The Peripheralization of Southern-European Capitalism within the EMU

Stefano Solari Contact *stefano.solari@unipd.it*
Francesca Gambarotto
Università di Padova, Department of Economics & Management

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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.

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1. Introduction: The difficulties of Southern European capitalism

Europe and in particular the EMU (European Monetary Union) have 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 diversity characterizing this model of capitalism relatively to the Continent that once allowed parallel processes of growth, today, exposed to a changed context, it is causing severe difficulties to the whole Europe.

The framework of *models of capitalism,* in particular that highlighting a "Mediterranean" or "Southern-European" (SE) model (Amable, 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. Also the concept of *semi-peripheral* countries advanced by Arrighi (1985; 1990) and Wallerstein (1985) sounds interesting to study the relation between the specific process of institutional change and the specific economic difficulty of SE countries. The aim of this study is to merge or, at least, to connect the two theories to supply an original view of the institutional evolution of SE capitalism.

According to students who analysed it, SE capitalism was distinctively based on a specific mix of structural and institutional ingredients: low and medium-tech product markets, a high labour market regulation, bank-based finance, an underdeveloped social security supplemented by a coordinating and a redistribution role of the family and, finally, a deep intervention of the state in the economy. Its difficulties can be considered a consequence of the institutional configuration chosen by Europe to aggregate the many varieties of capitalism. In fact, 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. Maastricht treaty's main institutional design was based on a subordination of government budgets to rigid ties and to the evaluation of financial markets. The bad effect of this subordination, due to the clashing logic of models, clearly emerged during the financial crisis of Greece and other Southern countries. It also had some evident relenting effect on Italy and Portugal since the end of the 1990s. This arrangement and the reforms it implied, not only reduced the political autonomy of the single states, but effectively hindered 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. That led to some deep coordination failure in the SE economies despite the intense market-oriented reforms (Rangone and Solari, 2012). This "disorganising" tendency has caused both structural and macroeconomic unbalances to these economies. This fact, amplified by other systematic asymmetries in the way monetary policy affects the single economies, led to a boom and bust trajectory of these economies (only bust for Italy).

The present crisis has been framed and contrasted in purely financial terms. This is due to the adoption of a "narrative" concerning the nature and dynamics of the problems totally built on a financial perspective. 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 social and economic 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.
The perspective proposed here is that the changed institutional arrangement, together with the deflationary policies, is responsible for the collapse of SE countries. The connection between institutional change and the weakening of countries' economic performance is the point discussed here by an original link between the theoretical perspective of variety of capitalism and the vision of evolving world capitalism proposed by Arrighi. The paper structure is the following: in section two we expose the different EU economic features *between* countries and the core-periphery structure emphasised by the globalization process. In section three we briefly recall the territorial dynamics of capitalism deepening the notion of semi-peripheral capitalism proposed by Arrighi while the institutional arrangement and reforms of the SE countries will be presented in the fourth and fifth sections. The inflationary macro-dynamics of these countries will be contrasted to deflationary policies in the sixth section. The final connection between the two perspective will be proposed in the last section.

2. The European Union as regional system and its centre-periphery divide

The process of European integration has definitely reinforced the European regional system in the globalization process, especially after the Single Market and the adoption of the Maastricht Treaty. However, the integration process has not been smooth and it also can be hypothesized that to enlarge the countries' group the UE has adopted a strategy to internalize costs of regional asymmetric income distribution accepting a *within* North-South divide (Gambarotto, Solari, 2009). This has introduced a weakness in the convergence process, with countries specialized in high-tech industrial activities and others, in particular the Mediterranean countries, characterised by the increasing agglomeration of low-tech industries (Krugman, 1990; Brülhart, 2000). This core-periphery divide was recently magnified by the EMU. 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 determine an increasing spatial agglomeration of production inputs. Spatial clustering produces externalities like technological spillovers, labour market pooling, market size effects, and promote advantages for industrial specialization. Thus, this process of factors mobility reinforces regional economic divergence and the production activity concentrates spatially to exploit economies of scale and to increase regional exports and competitiveness.
Up to the start of the euro Aiginger and Pfaffermayr (2004) did not perceive any concentration in industrial activities. This observation can be explained by the still prevailing gravitational force of central regions within each nation. In the last decade national centres have apparently loss their force in favour of a polycentric, but very concentrated single area in Europe corresponding to former West Germany. As a consequence, we can now start reading Europe, at least EMU as a single space with a centre and its many peripheries.

