Public Governance Institutions and Delocalization of Estonian Labor Intensive Industries

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Abstract

The transfer by multinational companies of production from one country to another has become an important issue in different sectors of economy. The impact of policies applied by EU new member states and adjustment mechanisms used by participants in this process are the main problems discussed in this paper. The policies have been applied in different fields like industrial policy, innovation policy, foreign direct investments (FDI), labour relations, support to clusters, support to local companies to improve position in value chain. The role of multinational enterprises (MNE) and their relationships with different level governing institutions is another important factor. The critical areas where economic interests of MNE-s and policy goals of governing institutions meet are the labour market regulations, the FDI related problems, conditions for foreign trade, innovation, taxation and state aid. Subcontracting, outsourcing, off-shoring and offshore outsourcing, value chain and clusters are the specific concepts what describe forms in which organisational and technological capacities have been matched together. One task of current paper has been to clarify those concepts and describe policies and regulations applied in Estonia. The examples used in the paper are from electronics and garment industries.

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1. Introduction

The following paper seeks to cover public governance problems and opportunities related to delocalisation problems of labour incentive industries. The public governance issues are treated at the EU, national, local and sector levels. The main goal of this paper is to summarise the objectives and experiences of policies applied by different agents.

The role of multinational companies and their relationships with different level governing institutions is another important factor. The critical areas where economic interests of MNEs and policy goals of governments meet, are the labor market regulations, FDI related problems, innovation.

The EU membership of Estonia from 2004 brought on the EU level discussion of the issues. The earlier screening and harmonization procedures necessary for the EU membership framed requirements for regulatory tools to deal with these issues. At the same time, the exact content of these tools has been still substantially determined by national governments. The change of position of particular industries in the delocalization process is an important stimulus to work with policy tools.

Estonia has been dominantly a target place for new investments from developed countries. The increasing labor and other costs, however, are changing the situation at least for some industries, which saw outsourcing of important part of production activities to countries with even lower costs. The adjustment mechanisms so give interesting evidence from different aspects of those developments.

The paper covers important concepts describing delocalization process, the impact of industrial policy, labor market relations, FDI. The examples are from electronics and garment industries.

2. Definitions

Governance is generally understood as a broad process affecting the collective decision-making roles and procedures, management and authority relationships of social and economic agents involving multiple jurisdictions and domains. Governance is about governing and therefore cannot be isolated from political responsibility in all areas in which delegated authority makes decisions.

There are several definitions of governance. Daniel Kauffman of the World Bank describes governance as “the exercise of authority through formal and informal traditions and institutions for the common good” (Kaufmann, 2003). UNCTAD refers to “the way in which the main players in the society, governments, business and civil society work together to make the society better” (UNSTAD, 2003). The EU body gives the following definition: “The term governance, in corporate and State contexts, embraces executive bodies, assemblies (e.g. national parliaments) and judicial bodies (e.g. national courts and tribunals). The term governance corresponds to the so-called post-modern form of economic and political organisations (European Union, 2005a)”.

The main tools of governance are institutions creating rules of the game and enforcement means putting those rules to work. The governance is a very important factor in determining the value of human and social capital. The governance is realised on different levels and in different policy areas. In our study, the governance aspects related to delocalisation problems of labour incentive industries are under consideration. Within the framework of our approach it is assumed that different policies at different levels could be supportive to each other or there could be also contradictions and negative side effects of different policies on each other. For
example, innovation activities at regional and national levels could support each other. On the other hand, there are several evidences that innovation policy measures and labour policy measures could produce mixed results and not support each other. One task of the current study is to analyse the problems emerging from parallel application of policy tools targeted at governance at different areas and to propose more useful policy mixes.

3. Internationalisation and governance

Political, economic and technological processes are integrated in the world. The process called globalisation is linking more and more areas, activities and persons into the process of development. Those trends are related to change of values, ideologies, income levels and consumption patterns. For our study, the increasing trade, capital mobility and widespread diffusion of technology are the most influential factors of interdependence of countries, which is the basis for economic side of globalisation. Studies of different problems of internationalisation and globalisation of entrepreneurship have acquired an increasing importance (Bollinger et al., 1993; Commission of..., 2001, 2003a, 2003b; Storey and Tether, 1998; McDougall and Oviatt, 2000; Doing Business ..., 2004; World Development Report 2005..., 2004).

The role of multinational enterprises creating spillover effects between private enterprises located within or outside the national borders is becoming increasingly significant. Alongside with transfers of technology inside large trans-national enterprises (TNE), adaptation to legal framework, to cultural differences are important factors that determine success of internationalisation (Johansson and Vahlne, 1977, 1990; La Porta et al., 1998 and 1999, Djankov et al., 2002; Glaeser and Shleifer, 2002).

Such spatial phenomenon as geographical proximity has been considered important (Krugman, 1991). Agglomeration effects, related to territorial concentration of capital, are influential in determination of internationalisation path (Fujita et al., 1999; Krugman, 1991, 1995). There is a certain role for governments in bringing about agglomeration. Similarity of institutions is considered to be very significant (North 1990, Aoki, 2001). Scholars have emphasised the substantial management costs for a firm when expanding from its home country system to another, less familiar environment. The market entry choices of the internationalising firm reflect a desire to avoid where possible any added complexity and additional costs related to novel institutional environment. One possible way of adaptation is to focus on those countries where legal system is the same as in the firm’s own country. Several authors have described the ways of adaptation to those additional problems.

Oxley (1999) has showed empirically that firms adopt more hierarchical governance modes when the institutional environment weakly protects exchanges. Coeuerdroy and Murray (2005) proved that new technology based firms in service sector enter countries with different legal environment later in their internationalisation process than high technology firms in manufacturing industries. That is because in sectors that are dependent on highly codified and formalised information, for example high-tech hardware manufacturers, limited access to local technical knowledge is likely to influence less the firms’ foreign market entry decisions. Over time, the market acceptance of “best practice” manufacturing system is likely to be universal and not country specific. Conversely, for a service sector firm exploiting more tacit and idiosyncratic forms of knowledge, the locality in which that information is either applied or sourced would influence the value of that knowledge.
This constraint inhibits the inception or scale of internationalisation of service companies.

4. The EU level

4.1. Discussion about the role of EU

The EU represents an intergovernmental organisation with tendencies toward deeper integration in the federal form. In this sense, the EU is different in comparison with regional organisations, which have concentrated their efforts first of all on creation of free trade area without deeper integration efforts in other fields of policy making.

In discussion about the future governance models of the EU, two wide sets of problems have been brought out. The first one is related to overlapping jurisdictions and another concerns a principal choice between dirigisme and rhetoric versus laissez-faire.

In the case of dealing with problems of delocalisation of labour, both sets of problems are important. The overlapping jurisdictions and regulations issues concern the impact of regulations in the field of social protection and labour market issues on the EU level and division of responsibilities between the EU institutions and national

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1 The EU could be treated as a regional intergovernmental organisation. Such organizations are a possible response of nations to the process of globalisation. First, they are a “platform” established to enable an active participation of member states’ economies in the global world. Secondly, they spread out a “safety net” against the threats coming from a turbulent intensification of the international exchange. Other examples are North American Free Trade Area (NAFTA), the objectives of which are elimination of barriers to trade in, and facilitate the cross-border movement of goods and services between the territories of the Parties, promotion of conditions of fair competition in the free trade area, increase substantially investment opportunities in the territories of the parties; provision of adequate and effective protection and enforcement of intellectual property in each Party’s territory, creation of effective procedures for the implementation and application of the Agreement for its joint administration and for the resolution disputes; establishment of a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreements. See, NAFTA (2005); Association of South East Asia Nations (ASEAN) with the objectives: 1) to accelerate economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of Southeast Asian nations; 2) to promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries in the region and adherence to the principles of the United Nations Charter. See, ASEAN (2005).

