INTEGRATION AND INEQUALITIES IN THE EASTERN EUROPEAN COUNTRIES

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Abstract
Within the European Union, regional economic performance and economic development respect the principles of the core-periphery model, with core-countries in Northern and Western Europe and periphery-countries as the Southern and Eastern European states. Thus, although treaties and cohesion policies promote balanced development throughout the European Union, it continues to be a divided entity. Despite the efforts of both public institutions at both the national and EU level, and the private sector, inequality still persists and in some cases is increasing. In analyzing the causes of these perpetuating disparities and especially in shaping solutions to ensure balanced development throughout Europe, one should take into account that when joining the European Union, its Member States should be treated as regions of a supranational organization. Hence, it follows that development and growth programs, as well as the allocation of cohesion funds must consider the dissimilar socio-economic and cultural backgrounds encountered in the Member States, the 'one size fits all' approach threatening to intensify Europe's North-South division. Using panel data, this paper provides an empirical study of the inequality determinants, aiming to identify convergence or divergence trends across countries and regions of Eastern Europe. Our findings partially confirm the theory, indicating that, in the long run, the new EU Member States recorded a process of convergence, reducing the gap between rich and poor regions, even if in the short-term, and especially in times of economic crisis, the economic disparities may widen. Moreover, the results highlight that there is potential for boosting GDP per capita in all territorial units analyzed.

Key words: inequalities, convergence, economic geography

JEL classification: O19, R11, R58

1. Introduction

Regional economic development within the European Union respects the core-periphery distribution [13], with *core* areas, like Northern Italy, Benelux, North-Western Germany, Southern and Central UK etc., and *periphery* areas, like Southern and Eastern European regions. Since the beginning of the "modern" EU, but especially in the last 20-30 years, it has continued to be an entity divided between the developed countries in the North and West and the significantly less developed countries in the South and East. Regarding the causes of these disparities, one explanation offered considers historical antecedents of the Member States, and regions, which could set the premises for a slower or faster development process. By the same vein, Cornia [7] found, based on empirical data, that the emergence and evolution of disparities can be explained by the unequal distribution of income among employees, equity holders and rentiers. Another reason for the unequal development are the more or less rational expectations of economic agents [14], which, by their actions, have the ability to influence the degree of advancement in a geographical area.

More recent studies [18] show that differences in yield between capital and labor generate, in turn, inequalities, which, perpetuating in the long term, can undermine the core values of a modern society. The same research estimates that mechanisms are not "naturally" created to prevent or mitigate disparities, hence the need for a stakeholder's intervention, in order to create the conditions for sustainable and balanced development and to offset, in an equitable manner, the losses of those who are unable to cope with economic competition. It is also important to note that the process of economic growth, although it has a positive impact on the overall level of welfare, it itself generates winners and losers [1].

A phenomenon that contributes to increased interregional differences is the concentration of economic activities, in particular the non-financial economic activities. Thus, while some activities - such as retail - are spread relatively evenly in most regions, many others show considerable variation in their level of concentration. This leads to the creation of regions with a high degree of specialization and the formation of industrial clusters that contain a small number of regions, but sums up much of the production in a particular area.

Economists appreciate, however, that regardless of the causes that led to inequality, disparities both within a state and the interstates' ones will be reduced until they reach a level considered to be acceptable [15]. The divergences in the short-term and long-term convergence coexist [17] and are, in fact, two sides of the same coin. However, it appears that the less developed countries have a growth rate higher than developed countries [4], which in the long-run contributes to reducing disparities as well. The convergence process is influenced by international trade liberalization and facilitation of FDI [2] and, in the European Union, by the policies and freedoms that are generated by the single market. Another important factor in reducing inequalities, generated by the integration process, (e.g. the Single market) is the transfer of technology and knowledge among the Member States, and the investment in education and human capital [7] – [19], which can generate an increase in the number of qualified staff and hence an increase in the competitiveness and the pace of economic development.

2. The Economic Geography of Europe

The process described in the previous section led to the formation of clusters of interconnected companies (industrial clusters or economic agglomerations). They have specialized in a particular field or in several related areas, and their appearance is due to the productivity growth of the companies within the industrial agglomeration (for example London area produces over 20% of UK's GDP; Stuttgart, Wolfsburg or Torino have a GDP of almost 70 billion EUR), following the interrelationships established among the system components. Hence, development and modernization of clusters has become an important strategic program for both national governments and regional administrations, but the achievement of the goal requires a very important contribution from the private sector. Initiatives in those programs outline a new direction in economic development, based on both previous efforts of macroeconomic stabilization and stimulation of the educational (learning) process and research, as well as market and trade liberalization.