[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.

3. The evolution of capitalism according to Giovanni Arrighi

Many scholars and European technicians expected EMU to produce a higher integration among the EU members. This process would be passed 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 Capitalism. 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, South-European 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 expectations, the South-European EMU members have become the 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, 2013). Even if cohesion policies have in part mitigated the monetary effects on real markets, many regions negatively affected by market shocks have suffered from the addition of European integration and increased market flexibility. For example, a more flexible labour market supplies incentives the most trained people to concentrate spatially in regions where wages are higher. Similarly, investments prefer core regions where returns are higher and innovation activity is supported by a more “enabling” context (Martin, 2001; Thirlwall, 2000; Krugman, 1998).

Simply put, the expected result of the EMU is not straightforward. The basic idea - to be more competitive in the global economy designing a more homogeneous capitalism area – cannot be easily realized adopting a single currency but fitting the co-existence of different capitalism models of the European members to the higher complex macroeconomic context. The unsurprising scenario produced by the monetary union is that of a core-periphery economic model where inequalities tend to strengthen (Hall and Ludwing, 2010; Dunford and Smith, 2000; Reinert, 2013).

This outcome could have been easily predictable whether we had followed Arrighi’s model about the evolution of the world economic system. From his theoretical viewpoint, in the future, we will not see emerging a core-pheriphery world capitalism with a single leader country concentrating economic and political power but, more reasonably, regional areas composed by a set of countries (Asia, European Union, USA, Latin America, North Africa,..) – not fixed but enlarging through time – able to become a core production and trade area in the worldwide political and economic system. This means that the Nord-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 a wealth production when it is based on exploitation and exclusion in the use of scarce resources (Arrighi, Silver, Brewer, 2003).

The evolution of capitalism is thus driven by agreements among countries belonging a particular regional area and between different regional production systems. And this capitalism shifting is an historical phenomenon that expands through crises, the only phasing out strategy that capital accumulation stagnation normally arises after a period of strong competition among firms. During crises, financial capital becomes crucial to feed capital

accumulation but it also plays a crucial role for the rise of a country's political hegemony in the word system (Braudel, 1984; Arrighi and Silver, 2001). In this way the capital evolution fuels the core-pheriphery economic geography.

Following Arrighi (1990), during the growth of capital accumulation we can detect three different phenomena: an increase in firms' competition and in the rivalry among states; an escalation of social conflicts; the rising of new power configurations in the system gaps (institutional and cultural hegemony). Capitalism renews itself when the 'hegemony supply' 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 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 given that innovation is a risky activity, with a very diminishing return in the short run, they prefer to invest in speculative worldwide activities. The consequent financial expansion produces a word system destabilization, i.e. a crisis, because there is a 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 crisis time, it arises a "demand of hegemony" by dominant groups, i.e. a demand of systemic order that becomes more and more rigid when crises are very harsh. Countries, or macroeconomic regions, compete to become the new power centre and to win the hegemony role for political, financial and productive relationships worldwide.

This short way of accumulation (Marx, 1962), where capital does not pass through goods production, exploits the state debt as mechanism of accumulation. During crises, fiscal revenues decrease and States have not enough incomes to afford expenditures for public goods and services. They 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.

Substantially, the systemic expansion of capitalism occurs by two different processes: when the profit levels of production are high, which implies a low level of 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 production decline, capitals are disembedded and states rivalry dominates. At this stage of the accumulation process we observe an increasing *competition attitude* among states that feed the rising in the financial mark-up. This is the financial expansion stage. A new hegemonic cycle begins when new political relationships among states are introduced 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 rising of USA, was based on three basic ingredients: multinational as new firms' organisation, technological innovation especially for military purposes, new institutional setups (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 Union.

On the contrary, the present financial crisis does not seem to be in line with this known configuration re-organization. As Arrighi hypothesizes there are some anomalies in this last crisis that should be taken into account: the first one is that the surplus accumulation is

concentrated in China, the possible emerging hegemonic state.[2] 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 the state policies 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.

