

Scaling up the transatlantic partnership from security to prosperity: Economic resilience in Eastern Europe¹

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Context: Overlapping security, political, and economic challenges in Eastern Europe

SINCE RUSSIA INVADED UKRAINE ON FEBRUARY 24, 2022, the transatlantic community refocused heavily on the security of the region. Beyond the military battlefield in Ukraine, malign political and economic influences from Russia and China have persisted across Eastern Europe for many years—both within the European Union (EU) and in the broader Black Sea region.

The nature of the current challenges raises the need for a comprehensive course of action that deals not only with a sharper regional awareness of threats and vulnerabilities but also with their variety, in economic, social, and political dimensions.

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Eastern Europe has experienced a steady process of economic and political integration with the rest of Europe over the past three decades. Gradually, up to 2016, countries from East-Central Europe (ECE)² joined the EU; after that date, the Eastern Partnership (EaP)³ countries signed Association Agreements with the EU, showing that a pathway to EU membership was possible.

The domestic politics of ECE countries like Bulgaria and Hungary, and EaP countries like Georgia or Armenia have long been divided in terms of their alignment with the Western community. The apparent lack of commitment to democratic values on the part of some political leaders led to questions about electoral integrity in the EaP states of Ukraine, Moldova, and Georgia.⁴ In East-Central Europe, rule-of-law issues, and even rising authoritarianism in the case of Hungary, have not only affected the quality of democracy, but also the fairness of institutional checks and balances in the field of economic policies.⁵ In contrast, for the countries more politically aligned toward the United States, vulnerabilities took an economic form: large investment gaps in critical infrastructure—like energy, transport, or digital technologies—have left countries like Poland, Czechia, Romania, Slovakia, or Moldova vulnerable to the current disruptions in supply chains and rising energy prices. Europe faces overlapping economic and energy crises, and if each country faces these vulnerabilities alone, it could reinforce the political discord amongst Western allies.

Therefore, as this chapter argues, the road toward freedom and prosperity in ECE and in the EaP countries requires a clear strategic engagement from Western allies in the EU and the transatlantic community, linking immediate responses to the war in Ukraine with clear longer-term prospects for development in the region as a whole. Essentially, stabilizing East-Central Europe will require a scaling-up of effort, from security to economic partnerships that deliver long-term prosperity to all partners.

This chapter is built in a telescopic manner, as it reviews the quest for prosperity from the perspective of global trends, applies these trends to the current context of Eastern Europe, and focuses further on the case study of Romania to reflect specific mechanisms of development. The chapter also engages with three major growth trajectories: through economic integration, through the development of sustainable growth models at the national and local levels, and through local developmental alliances. In our opinion, these three trajectories of growth should be seen as overlapping layers of a comprehensive development model that is resilient to overlapping crises, anchored in freedom, and delivering long-term prosperity.

Trajectory: Eastern Europe in the transatlantic community and the EU growth trajectories through European integration

The Freedom and Prosperity Indexes of the Atlantic Council allow us to trace a clear connection between growth trajectories and economic, political, and legal freedoms.⁶ EU integration consolidated the economic, political, and legal freedoms in many of the ECE countries, which in turn allowed them to develop more sophisticated economic models.⁷ While many countries in the region experienced economic growth, data in the Freedom and Prosperity Indexes raise the question of how sustainable their development trajectories have been: improvements in freedom are equally important, ensuring a greater and more durable prosperity.⁸

Unlike Western Europe, which went through a period of economic slowdown, for ECE countries the last decade saw a period of economic growth and prosperity. Overall convergence was clear in the region—to a greater extent for countries with larger development gaps to fill (e.g., Romania, Lithuania, Latvia) or a lesser extent for better-integrated economies in the regional supply chains

(e.g., Hungary, Czechia, Slovenia). EU member states from this region are in fact net beneficiaries of European funding, receiving much more than they contribute to the EU budget, mainly in the form of cohesion funding. However, because much of the economic convergence has been based on foreign direct investment (FDI) and not domestic companies, the amount of profits that flow *from* Eastern to Western member states exceeds the EU funding *into* the ECE.⁹ Still, the EU funding has provided ECE member states with very strong leverage in attracting higher-value-added foreign investments—a game which some countries played virtuously (e.g., Hungary, Czechia, Poland), while others less so (e.g., Bulgaria). Essentially, EU funds were used in the ECE region to provide direct state aid to large foreign investors in key strategic sectors (e.g., automobile manufacturing, information and communication technology (ICT), energy), or to finance enabling infrastructure for foreign investments (e.g., road, rail, and even air transport facilities, digital infrastructure, or human resource formation in targeted specializations like science, technology, engineering, and mathematics).

