

**INDUSTRIAL POLICIES IN SELECTED CEE TRANSITION
COUNTRIES: AN OVERVIEW**

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Contemporary debates about the role and the importance of industrial policy to promote economic growth and development have attracted the interest of policymakers around the world, especially during the period of the Global economic crisis.

The experience and the effectiveness of industrial policy as a development tool differs significantly among countries and regions.

The main argument of this statement is the story of successful emerging market economies (China, South Korea, Singapore, Malaysia) versus other unsuccessful developing countries. Or, if we compare some countries within the CEE transition countries (Slovenia, Slovakia, Hungary, Czech Republic versus some Western Balkan or FSU countries).

Industrial policy from a transition country perspective

Industrial policy in the centrally planned economies?

Industrial policy under market socialism?

Industrial policy in the Former Yugoslav economic system of self-management:

- Fascination with the practice of industrial policy in advanced “capitalist” countries
- Every economist had heard of the Japanese MITI of the time
- The decentralized nature of the economic system provided for implementation of certain industrial policy measures
- Federal units (republics) had significant and increasing autonomy in this area until the break up of the SFRY, trying to utilize their comparative advantages.

Industrial policy under duress during early 1990's

Does privatization represent industrial policy?

Liberalization and Enterprise restructuring certainly do

Unfortunately, the process was chaotic, due to a number of external shocks at that time, such as:

- the dissolution of COMECON;
- the break up of the former SFRY and former Soviet Union;
- wars of succession on the territory of the former SFRY.

Political economy of industrial policy in the CEE transition countries

Piecemeal approach, consistent with the overall POPULIST approach in the design and implementation of economic and social policies, after 2008 in particular

The Great Recession (the American Auto and Insurance industry effect: the bailout of GM, Chrysler, and ING)

Piecemeal and populist measures – a little bit of something for everybody

Of course, this is a recipe for a limited effect of the industrial policies measures.

Economic performance in selected CEE countries

The rates of economic growth among the CEE countries in the last two decades have varied significantly

Country	1996-2015	1996-2007	2008-2015
Armenia	6.53	9.48	2.09
Azerbaijan	9.98	13.62	4.53
Russian Federation	3.26	4.69	1.11
Ukraine	1.28	3.72	-2.38
Belarus	5.62	7.34	3.04
Kazakhstan	5.99	7.03	4.42
Georgia	5.86	7.34	3.64
FSU	5.40	7.18	2.61
Euro area	1.50	2.22	1.53
Estonia	4.21	6.08	-0.04
Czech Republic	2.46	3.37	1.02
Croatia	2.02	3.98	-1.16
Hungary	2.26	3.20	0.56
Lithuania	4.42	6.37	1.01
Latvia	4.25	6.55	-0.47
Bulgaria	2.81	4.05	1.15
Poland	4.05	4.56	3.24
Romania	2.76	3.94	1.57
Slovak Republic	4.00	5.23	2.20
Slovenia	2.55	4.25	-0.12
New EU member states	3.25	4.69	0.81
Albania	4.62	5.82	3.03
Macedonia	2.85	3.23	2.56
Montenegro	2.48	3.53	1.59
Serbia	2.71	4.22	0.59
Bosnia and Herzegovina	4.46	6.90	1.23
Western Balkan countries	3.36	4.53	1.80

What is the main reason why some transition countries still lag behind from their sustainable growth-path?

According to the new growth theory and empirical evidence, the main driving force and engine for long-run economic growth in small open economies, like in almost all transition countries, is the process of *industrial upgrading* and *export diversification*.

The paper examines industrial and export performance of selected transition countries from the CEE region and explores the role of industrial policy and its impact to promote the production and industry structural transformation.

Hausman and Rodrik point out that industrial policy might play an important role in designing development strategies in the contemporary period, and they focus on the industrial policy as a tool to overcome the previously addressed market failures in order to promote structural transformation (Hausman and Rodrik, 2005).

Lin suggests that the government has a crucial role in facilitating private sector's ability to exploit the country's areas of comparative advantage. Moreover, governments should accelerate the process of industrialisation and technological upgrading by a variety of measures and effective industrial policies (Lin and Chang, 2009).

Moran extends the previous work of Hausman, Rodrik and Lin by stressing the role of FDI as a main source for industrial upgrading and consequently policies for attracting it (Moran, 2015).

Bartlett in his paper investigates the role of industrial policy in SEE countries, concluding that Europeanization of industrial policy has taken place as a consequence of the EU pre-accession, and each country within that framework should create its national industrial policy (Bartlett, 2011).

Cerovic et al. explore the industry/manufacturing output and export as important factors of growth for the transition countries (Cerovic et al., 2014).

Damiani and Uvalic in their paper analyze the main characteristics and major changes in manufacturing in the old EU member states over the past twenty years, in order to offer some lessons and guidelines for formulating better industrial policies in the SEE countries (Damiani and Uvalic, 2014).