4. The economic profile of semi-peripheral areas

The peripheralization of SE capitalism is only a small part of 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" for tendency of increased depression of peripheral lands. 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. 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. Myrdal stressed the role of institutions, in particular the rigidity of local traditional institutions, as cause of behind development. In our case, the situation is different as SE countries found a way to cope with institutional changes required by industrialization and achieving a good level of income. The problem is that with the recent evolution of capitalism and with the EMU, the adopted solutions became obsolete and non viable. The Southern European countries have been included by these authors in *semi-peripheral* countries and, in our opinion, they can still be included in this category despite the relative catching up performed in the last fourty years.

According to Wallerstein (1979) the world economy can be structured according to centre-periphery relations. Such relations do not link nations, but they connect production processes along the international commodity chain (today we talk about "value chain"). Core activities are those that command a large share of total surplus, peripheral activities command a minor one; so 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),[3] 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 as 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;

[2] 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.

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

Finally, the government is required to play a more important role than in central areas 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 on rules to keep profitability high (Rangone and Solari, 2011). Some country has succeeded in upgrading (Japan), others have succeeded partially but constantly risk downgrading.
In this perspective of capitalism evolution, the Monetary Union has induced a further phase of peripheralisation. Arrighi and Piselli explained that «*by 'peripheralization' we understand a process whereby some actors or locales, that participate 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 failed the upgrading process (in the sense of strengthening of the supply).[4]
The South European periphery is therefore more affected than central economies by the submission to the limits on governments' decision making imposed by Maastricht and by the prevailing central ideology of prices and fiscal stability.[5] The supply-side policies proposed to cope with the crisis, such as labour market flexibilisation 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. 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 in recent times

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

[5] 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).

To better understand the position of the SE countries in the European geography, we use the typical institutional configuration depicted by Amable (2003) as well as by some previous authors.[6] 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 (Rokkan and Urwin, 1983). In these economies the state had to assure some coordination able to sustain the industrial system of division of labour which the private economy was not able 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. As a consequence, economic coordination was achieved thanks to some relevant state intervention. The latter could be seen as inefficient, but it was thanks to it that these countries record high growth rates and a reasonable distribution of income. Portugal actually enjoyed some managing activities of its Atlantic-oriented trading activity, but the rest of the economy experimented a slow process of development. 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.
Briefly, these countries did not contribute to fix the European welfare standard and they represent a systemic problem for the positioning of the EU in the global economy.
In order to clarify their role for the evolution of the UE economy, we have to trace their recent institutional innovation processes taking into account the coordination path-dependency. Above we said that SE countries are featured by late industrialization and with a deep role of the state (Sapelli, 1996; Fuà, 1980; Shonfield, 1965). For the issue studied here, however, 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.

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	Moderated 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.

All Mediterranean countries previously experimented authoritarian regimes and some form of corporatism.[7] 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. The state in the 1980 was in this way proprietor of a large share of large

[6] See also Rangone and Solari (2012).
[7] See Bastien and Cardoso (2004) for a discussion of the Portugese case.

concerns. Labour market was rather rigid with a high protection of labour and industrial relations remained weakly institutionalized despite several attempts to introduce income policy 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 minimal social security mostly based on pensions just to complement the persisting role of the family and short social ties in redistribution.
Reforms induced by EU and EMU plus globalisation did not find affinity in the institutional basis of SE countries so that convergence failed. Path dependence prevails because internal coalition driving to maintain rent positions (Deeg and Jackson, 2007; Amable and Palombarini, 2009) and social inertia slow down the institutional shifting.
At the same time, these countries have maintained their specificity in terms of institutional set-up despite reforms inspired by liberal-market regimes introduced to reduce the distance from continental model (Bouaroudj et al., 2012). As the state continues to have a role (Schmidt, 2008) in globalization, the new institutional framework appears failing the European coordination goal.

6. The painful turn from inflationary to deflationary policies

Institutional change is not the only cause of difficulty. Also the policy regime, strictly related to the institutional configuration, assumes an essential role. In accordance with Simonazzi et al. (2013), the centre-periphery perspective finds an answer to the mostly singular German fiscal policy. 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" demand-led process of aggregate demand growth (fig.1 B, C, D, E) – even if in the last decade it was based on increasing private debt.

