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THE INCREASING ROLE OF THE PRIVATE SECTOR IN ASIAN INDUSTRIAL DEVELOPMENT

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I. INTRODUCTION

Since UNIDO became a specialized agency of the United Nations system in 1985 with a mandate to promote industrial development and industrial co-operation, the Organization has put special emphasis on working together with the private sector in the fields of industrial and technological development. This approach has been vividly demonstrated in the Asian and Pacific region, where private sector-oriented policies in most of the region's countries have provided a favourable context for UNIDO's related technical co-operation programmes and activities.

It is the intention of this paper to put this issue into a broader perspective. Chapter II provides a summary account of recent trends in strengthening the role of private industry in the region. Chapter III reflects upon the changing role of the state in creating overall conditions conducive to efficient industrial development. Chapter IV discusses some selected implications concerning the nature and scope of services that international organizations can render in response to the needs of private industry as final user. Chapter V provides selected illustrative examples of UNIDO programmes benefitting private industry.

The present paper is exploratory in nature. Its main objective is to raise selected key issues for discussion rather than to present a comprehensive review of private sector involvement in the region's industrial and technological development.

II. THE PRIVATE SECTOR IN ASIAN INDUSTRIAL DEVELOPMENT: RECENT TRENDS

1. Overall Evidence

In recent years, there has been a powerful trend on the global scene and above all in the Asian region for the private sector in general and private industry in particular to assume a growing, and indeed leading, role in economic and industrial development. Many governments - disenchanted with the limited growth dynamics generated by public sector-led industrial development - have turned to stimulating private initiative through far-reaching deregulation and privatization programmes. In industrial restructuring efforts, increased reliance has been placed on market forces within an environment of stronger competition in final product markets, input markets and financial markets. As part of this overall process, import protection has generally declined and many restrictions on foreign direct investment have been lifted.

These trends are reflected in above-average growth rates for private investment in most countries. A recent quantitative survey undertaken by the International Finance Corporation points out that the rebound of private investment in the second half of the 1980s was stronger than the recovery of gross domestic investment, implying a shift within total investment in favour of private sector capital formation.[1] From Table 1 it emerges that for a sample of 40 developing countries the share of private in total investment between 1985-1989 rose from 53.2 to 58.4 per cent. This clear upward trend is particularly pronounced in the Asian and Pacific region although with a

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[1] Cf. Pfeffermann, G.P./Madarassy, A., Trends in Private Investment in Developing Countries, 1990-91 edition, IFC Discussion Paper No. 11, January 1991.

significant difference between Southeast and East Asia on the one hand and South Asia on the other. Whereas the private investment share more or less stagnated in the latter sub-region, it reached almost three quarters of total investment in Southeast and East Asia - the highest share recorded in any developing region.

The figures presented in Table 1 relate to overall investment shares across all sectors of the economy. To the extent that sector-specific data on the distribution of private investment are available, these reveal a heavy concentration in the rehabilitation, modernization and expansion of industrial production capacities (manufacturing, mining and construction) and related services. In turn, public investment continues to play a lead role in creating and/or upgrading the required physical infrastructure - increasingly within programmes aimed at redressing disparities which have resulted from the widespread past neglect of regionally balanced development.

Table 1. Share of private investment in total investment, 1985-1989
(percentage)

Country	1985	1986	1987	1988	1989
Southeast and East Asia a/	64.2	62.7	67.4	70.6	72.6
Fiji	67.0	67.3	69.9	60.2	56.6
Indonesia	47.6	52.2	52.3	54.2	59.2
Korea, Rep. of	73.8	74.6	78.9	80.5	81.3
Malaysia	47.0	40.7	48.8	62.2	64.4
Papua New Guinea	76.9	68.6	73.9	72.6	76.3
Philippines	75.5	75.2	77.4	77.2	78.3
Singapore	63.7	58.1	64.8	76.4	82.0
Thailand	61.9	64.7	73.3	81.2	83.0
South Asia a/	49.1	47.3	48.3	50.6	50.1
Bangladesh	48.5	43.2	41.1	49.6	51.3
India	50.0	48.1	48.0	50.2	50.7
Nepal	61.3	58.3	60.6	56.4	44.2
Pakistan	41.6	41.2	40.6	41.9	43.6
Sri Lanka	44.1	45.7	51.1	55.0	60.9
Sample of 40 developing countries	53.2	53.2	55.3	57.1	58.4

Source: See footnote 1.

a/ Simple (non-weighted) average.

(Note: Averages have been recalculated).

As a further result of conducive, increasingly liberal policies combined with excellent business opportunities, there has been a growing flow of foreign direct investment into the Asian and Pacific region.[2] During the 1980s when other developing regions found it increasingly difficult to attract foreign investment, the Asian and Pacific region raised its share to 55 per cent of total flows to developing countries (Table 2).

Table 2. Inflows of foreign direct investment to developing countries, by region, 1980-1989
(percentage shares)

Host region	Average annual inflows		
	1980-1984	1985-1989	1988-1989
Africa	9.6	11.7	11.0
Latin America and Caribbean	48.8	37.4	34.2
Asia and Pacific	41.6	50.6	54.5
All developing countries	100	100	100

Source: Calculated from UNCTC, **World Investment Report 1991**, New York, July 1991, (Table 4).

2. Privatization and deregulation policies

In the overall context of the recent accent on strengthening the private sector's role in most Asian developing countries, the **privatization** of public enterprises (PE) has received growing attention particularly since the mid-1980s. The need for such a reorientation stemmed from a pervasive dissatisfaction with the performance of public enterprises, which in the early 1980s were estimated to account for over a quarter of gross fixed capital formation in all developing countries. Primarily driven by the need to lessen the fiscal burden which inefficient and loss-generating PEs had placed on state budgets, a great number of developing countries have embarked upon privatization programmes and policies albeit differing in scope, pace, methods and results.

In general terms, privatization is understood as the transfer of ownership and control of an enterprise or activity from the public to the private sector. Privatization or - as is mostly used synonymously - divestment thus comprises the outright or partial sale of state holdings to private sector interests as well as the contracting out or granting of operating concessions to private business including management, leasing and franchising arrangements. Moreover, the charging of market prices instead of fees for publicly supplied goods and services in a broader sense is sometimes being referred to as financial privatization. In turn, privatization is not

[2] Cf. UNIDO, Foreign Direct Investment Flows to Developing Countries: Recent Trends, Major Determinants and Policy Implications, PPD.167, 10 July 1990

to be equated with the concept of **deregulation** of an economy which encompasses the relaxation or removal of government regulations interfering with market forces, including constraints imposed upon competition against public enterprises. Yet, in order to reach its objectives, privatization would have to be closely co-ordinated with deregulation measures.

Whereas the relative importance attached to different approaches of privatization varies among Asian developing countries, there are a number of common motives behind the increased involvement of private industry in areas hitherto reserved for public enterprises. These include:

- an increasing awareness of the general desirability of a more pronounced participation of the private sector in the development process;

- the financial strains stemming from large and persistent operational deficits of PEs, which have to be accommodated by public subsidies; and

- a growing discontent with the serious efficiency and productivity shortcomings recorded for the majority of PEs.

