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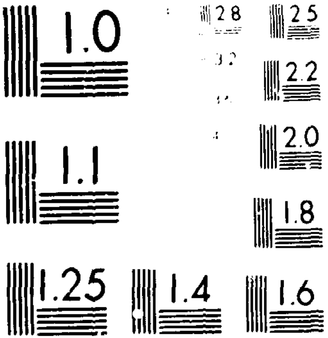

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LONG-TERM CONTRACTUAL ARRANGEMENTS FOR THE SETTING UP OF CAPITAL GOODS *)

Prepared by the
Negotiations Branch,
Division of Policy Co-ordination

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Before presenting our proposals concerning long-term industrial arrangements, it will be useful to place our initiative in the context of the changes taking place in economic relations and to indicate the rationale of the approach we have taken in the light of the various current attempts to create a new balance between North and South. This clarification will help to explain the implications of the industrial arrangements and throw light on the intentions behind our proposals.

The main areas of research

The historical development of international economic relations shows that there is a close connexion between the development of trade and the emergence of new products, new markets and new commercial and financial practices. If we look at the past decade from this point of view, we will observe a sharp increase in international trade bearing witness to the new monetary and commercial options open to developing and industrialized countries. The increase in the volume of trade was accompanied by an evolution in commercial flows, a diversification in the exchange of goods and services, the development of complex forms of exchange and the internationalization of commercial relations. Whereas in the past commercial and financial practices used to adapt to the needs expressed, thus supporting the development of trade, the recent, sudden appearance of new and complex needs among partners with different technological capabilities has not led to the development of new commercial instruments. The established instruments had been conceived for certain well-defined relationships between partners at similar stages of development, although we cannot overlook the fact that changes have been introduced in the sphere of financing and with regard to the content of existing formulae without, for all that, achieving any great success in the field of transfer of industrial capabilities. Satisfying this need for new instruments, which is not met by the current formulae, appears more and more important for the development of such relations in the future.

The developing countries, on the other hand, realizing both the imbalance in their relations with the industrialized countries and the strategic nature of their resources, are demanding the establishment of a new international economic order founded upon a balance in the trade between North and South. The positions of both sides are strong enough for a balance in their economic relations to appear feasible. The exchange of technology for natural resources must accordingly be regarded as the basis for future balanced relations between industrialized and developing countries. It is important, therefore, that this balance should appear in all the readjustments taking place (North-South dialogue, South-South co-operation and bilateral negotiations). In bilateral relations, therefore, which are of particular concern to us, industrial arrangements should include the component of exchange of technology for natural resources. This approach, which combines the advantages of barter and monetary exchange, constitutes a system of guarantees for both sides by virtue of mutually dissuasive economic pressures.

On a different level, the interdependence of international economic relations enables the developing countries to secure their political independence by a diversification of their relations. Their relations with the North are founded upon the observance of the principles of equilibrium, mutual respect, non-interference and mutual interest. The violation of these principles which occurs in practice causes the developing countries to establish short-term relations and the sole remaining long-term economic relations are engendered by political preferences. Industrial co-operation, however, requires the establishment of long-term economic relations between the parties involved. In order to reconcile this constraint with political necessities, we have been looking for a framework of long-term relations which combines observance of the above principles with balance and high stability. The scope of such an agreement can only be sectoral, thus allowing for a sector-by-sector diversification of the parties on both sides and offering the advantage of technological coherence in each sector. Our approach opposes the compartmentalization of industrial exchanges resulting from a monetary view of economic relations and aims at increasing the efficiency of exchanges.

Besides, the very different situations of developing countries and the peculiarities of each sector require that the new long-term industrial arrangements be given a flexible form. Keeping them adaptable to the diversity of situations will be the best way of ensuring that they remain universally applicable. One reason why the formulae normally used in industry at present have been unsuccessful is that they cannot be adapted to all situations. Our proposals will therefore have to give due consideration to this international and intersectoral diversity.

Furthermore, relations in the field of industry between developing countries and industrialized countries with mixed economies have been suffering from the subordinate role officially played by the State in the industrialized countries. The official separation of the State and industrial firms penalizes developing countries in that no real guarantee is offered to them in the event of bankruptcy of the industrial firms. The fiction of the privatization of firms gives the industrialized countries an excuse for allowing the systematic maximization of profits accruing to industrial firms from their positions of strength vis-à-vis the developing countries; yet as soon as the commercial interests of the firms are in danger, the Governments of industrialized countries put pressure on the developing countries.

