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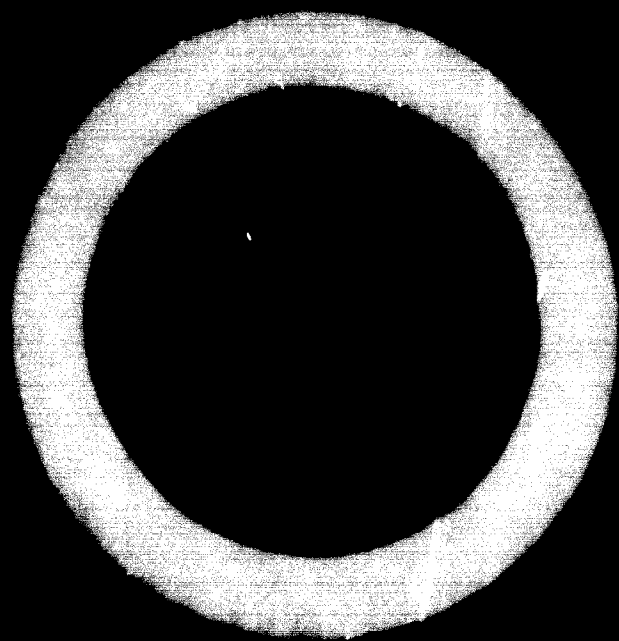
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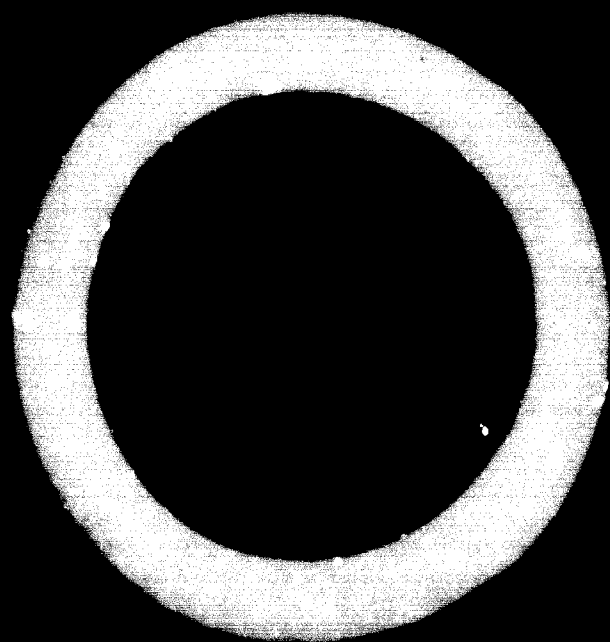
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UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
VIENNA

SELECTED ASPECTS OF INDUSTRIAL POLICY

**Report and Proceedings of Interregional Seminar
Beirut, 4-15 January 1971**



UNITED NATIONS
New York, 1971

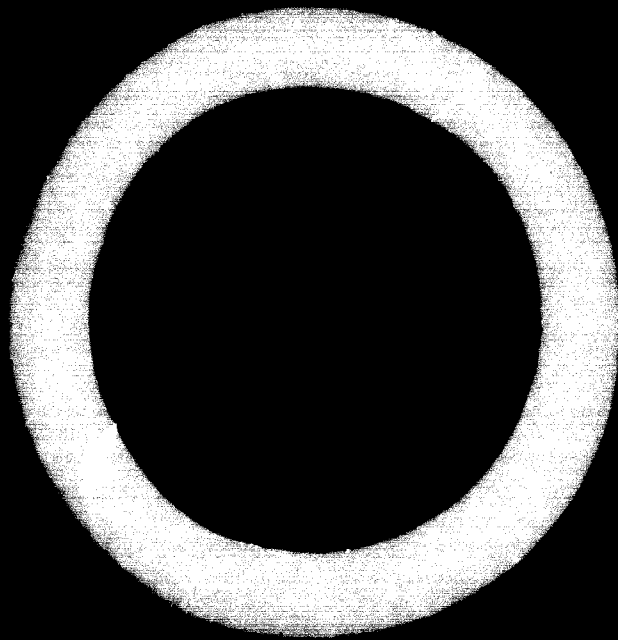
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ID/66
(ID/WG. 86/10)

UNITED NATIONS PUBLICATION
Sales No.: E.71.II.B.17
Price: \$U.S. 1.00 (or equivalent in other currencies)

Contents

	<u>Page</u>
Foreword	5
Introduction	7
Chapter 1 Building an industrial manufacturing sector capable of generating and supporting further growth	<u>11-14</u>
Structure of the industrial sector	11
Self-propelling industrialization	12
The basic approach	12
Measures and instruments used	13
Chapter 2 Maximizing employment opportunities	<u>15-18</u>
The effect of existing policy	16
Adapting industrial policy to promote employment	17
Promoting employment in small-scale industries	18
The importance of training industrial labour	18
Chapter 3 Developing a capability to adapt, develop and effectively use modern industrial technology	<u>19-22</u>
Choice of technology	19
Ways in which technology is transferred	20
The capability to develop new industrial technology	21
Chapter 4 Making optimum use of regional industrial co-operation	<u>23-26</u>
Regional agreements	23
A new agency to promote industrial co-operation	24
Chapter 5 Developing internationally competitive export industries	<u>27-33</u>
The level of protection	27
Promoting exports of manufactured goods	30
Competition and economies of large-scale production	32
<u>Annexes</u>	
1. Agenda	35
2. List of participants and observers	36
3. List of documents	41



FOREWORD

The Seminar on Selected Aspects of Industrial Policy was held in Beirut, Lebanon, from 4 to 15 January 1971. It was organized under the joint sponsorship of the United Nations Industrial Development Organization (UNIDO), the United Nations Economic and Social Office in Beirut (UNESOB), and the Industrial Development Centre for Arab States (IDCAS). The co-sponsors took into account the previous activities of UNESOB, which have so far consisted in programming and policy formulation for industrial development, and considered the Seminar as a follow-up of these activities by concentrating on specific industrial policy problems faced by the countries of the region.

In preparing the programme for the Seminar, the co-sponsors were guided by the fact that industrial policy formulation is an integral part of the planning process and that appropriate policies and measures are a prerequisite for meeting the targets for industrial development. Bearing this in mind, the Seminar reviewed the different types of industrial policies followed in the participating countries, analysed the criteria used in determining the choice of these policies, and considered these various policy measures and instruments within the context of regional industrial co-operation.

The Seminar was attended by senior officials from eleven Arab countries of the Middle East and North Africa, nominated by their Governments but participating in their personal capacities. Expert consultants and guest speakers were invited on the basis of their professional competence and experience to make formal presentations and to lead discussions on various aspects of the subjects considered by the Seminar. Representatives were invited from the International Labour Organisation (ILO), the United Nations Conference on Trade and Development (UNCTAD) and the Economic Commission for Africa (ECA).^{1/} The opening session was addressed by Mr. J. P. Martin, Director of UNESOB, on behalf of the co-sponsors.

