GLU

Global Labour Column
http://column.global-labour-university.org/

Number 81, December 2011

CSID
CORPORATE STRATEGY AND
INDUSTRIAL DEVELOPMENT

What role do big corporations play in the economic well-being of the European Union? A non-standard view of Eastern Europe

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The global economic crisis caused demand in the European Union (EU) to drop to low levels. In order to mitigate the effects of the crisis, stimulus packages were hastily put up in the old member states (OMS). A considerable part of the spending was directed to the financial and banking sectors as it was concluded that these were systemically important. In addition, the core sector of Europe's industry, car production, also received significant financial support.

Both the banking sector and the automotive industry play a crucial role in the new member states (NMS) of the EU. Hence one would expect that spending on banks and automotive firms in Western Europe, where the OMS are located, is what would have kept Eastern Europe's economy, where most of the NMS are located, afloat during the crisis. Yet that assumption is wrong; the money that has gone to the big international European corporations has largely benefited them alone. To see why, it is important to consider how the economic integration of the NMS was conducted.

Since in the early 1990s, the NMS have opened up to trade and investment, sold off the banking industry to foreign investors, closed certain sectors to better exploit their comparative advantages and implemented the Acquis Communautaire of the EU. One important side effect of the deepening integration is that if there is a - upside or downside - shock in Western Europe, the NMS feel the impact within a short period of time. Given their advanced integration into the Western European economy, part of the additional spending in the OMS therefore entered and invigorated the NMS's economies.

At the beginning of the crisis the European Statistics office, Eurostat, added gloom to the already pessimistic mood by forecasting a dire outcome in the NMS. In fact, all the NMS are deficit economies with current accounts in the red ranging between a few percentage points and a dramatic one quarter of their respective GDPs. Fortunately, the structure of capital inflows has been dominated by direct investment with a rather small share of "hot money". Hence, there was not much capital outflow while at the same time decreasing imports narrowed the current account deficit. That is why the subsequent "miracle" in Eastern Europe does not come as a surprise. On average, the NMS fared better than the OMS during the global economic crisis. Average GDP output loss in 2009 was 3% in the NMS while the old members faced a loss of 4%. Unlike the situation in the eurozone for example, a serious systemic crisis in the Eastern part of the EU never emerged.

Attempts to explain the outcome mostly draw on a multiplier approach: because the old member states spent some 3% of GDP on stimulus measures in 2009 and 2010[1] it is expected that they would have an effect on the NMS.

The financial sector link

As the crisis began, observers were wondering whether the financial integration within the enlarged EU was going to make things worse. Up to 98% of bank capital and assets in the NMS are owned by Western European banking institutions. On average, the foreign capital share of the sector in the NMS is more than twice the share in the OMS. Since the financial link across the EU has grown so big, integrated financial markets mean a quick and unrestricted transmission of shocks. On the downside one could plainly expect that the dependence of most NMS on Western European banks should further facilitate the spill-over of the crisis from the West to the East. On the upside, recapitalisation and the bail-out of banking corporations in the old member states are supposed to positively affect the economy of the NMS.

The actual result is sobering: The EU has channelled approximately 3% of its aggregate GDP/GNI in 2009 and 2010 (automatic stabilisers not included) into stimulus spending. Approximately one third of that 3%, or 1% of GDP/GNI, went to the financial (mostly banking) sector. Yet spending on the banks in the West has – other things equal – accelerated the NMS's economy by a meagre 0.42% in 2009 and in 2010.

The automotive sector link

The car industry is the pride of the NMS. It is perceived to be their most effective transmission of technological innovations and modernisation. Moreover, it constitutes a large proportion of their exports to the OMS and is an important employer. In 2008 car sales dropped sharply in Germany and Western Europe putting more pressure on a sector already overburdened with overcapacity and structural imbalances. As the industry is too important in terms of employment and export share, Germany, France, and other major car-producing nations in Western Europe introduced temporal publicly-financed schemes based on bonuses of up to €2500 per old car being scrapped in exchange of a new one. These "scrappage schemes" came at a cost of up to €5 billion in Germany, and €0.5 billion in France, Italy and UK respectively, whereas the NMS in general abstained. However, in percentage terms, the effect on the GDP growth in the NMS is not impressive. Even if assuming the lion's share of the stimulus has gone to the five largest car producers in the NMS, the effect is negligible. The overall effect is a mere 0.12% of the NMS's GDP.

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(Another beneficiary may have been the governments of the spending nations themselves. It is estimated for Britain that an average price of €10,000 for a new car bought under the scheme would generate a total of €120 million profit for the state in VAT receipts for all cars)

Who rescued the new entrants?

