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## **New Eastern European EU Members Need a Modern Industrial Policy: Poland and Slovenia Highlighted**

New Eastern European EU Members have recently joined. Therefore their firms must develop in order to compete successfully with Western and global companies. The answer goes beyond admonitions to privatize state owned industries. This was the old answer for economies in transition when the problem was to move economies from centrally planned ones to the market system. This article addresses the future need to be competitive. It points out how Eastern Europe has focused on a policy for foreign trade based on a model of “short business distance”. The article proceeds with a combination of description and analysis of the Polish and Slovenian economies in transition. These two countries have been selected because they are, in a significant sense, the two ‘gateway’ countries for the rest of Eastern Europe; the former by way of size and the latter by way of per capita income. Furthermore, both are ‘impact’ countries by their history of intellectual leadership, current development toward market economies and sustainable global enterprise. How they advance will serve as an example for the rest of the Eastern European countries that have recently joined the EU. Together they can bring a range of benefits to the EU. Finally, it is shown that the situational logic calls for a “modern” industrial policy in both these ‘gateway’ countries. A novel but satisficing method of selecting industries to build is advocated. The industries should then be ones, which have sustainable competitive advantage.

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The decision on the EU's eastward enlargement is of historical importance. For the first time the idea of a united Europe ranging "from the Atlantic to the Ural", as once advocated by General Charles de Gaulle, can come true. Moreover, as seen from the point of view of the vital interests of Eastern European countries, full regional integration of Europe seems to be the only reasonable solution. However, the noble idea and benefits of European regional integration are neither commonly understood nor fully accepted with proper understanding and satisfaction by all Europeans. Therefore it seems worthwhile to inform them and make people aware of the consequences of these benefits. There are two fundamental vectors advocating Eastern Europe's accession to the EU; and for the same reasons advocating that the EU should accept the 10 new Eastern European countries. These vectors are economic/social, and sustainable global enterprise. At this stage it is useful to profile the Poland and Slovenia economies.

**Table 1. Economic profiles of Poland and Slovenia: the 'Gateway' Countries**

| Variables                                      | Poland         | Slovenia       | Previous EU-15 States: |
|--|----------------|----------------|------------------------|
| Population                                     | 38.63          | 1.99           | Total 378 million      |
| GDP USD Billions                               | 187.7          | 21.1           | Total 8562.8           |
| GNP <i>per capita</i> USD                      | 4570           | 9810           | Average 22,594         |
| Purchasing Power Parity <i>per capita</i>      | 10,130         | 17,690         | Germany 26,220         |
| Technological Competitiveness*                 | Global Rank 34 | Global Rank 24 | Germany Global Rank 14 |
| Foreign Direct Investment Stock USD Billions** | 45.2           | 5.1            |                        |
| % of Total Exports to West Europe***           | 70%            | 68%            |                        |
| % of Total Exports to East Europe***           | 20%            | 29%            |                        |

\* *Global Competitiveness Report 2003-04*, World Economic Forum

\*\* *World Investment Report*, UNCTAD 2003

\*\*\* *Handbook of Statistics*, UNCTAD 2003

Sources: *World Development Indicators*, World Bank, July 2003

With reference to the new EU members from Eastern Europe, the two 'gateway' countries are leaders on two different variables. Poland's population is

by far the largest and is in fact well over 50% of the total for these 10 countries. Slovenia GNP *per capita* is the highest for these countries barring that of the small island of Cyprus, and in purchasing power parity terms is within two percent of that of Cyprus.<sup>1</sup> With regard to foreign trade, Table 1 shows how both Poland and Slovenia do almost all their trade within 'short business distance'; over two-thirds of the trade is done with Western Europe and the bulk of the remainder with Eastern Europe. Moreover in terms of logistics, Poland and Slovenia also are 'gateway' countries; Poland connecting Germany and Russia and Slovenia being at the entrance to South Eastern Europe.

