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Panel V
Industrial policy reforms: The changing role of Government and private sector development

Background Paper

Recent industrial policies in developing countries and economies in transition: Trends and impact

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LIST OF ABBREVIATIONS

BOT	Build-Operate and Transfer
FDI	Foreign direct investment
GNP	Gross national product
LDCs	Least developed countries
SMEs	Small and medium enterprises
NAFTA	North American Free Trade Agreement
NIS	Newly independent states
R&D	Research and Development
SOEs	State-owned enterprises
TNCs	Transnational corporations

EXECUTIVE SUMMARY

The basic policy changes towards increased market orientation and private-sector development in recent years have been necessitated by global economic developments. In the newly independent states (NIS) and the former socialist economies of Eastern and Central Europe, a major shift to market orientation and private-sector development through liberal policies was essential. This became equally necessary for developing countries, because of major global trends towards competitiveness and efficiency. Rapid and revolutionary technological developments in communications and production processes have resulted in globalization of markets and communications, and increased internationalization of production. The Uruguay Round Agreements are expected to result in major liberalization of global trade. At the same time, the emergence of important trading blocks, such as the European Union and NAFTA will inevitably have substantial impact. There is likely to be more intense competition for various goods and services, and competitive technological processes and improved quality standards will need to be ensured, besides compliance with environmental standards. It will be increasingly necessary for developing countries and for transition economies to adapt their industrial structure and their production and marketing mechanisms in order to participate in the mainstream of international trade and investments.

Effects of recent industrial policy reforms

The impact of policy changes needs to be assessed in relation to specific issues. These relate to: legislative and regulatory measures; trade liberalization; institutional facilities; privatization; inflow of Foreign Direct Investment (FDI) and technology; domestic entrepreneurship; and the role of national governments and institutions.

Progress in codifying the legal framework

In most developing countries, the tax structure is fairly well defined, while several financial incentives such as tax holidays, accelerated depreciation and duty-free imports of capital goods have been provided under the new policies. At the same time, while the overall legislative framework has been set up, promotional guidelines and institutions have not always been well established. Permission is still required in certain countries for new foreign investments while, in others, approval procedures continue to be cumbersome and time consuming. Company legislation and procedures are not well developed, particularly in some of the transition economies. Institutional facilities for industrial finance are inadequate not only in transition economies but in most developing countries in Africa. Institutional support is also lacking with respect to industrial information, technology and external linkages in several developing countries and transition economies.

Impact of trade liberalization

The most favourable impact of import liberalization has been the increased emphasis on development of export capability. This is particularly necessary in the context of the Uruguay Round Agreements, which necessitate that products and services from developing countries and transition economies must achieve increased competitiveness and higher quality standards. It is important that such time-bound incentives as are permissible under the Uruguay Round Agreements, are fully availed of by the developing and Least Developed Countries (LDCs) during the respective periods of transition for these countries.

Progress in privatization

Perhaps the most significant impact of recent policies has been the progress made in privatization. While the divestment of State holdings in industrial enterprises constituted an essential prerequisite for greater market orientation in transition economies, privatization policies have also had very significant impact in a number of developing countries. The process of privatization of State-owned enterprises (SOEs) continues to be indispensable for transition economies and developing countries. A major issue, however, relates to the financing of privatization.

The overall impact of privatization on industrial development, particularly production, employment, productivity and modernization has, in general, been quite favourable. Additional revenues have been generated and budgetary deficits have been reduced. Additional capital investments and inflow of technology and managerial expertise have taken place and have had substantial positive impact on productivity and modernization through private-sector initiative. At the same time, the effects on employment have posed considerable problems. In most privatized enterprises, there has been substantial reduction in overall employment and varying degrees of retrenchment have taken place, causing serious social problems. There has also been criticism of increased fees and charges by privatized enterprises in fields such as telecommunications and services operating in monopolistic conditions, highlighting the need for regulatory measures.

Inflow of foreign direct investment

One of the major effects of liberalized industrial policies has been the substantial increase in foreign direct investment (FDI) and technology inflow to developing countries and transition economies.

While annual average inflow of FDI to developing countries was around $13.1 billion during 1981-1985 (about 26 per cent of global flows), this rose to $25.3 billion in 1986-1990, though the share of global inflow declined to 16 per cent. During 1991-1993, there was a substantial increase, with the annual average inflow rising to over $54 billion, constituting over 32 per cent of global flows. In 1993 alone, FDI inflow to developing countries increased to $70.8 billion

(38.6 per cent of total), rising to an estimated figure of $79.7 billion in 1994. FDI in developing countries has, however, been largely concentrated in a few developing countries, mainly in Asia and Latin America, with little FDI in African countries.

Foreign technology

Inflow of foreign technology and know-how has been an integral feature of FDI. Such investments have generally been accompanied by proprietary technology and know-how, besides specialized technical services for plant engineering, construction and project implementation. Apart from technology linked to foreign investments, however, there has also been substantial increase in the flow of advanced production and service technologies to a number of developing countries and to some of the transition economies through licensing arrangements and joint ventures.

It needs to be emphasized that, with increased industrialization, developing countries and transition economies may increasingly need to acquire technology and know-how through licensing arrangements, or joint ventures, in view of the wide range of requirements. While technology will continue to accompany foreign investment, the licensing mechanism is increasingly emerging as an independent function, which can be separately acquired and adapted to local conditions.

Entrepreneurial capabilities

The liberalization of industrial policies has provided considerable opportunities for private-sector entities in developing countries to expand production and services in new directions. This has been particularly successful in several Asian and Latin American economies which have had strong private-sector entities and where institutional facilities have developed, particularly with respect to financial services. In these countries, market-oriented policies have resulted in a major increase in private-sector investments and activities in various fields. In countries, however, where existing private-sector enterprises are weak or where the financial infrastructure is inadequate, as is the case of African countries, the impact of more liberal policies has inevitably been limited. Unless extensive programmes for entrepreneurial and business training are undertaken, this will continue to be a major gap.

Inadequacy of the institutional framework

The essential institutional facilities required are still not available in several developing countries and transition economies. The most important are financial institutions, particularly those designed to meet long and medium term credit needs. The accelerated industrial growth rate in the Republic of Korea and other South-East Asian economies has largely been the result of a close-knit and integrated approach between governments, financial institutions ranging from commercial banks, venture capital funds to local stock exchanges, and

representatives of major industrial groups in these countries, with respect to major investment programmes.

To the extent that appropriate financial institutions are not adequately available in a number of transition economies and in several African countries, the growth of small and medium industries faces a serious constraint. Another major constraint in these countries relates to inadequate training programmes for local entrepreneurs and lack of training institutions to organize entrepreneurial and managerial training for local personnel. The development of institutions for quality standards and metrology is also an urgent necessity in most countries particularly with liberalized global trading arrangements and the prescription of international quality standards.

An important institutional requirement is for the promotion of foreign investments and technology inflows. While institutions have been set up to deal with new investments in most countries, the functions need to be extended to the preparation of investment profiles, pre-feasibility studies and assistance in selection of technology and know-how. Such institutions should also provide support to local entrepreneurs on negotiations of contracts with foreign partners and technology suppliers. The development of institutional capability in applied research in different fields, including absorption of new technologies, is also an important institutional requirement.

The changing role of governments

The role of the State and policies of State intervention in a number of developing countries and transition economies have gone considerably beyond the creation of a suitable climate for new investments. The need for regulatory activities by national governments is also becoming increasingly pronounced during the post-privatization stage, particularly in the case of privatized monopoly operations such as in telecommunications and other services or in basic industries such as steel and petrochemicals. In the case of private monopolies, certain government controls would need to be retained during the post-privatization stage in order that national and consumer interests are adequately protected. The most important issue, however, is with respect to the redundant surplus labour as a result of privatization. So far, only limited programmes have been undertaken for the absorption of such surplus labour in other industrial or service sectors.

It must also be emphasized that, in most developing countries and transition economies, specific promotional measures will be necessary to mobilize local industrial investments and participation. While market forces will undoubtedly provide the basic motivation, they will have to be supported by effective institutional measures for ensuring that local investments are not only mobilized but also that necessary institutional, financial and technological support is provided for accelerated and sustainable growth.

