Globalisation: The experiences of small EU economies

University of Sofia Economics Faculty

November 18th, 2009

Dr John Bradley

john.bradley@iol.ie

Implications of globalisation for small states

“The real economic challenge ... [of a country or region] ... is to increase the potential value of what its citizens can add to the global economy, by enhancing their skills and capacities and by improving their means of linking those skills and capacities to the world market."

Robert Reich (US Secretary for Labour, 1993-1996)

Human capital

"Economic success in the future will depend not on scarce land, nor on capital, which is now if anything in overabundant supply, but instead on intelligence, creativity, empathy, and other characteristics that economists describe as "human capital".

Diane Coyle, *Paradoxes of Prosperity*, 2001

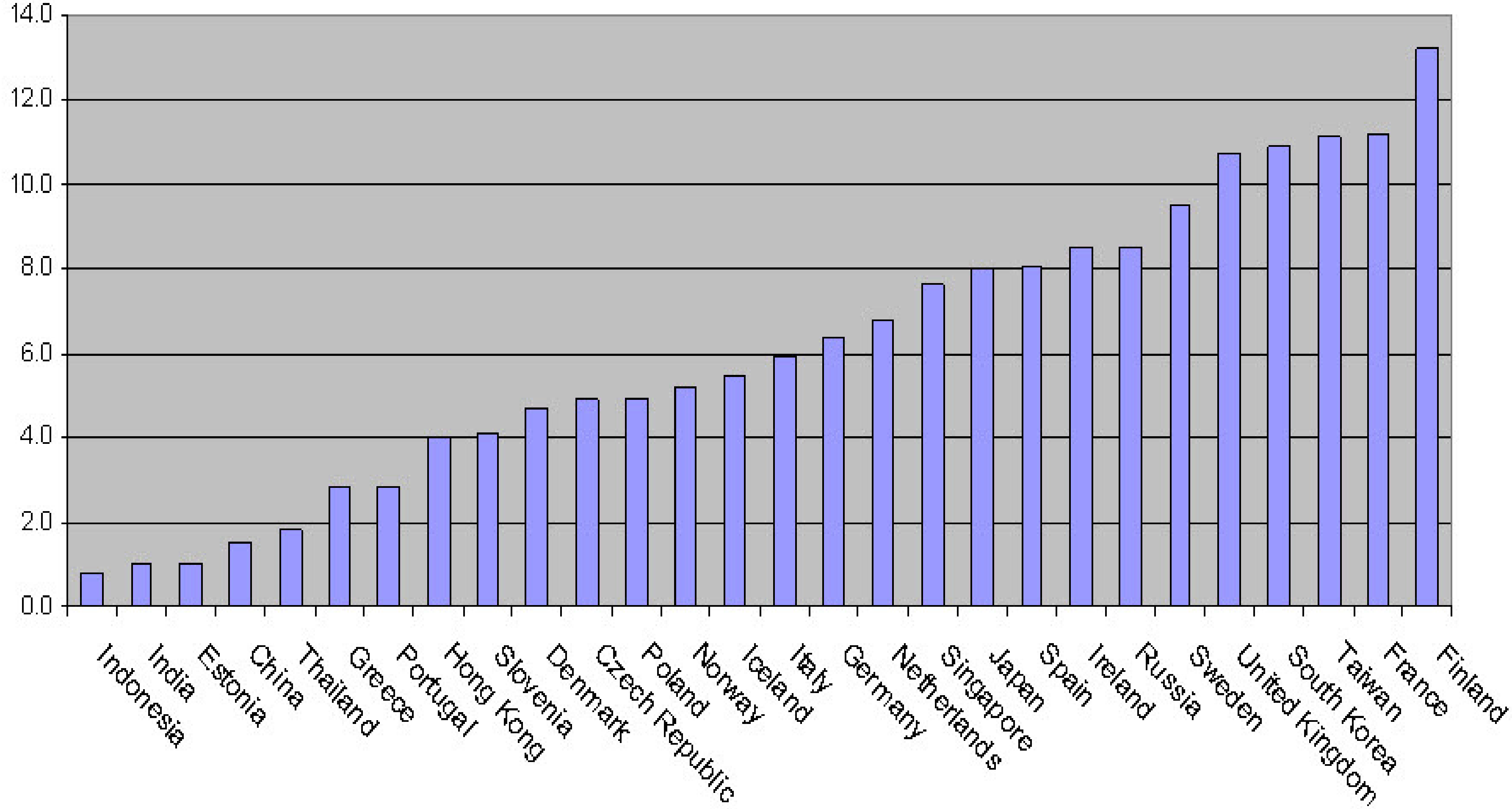
What Is Human Capital?

