

ECONOMIC GROWTH IN THE EUROPEAN MODEL

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Abstract

Within the European model, the macroeconomic and cohesion policies insure a good substantiation of the sustained economic growth. The achievement of the Single Market had positive effects upon the European economy as a whole, but these benefits have not been equally distributed among states, regions and social groups. The market is the most efficient mechanism of resource allocation within the economy, but it is not the tool insuring the distribution of the registered benefits. For this reason, the mechanisms of the cohesion policy can improve the tendencies of the economic activities concentration, once the economic integration process has intensified. The economic convergence consists in the very close, even identical evolutions of one variable in two different countries or regions. In this paper, the author proposes to explain the defining elements of the European model, emphasizing the connection between the convergence process and real economic growth process. In this sense, we will present the European model of regional growth, which contributes to the achievement of a real economic convergence process..

Keywords: Economic growth, European model, economic convergence.

JEL classification: R11, F43, O42, O43, O47

1. INTRODUCTION

In the contemporary world, economic activities are strongly interrelated, as their contents and meaning are understood and assessed in terms of social and political environments, as well as national and regional interests. Macroeconomic activity passes through different successive stages like growth, development, stagnation and crisis. The intensity of these changes varies in time and from one country to another. It is now unanimously agreed that economic growth is the synthetic expression of the opportunities for a better life and represents a major macroeconomic policy objective of every state.

Specialists have approached the concept of economic growth and have expressed various opinions regarding this notion. Economic growth can therefore be defined as a continuous steady trend of the total national income and per capita income, which is accompanied by certain structural changes. There are various vague definitions of the term

“*regional economic growth*” in the specialty literature, where it is viewed either as a process or as a result. During the 1950s and 1960s, worldwide governments were increasingly preoccupied with economic growth. At the time, national governments often directed regional economic growth towards agricultural development infrastructure projects or development plans for the regions in recession, as an attempt to reallocate industries to regions in decline. In early 1970s, the world entered a new era of globalization, deregulation and liberalization of markets, which determined a vast and substantial restructuring, with a differentiated impact on areas and regions.

Neoclassical models offered a useful basis for understanding the implications of labour and capital changes on national and regional economic performances; the previously ignored social capital provided these models with an economic development dimension. Thus, economic growth was approached both from a quantitative and a qualitative perspective.

Regional growth theories gradually evolved from considering regions as non-spatial elements of the national economy to explicitly considering space. The first category includes the neoclassical model (based on Marshall’s principles), the cumulative causation model (Myrdal-Kaldor), the export potential model (Bolton), the econometric models (Czamanski, Klein, Harris etc.), the input-output models (Leontief, Moses, Richardson etc.). As an alternative perspective to traditional models, *the recognition of the importance of spatial components can be noticed in such theories and models as:* the centre-periphery model and the development corridor models (Friedman); spatial variants of growth poles theory (Boudeville etc.); the agglomeration theory and the “hinterland” effect on the dimension and distance between urban areas (van Böventer); the discussions on the role played by transport and polarizing forces in regional growth (Siebert); the development axes theory (Pottier); the theory of spatial diffusion of innovation (Hägerstrand and, later, Romer), so on and so forth. [4]

The comparative approach of these two main trends resulted, among others, in a largely debated theoretical issue, with obvious practical implications in the sphere of regional policies. It refers to *the competitive or generative character of regional growth*.

However, generative growth models greatly emphasize regional dimension, as they treat national economic growth rate as a resultant of regional growth rates. In this view, the whole growth is spatially oriented, in other words, the growth within any sector of national economy has its origin in a certain location.

These brief considerations underline the necessity of taking spatial component into account as far as regional economic growth theory and urban–regional analyses are concerned. On a practical scale, this translates in the careful study of the implications of adopting certain regional development policies, which may differ according to the span of the political power intervention, the microeconomic or macroeconomic orientation of the advocated policies with an interregional or intra-regional sphere of action, the focus on workforce or capital redistribution, on the exogenous sources or the potential for endogenous development, the promotion rate of the innovation process, the growth rate of the tertiary sector or the traditional sectoral policies etc.