^{1/} A complete list of participants is given in annex 2.

The programme of the Seminar was divided into two parts. The first part was devoted to considering five selected objectives of industrial policy, the instruments and measures used to achieve these objectives, and the problems and conflicts encountered by policy-makers when selecting and designing measures to achieve the selected objectives. Each objective was introduced by an expert consultant or guest speaker who highlighted the main issues for general discussion by the Seminar.

The second part of the programme was devoted to applying the instruments and measures discussed in the first part to "country case studies" of hypothetical situations. Participants were divided into three working groups constituting policy advisory missions to the countries depicted in the cases. Having studied the economic situation of the country, reviewed the objectives of industrial policy and the existing instruments and measures, each group prepared a report on its mission in a form of policy recommendations based on the terms of reference of the case studies. The group reports were later submitted to the plenary sessions of the Seminar for general discussion. As officials advising their respective Governments on industrial policy formulation and implementation, the participants showed enthusiasm and expressed great interest in the case method approach, which offered an opportunity to examine the structure of an entire economy and to relate the role of industrial policy measures to other economic measures in achieving over-all development objectives.

This report was drafted to highlight the discussions and was reviewed by the Seminar at its closing session.

Introduction

1. The promotion of rapid industrialization is a major objective of economic policy for all of the eleven Arab countries represented at the Seminar.^{2/} Industrial policy is an important branch of economic policy which needs careful consideration. The instruments and measures used to promote and regulate the industrialization process need to be considered as an integral part of economic policy.

2. Guidelines that are generally applicable for the formulation of industrial policy are difficult to establish because the Arab countries face economic circumstances and use economic and social systems that are different from those in other regions. However, Arab countries have encountered some common problems in their industrialization efforts. Thus, the Seminar found it useful to compare the experience of countries using different sets of policy instruments and measures to implement their industrialization programmes. Comparisons with the experience of other developing countries and the industrialized countries were also made.

3. A wide range of policy objectives was considered. It was recognized that the importance attached to each objective by a Government will depend on (a) the size of the country and its population; (b) its human, natural, mineral and financial resources; and (c) the stage of economic and industrial development reached. In some Arab countries balance-of-payments difficulties act as a constraint on development; others have ample foreign exchange resources. In most of them skilled industrial labour is scarce; however, unemployment or underutilization of unskilled labour represents a waste of resources.

4. Improving the welfare of the people was accepted as an overall basic objective of economic policy, but there was some disagreement as to whether this is best achieved by maximizing the

^{2/} Fourteen countries were invited to participate: Algeria, Iraq, Jordan, Kuwait, Lebanon, Libyan Arab Republic, Morocco, Saudi Arabia, the People's Democratic Republic of Yemen, Sudan, Syrian Arab Republic, Tunisia, United Arab Republic and Yemen.

level and growth of (a) output or (b) employment. However, in practice, the conflict is usually not clear cut. The impact of industrialization on output and on employment depends on the importance attached to these and to a number of other objectives when the Government selects industries to be established and determines the size of enterprise and type of technology to use.

5. It is particularly important to ensure that the impact of policy is such that the cost of capital and labour to individual manufacturing enterprises (under both public and private ownership) reflects as closely as possible the relative scarcity of these factors and their cost to the economy as a whole. Otherwise, capital-intensive industrial projects may absorb too large a part of the national resources of capital available for investment, while opportunities to spread the benefits of industrialization through the use of more labour-intensive techniques of production may be missed.

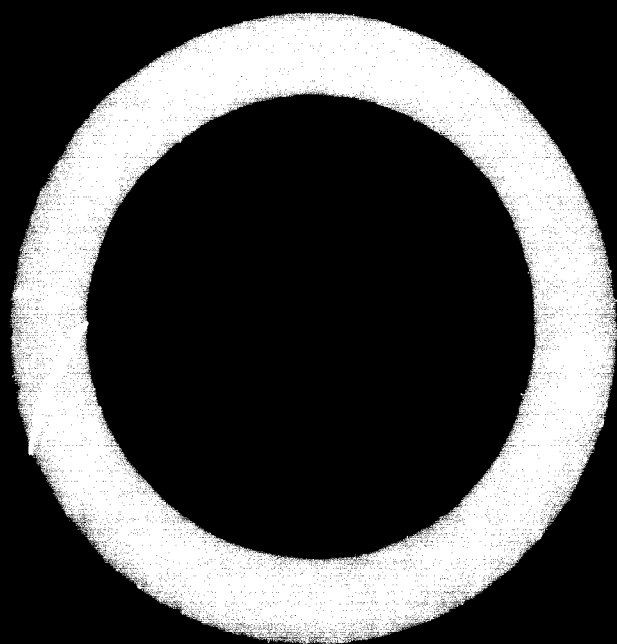
6. The following secondary and more specific long-term objectives of industrial development policy and the measures used to achieve them were discussed in detail:

- Building an industrial manufacturing sector capable of generating and supporting further economic and industrial growth;
- Maximizing employment opportunities;
- Developing a capability to adapt, develop and effectively use modern industrial technology;
- Making optimum use of regional industrial co-operation;
- Developing internationally competitive export industries.

7. These are important long-term objectives of industrial development programmes implemented under public, private or mixed patterns of ownership. The achievement of certain objectives may be affected by the type of ownership policy followed, but ownership policy affects mainly the type of instruments and measures selected to implement policy and the government machinery used to administer these measures.

8. It was recognized that the policies, incentives and other measures used by some Arab countries at present are not always

well adapted to achieve these goals. This is at least part of the reason why the volume of new industrial investment and output has failed to reach the target level established in national development plans in these countries.



CHAPTER 1

BUILDING AN INDUSTRIAL MANUFACTURING SECTOR CAPABLE
OF GENERATING AND SUPPORTING FURTHER GROWTH

9. The development of an industrial manufacturing sector capable of generating and supporting further growth of industry and the economy as a whole is among the most important subsidiary objectives of industrial development policy. To achieve this goal, special attention must be paid to evolving a structure for the industrial sector that will make the industrialisation process a self-propelling and self-generating one.

Structure of the industrial sector

10. Most Arab countries are still at an early stage of industrialization, and their primary goal is to establish a broadly based industrial sector capable of generating further growth. Planning should ensure that the industrial sector is effectively co-ordinated with the development of other sectors of the economy (so that it will be capable of supplying the manufactured goods required by these sectors). It was considered that the appropriate approach is to aim at developing an integrated industrial sector by identifying suitable opportunities to manufacture intermediate goods, parts and components previously imported, rather than selecting projects at random.

