

Picking Winners? Trade and Investment Policy in Socialist Eastern Europe

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2740 words

1 Introduction

Industrial policy has experienced a global resurgence in recent years. This shift is driven in part by the remarkable industrial development witnessed in East Asia, most notably China.¹ In parallel, the United States has rekindled its industrial base through initiatives such as the Inflation Reduction Act, while European nations, spurred by the COVID-19 pandemic and evolving geopolitical challenges, have reassessed their priorities regarding supply security and economic security.² Additionally, growing concerns over the "middle-technology trap", characterised by low productivity, sluggish growth, and stifled innovation,³ have further catalysed a re-evaluation of industrial strategies. Yet, one historical precedent is frequently ignored: the rise and eventual economic stagnation of the Eastern Bloc during the Cold War. While centrally planned economies in Eastern Europe pursued large-scale industrialisation strategies, their long-run failure to achieve sustained growth, especially from the 1970s, raises questions about the risks and pitfalls of state-directed investment.

This paper analyses Eastern European industrialisation strategies to examine how state-directed investment shaped trade performance and competitiveness. The central research questions are: (1) How were investments allocated to stimulate industrial development, and did these strategies exhibit biases favouring certain sectors? (2) To what

1. Volker Brühl, "The economic rise of China – an analysis of China's growth drivers," *International Economics and Economic Policy* 22, no. 1 (December 2024): 16, ISSN: 1612-4812, <https://doi.org/10.1007/s10368-024-00640-w>.

2. John A. Yarmuth, *H.R.5376 - 117th Congress (2021-2022): Inflation Reduction Act of 2022*, legislation, Archive Location: 2021-09-27, August 2022, accessed April 20, 2025, <https://www.congress.gov/bill/117th-congress/house-bill/5376>; Claudia Schmucker and Guntram Wolf, "Managing Risks in the EU-China Economic Relationship," Publisher: DEU, *DGAP Policy Brief* 33 (2022), ISSN: 2198-5936; *Joint Communication To The European Parliament, The European Council and The Council On "European Economic Security Strategy"*, 2023, accessed April 20, 2025, <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=JOIN:2023:20:FIN>.

3. Clemens Fuest et al., *EU Innovation Policy: How to Escape the Middle Technology Trap*, technical report (ifo Institute - Leibniz Institute for Economic Research at the University of Munich, 2024), https://ideas.repec.org/p/ces/econpr/_report.html.

extent were these countries able to develop industries capable of competing globally, assessed through export performance rather than mere production volumes?

Picking Winners makes three key empirical contributions. First, it constructs a novel dataset combining primary sources from statistical yearbooks across eight Eastern European countries with secondary data, linking investment flows to trade outcomes at the sectoral level from the 1960s through 1980s. Second, it develops a complementary granular dataset for Yugoslavia with industry-level investment and SITC 2-digit trade data, enabling detailed analysis of how investments in specific sectors affected export competitiveness. Third, it applies panel data methods, including local projections and revealed comparative advantage measures, to establish causal relationships between investment policy and trade outcomes.

The findings challenge conventional narratives about Eastern European economic failure. Investment was heavily concentrated in industrial sectors irrespective of comparative advantage, leading to convergent export structures across COMECON countries and weak regional integration. While higher investment-to-capital stock ratios temporarily boosted total trade, these effects quickly reversed, and no significant effect can be found after 4 years. Exports would steadily increase in the first three years of an increase in the investment-to-capital stock ratio, but would not lead to further increases in the longer run. These results suggest, particularly after 1973, misallocation rather than overinvestment. The Yugoslav case study confirms that only investments aligned with comparative advantage enhanced exports, with particularly strong returns in chemicals and machinery. Investments in strategic but economically suboptimal sectors, such as food production or natural resources extraction, were negatively associated with export performance.

These findings contribute to three interrelated strands of literature. First, it enriches the economic history of Eastern Europe by integrating trade with analyses of industrial policy.⁴ Second, it intersects with studies on firm-level decision-making in Socialist economies. This set of literature includes case studies on firm dynamics in a specific country,⁵ the role of firm investment in the rise and decline of the Eastern Bloc,⁶ and the

4. Michael Kaser and Lisanne Radice, *The economic history of Eastern Europe, 1919-1975. Vol.1-3, Interwar policy; The War and reconstruction* (Oxford: Clarendon Press., 1985), ISBN: 0-19-828445-4; Robert Bideleux and Ian Jeffries, *A history of Eastern Europe: crisis and change*, 2nd (London: Routledge, 2007), ISBN: 978-0-415-36626-7 978-0-415-36627-4.

5. George R. Feiwel, *The economics of a socialist enterprise; a case study of the Polish firm*, Praeger special studies in international economics and development. (New York: Praeger, 1965); Joseph S. Berliner, *The innovation decision in Soviet industry*, Publication Title: The innovation decision in Soviet industry (Cambridge [Mass.] ; M.I.T. Press, 1976), ISBN: 0-262-02118-8.

6. Jean C. Asselain, *Planning and profits in socialist economies*, Routledge library editions. (London: Routledge, 2003), ISBN: 0-415-31307-4; Tomasz Stankiewicz, "Investment under socialism," Publisher: Routledge, *Communist Economies* 1, no. 2 (January 1989): 123–138, ISSN: 0954-0113, <https://doi.org/10.1080/14631378908427597>, <https://doi.org/10.1080/14631378908427597>; Jeffrey A. Summers, "Investment under socialism: A comparative study of the USSR and Poland," Publisher: Routledge, *Communist Economies and Economic Transformation* 3, no. 2 (June 1991): 235–250, ISSN: 1351-4393, <https://doi.org/10.1080/14631379108427681>, <https://doi.org/10.1080/14631379108427681>; Tamás Vonyó, "War and Socialism: Why Eastern Europe Fell Behind Between 1950 and 1989," *The Economic History Review* 70, no. 1 (2017): 248–274, ISSN: 0013-0117, <https://doi.org/10.1111/ehr.12336>; Leonard Kukić, "Technical change and the postwar slowdown in Soviet economic growth in a long run perspective, 1885–2019," *The Economic history review*, 2023, ISSN: 0013-0117, <https://doi.org/10.1111/ehr.13284>.

concept of the soft budget constraint.⁷ Third, it provides lessons for modern industrialisation debates, particularly in light of the renewed global emphasis on targeted industrial policies driven by recent geopolitical and economic trends.⁸

2 Data Construction and Methodology

2.1 Novel Dataset Architecture

This study employs two complementary datasets that together provide unprecedented granularity in linking Cold War investment policy to trade outcomes. The first is a macro-level panel covering eight Eastern European economies (Bulgaria, Czechoslovakia, GDR, Hungary, Poland, Romania, USSR, Yugoslavia) from the 1960s through the 1980s. The second focuses on Yugoslavia with industry-specific investment and detailed trade data.

