

TRANSITION REPORT 2014



European Bank
for Reconstruction and Development



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Erik Berglof, Chief Economist
Cairo, December 2014

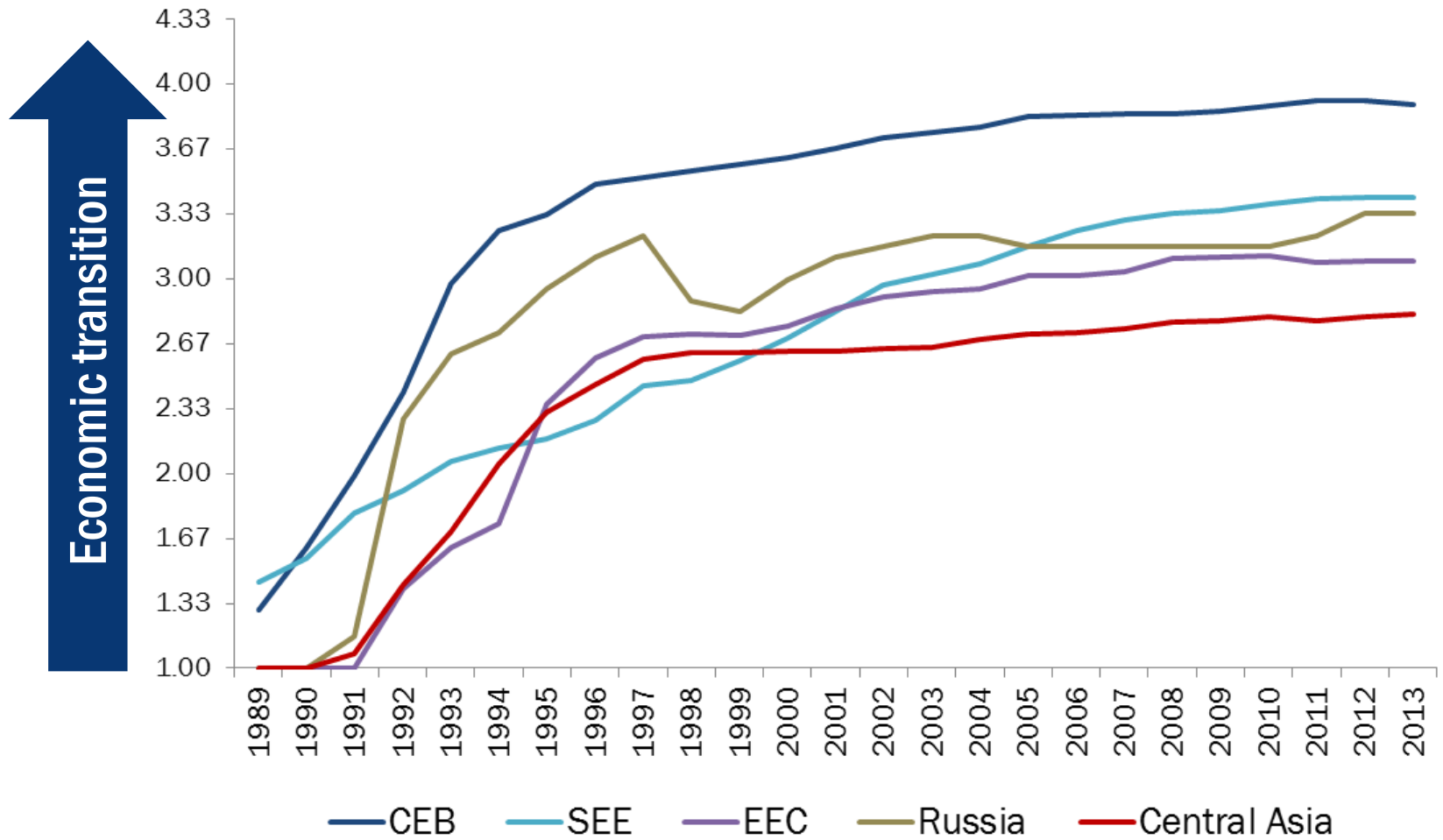
Innovation in Transition

A wake-up call

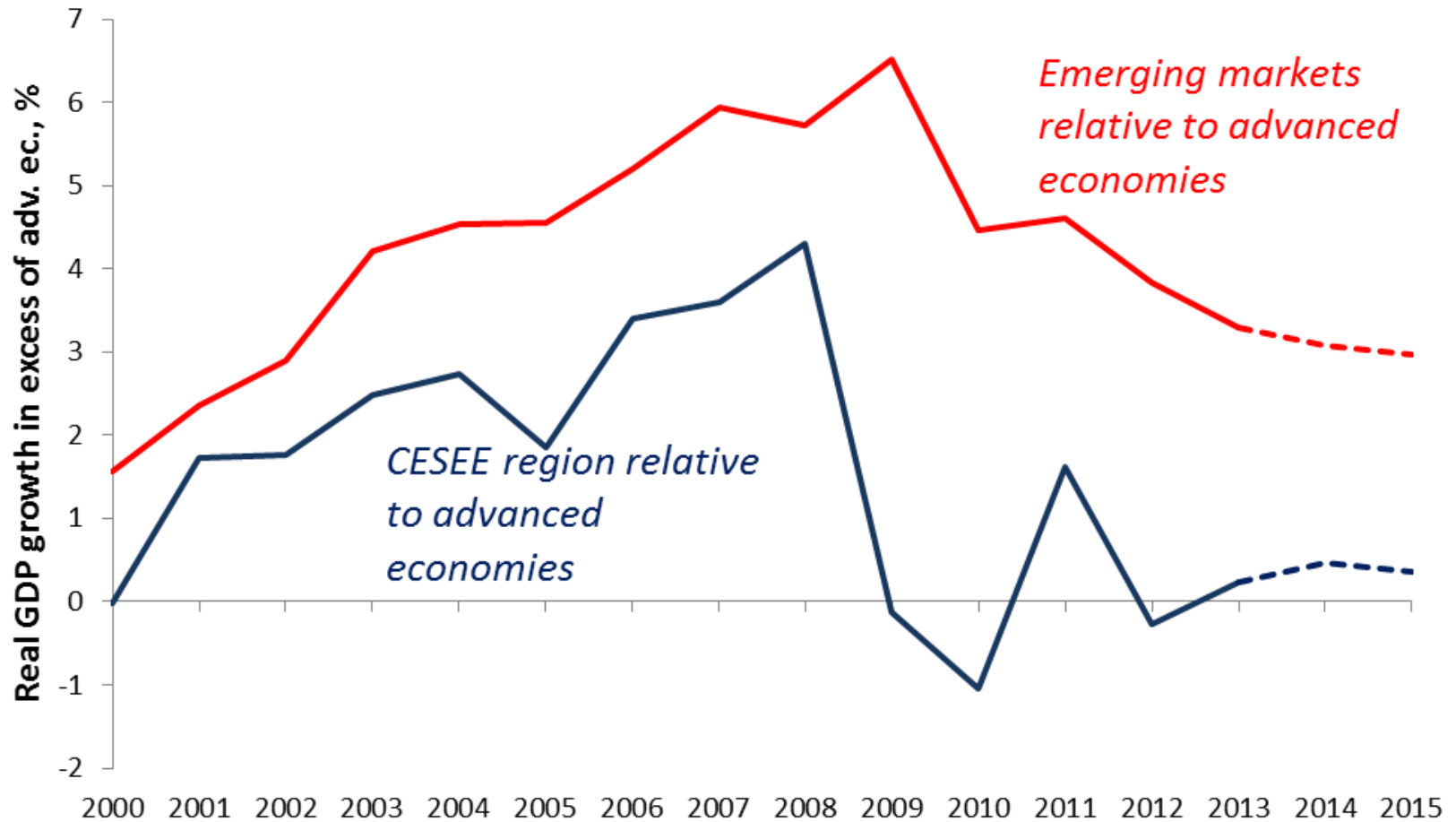
**Reform fatigue is slowing the
process of convergence**



Transition slow-down...



...means convergence slow-down



Sources: IMF WEO, EBRD REP, weighted averages.

**Innovation by
companies as a
driver of growth...**

**...re-energises
transition**

Adopt, Adapt, Advance: Picking the low-hanging fruit

Innovation = improving productivity within firms

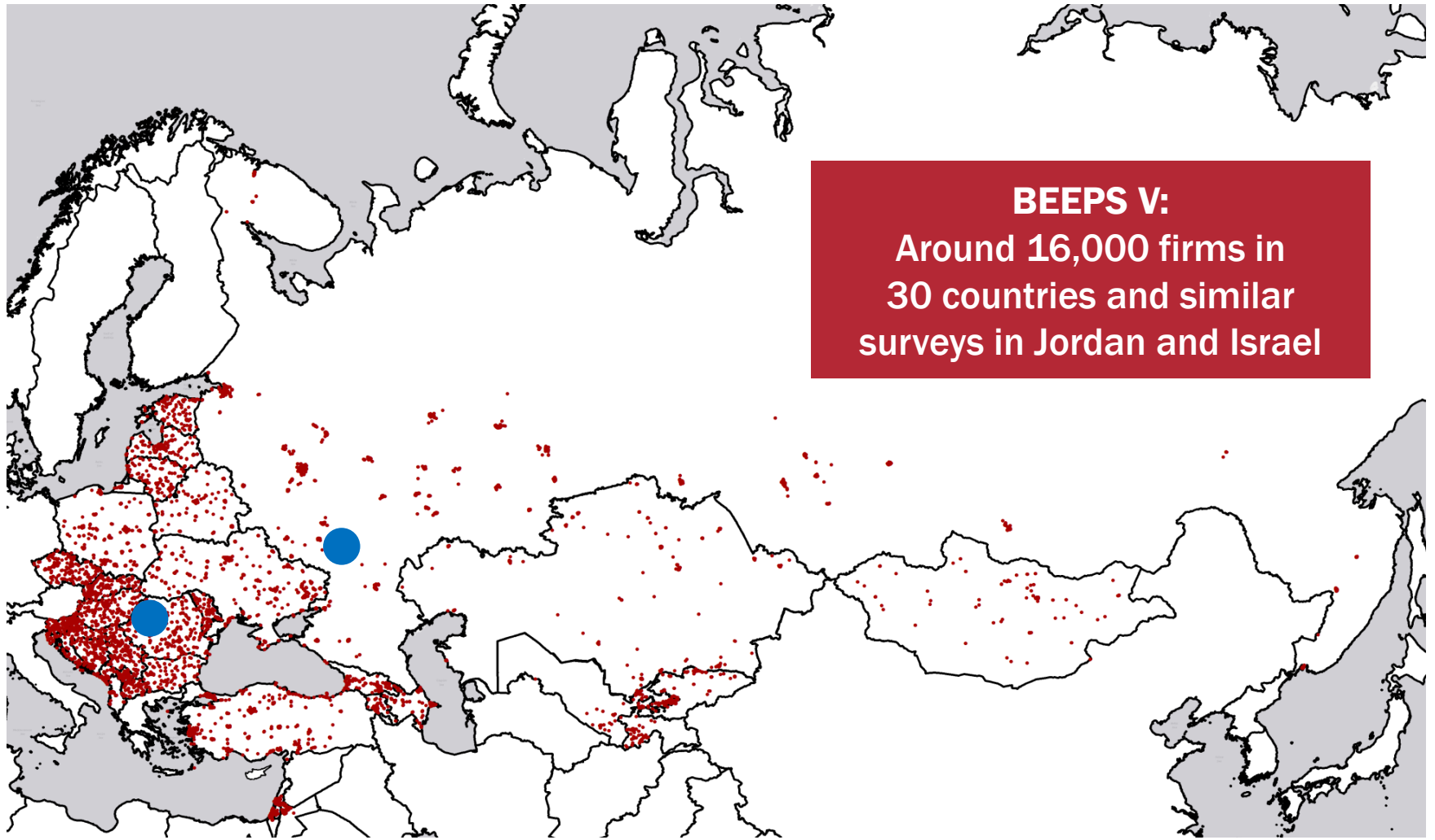
Innovation goes well **beyond R&D** in high-tech sectors

