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Regional impact of global and European integration

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FFRC Conference June 8, 2006

The difference between a nation and a region: integration transforms nation states to regions

- **<u>“NATIONAL ECONOMY”</u>**
- **Less open than a region**
- **Economic policies**
- **Border control**
- **Own currency** + **exchange rate**
- (possibility of devaluation)

<u>“REGIONAL ECONOMY”</u>

More open economy

No economic policies

No border control

No exchange rate

(no possibilities of devaluation)

Some other means of flexibility are needed: wages? unemployment? migration? Regional policy is a compensation of missing adjustment possibilities!

Integration (= globalization) reduces ”trade costs”, which has impact on the balance of centripetal and centrifugal forces

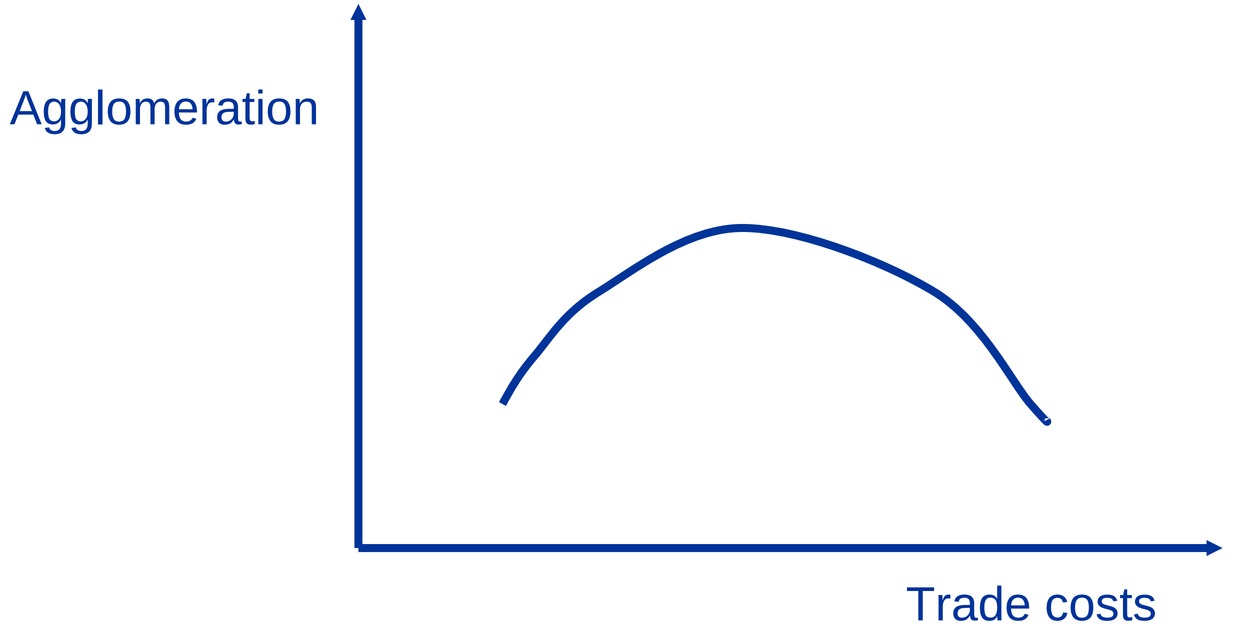
Centripetal forces:

- market-size effects
- matching effects
- spillover effects (knowledge spillovers)

Centrifugal forces:

- factor market crowding effects
- product market crowding effects
- congestion effects

Global integration is expected to have a non-linear effect on the agglomeration



In USA trade costs have been until now lower than in EU: concentration has been higher

What will happen via global and European integration within EU?