- A broad concept encompassing many different types of investment in people
- More narrowly: Knowledge and skills embodied in people and accumulated through schooling, training and experience that are useful in production of goods, services and further knowledge

From Clothing to Computers

	Clothing (Macedonia)	Engineering (Slovakia)	IT (Ireland)
Technology	Low	Medium	High
Wage rates	Low	Moderate	High
Skill levels	Moderate	High	High
Human capital	Low	Medium	High
Economic infrastructure needs	Low	Improving	High

Percentage of 24-year olds with S&E degrees



Where is Bulgaria positioned on this chart?

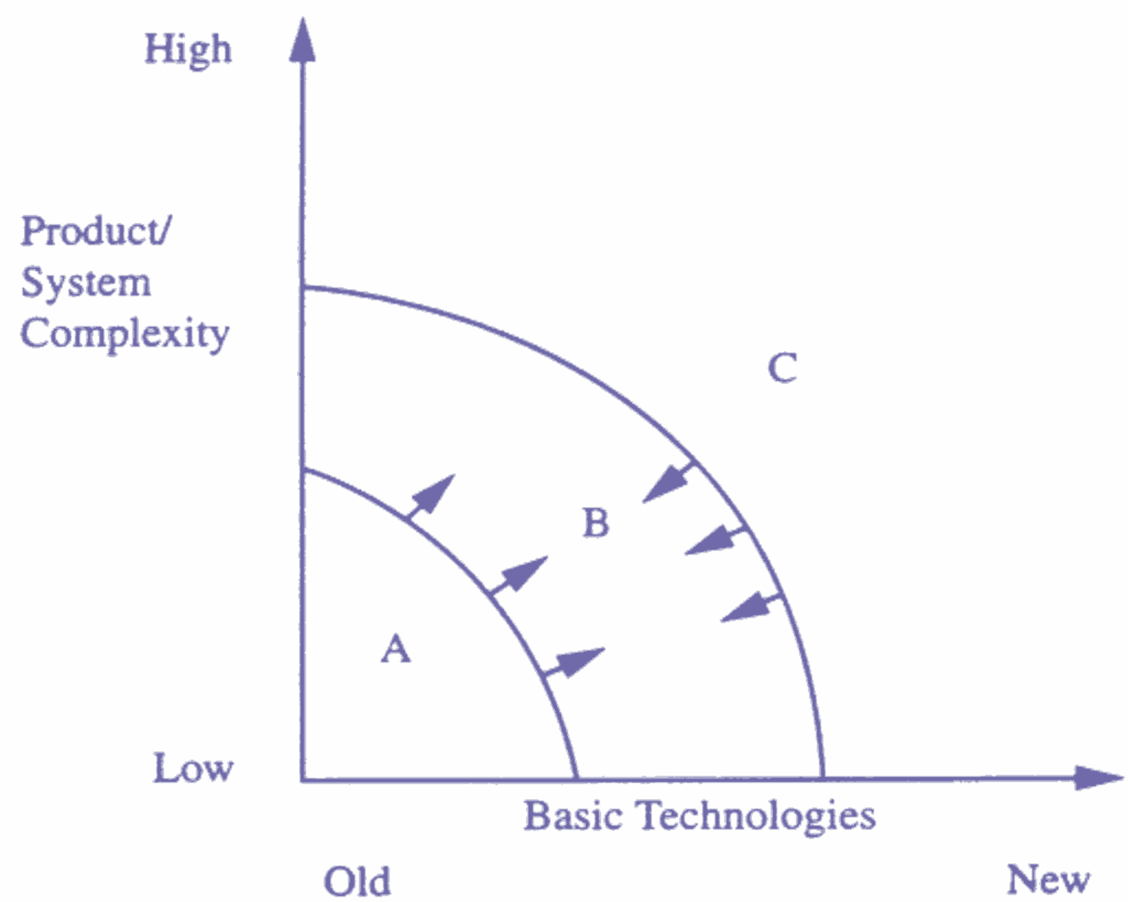
Percentage of 24-year olds		
Country	All degrees	S&E degrees
Bulgaria	16.5	0.7
Romania	17.1	4.3
Croatia	13.8	4.4
Macedonia	8.4	2.3
Turkey	9	2.5
Ireland	27.1	8.5
Denmark	18.4	4.7

