THE CAR INDUSTRY AS A MOTOR FOR INTENSIFYING INTEGRATION OF CENTRAL AND EASTERN EUROPE INTO THE EUROPEAN UNION: A POST-NATIONAL NATION-BUILDING PROCESS

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Nation-building under the conditions of globalization

There is a general belief in Asia, that the European Union (EU) is primarily an economic undertaking.[1] Foreign policy analysts therefore primarily address the politics of national governments where the "telephone number is known ", to borrow from Henry Kissinger's famous dictum. In this article, one aspect of the community building process in Europe, i.e. post-ethnic nation is addressed. The central argument is that the intensified economic integration despite being based on neoliberal principles, as with contemporary globalization, will lead under certain conditions to a stronger drive for political community building. That drive, it is claimed, is contributing to the emergence of a stronger European body politic.

Among the sure candidates for great power status in the emerging multipolar system, perhaps Russia and China fit into the type of ethnically constituted states so common in Europe since the16th century (in the case of China, with several ethnic minorities). European Union community building as opposed to an ethnic nation is not singular in its orientation, despite the ethnic dimension still being predominant in the Union.

Identities can be considered as invented[2] but are the result of social interactions. People do not learn about their identity because there are common traits like religion or language, but because on the basis of such traits compacts are made for promoting common interests. Such compacts or coalitions lead to the consciousness of an identity, as identity reduces

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1 Hartmut Elsenhans, "Two Superpowers in the Making: Dangerous Misunderstandings for their Trajectories: The Idealism/Realism Debate and the Perceptions of the Euro Crisis", *Foreign Policy Research Centre Journal,*13 (2013): 127-156. Hartmut Elsenhans, "European Union's External Relations: Nature, Priorities, and Issues", in Jayaraj Amin (ed.), *The European Union in a Changing International Order* (New Delhi: Kaveri, 2013), 125-173.

2 Benedict Anderson, *Imagined Communities: Reflections on the Origin and Spread of Nationalism* (London: Verso, 1983).

transaction costs in organization. T.K. Oommen's[3] explanation of the historical emergence of Indian nationalism is a good case study for understanding such a process. The majority of the Muslim community did not participate in the process of Indian nation building for fear of Hindu domination, therefore Muslims were largely absent for it was not in their interests.

In today's world, communication is less and less restricted by space, time, and especially not by language. Factors for constructing identities other than language or history have to be taken into consideration. They may be less palpable than the ones which were prominent in the last four centuries, but the weakness of factors secondary to community building were common in the pre-capitalist empires, which linguistically, ethnically, social structure wise, and even in the realm of religion were quite heterogeneous.

In the case of the EU, such a process of community building is under way. It is regularly documented in Eurobarometer surveys that the most economically and socially dynamic elements of European societies, particularly from the core regions, are highly inclined to perceive themselves as European and support the identity building mechanisms of this process. A coalition of hypercritical human rights activists, environmentalists, and other single issue campaign groups – all believe in the emergence of an era of post-national second modernity. Such sentiments are discernible in the European Union discourse, albeit coupled with a strong underlying commitment to their own economic advancement.

The contention of the author is that there is a contradiction between neoliberal globalization and economic convergence, even if neoliberal globalization is pushed to its very extreme as in the framework of the EU. The very process of neoliberal globalization creates new interests in political regulation: this shift to a new political dimension will lead in the case of the EU to political action in favour of state-moderated economic integration, which implies stronger institutions at the EU level. The process of convergence is built on elements similar to those at play in intra-nation

[3] Tharaileth Koshy Oommen, "Insiders and Outsiders in India: Primordial Collectivism and Cultural Pluralism in Nation-Building", *International Sociology* 1, no. 1 (March 1986): 53-74.

economic convergence, although EU social policies are characterized by patterns to be found in convergence between nation states.

The neoliberal model of convergence sees increasing specialization leading to convergence of factor prices and levels of development. If there are agglomeration effects, i.e. more favourable conditions of production due to sunk costs which provide cost advantages in strategically important branches of production*, convergence may be driven by economic liberalization but will ultimately succeed only if the disadvantages are compensated by a non-market intervention. On the one hand, there is the possibility of opting out from the integration process, the old argument of Friedrich List. Opting out would deprive the Central and Eastern European Countries (CEECs) of the advantages of easy access to the established markets of the economically more advanced member states of the Union. Non market-type intervention has to take place at the Union level. Therefore the prediction of this author is that the CEECs will opt for enhancing powers at the Union level and will be able to find support for the enhancement of centralized powers. Contradictions within the neoliberal globalization process, as manifested in the EU, will trigger a process of reinforcing regional identities against transregional economic integration and contribute to the augmentation of the political base for this process.

The relevance of the integration of Central and Eastern European (CEEC) economies into the European Union for explaining trends in the international division of labour

The integration of the CEEC economies into the European Union is a process which is closest to textbook interpretations of globalization. Obstacles to the movement of goods and factors of production, especially capital, have been removed very rapidly. Capital can migrate to the newly integrated production sites with their as yet cheap labour. Labour, especially skilled labour, have the choice to migrate to the areas of high wages in Northern Europe provided their skills match demand. Goods can move freely across boundaries. The EU, formally still comprises national economies, however, they are gradually but steadily eroding and transforming into structures normally associated with the dynamics at work in national economies.

* As occurs in the case of especially favourable natural conditions of production, but also in case of advances in technology creation, on which this contribution focuses.

The degree of integration is much more intense than merely the opening up of the core markets to the exports of an ambitious “periphery”. “Peripheries” outside the European Union often suffer from self-created hindrances in attaining liberalization. The newly industrialized countries for instance, have continued to impose restrictions on free economic flows, especially of capital. The CEECs on the contrary, had to accept the *acquis communautaire* and remove all obstacles to the creation of a common internal market of the European Union based on the free movement of goods, labour, capital and services.

