

## **What lessons can be learnt from the economic crisis to implement a European industrial policy?**

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### **The role of industrial policy in European re-industrialisation**

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I would like to start with a methodological remark. In my view we have to overcome the intellectual dichotomisation to conceive and analyse issues related to the crisis, growth, fiscal or structural asymmetries in Europe or at the national level either from a macro- or structural perspective. Macro- and structural factors are closely interdependent. Industrial policy and structural factors are needed to enhance productivity, competitiveness and growth while stable and balanced macro-conditions are often a crucial complementary prerequisite for achieving these goals. Hence, it is counterproductive to concentrate on macro imbalances, deficits or price-cost aspects and disregard the underlying deep structural weaknesses and inefficiencies related or even affecting and destabilising the macro-economy, or, inversely, to emphasize structural issues by completely disregarding the macro-economic environment and constraints within which structural policies have to be implemented.

Having made this remark I will focus on the following six issues:

1. My first point is that the recent crisis showed that we have to distinguish more clusters of countries within the E.U., with different crisis management capabilities, different governance capabilities and performance and divergent production, technology and investment structures. In addition to national factors, European capabilities to manage the crisis and the economic and social questions in Europe have also a severe impact on the policy outcome at the level of both, individual countries and Europe. The consequence is that the appropriate mix between industrial, structural and macro-economic policy takes a quite different form, depending on which part of Europe we consider. Intra-European differences regarding production and technological specialization coupled to future national, European or world challenges have to be tackled with different policy mixes. Roughly, three broader strategies can be distinguished:

- a) Strategies aiming at the frontier,
- b) Catching-up strategies for (fast or slow) followers,
- c) Preventive strategies to address global risks.

Each strategy has its own advantages and risks, which depend on goals, country environments, forms of governance and institutions and on the timing. In addition, all these three types of strategies can take a more targeted (pro-active) or a more neutral form.

2. My second point refers to the crucial opportunity of Europe to combine strategies aiming at the frontier while addressing global risks. Global players and, hence, European societies are faced with the need to develop technological solutions for addressing climate change, energy, other environmental issues, which occupy an increasingly important place in the

world agenda. The advanced European countries are faced with a double challenge: First, to develop timely leading positions based on frontier technologies and knowledge and foster their growth and capabilities, and second, to contribute to the mitigation of these global risks and their severe results. Experience shows that being a latecomer in frontier technologies has serious implications which persist for years, are difficult to reverse and affect economic and social performance. Whether success can be based on market selection or the interplay between market and pro-active policies is a key issue. However, success depends also on the capability of Europe to address its lasting macro-economic problems.

3. Cost- and efficiency-related policies enhance productivity, but this might not be adequate. Productivity improvement is important but could be irrelevant if it cannot preserve competitiveness. Consequently, productivity-related policies have to lead also to the creation of activities which are the real pace-setters in the growth process. Productivity growth and diversification of production are interrelated elements of a winning strategy aiming at supporting entrepreneurship in new sectors, widening the productive activities and increasing the knowledge content of products. Such a strategy could shift old productive patterns into more promising ones and build capabilities to face the challenges of tomorrow.

4. My fourth point is that the success of industrial and technology policies is determined by a range of heterogeneous factors, among which technology variables are interacting with many other economic but also social and political factors, making success complicated and non-linear. Specialisation strategies, allocation of investment, macro-economic policies, appropriate synergies between the State and the Market, are macro-related factors influencing also different parts of the overall value chain of firms. In such a diversified environment firms can attain diverse combinations between the single components of their value chain and achieve very different and unpredicted specific or niche production and competitive advantages.

5. Always, the question is how policies can be effective in attending targets. Public Policy involvement per se does not guarantee a successful outcome. Efficient Public Policy requires a successful combination of crucial parts of the whole policy chain, such as management of knowledge, priority setting, strategic thinking, long term policy design and management approaches. Otherwise the result might be insignificant, fragmentary and temporary and the impact on crucial economic variables quite weak.

Consequently, Industrial Policy has to be based on the co-evolution of more elements, such as:

- To strengthen the production and technological specializations by enhancing variety creation and selection, and supporting 'differentiation' elements against competitors.
- To achieve a good functional coordination of research activities, social needs, new knowledge, learning activities, public demand and inter-country cooperation.
- To be flexible enough to adapt institutional arrangements, incentives, types of financing and supportive policies to changing conditions.

- To provide timely new infrastructures encouraging the absorption of new knowledge.
- To make the preservation of a competitive ecology a key ingredient of policy making and to facilitate entry of new firms in new innovative activities.
- To learn from policies and practices of third countries.

The fact remains, that both pro-active and horizontal policies even if based on market-evidence, are subject to risks of failure. Successful specializations rarely could be discerned ex ante. There is an inherent high uncertainty and unpredictability of foreseeing 'what a country will be good at producing' or 'where the advantages can lie'. Even countries with very similar levels of technological capabilities and factor endowments followed very different specialization patterns as a consequence of different historical evolutions, entrepreneurial initiatives and policy responses. Production systems with inefficient forms of value chain management in the business sector, limited social capabilities to create or even to seize new opportunities and forms of governance that oppose the transformation of the national production system will be faced with the adverse experience of lagging behind and stagnating. In all such cases the goals are unlikely to be successfully achieved without directed public actions.

In fact, the history of industrial and technological evolution shows that:

- Rarely if ever could significant production capabilities be developed without strong public supportive mechanisms,
- During longer periods interactions between public policies, investment structures, institutional and technological changes cannot be classified within one discernible pattern,
- Often public policies alternate between pro-active and reactive forms according to the specific evolutions and needs.

6. The crisis in Europe was not just a macro-economic policy failure. From a policy view, the building of the Eurozone, its governance after 2000 and the crisis management of the last years manifested many flaws, including mismanagement, inabilities or unwillingness to follow the rules. However, besides macro-management issues, the actual questions in Europe are deeply connected to the weak productivity, poor investment, growth and demand as well as to an increasing social and political disappointment. I am arguing that the dominance of the financial system over the real economy and the hypothesis that the strength and stability of a common currency can be based on common macro-economic rules but not on convergent production bases, proved to be untenable. A strong production base has to underpin the European economy and ensure its overall performance vis-a-vis third powers.

Consequently, industrial and pro-active policies have to address the serious divide between the stronger, the middle and in particular the crisis countries within the Eurozone. The crisis showed that significantly unequal productive and competitive capabilities don't affect simply the individual performance of the concerned agents but also the overall macro-performance of the Eurozone itself. The solution is either a policy fostering long-term production-based

convergence between members of the Eurozone or a transfer mechanism to counterbalance the resulting imbalances or a mix of both. To the extent that Europe fails to manage efficiently either answer to the question, the impasse will deepen, the increasing economic and political cost will affect unequally the countries of the Eurozone and exert a significant destabilising effect on the smooth functioning of both, the E.U. and the Eurozone.