Typical European approaches to development and industrial strategy

- **The "Nordic" model:**
  Focused on growing indigenous industry

- **The "Irish" model:**
  Focused on attracting and retaining foreign direct investment

The small country “squeeze”



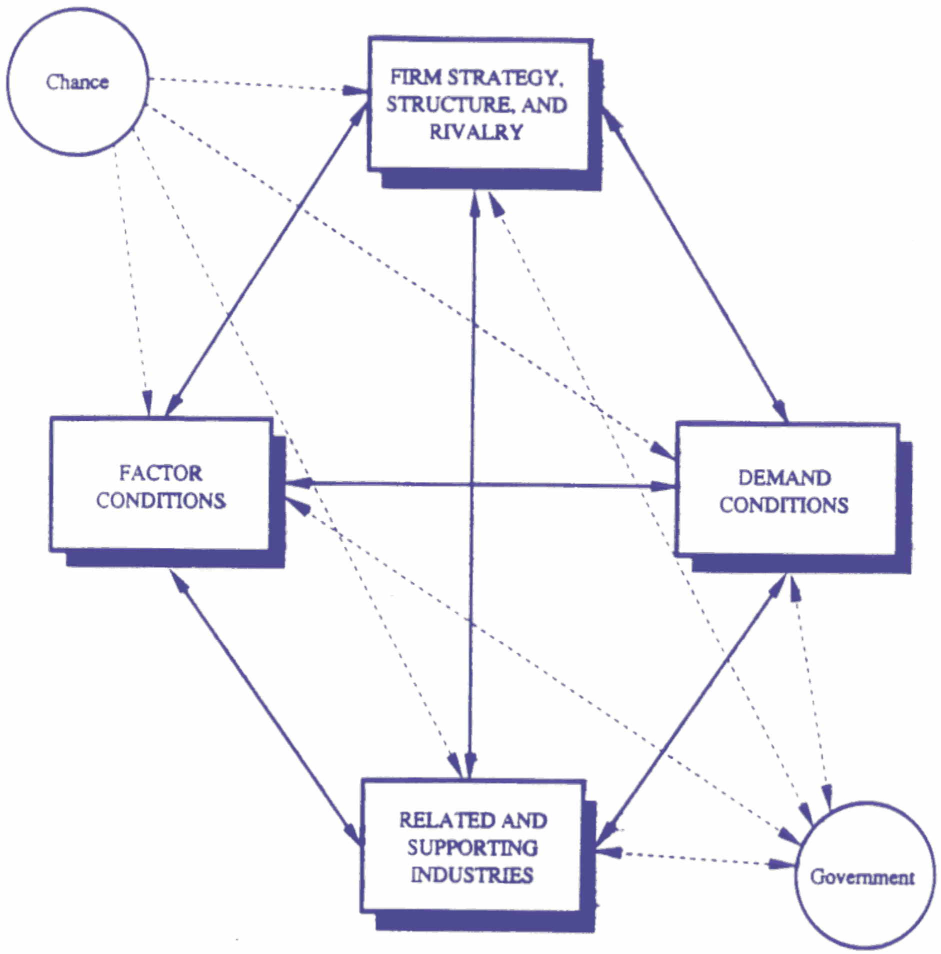
The “Nordic” development model (Denmark, Finland, Slovenia)

- Select segments of indigenous industry, to increase efficiency and performance
- Address serious entry barriers: need for new product development, efficient marketing, distribution and service
- Target niche sectors and products; win greater share of export markets
- Domestic skill and cost base is crucial

