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Industrial Policy for Growth




Roman Stöllinger and Michael Landesmann

The issues

- Does manufacturing matter for a country's macroeconomic performance?
- If economic structure matters is there a role for industrial policy to support growth?
- What could be elements of a growth-enhancing industrial policy in the CESEE region?

(1) The 'manufacturing imperative' and macroeconomic performance in Europe

Economic structure matters:
The case for a 'manufacturing imperative' in Europe

- Innovation 
- Productivity growth 
- Wages 
- Manufacturing base and the current account

A larger manufacturing base reduces the risk of external imbalances

Dependent variable: current account balance in % of GDP

	fixed effects 1995-2011				cross section 2011
	EU27 (1)	CESEE (2)	NMS-10 + Balkan (3)	CESEE (4)	EU27+ CESEE (5)
manufacturing base	0.7423 *** (0.150)	0.8271 *** (0.136)	0.6879 *** (0.207)	0.7715 *** (0.187)	0.4016 ** (0.169)
log GDP per capita	-0.574 *** (0.188)	-0.5477 *** (0.124)	-0.8401 *** (0.265)	-0.8514 *** (0.231)	-0.5496 ** (0.201)
(log GDP per capita) ²	0.0277 *** (0.017)	0.0250 *** (0.007)	0.0375 ** (0.015)	0.0392 *** (0.013)	0.0316 *** (0.011)
F	44.77	43.17	7.11	10.84	5.77
R ²	0.744	0.754	0.635	0.670	0.436
R ² -adj.	0.715	0.728	0.578	0.621	0.379
Obs.	448	577	253	299	34

Source: Eurostat, national statistics, wiiw estimations. Fixed effects estimations control for country and time fixed effects.



1 percentage point increase in the value added share of manufacturing improves the current account by 0.77 p.p.

Economic structure matters:

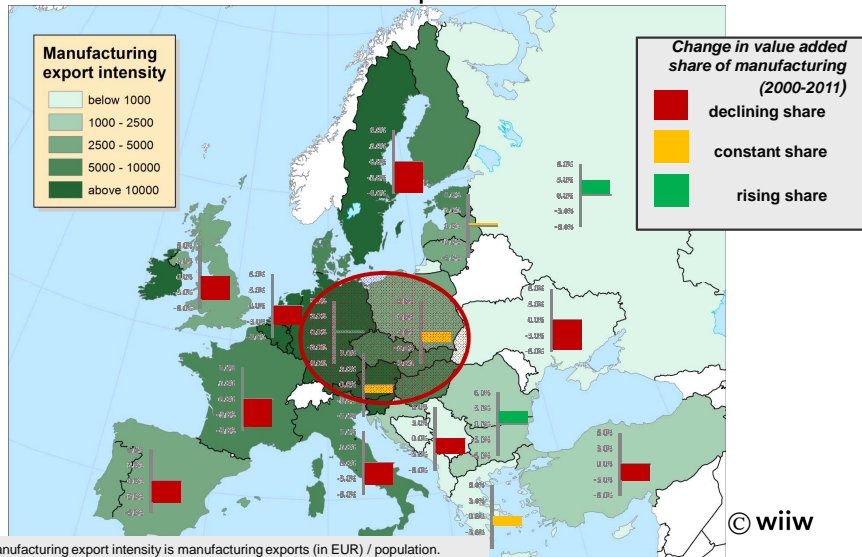
The case for a 'manufacturing imperative' in Europe

- Innovation
- Productivity growth
- Wages
- Manufacturing base and the current account



20% objective for manufacturing set by Europe 2020 strategy

Manufacturing activity is going to be increasingly concentrated in a Central European Core



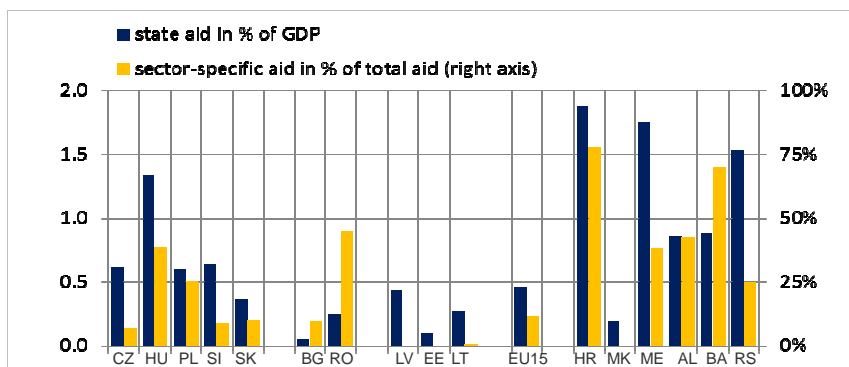
(2) The role of state aid and industrial policies

The role for industrial policies to support growth

- Industrial policy attempts to shift the production structure towards sectors **that are expected to offer better prospects for economic growth** (Pack & Saggi, 2006) and to **foster competitiveness** (European Commission)
- Plethora of industrial policy measures
 - State aid as example of **hard industrial policy**
 - Vocational training system as example for **soft industrial policy** ('below the radar measures')

State aid in the EU and the Western Balkan countries

State aid to industry and services in % of GDP, average 2006-2011



Source: EU State Aid Scoreboard, national competition authorities. Figures refer to the aid element in national state aid measures. Excluding crisis-related aid.

