Comparative patterns of public governance in labour-intensive industries

Kaarel Kilvits
Tallinn University of Technology
Kopli 101, 10613 Tallinn, Estonia, email: kilvits@tv.ttu.ee

Alari Purju
Estonian Business School and Tallinn University of Technology
Lauteri 3, 10114 Tallinn, Estonia, email: alari.purju@ebs.ee

Abstract

The following paper covers public governance problems and opportunities related to delocalisation of labour-intensive industries.

The first part of the paper covers theoretical findings related to the internationalisation process and delocalisation of industries. The role of different governance tools applied by national and local governance is treated in this part of the paper. The role of multinational enterprises and their relationships with different-level governing institutions is an important factor. Different public governance issues have been investigated through evidence from surveys and analysis of respective data on economic regulations in countries included in the sample of the study. That information was supplemented by interviews with key representatives of business and politics of respective countries and industries.

The second part of the paper consists of an analysis of information received through surveys conducted in the United Kingdom, Greece, Poland, Bulgaria and Estonia, where the opinions and attitudes of managers of enterprises in four industries on governance issues were identified. The main areas of interest were the employment conditions, role in and impact of trade unions and business associations, product quality, health and safety standards on the firms' delocalisation decisions. Also tax levels and other important parameters describing the influence of taxation on firms have been covered. Different-level government policies toward foreign trade and FDI together with outside assistance patterns are another important aspect of our analysis. Specific aspects of education and training are a final topic of this approach. Information from surveys is supplemented with a description of important regulations and governance tools applied in those countries. The paper ends with conclusions on the fulfilment of the hypotheses.

Key words: public governance, delocalisation, labour markets, economic policy

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1 Introduction

The following chapter covers public governance problems and opportunities related to delocalisation of labour-intensive industries. 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.

The internationalisation process and the related delocalisation of industries makes it necessary to treat governance possibilities at global, EU, national, local and sectors levels. The role of multinational enterprises (MNE) and their relationships with different level governing institutions is an important factor. Critical areas where the economic interests of MNE-s and policy goals of governing institutions meet are the labour market regulations, 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 that describe forms in which organisational and technological capacities have been matched together.

Analysis of information received through a survey conducted in the United Kingdom, Greece, Poland, Bulgaria and Estonia in governance related issues is presented in this chapter. Information from surveys is supplemented with a description of important regulations and governance tools applied in those countries.

The aim of the analysis is to compare the governance tools applied in different countries with the results and to contribute to the theory of international business and policy. The results would also create a basis for economic policy suggestions.

2 The Literature

2.1 Definitions of governance

There are several definitions of governance. The *Oxford English Dictionary* defines governance as “The action, manner or fact of governing; government”. Wolfgand Michalski *et al*. of the OECD Secretariat refer to “the general exercise of authority” (Michalski, Miller and Stevens 2001). 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” (UNCTAD 2003).

The European Commission 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 Commission 2005a)”.

The main tools of governance are institutions creating rules of the game and enforcement means putting those rules to work. Governance can be implemented at multiple levels and in different policy areas. Terms such as ‘multi-level governance’ that have been introduced in the ‘90s (Marks, Hooghe and Blank 1996), describe the situations (such as the EU) in which authority and policy-making are shared across multiple levels (subnational, national and supranational) of government. Gereffi and Mayer see the role of governance not only in facilitating market growth and stability, but also in the regulation of markets and in creating compensations for undesirable effects of market transactions (Gereffi and Mayer 2004).

In our study, the governance aspects related to delocalisation problems of labour-intensive industries are examined. The study concentrates on the impact of different tools of governance, compares attitudes of managers of companies toward the impact of these tools on the activities of companies and their delocalization decisions and also evaluates the effectiveness of the tools in the framework of general goals of different level governance.

2.2 The EU

Different definitions – and visions - of the European integration have direct implications on EU governance interpretations, given that policy formulation and implementation at the European level is greatly shaped by the course of European integration. During the first 2 decades of the European Communities, the debate was dominated by the federalist, functionalist and neo-functionalist approaches, with the first calling for a direct creation of a European Federation through the establishment of international (federal) institutions that would prevail over member states. The functionalists argued that European integration would emerge gradually as a consequence of cooperation between sub-national institutions, while neo-functionalists added to the functionalist approach the crucial role of central, supra-national bodies (like the European Commission) in initiating and guiding sectoral cooperation. (Haas 1964, Lindbergh 1963). Later, during the ‘80s, these approaches were seen to co-exist within the integration process, reflecting the different roles of supra-national elements such as the Treaties of the EU, the extent of cooperation in specific areas (such with the ESPRIT programme in early ‘80s) and the evolving role and functions of supra-national bodies such as the Commission, the Council and the European Parliament (Lodge 1989).