CHAPTER I. INTRODUCTION

Pure *laissez-faire* is not practised in any market economy.[1/] Historically, rapid economic development stemmed from the conscious selection of policy instruments and carefully targeted intervention in most market economies. The industrial sector in particular has been a major target of such policy pronouncements in most of the newly industrializing countries in East Asia. A modern market economy requires a complex system of corporate law, guarantees for intellectual property rights, well-developed transport and telecommunications infrastructure, and an all-round educational system capable of keeping pace with the changing dimensions of industrial development. There is no automaticity in the creation of essential basic conditions of a desired pattern of industrial development in a market-driven economy. Actions of individual entrepreneurs may result in socially and ecologically undesirable patterns of development in the absence of clearly defined norms, priorities and direction of industrial development.

Creating the institutional and infrastructural base for industrial development and balancing the various interests in society are essential government roles. In a number of rapidly growing market economies, governments working closely with the business community have successfully implemented industrial policy instruments towards fostering a healthy pace of industrial expansion; even initiating and completing the process of industrial modernization or restructuring.

Industrial policy is particularly important in economies in transition because of the very high level of public ownership in the industrial sector. Adapting the sector to its role in an open economy requires a complex, long-term process of privatization and restructuring. Clearly defined industrial policy instruments are needed in order to ensure the strategically important industries meet domestic needs as well as the requirements of global competitiveness.

Although industrial policies have at various stages been influenced by political/social priorities, present-day industrial policy-makers seem to show a strong preference for the institutionalist approach and policies are therefore largely confined to creating and safeguarding a proper business environment. The integration of industrial and macroeconomic policies, clear and realistic objectives, well-established monitoring procedures, involvement of the business community, removing barriers to competition, a phasing out of declining industries and stimuli for the diffusion of new technologies, and complementary measures to improve infrastructure and training and to promote small and medium-scale enterprises are increasingly constituting the principal tenets of present-day industrial policy pronouncements by governments.

A common feature of recent industrial policy reforms in developing countries and economies in transition is the accent on market orientation and the increasing importance of private sector-led development. However, there are critical differences in the experience of countries, even in the same region, due to the differences in factor endowments, country-specific economic conditions, incidence of technical progress, and levels of skill development. Recent experiences of developing countries and transition economies clearly indicate that a modern industrial economy needs the State in defining the main goals and priorities of industrial development, and to facilitate the effective integration of the industrial economy into the global economy. It is in this context that the study attempts to highlight the principal features and the impact of recent industrial policy reforms in developing countries and economies in transition. To this end, the study focuses on recent industrial policy reforms, market-oriented development, privatization, technological change, investment, competitiveness, entrepreneurship, and the institutional framework for industrial development.

This study comprises three Chapters. Chapter I explains the rationale of industrial policies. Chapter II elucidates the objectives and tenets of recent industrial policy reforms, with a focus on the prerequisites of market orientation, privatization and an enabling environment. Chapter III analyses the effects of recent industrial policy reforms on the required legal framework, trade liberalization and competitiveness, institutional support facilities, privatization, foreign direct investment, inflow of foreign technology and know-how, national entrepreneurship, and on social development.

CHAPTER II. RECENT INDUSTRIAL POLICIES AND REFORMS

A. Towards market orientation and private-sector-led development

In most developing economies, industrialization has constituted a major objective of development strategy and government policy. It has been recognized that rapid industrial growth is the principal means for achieving increased employment, incomes and living standards and that socio-economic transformation of these countries cannot be achieved other than through accelerated expansion of industry and services.

At the same time, the strategy for industrial growth has varied considerably. In certain South-East Asian countries such as Singapore, Hong Kong, and Taiwan Province the emphasis has been primarily on the promotion of private-sector investments, including those of transnational corporations. At the other end of the policy spectrum, in several countries including a number of African countries emerging from colonialism, the State undertook a major role in industrial and business activities and State-owned enterprises (SOEs) were set up in various production and service sectors. This development was largely due to socialist planning models adopted in these countries, but also because of the absence of a dynamic, local private sector. In between these two models of industrial policy, a number of developing countries adopted the structure of "mixed" economies, where the private sector was allowed to flourish and grow, with varying degrees of regulatory control by governmental agencies and SOEs were set up in critical industries and some commercial activities.

The "mixed" economy model, which was adopted in several Latin American and Asian countries, including oil-producing countries, became particularly pronounced during the 1960s and 1970s, following the nationalization of petroleum, minerals and other foreign-owned industries in a number of countries. By the end of the 1970s, governments and SOEs in a large number of developing countries held a substantial share in the ownership of enterprises. This was particularly the case in resource-based and basic industries including iron and steel, fertilizers, petroleum exploration and processing and petrochemicals, and also in sectors such as transportation and tourism, as well as infrastructure development, which was recognized as a government responsibility. The rapidly expanded role of SOEs was accompanied, in most cases, by policies of import substitution and a high degree of protection, including quantitative import restrictions. While foreign investment was generally welcomed, it was often channelled to particular fields of activity, with pressure for increased holdings by national partners and shareholders, including government agencies and SOEs. There were, however, notable exceptions such as the Republic of Korea and Chile, where export-oriented policies assumed major emphasis since the late 1970s, or Singapore and Thailand, where foreign direct investments (FDI) were encouraged without ownership restrictions.

SOEs in most developing countries rarely got off to a good start, except in the petroleum sector. In a number of cases, they were neither well planned nor efficiently implemented and often resulted in considerable overinvestment and poor performance, necessitating substantial government subsidies, which often increased with time. With the heavy pressures on most governments for development of basic infrastructure, inadequate emphasis was given to the planning, execution and management of State-owned industrial enterprises and a large proportion of SOEs gradually became an increasing financial burden on the national governments concerned.

Since the latter half of the 1980s, disappointment with the performance of many such enterprises, combined with the deteriorating economic situation and the heavy debt burden faced by a number of developing countries, forced most of these countries to undertake fundamental and far-reaching reforms with respect to policies impacting on industrial growth. These reforms, which received strong support from the IMF and the World Bank and have been integrated within structural adjustment programmes, have principally taken the form of a major shift to greater market orientation and recognition of the private sector as the principal engine of industrial growth. The essential element of the new policy approach has been the major liberalization of investment codes and regulations relating to promotion of new private sector investments, particularly FDI, and inflow of foreign technology; implementation of privatization and complete or partial divestment of government holdings in SOEs; increased liberalization of trade and removal of import and export restrictions, and increased emphasis on the development of export capability. During the 1990s, poverty alleviation and the achievement of socio-economic objectives, particularly increased employment and income, have also been accorded major emphasis.

The above policy developments have been the result of several factors including the heavy international debt burden of several developing countries, particularly in Latin America, during the 1970s and early 1980s; the deteriorating economic situation in a number of developing countries, especially in Africa, and the unsatisfactory performance of a large proportion of SOEs. The shift to market orientation and emphasis on private sector development further accelerated with the collapse of centrally-planned economies in the former Soviet Union and in Eastern European countries, which had constituted a role model, to varying degrees, for several developing countries.

The fundamental and far reaching policy changes inherent in the approach towards increased market orientation and private sector development are fully consistent with the impact of global economic changes during the early 1990s. While, in the case of the newly independent states (NIS) comprising the former Soviet Union, and in the former socialist economies of Eastern and Central Europe, a major shift to market orientation and private sector development was essential and inevitable, this became equally necessary for a large number of developing countries because of major global trends. Revolutionary technological development in communications and production processes have resulted in globalization of markets and increased internationalization of

production. The Uruguay Round Agreements involve major liberalization of global trade. At the same time, the emergence of important trading blocs, such as the European Union and the North American Free Trade Agreement (NAFTA) would inevitably have substantial impact. There is likely to be more intense competition for various goods and services, and competitive technological processes and improved quality standards will need to be ensured, besides compliance with environmental norms and standards. It will be increasingly necessary for developing countries and for transition economies to adapt their industrial structures and their production and marketing mechanisms if they are to participate effectively in the mainstream of international trade and investments.

The impact of major policy changes relating to private sector development needs to be reviewed at the country level in relation to the role of such enterprises, both prior to policy liberalization and thereafter. In a number of Asian and Latin American countries, the private sector is very well established, with a large number of major corporations and conglomerates having undertaken major initiatives for industrial growth in different fields. These enterprises have proved to be effective instruments not only for the purchase and management of privatized SOEs but also for initiating new relationships and alliances with companies in industrialized economies with respect to finance, technology, marketing and other contractual arrangements. At the same time, in most African countries, particularly the least developed countries (LDCs), the growth of local enterprises has been fairly limited and most industrial activities are often confined either to the operations of transnational corporations (TNCs) or to SOEs. A new class of local entrepreneurs, which can initiate small and medium enterprises needs to be developed. The same is even more true of the transition economies, where a very wide range of private sector industrial activities need to be generated.