This author’s analysis reveals simultaneous mainstream convergence processes and continuing heterodox differentiation processes that could be attributed to the agglomeration effects with high degrees of integration blocking convergence, as reflected in economic geography[4].

Agglomeration effects are improvements in the overall conditions of production which are owing to industrial production. Industrial production has the inevitable effect of bringing about changes in infrastructure, skills and sociocultural norms, which later on does not engender more costs. The simultaneous improvements are a result of the agglomeration of industrial activities and can be considered as lasting, because isolated advances in productivity in lone sectors in aspiring peripheral regions do not cause the same cost reductions.

Impressive growth performance of the CEECs

The process of European integration, especially the integration of the technically and economically less advanced CEECs, disproves standard theories of polarization within the framework of transnational capitalist structures. A great push in growth can be noticed while comparing the CEECs with the EU, the Euro area and the Newly Industrializing Countries. The reference years are 2000 and 2012. Gross Domestic Product at current prices has grown from 2000 (2000=100) to 2012 as follows: Slovakia 455, Romania 454, Bulgaria 395, Estonia 392, Lithuania 367, Latvia 365, Czech Republic 334, Poland 286, Hungary 268 and Slovenia 227, compared to the overall EU27 and the Euro area where it was just 195 in 2012. This increase in GDP over 12 years compares favourably to Asia: the average level (2000=100) in the newly industrialized countries of Asia in 2012 was 248,

[4] Paul R. Krugman, "Increasing Returns and Economic Geography," *Journal of Political Economy* 99, no. 3 (June 1991): 483-499.

with the second tier group of newly industrializing countries at 386, only slightly higher than most CEECs. China's increase is obviously phenomenal (701), but all European accession countries are higher than Taiwan (136) and Korea (145).

Tables 1 and 2 summarize some indicators of the CEECs' performance. The author has concentrated on the four most advanced CEECs – the Czech Republic, Hungary, Poland and Slovakia. Some patterns stand out:

- Foreign Direct Investment (FDI) plays a major role, with the CEECs showing nearly double the growth rates in world FDI and growth rates in FDI of the newly industrialized countries of Asia. The growth is similar to the second tier of newly industrialized countries of Asia. The ratio between FDI and GDP has increased from 29% to 58%. These increases are especially high in the smaller economies – the Czech Republic, Hungary, and Slovakia in comparison to Poland.
- Foreign Direct Investment growth rates and road vehicle export growth rates show a similar ranking: Slovakia leads, while Poland, the Czech Republic and Hungary are runners up. In export of machinery and transport equipment there was a slightly different ranking, with the Czech Republic being ahead of Poland. This can be attributed to greater diversification of the metal working and machinery industry in the Czech Republic. However, the share of cars in exports rose slowly, with a maximum of three percentage points in the case of Slovakia.
- There is a parallel upgrading of exports in machinery (metalworking machinery and special machinery), with Poland as leader followed by the Czech Republic. Very low increases, especially in Slovakia and Hungary, show that the connection between road vehicle exports and proficiency in high-tech machinery is weak if there is no broader economic basis. This fact is further illustrated by the low share of machinery in total exports in relation to the share of car exports. With less than half the share of cars in total exports, the newly industrialized Asian countries have achieved a higher share in export of special machinery and metalworking machinery than the four CEECs.

Table 1: The Race for Exports and Upgrading of Exports: Czech Republic, Hungary, Poland, Slovakia and the Newly Industrialized Countries of Asia

	Growth 2000–2012 (2000 = 100)										
Country or region	**GDP**	**Exports**	**Exports in high-technology**	**Foreign direct investment**	**Road vehicle export**	**Exports of machinery and transport equip-ments**	**Imports of machinery and transport equipment**	**Share of road vehicles in total exports (per cent)**		**Share of machine tools and metalworking machinery in total exports (percent)**	
								2000	**2012**	**2000**	**2012**
Czech Republic	334	538	888	630	595	659	452	15,5	17,3	4,9	3,5
– to EU28		507	839								
Hungary	277	367	341	452	403	328	239	8,8	9.6	1,6	1,5
– to EU28		338	293								
Poland	286	581	1188	684	667	637	292	9,8	11,3	2,3	2,4
– to EU28		517	824								
Slovakia	455	672	1144	800	740	935	418	20,6	23,6	2,5	2,1
– to EU28		625	1127								
Total 4 CEEC		519	603	619	609	533	368				
– to EU 28		483	669								
Newly industrialized countries of Asia	248	263	231	371	451	230	223	2,8	4,8	1,9	2,6
– to EU28		162	185								
second tier	386	261	166	457	805	178	235	1,5	4,7	0,6	1,2
– to EU28		161	118								
World	221	288	244	310	231	224	227	8,7	6,9	3,4	2,8

Source: UNCTAD, Merchandise trade matrix, product groups, detailed products, GDP by type of expenditure and value added by kind of activity, inward and forward investment stock.

- Although exports to the EU still play a major role, the growth of exports to regions outside the EU have become increasingly important. Growth performance is higher with regard to regions outside the EU, admittedly from relatively low levels to begin with.
- A new export profile is emerging. The share of labour-intensive exports in total exports has decreased substantially: in the case of Poland to about 60 per cent, and in the Czech Republic, Slovakia, and Hungary to 50 per cent of its 2000 level. In a mirroring process, the share of high technology exports increased in the case of the Czech Republic by 60 per cent, in Poland by 50 per cent, whereas Hungary and Slovakia show much lower levels of this indicator. Here, the share of labour-intensive exports decreases mostly to the benefit of medium technology exports.
- Although there is a clear upgrading in the level of technology of the

exports,[5] it is decisively lower than in the case of the newly industrialized countries of Asia. In Asia, high technology exports are around 40 per cent, albeit with a decreasing tendency. Both for the newly industrialized countries of Asia and its subgroup second tier (as defined by UNCTAD), the main growth sectors are medium technology exports. Medium technology exports also constitute the highest share of the exports of Poland and Hungary, especially exports to the EU.