11. The Seminar considered that aiming at a high degree of national self-sufficiency is not a desirable objective; such an objective is in any case impossible to achieve in the smaller Arab countries. Trade offers greater flexibility than autarky.

and emphasis should be on interdependence and on regional co-operation, which offer considerable scope for expanding trade in manufactured goods among Arab countries. Increasing trade among Arab countries will help to accelerate industrialization in the region. An increasing proportion of the growing volume of intermediate and capital goods required in the 1970s should be manufactured within the Arab countries.

Self-propelling industrialization

12. If industrialization is to become a self-generating process, policy must ensure (a) that the industrial sector generates a steadily rising proportion of the savings needed to finance further investment, and (b) that there is a steadily increasing supply of innovative organizers and expansion-minded industrial managers in both public and private sectors. Industrialization should not be directed from the centre, and a policy that relies extensively on regulations and controls will hamper the self-propelling nature of the industrialization process.

The basic approach

13. For the public sector, the main aim should therefore be to establish an organizational structure in which those responsible for establishing and managing industrial enterprises are free to act in a businesslike manner, free from political interference. Projects should be identified well in advance. Both new and existing enterprises should be expected to make an adequate return on the capital they employ. The Government should compensate enterprises for services or locational disadvantages undertaken in the national interest. Policy should not discriminate in favour of public enterprises and against private enterprises in a mixed economy.

14. For the private sector, the main emphasis should be placed more on promotion and incentives than on protection. The strength of the incentives offered will vary from branch to branch and

project to project. Special incentives will be needed and justified for enterprises locating in less developed regions of the country. Finding the appropriate level of subsidy is largely a matter of trial and error depending on circumstances prevailing in the country concerned.

Measures and instruments used

15. In those Arab countries that rely predominantly on the public sector, the main problem is one of organization. Even where projects have been identified sufficiently far in advance, their implementation is sometimes delayed by the failure to delegate responsibility for plant construction to experienced managers and engineers free to act in a businesslike manner. The operation of existing enterprises is often handicapped by a failure to define clear objectives for individual enterprises and to make the managers of enterprises accountable for their performance. It was suggested that one or more autonomous state holding companies established as separate legal entities, which could set clear objectives for public manufacturing enterprises and control and co-ordinate their operations and financing, would be a suitable framework within which to achieve these goals. A policy permitting public-sector enterprises to compete with the private sector for the best industrial managers available was considered desirable.

16. For countries relying on private enterprise for implementation of part of their industrial development programmes, a number of common obstacles, which future policy could help overcome, were noted. These include:

- (a) Lack of information on investment opportunities and assistance in making pre-investment studies;
- (b) Inadequate infrastructure and difficulties in obtaining a suitable manufacturing site;
- (c) Difficulty in obtaining an adequate volume of financing on suitable terms;
- (d) Lack of information on technology and equipment selection;

- (e) Shortage of skilled and semi-skilled labour;
- (f) Shortage of trained and experienced managers.

17. In selecting policy instruments and measures to overcome these obstacles, Governments will have to ensure that policy is formulated in a manner that makes investment in manufacturing more attractive in relation to the risks involved than in other competing investment outlets, such as trade, real estate and investment abroad. Adequate but not excessive tariff protection and other forms of incentives will usually be needed to compensate for the limited size of the domestic market and to overcome the established position of foreign suppliers. Import duty concessions on machinery reduce the total capital requirements of a project. Tax incentives can help make projects more attractive. Industrial estates and areas should be developed and factories or sites provided at subsidized rents. Assistance in the pre-investment stage and financing on favourable terms and conditions are likely to be among the most effective measures.^{3/}

18. All these measures combined, however attractive financially, may still be unsuccessful if government policy fails to make it clear that private investment in industry is welcomed and will continue to be encouraged in the future. When doubts arise about the future intentions of the Government, private investment is deterred so that the Government has to rely more extensively on public-sector initiative and investment than was expected.

19. If government policy encourages regional and/or foreign investment, the areas of industry in which such investment is welcome should be identified in advance, with the terms and conditions clearly indicated. Special measures could be enacted on both a national and regional basis to guarantee the security of foreign investment.

^{3/} For further details, participants were referred to Incentive Policies for Industrial Development, United Nations publication, Sales No.: 71.II.B.2.

CHAPTER 2

MAXIMIZING EMPLOYMENT OPPORTUNITIES

20. The implications for industrial policy formulation of unemployment and underutilized manpower resources in Arab countries were carefully considered. The labour force in Arab countries is expected to grow more rapidly in the 1970s than previously. With the growth of the urban labour force expected to reach 4 to 5 per cent per annum in many countries, widespread unemployment threatens the cities, enhancing the risk of social unrest. Unemployment is likely to be of such magnitude that it merits special consideration by the Governments of most Arab countries when they formulate industrial development policy.

21. Since 1950, the increase in employment in manufacturing industry has averaged 4 per cent per annum in developing countries, while the growth rate of manufacturing output averaged 7 per cent per annum in the 1950s and about 6 per cent between 1960 and 1968. If this trend continues into the 1970s, manufacturing industry will be unlikely to absorb more than a small part of the fast growing labour force, let alone contribute to a reduction of the existing level of unemployment and underemployment. In most Arab countries the manufacturing sector, including artisan and handicraft activities, at present provides employment for between 10 and 20 per cent of the available labour force, but the more modern sector of manufacturing typically accounts for only a fraction of employment.

22. The possibility of adapting policy to promote more widespread use of labour-intensive techniques was considered. Although the reduction of unemployment is an overriding concern of most Arab

countries, with a few developments of some established employment targets for the manufacturing sector. While there may be room for policy measures favouring employment objectives, too great an emphasis on the expansion of manufacturing employment may conflict with the goal of raising the level of productivity of labour. Most participants felt, therefore, that the contribution of manufacturing industry to enlarging total national output (on which the general welfare of society depends) should not be compromised in favour of employment objectives; the expansion of employment opportunities should be sought elsewhere in the economy.

The effect of existing policy

23. At present, industrial policy in many Arab countries tends to favour the adoption of relatively capital-intensive techniques in manufacturing industry because the cost of capital and labour to the domestic enterprise does not reflect their scarcity value. Sharp distortions in the prices of these factors away from their "social costs" are caused by import duty concessions for machinery and equipment, the artificially low level of interest rates, and the increase in labour costs resulting from minimum wage legislation and social security payments. The continuing shortage of trained and skilled personnel also favours the choice of automated production.

24. The indiscriminate adoption of the type of fiscal incentives used in developed market economies to promote capital investment in industry and to encourage early replacement of machinery and equipment with those representing a more modern technology is also a policy which favours capital-intensive techniques. Such measures as accelerated depreciation, investment allowances, and investment grants when used in developing countries encourage capital-intensive technology and discourage labour-intensive processes of production in a manner which does not reflect true scarcities and factor endowments.

