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ASIA-PACIFIC REGIONAL FORUM ON INDUSTRY  
Bangkok, Thailand, 23-24 September 1999



Proceedings

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**ASIA PACIFIC REGIONAL FORUM ON INDUSTRY**

**Vision and Challenges for Sustainable Industrial Development:  
Lessons from Asian Crisis**

23-24 September 1999  
Bangkok, Thailand

**PROCEEDINGS**

Organized by UNIDO in cooperation with the Ministry of Industry,  
Government of Thailand

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# Inaugural Address by His Excellency Mr. Chuan Leekpai, Prime Minister of Thailand

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*Mr. Director-General,  
Excellencies,  
Distinguished Participants,*

*Ladies and Gentlemen,*

I am very pleased to have been invited to deliver an address during this morning's inaugural session for the Asia-Pacific Regional Forum. Before I proceed, however, I should like to extend a warm welcome to all of the distinguished participants attending this Forum, particularly those of you who have traveled from afar.



*Ladies and Gentlemen,*

As all of you are well aware, the onset of the Asian financial crisis in July 1997 had brought about an abrupt halt to the rapid economic growth and prosperity of many countries in the region. Within a very short period of time, crisis-hit countries registered sharp falls in industrial activity, which eventually led to increased bankruptcies, layoffs, and other economic and social problems.

Today, however, I am pleased to inform you that we have been making steady progress with our economic recovery. From figures just released, economic growth for the second quarter of this year reached 3.5 per cent, up from 0.9 per cent registered during the previous quarter. Growth this year is now expected to be around three to four per cent, up from the original projection of only one per cent made earlier this year.

Contributing to this rebound have been the economic stimulus measures we have undertaken to boost private consumption and investment, as well as the recent rise in exports, which, after more than a year of negative growth, have risen by 3.4 per cent during the first eight months of this year.

Given these positive developments and our rising level of foreign reserves, we have decided that it will no longer be necessary for us to proceed with the next

disbursement of funds under our economic adjustment programme with the International Monetary Fund.

Despite this improving macroeconomic picture, however, we are still confronted with lingering problems, including, among other things, weaknesses in our banks and financial institutions and high levels of non-performing loans. We will therefore continue to work hard to address these issues. We will also continue to restructure our financial and industrial sectors as well as improve our legal and regulatory frameworks.

Looking back, Ladies and Gentlemen, I believe the crisis has taught us several important lessons.

First, just as the world is becoming increasingly interdependent, the various sectors in our economies are also becoming inseparable and intertwined. As a result, what began as a financial crisis soon expanded into a full-fledged economic crisis, with severe repercussions upon the real sector.

Second, the crisis has exposed weaknesses in our local industries, which were overly dependent upon foreign capital and technology at the expense of building upon their own capabilities. Therefore, if we are to remain internationally competitive, we have no choice but to increase our productivity. We must use all our factors of production - be they our capital, our labour or our natural resources - more efficiently and more effectively. To keep moving up the value-added curve, more needs to be done to train our workers and develop their skills. More also needs to be done to develop our scientific and technological capabilities, giving particular emphasis to applied technological know-how to help increase the efficiency of our production and develop our export base even further.

Third, there is a need to promote good governance, not only in the public sector, but also in the private sector as well. Good corporate governance is crucial if companies are to manage themselves with transparency and accountability. Good corporate governance is also crucial if companies are to operate efficiently, while not imposing social costs to society as a whole.

*Ladies and Gentlemen,*

Given the necessity of increasing our industrial productivity in the medium and long term, my Government has adopted an Industrial Restructuring Master Plan. Comprising eight action programmes for thirteen targeted manufacturing sectors, this Master Plan focuses upon the need for our industries to improve their efficiency and international competitiveness.

As over 90 per cent of our manufacturing companies are small and medium enterprises or SMEs, we have also come up with specially designed programmes for these enterprises. These programmes include, among others, measures to improve research and development of production technologies and managing techniques, as well as those to strengthen human resources development and technical skills through the convening of trade seminars.