More recently and given the major developments in EU integration (EMU and Euro, extension of qualified majority at the Council), the governance debate has focused on the relations of the EU with its constituent member states. The intergovernmental or “state-centric” governance is based on the presumption that European integration does not challenge the autonomy of nation-states and that state sovereignty is preserved through EU membership. It is argued that bargains among member states are the main governance process, and that no country has to integrate more than it wishes because the Council decisions are based on the lowest common denominator. Thus, policy outcomes reflect the interests and relative powers of the member states (Marks and *et al.* 1996). The multi-level governance approach (Marks 1993, Hooghe 1996) argues that as the European integration proceeds, authority and policy-making influence are shared across different levels (subnational. national and supranational) of government. Member states lose some of their authoritative control and their sovereignty is diluted in the EU by collective decision-making among governments and by the independent role of the European Commission, the European Parliament and the European Court of Justice. (Marks *et al.* 1996).

Given the strong reluctance of certain member states to yield more powers to supra-national institutions, the Commission adopted a new form of governance at the beginning of the present decade, “the open coordination mechanism”. Starting with the policy area of employment, at the Luxembourg Summit of 1997 (20-21/11/1997), this method was quickly extended to other areas that remained by and large under national sovereignty.

This method can be described briefly as follows: The Commission provides a detailed analysis of the situation in the areas concerned, and sets specific, quantified targets for the member states to meet them. It is then left to the member states to formulate and implement the policy measures that they deem appropriate in order to achieve these targets, while the Commission ensures proper monitoring and facilitates benchmarking between the various national policies.

The governance of delocalization is very much treated in the framework of open coordination mechanism. 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.

In the case of dealing with problems of delocalisation of labour, the overlapping jurisdiction and regulation 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 governments.

2.2.1 Industrial policy

The EU does not have an industrial policy as such. There was, however, an enterprise policy and policy on research. Industrial policy is horizontal in nature and aims at securing framework conditions favourable to industrial competitiveness. 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 a debate on industrial policy (European Commission 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 a new Communication "Fostering Structural Change: an Industrial Policy for an Enlarged Europe", which examines the competitiveness of the European industry, assesses the existence and scale of the risk of de-industrialisation and proposes specific solutions (European Commission 2004).

One important question related to delocalisation issues is whether the European countries should implement policy measures to fight de-industrialisation, i.e. decline of production industries both as a share of total output and in terms of employment levels? A possible answer is yes, but also the choice of tools is important. Most of the industrial policies are not carried out at the EU level, but under the competence of the member states.

2.2.2. Lisbon Agenda

With the adoption of the Lisbon Agenda in 2000, the European Union established an ambitious goal of becoming the most dynamic and competitive economy in the world by 2010. The initial observation of the Lisbon Strategy was that the existing EU arrangements are not the globally most competitive ones.[1] The need to de-emphasise 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 communication 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.

[1] 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 communication technology to revert the present trend, in the framework of a ten-year-programme. See, European Commission (2000).

This ambitious commitment was further broadened in the subsequent European summits where the 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.[2]

Realisation of the targets of Lisbon Agenda depends substantially on the efforts of the EU member states and there are only limited tools to enforce the governments to fulfil the respective criteria. The fulfilment of those targets, on the other hand, has an important impact on global competitiveness of the European economic space.

2.2.3 Employment

The European Commission adopted a communication setting out measures to be developed or strengthened with the aim to improve management within the EU in 2005. The Commission proposed to refocus the European employment strategy around three priorities: 1) boosting the labour market participation; 2) improving the adaptability of workers and companies; 3) invest more in human capital (European Commission 2005g). In the context of delocalisation, the critical issue is the creation of new activities and jobs, and shifting of resources from declining sectors to sectors where the EU can sustain a comparative advantage. The coordination across the range of already existing EU policies, such as industrial, competition, trade and employment policy, is considered to be necessary. Also harmony with the revised Lisbon strategy for growth and employment with details of structural reforms needed to make the EU the most competitive economy is considered to be important here. However, employment policy has been still very much dealt with by national governments.

2.2.4 Tax policy

The EU does not have a common policy for taxation as it has a common policy for trade, competition, and agriculture. Its policy is to co-ordinate and harmonise (or approximate) 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 the 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 (European Commission 1992).

