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DISCUSSION PAPER

Industrial Restructuring in Single-industry Towns and Areas:
Major Issues

UNECE Secretariat



Organization for Security and Co-operation
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INDUSTRIAL RESTRUCTURING IN SINGLE-INDUSTRY TOWNS AND AREAS: MAJOR ISSUES

Note by the UNECE secretariat*

1. Introduction

The present note was prepared by the UNECE secretariat for discussion at the OSCE-UNECE Forum on “Public-Private Cooperation in Industrial Restructuring” to be held in Almaty, Kazakhstan on 2 and 3 November 2004.

The note highlights the basic features of industrial restructuring in transition economies, identifies the major economic and social problems arising in single-industry towns and areas, and reflects on the available experience of handling those problems, including the role of Governments therein. Finally, a number of questions for discussion are raised.

2. Basic features of industrial restructuring¹

Industrial restructuring can be viewed at various levels of aggregation and from various angles. At macro-economic level the industrial restructuring “... refers to the process whereby the shares of certain sectors in GDP, employment, exports, etc., increase, while the shares of other sectors fall”. At the sectoral level, industrial restructuring occurs when either the mix of products or the technologies with which these are produced, or both become uncompetitive, and there is a need to stop the production of outdated products and the use of outdated technologies, and introduce new products and technologies.

At the enterprise level, one distinguishes the restructuring of the already operational but uncompetitive enterprises, which is the main cause of concern for transition economies. Related to this issue are the downsizing and closures of some of uncompetitive enterprises, as well as the entry of new enterprises into the sectoral-product market and its impact on the competitiveness of that market.

The industrial restructuring is induced by changes in supply and demand caused by income growth, introduction of new cost-saving technologies, changes in input prices, rising production costs due to depletion of natural deposits as well as by restrictions imposed by Government regulations, for example in the area of environment. Theoretically, under normal conditions of the market economy, the industrial restructuring should be a permanent process of structuring adjustment, requiring only limited involvement by the public sector.

However, in many of transition economies, the loss of competitiveness and the need for industrial restructuring have emerged as a result of “reform shock”. Many enterprises have lost competitiveness at initial stages of transition as a result of rapid price liberalization, deregulation of energy and transport tariffs, opening of markets and increased import competition. This loss of competitiveness has particularly stricken the basic industries, in particular mining (coal), iron and

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¹ The basic definitions of industrial restructuring are taken from TRADE/WP.8/AC.1/SEM.22/2003/1 (Social aspects and financing of industrial restructuring. Discussion paper for the Regional Forum on Social Aspects and Financing of Industrial Restructuring, held in Moscow, Russian Federation, 26-27 November 2003, prepared for the UNECE Secretariat by Prof. Paul Hare, School of Management, Heriot-Watt University, Edinburgh, United Kingdom), p. 1.

steel; engineering and automobile manufacturing, as well as some of the consumer goods industries (e.g. textiles).

3. “Core” enterprises and single-industry towns

Industrial restructuring in a particular town or geographical area becomes a pressing issue when industries forming the local economy lose competitiveness. It aggravates further when town or area lack alternative employment opportunities. While this problem is not specific to the former socialist economies, in many of transition countries, especially those with large territories, it has not gained challenging proportions. One of the reasons for biased economic structure of individual areas lies in the history of centrally-planned industrialization, which has brought about economically unjustified industrial location decisions. In particular, the subsidized transport tariffs and the absence of land prices have enabled the establishment and operation of enterprises, which would not have been viable under the conditions of market pricing of economic resources.

Often these enterprises represent the sole economic activity in a town or geographical area, on which the incomes and subsistence of the majority of local population depend. Such enterprises are usually called “core enterprises” implying that they form the basis for the whole local economy in a given area. Towns and areas crucially dependent on core enterprises are known as single-industry towns or areas.

The economic importance of the core enterprises stems from the fact that they:

- provide employment to the bulk of local labour force;
- generate incomes for the majority of local population;
- finance the public services - childcare, housing, medical care, sometimes health and rehabilitation centres – which otherwise would have been provided by the state or not provided at all;
- pay the greater part of local taxes, which form the basis of local budgets.