To provide equity investment to support new investments as well as to assist the recapitalization of restructuring efforts by our businesses, including SMEs, we have, just last month, announced the establishment of the Equity Fund, the Thailand Recovery Fund and the Fund for Venture Capital Investment in SMEs. Investment by these funds will help to lower the debt-to-equity ratio of Thai businesses as well as to lower financial costs and reduce business risks.

Furthermore, Financial Advisory Centres for SMEs are being established by the Federation of Thai Industries and the Thai Chamber of Commerce, with government financial support, to help SMEs address their financial problems, including sourcing financing, improving financial management, and restructuring debt.

As our economic fundamentals are still sound and our manufacturing base well-diversified, I am confident that our efforts will help increase our competitiveness and contribute towards the restoration of the viability and sustainability of our economy in the long-term.

*Ladies and Gentlemen,*

Many of the programmes and measures I mentioned above would not have been possible without support and assistance from the international community and multilateral financial institutions, including the World Bank and the Asian Development Bank. It is therefore clear that, alone, crisis-hit countries will find it even more difficult to stage a quick economic recovery.

That this Forum is now being organized is thus timely. I sincerely believe that we need to engage ourselves in serious discussions of what actions and measures we need to take to overcome the present crisis. We also need to search for new strategies that will ensure the continued development and prosperity of our countries and the Asia-Pacific region as a whole, especially as we are about to enter the 21st century, which marks the new development era of the next millennium.

Towards this end, I believe we must also examine our industrialization as a whole. As with economic development, industrialization should lead to the betterment of our peoples' lives. Rather than profiting certain segments of our societies, industrial development should benefit our general populace. The challenge before us now is thus how to ensure that the rewards of industrialization are both deepened and broadened, contributing towards the welfare and prosperity of our societies as a whole.

On this note, Ladies and Gentlemen, I take great pleasure in declaring open the Asia-Pacific Regional Forum on Vision and Challenges for Sustainable Development: Lessons from the Asian Crisis. I wish you every success in your deliberations in the days ahead as well as a pleasant and memorable stay in Thailand.

Thank you.

## Opening Statement of Mr. Carlos A. Magariños, Director General of UNIDO

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*Your Excellency, Prime Minister, Mr. Chuan Leekpai,  
Minister of Industry, Mr. Suwat Liptapanlop,  
Deputy Minister, Mr. Wutthichai Sanguanwongchai,  
Members of the Diplomatic Corps,*

*Ladies and Gentlemen,*

I am particularly happy to join the Kingdom of Thailand's Prime Minister and the Minister of Industry in welcoming you on behalf of UNIDO to the start of UNIDO's Asia-Pacific Regional Forum on Industry.

This is the first of a series of fora on The Vision and Challenges for Sustainable Industrial Development that UNIDO plans in the run up to its main forum on Industrial Development, which we will be holding in Vienna as part of our General Conference this November. As their title implies, they are fora with a specific purpose - understanding the nature of manufacturing as it will evolve in the first decade of the new century, and accordingly, repositioning and redesigning sustainable industrial development and its main components in developing economies.

These are crucial questions. The right answers will directly help the private industrial sector to survive and prosper. They will help governments and non-government organizations design and support the business and legal environment the private sector needs. And they will help the international community prioritize the assistance that UN organizations and the development banks can give to governments. More specifically, they will help UNIDO work with governments, NGOs, sister UN organizations, the Bretton Woods institutions and the private sector to deliver the changing pallet of services that developing economies will need.

The immediate contexts for our Asia-Pacific conference are of course mainly two: the dramatic globalization of industry since the late-1980s, and what has come to be known as the "Asian crisis" of the late 1990s. By common consent, the first is unstoppable, and the second should be made unrepeatable.



Their meaning for industry and industrial development are also the broad themes of our first two sessions today. This morning we will examine the implications of the Asian crisis for Asia-Pacific's industry and industrial policy. After lunch we will look at the microeconomic reforms required to enhance industrial competitiveness, in particular at strategies to ensure that small and medium-size industrial firms (industrial SMEs) can continue to be created and survive in a globalized economy. The underlying questions are whether and how they will continue as a prime source of employment and job creation in developing countries.