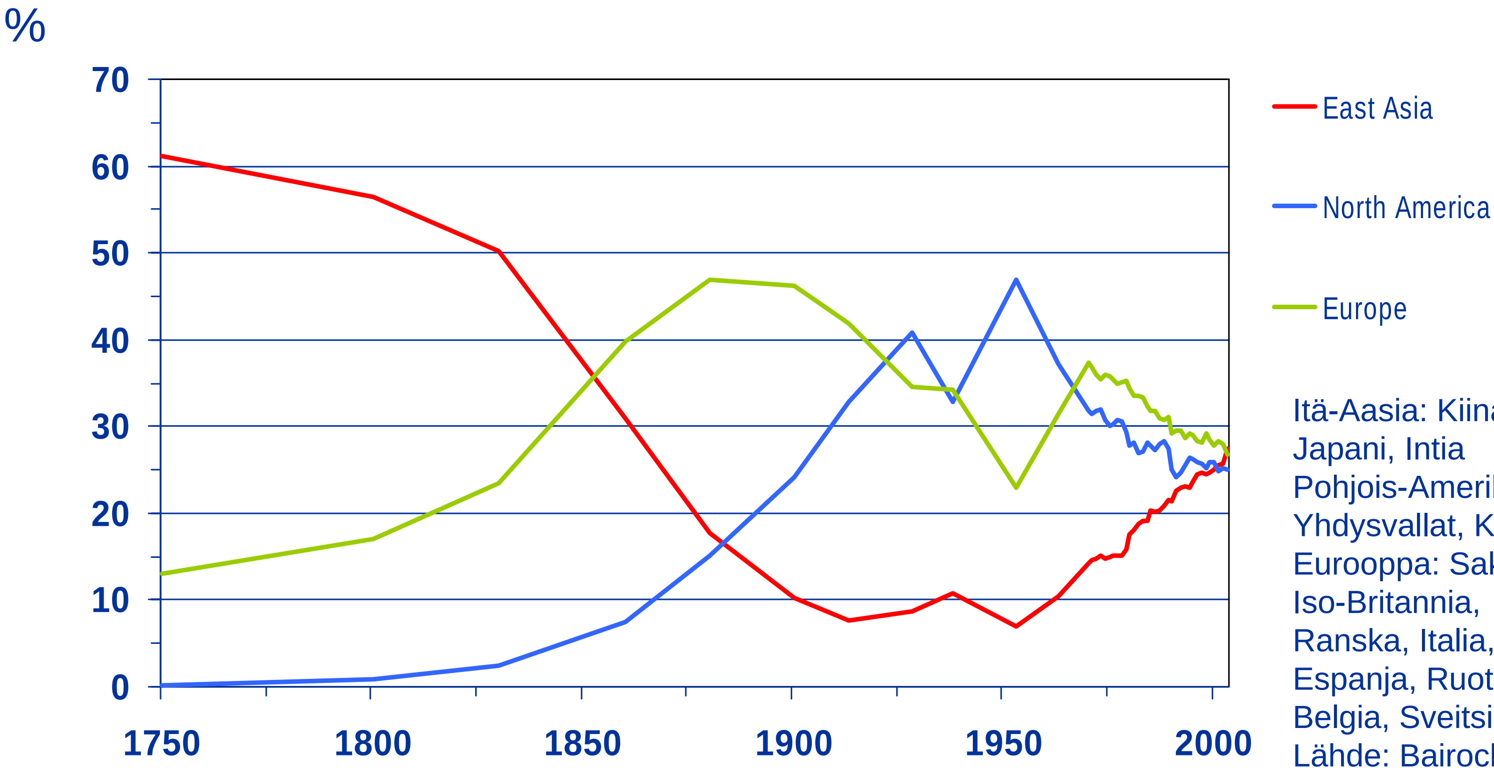
Growth rates in different groups of countries

(%/p.a.)

	1960`s	1970`s	1980`s	1990`s
Rich countires	4,7	3,1	2,3	2,2
Globalizers	1,4	2,9	3,5	5,0
Non-globalizers	2,4	3,3	0,8	1,4

- **Number of poor people (income < 1,5 $/day) decreased by 400 million during the 1990´s, still there are 650 million such people.**
- **The income gap between the richest and the most poor has been widening at the same time**

Regional division of manufacturing output of the world 1750-2003



Itä-Aasia: Kiina, Japani, Intia
Pohjois-Amerikka: Yhdysvallat, Kanada
Eurooppa: Saksa, Iso-Britannia, Ranska, Italia, Espanja, Ruotsi, Belgia, Sveitsi
Lähde: Bairoch (1982), ETLA

Growth effect of the European integration

- Has it a growth rate effect or an income level effect?
- Via which way it actually comes: investment-led growth?
- Growth rate 0,6 - 0,8 percentage points (p.a.) higher in EC/EFTA (Henrekson et al. 1997)
- Income level is now in EU 20 % higher than without EU integration (Badinger 2005)
- No clear differences in gains between small and large member countries

Income level convergence in European integration: past experiences

Convergence or divergence -debate

* “conditional convergence” is the basic tendency, not an universal law

Convergence in EU14 in 1961-98: 2,05 % p.a.