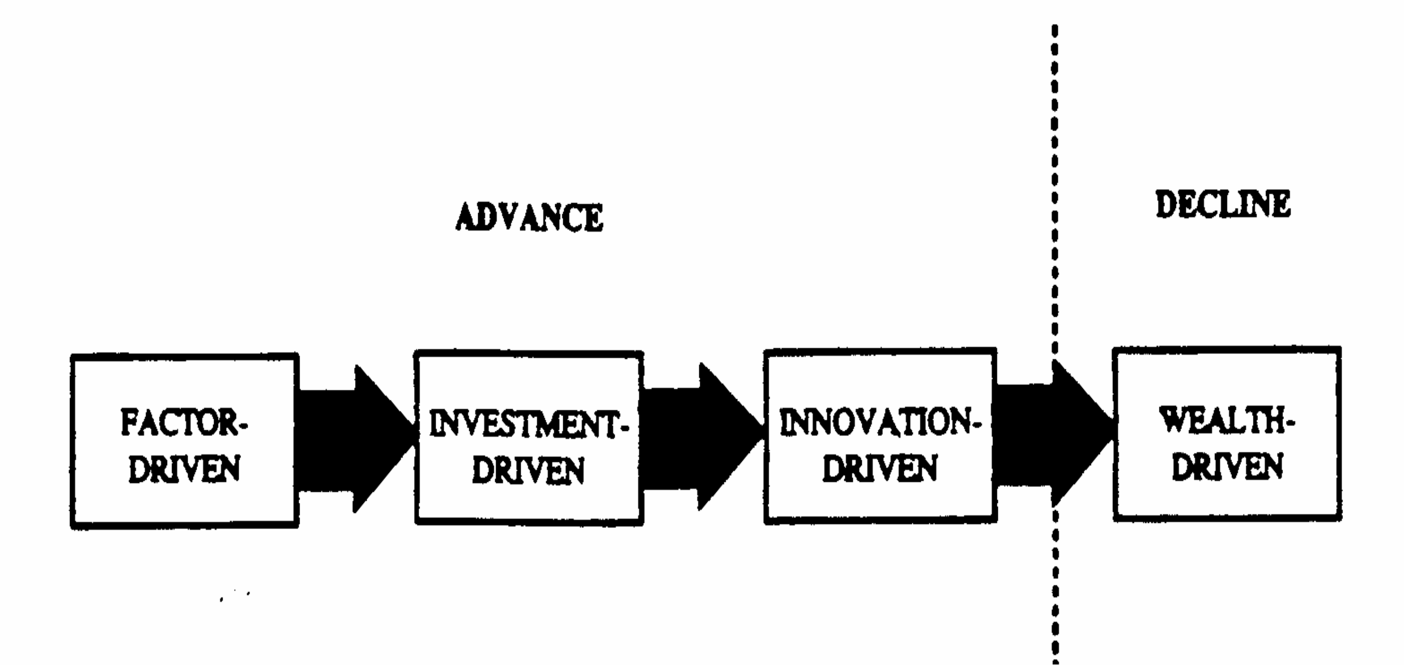
The “Irish” model (Ireland, Slovakia, Czech Republic)

- **Attract export-oriented foreign direct investment (from USA, Germany, Japan, etc.)**
- **Ensure attractiveness of business and productive environment to capture greater share of mobile investment**
- **Being inside EU is important**
- **“Jobless” growth for a while, as old labour intensive industries fail and are replaced by the new foreign-owned businesses**

Porter's diamond of competitive advantage



Porter's stages of competitive development



Some brief Irish economic history

Independent Ireland: 1922

- **Major industrial base on the island was in Northern Ireland, which remained in the UK**
- **The new Irish state had almost no manufacturing base**
- **An agricultural economy, supplying the British market at depressed prices**
- **High birth rate, high emigration, declining population**

The first Irish economic strategy: import substitution

- Imposition of high tariff protection in 1930s
- Attempt to build a locally owned manufacturing sector behind tariff barriers
- Strict controls on foreign ownership of firms
- Tariffs remained in force until early 1960s

GDP per head, PPP: EU-15=100

Country	*1960*
Belgium	**97.4**
Denmark	**126.0**
Ireland	**63.2**
Greece	**43.7**
Portugal	**40.6**
Spain	**59.4**

Strategic policy changes: 1960

- **Removal of tariff barriers**
- **A zero rate of corporation tax (on exports)**
- **An attractive range of investment incentives**
- **Training grants for firms**
- **Basic reforms in the second level education system**

The openness of small European economies

Country	Export share % GDP *1960*	Export share % GDP *2000*
Belgium	39	74
Denmark	33	35
Ireland	30	86
Portugal	16	33
Greece	7	16

Ireland: Stages of modern industrial development

- **<u>First stage</u> lasted almost 25 years in Ireland, from the late 1950s to the mid 1980s, was "factor" driven, based on policies of low rates of corporation tax, low wages, subsidized capital formation**
- **<u>Second stage</u> lasted from the late 1970s to the late 1990s: massive public and private investment in plant, infrastructure and human capital, co-funded generously through EU regional aid from 1989 onwards.**
- **Policy-makers now seeking to shift to Porter's <u>third stage</u> (innovation driven). But has exposed limitations of an industrial strategy that came to be based largely on foreign direct investment**