To highlight the differences between the more developed regions and the poorer one, a group of French geographers, led by Roger Brunet in 1989 developed the concept of *Blue Banana* or the European Megalopolis also known as the backbone of Europe, which refers to a geographical corridor, with a population of about 110 million, which includes the most developed regions of Europe and is one of the largest industrial agglomerations worldwide. The corridor starts in North West England and ends in Northern Italy, having, as the name suggests, a banana shape [5] and includes cities such as Leeds, Liverpool, Manchester, London, Lille, Amsterdam, The Hague, Rotterdam, Brussels, Antwerp, Eindhoven, Düsseldorf, Bonn, Frankfurt, Luxembourg, Strasbourg, Stuttgart, Munich, Basel, Zurich, Turin, Milan, Venice and Genoa. This corridor is one of the EU's development models, the new Member States seeking to implement policies aiming to create similarities between them and the aforementioned cluster.

Factors contributing to regional specialization are diverse and include availability of natural resources (e.g. mining industry, wood industry, etc.), availability of qualified personnel (for scientific research and development), costs (salaries, raw materials etc.), infrastructure (transport networks or telecommunications), legal framework, topographic and climatic conditions (especially in terms of tourism related activities) and proximity to important markets or the size of the economy [9]. It thus appears that physical distances and transport costs play an important role in trade flows and intelligent use of interregional networks (elements of logistics and transport network connections) could alleviate the traditional barriers imposed by physical distances [16]. In this regard, Anderson and Winecoop [3] found that a doubling of the distance between two places leads to reducing their trade by about 50%, this percentage may be even higher when transport costs are high or when there are trade barriers.

Estimates based on econometric analysis can identify key factors in the economic growth of regions, among the most important being: the initial GDP / capita, public infrastructure (measured, for example, via density highways) innovation activity (rate of registration of patents) and agglomeration economies (such as industrial specialization and diversity) and the market potential (for example in terms of GDP, density of population and the number of connections with other areas) of a region [12]. In order to have an accurate model of growth and convergence, one should add to these determinants human capital and markets' functioning variables (overall economy indicators, trade opening rate, foreign direct investment, demographic and socioeconomic factors etc.). These estimates suggest that, in general, a high degree of accessibility of a region confers an advantage in its growth prospects, especially with the better use the highly qualified labor force, in conjunction with other positive externalities. The evidences also underline the importance and the statistical significance of sectorial diversity with a good access to markets for richer regions at the expense of the poorest.

Generally, these determinants that stand out so strongly emphasize their relevance in regional growth, requiring policies not only at national level but also regionally, aiming to mobilize labor resources, development of local facilities and exploitation of comparative advantages. The relationship between market size and growth rates show a positive correlation between the various economies of agglomeration, local characteristics and spatial economic development. Large gaps between the economic performance of regions and micro-regions reveals heterogeneity of Eastern European states, suggesting that there are potential determinants of growth in all spatial cut-outs.

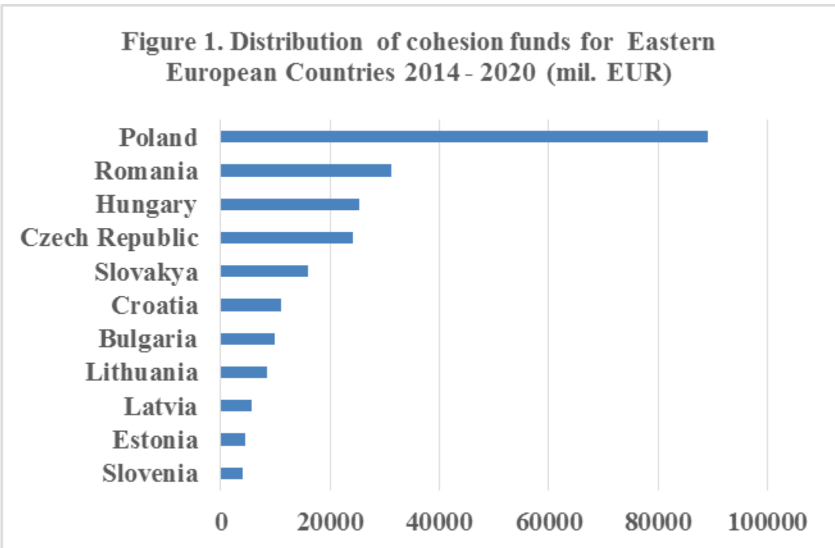
3. Regional Policy of the European Union