2 The problem of overlapping jurisdictions is connected to confusion about the allocation of powers between the Commission (the super-national body) and the Council (the quintessential intergovernmental body). Other side of the same problem is related to confusion about the role of EU institutions and national competences. The theoretical literature of federalism provides a clear principle of allocation of responsibilities between national governments of the EU: the latter should engage in those policy areas where economies of scale and externalities are large and heterogeneity of preferences amongst different countries is low. The second problem is the clash between dirigisme and laissez-faire. A dirigist and regulatory approach to the economy, with the heavy emphasis on “coordination” and “plans” has had so far a relatively limited impact, because the powers of EU institutions in many policy areas are still limited. The Constitution has tried to solve the first problem with mixed results. The second problem has to do with the “culture” and vision about the role of government. In this respect the Constitution adds problems…These views should not be taken as saying that the European integration project is intrinsically wrong. On the contrary, there are many benefits from internalising externalities and economies of scale that can be gained with a supernational structure. In fact, those areas where the two problems have been avoided have been a success for Europe…One is the European Central Bank and the common monetary policy… The second example is single market and competition policy. See, Alesina and Perotti (2004).
governments. The role of increasing EU legislation in social areas and national
governments’ choices between economic policy models is one example.³

It is possible to argue that those general problems are important while dealing
with different governance problems of the delocalisation. Those general approaches
biased toward more market based or more intervention based policies determine also
scale and scope of measures applied at the EU level and influence through
harmonisation efforts national policies.

4.2. Documents on governance

The European Commission established its own concept of governance in the White
Paper of European Convergence (COM (2001) 428 final, 25 July 2001) and in the
Council conclusions of May 2002. The White Paper describes how the Union uses the
powers given to it by its citizens. In addition, the Commission has published a number
of communications and strategic documents on the governance theme over recent
years (for example, Communication on EU neighbourhood policies (“Wider Europe”,
COM (2003) 104 final, 11 March 2003) and Communication on human rights in the
Mediterranean region (COM (2003) 294 final, 21 May 2003). In these documents the
term “European governance” refers to the rules, processes and behaviour that affect
the way in which powers are exercised at the European level, particularly as regards
openness, participation, accountability, effectiveness and coherence. These five
“principles of good governance” reinforce those of subsidiarity and proportionality
(European Union, 2005d).

In October 2003, the Commission adopted a Communication on governance
and development (COM (2003) 615), which sets out a new, more pragmatic vision of
countries’ effectiveness in eradicating poverty and promoting sustainable
development in the world.

On the basis of lessons learned from the governance approaches adopted by
the Commission and other donors, and taking account of these views of partner
countries and their own experiences, the Commission Communication aims at
identifying practical ways of governance.⁴

This will be the means by which the Commission will guide the EU’s
approach to governance and development, identify the type of measures to be
supported in different situations, and contribute to the international debate on these
issues. A handbook will help translate this policy approach into practical cooperation.

The debate on European governance, launched by the Commission in its
White Paper of July 2001, concerns all the rules, procedures and practices affecting
how powers are exercised within the European Union. The aim is to adopt new forms
of governance that will bring the Union closer to European citizens, make it more
effective, reinforce democracy in Europe and consolidate the legitimacy of the
institutions.

³ For example, there is documented a large increase of EU legislation in areas such as welfare and
citizen protection that are quite far from the original mandate of EU institutions. See, Berglöf, et al.
(2003).

⁴ The principles of governance are related to following targets: building capacity for governance and
increasing partner countries’ input into formulation of the relevant reform programmes; ensuring
synergy and consistency between the various Commission and EU instruments and policies;
reinforcing development partnerships on a regional basis with a view to achieving coordination
between donors’ priorities and partner countries’ agendas by way of policy dialogue, as well as
complementarity between fund providers; contribution to protection of human rights and spreading
democracy, good governance and the rule of law. See, European Union (2005d).
4.3. Innovation and the Lisbon Agenda

Functioning interface between various partners in the innovation system has been given high priority in the EU already during the 1990s. With the adoption of the Lisbon Agenda in 2000, the European Union established for itself the ambitious goal of becoming the most dynamic and competitive economy in the world by 2010. The starting observation of the Lisbon Strategy was that the existing EU arrangements are not the globally most competitive ones. The need to de-emphasize traditional redistribution, the urgency to lessen the role of funding for primary branches, the need to roll back welfare reducing protectionism in favour of information and communications technology development, flexibility and innovation has been very real. Specific attention was given to interface between firms and research institutions and dissemination of new knowledge into the business sector.

This ambitious commitment was further broadened in subsequent European Summits, where leaders undertook to achieve additional objectives in the economic, social and environmental spheres. The European Council eventually adopted a set of 14 quantitative targets that summarise different commitments.

Because many of these policy areas are the prerogatives of member states, the Lisbon Strategy is based on the “open method of coordination”. That framework avoids the traditional centralisation of policy formulation and relies instead on the peer review of progress made by individual member states.

Despite initial optimism, the first half of the decade has been dispiriting and targets established under the Lisbon strategy will be difficult to achieve. This is best illustrated by the commissioning of former Dutch Premier Wim Kok in the Brussels Council in April 2004 to conduct a study on the causes for lack of progress. The High Level Group chaired by Wim Kok came on the following conclusion: “Too many targets will be seriously missed. Europe has lost ground to both the US and Asia and its societies are under strain” (Kok, 2004). Governments have failed to implement the policies required to achieve these targets and therefore, without radical changes, the strategy will fail to deliver its promises.

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5 The Lisbon Agenda contains a self-critical assessment of the global position of the EU and calls for structural reforms and investment into human capital and information and communications technology to revert existing trend, in the ten framework of a ten-year-program. See, Commission of the European Communities (2000).

6 The 14 basic structural indicators are the following: GDP per capita, labour productivity, aggregate employment rate, employment rate of older workers, education achievement, expenditure on research and development, business investment, comparative price levels, at-risk-poverty rate, long-term unemployment, dispersion of regional employment rates, greenhouse gas emission, energy intensity of the economy and volume of transportation. See, European Union (2005f).

7 The EU (former) Commissioner for Enterprise and Information Society Erkki Liikanen said, that Europe’s industry is in confrontation with challenges that reflect partly technological shocks and partly the advancing process of globalisation. At least three factors have contributed to uncertainty: 1) the technological revolution associated with development of ICT technologies and concomitant enterprise re-organisation; 2) the on-going process of trade and capital account liberalisation has reduced barriers in international trade and investment and has expanded possibilities for locating production in areas different from the market where a product is sold as well as opportunities to act pre-emptively and position oneself in growing markets to exploit first-comer advantages; 3) international and domestic competition has intensified, leading to various adjustments and economic strategies on the part of enterprises to cope with a changing business environment. The challenge of competitiveness the EU is currently facing is, according to him, twofold: 1) for advanced nations, a challenge is determined by relative innovation and productivity performance; 2) for developing nations and for the new Member...
Realisation of targets of Lisbon Agenda depends substantially from efforts of the EU member states and there are only limited tools to enforce governments fulfil respective criteria. The realisation of those targets, on the other hand, has important impact on global competitiveness of the European economic space.  