The conclusions you draw from those discussions will feed naturally into tomorrow morning's session on strategic vision and industrial policies required for the new millennium. For - let us be clear about it from the beginning - the world does need a new vision for industrial development. It has to be shared vision that allows for sharing of the benefits of developing countries' industrialization. It has to recognize and remedy the defects in the old vision while grasping the opportunities of a broader vision of how the world is today, and how it will probably evolve in the first part of the next century.

Let me begin therefore by sharing some thoughts on why the old vision, despite its achievements, is no longer valid.

### **Vision Overtaken**

The old vision was deceptively simple. For developing countries, industrialization was synonymous with prosperity. In the post-war, post-colonial years, the 1950s and 1960s, they still had relatively little of the manufacturing industry (in contrast to their extractive industries) by which the successful countries came to dominate the 19th and 20th centuries.

The international community agreed: industrialization was a necessary vehicle through which less advanced countries could accede to higher states of development. Through expansion and diversification of productive activities and with benefit of new technologies it would be possible to:

- lower unemployment and reduce poverty.
- improve per capita incomes
- raise skill levels of labour

At best, increased prosperity promised convergence. The gap separating the less developed from the richest countries would be narrowed. This was the underlying hope, the *raison d'etre* for supporting industrialization.

At the same time, it was already evident that industrial production in developing countries did not increase automatically. Arrangements confined to creating industrial production capacity would not suffice. It was not enough, for example, simply to provide the capital required for manufacturing investment. What was needed was comprehensive industrial development, ranging from strategy and

policy support to R&D, training, and all manner of technical assistance to start up and operate industrial plants and factories. It therefore made sense to create a fully independent international organization that would help provide the “public goods” necessary to support the process. It was therefore through the United Nations that the international community pursued its objective of industrialization for all countries.

The cornerstone of the work of the new agency, by then established as the United Nations Industrial Development Organization, was the ambitious and wide-ranging Lima Declaration, signed by Member States in Lima (Peru) in 1975.

Two of its concerns are worth recalling today:

- Increasing developing countries’ participation in world industrial output - raising their share from around 11 per cent (not counting data for China) in 1975 to 25 per cent in 2000; and
- Taking special care that multinational firms conform to the economic and social aims of developing countries, and “avoid discriminatory and aggressive acts”.

Today, 25 years later, we have some answers.

Next year, our forecasts show, developing countries (including both emerging and newly industrializing economies) will account for over 26 per cent of global manufacturing value added. Thus, the quantitative target has been reached. This is despite the ideological reservations of the mid-1970s, and thanks to a large degree to the possibilities opened by activities of multinational firms and finance capital in expanding trade, internationalizing capital markets and undertaking foreign investment. Those very firms’ self-interest incorporates the developing world in the world factory.

The underlying element that made it possible, of course, was technological change. The combined impact of the information revolution on the technologies of production and design, and the reduction in the costs of transportation and communication revolutionized the implementation and organization of productive processes. They also gave rise to vigorous service sectors. The developing world, or at least part of it, has already been a major beneficiary.

Technological change also rendered obsolete the political and ideological prejudices expressed by both sides at the time (by developing countries as well as MNCs). Politics and ideology are, of course, present in all of life’s activities. But one message of the past 25 years is that progress in the search for concrete solutions in issues related to development has to be sought in careful analysis of technical aspects rather than in political and ideological debate.

### **Shortfalls and Challenges**

Despite this quantitative success, it is pertinent to ask to what extent developing

countries' increased participation in global manufacturing output has been matched by the other economic goals. For example, whether it lowered unemployment and increased prosperity, and whether increased prosperity has indeed narrowed the gap between rich and poor countries? We must also ask whether there are new goals and concepts for industrial development to take on board.

