and often more rural, peripheral areas. In the Netherlands, for example, the Randstad (as the combined agglomeration of Rotterdam, the Hague, Amsterdam, Utrecht, and the cities in between is often called) may be contrasted with the more rural areas in the North, East, and South of the country. The relation between the economic centre and periphery is depicted by a number of characteristics and mutual dependencies. The periphery in general supplies the natural resources and manpower to the centre, the centre provides the knowledge and capital. In addition, whereas the centre produces goods and services, the periphery provides the market for these goods to a considerable extent. This relationship generally requires a nurturing role by national governments to ensure a redistribution of the profits made in the centre to the periphery, enabling living standards in the periphery to be similar to those of the centre. Only with such an effort is a structurally harmonious relationship between the centre and periphery possible and the sustainable economic growth and socio-political stability of a country is preserved. If this does not happen, the centre, because it structurally out-competes the periphery, would drain the periphery of its resources and labour, and would flood the periphery's markets with its products. This has negative consequences for the employment, purchasing power, and economic growth in the periphery.

In many ways the relationship between northern and southern Eurozone countries seems remarkably similar to the centre–periphery relationship we just described, yet without the harmonizing role that national governments may play. While it is hard to evidence the relationship, the series of financial and economic crises currently affecting many southern EU countries may be considered as indicative of what we would expect from the adverse effects of centre–periphery relations among Eurozone countries. Let us elaborate on how and why this is so.

First, while we mostly tend to look at the various problems of public debt and budget deficits in Greece, Spain, Italy, and Portugal as a matter of rampaging spending and governmental mismanagement of the budget,¹ it is no secret that the financial crises in those countries are also partly caused by the trade imbalance between southern and northern EU countries. Germany, for example, exports a far larger amount of goods to southern EU countries than these countries do to Germany. To illustrate, the 'German trade balance for 2009 was a surplus of 134 billion euros, compared to negative trade balances of 18, 28, and 51 billion euros in Portugal, Greece and Spain, respectively.'² While this benefits the German economy in general and its industry in particular, as the capital used to buy German goods flows back to Germany as profits, it hurts the importing countries because they become indebted while attempting to purchase German products without the necessary money to pay for these goods (partly as a result of a lack of export revenues, i.e. negative trade balance). Southern countries thus have to borrow money in order to level the balance and/or purchase foreign goods to retain a certain standard of living. The hope is of course that they will be able to repay the loans in the future; the risk being their ability to do so. What makes the negative trade balance relevant is that this direction of flows of goods and capital between northern and southern countries represents the way in which products and capital move between the centre and periphery within countries: products from the industrial centre to the periphery, capital from the periphery to the centre.

Second, the relatively high unemployment in southern countries as compared to northern countries could be seen as indicative of centre-periphery relations. According to Eurostat (September 2011), the levels of unemployment in southern countries are higher than those in northern countries, especially noting the double digits of Spain (21.2), Greece (16.7), and Portugal (12.3), among others. Basically, when northern industry outcompetes its southern counterparts, northern goods flood southern markets, causing southern factories to receive fewer orders and perhaps eventually close. This in turn leads to a loss of jobs in the south and higher unemployment levels. Over time, such a development would be in line with the function of the northern industrial centre as the provider of jobs, and the southern periphery as the provider of labour. In this respect, we may also expect to see certain work-related migration patterns and perhaps even a 'brain drain' from peripheral areas to the centre. The labour related migration from eastern EU countries to the Netherlands, Germany, and so on does seem to provide some evidence of this simple division of roles. However, a true brain drain in the south by the north still has to emerge. Nevertheless, the preconditions seem in place considering that unemployment in Spain for example seems to affect the young and higher educated relatively more and that they are also generally a rather mobile group. It may hence be only a matter of time.

Finally, if we look at the competitiveness of northern and southern EU countries (global competitiveness report 2009–2010 by the World Economic Forum), there seems to be a clear difference between countries. Whereas Sweden, Finland, Denmark, Germany, the Netherlands, the UK, and France rank 4, 5, 6, 7, 10, 13, and 16

respectively on a global scale, the Czech Republic (31), Spain (33), Estonia (35), Slovenia (37), Poland (46), Italy (48), with the likes of Greece and Portugal on ever lower positions, do notably worse.³ This cements the impression of a *structural* centre–periphery relationship between northern and southern EU countries. The figures imply, after all, that the centre is expected to outcompete peripheral areas for the time being. In turn, the flow of goods and capital between the centre and periphery is unlikely to change and reverses in trade imbalances are unlikely to emerge. It also implies that a structural upswing in employment in Southern countries is unlikely to occur. If we combine these statistics with the growing public debt in southern Eurozone countries, it seems that southern countries are increasingly hard-pressed to generate sustainable economic growth and maintain standards of living similar to those in the north.

Summing up, it seems that the various crises in southern EU countries may be perceived as symptoms of centre–periphery relations between the north and south of Europe, wherein the north-western countries of the Eurozone take on the role of the centre, i.e. as the owners of capital, hubs of knowledge, exporters of products, and providers of work, while south-eastern countries are beginning to play the role of the periphery, i.e. as providers of resources, labour, and markets. Without becoming deterministic, but assuming for a moment the presence of these relations, we may speculate whether we are witnessing the early beginnings of a European division of labour within the Eurozone (and perhaps even the EU). What if we consider the economic space between Paris, Vienna, Berlin, and Amsterdam as the industrial heart of the Eurozone while the rest of Europe assumes the role of periphery? What does this imply and where may it lead us?