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

A. Germany

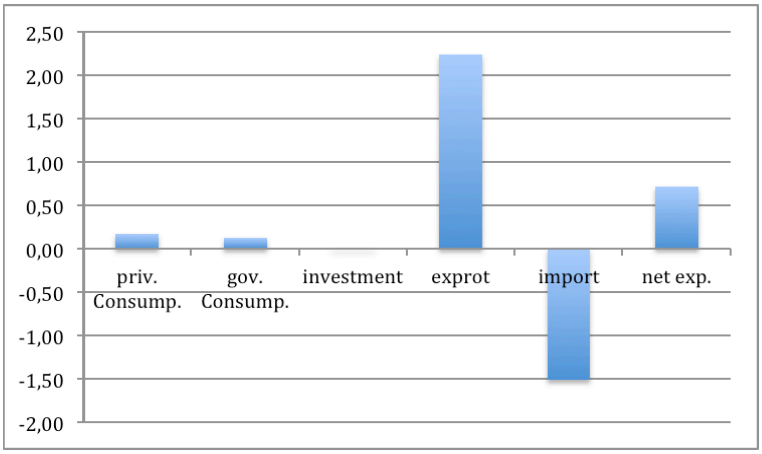
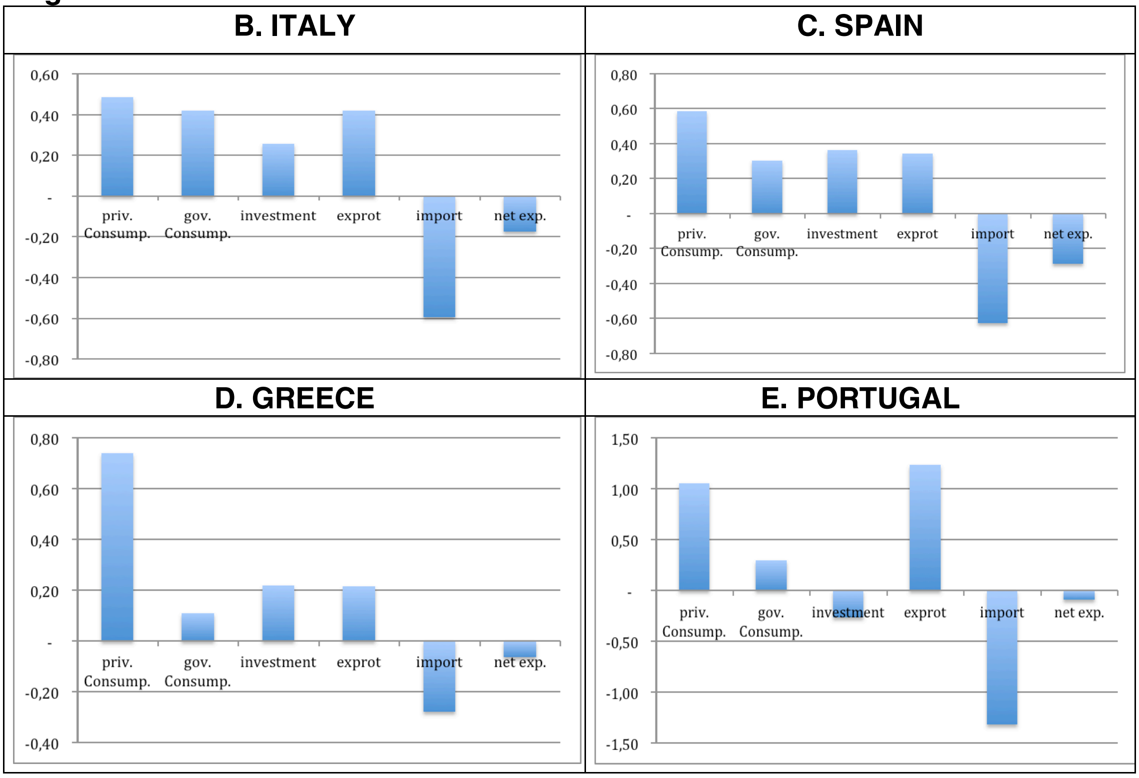


Fig.1 continued



We can simply note that such change in macroeconomic policy coincided with the introduction of the euro. Germany abandoned their income policies to adjust for unemployment, but was able to compensate with export. Therefore Germany begun to act as a “centre”, with its strong exporting sectors and enjoying the inflow of valuable resources. On the other hand, SE economies continued in their wage-led growth (Stockhammer and Onaran 2013). They suffered from balance of payment deficits and managed to sustain growth by expanding expenditure in an inflationary way, then, finally they had to turn to deflationary policies, which had the opposite effect compared to the centre due to their weaknesses.