Methodological framework

- Empirical analysis of sectorial structure with special focus on industry and the manufacturing sector
- Sector-side growth source approach
- Comparative benchmark analysis of export performance and competitiveness
- Analytical method for exploring industrial policy

Sample of countries and time period

The sample of countries that we analyze is consisted from three groups of CEE countries:

- I. **Five Western Balkan countries** (Macedonia, Serbia, Albania, Montenegro, and Bosnia and Herzegovina),
- II. **Ten new EU member states or Emerging European economies** (Czech Republic, Hungary, Slovak Republic, Poland, Slovenia, Romania and Croatia), including the **Baltic countries** (Latvia, Lithuania and Estonia), and
- III. **Seven Former Soviet Union (FSU) or Commonwealth of Independent States (CIS) countries** (Kazakhstan, Belarus, Russian Federation, Ukraine, Armenia, Georgia and Azerbaijan).

The time period covers the period from 1996 to 2015.

Main characteristics and changes in relative share of manufacturing in GDP, %

	1996	2000	$\Delta 96-00$	2008	$\Delta 96-08$	2015	$\Delta 96-15$
Croatia	18.32	17.77	-0.55	15.08	-3.25	14.72	-3.60
Estonia	18.68	17.30	-1.38	15.48	-3.20	15.84	-2.84
Czech Republic	24.83	25.91	1.09	24.53	-0.29	26.97	2.15
Lithuania	17.97	18.86	0.89	17.49	-0.48	19.34	1.37
Latvia	19.35	15.35	-4.01	10.77	-8.58	12.51	-6.84
Poland	19.79	18.16	-1.63	18.65	-1.14	19.69	-0.10
Romania	26.86	22.08	-4.78	21.55	-5.31	/	/
Slovak Republic	24.41	23.91	-0.50	22.26	-2.15	22.45	-1.95
Slovenia	25.37	24.93	-0.44	21.95	-3.43	23.23	-2.14
NEU member states	21.73	20.48	-1.26	18.64	-3.09	19.35	-2.39

The evidence shows the process of deindustrialization in all New EU member states.

Empirical work (cont.)

Main characteristics and changes in relative share of manufacturing in GDP, %

	1996	2000	$\Delta 96-00$	2008	$\Delta 96-08$	2015	$\Delta 96-15$
Macedonia	23.01	10.64	-12.37	11.35	-11.65	12.34	-10.67
Montenegro	/	10.23	/	6.72	/	6.00	/
Albania	9.10	7.20	-1.91	5.76	-3.34	5.72	-3.39
Serbia	22.50	25.65	3.15	16.66	-5.85	/	/
Bosnia and Herzegovina	13.93	10.10	-3.83	13.53	-0.40	14.12	0.19
Wester Balkan countries	17.14	12.76	-4.37	10.80	-6.33	9.54	-7.59

The deindustrialization process is much more significant in Western Balkan countries than in New EU member states.

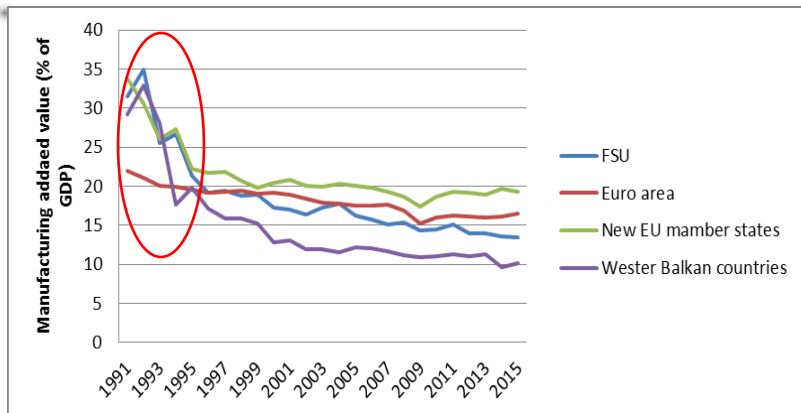
Main characteristics and changes in relative share of manufacturing in GDP, %

	1996	2000	$\Delta 96-00$	2008	$\Delta 96-08$	2015	$\Delta 96-15$
Armenia	24.79	18.53	-6.26	9.98	-14.82	10.35	-14.44
Azerbaijan	11.59	5.64	-5.95	5.04	-6.55	5.77	-5.83
Kazakhstan	13.94	17.66	3.72	12.66	-1.28	10.83	-3.11
Kyrgyz Republic	8.49	19.46	10.97	15.22	6.73	13.73	5.24
Belarus	33.33	31.64	-1.69	30.63	-2.70	25.93	-7.40
Georgia	11.13	9.10	-2.03	12.06	0.92	12.81	1.68
Ukraine	31.05	19.23	-11.82	19.99	-11.06	14.22	-16.83
FSU countries	19.19	17.32	-1.87	15.08	-4.11	13.38	-5.81

The process of deindustrialization is also present in FSU countries.

