INDUSTRIAL COMPETITIVENESS AND RESTRUCTURING IN ENLARGED EUROPE: HOW ACCESSION COUNTRIES CATCH UP AND INTEGRATE IN THE EUROPEAN UNION, Iraj Hashi, Paul J.J. Welfens and Anna Wziątek-Kubiak (eds.), Palgrave Macmillan, London, 2007, 303 pp.

Review*

Enhancing the competitiveness of economies in the process of the accession to the single European market and the accompanying industrial restructuring and alignment with EU standards are issues that have, since the start of the accession agenda, preoccupied the minds of not only the creators and implementors of national integration policies, but also wider academic, business and specialised audiences.

This book tells us about the key changes in the industrial competitiveness and restructuring of three leading pre-accession reformers of the Central and Eastern Europe: Hungary, the Czech Republic and Poland. This topic is also in the centre of attention in Croatia, which is presently racing against time in order to comply with all the required EU accession criteria and which could therefore find in the experiences of new EU member-states valuable way markers and inspiration.

After a decade of extensive preparations for accession, in May 2004, the three transition countries examined finally joined the EU. The main initial characteristics of their industrial sectors were: obsolete technology, low productive efficiency; low quality of goods, a non-competitive and distorted industrial structure with an over-extended share of heavy and extractive industries. For that reason, the expectations of the positive influence of the accession to the EU on the total economic development of the countries in question were extremely uncertain. The analysts were concerned, and envisaged that domestic industries would not be capable of surviving the competitive pressures of the enlarged market. Similar worries exist in Croatia today. This book analyses the main factors that influenced the change in the level of industrial competitiveness in the three selected countries. The text demonstrates how the industrial restructuring, government economic policies, trade specialisation as well as industrial networking have contributed to the catching-up process, convergence and integration in the single European market.

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The authors of the book investigate, analyse and attempt to provide answers to a number of questions related to the problem of competitiveness such as: were transition countries that joined the EU in the last 2004 enlargement wave successful in transforming their economies to cope well with the competition in the EU market? Could the countries of the Central and Eastern Europe (CEE) after being part of a non-market economic system for such a long time and practically isolated from international competition, become internationally competitive after joining the EU? What are the preconditions for successful market integration of these countries and convergence on developed EU members, and what are the obstacles on that path? What aspects of their specific economic development path in the past made the integration more difficult and what easier?

The content of the book is divided in three thematic parts and eleven chapters. It also includes a list of tables and charts, a foreword, t biographical notes, a list of abbreviations and index.

The authors' contributions are based on original empirical data and results of the research project *Changes in Industrial Competitiveness as a Factor of Integration: Identifying the Challenges of the Enlarged Single European Market,* which was financed by the European Commission through the Fifth Framework Programme for Research and Development (FP5).

The first chapter starts with a theoretical introduction and an overview of the topics and issues that are analysed. The editors **Anna Wziątek-Kubiak** and **Iraj Hashi** continue with an excellent summary of the main messages of the authors' contributions. The text provides a theoretical and empirical overview of the competitiveness problem on the macro and micro levels, which serves as a good introduction to the specific problems of the industrial sectors and selected national economies that are analysed later on. The authors considered it interesting to examine the implications of the radical opening of ex-socialist economies to international trade and how this affected the industrial restructuring and competitiveness of their products, as well as the structure of industry. For it is well known that the countries of the ex-socialist bloc had distorted trade specialisations due to excessive inter-bloc trade, especially with products that were completely non-competitive on the western markets. Wzyatek-Kubiak and Hashi emphasise that the Central and Eastern European countries had much larger potentials in their educated and skilled labour force, as well as in the quality of human capital, than were actually reflected in their trade specialisation and international trade. They invoke the research results of Helpern (1995), Gros and Suhrcke (2001) and Tajoli (1998), which show that the dominant share of low quality products was an outcome of an exceptionally high share of trade within the ex-socialist bloc as well as very weak incentives for innovation and technological change. Linder had discussed as early as 1961 the theory of "preference for similarity" in international trade that exists among countries with a similar industrial structure. In accordance with this theory, in order to break out this vicious circle of trading with low quality products, the countries of Central and Eastern Europe had to radically improve their product quality in order to increase the total scope of trade with the EU. That change was naturally to a large extent dependent on the increase of their industrial productive efficiency and of related production factors.