Any analysis of the pattern of change envisaged as a result of increased emphasis on private sector development requires a review of the principal elements involved in the liberalization and reform of industrial policies. An assessment also needs to be made of trends in inflows of FDI and foreign technology as a result of policy liberalization and the extent to which alternative arrangements for inflow of technology and know-how have been developed by local private enterprises. A similar assessment is necessary regarding trends in privatization. It is also necessary to review the role of the State, both in bringing about major policy changes and reforms, and in ensuring necessary institutional support for the implementation of the objectives of the reform process.

B. Objectives of industrial policy reforms

The objectives of industrial policy reforms are to achieve an accelerated pace of competitive and sustainable industrial growth, primarily through privatization and increased private sector investments, and greater market orientation and development of export capability. Private-sector industrial activities should also

bring about socio-economic development, including increased employment and incomes and improved living standards in less-developed areas and better living conditions for poorer and more vulnerable sections of the community. This necessitates consideration of policy aspects and their likely impact not only on the promotion and growth of large and medium-sized factory establishment with foreign investment and competing in global markets, but also on the development of small and micro-enterprises in the informal sector.

Private sector development depends, to a great extent, on the overall macro conditions, policies and variables in a particular economy. Apart from stable socio-political conditions, a conducive climate for investments needs to be developed, together with controlled levels of inflation; the availability of short term and long-term capital at reasonable interest rates and of participatory local investments, both domestic and foreign, non-discriminatory treatment of foreign investments; promotional policies for inflow of foreign technology and managerial expertise; availability of foreign exchange to meet essential capital goods and other imports, and a tax regime with adequate incentives for new investments and development of production, services and export capability. Most developing countries face severe constraints with respect to several of these variables. At the same time, such constraints can be adjusted, to a varying extent, through appropriate macroeconomic policies to meet the needs of new investments and to respond effectively to increased private-sector initiatives. Most of these factors can be integrated in the development of a favourable or conducive climate for new industrial investments.

1. Creating an enabling environment

The development of an enabling environment for increased private-sector investment involves certain prerequisites. These include among other things: stable socio-political conditions; the availability of basic physical infrastructure such as electric power, transportation and telecommunications; the development of the institutional infrastructure and mechanisms for mobilization of investible resources; and providing institutional support for the development of competitive and sustainable capability. While these prerequisites are similar for domestic or foreign investments, the requirements for FDI tend to be far greater, since such investments have much greater choice.

a. Political and economic stability

Political stability should not imply the continuance of a particular regime, but rather a stable form of political governance and decision-making, where changes in government do not necessarily have major impact or changes in the overall investment climate.

b. Improvement of procedures

It is essential that, as part of industrial reforms, regulatory and bureaucratic controls should be substantially dismantled. Revisions in investment codes must

be accompanied by necessary changes in administrative regulations, procedures and controls. Despite liberalization of investment legislation, government approval of new investments is still required in many countries. Policies and regulations would need to be re-oriented increasingly towards promoting new investments and, at the same time, ensuring adequate competition, achievement of quality standards, and meeting environmental and ecological requirements.

c. Investment decisions

It is important that investment decisions should be left to entrepreneurs and enterprises, both domestic and foreign and should not be regulated by governmental bodies. At the same time, regulatory measures are necessary to ensure: that undesirable monopolies do not develop and competition is not curbed by restrictive practices; that quality standards are defined and maintained; and that environmental requirements are observed in industrial activities as a whole, and in specific industries exposed to greater ecological hazards.

d. Policies on investment promotion

It is necessary that an active programme of promotion, both domestic and foreign, is undertaken to induce new investments, especially in desired fields. Such a programme could include:

(i) guarantees against nationalization and for fair and adequate compensation for any expropriation;
(ii) assurance to foreign investors for remittances of profits, royalties and fees, interest, and income from sale of shares;
(iii) tax and other incentives for new investments or major expansion/restructuring of existing enterprises, including tax holidays, exemption from customs duties for initial capital equipment and components, spares and material for one to two years, and accelerated depreciation;
(iv) promotional measures for required inflows of foreign technology under reasonable terms and conditions;
(v) freedom to employ expatriate experts and personnel for reasonable periods;
(vi) special incentives for exports, including higher royalties, import entitlement and drawbacks, and tax concessions; and
(vii) in general, a package of promotional measures for new investments by both foreign and domestic investors on the basis of equal treatment.

e. Physical infrastructure

An important prerequisite for accelerated private sector development is the availability of physical infrastructure, comprising land, water, electric power, transportation and telecommunications facilities. Electric power shortages and interruptions are a chronic problem in many developing countries and a serious

deterrent to the introduction of modern production processes. A major bottleneck may also be caused by inadequate telecommunications facilities, both within a country and externally. Inadequate or high-priced transportation facilities, both within a country and externally may also serve as a deterrent to private sector investments.

f. Institutional support facilities

The availability or otherwise of adequate institutional support facilities can constitute a major factor in enhancing the role of the private sector. It is sometimes argued that market forces, by themselves, would ensure the appropriate growth of institutional mechanisms and arrangements. Such an approach may not be consistent with conditions prevailing in a number of countries where major constraints facing private-sector development can only be mitigated through institutional facilities set up by the governments concerned. Unless effective policy support and institutional assistance is provided, the liberalization of policies and adoption of the market mechanisms is, in principle, unlikely to yield successful results, particularly in Africa and in less-developed economies. Appropriate institutional support facilities must be created, however, with the active involvement of private sector associations and institutions, particularly in order to ensure sustainability.

Institutional infrastructure must necessarily cover a wide range of requirements. Firstly, appropriate financial institutions need to be developed, extending from commercial banking, insurance and other financial services to the development of a capital market, including venture capital finance for equity requirements and development of loan finance, especially for small and medium industries and to meet the needs of micro-enterprises in the informal sector. Secondly, the necessary training institutions must be developed for small, medium-scale and micro entrepreneurs. Training facilities have also to be provided for managerial personnel of local enterprises and for the development of specialized skills, such as in design and engineering. Specialized industrial training must also cover the training of personnel in new technologies, particularly computers, telecommunications and software, based on assessed requirements in these fields over a period of time. Industrial training at national level should concentrate primarily on the training of trainers in various fields and should be based on close linkages with universities, technical institutions and management organizations in each country. There must, however, be close involvement of private-sector associations, including chambers of commerce in the planning of training programmes and the development of training curricula. Thirdly, a critical element of institutional infrastructure relates to the development of quality standards in various fields of production and services and of ensuring adequate quality control. Fourthly, institutional facilities need to be developed for industrial information, ranging from information on alternative sources of investment or technology to data and material on trade and markets in various fields. Fifthly, institutional mechanisms have to be developed with respect to investment promotion and technology inflow, absorption and adaptation. These should be essentially promotional and, at the same time, provide adequate

guidance to local entrepreneurs on negotiations and contracts of various types. Finally, institutional capability must be developed in applied research in selected fields. The structure of industrial R & D in developing countries needs to be reviewed. With the limited resources available for this purpose, efforts need to be concentrated primarily on applied research activities.

The range of institutions described above are indicative of the multi-disciplinary institutional requirements for industrialization. To a lesser or greater extent, institutional facilities have been developed in a number of countries. What is essential in the immediate future, however, is the closing of gaps such as those in information systems and industrial R & D, and adjustment of existing institutional capability to meet the changing requirements of the private sector in particular countries. The growth of small and medium industries, which has particular potential in most developing countries, would largely depend on the extent to which financial and institutional support can be made available in different country situations.

2. Creating competitive pressures for efficiency gains

The liberalization of foreign trade constitutes an essential element of policy reforms towards increased market orientation, and a major shift from import substitution strategies, which have been a feature of industrial policy in most developing countries. At the same time, the removal or substantial reduction of balance of payments deficits and the development of export capability are also essential. Apart from petroleum exporting countries, most developing countries face growing constraints because of falling world prices for most commodities and traditional exports from these countries. In several countries, acute foreign exchange shortages continue. Global and regional trends in foreign trade do not suggest that the situation will significantly improve for most developing countries without major efforts. Varying degrees of trade liberalization and development of export capability will be necessary. The Uruguay Round Agreements, while providing for global trade liberalization, may not yield significant gains for developing countries, unless competitive production capability can be developed in an increasing number of industrial subsectors. The likelihood of a greater volume of trade between developing countries, however, appears to be greater.