Trade Data Collection: Trade data come from hand-collected primary sources, in particular national statistical yearbooks and trade yearbooks, supplemented by the WIIW COMECON Database (2024).⁹ The language barrier and inconsistent table structures across countries make large-scale OCR very challenging, necessitating manual data collection. Coverage spans between 1945 and 1989, depending on the country, with export and import values recorded by partner country and product category.

A major challenge was classification standardisation. Socialist countries did not uniformly adopt SITC or other standard classifications used in the West. To enable comparability for revealed comparative advantage calculations, this study uses the CTN (Customs Tariff Nomenclature) classification with five broad categories: industrial machinery and transport equipment (CTN 1), fuels and raw materials (CTN 2), chemicals and building materials (CTN 3-4), foodstuffs and related industries (CTN 5-8), and industrial consumer goods (CTN 9). For Yugoslavia, more granular SITC 2-digit data (up to 60

7. Mathias Dewatripont and Eric Maskin, “Credit and Efficiency in Centralized and Decentralized Economies,” Publisher: [Oxford University Press, Review of Economic Studies, Ltd.] *The Review of Economic Studies* 62, no. 4 (1995): 541–555, ISSN: 00346527, 1467937X, accessed April 21, 2025, <https://doi.org/10.2307/2298076>, <http://www.jstor.org.lse.idm.oclc.org/stable/2298076>; János Kornai, Eric Maskin, and Gérard Roland, “Understanding the Soft Budget Constraint,” Place: Nashville Publisher: American Economic Association, *Journal of economic literature* 41, no. 4 (2003): 1095–1136, ISSN: 0022-0515, <https://doi.org/10.1257/jel.41.4.1095>.

8. Gerard DiPippo et al., “Red Ink: Estimating Chinese Industrial Policy Spending in Comparative Perspective,” May 2022, accessed April 21, 2025, <https://www.csis.org/analysis/red-ink-estimating-chinese-industrial-policy-spending-comparative-perspective>; Lee G. Branstetter, Guangwei Li, and Mengjia Ren, “Picking winners? Government subsidies and firm productivity in China,” *Journal of Comparative Economics* 51, no. 4 (December 2023): 1186–1199, ISSN: 0147-5967, <https://doi.org/10.1016/j.jce.2023.06.004>, <https://www.sciencedirect.com/science/article/pii/S0147596723000586>; Réka Juhász, Nathan Lane, and Dani Rodrik, “The New Economics of Industrial Policy,” Place: Palo Alto Publisher: Annual Reviews, *Annual review of economics* 16, no. 1 (2024): 213–242, ISSN: 1941-1383, <https://doi.org/10.1146/annurev-economics-081023-024638>; Shawn Kantor and Alexander Whalley, “Moonshot: Public R&D and Growth,” *American Economic Review* 115, no. 9 (September 2025): 2891–2925, <https://doi.org/10.1257/aer.20220540>, <https://www.aeaweb.org/articles?id=10.1257/aer.20220540>; Mario Draghi, “The future of European competitiveness (Part A),” *European Commission*, 2024,

9. *wiiw COMECON Database*, 2024, accessed April 21, 2025, <https://comecon.wiiw.ac.at/>.

categories) allows detailed sectoral analysis. World trade data from UN Comtrade (1962 onward) enables the calculation of world market shares, which will be used to identify Revealed Comparative Advantages (RCA).¹⁰

Investment Data: Total investment and capital stock data for nine countries come from WiiW COMECON (2024), cross-validated against estimates from Vonyó and Klein (2019) to account for potential data manipulation, a known issue in Socialist statistics where production achievements were inflated.¹¹ Investment by industry group is compiled from primary sources and WiiW, though granularity varies significantly across countries. Poland and Yugoslavia offer notably high-quality, detailed investment data, making them particularly valuable for sectoral analysis.

Data Reliability Considerations: Trade data is relatively reliable since officials needed accurate statistics on Western currency holdings, and export production targets were negligible for most firms.¹² Classification issues are more relevant than manipulation. Investment data, however, was prone to inflation as governments boasted about capacity expansion. Vonyó and Klein (2019) document that investment figures were inflated in Czechoslovakia, Hungary, and Poland, particularly in later years.¹³ While their corrections provide robustness checks, using only corrected data would dramatically reduce sample size and eliminate the sectoral granularity necessary for this analysis. The solution is to focus on investment-to-capital stock ratios, where overvaluation affects both the numerator and the denominator. Alternatively, the main focus rests on investment shares across sectors as proportions matter more than absolute levels.

2.2 Empirical Strategy

Macro Panel Analysis: The dynamic relationship between investment and trade outcomes is estimated using local projections following Jordà (2005).¹⁴ For each horizon $h = 0, 1, \dots, 5$, a separate regression is estimated:

$$\text{outcome}_{i,t+h} = \beta_h \cdot \text{icr}_{it} + \gamma_1 \cdot \text{icr}_{it-1} + \gamma_2 \cdot \text{icr}_{it-2} + \delta \cdot \text{gdppc}_{it} + \mu_i + \lambda_t + \eta_{i,t+h} \quad (1)$$

where the dependent variable is the future outcome for country i at year $t + h$. These outcome variables are logarithms of indices for total trade and export, respectively. The

10. *UN Comtrade*, accessed April 22, 2025, <https://comtradeplus.un.org/TradeFlow>.

11. *wiiw COMECON Database*; Tamás Vonyó and Alexander Klein, “Why Did Socialist Economies Fail? The Role of Factor Inputs Reconsidered,” *The Economic history review* 72, no. 1 (2019): 317–345, ISSN: 0013-0117, <https://doi.org/10.1111/ehr.12734>.

