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INDUSTRIAL POLICIES AND THE EUROPEAN ECONOMIES IN TRANSITION

(Working title)

Draft

FOREWORD

After initial euphoria, policy makers and entrepreneurs in Central and Eastern Europe have come to recognize that the transition from central planning to a market economy is a complex and lengthy process which must be supported by sound industrial policies. However, in formulating and executing such policies, governments play a role which is very different from the past, guiding and supporting the activities of free enterprise rather than controlling economic activities.

To discuss the issue, a Workshop on Industrial Policies in the Economies in Transition was held in Budapest from 12-13 October 1993. The Workshop was attented by representatives of governments, governmental agencies and international organizations, senior managers from private enterprises and high-level experts. Proceedings of the Workshop were prepared by the UN Economic Commission for Europe.

The present document takes the Workshop as a basic point of reference, but the approach used differs from the UN/ECE publication. Apart from reflecting key elements of the presentations and discussions at the Workshop, it also refers to the debate that is taking place in professional publications on industrial development issues in the economies in transition.

The structure of the document is as follows:

Chapter 1 argues that there is a need for industrial policies in the industries in transition; as in the developed market economies, market forces by themselves are unlikely to succeed in balanced development. Chapter 2 outlines developments in the international environment (such as the establishment of the Single European Market) - the opening up of the Central and East European economies has exposed them and forces them to respond to these developments. Chapter 3 discusses the key elements of industrial policy, and presents some case studies of individual countries. A special section is devoted to measures for small and medium-scale industry, which in the future is likely to play a much more important role in Central and Eastern Europe. Chapter 4 then focuses on a major aspect of transition, the privatization of public enterprises; this chapter includes several examples of actual developments at the country level as well. Chapter 5 summarizes the activities of UNIDO in assisting industrial development in the economies in transition. Chapter 6, finally, draws some general conclusions and presents some suggestions for follow-up action.

The document was prepared by the Regional and Country Studies Branch, assisted by Paul Hesp, UNIDO consultant.

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1 INTRODUCTION: WHY INDUSTRIAL POLICIES?

The fact that the former CMEA member countries have abandoned central planning in favour of market-led economic development is often considered as irrefutable proof of the superiority of laissez-faire economics. It is moreover evident that the wave of economic deregulation in the market economies during the past decade has stimulated private enterprise and has contributed to a period of rapid growth.

In the debate on economic development, these events have strenghthened the position of strict non-interventionists advocating unrestrained freedom of action for private enterprise. Competition, according to them, would "weed out" all unviable activities and the benefits of economic development would be maximized. The image used in this connection is "natural selection", drawn from biological evolution theory[1]. In the former CMEA countries themselves, the new breed of private entrepreneurs is - not surprisingly - often suspicious of Government intervention.

It is however doubtful whether natural selection has actually provided a basis for economic development; and pure laissez-faire is not practiced in any market economy. Historically, the basis for economic development has been the conscious selection and manipulation of of plants and animals, and similarly carefully targetted intervention has played a fundamental role in the development of some of the most successful market economies, notably Japan, the the Federal Republic of Germany (FRG) and France. Some of the rapidly growing developing economies in East Asia also rely heavily on Government intervention. By contrast, the relative weight in the global economy of the two countries which are the most outspoken advocates (though not consistent practitioners) of laissez faire - the USA and the United Kingdom - is declining. It can be concluded that the development of a market-oriented policy framework and supporting institutions is evidently essential if the Central and East European countries are to make a successful transition to a market economy[2].

There are a number of reasons for an active role of government. In practice, "natural selection" among firms often leads to market control by oligopolies or monopolies, to the detriment of consumers. Market economies have all entrusted their governments with formulating and enforcing legislation ensuring competition. A modern market economy also requires a complex system of corporate law, guarantees for intellectual property rights, a well-developed transport and telecommunications infrastructure, and an all-round educational system. Many of these essential basic conditions for long-term development cannot be created by private enterprise.

Actions of individual entrepreneurs may moreover result in social or environmental costs which have a negative influence on overall development; it is therefore in the interest of society as a whole to minimize these costs. In the case of environmental damage it can be argued that the record of public enterprises in the former centrally planned economies was often worse than that of private enterprises in market economies. But private ownership and competition are no guarantee for better environmental standards: enforcing these in a market economies is very much a task of government, spurred by environmental pressure groups which can function effectively in a democratic society.

Providing a basis for the institutional and physical infrastructure which are essential to economic development and balancing the various interests in society, in short, are essential government roles[3]. The economies of transition have additional arguments for government intervention. First, pure laissez-faire in Eastern Europe would place industrial enterprises at a serious disadvantage vis-à-vis the industries of the developed market economies, which very often benefit from government support in one way or another[4]. Second, the transition towards a market economy creates special conditions:

> "...macroeconomic/microeconomic interaction is not working as it does in mature market economies. Macroeconomic policies have perverse effects on microeconomic structures and behaviour if the obstacles to industrial restructuring are too high to be removed by weak market forces; and delays in industrial restructuring may make macroeconomic objectives more and more difficult to achieve"[5].

Without a policy framework to guide economic activities in a country in transition, "...politicians will inevitably make ad-hoc decisions as they respond to pressure to 'do something'. In turn these individual actions are liable to accumulate as unplanned and incoherent precedents with unpredictable knock-on effects across the economy"[6]. The resulting unstable, un-transparent policy environment is very likely to deter foreign and domestic investors, jeopardizing the transition process to a fully developed market economy. A comprehensive approach to policy is thus essential[7].

Policies can broadly be categorized as those intended to stimulate the emergence of promising new national industries and those intended to protect declining industries from the encroachments of (foreign) competitors. A rather similar categorization of policy theorists and policy makers distinguishes between:

> "(i) Those whom we may call institutionalists [who] think that by the creation of the institutions of an open, free-market system and civil society the conditions can be established under which a competitive and efficient industry can flourish...(ii) those whom we may call industry sector activists [who] think that the government should be able to stop further damages to be suffered by industry by helping its organizational, managerial and

technical restructuring, and by enabling it to strengthen its position on foreign markets and by better protecting it on its national markets - through direct intervention and various ways of direct support"[8].

On the whole, present-day economic policy makers in developed market economies show a strong preference for the institutionalist approach and policies are therefore largely confined to creating and safeguarding a proper business environment. The entrepreneurs have the main responsibility for industrial development. But the special problems of the less advanced EC members in Southern Europe and of the transition to a market economy in Central and East Europe have induced governments to intervene directly in particular areas, as the country examples in chapters 3 and 4 will show.

In Central and Eastern Europe, industrial policy is particularly important because of the very high level of public ownership in this sector, and the complex, long-term nature of the privatization and restructuring process needed to adapt the sector to its role in an open economy. In the past, industrial policy was based on five-year plans co-ordinated among the centrally planned economies. No experience is available on which entrepreneurs and policy makers can rely during the transition[9]. The capacities for designing and implementing industrial policies in individual countries are thus heavily taxed by the need to ensure that this strategically important sector sector meets domestic development needs as well as the requirements of international competitiveness[10].

When policy makers in the economies in transition study the experience of OECD countries with regard to policy making, they will often find that the record of government intervention has been disappointing. Industrial policies have at various stages been characterized by political/social priorities rather than economic priorities and by an overestimation of governments' capabilities and expertise with regard to the issues at hand. On the other hand, there are positive experiences. Japan's measures to restructure ailing sectors constitute a good example, and the following chapters will refer to some successful support strategies in Europe. Generally speaking, intervention which has had positive effects has been characterized by:

- Integration of industrial and macro-economic policies;

- Clear and realistic objectives;

- Well-established monitoring procedures;

- Involvement of the business community and the labour unions;

- Removing barriers to competition;

- A phasing-out of declining industries and stimuli for the diffusion of new technologies;

- Complementary measures to improve infrastructure and training and to promote SMI development".

The most important underlying reason for industrial policies is to maintain or strengthen the sector's position vis-à-vis competitors in the global economy. Before discussing the elements and effects of policies in more detail, it is therefore necessary to outline the international economic developments which are most likely to affect the countries in transition.

2 REGIONAL AND GLOBAL DEVELOPMENTS - THEIR IMPACT ON NATIONAL POLICY MAKING

"The transition of central and eastern European economies to market economies poses new challenges. There is no precedent of an enlargement of world markets...of that size and suddenness"[12].

During the 1980s, the CMEA industries contributed 30-35 per cent of world industrial production; their share in world trade in manufactured products was only 3 per cent. Most of the production was destined for heavily protected national and CMEA markets. There was a fairly well-developed division of labour among the member countries of the CMEA with regard to industrial production, but in some respects the manufacturing sectors in the individual countries were quite similar: large-scale plants turned out standardized products of comparatively low quality, with low prices due to cheap energy and raw materials. There were significant R&D facilities, but these were often focussed on military technologies and a narrow range of capital goods (heavy machinery, etc.) - rarely on consumer goods[13].

In recent years, demand for industrial products in former CMEA member countries has decreased strongly, and the decline is continuing. There are several reasons for this decline:

- Domestic markets have contracted as a consequence of reduced government and private spending. The drastic curtailment of defense budgets, for example, has led to serious problems for the defence products industry. For security reasons, the CMEA was self-sufficient in these products; the industry was a large one, and many subcontractors were dependent on it. Its decline consequently had strong effects on the individual economies.

- The disintegration of the Soviet Union, which constituted by far the largest single market, has affected exports of the other countries.

- Finally, trade among the countries is now based on payments in convertible currency. This has vastly increased competition by producers from industrialized market economies and developing countries: their products are often cheaper and better, delivery is faster, manufacturers respond quicker to changes in consumer taste and provide better user services[14].

As the economies of Central and Eastern Europe open up, the impact of international economic trends is increasingly felt. The most important developments are probably the realization of the Single European Market and the continuing efforts towards further unification among the member states of the EC, an economic region which is geographically and culturally closer to the economies in transition than any of the other major regions.

The countries in transition are well aware of the crucial importance of the EC. In 1991, Poland, the Czech Republic, Slovakia and Hungary concluded association agreements with the EC; similar agreements were being negotiated by Roumania and Bulgaria. Co-operation agreements with the Baltic States and Albania are in preparation.

These agreements improve access to markets and provide a long-term framework for co-operation. More specifically, they cover:

- Trade liberalization and rules for competition;
- Economic and financial co-operation;
- Establishment of enterprises in member countries;
- Services;
- Movements of capital and labour;
- Standardization and certification;
- Intellectual, industrial and commercial property;
- Co-operation in the field of telecommunications, science and technology and the environment[15].