Before addressing some of the major problems and constraints encountered by recent privatization efforts in Asia, a brief review of the approaches adopted in selected developing countries of the region is given below.[3] As will be seen, the privatization issue is not only being addressed in the region's more advanced economies which have always strongly advocated the private sector's developmental role, but also in South Asia where public sector activities have traditionally been assigned important functions. Finally, initial moves towards opening the state sector to private business are also to be observed in several of the hitherto centrally planned economies of the region.

a. Country experience

Privatization efforts in the **Republic of Korea** have been regarded as a means to instil greater efficiency in loss-making PEs with a view to strengthening the industrial sector's overall performance.[4] While the government in its development strategy in the 1960s and 1970s had attributed a strategic role to PEs, a first significant privatization programme was initiated in 1968, involving, inter alia, Korean Airlines, the Commercial Bank of Korea and several heavy industries. A second privatization round was launched in 1981 by the sale of the national oil company, the conversion of the telecommunications authority into a publicly-held corporation and the privatization of all seven government-owned national commercial banks including the issuance of licences for more than fifty private finance

[3] The following survey is partly based on ESCAP, Industrial Restructuring in Asia and the Pacific, Bangkok 1991, pp. 133-138, and Ng Chee Yuen/Toh Kin Woon, Privatization in the Asian-Pacific Region, Asian-Pacific Economic Literature, Vol. 6 (1992), No. 2, pp. 42-68.

[4] Cf. Song, Dae Hee, Privatization of Public Enterprises in South Korea, in: Gouri, Geeta (ed.), Privatization and Public Enterprises - The Asian-Pacific Experience, (Institute of Public Enterprise), Hyderabad 1991.

institutions. Following the introduction in 1984 of several institutional measures to improve the PEs' efficiency, in 1987 the People's Share Programme was started with the divestment of 40 per cent of the equity of Pohan Iron and Steel Company. While strict bureaucratic controls have so far been maintained over the privatized commercial banks, the extension of the privatization programme accompanied by deregulation and liberalization measures is foreseen for the 1990s. The envisaged close co-ordination between government and private business in these efforts is a salient feature of the country's privatization approach.

In **Singapore**, the main objectives of the privatization policy embarked upon in 1984 have been (a) to reduce government involvement in industries which private companies are able to operate competitively, (b) to expand the local stock market by selling PE shares to private business. As in the Republic of Korea, virtually all of the approximately 500 PEs either directly owned or controlled by the government in the mid-1980s were operating successfully. These companies were engaged in a broad range of activities, including large-scale manufacturing industries, oil refining, defense, transportation, the financial sector and housing. Following the sale of a 45 per cent minority stake of the largest state investment company in 1984 and the partial divestment of the national airline, the Public Sector Divestment Committee in 1987 recommended the gradual privatization of 41 PEs through the sale of shares as well as of 4 statutory bodies including the telecommunications authority. In implementing this recommendation the government has so far adopted a rather pragmatic approach, leaving at least minority stakes with the public sector in many cases. In total, between 1985 and 1990, more than 30 public enterprises were either fully or partly divested.[5] By adopting a concept of "rolling privatization" (involving the channelling of funds from asset sales into new public ventures in technologically highly advanced areas) the government has underlined its ongoing commitment towards safeguarding the countries' international competitiveness.

Since its inception in 1985 privatization policy in **Malaysia** has largely taken place on an ad-hoc basis resulting in the divestment of 26 PEs by 1990. According to the 1990 Privatization Master Plan, 50 out of a total of 900 PEs in a wide range of sectors with total assets estimated at M$ 46 billion are now recommended for sale; another 99 loss-making PEs have been identified for restructuring before divestment. Moreover, the government has been advised to sell off its majority stakes in 29 companies listed on the Kuala Lumpur Stock Exchange as well as its minority holdings in another 54 companies. However, whereas the national electricity board, the civil aviation department, the railways, and the postal services have recently been earmarked as potential privatization candidates by the government, in the past the state has retained a substantial share (referred to as "golden share") in most of the privatized companies, e.g. the national airline, the shipping company and the national car manufacturer. Basically, privatization efforts in Malaysia had been stimulated by the dismal performance of PEs which had surged in number under the New Economic Policy in force from 1970 to 1990 aiming at the redistribution of economic power in favour of the indigenous Malays. The new National Development Policy introduced in 1991 has reiterated the government's commitment to further privatization initiatives.

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[5] Cf. Low, Linda, The Political Economy of Privatization in Singapore, Singapore 1991, Appendix 6.1,

Inefficient state enterprises also marked the starting point for launching privatization in **Thailand** in the mid-1980s, when PE deficits totalled US $1.7 billion, equalling 3.5 per cent of GDP. However, while the increased involvement of the private sector in infrastructure projects has materialized in a number of cases as announced (such as in highway construction, the new eastern seaport, telephone systems, or urban bus transport) privatization efforts in the majority of the 67 areas selected in the 1986 privatization programme seem to have come to a halt. This is attributed to the lacking attractiveness of loss-making PEs, complex legislative processes and strongly opposed trade unions.

Unlike her ASEAN partners, **Indonesia** up to now has not explicitly formulated a comprehensive privatization policy for the more than 500 PEs - 200 thereof 100 per cent public - covering activities as diverse as petrochemicals, utilities, finance, transportation, communications, and major manufacturing sub-sectors. Rather, the policy pursued by decree since 1989 envisages privatization as one of several means of reorganizing the PE sector with a view to alleviating the strain on the state budget caused by inefficient entities. While the contracting out of customs inspection to a private foreign company in 1985 appears to have been the first and single most effective privatization measure, reservations have repeatedly been made regarding the transfer of PEs deemed strategic, such as the railways or the shipping line. Overall, the major thrust of government policies has been on a substantial deregulation of the economy, e.g. in foreign trade and banking, rather than on outright privatization.

In spite of the recommended privatization of 140 out of 296 PEs as identified by the Committee on Privatization set up in late 1986, actual privatization in the **Philippines**, which was primarily targeted at reducing the fiscal burden caused by inefficient PEs, had initially remained far behind expectations. Thus by April 1988 only ten and by November 1989 only 30 out of 121 PEs decreed by the president for privatization had been sold, a consequence of strong resistance from key industries and large enterprises, but also of macroeconomic uncertainties and structural weaknesses, such as a thin capital market. However, with the divestment of a 30 per cent share of the Philippine National Bank in 1990 and the more recent sale of a large mining company, privatization appears to have regained momentum. By September 1992, a total of 72 PEs were privatized.

