

Industrial restructuring in Europe and the euro crisis

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The search for value

The European Union is struggling since the year 2000 to become, in the wording of the Lisbon strategy, “*the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment*”, and, after the failure of that strategy, and the global financial crisis, to put in motion, in the wording of the Europe2020¹ strategy, “*a smart, sustainable and inclusive growth*”. It is easy to find that “smart” is for knowledge, and “inclusive” is for “*fostering a high-employment economy delivering social and territorial cohesion*”; it is an old wine in a new bottle.

What is really looking for the EU, aside from the hype, to maintain this grand-plan?

¹ COM(2010) 2020, Brussels, 3.3.2010

In short, the idea that the only competitive possibility for the EU economy is moving upstream in the value chain, and at the same time achieving a high factor mobility and a high flexibility in combining these factors, according to the specific necessities of each industry and, more and more, of the single firm.

But for a better understanding of the situation, a step backward to the Delors *White Paper* (1993) and the first Job study (1994) is useful.

The Delors' White Paper

In the *White Paper*, that is the document illustrating the strategy to implement the Maastricht Treaty (1992), there are five critical areas to be tackled:

- I. the potential rate of growth;
- II. the continuous rising of unemployment, namely the structural one;
- III. the investment ratio and the weakening of the EU competitive position in relation to the USA and Japan.

What is interesting is that at the centre of the stage there is the composition of industrial structure, both in terms of traditional versus innovative industries, and of employment intensity. The first couple, traditional vs. innovative, is explicitly linked to a new role in the new international division of labour with the clear cut objectives of increasing the share of export markets, through R&D and innovation to be incorporated into tradable goods and the development of new products. What looks today unusual is the analysis of the relations between the growth pattern and the need to increase the employment level. It is clearly stated that there are two different perspectives, the level of growth and its employment content and

*“however, there are significant differences in the scope for progress towards faster sustainable growth and in that towards a higher employment intensity. In addition the social implications can be quite different and there are some important tradeoffs. It is therefore right to examine the degree of realism and the implications of the main different alternatives”*².

At that time this was considered a matter of political choice, but the alternatives devised are somehow manipulated in the form of : *“modest growth and very high employment intensity, and stronger growth and higher employment intensity”*; so stated, the choice is for a *“growth pattern combining a more modest increase in the employment intensity of growth with a stronger rate of growth”*. The logical chain considered realistic was:

*“there is no contradiction between calls for increased productivity growth in all sectors open to international competition and at the same time calling for measures which increase the weight of sectors where productivity increases are low. In fact, the process **whereby** the increased productivity emanating from the high-productivity sectors feeds through to all sectors of the economy is at the heart of any development model”*.

The “whereby” is a decisive condition because

*“as the wealth of a country increases, so can the relative importance of certain sectors, with usually a high labour content which help distribute the wealth so created and at the same time improve the conditions for additional increases in this wealth”*³.

In this answer all the features of what is known as neo-liberal orthodoxy can be found – namely in the proposals on the labour market and flexibility - but the structure of the industry was still at the centre of the scene, and the proposals were argued starting from the idea of an economy with two kind of sectors, with the two twin problems of employment and wealth distribution. In the first of the job studies *“macroeconomic and structural policies fostering innovation and firm creation played a secondary role”*⁴, but there was a significant convergence on the central role of

² White Paper on Growth, competitiveness, employment. The challenges and ways forward into the 21st century. COM(93) 700, 5 December 1993, p.40

³ Ibidem, p.38

⁴ Destefanis, S., Mastromatteo, G. – *More Jobs? A panel analysis of the Lisbon strategy* – CSEF- WP No 264, 2010, p.8

the labour market reform as a key to higher level of employment. Since then the evolution of the EU policies, along the road to the euro, became completely aligned to the OECD analytical and political framework.

The Lisbon Strategy was devised seven years after the Delors white paper in a situation of the EU extreme self-confidence; in the Presidency conclusions was stated: *“its best macro-economic outlook for a generation”*, but

“More than 15 million Europeans are still out of work. The employment rate is too low and is characterised by insufficient participation in the labour market by women and older workers. Longterm structural unemployment and marked regional unemployment imbalances remain endemic in parts of the Union. The services sector is underdeveloped, particularly in the areas of telecommunications and the Internet. There is a widening skills gap, especially in information technology where increasing numbers of jobs remain unfilled”.

The good macroeconomic situation is a chance for a *“quantum shift”*, that was translated in a shift toward the *“knowledge economy”* represented by the so-called *“information society”*, through a widespread utilisation of Internet and the development of the e-commerce. The catching word was *“innovation”*; on this ground a *“Research Area”* was built, still the most lasting and positive inheritance. Since mid-nineties there was in Europe a growing disregard of industrial manufacturing as a reliable foundation for the future of Europe. The fifth framework programme of research – 1998-2002 - was so conceived that the German government set up, together with the Italian government, a group of scholars to create a permanent observatory on the factory of the future⁵ and to start a political and scientific pressure on the Commission to restate, in the research funding, the central role of industrial manufacturing.

It is not by chance that since the Delors’ White Paper the problem of unemployment was defined as *“structural”*, meaning that it cannot to be reduced by raising the level of internal demand⁶:

*“Economic policy must therefore aim at fostering a higher rate of growth and, at the same time at encouraging investment so that it will grow faster than consumption. **This relatively slower real expansion of consumption** is the price that society must pay over the next few years to ensure amore equitable distribution of the access to gain full employment and to ensure its future overall prosperity”*.⁷

What should be done, therefore, is becoming more competitive globally by tackling the rigidities in the labour market and cutting labour costs, on one side, and, moving upstream in the value chain, on then other side. The budgetary analysis, besides, states that:

“Economic policy must therefore aim at fostering a higher rate of growth and, at the same time at encouraging investment so that it will grow faster than consumption. This relatively slower real expansion of consumption is the price that society must pay over the next few years to ensure a more equitable distribution of the access to gainful employment and to ensure its future overall prosperity. Higher investment would produce positive results over and above the mechanical relationship between capital and output just mentioned. It would, for instance, accelerate the incorporation of new technologies into the production process thus leading to more efficient and

⁵ I was one of the Italian member of that observatory; the observatory was set up after a bilateral meeting on the 4th and 5th of September, 1997 at Villa Vigoni – the site of the bilateral association, which was founded by the German Federal Republic and the Italian Republic. The observatory was active for some years.