Adapting industrial policy to promote employment

25. It may be more appropriate, perhaps, to base tax incentives in developing countries not on the level of profits earned in the early years of a project's operation, but instead on the number of employment opportunities an enterprise creates. It was therefore suggested that instead of tariff protection, Arab countries may wish to consider providing subsidies to industry based on their labour force. Such a fundamental switch in policy would help promote export-oriented, labour-intensive industries, which offer considerable potential for creating additional employment opportunities in the manufacturing sector.

26. Employment could be increased without additional fixed capital investment if the transition were made from a one-shift operation to two or even three shifts; fiscal incentives might be used to encourage more extensive use of multiple-shift operation in manufacturing industry. There is also scope for using additional labour to give machinery more extensive preventive maintenance than is commonly indicated as necessary in engineering manuals written in terms of the circumstances of industrialized countries. Other possible instruments, such as high sales taxes on industrial equipment, might be used to encourage the choice of labour-intensive methods for the handling of materials, warehousing, packaging, maintenance and in-plant transportation.

27. Another policy instrument available in many Arab countries is the industrial licensing system, which can be used judiciously to discourage capital-intensive processes of production where adequate alternative processes of production are known to exist and their use does not handicap the efficient operation of the enterprise.

28. The employment created indirectly as a result of establishing a new manufacturing enterprise may be as great as that provided directly by the manufacturing enterprise itself. Policy should therefore encourage steadily increasing reliance on local inputs of raw materials, intermediate products and specific services.

Promoting employment in small-scale industries

29. The important role of traditional, small-scale manufacturing enterprises in providing employment opportunities was stressed. The artisan or traditional sector of manufacturing industry is expected to continue to provide about half of the total employment provided by manufacturing industry in most Arab countries. It was acknowledged that the growth of the modern sector of manufacturing may lead to some displacement of artisan labour, since some crafts and related trades may be neither fully substitutable nor easily transferable. Special measures should be adopted to expand and modernize the traditional small-scale sector of manufacturing industry. The policy measures suggested include: cash grants to proprietors to purchase new machinery; subsidized rental of factory buildings on industrial estates; subsidized loans for new investment; provision of advisory and extension services; organization and financing of advertising campaigns to promote sales of artisan products; government purchases; and assistance in the development of sales on a subcontracting basis to larger manufacturing enterprises.

The importance of training industrial labour

30. Unemployed labour in Arab countries is mostly unskilled and does not easily lend itself to modern industrial activity irrespective of the production technique chosen. The Seminar placed special emphasis on the need for expanded programmes of labour training, although this subject was outside the agenda of the Seminar. While basic skills can be developed in government-supported vocational training institutions, manufacturing enterprises need to be encouraged to develop apprenticeship schemes and other forms of in-plant training for their own labour force. Government support may take the form of a subsidy based on the number of workers being trained and the type and cost of training required.

CHAPTER 3

DEVELOPING A CAPABILITY TO ADAPT, DEVELOP AND EFFECTIVELY USE MODERN INDUSTRIAL TECHNOLOGY

31. Three major aspects of the use of modern industrial technology were considered: (a) the initial choice of technology for new manufacturing projects and the way in which it is transferred; (b) the subsequent effective use, improvement and updating of this technology during the plant's operation; and (c) the development of capability to adapt existing technologies or develop new technologies suited to the resources and requirements of the Arab countries.

Choice of technology

32. It was suggested that the term "appropriate" industrial technology be used rather than "modern" industrial technology. If major importance is attached to maximizing employment opportunities, the most modern technology (usually a capital-intensive technology) may be less appropriate than other technologies; when selecting a technology, the value of output achieved per unit of capital investment is a relevant criterion for countries with limited investment resources.

33. The view was expressed that special care should be taken when applying such a criterion to projects designed to serve export markets; the rapid pace of technological change makes it essential to adopt up-to-date technology for these projects. For projects serving the domestic market, there was less agreement on the most appropriate principles to apply. Some participants accepted that

modern technology is not always necessary and may even be inappropriate if the skilled labour required for the maintenance and operation of modern machinery is not readily available; others took the view that modern technology will usually be the best choice, particularly for large, strategic industries. The use of second-hand machinery was not favoured because it often produces second-rate products.

34. The need to compare alternative technologies or manufacturing processes was widely accepted. Existing enterprises established under private ownership have not always considered alternative choices of technology. In some Arab countries, non-technical considerations sometimes influence the choice made for public-sector projects.

35. Lack of information is a handicap to Arab enterprises when selecting technology. There is a need to develop improved sources of technical information. Technical information and documentation centres serving both national and regional needs are being promoted by IDCAS for selected industry sectors, but facilities to disseminate technical information at the national level still need to be strengthened. International organizations, and UNIDO in particular, could help Arab countries to draw up and implement a suitable long-term plan for action in this important area.

Ways in which technology is transferred

36. The way in which technology is transferred varies from country to country, from branch to branch and from project to project. Foreign technical know-how can be purchased, and there is no necessity to link it to foreign investment. However, where foreign investment is acceptable, the joint venture has many advantages for both private and public partners in Arab countries.

37. The Government has an important regulatory role to play in the selection of technology. Repetitive purchases of the same technology should generally be avoided. The Government should ensure that technical collaboration from industrialized countries

is not used when technical know-how can be developed locally by adapting freely available technology, or when technical know-how can be obtained from another Arab or developing country.

38. The Government needs to regulate the purchase of technical know-how to see that the charges are appropriate and that other aspects of the contractual agreement between enterprises conforms with the national interest. A short-term contract (5 to 10 years) may help stimulate accelerated training of local personnel. Provision can be made for assisting other local industries to develop as suppliers of parts and components.

39. The raising of productivity in existing enterprises is an important objective of industrial policy. Inadequate initial training of managers, supervisors, and skilled labour and maintenance personnel results in ineffective use of modern technology in many industries. Although training was not on the agenda of the seminar, its importance was stressed again in strong terms. The establishment by one Arab country of an institute to provide advanced training in metallurgy was cited as an example of the needs encountered when technologically complex industries like integrated iron and steel production are being developed.

40. The need to update and improve manufacturing processes in existing enterprises was also stressed. Access to improvements in the technical know-how supplied by a foreign collaborator is an important element of the contractual agreement. A more competitive business environment and incentive measures to encourage reinvestment of profits in modernization and process improvements are often needed.

The capability to develop new industrial technology

41. Finally, ways of meeting the need to develop capability to adapt available technology or develop new industrial technology suited to the needs of Arab countries was discussed. The Seminar noted the rapidly growing proportion of national resources devoted to research and development activities in industrialized countries

and considered how Arab countries should respond to this trend within the constraints set by their limited resources of finance and trained personnel.^{4/}

42. Industrial enterprises themselves play the leading role in research and development in industrialized countries. The Governments of Arab countries should therefore expect the larger manufacturing enterprises to establish their own research and development departments. Existing industries should be encouraged to develop their own research associations at both the national and regional levels. Government support and international assistance could be used. The assistance of IDCAS and UNIDO in establishing regional institutes for selected industries was cited as an example.