- For all four CEECs, car making is very important. In 2012, the share of cars in exports was around 10% for Hungary and Poland, 17% for the Czech Republic and 24% for Slovakia, much higher than in the newly industrialized countries of Asia. Machinery and transport equipment are the main product groups (55 per cent of all the exports of the Czech Republic and Slovakia, 51 per cent of the exports of Hungary and 40 per cent of the exports of Poland), with a rise in the export of cars by Poland (2000=100: Poland at 667, the Czech Republic 595 Hungary 403, but Slovakia 740[6]).
- The ranking in growth of machinery exports does not match the ranking in road vehicle exports. Poland and the Czech Republic with more diversified economies, have outstripped Hungary and Slovakia in machinery exports, despite the high performance of the Slovakian car industry.
- All CEECs specialize in standard consumer durables. A look into the type of products shows that premium cars are still produced in the industrial centres of the EU, particularly Germany and France, whereas older models and standard cars are produced in the CEECs.[7]
- Qualitative descriptions of the East European car industry highlight its rapid growth but also its limited linkages with the local

[5] Laura N. Haar, "Industrial Restructuring in Romania from a Bilateral Trade Perspective: Manufacturing Exports to the EU from 1995 to 2006," *Europe-Asia Studies* 62, no. 5 (July 2010): 779-785.

[6] Lucia Kureková, "Success Against All Odds? Determinants of Sectoral Rise and Decline in Central Europe," *East European Politics and Societies* 26, no. 3 (August 2012): 652-54; Katarzyna Witczynska, "Deutsche Direktinvestitionen in der polnischen Automobilindustrie," *Osteuropa-Wirtschaft* 56, nos. 3-4 (2011): 237-244; Maria C. Latorre, Antonio G. Gómez-Plana, "Multinationals in the Czech Motor Vehicles Industry: A General Equilibrium Analysis for a Transition Economy," *Europe-Asia Studies* 63, no. 8 (October 2011): 1425-1447.

[7] Kureková, Ibid.

economy.[8] There is no research material in the EU statistics on those linkages. The experiences of other countries, such as Brazil, South Africa and China, show[9] that car industries correspond to a large degree to what the French development discussion had termed "industrializing industries".[10] However, UNCTAD data does not give any indication of these linkages. Sass and Szalavetz[11] place emphasis on the value chain of production model where the highly concentrated character of the industry does not allow higher value added activities outside the core factories of the value chain. The car industry replaces to some extent the first sector of specialization, namely textile industries[12], without constituting a basis of production from which further upgrading can ensue. In the case of the CEECs, the car industry does not play the role of an intermediate market for local machinery production.

- We can summarize the data for CEECs as an indication of the rapid growth of the car industry as a medium level technology production and underperformance in high-technology in comparison to other emerging economies. The competitive advantage in car industry is probably linked to the proximity of the EU market, and the strong presence of car producing Western companies, which can expand without serious hindrances despite

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[8] Marc Ellingstad, "The Maquiladora Syndrome: Central European Prospects", *Europe-Asia Studies* 49, no. 1 (January/February 1997) : 11; Latorre and Gómez-Plana, "Multinationals in the Czech", 1425; Annie Kahn, "L'Europe de l'Est perd de son attractivité au profit des pays méditerranéens", in *Le Monde,* 26 May 2009, 13.

[9] UNCTAD, *Structural Changes in the Automobile and Components Industry During the 1980´s with Particular Reference to Developing Countries* (Geneva: UNCTAD, November 1990); Hubert Schmitz, Ruy de Quadros Carvalho, "Automation and Labour in the Brazilian Car Industry," *Journal of Development Studies* 26, no. 1 (October 1989): 81-119; Inga Ivarsson, Claes Gölan Alvstam, "Technology Transfer from TNCs to Local Suppliers in Developing Countries: A Study of AB Volvo's Truck and Bus Plants in Brazil, China, India, and Mexico," *World Development* 33, no. 8 (August 2005): 1325-1344; Kenneth W. Grundy, "On Domesticating Transnational Corporations. South Africa and the Automotive Industry," *Journal of Commonwealth and Comparative Politics* 19, no.2 (July 1981): 160.

[10] Gérard Destanne de Bernis, "Industries industrialisantes et contenu d'une politique d'intégration régionale," *Economie Appliquée* 19, nos. 3-4 (July-December 1966) : 415-473; Wladimir Andreff, Abderrahman Hayab, "Les priorités industrielles de la planification algérienne sont-elles vraiment 'industrialisantes'?", *Tiers Monde* 19, no. 76 (October-December 1978) : 881.

[11] Magdolna Sass, Andrea Szalavetz, "Crisis and Upgrading: The Case of the Hungarian Automotive and Electronics Sectors," *Europe-Asia Studies* 65, no. 3 (May 2013): 491.

[12] Haar, "Industrial Restructuring in Romania", 784.

being non-European Union countries. However, in these non-European Union countries, the indicators for other products seem to reflect the fact that the car industry is used as a motor for industrial diversification by climbing up the production chain. Anecdotal evidence suggests that in the case of the CEECs the car industry provides high export earnings and, in comparison to the industrializing Asian economies, little incentive to transform.