In the first place, let us acknowledge the achievement in creating jobs. The increase in developing countries' share of world manufacturing value added (MVA) generated more employment and prosperity in those regions that took part in the process of "internationalization" of industrial production than in those that did not.

But we also have to recognize that the main benefits of industrialization have gone to only a relatively few countries, most of them the newly industrializing countries (NICs) of East Asia. Meaningful industrialization, like the more recent phenomenon we call 'globalization', bypassed many Asian developing countries, not to mention virtually the whole of Sub-Saharan Africa and many countries from my own region, Latin America. The entire continent of Africa saw its share in world MVA declining from 2 per cent to 1 per cent in the last 25 years, while for developing countries as a whole it increased.

The phenomenon of "internationalization" of industry shows distinct tendencies to "agglomerate" in certain regions. It also agglomerates in certain regions within the boundaries of developing countries. To put it another way, the industrialization of recent years has not contributed to raising living standards in a balanced way - neither among nor within developing countries. As a consequence, improvement in the living standards of the population in developing countries has been very unequal.

Secondly, it was not enough just to create industrial capability and capacity. Manufacturing had to be economically sustainable. For example, the import-substitution capacity installed by governments during the 1960s and 1970s (and protected with high tariffs against external competition) proved, ultimately, to be not sustainable in the 1980s and 1990s. Withdrawal of governments from the productive sector, and allowing the private sector the driving role - taking the risks in return for profit-taking on a level business playing field - were a direct result. Today, there is broad agreement that the new government role is that of "enabler" rather than investor and controller. But there is no consensus yet on what this means in practice.

Thirdly (and this is not so widely appreciated, even today): macroeconomic stability is a *sine qua non* for industrial development. In my own country, as in many others in Latin America, industrial development came to a standstill in the 1980s because of macroeconomic instability. Structural adjustment and other macroeconomic measures are indeed an essential basis for development. Neo-liberal thinkers are perfectly correct in this: Governments' first task is to control money supply, inflation, public spending and current account deficits. These are the prerequisites for all other development.

But there is growing consensus that neo-liberal thinking does not go far enough - that the new fundamentals for economic policy and strategy must be based on an understanding of the requirements of a range of reforms spanning the economy from macro to microeconomics. Macroeconomic reforms are an incomplete recipe. They are the basis of long-term growth, but by themselves they will not stimulate it. It is also becoming clear that structural adjustment can actually widen existing inequalities and that the urban poor in particular are adversely affected.

This is important from a policy perspective because, as the World Bank's next World Development Report will show, it is the level of income inequality that determines the effectiveness of economic growth as an instrument for reducing poverty. If inequality is too great, growth will worsen, not alleviate, poverty. This not only means that macroeconomic measures must be accompanied by appropriate microeconomic policies - policies that promote industry have to be prominent among them - but that in certain countries, industrial policies must focus particularly on reducing the level of income inequality. If we want to foster change and social progress within democratic, participatory and pluralist environments, balanced development thus remains an inescapable goal.

A fourth conclusion concerning developing countries' overall success in increasing their share of manufacturing output is that future increases will have to come from industrial development that is environmentally sustainable. Environmental soundness is the new factor that conditions the activities of industrial promotion. It has emerged as a critical aspect of economic development and has to be taken fully into account in the formulation of policies, strategies and actions.

A final conclusion, based on the above, is that it is important to foster activities and attitudes that allow countries to make gains in overall social and economic productivity. Rather than indiscriminate support for a specific sector, such as agriculture or industry, it would be better to focus on the productivity gains that constitute the most sustainable path to balanced improvement in living standards. Such gains, it seems self-evident, are also the best mechanism for identifying the effective contribution of a specific sector to economic development. And I have no doubt that most of them will be found in the industrial sector.

### **Towards a New Vision**

Unless our vision of industrial development for the early 21st century resolves at least these issues, I am sure it will not succeed. That is why they will form the meat of our General Conference Forum in November. And it is why I propose that they form the background to your discussions this week in Bangkok.