⁶ But the proposal for a European programme of public investment in infrastructure.

⁷ White Paper on Growth, competitiveness, employment. The challenges and ways forward into the 21st century. COM(93) 700, 5 December 1993, p.43

more environmentally sustainable production. The competitiveness of the economy of the Community would be greatly enhanced.”⁸

As the late Smith (J., G., Smith, 1997:194) pointed out there are two fallacies in the White Paper “*namely that unemployment is primarily a problem of labour costs*” and that the way to a more labour-intensive European economy should be envisaged in “*a higher proportion of low-paid service jobs in the private sector, such as domestic service –in effect a reversion towards prewar society*”, dismissing for budgetary reasons “*the one plausible version of a more labour-intensive path for a relatively affluent society, one that would satisfy the demand for better public provision of education and health care*”.

Innovation

Private and public investments.

Since the Maastricht Treaty innovation is the key concept at the core of the European strategy. At the beginning it was conceived as way to maintain high level of employment, as well as to become more competitive. The Minsky criticism fits perfectly with that situation. He was depicting a high-profit, high-investment economy; the EU strategy added, as well as the USA, to this sketch the high-tech feature, as the critical key to select the kind of investments to be supported. Private investments supported not only by public money, through incentives and money transfer, but also, as Mazzucato demonstrated, through initial public strategic investments on the edge of the new technological trends, ICT as well as biotech or the internet-of-things or *Big Data*, to create the economic pre-requisites for successful private investments. It is worthwhile remembering Minsky commenting on the reception of Keynes’ notion of the socialisation of investment in the Post-war period; it was very critical on the path that was taken to reach full employment. To avoid the socialisation of the ownership of industry the choice was in favour of ‘*a large government sector, in part financed by deficits*’ (Minsky, 2008a:156), because it is possible to achieve ‘*an approximation to full employment (...) as long as government, through its budget, is big enough*’ (Ibidem: 156). The overall consequences were that

‘as the gap between consumption at full employment, even allowing for transfer schemes, and full-employment output must be filled with either government spending that uses resources or private investment if full employment is to be sustained, measures to induce investments by increasing profitability have been insinuated into the tax and spending systems. Thus a high-profit, high-investment economy has been created in which tax and government-spending policies are evaluated on the basis of their impact upon private investment rather than on the basis of their impact upon consumption or equity respect to income distribution’ (Ibidem: 156). It was, says Minsky, ‘*a socialism for the rich*’.

This was also the period of the idea of the dematerialisation of the economy as whole.

Later on, innovation is considered the way “to rejuvenate” the old and boring manufacturing, to make a leap in the upper part of the global value chain, through the new manufacturing model. In this framework innovation was, at the beginning, considered as a synonymous of high-tech, later on, both corporate governance and industrial organisation were upgraded to the status of key innovations, and more recently the possibility of radical rethinking of traditional business models are considered a source of successful competition. The inherited features of the previous conceptual scheme, employment and social dimensions, were redrafted and morphed into the competitive agenda, as employability and flexsecurity.

⁸ Ibidem, pp. 43- 44

Technological intensity vs. product-cum-services production.

Technological innovation, besides, should be critically assessed. If the first assumption, in the EU model, is the radical belief that development means innovation, the second one is that innovation is born of basic research and will result in the availability of high technology.

Consistent with this approach the degree of intensity in R&D or technology as defined by the OECD distinguishes industries into four categories: high, medium-high, medium, low, low technology. The use of this classification has long attracted critical reflections. Without entering into a theoretical discussion of what is relevant for the purpose of this article is that the technological intensity is not the only possible criterion of innovation and therefore the idea that Europe should focus on high technologies to compensate for the difference in costs, namely that of labour, is a controversial opinion. Firstly, these industries have high margins of added value but a relationship between investment and employment very low, and certainly cannot represent but a minority section of economic activity. Secondly, there are more and more obvious paths of innovation that arise from the possibility of diversification / specialization towards more complex products that, for example, include services whose exclusivity creates value. In fact (John R. Bryson, 2009:7) states:

" The academics and policy-makers have begun to shift their attention away from a narrow fabrication view of manufacturing to one in which the manufacturing includes research and development, design functions, marketing and advertising, services that support production processes and a set of services that have been created to support customer's of a product. Manufactured goods should now be conceptualized as products that contain different quantities of service inputs, some of these service inputs are wrapped into a good during the production process and some are wrapped around a complete product . "

There is, in short, an interdependence between manufacturing and services which may affect significantly the so-called mature industries.

This interdependence, states Bryson⁹, quoting many different streams of research, should be considered different from the traditional one; he introduces the concept of "servuction", by Langeard and Eigler (1987), which is the co-production of a service by producers and consumers. It leads, according to Bryson, to something very close to the Marx concept of *productive consumption*; in Marx it was the product that becomes a real product when it is being consumed, and today also a service becomes a service when it is coproduces in a relationship between a service provider and a consumer. In these cases, therefore, it should be made a distinction between production-supporting services – the traditional interdependence – and product-supporting services, these new *breed* of services are integral parte of the final product, and its represent a large part of the final value of the product, because manufactured products are supplied

" to consumers as a vehicle for accessing services. In this case the product is not the end point of the transaction, but only the beginning of the relationship between the consumer and the producer¹⁰".

Services are somehow encapsulated in products, as for instance in the case of the iphone; this is the meaning of a new concept of manufacturing, the hybrid manufacturing. The economic consequences are not trivial because it is not difficult to see that the producers of this new hybrid of product-cum-services have "*more than one moment to obtain profit from a transaction*": the traditional one based on selling the product and the new one related to "*the post sale product-related services*"¹¹. In this perspective the role of technological intensity is less relevant, and the

⁹ ibidem, pp. 23-25

¹⁰ ibidem, p. 29

¹¹ ibidem, pp.31-35, according to this set of equations: **Time 1 Profit** = Exchange value – (Manufacturing Processes (M) + Production-Related Services (PRS) + Product-Related Services (ProRS) + cost of finance + cost of labour + cost of material inputs)

Time 2 Profit = Exchange value – (post sale product-related services (ProRS) + cost of finance + cost of labour + cost of material inputs)

very rethinking, of both the business models and the concept of what manufacturing is about, becomes the driver of innovation