4.4. Industrial policy

The general principles of EU industrial policy date from the Communication “Industrial policy in an open and competitive environment: guidelines for a community approach” of October 1990 (Commission of the European Communities, 1990). Its instruments, which are initiatives, exploit their ideas and build on their opportunities. Three key factors of industrial competitiveness deserve particular attention: knowledge, innovation and entrepreneurship.

In December 2002, the Commission published its Communication on “Industrial policy in an enlarged Europe” to launch the debate on industrial policy (Commission of the European Communities, 2002). In order to address current fears about de-industrialisation, the European Council in October 2003 asked the Commission to assess the situation and to present solutions to counteract this trend in order to revive Lisbon strategy of making the EU the most competitive economy in the world by 2010.

Industry leaders and politicians have voiced their fears about the EU’s manufacturing base moving out of Europe to benefit from cheaper labour, lower social costs and more flexible regulation in the East. The Commission on 20 April 2004 published new Communication “Fostering Structural Change: an Industrial Policy for an Enlarged Europe”, which examines the competitiveness of European industry, assesses the existence and scale of the risk of de-industrialisation and proposes specific solutions (Commission of the European Communities, 2004).

The Commission recognises that the EU is facing a process of structural change at various levels, but points that “the ongoing process of resource allocation from manufacturing industry to service should not be confused with a process of de-industrialisation. In order to support the process of structural change in the EU, the Commission has outlined a set of specific measures, which cover regulatory framework, community policy and combines sector level policies”.  

States, the challenge is based on relatively low cost and standardised technology that makes possible product imitation. See, Liikanen (2004).

This disappointment with the progress made so far needs to be put in the historical context of the Lisbon Council Meeting. When EU leaders met in Lisbon, in March 2000, the European economy was at the top of its business cycle and stock markets were at their highest points. In this environment, it was easy to become excessively optimistic. An important contribution of the Lisbon Strategy is that it encourages European leaders to agree a common economic framework. This would be helpful in an environment where national differences are important and where cultural values and social choices differ. By establishing quantitative benchmarks against which progress can be monitored, the Strategy provides a transparent method of fostering a dialogue with all interested parties.

Regulatory framework arguments support an idea that burdens on industry must be reduced to the bare minimum of what is strictly necessary to achieve objectives of regulation and a balance must be struck between industrial competitiveness and the need for regulation. Community policies arguments stress, that synergies must be better exploited to improve the policies’ impact on industrial competitiveness. The focus should be on developing a knowledge-based economy and strengthening cohesion in an enlarged EU. Combination of policies at sector level means that the EU must continue to develop the sector dimension of industrial policy while ensuring that its sector policies are strengthening industrial competitiveness. See, Commission of the European Communities (2004).
The Commission will continue to examine the competitiveness of specific sectors each year and launch initiatives as necessary. For 2004 and 2005, initiatives are planned for the following activities: 1) an initiative in the mechanical engineering sector; 2) an analysis of the eco-industries sector with a view to taking certain measures; 3) the creation of a high-level group in the automobile sector; 4) study of the non-ferrous metals and the IT sector (Commission of the European Communities, 2004).

Most of the industrial policies are not carried out at EU level, but under the competence of the Member States. The open method of co-ordination, set up by the Lisbon European Council, offers a context in which national policy performance can be discussed, developed and improved.

One important question related to delocalisation issues is whether the European countries should implement policy measures to fight de-industrialisation, i.e. the decline of production industries both as a share of total output and in terms of employment levels? Mathieu and Sterdyniak described three possible general approaches to that issue: 1) de-industrialisation is a natural phenomenon and should not be opposed; 2) policy means should be targeted to important structural supply side issues like R&D, education and factors related to general competitiveness of economic environment like tax policy, burden related to welfare state; 3) the traditional view that specific support should be implemented in favour of unskilled labour, because their loss of jobs and increase of unemployment for that reason should not be tolerated (Mathieu and Sterdyniak, 2005).

Every approach requires different policies and roles of public governance agencies. Seemingly the process needs state intervention, but bias toward one or another approach would be determined by future developments and depends on industrial structure and development level of particular country. To find out interrelationships between policy bias and required public governance structures to realise it, is one task of the current research.

The Commission estimates that EU enlargement presents unique opportunities to European business. Value chains can be reorganised across the continent to benefit from the current competitive advantages of the new Member States. This may enable companies to keep production within the EU that would otherwise have been transferred to Asia, and maintain their competitiveness.

Experts are divided over the impact of de-industrialisation on European competitiveness and employment. While many, including the employer organisation UNICE, underline the fact that the trend destroys jobs and value creation in Europe, others consider de-industrialisation a necessary evil to maintain the competitiveness of the EU’s industrial base. Through outsourcing, goes the argument, companies will be able to keep costs down and thus boost growth, which will ultimately benefit and stabilise its European operations (UNICE, 2003, 2004).

Other economists argue that Europe’s future is not so much threatened by de-industrialisation as by other aspects of delocalisation, including the migration of R&D activities to US, particularly in the high technology, research-intensive sectors as pharmaceuticals or biotechnology (Fontagne, 2005).

There are three critical questions for research and design of governance tools: 1) Should manufacturers be encouraged not to delocalise? 2) Should there be massive investment in research and development in an effort to maintain a technological edge
and what are conditions for that? 3) Is it possible that delocalisation creates massive unemployment and social problems at that critical level that forces the EU to restore barriers to protect European industry? The evidences from industries give some possible answers to those questions.

4.5. Taxes

The EU does not have a common policy for taxation as it has common policy for trade, competition, and agriculture. Its policy is one of co-ordination and harmonisation (or approximation) of national tax policies as much as necessary for the functioning of the internal market.

Tax harmonisation can be defined as a process of adjusting tax systems of different jurisdictions in order to achieve a common policy objective. Narrowly defined, tax harmonisation implies convergence towards a more uniform effective tax burden across EU Member States (Kopits, 1992). It can occur as a result of action at EU level by Member States, the Commission or other EU institutions (as the European Court of Justice, hereafter referred to as the ECJ or as the Court).

Harmonisation does not mean unification: differences in national law may persist if they do not violate EU law. Tax co-ordination is a wider term, which includes any policy action or measures undertaken to achieve an objective shared by a group of countries (Tanzi, 1989). The aim of tax co-ordination is to influence the tax practices of the Member States. Tax co-ordination might take the form of tax treaties between Member States, international agreements or legislative acts of the EU (Commission of the European Communities, 1992).

The countries co-ordinate tax policies to achieve higher level of neutrality for investment decisions, which in turn contributes to more efficient allocation of resources. Although the harmonisation of tax burdens can also take place as a result of the interplay of market forces, it is often argued that government action in the form of tax policy co-ordination is necessary. By co-ordinating their tax policies states intend to achieve that the resources would be allocated according to their comparative economic advantage not according to the tax differentials. Harmonisation of the definition of tax base, which contributes to transparency of economic decision-making, can improve efficiency of resource allocation (Kopits, 1992, p. 3.).