On the other hand, the accession negotiation process with the EU itself resulted in a speeding up of the process of industrial restructuring and adjustments in the institutional framework of the market in the accession countries (Kaminski, 2001; Winiecki, 2002). Contrary to the analysts' expectations, the integration of the transition countries into the single European market did not cause their further marginalisation or push them further towards the periphery of the international trade flows. What happened actually was totally the opposite. During the pre-accession period, the level of technical and business efficiency of the enterprises increased and significantly converged on the level in the old EU member-states. This also resulted in the convergence of levels of GDP per capita and their gradual increase. The continuation of the institutional reforms, further narrowing of the productivity gap, structural changes in the accession economies and increase of the FDI inflows have led towards a decrease of the differences in development levels between new and old EU members (Disdier and Mayer, 2004; Reiser et al. 2004). The clear trend of converging levels of GDP per capita, structural economic reforms, increase of exports and market shares of the new EU member-states are strong indicators that their economies are becoming more and more competitive on the market.

After matching the required Copenhagen criteria i.e. making their economies capable of successfully coping with the competition in the single European market, the eight transition countries joined the EU in May 2004. By achieving this, it is certain that at least some of their industrial sectors and branches were fully capable of dealing with competitive pressures and challenges in the EU. But membership in turn enabled them to achieve more than that. Some of the industries managed to expose similar industrial sectors in the old EU-members to increased competition thus contributing to increased competition within the EU market.

This book attempts to provide answers to very important research issue, the identification of the main factors behind the increase of industrial competitiveness in the Czech Republic, Hungary and Poland. Are these perhaps the advantages of low labour costs, or do other factors prevail, such as the quality of human capital, education level, a large increase in FDI, improvements in the quality of the available financial capital, the level of innovations, changes of industrial structure, networking of the business enterprises or government policies?

The changes in industrial competitiveness have in turn affected the speed of *catching-up* with the EU level of economic development, both directly and indirectly through the changes of economic structure. Structural changes towards larger participation of higher value-added industrial sectors are also exceptionally important as they result in changes in the trade specialisation pattern of accession countries.

The authors of this book are in fact dedicated to identifying the crucial determinants of the restructuring of industrial production, labour market and employment, the patterns of trade specialisation and their total effects on the productivity level of production factors in the manufacturing industry of transition countries.

Although there is quite a number of analyses and publications which have covered the issues of adjustment process of industries in the EU accession countries, surprisingly very few of them actually focus on examining the underlying factors of change in the industrial competitiveness, or the structural changes in the manufacturing industries of these countries.

In the introductory chapter the editors emphasise the complexity of the term "competitiveness", the lack of the universally accepted definition, and its different as well as often ambiguous meanings. In the literature, two main approaches to competitiveness prevail: microeconomic and macroeconomic.

In the microeconomic meaning, under the term competitiveness we understand the rivalry and competitive ability of products and enterprises in the market. Competitiveness and its determinants stem from the forms, factors and effects of such rivalry. This includes the rivalry among the potential competitors in price and non-price factors. The microeconomic approach actually refers to technical and technological efficiency and does not take into account allocative efficiency, structural changes or related shifts of economic resources from one industrial sector or activity to another, which actually affects the aggregate level of factor productivity and economic growth dynamics.

In contrast to this understanding, the macroeconomic meaning of competitiveness focuses on the national level and ability of the economy as a whole to enable its population a strong and sustainable growth of living standards and a high employment rate. This approach takes into account structural characteristics of the economy, which are considered to be the main factors determining a certain level of living standards as well as the level of national competitiveness in international trade.

The editors considered it important to stress that EU institutions, bodies and policies take into account both definitions of competitiveness and that this book also recognizes these two approaches when examining the competitiveness of the economies of the three selected countries in the pre-accession period (1995-2003). The specificity of the presented analyses in this book is however that it focuses exclusively on the industrial sector.

After the introductory chapter the book is divided into the three thematically coherent parts. The first part consists of five authors' chapters.

It starts with second chapter under the title *How do New Member States Cope with Competition in the EU Market?* in which the authors **Anna Wziątek-Kubiak** and **Iga Magda** examine the concept of competitiveness from the microeconomic point of view. They take into consideration those market pressures that stem from the rivalry and competition of the single productive factors at the level of industrial sectors and enterprises. The authors identify the crucial factors that affect the change and improvements in the level of competitiveness of a single industrial sector or branch in the pre-accession countries, especially when compared to the old EU member-states. Their analyses also take into consideration changes in the level of competitiveness of those industries in the new member states which created an increase in competitive pressures for the old member states, especially those with strong and continuing growth trends, categorised as *big winners.* The authors demonstrate that the changes in the industrial structure in three accession countries were mainly stimulated by the differences in productivity growth as well as the changes in relative labour unit costs.