Russia, Ukraine and several other CIS countries have quite a number of single industry towns or areas, dependent on core enterprises. For example, Russia alone has more than 450 single industry towns and over 300 settlements of this type. Altogether they are estimated to host about 25 million inhabitants, which is equivalent to 25 per cent of the Russia’s urban dwellers.¹ In Belarus, there are 170 small towns, of which 71 have mono-industrial economies. As many as 88 per cent of single-industry local communities face severe unemployment problems.² There are at least 10 small single-industry towns with depressed economy in Kazakhstan.³

4. Major problems encountered during restructuring in single-industry towns

When a core enterprise in a town or area becomes uncompetitive, that is when the market does not accept its products and/or their production becomes too costly, it faces the alternative of regaining competitiveness or closure. Both options often entail the downsizing and drastic cuts in

¹ Union of Investors. Single-industry Towns and Core Enterprises (in Russian) (http://www.unioninvest.ru/city_mong.html).

² L. Istomina and T. Eletsikh. The restructuring of core enterprises in single-industry towns: avoiding social tensions. Paper presented at the UNECE-ILO Regional Forum “Social Aspects and Financing of Industrial Restructuring”, 26-27 November 2003, Moscow, Russian Federation, p. 2.

³ S. Baisakov. Solving the Economic Problems of Small Towns: The Experience of Kazakhstan. Paper presented at the OSCE-UNECE Forum “Public-Private Cooperation in Industrial Restructuring”, 2-3 November 2004, Almaty, Kazakhstan, p. 5.

labour force employed. The lost jobs and family incomes through the negative multiplier mechanism cause secondary cuts in incomes, taxation base and revenues of local budgets. This undermines the capacity of local authorities to help the laid off workers and their families on the one hand, and financially support new enterprises providing new jobs, on the other.

In addition, the lack of own funds prevents local administrations from taking onto their balances the public service establishments (medical care, nurseries and kindergartens, primary schools and similar) previously financed by the core enterprises. As a result, the population risks to be deprived of these basic services when the latter are hived off by the core enterprises. Alternatively, these services could be rendered by independent private providers. However, since previously the service establishments on books of the core enterprises were subsidized by both federal and regional budgets, their takeover by private entrepreneurs might raise the cost of such services to the consumer considerably.

Therefore, there are basically four kinds of social problems, which the public authorities have to deal with in single-industry towns and areas:

- steep hikes in unemployment and lacking alternative employment opportunities;
- loss of family incomes;
- loss of local taxation receipts;
- need to finance, find a new provider or discontinue public services, which used to be rendered by uncompetitive enterprises;

The key obstacles to resolving these problems are (i) lack of employment alternatives and (ii) low incomes of workers' families, which depend on enterprises undergoing restructuring, and (iii) the lack of or underdeveloped housing market. In a multi-sectoral local economy, the employment losses provoked by a closure or production cuts at one, even big enterprise, could have been compensated by expanding enterprises in the rising sectors. However, this opportunity is missing in single industry towns and area. At the same time, low family incomes prevent the laid off workers from moving out of the town or area hit by unemployment to a place where jobs are in good supply. Low mobility is further hindered by low educational levels and limited qualifications and skills of redundant workers. Finally, the lack of or insufficient market supply of suitable accommodations in towns and areas, where employment opportunities exist, obstructs the mobility of newly unemployed even more.⁴ All these factors combined often require from decision-makers finding solutions on site, in the ailing town or area itself.

Given its complex multi-dimensional nature, problems of single-industry towns or areas have to be resolved by coordinated efforts of all the stakeholders – Governments at their various levels, entrepreneurs, trade unions and population at large. The accumulated experience in both developed market and transition economies shows that such a cooperation has been the key factor of successful transformations. Equally essential is the adequate financing of restructuring, where the assistance from international organizations often becomes an important element of success.