Table 2

	Percentage in total exports							
	Labour intensive exports		**Medium technology exports**		**High technology exports**		**FDI to GDP in percent**	
Country or region	**2000**	**2012**	**2000**	**2012**	**2000**	**2012**	**2000**	**2012**
Czech Republic	17	8	44	45	15	24	37	69
– to EU28	17	9	45	42	14	24		
Hungary	12	6	25	38	33	31	49	83
– to EU28	13	7	39	39	30	27		
Poland	25	14	29	33	13	18	20	48
– to EU28	26	15	31	32	12	18		
Slovakia	19	9	37	43	19	23	34	61
– to EU28	19	9	38	39	12	22		
Total 4 CEEC	19	10	38	38	19	23	29	59
– to EU 28	19	10	38	38	18	22		
Newly industrialized countries of Asia	16	6	17	20	48	42	49	74
– to EU28	16	10	18	22	52	42		
second tier	15	9	11	17	45	27	26	30
– to EU28	20	14	13	17	49	36		
World	11	8	25	22	31	26	23	32

Source: UNCTAD, Merchandise trade matrix, product groups, detailed products, GDP by type of expenditure and value added by kind of activity, inward and forward investment stock.

- Import indicators corroborate this picture: In 2012, road vehicle exports from Poland reached 665, but machinery and transport equipment imports increased to 292 of the 2000 level, whereas the newly industrialized countries of Asia showed an increase of road vehicle exports to 451 with an increase of machinery and transport equipment imports only to 223. The second tier of newly industrialized countries of Asia achieved an increase of upto 805 in road vehicle exports and an increase of 235 for machinery and transport equipment imports, whereas Slovakia achieved 740 in car exports and 696 in machinery and transport equipment import. Imports were three times as much as that in its Asian equivalents. As the data does not take into account the non-exported part of car production, they can only be indicators for a presumably high dependence of car production on imported machinery in the CEECs.

- This indicator is complete when we factor in the imports of specialized machinery and metalworking machinery. Here, the CEECs compare favourably to the newly industrialized countries of Asia, however, not with the second tier of countries. As the more advanced newly industrialized countries of Asia can be perceived as importing such machinery increasingly for the non-road vehicles sectors, the high value in relation to road vehicle exports does not really provide much information. However, it is interesting to note that for the second tier the relation between the increase of special machinery and metalworking machinery in relation to the growth of road vehicle exports (275: 804=0,34) is much more favourable than in the case of the CEECs (257: 609= 42). The ratio between the growth of import of such machinery and the export of road vehicles is 25% lower in the second tier of newly industrialized Asian countries in relation to the CEECs. The CEE car industry earns a profit which allows the import of technology, whereas the East Asian car industry may earn less profit but has developed more linkages with the rest of the economy.

Why does a complex industry like car production not spill over into substantially growing local technology production, and instead reproduces an unequal international division of labour within the EU not so different from the pattern which critics from the Third World had highlighted in the case of import-substituting industrialization?[13] Nölke and Vliegenhart[14]

[13] Hiranyappa Venkatasubiah, *Indian Economy since Independence* (London: Asia Publishing House, 1958), 199.

[14] Andreas Nölke, Arjan Vliegenhart, "Enlarging the Varieties of Capitalism: The Emergence of Dependent Market Economies in East Central Europe," *World Politics* 61, no.4 (October 2009): 670-702.

have presented the concept of dependent market economies. Like practically all of the sociologically-inspired “varieties of capitalism” literature, the dependent market economy model identifies and describes characteristics which are explained as complementary, but without going into the causes which produce these characteristics.[15] The authors insist on the rigidity of value chains in the car industry under the domination of the West European car manufacturers and the affiliates of Western banks in those countries. Dependency appears as a fetter which limits an increase in incomes of the masses, limits skill enhancement through the national education system and limits the spread of technical skills. It is apparently the dependency on foreign exchange which imposes such fetters. Myant and Drahogoupil[16] have explained the reaction of the CEECs to the global financial crisis of 2008 in the light of the effects of foreign exchange scarcity on economies that have completely different modes of integration into the world financial markets and very different opportunities of earning foreign exchange. All these explanations share a reference to the unifying power of companies, even though it is not explicitly discussed. Hindrances to convergence appear owing to defects in the functioning of global capitalism which can be traced to increasing monopolization and financialization. Since the EU adheres to the norms of neo-liberalism it has difficulties in addressing these phenomena, as neoliberalism is the main motor of deconstructing nationally based political regulations of the market which could distort economic homogenization. Whereas political processes aiming at convergence of regulations are difficult to organize, neo-liberal strategies are easier to implement and the impact of volatile capitalism has to be tacitly accepted until a homogeneous body politic emerges at the EU level.

The author’s explanation regarding the hindrances to more broad based industrialization has provided material which can be discussed as the interaction between simultaneous processes which correspond to either neoclassical convergence or heterodox polarization in the real economy.

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[15] Hartmut Elsenhans, "Capitalism – An Achievement of Labour: Empowerment of Labour and Rising Mass Incomes as a Condition of Capitalist Growth," *Erwägen – Wissen – Ethik* 26, no. 4 (2014).

[16] Martin Myant and Jan Drahokoupil, "International Integration, Varieties of Capitalism and Resilience to Crisis in Transition Economies," *Europe-Asia Studies* 64, no. 1 (January 2012): 1-33.

Table 3: Transformation indicators

		Exports in per cent of GDP	Industry in per cent of GDP	Manufacturing in per cent of GDP	Machinery and transport equipment in per cent of manufacturing	Services in per cent of GDP
Czech Republic	2000	48	37	26	24	59
	2012	76	37	25	33 (2007)	60
Hungary	2000	67	32	22	27	63
	2012	87	30	22	31 (2008)	65
Poland	2000	27	32	18	15	64
	2012	45	33	18	21 (2008)	64
Slovakia	2000	54	36	24	20	60
	2012	92	35	21	28 (2008)	61
China	2000	23	46	32	14	39
	2012	27	45	31	17 (2007)	44
India	2000	13	26	15	16	51
	2012	24	32	18	18 (2008)	50
Indonesia	2000	41	46	28	20	39
	2012	25	44	27	18 (2008)	39
Korea	2000	35	38	29	41	58
	2012	56	38	31	48 (2008)	60
Malaysia	2000	120	48	31	38	43
	2012	85	41	24	41 (2010)	49
Singapore	2000	189	35	28	57	656
	2012	195	27	20	57	73
Thailand	2000	67	42	34	26	49
	2012	75	44	34	35 (2006)	44
Vietnam	2000	50	34	17	12	43
	2012	80	39	17	15 (2010)	41

Source: World Bank: Development Indicators, downloaded 1 May 2015.