Creative destruction vs. destructive creation

Innovation is not a value in itself; it should be qualified starting from its long-term social consequences, and the previous paragraph on products-cum-services can highlight the relevance of it. As Soete¹² points out:

*“Innovation does not always represent a Schumpeterian process of “creative destruction”(..) but rather represents now and then the exact opposite pattern: a process of what I will call here “destructive creation”. Innovation benefitting a few at the expense of many with as a result an opposite pattern of a long term reduction in overall welfare or productivity growth(..) The core reason why such patterns of “destructive creation” appear to have blossomed over the last ten to twenty years is closely related to the advent of new, digital Information and Communication Technologies (ICT). ICT has allowed for a dramatic growth in opportunities for the fragmentation of service delivery: what has become known as **the long tail** of product and service delivery differentiation (Anderson, 2006). There is little doubt that doing so ICT has had major growth and welfare increasing effects. It has allowed to satisfy consumers’ wants practically along the full demand curve. As a result many consumers who before could not afford a whole range of services, can now consume those at much lower prices. New “versions” of services have emerged and have been behind the rapid growth of many new varieties of services. However in many areas, and in particular networks services, the emergence of such service differentiation has also led to opportunities for cherry picking: for selecting those most profitable segments of demand which were essential though for the “full” service delivery. As a result, many features of “universal service” delivery associated with the previous network service delivery have come under pressure. Their quality of delivery has become of lower quality or in the worst case has even become discontinued. In network services it has increasingly become expensive to be poor.”*

A new concept of innovation

It becomes, therefore, a critical point to go beyond the Schumpeter’s idea that innovating consists of putting new, reliable products or services onto the market. Schumpeter’s concept doesn’t seem to be the right answer; a new innovation concept is needed. It becomes necessary to pose a series of questions regarding the social aspects:

A. Innovate what? The products, the processes, or both? Today an efficient process and high level of technical quality are prerequisites.

B. Innovate to achieve what? To generically satisfy a client/consumer irrespective of the nature and the quality of the demand? Or vice versa, to establish the hierarchies of the objectives? A set of priorities decided in a democratic process, that is, in a process where the elected and democratic bodies have the power to set the economic agenda.

C. Why innovate? As a condition to be competitive in general? Or more selectively for setting up a different match of supply and demand?

D. Who is responsible for the unexpected social consequences (side effects) of how the innovative processes are managed? How should risks be managed? It means that innovation must take into account not only technological cleverness, but also social, cultural and philosophical dimensions, and how to design complex governance systems and to reform the EU institutional set-up. It must embody in its guidelines a gender and nature-friendly orientation in the design, composition, and technological structuration.

From this perspective, the problem is the overall quality of the products/services. In a macro-economic perspective focusing the driver of innovation on the capacity to establish a new

¹² Soete, L. - *Maastricht reflections on innovation*- Tans lecture 2011

kind of demand leads to a new concept of innovation. It is based on a public and private domestic demand, both individual and collective, thus converging with the conclusion on the social side.

In between the Maastricht Treaty and the global crisis

The open coordination method and networking

The coordination method, to drive the then fifteen countries of the EU to that targets, was the so-called open method, based on soft-law and peer pressure and on the three stages of setting targets, measuring results, benchmarking its against the best practises available; a market-driven approach fully consistent with ideology of self-regulating markets.

The Lisbon strategy didn't deliver what promised but the process of industrial restructuring started with the implementation of the Maastricht Treaty. It should be considered that upon launching the European Union a transformation has occurred with regard to the preceding approach, a "*French-derived top-down approach in which a central authority, with the capacity to coerce and command the lower hierarchical levels defines an action in the common name, with which individuals then bring themselves into line,*"¹³ and the new one, a German-inspired bottom-up kind, in which individuals may outline their own actions within a framework of common rules and opportunities. The instrument for developing this new policy is *networking*¹⁴ - that is, the creation of an opportunity for a restricted group of people to co-operate on a precisely identified problem. This new policy emphasising on the capacity to grasp the opportunities from the bottom, built at Union level, leads to the very fact that the most successful ones will be

*"those who, already advantaged, find themselves with the best initial set of conditions, such that over time (this being a cumulative process) the disparities tend to increase and the leading role of the most active players is consolidated, leaving the weakest facing the alternative of either not participating in the game or of taking on a following role."*¹⁵

It is not difficult to see that "bottom-up", in this context, is for "market-driven".

The building of a European industrial structure

The networking activities were very active, indeed. The building of a European industrial structure was based on a process of concentration. The concentration process was not centralised, in the classical way of a highly integrated company. On the contrary, concentration without centralisation (Harrison, 1994:47) was the model chosen. It consists of a double move; on one side the strategic functions of a corporation become more and more concentrated, on the side of the production operations there is a strong disarticulation via a new concept of the supply chain. Unlike what it seems to be, decomposition and/or deconstruction, it conceals a very high level of concentration of capitalistic power; as a matter of fact the firms at the top of each network have the classical prerogatives of the managers: decide for the other companies on how to plan the output's quantities in a given period of time, the pace and the speed to deliver the output's batches, how to arrange in sequences a mix of different items, etc.

¹³ Bianchi P., *Le Politiche Industriali Dell'Unione Europea*, Il Mulino, 1995, p.240

¹⁴ as to the distinction between the two concepts of network and networking see Rasmussen L. B., Garibaldo F., *From field to table - Concepts and dimensions of the cross-cultural study on networking and innovations in the dairy sector*, Paper presented at the Conference, *Enterprise Cultures and Innovation in the Information Society* University of Brighton, 13-17 September 1999, pp. 6-7,

http://www.it.bton.ac.uk/research/euindia/knowledgebase/workingpaper/pages/from_field_to_table.htm, last visited 25/03/2014

¹⁵ Bianchi, P., op. cit., p.243

Besides, in Europe after the Maastricht Treaty and the Delors' Plan, a process of heightened 'destructive' competition can be highlighted, which culminated in record levels of mergers and acquisitions in the two years immediately before the start of the current crisis, 2006 – 2007¹⁶, as well as of offshoring, through IDE and of outsourcing. Greater centralization was dictated by the oligopolistic strategy of controlling larger market shares. Yet the merger movement jeopardized the existing oligopolistic structure in many industrial branches, so that some of the big players increasingly were themselves at risk. The opening up of Eastern Europe to Western European capital after the fall of the Berlin Wall in 1989 accelerated the industrial restructuring which had begun in the late 1970s, while an additional powerful stimulus came from China's entrance into the global manufactures market.