Privatization efforts in **Bangladesh** date back to the early 1970s when a number of small industries inherited by the state at independence were reprivatized. Under the "New Industrial Policy" promulgated in 1982 the list of industries reserved for the public sector was reduced to six: arms and ammunition, atomic energy, air transport, telecommunication, electricity and mechanized forest extraction. Consequently, within one year, 27 textiles mills and 33 jute mills - most of which had incurred losses - were divested, representing 38 per cent of the jute processing capacity, 45 per cent of the spinning capacity, and 57 per cent of the weaving capacity of the textile industry. Other privatization measures were directed at large-scale industries in chemicals, food, steel and engineering. Due to strong resistance from unions and workers the privatization programme came to a halt in 1984. Hence, a plan which foresaw the conversion of the public sector corporations into public limited companies and the sale of up to 49 per cent of the shares to the private sector was not implemented. With the "Revised Industrial Policy" of 1986, the scope for further privatization was broadened again leading to divestment of another eleven large enterprises by 1988.

Overall, the privatization programme in Bangladesh, with more than 600 units affected, has been one of the largest in any developing country, yet its success has so far been limited. Numerous units were closed down soon after privatization, inter alia, because of the high debts inherited and a refractory labour force resisting any staff reduction.

In **Pakistan**, after nationalizing numerous industries in the 1970s, efforts aimed at increasing the operational efficiency of PEs on the one hand and at divesting some of them to the private sector on the other have been undertaken since many years. Thus, small-scale firms in cotton-ginning, rice-husking and flour-milling were reprivatized after 1977, as well as two larger firms - one engineering and one foundry company. When various measures taken in the early 1980s to improve the PEs' performance failed to reduce the widely incurred losses, the government decided to divest 14 major PEs in chemicals, textiles, steel, automobile, sugar and in non-metallic mineral production. None of these units was actually privatized, however, partly as a result of private sector disinterest in acquiring loss-generating enterprises, problems related to potential labour lay-offs and the settlement of company debts as well as the thinness of the country's stock market. The present government, setting up a Privatization Commission in early 1991, has launched a new privatization initiative aimed at confining public sector investments to activities outside private sector interest or capability. Expressing a strong commitment to move ahead rapidly, 115 PEs have been earmarked for full or partial divestment over a period of two to three years. So far, the Privatization Commission has sold 54 industrial units to private investors and has transferred management of further 42 enterprises.[6]

In **Nepal**, the history of government-endorsed privatization programmes dates back to the late 1970s; until now implementation of the various programmes has, however, fallen short of the declared targets. Within the government, a mixed attitude has prevailed with respect to the potential benefits of privatization which was considered to be in conflict with the basic needs planning approach and to lead to an excessive concentration of economic power in the hands of only a few private investors. Accordingly, most privatization offers were extended on the basis of only a partial (minority) transfer of ownership to the private sector which in turn showed a lukewarm response.

In the wake of significant economic reforms currently underway in **India**, in early 1991 the government embarked on a first step towards public-sector disinvestment by offering for sale up to 20 per cent of the equity in 31 profit-making companies active in utilities as well as in steel, engineering, petrochemical and fertilizer industries. So far bids have been invited only from several mutual funds and financial institutions indirectly controlled by the government. However, as in principle these institutions are free to resell the acquired companies to the public, this move does indicate a certain reorientation of the previous policy not to consider any privatization of PEs and rather to strive for more efficient management of PEs by enhancing their autonomy.

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[6] Cf. "Privatization Stimulates Economic Growth", in: Economic Review (Karachi), 11/1992.

In the Lao PDR, a major economic strategy shift was initiated in 1985 with the so-called New Economic Mechanism which was followed by a number of further decrees, inter alia, covering privatization or divestiture of public enterprises. The privatization decree issued in March 1990 states that public sector disengagement is sought from "non-strategic" industries, i.e. excluding public utilities, banks and insurance, mining etc. Since mid-1989, the pace of privatization has significantly increased, largely driven by the Prefecture of Vientiane as supervising agency of 70 mostly medium-scale enterprises. In November 1989, half of the manufacturing companies (accounting for 35 per cent of all enterprises by number) had already been privatized and initial action had been taken on another 20 per cent. The approach adopted by the authorities has so far largely been on a case-by-case basis, i.e. not following any predetermined rules or guidelines. The relatively small size of companies offered as well as the inclusion of foreign investors, particularly Lao expatriates, have facilitated the programme's realization.

Summing up, while it is difficult to generalize on the individual countries' privatization experience, there can be no denying that in most cases so far progress has been fairly limited and thus stayed behind initial expectations.

b. Obstacles to privatization

Basically, there are two groups of privatization obstacles which, as in other developing regions, have also surfaced in Asia: **implementation constraints** and **political constraints**. As to the former, considerable managerial deficiencies within the state administration frequently prevail and are aggravated by overall structural weaknesses of the economy.

The administrative capacity to carry out multifaceted and often complicated tasks related to privatization measures has not been available in all cases. This applies to the issues of properly valuing the PEs' assets when determining or judging sale prices; the assessment of buyers' bids; the arrangement of ensuing finance and insurance; the complex legal issues involved; and frequently also includes the preparation of well-designed rehabilitation plans or the setting up of appropriate regulatory structures around the newly privatized firms. Furthermore, weak capital markets, particularly with respect to lacking or poorly developed stock markets unable to absorb large divestments, continue to be a major structural impediment to privatization in many countries. In turn, private sector and local bank funds may not suffice to finance purchases of PEs which often are among the largest companies in a country. In fact, experience shows that the more developed a country's capital market, the easier it is to find suitable investors for PEs to be privatized.

The scarcity of all PE managers familiar with providing corporate leadership and direction when obliged to acting in a more market-driven environment is another typical structural weakness. Also, potential private investors who for whatever reason lack confidence in a government's privatization policy can only be expected to step in at a later stage. In this context, given the predisposition of many countries to primarily sell off hitherto unprofitable PEs, the cautious private sector response has come as no surprise.

Concerning **political constraints** to privatization policies, it is obvious that the immediate potential losers generally utter their strong opposition. Thus labour groups or unions afraid of both substantial lay-offs at privatized companies and a subsequent loss of political influence tend to offer strong resistance. The same applies to the management of the concerned PEs and the corresponding line ministries unwilling to relinquish long-standing vested interests. Finally, in some countries a delicate social balance safeguarding the relative positions of certain economic groups also places limits on the scope for privatization.

As has been shown, the sometimes ambitious privatization programmes have materialized to a limited extent only. Furthermore, it needs to be pointed out that privatization of PEs does not on its own bring about increased efficiency and profitability. To reach its objectives, privatization has to go hand in hand with a strengthening of market forces through carefully designed deregulation and liberalization moves. For instance, divesting a PE enjoying a monopoly position without ensuring free market access for other companies or introducing anti-monopoly legislation is clearly self-defeating. Privatization is but one facet of the larger policy issues of private sector development; by itself it does not constitute a sufficient condition for an increased role of the private sector in economic development.

III. CHANGING PRIVATE-PUBLIC SECTOR RELATIONSHIP

1. General observations

The above brief overview of privatization approaches pursued in selected Asian developing countries confirms that the issue ranks high on the present policy agenda. At the same time, it demonstrates that in most cases privatization initiatives have not always met the initial high expectations placed on them.