These agreements will play a major role in determining the scope and character of future industrial and macro-economic policy in indivdual countries. Some authors have therefore expressed concern that they may disadvantage the manufacturing sectors of the economies in transition:

> "Industries which in Eastern Europe derive comparative advantage from lower labour costs such as foodstuffs, textiles, garments, footwear, steel and coal, generally face significant tariff and non-tariff barriers in the EC [the dismantling of duties on textiles will take six years]. At the same time associate membership of the EC requires Eastern Europe to reduce protection of its domestic industry and open up markets to EC imports... Polish exporters have adjusted very quickly to the collapse of Russian markets and today over 60 per cent of export trade is with the EC. By contrast only 3 per cent of EC exports go to Poland. As a consequence the costs of protectionism in the EC are much more significant for the Polish economy than protectionism in Poland for EC exports. Another damaging effect of protectionism in the EC is that it deters foreign investors from looking for a low cost export platform in Eastern Europe from which to source the EC market"[16].

UNIDO studies have established that some 30 per cent of all East European exports and 70 per cent of the region's textile exports are affected by tariffs and non-tariff measures restricting trade. The threat to the EC market on the other hand would seem to be minimal, as Eastern Europe rarely supplies more than 2 per cent of imports of any given product, wood products excepted, where figures ranged from 7-10 per cent[17]. A more rapid reduction of EC barriers for certain imports from Eastern Europe would therefore seem justified.

Potential members of the EC will also have to take account of the Community's approach to industrial development. At present, the EC expects member countries to adhere to the following principles with regard to industrial policy[18]:

- Allowing and encouraging private enterprise to take the leading role in industrial development and to take restructuring measures where necessary, by minimizing bureaucratic interference (especially for SMI);

- Actively promoting adjustment instead of protecting weak industries;

- Ensuring that the benefits of competition and specialization are maximized by opening up markets;

- Encouraging competition by reducing subsidies and preventing monopolies and oligoplies.

The need for an alliance with the EC is underlined by the fact that the role of large economic regions in the global economy is increasing: over three-fourths of all international trade now takes place between the EC member countries, North America and Japan. Innovation, investment and human capital are also heavily concentrated in these regions. If the economies in transition are not to be marginalized, they must secure access to this "triangle". At the same time, countries in Central and Eastern Europe should give serious thought to reviving or newly creating forms of co-operation to strengthen their position in the global economy, even though fresh memories of the failure of the CMEA may not immediately encourage this.

Policy makers and entrepreneurs in the economies in transition should also be aware of the increasing role played by some East and Southeast Asian developing countries in the global economy, whose industries are heavy competitors for the East European countries in several areas. During the 1980s, these Asian countries raised their share of all investment flows to a selected group of developing countries to 55 per cent. The trend is particularly clear in the Asian countries along the Pacific Rim, which is becoming a major global economic region. Indonesia, for example, has in recent years absorbed more foreign direct investment than the countries of the CIS combined.

The Asian NICs - Singapore, Hong Kong, South Korea and Taiwan - accounted for 56 per cent of manufactured exports by selected developing countries in 1985. These exports are mainly absorbed by the leading industrialized nations[19]. The NICs are often strong in industries which also occupy key positions in Eastern European countries such as chemicals, textiles and metal products; they are in many cases ahead of the East European countries in terms of technology, marketing strategies, etc., and the latter will therefore be faced with additional difficulties in trying to penetrate the major export markets. Policy-making in Eastern Europe could benefit from a study of the industrial development strategies of the NICs, and of the factors which have made these countries atttractive to foreign investors.

What do East European industries have to offer in the world market? A recent analysis[20] of industrial production in Bulgaria, former Czechoslovakia, Hungary, Poland and the former Soviet Union, using data for the late 1980s, shows that after adjustments for world prices and quality much of the output was uncompetitive, particularly in the food processing industries. Most of the exceptions being found in the chemicals sub-sector and in some branches of the wood and metals sub-sectors. The transition has so far not resulted in a shift to more competitive products.

The analysis indicates that, as long as product quality is below the standards of high-income markets, developing country markets could be the most attractive ones for East European producers. Within the EC market, future restructuring which would emphasize branches that are most competitive <u>now</u> would have the strongest positive export effects in the clothing, footwear, paper products, non-metallic minerals and non-ferrous metals industries. The overall impact on EC markets, however, would still be minimal, with additional net imports by the EC exceeding 1 per cent only in the last two branches. In the longer run, Central and East European producers will of course have to move on to new industries to strengthen their export position. To succeed, they will require a transfer of technological, management and marketing know-how by investors from developed market economies.

Fortunately, for the East European countries, the most competitive branches in one country are seldom the same as in another, according to this analysis. Encouragement of the most competitive branches in each country is therefore unlikely to lead to a flooding of export markets, and the apparent complementarity would also be an advantage in reviving trade among former CMEA countries, once demand picks up. To an extent, the "gap" left by the incorporation of the former GDR - a major supplier of industrial products in the CMEA - in the FRG could also offer export opportunities at the sub-regional level[21].

An EC analysis[22] agrees that chemicals are among the most competitive products now being produced in Eastern Europe. The metal products sub-sector, although important, is seen as being partly outdated and will require restructuring and modernization to remain competitive. The analysis is rather positive about the future of the food processing industry in the countries in transition, because of the large internal/sub-regional market; enterprises from EC countries have already become strongly involved in joint ventures in this sub-sector.

The discussion above will have made it clear that globalization narrows down the policy options of individual countries. The effects of globalization on national industrial policy can be summarized as follows:

- Global investment and co-operation strategies of large firms increasingly call into question the viability of governments' measures based on the notion that "national" firms still exist whose basic interests would coincide with those of government policy;

- Globalized financial markets can impose "world standards of profitability" on investment, and hence are bound to have an impact on government policies to promote domestic investment;

- Science and technology networks are becoming globalized, and competition-related factors are exerting increasing pressure on basic research which is often financed to a large extent by the government.

No Government can isolate domestic industrial development from such trends any longer; the attitude should therefore be to formulate appropriate reactions which allow countries to derive maximum benefits for industrial growth from global trends. The next chapter will discuss key aspects of the policies and measures which are required.

3 KEY ASPECTS OF NATIONAL INDUSTRIAL POLICIES

3.1 Overall requirements of industrial policy

While an extensive discussion of macro-economic policies is outside the scope of this publication, it should be pointed out that industrial policies should be harmonized with a macro-economic framework and other measures which ensure an attractive environment for private enterprise. Key issues to be covered by macro-economic policy would be exchange rates, interest rates, trade liberalization, wages and employment. And while under the present circumstances, short-term crisis management will often be unavoidable, Governments should strive for long-term stability in its macro-policies to gain the confidence of investors - especially in the manufacturing sector, with its long gestation periods for investment.

Special attention should be paid to the development of capital markets to ensure a sufficient supply and an efficient distribution of investment capital. Industrial policy makers, furthermore, should ensure that the needs of industry are taken into account when policies for science and education, the development of physical and institutional infrastructure, environmental protection and the development of natural resources are formulated.

The East and Central European countries will also need to strengthen the capability of government agencies to handle the complex of policy issues in a market context, and Government officials must develop a positive attitude towards private business; for entrepreneurs are deterred as much by "bureaucratic opacity"[23] as by incoherent policies. Co-operation with the business community is essential to achieve these goals; the value of concerted action by Government and the business community in ensuring long-term economic growth has been amply demonstrated by, among others, a country like Japan.

Within this broad policy and institutional context, industrial policies in the economies in transition should be based on the following two principles:

- The ability to attract foreign direct investment. The question here is whether creating an appropriate general environment is sufficient or whether specific stimuli are needed as well. (In the latter case, preferential treatment of foreign firms over domestic firms should on the whole be avoided).

- Selectivity. Selectivity of Government policies would have two aspects: (i) eliminating unviable activities and (ii) ensuring long-term growth. Aspect (i) concerns the purging from industry of non-viable activities: some Government direction may be needed because markets are as yet too weak to carry out the selection process by themselves. With regard to aspect (ii): at present, the relative export performance of industrial branches does probably not reflect the long-term comparative advantages of the sector. In the long run, competitiveness cannot be assured by low-quality mass products, but must rather be based on knowledge-intensive products aiming at specific market segments[24].

The importance of innovation for a competitive manufacturing sector cannot be sufficiently stressed. In Italy, R&D expenditure is growing at a higher rate than enterprise turnover. Although the Italian Government has reduced its role in economic management, it was felt that support to innovation had to be stepped up, as many innovative activities are not profitable in the short run and are therefore unlikely to be undertaken by any but the most financially powerful companies. In Italy, special measures have been taken to foster innovative activities in small and medium-size enterprises[25].

Future policy making in the economies in transition will generally have to pay more attention to SMI, whose development potential has remained virtually unexploited during the central planning period, with its heavy emphasis on large-scale manufacturing. Among the specific positive characteristics of SMI, their flexibility, employment generating capacity and the relatively low barriers to entrance (facilitating the spread of manufacturing activities) should be mentioned. As in other countries, some forms of positive discrimination of SMI may be required in compensation for the advantages which large-scale enterprises derive from their size and resources.

While a daunting number of issues will have to be addressed by industrial policies, the economies in transition should realize that they have a number of important assets which can be turned to advantage. Their proximity to the EC market has already been referred to. The countries also have a well-educated labour force, technical skills are widely available, and wages are as yet comparatively low. Some industries have well-developed research facilities. There would seem to be a definite potential for the development of knowledge-intensive industries.

In general, industrial policy in the economies in transition should address the following issues:

- Investment promotion;

- Innovation and technology diffusion;

- Restructuring and privatization and for the introduction of modern management methods;

- Development of small and medium-scale industries (SMI);

- Development of industrial support services;

- Human resource development, labour relations, and employment issues[26].

One problem which is peculiar to the economies in transition is that the performance of enterprises - and of the industrial sector as well as the economy in general - has never been assessed using parameters that are relevant to market economies. A careful assessment of the existing situation in the countries is therefore essential before policies are formulated or - in the case of the international community - assistance projects are implemented.

The following sections will give a brief description of policies for the manufacturing sector. In the economies in transition, such policies are sometimes still very sketchy. During the Workshop, much attention was therefore paid to industrial policy trends in developed market economies on the periphery of Europe. Developments in these countries can serve as a source of inspiration to policy makers in Central and Eastern Europe. For the same reason, a special section is included which deals with SMI development programmes in selected European countries.