43. The existence of national industrial research institutes in some countries was noted. In many cases, these need to be strengthened. Additional government support may be warranted, but the main aim should be to encourage existing industries to make greater use of the services of these institutes.

44. The heavy reliance Arab countries place on foreign consulting firms for the design and engineering of industrial plants was criticized. National or subregional engineering consulting firms should be developed to take over much of this work, at first on a partnership basis with foreign firms but later on an independent basis for simpler projects.

45. The shortage of technical universities in the Arab world was also noted. Existing universities need to adapt their curricula to the practical needs of industry and to provide training in industrial plant design and industrial process engineering.

^{4/} It was recognized that suitably challenging opportunities could help attract many of the thousands of Arab university graduates working in the United States and other industrialized countries to return home.

CHAPTER 4

MAKING OPTIMUM USE OF REGIONAL INDUSTRIAL CO-OPERATION

Regional agreements

46. Historically, Arab countries were one of the first groups to recognize the advantage of regional co-operation. After a series of agreements to liberalize trade, dating back to 1953, some of the countries that ratified the Arab Economic Unity Agreement in 1964 have advanced towards an Arab Common Market, and a Free Trade Area is expected to come into full operation in 1971.^{5/} Co-operation between Arab countries in North Africa began in the Maghreb in the mid 1960s.^{6/} In 1970, the Libyan Arab Republic, the Democratic Republic of the Sudan, the United Arab Republic, and the Syrian Arab Republic agreed on a progressive freeing of trade. Discussion in the Seminar concentrated mainly on the so-called Arab Common Market.

47. The impact of these agreements on regional industrial co-operation has been limited. The progressive freeing of trade among member countries of the so-called Arab Common Market has not so far stimulated a much greater exchange of manufactured goods. Trade among member countries accounted for no more than 6 per cent of their total trade in the late 1960s. Only a few

^{5/} Member states that have so far ratified the Arab Common Market Agreement are Iran, Jordan, Syria and the United Arab Republic.

^{6/} Algeria, Morocco, Tunisia and (at that time) Libya formed the Maghreb Permanent Consultative Committee.

- 1 -

new industrial projects have been established specifically to serve the regional market. The continuing imposition of non-tariff barriers and the failure to agree (often due to political rather than technical reasons) to establish multinational industrial projects were identified as the main causes.

48. Disappointment with these preliminary results should be considered in a broader perspective. Member countries have to find ways of overcoming difficulties posed by the different economic and social systems adopted and the different levels of development achieved. The creation of a payments union and a clearing system in 1971 will take regional co-operation a step further. Studies show that 40 per cent of the items included in the tariff schedules of member countries are at roughly the same level; the harmonization of external tariffs, the final step in creating a Common Market (after the abolition of all administrative restrictions), is therefore expected to be completed in the near future.

49. There is more scope for Arab countries to borrow capital from one another than to borrow from outside the region. The establishment of an Arab Development Fund was agreed upon in principle in 1970; an agreement to facilitate the transfer of capital among member states has been ratified by some countries; and a multilateral investment-guarantee insurance scheme for private investment is awaiting ratification.

50. Although in retrospect it may seem that too much importance has been attached to the freeing of trade, many of the important preconditions for successful regional industrial co-operation (guaranteed free access to neighbouring markets and free movement of capital) have now been agreed to in principle, if not yet fully implemented in practice.

A new agency to promote industrial co-operation

51. The Industrial Development Centre for Arab States (IDCAS), a co-sponsor of the Seminar, plays a leading role both in strengthening industrial development efforts at the national level and in

promoting regional industrial co-operation. IDCAS, which was established in 1969, is serving all of the fourteen Arab countries invited to attend the Seminar. At the national level, IDCAS is helping Arab countries to make forward-looking surveys of their existing industrial sector. This collection of basic data will not only help Governments to draw up appropriate plans and policies for industrial development, but should help to identify opportunities for various forms of regional co-operation in the field of trade and industrial development.

52. Effective regional industrial co-operation requires appropriate technical institutions and a political spirit to support their development. At the symposium in Algeria sponsored by IDCAS in December 1970, it was decided to establish an Arab Institute for Iron and Steel. A similar practical approach is being applied to the development of co-operation in the industrial branches of textiles, petrochemicals and fertilizers, sugar, pulp and paper, and agricultural machinery.

53. For each of these six branches of industry, comprehensive reports will be prepared in 1971 with the help of UNIDO to assess: (a) world trends in the industry; (b) the present state and development potential of the industry in Arab countries; and (c) estimated present and future consumption of the industry's products (up to 1980) in Arab countries. These studies will suggest ways in which Arab countries can co-operate in the marketing, technical and production aspects of these industries. Further industries will be examined at a later date.

54. These detailed studies and technical investigations should identify the opportunities for specialization of production through the establishment of specific projects to supply the markets of regional or subregional groups of Arab countries. The subsequent effective development of regional industrial co-operation will then depend on negotiating a satisfactory solution, taking account of the economic interests of all countries concerned.

55. This will require appropriate institutional arrangements to negotiate plans for implementing agreed projects and to follow them up. It will also require that the real economic and technical advantages of regional industrial co-operation are not nullified by political considerations. If these conditions were fulfilled, there would be reason to be optimistic that the industrial policy of Arab countries would be based on the principles of regional industrial co-operation to a greater extent in the 1970s than it was in the 1960s.

CHAPTER 5

DEVELOPING INTERNATIONALLY COMPETITIVE EXPORT INDUSTRIES

56. The free trade argument that countries should concentrate mainly on developing industries in which they have a comparative advantage was considered inadequate to meet the development needs of the Arab countries. The application of such an approach to the industrial policy of Arab countries has to be modified by (a) the need to protect newly established industries from competition by goods produced by long established manufacturing firms in foreign countries with larger markets; and (b) the tariff, non-tariff trade barriers and practical difficulties encountered in developing a growing volume of exports of manufactured goods to industrialized countries. Discussion therefore concentrated on an appropriate level of protection for industry in Arab countries; and the types of measures that could be used to promote exports of manufactured goods.

The level of protection

57. The level of protection provided at present varies from country to country. In Kuwait, Libya and Saudi Arabia, the level of protection is modest; in those countries that adopt a partial or total state trading system, some industries are heavily protected by quantitative restrictions. In other Arab countries protection policy falls somewhere between these two extremes. In countries where tariffs are the principal form of protection, the level of tariffs varies greatly from product to product because (a) the

structure of tariffs still reflects primary concern with raising revenue; and (1) the protection afforded products of local industries has been the result of a series of ad hoc decisions.