12. János Kornai, “Comments on Papers Prepared in the World Bank about Socialist Countries.pdf,” *CPD Discussion Paper*, no. 10 (1985): 23, accessed May 17, 2024, <https://documents1.worldbank.org/curated/en/604631492001166410/pdf/Comments-on-papers-prepared-in-the-World-Bank-about-socialist-countries.pdf>.

13. Vonyó and Klein, “Why Did Socialist Economies Fail? The Role of Factor Inputs Reconsidered.”

14. Òscar Jordà, “Estimation and Inference of Impulse Responses by Local Projections,” *American Economic Review* 95, no. 1 (March 2005): 161–182, <https://doi.org/10.1257/0002828053828518>, <https://www.aeaweb.org/articles?id=10.1257/0002828053828518>.

key parameter of interest is β_h , which traces how an investment shock at time t affects outcomes over subsequent periods. The specification includes the investment-to-capital stock ratio (icr) at time t as the treatment variable, along with two lags (icr_{t-1} and icr_{t-2}) to control for past investment dynamics. GDP per capita controls for differences in economic development. Country fixed effects (μ_i) and year fixed effects (λ_t) control for unobserved heterogeneity. The sequence of coefficients $\{\beta_0, \beta_1, \beta_2, \beta_3, \beta_4\}$ forms the impulse response function, revealing how investment shocks propagate through the economy over five years.

To examine competitiveness, revealed comparative advantage (RCA) serves as the dependent variable:

$$RCA_{i,j} = \frac{\sum_j X_{i,j} / \sum_j X_{i,j}}{\sum_i \sum_j X_{i,j} / \sum_{i,j} X_{i,j}} \quad (2)$$

where RCA measures country i 's export share in product j relative to the world export share. RCA regressions include both total investment and sectoral investment shares (constructed as moving averages over five years) to isolate the effect of investment allocation patterns beyond aggregate levels.

Yugoslav Sectoral Analysis: The granular Yugoslav data enables industry-specific analysis using local projections. Investment categories are hand-mapped to SITC 1-digit classifications. The first specification examines short-run dynamics by estimating separate regressions for each horizon $h = 0, 1, \dots, 5$:

$$\begin{aligned} \text{Exports}_{j,t+h} = & \alpha_h \cdot \text{Own}_{jt} + \alpha_{h,1} \cdot \text{Own}_{jt-1} + \alpha_{h,2} \cdot \text{Own}_{jt-2} \\ & + \beta_h \cdot \text{Other}_{jt} + \beta_{h,1} \cdot \text{Other}_{jt-1} + \beta_{h,2} \cdot \text{Other}_{jt-2} + \epsilon_{j,t+h} \end{aligned} \quad (3)$$

where exports for industry j at time $t + h$ depend on investment in the same SITC 1-digit category (Own) and investment in different categories ($Other$), each measured at time t with two additional lags to control for past investment patterns. Both dependent and independent variables undergo inverse hyperbolic sine transformation to handle zero values while maintaining approximately logarithmic interpretation for large values. The coefficients α_h and β_h trace the dynamic response of exports to own-sector versus other-sector investment shocks over six years, capturing pre-investment production surges, mid-investment disruptions, and post-investment capacity improvements.

The second specification tests alignment with comparative advantage by examining the five-year impact of investment in each SITC sector on exports:

$$\text{Exports}_{jt} = \alpha_1 \cdot \text{SITC0}_{jt-5} + \dots + \alpha_8 \cdot \text{SITC8}_{jt-5} + \alpha_9 \cdot \text{Unclassified}_{jt} + \epsilon_{jt} \quad (4)$$

This specification estimates how investment in each SITC 1-digit sector five years prior affects current export performance. Economically efficient allocation should yield statistically insignificant coefficients (investment matched to returns), while positive coefficients

indicate missed opportunities where additional investment would have boosted exports, and negative coefficients suggest overinvestment in sectors unable to convert capital into competitive exports.

3 Macro-Level Empirical Results

3.1 Investment Patterns Across the Eastern Bloc

The data reveal systematic patterns in investment allocation, as presented in Figures 3.1 and 3.2. Investment-to-capital stock ratios (Figure 3.1) were higher in Eastern and South-eastern Europe (Bulgaria, Romania, USSR, Yugoslavia) than in Central Europe, reflecting catch-up dynamics from lower initial capital stocks. Most economies devoted 30-60% of total investment to the industrial sector (Figure 3.2), with particularly high values in East Germany (GDR) and Romania. This far exceeded investment in agriculture (rarely above 20%) or services, regardless of country-specific endowments or comparative advantages.