This is the new social division of labour in Europe: an integrated industrial system with an uneven territorial distribution of core competencies and corporate headquarters; the companies of the eastern countries of EU-27 are mostly under the control of western corporations.

These webs of firms sharing a production process of goods or of services are under certain circumstances, from the point of view of the production process, a comprehensively integrated process; thus a kind of factual congruity between the internal organisation and the nature of the relationship between the firms involved should be posited. These new extended or virtual companies are the new key industrial players in Europe and they consider the EU territory as a strategic resource. They can, indeed, organise their networks utilising all kind of diversity of legal, fiscal, social obligations, as well as of skills and competencies availability, as a way to fine-tuning their internal division of labour.

Summing up, two main closely inter-related and reinforcing processes have profoundly changed European and global 'industrial capital': centralization without concentration, and a model of competition based, in a neo-mercantilist framework, on the endless pursuit of a never-ending expansion of all kind of consumption, engendering the necessity to seek new markets. This struggle has been fought by adding new productive facilities, when the existing ones already carried significant unused capacity. We are therefore convinced that this is also a crisis driven by oversupply in key sectors, because the productive capacity of the new plants competed with that of the same firms in the Euro-15 countries, leading to a state of endemic overproduction, by an excess of investments, in key industries such as automobile and "white goods".

In a capitalistic regime the excess of supply over demand - a paradox in itself, because of the unbelievable amount of existing and unfulfilled individual and social demands - is of course always relative. It depends on the impossibility to sell commodities, goods and services, with a profit, to be more precise with an acceptable profit. To be "acceptable" is a social and not an absolute measure. Overcapacity and income stagnation, when not outright deflation, for the working class urged countries, to find outlets for their outputs. This, in turn, has led to an enormous space for manoeuvre for financial capital. The leading role of financial capital pushed up the crossbar of profit acceptability, in some cases to limits totally unrealistic for any sound industrial activity, in a vicious circle.

This situation was compounded by huge investments, made easier due to the liberalisation of capital market, in the new potential markets (such as China), with the consequence of building up new excess capacity. The perspective of these "green prairies" for European producers lead, therefore, to a run for creating industrial bridgeheads in these new potential markets. For Europe the neo-mercantilist approach, together with a process of industrial restructuring, was the way to manage the effective demand trough a current account surplus of the balance-of-payments. The surplus was not evenly distributed within the EU and the Eurozone, with a clear advantage for Germany and its satellites. The profits resulting from this position of advantage were invested abroad along two different paths: directly, from each country into USA "toxic" finance; within Europe, to finance the trade deficits of the Southern countries of Europe, reinforcing the internal

¹⁶ http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d10_en.pdf, last accessed on the 8th of December 2013

current account surplus, mainly of Germany. For European (especially French and German) banks and finance the Treasury bonds of the European periphery played a role similar to subprime loans in the USA.

Germany and the integration of Europe

Germany utilised this new strategies in a very effective way, from the point of view of the corporate's efficiency and profitability in the framework of a export-lead, or mercantilist, model of growth.

The political economy of the European Union has evolved on the premise that net export balances could be achieved. However, not that every country is in a position to attain that goal: the core six countries of the former Common Market with Austria and the three EU's Scandinavian countries do see export growth as being more significant than the expansion of domestic demand. Within the export oriented countries there is a definite hierarchy among the big three who happen to be also in the Eurozone. The first in the hierarchy is Germany whose export dynamics did not and do not depend on nominal exchange rates with the other main currencies. Rather, German exports are tied to technological innovations and to the widespread array of capital goods sectors. The price competitiveness element comes from what, for all practical purposes, is wage deflation. Indeed Germany extended that policy to the whole of the Eurozone upon the formation of the euro. The second in line is Italy because her export orientation is exactly the opposite of Germany's. It was based on a weak currency, on competitive devaluations. But with the Euro the weak currency approach has vanished and Italy needs wage deflation even more than Germany. Third in line is France. Paradoxically France has a net export objective but only occasionally achieves it. Yet the policy posture of France is to combine financial conservatism with wage deflation and neo-mercantilist goals, though the latter are seldom attained. Neo-mercantilism to export goods and services to where? The extra European Union's trade absorbs a substantial part of total EU exports. But the bulk of the surpluses of net exporters are realised within the EU itself. In relation to China, Japan and Korea the EU countries have a growing deficit, determined by the trade with China. Yet in this case we have significant differences, depending on the nature of the deficits: active vs. passive deficits. It is different to have a deficit because of imports of intermediate goods feeding the high added value domestic producers, export oriented as in the case of the German automobile sector, or importing goods with no relations with the export-oriented part of the domestic industry, as is mainly the case for Italy.

For whom should Europe (the EU) work? For Germany the European Union is the main area of profitable effective demand. It is the area where the Federal Republic's economy realises most of its external surpluses. These in turn represent the financial means with which German corporations internationalise their activities in the rest of the world. The net balances are mostly obtained in European markets.

According to some authors, the German export boom has been based, since the 1990s, on big productivity gains. They analyse four hypotheses:

1. Improved cost competitiveness through moderate collective wage agreements since the mid 1990s;
2. Ties to fast growing trading partners as a result of a desirable product mix or long-standing trade relationships;
3. Increased export demand for capital goods as a response to a global rise in investment activity;
4. Regionalised production patterns through off-shoring of production to lower cost countries, partly as a result of European economic integration.

These authors stress the importance of the second and the fourth factors. The productivity gains were implemented without a spin-off for employees' general conditions (wages, social provisions and working conditions). To the contrary there has been wage moderation and a reduction of social provisions with the shrinking of the domestic market. The off-shoring of production to lower cost countries, also within the EU-27 area, to implement a very aggressive export strategy, has compounded this situation.

The employers' strategy for overcoming the limits of the traditional relative high wage situation of post-war Germany changed dramatically in the 1990s. There was a huge shift from the automation strategy of the 1970s and the 1970s, to the off-shoring of upstream activities mainly to the Eastern Europe and partly, as it is also the case for Northern Italy, to the old EU-15. There has been a contemporaneous huge shift of investments to Eastern Europe, on such a scale that Sinn can write that: 'German firms are currently engaged in an investment strike to use the Marxian term'.