## **1. Economic/social backgrounds of Poland and Slovenia**

### **1.1. Poland: evolution in recent years**

Government in its export objectives has given greater consideration to production capability than to market opportunities abroad. So coal and sulphur sectors were targeted as export winners as were certain selected industries: construction equipment, ships and some food industry products. Firms have not been too interested in export markets as domestic demand has been adequate for them. Those that have been linked through cooperation agreements with foreign companies found their firms are more or less subcontractors who control only the local management function. They do not have strategic control over capital, technology, and marketing.<sup>2</sup> There are two problems. One is that Eastern European economies have similar resource bases and are all trying to restructure their economies along the same general lines. This means they cannot stimulate their economies with intra trade in the region. Thus the EU free trade area is a Godsend. Two, is that most of the trade with Western countries is subcontractor trade and so Polish firms cannot really develop under such circumstances. Their basic comparative advantage lies in their relatively well-educated, trained, cheap labour. But China and India have even cheaper labour that is becoming better educated. So unless better selection is made of potential export winner industries which have sustainable competitive advantage Poland will remain a subcontractor and the economic level will remain correspondingly low.

Poland had an industrial culture that was slowly leading it to more competitive industrialization but that type of "free market thinking" was destroyed under Russian led communism. The leaders of "transition" did not formulate Industrial Policy. They moved to obtain foreign investment in selected "crisis" sectors. The foreign direct investment (FDI) was to be paid off by

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<sup>1</sup> *World Development Indicators*, World Bank, July 2003.

<sup>2</sup> K.Fonfara, M.Collins, *The Internationalisation of Business in Poland*, "International Marketing Review", vol. 7-4/1999, pp.74-99.

exports to foreign countries, which were basically in a “short business distance” periphery. Therefore sustainable competitive advantage sectors of industrial development often did not emerge.

In Poland the liberalization by the ‘Big Bang’ Balcerowicz Plan of 1990 led to a dramatic recovery. GNP growth in the period 1992-96 averaged 4.8 % per year. In November 1991 Poland made an agreement of Associate Membership with the EU. This helped Poland’s exports to the EU to expand to \$16 billion in 1995 from \$6.4 billion in 1990. By 1995 some 70% of Poland’s exports went to the EU and by 1996 consumer price inflation had fallen below 20% annually. Poland’s vibrant private sector was the driving force. Its agricultural sector had been predominantly private. Moreover because of relatively lax restrictions on foreign travel, ad hoc private trading had flourished for many years. Thus before the fall of Communism, there was a rapid accumulation of private capital both financial and human that was unique (Berg, 1994). FDI rose to \$4 billion in 1996 and FDI stock in at the end of 2002 was \$45.2 billion. MNCs see Poland as an attractive export platform to Eastern Europe. Fiat and General Motors are doing well in the auto industry. Further Bank of America and Korea’s LG Group have based their Eastern European Headquarters in Poland. MNCs are well aware that Poland has 38 million consumers while Czech and Hungary only have 10 million each.

However Poland has longer-term problems that may be serious. It has an overburdened social safety net; in 1994 about 50% of GDP was redistributed through the public sector. It has in fact a “premature welfare state”.<sup>3</sup> Furthermore the question remains as to how it will build sustainable competitive advantage for its exporters and for its producers who will have to compete with imports. This premises a government industrial policy which is liberal and institutional; besides being interdependent with an export enhancing policy. As Poland’s economy becomes more open with its membership of EU, its economic and industrial policy must be a general upgrading of the competitive capabilities of enterprises. This involves stimulation of capital investment, infrastructure, R & D, and education and training.<sup>4</sup> Thus the old policy of treating foreign trade as a subsystem detached from the rest of the economy is no longer possible.

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<sup>3</sup> B.Slay, *Poland’s Supernatural Recovery*, “The International Economy”, January/February 1992, pp.12-19.

<sup>4</sup> M.Gorynia, *The Polish Economy’s International Competitiveness and Economic Policy*, “Russian and East European Finance and Trade”, No. 34/1998, pp.7-26.