It seems then that the NMS have not been able to draw on much of the money spent on big Western European corporations. Actually, the major source of recovery in the NMS has been their own stimulus packages. It ought to be borne in mind though that different states in Central and Eastern Europe were affected differently by the crisis, with Poland not being affected at all. But what counts is the response to the crisis, particularly the vigour with which the NMS reacted. The new entrants extended their fiscal deficit, although less than the Western European members. The extension was partly attributed to the automatic stabilisers as less tax revenues and more spending on items that cannot be cut easily (e.g. social programs) began to tell. The automatic stabilisers in the NMS as a group are roughly 40% of GDP. Therefore, since the fiscal easing is 3.3% of the NMS's GDP, about 1.3% is due to the automatic stabilisers, while the remaining 2% is due additional spending to stimulate the economy. This is consistent with the data provided by the EU Commission.[2] Stimulus decisions usually address both the revenue and expenditure side of government activities. The NMS spent roughly 0.8% of their aggregate GDP on investment initiatives which translates into a 1.25% contribution to growth. Within the group of new entrants the effect of crisis-related investment programs spreads from zero in Lithuania and Hungary to 1.88% in Poland and Slovenia. This finding sheds light particularly on the better performance of Poland compared to the other NMS.

Surprisingly, although most countries engaged in (temporary or permanent) tax reforms, the contribution of tax cuts was small. GDP only changed by a small fraction in 2009 and stayed constant in 2010.

Next we look at the effect of measures aimed at keeping households' income stable which usually take the form of either new or increased government transfers. Transfers encourage growth through increased demand and are expected to have mitigated the effect of the downswing. Additional transfers are estimated at up to 0.9% of the aggregate NMS GDP which makes them a significant part of the aggregate discretionary stimulus in the new members. Given the NMS's multiplier they seem to have produced an additional output of up to 1.4% of GDP (all other indicators kept unchanged).

Finally, we calculate the overall effect of the NMS's own stimulus package. With some precaution it seems to have reached roughly 2.66% of GDP - made up of the contribution of the investment spending, expanded government transfers, and a smaller tax burden due to various tax cut initiatives.

Conclusions

Turning to the question "What roles do cross-border corporations play in Europe's economic reality, and how have these roles shown up during the global crisis?" we can assess that without the NMS's domestic stimulus packages their GDP performance would have been a dismal one. The economy would have shrunk by 6% instead of 3% as it has been repeatedly estimated by Eurostat. In that sense the domestically-designed efforts in the region have contributed to a considerable anti-crisis effect.

The stunning conclusion is that the automotive industry has not been a significant engine of growth despite the perception that the sector is vital for both Western and Eastern Europe. Regarding large financial firms, particularly banks, the feeling of the general public is that cross-border financial businesses play a destabilising role. Their key role in domestic politics means that they have a strong influence over the articulation of fiscal and economic policies in the form of socialising losses while privatising benefits. (And it is assumed that only the so-called "Vienna Accord" has barred them from doing more harm to the NMS). Moreover, the European automotive giants have been of little help.

Praise is not justified when estimating the role of cross-border industrial and financial corporations during the crisis on a cost-benefit basis. While certain contributions to the GDP performance cannot be denied, on balance, the relatively good outcome in Eastern Europe is mostly attributed to the domestic efforts of the nations there. This defies the assumption that the NMS have been free-riders on the ticket of the West and vindicates perceptions of large firms being less helpful in times of crisis.

1 Calculations of the overall stimulus package involve diverging considerations of data. However, most observers tend to estimate it around 3% of GDP over a two-year period. For a good short overview see for instance Stéphanie Marie Stolz and Michael Wedow, Extraordinary measures in extraordinary times – public measures in support of the financial sector in the EU and the United States, Deutsche Bundesbank Discussion Paper Series 1: Economic Studies No 13/2010 at: (http://www.bundesbank.de/download/volkswirtschaft/dkp/2010/201013dkp.pdf).
Other estimates are done by the EU Commission: Dominique Simonis, Emmanuelle Maincent, Jonas Fischer and Markus Schulte, The EU's response to support the real economy during the economic crisis: an overview of Member States' recovery measures. European Commission, EUROPEAN ECONOMY Series, OCCASIONAL PAPERS 51, July 2009, Brussels, at: (http://ec.europa.eu/economy_finance/publications/publication15666_en.pdf)

2 Simonis, Maincent, Fischer and Schulte, The EU's response to support the real economy during the economic crisis, op. cit., Table 2

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