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Global trends and the economic crisis: Future alternative European growth strategies☆

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In front of fiercer competition from outside (especially from emerging countries), of the contraction of the internal demand, following the crisis and the problems with public finances, and of the process of European integration that fostered increases in wages and inflation in its Eastern countries, Europe can no longer prosper without a clear long-run development strategy as it used to do before 2007. This paper aims at describing the long-run outcomes emerging from possible alternative growth strategies, differentiated between CEECs and EU15 countries, that had historically grown on the basis of two different development strategies. The analysis involves the development of scenarios over a time span of 18 years, from 2012, the latest year with actual data, up to 2030. Results show that the effects of Eastern countries' development strategies are highly influenced by the strategies chosen by the Western ones, while the opposite does not hold. Moreover, a scenario in which both groups of countries increase the quality of their original strategies, but remain in their actual productive specialization trajectories, is the least expansionary. In all cases, a strategy of modernization of CEECs economies leads to a more expansionary scenario; this strategy pays the most for Eastern countries if Western countries also move towards an industrial strategy. Finally, the most expansionary scenario is one of an advanced industrial Europe, and interestingly enough, this is also associated to lower increases in regional disparities.

1. Introduction

In front of fiercer competition from outside Europe (especially from emerging countries), of the contraction of the internal European demand, following the crisis and the problems with public finances, and of the process of European integration that fostered increases in both wages and inflation in Eastern countries, European countries can no longer prosper without a clear long-run development strategy as they used to do before 2007.

The pre-crisis, medium-run development patterns of the EU were in fact quite different between Western and Central and Eastern European countries (hereafter, CEECs). While EU15 countries had been focusing for the two decades on a mix of high and low value added service activities (Belloc and Tilli, 2013), CEECs attracted manufacturing plants off-shored mostly from Western EU countries and foreign direct investment (henceforth, FDI) from all over the world, thus enjoying remarkable productivity gains. However, such development patterns could be considered more as a way to adapt to the worldwide globalizing trends in a yielding way, rather than a conscious choice translated into a full-fledged growth policy.

The economic contraction that begun in 2007–2008 exposed the limitations associated with these development processes.[1] Because of the slowdown of the EU economy with respect to (hereafter w.r.t.) the major competitors, the crisis

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[1] The costs of the economic crisis have been assessed with the use of the MASST3 model in Capello et al. (2015a), with a specific focus on the role of cities as sources of regional resilience, and in Capello et al. (forthcoming), where the spatial distribution of such costs has been the main object of analysis.

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calls for conscious—and different w.r.t. the past—growth strategies. This paper aims at describing the possible long-run consequences stemming from alternative growth strategies, keeping in mind the two historical growth models that the two blocks of countries have always shown, irrespective of the undisputable variance characterizing Eastern and Western Europe. These historical differences in the growth models adopted make the distinction between these two blocks of countries a particularly relevant case study. Alternative strategies are in turn built upon the idea that EU countries could choose them in reaction to the relevant economic problems and consequent structural changes brought about by the crisis.

In order to reach this goal, this paper describes possible alternative strategic responses of the EU to the relevant economic problems caused by the crisis. This analysis is carried out on the basis of a scenario building exercise, whereby different combinations of strategies adopted in Western and in Eastern European countries are combined to produce different development trajectories for these two groups of economies.

This exercise is helpful for the debate that is taking place at the European and country level, related to the role Europe wants to play in the new world economic order. Facing a new multi-polar global economy, and the emergence of new powerhouses such as China, Europe is no longer the core continent and struggles to identify a new economic role, after the failure of the Lisbon strategy, the incomplete achievements in the first years of the EU 2020 strategy, and the present economic crisis. Ideally, this role should also take Europe's economic and social welfare and way of living specificities into account. But more than that, the paper is useful for understanding the advantages that CEECs reach when the way towards an endogenous growth pattern, through modernization and reconversion to high value added production activities, is undertaken in a decisive way.