According to Sinn this shift has been so huge that the depth of the German industry in terms of share of own value-added in manufacturing output went down from 36% to 33%. The rationale of this strategy is that high tech investments can grant Germany a gap with the new competitors such as India and China, making the medium-high sector of these mass markets available for its exports, ahead of a never-ending catch up attempt by India and China. These markets have such a dimension that even if only the richest parts of these emerging economies become available they are enough to guarantee adequate returns on investments, as it happened to Volkswagen in China.

In this context the present crisis, which at first was hitting German exports hard, was a major challenge for German capitalism as a whole.

Which general consequences for the EU stemmed from this German strategy? The overall effect of this strategy, according to Simonazzi et al. (2013), was: '*the impoverishment of the productive matrix of peripheral countries and the quality composition of trade flows*'. They have clearly explained the importance of the different composition of the productive matrix within the Eurozone. They have also highlighted that the competitive advantage of Germany, in comparison with the other Eurozone countries, is only partially related to the differences in price competition, but on the quality of the products and the coherence of the productive matrix with the external trade demand, namely from China and other countries, with a new emerging middle class. Based on their analysis it is more evident the strategic relevance, for the German model, of the industrial reorganisation, we have described before, namely of a European networks of suppliers and of the relocation abroad of parts production, namely in Eastern countries of the EU. It is of paramount importance the impoverishment of the productive matrix they describe because as a consequence "an expansion of the German internal demand, albeit necessary, would not suffice to provide a viable response to the long-term sustainability of the euro area" (Ibidem: 671). As a matter of fact, each increase in demand will be transmitted primarily to the German production trans-national value-chain system.

The global crisis

The European neo-mercantilist model was put under severe stress because of the shrinking of USA and Southern European export markets. The fallacies in the design of the euro came to the fore. Firstly, the institutional setting of the Eurozone and the German self-defeating obsession for fiscal austerity, vis-à-vis the financial crisis, pushed the Eurozone into a double dip recession. Secondly, the idea that what was viable for Germany, that is, an export-driven growth, could be viable for the Eurozone as a whole, suffers from a "fallacy of composition". There are, indeed, clear imbalances of the current account balances among the Eurozone countries. To wit, for us, the

imbalances are the symptoms of and underlying cause: the nature of the economic model shortly sketched before, intertwined with the underlying power relations among nations both in terms of market and political power. Simonazzi et al. quote Felipe and Kumar arguing that: “*the lack of competitiveness of peripheral countries*” – the cause of the imbalances – “*is not due to the fact that they are expansive or the labour productivity has not increased. The problem is that they are stuck at middle levels of technology and they are caught in a trap. Reducing wages would not solve the problem*” (Ibidem: 666).

But the consequence of this is that the role of locomotive of Europe for Germany, cannot be analysed only in terms of the balance of the current account balance on one side, and the redistributive effects of share of production from Germany to the other European countries, on the other side, but also in terms of quality. It is a question of seeing what kind of production is outsourced and which kind of interdependence is created between production and trade of intermediate goods and capital goods trade. From this point of view it is easy to see that the nature of the processes of relocation Germans, both as construction of integrated value chains both as IDE to create new production capacity final, causes the production of industrial systems satellites composition is largely determined the growing needs of German industry which is heavily export-oriented, so in turn dependent on the dynamics of consumption of the new emerging countries, specifically from the opulent consumption in these countries.

Another root of the process of change in Europe, before the crisis, is the capital – labour relation. The European situation represents the actual implementation of the Kalecki scheme (1943) of a capital strike due to an actual reduction of the profit’s levels, as a result of the success of the labour movement success in the late Sixties and the first half of the Seventies. The rollback strategy initiated in the mid Seventies, largely achieved in the Eighties, and accelerated and sharpened after the “fall of the wall” (1989), led to the fragmentation of the working class, achieved also through new productive networks, and to the progressive weakening of the national Trade Unions in the EU countries. This was very instrumental to setting up a highly fragmented labour market. The progressive freedom of circulation of capitals and not of workers in the Eastern countries was the way to realise what Sinn (2006) nicknamed as the German Bazaar economy.

A case in point: the automobile sector

Networking

There are many drivers for outsourcing¹⁷:

1. Offloading a part of the investment and warehousing costs onto others;
2. Offloading a part of the responsibilities of the employment levels onto others;
3. Differentiating the hourly cost, on a par with other factors, between inside and outside, thus taking hold of a higher proportion of the value creation or, in the case of a negative situation, reducing the losses;
4. Offloading the *just-in-time* costs onto others: in practice, the sub-supplier must be equipped, even through specific models of work organisation, to absorb all the “variations” that the contractor experiences both in terms of the volumes and principally in terms of the speed of the response in changing the mix – in some cases less than an hour, generally speaking within 4-5 hours;
5. Optimising the investments and the working process both for the contractor and for the sub-supplier that specialise by concentrating on well-defined activities;

¹⁷ F. Garibaldi – *What we have learnt* – in F., Garibaldi; V., Telljohann (eds.) – *Globalisation, Company Strategies and Quality of Working life in Europe*. Peter Lang, 2004

6. Fully exploiting the chance to organise production through “heterogeneous cycles, with parallel tasks, associated by addition.¹⁸” This is a fundamental point as it implies that there can be parallel cycles, functionally connected through a small temporal displacement with the result of reducing enormously all the production times – both those of design and the process *lead times* and the overall time-to-market. In order to fully deploy its advantages this process must put into play the equipment or resources that are mutually used, this pushes, when the prime reason is not merely cost-cutting, towards forms of strategic integration between the sub-suppliers and the contractor companies.

In the case of the European OEMs there is a clear distinction regarding the reason why to relocate capacity abroad. In the case of relocating within the EU boundaries the main reasons are the points from 1 to 4, with no particular stress on the wage differentials but a strong emphasis on the labour protection levels, as the rush to invest in new facilities in Spain demonstrates¹⁹. The reasons indicated in the points 5 and 6 are at the origin of the new phenomenon of outsourcing started at the end of the eighties of the twentieth century and so they are still the basis of all kind of the outsourcing practices. In the case of the BRIC countries and USA the main reasons are a mix of legal constraints and of all the six reasons stated before; in the specific case of Asia the wages costs advantages as well as the poor labour protections represent a well-received grant.