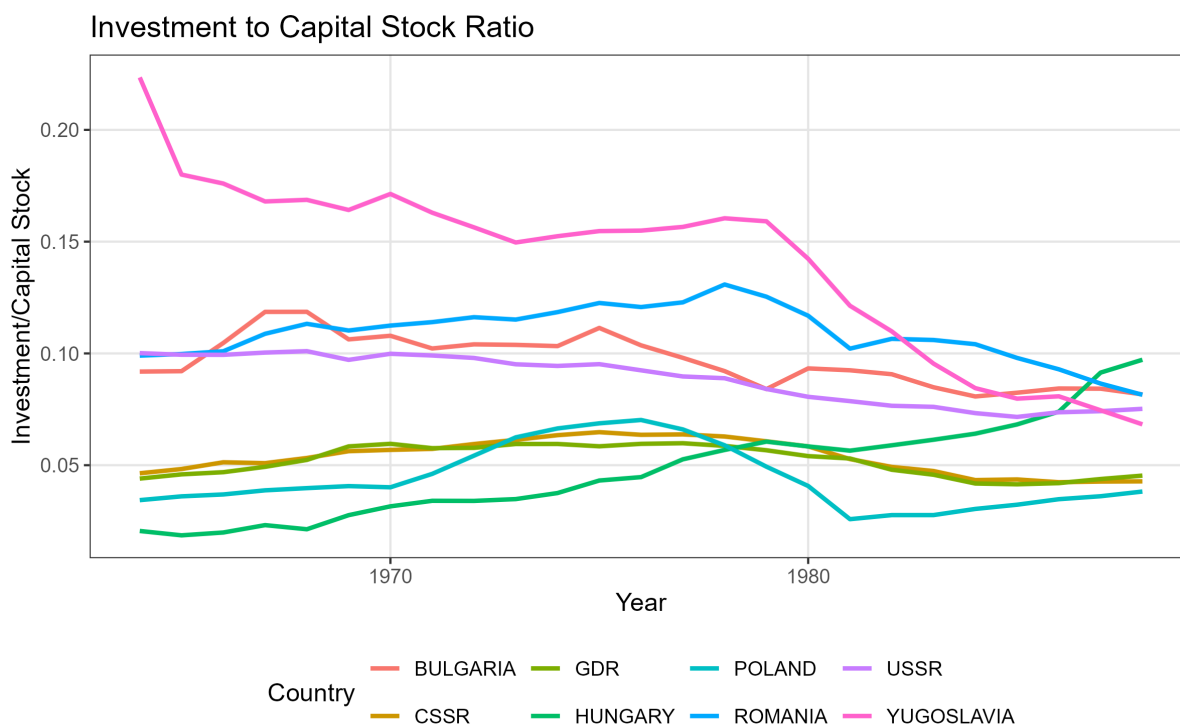


Figure 3.1: Investment-to-Capital Stock Ratios in Eastern Europe.

A critical break occurred after the 1973 Oil Shock. Investment-to-capital stock ratios declined sharply as balance of payments crises forced austerity. While some countries like Hungary recovered investment rates in the 1980s, most never returned to pre-1973 levels. This episode highlights the vulnerability of heavy-industry-focused economies to external shocks and financing constraints.

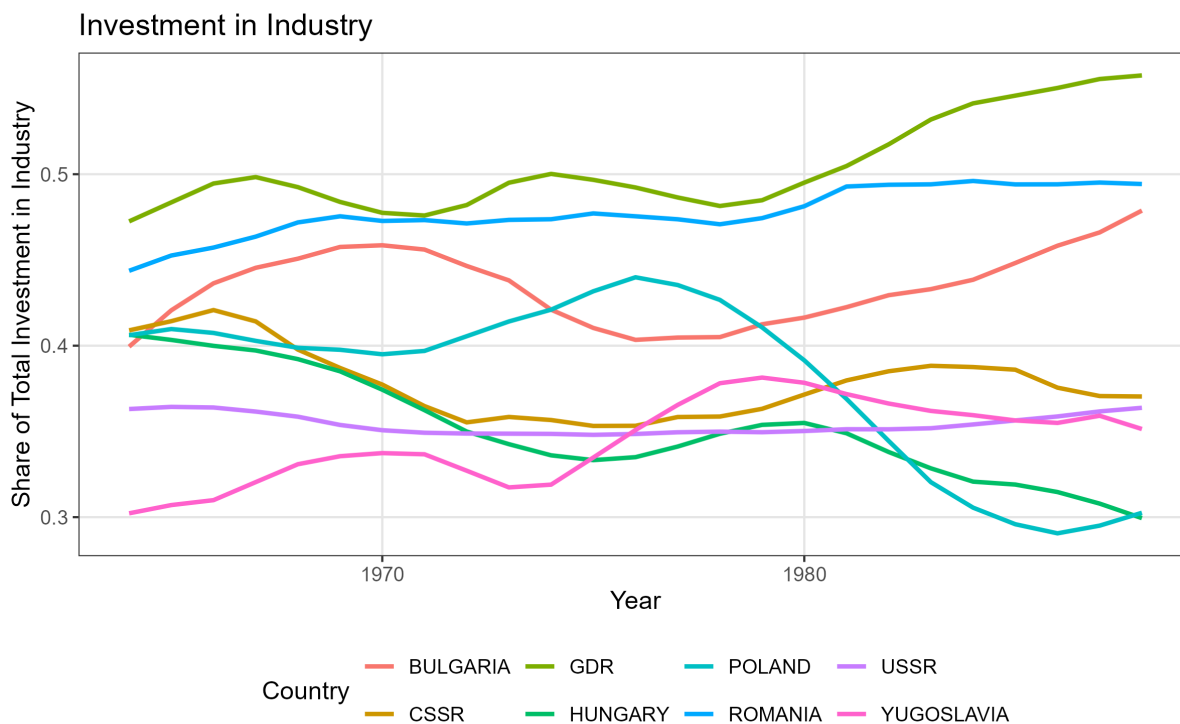


Figure 3.2: Share of total investment in the industrial sector.

Within industry, investment is heavily concentrated in sectors like metallurgy, mining, and chemicals across all countries. Polish data, presented in Figure 3.4, shows electrical and mining industries consistently received over 50% of industrial investment, while light manufacturing (textiles, consumer goods) remained below 20%. Yugoslav patterns, shown in Figure 3.3, are similar despite different ownership structures: Metals, electric power, and heavy industry dominated. This "high-selectivity" bias towards heavy industry, as Brus (2003) termed it, was uniform across the Bloc despite vastly different economic conditions.¹⁵

3.2 Investment and Trade: Dynamic Effects

The local projections reveal distinct dynamic patterns in how investment shocks affect trade outcomes. For total trade, a 1% increase in the investment-to-capital stock ratio in year 0 is associated with a 2.64% rise in the same year, with positive effects already emerging one year prior. However, these effects decay rapidly thereafter, becoming statistically insignificant by year 2. After five years, the point estimate turns negative, but remains insignificant.

This pattern suggests enterprises used investment funds to immediately import equipment and machinery, temporarily boosting trade volumes. Production disruptions during facility upgrades initially prevented export growth, explaining the insignificant contem-

15. Włodzimierz Brus, *The Economics and Politics of Socialism* (Oxford: Taylor & Francis Group, 2003), 13, ISBN: 978-1-136-50472-3, <http://ebookcentral.proquest.com/lib/londonschoolecons/detail.action?docID=1539119>.