In order for the State in an industrialized country to become a party to industrial relations, the economic and political stakes must be considerable. Thus at the present time the desire of industrialized countries to secure energy and mineral resources leads the State to step out of its official role and to offer technological compensation. Our proposals for long-term industrial arrangements will take these elements into account so as to obtain direct State involvement from industrialized countries.

In view of needs repeatedly expressed and insufficiently met, the long-term industrial arrangements are intended to allow for efficient long-term co-operation on a sectoral basis between partners of varying technological capability under the control of partner States by an organized equilibrium between technology and natural resources.

Purposes of the study

The search for new forms of industrial arrangements is part of the endeavour to balance industrial relations between industrialized and developing countries. The intention is to support current attempts both to establish a new international economic order and to change the present forms of industrial arrangements.

In the industrial sectors themselves, unfortunately, these attempts did not immediately lead to satisfactory results. Aware of this shortcoming, the United Nations Industrial Development Organization (UNIDO) took account of this concern by putting forward the idea of a bilateral contract for sectoral development. This initiative, which combines the advantages of previous approaches and supplements them, is intended to bring about balanced relations between partners with different industrial capabilities, in a specified industrial sector and over a long period of time.

In order to retain its universal character, this contribution should not be limited to the formulation of a new instrument of contractual relations but should rather be adaptable to the diversity of situations of the parties involved in the North and the South. Our proposal was supposed to take account of the concern for equilibrium, the idea of a bilateral agreement and the necessity of long-term relations, and to present a method of shaping new forms of industrial arrangements adapted to each sector and each partner.

Could such an attempt, intellectually attractive though it may have been, really bring about a new form of industrial arrangement in practice? The answer to this question was to be found in a trial application in one sector. The choice of an experimental sector fell on the iron and steel industry, for the following reasons:

- The advanced stage of UNIDO's work in this field;
- The ease of collecting the information required by the method;
- The particular importance of the iron and steel industry for the industrialization process in developing countries.

But why, you might well ask, present a paper like this at a meeting on the capital goods industry? It seemed important to us at UNIDO while working on this sector to demonstrate the contribution made by the concept of a sectoral development contract. On-going studies on typology, on the degree of sophistication of products, on the versatility of production tools and on the possible means of entry for developing countries will eventually allow the method to be applied to the whole sector. But even now the method can be used for certain standard goods. And finally, as the application to the iron and steel sector shows, contracts in other sectors can be used as a basis for growth in the production of certain specific standard capital goods.

The usefulness of a paper such as this one thus lies essentially in its presentation of a method for setting up new industrial arrangements, even if the iron and steel sector has, for practical reasons, been chosen as field of application. The method remains generally applicable, however, and in particular to the capital goods sector.

Definition of the sectoral development contract

Before the method is presented, the concept of the sectoral development contract should be defined for the sake of better general understanding. The most suitable definition seemed to us to be this:

> "Sectoral, multiform, long-term contract between two partners with different industrial capabilities based on a balanced exchange of a quantum of development against strategic resources. It is the result of a methodical sectoral analysis of existing potentials and complementarities and presupposes the collaboration of all the parties concerned under the leadership of their respective Governments. The equilibrium of the contract as a whole thus comes about by the parties concerned agreeing on a long-term programmatic list of development objectives on which the legal, technological, financial and commercial constructs of the contract are based. As a set-off for this co-operation and for keener prices, the industrially least favoured partner provides adequate compensation for his counterpart."

Presentation of the method

Starting out from a specific industrial sector, a developing country should establish the consecutive levels of its industrial capability, possibly draw up a flow chart of technological decisions, clearly identify the system of elements influencing the investment decision, know which elements are outside its influence, analyse forms of control over these elements, understand the connexions between these controls, assess its own situation, draw up a list of items for negotiation, analyse the long-term development of its resources, conceive solutions, distinguish between solutions to be expected from North-South negotiations, South-South co-operation and bilateral agreements, identify possible complementary partners, acquaint itself with their strategies in the sector concerned, set up a system of compensations and finally make the appropriate industrial arrangement.

The application of a method like this one thus requires a good knowledge of the relevant sector, its technological development, the protagonists in it and their strategies. It implies that the developing country which uses it should assess its own degree of industrial capability, formulate a development strategy in that sector, set priorities among its objectives and finally have the will to overcome the traditional exchange of technology for money. It thus appears essential to experiment with the method in order to prove its utility. The attached studies will enable the reader to follow the course of the analytical process in the industrial sector chosen. The first study is devoted exclusively to the application of the method and leads on to the fundamental topics to be covered in the development contract. The second study takes up the conclusions of the preceeding one in a more detailed analysis in which it tests their coherence and builds up the system of contributions and set-offs. While the first study attempts to justify the concept of the sectoral development contract and to give it its place in international economic relations, the second study makes use of the data supplied by the first one and attempts to outline possible areas to be covered in a development contract in the sector concerned.