Furthermore, it is argued that with a centrally coordinated tax harmonisation, rather than one enforced by the competition of tax systems, Europe would not have to give up its social welfare achievements and current levels of redistribution.10

The gradual reduction of market barriers has considerably increased mobility of factors, particularly mobility of capital. Portfolios have become more international, the number of cross-border mergers as well as foreign direct investment has increased. As a result of liberalisation, globalisation and integration of the markets, the international spill-over effects of national tax policies have increased. Because capital can move more easily from one jurisdiction to another, the differences in tax policies can have an important impact on investment flows.

In the field of corporate taxation, differences in tax laws can cause double taxation or non-taxation of the cross-border income flows. Tax co-ordination can contribute to the elimination of double taxation or non-taxation. One important form of bilateral tax co-ordination is a double taxation agreement between the states. It is argued that co-ordination of the methods of providing relief for double taxation of

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income from cross-border investments decreases the tax barriers for cross-border investments and thus contributes to efficient allocation of resources and economic growth.

Most important taxes in the context of EU integration are the customs duties, the VAT, excise taxes, capital duties, and corporate taxes. Fiscal harmonisation began in the field of indirect taxes. Discriminatory customs duties and other taxes imposed on goods and services are considered the most important impediments to the free movement of goods and services in the EU market. To date, the major steps toward harmonisation have been achieved in the field of indirect taxation, most importantly, the abolition of customs duties, the introduction of the Community Customs Code and common VAT system as well as the harmonisation of the most important excise duties. The harmonisation of indirect taxes has been far more advanced than the harmonisation of direct taxes so that the room for further harmonisation in the former area is much smaller than in the field of direct taxation.

Taxation policy has a vital role to play in the European Union strategy. The 10 new EU members, most of which are from Eastern and Central Europe, have an average corporate tax rate of about two-thirds of the other 15 EU members. These relatively low levels are contributing to the delocalisation of industries and jobs from Western Europe to Eastern Europe. New members think low taxes are necessary for promotion of their economies so they can catch up with the West. Their model is Ireland, which for decades has aggressively employed tax incentives (Forbes, 2004).

Commission has established as one of its priorities in the tax field the creation of a common consolidated corporate taxation base in the European Union. But a common company tax base in the EU would not mean a common corporate tax rate. Commissioner Kovacs said in his speech: “I believe that tax competition is not bad by definition and I support a degree of tax competition between Member States to the extent that it forces governments to produce value for money” (Commission of the European Communities, 2005).

The governance delocalisation of labour intensive industries through tax policy is possible but can be considered still as a tool applied at national level. The discussion between supporters of tax harmonisation and tax competition approaches is one important factor what will determinate future development of taxation level and structure\textsuperscript{11}.

4.6. State aid provisions

The EC Treaty prohibits State aid to undertakings (Articles 87-88), including fiscal support measures unless they qualify for one of the derogations from the general principle of incompatibility laid down in Article 87(1). Specific national tax measures possibly constituting state aid have to be notified to the Commission prior to their implementation. If the Commission prohibits the fiscal support measure but the Member State does not abide or if it has implemented a measure without prior notification, the Commission may take that State to the European Court of Justice. The question of whether a tax measure is restricting free movement within the internal market is a critical criterion.\textsuperscript{12} An advantageous tax provision is the State aid if it is limited to certain geographical regions, or to certain sectors of economic activity.\textsuperscript{13}

\textsuperscript{12} See, Schön (1999, p. 925).
The Commission may decide that the Member State must amend or abolish aid what the Commission finds to be incompatible with the common market. Where aid has already been implemented in breach of these rules, the Member State must in principle recover, from the recipient, the aid illegally granted (with interest), irrespective of national time limits or other national legal impediments to recovery. Definition of state aid procedures is important in determination the possible state aid size and tools.

5. National level

The state’s role in governing structural industrial problems such as delocalization, has been widely discussed in economic literature. In the 1950s and 1960s, aid programs and academic advisors propagated the idea of state bureaucracy as the lead agent for the transition to what was then known as modernization (Stone, 1965). Aid agencies favored large-scale projects of industrial development, which, in their turn, required the guarantee of government involvement (Esman 1988). The state-led development was not only imitative but also built on a response to local circumstances. The case was made in re-structuring the economy towards “inward directed” industrial development on the basis of import substitution (Todaro 1994). Until the mid-1980s, the role of the state expanded, in advanced countries faster than among developing countries. The statist model became subject to criticism. As Batley and Larbi defined, until the full force of the neo-liberalism perspective arose in the 1980s, this was not a matter of ideological opposition to the extension of the state as such. It was rather a question whether the states and public administrations of developing countries were structurally (not just technically) capable as the agent of development (Batley and Larbi 2004: 3).

The immediate roots of the neo-liberal revival lie in the economic crises that followed the rise in oil prices in the early 1970s. Many countries were slow to adjust to the new economic order and got themselves into deep difficulties of debt and inflation. They had to resort to the IMF and the World Bank loans, which were linked to certain conditions, the reduction of the role and scale of the public sector. That was accompanied by spread of new liberal view with a deeper skepticism about the capacity of state administration to play a developmental role under any circumstances. That approach was quite important also in transition countries where creation of market economy started in the beginning of 1990s. Partly in response to the experience of liberalization during the 1990s, partly due to impact of Association

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13 Even very broadly defined sectors may be caught by the State aid prohibition: the Commission decided that a 10 per cent tax rate (at variance with the general tax rate of 32 per cent) for the whole of the Irish manufacturing sector constitutes State aid because it excludes traders and services and favours export-oriented undertakings. See, Case E-2/98, 'Proposal for appropriate measures under Article 93(1) (i.e. now Article 88(1)) of the EC Treaty concerning Irish Corporation Tax (ICT)', in OJ C395 of 18 December 1998, p. 19.

14 The only justifications that the ECJ accepts for not recovering illegally granted aid are (1) absolute impossibility to recover the aid; (2) if from Community action the recipient may reasonably infer that everything is in order (justified expectations). See also Terra and Wattel (2001, pp. 197-198).

15 Batley and Larbi mention that the United Kingdom experienced the first structural adjustment program when in 1976 it negotiated a loan from the IMF. In return it had to accept public expenditure cuts, divestiture of public enterprises, a floating exchange rate and restraints on money supply. These became the principal elements of the structural adjustment programs that were later applied globally. See, Batley and Larbi (2004: 5).

16 In transition economies like Estonia, there was a very limited expertise in market economy for a number of spheres of economic policy early in the 1990s. The role of international organisations was for that reason extremely important in formulating principles of legislation, regulations and in making general economic policy choices. Their representatives often preferred solutions that were not influenced by local lobbies but based on market solutions.
Agreements and integration with the EU, the institutional side of reforms started to be more important. The goals of reforms were extended from freeing market forces and making economies efficient to addressing problems related to institutions like clear property rights, the rule of law, financial systems, accountability of government, effective and efficient public administration (Kohsaka 2004; Rodrik 2004).

In general approach to government roles, we can use division to indirect and direct roles described in economic literature. The indirect roles concern policy and rule making, enforcing and upholding law, maintaining competitive conditions, providing information. The direct roles are related to managing and provision of service delivery through different government agencies (Batley and Larbi 2004: 17).