Notwithstanding the slow progress made in many of the privatization programmes, it is clear, however, that in most countries of the region the private sector is regarded as key engine of growth and will play the lead role in industrial development in the future. In the course of time, the share of production and investment originating from public industries can be expected to further decline as a result of the dynamism unleashed in a private sector less stifled by bureaucratic restrictions than in the past.

This implies a changing private/public sector relationship away from the traditional top-down approach towards greater co-operation and co-ordination. Private companies themselves will increasingly have to articulate the requirements for government support, be it in terms of policy frameworks, incentives schemes or financial assistance. Also, with the reduction of government involvement in the financial sector, there will be an enhanced role of private banks and other financial institutions in promoting industrial development.

In general, the private sector will have to undertake sizeable investments and become more active in areas hitherto in many cases considered a government domain. This refers, above all, to industrial research and development, to training and skill upgradation programmes and to industry-related consultancy services.

Given the strong trend towards increased regional integration in Asia and the Pacific, there is also a need for the private sector to co-operate across national boundaries, parallel to inter-governmental co-operation arrangements. A good example of this is being given by ASEAN where the co-operation process is based on a strong private sector involvement through the ASEAN Chamber of Commerce and Industry and several branch-specific regional industry clubs.[7] In the field of multilateral R&D efforts involving the private sector, reference can be made to a number of successful schemes applied in the EEC which may offer some lessons also for some sub-regions in Asia and the Pacific. For instance, the so-called EUREKA programme was designed to strengthen interaction between the various national actors in technology development with a view to enhancing competitiveness. Its emphasis thus is not on implementing specific technology projects but on paving the way and creating an institutional basis for co-operation of relevant public and private sector organizations and companies.

At the same time, the increased role of the private sector in industrial development does not imply that government policy is becoming redundant or is becoming less important than in the past. On the contrary, a strong and efficient government capable of designing, implementing and enforcing a consistent set of industrial policies is a sine qua non if the private sector is to prosper in a stable framework. Reliance on markets, competition and private initiative is not to be equated with a 'laissez-faire' economy.

A number of government functions have traditionally been generally accepted. First, these relate to instances in which markets cannot function as a result of market failures occurring systematically.[8] Typical examples are externalities as well as natural monopolies. In the case of externalities - external costs or external savings - a third party not involved in an economic activity is affected by it leading to a divergence between private and social costs and benefits. For instance, goods involving external costs, such as environmental pollution, tend to be overproduced from a social point of view as long as these costs remain unaccounted for and thus do not reduce a company's profitability. Natural monopolies may arise from increasing returns to scale (applying to many public utilities) thus excluding fair competition.

Secondly, governments must provide so-called public goods, i.e. those goods available for general consumption, and are generally expected to provide so-called merit goods. i.e. goods which individuals are not demanding at socially desirable levels when left to the free market (e.g. health; basic education).

Accordingly, the classic government functions, inter alia, encompass the creation of the **physical** infrastructure (transportation; power and water supply; communication) for industrial development which has proven to be of critical importance, inter alia, for the locational pattern of industry and thus the degree of regional disparities. This does not imply, however, that there would be no room for the private sector in the provision of

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[7] Cf. Rieger, H.Ch., ASEAN Economic Co-operation Handbook, Singapore 1991, pp. 77-83.

[8] Cf. UNDP, Private Sector Development for Promoting Economic Growth in Developing Countries of Asia, April 1988

infrastructural services. In many cases, public goods (e.g. telecommunication and transport services, including roads and railways) can be and actually have been commercialized. For instance, in Thailand the private sector has recently become involved in unconventional activities such as the selling and full development of land for industrial estates (which are subsequently taken over and operated by the Industrial Estates Authority of Thailand); the construction and operation of the large-scale Bangkok expressway project; and the private management of a number of container ports. In such cases, it remains the government's central task to ensure that the potential monopoly power associated with the allocation of large-scale infrastructural projects/services to private companies is effectively controlled.

It is increasingly being recognized, however, that the role of governments in promoting industrial development will need to go beyond the areas outlined above. Governments - in addition to creating the required infrastructure and a stable macro-economic framework through appropriate monetary and fiscal policies - can make critical contributions to stimulating technological innovation and enhancing industrial efficiency and competitiveness. Indeed, international competitiveness is no longer just a micro-level phenomenon; today it is as much determined at the sectoral and national level as it is at the company level. "In a world of increasingly global competition, nations have become more, not less important. As the basis of competition has shifted more and more to the creation and assimilation of knowledge, the role of the nation has grown."[9] A whole national economy can be regarded as a 'unit' in competition with other economies in the international market. Therefore, national competitiveness needs also to be seen in a longer-term perspective, as the competition of entire economic and social **systems**. In the long run, the development strength of an economy will depend upon the ability of its productive sectors to dynamically develop and secure future competitiveness and thus future increases in real wages and living standards of the population.

In this context, the creation of an efficient industrial system plays a crucial role. Key elements of such a system would be

- a sufficient number of large corporations which can realize economies of scale and economies of scope in research & development, marketing and sourcing networks and financial capabilities, follow new technological trends and market opportunities and have a pull effect on associated companies;

- a dynamic small- and medium-scale industry sector which can be innovative in terms of identifying product and market niches - as well as improving process technologies - and which can offer itself as a nucleus for future growth industries;

- efficient specialization patters and interlinkages between the various types of companies such as through sub-contracting of products; sub-deliveries of parts, components and services; and joint small-scale firm co-operation;

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[9] Porter, M.E., The Competitive Advantage of Nations, in: Harvard Business Review, March-April 1990, p.73.

- the existence of a broad range of support institutions and consultancy services in areas such as management advice, marketing, financing, technology upgradation, energy audits, industrial rehabilitation, etc.

In efforts to establish efficient industrial systems, two elements have recently been particularly emphasized: First, the significant role of a broad range of so-called supporting industries which not only provide parts and components (thus reducing import dependency) but also contribute to innovation through close buyer-supplier relationships. Second, the importance of inducing clusters of inter-related industries in close proximity to each other to take advantage of co-operation potentials. Related attempts to pool resources, capabilities and efforts in an integrated manner have brought the regional development dimension into focus in many countries, developed and developing alike.

In general, governments are no longer - if they ever were - in a position to design a single national economic strategy and push it through in a top-down approach by picking "winners" or "strategic industries". Instead, they need to develop an overall strategic "vision" of building up national competitive strength and to establish the conditions under which synergy effects can be achieved in the strategies pursued by various actors: companies, industrial associations, trade unions, support institutions, banks, etc. In other words: the process of industrial strategy formulation by governments is moving "upstream" to synchronize and support a multitude of existing strategies rather than to impose a unified final design. Therefore, assigning to the private sector a lead role in industrial development must not be seen as requiring a 'minimal state'. Rather, it presupposes an efficient and competent government machinery with highly qualified staff capable of working closely with the private sector. Some selected illustrative examples of public/private sector co-operation in the field of industry and technology are given below.