Stabilization of inequality owing to specialization through good earnings

Suppose there is an economy that is lagging behind in the technological arena. It may have a few products which are competitive in the world market and the profit rates are highest there. In the neoclassical model, one can expect that economy to expand the production of those products. The production will increase, particularly if the use of foreign material in these products is low. The economy will react to saturation of its export markets by accepting decreasing foreign currency prices, possibly through devaluation of its own currency. As a result of the devaluation, the previously uncompetitive production lines will become competitive in the world market, hence their export production will increase. When saturation occurs, new products will accept decreasing foreign currency earnings. Further devaluation increases the competitiveness of other less productive sectors. In such a process of devaluation, total export earnings may, however, decrease. A decrease in total export earnings is rejected in such cases if there is a lack of perfect competition.[17] The rejection of perfect specialization is a major characteristic of the technologically less advanced countries which specialize in products with low price elasticity of demand. In this regard, the oil exporting countries are a prime example; however political conditions may play a crucial role. The threat of migration of the factors of production in the European Union, particularly labour with skills that may be in demand in other countries of the Union, depends to a great extent on political conditions that allow outmigration of labour without limits. Belonging to the EU has opened up possibilities of migration for the CEECs which are not available for non-EU countries. Within a region which has economic and political integration such as the EU, the spread of migration does not allow too high differences in salaries.

Despite the still substantial differences in labour remuneration within the EU (13:1, Belgium to Bulgaria, but around 5:1 if the more remote countries are excluded; Eurostat figures), the establishment of a Union-wide labour market reduces the possibility of regional wage disparities, at least of skilled labour. The requirement of maintaining social and political cohesion also limits difference in wages within the same region, in accordance with skills. The CEEC car industry, a highly productive sector, can be expected to earn foreign exchange at an already high international price of its labour and this leads to equilibria in the foreign balances (balance of trade or balance of payments or an overall balance of both) without allowing any further enhancement of the competitiveness of the rest of the sectors of production at the going wage rate.[18]

If there is resistance to increasing wage differentiation between the CEECs and the richer areas of the EU, further enhancement of competitiveness in the CEEC is hindered. Flows of capital from the core area and subsidies,

[17] Characterised by free access and exits of competitors and their flexible reaction to price signals so that scarcity rents are limited.

[18] Doris Fischer, "Comparing Transitions: Insights from the Economic Transition Processes in Former Socialist Countries for Sustainability Transitions," *Osteuropa-Wirtschaft* 55, no. 4 (2010): 300.

only augment the hindrances as they contribute to stabilizing the balance of payments even in cases of balance of trade deficits. As long as foreign exchange is available and the unemployment rates are politically tolerable, specialization in sectors largely dependent on imports can remain relatively stable, without extra efforts to move up the chain of production.

The internationally competitive sector earns good money, but has limited opportunity to invest its relatively substantial profits into the rest of the economy, where productivity is lower. This was an experience which many Third World countries went through in the 1960s, with foreign investors preferring to invest profits abroad instead of increasing linkages with the local industry. All the national regulations in the South imposing the compulsory use of local material, especially in the car industry, are based on the need for promoting higher productivity in the export sector and lower productivity in the rest of the economy. Here is where the suppliers of parts to the car industry come in. Wages in this sector, however, may not be high enough to promote technological innovation. This is what was described as the dualist structure of the post-1945 Japanese industry.[19] On the other hand, there may be no spill over effects from the highly productive sector to the rest of the economy as long as wages are not low enough to attract external capital into totally new sectors. The "Dutch disease" triggered off by the existing high performing sector implies low enough wages to keep local industries in the chain of value formation from being dynamic and high enough wages to stop new industries from being launched.

The post-1945 Japanese case indicates that such a duality may be overcome by a scarcity of labour created by competitive international labour costs in a variety of industries. Where productivity lags in relation to the leading economies in the world market greatly differ, devaluation has always been a convenient mechanism for combining low nominal wages in international currency with relatively high real wages in local purchasing power.

[19] Axel J. Halbach, *Multinationale Unternehmen und Zulieferindustrien in der Dritten Welt. Ihr Beitr. zum Aufbau einer Interdependenten Industriestruktur* (Frankfort on the Main and New York: Campus Verlag, 1985), 80; Rhys Jenkins, "Internationalization of Capital and the Semi-Industrialized Countries: The Case of the Motor Industry," *Review of Radical Political Economics* 17, nos.1-2 (Spring-Summer 1985): 72; Larry D. Qiu, Zhigang Tao, "Export, Foreign Direct Investment, and Local Content Requirement," *Journal of Development Economics* 66, no. 1 (2001): 101.

This mechanism of currency devaluation or low international labour costs, even in highly productive branches, is difficult to apply in the CEECs because of the possibility of labour outmigration to Northern Europe from the highly productive sectors of the economies with low average productivity. The mechanism of determining national average wages dependent on how labour-intensive is the job, which draws on Marx's labour intensity as against labour productivity, is no longer applicable. One basic mechanism of national integration is weakened. Membership of a politically and economically integrated international organization, such as the EU, implies the loss of the option of catching up by devaluation-driven export-led growth, although the accessibility of the higher income market in such a union increases earning capacity from exports for the emerging economies. The decisive element is not being part of the Eurozone, but the possibility of migration of skilled labour to high wage areas in case of devaluation.