1960`s	2,51%
1970`s	2,25 %
1980`s	0,83 %
1990´s	3,59 %

The economic integration is in favour of economic growth and of convergence because it mean access to the same technology and to the same markets

The conclusion depends on the level of regional disaggregation

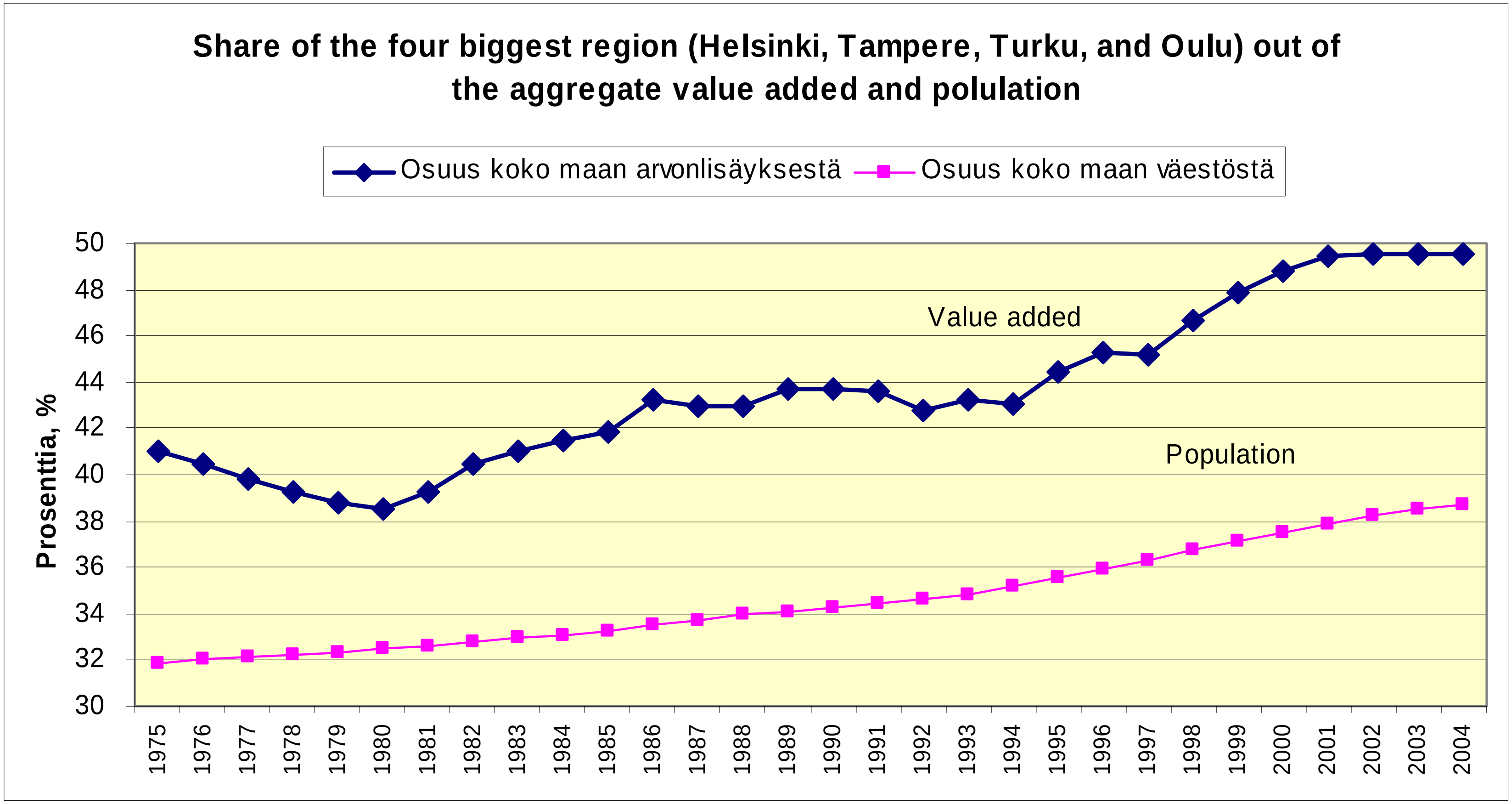
Comparing US and EU internal regional structure

- USA has regionally more concentrated industrial structure (regional clustering) than EU
- Expectations for EU have been that deepening economic integration will results in stronger regional clustering, too
- Until now it has not happened:
  - **Regional concentration of value added is declining both in USA and EU**
  - **In US food and textiles are concentrating**