Empirical work (cont.)

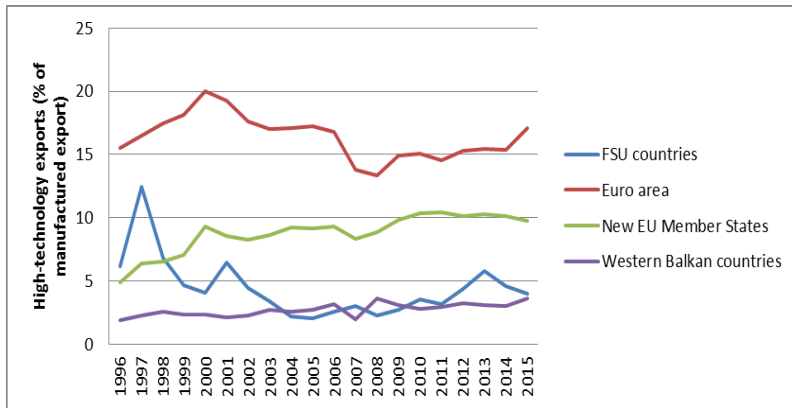
Main characteristics and changes in relative share of manufacturing in GDP, %



The impact of manufacturing on economic growth

New EU Member States	1996	2000	2008	2015
Manufacturing, value added (annual % growth)	4.39	9.74	1.90	5.75
Manufacturing, value added (% of GDP)	21.73	20.48	18.64	19.35
Absolute contribution, %	0.95	2.00	0.35	1.11
Rate of economic growth, %	4.07	4.49	2.41	2.97
RELATIVE SHARE, %	23.42%	44.43%	14.69%	37.46%
Western Balkan countries	1996	2000	2008	2015
Manufacturing, value added (annual % growth)	2.25	12.79	0.83	2.62
Manufacturing, value added (% of GDP)	17.14	12.76	10.80	9.54
Absolute contribution, %	0.39	1.63	0.09	0.25
Rate of economic growth, %	4.24	5.51	5.57	2.89
RELATIVE SHARE, %	9.10%	29.61%	1.62%	8.65%
FSU countries	1996	2000	2008	2015
Manufacturing, value added (annual % growth)	-0.84	-2.45	3.94	-3.39
Manufacturing, value added (% of GDP)	19.19	17.32	15.39	13.43
Absolute contribution, %	-0.16	-0.42	0.61	-0.46
Rate of economic growth, %	1.89	6.97	6.18	-0.63
RELATIVE SHARE, %	-8.56%	-6.09%	9.81%	-72.23%

Comparative analysis of export sophistication



What is the explanation of the huge variation in industrial and export performance among the CEE transition countries?

1) Market failures

- Information externalities (insufficient entrepreneurial skills of private sectors to engage in the processes of discovering new industries, sectors and products where a country might have latent comparative advantages).
- Coordination externalities (markets were unable to create a full supply chain and all capabilities for building a new industries).

2) Government failures

- Insufficient economic reforms, lack of institutional capacity (corruption, rent-seeking, political instability, rule of law), and government inability to provide public goods (education, infrastructure etc.) in order to address the coordination failures.
- Absence of modern industrial policy (building national innovation system, bridging the gap between academia and industry, sectorial policy for attracting FDI, promoting new activities and modern industrial sectors, supporting SME).

Conclusion and policy recommendations


The paper concludes that implementation of industrial policy, or the lack of it, could have a decisive role in the structural transformation of transition economies towards an optimal industry structure that fits specific historical, political, cultural, and economic circumstances in each of these countries, including their overall production capabilities.

So, the paper gives some policy recommendations in a way that each individual country should engage in the process of self-discovery by identifying the industries and sectors where it might have latent comparative advantages and to promote structural transformation and export diversification in those industries by an active industrial policy.

Moreover, countries should create sectoral policies towards attracting FDI as a way to accelerate the process of structural transformation, in particular policies that will aim to integrate domestic economy (firms) into MNC's supply chains.

Specific recommendations for the FSU and WB countries

- Adverse trends in deindustrialization and loss of competitiveness require active industrial policy measures;
- The majority of industrial policy measures from the EU reindustrialization and export competitiveness increasing strategies might be useful for the advanced EU countries only, and a handful of CEE economies (Slovenia, Czechia, Slovakia);
- Therefore, these countries should direct their industrial policy measures towards support of industries with comparative advantages;
- Also, these policies should aim to overcome the identified constraining factors with the most distortive effects in the process of structural transformation and increasing of the export competitiveness.



Thank you for your attention!