The situation is very different from the suppliers, namely for the 2nd and 3rd tier suppliers. The first basic reason is the different weight of the wages costs on the total costs of the suppliers, but there are more cogent and structural reasons.

The typical supply chain in the automobile sector is structured in thousands of tier-2 suppliers, hundreds of tier-1 supplier, and dozens of system integrators and/or specialised suppliers, therefore dealing with sub-systems and modules. In this configuration the typical OEM manufacturing footprint is: assembly, powertrain and stamping. The key suppliers, system integrators and specialised industrial and services suppliers, normally are not bound to single OEMs, but they supply many of them. This leads to the rise of a web of suppliers that develop an in-house specialised know-how and/or knowledge and product/services innovation. It means that part of the dynamic of the innovation in the sector is no more within the control and the ownership of each OEMs, as a competitive margin against the others, but distributed in this new industrial structure. An industrial structure whose main features are very consistent with network economics, namely as a situation in between market and hierarchies, which is a network of firms²⁰. As Piller and Ihl analysing the open innovation paradigms potentialities, state (2009:11):

Today the common understanding of the innovation process builds on the observation that firms rarely innovate alone and that the innovation process can be seen as an interactive relationship among producers, users and many other different institutions(.) As a result, the early Schumpeterian model of the lone entrepreneur bringing innovations to markets (Schumpeter 1942) has been superseded by a richer picture of different actors in networks and communities (Laursen & Salter 2006).(.)Innovative performance today is seen to a large extent as the ability of an innovative organization to establish networks with external entities.²¹

In the same direction goes the concept of complementary assets and technologies by Teece (2006:1135) and the case study by Dedrick, Kraemer and Linden (2008).

¹⁸ N., Georgescu-Roegen - *The Entropy Law and the Economic Process* -Harvard University Press, Cambridge, 1971,pp. 237-238

¹⁹ - T., Barber – *Europe’s labour market reform takes shape* FT 14/02/2013.

²⁰ C., Antonelli– *The economic theory of information networks* – in C., Antonelli (ed.)- *The economics of information networks* – North-Holland, 1992, pp. 5-27

²¹ F., Piller; C., Ihl – *Open innovation with customers* - IMA/ZLW & IfU, Aachen, 2009, p. 11

The auto industry is characterised by high complexity and high volume at the same time; there are 20.000 detailed parts with about 1000 key components to be managed, it means that the possible end-items configurations are, theoretically, up to millions, and actually several thousands.

So complex is the task to be achieved that there was, therefore, a shift of relevance, within manufacturing, in favour of the supply chain. This is the reason why it is the supply chain that makes the difference in the ability to successfully control final markets and market share; this is also the message from a special report of the Financial Times²².

Material and Value flows

It should be elaborate more in depth on this point. This case highlights our thesis regarding capitalism as a whole, from the process of circulation to the process of accumulation; the macroeconomic level as well as the corporate governance (value for shareholders and short-termism), the new productive structures, based on the centralisation without concentration (distributed global supply chains and the de-structuration of old corporate model).

On one side there is the integration of functions and processes to make a car, involving only some suppliers, and the management of the material flow of parts, involving the supply chain as a whole; on the other side, there is the process of managing the overall supply chain as an integrated value chain, this is up to the OEMs and involve all the actors, at all the levels, of the supply chain. These two sides, the material side, that is the flow of parts, subsystems and modules, and the value side, that is the cash-to cash cycle, should be each other coherent and synchronized, taking into account also the global span of the supply chain.

This is also the reason why the OEMs, in the attempt to manage demand variability, downstream to the dealers and the final market, and global supply chain, upstream to the assembly lines, need, on one side, collaborative schemes, through the supply chain, with the consequence of letting fade traditional organisational boundaries, in favour of closer integration upstream and downstream. On the other side, according to a JDA report²³, the: *“The basis of competition has moved away from operational efficiency in a given functional area to the operational efficiency of the overall value chain. A rough measure of operational efficiency associated with manufacturing and the supply chain is shown in the equation below. This “return on supply chain” subtracts R&D and depreciation costs from COGS and then uses the result to calculate a margin against revenue.”*²⁴

The same report states that: *“The major remaining costs contained in the above equation are materials and operational/transformational costs. This is only a relative measure since costs will still contain some level of non-supply chain costs such as warranty and financial services. It does, however, give some sense of operational and purchasing efficiency of automakers”*.

There is also a non-financial dimension of operational efficiency of the overall supply chain: the management of the material flow of parts, involving the supply chain as a whole.

This is a very specific problem of the automobile industry, quite different from other industries. Look for instance at the customer demand for a very great variety of goods: if the stock-keeping units (SKUs: the number or code used to identify different things for sale in a store or other business) are taken into consideration, the figures are growing up very sharply in the last years also in mature product categories, according to McKinsey²⁵ which states: *“products and*

²² *The Connected Business*, Financial Times Special report, 26/01/2011.

²³ Kelly, T. - *The Automotive Supply Chain in the New Normal: Analysis of the Industry and Its Supply Chain Opportunities* – a 2012 White Paper by the JDA company - www.semresources.com/whitepapers.html last visited on the 7th of February 2013

²⁴ **Return on Supply Chain = (Revenue — COGS — R&D — Depreciation) ÷ Revenue** [COGS is for the cost of goods sold: supply chain costs including material costs, R&D, Depreciation.]

variants tend to proliferate, creating portfolios with long tails of niche offerings".²⁶ The two spaces at the intersection of the percentage of the SKUs and the revenues, and at the intersection of the percentage of the SKUs and the geographic locations, both are often spaces representing very small niches. It means that the configuration of the supply chain and the logistics are more and more the drivers of key business decisions. In this cases logistic management and ICT based technologies are able to manage the problem optimizing the stocks.

In the case of the automobile industry because cars are:

*"heavy, expensive and full of options. As such, it is difficult to get the right SKU at the right "shelf" at the right time. In the consumer products industry, the answer to this would be to provide a "response buffer" upstream and take advantage of pooling inventory in a manner such that retail locations would pull from this larger pool to more precisely satisfy demand. The ultimate answer is to push the response buffer further upstream to capacity, reduce lead times and have customers order the exact configurations they want. This idea of the "three-day car" or "x-day car" was one of the mantras of the late 1990s as many tried to copy the model of the personal computer industry and apply it to automotive. But it turns out that many consumers need to see and feel the product before they buy it – they like inventory"*²⁷

So the main non-financial objective of the supply chain is to deliver *"the right product in the right configuration at the right price and right time to satisfy the customer"*²⁸

Social consequences

These two requirements, the financial and the non-financial, can be jointly optimized only if there is a synchronisation of the sales and marketing requirements and forecasts with parts flowing in from suppliers. This leads to a strong pressing on the suppliers in terms of flexibility.