Products and production processes **new to the firm**

Firms need to **Adopt, Adapt** and **Advance** towards technological frontier



Taking the pulse on firm innovation



Innovation: New products

Sam Mills in Satu Mare, Romania.
A corn milling company since 1994

Significantly increased value added
through in-house R&D since mid-
2000s

New products: gluten-free pasta,
products with a low glycaemic
index

Selling through chains in US, EU
and Asia: via Amazon and
specialist health-food stores



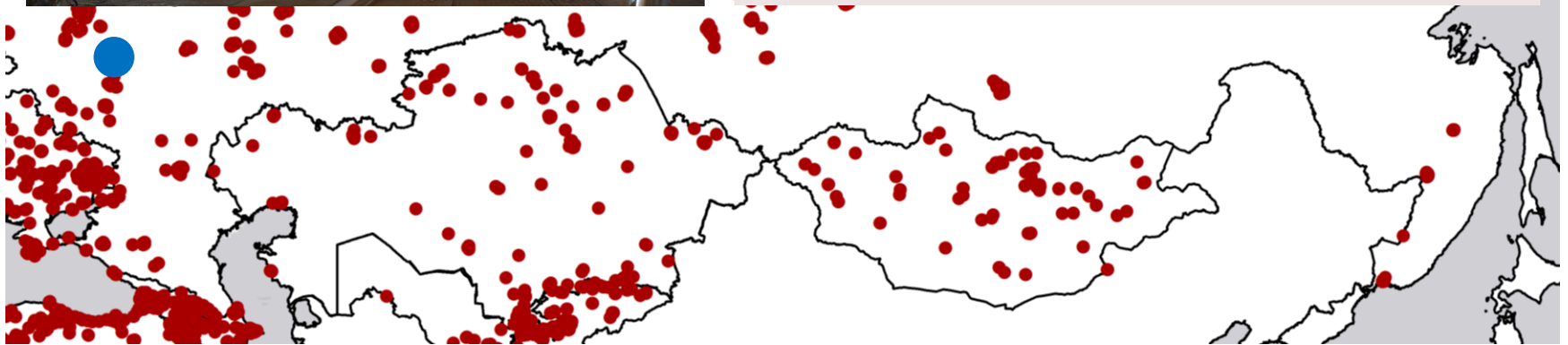
Innovation: New production processes



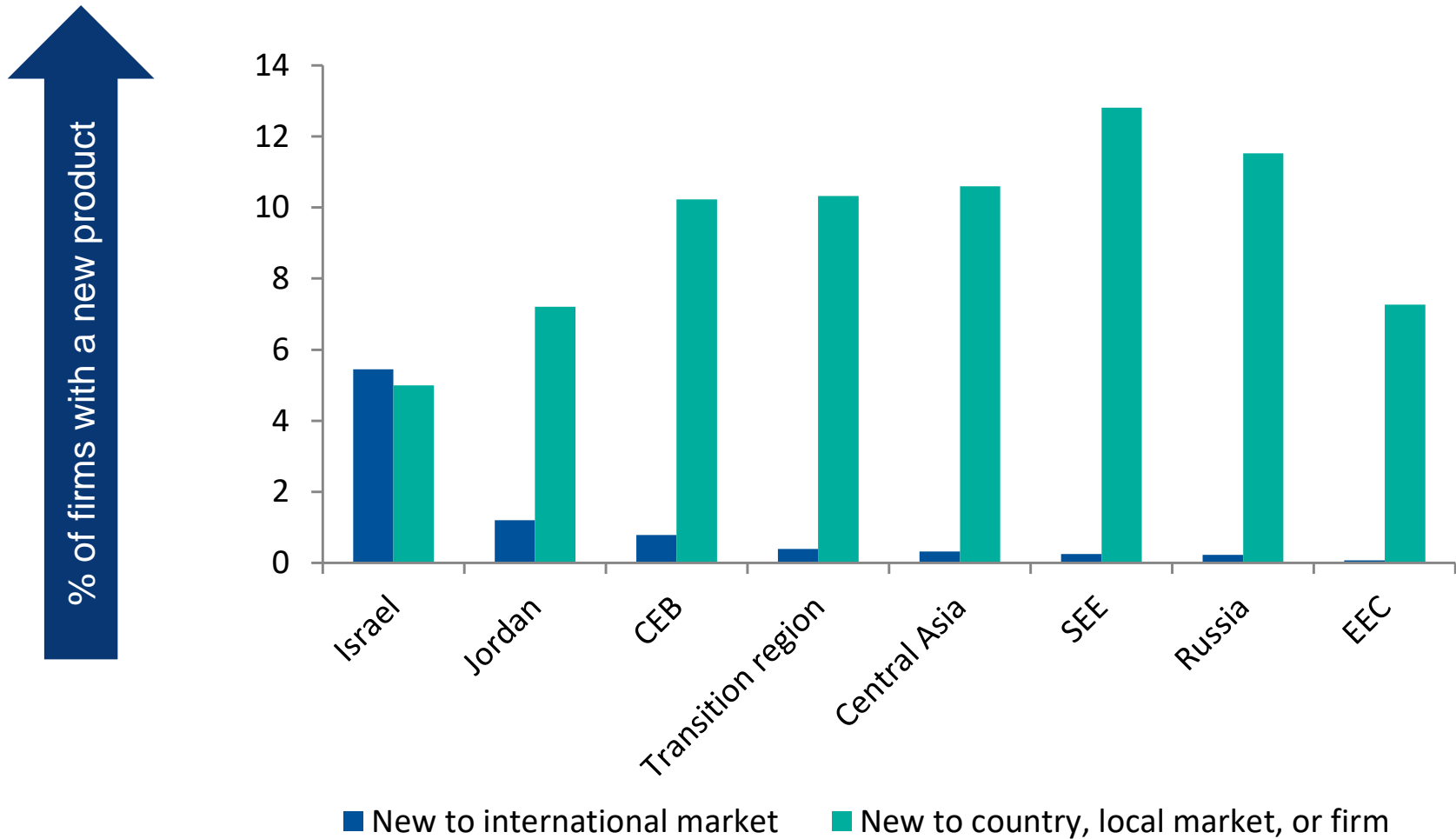
Russia's NLMK founded in Lipetsk in 1931

One of the world's largest steel producers

New process (pulverized coal injection) helped reduce costs (cut gas consumption by 70%)