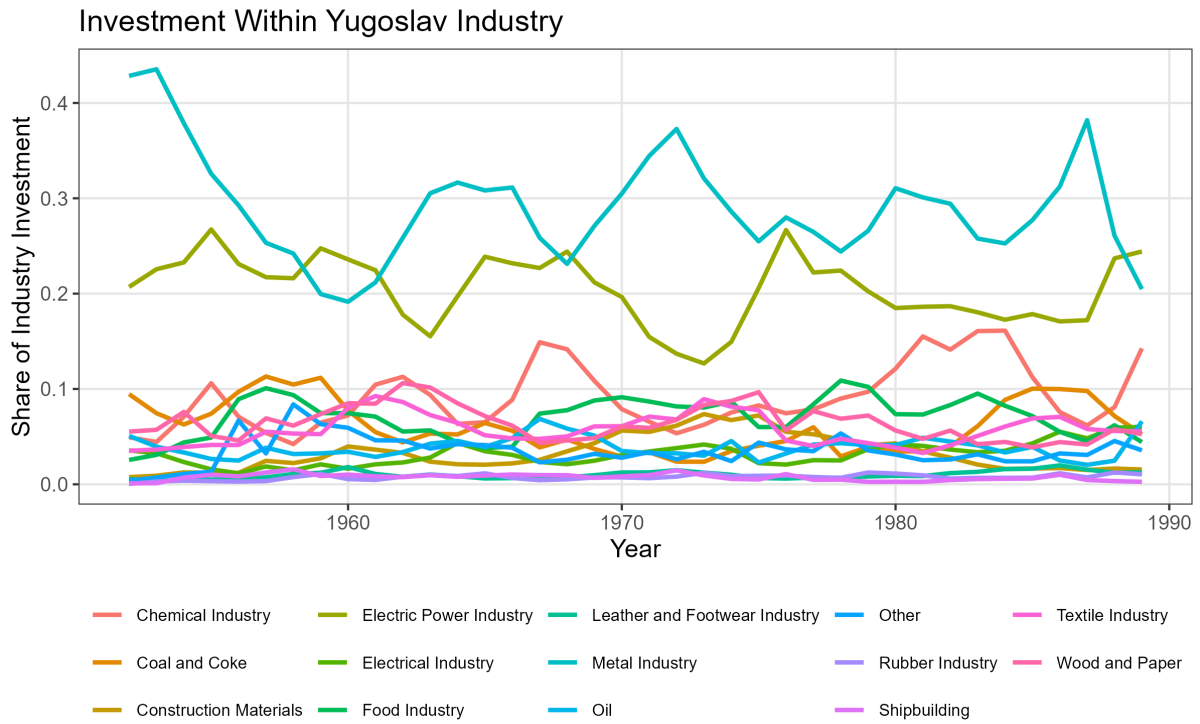


Figure 3.3: Distribution of investment within the industrial sector in Yugoslavia.

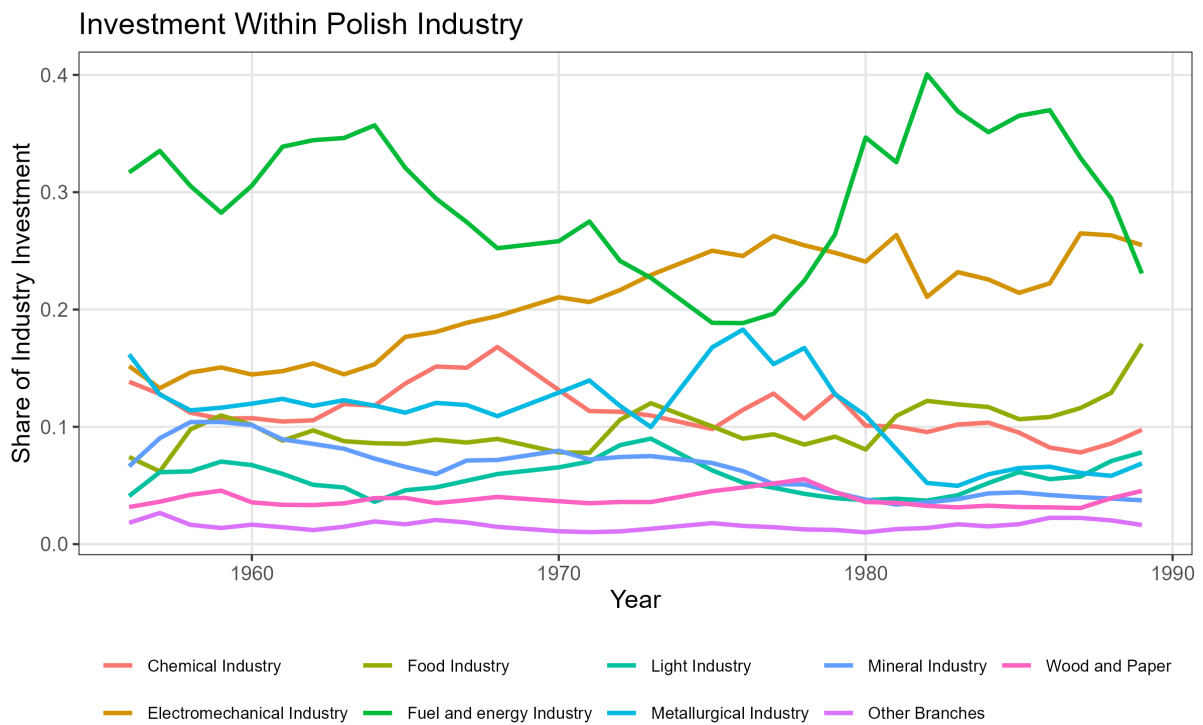


Figure 3.4: Distribution of investment within the industrial sector in Poland.