2. Human resource development

It is stating the obvious to stress the paramount importance of high education and skill levels for a country's industrial growth and technological dynamism. The Asia and Pacific region in particular abounds with examples of countries owing much of their economic success to the early priority given to human resource development.

An interesting specific aspect in this context relates to the rapidly growing industrial application of new technologies based on micro-electronics. This has the effect of making production systems much more similar across various industrial branches than they have been hitherto. The implications of this tendency for a rational organization of vocational training are far-reaching and call for increased co-operation between industry and government. Under the conditions of increasing convergence of industrial technologies training for industrial activities which make use of the new technologies can clearly yield economies of scale in the sense that a general technical training can easily be adapted for use in specific industrial branches. This implies that sooner or later industry will obtain benefits in strict cost terms through participating in general training courses in the use of new technologies. The financing of such training could come both from industry associations and the public purse; the benefits for government would result from supporting industry in its efforts to remain internationally competitive.

Furthermore, this type of training tends to maximize the mobility of semi-skilled staff and thus creates more opportunities of dynamizing the industrial sector as a whole. This point is especially relevant given the emphasis in many, particularly Asian developing countries towards the creation of supporting industries and close networking of service and producing enterprises. For the most part the smaller firms which grow up to meet the needs of more complex industrial structures are created by people who previously acquired industrial experience through working in already established larger enterprises.

A high level of general technical training thus appears to be conducive to strengthening the position of smaller firms. The same is true for a standardized system of examinations and certificates - again a field in which government action is required to pool and synchronize efforts undertaken in the private sector. The more technical competence is visible from standard certificates the more will inter-firm mobility be encouraged.

3. Institutional framework for technology promotion

On the one hand, experience shows that competitive pressure in open markets is among the most powerful mechanisms to induce changes in products and processes and respond to opportunities offered by new, more efficient technologies. On the other hand, in many developing countries only insufficient information is available on the nature and range of new technologies on offer as well as on the terms and prices of acquisition. Furthermore, the developmental role of new technologies typically implies disparities in the perceived private and social returns of their introduction. Government policy and public institutions thus are needed to complement and reinforce the market mechanism.

Specifically, collecting and assessing relevant information is one important area. In view of the skills required for the related activities, the costs involved and the relevance of specialized technology information for a wide range of industries, many countries in the region have established centralized **technology information agencies** often as a joint government-private sector effort. Such institutions have the task

- to collect, process and provide information on existing industrial technologies, including sources and prices of technology supplies;

- to monitor and assess emerging technological trends, particularly as regards their impact on structural change in industrial production;

- to link technological information with market intelligence so as to enable producers to take preventive action in line with prospective market trends.

Another important area calling for institutional measures is the gradual building up of **domestic R&D capacities**. While in most countries in the region public research institutes and laboratories are in place, their research orientation leaves much to be desired. More often than not, research programmes follow academic basic research interests which remove them from the more immediate needs of their country's industries (or, for that matter, of other productive sectors of the economy). What is often lacking is the close interaction of R&D institutions and industry. Industrial companies are to be encouraged to demand research services; universities and other research institutions in turn should pursue more industry-related research. The lack of such co-operation appears to be a result partly of traditional attitudes, partly of weak communication links between the actors concerned and partly of the overall lack of integrated industrial production systems. **Transfer agencies** - i.e. agencies concerned with the commercialization of research results and the design of industry-relevant research programmes - could play a key role in overcoming some of these barriers. Their creation would ideally be a private-public sector joint effort.

Reference can be made here to the case of the Republic of Korea. At an early stage in the country's industrialization specialized public research institutes with a strong industry orientation were created. They were complemented from the outset with a number of institutions - or sometimes departments within the research institutes themselves - with the mandate to identify and promote commercial applications of research results.

Finally, following the experience of developed countries, the establishment of science-parks could yield substantial benefits for some more advanced developing countries which have already acquired certain capabilities in research-intensive industrial production.

4. Promotion of foreign direct investment

With the general relaxation of foreign investment rules, the function of national investment agencies has become less regulatory and is now increasingly geared to promotional and supporting activities. In many countries, investment agencies are undertaking efforts to integrate foreign investors more strongly into the national economy, e.g. through linking them up with domestic companies with a view to increasing the local content of production. Thailand's Board of Investment (BOI) is a case in point. In early 1992, the BOI launched an initiative to establish so-called 'investors clubs' for export-oriented manufacturers seeking Thai sub-contractors to supply parts and components. The BOI serves as a matchmaker which in specified industrial branches - starting with the electronics and the machinery industry - brings together interested companies and also seeks to stimulate a pooling of resources of small domestic companies so that they can meet the demands of large foreign firms. The overall objective of this BOI programme is to counteract the country's eroding competitiveness as low-cost manufacturing base and to create new system advantages in terms of integrated production structures.

IV. IMPLICATIONS FOR INTERNATIONAL ORGANIZATIONS

International organizations active in the field of industrial co-operation are facing a situation of the private sector now being the dominant economic force in most of the Asian region's countries. In others, a transition towards market-based development and a greater private sector involvement is underway. Indeed, this is a trend which has long been advocated and supported by most international organizations. Now strategies and programmes of the international organizations themselves are called for as to how they can respond most effectively and mobilize their resources for the benefit of the private sector. Both the actual areas of co-operation and the nature and form of the services offered will need to be adapted to the requirements of the final user - private industry. This means not only that private industry will have to play a major role in identifying and formulating the actual assistance requirements, but also that the services will have to be provided directly and speedily to the industrial entities according to the terms and conditions prevailing in the private sector.

In this context, a number of issues arise for international organizations:

- First, what are the most essential areas for technical assistance to private industry?

- Second, how can it be assured that the technical assistance is carried out in conformity with the market and no distortions are created in terms of selection of recipients, costing of services and competition with commercial entities?

- Third, what are the most suitable modalities, including financing schemes, for assistance to private industry?

The following sections intend to provide a basis for discussion of these issues, inter alia by drawing on UNIDO's recent experience in co-operation with private industry.

Three different levels can be distinguished at which international organizations can make contributions to strengthening the role of the private sector in industrial development: (1) the overall policy level, (2) the institutional level and (3) the company level.

(1) To start with, international organizations can provide essential analytical inputs and policy advisory services to governments that have embarked upon strategies to promote private industry. This involves both general advice on conducive macro-economic and industrial policies and specific assistance concerning privatization and/or deregulation programmes. While it will remain the governments' prerogative to decide about the objectives, pace and priority areas of privatization efforts, they could no doubt benefit from impartial advice and assistance in designing consistent privatization policies and measures and in translating these into concrete implementation approaches. Some crucial areas for such assistance would include:[10]

- **Human resource development**: This involves the training of government staff in the mechanics of privatization, including reorganization techniques, methods of company valuation, formation of joint ventures, offer of shares in the market, underwriting etc. It also refers to training for public-sector managers in operating companies under the pressure of competition, with special emphasis on marketing and financial management training.