Despite the efforts of public institutions and private sector, development inequalities persist and in some cases deepen. In analyzing the causes of inequalities and especially in shaping solutions to ensure balanced development throughout Europe, one should bear in mind that when a country joins the European Union, as a member state, it becomes a region of this political-economic organization. Hence, it follows that development and growth programs must take into account the more or less homogeneous characteristics encountered in the states, as one-size-fits-all policy applied in all countries is not always the best solution.

In terms of regional development, one of the main objectives set out in the European Union's founding treaties is to reduce disparities among regions through programs aimed at the social cohesion and convergence in terms of income distribution. To achieve this goal one of the most important tools is improving the productivity and competitiveness of each and every geographic area. Regional policy is therefore an expression of the principle of solidarity existing within the European Union and involves allocating funds for the development of poorer regions and economic sectors in difficulty. Nowadays, the European Union consists of 28 states, after the admission of Croatia on 1st July 2013, the 272 NUTS (Nomenclature of Territorial Units for Statistics, where level 2 is the main framework for implementation of European policies, the so-called "development regions") 2 regions.

An important aspect of EU Cohesion Policy, which is specifically intended to reduce disparities, is the ranking of regions in terms of their level of prosperity in relation to the EU average. This ranking largely determines whether and how much a region will be financed from the EU budget in order to increase competitiveness and reduce disparities compared to the more developed regions or countries. The level of regional development and the ranking depend largely on how the disparities and economic development are measured [20]. The lack of clear definitions of the concepts and differences in statistical methodologies used at national level make such an approach difficult to put in practice, both scientifically and in political and administrative terms.

In 2014, 28 of the 272 EU regions analyzed, 76 had a GDP / capita less than 75% of the European average, the lowest value (28.68% of the EU-28) was recorded in the North-East region of Romania, and the highest (320.79%) in the Inner London region, United Kingdom. Regarding the Eastern European countries, in 56 regions analyzed, 49 had a GDP of less than 75% of the EU average, only 6 regions managed to reach or exceed this value. It is important to note that all these regions comprise the capital of the state: Praha – Prague, Közép-Magyarország – Budapest, Mazowieckie – Warsaw, Bucureşti – Ilfov – Bucharest, Zahodna Slovenija – Ljubljana, Bratislavský kraj – Bratislava. The most developed region Bratislavský kraj, in Slovakia, which has a GDP/capita equal to 186.08% of the European average.



Source: own preparation based on Eurostat data.

In March 2013, there were 75 NUTS 2 regions with an average GDP per capita of more than 25% below the EU27 average. 26 regions were concentrated in six of the EU-15 countries: Greece (eight regions), Italy (five southern regions), UK (five regions), Portugal (four regions), France and Spain (two regions each). The other 49 regions were in Member States that joined the EU in 2004, 2007 or 2013 (Croatia): all these Member States (except Cyprus and Malta) had at least one region with a GDP/capita below 75% of the EU average. Among these geographical areas there were 22 regions where average GDP per capita was less than 50% of the EU-27, which are located in Bulgaria, Hungary, Poland, Romania and Slovakia. Around 38.4 million people were living in the 22 regions whose GDP per capita was less than 50% of the EU-27 average, equivalent to 7.7% of the EU-27 population.