Regional concentration in Europe

- Geographic concentration is higher in service sector than in manufacturing (Brulhart-Traeger 2005)
- Manufacturing sector is slowly becoming more concentrated relative to the spatial spread of total employment
- Relative to physical space manufacturing concentration has been decreasing and because its share has been decreasing, its contribution to the topografic concentration of the total employment has fallen
- In the service sector transport and telecommunications sector has been deconcentrating, others have been remained strongly concentrated

Regional concentration in Finland: reasons are both inside and outside the country



Expected income convergence in the large EU with the single currency

Factor price equalization is the ultimate measure of integration!

* like absolute zero in low-temperature physics! (Kindleberger 1968)

EMU nominal convergence criteria contra real convergence?

* different growth rates - different inflation rates!

* Balassa - Samuelson effect

* new members may come too early into the EMU?

Convergence is quite slow: after 26 years the accession countries have come up to the level of 70 % of the EU25

(2 % convergence speed means that 50 % of the original gap remains after 34 years)

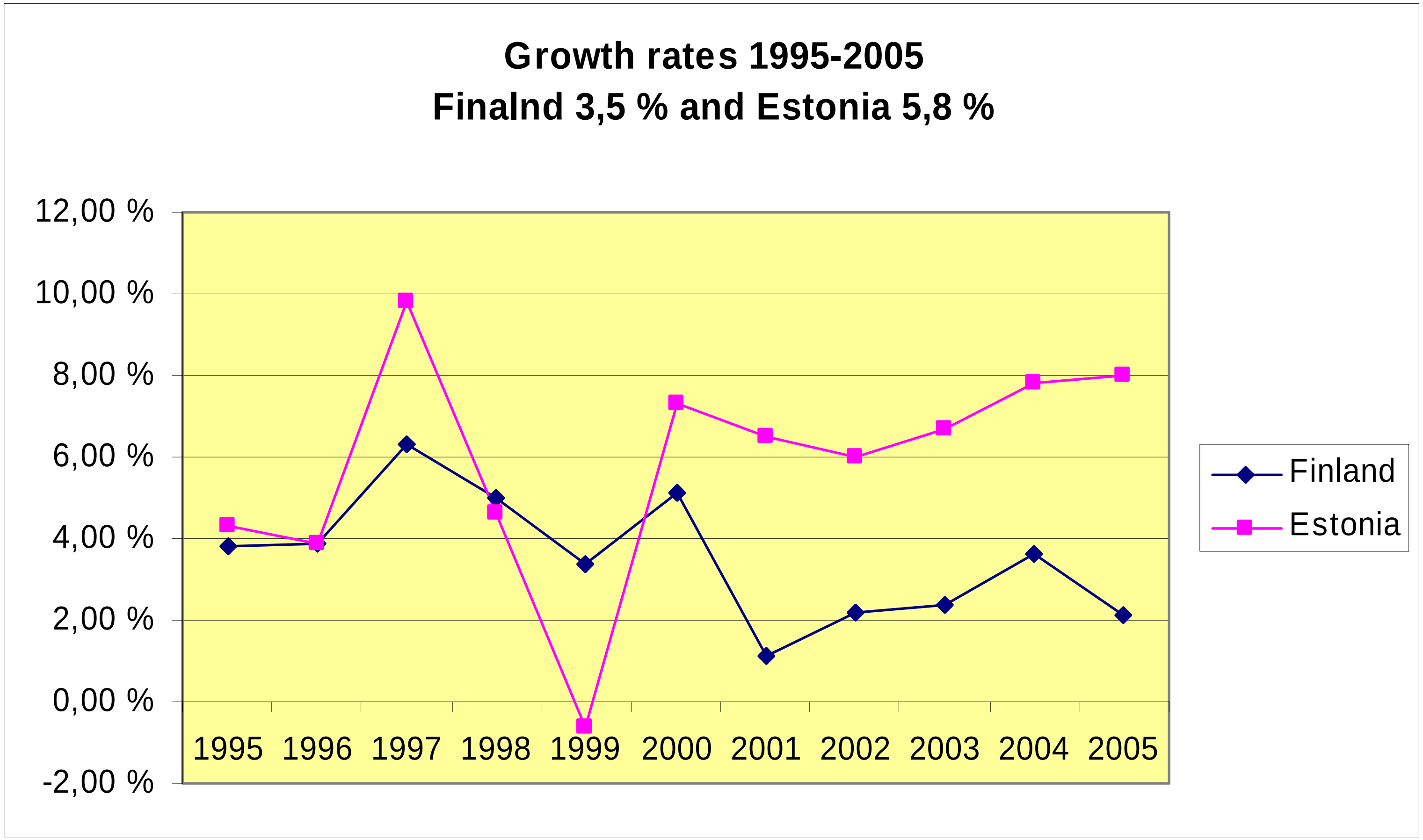
Income differences as fuel for growth in the integrating world and in Europe