2. THE EUROPEAN MODEL

Classical analysis of regional growth and corresponding regional policies refers to *the possibility of solving the conflict between efficiency and equity*. If low-income regions of-

ferred the perspective of an efficient use of capacity, these objectives would no longer be opposite. But agglomeration economies, market opportunities and other factors act in favour of high-income regions. That is why a series of “compensations” should be admitted between efficiency and equity. From a theoretical point of view, the conflict can easily be solved by means of an economic-mathematical model. One option is to choose a primary objective and maximize it, while the other objective will be treated as a constraint. The European model comprises two *regional policy objectives*: to maximize economic growth at the level of national economy (efficiency); to reduce interregional inequalities with regard to income, welfare, regional economic growth (equity). For example, in a simplified two-region economy, where efficiency is the primary objective, the decision model at national level will be:

$$\begin{cases} \max y_n \\ \frac{Y_{r1}}{Y_{r2}} \geq Z \end{cases} \quad \text{- where: } y_n = \text{national income growth rate; } Y_{r1} \text{ and } Y_{r2} = \text{income level of the two regions, where } Y_{r1} < Y_{r2}$$

However, there is no need to establish a hierarchy of the two objectives or to adopt the assumptions of linear programming. A less restrictive approach is to *trace an indifference curve between the alternative economic growth rates and the regional equity index*. For the sake of simplicity, every economic growth rate is assumed to imply a certain interregional distribution. [2]. However, in practice, there are many alternative interregional distributions that may lead to the same economic growth rate.

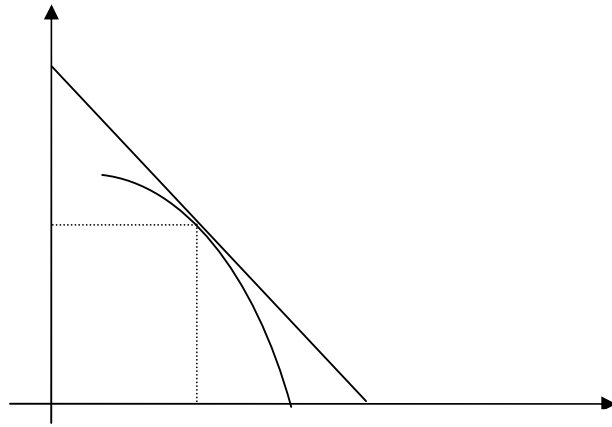


Figure no. 1 Indifference curve between economic growth and interregional equity

Supposing that the indifference curve was traced, any combination of equity growth objectives described by one of its points can be chosen according to the function describing the decision makers' preferences. Thus, it is assumed that these points clearly represent *social preferences* and the substitution ratios between equity and efficiency preferred by society are linear.

The functions expressing these preferences may be represented by a set of right descending lines. The tangent point of the highest preference function (P_{fe}) and the TT' curve is the optimum point on the indifference curve. This provides the *optimum combination* between the economic growth rate (Y_{ne}) and the regional equity coefficient (ze).

This possibility may be ignored if the institutional environment and the instruments of regional policy remain unchanged. An indifference curve of this type may be seen in figure 1. Still, the shape of the TT' curve is not certain. Normally, the equity index z is expected to be inelastic with respect to the modifications of the economic growth rate y_n , because the regional income convergence may be achieved very slowly, by means of long-term persistent differences in regional growth rates and not through short-term resource redistribution.

Although the curve may be traced based on statistic observations of the economic growth rate and the equity index, there may be some risks in terms of its use for forecasting and planning purposes. Another problem is that national development programs are forecast on a shorter term than corresponding regional programs and policies.

3. ECONOMIC GROWTH SLOWDOWN IN THE EUROPEAN UNION

At the end of 2008, due to the turbulent consequences of the economic crisis, the European Union's main problems are price growth and inflation rate growth (3.8% in the EU, 3.6% in the euro area).

An economic growth slowdown was recorded (1.3% in the euro area). Following the increased global economic instability, the production began to decline in many developed countries. In some cases, the phenomenon was determined by the real estate downturn. GDP decreased by 0.1% in the EU and by 0.2% in the euro area.

A year after the outbreak of the crisis, the international financial systems are still in a fragile state, insofar as many important credit markets are still seriously affected. Despite this situation, following increased financial instability in the last quarters of 2008, the decrease in confidence indexes became manifest in the Member States, at various levels (with a noticeable downturn of the general economic perception index in Spain and the United Kingdom).[7] .

Several indicators such as the industrial production or the retail sector show a growth slowdown during the last months, both in the European Union (EU) and the euro area. Anticipated inflation decrease which should sustain family income and consumption during the fourth quarter, represents one of the factors that might determine a change of trend.

