Southeast Europe: in search of a favorable interaction between endogenous and exogenous factors in development

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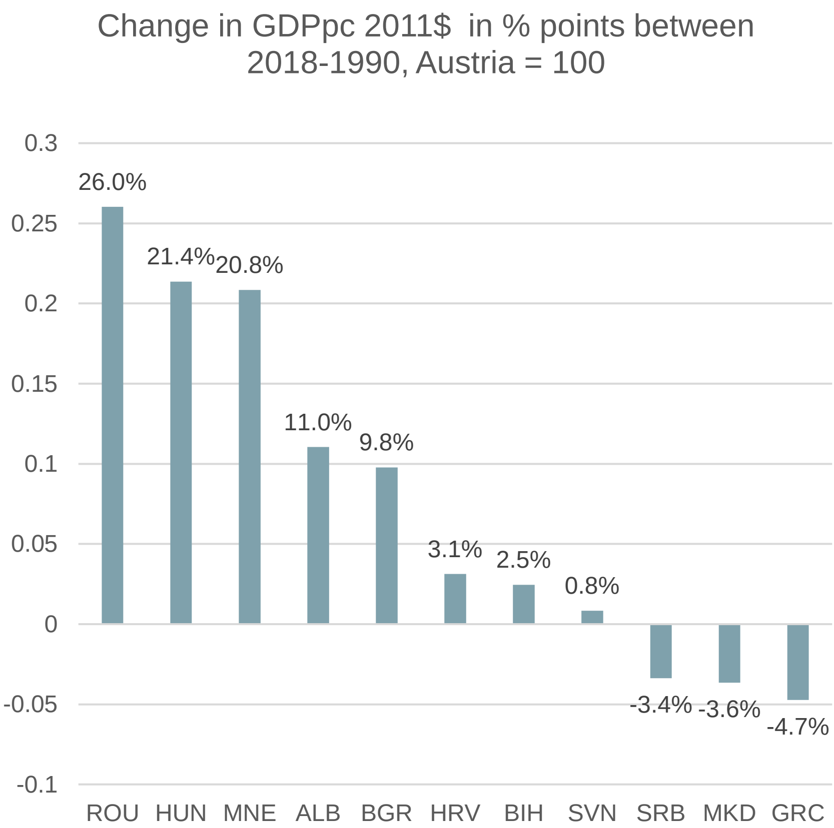
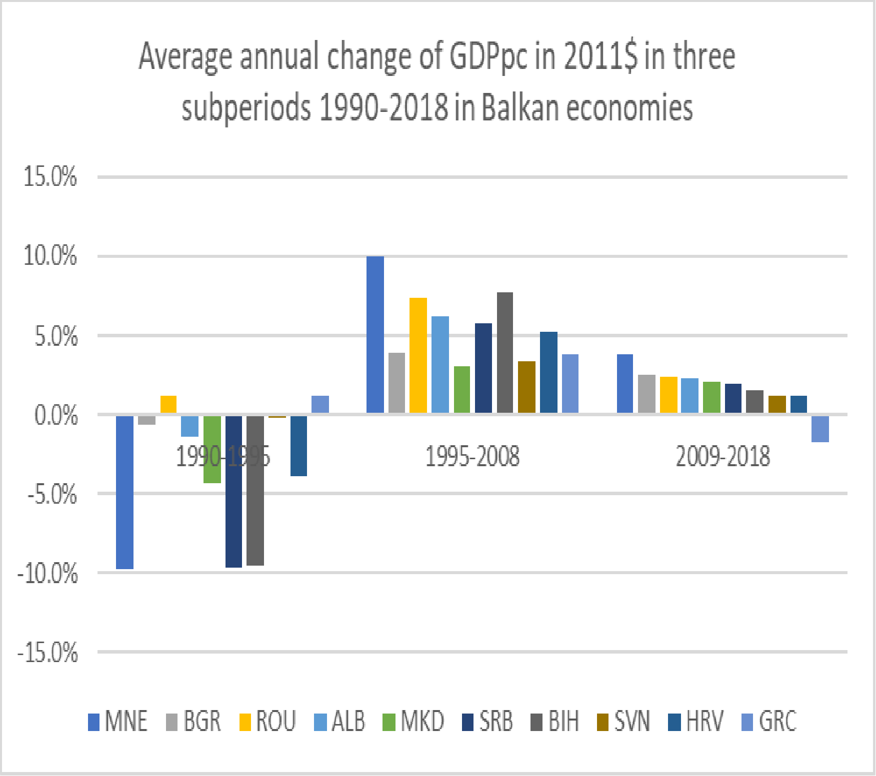
Post-socialist institutional convergence but differentiation in growth outcomes