Agglomeration effects work like natural monopolies. They provide the economy which enjoys them with comparative advantage. In the leading economies, such productivity increases do not lead to wage increases in those sectors which reduce costs for other sectors, without such agglomeration effects. An economy which is leading in technological innovation and is a leader in machinery production is also likely to be in the forefront in the production of innovative machinery. This machinery will be sold at its cost price, including the cost of further research for maintaining the competitive position of the enterprise. Productivity increases are transferred economically - in the form of the reduction of cost of production in the machinery-using branch - but not materially - in the form of the improvement of skills in machinery production - to the users of that machinery. Lower machine costs in relation to the performance of the machinery causes this increase in productivity. Hence, there are very large differences in physical productivity in technology production between agglomeration centres and the economies which have to build up such agglomeration centres. Productivity differences between two such areas in the utilization of technologies from the agglomeration centre are much lower. The comparative advantage of the leading economy rests with technology production and is transformed into price competitiveness as average wage increases are lower than productivity increases in technology production. Adaptation of relative prices, i.e. relatively lower increases of prices for machinery in relation to their increase in performance, keeps the advanced region from appropriating the economic gains of the users of its services. Under competition, the technology producing sector has to sell cheap. For the advanced economy to maintain the attractive specialization, it is sufficient that the users of the technology (including inside the country, abroad and in foreign currency areas) participate in the machinery's contribution to the increase of productivity in the production chain. Exchange rates, or the differences in labour costs, do not reflect the difference in performance in machinery production but are somehow more favourable to the users of machinery, normally corresponding to the differences in productivity in the utilization of technologies which are much lesser.[20]

Compensating agglomeration effects at the international level

The differences in agglomeration effects in accordance with specialization has been a major topic in theories of unequal development and imperialism. When the colonial and semi-colonial South after gaining independence acquired the political right to create its own frameworks for economic development at the national level, it was important to attract the structures which had emerged in the industrialized world in the wake of agglomeration effects. It was assumed that the mobilization of financial resources would create centres of innovation, a process discussed today as the development of national innovation systems.[21]

These attempts based on import-substituting industrialization ended in relative failure for three basic reasons. Firstly, the relation between production levels and technology development required large markets. Large markets are fundamental for spreading the cost of technology development for products manufactured on a large scale with a new technology. Secondly, in order to defend rent collecting, an opening to the world market on the basis of low supply prices was considered as a loss of financial resources for financing the national innovation system. The alternative of developing the internal mass markets was considered as

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[20] Explored further in Hartmut Elsenhans, *Saving Capitalism from the Capitalists: A Contribution to Global and Historical Keynesianism* (London: Sage, 2014) 156, fn. 49.

[21] Gunter Deuber, Falk Kunadt, "A New Transition for Growth in Central and Eastern Europe? Knowledge Policies as Vital Factors for Economic Stabilisation and Competitive Advantages," *Osteuropa-Wirtschaft* 55, no. 4 (2010): 262-268; Martin Myant, Jan Drahokoupil, Ivan Lesay, "The Political Economy of Crisis Management in East Central European Countries", 384.

politically costly, as it was seen as diverting resources from investment. The link between technology development and rising mass incomes was neglected. Thirdly, the discipline of the emerging ruling elite was not strict enough nor across the board, which resulted in increasingly corrupt practices in their own ranks. Corruption was tolerated as a mechanism of consensus building within the decision-making processes. [22] The commitment to development and social equality as professed by the resistance movements against colonialism, soon after independence became secondary to the need to address the requirements of capitalist competition, as had been predicted by the neoliberal opponents to state guided development policies (e.g. Bauer 1957).[23] Economies with low raw material rents like the East Asian Tigers soon had to abandon this pattern of channelling rents into innovation.

The new strategy of export-oriented industrialization involved an alternative model of rent mobilization - it was not simply economic liberalization. International competitiveness was achieved on the basis of low labour costs, initially in labour-intensive sectors with little technical requirements. (Low labour costs do not mean low real wages.) Depending on the definition of the basket of consumer goods (especially with regard to the question of the inclusion of housing), the purchasing power of wages, hence real wages were at least four times higher than the purchasing power of the wages (at the official exchange rate) in the importing countries of the West. Obviously, such massive devaluations were possible only if an increasing number of workers in the export industries could be supplied with necessities at low prices. As this local purchasing power was much higher than their purchasing power in the world market, the difference between what could be bought locally by these workers and what could be imported through their share in the value formation of the export industries had to be covered by additional local production.[24] Devaluation below purchasing power parity is possible only if the local economy produces a surplus of wage goods which could be

[22] Hartmut Elsenhans, "Dependencia, Underdevelopment and the Third World State," *Law and State* 36 (1987): 65-94.

[23] Peter Tamás Bauer, *Economic Analysis and Policy in Underdeveloped Countries* (Durham: Duke University Press, 1957).

[24] Hartmut Elsenhans, "Macroeconomics in Globalization: Productivity, Wages, Profits, and Exchange Rates in an Era of Globalization," *Brazilian Journal of Political Economy* 22, no.85 (January-March 2002): 66; Hartmut Elsenhans, *Globalization between a Convoy Model and an Underconsumptionist Threat* (Münster:Verlag, 2006), 229-239.

exported to the world market.

The costs of the agglomeration effects of the leading industrial countries were like a natural advantage, already amortised. It was compensated in the newly industrializing countries of Asia by a (indirect) subsidy to additional export workers paid for by the rest of the local economy. This subsidy took the form of low prices for the basket of consumer goods necessary for subsistence. Labour could be employed at lower international costs than necessary for its subsistence, achieved through imported subsistence goods. This was a means of transforming comparative advantage into cost competitiveness.

In devaluation-driven exported-oriented industrialization the rest of the economy has to supply the wage goods which are demanded locally. This requires some sort of obstacle to their export (e.g. tastes in the export markets, quality, etc.) or deliberate interdictions (e.g. a monopoly on food exports) by government regulations.