But large subnational disparities mean the beneficial effects of economic integration are not felt equally, and the relative economic deprivation in some parts of Central and Eastern Europe can be linked to growing anti-liberal political sentiment. For example, Czechia's poorest regions, home to the declining coal industry, are strongholds for the ANO (Action of Dissatisfied Citizens) populist party, while poverty-stricken rural areas in Poland all voted for PiS (Law and Justice) in the last presidential election. European funding has contributed to local development, but it has also placed a heavy burden on administrations that often lack both technical capacity¹⁰ and capital to fulfill the co-financing requirements.¹¹

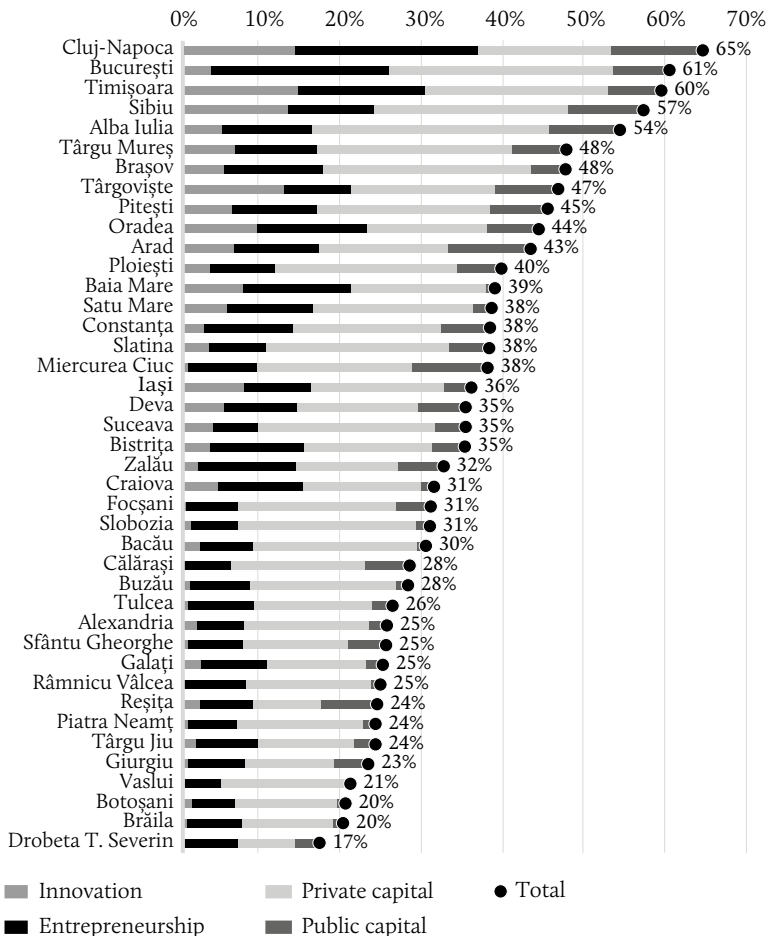
Local resilience can be defined as “a community’s capacity to resist, adapt and recover its functions and structures after a crisis or a disruptive event.”¹² Based on a review of several existing resilience indicators, the authors of this chapter have developed

a pilot index on local resilience in Romania and Moldova in 2022 (as an example, Figure 2 shows results for the socioeconomic pillar for Romania). Our Local Resilience Index (LOCRES) comprises three dimensions: economic, societal, and security. For economic local resilience, we used three pillars: socioeconomic policies (i.e., adaptive economic policies and targeted social policies responding to the specific context of the local community), access to basic services (i.e., basic level of quality of services, and intra- and inter-community connectedness), and local economic opportunities (i.e., employment perspectives, mobility or availability of financial resources, entrepreneurship, and private sector development). All three socioeconomic pillars have been measured through a mixed data set, comprising both statistical indicators and population survey data. We found that in the case of Romania, there is a balanced level of development in terms of policies' capacity to cater to local needs and in terms of access to public services (see Figure 2). However, the large prosperity gaps are correlated with large discrepancies in economic opportunities between localities—with people in the capital region of Bucharest having nine times more economic opportunities than those in the county of Vaslui, near the eastern border (see Figure 2).