## 1.2. Slovenia: evolution in recent years

Slovenia prepared an integral strategy for economic development in 1995, putting into concrete terms the measures required for accession to the EU.<sup>5</sup> The policy guidelines and development priorities were laid down in the *Strategy for the Economic Development of Slovenia (SEDS) and the National Development Programme (2003)*. The SEDS primary objective is sustainable development, which means balanced progress of the economic, social and environmental dimensions of the welfare of individuals, including balanced regional and spatial development. The objective is a long-term stable economic growth rate. The SEDS determined the following principal elements to achieve this objective: gradual reduction of inflation and the gradual elimination of the public finance deficit. Speeding up structural reforms and increasing investment in modern development factors. The latter consisted in particular in the creation of the knowledge – based society , enhancing competitiveness, strengthening social cohesion, more efficient government, and reducing the government's role in managing and regulating the economy and markets. Slovenia has noted that for small countries like itself the formulation of a strategy to respond to globalization's challenges it makes sense to accede to regional integration. From such integration they will be drawn to integrate into global production systems and international trade and finance.<sup>6</sup>

The Slovenian economy is much more intensively integrated into regional economic trends through trade flows than through FDI. In 2002 Slovenia's goods and services exports were 58% and imports 57% of GDP, which shows the high integration into the regional European economy (see: Table 1) and the openness of Slovenian markets to foreign competition. FDI stock in Slovenia at the end of 2002 was \$5.1 billion, of which \$1.9 billion occurred within the year. The EU member States dominate with a total share of some 80%. The leader is Austria with over 20% of the total stock. The Austrian FDI is spread over a number of industries, including pulp and paper, and financial intermediaries. Next is the non-EU Switzerland, investing in Slovene companies dealing in the production of chemical products and engines.<sup>7</sup> Third and fourth are Germany and France. The predominate sector of total FDI is manufacturing with over

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<sup>5</sup> *Strategy for Economic Development: Approaching Europe – Growth, Competitiveness and Integration; EU Accession Strategy for the Republic of Slovenia: Economic and Social Sections, 1998; Strategy for the Economic Development of Slovenia (SEDS) and the National Development Programme*, Slovenia: Report on Structural Reforms, November 2003.

<sup>6</sup> *Slovenia in the New Decade: Sustainability, Competitiveness, Membership in the EU; The Strategy for the Economic Development of Slovenia 2001-2006*, Institute of Macroeconomic Analysis and Development, 2001.

<sup>7</sup> *Statistika: Direct Investment 1994-2002*, Banka Slovenije, May 2004.

45%, followed by financial intermediation with 19%. According to UNCTAD data, Slovenia ranks 105 among 140 countries in terms of attracting FDI but occupies a high 29<sup>th</sup> place in terms of its potential to attract FDI.<sup>8</sup> This indicates Slovenia is failing to make proper use of its advantages to attract FDI.

## **2. Poland and Slovenia: Sustainable Global Enterprise**

Sustainability of Planet earth has become a major issue in international affairs. UN Secretary General Kofi Annan stated in his Millennium Report to the General Assembly that “Freedom from want, freedom from fear, and the freedom of future generations to sustain their lives on this planet” are the three grand challenges facing the world at the dawn of the 21<sup>st</sup> century.<sup>9</sup> A strategy for an R&D system tailored to the particular needs of the sustainability challenge has to be developed. A widening discourse on science, technology and sustainability has revealed differences in perspectives and priorities between the North and the South, the richer and the poorer.<sup>10</sup> But a general consensus seems to be emerging that sustainability involves ways of simultaneously meeting human needs, especially the reduction of hunger and poverty, while protecting Planet Earth’s essential life support systems and biodiversity. Dealing with sustainability requires integrated knowledge systems that have horizontal connections among regional research and application centers and vertical connections with the best researchers in the world.<sup>11</sup>