Can state aid help improve the country's competitive position in manufacturing?

Dependent variable: Member States' share in extra-EU value added exports

	base (1)	one- period lagged (2)	two- period lagged (3)
manuf aid	-0.0101 *	-0.0088	-0.0115 **
(manuf aid) ²	-0.0008	-0.0005	-0.0008
gov eff	0.4557	0.3526	0.4017
(gov eff) ²	0.8343	0.7267	0.0067
(manuf aid) x (gov eff)	0.0890 ***	0.0703 ***	0.0421 *
F-test	4.80	3.73	2.76
R ²	0.991	0.993	0.994
R ² -adj	0.990	0.992	0.993
obs.	380	353	326

On average, aid to manufacturing hurts competitiveness

If gov't effectiveness is high, aid to manufacturing supports competitiveness

Source: WIOD, World Bank Worldwide Government Indicators, European Union State Aid Scoreboard.
Note: All variables in logs and centred. All regressions include country and time fixed effects.
*, **, *** indicate statistical significance at the 1, 5 and 10% level respectively.

Export subsidies do what they are supposed to ...

Dependent variable: Member States' share in extra-EU value added exports

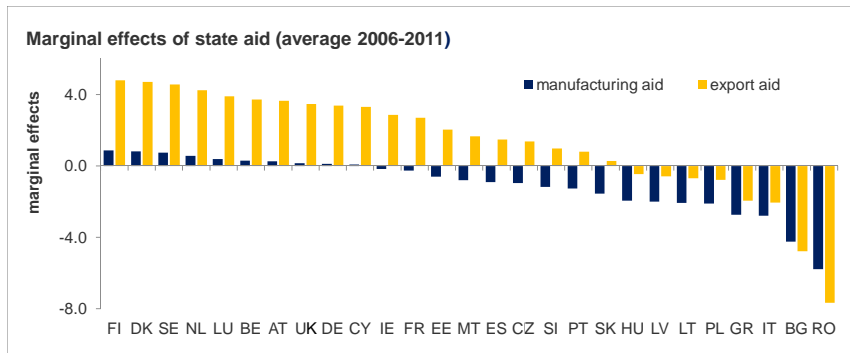
	base (1)	one- period lagged (2)	two- period lagged (3)
export aid	0.0128 **	0.0156 ***	0.0168 ***
(export aid) ²	-0.0009	-0.0014	-0.0010
gov eff	0.3187	0.3244	0.3617
(gov eff) ²	-0.3752	-0.2292	-0.6453
(export aid) x (gov eff)	0.1668 ***	0.1440 ***	0.1146 ***
F-test	13.09	8.04	5.74
R ²	0.993	0.994	0.995
R ² -adj	0.992	0.993	0.994
obs.	380	353	326

... particularly if gov't effectiveness is sufficiently high

Source: WIOD, World Bank Worldwide Government Indicators, European Union State Aid Scoreboard.
Note: All variables in logs. All regressions include country and time fixed effects.
*, **, *** indicate statistical significance at the 1, 5 and 10% level respectively.

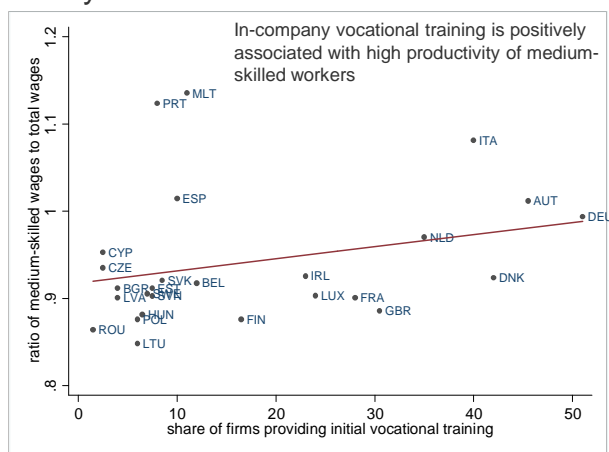
The effect of state aid on competitiveness is ambiguous

- Positive effects but small
- Possibility of 'government failure' and detrimental effects of state aid
- Export aid more likely to be successful



Source: wiiw estimations.

Vocational training and high productivity of medium-skilled labour is a key factor for a successful manufacturing sector



Source: Eurostat, wiiw calculations.

First implications for industrial policy (IP) strategy in the CESEE region

- Formulation of IP depends on the technological capacity and human capital of each country, the existing industry structure, and on the external environment (EU membership)
- CESEE countries with a small manufacturing base **should prioritize the manufacturing sector in their industrial policies**

Prerequisite for successful industrial policy

- Improve government effectiveness. Make use of the EU as an **'institutional anchor'**.

