

Industrial Renewal Through Regional Development

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The dissolution of the centrally controlled political and economic system in Eastern Europe has led naturally to the regionalization of this part of the continent. National and – increasingly – regional (i.e., subnational) governments are assuming responsibility for fundamental political and macroeconomic decisions formerly made for them by central planners. On the enterprise level, the managements of large combines are becoming more and more independent of their respective governments.

This dissemination of authority is both bad news and good. The heated nationalism that has accompanied political and economic upheaval – from the former U.S.S.R. to Yugoslavia – is a cause for much concern. On the other hand, economic individuation and even rivalry among nations and subnational regions is healthy, so long as grossly lopsided disparities do not develop. We argue that the regionalization of the Eastern European economic landscape presents unique opportunities for industrial renewal, both as a means for Eastern European countries to foster job growth quickly and as a way for other developed countries to tailor more effective aid programs. In this respect, the German experience can serve as a model for other countries.

Eastern Germany as a Model

Over the last three years, the former German Democratic Republic has undergone a rapid process of development as it has been integrated into the Federal Republic of Germany. Although other countries in Eastern Europe are unlikely to enjoy the enormous infusions of capital that Eastern Germany has received from its „rich brother,“ its experience may nonetheless prove relevant, as the overall direction of industrial renewal policy is likely to be similar across the region.

In the past two years, the Treuhandanstalt, the agency responsible for privatizing Eastern Germany's state-owned enterprises, has sold half the enterprises in its portfolio. Along the way it has overseen the dissolution of numerous large, vertically integrated industrial combines. These firms – which not only made products but produced the raw materials, constructed their own machine tools, and handled product distribution – have been broken down into their „core“ businesses.

A significant consequence of this privatization has been large-scale layoffs, which have been necessary to improve the competitive chances of the enterprises in question. As the ranks of the unemployed have grown, it has become clear that the industrial renewal process must include unemployment programs. Since unemployment programs cost billions of deutsche marks each year, the government has sought ways to create new jobs as quickly as possible. One approach is the continuing effort to attract outside investors, both for privatization of the remaining Treuhand companies and for greenfield investments. Another is to provide strong support – on a local-region basis – for the emerging small and medium-sized companies. This latter approach has proven particularly effective at creating jobs fast. In Eastern Germany, it has become apparent that industrial restructuring needs to be combined with strong regional development measures.

Regional Development in Eastern Germany

In order to raise the standard of infrastructure to the Western German level and to make it possible for the newly restructured firms to compete with their counterparts in developed countries, the German government has undertaken a comprehensive regional development policy in Eastern Germany. It has invested billions of deutsche marks in the rebuilding of roads, railways, airports, telecommunications, and public utilities, and in mitigating environmental pollution and preparing industrial land. While funded primarily by Bonn, these programs are in large part implemented at the state and county levels – the optimal levels for effective administration and political oversight.

Regional support programs are essential because small and medium-sized companies require strong „umbrellas“ under which to grow. Such umbrellas may take the form of industry associations, nearby research centers, or inexpensive „incubator“ space. The German government and business organizations have recognized this need by establishing regional technology-transfer offices, fostering inter-firm networking, and providing generous financial packages for business start-ups. For example, qualified start-ups can receive up to 50 percent of their financing at below-market rates – and with an interest-free payback period of up to three years. Qualified firms also receive subsidies for participation in regional and international trade fairs.

Eastern Germany's industrial restructuring process has begun to succeed largely because regional measures have helped absorb the shock of privatization by laying the groundwork for new firms. These measures have been administered within a carefully laid-out strategic plan that includes, for each region, a prioritized infrastructure development program and a comprehensive package of business assistance programs tailored to the circumstances of the region. Infrastructure projects, primarily in the areas of telecommunication and transportation, are ranked according to their relative potential for creating new jobs. Business assistance

programs include, for example, technology transfer, small business loans, and worker training.

Similar programs can benefit other regions. The question is, which ones?