If we adopt a double level, regional and European, view of the processes, we should understand the relationship between the increase of German productivity with low wage increase and the low SE real productivity increase with an inflationary expansion of expenditure (tab.2). 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 achieved by letting wages expand, which in turn pulled productivity (Stockhammer and Onaran 2013). 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 nit 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 30%-40% in twelve years.

Tab.2 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

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

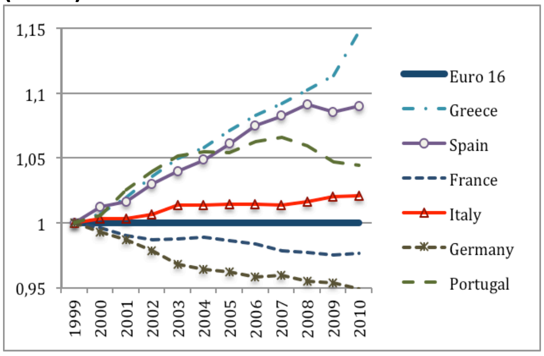
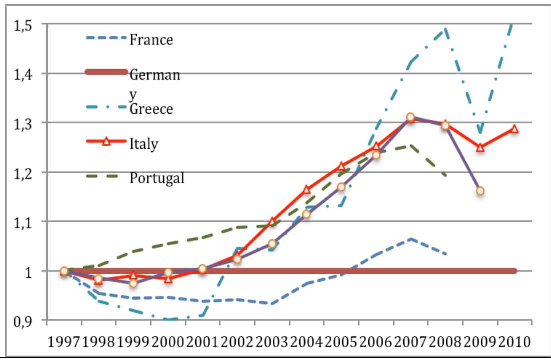


Fig.3 Real Exchange Rate Adjusted ULC (OECD) relative to the German



Computation on OECD data

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.[8]

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 solved but simply smoothed by structural funds of cohesion policies; on the other hand, industrial policies () would achieve poor results if not supported by a proper institutional framework able to resist centripetal forces. The real problem is the institutional arrangement that Europe can find to assure a reasonable pattern of growth to its periphery (without ending in separation and protectionism).

6. The evolving pattern of production in the South

The difficulties of the SE economies are mainly due to a situation of lock-in due to specialisation and exposition to international competition. SE capitalism is not only trapped on mature and medium tech productions. It is also experiencing a difficult transition towards services. As mature productions are partly re-located in other areas, service activities remain concentrated in former industrial districts. That supplies a false image of a service-based economy, which is simply given by the declining industrial production. In fact, the transition towards a service economy is not taking place in the high quality stable and increasing

[8] All that is also complicated by the existence of some relevant "peripheral region" in Germany as well as of some central region in the SE.

productivity services – concentrating in central areas – but it takes place towards precarious and low-value added activities which absorb precarious labour in non qualified activities.
Obviously, some exception exists: two Portuguese regions appear as developing some strong service economy but that does not help its own marginal areas in difficulty. As in the standard model of core-periphery, these semi-peripheral countries display difficulties due to the rising differentiation between high quality and low quality activities, facilitated by deregulation. The flexibilisation of labour market helps core sectors of semi-peripheral regions, but it also increases the quantity of marginal activities, leading to a negative aggregate effect. The result is a rising inequality. This can be indirectly seen in the figures of the "working poors" (fig.4).