58. The basic philosophy underlying the tariff structure in Arab countries typically places a low level of duty on imports of machinery and raw materials, a modest rate of duty on intermediate and semi-manufactured goods, and a higher rate of duty on manufactured goods. Consumer manufactures are commonly afforded the highest rates of protection.

59. The present level of protection for some industrial products in many Arab countries was considered to be excessive; nominal tariffs within the range of 50 to 100 per cent are found in some countries, and quantitative restrictions frequently permit industries to develop with a high cost structure. This contrasts with an estimated average level of protection in industrialized countries of between 20 and 30 per cent for a wide range of manufactured products.

60. When reviewing levels of protection, the effective rate of protection for that part of the manufacturing process carried out within the country is the relevant measure. This is usually considerably higher than the nominal tariff rate because inputs for the manufacturing process are also protected, although usually at a lower rate of import duty than the final product. Where quantitative restrictions are used, an implicit rate of effective protection can be calculated.

61. A high level of effective protection encourages or permits the establishment of industries with costs of production that are high when compared with international levels. But the current f.o.b. export price from an industrialized country is not always the relevant comparison. Account should be taken of: (a) year-to-year fluctuations in the f.o.b. price of the product (the sharp rise in steel prices in 1970 was noted); and, (b) the common practice of selling exports at below home-market prices. Hence, the price at which imports of the product could be purchased over a

period of years becomes the relevant comparison. The effect of transport costs must also be considered.

62. The appropriate levels of effective protection were not discussed, although it was agreed that a more uniform level of protection for final manufactured products would help to correct the present situation where some industries are given excessive encouragement and others too little. The present excess capacity in some industries may have been promoted by excessive rates of effective protection. Relatively low levels of protection may be holding back the development of intermediate and capital goods industries in some countries. Import duty concessions granted as an incentive measure sometimes discourage reliance on local sources of raw materials, parts and components.

63. Relatively high protection often results in a waste of resources and can drastically reduce the purchasing power of consumers and/or act as an obstacle to the development of exports of manufactured goods when the product is used as an input by other industries. High levels of protection also create a structure of prices for manufactured and agricultural products which overencourage industrial development at the expense of agricultural development.

64. It was suggested that there is a need for many developing countries: (a) to review their exchange rates to see whether they are overvalued; (b) to introduce more moderate levels of protection; and (c) to consider a fundamental change in policy whereby all or part of the protection would be replaced by a subsidy based on the labour used by manufacturing enterprises. (See also paras. 25 and 75).^{1/} Many participants felt, however, that the question of a labour subsidy should be further investigated, taking into account the conditions of labour supply and demand in each country.

^{1/} It was further suggested that the cost of the labour subsidy might be met by a tax on output or sales which initially raised the domestic selling price to the level which the previous level of tariff permitted.

- 3 -

65. It was recognized that the structure of protection that has evolved in many Arab countries has been influenced mainly by balance-of-payments and fiscal considerations. To be an effective instrument of industrial policy, protection policy should: (a) make tariffs rather than import controls and other non-tariff barriers the principal form of protection; and (b) ensure that tariff protection is gradually reduced to levels that are not excessive. In some countries, an over-all review of protection policy may now be needed to ensure that the structure of protection is well adapted to the next stage of industrialization.

Promoting exports of manufactured goods

66. Promoting the establishment of industries with an internationally competitive cost structure was recognized as the most effective way to promote exports of manufactured goods. Where the domestic market is not large enough to support a plant of economic size, consideration should be given to the possibility of establishing a plant large enough to be able to export to world markets and to serve neighbouring Arab countries whose markets are more readily accessible because of their proximity and as a result of the removal of trade barriers in accordance with regional co-operation agreements. The total market might then be large enough to justify a plant with internationally competitive costs.

67. The prospect of exporting to industrialized countries has improved through the recent agreement on preferential arrangements for the access of imports from developing countries, negotiated on UNCTAD's initiative. The tariff reclassification of import categories by the Customs Co-operative Council in Brussels, which is being undertaken in 1971, may also help, provided that UNCTAD is informed of the Arab countries' special interest in exporting selected artisan and craft products.

68. However, developing exports of manufactured products will remain a demanding task, requiring the manufacturer to adapt the design of his products to export market requirements and to make

special marketing efforts. A wide variety of incentives for industrial exports can encourage enterprises to make these efforts; such measures are widely used by industrialized countries and some developing countries.^{3/}

6). Contractual provisions to promote export sales can be made when a new industry is established. Some Arab countries have negotiated contracts to purchase new industrial plants that provide that repayments will be in kind (that is, in export sales of the goods manufactured by the plant) to the country supplying the equipment. Existing industries can be encouraged to export part of their production. In one country, annual export targets are set for most of the larger state-owned manufacturing enterprises.

70. Another approach is to provide additional incentives or subsidies for the establishment of new export-oriented industries. An important policy issue here is whether different industries require incentives of the same strength and, if not, how the strength should be determined.

71. Duty-free imports of machinery, subsidized financing, and long tax holidays (or even complete exemption from taxation) are provided by some developing countries. The operation of export-oriented industries can also be facilitated by the establishment of a free trade zone in which they can locate. Given the proximity of Arab countries to Europe and the success of this approach in some Asian developing countries, it is surprising that this method has not been more widely used so far.

72. The profitability of the exporting process itself can also be enhanced. Imports of raw materials, parts and components subsequently used in goods exported are commonly exempted from import duty by most developing countries. A variety of methods can be used to make the exchange rate applicable to export transactions more favourable than the exchange rate applied to other transactions. This can have a powerful effect on the profitability of

^{3/} The measures used by other countries are described in the UNCTAD publication Incentives for Industrial Exports (TD/8/C.2.89/Rev.1) UN Sales No. E.70.1.2.8.

export sales. Direct subsidies or subsidies in the form of relief from taxation are provided by some developing countries. These may be based on the sales value of exports, the increase in export sales over the level achieved in previous years, or (perhaps more appropriately) on the value added in the manufacturing process.

73. There also appears to be scope in most of the Arab countries for the establishment of export-promotion centres and greater use of subsidies and other forms of government assistance, such as trade fairs to support intensified export-marketing efforts. Schemes for insuring export sales and providing subsidized credit to finance export transactions should also be considered.