Devaluation is costly. It may be worthwhile to support “learning- intensive” sectors beyond lowering of the exchange rate and subsequent increase in the cost of foreign imports. It is especially attractive if the sectors chosen for technical learning are important as sources of input supplies, particularly semi-finished products or machinery. Earmarking locally produced semi-finished products or machinery for highly competitive export sectors, even at prices higher than imports from the world market, may be sustained by the already established export sectors at much lower rates of devaluation than would be necessary to make these semi-finished products and machinery competitive on the local market in comparison to imports.

Future costs of the intervention in favour of local production depend on the learning curve, which may be favourable enough to guarantee international competitiveness after a short delay. The CEE car manufacturers produce with imported technology but are not learning to produce the machinery for the said car production. Owing to the government’s ban on textile machinery imports, the Korean textile exporters of the 1980s had to pass on all their knowledge of production of finished goods to the initially not very efficient textile machinery producers. Due to the sheer size of the Korean textile industry, these producers became efficient in making machinery for the textile industry and subsequently also in machinery for other industries.[25]

Overcoming deficiencies in productivity in strategically important branches of technology creation when the leading economies are benefiting from agglomeration effects, implies government intervention. The convergence model of neoclassical economists is based on the premise that there are no permanent advantages from agglomeration effects in favour of such strategically decisive branches. This is opposed to the long-standing argument about polarization. Overcoming polarization depends on three elements: firstly, combining low international prices of factors of production, particularly labour, secondly, the neoclassical belief about specialization based on comparative advantage, and thirdly, on protective measures in favour of such strategically important branches. The less intervention there is in the market mechanism through any combination of the three elements the more efficient it will be in finding solutions. Interventions should be limited to the creation of "quasi-rents" in favour of technology production.[26] The neo-liberals point out that at the micro-level, it is difficult to determine which branches and enterprises should be favoured.

Unequal specialization and political vocation of the CEECs

It is improbable that the CEECs will opt for a strategy of devaluation as long as "dependent" development in close association with the growth poles in the core areas of Europe (the Blue Banana[*] and Western European Mediterranean coast) provide the Central and Eastern European region with sufficient opportunities for employment at acceptable wages. The attempt to create growth poles in Eastern Europe on the basis of agglomeration effects is not visible in the empirical research. The unequal division of labour between the CEECs and the growth poles of Western

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[25] Stephan Mark Haggard: *Pathways from the Periphery: The Newly Industrializing Countries in the International System*, Dissertation (Berkeley: Cal., 1983), 83; Lynn Krieger Mytelka, "The Transfer of Technology: Myth or Reality?", in Carol Cosgrove, J. Jamar (eds.), *The European Community's Development Policy: The Strategies Ahead* (Brugge: De Tempel, 1986), 259.

[26] Yilmaz Akyüz, Charles G. Gore, "The Investment-Profits Nexus in East Asian Industrialization", *UNCTAD Discussion Paper*, Issue 91 (1994): 11.

[*] The Blue Banana is a discontinuous corridor of urbanization in Western Europe with a population of around 111 million. It stretches approximately from North West England in the north to Northern Italy in the south.

Europe will continue. This entails the danger of being outsmarted in competition by areas outside Europe such as the newly industrialized countries and requires gaining greater influence in Europe to shape the region's role in world trade.

This exactly is also the danger the less dynamic branches of production face within a national economy. The suggested remedy is structural adjustment to new competitive challenges by upgrading the skills of labour. The experience of the EU countries indicates that upgrading of skills is not sufficient, for it can only facilitate the new growth which depends on launching new high-technology branches by increasing internal demand. Jobs are lost primarily not by delocalization of production but by self-inflicted limits to production increases.[27] New growth possibilities emerge not necessarily where they are needed, but depend on the growth potential of the highly productive sectors of the economy. Within a nation there is, in principle, labour mobility and when there is overall growth it leads to additional employment for the whole of the labour force. Where dynamic and less dynamic branches are regionally divided, labour cannot shift easily to new jobs outside its region. The economy with a high share of dynamic branches will experience low unemployment rates and perceive the high levels of employment as a result of its competitiveness. Dominant political forces in the dynamic economy will claim that joblessness in economies with less dynamic branches is owing to self-created hindrances which have to be overcome locally.

The danger of competition from areas outside the EU for the CEECs is often mentioned.[28] It is in principle not different from the danger of losing competitiveness which many industries, like textiles or shoe making, have suffered owing to the deindustrialization processes the leading economies have gone through in the last four decades. Where productivity levels

[27] Chang-Tai Hsieh, "Measuring the Effects of Trade Expansion on Employment: A Review of Some Research", in *International Labour Review* 107, no. 1 (January 1973): 1-29; Robert Rowthorn, Ramana Ramaswamy, "Growth, Trade and Deindustrialization", *IMF Staff Papers* 46, no. 1 (March 1999): 18-41.

[28] Deuber and Kunadt, "A New Transition for Growth", 268, similar configuration in Hartmut Elsenhans, "Social Consequences of the NIEO: No Change for Continued Reformist Strategies in the Centre without Structural Change in the Periphery," in Egbert Jahn, Yoshikazu Sakamoto (eds.), *Elements of World Instability: Armaments, Communication, Food, International Division of Labour,* Proceedings of the Eighth International Peace Research Association Conference (New York: Frankfort on the Main Campus, 1981), 90.

differ, branches of production that are technically advanced often determine real wages and the exchange rate. Less innovative activities may be crowded out. In any country, there are regions with better export chances and regions with lower chances of growth via external demand. There are two mechanisms for coping with this problem: internal migration or subsidizing backward regions in their shift to more remunerative activities. Both are financed through the solidarity of the national community, including the costs of social cushioning.

