CLASH WITHIN CIVILISATIONS

POLAND'S STRATEGIC CHOICES FOR INDUSTRIAL UPGRADING

CENTRE FOR INTERNATIONAL RELATIONS

Comment

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At a time when the headlines are dominated by civil war in Syria, anti-immigrant sentiment in Europe, and conflict in the South China Sea, people are inevitably reminded of Samuel Huntington's "Clash of Civilizations" thesis. He was partly wrong - there is no Islamic economic region or Confucian economic region. But he was also partly right - about the rise of economic regions. And the real clashes are occurring within these civilizations: between rich and poor, between the educated and the uneducated, and between the employed and the unemployed. In places like Syria those clashes are violent. In places like the United States and the European Union they are political. But they are clashes all the same.

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In 1993, Huntington argued in his article that in the future the "great divisions among humankind and the dominating source of conflict will be cultural". He specifically identified Western, Confucian, and Islamic cultures as the three civilizations that would clash. And he also said something else that was way ahead of his time: that globalization was not creating a single global economy. It was creating three regional economies: in North America, Western Europe, and East Asia. The rest of the world consists of economic outsiders, and most of those on the outside want to get in.

Economic regionalism

Economic regionalism is increasing. The proportions of total trade that were intraregional rose between 1980 and 1989 from 51 percent to 59 percent in Europe, 33 percent to 37 percent in East Asia, and 32 percent to 36 percent in North America. The importance of regional economic blocs is likely to continue to increase in the future. Huntington was right. Regionalism is increasing. Intra-European trade now makes up 70% of all European trade. In East Asia and North America the figure is well over 50%. These three regions, taken together, represent nearly 80% of the world's GDP. The big economic story of the last forty years isn't globalization. It's regionalization.

The European Community rests on the shared foundation of European culture and Western Christianity. The success of the North American Free Trade Area depends on the convergence now underway of Mexican, Canadian and American cultures. Japan, in contrast, faces difficulties in creating a comparable economic entity in East Asia because Japan is a society and civilization unique to itself. With such words, Huntington predicted an unresolvable civilizational conflict between Japan and China. Anyone reading the headlines today would think he was right. But anyone examining the data would know he was wrong. Japan is the number one source of foreign direct investment in China. It is China's number two export market and third biggest tourist destination. Today Japan is at the heart of an East Asian economic zone, clash of civilizations be damned.

And what about the civilizational conflict between the Muslim world and Christian Europe? A small number of Muslims engage in terrorism against Europeans. Many, many more engage in terrorism against other Muslims. Even more simply want to escape the Muslim world ... to Europe. They don't come to Europe for its "Western Christianity." They come to Europe for its economic opportunities.

The new economic geography

Global economic statistics are collected and reported at the country level. For Europe, this works reasonably well: the European Union can be broken down into 28 countries (soon to be 27). But European countries don't trade with each other the way they did 50 or 100 years ago. Countries used to trade with other countries. Now companies move goods from place to place, and when those movements happen to cross borders, we call it "international" trade.

Consider the aircraft industry. When World War One broke out, every major belligerent was able to make its own aircraft. The entire airplane supply chain could be encapsulated within a single country. Today that is no longer true. Consider the Airbus A380. It is "made" in France. But the wings come from Britain and the fuselage comes from Germany. The jet engines come from either the UK or the US. The avionics are French but include electronic components sourced from North American and East Asian commodity chains. The tires comes from Japan.

The A380 is a good example of a regional product. Like the A380, most complex manufactured goods are made mostly in one region and exported as finished goods to other regions of the world. In Western Europe, a "regional" product might be made in several EU countries. In East Asia a "regional" product might be made in China by a Japanese or Korean company. And in North America a "regional" product might be made mostly in one country, the United States. Since there are no customs borders inside the United States we don't know how "regional" a Boeing 747 is. But just as an Airbus is mostly made in France, Germany, and the UK, a Boeing is mostly made in Washington, Kansas, and Ohio. Only the Boeing final assembly doesn't show up in international trade statistics.

Nonetheless it is important to consider North America as an integrated region in the same way that Western Europe and East Asia are regions. When we think of the United States as a country and compare it to Germany or Japan, the United States is somewhat richer. Gross domestic product (GDP) per capita in the United States is 36% higher than in Germany and 69% higher than in Japan. But the United States is not a single economic unit. The Northeastern United States -- the core of the North American economy, running from northern Virginia through Washington, New York, and Boston -- is 50% richer than Germany and nearly twice as rich as Japan. In economic terms, if Germany were a US state it would be on a par with Alabama. If Japan were a US state it would be Mississippi.