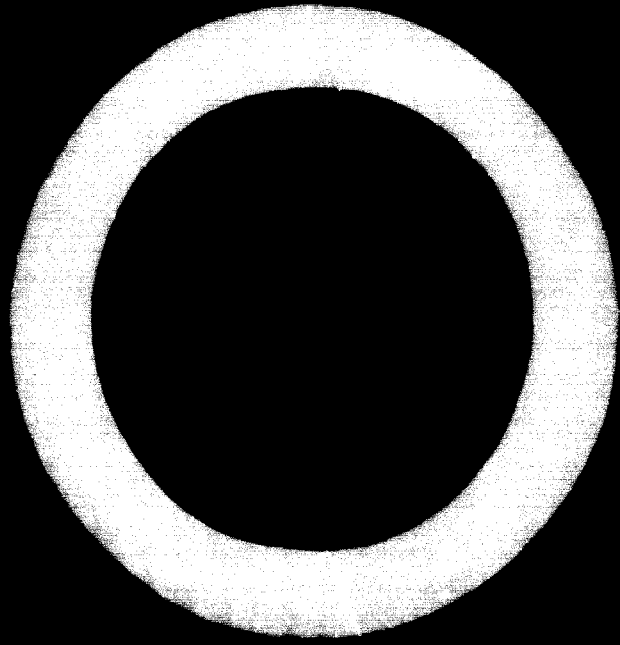
74. Guidelines for establishing the appropriate level of subsidy for export of manufactured goods were not considered in detail, but it was noted that the policy applied by most Arab countries in protection and export incentives made it more profitable to supply the domestic market than export markets. It was further noted that the fundamental switch in policy from protection to subsidising labour in manufacturing enterprises (para.64) would:

- (a) help promote export sales from existing industries by lowering manufacturing costs; and
- (b) promote the establishment of labour-intensive, export-oriented industries.

Competition and economies of large-scale production

75. In addition to considering the lowering of protection from external competition, it was agreed that competition within domestic industry should be encouraged. It was suggested that the tendency to give local manufacturers a monopolistic position in their domestic markets has led to excessive "feather-bedding" of industry, with the result that insufficient attention is paid to the interests of the consumer and there is little incentive for innovation. A competitive industrial structure might provide the necessary stimulus for efficiency so that the changing pattern of consumer demand would be satisfied at reasonable price levels.

76. However, most participants felt that a main objective of a planned economy is to eliminate wasteful duplication in order to achieve full economies of scale. This applies particularly to the basic capital-intensive industries. Undue fragmentation should be avoided. Planning controls should ensure an adequate integration of the various sectors and the establishment of complementary rather than competitive relationships between enterprises.



Annex 1

AGENDA

1. Objectives of industrial development policy
2. Measures to develop an integrated and self-propelling industrial sector
3. Measures to develop a more competitive industrial sector
4. Industrial development policy and regional co-operation
5. Industrial development policy and employment
6. The efficient use of modern industrial technology
7. Case studies
8. Consideration of highlights of discussion

Annex 2

LIST OF PARTICIPANTS AND OBSERVERS

Country participants

IRAQ

SUHAIL MOHAMMED SALIH
Director General
Iraqi Tobacco Co.
Ministry of Industry

JAWAD AL-NE'AIMI
Director General
Mosul Cement Factory
Ministry of Industry

SALAH AL-SHAIKHLY
President
General Statistical Organization
Ministry of Planning

SABAH KACHACHI
Director General
Industrial Department
Ministry of Planning

JORDAN

FUAD HADIDI
Head
Industrial Department
Jordan Development Board

TALAL M. GHEZAWI
Head
Industrial Control
Ministry of Economy

KUWAIT

ABDUL HAMEED AL-FARES
Head
Industrial Licensing Section
Ministry of Commerce and Industry

LEBANON

IMAD NA'AWAM
Industrial Engineer
Ministry of National Economy

JEAN-PAUL TOUMA
Industrial Expert
Ministry of Planning

BOUTROS LABAKI
Industrial Expert
Ministry of Planning

LIBYAN ARAB REPUBLIC

MOHAMED A. ZAIED
Ministry of Industry and Mineral Wealth

SAUDI ARABIA

MAHSOUN B. JALAL
Adviser
Industrial Studies and Development Centre
Ministry of Commerce and Industry

SUDAN

MOHAMED A. I. HAMO
Ministry of Industry and Mineral Resources

SYRIAN ARAB REPUBLIC

ABDULLAH SALLOUTA
Deputy Minister
Ministry of Industry

MOHAMED IMADY
Deputy Minister of Planning

SAAD DIBS
Ministry of Industry

UNITED ARAB REPUBLIC

KAMEL MAKSOUD
General Director
Metallurgical Projects
General Organization for Industrialization

SHAWKY EL NAHAS
General Organization for Industrialization

YEMEN

ZAID ALI AHMED
Technical Office

MALEK ALIRYANI
Ministry of Economy

Expert consultants and guest speakers:

A. EL-BANNA
Secretary General
Arab Economic Unity Council
United Arab Republic

MOHAMMED DIAB
Professor
American University of Beirut

A. N. KAISSOUNI
Consultant to the Government of Kuwait

MARWAN NASR
Association of Lebanese Industrialists

MAURICE SCOTT
Fellow
Nuffield College
Oxford, United Kingdom

VENIERO A. MARSAN
Central Director
Long-range Investment Planning and Economic
Studies
Institute for Industrial Reconstruction (IRI)
Rome, Italy

Observers

MICHEL CHATELUS
Professor
Faculty of Law and Economic Sciences
Université St. Joseph
Beirut

BURHAN DAJANI
Union of Chambers of Commerce, Industry and
Agriculture for Arab Countries
Beirut

M. SHAFEI
Professor
Beirut Arab University

A. SHARIF
National Council for Scientific Research
Beirut

Industrial Development Centre for Arab States (IDCAS)

M. E. SALAMA
Director General

FOUAD H. AWAD
Consultant
Professor of Economics
Cairo University

AHMED HAMDI
Economic and Social Division

MOHAMED SAID ALI
Senior Industrial Economist

FAWZI R. FAHMI
Head of Survey Team
Syria

United Nations organizations

UNDP

HASHEM JAWAD
Resident Representative
Beirut

M. EL-HALFAWI
Senior Industrial Development Field
Adviser

ILO

S. K. BURGAN
Director, ILO Office
Beirut

PRASANTA K. DAS
Regional Adviser
Middle East Region

W. WESSELS
Associate Expert

KEITH MARSDEN
Senior Economist
Research and Planning Department
ILO, Geneva

ECA

LOUIS SANGARE
Economic Affairs Officer
Industry Division

UNCTAD

S. EL-NAGGAR
Deputy Director
Research Division

UNIC

G. AL-ATRAQCHI
Officer in Charge
United Nations Information Centre in
Beirut

UNIDO

C. AKHRAS
Chief
Industrial Policies and Financing Section

K. ADUSEI-POKU^{1/}
Industrial Policies and Financing Section

RICHARD LINE
Industrial Policies and Financing Section

UNESOB

JEAN-PIERRE MARTIN
Director

^{1/} Rapporteur of the Seminar.