Third chapter, entitled *Can Government Policy Influence Industrial Competitiveness? Evidence from Poland, Hungary and Czech Republic* questions the efficiency of the government policies and incentives for improvements of the industrial competitiveness in the examined three transition countries. The authors, **Hashi, Hajdukovic** and **Luci** examine the role of government from the points of view of theory of public choice and rent-seeking behaviour and question the widespread opinion that government intervention through the use of taxes and subsidies can lead to a higher level of competition of domestic industry. The starting approach in their analyses is micro-economic competitiveness i.e. the ability of a single industry to increase its market share in both domestic and EU markets. The authors use econometric analyses of panel data to measure the impact of the level of taxes and subsidies on the domestic and international competitiveness of each industry sector in the three countries. Contrary to the widespread opinion in the transition countries, their research indicates that government interventionist policies have an exceptionally weak impact on the rise in the level of competitiveness in the investigated industries.

The fourth and fifth chapters are focused on the research of the interrelations between the real exchange rate, trade, innovation, structural changes and economic growth. Authors **Welfens** and **Brandmeier** base their research on the modified neo-classical model of endogenous growth in which they also included the FDI inflow. The research focus of both chapters is how the real exchange rate level affects the trade flows and economic growth. Using various scopes of research, hypothesis and models, the authors offer alternative explanations of the geographical distribution of FDI in transition countries as well as their divergent growth and development paths. Welfens, by introducing a new approach to monetary growth policy in an open economy, demonstrates that a real appreciation of the currency in the new EU members actually follows from the influence of the relative size of the market on the exchange rate. The appreciation also depends on the size of the demand shifts between sectors which produce tradable and non-tradable goods. An advantage of the presented model is the ability to track fiscal and monetary policy supply shocks simultaneously. Following the research results of Foot and Stein (1991), Welfens assumes a negative correlation between the real exchange rate (RER) and the volume of the FDI inflow into the new EU member-states and analyses the impact of the RER on capital flows which influence growth.

In the fifth chapter, **Brandmeier** extends the starting assumptions of **Welfens** by additional assumption that the level of the FDI inflow depends on the level of the human capital stock. He argues that the human capital and the relationship between the labour costs and productivity are more important factors determining the total FDI inflows. The argument stemming from his analyses is that the more human capital is needed to create the increase of labour productivity, the bigger is the positive spill-over effect of the FDI on the industrial sector of country in question. Brandmeier considers the availability of human capital that can be employed at comparatively lower costs than in other production sites in Europe of crucial importance for the effective use of invested capital.

Richard Woodward and **Piotr Wojcik** in the sixth chapter under the title *Network and Competitiveness,* analyse the relationships between firms and how this affects the level of competitiveness and investigate the patterns of enterprise clustering and networking dominant in the Czech Republic, Hungary, Poland and Spain. They also compare the networking patterns of domestically-owned and foreign-owned enterprises. The authors base their research into the issue on the survey data of a quota sample of 600 enterprises in four industries (electronic, pharmaceutical, food production and automotive industry) in the three new EU member-states and one old EU member with similar industrial structures. The research results demonstrate that the strategic use of networking and business partnerships were still in the early phase of development in the three accession countries and therefore have not had a more significant impact on the competitiveness of the examined industries. Foreign ownership seems to have a dominant effect on such networking and on the competitiveness of enterprises in the selected industries.

The second part of the book gathers texts dealing more with the issues of catching-up process with EU economies through a deep restructuring of the industries of new members and the change of dominant trade specialisation patterns. This part consists of four author contributions which present the main characteristics, trends and determinants of the changes in the industrial structure and trade specialisation.

This part of the book starts with the seventh chapter The *Process of Structural Change in Polish Manufacturing in 1995-2003 and its Determinants*. The authors, **Marczewski** and **Szczygielski,** analyse the determinants of structural changes in Polish industry. Polish experience is especially relevant when one talks about the convergence and catching-up process with the developed EU-members. The Polish GDP value is higher than the Czech, Slovak and Hungary GDPs taken together. In the beginning of transition Poland was far less developed and much more closed than other transition countries and also far less integrated and linked with the EU than the Czech Republic and Hungary. Initially, Poland's catching-up process was accompanied by high unemployment rates, changes in the allocation of the labour force and other resources across the industries, as well changes in the structure of industrial output.