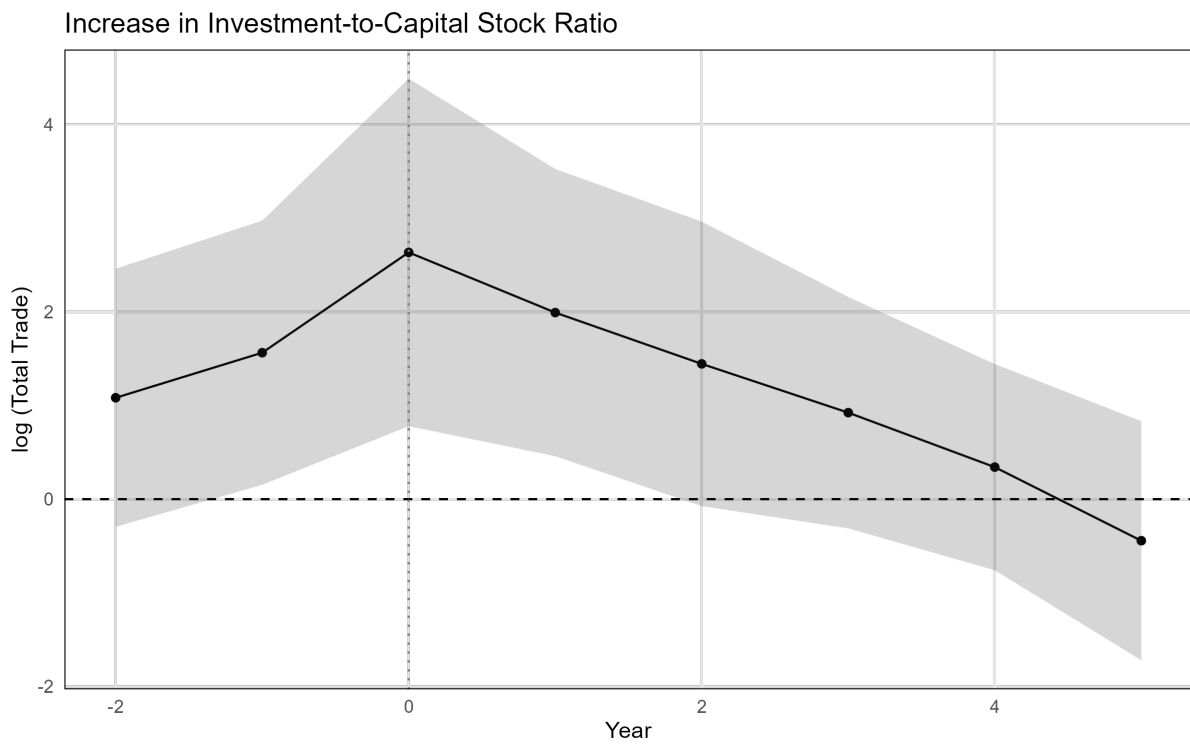


Figure 3.5: Dynamic effects of investment shocks on an index of total trade. The figure plots impulse response functions estimated via local projections (Equation (1)), showing how a 1% increase in the investment-to-capital stock ratio in year 0 affects total trade. Shaded regions indicate 95% confidence intervals.

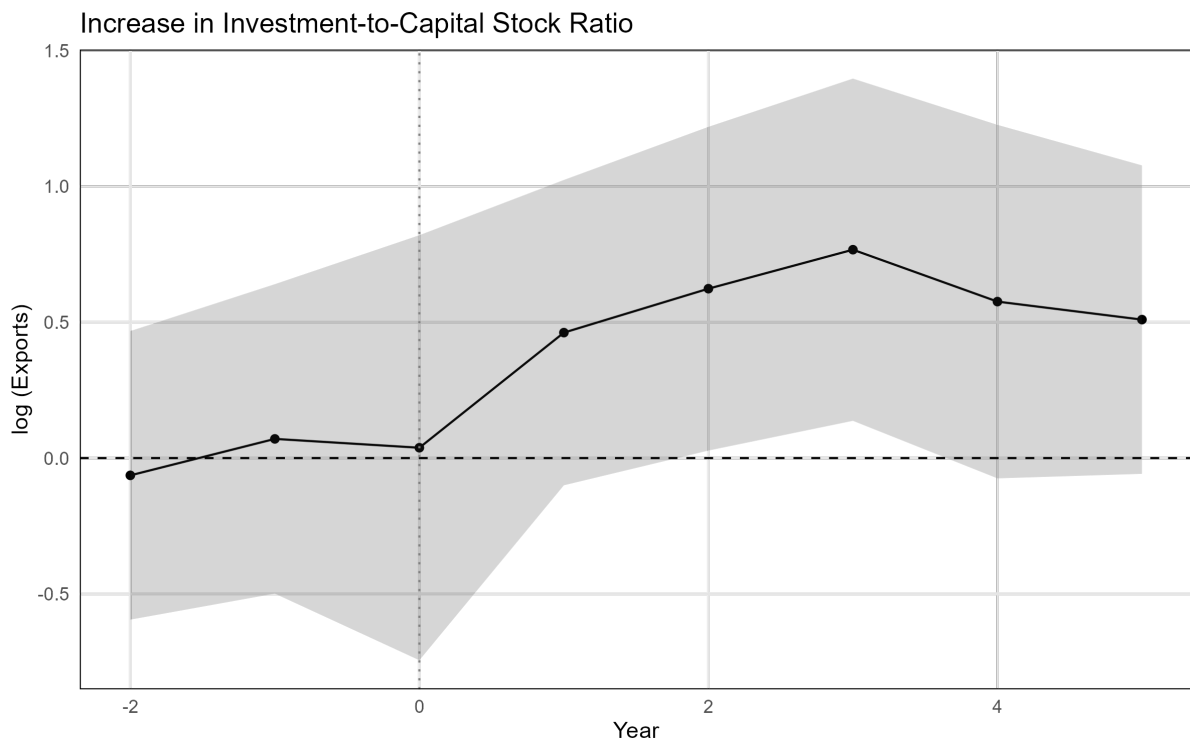


Figure 3.6: Dynamic effects of investment shocks on an index of exports. The figure plots impulse response functions estimated via local projections (Equation (1)), showing how a 1% increase in the investment-to-capital stock ratio in year 0 affects exports. Shaded regions indicate 95% confidence intervals.

poraneous effect. Only after two to three years, after the retrofitting of factories was completed and new capacity became ready, exports started to grow. The export effects then decline at longer horizons but remain positive, indicating that completed facility upgrades provide diminishing but lasting capacity improvements.

3.3 Sectoral Investment and Competitiveness

While total investment shows delayed effects on aggregate exports, the sectoral allocation reveals substantial variation in how investment translates to competitiveness across industries. Revealed comparative advantage regressions for CTN categories, presented in Figure 3.7, demonstrate that investment impacts differ markedly by sector and evolve dynamically over multiple years.

Investments in chemicals and building materials (CTN 3-4) show consistently positive associations with RCA, with statistically significant effects from the contemporaneous period through three years after the shock. This sustained positive response indicates that chemicals and building materials represented sectors where Eastern European countries could successfully convert investment into lasting competitive advantages.