Regional Development in Eastern Europe

In other Eastern European countries, the need for regional development efforts is even more urgent than in Germany. Because they have fewer internal financial resources, their restructuring process is likely to be slower, and they may have less Western capital available to them. Thus it may be even more imperative for small and medium-sized businesses to develop as quickly as possible, in order to raise the standard of living. Given constrained resources, however, it will be necessary to select a relatively small number of „model“ regions for initial development. Selection of these regions should be based on their ability to realize the greatest positive impact and on the transferability of project results to other regions.

For example, regional development programs could focus on the following areas:

- *The Baltic Sea countries.* Regional development could concentrate on the coastal regions, including the harbor cities Stettin, Gdansk, Riga, Tallinn, and St. Petersburg. Once these coastal regions prosper, growth should spread inland.
- *The regions on the border between the EC and Eastern Europe.* Aid programs should spur cross-border industrial cooperation projects between the German regions of Mecklenburg-Vorpommern, Brandenburg, Sachsen, Thüringen, Bavaria, and neighboring Poland and the C.S.F.R. Models for such cross-border projects include the *maquiladoras* straddling the border between the United States and Mexico, as well as the German-French industrial cooperation projects in Saarland.
- *Russia's many economic regions.* The Republic of Tatarstan, for example, has a large oil industry, comparatively modern military production, and a huge automotive sector. It has the potential to develop into a relatively prosperous region within the Russian economy.

Naturally, the selection of some regions – to the exclusion of others – will present political challenges. Regions that will not immediately benefit from aid programs will likely oppose any uneven distribution of aid. Eastern European governments are acutely aware of this restiveness and would likely favor a policy of dispersing aid evenly. Such a policy would be ill-conceived, however, because without critical masses of resources in certain regions, industrial restructuring programs will not succeed. And with such critical masses of resources, restructuring and renewal can thrive, as illustrated by the experience of the EC.

Islands of Excellence

One of the less well-known developments in the European Community is the emergence of flourishing cross-border regions. Such regional „islands of technological innovation,“ located along an axis from London to Milan, have driven growth in the entire European market. One recent study estimates that 80 percent of all innovation projects in the EC are concentrated in these areas. In the future, a growth axis might stretch east-west as well and include the newly emerging „sunbelt“ regions of southern France and northern Spain, as well as the new industrial regions of Eastern Germany including Thüringen, Saxony and metropolitan Berlin.

From the Eastern European point of view, it is noteworthy that these regions know practically no borders (and their borders will erode even further when the European Common Market comes into effect). More important, they are extremely dynamic. These regions are closely linked economically yet they also compete intensely for investors and government aid.

These regional „centers of excellence“ are spurred both by market forces and by innovation programs sponsored by the EC or its member states. Meanwhile, political pressure has forced the EC to counterbalance the development of these regions by providing various types of funds to less-developed areas. Recognizing these political realities, we do not advocate that all development be restricted to only a few regions, but urge that significant regional development funds be concentrated in a limited number of areas.

Development Aid for Self-Help

Developed countries have recognized the need to support the transformation of Eastern and Central European economies. Yet current aid programs do not reflect either the experience in Eastern Germany or experiences with regional development in Western Europe and elsewhere. Current technical assistance programs are directed at national governments and focus on industry-sector restructuring – solving only part of the problem. Neither the EC aid programs for Eastern Europe nor the planned aid program of the G7 anticipate the problems that a regional approach could address. This omission of the regional component is more than a minor oversight. Policies that „spread a bit everywhere“ will achieve little progress in Eastern Europe. Without such progress, developed countries will feel that their aid has been squandered, which will threaten future aid programs.

The German experience of linking industrial restructuring to regional development can serve as a useful example for Eastern Europe. By improving public infrastructure and establishing regional business support programs, Eastern European governments can foster the growth of small and mid-sized companies so urgently needed throughout Eastern Europe.

We believe that the designation of model regions to be immediately supported by aid programs could accelerate the process of industrial renewal. Such regions would serve as „beta sites“ for other regions, which would subsequently be funded by the Eastern European governments themselves. Industrial renewal through regional development is the best help toward self-help.

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