3.2 Market economies on the European periphery

- Finland[27]

Finland has in the past developed a strong industrial sector without heavy Government interference, although some public enterprises existed in the manufacturing sector. The limited internal market has forced the sector to focus on external markets; war reparations provided manufacturing with a foothold in the large market of the neighbouring USSR, which became a major trade partner. The country developed, among others, an important metal-based industry. In the late 1980s however the USSR market collapsed. At the same time, the economy was showing signs of overheating. By 1992, manufactured exports were down by 30 per cent.

A dialogue between the business community and the Government has resulted in the establishment of overall medium-term growth targets for GNP, industrial output and exports which require the country to:

- Concentrate efforts on strategically important existing industries (pulp and paper, machinery) while at the same time creating new, innovative enterprises concentrating on niche markets - this is expected to require an annual increase in investment of 50 per cent;

- Pay special attention to developing the growth potential of small-scale entreprises;

- Strongly increase expenditure on R&D: a target of 2.7 per cent of GDP for 1997 has been mentioned.

Government has an important role to play as a facilitator of a new upswing: reducing taxes to attract foreign investors; reducing energy costs and expenditure on social legislation; improving education; providing special financial facilities for innovative new SSI (but stopping short of overprotecting such infant industries). Apart from this, Government should also provide an overall environment increasing business confidence, through a sound balance of payments and exchange rate policy. Firm management must become more aware of the strengths and weaknesses of Finnish industries, and concentrate on its strong points to establish or retain its position in export markets. With regard to these markets, Central and Eastern Europe will remain important, but efforts to target the EC will be increased. It is likely that the country will eventually join the Community, as other EFTA countries have done.

- Ireland[28]

Economic development programmes in the Irish Republic have in the past to a large extent concentrated on creating an enabling environment and providing essential infrastructure for manufacturing. This resulted in high industrial and export growth rates, particularly during the 1960s, but the world recession of the early 1980s brought structural weaknesses to light which led to industrial stagnation. By 1984, a new industrial policy had been formulated which had the following major objectives:

- Creation and maintenance of sustainable employment in the manufacturing (and services) sector, with special attention to jobs requiring high-level skills;

- Maximization of local value added;

- Increasing international competitivity of both local and foreign-owned enterprises;

- Increasing linkages between foreign-owned firms and local industries as well as educational institutions.

Government resources available for helping the industrial sector to attain the development objectives would be shifted from investment assistance to technology acquisition and export marketing. The former was to be mainly a spin-off from foreign investment, and only foreign manufacturing firms which could be expected to make a clear contribution to the development of local industry became elgible to Government support.

This strategy towards technology acquisition was chosen because the economy was considered too small to be able to support independent world-class R&D. Generally speaking, in the Irish view, size should be taken serious as a factor determining which are the most appropriate ways of developing a country's manufacturing sector. Small firms or economies are usually not in a position to out-compete the large players in the world economy; rather, the former should attempt to find ways in which the presence of the latter can be turned to advantage.

Ireland has indeed been able to attract foreign firms using advanced technologies, and industrial growth rates have been high in recent years. But foreign enterprises have on the whole not become catalysts for the local enterprises. A debate on the desirability of concentrating more Government resources and efforts led to an Industrial Policy Review, published in 1992.

The basic thesis of the Review is that a broader approach to industrial policy is required - more attention must be paid to macro-policy elements such as the level and structure of taxation as well as to the quality of the country's infrastructure and educational system, the latter providing more of the skills required for an internationally competitive economy. On these basic concepts policies should be formulated to assist local industry in reinforcing its competitive advantage. Financial assistance to firms should be reduced (under present EC rules, such support would often be allowed no longer). The promotion of foreign investment and of local industry should be separated. Local manufacturing enterprises on their part must become more cost, quality and technology conscious, and focus on higher value-added activities.

Many of these recommendations have meanwhile been taken up by policy makers, who are also aware that industrial development strategies need continuous revision to formulate effective reactions to change in a dynamic global economy. Ideally speaking, the Department of Industry should play a proactive role, anticipating such developments.

- Portugal[29]

During 1988-1992, Portugal's industrial development efforts have taken place in the framework of the Programa Especifico de Desenvolvimento de Industria Portuguesa. In formulating this industrial development programme, Portugal took account of the basic industrial strategy of the EC (which has provide financial resources for the programme) and of the emerging pattern of specialization within the Community. Within the EC, Portugal, Spain, Greece and Ireland constitute a group of less developed countries which have a comparative advantage vis-à-vis the other member states with regard to labour-intensive industries. While full exploiting this factor, Portugal is aware of the increasing competition from low-wage countries outside the EC, and therefore a transition to more technology-intensive industries is foreseen, as in the other three less developed EC countries.

PEDIP's general purpose is to complement market mechanisms by:

- Restructuring and modernization measures for traditional industries (textile, clothing, footwear);

- Stimuli to strengthen the role of domestic raw-material based industries;

- Measures which help to diversify the industrial structure, particularly through foreign investment.

Selective support has been given to Portuguese industry in the areas of physical infrastructure, training, technology transfer, venture capital and the improvement of porductivity, product quality and design.

Privatization of industries (and financial institutions) nationalized during the 1970s was high on the PEDIP agenda, and the Government has progressively reduced its involvement in the manufacturing sector. In the context of privatization, restructuring took place to improve the performance of the enterprises in question. Obstacles to the operation of market forces were removed, and employees as well as the public in general have become more conscious of the importance of a healthy manufacturing sector through the acquisition of shares. The sale of shares has also stimulated activity in the capital markets. Restrictions on foreign investment have been retained only in a small number of industries considered to be of vital importance to the country.

PEDIP has been successful in:

- Revitalizing the industrial base by helping to improve management, financial structure and productivity in existing firms, which strengthened their capability for meeting competitive pressures in the EC;

- Stimulating the establishment of new industries with higher technology levels and stronger linkages with other Portuguese industries as well as the country's raw material base, increasing the level of domestic value added in the manufacturing sector;

- Eliminating structural obstacles to industrial growth.

- Spain[38]

A serious downturn during 1976-1985 resulted in two different attempts to stimulate the manufacturing sector. From 1978-1982, the country followed a strategy of providing support to individual companies, with size and location as major determinants. This was complemented by assistance to rationalization efforts in the textiles, steel and shipbuilding industries. The continued worsening of the economic crisis led to an expansion of the number of industries covered by Government intervention, and eventually most of the basic metals and metal products as well as electrical goods industries also qualified for support. The strategy failed because many of the industries were considered a bad risk by the financial institutions which were expected to support the programme, and because such funds as were available were often used to avoid rather than to initiate restructuring.

A different approach was followed from 1982-1985. After consultations with the economic partners, a restructuring and reindustrialization policy was formulated which covered on the restructuring of companies and company managements (Spain had a large public sector); financial and tax incentives to stimulate training, R&D, standardization and design; labour and social issues; regional development; and technological innovation. This policy helped to eliminate redundant labour, improve financial performance and enterprise management and increase investments in new technologies. It thus helped to prepare Spain's manufacturing sector for the country's EC membership.

As an EC member, Spain uses the industrial development strategy of the Community as a basic guidance for its industrial policy. On this basis, the following specific objectives have been formulated, which have been incorporated in the 1992 Industry Act:

- Technological modernization which gives priority to R&D, environmental considerations, training and the diffusion of technological developments (tax concessions are among the stimuli available for this purpose);

- Differentiation of the product range of the Spanish manufacturing industry, with greater attention to consumer requirements and such issues as industrial and environmental safety, design and quality;

- Internationalization to form strategic alliances with foreign firms, build up marketing networks, get access to new technologies and sources of finance, and achieve optimal size of manufacturing establishments;

- Human resource development which is adapted to the needs of the sector, and ranging from refesher courses to industrial research skills.

Branch-specific support measures are only to be used in exceptional cases (steel and textiles for example), in accordance with EC regulations. In principle, measures and programmes with regard to the various elements of the abovementioned objectives (R&D promotion, technical training, the Programme for the Environment) therefore apply to the whole sector. Special attention however is to be paid to SMI.

The role of central Government is being reduced: in the future, its function will be to enable rather than to control, complementing market forces where this will help the continuous process of change, or where the market is likely to fail (as in the case of environmental protection). Public sector enterprises will be required to become more efficient. The remaining public enterprises will in the future have to function on the basis of market criteria. Administrative decision-making power is being devolved to lower administrative units. Decentralized decision-making is part of a drive to stimulate the less developed areas of the country by maximizing the endogenous growth potential of these. This policy has been formulated in accordance with EC rules as well, the final aim being country-wide economic equilibrium.

The success of Spain's industrial development policy is seen as being dependent on two major factors: rigorous analysis of the existing situation and bottlenecks, and intensive negotiations with the business community and the trade unions to guarantee national consensus for the often painful transformation process of Spanish industry.

- Sweden[31]

While Sweden has a long tradition of public enterprise, only 8-9 per cent of the manufacturing sector, in industries considered of vital importance to the country, was Government-owned by the early 1980s. This section will concentrate on public enterprises.

An important change with regard to public enterprises took place in 1982:

- All public-sector enterprises had to become profitable;
- Politicians were excluded from enterprise boards and day-to-day management;
- Enterprises were restructured financially and cost reduction programmes were carried out;
- Financial restructuring could be accompanied by an additional capital injection - but the basic policy was to stop providing financial assistance to manufacturing.

The programme helped to improve performance of the public sector, but it was not considered sufficient. A next step was partial privatization of the companies in the sector in the late 1980s; some of the companies are now listed at the Stockholm stock exchange. To improve competitiveness in these companies, large investments in new technologies took place and employment was be reduced considerably, the labour force being cut by 40 per cent. Some industries were drastically slimmed down (such as shipbuilding), in others mergers took place (steel). New plants in other industries have absorbed some of the workers who were laid off, and retraining programmes have been made available.

The basic lesson of the privatization programme is that independent action of the management and boards of directors is essential for a successful enterprise. The Government is therefore progressively reducing its participation in manufacturing enterprises, and encouraging shareholding among the population. Privatization has so far not touched enterprises working outside the normal competitive environment, such as those providing a public service. Programmes are however under way to create markets for such activities - the telecommunications sector provides an example. In the long term, the Government's main economic function will be to provide a regulating framework for the activities of private enterprise.

3.3 Policies and measures for SMI in selected European market economies

- Austria[32]

In Austria, assistance to SMI is at present based on legislation adopted in 1986 which specifically focuses on the encouragement small and medium-scale enterprise in all sectors. Measures can be divided in two groups:

- Those aimed at strengthening the enterprises through innovation, rationalization, inter-firm co-operation, information services, etc.;

- Those aimed at increasing their competitiveness and presence in the market through measures such as financial guarantees for the establishment of enterprises and export credit guarantees.