The paper focuses on the economic aspects and analyzes two opposite economic development strategies for the two groups of countries forming the European Union.

CEECs, whose membership of the EU is more recent, are assumed to increasingly face the choice between a modernizing industrial strategy and a conservative one. The first strategy, labeled “Modernizing CEECs,” involves a shift from traditional to more advanced industries, the strengthening of the system of second-rank cities, and a general improvement of the research and innovation systems. This first approach implies that CEECs will move from their traditional cost-competitive strategy and attraction of foreign capital towards a more endogenous mode of industrial development. The second strategy, labeled “Traditional industrial CEECs,” represents a scenario based on the assumption that CEECs will try to maintain their cost-competitive approach and focus their growth potential on their capability to attract the off-shoring of Western firms and export.

The growth effects of these strategies are, however, not independent from which strategy Western countries will choose in turn. Western European countries are assumed to choose between two different strategies to deal with the economic crisis and maintain a role in a globalized world. The first of these strategies is labeled “Industrial EU15” and focuses on a reprise of Western Europe as a global manufacturing center. This is made possible by the shift towards higher quality manufacturing, customized production, and reshoring to control production processes. The opposite strategy is labeled “Post-Industrial EU15”; in this case, Western Europe almost completely gives up manufacturing, delocalizing all production functions and concentrating on the provision of advanced services on a global scale. The latter strategy involves a shift from low-level labor-intensive service activities to knowledge-intensive business services.

All these strategies represent a discontinuity with the pre-crisis development patterns; in fact, also in the case of a procrastination of the current dualism between a manufacturing Eastern Europe and a tertiary EU15, our scenarios will assume a conscious decision to improve the quality of the existing production infrastructure; as above anticipated, this would lead EU15 countries towards specializing in advanced services, while CEECs would occupy higher niches in the markets for products.

The combination of the possible alternative strategies by CEE and EU15 countries produces four different scenarios, whose consequences will be analyzed at a disaggregated spatial level by using the last (third) version of the macroeconomic sectoral regional growth model called MASST3 (Capello et al., 2014). The time span of the analysis covers 18 years, from 2012, the latest year with actual data, up to 2030.

The scenarios presented have a clear connection with the recent resurgence of industrial policies in several advanced economies. EU's Industrial Compact, Juncker's Investment plan, and the recent industrial policy communication “for a European Industrial Renaissance” (EC, 2014) in the EU, and Obama's new industrial policy for the US (Cooney, 2014), all suggest that industrial policies could represent possible ways to resume growth where economic performance has been sluggish, as in the case of several EU countries, or instead to fully regain momentum, as in the case of the US. The results discussed in this paper enter the debate on the rationale for such industrial policies and provide a first assessment of the possible outcomes for future growth in EU regions.

This paper is structured as follows. Section 2 summarizes the stylized facts that characterized the evolution of growth trajectories in the EU before the inception of the ongoing crisis, and the ensuing discontinuities that justify the analyses here presented. In Section 3, we describe the way development strategy scenarios for Europe are built, on the basis of the four possible combinations of the strategies for EU15 and CEE countries as above summarized. The main assumptions needed for the simulation of the four scenarios are summarized in Section 5, while Section 6 offers a detailed account of the main empirical results for the scenario simulations. Finally, Section 6 concludes with the main messages from our analyses and the most relevant policy implications that can be derived from our results.

2. The crisis and its structural breaks: Stylized facts

The EU faces a crucial crossroad (Podkaminer, 2013). The combination of the incomplete transition of CEEC economies (Dobrinsky and Havlik, 2014) and the relevant impact of the presently ongoing economic crisis (Capello and Perucca, 2013, 2014; Capello and Caragliu, 2014) sum up to make the weaknesses of the EU economy even more evident.

The average small size of firms in Southern and Eastern European countries has also worsened the impact of the