Ireland's changing policy environment

- **1922-1960: A dependent small underdeveloped state on the periphery of the United Kingdom**
- **1960 onwards: A small regional modernising economy progressively integrating into an encompassing European economy**

Convergence was slow!
GDP per head, PPP: EU-15=100

Country	1960	1973	1986
Belgium	97.4	102.8	104.3
Denmark	126.0	120.9	117.8
Ireland	63.2	62.3	65.9
Greece	43.7	71.0	62.8
Portugal	40.6	57.5	54.5
Spain	59.4	77.2	71.8

A boost to Irish convergence: the rise of EU regional aid policy in the late 1980s

The goal of EU regional investment aid policy

“To design and implement policies with the explicit aim of transforming the underlying structure of the (poorer) beneficiary economies in order to prepare them for exposure to the competitive forces unleashed by the Single European Market and Monetary Union”

EU regional investment aid

- EU financial aid with domestic co-financing
- Improvement of physical infrastructure (roads, rail, ports, telecommunications)
- Improvements in human resources (training, education)
- Direct investment aid to productive sectors (marketing, design skills, R&D)

Irish Structural Funds : main areas
(percentage shares of total)

Type of expenditure	1989-93	1994-99	2000-06
Productive sectors	56	47	16
Human resources	25	32	36
Physical infrastructure	19	21	48

The Celtic Tiger roars!
1994-2002

Convergence at last!
GDP per head, PPP: EU-15=100

Country	1960	1973	1986	2004
Belgium	97.4	102.8	104.3	105.7
Denmark	126.0	120.9	117.8	120.8
Ireland	63.2	62.3	65.9	122.0
Greece	43.7	71.0	62.8	69.9
Portugal	40.6	57.5	54.5	73.7
Spain	59.4	77.2	71.8	83.9

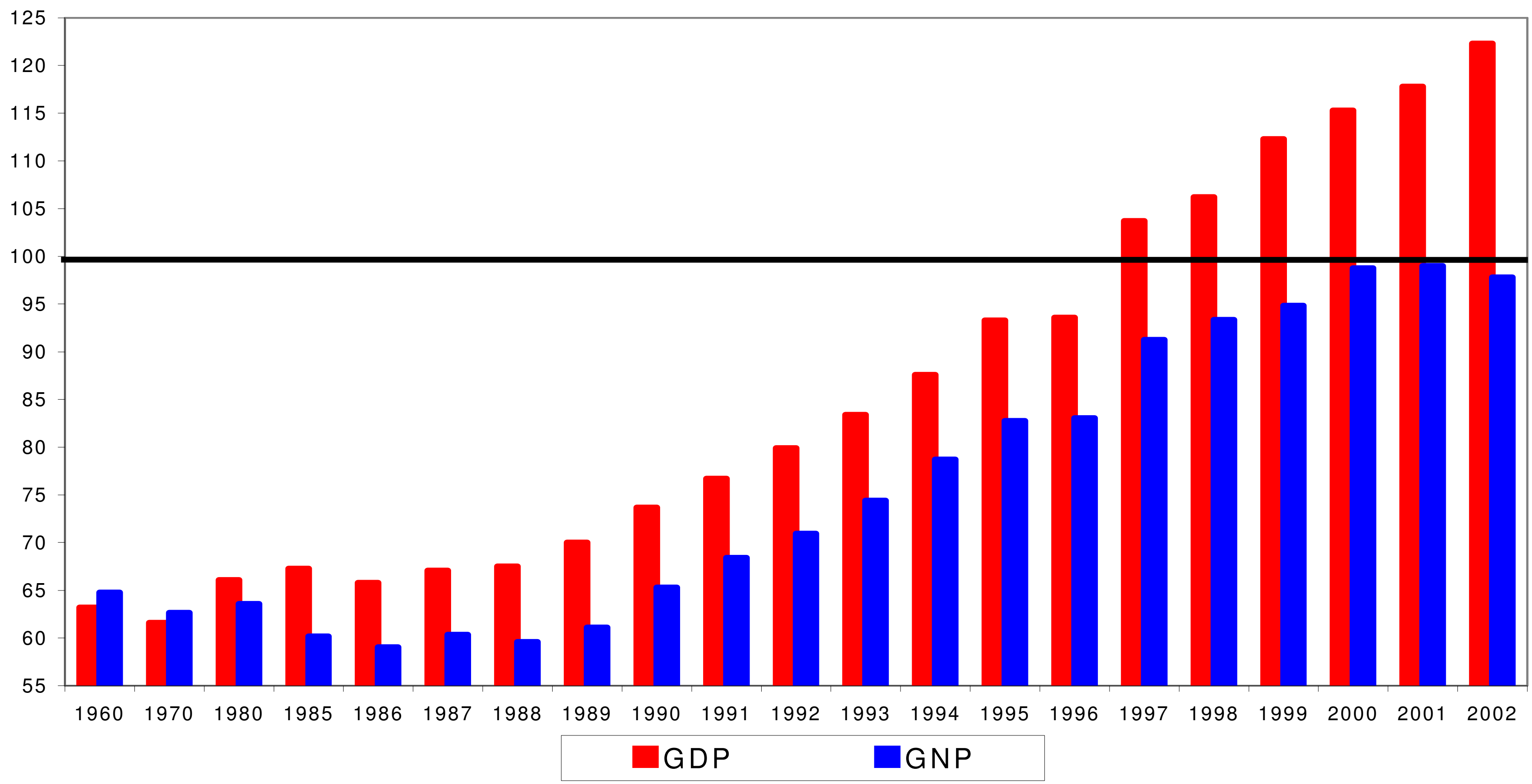
After enlargement: EU-27 = 100 (pps)