5.1. Employment

There is a large number of economic literature on labor market problems of the EU (Blanchard 2004; Boeri 2000; Boeri and Terrell 2002; Svejnar 2004). Blanchard presents the made-up quote that is a fair presentation of the opinion of many experts and many organizations and states over-regulation of the labor market.17 In our approach we will concentrate on worker−firm relations and will not treat wider set of aspects related to other labor market issues.

Governments intervene in worker-firm relations on three main fronts: they intervene in the wage-setting process, they regulate working conditions and they control firing and hiring of workers. The government commonly regulates work hours and the cost of overtime; mandates vacations, holidays and sick leave; sets minimum wages; restricts child and forced labor; ensures non-discrimination; provides unemployment, disability and retirement income insurance, and in many countries health insurance, and sets and conditions for hiring and firing, unionization and collective bargaining (“European Union” 2005b; OECD 2003; World Bank 2004)

These interventions are theoretically justified by the ability of pure market conditions to deliver efficient and equitable outcome. At the same time, the government interventions need to strike a balance between several interests. There are tensions not only between the interests of firms and workers. Workers in the informal economy and the unemployed can have very different interests from those currently employed in the formal economy. There could be very special interests of particular lobby groups.

The World Bank study shows that from an investment climate perspective, labor regulations can be a major or severe constraint on firm operations in many developing countries. Regulations can reduce incentives to make new investments, adjust the organization of work to take advantage of new technologies or opportunities, or hire more workers. Some curtailment of those incentives can be justified by social goals beyond those reflected in the core labor standards including, for example, the promotion of workplace safety. But ill-conceived approaches can exacerbate poverty by contributing to unemployment and swelling the size of informal and unprotected economy…. Governments need to confront these difficult and often sensitive tradeoffs (World Bank 2004: 141-142).

Increased economic integration and free movement of labor has a strong impact on domestic labor markets. In the case of Estonia, highly skilled and reasonably

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17 Western Europe suffers from too many labor market rigidities, from excessively generous unemployment insurance, high employment protection, and high minimum wages. It is essential that countries putting in place new institutions do not make the same mistakes. See, Blanchard (2004: 129). However, Blanchard himself is more sceptical, saying that labor markets are far from textbook competitive markets and do not function well without proper institutions. And these institutions came into being in response to clear market failures…That… does not imply that the institutions we have today are optimal in any sense. …Still, it is clear that simple slogans will not do. Economists owe countries in transition clear analysis of what institutions are needed today, how they should be designed and how existing institutions should be reformed (Cit.op.).
priced labor has been one of the cornerstones of rapid economic growth. The relatively flexible labor market contributed positively to changes in the structure of economy. During last couple of years and especially after joining the EU in May 2004, migration became a significant economic and social policy issue in Estonia. One of the main incentives for migration is the existence of an income gap between the home country and destination countries, first of all Scandinavian countries, but also Ireland and United Kingdom. The latter two are the EU countries not applying a transition period for labor market opening for the other EU members.

Many investors in Estonia are still interested in the maintenance of low technology, cheap labor requiring jobs and even creating of the new ones. At the same time, many low-paid workers move away from Estonia to earn much higher wages for analogous work in other EU states where also working conditions are better. That has an impact on wage setting in Estonia and creates increasing problems for labor-intensive industries in Estonia. The hardest hit are subcontracting enterprises like wearing apparel, where proportion of labor costs in total costs is up to 80%.

Emigration of labor force launches a chain reaction in the labor market. The jobs of those who left for abroad are filled with workers lured over from other enterprises or with unemployed. When skilled people leave it is necessary to train new people to replace them. This leads to a rise in qualification of employees and reduction in unemployment. Age discrimination will decrease and employment of handicapped people will increase.

International competition from low wage countries makes it impossible to substantially increase wages, which creates problems with finding workers. In Estonia, it has been possible to find low skilled and badly disciplined labor force from peripheral regions and attract them to industrial towns. Such kind of activities, however, would even more aggravate social and regional problems.

Another option is immigration from the third countries that would make it possible to keep the present economic structure and prevent overall socio-economic deterioration. That depends to a large extent on the national policy that has been restrictive until now regarding inflow of foreign labor.

The overall labor market policy on government level is a duty of the Ministry of Social Affairs. The main institutions dealing with conflict resolution are the industrial dispute commissions, the public conciliator as well as local conciliators, and courts. In general, the industrial relations are mainly regulated through minimum standards set at the state level (minimum wage, unemployment benefits, the minimum subsistence level), partially through social dialogue on national level and through individual contracts or enterprise level contracts. The social dialog is realized through tripartite negotiations, where the parts are the government, representatives of employers and employees.

The flexibility of labor markets is closely linked to the trade unions and rules and habits of negotiations concerning labor market regulations.

5.2. Trade unions

Trade unions have played an important role in labor relationships in Europe. The main play filed has been on nation level. Union coverage started to be lower in service economies in comparison with industry dominated economies. Trade unions in the former Soviet bloc countries have changed from institutions of Communist party controlled and distributors of fringe benefits to becoming representatives of workers’ economic interests (Svejnar 2004).

18 Flexibility of labor markets is divided into macro and micro level flexibility. On macro level, institutional and wage setting flexibility are the forms of it. On micro level, flexibility is related to job flows, job creation and destruction. See Blanchard and Jimeno (1995), Layard et al. (1991).
There are powerful organizations on the EU level. The European Trade Union Confederation (ETUC) has called for the activities underpinning competition. Without that, market forces will lead to firms competing on the basis of low quality, low prices and bad and low-paid jobs, says ETUC, blaming industry for using existing problems as an excuse for pushing through a deregulation and the liberalization agenda. ETUC has also called for more emphasis on social protection and sustainable development (ETUC 2005).

Trade unions in EU-15 countries have been worried about the generally low position of trade unions in the new EU countries. The active support and involvement of the ETUC in those countries have been seen as the main task. There are areas like collective contracts, firing conditions and minimal wage where trade unions’ role should be compared in different countries.

There are two national trade union confederations in Estonia. The Confederation of Estonian Trade Unions (EAKL) is the largest organization for blue-collar workers, comprising 23 branches and approximately 50,000 members. The Estonian Employees’ Unions’ Confederation (TALO) is the organization of trade unions of white-collar workers, first of all civil servants in public educational sector. It is estimated that approximately 15% of the labor force belonged to trade unions in Estonia (Eamets and Kallaste 2005).

The low level of membership is accompanied by a low level of collective bargaining coverage. This indicates that there is no higher level binding collective bargaining than the enterprise level (with the exception of transport and health sectors with branch level agreements).

Regarding impact on delocalization issues, the evidences from other countries confirm that possibility to switch the location of production reduces the bargaining power of unions. The possibility of labor migration at the same time increases bargaining power of unions (Calmfors 1993). In Estonia, examples of possible effects have been demonstrated by an earlier study: in health care sector unions have gained additional strength by the possibility for medical personal to move abroad; in the textile sector the unions have lower bargaining power due to the possible relocation of industry (Eamets and Kallaste 2005).

As it is possible to see from those examples there are in force factors supporting and weakening effects of trade union activities. Nevertheless, it is possible to see several additional tasks for trade unions playing bigger role in negotiations, consultation and representation of members in legal issues, also on international level.

