Central and Eastern Europe's Role in Europe and beyond: Where is the region heading?

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The 10th anniversary of the Grow East Congress series is a great occasion to debate the role of Central and Eastern Europe (CEE) in Europe and in the world today and to ask how well prepared the CEE countries are to deal with challenges on the way to further prosperity. Looking back the countries can be very satisfied with their achievements so far. The CEE economies and industries have undergone an impressive economic catching-up process and a massive modernization in the last 30 years. The GDP per capita has grown by 160% in Estonia, 141% in Poland, and 129% in Slovakia in the period 1995–2017 (The World Bank, 2018). Incomes per head reached in 2017 in the Czech Republic 88% of the EU-28 average, in Slovenia 84% and in Poland 70%, while Romania with 62% and Bulgaria with 50% are still trailing behind (GDP/head at PPP, wiiw, 2018). It is indisputable that marked differences in economic development between Central and Southeast Europe and between the metropolitan and rural areas within each country still exist and continue to be a major concern for national and EU politics – not just for economic but also political reasons as the rise of national-populism shows.

The Western liberal model of democracy and market economy has been the guiding model for the reforms in CEE at the beginning ("Washington consensus"). Later this reforms merged into the EU accession process. Then, the transformation was mainly driven by the vision of a rapid economic and political integration into the EU. The EU has supported the transformation process by guidance, value system, funding and offering access to the large and wealthy European single market – it is fair to state that the EU acted as the institutional role model for this transformation process. Within this framework, national governments, local and foreign firms have modernized and restructured the economies. Foreign investors have played a central role in this economic growth model for CEE as they transferred capital, but also technology and management knowledge to those reforming countries. What was even more important, global players such as VW, Siemens, Fiat or General Electric integrated local firms into their transnational value chains (and often into their corporate groups) what allowed those local firms to play a bigger role than the demand in their local markets would have allowed. Foreign banks such as Raiffeisen Bank International or Erste Bank brought modern banking systems and technology to CEE. The huge market potential, lower labour and production costs, a well-educated workforce, lower taxes and the geographic proximity were main motives for the going East of Western investors.

In no other region of the world, we can see such a strong impact of foreign direct investment on local economies. The foreign direct investment (FDI) was a strong driver of change in the economies. Its importance is mirrored in high ratios of inward FDI stocks to GDP with 80% in Bulgaria and Estonia, 68% in the Czech Republic and 61% in Hungary compared with an OECD average of 41% (wiiw 2018, OECD, 2019). It should not surprise us, that such a development raises critical voices in CEE. The benefits that come with inward FDI are among others local value creation, rise of quality standards, internationalization of the economy and transfer of modern management systems. They are contrasted with drawbacks such as the crowding out of local competitors, the emphasis on the low-cost model, the perceived loss of control over the economy and the transfer of high profits out of the countries. The reference to the notion of a "dependent economy" whose key industries (banks, utilities, media, retailing etc.) are dominated by foreign firms is a frequently used element in the speeches of national-populist politicians and in the bashing of foreign multinationals. But the "our country first" movement is not specific to CEE – today we can find it globally from the USA to China.

The new self-confidence of Central European governments can be certainly attributed to the successful reforms and marked rise in wealth. Now these countries look for more independence, politically and economically. Their politicians – especially nationalist-populist politicians – demand more room for national policies and are questioning a deeper integration of the EU. At the same time, these politicians in Poland and Hungary are gratefully accepting the huge inflows from the cohesion funds by which the EU supports the catching-up process of their underdeveloped regions. While it is obvious that the transition from a centrally planned to a market economy also generated injustices, the question is how to deal with these outcomes today. Attacking the liberal model of democracy and market economy, trying to get rid of institutions that are limiting their policy space and influence and establishing a system that discriminates against foreign firms and organizations and favours local ones is not compatible with an EU membership. We observe at least at the government level a rejection of the Western values and institutions that they tried to imitate so far.