Industrial consumer goods (CTN 9) displays a striking non-monotonic pattern. Investment shows significant negative associations with RCA in the short run, likely reflecting production disruptions during factory retrofitting. However, the relationship reverses at longer horizons, becoming significantly positive and statistically significant after five years. Other sectors do not show any statistically significant reactions to an increase in the investment-to-capital stock ratio. Curiously, this also includes machinery and transport equipment (CTN 1), which was a relatively large and competitive sector in Eastern Europe.

These sectoral patterns reveal three critical insights. First, only certain sectors could convert investment into sustained competitive gains. Second, dynamic trajectories differed substantially: chemicals showed immediate positive effects, while consumer goods required five years to realise gains after initial disruptions. Third, the absence of effects or negative patterns in machinery, fuels, and foodstuffs indicates systematic misalignment between investment allocation and comparative advantages.

4 Yugoslav Case Study: Granular Sectoral Evidence

The Yugoslav data permit testing theoretical predictions about investment timing and comparative advantage alignment at fine sectoral resolution.

4.1 Investment in adjacent and non-adjacent industries

The local projections in Figures 4.1 and 4.2 reveal strikingly different patterns between own-sector and other-sector investment effects. Investments in the same SITC sector does show a positive impact in most years following the investment, but they are not

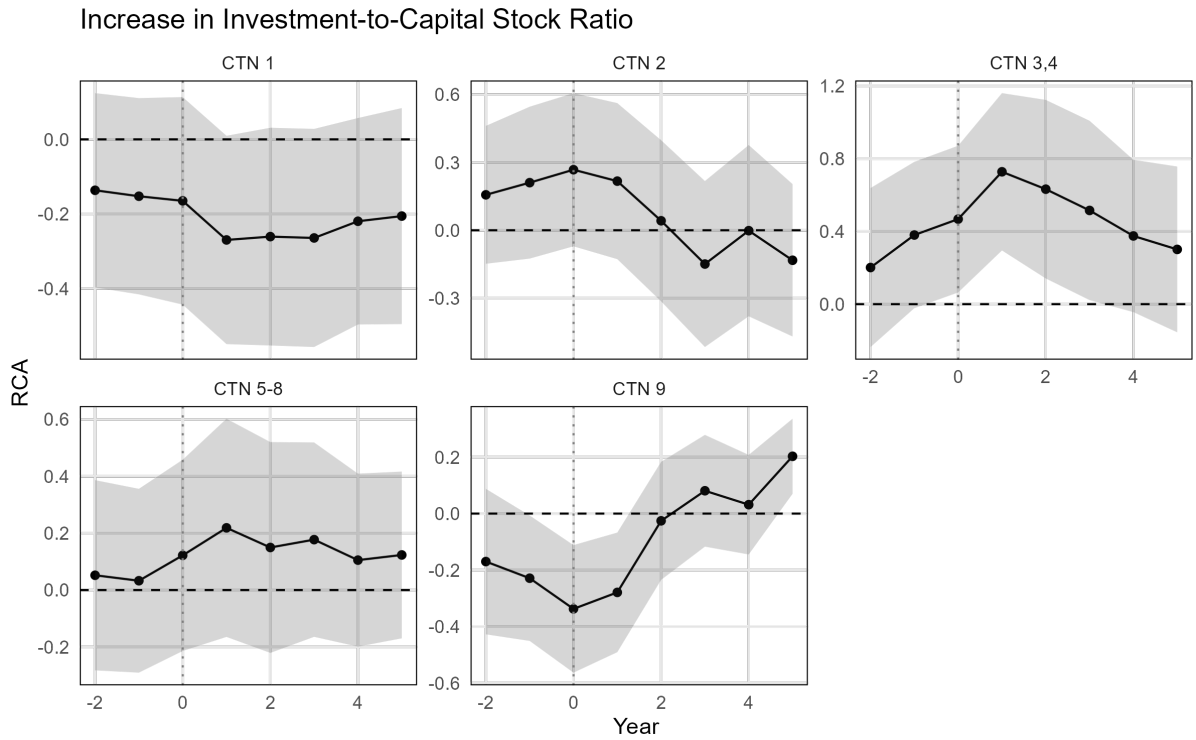


Figure 3.7: Dynamic effects of investment shocks on Revealed Comparative Advantages (RCA). The figure plots impulse response functions estimated via local projections (Equation (1)), showing how a 1% increase in the investment-to-capital stock ratio in year 0 affects the RCA. Shaded regions indicate 95% confidence intervals.

statistically significant. Direct sectoral investment in Yugoslavia led only to a limited boost in export performance. In sharp contrast, investment in non-adjacent sectors had negative and significant effects on a sector's exports in the short to medium run. The pattern suggests that when investment flows to other industries, focal sectors experience substantial declines, likely reflecting economy-wide resource constraints: capital, skilled labour, and imported inputs become scarcer as they are diverted to investment-priority sectors.

Moreover, supply chains in Socialist countries tend to be less adaptive. The organisation of deliveries is inherently tied to hierarchical planning through directives. Enterprises cannot independently procure means of production; instead, they must obtain a delivery slip ("Kontingent") to access the necessary resources.¹⁶ In such a system, spillover effects as well as the improved accessibility of inputs are likely to take longer, a phenomenon that can be observed in the data. On the other hand, the aforementioned negative effects, including the diversion of resources, kicked in immediately, leading to the seemingly counterintuitive pattern.