Within a national economy, the differences in physical productivities due to agglomeration effects are normally considered as natural, as under conditions of high employment, homogeneous factor remunerations, including wages, will emerge through migration. In case of high levels of employment, scarcity of labour will translate into rising wages also in sectors with relatively low increases in productivity. At high overall employment, the centre attracts labour from the weaker regions where labour can also become scarce. Migration curtails the tendency to regionally isolated wage increases in the agglomeration pole and favours wage increases in the weaker regions through decreasing availability of labour.

Equalization of factor remunerations despite differences in physical productivity development can be defined as an essential characteristic of a national economy whereas at the international level this equalization through migration does not take place. In order to present international specialization as a substitute for trans-border migration, the Heckscher-Ohlin-Samuelson model disregards the effects of agglomeration by making productivity alone dependent on amounts of capital employed in production.[29]

The mechanisms of compensating agglomeration effects at the international level cannot work in the presence of the unequal division of labour within the EU. Therefore member states have no other option but to opt for the national mechanisms of equalization of development levels and economic convergence. Following the rules of a national economy within an unequal division of labour is economically advantageous with regard to earnings for the less advanced economies. Purchasing power in the

[29] Paul A. Samuelson, "International Trade and the Equalization of Factor Prices," *Economic Journal* 58, no.230 (June 1948): 183.

international currency is relatively high for the CEECs in comparison to the second tier of newly industrialized countries in Asia. The West German–East German experience, however, shows that the transfer of agglomeration nuclei, even to an historically highly industrialized area, is not successful in practice. Despite the considerable successes of East Germany in catching up with West Germany, the centres of technological innovation have remained in the West. Following the rules of convergence in national economies requires that the aspiring regions and the established ones have an implicit national consensus.

One mechanism which forces convergence consists in making labour scarce in the poorer regions and providing more labour to the dynamic regions through outmigration. Massive intra-Union migration cannot help but challenge some of the major premises of the European integration process: if migration is desirable, the founding fathers of the EU did not expect it to increase to levels where the cultural or social profile of the receiving states would be challenged or where the regions of outmigration were transformed into permanently non-dynamic areas.

The principles of the (limited) social policies of the EU show that at the base of European social policy, there is the conviction that there should be migration of capital, but labour migration should not be excessive. There is total absence of coordination of wage policies because wage differences are considered important for promoting convergence through outmigration of capital to the economically weaker areas.[30] From the argument presented in this paper, it is clear that the productivity differences in sectors which create agglomeration effects remain too large to be overcome by differences in labour payments. Labour payments in the non-innovative region where there is no machine industry are too high: the general wage level is determined by average productivity and, hence, by the machinery using branches, the share of which is important especially in the regions that are catching up. Owing to the possibility of outmigration of skilled labour, there is limited political tolerance for income differences within a politically converging space like the EU. Sufficient differences in wage levels cannot be achieved, as in the case of countries capable of

[30] Hartmut Elsenhans, "Nation-building and Migration in the European Union: Convergence Precedes Migration or the Probably Deplorable Effects of Migration without Preceding Convergence: A Dissenting Note", *Migration, Education and Development in South Asia*, (Islamabad: Department of Anthropology, Quaid-i-Azam University, 2014), 11.

opting for delinking from the wage levels of the centre by devaluation and/or supply of large quantities of locally produced wage goods to their labour at very low prices.

The current crisis of the EU is just one aspect of this dilemma: the higher degree of the indebtedness of the southern countries is a consequence of their inability to follow in the footsteps of the core area, especially Germany, in fighting increasing unemployment through export surpluses at levels of labour remuneration which are politically tolerable. Ultimately, the surplus countries will have to finance the deficit countries, because at the national level (in any country) the regions of surplus do so for the deficit regions[31] while accepting the necessity of economic growth to provide the weaker regions with higher levels of employment and scarcity-driven instead of productivity-driven wage increases. The impossibility of reducing the international price of CEE labour to levels of the devaluation-driven non-European Union countries, requires the solidarity of the core regions with the weaker ones so that those mechanisms which operate within a nation can function. A courageous shift to such solidarity allows transfers in an orderly manner which in any case would have to occur. In the case of the EU, with its still strong national identities despite an increasing European consciousness, solutions won't come through increased migration but by reliance on other mechanisms of political intervention in the market.

Such policies require greater powers at the Union level. Whenever there are deficiencies in such policies, migration will increase. The more migration increases, the more the political basis for such powers for the Union increases: every push in migration creates in the core areas better structures for receiving new migrants and the number of the latter will assume more importance. The only alternative to economic redistribution between regions, i.e. more migration, will provide a political basis for support to increase the Union's powers.

Migration creates communities abroad, which are not given any say by national legislation in the affairs of the countries they reside in. It is at the Union level that they have representatives who can address their interests.

[31] Hartmut Elsenhans, "Für eine Erneuerung des Kapitalismus," in Detlef Nakath, Wilfried Telkämper (eds.), *Europa in der Debatte. Überlegungen aus linker Perspektive*, (Potsdam: WeltTrends, 2014), 81-89.

These voters are, in the defence of their interests, interested in strengthening Union level powers and will create a community of voters for EU institutions. As many of the immigrants are not allowed to vote for national parliaments, they will be interested in more powers for the European Parliament. In European capitalism, state building, especially with its welfare dimension, has been driven by the need to correct the imbalances of the market, especially as there are rarely any perfect markets. In Europe, the market did not spontaneously deliver for the masses. Rather it was the masses which imposed state regulations to make sure that they had a share in market-led prosperity. In a similar manner, the CEECs can soon be expected to support greater powers for the Union, underpinned by democratic legitimacy and an enhanced role for the European Parliament. The handling of the Greek crisis demonstrates that as opposed to the simplistic idea that European integration, including a common currency are non-viable, the contradictions within a basically neoliberal process of convergence will not lead to abandoning this process but to embedding it within a political structure appropriate for dealing with its negative effects. This configuration between, on the one hand, territorially converging political management and, on the other, the economics of market-driven integration, has historically been the alliance which formed the modern nation state.