Regions that lag behind on the LOCRES Index are extremely vulnerable to economic shocks, with low resilience, and lower capacity to recover, regardless of the dimension of local resilience—political, security, or economic. These regions usually share some common characteristics: a lack of critical infrastructure and medical supplies; poor access to basic education; a low level of digitalization; social divisions, and social polarization in general; a high level of corruption and clientelism at the local level; and a high level of non-conventional threats like fake news and disinformation. Low gross domestic product (GDP) per capita and limited labor market opportunities diminish further the local capacity. Moreover, there is a salient mistrust in public authorities

in these regions, and the civic culture—expressed as personal involvement in civic actions at the local level—tends to be limited.

Figure 1. Romanian local development—innovation, public and private capital, and entrepreneurship (2022)



Source: Clara Volintiru and George Ștefan, *Economic Development and Opportunities in Romania: Local Business Environment Index (LBEI)*, Aspen Institute Romania, December 14, 2018, https://aspeninstitute.ro/wp-content/uploads/2018/10/WHITE-PAPER_Economic-Opportunities-Program_2018.pdf.

Figure 2. Economic resilience at local level in Romania, 2021



Source: Local Resilience (LOCRES) Index: Romania, “Understanding Local Resilience: Definitions, Dimensions, and Measurement,” October 2021, https://locres.eu/wp-content/uploads/2022/02/Raport-Oct-21_logo.pdf; data not yet published.

Malign economic and political influences have swept through the region's democracies for a long time and there is a sense of complacency in the way the transatlantic community has approached them. First, it took too long for us to connect the dots, and realize that political actors supported by the Kremlin had similar narratives and strategies across Central and Eastern Europe and beyond.¹³ Second, the desirable plurality of elections and the quest for foreign direct investment meant that too often malign interventions were welcomed as endogenous elements of liberal economies. Third, there was a reluctance in the West to admit that some of the malign influences—Russia and China, for example—were targeting salient economic and political vulnerabilities: low political influence in international relations, and large investment gaps, including in key strategic sectors (e.g., energy, infrastructure, digital technologies).¹⁴ Our data show the importance of attending to the local level within Eastern European democracies, both to understand their vulnerabilities to malign political influences from Russia, and to address the persistent economic divides at subnational level.

Growth trajectories in a new economic model

While initially the economic convergence was built on the back of economic growth, the persistent inequality levels highlighted the need for a more comprehensive approach to European convergence. As such, aligned with international trends, evidence on human development levels enabled decision makers to craft targeted, informed policies that helped people take full advantage of the opportunities created by economic growth.¹⁵

Several layers of transformation occurred in the global economy over the past decade that are changing the growth model for Eastern Europe. These can all be linked to the way the traditional bottom lines of business strategies have changed. One dimension of transformation is linked to the way productivity is achieved,

and the way competitiveness is defined more in relation to sustainability than to profit margins. To this end, increasing amounts of public capital are being used to derisk private investments in new technological sectors that can support both sustainable and competitive objectives. Thirdly, enabling endowments such as infrastructure, skills, and governance are as important as profit margins. Finally, profit margins are increasingly becoming a secondary priority to geopolitical alignments.

Across Europe and in the United States, there has been a concerted effort to reorient economic policy in a new direction informed by climate action. As the EU coins the term “competitive sustainability,” which can be defined as “the ability of an economy, companies and industrial ecosystems to excel relative to international competitors in their transition to a sustainable economy – with climate neutrality at its core – through investment in the necessary innovation.”¹⁶ The European Commission thus links unequivocally the pursuit of economic growth and prosperity to a “fair, just, green, and digital transition.”¹⁷ Similarly, the United States is engaged in a comprehensive effort to link economic transformations to climate action goals such as reducing carbon emissions (as seen, for instance, in the Inflation Reduction Act of 2022¹⁸). As the economic and energy crises are increasingly interconnected, the dual pursuit of prosperity and sustainability will likely pose a new economic challenge to Eastern Europe.

The new ambitions of linking competitiveness to sustainability have required more and more blended financing. Public capital is increasingly used to leverage private resources—both financial and intellectual—to develop niche sectors in leading economies of the United States, EU, or China. This new form of industrial policy is not, however, led by the state, but rather a codesign process, which some authors characterize as the “Wall Street consensus,”¹⁹ “state capitalism,”²⁰ or a “hidden investment state.”²¹ Either way, the disadvantage of smaller economies with poorer national

budgets is clear, and the need for concerted action amongst Western allied economies is very large.