If low income countries have access to the same technology and markets, the steady state income levels of the poor and the rich are the same, but actual levels are far from each other = catching up potential

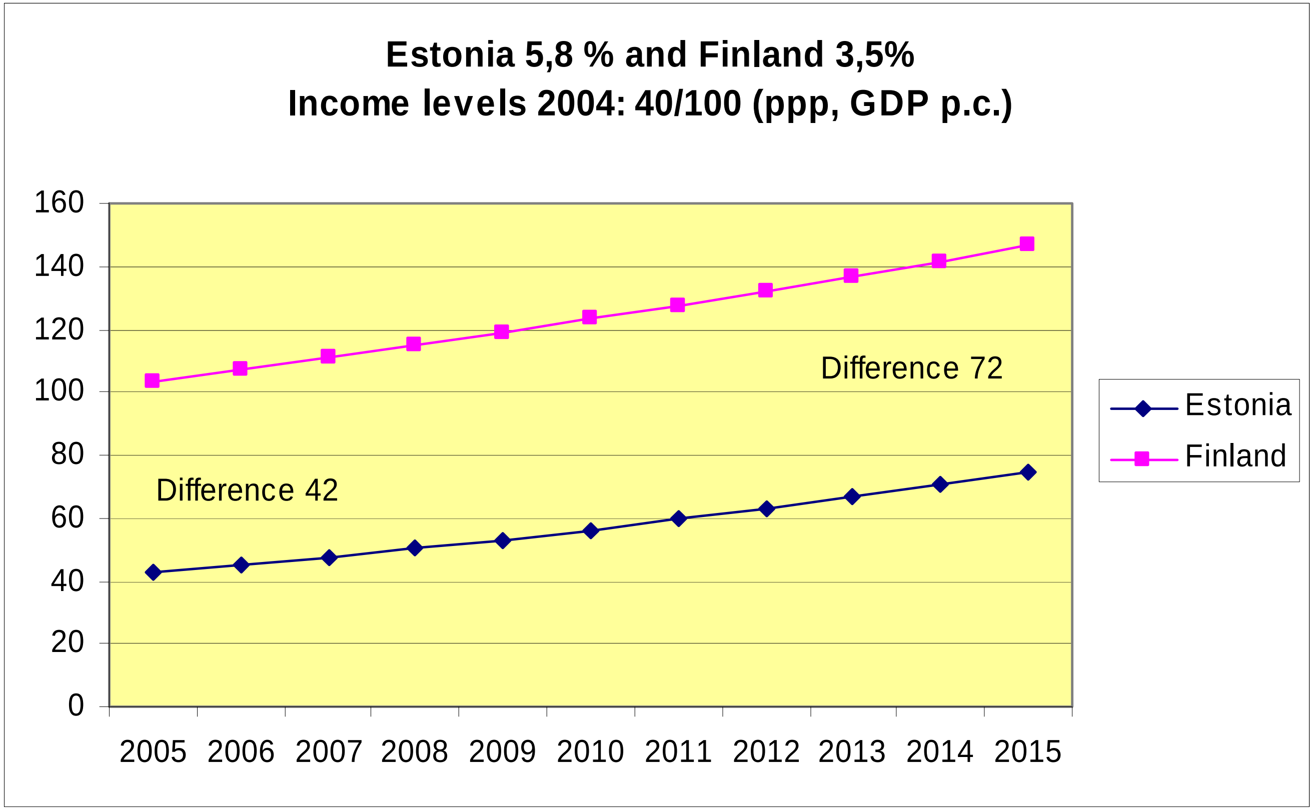
The average growth rate is higher if catching up goes on

* requirements for catching up: investment into human capital and technology transfer (FDI); reduction of the primary sector