The Bulgarian writer Ivan Krastev regards this constant pressure to imitate the institutions and follow the rules as a trigger for the revolt of Orban and Kaczynski against the EU – they now would like to see the others imitating them, namely their ideology of an "illiberal democracy" as a role model. The nationalist-populist politicians play the national identity card and see their countries' great future in a return to Christian and conservative values and in a stronger identification with the nation and its history. To a certain degree, this is even understandable when thinking of the many Baltic, Central European and Western-Balkan countries with small and shrinking populations and their fear of extinction of their nations and cultures. In the last years the whole discourse has switched from one that highlighted the improvements in household incomes, increase of personal freedoms as well as the opening and liberalization of society and culture, to one that puts national identity into the spotlight.

Moreover, the CEE countries still do not feel fully accepted in the EU as, for instance, the recurring discussions about quality differences and double standards in food in EU demonstrate. CEE politicians say that they feel like “second-class” consumers and citizens when they get inferior products compared to the ones in Western Europe. While there are conflicts where CEE citizens share the critical view of their governments, in the overall assessment the people seem to understand the advantages of being part of the EU very well. In the latest European Parliament’s Spring 2019 Eurobarometer survey CEE citizens have a very positive view of the EU membership: 74% of Estonians, 68% of Poles, 61% of Hungarians and 57% of Romanians think that EU membership is a good thing (EU27 average is 61%). Only Czechs (33%) and Croats (40%) are together with Austrians (46%) and Italians (36%) among the weakest supporters.

Against this backdrop, the CEE countries have to find ways how to move their economies from a low-cost to an innovation-driven economic model, beyond the “middle-income trap”. It is questionable if the existing economic model based on low-cost production and export platforms will be competitive, given the achieved high-income levels and currently strong rising wages. How can they move their economies to a higher income level? Either they convince foreign investors to locate higher value-added activities in their countries or they have to build up their own international value chains based on indigenous innovation. Successful examples for both options can be found in all countries. In the automotive industry, we see an upgrading from assembling towards more R&D value activities, for instance, in the autonomous driving and the electric vehicle area. Local champions with international reach can be found in the energy (MOL, PKN Orlen), manufacturing (Hidria, Agrovert, Solaris, Atlantic Grupa), services (Wizz Air, OTP Bank), retailing (LPP, InterCars, CCC), digital solutions (AVAST, ESET, Sygic) or pharma sector (Richter Gedeon, Krka).

Digitalization might be an enabler in this process if the countries regard it as a chance. As it encompasses such different areas as the optimization of industrial processes (“Industry 4.0”), the rise of e-commerce and the communication with and engagement of customers the outcome of this transformation is still unclear. According to the recent McKinsey report “The Rise of Digital Challengers” (2018) digitization can be the next driver of sustained growth for the region with a potential of € 200 billion of additional GDP by 2025. The countries of CEE are uniquely positioned to capture this opportunity due to good education, a large STEM and ICT talent pool, a high-quality digital infrastructure and a vibrant emerging digital ecosystem.

All these studies lead to one major conclusion: the cornerstone in the future development is human capital. While praised for the good formal education, demographic decline, brain drain, skills mismatch and labour shortage in general are limiting the pool of qualified labour, especially in Central Europe, that is needed for driving the economic upgrading process.

Well-educated people leave the countries of the region in search for better-paid jobs, career opportunities and living standards abroad. Nearly 20% of the population have left Romania since 2010, 14% of Bulgarians, 10% of Serbs and 9% of Poles (COFACE, 2017).

The weak social infrastructure, a still high pervasiveness of corruption and an anti-liberal political climate at home influence this decision to leave the home country too.

The dramatic demographic decline in the workforce in the coming years and decades will be the greatest challenge for governments as well as local and international firms. Without skilled people and talents, neither the rising local champions of the knowledge economy nor the up-grading foreign investors will be able to bring the economies to higher levels of prosperity.