Within the EU, there is an East-West divide on measures of basic competitiveness indicators in the Eurostat Regional Competitiveness Index: quality of institutions, macroeconomic stability, infrastructure, health services, and basic education.²² Eastern Europe was also much less competitive than the West in technological innovation. The values of these metrics in ECE countries were, on average, two times smaller than the average of older member states (e.g., Denmark's maximal value of 0.89 vs. Romania's minimal value of -1.44 on the national averages of the Regional Competitiveness Index).²³ While recent growth patterns in Eastern Europe have shown increases in labor productivity, the region had not gained ground in innovation or technology.

Geopolitical realignments have become increasingly visible over the past decade, with the war in Ukraine drawing firm ties between allies. These realignments have been amplified by the dire realities of global value chain (GVC) vulnerabilities that surfaced during the COVID-19 pandemic. Eastern Europe is looking for economic support in this context from its security allies in the transatlantic space. The geopolitical positioning of countries like Romania and Poland comes with expectations for strengthening economic ties. This is not just a transactional logic in the diplomacy of nation states, but an important policy commitment for ensuring governments retain the support of their populations for the security pledges they make. Further shifting the sands of the regional economy, by the beginning of 2023 over 1,000 Western companies had curtailed operations in Russia, according to the Yale School of Management monitoring data.²⁴

For all of these reasons, Eastern European economies are prone to engaging in a redesign of their national economic models, moving away from the lure of cheap labor, and fighting hard for high-value-added (HVA) investments. Moving beyond the

automotive and basic manufacturing sectors, countries in Eastern Europe are now focusing on attracting FDI in biotech, aviation, information and communications technologies (ICT), and cyber, defence, or energy. These can deliver more prosperity to the local economies, and would be supported by more complex pull factors. HVA investments can make use of a skilled labor force, can access EU funds for leveraging foreign investments, and can build on geopolitical alliances in near-shoring or allied-shoring processes. As opposed to Hungary, both Romania and Poland share a better territorial distribution of HVA investments (see Table 1). While Hungary has been more skilled in leveraging EU funds to attract and increase its HVA investments, its decreasing level of freedom (according to the Atlantic Council Freedom Index) leaves it unable today to mobilize the full spectrum of drivers of a new economic model that might otherwise be possible through allied-shoring and pooling public resources such as EU funds.

Table 1. Territorial distribution of high-value-added (HVA) foreign investments in Hungary, Poland, and Romania (top 15 localities with at least 15 foreign investment projects between 2004 and 2020)

| Hungary | | | |
|-----------------|-----------------------------------|--------------------------------|-------------------------|
| Locality | No. of foreign investments | HVA foreign investments | Share (%) of HVA |
| Budapest | 509 | 467 | 91.75 |
| Szeged | 15 | 11 | 73.33 |
| Debrecen | 47 | 22 | 46.81 |
| Biatorbágy | 15 | 7 | 46.67 |
| Pécs | 29 | 13 | 44.83 |
| Miskolc | 27 | 9 | 33.33 |
| Győr | 71 | 22 | 30.99 |
| Székesfehérvár | 54 | 16 | 29.63 |
| Veszprém | 27 | 8 | 29.63 |
| Kecskemét | 29 | 8 | 27.59 |
| Szombathely | 17 | 4 | 23.53 |
| Tatabánya | 36 | 5 | 13.89 |
| Esztergom | 15 | 2 | 13.33 |
| Mosonmagyaróvár | 16 | 2 | 12.50 |
| Zalaegerszeg | 19 | 2 | 10.53 |
| Romania | | | |
| Locality | No. of foreign investments | HVA foreign investments | Share (%) of HVA |
| Iași | 65 | 59 | 90.77 |
| Bucharest | 607 | 548 | 90.28 |
| Constanța | 24 | 19 | 79.17 |
| Cluj-Napoca | 125 | 93 | 74.40 |
| Timișoara | 126 | 83 | 65.87 |
| Brașov | 81 | 38 | 46.91 |
| Sibiu | 57 | 25 | 43.86 |