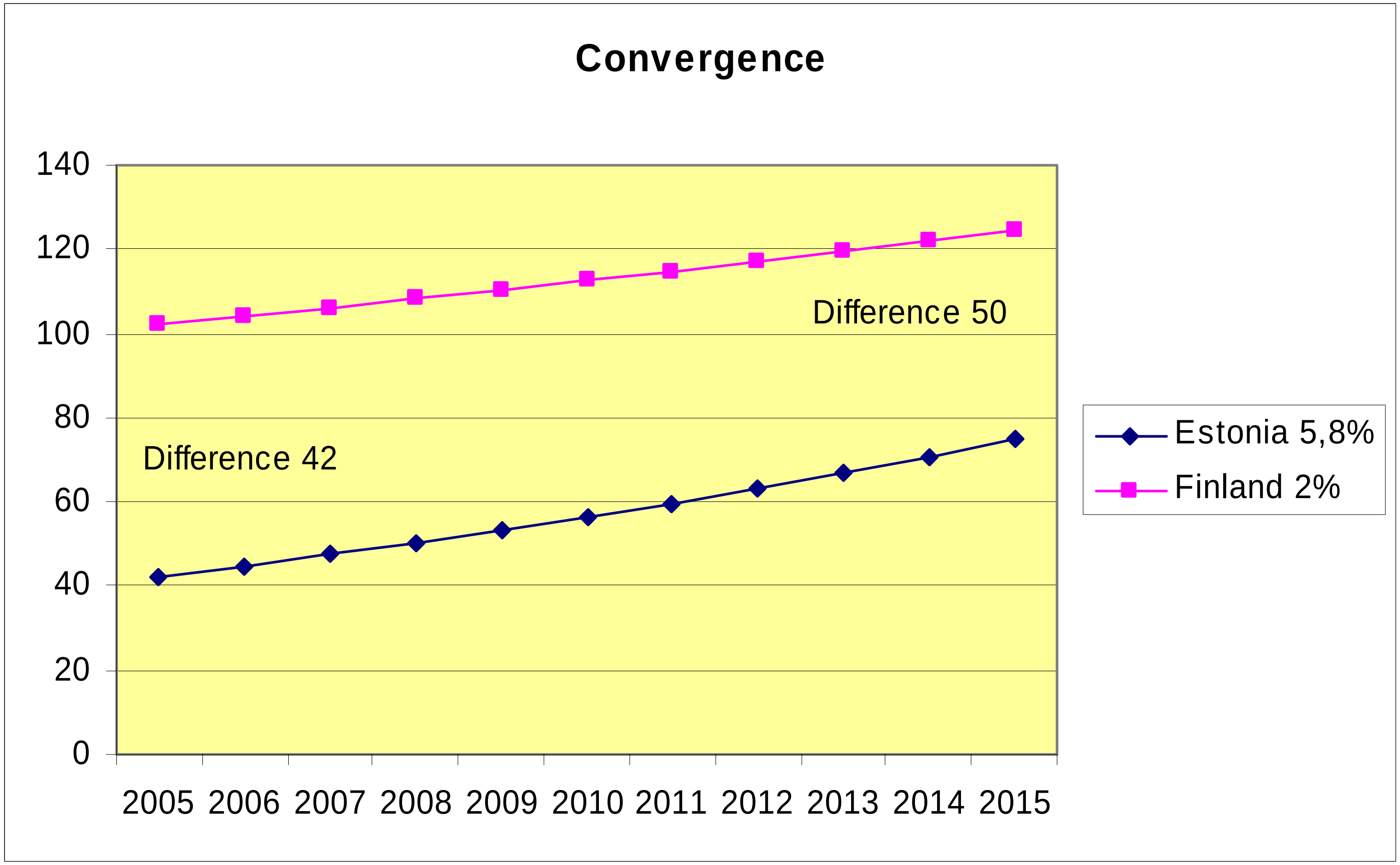
Growth rates in Estonia and in Finland 1995-2005



If growth rates remain into the future, there will be divergence even if beta-convergence,



Convergence (beta and sigma)



Conclusions

Globally integrated markets open up possibilities to benefit from income/cost differences. There is a strong tendency towards factor price equalization and towards income convergence.

The high income level countries are in front of a challenge: they must have sufficient capacity to transform and a good potential for innovation driven growth. European innovation capacity is not high.

The low income level countries: they must be capable to create an endogenous growth process by investing into physical and into human capital (foreign direct investments are needed)

The main price of the narrowing income level gap is chancing regional structure of the production and employment: the price is higher in low income level countries than in rich countries

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