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[10] Cf. UNIDO, Privatization Theory and Policy, IPCT.156 (SPEC.), 16 April 1992; UNDP, Guidelines on Privatization, New York, 1991.

- **Financing**: The development of capital markets is of critical importance in the more advanced countries of the region and the Asian Development Bank is very active in this field. Above all in the least developed countries (LDCs), development finance institutions (DFIs) would have to be key actors in view of the shortage of indigenous entrepreneurs with sufficient financial resources to take over large public enterprises. In Least Developed Countries (LDCs), therefore, most enterprises intended to be privatized will have to be joint ventures - involving foreign private investors and/or domestic or foreign DFIs. International organizations can act as a broker to bring about such arrangements.

- **Rehabilitation**: Assessing the rehabilitation/modernization requirements (including related feasibility studies) of companies to be privatized could effectively accelerate the privatization process in many countries. Such pre-privatization company audits - to be carried out by neutral analysts - would be a critical input for take-over decisions by interested private investors. They could establish which specific action is required and at what cost to secure the long-term viability of individual companies.

At present, a number of international organizations are actively supporting ongoing privatization and deregulation programmes. This includes both financial assistance provided by the World Bank and the Asian Development Bank in the framework of Industrial Sector Programme Loans and technical assistance as provided by UNDP (within their Interregional Network on Privatization established in 1988), UNIDO and other organizations.

(2) At the institutional level, international organizations - drawing on their experience in a multitude of countries in different regions and at different levels of development - can assist in building up efficient forms of private industry representation and organization. Particularly in LDCs where such institutions are often lacking or malfunctioning, industrial associations such as Chambers of Industry and Commerce need to be established and typically need some seed funds as well as expert advice and operational support in the initial stage. The existence of efficient industry associations is essential for various reasons, including (i) to deliver services to member companies, (ii) to act as representatives of private industry in policy dialogues and negotiations with the government and (iii) to function as counterpart for technical assistance and other promotional programmes by international organizations. In a way, therefore, in many countries the latter are facing the challenge of first having to create the institutional conditions under which technical assistance can subsequently be delivered to private industry.

It is crucial that international organizations work out modalities to co-operate with private industry without compromising their own impartiality and without distorting competition. Implementing projects together with industry associations would seem to be a logical approach to ensure that these objectives are met by spreading the benefits derived from assistance projects to a wide range of industrial companies. For instance, in Thailand UNIDO is implementing projects with the Federation of Thai Industries as counterpart in which sophisticated testing services as well as plant-level advice on "best manufacturing practices" are available upon request to all private companies in specific branches.

(3) Finally, international organizations in principle can also work directly with private manufacturing companies through providing plant-level assistance. So far, UNIDO is unique among the UN agencies in this respect based on its mandate to support "industrialization in the public, co-operative and private sectors". Since 1986, UNIDO has extended its services to numerous private industrial enterprises in Asia and the Pacific as well as in other developing regions. Such services - which are rendered within the context of a new financing modality, the so-called special trust fund agreements[11] - encompass the full range of UNIDO activities.[12] In general, these services are not different from those provided to public sector enterprises in the past. However, in the case of private companies specific issues arise concerning the modalities and financing of technical assistance.

Generally, private companies operating in highly competitive markets require a speedy delivery of highly specialized and flexible assistance inputs. However, "quick response" has not been a major strength of international organizations in the past and therefore adjustments are necessary in the administrative procedures which were primarily geared to large-scale and long-term assistance projects serving government institutions.

Moreover, as mentioned above, when implementing projects directly benefiting private industrial companies, international organizations must ensure that no market distortions are created. Therefore, the full costs for company-level services should be borne by the recipient enterprises which will increase their efficiency and profitability as a result of the specific assistance provided.

A further aspect in this context refers to a potential competition between international organizations and domestic consultancy companies. The former - given their special reputation and mandate as unbiased neutral advisers - should not act as just another consulting firm. First, they should concentrate on particularly demanding segments of consultancy services requiring sophisticated international expertise and access to multilateral information networks. Complex procurement services or feasibility studies involving international market assessments would be cases in point. Second, within their advisory services to the private sector, international organizations should seek to involve, to the maximum extent possible, existing domestic consultancy firms, e.g. through sub-contracting arrangements thereby extending training and support to their further development. In the case of large-scale projects, it would also appear appropriate to cooperate with big international consulting firms - a model that could be referred to as "co-consulting" in analogy with the co-financing of development projects.

V. UNIDO'S COOPERATION WITH THE PRIVATE SECTOR: SELECTED PROGRAMMES

The majority of the technical co-operation projects carried out by UNIDO are directly or indirectly benefiting the private sector in terms of improving the overall business environment, initiating industrial policy dialogues, strengthening support institutions, providing research and information inputs

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[11] These can be either self-financed (in which case a private company pays UNIDO for its service) or third-party financed.

[12] For details, see Chapter V, below.

and extending technical and managerial training. Also, in implementing projects, approximately 50 per cent of all UNIDO experts are drawn from the private sector and concerning contracts awarded for the purchase of equipment and for operational activities, the large majority are with companies in the private sector. In what follows, attention is drawn to only a few selected UNIDO programmes of particular relevance for private industry.

In 1986, UNIDO launched an innovative approach of project financing, the so-called **special trust fund scheme**. This new scheme is aimed at enabling industrial partners to cooperate through projects arranged, supervised and carried out by UNIDO, with the main purpose of providing direct support to manufacturing plants - both public and private. The three major thrusts of the special trust fund programme are:

- Direct support to manufacturing plants in the developing countries for performance improvement, training, rehabilitation and expansion with the aim of safeguarding the value of investments made in those plants by immediately improving their performance through provision of advisers and operational teams and by ensuring their long-term viability through, for example, manpower development, maintenance and self-help programmes;

- Service to development finance institutions in designing, formulating and implementing selected industrial projects where advantage can be taken of the specific experience and capabilities of UNIDO, particularly in rehabilitation of industrial plants, small- and medium-industry development, indigenous entrepreneurial development, training (including development of women's resources), and technical cooperation among developing countries (TCDC);

- Programme or project management services to donor agencies in the design, formulation and implementation of programmes and projects on selected priority objectives, e.g., integration of women in industrial development, enterprise-to-enterprise cooperation, economic and technical cooperation among developing countries (ECDC/TCDC), procurement of goods and services, agro-industries development, export industries development, small-scale industries development and human resources development.

There is a strong and growing demand for such UNIDO services which meanwhile account for approximately 25 per cent of the total technical cooperation expenditures of UNIDO. The funds required for each project come either from the beneficiary of the UNIDO assistance in the developing country (in which case it is called a self-financed trust fund project), or from a third-party donor, which may be a development finance institution, a governmental or non-governmental donor agency, an individual or group of companies, or industrial associations.[13]

Flexibility, direct negotiations, and quick response are the features that make the special trust fund programme particularly suitable for providing direct support to manufacturing industries and for bringing industrial partners in the developed and developing countries together in industrial cooperation projects that are partly or wholly executed by UNIDO. The trust

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[13] A schematic description of both schemes is provided in the Annex.

fund schemes are especially advantageous when the funds of a development bank or donor agency are to be channelled to private sector development in the developing countries and where such funds are to be supplemented by local or foreign contributions from private companies. The schemes therefore complement UNIDO activities financed by multilateral sources such as UNDP and IDF.