This chapter deals with the specific characteristics of structural changes in the industry and factors which influence that process as well as with effects of the process on the aggregate labour productivity and labour market development. The in-depth analyses of these problems measure the impact on the characteristics of various industries of factors such as the type of technology, labour skills intensity, production factor intensity, concentration and internationalization of production, import penetration, and FDI impact on the changes in the employment levels and value added creation in the 1995-2003 period.

As the previous chapter focuses on the changes in the competitiveness of the Polish industry before accession to the EU, **O'Donnell** in the following, eighth, chapter *Structural Change, Productivity and Performance: Some Evidence from Irish Manufacturing,* compares the changes in the industrial competitiveness of Ireland in the two periods: before and after joining the EU. O'Donnell assigns the key role in the catching-up process to the structural changes in industry and focuses his text on the various dynamic dimensions of the relationship between the structural changes and the labour productivity level in the periods before and after accession to the EU. In his analyses the author attempts to find out to what extent the changes in the industrial structure and reallocation of the resources towards more competitive sectors have contributed to the increases of labour productivity.

In the next ninth chapter *What Drives Specialisation in the New Member States?* **Dora Borberly** puts into the focus of her research those very changes that were crucial for altering the trade specialisation patterns of the Czech Republic, Poland and Hungary. The determinants of such changes were factors such as: quality and intensity of production factors; the level of industrial production; unit value of exports; relative wages; labour productivity; labour unit costs, FDI and research and development costs. Her research has demonstrated that the new EU members are significantly more highly specialised and have a comparative advantage in the labour-intensive industries then old EU-members. The impact of the different examined factors significantly varies across the industrial sectors in accordance with factor intensity. For instance, the unit value of exports to a significant extent explains the comparative advantage of industries that are dominantly knowledge and innovation-based, while it hardly explains the comparative advantage in labour intensive industries. On the other hand, research found out that the level of FDI, relative wages and labour unit costs have a particular impact on the comparative advantage in labour intensive industries.

The tenth chapter brings **Brendmeier's** comments on the Borberly analysis based on the German experiences and extends the analysis by focusing on *outsourcing* and other important methods of increasing the competitiveness of domestic industry and its trade specialisation. He explains that the increase of competition in labour-intensive industries is happening not only in the relations old-new EU member-states, but also in the relations between Western Europe and Far Eastern countries. He argues that although EU-15 still has comparative advantage in the goods of high-technology industries as well as in the human capital and knowledge-intensive industries, this advantage is also eroding. Commenting on the determinants of changes in the export patterns in the new EU member-states as well as the volume of *outsourcing* in these countries, he points to the exceptional importance of FDI in the process of change. However, although lower wages in Central and Eastern Europe are an important element in decisions on the location of such industries by German companies, he did not establish a significant correlation between the volume of *outsourcing* from Germany to CEE and the relative wages there. He explains the extent of *outsourcing* by the differences in the sectoral labour productivity and suggests that the actual type of trade specialisation is affected primarily by the changes in the productivity gap as well as by the type and quality of human capital.

Readers will probably find most interest in the third part of the book, i.e. the final eleventh chapter which skilfully summarises the recommendations and implications relevant for economic policy-making. The authors **Ferrer** and **Kernohan** draw on the research results presented in the previous chapters and assess what the lessons and implications for old and new EU member-states are. They argue that various EU industries should make better use of comparative advantages of low labour costs and a relatively high level of education in the labour in the new member-states in order to increase the competitive ability of the EU in the world market and improve the total level of welfare of all member-states. Even in the short run, the new EU members could become strong competitors in certain geographic areas. However, this fact is not always well received by the old EU member-states due to the danger of increased competition among them, which could lead to a decrease in the competitiveness of some of their industries and as a consequence lead towards reallocation of certain industries from old to new member-states. In conclusion, for the increase of the competitiveness of certain industries, the authors recommend more measures targeting improvements of the overall investment and business climate (especially for instance on the services market). They are rather sceptical concerning the specific sectoral industrial policies that were previously thought to be helpful in increasing industrial competitiveness. The authors consider it especially important to single out the strong links between FDI, innovation and the competitiveness of the industrial sector in the three countries. Exactly due to this correlation, contrary to expectations based on traditional trade theory, the new EU member states more and more demonstrate the shift from labour-intensive industries towards industries with high technologies, knowledge and capital intensity.

Is the same trend valid for Croatia? No clear answer can be given without similar in-depth empirical and econometric analyses.

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