Results of the method

We are presenting them as a summary of the conclusions of the studies.

Principles for the construction of the industrial arrangement

Structuring the industrial arrangement around complementary partners: engineering firm, iron and steel producer, supplier of capital goods, project promoter, Governments of the countries concerned.

Balance of the contract based on guarantees for long-term sectoral development in return for a guarantee for supplies of strategic resources.

Risks arising from the contract distributed in accordance with the natural responsabilities of each partner.

Planning the development objective.

Prior choice of set-offs and establishment of a system of premiums linked to the fulfilment of the objectives.

Assessment of competition on the basis of a prior analysis of the potentials and complementarities of possible partners.

Drawing up an organizational chart of relations between partners.

Possible topics to be included in the development contract

Financing

Linkage of financing with the results of taking up production.

Extension of financing to the financial needs arising while production is being taken up.

Extension of financing to local currency requirements.

Investment costs

Analysis of the technological options available and choice of economical solutions.

Competent partners should elaborate the content of preliminary studies, which should be detailed, complete and adapted to local conditions. These studies should be available before negotiations begin so that an agreement between the parties can be reached without ambiguities or financial surprises.

Rejection of traditional forms of implementation which commit the partners from industrialized countries neither technologically nor financially.

National integration

Establishment of a national engineering system at the level of details, of a general conceptual framework or of a process.

Search for an integration target which is compatible with intersectoral planning, and creation of appropriate means.

Analysis of the problems of manufacturing spare parts locally and consideration of the objectives laid down in the sectoral development contract.

Extensive use of techniques for the utilization of iron and steel products from the future factory and assistance from the partners in reaching this target in time.

Taking up production

Establishment of an organization for the transfer of technology to keep watch over the progress of work in the following areas (among others):

- Nature and extent of relations between partners;
- Adaptability of the conceptual framework to local conditions;
- Organization of training and processes in starting production;
- Quality and amount of documentation and training (individual and collective).

Assistance in manufacturing spare parts locally, in building up working stocks and in the rapid delivery of imported parts.

Management

Taking in supplies of raw materials (coke), consumable goods and spare parts in such a way as to ensure the stability of prices and deliveries.

Assistance in improving productivity.

Creation of social conditions ensuring the stability of staff.

Systems of set-offs

Working out a system of set-offs is a complicated matter because it depends not only on the potentials and complementarities of partners but also on the number and extent of the objectives set.

In order to select the most suitable system, the developing country should, to begin with, formulate basic clauses of the following kinds:

- Financial premium;
- Long-term delivery of mineral or agricultural raw materials at favourable rates;
- Long-term commercial agreement on: iron and steel products; capital goods.

It will have to make a choice between these various clauses after testing their value in respect of each partner. The best solution is in fact likely to be a combination of these formulae which allows the kind of financial involvement best suited to the partners concerned to be determined for each period by the success in reaching the targets for that period.

The system chosen should also be interesting enough for the Government of the industrialized country to agree to guarantee the development contract. Such a guarantee should work naturally in favour of the set targets during the entire period of fulfilment of the contract.

Conclusions

International economic relations are characterized by their more and more distinct interdependence with the development of trade. The developing countries have gradually realized the necessity of putting this interdependence on a more equitable footing, having become aware of their own economic lag but also of the value of their resources. To this end, various paths have been opened for negotiations between countries of the North and South. Our proposal is one of these possible paths: its chief merit is that it presents a formula in line with the needs and capabilities of the developing countries.

Exchanges in monetary form are particularly well suited to industrialized countries carrying on trade with goods and services, whose level of development allows them to take full advantage of that method. Developing countries, on the other hand, are at a disadvantage in monetary exchange even when they have considerable financial resources. For, in the field of technology, resources are not enough to ensure good purchasing, good utilization and good management. Any formula allowing for an exchange of technology against natural resources leads to a better balance between partners of different industrial capabilities by putting them on an equal footing in cases of unequal exchanges.

One of the merits of the development contract is thus to have taken account of the organization of economic interdependence on a bilateral basis, to have paved the way for a balancing of relations between partners through the system of set-offs, and finally to have laid methodical foundations for co-operation.