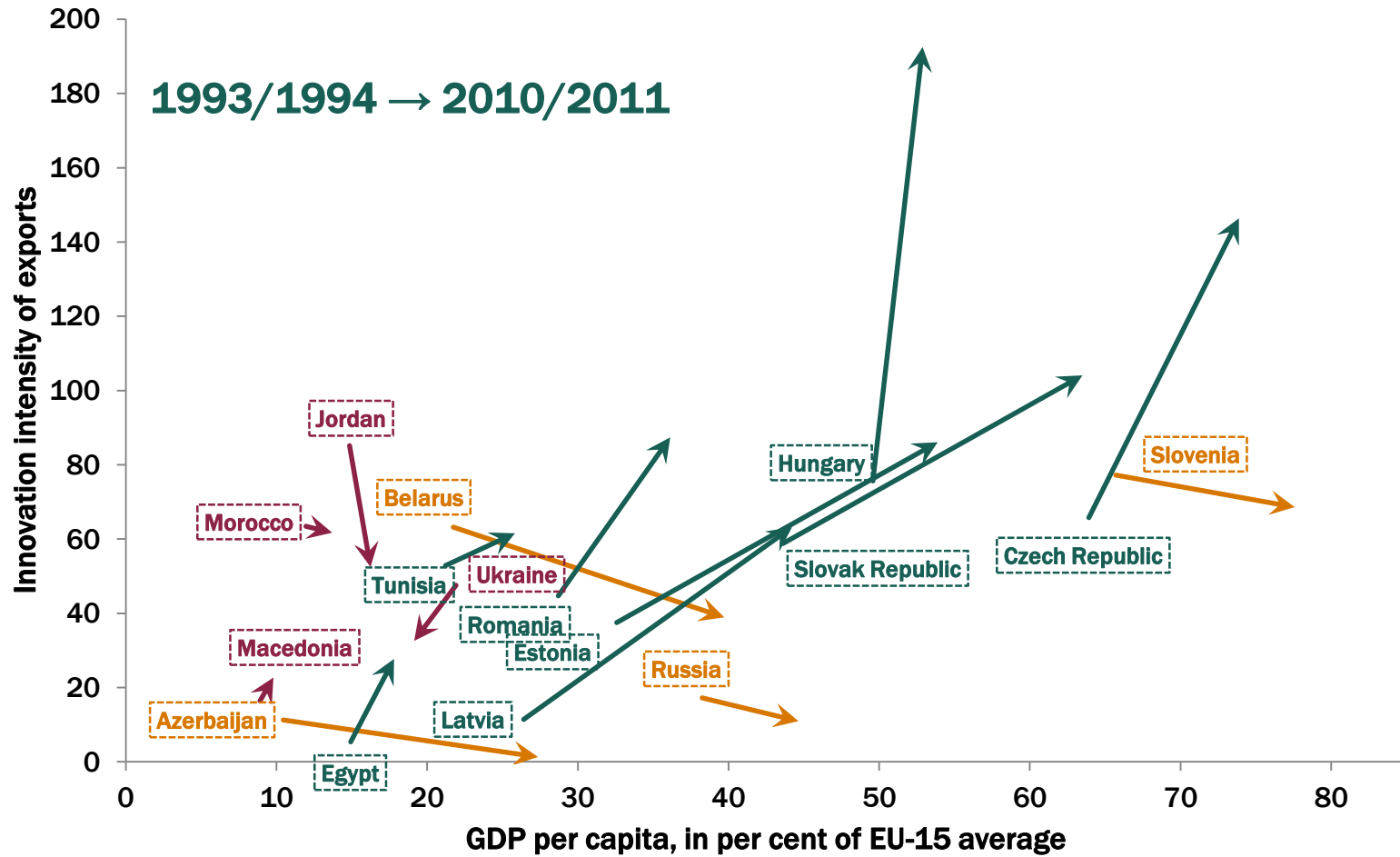


Firms in the transition region focus on technology adoption



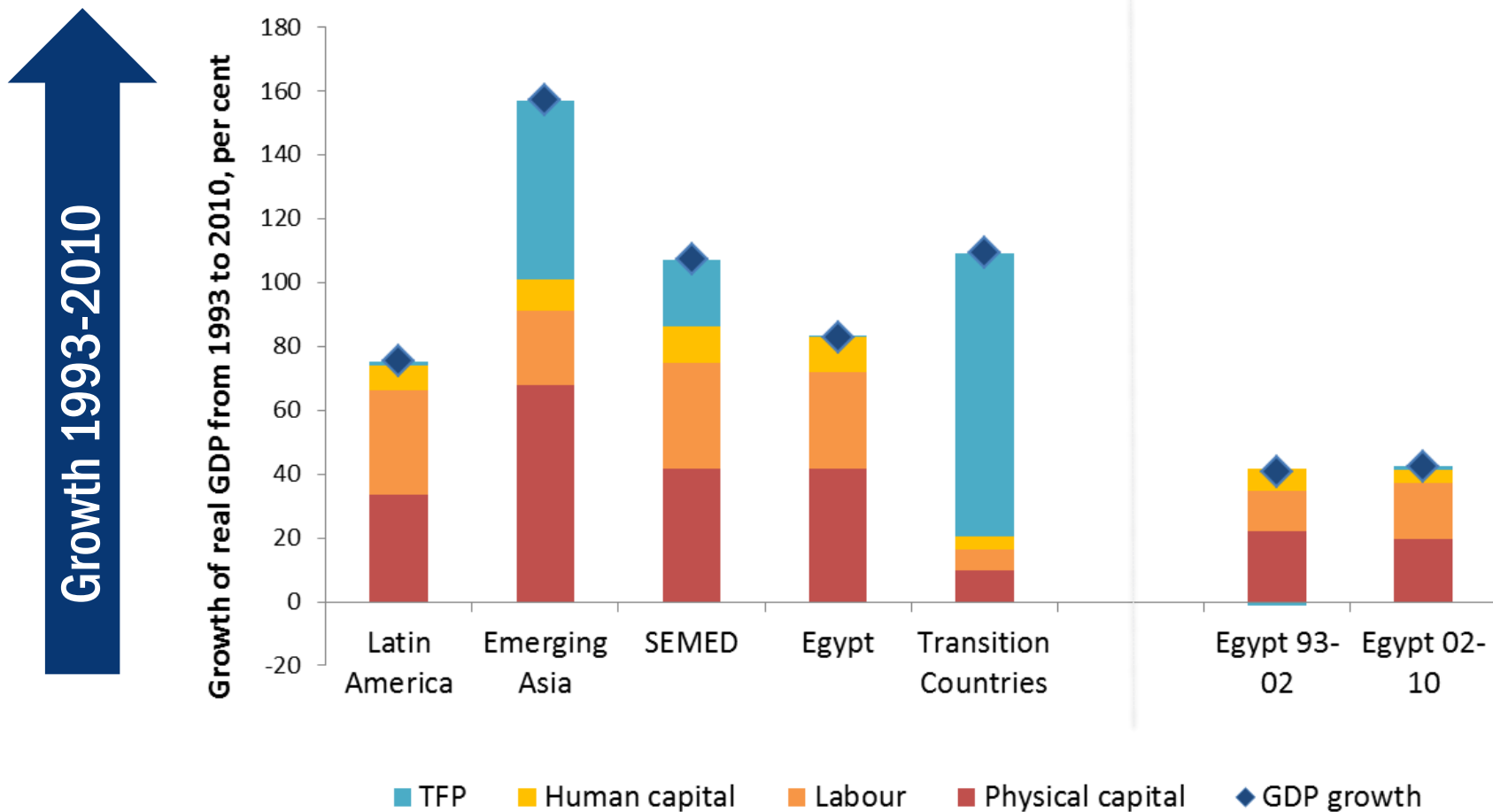
Source: BEEPS V

Firm innovation gets countries unstuck...



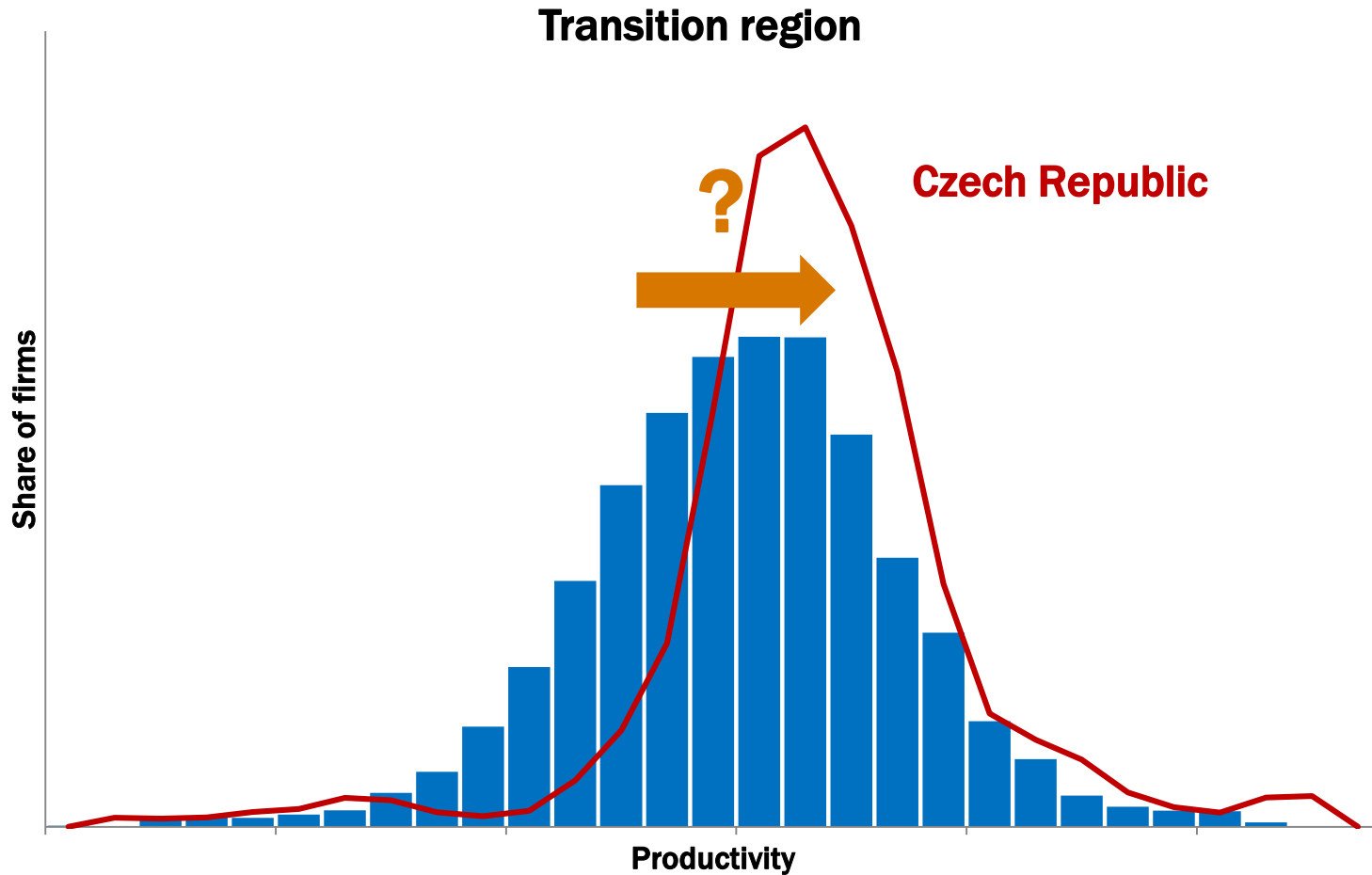
Source: USPTO, UN Comtrade, Feenstra et al. (2005)