Special trust fund activities may cover the entire project cycle from conception of the project idea to completion of the industrial plant and its operations as a viable industrial entity. The range of services may therefore include opportunity and feasibility studies; supervision, inspection, and procurement services during the construction phase; technical and managerial support programmes and manpower development programmes during the early years of plant operation; diversification and expansion programmes when a plant reaches maturity; revamping, retrofitting and rehabilitation programmes wher a plant begins to fall ill. In implementing projects within the trust fund schemes, UNIDO can draw on its rich and long-standing expertise in plant-level assistance and on its international technology information and investment promotion networks. Two programme areas of special relevance to many ongoing trust fund projects in the private sector are outlined below: industrial rehabilitation and investment promotion.

UNIDO has developed a comprehensive approach of **industrial rehabilitation and modernization** which has been applied successfully in many cases. This approach follows a sequence of distinct stages:

- The first stage is the **pre-diagnostic stage** in which an analytical survey is undertaken of the country's overall industrial sector and the specific sub-sector concerned so as to place the individual enterprise's operational problems into a broader perspective, including the institutional and policy framework;

- The second stage is the **diagnostic stage** in which short-term reorganization and restructuring measures are carried out (e.g., in the area of financial management, inventory control, quality control or preventive maintenance) which do not require a major capital investment, and detailed medium- and long-term rehabilitation work plans for each aspect of the operation of the enterprise (management, pre-investment analysis, marketing, technology, etc.) are elaborated;

- Once the diagnostic analysis is carried out, an investment promotion and technical assistance **donors' meeting** is held as the third stage to mobilize external support to finance the planned restructuring measures;

- As the fourth stage of the programme, international experts produce an assessment of the related training needs which can serve as the basis for follow-up technical assistance. They also carry out **training seminars** - based on the problems encountered and the lessons learned in the diagnostic stage.

As a direct component or as follow-up of trust fund projects, very often opportunities for promoting foreign investment emerge. The **promotion of foreign investment** and other forms of international industrial co-operation constitutes a major programme element of UNIDO's work with a view to upgrading domestically available production capabilities through much needed external capital, technology, managerial and marketing know-how. To this end, UNIDO closely co-operates with other international, regional and bilateral institutions and development banks whose financial resources can be complemented by UNIDO's technical expertise. Essentially, UNIDO's investment-related activities encompass five different yet interlinked elements.

First, UNIDO's research division regularly monitors and assesses pertinent trends in the international investment system with regard to changes in the magnitude and pattern of foreign investment flows; the determinants of investment decisions; corporate strategies; and technological and organization innovations.

Second, with a view to completing these overall studies through a country-specific information base and guidance for foreign business partners and investors, UNIDO prepares special Industrial Development Reviews. These contain up-to-date information on the structure and performance of a country's manufacturing sector; its industrial strategy and policies; the major institutions involved; and specifically, its investment legislation, procedures and incentives. [14]

Third, UNIDO actively supports developing countries in the identification, screening and appraisal of investment projects so as to create a portfolio of viable and bankable investment projects suitable for subsequent promotion efforts. In this, various degrees of sophistication can be chosen ranging from a simple presentation of a project's economic and financial 'basics' with or without having been screened using UNIDO's Project Profile Screening and Pre-appraisal Information System (PROPSPIN) computer software, to a full-fledged feasibility study based on UNIDO's own Computer Model for Feasibility Analysis and Reporting (COMFAR).

Fourth, UNIDO offers a wide range of investment-related technical assistance services at both the institutional level and the company level. As to the first level, assistance is rendered in building up and/or strengthening of national investment promotion agencies, including on-site and overseas training of their staff in various project appraisal and promotion techniques. At the company level - increasingly also in the context of privatization programmes - UNIDO conceives and implements rehabilitation/ modernization plans which in many cases are a precondition for making a company at all 'promotable' in terms of stimulating the interest of foreign investors.

Finally, UNIDO sees its essential role as being an 'honest broker' in bringing together local investment project sponsors and interested foreign partners. This is most prominently achieved in the framework of country-specific Investment Forums to which foreign partners - based on a carefully prepared project portfolio - are invited so as to negotiate bilaterally with the local project sponsors concerned. In Asia, the most recent examples of such Forums include China (Northwest Provinces), Fiji, Nepal, Sri Lanka and Viet Nam. When organizing such Forums, UNIDO draws on its worldwide resources and experience in fostering both North-South and South-South investment. The

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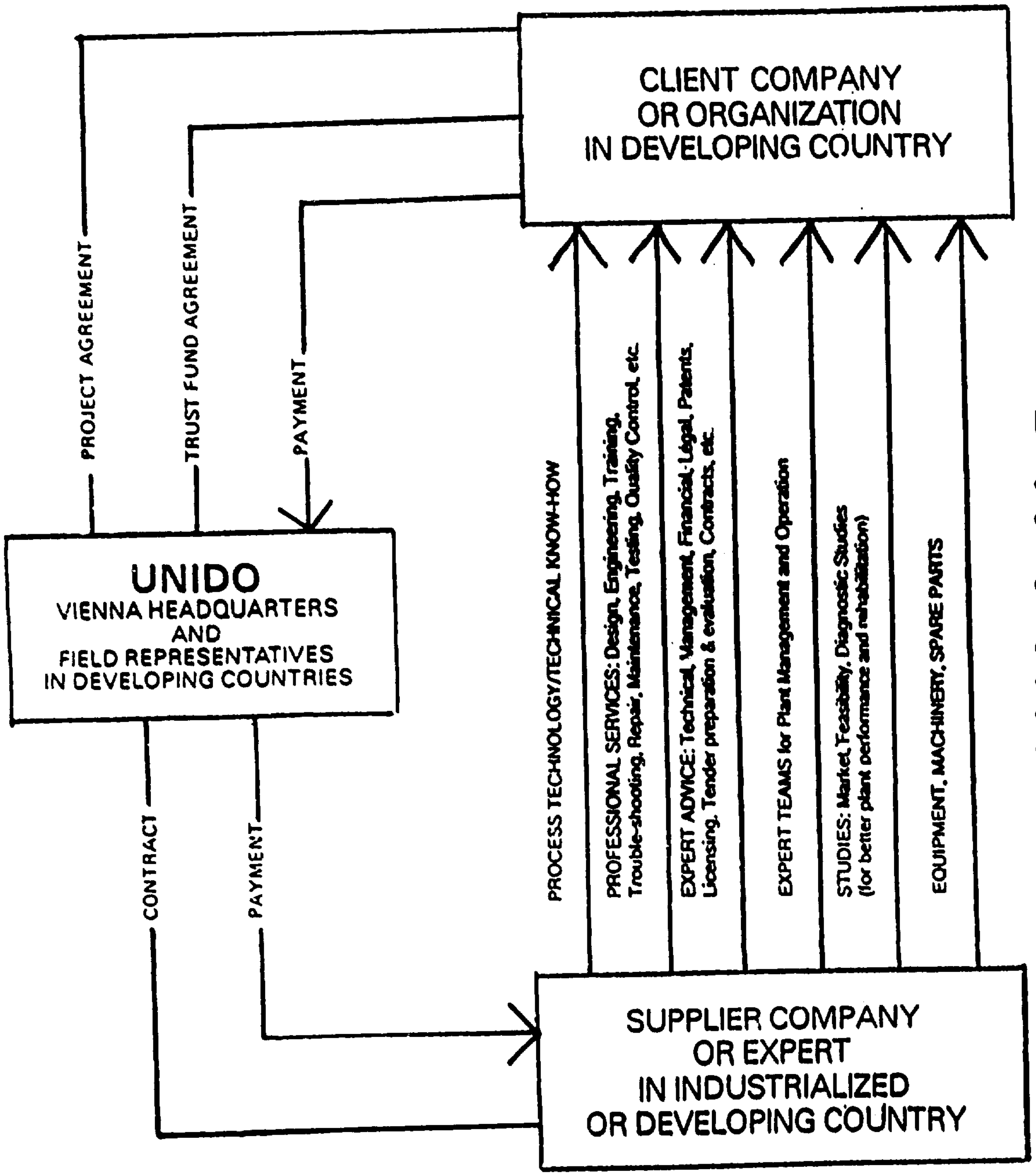
[14] The most recent Industrial Development Reviews on Asian developing countries include China, India, Indonesia, Malaysia, Pakistan and Thailand.