5.3. FDI

Delocalization with capital contributions, i.e. creation of a subsidiary company or fusion-acquisition is very important. The company acquires a factory in other state and that factory starts to produce whole or part of its production. The delocalization with capital contributions is the riskiest by far.

Over the past decade, the FDI intensity (defined as the sum of outward and inward FDI positions over GDP) has increased significantly in the European Union. Most of the global FDI takes the form of ownership changes in existing enterprises (mergers and acquisitions, privatization), with so-called “green-field” investments playing only a minor role.

Attracting FDI has become a central component of industrial policy in developed and developing countries. Image, brand awareness, and perceptions are major factors influencing the location of FDI. Companies make investment location decisions on the basis of their information pool and understanding of an area’s location “offer”. Investment promotion is therefore an essential component of
attracting investment. There has been a rapid growth in the number of investment promotion agencies (IPA-s) across the world.

It is not enough for individual countries to simply engage in a race to attract foreign investors. Some form of “institutionalized confrontation” between host Governments, supranational Organizations and representatives from the MNEs should be developed.

Investment promotion can be divided into the following areas: 1) strategy and organization (includes setting the national policy context, objectives, structure of investment promotion, competitive positioning, sector targeting strategy); 2) lead activities (marketing; company targeting); 3) facilitation (project handling); 4) investment services (after-care and product improvement; monitoring and evaluation)\(^\text{19}\).

An investment promotion strategy involves the organized use of a range of promotional activities to enhance the capacity of a country to absorb FDI and thereby to increase level of investment and intensify linkages in a country. Most of the strategies use four different but interrelated sets of activities with varied emphasis depending on changing conditions: 1) activities to service existing, prospective and new investors (involves pre-approval services, approval services and post-approval services to existing, prospective and new investors. The key issue in investor servicing is policy effectiveness in reducing uncertainty for the investor); 2) procedures aimed at identifying and removing administrative obstacles and managerial impediments to the FDI; 3) campaigns to enhance the image of a country (comprises effective communication about the location); 4) actions to generate and increase flow of investor’s projects (involves broad- or narrow-cast targeting as well as direct marketing to individual investors)\(^\text{20}\).

The importance attached to each of these activities varies by country and over time, but at any given time most of the strategies include elements of all four activities. An investment promotion strategy should combine these techniques in innovative ways that suit the economic and industrial development requirements and the resources of an individual country.

Incentives can and do affect investment location decisions. However, the emphasis on incentives varies considerably. Options include national, regional, or local grants, tax credits, research and development and other special purpose incentives, employment incentives, recruitment and training assistance and site or infrastructure improvements. Incentives can be up-front, or dependent on continuous upgrading of the investment project. Many IPAs use their governmental network of overseas foreign offices for overseas promotion. There is also increasing cooperation between agencies.

The general supportive macroeconomic framework with relatively modest tax burden and development of institutions typical for market economies have been a major supportive argument for the FDI in Estonia. Closeness to Scandinavia, and not only in geographical terms, played also a certain role. Afterwards the EU integration and membership achieved in 2004 gave evidences about increasing maturity of market economy institutions. There were no special treatment of foreign companies since 1994, national treatment of all investors were a significant supportive factor.

5.4. Innovation

\(^{\text{19}}\) See, Christodoulou (1996), Dicken (1990), Loewendahl (2001), Young et al. (1994).
Innovation development is related to institutions and financial incentives to promote technology transfer. Innovation policy is widening to include support for new firm start-ups, university spin-offs, science and technology incubators and parks and promotion of an innovative, entrepreneurial culture.

Comparative studies on innovation policy recognized that it is not easy to define who is responsible for innovation policy. In many cases, governments attribute innovation to the ministry with responsibility for economic affairs or industry. However, even where there are specific departments of ministries with a remit for innovation and technology policy, they do not play a role in co-coordinating innovation policy matters across ministries. Funding of industrial R&D and innovation is delivered on a sectoral basis (ministries of economic affairs, education, health, transport, regional development etc). The existence of government policy documents or even funding agencies and programs do not guarantee either the availability of government funding for innovation policy initiatives or the effective disbursement of funds ("Innovation policy issues in six candidate countries" 2001:13-16).

Other part of the issue is that comparative research across the countries has extensively reported that a very big proportion of innovations have been made by MNEs and there are important and persistent differences between foreign subsidiaries and domestic firms (Dunning 1993). On those circumstances, it is important to investigate how innovation activities and tools are combined with innovation taking place in MNEs and how much those big companies use research organizations in home countries.21

There is a linkage between FDI, innovation taking place in firms with foreign capital, and employment.

5.5. Subcontracting, outsourcing, off-shoring and offshore outsourcing

Delocalization without capital contributions by means of subcontracting is the most widespread form. Subcontracting is defined as the manufacture of goods by one firm (the subcontractor) to another (the lead firm) based on the specification of the latter. Often there can be several layers of firms or intermediaries mediating the relationship between the actual production workers and the end product market. The lead firms normally exercise considerable control over their subcontractors in terms of price, quality and timing of the products they supply.

According to UNCTAD, subcontracting is yet another form of investment, although a non-equity one: “Foreign direct investors may also obtain an effective voice in the management of another business entity through means other than acquiring an equity stake. These are non-equity forms of investment, and they include, inter alia, subcontracting, management contracts, turnkey arrangements, franchising, licensing and product-sharing” (UNCTAD 2004: 346).

Outsourcing is the delegation of tasks or jobs from internal production to an external entity (such as subcontractor). Most recently, it has come to mean the elimination of native staff to staff overseas where salaries are markedly lower. This is despite the fact that the majority of outsourcing that occurs today still occurs within the country boundaries.

Off-shoring can be defined as relocation of business processes (including production/manufacturing) to a lower cost location, usually overseas. Offshore outsourcing is the practice of hiring an external organization to perform some or all business functions in a country other than the one where the product will be sold or consumed.

21 Study on Belgium shows that if there is a competitive and internationally recognized academic community, MNEs finance a big part of research in academic institutions. See, De Backer and Sleuwaegen (2004).
Governance of delocalization of labor intensive industries through subcontracting, offshoring and outsourcing is a possible supply chain management (SCM). This is the management of upstream and downstream relationships with suppliers and customers to deliver superior customer value at less cost to the supply chain as a whole.

5.6. Value chain

To better understand the activities through which a firm develops a competitive advantage, it is useful to separate the business system into a series of value-generating activities referred to as the value chain (Porter 1990). The primary value chain activities are: inbound logistics, operations, outbound logistics, marketing & sales and service. The primary activities are supported by the infrastructure of the firm, human resource management, technology development and procurement.

Position in the value change has a major impact on company’s profits. Markets are very competitive concerning the low part of value chain. There are less competition and higher profits in upper side of the value chain. Very questionable is the existence of direct tools that support company’s moving up along the value chain. We argue here for indirect measures related to business environment, human capital development etc.

5.7. Clusters

There is a wide set of theoretical literature on basics of clusters (Humphrey and Schmitz 2002; Porter 1990, 1998, 2000; Roelandt and Hertog 1999). Clusters could be treated as a national phenomenon or as a regional feature. The size of the country is one important factor that determines the role of cluster. In big countries like UK or Poland, clusters are more regional features. In small countries they could be a national phenomenon. In tiny countries like Estonia, the cluster approach works if the country as a whole is considered to be a part of some larger territorial unit like Scandinavia.