[2] 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-of-poverty rate, long-term unemployment, dispersion of regional employment rates, greenhouse gas emission, energy intensity of the economy and volume of transportation. See, European Commission (2005c).

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.

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 that will determinate the future development of taxation level and structure[3].

2.3 National level

The state's role in governing structural industrial problems such as delocalisation has been widely discussed in economic literature. Until the mid-1980s, the role of the state expanded, in advanced countries faster than among developing countries. The immediate roots of the neo-liberal revival lie in the economic crises that followed the rise in oil prices in the early 1970s. That was accompanied by a spread of new liberal view with a deeper scepticism about the capacity of state administration to play a developmental role under any circumstances.

That approach was quite important also in transition countries where the creation of market economy started at the beginning of 1990s. Partly in response to the experiences of liberalisation during the 1990s, partly due to the impact of the Association Agreements and integration with the EU, the institutional side of the reforms started to be more important. The goals of the 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 (Batly and Larbi 2004, Kohsaka 2004; Rodrik 2004).

In the general approach to government roles, we can use division into 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).

2.3.1 Employment

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 labour; ensures non-discrimination; provides unemployment, disability and retirement income insurance, and in many countries health insurance, and sets conditions for hiring and firing, unionisation and collective bargaining (European Commission 2005b, OECD 2003, World Bank 2004).

[3] See, Cnossen (2002, Cnossen and Bovenberg (1997), Mitra and Stern (2004), OECD (2000), Purju (2004).

A World Bank study shows that from the investment climate perspective, labour regulations can be a major or severe constraint on firms' operations in many developing countries. Regulations can reduce incentives to make new investments, adjust the organisation 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 labour 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). In our study, the role of labour market conditions in delocalisation has been studied.

2.3.2 Trade unions

Trade unions have played an important role in labour relationships in Europe. The main play field 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 control and distributors of fringe benefits to becoming representatives of workers' economic interests (Svejnar, 2004).

There are powerful organisations 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 liberalisation 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 wages where the trade unions role was compared in different countries. There are interesting questions about linkage of the FDI from countries with strong trade unions (Germany, Scandinavian) to new EU member states with low trade union coverage (Bulgaria, Estonia, Poland).

2.3.3 FDI

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, privatisation), 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. Investment promotion is therefore an essential component of attracting investments. There has been a rapid growth in the number of investment promotion agencies (IPAs) across the world.

Investment promotion can be divided into the following areas: 1) strategy and organisation (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)[4].

An investment promotion strategy involves the organised use of a range of promotional activities to enhance the capacity of a country to absorb FDI and thereby to increase 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.[5]

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 to suit the economic and industrial development requirements and the resources of an individual country.

2.3.4 Foreign trade

One paradox of the increasing role of foreign trade is that the growing integration of the world markets has brought with it a disintegration of the production process in which manufacturing or service activities done abroad are combined with those performed at home. A number of researchers have referred to the importance of the idea that production occurs internationally. Bhagwati and Dehejia (1994) called this "kaleidoscope comparative advantage," as firms shift location quickly; Krugman (1996) used the phrase "slicing the value chain", Leamer (1996) prefers "delocalisation". The delocalisation of production has a direct impact on foreign trade volumes, because slicing up the value chain and delocalisation of some parts of it to other countries create foreign trade flows between those countries.

Those issues are very closely linked to the institutional framework for foreign trade. At the same time, the external opening underpinned by the acceptance of multilateral and regional disciplines play a great role. Both, multilateral commitments within the WTO and the EU-related rules, have a similar role. They contribute to the quality, transparency and coherence of the legal and regulatory system as well as its efficient enforcement.[6] For companies involved in foreign trade, that means a very big role of particular agreements achieved in the framework of the WTO or the EU context. The sensitive aspects like import of textile products from Asia, outsourcing and subcontracting issues are more important in the framework of the current study.[7]

2.3.5. Education, training and innovation policy

The first and most visible policy to promote manufacturing is educating 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 particular importance of technical education is related to software and electronics industries covered in our research.

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[4] See, Dicken (1990), Loewendahl (2001), IFC (1997), Young *et al*. (1994).

[5] See, for example, analysis and suggestions of international organisations concerning inter-relationships between the FDI and business environment, by *Doing Business 2004*…(2004), OECD (2005), UNIDO (2005), World Bank (2004), WIIW (2005).

[6] See, *Promoting Trade in Services* (2004).