Recognition is now widespread that knowledge has a powerful impact in the production process and is an obvious prerequisite for technological innovation. There also is a growing interest from policy makers in the knowledge-based economy (KBE). In the past few years growth of the U.S. economy has been substantially based on productivity increases. The OECD defines KBE as an economy directly based on the production, distribution and use of knowledge and information.<sup>12</sup>

Both Poland and Slovenia are committed to ‘Sustainable Global Enterprise’. Both these countries have always preserved a high intellectual culture. This is indicated by their present urge to develop a KBE. By doing so these ‘gateway’ countries will also serve as leaders and guides to the other new members who

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<sup>8</sup> *World Investment Report*, UNCTAD, 2003.

<sup>9</sup> K. Annan, *We the Peoples: The Role of the United Nations in the 21<sup>st</sup> Century*, United Nations, New York 2000.

<sup>10</sup> R. Kates et. al, *Sustainability Science*, “Science”, No. 292/2001, pp.641-642.

<sup>11</sup> W.C. Clark, *Research Systems for a Transition Toward Sustainability*, in: *Challenges of a Changing Earth*, eds. W. Steffen, J. Jager, D.J. Carson and C. Bradshaw, Proceedings of the Global Change Open Science Conference, Amsterdam, July, p.10-13.

<sup>12</sup> *The Knowledge Based Economy*, OECD, Paris 1996.

have joined the EU. The KBE societies need to interconnect and interweave education and training, R&D and innovations, and the information society. Both countries have taken steps to establish an institutional framework. Slovenia has even established a Ministry of the Information Society in 2000 and the introduction of ICT is increasingly a planned process. Slovenia has opted for sustainable development, which ensures that the needs of current generations are met without impeding future generations in meeting theirs to the same extent. The enrichment of current generations is acceptable only if it strengthens welfare resources and improves the factors of development e.g. investing in infrastructure, technological development and human resources.<sup>13</sup> Poland also is a firm believer in the above path.

### **2.1. The role of technology**

R&D investments in Poland are running at only 0.68% of GDP but in Slovenia they are running at over 1.50% of GDP. For innovation processes the leading paradigm in the 1960s and 1970s was the 'linear model.' It assumed one-way steps from the input (R&D) via the throughput (cooperation) to the output (innovations). Over time the model lost credibility. It did not allow for the impact of information from feedback loops. Further it did not allow for variance in R&D input not being reflected in equal variance in output. Moreover the R&D input does not cover all inputs and accounts for less than 50% of the total amount of innovation expenditures.<sup>14</sup>

The innovation survey in the EU contains information on several aspects of KBE: R&D expenditures, cooperation with partners seeking innovation, the realization of innovative products and processes, and factors hampering the innovation process. The most striking output indicators are the realization of new products and processes.<sup>15</sup> The contribution of new products to total turnover is obtainable but it is difficult to establish an indicator for process innovation; perhaps the reduction in production cost might serve. A question is whether to include organizational change in the concept of innovation. At Statistics Netherlands about 50% of innovating firm respondents report that they are unable to split the impact of technological from non-technological innovations. But the majority of the other 50% judge non-technological innovations as most important. These latter innovations are organizational, managerial, and changed corporate strategic orientations.

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<sup>13</sup> *Slovenia in the New Decade: Sustainability, Competitiveness, Membership in the EU; The Strategy for the Economic Development of Slovenia 2001-2006*, Institute of Macroeconomic Analysis and Development, 2001.

<sup>14</sup> *The Knowledge Based Economy*, OECD, Paris 1996.

<sup>15</sup> *Statistics in Focus*, Community Innovation Survey 1997/1998, Eurostat, vol. 9-2/1999.

Can a Balanced Score Card (BSC) contribute to the study of development of innovative capability? This builds on the original BSC idea.<sup>16</sup> The approach will be that of reaching for economic growth. This growth being caused by 'Economic Efficiency' arising from 'Social Sustainability' and 'Social Efficiency' arising from 'Ecological Sustainability'. The original BSC consisted of four dimensions: finance, customers, processes, and organizational development.

