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Labour market, FDI and investments during the high-pressure economy in Central and Eastern Europe

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Extended abstract

Central and Eastern European countries experienced a slow recovery, then a high-pressure economy after the global financial and economic crisis in the 2010s. As a result, they achieved an on-going convergence to the European Union's average level of development in terms of per capita GDP (partly affected by the slowing down of the Mediterranean member states' growth). The dominance of the capital city regions in driving economic growth is still reinforced, and the spatial distribution of foreign direct investments also plays a significant role in shaping regional inequalities. Despite explicit convergence at the national level, interregional income differentials are persistent and left-behind regions experience on-going stagnation. Although capital city regions enjoy above-average level of economic development, many regions in the eastern periphery are amongst the 20 poorest regions within the EU.

In this research we first depict the main features of the post-crisis national and regional development paths, as well as the trends of some common spatial inequality measures. Then, the rationale and the working of the high-pressure economy will be outlined. Finally, we try to estimate the scale of the economic downturn caused by the pandemic crisis, its implications on regional inequalities, as well as the way forward in the coming years. We intend to take a comparative approach and contrast the national-level economic development trends with those at the regional level.

Our research uses exploratory statistical data analysis and multivariate statistical analysis, primarily, principal component analysis, to investigate the relative importance and the territorial dynamics of selected regional economic indicators. The level of the spatial disaggregation is the NUTS 2 regions, and, where possible, the NUTS 3 regions. The geographical coverage of our research is the Central and Eastern European countries. We intend to focus on those variables that allow us to capture the working of the high-pressure economy, such as labour market indicators and investments, including foreign direct investments. We use publicly available statistical data in a regional disaggregation collected from Eurostat and national statistical offices.

Principal component analysis is a multivariate statistics method that reduces the dimensionality of large data sets, by transforming a large set of variables into a smaller one that still contains most of the information in the large set. It help us capture the interplay between the selected regional-level economic indicators. Our aim is to get a general picture about the nature of economic pressure in the different territorial units and its outcomes in terms of the regional per capita GDP. It could be similar to the case of a compound index measuring economic pressure.

Some authors suggest using principal component analysis for spatial time series data (e.g. regional-level GDP time series) to extract the common factors behind the various regionally disaggregated time series. This way, the first few extracted principal components may be regarded as the common 'national effects' behind the regional processes that are common to all spatial units. The loadings of the individual regions indicate that how strong the co-movement is between the growth path of a region and that of the national economy. Employing this method delivers us different results in the countries involved in our research. The most striking outlier seems to be Hungary, because in the other Visegrad countries, one principal component is enough to capture most of the cross-sectional variance, but more than one is needed in Hungary. This means that the economic processes underlying the regional growth paths are not homogenous in Hungary, at all, but they are more similar in other CEE countries.

The idea of a high-pressure economy was used to overcome the slow post-crisis economic recovery. It contrasted the previously used austerity-based crisis management that was common in the European countries. As the actual output was persistently below its potential level, a sustained high demand pressure was proposed to drive it back to the potential output. A high-pressure economy is associated with strong economic growth and low unemployment under which those who want a job can easily find one. In many cases, employment growth is larger in the lower-status segments of the labour market which means that larger employment and larger economic growth does not necessarily go along with higher labour productivity. High-pressure economy was maintained through lax monetary policy, expansionary labour market policies and the broad room for budgetary manoeuvre.

The era of the high-pressure economy caused notable shifts in regional growth paths. The regions surrounding the capital cities enjoyed increasing growth in all CEE countries. The buoyant non-capital regions could also hold their positions, with some exceptions, though. In the peripheral regions the benefits of the high-pressure economy appeared through the improving labour-market conditions. Our data show two noticable features. First, that the position of the lagging regions apparently improved during the second half of the 2010s compared to their own previous position, their growth rate increased in this period. Even though, their relative position within each country remained mostly unchanged, because their moderate growth started from quite a low basis. Moreover, their economic development was mostly fuelled by the spectacular, positive changes in their labour market conditions, but it was not supported by other growth factors, such as investments and FDI. Obviously, labour market expansion is not sustainable in these regions in the medium and the long run. Our second remarkable observation regards some of the regions that enjoyed the advantages of intensive FDI inflow after the start of the post-socialist period and were the front runners of economic growth after the Great Recession. These regions are located in the so-called 'Central European manufacturing core'. Our data shows that the labour market in these regions became reasonably tight, which was further amplified by the large-scale job-creating investments in the manufacturing sector (often in the low value-added segments). These trends are resonating with the challenges of the dependent market economy model, since these regions seem to be quite vulnerable to the global market fluctuations, as well as to foreign investment decisions. These two observations both underline the fact that local and regional development is hindered by the lack of spatial spillover effects, and even the relatively prosperous regions, including the capital cities, are challenged by the middle-income trap. With the exception of some rural peripheries, there are signs of the spread of economic dynamism towards some re-industrializing areas outside the capital cities, and much of the convergence occurs in these regions.

The coronavirus pandemic brought in new challenges, and the high-pressure economy cannot continue in the same way as before. A high degree of uncertainty remains over future growth prospects which hinders investment activities, especially on a transnational scale. We expect that hysteretic effects will appear in the national and regional growth paths. This means that the economies will not return to their pre-pandemic growth trajectories, but rather to lower paths. The high demand-pressure will decline due to the higher degree of monetary policy stringency in response to the increased inflation, and also due to the deteriorating fiscal conditions as a result of the large-scale pandemic stimulus packages. Moreover, certain sectoral and regional imbalances are expected to appear in the post-pandemic recovery process, such as in the tourism sector and in regions reliant on it. Economic resilience has a crucial role in these uncertain times, and, although some manufacturing-oriented FDI host regions and re-industrialising regions were hit hard by the pandemic crisis, they are better endowed with skilled labour and capital resources, therefore they are able to build back their economic potential more quickly.

Our preliminary results indicate that FDI has an essential role in ensuring a relatively high level of regional development, but the growth performance of FDI host regions proved to be unstable in some cases.