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| Romania | | | |
|-----------------|-----------------------------------|--------------------------------|-------------------------|
| Locality | No. of foreign investments | HVA foreign investments | Share (%) of HVA |
| Craiova | 32 | 14 | 43.75 |
| Târgu Mureş | 15 | 6 | 40.00 |
| Piteşti | 24 | 8 | 33.33 |
| Arad | 29 | 9 | 31.03 |
| Ploieşti | 46 | 13 | 28.26 |
| Oradea | 38 | 10 | 26.32 |
| Satu Mare | 19 | 3 | 15.79 |
| Slatina | 17 | 0 | 0.00 |

| Poland | | | |
|-----------------|-----------------------------------|--------------------------------|-------------------------|
| Locality | No. of foreign investments | HVA foreign investments | Share of HVA (%) |
| Warsaw | 685 | 653 | 95.3 |
| Kraków | 211 | 185 | 87.7 |
| Gdynia | 31 | 27 | 87.1 |
| Gdańsk | 131 | 113 | 86.3 |
| Poznań | 160 | 130 | 81.3 |
| Wrocław | 243 | 183 | 75.3 |
| Strykow | 18 | 13 | 72.2 |
| Bydgoszcz | 34 | 24 | 70.6 |
| Katowice | 101 | 69 | 68.3 |
| Szczecin | 59 | 40 | 67.8 |
| Lublin | 28 | 16 | 57.1 |
| Opole | 19 | 10 | 52.6 |
| Torun | 18 | 9 | 50.0 |
| Łódź | 139 | 68 | 48.9 |
| Sosnowiec | 26 | 12 | 46.2 |

Source: Cornel Ban, Clara Volintiru, and Gergő Medve-Bálint, "The Politics of Local Developmental Alliances and Industrial Policy: Upgrading Strategies in Three Central European Cities," *Competition and Change* (forthcoming); based on FDI markets, <https://www.fdimarkets.com>.

Growth trajectories and freedom as an enabling condition for prosperity

Societal actors (e.g., civil society, media, lawyers, or political parties) are key in ensuring a free and vibrant democracy, one in which economic opportunities prevail, and public sector development leads to shared prosperity. Not only are societal actors able to implement checks and balances that uphold the quality of our democracies, but they are increasingly more involved in codesigning solutions in times of crisis (e.g., COVID-19,²⁵ the war in Ukraine), and long-term growth trajectories for local communities.

Of all the countries in Eastern Europe, Romania has by far the strongest civil society,²⁶ including the largest number of civil society organizations (CSOs). These CSOs have been part of large EU or international networks, or gained experience locally, in multimillion-euro projects and with large, diverse networks. Romanian CSOs have proven their resilience, and the sustainability of their business model, not only by working well internationally, but by partnering effectively with government when crisis situations required it.²⁷ Apart from Moldova, where the situation for nongovernmental organizations (NGOs) has seen improvements, the situation of NGOs in all other countries of the Black Sea region has either remained the same (e.g., Georgia) or became worse (e.g., Armenia). While some countries (e.g., Romania) have seen constant improvements in press freedom, others (e.g., Poland, or more noticeably, Hungary) have shifted more and more towards autocracy, with several independent media outlets in Hungary being closed by direct government intervention.²⁸ This has not led to immediate economic consequences for ordinary citizens, but we see signs that the economic situation in Hungary has deteriorated, with both its GDP and consumption decreasing in 2021, falling below most countries in the region.²⁹

A strong civil society is not only a prerequisite for prosperity, but an important facilitator for other factors associated with an open and free society, and a way to hold the government accountable for its decisions. Romania's case is particularly interesting from this point of view. From the summer of 2017 onwards, movements against internet regulation and for a stronger voice for local communities cohered into increasingly strong activist networks (e.g., #rezist, #insist, #unitedwesave). These networks became vocal opponents of corruption, fueling new political parties, and thus increasing the quality of democracy.³⁰

Online groups and social media were at the heart of these burgeoning movements, but free access to information has been a double-edged sword. It has not only driven a stronger civil society, but, as an unwanted consequence, allowed Russian propaganda and its anti-democratic narratives to find a way into people's minds—especially when events coincide with a crisis like the COVID-19 pandemic. The restrictions imposed by the governments during the pandemic had an impact on the overall feeling of freedom people were experiencing, and this created fertile ground for propaganda pushed by Russian actors.