Going back to the overall picture of the relationship between OEMs and suppliers it can be stated, therefore, that there are two opposite macro-requirements to balance. On one side, a strong push for reducing the operational autonomy and to squeeze the revenues of the suppliers to improve the performance of the overall supply chain, as an integrated value and productive chain. On the other side, the OEMs need a collaborative relationship with their suppliers to manage complexity²⁹. What the OEMs try to do is enjoy the collaborative part, and the connected offloading of the investments to the suppliers, to retain as much control as possible of the innovation dynamic and to improve the performance of the overall supply chain, that is to retain a strong control of the operative costs and of the collaborative and coordination costs³⁰.

²⁶ *Is your top team undermining your supply chain?* McKinsey quarterly, January 2011, p. 4.

²⁷ Kelly, T. – *ibidem*, pp. 12 – 13.

²⁸ *Ibidem*, p.13.

²⁹ Liker, J., K. and Choi, T., Y. -*Building Deep Supplier Relationships* - Harvard Business Review, on-line, December 2004

³⁰ A good example, related to Apple and HP, can be find at

http://www.google.it/url?sa=t&rct=j&q=&esrc=s&source=web&cd=4&cad=rja&ved=0CD8QFjAD&url=http%3A%2F%2Fweb.mit.edu%2Fis08%2Fpdf%2FDedrick_Kraemer_Linden.pdf&ei=908bUbWoFsXotQblnoDgBQ&usg=AFQjCNG9RwzSnZl3-M6NKxbaS90EZx2tJg&bvm=bv.42261806,d.Yms

An alternative model of recovery

This analytical framework goes beyond a pure Keynesian approach. The issue is not only of managing (and nowadays increasing) effective demand, although this is of course necessary, but at the same time to understand the supply side of the story, and then of planning accordingly a course of action. An exit from the actual depression, therefore, requires not only reflationary policies but also industrial policies and structural reforms, but a kind of structural reforms far away from orthodox suggestions.

We don't rule out the importance of the reflationary part, namely the suggestions of debts mutualisation, of a project of European investments (Varoufakis et al.), and of industrial policies, pointing at an improvement of the productive matrix of the peripheral countries, that is, a production upgrading through a process of diversification-cum-specialisation (Simonazzi et al.), in order to realise a European re-equilibrium. While we agree upon the analytical framework of Simonazzi, et al., and on a large part of the proposals on industrial policies, we are not convinced of the objective of a "high road" of competitiveness strategy, in the European experience. That strategy suffers of a "fallacy of composition", too; it is functionally dependent upon the distribution, through the supply chain, of a "low road" to other part of the system and namely of a dual labour market structure and of very low levels of working conditions. We are also not convinced of a path to recovery based principally on a high-investment, high technology, high-profit model, as we will argue in our concluding remarks.

We would like to focus on the more controversial part of the argument, also between heterodox economists and social scientists, the need for structural reform. The overproduction, expressed by an excess of investments in productive capacity, is not a consequences of the crisis and of a sharp reduction in mass consumption, but one of the reason of the crisis, because of a "destructive competition" between global players, compounded by the financialization of their corporate governance. We are also convinced that the destructive competition race comes from the overall economic model. What we mean is that the problem is also of the model of consumption, that is, of the quality of the demand. In the actual framework of the European industrial production it seems more and more difficult to foresee from where an effective demand will come, and it is questionable from where it is more desirable that it will come. In other words, yes, we should innovate the European production system but what innovation are we talking about?

The nature of the demand to satisfy is not idiosyncratically European but global; therefore it can lead to a new global supply of products/services. Furthermore, there is another important innovation possibility deriving from the collaboration between different economic sectors; for example, in the case of supplying sustainable mobility, a cooperation can be devised between the automobile and urban planning sectors or between government systems and governance systems on a meso-territorial scale. Indeed, the concept of a mobility platform implies a task to be fulfilled not only for mobility, but also for the architecture of the urban areas and on a synergy specifically designed between the two action strands.

Besides, innovation is not necessarily high-tech; from the open innovation perspective, innovation can be also the original combination of existing technologies.

A different kind of innovation, eventually, should be:

- a. Based on societal needs and demands;
- b. Socially responsible as regards risks;
- c. Based on forms of international division of labour, agreed upon through international multilateral agreements;
- d. Technologically "conservative", that is oriented to utilise all combinations of technology, beyond the Frascati Manual's distinction of high and low technologies (Bender, et al., 2005);

e. Based on an open cooperation between different actors, crosscutting sectors and technological domains, namely the divide between industrial production and services.

This kind of innovation requires a huge diffusion of innovation capabilities all along the value chain, not only as a requisite for OEM. It is a shift from a technocratic to a democratic innovation concept.

An export-led model of growth for the EMU zone and the EU area as a whole is flawed for two intertwined reasons. Firstly because of the changing nature of international competition, secondly because the idea that what is good for Germany and/or Italy can be good for Europe as a whole suffers of the fallacy of composition, already illustrated.

As to the changing nature of international competition, Germany is a case in point of the neo-mercantilist countries, the idea that the high-export model generates and delivers more wealth to the exporting country because of the substitution of low or unskilled jobs with medium or high-skilled jobs looks more and more like wishful thinking. According to Sinn (2006:14), "Thus total German employment calculated in full-time equivalents fell by 1.36 million people during the past ten years." There is not a purely market-driven way to spread innovation capabilities across the labour force as a whole.

Besides, the neo-mercantilist approach has made Germany more exposed to the effects of the crisis; it is not by chance that Germany registered the highest peak of production downturn among the EU-15 countries.

This is the reason why the shift to societal needs and demands as the driver of growth in a newly cooperative international division of labour, along with a broad social responsibility in preventing ecological and social risks, is needed. It should be remembered that the "beggar thy neighbour" policy, as Joan Robinson nicknamed the neo-mercantilist policy, leads to export devaluation and unemployment in other countries; the opposite should have been part of a broad scheme of international cooperation.

