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Opinion of ZPP Chief Economist Piotr Koryś on the factors driving development in post-World War II Europe

Determinants of European economic development from the end of the Second World War to the present day

The 20th century saw a continuation of the development of Western Europe, interrupted by world wars, the crises of the interwar period and the oil crisis. After the Second World War, there were several waves of dynamic growth in the countries of the European Community and later the EU. Throughout the period, European countries have retained a high capacity to produce human capital. In addition, due to the level of technological advancement of European economies, at least some of EU member states can be counted among the technological leaders. However, in recent decades, development problems have been intensifying due to a number of factors, including demographics and the model of European social policy affecting labour costs. Another growing and serious challenge is the EU's industrial policy oriented towards the creation of development niches that cannot be exploited. Since the end of the Second World War, European countries have also been benefiting from globalisation as one of the main global manufacturers and suppliers of advanced high-cost services.

The period after the Second World War brought a wave of rapid growth sometimes referred to as economic miracles. This was the case for Germany, France and Italy – key EEC economies. There were several factors behind the first wave of growth. First of all, the economies that had been destroyed by the war and were returning to civilian production had considerable untapped potential in terms of human capital, labour, and in part also material capital and infrastructure (although not always fit for use). Secondly, the American programme for the reconstruction of Europe created suitable conditions for these resources to be used – the inflow of capital, as well as currency that allowed to rebuild trade between European countries, became key drivers of development. Thus, it can be said that the years immediately following the war were a period of a return to past upward development trajectories and a relatively efficient use of production factors.

In addition, American policy at the time was oriented towards creating conditions conducive to economic integration, both at the level of individual companies (co-operation) and states. In the face of mutual lack of trust in war-ravaged Europe and efforts to rebuild national economies, problems related to currency convertibility were an important factor inhibiting these processes, although these were partly solved through bilateral trade agreements. For several years, the partial dollarisation of the European economy facilitated international trade. The Marshall Plan also brought an influx of American technology, new methods of organising production, and direct investment. The commercialisation of US technology in Europe, the growing use of military technologies for civilian applications, US development aid and the restoration of pre-war economic potential with macroeconomic stabilisation led to a rapid increase in the wealth of Western European societies. This resulted in an increase in demand for consumer goods. It should be pointed out that European economies were highly competitive at the time (due to relatively low labour costs, high productivity, favourable demographics and social cohesion).

These were the primary sources of the post-war economic miracles – a period of rapid economic growth, both in absolute terms and in comparison with the USA. The potential for this growth has been exhausted with increasing tensions in the global economy. The collapse of the Bretton Woods system, the decolonisation processes and, finally, the period of stagflation associated with the oil crisis contributed to the slowing down of this dynamic. In the meantime, recognised European brands expanded globally (in such categories as white goods, consumer electronics, the automotive industry as well as specialised capital goods and products in the modernised light industrial sectors, where Italian and French companies were gaining a competitive advantage despite rising production costs).
Several factors were behind the growth at the time, including the closing of the technological gap to the point where European industry took the lead in certain industries and the transformation of European societies into urban societies characterised by mass consumption. This process had already started before the First World War, but was slowed down by years of war and crisis. It was later resumed by the start of the economic integration process.

This third factor was especially important given that, the Treaties of Rome gave major impetus to the rapid integration of the major economies of continental Western Europe(after a dozen years or so, the United Kingdom also joined this group of countries). The rapid broadening and deepening of the market opened up new prospects for European companies, which were able to grow in size as the European market was becoming a ‘vestibule’ to global markets. Germany soon became one of the world's largest exporters, with France and Italy also generating significant international turnover.

This period of rapid global expansion allowed many European companies established before the Second World War to rebuild their position and was conducive to the development of new ones, as well. The increase in labour costs served to stimulate the R&D sector and promoted productivity gains. In turn, the falling cost of capital encouraged investment in new industries. The regulatory role of the European institutions was quite limited at the time, and national regulations tended to focus on protecting the interests of workers rather than creating new economic sectors. Environmental regulations began to significantly improve the quality of life for Europeans, while competing labour costs had not yet become a challenge for the most developed economies.

The oil crisis of the mid-1970s brought a slowdown in growth. The internal migration within Europe underway since the 1960s as well as the economic slowdown halted the labour cost dynamics in the countries of the European core (especially Germany, the UK and France). This was due to waves of immigrants both from southern Europe and from behind the Iron Curtain, which kept the European economies competitive.

The subsequent wave of rapid growth was further driven by the enlargement of the European Economic Community in the 1970s and later in the 1980s (what proved crucial was the accession to the European Community of less-developed countries, including Ireland, Greece, Portugal and Spain). This created suitable conditions for the relocation of parts of the manufacturing sector, especially to southern Europe (through direct and capital investment). At the same time, starting in the 1970s, after a decade of stagnation, the integration processes, especially in terms of monetary integration, accelerated. The result was the creation of the European Monetary System, which brought significant benefits to businesses, especially those active on European markets.

An important growth factor for the enlarged Community was the convergence process of the newly incorporated economies. The complementary flows of capital and labour added considerable potential to the European economy.

During this period, the key growth factors were:

- closer economic integration;
- broadening the integration grouping;
- efficient allocation of capital, labour and human capital resources within the integration grouping.