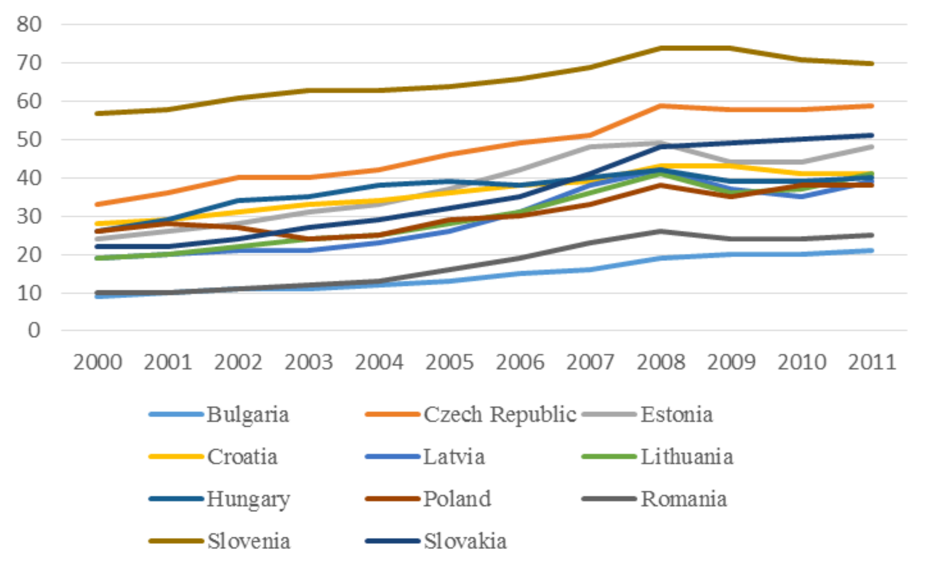
In 2007-2013, the European Commission allocated 347 billion Euro for regional policies, having the following the objectives: improving communication and transport networks, development of small and medium enterprises (especially in disadvantaged areas), increasing the quality of education, increasing innovation, increasing energy efficiency and combat the negative effects of climate change.

In the period 2014-2020 351.8 billion Euro will be allocated for regional policies aimed at creating jobs, combating climate change, reducing energy dependence and the reduction of poverty and social exclusion. The most important strategy in this area is Europe 2020, which envisages achieving specific objectives for each Member State. In addition to these funds, Member States have allocated themselves about the same amount of funds for developing regions [10].

According to the latest European Commission report (2011) on the convergence and disparities within the European Union, GDP / capita in the least developed regions has increased significantly since 2000. Predominantly rural regions were less affected by the economic crisis than the areas where exports, tourism and financial services have a significant weight. Nevertheless, regional disparities within Member States apparently continue to grow [11] and Europe remains a continent divided between North and West (richer), on the one hand, and South and East (poorer), on the other hand. The political, economic and social significance of this situation are considerable: the territorial organization which aims to streamline economic activity measures is required to support all regions and countries, but in particular the least developed ones. Strategies adopted at European and national level, but also the subnational/regional level should evaluate the existing conditions and growth determinants together with their size and their potential effects, in order to make the results to be optimal.

Economic studies [8] conducted before the 2004 enlargement wave show that European integration has always been beneficial for the new Member States and contributes to varying degrees, to reduce the gap between them and the states that were already part of the union. Integration also contributed to increasing disparities between Member States and non-Member States, and in some countries, such as Romania, there was a reduction of interregional disparities, but also an increase in intraregional disparities, respectively at the counties' level [5].

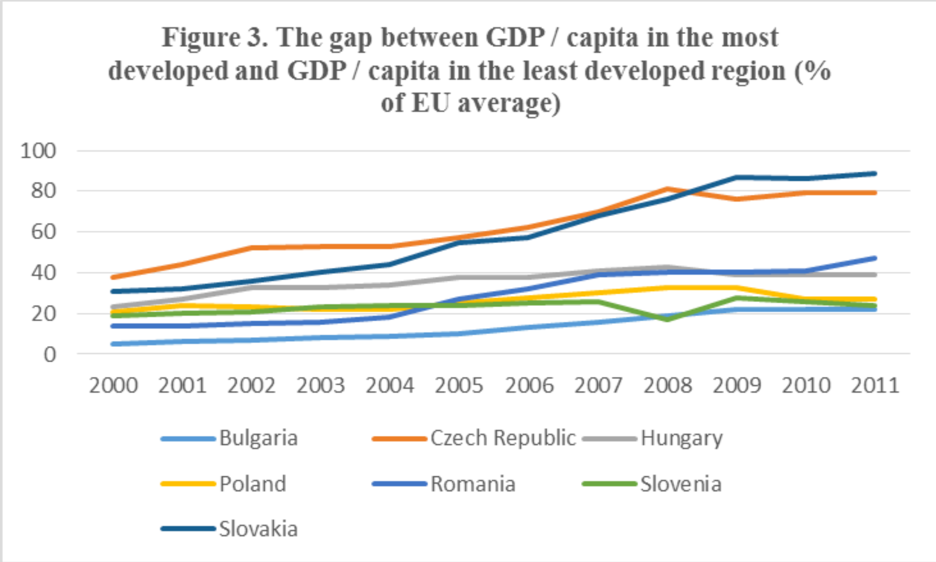
Figure 2. GDP/capita (EU 28=100%)



Source: own preparation based on Eurostat data.