Increased liberalization of imports as part of greater market orientation will, however, pose increased competition for locally manufactured products. This may be desirable for encouraging greater competitiveness of local products. However, it may also lead to stagnation and closure of local small-scale units which are unable to compete with low priced imports. Developments in foreign trade are likely to be seriously influenced by the growth of regional trading blocs. The impact of the European Union and of integration between Canada, Mexico and the United States of America through the North American Free Trade Agreement (NAFTA), or even the Mercosur trading block in South America, are likely to have considerable effects on countries and country-groups trading with these blocks. While the overall objective of the Uruguay Round

Agreements, as also of the regional blocks, is to liberalize and expand foreign trade, trading conditions are likely to become increasingly competitive for developing countries outside these blocks. Increased competitive capability in foreign trade will necessitate not only improved technological applications and higher quality standards in various fields but also a comprehensive set of policies designed for export promotion and institutional support for developing export capability within the permissible framework of the Uruguay Round Agreements.

3. Encouraging foreign direct investment

An important objective of policy reforms is to encourage and to promote foreign direct investment (FDI). This is necessary to meet gaps in investment requirement, as also for inflows of technology and know-how and development of competitive capability in these countries. While annual average inflow of FDI to developing countries was around $13.1 billion during 1981-1985 (about 26 per cent of global flows), this rose to $25.3 billion in 1986-1990. During 1991-1993, though their share in global investment declined significantly, there was a substantial increase, with the annual average inflow rising to over $54 billion, constituting over 32 per cent of global flows. In 1993 alone, FDI inflows to developing countries increased to $70.8 billion (38.6 per cent of total), rising to an estimated figure of $79.7 billion in 1994.[2/] FDI in developing countries however, has been largely concentrated in a few developing countries, mainly in Asia and Latin America, with little FDI in African countries.

4. Facilitating foreign technology inflows

One of the principal policy objectives for developing countries is to ensure adequate inflow of foreign technology and management expertise. The technology gap between industrialized and most developing countries has tended to increase considerably in recent years. At the same time, with greater diffusion and licensing of technology, the market for most established and mature technologies has expanded considerably, and most such technologies are available from multiple sources. Technology agreements represent an important alternative form of foreign participation, particularly when there is no foreign equity participation. Such agreements ensure inflow of needed technology and know-how and are assuming growing importance. The number of technology agreements tends to increase with higher levels of industrialization, as enterprise to enterprise relationships are sought to be strengthened. The choice of suitable technology is undoubtedly a critical issue, as are the terms and conditions under which these are secured. For this purpose, an effective system of information on alternative technologies is necessary, together with information on terms and conditions in various types of contracts. Technology choice and negotiations of terms and conditions of technology agreements should be left to the contracting parties.

Even if the prospects for FDI and technology inflow to developing countries appear promising, it will be essential for local enterprises in these countries to

increasingly take the initiative, both with respect to new investments and for acquisition of technology.

5. Developing entrepreneurial capability

While private sector entrepreneurial capability is well developed in most Latin American, South and South-East Asian and West Asian countries, this continues to be inadequate in most African countries and in less-developed regions in Asia and Latin America. The development of entrepreneurial capability is an essential prerequisite for the growth of a new business and entrepreneurial culture in African countries and in the transition economies. This is necessary, both for the rapid growth of small and medium industries in these countries and for the achievement of broader socio-economic objectives and extension of industrial activities to rural regions.

6. Fostering the pace of private sector expansion

The objectives of privatization include both those directly related to the SOEs in question and broader goals of economic policy. The former include financial savings and losses of such enterprises; income and earnings from sale of such enterprises, and greater efficiency of such enterprises, which often occupy a pivotal role in their respective sectors. An important objective may also be to ensure inflow of new investments, modern technology and management expertise through private-sector participation. The broader policy objectives can extend from overall debt relief, which constituted an important factor for privatization in several Latin American, Asian and African countries in the late 1980s, to a major shift to market-orientation in the case of transition economies.

In most developing countries and transition economies, privatization is designed and expected to achieve several objectives. It is expected to lead to a substantial increase in efficiency, generate revenues from the sale of such companies and assets, and reduce budget deficits. Privatization also aims to strengthen the private sector, both with respect to participation in industrial development and exports and in developing the domestic capital market. In several sectors, privatization has also been motivated by the increasing financial resources required for modernization and expansion. A decade of debt crisis has also resulted in considerable under-capitalization of infrastructure investments, particularly in electricity generation, telecommunications, transportation and port facilities, as also in extractive industries. Several governments have also privatized sugar mills, textile factories and other industrial activities where the decision making process often made such enterprises unresponsive to rapidly changing demand and the need for higher standards of performance.

An important precondition is the declared intention of the government to implement privatization and a general consensus among political decision-makers and other major interest groups. It is also essential to have a legal system which establishes property rights for the transfer of SOEs.

C. The changing role of governments

An important issue to be considered against the framework of policy changes and reforms is the changing role of the State. It is often assumed that in increasingly market-oriented economies, the role of the State and of governmental agencies should not only be substantially reduced, but that many of the existing promotional and regulatory responsibilities currently discharged by governments would automatically be taken over by the private sector and discharged by market forces. In the context of transition economies and developing countries, such a view may not be realistic, if industrialization is to be accelerated. At the same time, it should be recognized that the role of governments is undergoing considerable modification towards significantly reduced functions.

The development of a suitable climate for promoting private sector investments obviously involves major change and a dynamic, promotional and regulatory role for national authorities. While promotional policies have to be adopted for both domestic and foreign investments, with investment decisions taken by private sector entities, measures have to be evolved and applied to ensure that unregulated monopolies do not develop following privatization and that competition is not curbed by restrictive practices. It is also necessary that quality standards are defined and maintained, together with environmental standards applicable generally to industries and specifically to particular industrial sectors.

The changing role of government must, however, be viewed in the light of the experience of countries engaged in a shift to market orientation. It is not appropriate to suggest uniform policies or guidelines in this regard. The full interplay of market forces may not be wholly practicable, or even desirable, in several developing countries and transition economies facing multiple resource and other constraints, and country specific decisions and programmes should be determined.

CHAPTER III. EFFECTS OF RECENT INDUSTRIAL POLICY REFORMS

The effects of industrial policy reforms in recent years have to be assessed in terms of their impact on private sector development and increased market orientation and on increased industrial investment and growth. The impact of these measures has differed considerably across developing countries and regions and economies in different stages of transition. In the case of transition economies, while there have been substantial differences in levels of industrial investment and development, the assessment has to be primarily made with respect to progress in privatization which constitutes the initial stage of private-sector growth in these countries. In the absence of established private-sector-led entities, the role of FDI has also assumed major importance. Among developing countries, the impact of policy changes has depended partly on the period over which particular policies have been followed within a stable political and economic framework, but more importantly on the extent to which private sector funds, both foreign and domestic, have been able to be mobilized for privatization and for new investments.

Within the above broad framework, the effects of policy changes need to be further analysed in relation to specific issues. These relate, *inter alia*, to the following: legislative and regulatory measures for the development of a conducive climate for new industrial investments; trade liberalization and competitiveness; institutional support facilities for sustainable private sector growth; extent and impact of privatization and prospects in this regard; inflow of FDI and technology and development of competitive capability in selected sectors of production and services; national entrepreneurship; socio-economic impact of policy reforms, and redefinition of the role of national governments and institutions.

A. New legal framework for an enabling investment environment

In most countries, specific legislation and regulations have been prescribed as part of the new policy framework. In the case of developing countries, this has generally taken the form of revisions in investment codes which have liberalized investment rules and opened new fields and sectors to private investments, both foreign and domestic. Emphasis has also been given to guarantees against expropriation and measures have been prescribed for assuring remittances of profits, royalties and income from sale of shares by foreign companies. In most developing countries, the tax structure is fairly well defined, while several financial incentives such as tax holidays, accelerated depreciation and duty free imports of capital goods have been provided under the new policies. Provision for company legislation and procedures have also been developed in most of these countries, together with financial institutions providing investment and working capital. While the overall legislative and institutional framework has

been set up, implementation procedures, promotional guidelines, and institutional support systems are still not well established in several countries. Permission is still required in certain countries for new foreign investment proposals and while legislation has been liberalized, approval procedures continue to be cumbersome and take a great deal of time. The same is true of investments by local enterprises and with respect to approvals for foreign technology and recruitment of expatriate personnel. Company legislation and procedures still need to be developed in several transition economies and in certain less developed countries, while company legislation in the more industrialized countries may need to be increasingly simplified and streamlined.

