Abstract

Economic Integration of Sovereign States: The Path to Riches

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The Western European states lagged the United States in terms of productivity from 1890 to World War II. Both grew at a steady rate, but the percentage differential did not decline in this 50-year period. The signers of the Treaty of Rome in 1957 were only 53 percent as productive as Americans as measured by output produced per hours worked in the 50 years prior to World War II. In 1957 six Western European countries signed the Treaty of Rome and over the subsequent 25 years caught up to the United States in terms of productivity. Other European countries became integrated with these six countries and in time caught up as well. Now all of the first 15 EU countries are as productive as the United States as are some of those joining in 2004.

The Latin American countries were 25 percent as productive as the most advanced industrial countries in 1900 and still are. In this 110-year period, these countries did not catch up. Why the great catch-up in Europe and not in Latin America? Why did some Asian economies catch up? And why are a number of others catching up to the industrial leaders?

My thesis is that economically sovereign countries that are integrated with the advanced industrial countries catch up and in time join this set of countries. Country policies do matter. Western European countries' income per capita is only 70 percent that of the United States because their hours worked per adult is only 70 percent of the U.S. level. The reason for this low hours worked number is that Western Europe has much higher marginal effective tax rates does the United States. But this is not the topic of this lecture.

Why do economically integrated states have more productive economies? Factors that block the use of more productive work practices depress productivity. Weaken these factors, and productivity will rise. Groups who have a vested interest in blocking change that enhance productivity use the political process to block such changes. Productivity is output per hour worked in the market sector and is the prime factor in accounting for differences in living standards across economies at a point in time and over time.

If a group will suffer from the adoption of more efficient work rules and production processes, that group will use the political process to the extent possible to block their adoption. When successful, productivity and therefore living standards are depressed below what they would otherwise be. In the case of Slovakia, adopting more productive production processes will typically increase output by more than the increase in productivity. This results in an increase in employment and profits in that industry, which stakeholders in the industry all like. With economic integration, the nature of the game is that exporters oppose barriers on imports as they rationally fear retaliation, which would adversely affect their exports. The equilibrium is characterized by a minimum amount of barriers to efficient production and to high productivity. High productivity results in high payment per hour, and the most important input to production is people's time. There is a parallel between the European Union and the United States arrangement. There is competition between member states to serve their people better.

A somewhat arbitrary definition of a rich industrial country is an industrial country with at least half the per capita income, or equivalently per capita output, as the most advanced industrial countries. The set of rich industrial countries has been expanding with a few added every decade since 1950. Countries that have joined this exclusive club have all stayed rich. It appears to be an absorbing state. Using the modern way of determining purchasing power parity, Slovakia has become a member. My prediction is that in time Slovakian productivity will catch up to the leaders and Slovakia will be one of the most advanced rich industrial countries. Currently it is only a little over half the U.S. level.