To prepare SMEs for the expected EC membership, special training, information and advisory programmes are offered to managers.

Much attention is paid to R&D. This includes support for experimental research and the development of new marketable products, the establishment of technology parks for firms with less than 1,000 employees, support for patent applications abroad, etc. Support is often channelled through autonomous funds, to achieve a maximum of decentralization and diversification, and efforts are made to exploit local development potential through regional innovation schemes. Low-cost innovation services for SME are provided by the Association of Co-operative Research Institutes.

The Government-owned Bürges bank guarantees loans to and provides subsidies on interests paid by SME. Special schemes supported by the bank include regional development (in co-operation with the relevant Government agencies) and establishment, restructuring or take-over of small enterprises. The Government's investment and credit guarantee programmes also favour SME, and export credit guarantees are available for firms exporting goods or services with a maximum value of AS 100 million per year.

- Netherlands

In the Netherlands, policies can be divided in integration policies and functional policies, the former aiming at providing a favourable business environment, the latter helping to compensate weak points of enterprises and encouraging them to use their strong points. This section will concentrate on the latter type of policy, and on SME support services provided by private organizations in this policy context.

Firms with fewer than 100 employees which cannot meet normal collateral requirements are eligible for loans guaranteed by the Government; partial guarantees on invested capital are available for venture capital companies wishing to invest in small enterprises. Consultancy services to SME are subsidized. A Government information campaign on the consequences of Single European Market specially targetted SMEs, to help prepare them for the highly competitive environment in which they will operate from 1993 onwards[33].

Among the many organizations providing services to SME, the Vereniging voor Strategische Beleidsvorming (VSB) is one of the more noteworthy[34]. It is specialized in providing support to strategic planning, which covers the long-term orientation of a firm's activities and the internal structural adaptation which this requires. Research has shown than SME's pay insufficient attention to this issue. The main activity of VSB, apart from providing information on the subject, is the organization of training seminars of varying length. These have a strong pratical orientation, participants being encouraged to apply strategic planning techniques in their own firms on the basis of a brief introduction to the issue; the experience is evaluated during a follow-up seminar.

- United Kingdom

The UK's Department of Industry and Trade provides two types of support which have a particular focus on SME: subsidies on private consultancy fees, and information services.

Consultancy is available on a subsidized basis if the enterprise requesting the consultancy employs no more than 500 persons. In most cases, the Government pays 50 per cent of the fees; in some special cases (urban renewal areas, regions receiving development support) the Government share is increased to 66 per cent. The types of consultancy provided under this programme include marketing, design, quality, production methods, business planning and finance/administration. Private consultancy firms (one or two for each separate issue) are charged with the actual execution of the programme. The business planning programme has a similar objective as the Dutch strategic planning initiative (see above). But the approach is different: a consultant is made available to the firm who helps the management to formulate a firm strategy, and the programme is linked to SME financing, training and information schemes.

Information services among others cover exports, R&D and education/training, one Government agency - the Small Firm Services - specializing in the supply of information to small enterprises. For prospective exporters, the British Overseas Trade Board not only provides documentation on such issues as customs, duties, etc.; it also helps entrepreneurs to establish contacts with trading partners, overseas banks and Chambers of Commerce, etc., and it is involved in the provision of the market consultancy services mentioned in the previous paragraph. The programme for R&D includes incentives for joint R&D efforts; in some cases, up to 50 per cent of the costs of such R&D may be subsidized. The education and training programme aims at strengthening co-operation between the educational system (including research institutes attached to universities and colleges) and private enterprise. Under the "Teaching Company Scheme", for example, firms finance temporary employment for young graduates.

Decentralization and deregulation are important aspects of economic policy in the UK. As a consequence, services are provided by a great diversity of institutions, including regional development authorities, business schools and business centres in institutions for higher-level education, professional organizations, banks and local consultancy firms. These services basically adress the same issues as in the central Government's programmes. Entrepreneurs thus have a wide choice; their main problem may be to identify the supplier of the most suitable package of services.

3.4 The economies in transition

- Czech Republic[35]

Macro-economic policies have helped to bring about economic stabilization in the Czech Republic: in 1992, inflation was to a large extent under control, unemployment had stopped rising, output had been stabilized, there was a surplus of the balance of payment and the exchange rate was stable. This created a favourable environment for restructuring the manufacturing sector and for future growth. At the time of writing, it was too early to assess the long-term consequences of the separation of the Czech Republic and Slovakia.

The Government has formulated sectoral programmes to support the restructuring and privatization programme; the particular problems of individual sectors are considered too complex to be solved without special measures. In manufacturing, the steel industry is targetted by a special programme. Key elements in these programmes are organizational improvements, price liberalization, the restructuring of production and a review of financial relations with the Government. With regard to financial issues, the Government is following a policy of reducing pressure on enterprises among others through softer repayment conditions and by helping banks to make available more credit for promising enterprises. Even so, bankruptcy is often unavoidable because of the high rate of indebtedness and insolvency among public enterprises.

Privatization is the key element of Czech industrial policy, and it is felt that this should take place before restructuring. In most cases, Government offices do not have the information or instruments required to carry out restructuring; therefore it should be left to the private owners. While privatization is not going as rapid as expected, the Government has been quite successful in increasing ownership of enterprise shares among the population.

Other major elements in the emerging policy for the manufacturing sector are:

- Support to small and medium-scale industries, which are more flexible than the large firms dominating the sector, have a high employment creation potential, can mobilize private savings for productive purposes and would help to increase competition, with lower prices and a greater variety of goods as a result. Support includes assistance for technology transfers, provision of collateral for commercial loans, and subsidized interest rates. The financial support component, however, is to be phased out;

- Stimulating exports by keeping the exchange rate low after the initial devaluation of the Czech crown;

- Attracting more foreign investment, the main inducements being the exchange rate and the relatively low wages. A special fiscal regime for foreign enterprises, as in some other countries, is not foreseen as this would constitute preferential treatment vis-à-vis local firms; the Government, moreover, needs the tax income provided by foreign firms.

- Reducing regional inequality, with its undesirable social effects, by stimulating regions to identify and exploit their specific potential. Subsidies are available for this purpose, but their structure is being rationalized. The main industrial components in regional policy are support to SMI and training.

- Hungary[36]

Present-day policy in Hungary is based on the principle that the Government's tasks are to create conditions conducive to overall economic (and industrial) development, to stimulate innovation and generally to act as a catalyst. Market forces should in the future "pick the winners" among enterprises.

The Ministry of Industry and Trade (MIT) is charged with developing and executing industrial policy, but many essential aspects and instruments of such a policy - international relations, technological development, finance - are the responsibility of other Government agencies, and more effective co-ordination is essential.

The basic policy for the industrial sector is improve the sector's competitiveness, especially in the European context. In order to achieve this, a painful restructuring process has been initiated with the following major characteristics:

- Drastic reduction of financial support to inefficient public enterprises, many of which have not been able to survive competitive pressures;

- Termination of subsidies to energy costs, with a consequent reduction in the competitivity of energy-intensive industries;

- Shifting limited resources to the development of infrastructure;

- Privatization of public enterprises - by mid 1992, 15 per cent of these had become private, and transnational corporations already control most of the glass, cement, paper, sugar and tobacco industries.

This policy has initially exacerbated the consequences of reduced demand in domestic and former CMEA markets. There has been a heavy reduction in employment and in industrial output, which fell by 40 per cent between mid 1989 and late 1991. Worst affected was the machinery industry, which saw its production - mainly destined for East-European markets - decline by 62 per cent. With the introduction of a bankruptcy law, one-fifth of the medium and large-scale industrial enterprises were declared bankrupt. But while 1992 did not bring a recovery, the process of decline was slowing down.

To bring the process of transition to a successful end and to ensure long-term growth, Hungarian industrial policy has been formulated around three concepts: short-term stabilization, medium-term growth and long-term sustainability.

Short term stabilization has taken the form of a law on crisis management which allows the government to actively assist a small number (13) of promising enterprises to adapt to changing production and market requirements. These are enterprises which basically have good market prospects and up-to-date technologies. They will be supported by the provision of infrastructure, government purchases, consultancy to improve performance and financial guarantees (but no subsidies). Temporary protection measures may also be taken.

The medium-term growth concept has been translated into an industrial policy framework which is linked to the Government's 1992-1994 economic policy programme.

This policy framework addresses issues like further transformations in industrial ownership, adaptation of laws and regulations to accelerate integration in European and world markets, finance and investment, the revision of regulations pertaining to business organization, the elimination of monopolies, standardization and quality requirements, R&D, environmental protection and the prevention of unacceptable regional, social and sectoral imbalances. In contrast to many developed market economies, Hungary considers programmes targetting specific sectors (steel, among others) as essential for increasing their competitivity.

The long-term strategy builds on the medium-term programme. It focuses on a better integration of industrial and overall economic policy. This will required continued efforts to harmonize the activities of all relevant Government agencies, strengthening their capacity to guide and provide a long-term vision for industrial development in an open market economy. Eventually, this should ensure the integration of Hungary's industry in the international economy.

- Poland[37]

The main elements of macro-economic policy in Poland today are encouragement of private enterprise, including the provision of incentives for foreign investment; stimulating domestic enterprise through market protection and subsidized credit; and maintaining a stable exchange rate for the zloty through low inflation rates and stable budgets.

Deregulation, price and trade liberalization and the abolishment of most subsidies were until recently considered sufficient to eliminate weak manufacturing enterprises and create new, dynamic industries. The positive effects however have been less than expected, and domestic recession as well as the limited Government budgets have drastically reduced the demand for industrial goods, although Polish industry has to an extent been successful in finding new export destinations replacing the former CMEA markets, and although exposure to market forces has helped to increase the efficiency of firm management.

Industrial restructuring will require more than liberalization: massive investment is needed to rebuild a dynamic, competitive manufacturing sector. Such investment can only partly be provided by foreign entrepreneurs: investment based on domestic insurance funds and on individual savings must also be made attractive. Some financial support for enterprise restructuring is available through a World Bank programme. This allows the Government to intervene in promising enterprises which lack the required funds.

In privatization, the Government - as the former owner - has an active role to play, helping to ensure that the process will make a maximum contribution to renewed economic growth. Privatization has already affected well over one thousand Polish enterprises, and accelerated privatization of most remaining enterprises is foreseen; the others (in strategically important industries such as defense goods as well as in public utilities) will be reorganized and managed on the basis of market principles. In contrast to the Czech Republic, the Polish aim is to restructure viable enterprises before offering them to potential foreign investors. The decision to privatize is taken in consultation with the employees, and the following scenarios are being considered: sale to a local or foreign entrepreneur; transfer of a majority share to a bank of investment fund; management or employee buy-out; and sales of shares to the general public.