A conducive climate for the mobilization of industrial investments, however, requires more than an appropriate legislative and regulatory framework. Apart from ensuring necessary physical infrastructure, such as electric power, transport and telecommunications, it is necessary to create a strong institutional base comprising support systems for information, finance, technology and external linkages which would provide assistance and guidance to local enterprises in defining, promoting and implementing industrial projects. With the growing competition for new investments, a series of specific measures for investment promotion, including preparation of investment profiles and contacts with foreign enterprises, will also need to be undertaken.

In the case of transition economies also, the basic legislative and regulatory framework has, by now, been defined in most countries. The principal gap is with respect to institutional support systems, particularly for information and finance, which still need to be developed. Similarly, specific measures are required to promote investment and technology inflow on the one hand, and the development of national entrepreneurship and local small- and medium-industries (SMEs) on the other.

B. Foreign trade liberalization and competitiveness

Most developing countries have adopted measures for liberalization of imports in recent years, often as part of structural adjustment reforms, and there has been a marked shift from import substitution strategies to increased exports and participation in global trade. In the case of transition economies, the break-up of the COMECON trading arrangements has resulted in these countries developing new trading linkages, including with countries outside the former socialist bloc.

In some countries, such as Chile, import liberalization was initiated as far back as the late 1970s and by 1979, average tariffs in Chile had been reduced to 10.1 per cent. In the Republic of Korea, tariffs were reduced from the mid-1980s to a level of around 11.4 per cent in 1993. In certain Latin American countries such as Argentina and Mexico, there was considerable liberalization of imports between 1989 and 1994. In the case of Mexico, such liberalization resulted in a huge trade deficit of $23 billion in 1992. In other countries also, there was

considerable reduction in tariffs, as in the case of India where the average tariff was reduced to 33 per cent in 1994.

Import liberalization has constituted an important policy reform and brought about a major change from import substitution to increased emphasis on development of export capability by local enterprises. Increased imports have not only enabled substantial inflow of capital goods and equipment for enterprise restructuring and expansions, but have also resulted in making local enterprises more competitive and responsive to market forces. This has undoubtedly been a desirable development and will increasingly enable developing country enterprises to enhance their competitiveness in global markets. At the same time, when major imbalances in imports were combined with massive inflow of rapidly transferable portfolio capital, the effects were disastrous for Mexico in early 1995 and the impact was severe on other Latin American countries and on the global economy.

It must also be recognized that, at the micro level, liberal imports have had adverse effects on local small-scale enterprises, particularly in African countries, where these enterprises were unable to compete with low priced imports. Additional measures for financial and technological support to such enterprises will be necessary to improve their competitive capability in rapidly changing markets as a result of liberalization.

The most favourable impact of import liberalization has been the increased emphasis on development of export capability. This is particularly necessary in the context of the Uruguay Round Agreements, which will necessitate that products and services from developing countries and transition economies achieve increased competitiveness and higher quality standards. It is important that such incentives as are permissible under the Uruguay Round Agreements are fully availed of by local enterprises in developing countries and LDCs during the respective periods of transition.

C. Institutional support facilities

While considerable progress has been made with respect to legislative and regulatory measures, the necessary institutional support facilities are still not available in many developing countries and transition economies. These range from institutions for finance, industrial information, technological adaptation, and support of promotional bodies for FDI and technology inflow. Sustainability also requires close involvement of private sector groups and associations, in many cases.

The most important requirement is for strong financial institutions, including those designed to meet long and medium term investment requirements of industry, including commercial banks, development finance bodies, venture capital funds and stock exchanges. The accelerated industrial growth rate in the Republic of Korea and other South-East Asian economies has largely been the

result of a common and integrated approach between governments, financial institutions and major industrial groups in these countries initiating major investment programmes.

To the extent that institutional finance facilities are not adequately available in transition economies such as Kazakhstan, and in several African countries, the growth of small and medium industries faces serious constraints. Other major constraints in these countries relate to inadequate training programmes for local entrepreneurs and lack of training institutions to organize entrepreneurial and managerial training for local personnel. This can be a major shortcoming and has not been accorded necessary priority in a number of countries.

The development of institutions for quality standardization and metrology is also an urgent necessity in most countries. This has assumed greater importance with liberalized trading arrangements and the need to ensure higher quality and international standards such as ISO 9000 for key, exportable products, and to arrange for quality certification.

Institutional facilities are also particularly necessary with respect to industrial and trade information. While information systems are fairly well developed in more industrialized developing economies, there is considerable lack of such facilities in most African countries and transition economies. Information systems are essential not only for providing market data but also information on new technological developments and on alternative sources of investment and technology in different fields.

An important institutional requirement is for the promotion of foreign investment and technology inflow. While institutions have been set up for handling new FDI proposals, in several countries, the functions need to be extended to the preparation of investment profiles and pre-feasibility studies and assistance in the selection and acquisition of technology and know how. It is also necessary to provide support to local entrepreneurs on negotiations of contracts with foreign partners and technology suppliers, both through courses and seminars.

The development of institutional capability in technological research in different fields, including assessment of new technologies, is also an important institutional requirement. Some countries such as Brazil, India, Malaysia, Mexico and the Republic of Korea, are well advanced in this regard. Most African countries, however, have tended to lag behind. In transition economies, while R & D received considerable priority in the past, there has been a significant decline in recent years. It is necessary that industrial R and D activities must be coordinated with activities of private sector manufacturing enterprises and related to existing and projected demand in various industrial fields. It is also necessary to highlight the role of universities and technical institutions in developing countries with respect to applied R & D, as well as twinning of local institutions with external research organizations.

D. Extent and impact of privatization

Extent of privatization

During the 1980-1991 period. the number of privatizations in developing countries was estimated at 1,357. This number excludes the large number of re-privatizations which have taken place in Sri Lanka and Bangladesh, involving mostly small companies. Most of the privatization has taken place in Latin America, where SOEs played a key role in several basic industries such as steel, fertilizers, chemicals and mining, besides infrastructure and services. Extensive privatization was initially undertaken in Chile and, by the end of the 1980s, over 500 companies had been privatized. By 1990, revenues from privatization came to about $3 billion and the programme was largely completed. Considerable privatization also took place in Mexico during the 1980s. In 1989-1990, the two national airlines and the telecommunications company were privatized, and by 1992, several banks, mining companies, iron and steel plants and fertilizer enterprises were privatized. Revenues from privatization in Mexico amounted to about $30 billion. Privatization in Argentina was initiated in 1990 and extended by 1993 to telecommunications, national airline, electric power company, ports and highways and in petroleum and secondary activities. Proceeds from privatization rose to $10 billion in the first two years. Brazil's privatization programme was initiated in 1990 and, by 1992, covered 22 SOEs, generating sales of over $4 billion. Privatization programmes were also undertaken in Venezuela, Bolivia, Peru, Honduras and Costa Rica, besides Jamaica. Gross proceeds from privatization in seven Latin American countries during 1985-1992 came to over $49 billion.[3/]

A number of African countries have also undertaken privatization programmes, largely because of unsatisfactory functioning of SOEs. In many of these cases, privatization took the form of liquidation or closure. In Nigeria, the government sold shares in 51 companies during 1989-1992. Togo privatized 18 State-owned companies during 1984-1990, while Côte d'Ivoire privatized 28 parastatal enterprises during 1982-1989. Privatization has also taken place of 28 enterprises in the Gambia (1983-1990), 24 in Tunisia (1987-1991) and 21 enterprises in Zambia.[4/] In several countries, particularly at the early stage of their privatization programmes, i.e. up to the mid-1980s, there was extensive liquidation of small State-owned companies. Proceeds from privatization in relation to GNP remained fairly limited in most African countries and were not comparable with the revenues generated through privatization in Latin America.