UNESOR (cont'd)

BASTIM A. HANNEISH
Chief
Sector for Economic Affairs

VANGALA J. RAM
Chief
Section for Social Affairs

IGOR KARMILOFF
Chief
International Trade Unit

SALAH JOWHARI^{2/}
Chief
Industrial Development Unit

TRAN-LE QUANG^{3/}
Regional Adviser in Industrial Development

GABRIEL REZEK
Chief
Technical Co-operation Unit

ROBERT KAMINKER
Chief
Administrative Unit

MOHAMED O. ABDELMONEIM
Industrial Development Officer

TAHER KANAAN
Development Planning
Economic Section

RAMZI DALLOUL
Development Planning
Economic Section

ISKANDER MOUKARBEL
Trade Unit

ISMAT RISHANI
Research Assistant

^{2/} Co-Director of the Seminar.

^{3/} Co-Director of the Seminar.


Annex 2

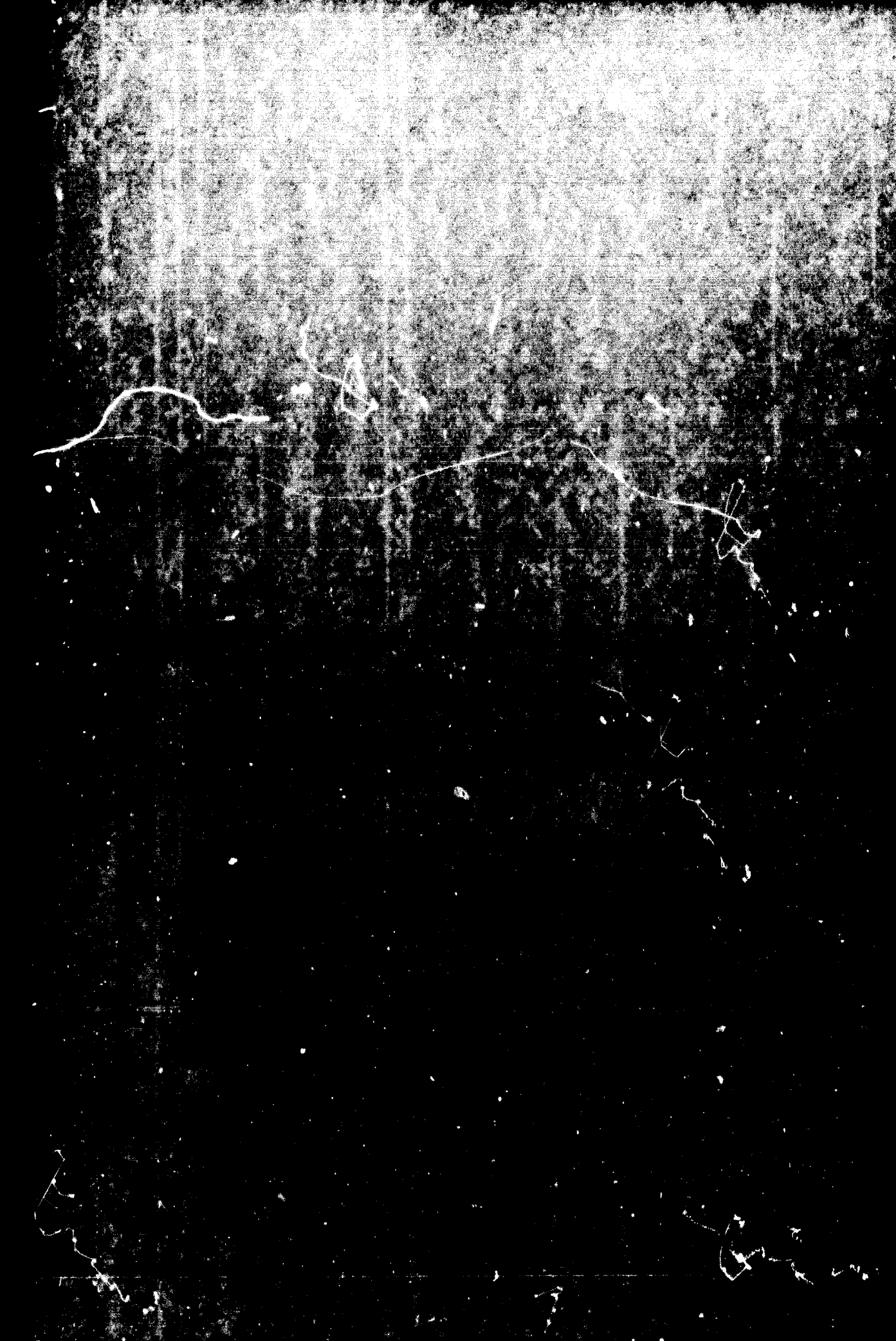
LIST OF DOCUMENTS^{1/}

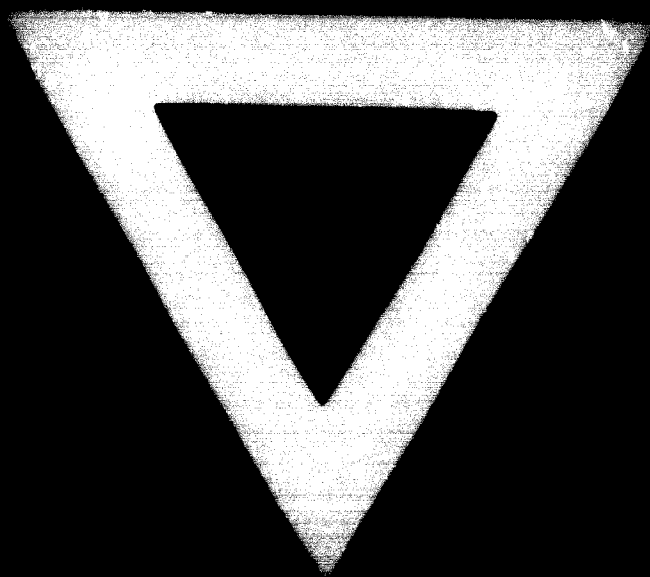
Meeting Documents

- ID/WG.86/1 Some objectives of industrial policy and the measures or instruments used to achieve them
- ID/WG.86/2 Industrial policies: the experience of the Syrian Arab Republic
- ID/WG.86/3 Industrial policies: the experience of Saudi Arabia
- ID/WG.86/4 Case study: country A - advisory mission on industrial policies
- ID/WG.86/5 Case studies to be worked out by participants: country B - advisory mission on industrial policies
- ID/WG.86/6 The experience of Iraq
- ID/WG.86/7 Regional co-operation of Arab States in the field of industrial development
- ID/WG.86/8 The world employment programme
- ID/WG.86/9 New approaches suggested by the Colombia employment programme

^{1/} A limited number of copies are available upon request.







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