Future industrial policy will have to address the following issues which are linked to transformation of the public sector:

- The character of Government incentives, subsidies and protection measures;

- The problem of reducing the industrial labour force in unviable industries/enterprises;

- The identification of industries considered strategically important to the country in the short and medium term;

- Establishment of a coherent approach to mergers of firms with similar characteristics, and to liquidation of firms without prospects;

- Better definition of responsibilities in the continuing restructuring programme;

- The formulation of interlinked measures ensuring the avoidance of social hardship for redundant labour, the proper handling of enterprise liabilities and property, and the reduction of environmental damage.

The longer-term development of the Polish manufacturing sector requires more than the transformation of the public sector. Other major issues now being tackled by industrial policy makers are:

- The provision of stimuli to the formation of new small and medium-scale enterprises. There is a particular need for such enterprises in the industrial services, which have never received much attention in the past.

- An active trade policy which on the one hand prevents unfair competition (through tariff and non-tariff measures) and provides consumer guarantees along the lines of EC legislation, and on the other helps Polish manufacturers to target those markets where they enjoy a comparative advantage. Exporters are to be assisted with export credit insurance and tax exemptions; exchange rate policy will also be used to boost exports. Apart from the former CMEA trading partners, Asian and African countries are considered to have a good potential; the EC countries are also targeted, but it is clear to policy makers that Polish products face very heavy competition here and that a niche strategy will be required.

- Competitiveness in among others European markets will depend on products meeting international standards, quality requirements and technological levels. A technology policy will be needed to stimulate innovation, increase efficiency and ensure the adoption of international standards.

- The gradual adjustment of the sector, and of the regulations and policies for the sector, to the EC. Under the Association Agreement with the EC, Poland is already receiving assistance for this purpose.

- Belarus[38]

Belarussian industry is going through a difficult period of adjustment after the steep decline in demand for its products in the Commonwealth of Independent States (CIS), which absorbed over 90 per cent of its exports. Industrial recovery is hampered among others by low output quality output, which makes it difficult to establish a presence in other markets, the limited energy and raw material base of the country and the high rate of inflation.

Industrial policy in Belarus will have to address two major issues: (i) establishing new industrial development objectives and (ii) setting branch-level priorities for industrial restructuring, with closure of declining industries. The selection of industries with future growth potential would be based on such criteria as:

- Comparatively low investment and production (inputs, labour) costs and reasonable profitability;

- Ability to use up-to-date technologies and to meet the requirements of new export markets (quality, product standards, etc.);

- The contribution of an industry, through linkages with other branches, to overall development in the manufacturing sector.

On the basis of these criteria, the industries which are to be given priority would include machine tools, electronics, scientific instruments, pharmaceuticals, polymers and construction materials. R&D, financed by the Government, is to be undertaken in the fields of electronics, informatics and new materials. Where inputs, capital goods, know-how and production licenses must be obtained from abroad, priority in the distribution of these is to be given to the abovementioned industries. The Belarus Government will provide favourable conditions for private and foreign investment and for joint ventures.

4. Public sector restructuring and privatization

4.1 The overall perspective

At present, the restructuring and privatization of public sector enterprises is a dominant policy issue in the economies in transition; it has also been at the centre of the debate on development strategies for these countries for several years now. The countries have established a variety of official bodies to guide or actively stimulate this process.

There is no doubt that the manufacturing sector in Central and Eastern Europe needs drastic restructuring in order to face competition in open markets. But does ownership matter? It is argued by some that "the really fundamental issues at enterprise level are managerial in nature, issues of control and strategy rather than of ownership"[39]. In other words, if good managers can be found who are given a free hand in running an enterprise, then the question who ultimately owns it becomes less important.

Others are of the opinion that ownership does matter: shareholders in principle determine the activities of an enterprise; if a government or one of its agencies retains control over firms, then managers are likely be restricted investment decisions, etc. Enterprises controlled by the Government moreover tend to deter private investors. Restructuring without privatization is also likely to mean that public sector managers will remain in charge. Even if these are more dynamic than in the past, they may constitute an obstacle to efficiency[40].

The examples in Section 4.2 below will show that while all countries agree on the necessity of drastic restructuring and accept the principle of privatization, the latter is not always radically applied. Usually restructuring and privatization are closely linked, although the relationship between the two may differ among countries, as the following section shows. Restructuring can - and should - take place at two levels:

- At the sector level, where the public sector sheds activities which can be left to private sector. A number of enterprises "in mature industries which are inherently unattractive to private investors"[41] may have to be closed altogether.

- At the enterprise level, dynamizing the management, modernizing and streamlining production. Private investors will show little interest in enterprises where excessive efforts are required to achieve this.

With regard to the latter, major efforts are often required to create an enterprise which will be profitable in an open market. In centrally planned economies, technological levels are seldom state-of-the-art (some defence industries excepted), productivity of the workforce is often low (serious underemployment is common), and in the absence of reliable supplies, much capital tends to be tied up in stock. Enterprises paid little attention to marketing, financial and HRD management skills, quality and consumer preferences. With regard to the last two issues it is evident that, "even where physical product qualities are comparable...most Eastern companies do not compare well with their Western counterparts in terms of non-product attributes such as delivery, convenience, information, and attendant services"[42]. To overcome the shortcomings, the restructuring priorities of foreign investors are likely to include:

- drastic cost-cutting and streamlining;
- better targetting of markets;
- raising the quality of management and improvement of internal communication;
- concentration of activities on core competences and the development of new products.

Joint venture partners will supply management expertise, technology, market strategies and capital; on the other hand they will expect the local firm to present a clear business opportunity, and their partners should possess knowledge of and access to local/regional markets as well as vision and drive. Last not least, the foreign partner will expect to have a major say in managerial decisions[43].

The foreign investor may have to create part of the network in which the firm operates. Enterprises cannot operate in a vacuum. The weakness of linkages and of the institutional infrastructure is one reason for the low performance levels of the industrial sector in the economies in transition: "Over and over in the cases studied, there was evidence of inadequacies which originate beyond the firm ... e.g. low quality raw materials, missed delivery dates by suppliers, inadequate distribution and services arrangements...and everywhere a lack of adequate credit and banking facilities"[44] While this document has indicated that there is a key role for government in the creation of a favourable business environment, including the establishment of a strong financial sector, the foreign investor may in many cases have to initiate the building-up of a network of essential linkages[45].

Not all enterprises will find new owners or joint-venture partners in the short or long term, and a number of them are likely to go bankrupt - something which was basically unknown in the past. A distinction however should be made between those which are inherently unviable and those which are basically viable but not immediately able to meet the demands of their creditors. Insolvency may for example have been caused by a temporary loss of markets through the demise of the CMEA. Firms which are basically strong enough to survive in a more stable economic environment should have the possibility to do so in the interest of the national economy.

A good bankruptcy law provides an instrument which may help an insolvent company to continue operations, as it requires the company to search for a solution with all its creditors - and reorganization rather than liquidation may be the outcome of this process. In Hungary, the new bankruptcy act is very severe and has already affected one-fifth of the labour force. Its strict approach may have led to the loss of potentially viable firms[46].

The financial means (and human resources) needed to acquire and restructure large public sector enterprises are often only available to foreign investors. While the economies in transition attract only a fraction of global foreign investment (policy makers should be aware of the heavy competition for investment funds), foreign investment in these economies has grown spectacularly in recent years (see Annex Table 1). By the end of 1992, there were almost 65,000 foreign direct investment projects in Eastern and Central Europe, representing a total value of more than US $ 24 billion[47]. The largest projects are found in the countries of the former Soviet Union, which also accounted for the bulk of foreign direct investment. Projects in manufacturing tend to dominate, accounting for 65 per cent in the former CSFR, 61 per cent in the CIS, and 59 per cent in Hungary[48].

Transnational corporations and other large companies at present mainly invest in Central and Eastern Europe to gain market access, although low wages are also a factor. Taking over large public enterprises which have dominated markets has the advantage of providing a large foothold in the market. But the lack of political stability in a number of the countries and the slow progress towards a transparent regulatory and legal framework are leading to reduction in the size of individual projects, indicating caution on the part of investors[49].

Popular ownership of shares, through employee ownership schemes or "voucher privatization" has received much attention. The latter involves a large number of people in the Czech Republic and Slovakia. But it is questionable whether employees or the general public can and will play a major role as enterprise owners - their funds are limited, and they will therefore be reluctant to risk these funds by becoming shareholders (the situation in the developed market economies is not essentially different); consumer goods are likely to be a priority anyway. In the Czech Republic, voucher privatization seems on the whole to have been restricted to less attractive enterprises - large, successful public enterprises have usually been sold to foreign investors by the Government[50]. The politico-psychological impact of popular ownership schemes may however be positive, increasing acceptance of the austerity measures which are unavoidable in the transition period.

In a large number of cases, management buy-outs seem to have been the preferred form of privatization for smaller firms. The number of these has increased among others because of the break-up of large public-sector firms which were reduced to their core activities. The smaller firms are usually of no interest to foreign investors and lack the collateral needed for loans - capital markets moreover are still underdeveloped. The relatively modest sums required are often within reach of (a group of) individuals, and these would moreover be motivated and knowledgeable about the firm[51]. But management buy-outs are more common in the services sector where returns on investment are more rapid, and hence risks lower than in manufacturing.

In the longer run, the crucial issue is how local investment in the manufacturing sector can be increased. Foreign investment is essential, but it can only complement domestic investment. Measures to promote it should target those industries which cannot be developed by local means because they are too technology/investment intensive. The development of local capital markets, as indicated above, is another area where government can play a positive, stimulating role. Large profits are at present being made through trading operations; it should be possible to channel such earnings to long-term investment in, among others, the manufacturing sector.

So far, progress has been modest. Stock exchanges, for example are still in their infancy: on the Budapest stock exchange, 23 firms were quoted in late 1992, and half of these were marginally profitable or unprofitable; as a result of disappointing performance of the economy after the initial euphoria of liberalization, the volume of trade dropped from 12.7 billion forint in 1991 to 6 billion forint in 1992. For 1993 however, a stabilization of the economy is however expected, and further adaptation of the legal framework is expected to lead to increasing involvement of local investors[52]. In the medium and long term, therefore, capital markets should be playing a more important role.