A large number of measures may fall under the heading of cluster policy. Among the various approaches are (Andersson et al. 2004): 1) broker policies aimed at strengthening the framework for dialogue and cooperation by various relevant stakeholders involved in clusters, and not favoring individual players; 2) demand side policies should seek to increase openness to new ideas and innovative solutions; 3) training policies that may be targeted at upgrading skills and competencies which are essential for effective clustering of SMEs; 4) promotion of international linkages that should be designed with a view to enhancing the interplay between foreign and domestic actors; 5) framework policies that should put in place an over-riding playing field marked by effective and consistent rules for inter-actor transactions.

Cluster policies have likewise become widespread since the early 1990s. The national approaches to cluster policy are very diverse in nature, as the policies are embedded in different business environments, cultural and institutional framework, as well as different governance systems. Some countries have a distinct cluster policy that aims to support national and regional clusters in different ways (Belgium, Denmark, France, Netherlands, Portugal, Luxemburg, UK). A national cluster program has also been launched very recently in Sweden. Other countries have specific regional cluster instruments. In these cases, the promotion of clustering is used as an element of innovation and regional policies (Austria, Finland, Spain, Germany, Italy, Norway). Still other countries (Liechtenstein, Ireland) have neither a national cluster policy nor specific cluster instruments. Roelandt, den Hertog (1999)

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22 On value chains in different industries, see Fujita et al. 1999; Gereffi 1995, 1999; Gereffi et al. 2003.
and Andersson et al. (2004) provide an overview of certain kinds of failures and policy responses in general across countries.23

Estonia’s economy is too small to create own clusters. At the same time, deep integration with Scandinavian economies brought together also integration into Scandinavian clusters, first of all in electronics industry but to a smaller extent also in garment industry. Developments in these industries are discussed afterwards in the current paper.

6. Local (regional) level

The traditional location policy addressed three issues: real estate is made available and infrastructure is improved; attraction of external investors is an important issue and facilitation of communication between the business community and public sector is considered valuable for creation of support to policy decisions.

As competition between potential locations became more intense, local actors started to pursue a more ambitious approach, which included at least one of the following elements: 1) the creation of roundtables, partnerships (including public-private partnerships) or alliances for local economic development in order to formulate and implement a strategy to improve the locational advantage or revitalize old locations; 2) the implementation of cluster initiatives; 3) the creation of dedicated local economic development agencies to coordinate and organize local level efforts (OECD 2001; Wallis 1996).

Specific regional policies to encourage investment in particular parts of a country form a major element of the national policy framework in many countries. While MNEs usually long-list countries rather than regions, it is at the sub-national level that MNEs draw up a short list of investment locations for in-depth evaluation and the policies and facilitation of regional agencies often play a critical role in determining who wins a mobile investment project.

A regional cluster policy can be by definition a policy aimed to sustain existing clusters or to support the growth of starting up clusters. The cluster approach should allow the regional system to move from more traditional policies based on infrastructure building and technological support to a more comprehensive policy trying to improve the environment in which firms and local actors operate. The keyword for such cluster policies is the improvement of regional competitiveness.

The policy also emphasizes the link of firms to the (regional) technological infrastructure of higher education and R&D institutions in which knowledge irrigates the regional economy. The policy in particular tries to bring new technology to regional networks of SMEs. More cooperation may demand attempts to change attitudes in both the technological infrastructure and in firms. Thus, regionally located higher education, research institutions and technology transfer infrastructure should

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23 There is a long experience of implementing different policy methods in countries. So, for inefficient functioning of markets, policy response has been competition policy and regulatory reform (in many countries). In the case of information failures, policy response has been technology foresight (Netherlands, Sweden), strategic market information and strategic cluster studies (Denmark, Finland, Netherlands). In the case of limited interaction between actors in innovation systems, policy response has been broker and networking agencies and schemes (Denmark, Netherlands), provision of platforms for constructive dialogue (Austria, Denmark, Finland, Germany, Netherlands, Sweden, United Kingdom), facilitation of cooperation in networks (Belgium, Finland, Netherlands, United Kingdom). Institutional mismatches between (public) knowledge infrastructure and market needs has been responded by joint industry-research centers of excellence (Belgium, Denmark, Finland, Netherlands, Spain, Sweden), with facilitation of joint industry-research cooperation (Finland, Spain, Sweden), human capital development (Denmark, Sweden), with technology transfer programs (Spain). Missing demanding customer was substituted by public procurement policy (Austria, Netherlands, Sweden, Denmark). Government failure has been addressed with privatization (most countries), horizontal policy making (Denmark, Finland), public consultancy (Netherlands), reduction of government interference (United Kingdom).
develop their competence and services to be more appropriate for local firms, and SMEs in particular should learn to use R&D when innovating.

Although the approach and phrasing differ, the national policies share a number of key objectives and characteristics. The cluster policy (and to some extent also cluster instruments) deals with broader issues as it is seen as a mean to promote economic development and structural changes, often through enhancing (regional) innovation capacity. The policy often stresses the need to be globally competitive in the “new economy”. The policy is based on improved business cooperation and networking, which may demand the stimulation of social processes (European Union 2005c).

Imbroscio and Williamson (2003) propose local policy responses to globalization. With ownership and control held in a more collective or community-oriented fashion, such enterprises tend to anchor or root investment more securely in communities, providing a counterforce to globalization. Six models are: 1) community-owned corporations (they are similar to traditional corporations save one crucial factor: they are owned primarily by citizens living in or strongly connected to the local community); 2) non-profit corporations (for example, in USA they account for over 6% of economy and over 7% of total employment); 3) municipal enterprise; 4) consumer cooperatives (they are self-help economic structures that provide quality goods and services to their members at a reasonable cost); 5) employee ownership (analysts see worker-owned firms as a means to bring democracy to the workplace or enhance employees’ incomes, but these firms also potentially can contribute a great deal to economic stability of communities); 6) community development corporations (those are non-profit organizations dedicated to bringing about the community economic stabilization of a clearly denoted geographic area).

In Estonia, regional policy did not play an important role in supporting business activities. Concentration of infrastructure, FDI and domestic investments in capital area created its economic domination. Afterwards increasing rental prices and other production costs started to be the main factor pushing out investments into other regions. University town Tartu in South Estonia played some balancing role in regional scene, but its capacity has been too modest to create any counterweight to Tallinn, the capital city.

7. Sectors

Industrial policy has a different status among other economic policies depending on how deep are interventionist attitudes of the government. Horizontal industrial policy is targeted at more general conditions of economic environment and could be seen as more emphasized also in the EU. Hierarchical industrial policy has been targeted at particular sectors.24 Though it has been less used recently, it seems to be become important in the case of delocalization. When sectors enter a decline stage, growth becomes negative for a variety of reasons including international competition (low-cost foreign competition pushing sector into decline). Within a declining industry, the degree of rivalry among established companies usually increases. Depending on the speed of the decline and the height of exit barriers, competitive pressure can become

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24 The special set of problems related to possibility of industrial policy concern economic restructuring in post-socialist countries. The dominating concept in the beginning of reforms was that creation of markets through price liberalization, opening of domestic markets to foreign trade, ownership reform, inflow of FDI, development of financial system, new labor market relations are fundamental and there is no place for industrial policy. One important argument has been that changes were so massive and unpredictable that there were no resources to support declining industries with industrial policy tools. Only afterwards the role of institutions and more complex policy measures have been recommended. However, there were also voices arguing for industrial policy approach during the earlier stage of reforms (see, Landesmann and Abel 1995).
as fierce as in the shakeout stage. That makes companies in the declining sector look for state support.