[7] See discussion of those problems in Gereffi (1994,1999), Gereffi et al. (2003), Kwan and Qiu (2003), Yeung and Mok (2004).

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

Education, training and innovation policy is important in the framework of the current study for the reason that it is important in particular industries and also related to the position of companies in the value chain of products.

2.4 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 the 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 location advantage or revitalise old locations; 2) the implementation of cluster initiatives; 3) the creation of dedicated local economic development agencies to co-ordinate and organise local level efforts (OECD, 2001b; Wallis, 1996).

A regional cluster policy can be by definition a policy aimed to sustain existing clusters or to support the growth of start-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.

2.5. Hypothesis for further study and methodology

Different public governance level issues have been investigated through evidence from surveys and analysis of respective data on economic regulations in countries included in the sample of the study. That information was supplemented by interviews with key representatives of business and politics of respective countries and industries. On the basis of the literature survey the following hypotheses were formulated:

H1: Flexibility of labour market is a critical issue and perceived also in this way by representatives of firms participating in the survey.

H2: There is a different sensitivity to increasing labour costs and different adjustment strategy in traditional (footwear and garment) and new industries (software and electronics);

H3: The FDI from countries with high coverage of trade unions have an impact on organisation of labour also in target countries of FDI.

H4: Tax policy matters. There is a correlation between tax burden and delocalisation attempts.

H5: There is a connection between public support company's attitudes toward delocalisation. Larger support creates a positive attitude.

H6: New industries (electronics and software) receive more public support than traditional industries (clothing and footwear). This is assumed on the basis of political rhetoric of governments).

3. The Evidence

3.1. Employment conditions

The general information on labour conditions covers here the employment rates, wage level and regulations, the level and structure of taxation, and costs of social protection (pensions, health care expenditures, unemployment benefits).

3.1.1. Employment

The total employment rate describes the participation of working-age people in labour market. A high employment rate is connected to availability of better jobs but also evidences about availability of social services that make employment possible for the sensitive part of population (women with small children etc.). This is one aspect of greater social cohesion. Proportion of part-time employment, especially for women, is an important indicator of labour market flexibility.

In comparison with the UK, all other countries have much lower employment rates. The largest is the difference in part-time employment of women. This could be considered as a potential source of additional labour force. However, to attract more women to labour market it also requires efforts from labour market institutions.

Table 1. Employment rates by age and sex (15-64 years old), 2004

	Employment rates						**Part time employment**	
	By age				**By sex**		**By sex**	
	15-64	**15-24**	**25-54**	**55-64**	**Men**	**Women**	**Men**	**Women**
EU-25	**63.3**	**36.8**	**76.8**	**41.0**	**70.9**	**55.7**	**7.0**	**31.4**
EU-15	**64.7**	**40.0**	**77.6**	**42.5**	**72.7**	**56.8**	**7.2**	**35.1**
Bulgaria	44.7	…	…	34.7	49.7	40.0	…	…
Estonia	63.0	27.2	78.8	52.4	66.4	60.0	5.4	10.6
Greece	59.4	26.8	73.5	39.4	73.7	45.2	2.2	8.5
Poland	51.7	21.7	68.2	26.2	57.2	46.2	8.2	14.0
UK	71.6	55.4	80.8	56.2	77.8	65.6	10.3	43.9

Source: EU Integration Seen through Statistics, Eurostat, 2006.

3.1.2. Wages and other labour costs

Average monthly labour costs are defined as total labour costs per month divided by the corresponding number of employees expressed in full-time units. Monthly labour costs include net wage, personal income tax and social tax. Minimum wages are those effective in 2006.

In Table 2, the figures have been recalculated from national currencies, and so also the interest rate movements influence the cost levels in different countries. Another important factor here is that the purchasing power of nominal earnings in different currencies may be quite different in countries due to differences in price levels. In the case of Poland, exchange rate changes between the zloty and the euro have an impact on the dynamics of labour costs.

Table 2. Monthly labour costs and minimum wages, 2000-2004

	Labour costs, EUR						**Minimal wage, EUR**	
	1996	**2000**	**2001**	**2002**	**2003**	**2004**	**2003**	**2006**
EU-25	**2254.7**	**2732.3**	**2768.7**	**2864.2**	**2892.6**	**2979.1**	**-**	**-**
EU-15	**…**	**3154.4**	**3149.8**	**3252.7**	**3330.2**	**…**	**-**	**-**
Bulgaria	…	179.0	189.8	193.6	202.2	213.5	56	82
Estonia	275.9	429.1	496.3	562.4	608.4	650.3	138	192
Greece	1446.3	1658.1.	1739.9	1849.4	1984.3	…	605	668
Poland	447.1	672.4	791.8	783.1	698.2	699.2	201	234
UK	2168.8	3676.9	3793.4	3891.3	3642.4	3848.6	1106	1269

Source: EU Integration Seen through Statistics, Eurostat, 2006.