4.2 The economies in transition - some country experiences

- Estonia[53]

In the Estonian case, a streamlining of the industrial policy-making system was carried out before restructuring and privatization were undertaken, the five ministries (each one responsible for a sub-sector) being merged into one.

The next step was to increase the co-operation between public enterprises in the manufacturing sector through the formation of associations. It was expected that this new organizational form would help to solve a number of problems which confronted manufacturing firms in the transition period. In actual practice, the activities of the associations were largely restricted to the provision of certain services to member firms.

In 1990, the Government initiated a programme of converting the public enterprises into joint-stock companies. At the same time, a restructuring programme was initiated to improve the performance of the enterprises. The whole process is being supervised by a board which includes representatives of the Ministry of Industry, the Ministry of Economic Affairs, enterprise managers and independent experts from, among others, the technical universities.

As yet, the responsibilities of these boards have not been fully defined, and most members have little experience with the issues at hand. Another obstacle to efficient functioning of these instruments is the fact that the boards are not fully independent from the ministries. This limits their ability to act, especially because there is still political resistance against privatization within the Government.

In the small-scale sector, privatization is well under way, some 40 enterprises having been auctioned by late 1992. Whether a firm commitment will emerge to a process of restructuring and privatizing which involves the whole public sector depends on future political developments and on a strengthening of the capabilities of the executing agencies.

- The former German Democratic Republic[34]

Privatization in the former German Democratic Republic (GDR) has a special character because of the reunification of Germany. A number of important lessons can however be drawn from the process.

The privatization process has the following basic aspects:

- The notion of creating a policy framework first was discarded - the emphasis is on rapid liquidation of the public sector;

- Strict rules were drawn up for prospective investors;

- Privatization is co-ordinated and implemented through a superholding, the Treuhand Gesellschaft.

The Treuhand Gesellschaft negotiates with prospective buyers of firms. In the negotiations, three basic issues must be tackled: property rights of possible previous owners; environmental impacts; and the firm's endebtedness. Where problems arise which have financial consequences, the Treuhand Gesellschaft is able to help prospective owners through funds made available by the Government. Investors are required to formulate a clear company strategy, and there are strict guidelines (backed up by penalties) for securing employment and ensuring that new investments are made in the companies.

Some 20 per cent of the privatized firms in the manufacturing sector were bought by their management; these were mainly medium-sized enterprises in industries where local competition is relatively light. The category contains a fairly large number of firms in the more sophisticated industries, such as precision and optical instruments, machine tools, etc. Management buy-out however is more common in the services sector, where a rapid return on investment can be expected[55].

By late 1992, some 6,000 companies (representing 40,000 individual plants) had been privatized. Some 2,000 companies remain; these are on the whole not considered to be very attractive to investors. While the speed of the process is impressive, and more than one million jobs were retained, a number of problems have been encountered:

- The overvaluation of the former GDR mark, which was exchanged at par against the FRG mark, has driven up labour costs and increased enterprise debt;

- The ownership issue proved unexpectedly complex;

- Expectations among the labour force with regard to better standards of living could not be met;

- Bottlenecks occur as a consequence of inefficiencies in the public administration of the former GDR.

It can be argued that a comprehensive policy approach, backed up by generous financing, might have been useful after all. Even more jobs could have been saved through an extensive training programme and by paying more attention to restructuring before privatization, increasing the number of viable companies. Information and marketing services could have helped more companies to find new export markets. Finally, with mounting competition for investment from other Central and East European countries, a more active search for prospective investors could have been undertaken.

- Hungary[56]

Hungary has a comprehensive strategy for restructuring and privatizating public sector enterprises, which is part of its industrial development policy. It is felt that a deliberate approach to these issues is to be preferred to a complete withdrawal of the Government from public enterprise, which may have traumatic social consequences and will not necessarily lead to optimal results for the economy. Important elements of the strategy are:

- Exposing the existing enterprises to competition by foreign firms and facilitating the "weeding out" of non-viable firms through the introduction of a bankruptcy law;

- Stimulating promising industries and neglected aspects of industrial development such as R&D, banking infrastructure, consultancy, etc., through Government investment and financial support;

- Administrative decentralization and the breaking-up of public sector monopolies, their management being usually charged with the actual organizational changes;

- Intervention in areas with high concentrations of declining industries (such as steel) or of viable industries which have lost markets (such as footwear and processed food) because of lower incomes and the breakup of the CMEA, to prevent hardship through employment programmes, etc.;

In the present view, the restructuring process should take place as fast as possible, but usually the actual restructuring process of individual firms is carried out only after take-over by the foreign investor; active Government intervention in this process is quite limited, except in the remaining public enterprises, which are also being restructured to improve their performance (the Government will retain partial ownership of some 20 industrial enterprises because of their strategic importance). The intention is to liquidate those public enterprises where restructuring is not possible.

One example of a restructured public enterprise is the Hungarian Oil and Gas Shareholding Co. (MOL Ltd.), which in 1991 shed 13 of its 23 subsidiaries to concentrate on its core activities: the production, transportation, refining and marketing of petroleum products and gas. It is expected that, by reducing operations to those activities which the firm can do best, it will be in a better position to compete with foreign and local private suppliers of hydrocarbons.

The privatization process is co-ordinated by the State Property Agency (SPA), which has a supervisory board large consisting of representatives from the ministries involved; in addition, there are some independent experts. SPA acts both as an initiator and - if required - as a mediator. The Hungarian Government has taken care to provide guidelines for privatization which are not affected by short-term pilitical change, to retain investor confidence. Privatization of industrial firms can take various forms:

- Sale of public enterprises through active intervention by SPA;

- Privatization initiated by the firm management itself;

- Privatization initiated by a buyer;

- Privatization through an SPA agent.

The initial step towards privatization was to transform public enterprises into legally independent companies. By late 1992, over 1000 firms (in all sectors) had acquired this status, representing one-half of all public enterprises. Several hundred enterprises have now been fully or partly privatized, and preliminary studies show that these firms have improved their management and overall performance, and are adopting technological innvoations. There are however also negative aspects: increasing unemployment, reduction of Government income (tax reductions up to 60 per cent are available for investors) and the need to invest in measures to limit the environmental damage resulting from lax regulations in the past.

Hungary has been quite successful in attracting foreign investment in former public enterprises. In 1990/1991, the country received 40 per cent of all investment from market economies in Eastern and Central Europe; the absolute amount of investment is some US $ 1.5 billion per year. The trend is expected to continue. In the food processing sector, foreign ownership already amounts to 40 per cent. US firms are the most prominent investors, but the NICs are also represented, by Korean investment in the electronics industry.

Local investment is usually restricted to small enterprises. The Government however does try to stimulate citizens to invest in privatized firms. Stimuli include:

- Special low-interest long-term credit with a three-year grace period;

- "Compensation vouchers" for expropriations during and after World War II, which can be traded;

- Employee ownership schemes, 10 per cent of shares usually being reserved for that purpose;

- "Privatization leasing", allowing investors to buy a small or medium-scale enterprise over a period of 5-10 years, after a 10 per cent down payment.

The "voucher" system used in the former Czechoslovakia will possibly be introduced on a limited scale in 1993.

Privatization proceeds over 1991 amounted to 10 billion forint, which have mainly been used to pay off national debt. Suggestions for future use of the proceed include financing of restructuring, employment programmes, the establishment of a credit guarantee fund and the improvement of infrastructure.

5 THE ROLE OF UNIDO[57]

During recent years, UNIDO has increased its assistance to Central and Eastern European countries from the policy-making to the enterprise level. UNIDO is supporting the development of integrated macro policy and industrial policy frameworks, also providing analyses of manufacturing sectors - often the first comprehensive analyses which were not made from the point of view of central planning. The organization also promotes foreign investment and provides direct support to the restructuring and rehabilitation of public sector enterprises.

5.1 Improving the environment for industrial development

UNIDO is helping several countries in analyzing structural weaknesses in key industrial subsectors and in formulating appropriate responses through policies and support programmes. While this requires the development of a long-term "vision", itv also entails the establishment of an information base, estimates of investment requirements for modernization and essential infrastructure, identification of uncompetitive production capacity and measures for the redeployment of redundant labour. Conversion from military to civilian production is a particularly important issue, because the most advanced technologies are often found in these industries.

To help promote foreign investment, UNIDO prepares and organizes investment forums during which foreign investors are invited to review projects and negotiate directly with local partners. A contact point, in the form a of Industrial Co-operation and Investment Promotion Service, has been set up in Warsaw and a similar office is now operating in Prague. The UNIDO Centre for International Co-operation in Moscow not only promotes investment in the country, but also the export of Russian technologies; the Centre furthermore stimulates co-operation in the field of telecommunications and agro-industry. Investment promotion also covers legal, institutional and information aspects as well as assistance in the preparation of feasibility studies.

This document has pointed to the need to complement the industrial structure by encouraging the development of small-scale industries (SSI). UNIDO has accumulated substantial expertise in this field. It has been involved in establishing SSI support schemes, incentives and credit facilities as well as training programmes covering both managerial and technical skills and the creation of a support infrastructure.

Finally, UNIDO can asssist in formulating and implementing regional development schemes and in region-to-region co-operation programmes between developed market economies and developing countries. Such schemes could also play an important role in the transformation and regeneration of the industrial sector in Central and Eastern Europe. They require the implementation of diagnostic surveys to identify potential development resources but also possible bottlenecks. On the basis of such surveys, investment opportunities can be identified as well as the need for special measures in support of private enterprise, skills development, R&D, etc.

5.2 Technical assistance at the enterprise level

In accordance with one of the central topics of this document, this section will focus on enterprise restructuring. It should however be pointed out first that UNIDO provides a broad spectrum of assistance at the enterprise level, covering such areas as the industrial application of laser technology, informatics, biotechnology, new materials, CAD/CAM and the introduction of modern numerical methods based on the finite element method (FEM) in metallurgical and engineering industries. Other activities include the improvement of measurement and control instrumentation and total quality management programmes. UNIDO has also become very active in the field of environmental impact studies, the establishment of environmental standards and the introduction of clean technologies, which are urgently needed in view of the severe environmental problems from which countries in Central and Eastern Europe suffer. All these activities include an important training component.

Poland provides a good example of direct support to enterprise restructuring. Here, UNIDO carried out nine major studies covering the issue at the request of the Polish Government, a project financed by the United Kingdom. The involvement of UNIDO as an impartial international organization among others helped to increase the confidence of employees and trade unions in the restructuring process

The objectives of the project were:

- To keep the enterprises operational technically and financially in the short term until a restructuring plan could be established. This involved the assessment of assets and debts, measures to improve short-term liquidity, negotiations with creditors and addressing short-term technical, marketing and financial problems.