Country	2001	2007
Belgium	*124*	*118*
Denmark	*128*	*120*
Ireland	*133*	*150*
Greece	*87*	*95*
Portugal	*77*	*76*
Spain	*98*	*105*
Bulgaria	*29*	*37*
Romania	*28*	*42*

Irish sectoral industrial portfolio: by the late 1990s

Sector	Output share (%)	Employment share (%)
Electrical & optical equipment	29	25
Chemicals, pharmaceuticals and man-made fibres	24	9
Food & beverages	21	19
Paper & paper products	10	10
Other	16	37

Figure : GDP and GNP per head, PPS, EU 15 = 100



Implications for small EU economies

- Base competitiveness on high productivity and quality rather than just on low wage costs
- Create a niche in global total value chain, assisted by trade liberalization, improvements in human capital and physical infrastructure, and direct incentives to encourage inward investment
- Needs a strategy of continual improvement in quality and towards higher value-added activities

How did Irish convergence become cumulative and self-sustaining?

- **An initial "cluster" of activities, supported by special incentives (e.g., low taxes) and local specialized inputs (trained labour force): role of *<u>industrial strategy</u>***
- **Increased local availability of skilled workers facilitated further growth of cluster: role of *<u>human capital</u>***
- **Spillovers of information and "learning-by-doing" encouraged further cluster growth: role of *<u>physical infrastructure</u>***
- **Macro and monetary policy stability, and consensual social partnership ensured *efficiency* is accompanied by *equity*, and facilitates self-sustaining regional growth**
- **Global recession has seriously challenged this process!**