When compared with privatization in Latin America in terms of magnitude and in Africa with respect to the number of enterprises privatized, privatization in Asian countries has been more limited. Major privatizations took place in Malaysia, generating income of $6.3 billion and including shipping and shipping terminals, airlines, telecommunications with a 24 per cent public offering, cement companies and component manufacture. In the Republic of Korea, the major privatization was of Korea Electric Power in 1989 with public offering of part of the Government holdings. Considerable privatization has also been

undertaken in Bangladesh (fertilizers), Pakistan (airlines and manufacturing companies) and in Sri Lanka (various industrial enterprises). In India, part of the holdings in some SOEs have been sold to State-owned unit trusts.

Impact of privatization

While divestment of State holdings in industrial enterprises constituted an essential prerequisite for greater market orientation in transition economies, privatization policies have also had very significant effects in a number of developing countries. The impact of privatization has been most pronounced in certain countries such as Argentina, Chile and Mexico and, to a lesser extent in Brazil in Latin America; in Singapore, Malaysia and the Philippines, and, to a lesser extent, in the Republic of Korea in Asia, and in most of the African economies. The effects of privatization have, however, varied considerably. In the case of the Latin American economies, sales of government holdings have largely taken place through local private sector enterprises, and often in the same field of operations. Thus, mining companies in Mexico were largely responsible for takeover of State-owned mines; steel and chemical companies in Brazil took over the State-owned enterprises in steel, fertilizers and petrochemicals, while private sector enterprises in Chile took over most State holdings in different sectors. Foreign companies have participated in certain privatized operations, particularly telecommunications and service sectors such as transportation.

From an overall viewpoint, privatization in Latin America may be said to have been successful in those countries which were not only able to reduce losses on account of subsidies, but were able to derive considerable revenues through sale of SOEs. There has also been considerable inflow of new capital and technology in privatized enterprises, particularly in telecommunications and services. At the same time, privatization has posed certain important issues, particularly with respect to regulatory measures required for enterprises now operating as privatized monopolies and absorption of surplus labour.

In the case of African countries, the positive feature of privatization has been the improved impact on the revenue of the countries concerned. As far as the operations of privatized enterprises, however, the impact has often been the closure or liquidation of such plants. This is largely because local enterprises were unable to attract investment while foreign investors have not been forthcoming. In the case of Asian countries, privatization has been successful in Malaysia particularly in telecommunications and services, and, to a lesser extent, in Pakistan and Sri Lanka. In some countries such as India, privatization is yet to be vigorously pursued.

The process of privatization of State-owned enterprises continues to be indispensable for transition economies and has also come to stay in most developing countries. It is increasingly recognized that State ownership itself can be an important contributory cause of inadequate performance. In several developing countries, State-owned enterprises have also caused increased

external indebtedness. In the three largest Latin American countries, Argentina, Brazil and Mexico, for example, State-owned enterprises held over one half of the country's external debt in the mid 1980s.[5/]

Preconditions and constraints with respect to privatization vary from country to country and for various subsectors. These extend from the political will to privatize State-owned assets to the viability of such enterprises; the availability of purchasers, both within the country and externally, and the implications of transfer to foreign ownership, where this takes place. The issues of ownership may itself constitute an important constraint, not only when transfer of ownership to foreign companies is involved but also for different segments of the economy. In Malaysia, for example, the Guidelines on Privatization specify that the ownership distribution should be at least 30 per cent Bumiputra, and a maximum of 30 per cent foreign share.[6/] The Privatization Law in Brazil limits foreign ownership to 49 per cent. Foreign ownership in the banking sector still continues to be restricted in most developing countries.

The commercial viability of enterprises to be privatized can be an important constraint. This is particularly applicable to enterprises in transition economies, but also to those in several developing countries. The privatization of such enterprises can only take place either if they are rehabilitated and modernized or if they are divided into smaller viable units of production or services, or if they are sold at nominal prices and restructured thereafter with substantial new investments.

A major issue relates to the financing of privatization. Weak domestic financial systems have been an important limitation to privatization, particularly in lower-income developing countries such as in Africa. Local stock markets, in most of these countries, have very limited absorptive capacity. In several middle-income countries, however, particularly in Latin America, but also in Malaysia and some other Asian countries, the local stock market has been used in combination with private offerings.[7/] During the 1989-1990 period, the participation of local capital in privatization increased considerably in several Latin American countries.

Privatization has also increased the number of domestic shareholders in countries such as Jamaica, Malaysia and Singapore though, in most cases, large national industrial groups have purchased the divested government holdings and have played an important role in financing privatization. Such industrial groups, for example, financed the takeover of banks, copper mines and steel plants in Mexico and of various industrial enterprises in the Philippines, and in Argentina and Brazil. In some countries, the government has sought to mobilize domestic financial resources through government loans at subsidized rates to local investors. Such schemes were used, for example, during the early stage of privatization in Chile. In Brazil, the government sought to promote the purchase of shares of privatized State-owned enterprises through the issue of "Privatization Certificates".

While privatization of SOEs can be implemented most efficiently in a well functioning market economy. the experience of several developing countries indicate that adequate progress can be achieved despite several constraints. Under such conditions, the form of privatization, the sequencing of industries and legal aspects of operations may need special arrangements and contractual modalities. It must, however, be emphasized that in most developing countries where major privatization programmes have been implemented during 1988-1994, these have been achieved in 'mixed' economies where State-owned and private-sector enterprises have co-existed and institutions of a market economy have been functioning.

The overall impact of privatization on industrial development, particularly on productivity and modernization of privatized plants, has, in general, been quite favourable. Additional revenues have been generated and deficits have been reduced. Additional capital investments and inflow of technology and managerial expertise has taken place and there has been substantial positive impact on costs, productivity and income through private sector initiative. At the same time, the effects on employment have been negative and have caused growing problems. In most privatized enterprises, there has been substantial reduction in overall employment and varying degrees of retrenchment have taken place, causing serious social concern. There has also been criticism of increased fees and charges by privatized enterprises in fields such as telecommunications and services operating in monopolistic conditions, highlighting the need for regulatory measures.

Likely trends in privatization

There can be little doubt that the concept of privatization has taken strong roots and is viewed as an important feature of industrial reforms and private sector development. While extensive privatization is inevitably necessary in transition economies and is gradually taking place, the process is likely to be more selective and gradual in most developing countries. The first phase of privatization, brought about largely through the pressure of high indebtedness of several countries in Latin America and Africa and certain countries such as the Philippines in Asia, can be considered to be completed. The next phase of privatization in developing countries is expected to be more selective. In certain countries, such as Argentina, Chile and Mexico in Latin America, and Singapore and Malaysia in Asia, the scope for further privatization may itself be fairly limited, unless the process is extended to various infrastructure functions, particularly power generation and distribution and services such as telecommunications, railways, ports and highways. With the massive financial outlays required to meet infrastructure costs, particularly electric power generation and telecommunications, the private sector's role in these fields may expand considerably and contractual arrangements such as Build-Operate and Transfer (BOT) may become more popular. In some of these countries, such as Brazil, China and India, there is considerable potential for privatization of several basic industries, apart from infrastructure and service facilities. The

undertaking of privatization programmes in these countries will, however, involve major political decisions.

E. Inflow of foreign direct investment

One of the important objectives of liberalized industrial policies was to bring about a substantial increase in FDI and technology inflow to developing countries and transition economies. This has certainly taken place in aggregate terms, but most of the FDI inflow has been concentrated in East, South-East and South Asia, which accounted for 66 per cent of total flows to developing countries, followed by Latin American countries with a share 27.7 per cent and 34.1 per cent, respectively, in 1993 and 1994.[8/] The most spectacular increase was with respect to FDI in China, which increased to $28 billion during 1993 and an estimated $30 billion in 1994. Other Asian countries which attracted substantial FDI included Singapore ($6.7 billion annually in 1992 and 1993); Malaysia ($4.5 billion and 4.3 billion in 1992 and 1993); Indonesia ($1.8 billion in 1992 and $2 billion in 1993); and Thailand ($2.1 billion in 1992 and $1.7 billion in 1993).[9/]

Foreign investments in Latin American countries were largely concentrated in a few countries such as Mexico, rising from $2.6 billion in 1988 to $4.9 billion in 1993; Argentina, rising from $1.1 billion in 1988 to $6.3 billion in 1993; Brazil with $2.9 billion in 1988 and declining to $1.4 billion in 1992 and $802 million in 1993; and Chile,with an average annual inflow of over $800 million during 1988-1993. Other Latin American countries with sizeable FDI inflow include Venezuela and Columbia.