At the state level, from the Eastern European states that joined the EU in 2004, Slovakia has benefited most from the accession, GDP per capita here evolving from 29% of the EU average at the time of accession, to 51% of the EU average in 2011. The second largest convergence was registered by the Czech Republic, which recorded an increase in GDP per capita from 42% of the EU average in 2002 to 59% of the EU average in 2011. Similar progress has been made in Poland, which approached the EU average, growing in the same period from 25% to 38% of the EU's GDP per capita average, respectively in the Baltic States, which recorded significant appreciation in the value of GDP / capita compared to the European average. As regards the countries that joined the EU in 2007, they also had a positive trend, Bulgaria evolving from a GDP equal to 16% of the EU average GDP to one equal to 21% of this average, and Romania of from 23 to 25%. It is therefore apparent that the best results were obtained from the less developed countries, which confirms the theoretical assumptions and indicate that there is potential for growth that can be exploited.

With regard to the disparities among the regions of the same state, empirical data show increased inequalities both in the pre-accession and post-accession time, the largest gaps occurring in Slovakia, Czech Republic and Romania, and the lowest in Poland. It is also remarkable that throughout the period analyzed (2000 - 2011), the most developed and least developed region maintained, with few exceptions, their status.



Source: own preparation based on Eurostat data.

4. Conclusions

The reduction or elimination of trade barriers and the promotion of free movement of production factors contributes to the spatial concentration of economic activities. Also, even if we consider spatial dispersion forces as determinants of economic activities, the theoretical framework projects a positive correlation between increased concentration and faster development. This phenomenon can be observed easily in areas with a high degree of economic integration, in which trade is liberalized, and the mobility of production factors is at a level high enough to allow the formation of industrial clusters, features that are met by the European Union.

Economic integration, however, requires not only the elimination of tariff and non-tariff barriers, but also comprises a significant number of non-economic factors, including: linguistic and cultural differences, socio-demographic characteristics, education level etc. Another important determinant of growth and convergence is the psychological factor, especially in terms of individuals' expectations about the future of a particular economic sector or a particular geographical area. These expectations, along with the importance attached to each individual's present actions in determining future results are also elements that influence growth and population density in certain areas and reduce these indicators values in others. The most obvious example in this matter is the continued growth of urban population, especially in big cities, and decreasing density in rural areas.

It is also important to note that, both in the theoretical literature and empirical data analysis, one of the determinants of industrial clusters and the accelerated development of a geographical area is the historical past. It can promote or place in an unfavorable position certain geographical areas and their economic development. Hence, even if some regions are not altogether influenced by the past, historical antecedents may set the foundation of development. Starting from this point, economic integration and enlargement of the European Union should consider the mitigation of historical and geographical differences among Member States.

Eastern European states accession, mostly of them being former communist, was an important step towards achieving a united Europe, but was at the same time, a new challenge in terms of ensuring the same level of development for all Member States. Cohesion, convergence and increasing competitiveness are therefore the main purposes of European and national policies, and the value of funds allocated to support programs aimed at the attainment of these objectives reflect this aspect altogether.

One solution easily put into practice is the use of EU structural funds which are just meant to direct financial resources from the rich towards the poor, in order to increase the competitiveness of the latter and to reduce the gaps between them. Examples demonstrate, however, that in order to really reduce interregional disparities, money need to be used for the development of suitable investments and sustainable projects and especially in disadvantaged areas. Policies should therefore take into account both the geographical features (presence of natural resources, positioning, infrastructure etc.) and socio-economic characteristics of the human capital.

In conclusion, one of the most important aspects of reducing inequalities among countries in Eastern Europe and, later, to reduce the disparities between them and Western Europe is the awareness of the fact that industrial concentration, the EU single market and human capital could determine the development of a region. Consequently, state bodies, enterprises and citizens should create and implement strategies that involve the collaboration of all stakeholders in order to increase the competitiveness, the quality of human capital of each region, and thus the cohesion of all of the European Union.

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