Therefore a new kind of innovation as the driver of a new social and macroeconomic framework is required in Germany and in Europe to support a sustainable recovery. Thus the recovery for Germany and Europe should be based on a new investment on people's ingenuity and capabilities, and on a societal environment supporting it.

What is required is a new kind of innovation whose driving power is a new kind of autonomous demand, both public and private. It has to be domestic on the European scale (i.e., not externally driven), both for individual and collective goods and services; an intervention targeted to not yet or not fully satisfied needs. This task cannot be accomplished through the workings of the spontaneous (anarchic) function of the market of this new capitalism. What is needed is what Minsky defined as the socialisation of finance, investments and employment.

Conclusions

Minsky commenting on the reception of Keynes' notion of the socialisation of investment in the Post-war period was very critical on the path which was taken to reach full employment. To avoid the socialisation of the ownership of industry the choice was in favour of 'a large government sector, in part financed by deficits' (Minsky, 2008a:156), because it is possible to achieve 'an approximation to full employment (..) as long as government, through its budget, is big enough' (ibidem: 156). The overall consequences were that 'as the gap between consumption at full employment, even allowing for transfer schemes, and full-employment output must be filled with either government spending that uses resources or private investment if full employment is to be sustained, measures to induce investments by increasing profitability have been insinuated into the tax and spending systems. Thus a high-profit, high-investment economy has been created in which tax and government-spending policies are evaluated on the basis of their impact upon private investment rather than on the basis of their impact upon consumption or equity respect to income distribution' (Ibidem: 156). It was, says Minsky, 'a socialism for the rich'.

Here lays the main root of the path followed by Western capitalism, since the end of the Sixties and the mid-Seventies. When the Post-war policies became unsustainable the choice was

not between a *laissez faire* and a controlled economy, rather it was one between measures, such as a tax and subsidy system, that increased corporate untaxed income, leading to a lower consumption-income ratio, 'to induce private investment, quite independently of the social utility of investment', on the one side, and policies operating 'on distribution of income so as to raise the consumption-income ratio', on the other (Ibidem: 162).

To wit, we agree with the Minsky's idea that an alternative economic path should increase the consumption-income ratio, instead of lowering it. It seems to us that, the problem was, for Minsky too, and it is of paramount relevance today, as we have already stated in the previous section, the nature of consumption to be developed. The concept of societal needs and demands, or of 'communal consumption', including public expenditures and welfare provisions, not based on monetary transfer payments, is what we are looking for. It is therefore logically coherent to criticise the joyless affluence and the poverty in the midst of plenty, as a result of the post-war consumption strategy, as Minsky did. The problem was and still is not only the level but also the social quality of consumption. It is not by chance, therefore, that the overall social consequences were a never-ending consumerism and a permanent instability because 'a high-investment, high-profit strategy for full employment – even with the underpinning of an active fiscal policy and an aware Federal Reserve System – leads to an increasingly unstable financial system, and an increasingly unstable economic performance' (Ibidem: 163). Minsky states that once it is clear that, under capitalist financial institutions, a system depending on private investments is intrinsically unstable a rational strategy should aim to decrease that dependence in favour of socialised investments. Minsky warns us that whatever we will do and we have to do we will never get a once-and-for-all resolution of the flaws in capitalism; it cannot be achieved because instability is endogenous to capitalism: 'but if capitalism is to be controlled so that the basic triad of efficiency, justice and liberty is achieved, then the design of the controls will have to be enlightened by an awareness of what was obvious to Keynes – that with regard to both the stability of employment and the distribution of income, capitalism is flawed' (Ibidem. 166).

What does it mean today in the EU?

First of all to restore a democratic stance: we refer to the need to rescue a public sphere where, through a public discussion, citizens can decide all kind of priorities and goals to be achieved, because all kind of social relations, the economic sphere included, are political issues, that is under the control of democratic decision processes. The divorce of capitalism from democracy (Stiglitz, 2012; Urbinati, 2013; Streeck, 2013) can be characterised through three major processes: 'the expansion of a powerful private domain and the dynamic interaction between a 'privatizing' executive and the erosion of citizens' privacy rights' (Sassen, 2006: 186); the 'privatization and marketization of public functions' (Ibidem: 186) and 'a new formalization of the private sphere, including a strengthening of its representation as neutral and technical, and of the market as a superior ordering from that of government' (Ibidem: 186). Without restoring democratic participation to the decision making process, affecting the nature and the quality of our social life, any kind of proposals cannot but remain a wishful thinking. In the EU and in the EMU area this means to go beyond the national boundaries, asking for the completion of the European unification process through the setting up of new institutions for a democratic government of the EU. We are using the word "institutions" meaning the government, the regulatory structure, the legal system and the financial institutions.

Secondly there should be coherence between the needed urgent initiatives to end the economic depression - such as reflationary and industrial policies as already quoted from Varoufakis, et al., and Simonazzi, et al., contributions – and the mid- and long-term reforms we are arguing for.

That being stated, a brand new approach to the concept of economic growth should be debated in the form of a new agenda. The basic idea is that the way to reduce endogenous and chronic capitalism instability is to work for a 'low-investment, high consumption, full-

employment economy' (Minsky, 2008b: 329) and, we can add today, environmentally sustainable. There are multifarious consequences of such a choice; in short:

a. To afford the high level of unemployment, namely youth, through investments in social infrastructures to give an answer to societal needs, also, but not exclusively, with targeted public programs for job creation, and in programmes for social and environmental activities. These programs should be medium-term designed in order to facilitated a transition from unemployment to a regular work for unemployed youths. The enrolling scheme should be based, as much as possible, on the individual experiences and instruction levels to favour a personal development.

b. Setting up EU-wide minimum and common standards for the quality of work and defining a floor for wages, starting from the specific national situations.

c. To support, with the availability of "patient capitals" and the long-term initiative of "an entrepreneurial state" (Mazzucato, 2013), innovation in the productive sphere, as qualified before, with the explicit target, and consequent constraints, of the decarbonisation of our economies;

d. Setting labour-intensive criterion as priority for all kind of public support to private investments. Public support, in the form of subsidizing demand, must be severely restricted to new advanced products/services supporting the decarbonisation process, such as the development of new mobility patterns (services and vehicles).

e. Eventually the economic sphere will consist of two sectors and modes of production: labour-intensive, due to specific public investments and policies, and capital-intensive, due to private investments but with specific social and environmental regulations.

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