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Research Report

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IW-Kurzbericht 30/2018

Economic crisis slows European convergence

Matthias Diermeier / Markos Jung / Pekka Sagner

Up until the economic and financial crisis, economic conditions in the European regions had been converging. This process has come to a complete standstill in recent years due to lower growth in Eastern Europe and stagnation in Southern Europe.

Ever since it was founded, the EU has made the raising of national living standards to a high level a core objective of European integration (European Economic Community, 1957; European Union, 1992). The financing of European cohesion policy, which accounts for 34 percent of the European budget (Darvas/Wolff, 2018), is also based on this objective. Cohesion funds are particularly important for less economically advanced countries: for example, the allocation of EU funds to Romania alone in the 2014–2020 funding period amounted to around 31 billion euros – compared with a Romanian gross domestic product of around 170 billion euros.

The high importance of the prospect of convergence for poorer member states and the large payments of the richer countries justify devoting considerable attention to evaluation. At the same time, a causal analysis of cohesion policy has proved to be extraordinarily difficult – first of all, because the question of a measure for the standardisation of living conditions must be answered. An important indicator for the evaluation of convergen-

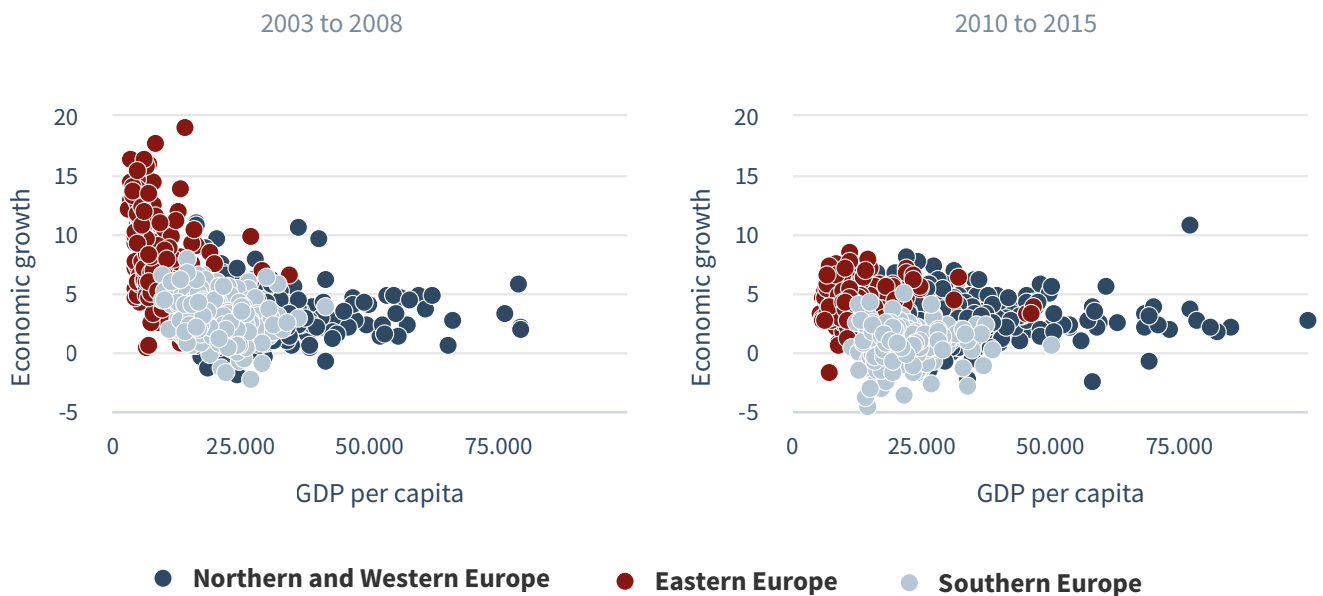
ce efforts is GDP adjusted for purchasing power. Starting from the idea that poorer countries need above-average growth to catch up to richer countries, the figure represents the so-called beta-convergence. According to this measure, by and large, convergence within the EU takes place when the poorer South and East experience faster growth than the richer West and North.

Viewed historically, in terms of real GDP per capita, such a convergence process has indeed taken place within the EU-15. Since the 1950s, economic output in the relatively poor countries of southern Europe – Greece, Portugal and Spain – has risen sharply, with the lowest growth being in prosperous Denmark. In particular, until the 1980s, the EU-15 has moved closer together economically (Goecke, 2013).