The consideration of financial objectives is important. But a further improvement is the focus on 'value drivers' that can augment the future value of a company. This makes sure that intangible assets, such as infrastructure, know-how, and employee skills, are considered in the calculus for strategic potential in the future. The 'Market Perspective' aims at the identification of relevant customer and market segments that contribute to the achievement of financial goals. Firms should efficiently structure the internal value driving processes to achieve the goals of customers and shareholders. The R&D processes are very relevant because of the contraction of market-cycles and extension of costly R&D cycles. The Perspective of Organizational Development tries to initiate learning effects through continuous reviews of strategic assumptions and operative strategic learning effects.

Therefore it is recommended that Poland and Slovenia propose a 'Sustainability Balanced Score Card (SBSC)' for their companies. For corporate sustainability, four different types of environment preserving strategies can be followed:

1. Clean: market buffering strategies – defend existing markets;
2. Efficient: cost strategies to be cost and environment efficient;
3. Innovative: differentiation strategies to differentiate by environmental products;
4. Progressive: market development strategies to develop markets environmentally.<sup>17</sup>

**Clean** = Show business as 'Green' and 'Responsible' so as not to lose their "license to operate".

**Efficient** = Focus on environmental and social objectives in order to 'reduce costs' The strategy is one of eco-efficiency to minimize cost related ecological damage.

**Innovative** = proactively tackle ecological matters which are market related. Recommended for mature markets where ecological aspects represent a potential for differentiation.

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<sup>16</sup> R.S.Kaplan, D.Norton, *Transforming Strategy Into Action: The Balanced Scorecard*, Harvard Business School Press, Boston 1997.

<sup>17</sup> T.Bleker, C.U.Gminder, *Towards a Balanced Scorecard*, Institute for Economy and the Environment, University of St.Gallen, Switzerland 2001.

**Progressive** = Focus on environmental and social objectives to develop existing or new markets in order to increase sustainability more than we have today.

The recommendation is that Poland and Slovenia organizations follow the 'Progressive' environment preserving strategy. This is the leader strategy with which these 'gateway' countries can impact on the new EU members. Moreover Poland and Slovenia may well provide a guide to many existing companies in the original 15 EU countries.

### **3. Poland and Slovenia: a modern industrial policy proposal**

Poland and Slovenia have to make an industrial policy, which is directed at building sustainable competitive advantage in selected industries. Some examples from other countries follow of modern successful companies that have sustainable competitive advantage. USA has Microsoft, Intel, GE, Nike and others. Germany has Mercedes and Volkswagen. Japan has Honda, Nissan, Toyota and Sony. India has software giants Infosystems and Wipro. Finland has Nokia. Italy has Benetton and Armani. How did the above companies spring up? There are many reasons for the various facets of their development but the overall platform was the industrial culture within the country in question. The government's role was to install a liberal – institutional industrial policy that fostered the development of enterprises.

However neither Poland nor Slovenia has the luxury of time in which their industries can grow gradually. Global competition from MNCs is intensifying. Furthermore competition from developed powerful EU multinationals is occurring. Therefore Poland and Slovenia have no choice but to develop those of their own industries, which can attain sustainable competitive advantage. The alternative is to become a sub-contractor to MNCs and run a branch plant economy where its only strength will consist of productive relatively low paid labour. In consequence Poland and Slovenia will be marginal economies; continuously threatened by even more lower paid labour from China and India who can perform the same tasks as productively, if not more so. The logic of the situation demands a "modern" industrial policy based on much private sector ownership.