Table no. 1 Harmonized Index of Consumer Prices (HICP) in 2008

	Quarterly HICP forecast				Annual HICP forecast		
	(% , year-on-year)				(% , year-on-year)		
	2008				2008		
	2008/1	2008/2	2008/3	2008/4	Spring cast 2008	fore- April	Interim forecast Sept. 2008

Germany	3.1	3.0	3.3	2.7	2.9	3.0
Spain	4.5	4.7	5.0	4.0	3.8	4.5
France	3.3	3.7	3.8	3.3	3.0	3.5
Italy	3.3	3.8	4.1	3.6	3.0	3.7
Netherlands	1.9	2.0	3.6	3.5	2.7	2.8
Euro area	3.4	3.6	3.9	3.4	3.1	3.6
Poland	4.5	4.3	4.8	4.4	4.3	4.5
United Kingdom	2.4	3.4	4.4	4.3	2.8	3.6
EU27	3.6	3.9	4.2	3.7	3.6	3.8

This downturn will, on the other hand, help ease inflationary pressures as oil prices come down and the risks of second-round effects diminish. But both labour markets and public finances are set to deteriorate. This forecast is surrounded by considerable uncertainty at the current juncture and downside risks prevail. [7]

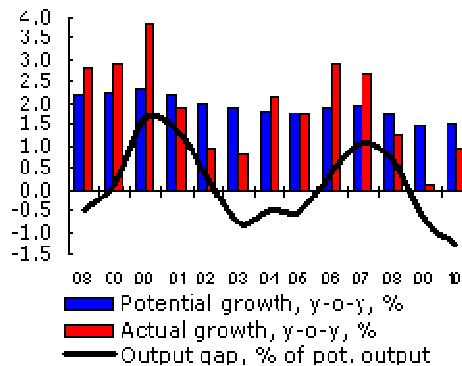


Figure no. 2 EU growth drops well below potential

With the financial crises having deepened and broadened in the past weeks, the Commission's economic forecast projects economic growth to drop sharply. The outlook for the EU economy remains bleak further ahead, with several of the EU economies in or close to a recession. According to the autumn forecast, GDP growth will slow down to 1.4% in 2008 (half what it was in 2007), 0.2% in 2009 and 1.1% in 2010 in the EU (1.2%, 0.1% and 0.9%, respectively, for the euro area). This cuts the spring forecast figure by half a percentage point (pp.) for this year and around 1½ pps. for 2009. More broadly, also global growth is forecast to slow markedly, especially among advanced economies. [8]

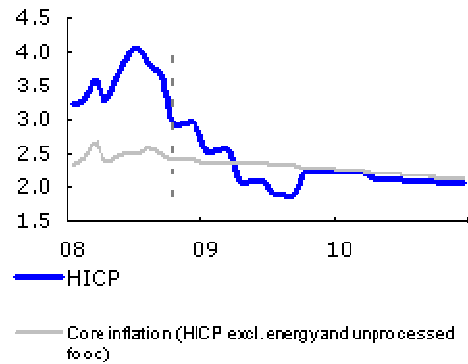


Figure no. 3 Euro-area headline and core inflation

Consumer price inflation is expected to have peaked and is set to fall rapidly to about 2¼% in 2009 and to about 2% in 2010 in both the EU and the euro area. The recent strong decline in commodity prices, together with a marked weakening of the growth outlook and a related easing of the labour-market situation, reduces considerably the risk of second-round effects and put wages on a decelerating path ahead. [8]

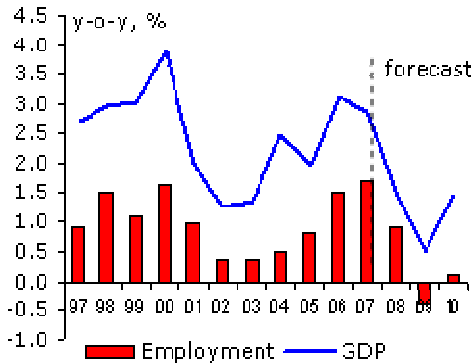


Figure no. 4 Growth of GDP and employment, euro-area

The moderation in growth has started to affect the labour market, and the outlook is for a fall in employment next year in both the EU and the euro area. Further ahead, a slight improvement in employment growth is on the cards for most Member States as economic activity picks up. Employment is thus expected to increase by about ¼ million jobs in the EU and ½ million in the euro area in 2009-2010, markedly less than the 6 million new jobs created in 2007-2008 in the EU (4 million of which were in the euro area). As a result, the unemployment rate is expected to increase by about 1 pp. in the coming two years. This would correspond to an unemployment rate of 7.8% in the EU and 8.4% in the euro area in 2009, with a further increase projected for 2010. [8]