Direct export promotion

- Provision of export credit schemes within the limits of international obligations (OECD arrangement, WTO ASCM, EU competition rules for EU-MS)

Sector-specific design of industrial policy

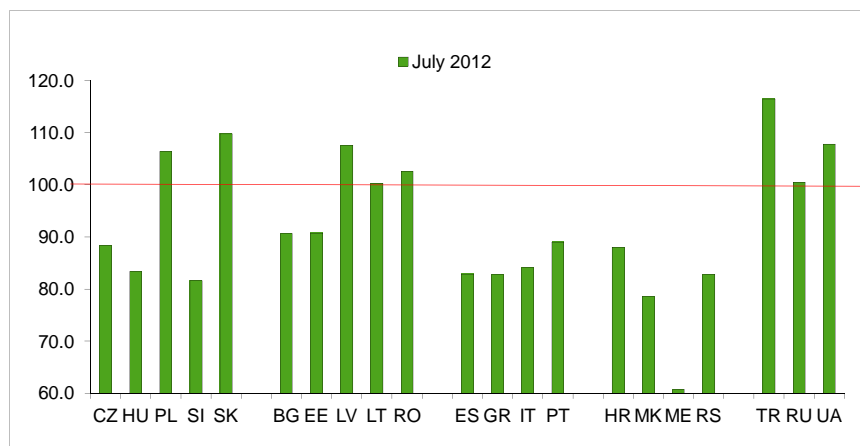
- Paying out subsidies to (large, incumbent) firms is insufficient for a growth-enhancing industrial policy strategy. 'Soft measures' have to be added such as in-company vocational training.

(3) Elements of a growth-enhancing industrial policy in the CESEE region

The rationale for the renewed attention industrial policy should receive in the CESEE region

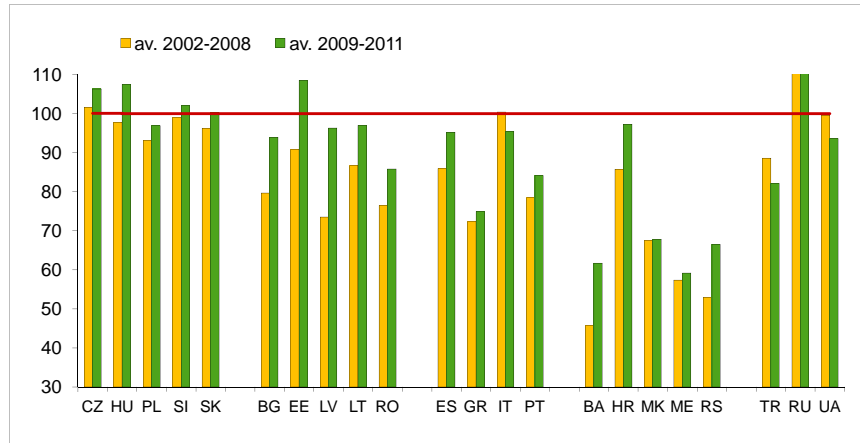
- No uniform pattern of 'convergence' in Emerging Europe
- Long-term structural imbalances in parts of Emerging Europe
- During crisis: structural adjustment has often not favoured tradable sectors
- Climate of reduced cross-border capital flows and weak banks
- Strong case for a 'manufacturing imperative' for parts of Emerging Europe (and parts of Europe's neighbourhood)
- Asymmetric emphasis on industrial policy tools in 'structural' deficit countries – should be recognized in EU policy agenda
- General framework policy recommendations (liberalization, financial intermediation, good governance) not sufficiently targeted towards strengthening tradable sector capacities

Levels of industrial production (July 2012 relative to September 2008 = 100)



Trade balances of goods and services

Exports/Imports in %



Remark: Data for RU, 2002-2008: 150.4; 2009-2011: 137.9.
 Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Industrial policy in the CESEE region

- Differentiated country groups (Central Europe, Baltics, Balkans, Ukraine etc.): location, diversification, (real) exchange rate flexibility
- Strong agglomeration of cross-border manufacturing production networks
- Support for new regional clusters can be successful; focus on main constraints/'public inputs' (transport, training, efficient supply services, administrative procedures, etc.)
- Governance issues (transparency, monitoring and control mechanisms) are very important to achieve positive outcomes: time-phasing of supports; exits
- Competition policy and industrial policy can play important complementary roles (EU authorities' enforcement of rules/transparency)
- Targeting of gaps in performance between FIEs and domestic firms; support linkages/spillovers; widen the spectrum of internationally competitive SMEs

Industrial policy in the CESEE region (cont'd)

- We do not expect a uniform success of industrial policy in the CESEE region; wide range of experiences in emerging economies
- Governance will be decisive: industrial policy should be formulated/monitored at top government level
- In countries with undiversified/concentrated production sector, incumbents' power has to be overcome
- Financing instruments, development banking: focus on new entrants, new products, widening of export activity
- In advanced CEEs: range of innovation policy instruments should be strengthened
- In other economies: integrated use of regional policy, training and labour market policies; emphasis on vocational training, new clusters, use of EIB/Cohesion Funds
- Macro-policies (incomes policy, fiscal policy, exchange rate) should support goals of industrial policy