International fragmentation of production, trade and growth: Impacts and prospects for EU member states

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The ongoing trend of increasing internationalisation of production over the last two decades or so raises concerns but also expectations. Countries, on the one hand, can sell more of their products to other countries whereas, on the other hand, more and more activities are offshored to other countries. The first aspect however also means an increasing dependency on developments in foreign markets, with the second aspect implying a strengthening of industrial competitiveness as countries and industries source at lower costs making them more productive. This paper investigates these interrelated channels and aspects of internationalisation using the World Input-Output database (WIOD), focusing on the internationalisation of the EU as a whole but also its individual member states therefore also providing insights into the evolution of intra-EU production networks.

- The EU has become more integrated in global value chains in line with overall trends. Around 15% of GDP in the EU is created which directly and indirectly contributes to satisfy final demand in other regions of the world. This has increased over the last 15 years or so by about 5 percentage points. A similar trend though slightly less significant can be seen with respect to employment: almost 12% of jobs are dependent on final demand in other parts of the world. Emerging economies like China gained importance in this respect at the expense of major advanced economies like the US and Japan.

- Similarly, as foreign markets have become more important as destinations for EU’s exports inputs are increasingly sourced from other countries in the form of intermediates used in EU production systems. About 15% of the value of the EU’s total extra-EU exports is value added generated in other countries. This share has increased by about 7 percentage points since 1995. Together with the fact that the EU’s overall trade balance, at around 1.5 to 2% of overall EU GDP, remained positive over this period can be interpreted as evidence that the EU as a whole was able to manage this period of increasing internationalisation quite well, notwithstanding the turmoil which hit the world economy and the EU in the aftermath of the global financial crisis.

- This successful withstanding of global competition has been driven not at least by a deepening integration of the EU economies amongst themselves. This integration with respect to trade and internationalisation of production is particularly visible with respect to the successful integration of the Central and Eastern European countries into the EU economy and thus becoming important in European production networks.
• However, the overall success of the EU as a whole and some countries in particular hide large differences across EU economies. Already in 1995 large differences existed with respect to the countries' foreign exposures concerning sales to intra- and extra-EU markets and sourcing structures. This pattern, however, seems to have become even more pronounced since 1995, with only a few countries – particularly Central and Eastern European countries, German, Austria, Ireland and Luxembourg – being successful in their export performance in value added terms, whereas other countries could only maintain or slightly improving them. One reason for this might be initial patterns of specialisation since internationalisation was largely driven by a few high-tech manufacturing sectors like the automotive and electronics industry in combination with successful innovation and productivity performance and moderate wage policies. Further, the successful internationalisation of production – which within the EU resulted in the integration of Central and Eastern European countries in more advanced countries production networks in these industries – played an important role. This improved international competitiveness of some countries which contributed to the EU's overall success with respect to its international position also aggravated structural differences across EU economies. These became visible during and in the aftermath of the global crisis and are still reflected in different positions concerning various strands of the policy debates.

• Evidence presented in this paper suggests that countries which have been successfully internationalising have performed better with respect to their overall growth performance in the pre-crisis period. The challenges ahead are therefore to reduce the structural differences amongst EU member states which have emerged over the last years and have become more evident over the crisis. Further integration of EU member states into production networks should make it possible that all countries benefit from the overall globalisation process and its opportunities, such that the EU as a whole can further successfully profit from the challenges and opportunities of the ongoing internationalisation process.