Troublesome Trends

While we should be fully aware that the above comparison hardly provides the evidence for considering centre–periphery relations in the Eurozone as an established fact, it does highlight nicely how centre–periphery relations might manifest themselves between countries if a redistribution of income between countries is absent. If we assume the continuation of centre–periphery relations between northern and southern EU countries for a moment, foregoing any leap in productivity and competitiveness in southern countries, a structural challenge to sustainable economic growth in the Eurozone (if not the entire EU) becomes apparent. Two implications immediately jump to the fore in this regard.

First, a continuation of the relationship creates an increasing economic gap between the centre and periphery that eventually frustrates the economic well-being of both areas. If we consider only mutual relations (excluding those with the rest of the world) we may even speak of a poverty trap for the south if productivity is not somehow increased to northern levels. With its stronger economic base, the northern centre structurally outcompetes the southern periphery, adversely affecting southern industries. This implies a series of consequences for southern countries. It creates unemployment there, lowers wages, southern purchasing power, and tax revenues

and government budgets, and stimulates emigration to the centre of highly educated personnel. In this setting, retaining economic growth levels and northern standards of living in the south will become increasingly difficult. Southern governments could of course try to stimulate industry, kick-starting development. Yet spending money for such purposes harbours the risk of budget deficits if increases in productivity and competitiveness fail to materialize, due to, for example, bad investment choices. Southern countries would suffer from rather similar financial crises to those that we currently see. The use of exchange rates, such as between the US and China, is also not an option due to the single currency. Hence there is a structural trap for these countries to remain unequal Eurozone partner countries. Negative effects are not limited to the South, however. We may expect that such an imbalance also hurts northern economies because a decreasing southern ability to buy northern exports will negatively affect northern industry and economic growth. Hence if the north wants to sell its exports, it needs to maintain purchasing power in the south. In other words, sustainable economic growth in the Eurozone is dependent on mutually beneficial relations between the North and South.

Second, having the means in place for solving the current financial crisis is unlikely to prevent the reoccurrence of similar future crises. For example, even when banks hold sufficient reserves in capital stocks, there is an emergency fund, and tight EC budgetary supervision occurs, the underlying problem of Greece is likely to remain. Even debt cuts do not change its low productivity. The question is simply what the consequences of the austerity measures will be in the medium and long term. While the proposed measures are likely to bring southern government finances back to order, averting bankruptcy, the budgetary restrictions are likely to actually decrease southern purchasing power and its possibilities to invest in industries and competitiveness in the longer run. This harbours the risk of a rising gap in economic development between the North and South and creates the conditions for a continuous reoccurrence of financial and economic crises. The alternative, to accept lower standards of living, is also not likely to be accepted by Southern populations. It would also put strong pressure on the euro. The common fiscal policy, as intended from the EU summit of 9 December 2011, is also likely to fall short. While it may bring budgets under control and stabilize the euro, it is unlikely to address the adverse effects, such as negative trade balances and unemployment, of centre-periphery relations in southern countries. Moreover, the north would still outcompete the south to the latter's detriment. In this way, the currently proposed measures may only solve the problem from a northern short-term point of view. The fundamental question that the northern countries have to ask themselves is what costs more: aid packages to stabilize the euro or the loss of export revenues (and potentially jobs)? In the end, however, muddling through with the current monetary and fiscal Euro system might work for the North despite the occasional crisis that needs solving: lack of competition, exports free from tariffs, and the ability for northern politicians to blame their southern counterparts for all the misery. Only if a future financial crisis would result in too much negative economic fallout to northern countries or when unemployment in southern countries disrupts their and Europe's political stability, might an alternative be preferable.

A Demanding Solution

One possible solution to the structural challenge seems obvious: the redistribution of the centre's profits to the periphery along the lines we saw in the Dutch example. Within countries, wages are kept equal, government subsidies go to less developed areas, and the cost of living and taxes may be lower in the periphery. In this way the centre and periphery benefit from each other. One provides labour, the other work; one provides resources, the other capital; one acts as producer, the other as market. This possibility, however, seems to lack any kind of support. The idea that northern countries start sending money southwards seems to be several steps too far for both northern politicians and populaces at the moment. It is also highly unlikely that EU funds for rural development or other local socio-economic stimulation packages have the potential to alter economic fortunes in this regard. To further structural economic growth and political stability in the Eurozone in general and the periphery in particular, a redistribution of wealth from the centre to the periphery – but more than mere aid packages – seems an unavoidable necessity.

Notes

1. An additional troubling factor here is the often democratic unpopularity of government cutbacks. Which politician or party dares to announce far-reaching cut-backs when large portions of a society depend on them?
2. D. Francis at Deutsche Welle online (17 March 2010) at: <http://www.dw-world.de/dw/article/0,,5349490,00.html>).
3. Switzerland, the US, and Singapore rank 1st, 2nd, and 3rd respectively. Japan and Canada are 8th and 9th respectively.

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