The North American economy has a primary core in the Northeastern United States and a secondary core on the West Coast. It is perhaps no coincidence that North America's richest area faces east toward Europe and its second-richest area faces west toward Asia. This pattern fits very clearly into the hierarchy of the global economy. North America is at the top of the pyramid, Western Europe is slightly lower and to the east, and East Asia is even lower and to the west. But the center is North America.

Western Europe and East Asia may be physically located on the same continent. But it takes a container 30 days at sea to get from Yokohama to Rotterdam. It only takes 14 days from Yokohama to Los Angeles. Japan and East Asia are not to the east of Europe. In the economic geography of world trade, they are to the west of California.

EU and Brexit

When the United Kingdom voted on June 23 to leave the European Union, most people focused on immigration as the key cause. Some said it was xenophobia or even racism. And certainly immigration, xenophobia, and racism were major issues in the referendum. But the ultimate cause of the Brexit vote wasn't immigration. It was economics.

Around 3.2 million non-British EU citizens live in the UK. Two-thirds of them are working there. Only 1.2 million British citizens live in the rest of the EU. Most of them are retired. More British citizens work in the United States than work in continental Europe.

Imagine if the Franco-German core of the European economy were like the Northeastern core of the North American economy: 50% richer than the UK instead of roughly on the same level. Instead of 2 million Europeans working in Britain, there might be 2 million Britons working in Europe. If that were the case, would there have been anti-immigrant sentiment feelings in the UK? Would there have been a vote for Brexit? Britain's Brexit vote is merely a reflection of larger global economic patterns that create little incentive for Britain to tie itself to Western Europe.

It is not inconceivable that in the near future the UK may make a transition from being a part of the Western European regional economy to being a third core of the North American regional economy. After all, Los Angeles is six hours by air from New York. London is only seven. Britain's finance industry is already more closely tied to New York than it is to Frankfurt or Paris. The rest of the economy may follow. Even before Brexit, British investment in continental Europe was declining. British investment in North America is rising.

Where is Poland's place?

Practically speaking, countries like Poland don't have the option to join North America. Poland is to Germany what Alabama is to New York: a low-cost manufacturing periphery and cheap source of skilled labor. If Brexit cuts off Polish immigration to Britain, Poland may become even more closely tied to Germany, the Netherlands, and the other rich countries of the Western European core.

But there are two big economic differences between Poland and Alabama. First, Poland doesn't enjoy large fiscal transfers of the kind Alabama receives from the richer areas of the United States. European Union transfers and migrants' remittances together make up just 3% of Poland's GDP. That is significant and certainly welcome, but it is not transformative. Whatever Poland does to upgrade its position in the global economy, it must do on its own.

And Poland has the policy autonomy to do it. The second difference between Poland and Alabama is that Poland has fiscal and monetary independence. Alabama has been stuck in a monetary union with the Northeastern United States since the standardization of the US Dollar around 1870. Over the last 150 years it has grown at the same pace as the Northeast. It has never caught up.

Poland's goal should be to catch up, if not with the Northeastern United States then at least with Germany and France. It is well placed to do so. Its structural position in Europe is similar to the structural position of Korea and Taiwan in East Asia. Like Poland today, Korea and Taiwan were once low-cost centers on the periphery of the East Asian economy. Now they are part of its core.

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As a peripheral country that is well-integrated into one of the world's three major economic regions, Poland's development prospects are very positive. But Poland must avoid the Alabama trap. In order to develop, Poland has to upgrade its position, not solidify its position. The pace to look for lessons is East Asia.

Upgrade made in Poland

Upgrading is easier said than done. But it has been done before, and it can be done again. Korea and Taiwan are two of the best examples. Many economists who look at East Asia take away the lesson that exports are the key to growth. And exports did bring Korea and Taiwan into the global economy. Both countries started as low-cost exporters and steadily clawed their way up the value chain to become innovation economies.

But other countries also started as low-cost exporters -- and stayed low-cost exporters. Korea and Taiwan prospered by keeping their currencies undervalued as their wage levels steadily rose toward developed-country levels. Without central bank intervention, export success leads to a rising currency. Korea and Taiwan kept their currencies down and instead pushed their wages up. Rising wages forced their companies to invest in productivity enhancements instead of relying on low wages to stay competitive.