#### **3.1. Poland and Slovenia: a modern industrial policy**

In Poland and Slovenia how are these selected industries to be chosen? In most countries, the infant industry to be protected received protective tariffs and/or help through quantitative restrictions from competition without specifying

when such protection would be removed.<sup>18</sup> In fact they tended to stay and this often led to a misallocation of resources. But Brazil was successful with its computer industry, which was treated as an infant industry that received appropriate protection and has done very well.<sup>19</sup> Italy has no Industrial Policy but tradition has built strong manufacturing and design industries especially in the North. Further Italian development has fostered clusters and networks. Clusters are growing in most developed countries; for example the USA has Silicon Valley and Nokia has an electronic cluster in Finland. The modern thrust is clusters and networks. In the latter specialists partner at every level to achieve seamless control from raw material to final delivery of product to customer. In contrast Poland just has independent companies. And Slovenia is dominated by MNCs like Revoz in automobiles, Petrol in oil derivatives, Elektro-Slovenija in power transmission, Gorenje GA in house appliances, Krka and Leh in pharmaceuticals, Sava in tire and rubber, to name a few.<sup>20</sup> Also most of these feed the local and Central /Eastern European markets.

How can Poland and Slovenia “best” select industries, which have the potential for sustainable competitive advantage? Sustainable Competitive Advantage (SCA) = Core Competence + Operational Capability to Deliver. In a modern economy SCA also requires marketing competency throughout the firm plus a transformation of the firm so that it can respond quickly to customer requests and other external cues. Appropriate transformation of the firm leads to quicker and more efficient decision making.

Poland has some unique products and locations, which confer natural competitive advantage. For example there is amber, the semi-precious stones, and there are shipyards at Gdansk. Poland also has some known firms. In clothing there is Llpsa. In food products, some names are Sokolow for ham, Hortex and Frugo for fruit drinks. In glass there is PZL. In furniture there is Eliot, in helicopters there is Swidnik, in jewelry there is Komozja, in pharmaceuticals one has Polypharm, in vodka there is Polmos. But already MNCs have picked up Polypharm and Polmos. Slovenia is a small country without any unique products but it has self-reliant people and is consciously developing an information society and using information-communication technology for further development. Furthermore they clearly recognize that the key factor for increasing the competitiveness is the strengthening of managerial

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<sup>18</sup> A.Lipowski, *Przemiany Strukturalne (Structural Transformations)*, Warsaw 2004.

<sup>19</sup> H.Schmitz, T.Hewitt, *Learning to Raise Infants: A Case Study in Industrial Policy*, in: *States or Market?: Neo- Liberalism and the Development Policy Debates*, eds. C.Colclough, J.Manor, Ids Development Series, Oxford 1994, pp.173-196.

<sup>20</sup> A.K.Kozminski, G.S.Yip, *Strategies for Central and Eastern Europe*, Macmillan Press Ltd, 2000, p.156.

skills and investment capacities, particularly in the development of the human factor, information and technological development.

Can Poland develop clusters? Maybe it can in Food Products, Furniture, and Amber, semi-precious stones and jewelry. Can Slovenia develop clusters? Possibly in ICT, an early example of a very successful software company has been Hermes Softlab. Can Poland or Slovenia develop networks? Probably not because their firms are not specialists with sustainable competitive advantage.

Our message is clear. The way of selection has to be by broad informed discussion; rather than based on past performance under protective conditions or by government fiat. The tendency of government in targeting specific industries for preferential treatment will possibly be to use traditional methods that consider factor endowment or the economies of scale argument. In contrast to “best” select target industries one needs a situational analysis of the industry, projected demand, and competitive analysis.

Our proposal is to set up a series of conferences and workshops to which government, industry practitioners, international executives, chambers of commerce, and academicians are invited to discuss and dialogue the criteria for selection and the actual choice of industries. Prior to the conference/workshop a task force should be set up, of knowledgeable persons representing the same group that will deliver a position paper. The discussions in the conferences/workshops should be widely publicized so that other input can be received. The impact of all this will also raise the confidence of these ‘gateway’ nations and indicate to all the thrust that is going to be instrumented in education and R&D to support the industrial policy within the framework of sustainable global enterprise. The process will impact on all the new EU members and may well receive great attention from the original 15 EU nations.

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