Fig.4 In-work at-risk-of-poverty rate *(Source: SILC Eurostat)*

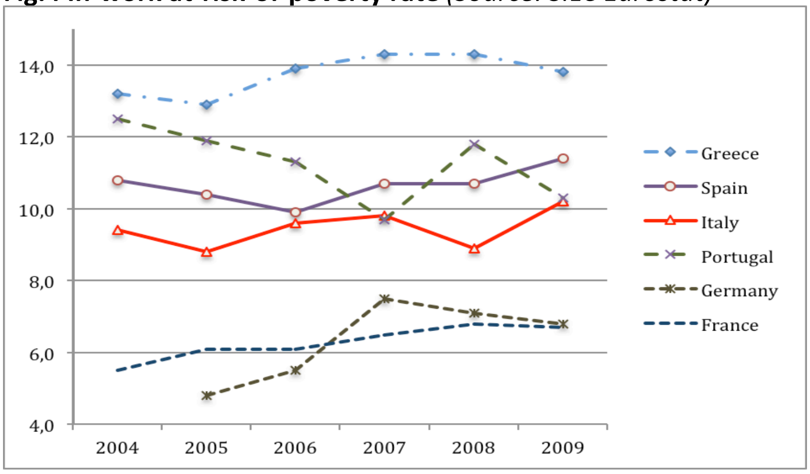
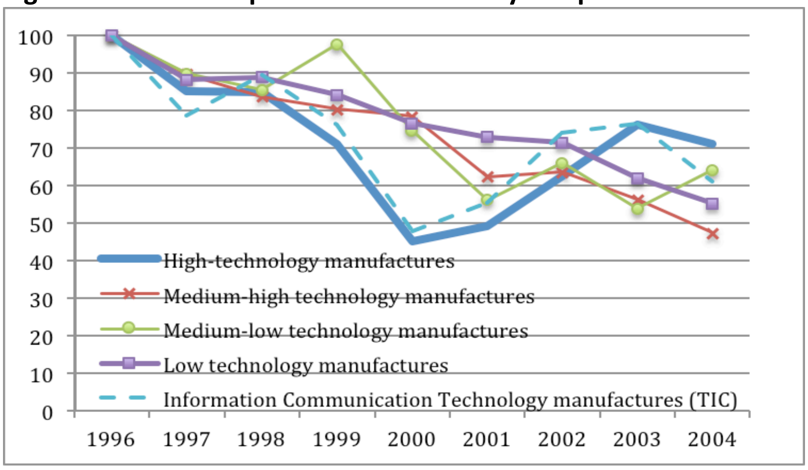


Fig.5 Southern Europe's share in Germany's imports



Elaboration of OECD data

One of the puzzling issues of this situation is why the political process of unification left peripheral countries so exposed to external pressure. The fact is that core regions are such more influential in political terms. On the other hand, 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. Core productions in SE

economies have been reinforced, but the decline of medium and low tech production overcomes such amelioration by 5/1 (fig.5).[9]
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 in Spain and Portugal), on the other, textiles and other medium-tech productions of Southern European (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 with low-cost-of-labour (and no rights and no safety standards) countries.[10] That caused a restructuring of SE economies investment in a perverse direction. The net effect, at the European aggregate level, is the persistence of a core-periphery model of production based on exploitation and exclusion.

7. Conclusion: the non-suitability of deflationary policies in semi-peripheral countries

The core-periphery model of production is an unavoidable territorial configuration in the context of globalization – as argued by Arrighi and Rokkan. Apparently, it also emerged in a wide space as the EMU and we know that this model states that the more deregulation is performed, the more concentration of value takes place in a few regions drying up resources in periphery. This framework can be useful to deepen the analysis of the persistence of production and wealth inequalities among the European regions and to focus on policies addressing the recent real economy shocks.
Peripheral activities and low value added regions are not only typical of SE economies, however, the latter contain a higher share of “weak activities” and a larger number of these regions. Moreover, SE central regions are no more very attractive. That let arose some problem of *territorial political economy* in Europe. This problem goes beyond the macroeconomic impact of the crisis. 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 situation.
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 institutions. That has produced some evident weaknesses in these countries. From the viewpoint of the concept of semi-peripheral capitalism, the EMU and globalisation have caused difficulties to SE governments in their 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 a “degradation” towards deeper peripherality.
These countries in the 2000s experimented an unbalanced catching-up thanks to private debt-led inflationary policies sustaining consumption and the demand for their internal production made of medium tech traditional products and services. The passage to deflationary policies literally smashed this mode of growth and crowded out most of small business living in traditional sectors.
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

[9] 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).
[10] Obviously, that happened also for many producers of Continental European countries.

more centralisation in Europe joined with some reinforced regional powers. This would make industrial policies more effective. The national state is not, at this point, a viable solution for European regional economies.

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