- To carry out a diagnostic survey of the enterprise covering equipment, production processes, products, markets, skills, etc., and the scope for rationalization measures.

- To provide advice, on the basis of the evaluation, regarding managerial and technical skills, product mix, the organization of production, markets, etc., taking account of the changing economic environment.

- To help the management in developing a coherent internal organization and a long-term strategy to strengthen the position of the firms in negotiations with potential partners.

The project also gave professional staff of the newly formed Polish Industrial Development Agency to gain first-hand experience in the formulation, execution, monitoring and evaluation of restructuring projects.

Basically, the enterprises selected were viable entities willing to make the required adjustments, but lacking the means to do so. The firms produced a wide variety of products ranging from linen fibre and fabric to TV sets, screen monitors and works stations, tracked vehicles, gear transmissions, locomotives and cranes. Employment varied between 1,000 and 20,000.

The project resulted in the following major general findings:

- A fundamental change in the management system was needed to prepare the enterprises for operations in a market environment. Managers would need training in modern management techniques and a modern management information system would have to be established.

- Products are old fashioned and their quality is low; before the firms can compete with importers, a thorough overhaul of the product range will be needed as well as the establishment of a quality control system.

- While technical know-how and skills were usually well-developed, the enterprises would need personnel with modern accounting skills and sales and marketing experience. Cost accounting and control are virtually unknown and are not used as an element in improving the competitiveness of enterprises.

- Major sources of high costs were excess labour, inefficient energy use and the high degree of vertical integration - many tasks could be more efficiently carried out by specialized contractors.

- Debts were increased by producing to stock even though markets no longer existed; high real interest then worsened the debt problem.

As a result of the project, some of the enterprises that would have gone bankrupt are now being restructured and will be able to prove their viability in a competitive environment. The restructuring plan based on the findings summarized above has increased the willingness of creditors and banks to reschedule debts and provide investment capital. Last not least, although restructuring will lead to a reduction of employment, a closure of the enterprises would have led to larger job losses.

6 CONCLUDING REMARKS[54]

The economies in transition are faced with the difficult task of "hitting a moving target" - catching up with industrialized countries which themselves are in a process of transition to a high-tech, service-oriented economy and (in the case of Western Europe) to a common market.

This final chapter therefore goes beyond a brief summing up of the major findings of the Workshop discussions; reference is also made to other policy-related issues which are of key importance for future industrial development but could not been given full attention during the workshop and which may be given greater prominence during a follow-up debate. A long-term convergence of Eastern and Western Europe is only possible if the full range of essential issues is addressed by adequate policies.

Follow-up meetings were definitely desired by the participants in the Workshop. The intention of the Workshop was to spark off the discussion and to "stake out the terrain"; it will hopefully prove a basis for more specific future debates on individual issues and countries (such as Russia, which merits special attention because of its sheer size).

Industrial policy making

A coherent policy for the industrial sector is as yet to be formulated in economies of transition. Priority is and must be given to the establishment of a macro-economic policy framework, and in particular to financial and environmental issues; only within this framework can an industrial policy be formulated which is not only internally coherent but also consistent with a country's overall economic priorities.

In a number of countries however progress is being made towards creating an industrial policy framework - Poland and the Czech Republic are good examples. While the economies in transition deal with the short-term problems of transforming their industrial sectors, the process of devising long-term stategies should also start, as in Hungary. A broad approach to industrial development which provide similar stimuli to enterprises across the industrial spectrum is generally preferred to intervention focussing on a narrow range of sub-sectors - although in the transitional period problematic sub-sectors may have to be given special attention.

Government agencies charged with policy-making and execution will often have to be reorganized and strengthened to be able to cope with the new demands made on them - the government may be retreating from direct involvement in the economy, but it will now have to make major efforts to provide the industrial sector with an environment which stimulates local entrepreneurs attracts foreign investors.

Confidence of the business community as well as the effectiveness of policies is increased if entrepreneurs are made partners in the policy-making process. To encourage private enterprise, industrial policies should also be stable in the long term, and should not interfere unnecessarily with enterprise decision making.

The experience of the developed market economies (and, indeed, of many developing countries) shows how important the contribution of SMI to industrial development can be. With their relatively low investment threshold, SMIs are comparatively easy to establish. They can have important spread effects and encourage the emergence of local entrepreneurship. Policy makers in the economies in transition should therefore pay special attention to them.

Restructuring and privatization

It is clear that the necessity of drastic restructuring and the principle of privatization are generally accepted in Central and Eastern Europe. The basic issue is not so much whether to have public or private firms but how to increase productivity, innovativeness, efficiency and to become more competitive. This requires know-how, capital and a free hand for management, and a combination of these three is in most cases only found in private enterprise. The possibility of efficient public ownership in certain industries should however not be excluded, as, among others, the example of France shows. In fact, the Hungarian government uses privatization to acquire sufficient capital to undertake an effective restructuring of those public enterprises which are considered strategically too important to be privately-owned.

Only foreign investors will usually have sufficient access to capital and know-how to bring about a reorientation of large enterprises. In the short run, foreign capital may thus dominate the transformation process. It is however important - not only politically but also from the point of view of the long-term effects on national economic development - to encourage local investment in privatized companies as well.

Many enterprises will not find buyers. Of these, a large number will be inherently unviable under market conditions, Others may have only have short-term liquidity problems. Basically viable enterprises should be given the opportunity to reogranize and reorient themselves to new markets. Otherwise, capital and expertise - which are scarce enough - may be lost unnecessarily.

New investment

New investment will often be more attractive than restructuring old enterprises - the cost of updating machinery and plant, improving environmental performance, etc., may be prohibitive. New industries can be expected to use the latest technologies and know-how. This would be to the advantage of the economies in transition, especially if firms are established which fill gaps in the pattern of manufacturing activities.

Experience in the market economies shows that artificial stimuli provided by governments rarely succeed in attracting such industries - the case of Ireland (see Chapter 3) has shown that such measures are at best partly successful. Only the Governments of the strongest economies, such as Japan, can afford to become deeply involved in innovation programmes. Generally speaking, therefore, market forces should be relied on to encourage investment in advanced industries. At the moment, this will often be foreign investment, but domestic investment will also play a role, albeit mainly in SMI. In the longer run, domestic private investment should play a more prominent role as the economies recover.

While the new investment for future growth should come from the private sector, this does not mean that there is no role for government. Apart from providing the infrastructure and improving overall qualification levels of the labour force, marketing the country's assets and investment opportunities is a task of crucial importance. Again, Ireland provides a good example, this time of successful action. Governments should realize that there is heavy global competition for investment. Countries therefore must not only have the right assets - investment policies and practices must also be attractive to investors. It should also be realized that if investment in a country is successful, this is likely to spur further investment.

Industrial services

Services for the industrial sector have in the past been given comparatively little attention in the countries of Eastern and Central Europe. The discussion in the previous chapters however has made it clear that - with increasing consumer orientation and competition, the pressure to be more efficient and the need to conserve resources - repair and maintenance, engineering design, industrial consultancy, R&D, marketing and distribution, etc. are taking on a far greater importance.

In a development parallel to the reduction of public sector conglomerates to core activities, large manufacturing firms in market economies have been reducing in-house services. Services departments are either made independent and allowed to contract work from other firms, or they are dissolved and the activities in question contracted out to existing services firms. Specialized know-how - which is becoming more important and more expensive - is thus used more economically; the cost of services is reduced and therefore access is also easier for SMI.

At present, the region relies heavily on services offered by foreign consultancy firms. At present a preference for services offered by firms which have long operated in a market environment is understandable, but they are unlikely to be acquainted with the local situaticn. Discussions during the workshop, for example, indicated that foreign consultants working in Hungary were often ignorant of local regulations and standards and found it hard to adapt their advice to the needs of private enterprises which tend to be much smaller than those in market economies.

A partnership with a local industrial services can do much to prevent such problems, and would also help the local firms to acquire experience. The reduction of public sector firms to core activities could provide a basis for such service firms: these could be created with qualified personnel from subsidiaries which covered the relevant activities.

The establishment of much-needed industrial services in Central and Eastern European countries would also help to reduce unemployment, which is growing as the manufacturing sector is transformed. The region has a large reservoir of technically competent people whose skills can thus continue to contribute to development. For non-technical skills however, which will become increasingly important in the future - both in the manufacturing sector and the fast-growing services sector - as the example of the industrialized market economies shows, a major training effort would be required (see below).

Regional development

While the present document is mainly concerned with issues at the national level, the need for regional development policies has been mentioned in various places. Policy-making should respond to the differences in development potential in a region to maximize benefits for the nation as a whole. In a number of market economies, Regional Development Corporations (RDCs) have been established in response to decentralization trends and play a catalytic role in mobilizing this potential.

RDCs pool the creativity and resources of the "agents of growth" in a region - policy makers, representatives of government agencies, entrepreneurs and employees and their associations, academic institutions, independent experts, etc. The basic objective is to bring together domestic and foreign enterprises and investors to exploit (industrial) development opportunities.

In the countries in transition, liberalization and administrative reorganization/decentralization are bound to have economic-spatial consequences which would call for the creation of RDCs. During the period of transition they can moreover support local and regional authorities in coping with changes as well as in the design of longer-term development strategies.

While initially, RDCs may have to be financed by the government or donor agencies, they should increasingly rely on fees charged for services, contributions from RDC partners and local/regional taxes. Poland is one country where a start has been made with

RDCs. The Lower Silesian Foundation for Regional Development (LSFRD) is an example. It co-operates with the University of California, which among others provides analytic expertise. Such forms of co-operation with academic or other institutes in industrialized countries which have experience with regional issues could help to lay a methodological/theoretical basis for the development of local expertise.

Human resource development

The international trend in manufacturing is towards increasing know-how and skill intensity. At the general/technical level, the Central and Eastern European countries have a well-educated and skilled workforce. However, non-technical skills - management, accounting, marketing - are in short supply; it has been emphasized before that these are of essential importance in a modern manufacturing firm.

To an extent, this will require an adaptation of the system of formal education, e.g. through (incentives for) the establishment of more business schools, and the improvement of teaching in existing ones. Management training deserves a high priority. Although quite a few management training institutes exist in Central and Eastern Europe, teaching methods on the whole do not seem to be up to the standard required in a developed market economy. While donor agencies and several world-class business schools have plans to provide support in this area, the long-term goal must be to create a network of training institutions based on local expertise. In all cases, close integration with actual business practice is required to guarantee optimal teaching results.