...by boosting aggregate productivity



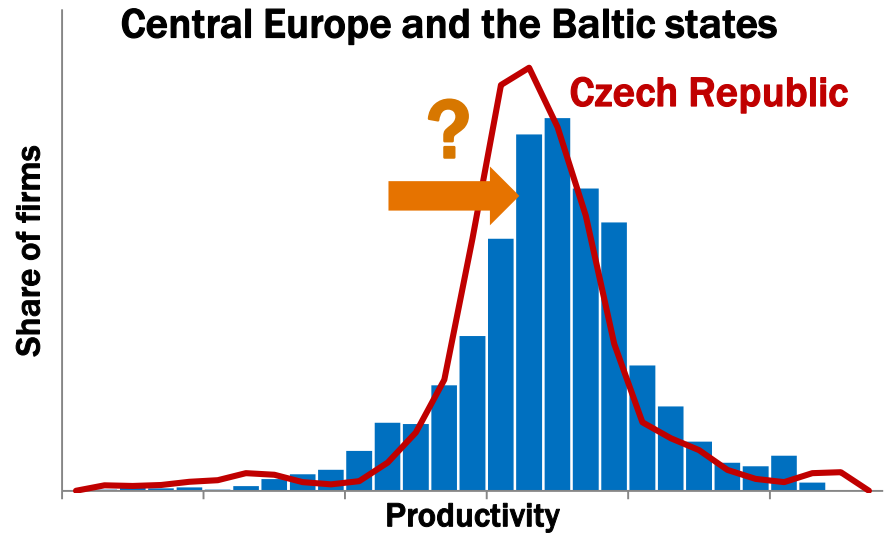
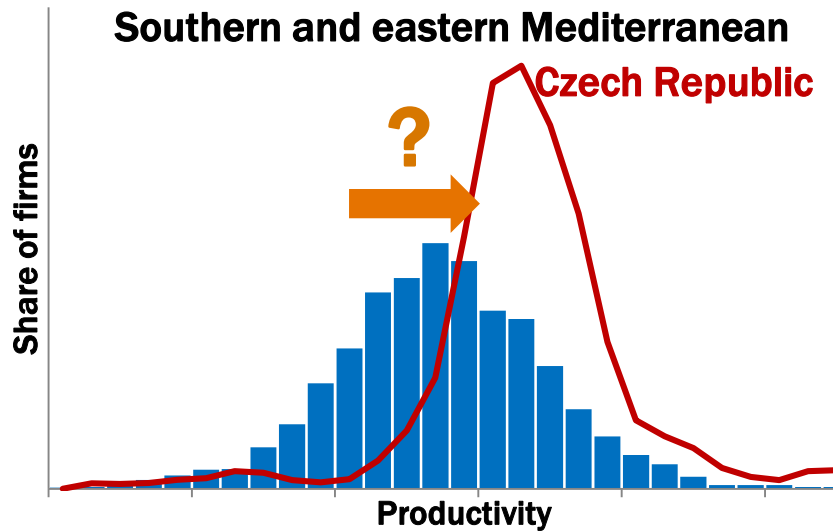
Source: EBRD Transition Report 2013, Penn World Tables 8.0.

In each country firms can innovate to improve their productivity



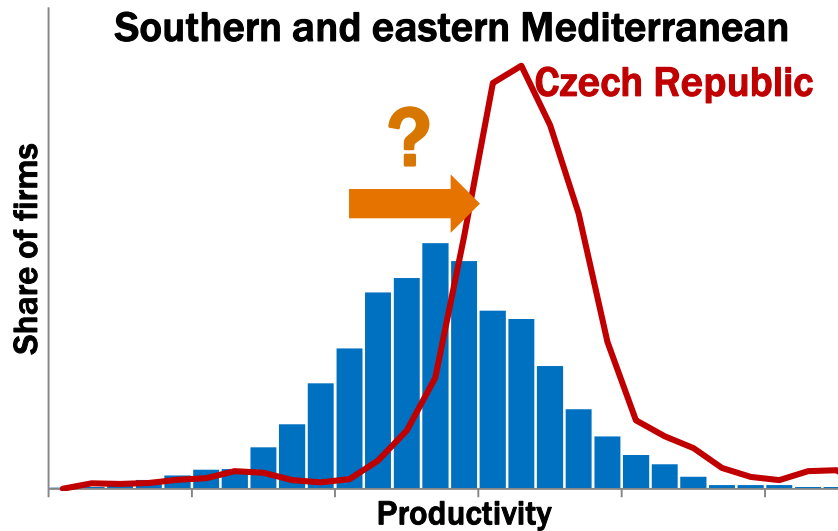
Firm innovation can improve productivity everywhere

- Some firms are as productive as leaders in advanced markets...
- ...but laggards must adopt and adapt – or die – to raise aggregate productivity and get countries unstuck

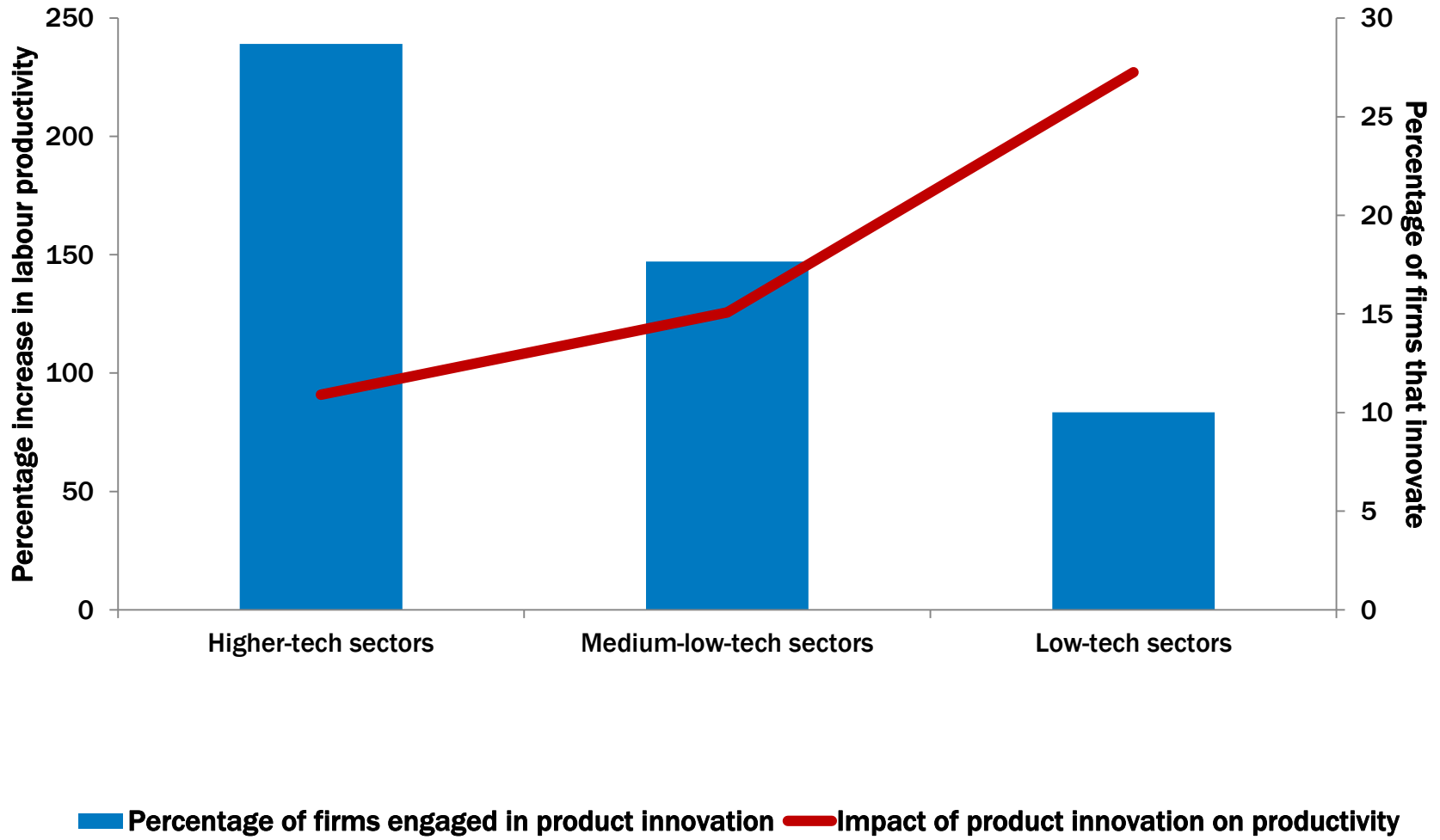


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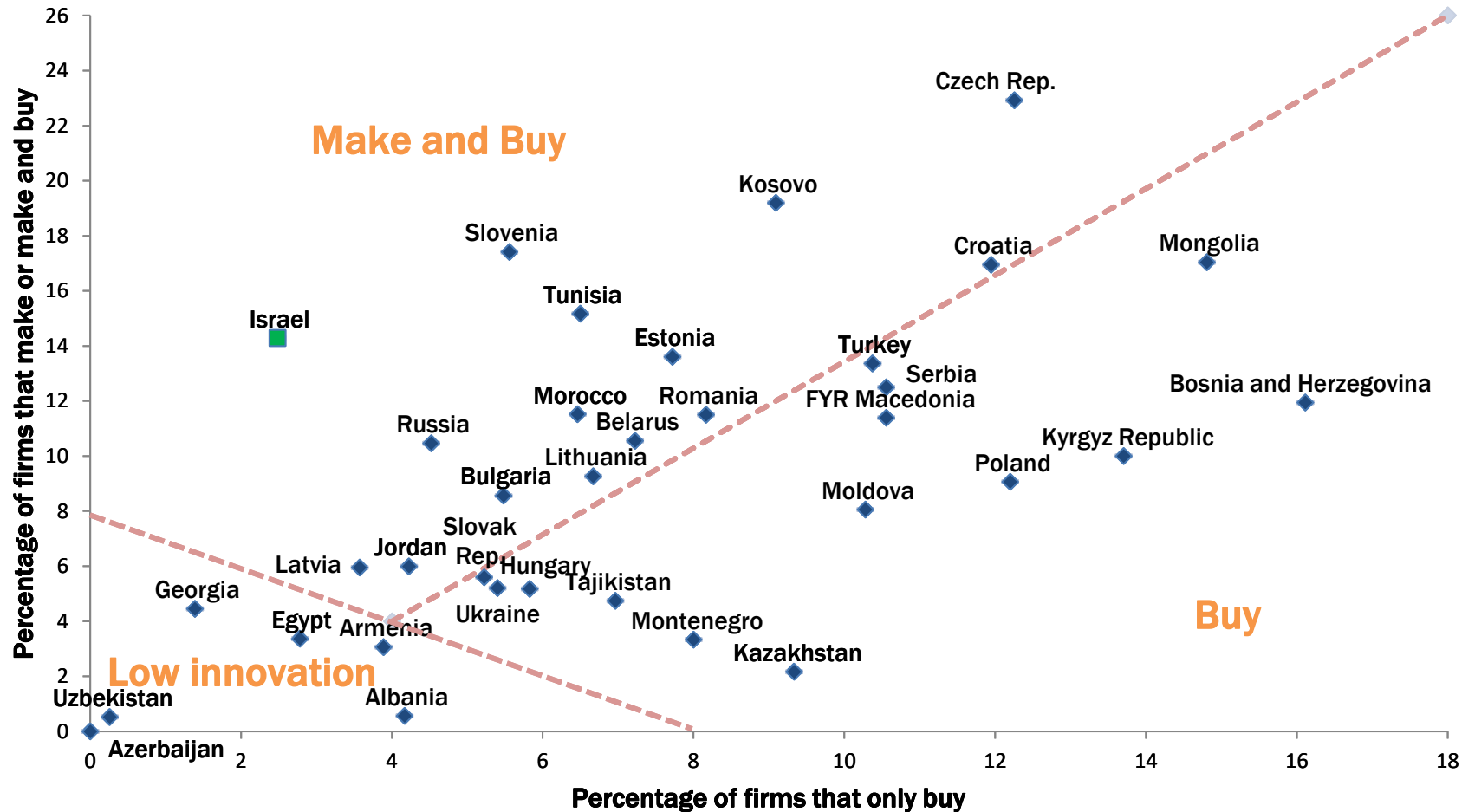
- Some firms are as productive as leaders in advanced markets...
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Pay-off from innovation highest in low-tech industries...