The proportion of the minimum wage to average labour costs was the highest in Bulgaria (38.4 per cent), in other states except Estonia between 33 and 34 per cent and in Estonia 29.5 per cent.[8] The relatively high level of minimum wage could be a

[8] The comparison is not fully correct because figures of different years are compared, but it gives some ideas about that very important statistical indicator.

problem for regions with lower than average wages where a national level minimum wage is applied.

In our survey a question about the impact of employment conditions on delocalisation was asked. Employment conditions (health standards, labour costs, working hours) had a positive effect on the company's decision to delocalise in 21.3 per cent of the cases and a negative effect in 10.4 per cent of the cases. The impact of those factors was higher in the UK (46.5 per cent) and Greece (44.7 per cent), followed by Poland (41.0 per cent), Estonia (29.2 per cent) and Bulgaria (19.1 per cent).

In terms of industries, these factors were more important in traditional industries such as clothing (52.1 per cent) and footwear (51.5 per cent) and less important in electronics (12.6 per cent) and software (10.6 per cent). It could be interpreted that in traditional industries of UK and Greece, high labour costs were the most important factor of delocalisation into lower labour cost countries (mentioned by 67.8 per cent of the companies in clothing and 66.7 per cent in footwear industry). These reasons were less imminent in software and electronics.

Bulgaria, Estonia and Poland have been regarded as the target countries of delocalisation. In Bulgaria, the positive role of employment conditions has been most important in clothing (for 30.0 per cent enterprises) and footwear industry (29.5 per cent). For Bulgaria's electronics and especially software industry, these conditions were not important for delocalisation.

Estonia and Poland belong to another group of countries based on the answers to that question. Traditional industries have been here more sensitive to employment conditions, but the impact was divided into positive and negative influence. This means that labour costs started to be a reason also for outward delocalisation from these countries, more in Estonia, less in Poland. Labour conditions were less important in software and electronics industry.

Table 3. Statutory minimum wages in the EU and USA (1 January 2006)

	Bulgaria	Estonia	Greece	Poland	UK	USA
Year of introduction	1990	1991	1991	1990	1999	1938
Coverage	All employees	All employ-ees	All employees aged 19 or over (non-manual) or 18 or over (manual workers)	All employ-ees	All employees aged 16 or over	Employees of private enterprises with turnover more than $500,000 a year, or in smaller firms engaged in interstate commerce, or in federal state or local government
Method of setting	Set by government based on recommend ations of social partners and taking account of state budget restricttions	Set by govern-ment	Annual negoti-ations with social partners	Set by govern-ment based on negoti-ations with social partners	Set by government based on recommend ations of social partners	Set by government

Method of updating	Set by government based on recommendations of social partners and taking account of state budget restrictions	Set by government based on negotiations with social partners	Annually, based on government forecasts of inflation	Once or twice a year, based on government forecasts of inflation	Set by government based on recommendations of social partners	Periodic review
Type of rate	Monthly and hourly	Monthly	Weekly	Monthly	Hourly	Hourly
Statutory level or monthly estimate, EUR, except USA	82	192.	668	234	1269	$5.15
In force since	01.01.2006	01.01.2006	01.01.2006	0.01.2006	01.10.2005	01.09.1997

Source: Statistic in Focus. Population and Social Conditions, 9/2006, Eurostat, 2006,

3.1.3. Impact of free movement of labour

Increasing economic integration and free movement of labour has a strong impact on domestic labour markets, especially in small countries like Estonia or Bulgaria. In the case of Estonia, highly skilled and reasonably priced labour has been one of the cornerstones of rapid economic growth. The relatively flexible labour market contributed positively to changes in the structure of economy.[9]

Over the 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 cap between the home country and destination countries, first of all with Scandinavian countries, but also Ireland and United Kingdom. The latter two are the EU countries which did not apply a transition period for labour market opening for the other EU members. After a two-year transition period, several other EU countries opened their labour market (for Estonia it was important that Finland opened its labour market from 1 May 2006).