The in-house training system of manufacturing enterprises will also have to be adapted to reflect the changed needs of the sector, and policy-makers should support this adaptation by, e.g., fiscal measures. Where foreign investment has taken place, the foreign partner would have a responsibility for transferring new managerial, administrative, marketing and technical skills. Again, investment regulations could make such transfers fiscally attractive.

Finally, formal and in-house training are not enough. Attitudinal changes in government agencies, manufacturing enterprises and industrial services firms alike are essential as well to make the transition a success: "Excessive regulation of social behaviour during the communist period has shaped attitudes of passivity. In the past, the benefits of development came 'trickling down'. It must now be understood that development can only be ensured if initiatives come 'bubbling up'"[59].

International assistance

To establish a macro-framework supporting industrial development, the economies in transition are receiving multilateral and bilateral assistance from a number of sources. In the longer run, the EBRD will possibly be more closely involved than the World Bank and the IMF; the latter may be expected to remain mainly involved in countries outside Europe, and assistance from an institution specifically focussing on the problems of economies in transition would moreover probably more effective.

The EBRD's initial focus will be on infrastructure and (financial) institution building, the creation of a regulatory framework, investment promotion and environmental issues; it will also have a direct impact on the manufacturing sector through its involvement in industrial restructuring, privatization and stimuli to private enterprise.

Of the multilateral organizations, UNIDO is best placed to provide assistance to the manufacturing sector. Its activities at various levels have been outlined in the previous chapter. The improvement of the environment for industrial development, promoting foreign investment and direct technical assistance at the enterprise level will remain key elements in UNIDO's programme for Eastern Europe.

Annex Table 1

<u>Eastern and Central Europe - Projected growth of foreign direct investment as at the end of 1992</u>

Country	Number of projects	Total value (US$ 1,000)	Av. value (US$)
Hungary	14,800	3,211,000	217,000
Romania	21,900	1,051,200	48,000
Former USSR	12,300	17,822,700	1,449,000
Poland	8,000	1,072,000	134,000
Czech/Slovak Fed. Republic	5,800	725,000	125,000
Bulgaria	2,000	750,500	375,000
Total	64,800	24,632,500	

* Value influenced by inflated foreign exchange rate

<u>Source</u>: UN/ECE - "Restructuring and Privatization and the Role of Foreign Direct Investments", Paper presented at the Workshop on Industrial Policies in the Economies in Transition.

NOTES

1. For a brief exposé see e.g. John Burton - **Picking Losers...? The Political Economy of Industrial Policy**, London 1983.

2. John S. Henley, "Industrial Policies in the Economies in Transition: Emerging Themes and Policy Dilemmas", **Paper presented at the Workshop on Industrial Policies in the Economies in Transition**, p. 9.

3. This was among others pointed out in the Opening Address by Gerald Hinteregger, Executive Secretary of UN/ECE, at the Workshop on Industrial Policies in the Economies in Transition (hereafter: Workshop).

4. The EC, for example, provides ECU 36 billion annually in support to enterprises; protectionist measures in the developed market economies among others reduce the volume of textiles that East European countries could export - information provided by the Head of UNIDO's Regional and Country Studies Branch during his presentation at the Workshop.

5. OECD - "The Role and Importance of National Industrial Policy in Economic Development", **Paper presented at the Workshop on Industrial Policies in the Economies in Transition**, p. 10.

6. Henley, op. cit., p.1.

7. Ibid.

8. Janos Fath - "Industrial Policies for Countries in Transition?", **Research Report** no. 187, Vienna Institute for Comparative Economic Studies, Vienna 1992, p. 6-7.

9. This was, among others, pointed out by mr. Iván Szabó, the Hungarian Minister of Industry and Trade, in his Opening Address at the Workshop on Industrial Policies in the Economies in Transition.

10. See the Opening Address by Charles S. Warner, Deputy Director General of UNIDO, at the Workshop on Industrial Policies in the Economies in Transition.

11. OECD, op. cit., p. 5-6.

12. Ibid., p. 8.

13. Fath, op. cit., p. 7.

14. Fath, op. cit., p. 8-12; Gordon Hughes and Paul G. Hare - "Industrial Policy and Restructuring in Eastern Europe", Oxford Review of Economic Policy, Vol. 8, No. 1, p. 83.

15. From an untitled paper presented by the Commission of the European Community at the Workshop, p. 8.

16. Henley, op. cit., p. 6.

17. Hughes and Hare, op. cit., p. 90-91, 101-102.

18. Paper presented by the Commission of the European Community at the Workshop on Industrial Policies in the Economies in Transition, op. cit.

19. Wilfried Lütkenhorst and Jürgen Reihhardt, "The Role of the Private Sector in Asian Industrial Development", **Intereconomics**, January/February 1993; J. Michael Finger and Patrick A. Messerlin, "The Effects of Industrial Countries' Policies on Developing Countries", **Policy and Research Series**, World Bank, Washington D.C. 1989, p. 15.

20. Hughes and Hare, op. cit.

21. See Franz Peter Lang - " Strategic Trade Policy for Eastern Europe", **Intereconomics**, July/August 1992, p. 188.

22. Paper presented by the Commision of the European Community, op. cit., p. 11-12.

23. Henley, op. cit., p. 7.

24. OECD, op. cit., p. 9-10.

25. Information provided by Enzio Panetti, Director, European Industrial Engineering, Venice, during his presentation at the Workshop.

26. See Gerald Hinteregger, op. cit.

27. Based on the presentation of Asa-Matti Lyytinen, Managing Director of Mec-Rastor, Espoo, Finland, at the Workshop.

28. Based on the presentation of Raymond A. Kerr, Assistant Principal Officer, Department of Industry and Commerce, Dublin, at the Workshop.

29. Based on the presentation by Luis Mira Amiral, Minister of Industry and Energy of Portugal, at the Workshop.

30. Based on the presentation by Amadea Petitbo Juan, Director General, Ministry of Industry Commerce and Tourism, Madrid.

31. Based on the presentation by Peter Tegner, Assistant Under-Secretary, Ministry of Industry and Commerce, Stockholm, at the Workshop.

32. Based on Fath, op. cit., p. 28-38.

33. Fath, op. cit., p. 30.

34. See Claude Potelle - **Produits stratégiques pour PME en Grande Bretagne at aux Pays-Bas**, AFPLANE, n.p., 1989, ch. 5.

35. Based on the presentation of Václav Kupcka, Deputy Minister, Ministry for Economic Policy and Development, Prague, at the Workshop.

36. Based on the presentation of Balász Botos, Under-Secretary of State, and on the Closing Statement by Peter Balász, Secretary of State, both of Ministry of Industry and Trade, Budapest, at the Workshop.

37. Based on the presentation by Henryk Kaminski, Deputy Director of the Industry Policy Department, Ministry of Industry and Trade, Warsaw, at the Workshop.

38. Based on a statement circulated by Nikolai Petrovits Zaitchenko, Deputy Director, State Planning Committee, Minsk, during the Workshop.

39. Henley, op. cit., p. 5.

40. See Bös, op. cit., p.96, for this line of argument.

41. Henley, op. cit., p. 5.

42. Derek F. Abell - **Turnaround in Eastern Europe: In-depth Studies**, UNDP, n.p. 1992, p. 9.

43. Derek F. Abell, op. cit., p. 25.

44. Abell, op. cit., p. 12.

45. An interesting example of a Western investor's successful efforts to initiate the building up of a value-added chain in an economy in transition - in this case McDonald's in the CIS - is quoted in Jeffrey M. Herzfeld - "Joint Ventures: Saving the Soviets from Perestroika", **Harvard Business Review**, January-February 1991, p. 80-91.

46. These paragraphs are based on the presentation by Paul L. Csiszar, Legal Counsel and Advisor, Los Angeles, during the Workshop.

47. The exact amounts are difficult to establish. The database of one of the largest Austrian banks, the Creditanstalt-Bankverein, which is heavily involved in business with the former CMEA countries, for example contains figures which are rather different from those in Table 1. The overall orders of magnitude, however, are more or less the same.

48. UN/ECE - "Restructuring and Privatization and the Role of Foreign DirectInvestment", **Paper presented at the Workshop on Industrial Policies in the Economies in Transition**, p. 3-4.

49. Ibid, p. 5-7.

50. Bös, op. cit, p. 97. Slovakia may adopt the German Treuhand model (see Section 4.2) for further privatization (ibid.).

51. See Harald Sondhof and Markus Stahl - "Management Buy-outs as an Instrument of Privatization in Eastern Europe", **Intereconomics**, September-October 1992, p. 210-214.

52. György Mohai and Gábor Sitány - "Privatisierung und Börse in Ungarn", **CA Quarterly** II/1993, p. 42-43.

53. Based on the presentation by Erik Terk, Tuleviku Instituut, Tallin, at the Workshop.

54. Based on the presentation of Klaus Höfner, President, Dr. Höfner & Partner Management Beratung, Munich, at the Workshop and on Bös, op. cit., p. 98.

55. See Sondhof and Stahl, op. cit., p. 211.

56. Based on the presentations of Lajos Csepi, Director General of the State Property Agency, Budapest, Gábor Gulácsi, Deputy Under Secretary of State, Ministry of Industry and Trade, Budapest, and József Subai, President of the Hungarian Oil and Gas Shareholding Co., Budapest, at the Workshop as well as on Mohai and Sitányi, op. cit., p. 40-43.

57. Based on UNIDO - **Industrial Restructuring in Central and Eastern Europe: Critical Areas of International Co-operation**, 1991 and Summary Report on Restructuring of State-owned Enterprises in Poland (mimeo) as well as on the presentation at the Workshop by George Assaf, Industrial Development Officer, Regional and Country Studies Branch, UNIDO.

58. Apart from reflecting the findings of the previous chapters, and the Workshop's Panel Discussion on Industrial Policy, this chapter draws on: UNIDO - **Towards Regional Development in Central and Eastern Europe**, PPD.217, 1992; Abell, op. cit., part VII; Karl-Heinz Kleine/Ernst Thien - "The Role of the IMF and World Bank in the Former East Bloc Countries", **Intereconomics**, January/February 1992, p. 20-27; Esther Dyson - "Micro Capitalism: Eastern Europe's Computer Future", **Harvard Business Review**, January-February 1991, p. 27; and Cord Jakobeit - "The EBRD: Redundant, or an Important Actor in the Transformation of Eastern Europe?", **Intereconomics**, May/June 1992. p 119-123.

59. UNIDO 1992, op. cit., p. 6.