Poland should do everything possible to keep the Zloty, and to keep it at 4.5 to the Euro. If at some point a sudden Euro appreciation offers the opportunity to lock in a rate of 5, Poland should lock in 5. Poland's foreign currency reserves have tripled over the last ten years -- a sure sign of an undervalued exchange rate. That's good news. Poland should keep the currency weak and, if necessary, let its reserves triple again.

But Poland needs rising real wages to complement its low exchange rate. The weak exchange rate means that exporters can survive higher wages. Domestic firms can survive them too. Domestic employers will say that if wages rise they will have to cut jobs. And if each one was alone in increasing wages, it would have to cut jobs. But when wages rise across the whole economy, the private sector as a whole hires more people. Higher wages would push Poland up the European value chain. And if Polish wages rise, low-cost production will move farther east. Poland shouldn't resist this movement. Poland should lead it.

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Poland should push Polish companies to export low-wage work from Poland to Ukraine. Poland is already active in building Ukrainian civil society and educating Ukrainian students. The next step is to build the Polish business community in Ukraine. Instead of importing low-wage Ukrainian workers, Poland should be exporting low-wage jobs to Ukraine. Higher wages in Poland would help make this happen.

Poland should ask itself the simple question: where are my poor people? If the answer is "in Poland," that's the wrong answer. Poland's poor people should be in Ukraine and the rest of southeastern Europe. That's the way for Polish businesses to thrive while Polish workers thrive too. Don't import Ukrainian workers. Export Polish jobs.

Partnership with the East helps to go West

Today's global economy consists of three major economic regions surrounded by a large number of economically isolated countries. Russia and central Asia, India and south Asia, the countries of the Middle East and North Africa, the countries of sub-Saharan Africa, the countries of central America, and the countries of South America are all isolates in the global economy. All of them trade more with the three major economic regions than they do with their own neighbors.

Development strategy is much more difficult for outsiders like Brazil, Russia, and South Africa than it is for insiders like Poland, South Korea, and Taiwan. Outsiders are not embedded in major regional value chains. They have no clear path to climb and no obvious partners to pull up after them. Poland has a clear path to the west and is an obvious partner to the east - Korea and Taiwan were in the same situation a generation ago. Today Korean and Taiwanese firms employ tens of millions of low-wage workers: in China. They didn't import low-wage workers from China to staff their low-tech factories. As their domestic wages rose, they moved their low-tech factories to China. Poland should do the same.

Poland's currency independence gives it the flexibility to push wages up in Poland. As it does so, Polish companies will complain -- bitterly. Don't let them import low-wage workers from Ukraine. Encourage them to move their low-wage production to Ukraine. That's a win-win strategy for the people of both countries.

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Polish companies claim that Poland is now in the midst of a labor shortage. If they are right, now is the time to push Polish wages up, not the time to import workers to keep wages down. Companies will scream bloody murder. Let them scream. The goal of development is not to be the most profitable place for companies to operate. The goal is to be the most productive place. Low-wage, low-productivity work should be mechanized -- or pushed further east.

Wages up!

Inclusive development based on rising wages is the way to end these clashes within civilizations. Most of Europe -- like most of the world -- is moving the wrong direction. But Poland doesn't have to. With close European integration, currency independence, a weak Zloty, a strong labor market, and good relations with its neighbors, Poland has all the ingredients necessary for a successful industrial upgrading strategy. All it has to do is put all the ingredients in a bowl and mix them together. Higher wages are the heat that will raise the dough and cook the bread.

Poland doesn't have to embrace a position at the bottom of Europe's value chain -- and the class warfare that comes from such a position. It can move up the chain by raising wages. And it can pull Ukraine along with it. The obstacles in the way of such a strategy are not economic. They are political. Get the politics right, and the economy will follow.

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Centre for International Relations (CIR) is an independent, non-government analytical centre established in 1996 which deals with Polish foreign policy and the most important issues of international politics. CIR is active in research, education and publishing, organises conferences and meetings, and participates in international projects in collaboration with similar institutions in many countries. CIR creates a forum for debate and exchange of ideas in matters of international politics, relations between states and challenges in the global world. CIR's activities are addressed above all to local-government officials and to entrepreneurs, as well as to officials of the central administration, politicians, diplomats, political scientists and the media. In 2014, CIR was again recognised as one of the best think-tanks in East-Central Europe in the study "The Leading Public Policy Research Organisations in the World" conducted by the University of Pennsylvania.

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