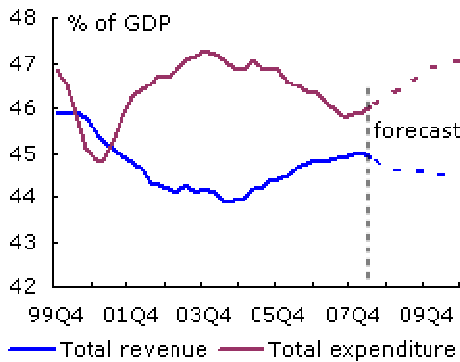


Figure no. 5 EU - Total revenue and expenditure

The worse economic outlook is expected to take a toll on public finances as well, with the deficit in the general government balances increasing from less than 1% of GDP in 2007 in the EU to 2.6% in 2010 (based on the usual no-policy-change assumption). For the euro area, the deficit is expected to rise to 1.3% this year and 2% in 2010. Most countries will be affected, although with significant differences. [7]. The outlook for public finances is particularly unsure due to uncertainties over the fiscal implications of government rescue packages, which may lead to even higher increases, notably in public debt.

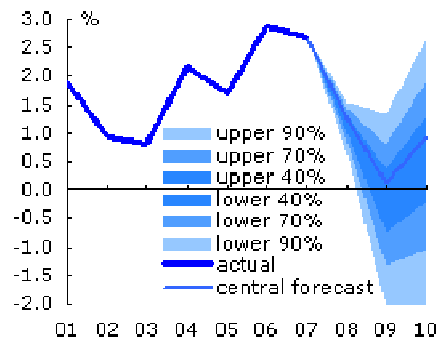


Figure no. 6 Euro-area GDP forecasts: balance of risks

This forecast is surrounded by considerable uncertainty and downside risks are significant. Most importantly, the financial stress may intensify even further, last longer or have a more pronounced impact on the real economy, fuelling the negative feedback loop.

This could also reinforce the ongoing correction of some housing markets, putting balance sheets under increasing strains, which could both hamper the necessary deleveraging process in the financial sector and, via negative wealth and confidence effects, reduce private consumption.

Moreover, abrupt shifts in risk-preferences cannot be ruled out in such a situation, and countries with sizeable external deficits and/or debts in particular could face increasing dif-

difficulties in securing their financing. Future commodity prices, on the other hand, are more likely to fall (than increase) as growth prospects deteriorate. This would ease inflationary pressures and makes risks for consumer price inflation more balanced.

4. CONCLUSIONS

The classical analyze of regional growth and regional polices refers to the possibility of solving the conflict between efficiency and equity. If the regions with low revenue would offer the perspective of higher efficiency of using the capacity, these purposes wouldn't be opposite to each other. But in agglomerate economics, the opportunities offered by the market and other factors acts in the favor of proper regions. Because of this, you will usually have to accept a series of compensations between efficiency and equity.

The European model of regional growth is based on identifying an indifference curve between alternative economical growth rates and the regional equity index. A function of flat preference implies a society that is orientated towards economical growth. The more abrupt the preference functions are, the more receptive society will be when faced with the redistribution measures in regional plan.

Placement economies represent the result of the geographical compression of certain enterprises which belong to the same sector. They include transfer economies (of connection) which are manifested as a result of geographic proximity of the firms between which input-output connection exists. These connection economies explain why the main points of the transport networks are those placements in which some distribution and assembly costs can be minimized.

The generative growth models are based on dimension, treating economic national growth rate as the result of growth rates from the region. In this conception, the entire growth is spatially orientated, in other words, it was growing in the frame of any part of the national economy and it comes from a certain place. The performances in the matter of regional growth can be enhanced without causing side effects upon the growth rate of the surrounding regions.

The growth rate induced by the innovative process can be put into this context: agglomerations and spatial proximity for any activity in certain cities and regions can induce a rate of innovations higher than the one which would be noticed without agglomerations; similarly, the changes which can appear in the intra-regional distribution of production factors, such as facility, of an efficient intra-regional system can also increase the production efficiency and regional growth rate.

However, in such cases you need to identify the circumstances which make choosing a positive growth rate possible and you need to realize an ex-post redistribution of the resulted economical growth. In conclusion, each economical growth rate implies a certain interregional distribution. Therefore, there are many alternative interregional distributions which can lead to the same economic growth rate.

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