One reason for orientation to some sectors is related to the reason that for certain reasons the whole sector will be damaged by global foreign shocks. In that case, dealing with sector in crisis is rational. Decline of several manufacturing sectors like clothing, textile, shipbuilding in European countries could be cases to investigate.  

It is common for investment promotion agencies to specify their priorities in the terms of sectors. By some authors, this leads to misdirection of industrial promotion efforts. The targets of public support should be viewed not as sectors but as activities (Rodrik 2004). This facilitates structuring the support as a corrective to specific market failures instead of generic support for this or that sector. Rather than providing investment incentives for some sector, government programs should subsidize bilingual training, feasibility reports, infrastructure investment, adaptation of foreign technology to local conditions, risk and venture capital.

The role of industrial associations has been important in dealing with sectors’ problems.

7.1. Electronics

The main impact on manufacturing comes from overall economic policies. Electronics industry has been also influenced by policies in the field of technology, defense, education and trade.

It is a specific industry because it employs a relatively big number of highly educated engineers, medium educated workers and people with basic skills. Another reason is that electronics industry is using relatively few materials, until nowadays not causing remarkable environmental problems and as an innovative industry gives high profits.

The first and most visible policy from promoting electronics and software industries in emerging economies is preparing of engineers and scientists. Educating of engineers in most of the technology areas requires substantial investments from universities and personal efforts from students. The number and quality of engineers are the concern of governments in highly developed and emerging economies. The USA and UK have used simplified visa requirements for programmers, engineers and other highly qualified workers (UNESCO 2005).

Another area of government interference is support for research and development activities. Electronics industry is a knowledge-intensive activity and support to research can create a sustainable competitive advantage. Often the main creation centers of electronics industry are located in nearby universities and public laboratories and government grants help to raise the general scientific and technological knowledge in the area.

Closely related to the government research support is public procurement. Public procurement of military, space and aviation products has fostered technological development. In some countries public sector is still the owner or major shareholder in telecommunications. Purchasing of telecommunication goods can therefore be influenced by the public sector.

Last but not least, a major role in public policy is played by standardization. Despite not being directly governmental activity, standards remain an important tool in trade practice. Bigger countries with dominating firms are in favor of common standards and weaker and smaller counterparts try to protect themselves by using

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different standards. Development of Estonia’s electronics industry has not been an exception to these general trends.

After major changes in 1990s, Estonia’s electronics industry started to be largely consolidated, heavily export oriented (90-95% of outputs are exported in most of the companies) and based on foreign capital. Empirical evidences (exports-imports, ownership, FDI, value added) show that the Estonian electronics industry is part of the larger Nordic electronics industry cluster. The main branches are the same as those of Finland and Sweden.

As most of Estonia’s electronics industry companies are operating in low part of the value chain, this industry is quite sensitive to wage pressures. Delocalization through FDI and subcontracting would move out quite big proportion of production from Estonia. That emphasizes the role of strategy and development of local resources.

The global market of electronics components is a very liberal and competitive one with large production volumes based on economies of scale and high degree of specialization. Competitiveness on those markets needs high level of investments in R&D and equipment. Due to the small size and limited domestic resources, Estonian enterprises are potential developers of niche products. The quality of industries innovation system will be a very critical factor for future development.

7.2. Garment Industry

The garment industry was the first branch of the manufacturing industry in Estonia that overcame the structural crisis early in the 1990s. As this is a branch with low capital intensity, the restructuring occurred quite rapidly due to the FDI from Scandinavian countries. The agreements with the European Free Trade Association (EFTA) and the Association Agreement with the EU played also a very positive role. Those agreements abolished customs duties for final products and introduced cumulative application of rules of origin.

In 2000s, the situation changed in terms that companies based continuously on subcontracting who did not manage to introduce own models and trademarks had to meet severe competition from low wage countries. Possible ways of adaptation have been moving out production of low cost models and operation to the CIS and China. The former production companies started to be first of all wholesale and retail sale companies (Baltika is an example).

Another way of adaptation has been delocalization of production regionally inside Estonia. Eastern Estonia with lower wage level than the capital area has been one target region. However, it is not clear how long this difference will make competition possible with low wage areas. Probably that is a transition period solution that postpones for a certain period taking of necessary strategic decisions related to location of production units.

The companies have been organized into the Estonian Clothing and Textile Association (ECTA) founded in 1993. The main goal of the ECTA is to promote development of the clothing and textile industry and represent and protect common interests. The ECTA is a member of the European Clothing and Textile Association (EURATEX).

Information, consultations and some possibilities to have impact on the EU level policy decisions concerning, for example, textile imports from third countries have been the main advantage of being part of international community related to this industry.

8. Conclusions
It is possible to distinguish between policies that form a general framework for entrepreneurship (a general legislation of business activities, taxes, social security costs and benefits) and policies that are focused to support particular fields or activities (foreign trade policy, innovation policy, active labor market policy, tools to promote investments or FDI in particular field).

We assumed that certain policies are more frequently applied and influential at particular institutional levels. The particular policies at different levels could be supportive to each other or there could be also contradictions and negative side effects of different policies on each other. Innovation activities at regional and national levels support each other. There are several evidences that innovation policy measures and labor policy measures could produce mixed results and not support each other.

The globalization process linking together more and more areas, activities and persons into the process of development, seems to be an important factor in determining trends at the level of the EU and national governments. For our study, the increasing trade, capital mobility and widespread diffusion of technology are the most influential factors of interdependence of countries, which is the basis for economic side of globalization.

The overlapping jurisdiction and regulation issues concern the impact of regulations in the field of social protection and labor market issues on the EU level and division of responsibilities between the EU institutions and national governments. That issue is linked closely to the general choice between more market based or more intervention based policies and determines scale and scope of measures applied at the EU level and their influence through harmonization efforts on national policies. In the context of our study, we can evaluate assumptions and results of different approaches to delocalization process.

The relationship between the MNEs and different level governments is one important issue in internationalization of economic activities. The critical areas where economic interests and public policies meet are the labor market regulations, the FDI related problems, innovation, industrial policy.

Subcontracting, outsourcing, off-shoring and offshore outsourcing, value chain and clusters are the specific concepts that describe different forms in which organizational and technological capacities have been matched together.

Electronics and garment industries are two branches that are both influenced by internationalization of business. Their starting positions for development have been quite different, garment industry having long traditions and in this sense very different from electronics with much shorter history.

At the same time, there are several similarities in current positions of industries. Location in value chain, innovation, role of FDI have determined development of both industries. There is also a very clear and strong competitive pressure from low wage countries that makes adjustment strategies very important in the future.

Integration with respective Scandinavian clusters has been important for both industries. The critical aspects for future development are connected to fate of those clusters and their adjustment strategies. Also position of Estonia’s companies in value chain is a very critical factor.
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