organization maintains a global network of Investment Promotion Service Offices in major capitals, including Cologne, Milan, Paris, Seoul, Tokyo, Vienna, Warsaw, Washington and Zurich. In addition to these, in early 1990, two Industrial Co-operation Centres (ICC) were established in Moscow and Beijing which are mandated to promote both inward and outward investment.

The programmes outlined above clearly demonstrate that there is increasing scope and demand for international assistance to the private sector through international organizations, such as UNIDO. However, in rendering such assistance it needs to be taken into account that the private sector is the most dynamic segment in industrial and technological development and as such is subject to rapid changes in its development patterns and support requirements. There is a strong need, therefore, to establish appropriate mechanisms for a continued and flexible dialogue between private sector representatives in the countries of the region and the various international organizations active in the field of industry and technology.



SELF-FINANCED TRUST FUND SCHEME

UNIDO Services

- Overall assistance for project planning and execution
- Identification of good suppliers/experts and evaluation of their offers
- Contract negotiation and selection of suppliers/experts in agreement with client company
- Supervision and control of work of suppliers/experts
- Follow-up activities for additional projects
- Assistance in obtaining funds for additional projects
- Other services and information for further industrial co-operation

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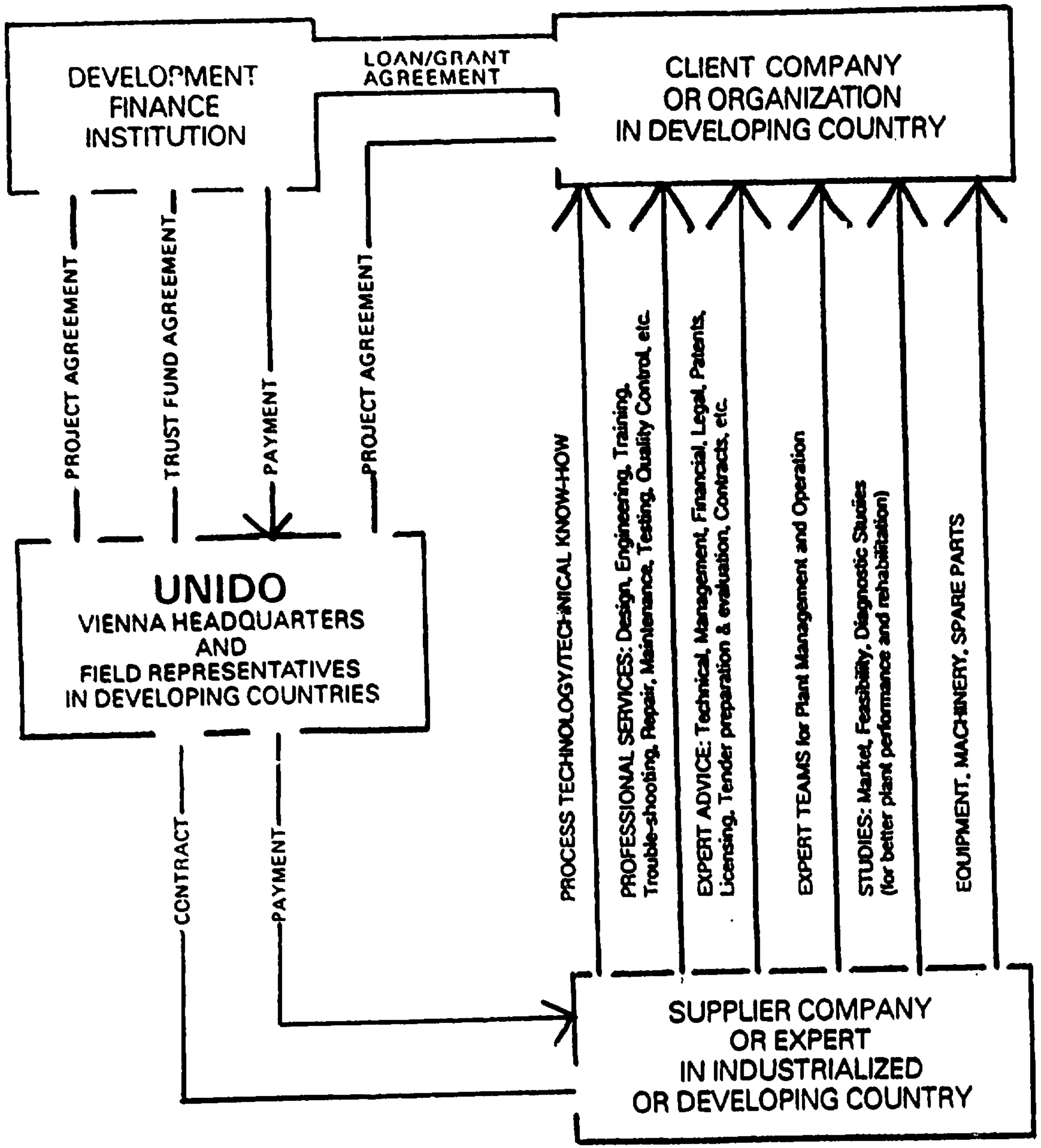
ANNEX 1

THIRD PARTY FINANCED TRUST FUND SCHEME



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