The instruments used to handle the social problems of single-industry towns and areas include:

⁴ The statistical analysis shows that as compared with earlier periods, in the second half of the 1990s the pattern of labour turnover in the Russian Federation did not change. The movement of labour force continued to be higher within geographical regions than across geographical regions (see Harry G. Broadman, Francesca Recanatini. Is Russia Restructuring? New Evidence on Job Creation and Destruction. The World Bank, Policy Research Working Paper 2641, July 2001, p. 28.

- adequate supply of information related to the restructuring plans, progress of restructuring and available employment opportunities to workers concerned and local population in general;
- allocation of severance payments to dismissed employees;
- provision of temporary employment, including through extraordinary public works;
- support of family incomes;
- training and retraining of end off employees;
- early retirement schemes;
- measures facilitating the geographical relocation of redundant workers – information on jobs and housing available in other towns and regions, and financial support to relocating families.

The above-mentioned tools are more effective when they are combined with the encouragement of new enterprises, which increase the output and employment opportunities in the affected area.

5. Clustering

Clustering represents a technique used to invigorate the local economy of underdeveloped and depressed areas. In broad terms, it is described by a situation when groups of closely located companies pool the available resources, such as technology, information, inputs, customers and supply channels allowing them to operate more productively. The benefits that companies can gain from being a part of a cluster include wider market opportunities, lower operational costs related to marketing, administration and rent, improved rating with the financial institutions and a better access to investment finance.

Successful examples of clusters can be found in a number of European regions, in particular in Emilia-Romagna (Italy), Baden-Wurtemberg (Germany), Silicon Valley (US), Technology Club cluster in Wales (United Kingdom), and more recently in some regions of south Korea and China.

Although for transition countries clustering is a relatively new regional development tool, there are examples of successful clusters developed in several regions of Ukraine (e.g. in Khmel'nitski region), the Czech Republic (Ostrava region), and in St. Petersburg, Moscow and Samara regions of Russia. The experience shows that the systemic approach to clustering as well as the involvement of various stakeholders in its creation and operation have permitted to locally develop new technologies, substituted locally-produced goods and raw materials for a number of imported counterparts, and have enabled important spill-over effects in the local economy. Through the activities of the building cluster in Khmel'nitski region for example, during the first two years of its operation (early 2000s) there appeared 480 new jobs, the cost of one square metre in newly built houses decreased by 10 per cent, while the labour productivity in construction grew by 15 per cent. Simultaneously, the cluster enterprises attracted the additional investment to the region equivalent to about USD 750 thousand.⁵

It is argued that the successful functioning of clusters depends on a number of region-specific institutional and cultural factors – national and regional policies and attitudes, customs and norms, as well as the degree of trust between the major stakeholders. For this reason, the emulation of successful experience, arguably, is not easily transferable from country to country and from region to region.

⁵ Nikolay Maliy. Cluster as a New Form of Entrepreneurial Amalgamation. Paper presented at the ILO-UNECE Regional Forum "Social Aspects and Financing of Industrial Restructuring", 26-27 November, Moscow, p. 4.

The Forum might wish to discuss the accumulated best practices of clustering, identify the major prerequisites of their success and reflect on the possibilities of their use in transition countries.

6. Solutions and the role of Governments

At national level, the legal and institutional framework as well as the economic policy of the Government determine the environment within which managers have to conduct restructuring. This central economic function of the state is not specific to individual sectors or geographic areas.

The role of laws and regulations related to entrepreneurship (establishment of new companies, their registration, taxation, supervision of their activities by government agencies and accounting etc.) is of particular importance. In transition economies, new enterprises, most of which are small, are known to be more productive and growing faster than large companies. At the same time, the regulations governing the establishment of new enterprises still incorporate a lot of red tape. At the end of the last decade, the number of procedures to follow in order to establish a new company in transition economies ranged from 7 in Latvia to 20 in the Russian Federation, while the time to comply with these procedures ranged from 23 days in Latvia to 89 days in Slovakia. These figures compare unfavourably with the most liberalized developed market economies: in the United States and the United Kingdom, for example, the number of procedures to follow does not exceed 4 and 5 respectively, while the total time required to comply with those equals 4 days.⁶