The end of the Cold War, the collapse of the USSR and the subsequent enlargement of the EU contributed to another wave of economic growth in Europe. It was driven by the expansion of the market as a result of two successive waves of expansion of the Community after the end of the Cold War (which included the neutral countries Sweden, Austria and Finland, and later a large group of countries from behind the Iron Curtain). Once again, this made it possible to benefit from the efficient allocation of human and physical capital as well as labour resources (including migration of workers to the countries of the European core from Central and Eastern Europe and investments made in the countries of the region). The need to rebuild and modify the transport infrastructure (such as roads, railways, but also urban spaces) in the newly acceded countries, made possible by EU funds and carried out with the significant participation of experienced companies from the European core, also become a catalyst for growth.

At the same time, the processes of deepening integration accelerated, as reflected by the single political formula of the European Union, a common currency, and the expansion of the Schengen area. This was beneficial for European companies. During this time, however, global competition revolving around labour costs began to intensify. The competition from Southeast Asian countries was, over time, becoming a problem.

At the beginning of the 20th century, and in particular with the advent of the Great Financial Crisis (2008–10), European industry and the competitiveness of European companies started to decline. The positive effects of the subsequent phase of European integration were felt relatively briefly in the European core, although the new form of the Union (with 25–28 members) brought another wave of growth – although driven mainly by processes of convergence and the relocation of industry to the new member states. Industrial and development policies served as political tools to stimulate development, specifically economic evolution.

Europe's economic development in recent decades has been linked to new concepts of economic policies designed to foster the development of businesses and especially that of industry. In historical terms, the first wave of post-war industrial policies was linked to the Marshall Plan. The period of economic miracles – the golden age of European economic development – brought in turn a wave of national policies supporting the specialisation of the countries of the European Community. These were based on identifying winners – companies and sectors that were to succeed with state support. At the dawn of the European integration process, the European Coal and Steel Community was established, oriented towards sectoral industrial policy at Community level.

From the 1970s onwards, this strategy was replaced with the idea of liberalisation and moving away from state interventionism towards building a market environment conducive to development. In particular, this meant deregulation and a drive to reduce companies' operating cost. Industrial policy took on a horizontal approach. At the level of the European Community, it was becoming increasingly clear that the lack of coordination of national development policies (including industrial policies) was a barrier to faster development. This resulted in the introduction of regulations at European level to ensure a favourable market environment, while at the same time fostering national and supranational development strategies, especially those oriented towards research and development in key sectors.

This way of thinking prevailed in the 1990s and 2000s, as reflected in the Lisbon Strategy of 2000, the aim of which was to create a framework for the development of citizens, companies and economies that would make the EU a leading global economic force, both in terms of productive capacity, innovation and the quality of life. The financial crisis of the end of the first decade of the 21st century brought another change in the approach to development and industrial policies. The involvement of the state in building and restoring domestic industrial capacity and modernising manufacturing processes was a fairly widespread and global, not just European, response to this crisis. The return to industrial policy gained a new dimension when its aim became to create a framework for economic development adapted to increasingly boldly formulated climate policies.

Since then, industrial policy has become a tool integrating both the previous experience of vertical, sectoral industrial policies and horizontal regulatory policies. This type of industrial policy has had a significant impact on shaping the market environment in which European companies operate. Despite their active participation in shaping many of these policies, it has proven to be extraordinarily challenging to confront the challenges of global competitiveness and adapt to regulatory frameworks at the same time.

European industrial policy today

In many areas, the European Union seeks to be a regulatory reference point, a leader of positive change and a model for shaping the regulatory environment for the whole world. The same is true of EU development and industrial policy. In this case, the aim has become to identify or find niches for the green economy and, through regulatory measures, to create suitable conditions for European companies to succeed in them as global pioneers. In other words, regulatory barriers are supposed to shape the economic playing field in such a way as to foster innovation in desirable sectors and ensure their successful commercialisation.

To understand the difficulties involved in making policy, it is worth taking a look back at the experience of a few key sectors in the European economy. In the case of sectors that are key for green transformation, where global competition is taking place, the niches created have been taken over by external competitors. What is meant here is wind power and photovoltaics, where the EU share in global production has fallen dramatically in favour of China despite the efforts of the European Commission. The results of attempts to build a strong position in the BEV sector through regulations banning the production of combustion cars have been worrying so far. The position of European car companies, one of the key sectors of European industry, has been unusually weak. This could have an impact on the European labour market due to the high level of employment in this sector.

Climate regulations are also affecting, albeit to a lesser extent, the competitive position of an increasing number of sectors due to the fact that they are not as strictly enforced in many regions competing with Europe. This means that, in addition to high labour costs, European companies are facing another challenge driving up production costs. This raises concerns that the new concept of industrial policy in support of the green transition could, in its current formulation, become a development challenge for the European manufacturing sector. Regulatory pressure is often intended as a response to the misidentified (including by the companies themselves) needs of large corporations, including those in the automotive sector. In turn, support measures provided at EU and national level often limit the possibility for new industries to develop spontaneously from the start-up level. In the US and China, successful automotive start-ups such as Tesla are trying to challenge unprepared and insufficiently agile large European car companies. This, in turn, begs the question whether the model of fostering innovation and shaping the development of the manufacturing sector through regulatory barriers that raise operating costs should be pursued in the current model. The objectives defined in the Green Deal should be pursued, but the way in which they are achieved should be reconsidered so as not to compromise the situation of European businesses. Otherwise, there is a serious risk, at both the political and economic level, of preventing the achievement of these objectives.