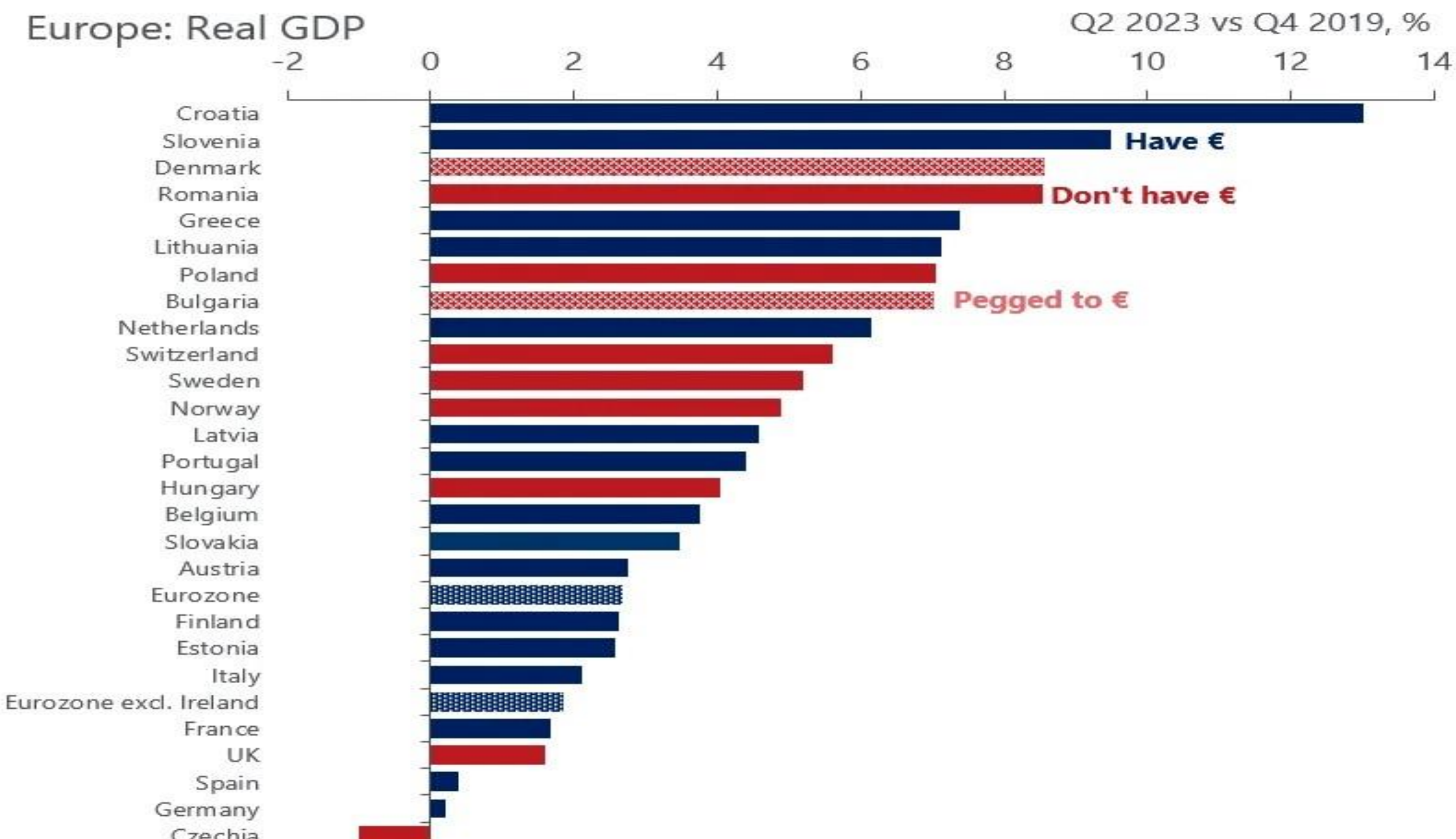
- Compared to Austria, **all ex-Yugoslavia** (except Montenegro) have **either further fallen behind or have only marginally caught up** with the ex-imperial power.
- Romania, Hungary, and, to some extent, Albania and Bulgaria have managed to catch up **to some extent.**
- Greece falling behind is **entirely of post-2008 origin** > excessive credit creation and Eurozone defects

The post-socialist period: three distinctive subperiods

	SEE avg	AUT	HUN
1990-1995	-3.7%	1.6%	-0.3%
1995-2008	5.6%	2.3%	5.1%
2009-2018	1.7%	0.9%	2.8%



2019-23: SEE compensating post-2008 declines: HRV, ROU, GRC, BLG



Source: Oxford Economics/Haver Analytics (UK based on blue book revision from 1 Sep)