With the entry of the Eastern European countries – whose income levels to some extent lag far below those of Southern Europe – into the EU family, the frame of reference for analysis has fundamentally shifted. And indeed, at first glance, between 1999 and 2016 a solid recovery in the Baltic and Eastern European economies can be seen compared with the EU average, which however is driven by very high growth rates in the pre-crisis period. The disastrous performance of Italy is conspicuous, in addition to the weak performance of Greece, both

European regions: from convergence to crisis

GDP per capita in purchasing power standard Euro 2003 (left) and 2010 (right) and average annual growth in per cent during the years...



Only regions that experienced economic growth above -5 or below 20 per cent and a GDP per capita of less than 80.000 Euro
Source: Eurostat, German Economic Institute

caused by the financial and economic crisis. In a comparison between 1999 and 2016 adjusted for purchasing power, Italy has lost an entire 25 percent compared to the EU-28 average (del Hoyo et al., 2017).

At the same time, income prospects have not deteriorated everywhere in Italy. The fact that the industrially strong regions of northern Italy have fared relatively well is hardly taken into consideration when looking at the country's aggregate GDP. Therefore, in order to take into account the differences within the countries, a differentiated consideration of the regional economic situation is needed. For the regional level, it is useful to consider the so-called NUTS-3 classification of the EU countries (see Goecke/Hüther, 2016). In Germany, this is determined from the division into 402 districts and independent cities, in Italy from the 110 provincias, in France from the 101 départements. Overall, the EU is subdivided into 1,341 NUTS-3 regions (NUTS-2013 classification).

The regional comparison covers a broad income disparity in Europe: for example, economic output per capita in 2015, adjusted for purchasing power, was 55 times

higher in Camden & City of London, UK, than in Silistra, Bulgaria.

Processes of convergence over time are particularly evident in the capital regions of Eastern Europe, which are characterised by strong economic development and are economically robust and densely populated in comparison with national averages (Alcidi et al., 2018): GDP per capita in Madrid in 2003, adjusted for purchasing power, was still twice as high as in Bucharest, but in 2015 Bucharest's population produced 20 per cent more than that of Madrid.

Goecke and Hüther (2016) find no clear economic convergence between 2000 and 2011 in their regional EU convergence analysis. In particular, the different growth performances of the regions of Greece and Portugal that were hit hard by the economic crisis justify a differentiated approach that presents the asymmetric crisis effect in detail.

The pre-crisis period between 2003 and 2008 shows a convergence process in Europe that is driven by high

rates of growth in Eastern Europe and the Baltic States. Small southern European regions – especially in Spain and Portugal – also registered catch-up growth. Among the prosperous regions, a number of French and British regions in particular fall behind in this period.

With the onset of the financial crisis, this picture changes fundamentally. On the one hand, the relative growth in the Eastern European countries is slowing down. For example, GDP per capita in Bulgaria and Romania, adjusted for purchasing power, grew by an average of 9.7 and 14.9 per cent respectively before the crisis (2003-2008), and thereafter at only 4.1 and 4.6 per cent. On the other hand, many Southern European regions were notably affected by the euro crisis. This is true even when one ignores the severe turbulence of the financial crisis in 2008 and 2009. Several poorer regions of Greece lost around four percent relative to the EU average each year between 2010 and 2015 alone.

On the other side there are German and British areas, which recorded strong growth in the post-crisis period from a high base level. For example, GDP per capita adjusted for purchasing power in Ingolstadt, Germany, was around 77,000 euros in 2010, four times higher than the EU average and thus ranked 10th of the 1341 European regions. Ingolstadt increased its lead to just under 5.5 times the EU average by 2015. No other EU region improved its position to such a degree.

Due to these various developments, the convergence process in the years following the financial crisis has stagnated. The rapid growth in the East has slowed down, the South is recovering only marginally and in places has been completely left behind, not experiencing any significant benefit from the recovering world economy and the favourable low interest rates. Nevertheless, recent data give reason for optimism. In 2017 Spain and Portugal grew more rapidly than the EU average, and Romania and Poland are also growing faster. The biggest problem children continue to be (southern) Italy and Greece, where necessary reforms have been less consistently implemented than in Spain and Portugal.

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