More liberal rules of establishment and enterprise operation will facilitate the emergence of new off-springs, capable of taking over the “non-core” production lines as well as absorbing the employees made redundant by downsizing core enterprises in single-industry towns and areas. At the same time, the resource transfer to SMEs should be encouraged both through easier market entry and exit mechanisms, and hardened budget constraints for large enterprises, which lose competitiveness.⁷

The role of central Government can be also instrumental in facilitating the labour mobility. In particular, laws enabling the operation of the real estate market, including the legal basis for the mortgage finance, are indispensable. These laws could permit the redundant workers sell their property and acquire a new one in areas where employment is available.⁸

The creation of framework conditions for restructuring by central Governments should not belittle the role of regional and local authorities. The experience of different countries shows that programmes by local administrations can effectively alleviate the hardships of restructuring. In 2001, in Tambov region of Russia, for example, the regional authorities initiated some extraordinary public works and arranged for temporary employment in an agro-industrial enterprise for redundant workers of Uvarovo Chemical Plant, which was going through restructuring. Simultaneously, the regional business incubator organised for them training courses in business management tailored to the needs of local SMEs.⁹ In the second half of the 1990s, the local administration in Lisakovsk, town built around the iron ore mining enterprise in Kazakhstan,

⁶ UNECE. Economic Survey of Europe, 2003 No. 1, p. 135–136.

⁷ Ibid.

⁸ Paul Hare. Industrial restructuring as a means of enhancing national competitiveness: overview of the problem. Paper presented at the Round Table “Industrial Restructuring in European Transition Economies: Experience to Date and Prospects”, 12-13 February 2002, Geneva, p. 8.

⁹ Olga Laptewa. Problems of Single-Industry Towns and Areas – the Experience of Tambov Region. Paper presented at the Round Table “Industrial Restructuring in European Transition Economies: Experience to Date and Prospects”, 12-13 February 2002, Geneva, p. 7.

successfully managed to organize the training and retraining of laid off miners, and to combine the income support measures with extraordinary public works as a social safety net measure.¹⁰

At the same time, in transition economies local initiative is limited by the financial weakness of regional and municipal authorities. For example, for lack of financing the public services previously provided by core enterprises cannot be taken over by local administrations and municipalities. For the same reason, local authorities cannot contribute to adequate retraining of laid-off workers and improve the information flow on vacancies and housing available in other towns and areas.

While the issue is controversial and opinions thereon diverge, many experts think that to remedy the situation and to enhance the local capacity in industrial restructuring the redistribution of revenues among different levels of Government is required. As suggested by Paul Hare for example, the reform of local and regional government finance should break the excessive dependence of local budgets on tax receipts from one or several big local enterprises.¹¹ The re-allocation of revenues collected at national level or at least at broader regional levels would enable the financing of local programmes supportive of restructuring, in particular the rendering of public services cut off the “core” enterprise, retraining of laid-off workers, information services for the unemployed and others. Preferential tax regimes for enterprises located in underdeveloped and depressed areas would work to the same effect.

Regarding some of the “social” functions of the core enterprises, a temporary solution could be to cut them off in such a way that though managed and owned by municipalities they would be financed by central (Federal) Governments. Subsequently, the local authorities could consider privatising some of these public services (e.g. in health care and child care), once the climate for entrepreneurship is improved.

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Questions for discussion

1. What are the major legal and regulatory obstacles to restructuring in single-industry towns and areas, and what should Governments do to eliminate those?
2. What instruments of restructuring in single-industry towns should be handled and financed respectively by Central Government, regional administrations and municipalities?
3. In what areas, do you think, the private sector could contribute to problem-solving most effectively?
4. How do you assess the role of labour associations and unions in restructuring the single-industry towns? How could their contribution be enhanced?
5. What are the major conditions for successful implementation of the clustering model in transition economies?
6. What criteria should be used to assess the effectiveness of clustering?
7. What action from Government administrations at different levels is required to facilitate clustering?

¹⁰ Sailau Baisakov. Op. cit.

¹¹ Paul Hare. Industrial restructuring as a means of enhancing national competitiveness: overview of the problem..., p. 8.