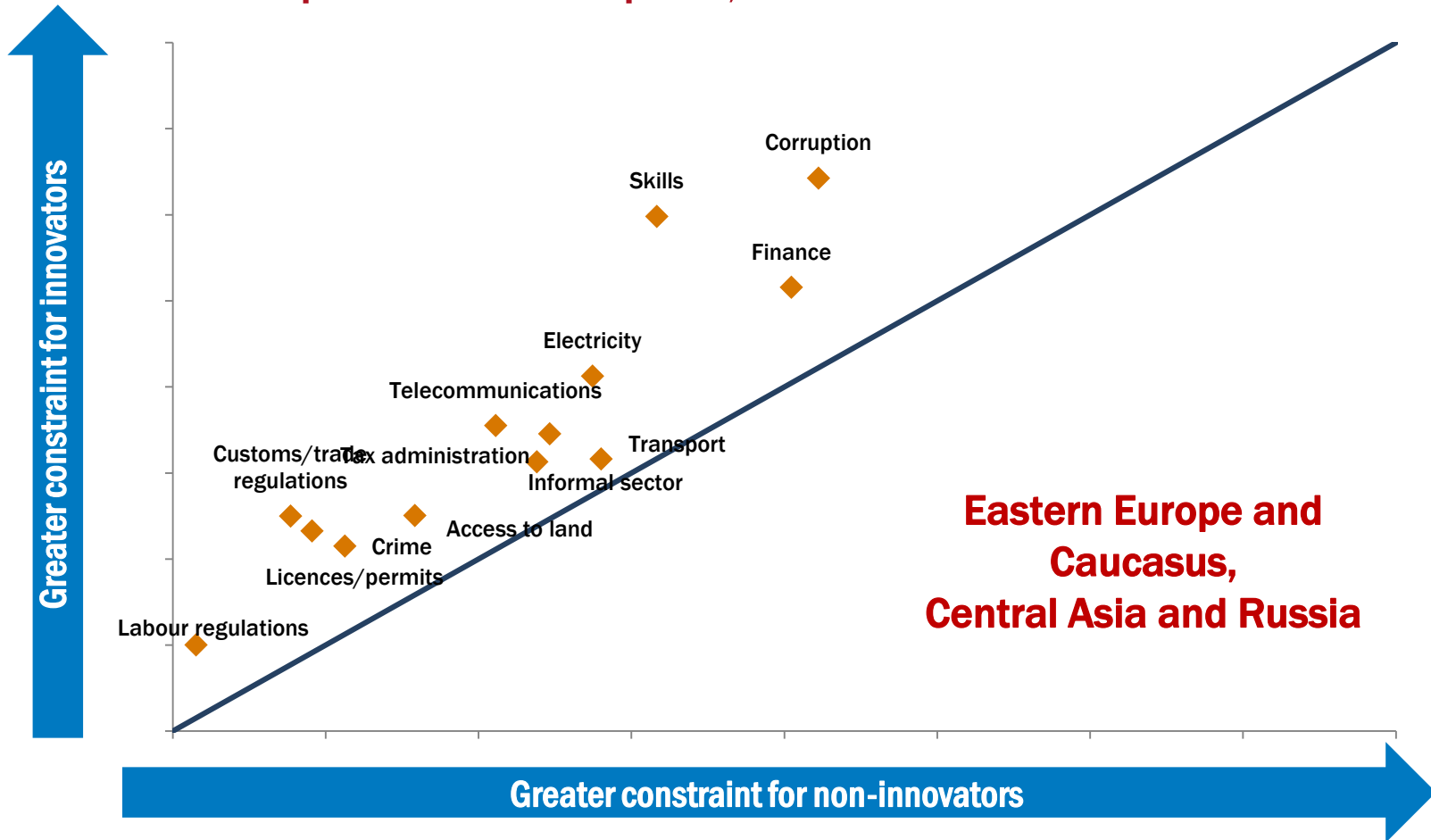


...often best achieved by simply acquiring foreign know-how

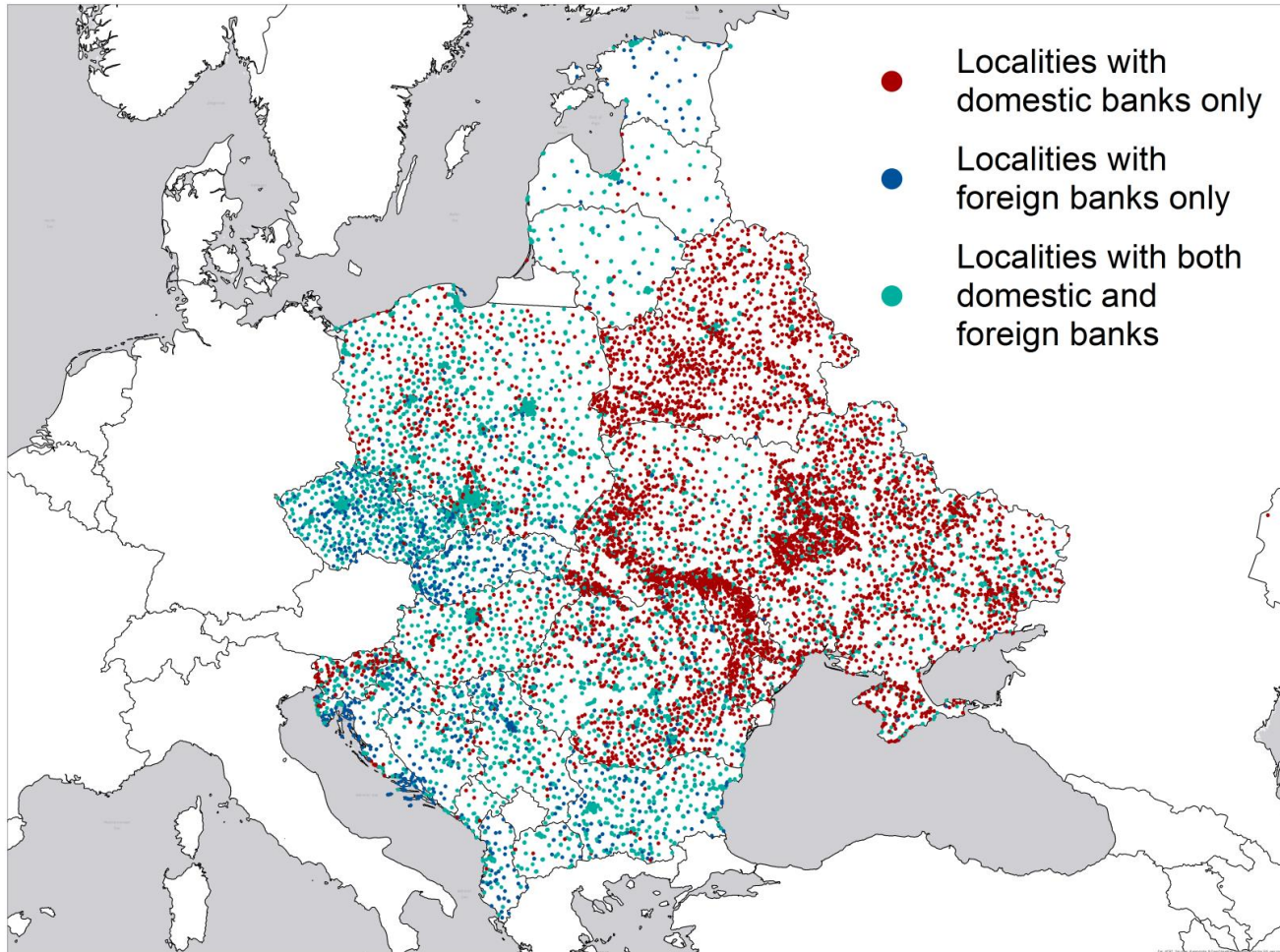


Innovative firms are more sensitive to the business environment

In particular: corruption, skills and access to finance

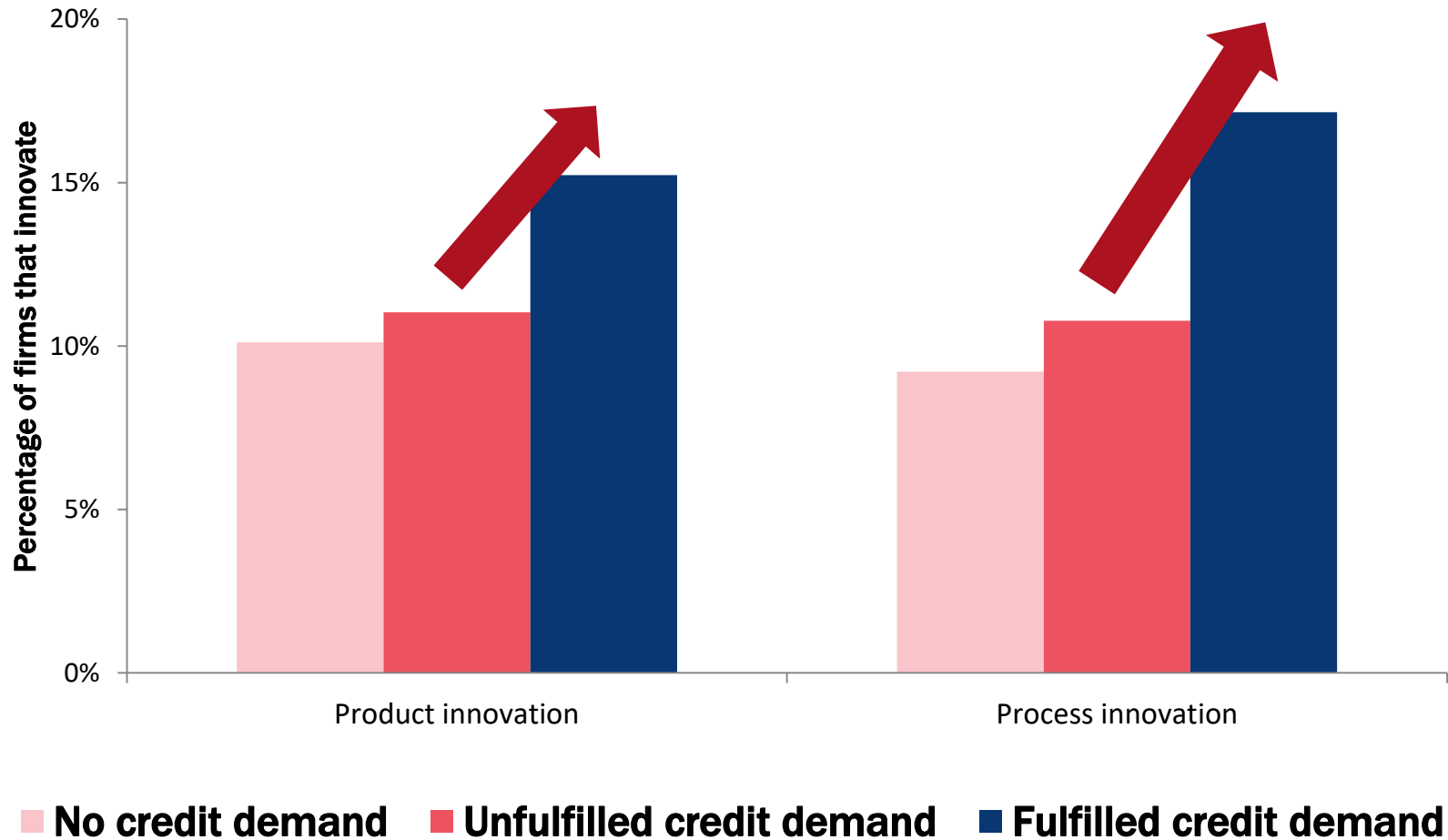


Variation in local banking markets affects firms' access to credit...



Source: BEPS II

...and their ability to innovate



What can policy-makers do?