Many investors in Estonia are still interested in the maintenance of low technology, cheap labour requiring jobs and even creating 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 labour-intensive industries in Estonia. The hardest hit are subcontracting enterprises like garment industry, where the proportion of labour costs in total costs is up to 80%.

Emigration of labour force launches a chain reaction in the labour 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 labour force from

[9] Flexibility of labour markets is divided into macro and micro level flexibility. On macro level, institutional and wage setting flexibility are the forms. On micro level, flexibility is related to job flows, job creation and destruction. See Blanchard (2004).

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, which 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 labour.

The overall labour market policy on the government level is a duty of the Ministry of Social Affairs. The main institutions dealing with conflict settlement 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 realised through tripartite negotiations where the counterparts are the government, representatives of employers and of employees.

3.1.4. Unemployment rates and benefits

Unemployment figures depend on the labour market situation but also on the size of unemployment benefits, possibilities for part-time work etc. The new EU members had higher figures for unemployment than EU-15 or UK and Greece in our sample. However, unemployment decreased substantially in Bulgaria and Estonia, and remained on the same level in Poland. Poland was the only country having increased the number of young people entering the labour market. At the same time, Poland, having with Estonia approximately the same income level, had three times higher level of unemployment benefits than Estonia. That made probably people more biased to accept those benefits with less attempts to find a work.

Table 4. Unemployment rates and benefits

	Unemployment rates, %						**Monthly unemployment benefits, EUR**	
	Total		**Men**		**Women**			
	2000	**2005**	**2000**	**2005**	**2000**	**2005**	**2000**	**2003**
EU-25	**8.6**	**8.7**	**7.4**	**7.8**	**10.3**	**9.7**	**-**	**-**
EU-15	**7.7**	**7.8**	**6.4**	**7.0**	**9.3.**	**8.8**	**-**	**-**
Bulgaria	19.7	10.1	…	…	…	…	…	…
Estonia	12.5	7.5	13.4	8.9	11.5	6.0	15.6	25.1
Greece	11.3	10.0	7.5	6.2	17.2	15.5	224.7	252.8
Poland	16.4	17.9	14.6	16.8	18.6	19.1	84.2	83.7
UK	5.4	4.6	5.8	5.0	4.8	4.2	174.6	180.3

Source: Statistic in Focus. Population and Social Conditions, 9/2006, Eurostat, 2006,

3.1.5. Trade unions and business associations

According to our study, the impact of trade unions and business associations on a company's decision to delocalise was practically missing in Poland, Bulgaria and UK. In Estonia and Greece, the influence of trade unions was also modest, but a little higher still. The influence of trade unions is common in traditional industries like footwear and clothing and business associations had some role in new industries like software and electronics.

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

We can say that Hypothesis 1 is proved on the basis of evidence from the survey and labour market statistics. Free movement of labour, low entry and exit barriers and low level of minimum wages and unemployment benefits made labour markets relatively flexible in those countries. The highest unemployment rate was in Poland with the highest level of unemployment benefits and minimum wages. It should be said that in Poland there have been very important demographic reasons for high unemployment.

The expected increase in the importance of trade unions due to FDI from countries with high coverage of trade unions according to our Hypothesis 3 was not proved.

3.2. Taxes

The tax burden is an important determinant in the costs related strategies of firms. It is interesting to see that all countries in our sample have lower than the EU-25 or Euro area average tax burden. There was a falling tendency of tax revenues in GDP in new EU members, but in Greece and UK taxes as a share of GDP increased. Estonia is a very clear example of a country with emphasis on taxation of consumption (and labour). Tax burden of labour is largely due to the high social tax. Taxation in UK is remarkably more than in the other EU countries biased toward taxation of capital, taxation of labour is light in relative terms in comparison with the other EU countries. The level of corporate income tax and labour taxes has been considered an important factor supporting FDI and delocalisation into Bulgaria, Estonia and Poland. The survey and results of other studies supported Hypothesis 4 about positive influence of a competitive tax structure and level on delocalisation. Another side of this phenomenon is that the position of companies of those countries in the value chain of

Table 5. Tax revenue and implicit tax rates by type of economic activity

	Tax revenue, % of GDP		**Implicit tax rate on:**					
			Consumption		**Labour**		**Capital**	
	1995	**2004**	**1995**	**2004**	**1995**	**2004**	**1995**	**2004**
EU-25*	**39.7**	**39.3**	**21.1**	**21.9**	**35.7**	**35.9**	**23.1**	**25.8****
Euro area*	**39.9**	**39.7**	**20.3**	**21.5**	**35.7**	**36.6**	**23.6**	**29.2****
Bulgaria	…	…	…	…	…	…	…	…
Estonia	37.9	32.6	20.3	20.8	39.2	37.6	17.9	10.3**
Greece	32.6	35.1	17.3	17.5	34.1	37.9	12.1	17.0
Poland	38.5	32.9	21.8	19.3	37.9	34.6**	…	19.4
UK	35.4	36.0	19.6	18.7	25.7	24.8	33.3	34.9