Foreign investments in African countries during 1993 and 1994 continued to be very limited, ranging between $2 to $4 billion for all the countries of the region. FDI inflow in Africa during 1991-1993 was led by Nigeria, ($836 million) followed by Morocco ($422 million), Angola ($418 million), Egypt ($402 million), and Tunisia ($244 million).

Foreign investments in Central and East European countries increased by 22 per cent in 1993, amounting to $6 billion for that year, principally to the Czech Republic, Hungary and Poland. Similar trends are likely in 1994 and 1995.

The high degree of concentration of FDI in only a few developing countries is reflected by the fact that in 1993, out of total FDI inflow of $70.8 billion, over $51 billion (81 per cent), was invested in ten recipient countries. China, the largest recipient with over $27 billion, was followed by Singapore ($6.8 billion), Argentina ($6.3 billion), Mexico ($4.9 billion), Malaysia ($4.3 billion), Indonesia ($2 billion), Thailand ($1.7 billion), Hong Kong ($1.67 billion), Taiwan Province ($917 million) and Nigeria (estimated at $900 million).

Most of the FDI to developing countries has been from the United States, Japan and the European Union. In Asia and the Pacific, FDI from Japan, combined with exports, has been the highest and has increased steadily, as have

investments from the United States of America. Investments from the European Union have tended to lag behind. In Latin America and the Caribbean, United States investments have tended to play a much larger role than from other industrialized economies.

An important trend in FDI inflows to developing countries has been the growing extent of FDI from other developing countries. It is estimated, for example, that nearly 75 per cent of FDI inflow to China has been made, or channelled through, economies with ethnic Chinese populations, such as Hong Kong, Singapore and Taiwan Province.

The liberalization of legislation and regulations relating to FDI has resulted in considerable inflow of new investments in two major fields. Firstly, such investments have been concentrated in resource-based industries, particularly petroleum and natural gas, mineral exploitation and marketing, and processing of scarce raw materials. This has taken place not only in Nigeria and Angola among African countries but also in Kazakhstan among transition economies. Several such investments have taken place through joint ventures with local enterprises, including State-owned organizations. The second area with significant investments has been in the consumer goods sector, ranging from soft drinks, beverages and food products to consumer electronics and investments in hotel and tourism. There has been some criticism that such FDI has often taken place in non-priority sectors. This may well be true but a liberal approach towards FDI would not be consistent with the imposition of restrictions on such investments. Restrictions continue to exist in certain countries such as Brazil, regarding foreign investments in public utilities and certain infrastructure sectors. These sectors will, however, require massive capital outlays during the next decade.

There is every likelihood that FDI inflow to developing countries will continue to increase during 1995-2000. With growing internal markets in these countries and availability of relatively cheap skilled labour, FDI is likely to increase significantly in several countries in Asia and Latin America if present-day liberal conditions continue. Such investments, will, however, be largely concentrated in a few countries. Considerable foreign investment is also likely to continue and increase in transition economies, particularly the Czech Republic, Poland and Hungary as well as Kazakhstan and Uzbekistan among the Central Asian States because of increased investment opportunities in the transition economies. It is also likely that measures for regional economic integration will have a significant impact on FDI flows. In recent years, European economic integration has led to considerable FDI from the United States of America and Japan to take up production activities within the European Union. The creation of NAFTA is likely to have a similar impact and also to promote greatly increased US and Canadian investments initially in Mexico and later in other countries, such as Chile. Closer trade integration in the Asia-Pacific region may lead to similar developments along the Pacific Rim countries. Certain developing countries such as Brazil, China, India and Indonesia provide the obvious advantage of large domestic markets, which is a major attraction for foreign

investors. South-East Asian economies have the advantage of highly developed skills, especially in electronics, as well as a favourable climate for new investments. Even apart from these country groups, the picture with respect to FDI during the 1990s appears to be fairly optimistic, though most other developing countries, particularly in Africa, may have to increasingly rely on the initiative and dynamism of local enterprises and entrepreneurs to attract foreign partners as investors or technology suppliers. It will also be necessary for both developing countries and transition economies to undertake vigorous and targeted promotion of foreign investments for particular projects having adequate viability and potential, including preparation of investment profiles and development of contracts and follow-up with potential foreign partners.

A major recipient country for FDI is likely to be India, which may become an important host country for FDI during 1995-2000 if its present liberal policies are continued. FDI in India increased from $211 million in 1992 to $505 million in 1993 and is expected to rise substantially in 1995 and thereafter. FDI can also be expected to continue to grow in most South and South-East Asian countries, with major new investments expected in Viet Nam. In the Latin American economies, the situation appears more uncertain at present, following the continuing impact of Mexico's financial crisis in 1995 but is likely to improve during 1996-2000. FDI in African countries should increase in the latter half of the 1990s, with greater stability and promotional activities in these countries. Such investments may increasingly take place from other developing countries. The overall prospects for FDI inflow to developing countries and transition economies is expected to be favourable during 1996-2000 and thereafter.

F. Inflow of foreign technology and know-how

With increased emphasis on private sector development, the role of governmental agencies screening technology agreements has been reviewed in several countries. During the 1960s and 1970s, a number of countries in Asia, Latin America and Africa set up regulatory bodies to screen and approve foreign technology agreements. Such regulatory measures may have been necessary at the time in order to strengthen the bargaining power of technology licensees from developing countries. Over the years, however, there is not only increased knowledge of such terms and conditions but greater acceptance on the part of the licensor regarding conditions considered undesirable in these countries. There has also been considerable liberalization in legislation and of procedures and guidelines with respect to technology agreements and technology choice and negotiations are increasingly being left to the parties concerned.

Inflow of foreign technology and know-how has been an integral accompanying feature of foreign direct investments. Such investments have generally been accompanied by proprietary technology and know-how, besides specialized technical services for plant engineering and construction and project implementation. Apart from technology linked to foreign investments, however, there has been a substantial increase in the flow of advanced production and

service technologies to a number of developing countries, and to some of the transition economies, through licensing arrangements and joint ventures.

With respect to transition economies, foreign technology has accompanied FDI inflow in several sectors, including resource-based industries, machinery manufacture and production of transport equipment, in the Czech Republic and Poland and in several manufacturing sectors, in Hungary. In the case of Kazakhstan, technology and expertise has constituted an essential element of foreign investments in resource-based industries and in the mining sector, where a number of joint venture agreements have been concluded. It needs to be emphasized that, with a high degree of industrialization, developing countries and transition economies may increasingly need to acquire technology and know-how through licensing arrangements, or joint ventures, in view of the wide range of requirements. This has been the trend in the more industrialized developing countries such as the Republic of Korea, Malaysia and India in Asia, and Brazil and Mexico in Latin America. While technology will continue to accompany foreign investments where this takes place, the licensing mechanism must be viewed as an independent function, which can be separately acquired and adapted to local conditions. As enterprises in developing countries and transition economies become increasingly competitive in global markets, greater efforts would be required to secure competitive technologies from different sources through licensing and contractual arrangements.

G. Entrepreneurial capability

There has been a spurt in entrepreneurial aspirations and commercial mentality in response to new waves of industrial policy reforms in a number of developing countries. However, there is a growing need for increased national entrepreneurship in several developing countries and transition economies where this is lacking so far. The liberalization of industrial policies and privatization of SOEs have provided considerable opportunities for private sector entities in developing countries to expand production and services in new directions. This has been particularly successful in several Asian and Latin American economies which have had strong private sector industrial groups and enterprises and where institutional facilities have developed, particularly with respect to financial services. In these countries, market oriented policies have resulted in a major increase in private sector investments and activities in various fields. In countries, however, where existing private sector enterprises are weak and where the financial infrastructure is inadequate, as in the case of African countries and LDCs, and in a number of transition economies, the impact of more liberal policies has inevitably been limited. Unless extensive programmes for entrepreneurial and business training are taken up in these countries, including in transition economies, there will continue to be a major gap.

Programmes of training in entrepreneurship and business techniques should include training in project preparation, accounts, production planning, technology selection and product marketing, up to the stage of preparation of business plans and establishment of external linkages. A wide range of training

courses for entrepreneurs, particularly for small and medium industrial enterprises are available. These need to be adapted to meet the needs of particular country situations.