Countries' innovation policies are too similar

- Too focused on high-tech, R&D, university-industry transfer of technology
- Not enough to adopt policies from advanced economies, must also adapt them

Tailor policies to account for distance to technology frontier and local institutional capacity

In most countries, more effort needed to help firms access foreign technologies

Embrace economic openness

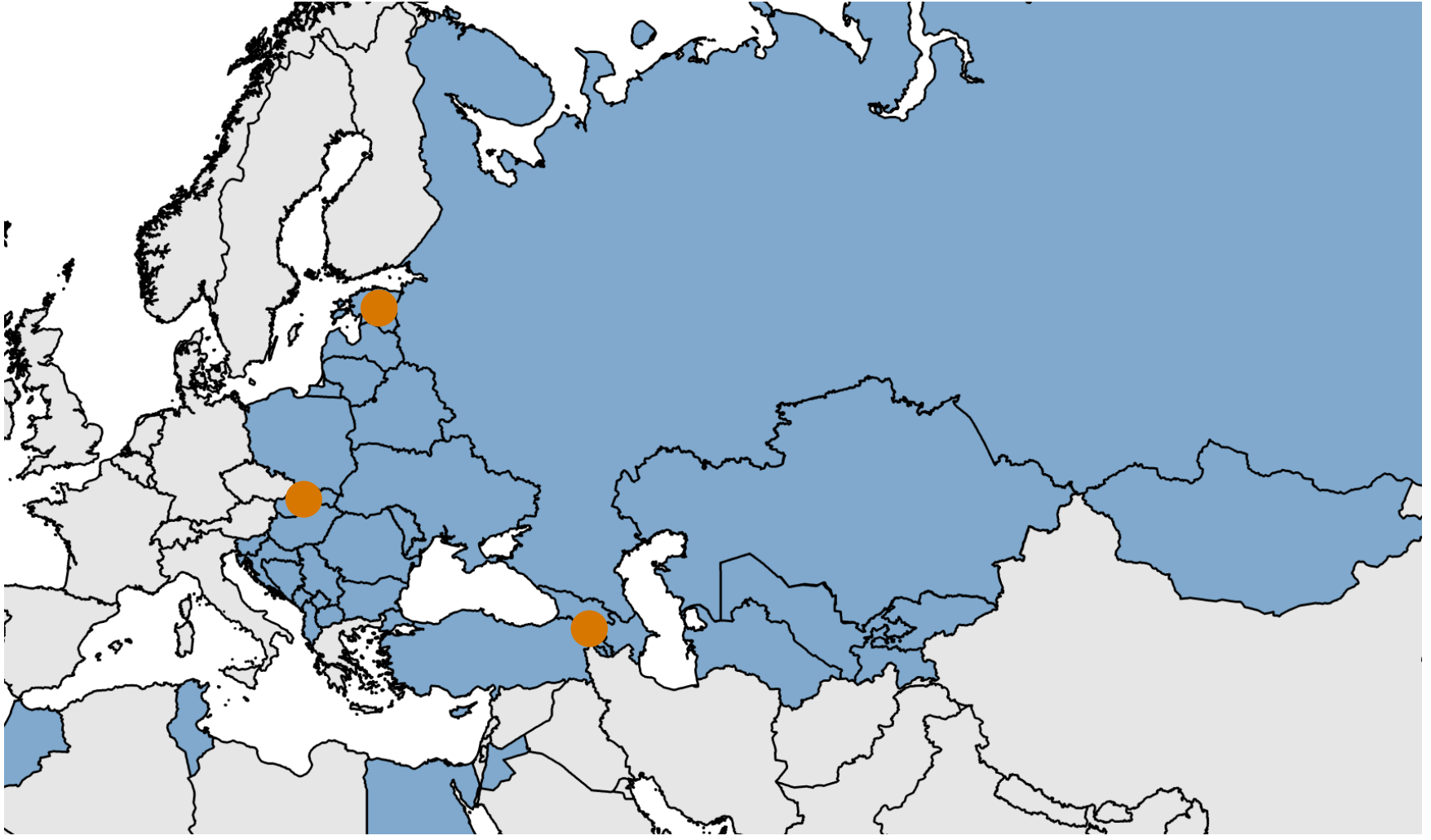
Help firms export and enter global value chains through:

Quality certifications

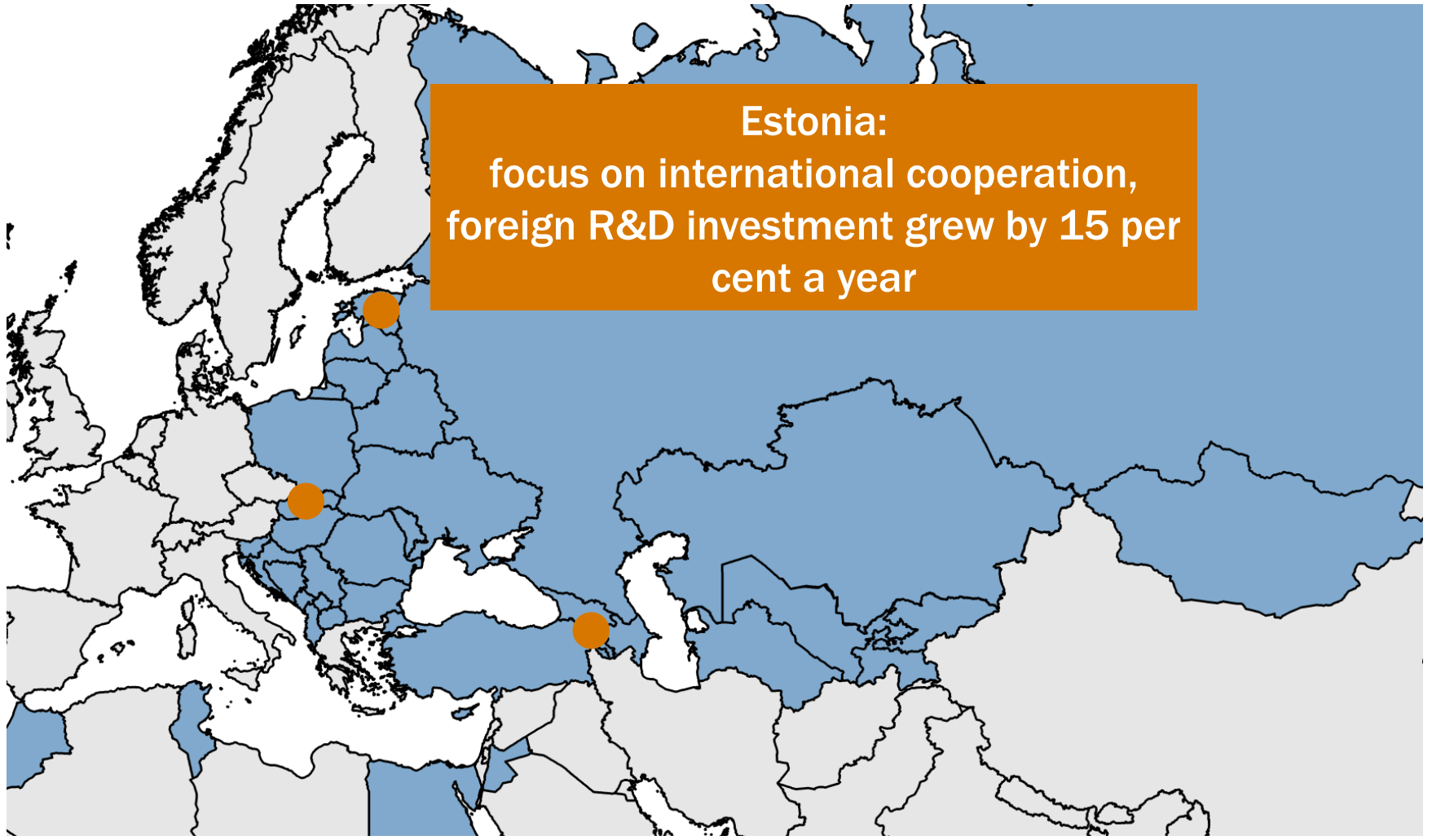
Streamlined export
procedures

VAT refunds

Embrace economic openness



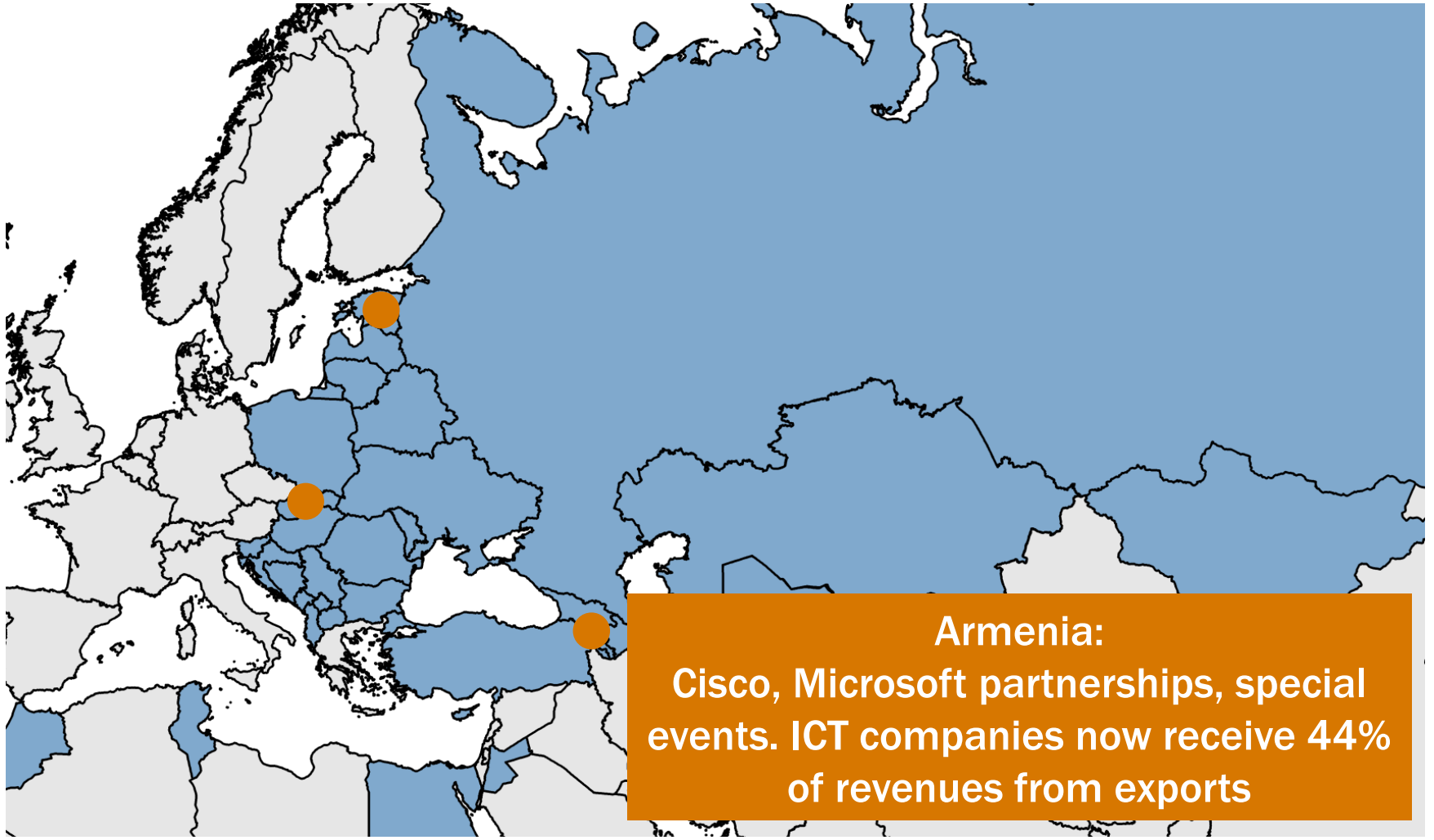
Embrace economic openness



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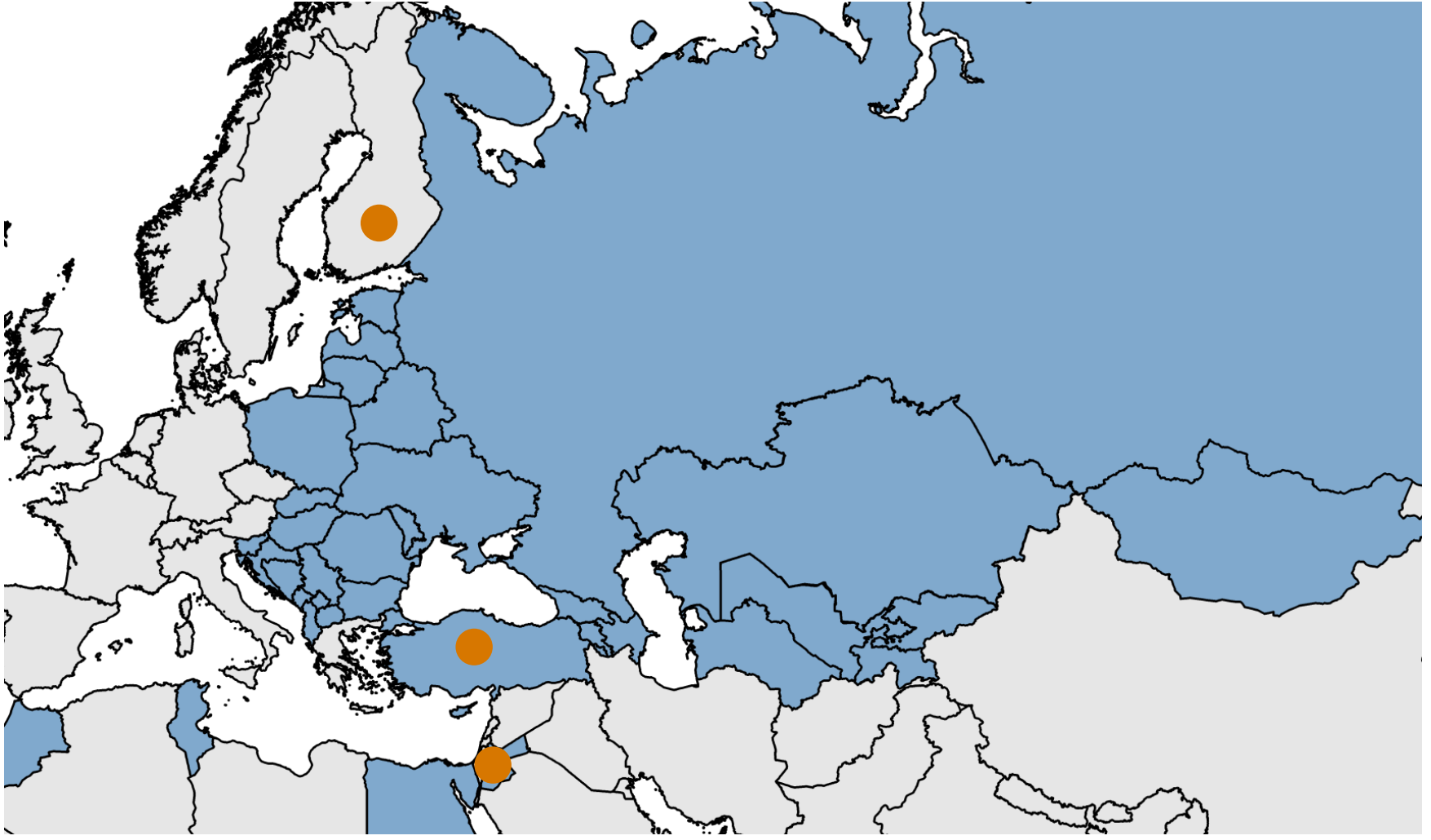


Right mix of horizontal vs. vertical policies

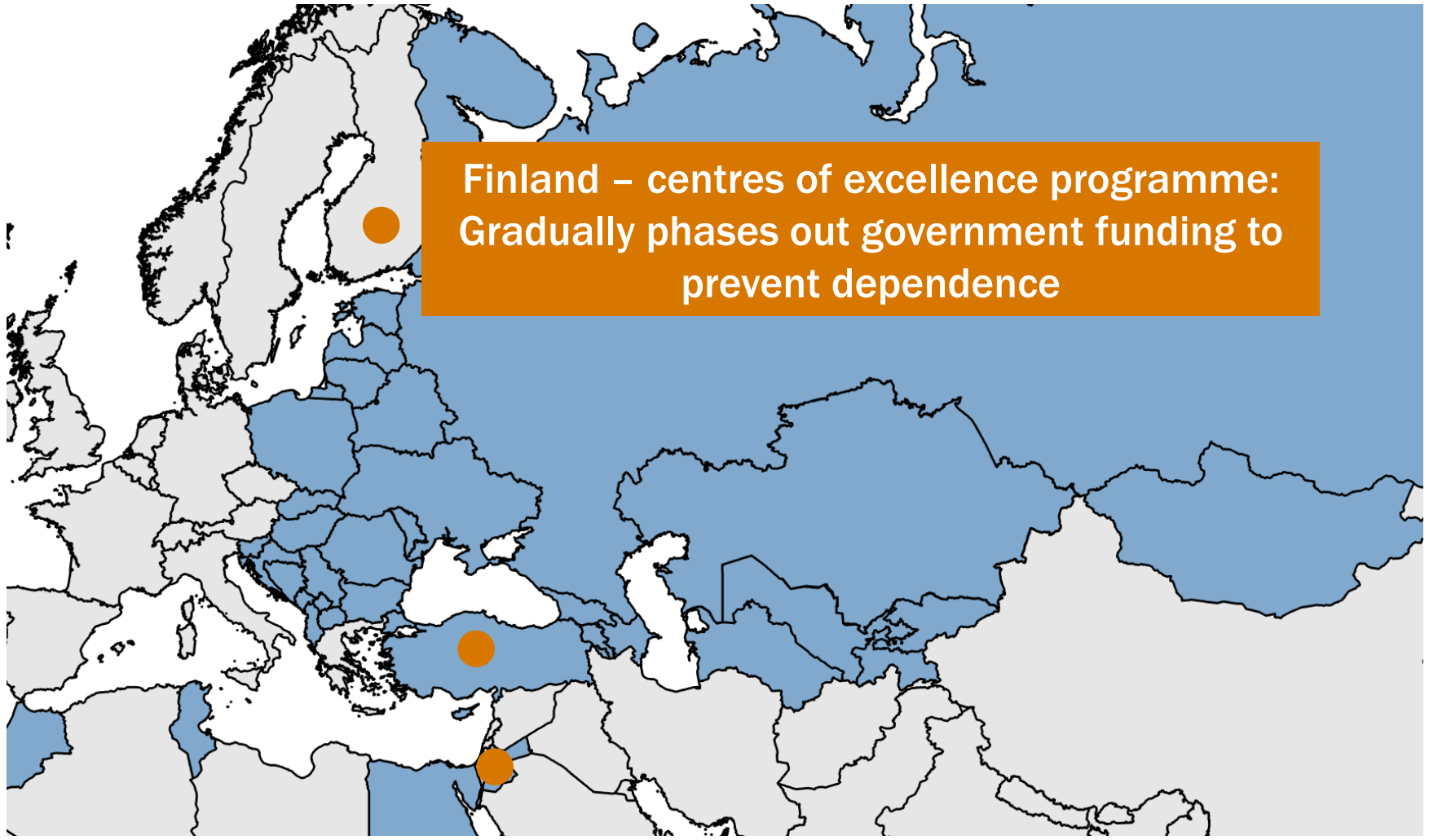
**Use vertical
policies to
crowd in the
private
sector**