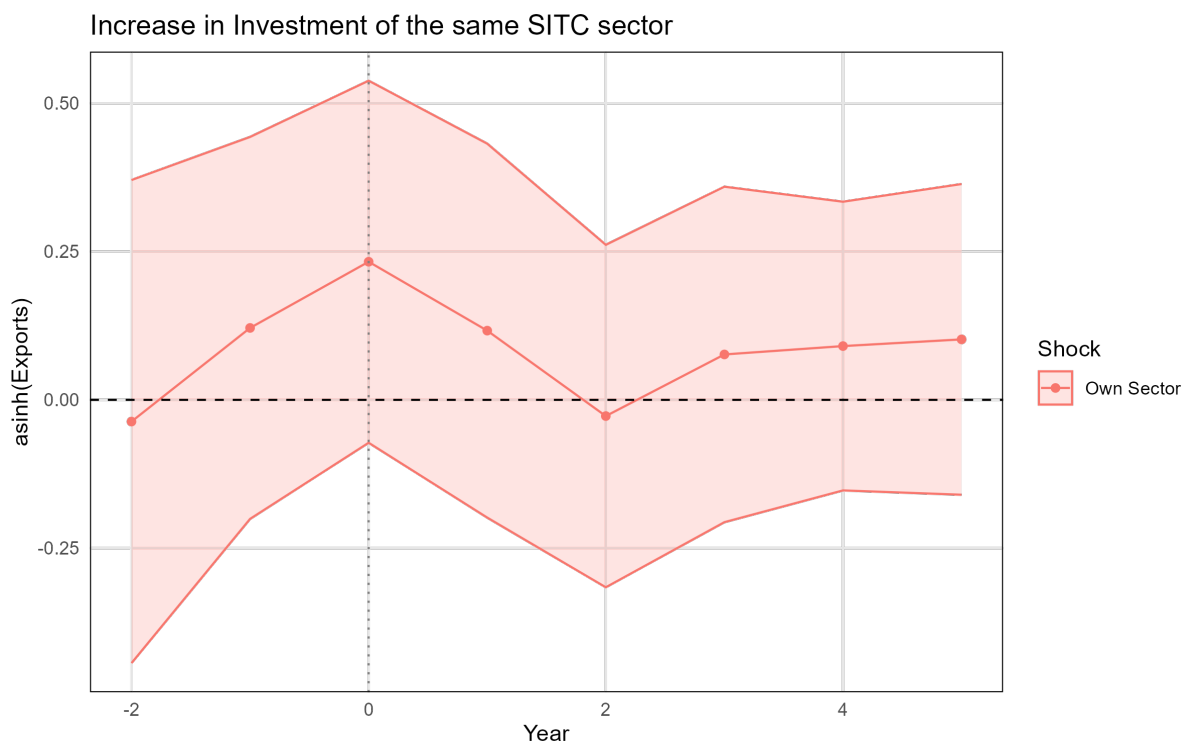


Figure 4.1: Dynamic effects of investment shocks on exports. The figure plots impulse response functions estimated via local projections (Equation (3)), showing how a 1 standard deviation increase in investment in the same SITC category in year 0 affects exports. Shaded regions indicate 95% confidence intervals.

16. Asselain, *Planning and profits in socialist economies*, 40–42.



Figure 4.2: Dynamic effects of investment shocks on exports. The figure plots impulse response functions estimated via local projections (Equation (3)), showing how a 1 standard deviation increase in investment in a different SITC category in year 0 affects exports. Shaded regions indicate 95% confidence intervals.

		Exports
SITC 0 _{t-5}	Food and live animals	-4.67*** (1.21)
SITC 1 _{t-5}	Beverages and tobacco	0.47 (1.43)
SITC 2 _{t-5}	Crude materials, inedible	0.87 (0.56)
SITC 3 _{t-5}	Mineral fuels and lubricants	-3.67** (1.11)
SITC 5 _{t-5}	Chemicals and related products	8.03*** (1.20)
SITC 6 _{t-5}	Manufactured goods by material	-12.15* (4.99)
SITC 7 _{t-5}	Machinery and transport equipment	6.89*** (1.89)
SITC 8 _{t-5}	Miscellaneous manufactures	-2.41** (0.88)
unclassified _{t-5}		6.54 (7.34)
R ²		0.80
Adj. R ²		0.78
Num. obs.		966

*** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$

Table 4.1: Regression estimates for equation (4). The equation includes SITC 2-digit and year fixed effects.

4.2 Comparative Advantage and Misallocation

As can be seen in Table 4.1, the five-year investment impact analysis by SITC sector reveals stark misalignment between investment allocation and export competitiveness. In particular, investments in chemicals (SITC 5) and machinery and transport equipment (SITC 7) show large and statistically significant positive associations with exports five years later. These capital-intensive sectors with strong scale economies represented Yugoslavia's comparative advantage, yet received insufficient investment relative to potential returns. Conversely, several sectors show negative five-year associations between investment and exports. The coefficients for food products (SITC 0), mineral fuels (SITC 3), and manufactured goods (SITC 6 and 8) are all negative and statistically significant. This suggests a pattern of overinvestment relative to optimal capacity.

There are two ways to read these results, one in terms of geoeconomics and another one in terms of infant industry protection. Goods that are highly strategic and would allow for autarchy in case of a geopolitical crisis, food and natural resources, seem to have received above optimal levels of investment. Similar isolationist behaviour could be found across the Eastern Bloc, where countries regularly prepared their economies for an escalation of the Cold War. Whereas strategic autonomy as such could have been a

sensible decision, it seems to have led to sub-optimal investment allocations.

From an efficiency standpoint, further investments in the chemicals and transport industries would have led to stronger comparative advantages in these sectors, which would have allowed for more competitive products abroad. The remaining funds could have been used to purchase imports for those products Yugoslavia's economy was not suited for. Instead, the data reveal the pursuit of diversification in domestic production at the expense of efficiency, explaining the high economic complexity and stagnant intra-Bloc trade patterns documented in Cokić (2026).¹⁷

5 Conclusion

This paper constructs novel datasets linking investment policy to trade outcomes across eight Eastern European countries and within Yugoslavia at granular sectoral detail. The empirical evidence reveals that Eastern European industrialisation policy suffered not from excessive investment but from systematic misallocation. Heavy industry bias appeared uniformly across countries regardless of endowments, preventing regional specialisation and integration. Investment-to-capital stock increases temporarily boosted trade, but these effects reversed, with no sustained export growth. Post-1973 austerity intensified vulnerabilities.

Sectoral analysis demonstrates that investment allocation, not volume, determines competitiveness. Supporting sectors like construction and transport infrastructure enable downstream industries by completing supply chains and eliminating bottlenecks. The Yugoslav case study confirms that only investments aligned with comparative advantage enhanced exports five years later, while strategic but economically suboptimal sectors showed negative associations.

The Eastern Bloc's relative decline stemmed not from ideological limitations alone but from capital misallocation that prevented the utilisation of comparative advantages. As contemporary policymakers embrace active industrial strategies, the Cold War experience offers valuable, if cautionary, evidence about the persistent challenges of centralised investment allocation and the critical importance of incentive-compatible, advantage-aligned strategies.

17. Marco Cokić, *Lone Rangers? What Happened to Eastern European Trade During the Cold War?*, 2026.

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