Despite this, Romanian civil society witnessed a surge in solidarity during the pandemic, and a broad community effort to support the vulnerable and those in need. Networks grew stonger, and new partnerships were fostered between the state and civil society, particularly in terms of social innovation. For example, Code for Romania (an association of volunteers from the IT industry) created a digital platform to support the COVID response. As a result of this growth, when Russia attacked Ukraine in February 2022, the response of Romanian society was swift and overwhelming: Tools built in COVID times were quickly repurposed in support of refugees.³¹ Local networks of NGOs, which had supported older people during the pandemic (with medicines, etc.), became active collectors of goods and first aid materials to be

sent to Ukraine. Over 300 Romanian NGOs have been involved in supporting the Ukrainian people since the beginning of the war. This strong, robust, and healthy civil society in Romania has proved to be a pillar of resilience when the country has been confronted with pro-Russian narratives related to the war: 65 percent of the population believe that there was no justification for the Russian invasion of Ukraine and 75 percent believe in NATO's capacity to defend the country.³²

In particular, the United We Save (#unitedwesave) movement was, in our opinion, the most important turning point in the Romanian civil society movement, from 2013 onwards.³³ Its major success was that it proved united citizens could influence government politics—especially noteworthy given the common perception, that a government ostensibly *of* the people was led neither *by* the people (but by a few corrupt politicians) nor *for* the people (but rather for corporate interests). Following this important milestone in the Romanian civil society movement, mass protests have managed to take down several governments for corruption-related issues,³⁴ when the state has not been perceived as functioning to the benefit of the citizens. These movements provided a strong indication that it was not only the government that needed reform, but the political class as well.

Romanian civil society has strongly supported the country's democratic institutions in their attempts to resist corrupt practices of politicians, or laws perceived as being made solely for corporate interests. Russian propaganda, trying to use the same channels as these movements, has had some minor success, especially in supporting the movement against COVID regulations, but as we have seen, in general the large mass of people has been well inoculated for defending liberal democratic values. In our view supporting a robust civil society that can withstand such challenges is the most important investment one can make, especially if we look toward the future reconstruction of Ukraine.

The resources that will be spent in repairing bridges, buildings, roads, and other infrastructure have to be matched by continuous investments in the strengthening of civil society. Here, Romania has useful experience, which can be transferred and used to the benefit of the Ukrainian people.

Mutual engagement between civil society and local administrations has been relatively poor in Hungary, Poland, and Romania.³⁵ However, the last decade has seen the creation of new formal and informal avenues of engagement between citizens and local governments. The key to collaborations that push back against the shrinking of civic space lies with civic actors' ability to participate, and with local governments' engagement in consultations, collaborations, and public deliberations. CSOs are essential actors in mediating the relationship between citizens and the state by building trust and social capital. They can play a role in advancing transparent and accountable governance by articulating and representing citizens' concerns, thereby furthering participatory governance, and by increasing the legitimacy of public actors and the relevance of their projects.

Conclusion: Ways forward for economic resilience in Eastern Europe

Since the war in Ukraine began in 2022, it is clearer than ever that Eastern Europe is a key battlefield for democratic values. It is no longer the region's inner transitional risks, but outward hybrid threats from Russia that pose the challenge to democratic alliances. Winning hearts and minds, however, is not only a battle of ideas—however important those might be—but also of ensuring that democracy and prosperity go hand in hand. Our central argument is that, considering the overlapping crises that are unfolding (e.g., energy security, inflation), economic

resilience should be seen as a key element of the security strategy for Eastern Europe.

The chapter tells the story of economic trajectories of growth for Eastern European countries. In a time when economic growth seems to be only a memory of the good times past, the region still relies heavily on a sustained dynamic of growth in order to maintain its stability. There are three core arguments that we present. First, European integration has been the life-line of the economic growth trajectory of the region, with large influxes of FDI and EU funding for investments. However, this has not translated into the pace of economic convergence that would have stabilized the overall trajectory of the region within the EU single market, as large economic disparities between and within member states persist. Second, the path to prosperity for the region has to account for a transition to a new economic model—one that is more embedded in national endowments, but also better aligned with the overarching energy and technological transitions of its Western peers. This will mean doubling down on efforts to attract high-value-added investments that allow for its growth trajectory to be maintained. Finally, in order to achieve a sustainable and shared prosperity, Eastern Europe must capitalize on all societal actors. A free and empowered society allows for a consolidation of capabilities. It is only through mutual engagement, mobilizing both public and private sector investments, and aligning strategic priorities in a way that reflects both freedom and prosperity, that the countries of Eastern Europe will achieve lasting stability and societal resilience in the face of malign threats and ever-emerging risks.