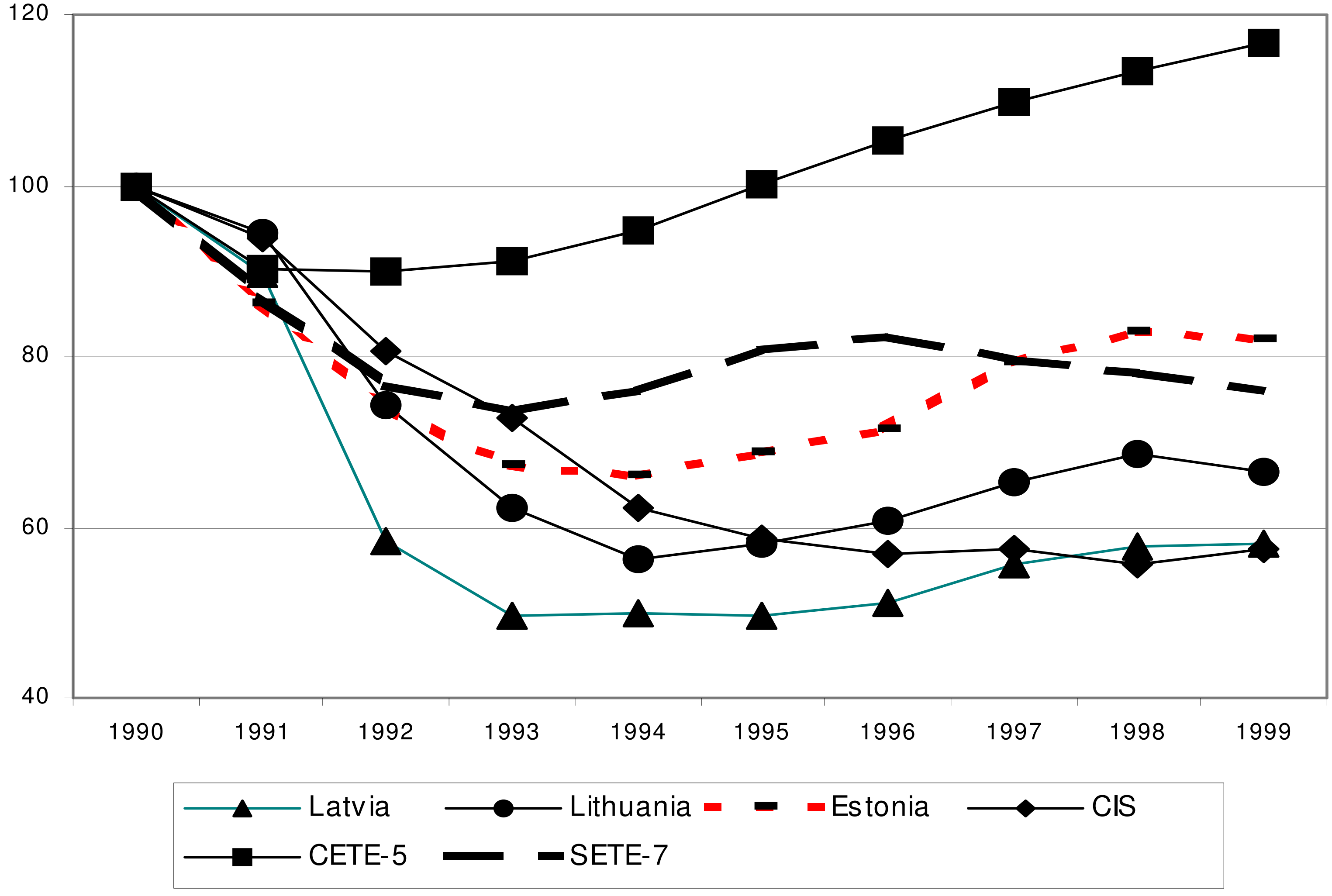
The new enlarged European Union:

Implications for the future

The context of development

- **Economic development from a low base within a given economic regime (Ireland, Portugal, Greece, Spain)**
- **Reversing decline after an economic regime switch (Bulgaria and most other new EU member states)**

Real GDP, 1990=100



The two phases of transition

- **Phase 1: Initial institution building, sectoral re-organisation and re-allocation**
  - **-> Early (2004) CEE entrants to EU: 1989-1994**
  - **-> Later (2007) entrants to EU : 1989-2000+**
- **Phase 2: Cohesion processes operate in a context of fairly stable but evolving institutional framework**

Transition and convergence in new EU member states: Key forces

- **Progressive trade integration with EU**
- **Foreign direct investment inflows**
- **Technology transfer**
- **EU-aided investment programmes, mainly for the support of infrastructural and human-capital development.**

Which industrial development strategy?

Ireland, Denmark or a mixture?

Copy Irish Strategy? Challenges

- Too heavy a dependence on foreign direct investment?
- Foreign direct investment (FDI) is concentrated into a narrow range of technologies that can quickly move through maturity and into decline
- The loss of its "first mover" status and greater global competition for FDI

Copy Nordic Strategy? Challenges

- Heavy demands on local entrepreneurship, skills and experience
- A need to focus on selected sectors. Which sectors?
- Difficult to build international competitive advantage from a small base in a global market

Some lessons from Ireland for transition economies

- Adapt to external market forces, but consistent with social objectives
- Detailed comprehensive sectoral "planning" inapplicable because of openness
- Strategy must be flexible, reactive and incremental
- Create a "winning environment" rather than pick "winners"
- Essential to monitor domestic developments against need for external competitiveness, and adjust when required

"When you do not know to what port you are bound, fair winds will not blow you there"

Seneca