**Focus on
horizontal
policies where
governance is
weak**

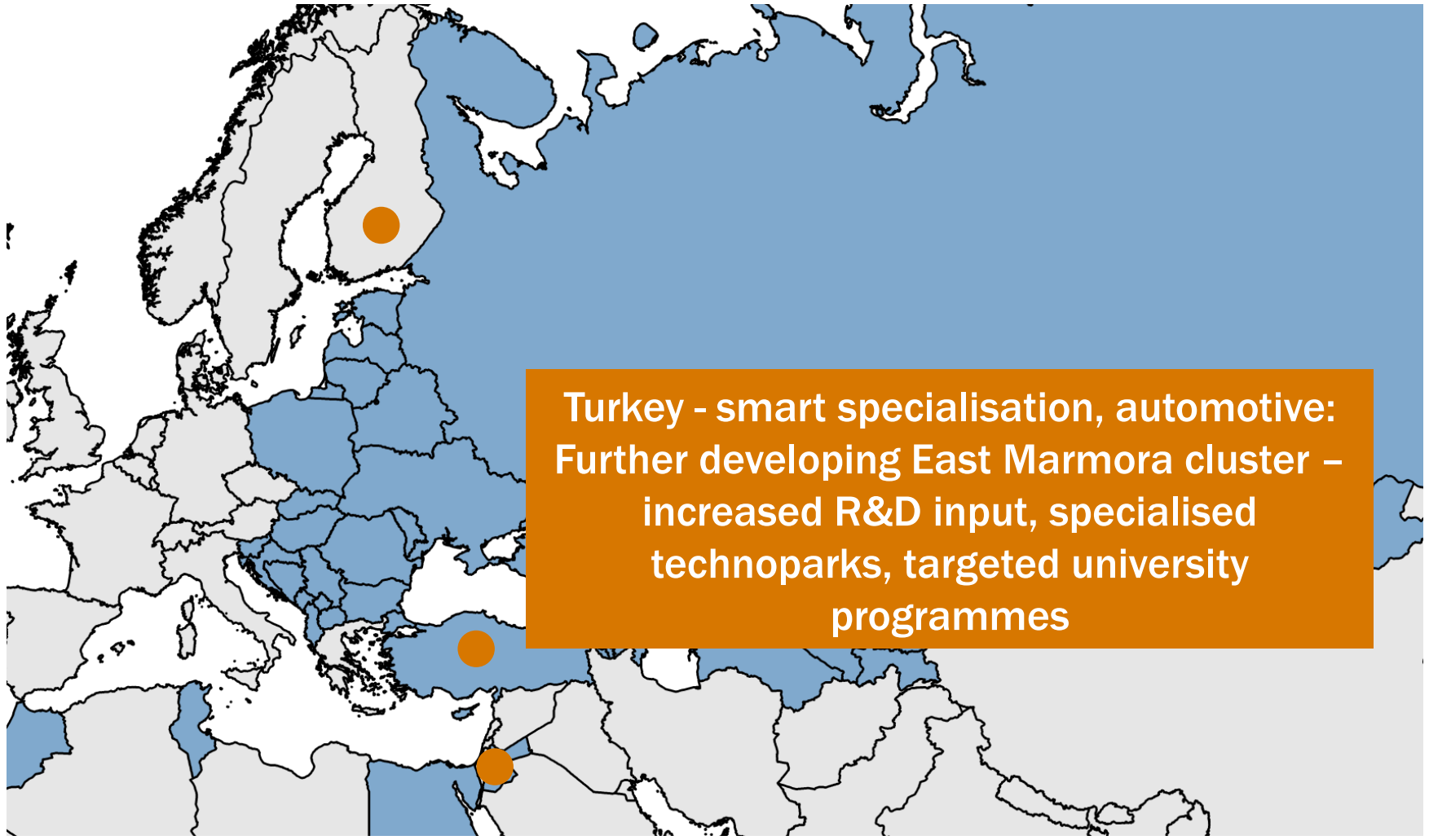
Right mix of horizontal vs. vertical policies



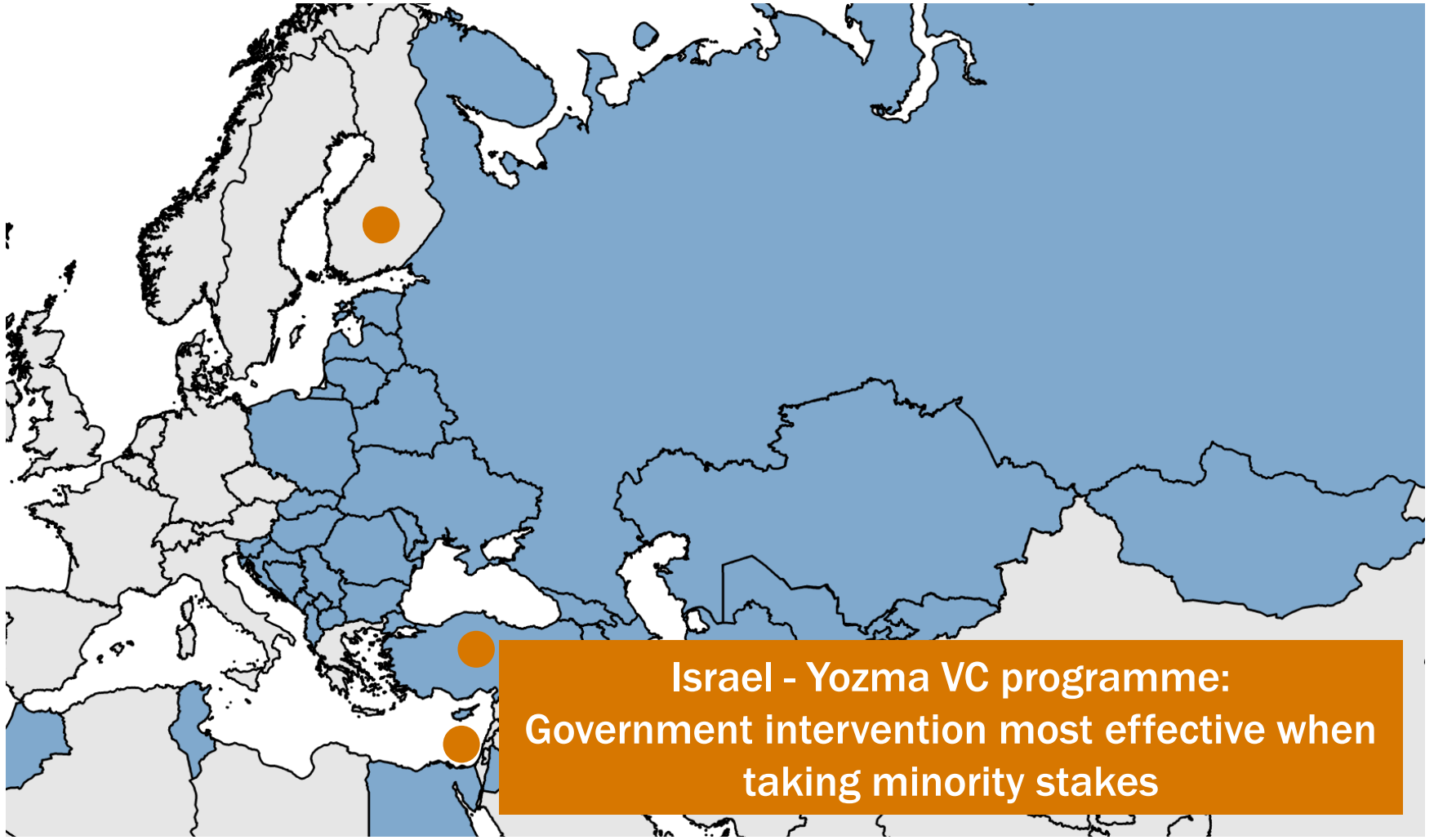
Right mix of horizontal vs. vertical policies



Right mix of horizontal vs. vertical policies



Right mix of horizontal vs. vertical policies



Getting 'unstuck': a double act

Need firms willing to innovate and governments facilitating innovation

Innovation must be nurtured and supported with a tailored approach:

Adopting/adapting phase:

- Tackle general barriers like corruption, labour skills and access to finance
- Help firms access international technology and value chains
- Promote smart specialisation

More advanced economies:

- Nurture creativity
- Encourage highly specialised human capital
- Improve competition policies
- Facilitate access to VCs and private equity for young start-up firms

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