Factors of endogenous growth in SEE: a structuralist perspective

- Population, income distribution and demand
- Science, innovation and enterprise
- Financial sector
- Government
- Trade, FDI and value chain integration
- Conclusion: None of these factors by itself seems to be a powerful driver of growth that could set change in other factors in motion

Population, income distribution and demand

- Demand is not a strong feature of SEE economies > **depopulation and low activity levels**.
- Income inequalities varying from **'relatively reasonable' to 'relatively equal' societies**.
- Some ec. with high unemployment of highly skilled; Others facing **skills constraints.**
- Pockets of sophisticated demand due to the **emerging middle class** using the internet above what would be expected given the income level of these economies.
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Industry and industry structure

- A strong **deindustrialisation and 'servicification**'.
- The deindustrialisation has **slowed down and has been reversed**.
- Most have **limited employment shares in technology-intensive sectors** (machinery and transport equipment) > but, ROU and BLG may be on the way to integrating these sectors into the EU industrial networks.
- NMA and ALB have a stronger presence in **clothing and textiles**, with other economies largely oriented towards **services or resource-based sectors** (cf. wood).
- The extent to which **services may become the driver** of economic growth is uncertain
- In high-tech knowledge-intensive services, only Romania, Serbia and Bulgaria have a critical mass of exporting activities in **ICT services.**

Science, innovation and enterprise: local firms and their R&D and innovation activities are not (yet) growth drivers

- The firm structure is dominated **by SMEs, which operate isolated** and unrelated to a small number of large firms.
- **Large firms are not very R&D active** and often enjoy a monopoly on local markets, especially as they are regionally or sectorally major employers.
- The R&D system is expanding but is of **low capital intensity** and oriented primarily towards fundamental research and activities of limited relevance to local firms. EU R&D integration is reinforcing the **dual nature of their innovation systems.**
- The upstream orientation of R&D and downstream orientation of the innovation system towards FDI without these two systems having close linkages.

Financial sector does not seem to be a factor of advantage of SEE economies despite the dominance of foreign banks

- Banking sector **orientation towards real estate and consumer durables from the past continues**.
- Large infrastructure projects are financed by **international banks or public -private partnerships** and continue dominating the investment spectrum.
- More **versatile sources of finance** required
- The **weak rule of law and inadequate business transparency** do not help.
- In new EU member **the EU funds, including recent Recovery and Resilience Facility funding** (ROU, HRV, BLG), represent the only macroeconomically relevant inflow of new investments some of which may facilitate technology upgrading.

Government as the promoter of economic development

- In none of the countries, the government is effective at the level of developed economies.
- Government roles vary from country to country, and **paths or trajectories of changes in this respect are very much country-specific.**
- However, a slow **secular trend of improvement** is present as a broad tendency but with cases also of strong (temporary) reversals.

Trade, FDI and value chain integration I

- SEE are small, open economies for whom **export** is the only long-term way to grow and upgrade technologically.
- **A proximity to Central European manufacturing cluster**, and labour cost differentials > **unexploited opportunity**
- They are gradually integrating as an **assembly type of economies**, though this path has significant variations. Bulgaria and Romania seem to be progressing well along this route.
- The nature of this integration varies and includes **production activities in nominally high-tech sectors** (electronics, automotive, machinery) but also integration in **buyer-driven chains in clothing and textiles** (Albania, North Macedonia, partly Bosnia).

Trade, FDI and value chain integration II

- However, the main engine of this model, **Germany, is losing steam** due to, among other things, weakening links with China.
- Some benefits from 'reshoring' and 'friend shoring' **may not compensate** for potential gains if the German export model weakens.
- A new emerging trend is **the increasing role of ICT services export** where Bulgaria, Romania and Serbia have already established a significant presence.

Conclusions I

- SEE endogenous factors were either **not individually strong enough** to set in motion growth chains or were **not mutually complementing** each other.
- For catchup > **congruence between domestic endogenous and external factors and institutional arrangements**, which can ensure access to market and technologies.
- How actors from core economies **behave in relation to periphery matters** (EU, FDI, China, Turkey).
- How **local elites** handle their economies' openness and autonomy also matters.

Conclusions II

- The issue is **who controls the technological modernisation process** > **Openness or autonomy alone** does not necessarily lead to growth and catching up.
- Current political and business elites are still **short-term rent-seeking oriented.**
- EU integration can drive growth for some time but will not lead to convergence **unless combinations of favorable endogenous drivers of growth reinforce each other**
- General lesson: the key development challenge is **the interaction between endogenous and exogenous forces in development**.

THANK YOU