The development of small and medium industries, specially through national entrepreneurs, also requires considerable institutional support, which continues to be inadequate in most African countries and in transition economies. This can range from the availability of credit from financial institutions at low and concessional rates, to the availability of physical facilities such as industrial estates and technology parks; assistance in production technology and marketing, and linkages with foreign enterprises.

During the 1990s, it is likely that an increasingly popular form of industrial relationship in developing countries and transition economies will be that of small and medium locally-owned enterprises with non-affiliate foreign technology licensing or other contractual arrangements with foreign enterprises, including buy-back and marketing arrangements. Such arrangements will need to be actively encouraged and promoted.

H. Socio-economic impact

An important indicator by which the success of policy reforms can be judged is with respect to their socio-economic impact. This has to be viewed in terms of both the direct and indirect effects on employment and income, particularly for poorer regions and more vulnerable population segments. It has also to be seen in terms of the impact on linkages between agriculture and industry, specially in the non-urban sector.

The immediate socio-economic impact of policy reforms has not been particularly favourable. Post-privatization unemployment has been a matter of growing concern in several Latin American and African countries and in most transition economies. Liberalization of imports has benefitted only certain sections, particularly richer and elite consumer groups. In the case of local enterprises, the benefit of increased capital goods imports will accrue only over time, while several local enterprises may not survive the test of increased competition from low priced imports. The immediate impact in terms of linkages between agriculture, industry and the services sector has also been very limited so far, except in countries such as the Republic of Korea, where increased market orientation and export promotion have been practised over two to three decades, or in Chile, where such reforms have been undertaken since the late 1970s. In most other developing countries, the effects of policy reforms have primarily been felt in metropolitan centres, with little impact on rural regions and for weaker sections of the population.

The direct effect on industrial unemployment and income has been fairly positive in most of the countries studied, even after allowing for increased post-privatization employment. This has, however, been largely concentrated in the urban metropolitan centres, with little direct impact in surrounding rural regions.

The indirect impact on the latter has also been very limited and there have been few linkages between agriculture and industry so far, as a result of policy reforms.

The inadequate socio-economic effects of policy reforms are, to a large extent, a question of time. Private sector development, during its initial stages, will tend to concentrate in urban, metropolitan areas where adequate infrastructure is available, except where availability of raw materials constitute critical locational factors. The permeation of private sector initiative to rural regions and among weaker and more vulnerable sections, such as women, can tend to be slow and gradual, and spread over a considerable period of time, unless the process is accelerated through promotional and institutional support. Such support has been available in certain countries, such as Bangladesh, particularly with respect to rural finance. In most developing countries, however, unless comprehensive promotional and institutional support is provided, socio-economic development solely through the private sector can take considerable time.

Efforts have been made to promote rural industrial development, specially through small and micro enterprises, in several developing countries, including Chile, Brazil, Mexico, and the Andean group countries in Latin America; India, Malaysia, and the Philippines in Asia and Ghana, Kenya, Tanzania, Uganda and Zimbabwe, in Africa. Several of these programmes have been relatively successful and have resulted in increased employment and income in rural areas, specially in agro-processing and in textiles, leather products and handicrafts. By themselves, however, these programmes are not enough. If socio-economic benefits through policy reforms are to be maximized and if poverty alleviation in the poorer regions of developing countries is to be effectively tackled, a comprehensive and integrated programme for rural industries needs to be implemented in developing countries and transition economies. This cannot be left to market forces alone; national authorities would need to take the lead in the formulation and implementation of such programmes in consultation with private sector groups and bodies in each country.

I. Redefinition of the role of national governments

An important issue is the extent to which national government policies, institutions and machinery have contributed to the success or otherwise of programmes for increased market orientation. It is also necessary to assess the role of national governments and institutions in the changed context of market orientation and increased reliance on the private sector. Does the role of national government lie primarily in evolving the policy framework for private-sector development and privatization and thereafter leaving further developments largely to market forces? The experience and impact of recent policy measures in developing countries and transition economies clearly point to the contrary. In fact, the most successful achievements have taken place in countries where State intervention has been most pronounced. This is exemplified by the experience of China with respect to FDI during 1992-1995; rapid development of export capability in the Republic of Korea during 1989-

1994 and the accelerated rates of industrial growth in Malaysia, Thailand, and Indonesia, and in India during the period since 1991.

At the same time, it would appear that the underlying motivations behind policy reforms have not always permeated through the public services and bureaucracies in several developing countries and transition economies. Attitudes towards the private sector on the part of bureaucracies and government institutions have often continued as before. The additional problems will take time to resolve. The most resilience is reflected in South-East Asian economies, where, as in Japan, a close relationship and integrated approach has developed between government, industrial groups and major financial institutions. The relationship between public institutions and services and the private sector is also fairly well established in most Latin American and South Asian economies but this may require considerable change before a really effective and integrated approach can be achieved. In African countries, new links are being developed between government agencies and the emerging private sector in these countries.

The role of the State and policies of State intervention in developing countries and transition economies where policy reforms have been relatively successful have gone considerably beyond the creation of a suitable climate for new investments. In several cases, there has been close link of policies and programmes between government, local industrial groups and local financial institutions as in the Republic of Korea or in Taiwan Province. In other cases, a major thrust has been provided by national governments both for accelerated industrial growth and for export development through a series of promotional policies and incentives in recent years. This has resulted in a major increase in industrial production and exports from countries such as Brazil, China, India and Malaysia, among others. On the other hand, in African countries and LDCs, comprehensive and integrated programmes for competitive industrial growth needs to be undertaken, particularly in the context of increased globalization and liberalized global trading arrangements under the Uruguay Round Agreements.

The need for regulatory activities by national governments is also becoming increasingly pronounced during the post privatization stage, particularly in the case of privatized monopoly operations such as telecommunications and other services or in basic industries such as steel or petrochemicals. In the case of private monopolies, experience in Latin American and Asian countries suggests that certain government controls should be retained during the post privatization stage in order that national and consumer interests are adequately protected. The most important issue, however, is with respect to the surplus labour consequent on privatization. So far, only limited programmes have been undertaken for the absorption of such surplus labour in other industrial or service sectors. This will, however, become a more pronounced problem with the extension of privatization to new fields, including infrastructure sectors.

As pointed out earlier, the socio-economic impact of policy reforms has, so far, been very limited. This process can extend over a considerable period of time unless national governments and institutions adopt a more challenging role in rural industrial development. Sole reliance on the private sector to achieve socio-economic objectives of increased employment and income in less-developed regions and for poorer sections, can be a grave mistake. It is necessary for national governments and institutions to undertake integrated programmes for rural industrial development, particularly through small and micro enterprises. This will require identification of fields of investment, training of entrepreneurs, particularly women, and institutional financial and technological support through industrial extension services to rural areas and communities. The role of national governments and institutions must be substantially expanded in this regard.

It must also be emphasized, in conclusion, that in most developing countries and transition economies, a number of promotional measures will be necessary to mobilize local industrial investments and participation. While market forces will undoubtedly provide the basic motivation for private sector growth, this will have to be extensively supported by effective institutional measures both for ensuring that industrial investments are adequately mobilized and also that necessary information, financial and technological support is provided for accelerated and sustainable growth.

ENDNOTES

1/ See UNIDO, *Industrial policies in the transformation to competitive market economies in the central and eastern Europe and former Soviet Union region*, 22 August 1994.

2/ UNCTAD, Division of TNCs, *Foreign direct investment in developing countries*, TD/B/ITNC/, Geneva, February 1995.

3/ Estimates are by Business International, *Privatization in Latin America*, The Economist Intelligence Unit, 1993.

4/ For further details on privatization, see UNIDO, *Private Sector Development and Privatization*, Industrial Development Review Unit, September 1994.

5/ For an analysis of state-owned enterprises around the mid-1980s, see Balassa, B., "Public enterprises in developing countries: Issues of privatization", *Proceedings of the 43rd Congress of the International Institute of Public Finance*, Paris, 1987. pp. 417-433.

6/ Government of Malaysia, *Malaysia Privatization Masterplan*, Kuala Lumpur, National Printing Department, 1991.

7/ This method has frequently been used in Chile, and more recently, to a lesser extent, in Mexico and Argentina.

8/ This section is based on UNCTAD, Division of TNCs, *Foreign direct investment in developing countries*, TD/B/ITNC, Geneva, February 1995.

9/ *Ibid.*

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