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Economic integration, industry location and frontier economies in transition countries

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Abstract

This paper deals with the spatial implications of the EU East enlargement on candidate countries at regional level. The research questions tackled in the paper focus on industry location patterns within and across countries, their determinants and changes during the 1990s. The aim is to understand what type of regions will gain and what type of regions will lose from the integration process. Through econometric evidence, the paper suggests that the enlargement process will have a different impact on regions according to their geographical location within the country and borders.

JEL classification: F15; R12

Keywords: Economic integration; Industry location; Transition countries

1. Introduction

International trade and Foreign Direct Investment (FDI)—the two driving forces behind economic integration—have undoubtedly a considerable impact on the economy, at national as well as at regional level. The possibility to exchange goods and services internationally opens opportunities to specialize and to use economies of scale and therefore may result in the concentration of economic activities in few locations, close to international markets. Furthermore, trade occurs in a heterogeneous space, where distance and quality of infrastructure matter, so that integration may have different consequences for the center and the periphery. Even more than trade, FDI affects domestic economy through technical—transfer of technology, skills, knowledge and governance—as well as pecuniary—backward and forward linkages with domestic firms—externalities, which may generate positive spillovers

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to domestic economies. Since, however, FDI tends to cluster geographically in Central and Eastern Europe, it can generate or further increase disparities across and within candidate countries.

Despite that, the spatial implications of the ongoing process of economic integration between Western and Eastern Europe have not been investigated in depth so far. Literature on the effects of the enlargement has focused mainly on the national level (Baldwin et al., 1997; Avery and Cameron, 1998), and the optimal speed of the transition process (Aghion and Blanchard, 1994; Blanchard, 1997), as well as on the composition and changes in patterns of trade and FDI (Hoekman and Djankov, 1996; Kaminski, 2001; Resmini, 2000). However, a general concern does exist, that the structural changes accompanying economic integration are likely to result in changes in the concentration of the spatial distribution of the economic activities.[1]

This paper aims at filling this gap by exploring and analysing on a comparative basis the impact of the East enlargement of the EU on regions in four candidate countries, namely Bulgaria, Estonia, Hungary and Romania. The research questions tackled in the paper deal with the location of the manufacturing activity within the countries, its determinants and changes occurred during the 1990s in order to understand what type of regions will win and what type of regions will lose because of the integration process.

The selected countries have different development levels and geographical characteristics that make their comparative analysis interesting. Hungary and Estonia are relatively more advanced than Bulgaria and Romania, and while the former will join the EU in 2004, the latter will not. In addition, the extension of the border area within each country, the location of the countries along different EU borders from north to south, as well as the fact that after the enlargement these countries will represent the eastern periphery of the EU, suggest the need for an in-depth analysis of adaptation processes in border regions.

The paper is organised as follows. The next section briefly summarises the main theoretical predictions on regional adjustments to trade liberalisation and economic integration. Section 3 describes regional industrial employment patterns in the selected countries during the 1990s. Sections 4 and 5 present econometric evidence for the determinants of industry location and adjustments over time. Section 6 offers some concluding remarks.

2. Economic integration and the location of industrial activities

The study of the spatial organization of economic activity has a long tradition, being deeply rooted in two broad schools of economic thought: the traditional location theory and the international trade theory.[2]

When discussing the spatial distribution of the economic activity in an economy close to international trade, the location theory has traditionally considered border regions as

[1] See, for example, the Second Report on Cohesion (EC, 2001) and its background papers as well as Petrakos et al. (2000) and Traistaru et al. (2003).

[2] Here, I have made no attempt at providing a comprehensive survey of these two broad fields of economics theory. This section just represents the necessary background for the later discussion of the empirical work. Excellent surveys on these topics can be found in Fujita et al. (2000) and Fujita and Thisse (2002).