*EU 25 and Euro area overall tax rates are computed on the basis of a GDP-weighted average.
** Figures for 2003.
Source: EU Integration Seen through Statistics, Eurostat, 2006.

a particular product depends also on the educational level and R&D expenditure of that country, which is mostly financed from the state budget with tax revenue being the source of those expenditures. For that reason, a positive impact of the relatively low tax levels on delocalisation decisions could be a short-run advantage. In long run, increase of costs (first of all labour costs in labour intensive industries) makes necessary decrease of cheap mass production. That production should be substituted by more valuable products with larger value added component, but that assumes larger R&D expenditures, product development, better higher education, what are financed greatly by taxes.

3.3 Product quality, health and safety standards

An important role in public policy is played by various standards, including those regulating product quality, but also health and safety conditions at work.

In our study we found evidence that regulations related to product quality, health and safety influenced the company's decision to delocalise in 23.5 per cent of the cases, in favour in 17.6 per cent and against in 5.7 per cent of the cases. A highest proportion of companies answering positively to this question were located in Bulgaria and Estonia. In Bulgaria, 26.7 per cent of the companies answered that regulations favoured their decision. That answer could be interpreted in the way that the binding regulations guaranteed health and safety standards and were supporting the delocalisation decision of foreign companies to Bulgaria. In Estonia the total impact of regulations was even higher than in Bulgaria. In 21.1 per cent of the cases regulations favoured delocalisation, but in 17.6 per cent had a negative impact on activities. The latter answer could be interpreted in the way that companies saw some regulations to follow too costly. For example, harmonisation of standards in companies due to the EU regulations was considered by companies as a waste of time and resources, not giving to them positive results in foreseeable future. For that reason, some measures were considered to create non-approved costs and negative impact on their activities.

3.4 Incentives and FDI

Incentives can affect investment location decisions. However, the emphasis on incentives varies considerably. The 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.[10]

Results of our study show that governments have been modest in undertaking activities to attract FDI or subcontracting into countries. From total answers only 18.7 per cent of the respondents mentioned initiative, 83.7 per cent said no initiatives were taken. The highest positive answer was for Estonia with 37.4 per cent, followed by Greece with 33.4 per cent, UK 14.8 per cent, Poland 12.2 per cent and Bulgaria 2.0 per cent.

[10] See, for example, analyses and suggestions of international organisations concerning inter-relationships between the FDI and business environment, by *Doing Business 2004*…(2004), OECD (2005), UNIDO (2005), World Bank (2004), WIIW (2005).

In terms of industries, the proportion of respondents receiving support for FDI was for clothing industry 24.3 per cent, electronics 22.4 per cent, software 14.5 per cent and footwear 8.8 per cent. The evidence showed that there is no difference in this sense between new and old industries, which was assumed according to Hypothesis 6. Clothing had more support than other industries. However, as the size of support was not exactly determined, our results are based only on the frequency of support. Other evidence demonstrated that large FDI into electronics industry were attracted by big government support in several countries. So, the real situation is more ambivalent than our results of the survey demonstrated.

The highest proportion of enterprises receiving government support was in Estonian clothing industry (66.1 per cent) and footwear industry (45.5 per cent), Greece electronics industry 42.9 per cent, Poland's electronics industry (23.8 per cent) and software industry (19.6 per cent) and UK's electronics industry (25 per cent).

3.5 Outside assistance

Regarding the answers on the role of outside assistance, the highest proportion of positive responses to the question was in UK (46.4 per cent), followed by Greece (41.6 per cent), Estonia (26.3 per cent), Poland (25.3 per cent) and Bulgaria (6.5 per cent). The support was more country than industry specific. In terms of industries, in electronics 58.8 per cent, in clothing 55.6 per cent, in software 45.5 per cent and in footwear 31.6 per cent of the respondents gave a positive answer to that question.

In Greece, Estonia and Poland, new industries were more supported than the traditional ones. This is in accordance with the economic policy related arguments and policy targets of governments in these countries. In Bulgaria, support was lower and the leading area was software with 13.7 per cent of the companies reporting on outside assistance; in other industries the respective figure was even lower.

Analyses of the financial assistance patterns make it possible to make the following generalisations. In the UK, the dominating supporter by number of evidence was the regional government. In Greece, in new industries, the EU was an important supporter close to the central government. In traditional industries, more assistance came from the central government (75 per cent of assistance), less from the EU.

In Estonia and Poland, support of the EU was accompanied by support from the central government. In Poland, also regional government was a minor partner in software and clothing industry. A quasi-government organisation, Enterprise Estonia, matching together pre-accession financial resources before 2004 and afterward, was organising the use of EU structural funds with a self-financed part in Estonia, which played an important role in assistance.

The dominant form of assistance was the public sector grant in the UK, Greece, Poland and Estonia. In Bulgaria, only 1 company reported having received a public sector grant. A few subsidised bank loans were mentioned (2 in Poland and 1 in Estonian electronics industry, 1 in Poland in clothing industry, 1 in Bulgaria in software industry). Also concession as a form of assistance was mentioned (in Greece, 1 in software industry, in Poland 2 in software, 2 in electronics, 1 in clothing and 4 in footwear industry).

4. Conclusions and policy suggestions

The hypothesis of the critical role of labour market flexibility has been partly supported by the evidence. Employment conditions are regulated first of all by the minimum standards set at the state level (minimum wages, unemployment benefits, minimum subsistence level). Traditional industries had a quite strong negative impact of employment conditions on the delocalisation decision. However, in the new EU member countries there is still a need for institutional arrangements that would make possible employment of groups of people whose involvement is critical for increasing the participation rate on the labour market. Of particular importance is the creation of relevant conditions for part-time work of women. As the answers given by employers involved in particular activities demonstrated, some short-run attitudes seemed to dominate in the answers. This is evidenced by low priority of long-run targets related to structural change capacities of economies, finance of R&D activities. This is especially true in Bulgaria, Estonia and Poland.

The second hypothesis about different sensitivity to increasing labour costs and different adjustment strategies in traditional (footwear and garments) and new industries (software and electronics) is partly confirmed. In electronics industry, the sensitivity to labour costs depends very much on where in the value chain of production a particular company is positioned. Producers in the lower part of the value chain behaved similarly to companies in traditional sectors. The public governance tools targeted at lower costs are critical for these companies. In this sense, software industry is substantially different relying more on the active role of different level governments in providing public services, (technical) higher education and research funding.

Different aspects are important for countries of outward and inward delocalisation. For outward delocalising countries, support to product development and marketing was important. In countries of inward delocalisation, support to creating new jobs, infrastructure development, training has been more important.

Trade unions' and business associations' influence on company's decision to delocalise was practically missing in Poland, Bulgaria and UK, quite limited in Estonia and Greece; there was no big difference between new and traditional industries.

Product quality, health and safety standards influenced company's decisions modestly. The negative impacts underlined were: some regulations, especially in the context of the EU membership and harmonisation context, costly to follow, no visible benefits.

Analyses of financial assistance patterns make it possible to make the following generalisations: in the UK, a dominating supporter by number of evidences was the regional government; in Greece, in new industries, the EU was the important supporter close to the central government. In traditional industries, assistance was dominantly financed by the central government, less came from the EU. Results suggest the significance of EU support for Estonia, Poland, lower importance for UK and Greece and perspective importance for Bulgaria. Semi-governmental organisations had an important role in absorbing EU funds and combining them with local resources. Strong points of those institutions are related to rules and expertise created to deal with projects and competitive bases for treatment of different applications for grants.

Regarding the fifth and sixth hypothesis on the impact of support on delocalisation decisions and position of different industries in this respect, it is possible to conclude that: the major market economies, such as UK and Greece, rely less on EU funding and tools, but get a dominating part of support from domestic sources. Respondents to surveys in the UK acknowledged the active role of regional governments, though the real amount of support was according to interviews small. In

Greece, respective means are more centralised and the central government had a bigger role in providing assistance. In Estonia and Poland, domestic resources, first of all from the central government, were combined with support from the EU. Regarding industries, the electronics industry was more supported, but the difference from other industries was not big. Support was more country than industry specific.

The dominating form of assistance was the public sector grant. Other forms of assistance were the following: help and support to purchase or rent of land related issues, financing specialisation in vocational school, training work force for particular enterprises, other types of training, visits to fairs and exhibitions, introduction of industrial zones, export zones with special tax arrangements. There are arguments for introduction of a wider variety of different support types.

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