### **Conference Goals**

The ultimate aim of our series of conferences, as I implied at the outset, is to help re-orient the key players in industrial development. Developing country manufacturing industries needs to understand the changing nature of manufacturing itself, and thus their own role and opportunities in it.

Governments need to understand this too. But from a development standpoint, they need to understand the ongoing role of industry in the next century - the growing importance of services, but above all the fact that in all but a handful of developing countries, manufacturing will remain the main engine for growth, for exports and the agent for transforming their economies.

Governments also have to understand their own role in the new setting for the development of industry - the need for policies that will do this, and the constraints on designing those policies. Our discussions will cover not only governments' vulnerabilities, but also their policy abilities - to provide or ensure:

- the right kind of economic and legal regime and the proper speed in setting it up;
- ways to attract foreign investment and generate domestic investment in industry;
- a modern industrial infrastructure;
- a skilled workforce that can operate and manage the technologies and systems required for global competitiveness; and
- mechanisms to promote technological upgrading in industry.

Finally UNIDO (its Secretariat and its Member States) needs to understand its own role in the new context. If we agree that governments everywhere need to create capabilities and institutions in order to profit from (rather than be exploited by) market forces, the very varied capabilities among governments become a major issue.

If supporting policy makers in the weaker (i.e. most developing) countries broadly defines the new task of international organizations regarding industrial development, what specifically does this entail?

Should our global forum function try to fill in policy makers' informational and analytical gaps? Should our technical assistance help governments and industry with benchmarking, with formulation of sectoral competitiveness strategies, improving technology infrastructures, policies and systems to support industrial SMEs, and with enterprise training schemes?

The Conference papers contain many proposals along these lines. I look forward to your new suggestions and your evaluations. And I thank you for coming - many from great distances - to help UNIDO with this work.

I will personally follow the sessions with great interest, and look forward to the results of your deliberations.

Thank you.

## **SUMMARY OF PROCEEDINGS**

# Introduction

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## Background

1. The Asia Pacific Regional Forum on Industry was organized by UNIDO in cooperation with the Ministry of Industry, Government of Thailand, from 23rd to 24th September 1999, in Bangkok, Thailand. About 140 participants, comprising about 40 from abroad, attended the forum (see Annex 1: List of Participants). They were high level policy-makers of Governments, representatives of the private sector, civil society and eminent members of academia and the research community from the region.
2. The forum was the first of a series of regional fora on the Vision and Challenges for Sustainable Development that UNIDO planned in the run up to its main forum on Industrial Development which would be held in Vienna, Austria as part of its General Conference in November 1999. It was conceived as an intellectual platform for the exchange of insights and sharing of experiences among those ultimately responsible for the creation of an environment conducive to sustainable industrial development within Asia and the Pacific.
3. The forum was considered timely for policy-makers in the region to reflect on some of the pertinent issues facing them in their pursuit to restore their economic growth in the wake of the Asian crisis. The crisis, which began as a financial crisis, spread quickly into the real sector and led to sharp contraction in economic and industrial production. During the crisis, unemployment rate soared and currencies plummeted in many countries in the region. The loss of income and dissipation of wealth gave rise to unprecedented social and political stresses affecting millions.
4. Today, two years later, clear signs of recovery are beginning to emerge in many countries. Currencies have strengthened and stabilized, inflation has been kept under control and stock markets in the region have recovered strongly. Industrial production has also rebounded to positive growth in many countries. Despite these signs of recovery, structural weaknesses are likely to delay the realization of economic aspirations.
5. As the region embarks on the road to recovery and to the new millennium, policy makers are facing the challenges of restoring the growth momentum not just to a high growth regime, but in a sustainable manner. At the same time, the economic environment is changing rapidly, both domestically and internationally. The world economy has been rapidly globalizing, which implies unlimited competition and increasing uncertainty about the economic environment. At this

juncture, past policies should be re-evaluated to help adopt appropriate policies in the future.

6. Indeed, many lessons could be learned from the crisis. Rapid globalization of the world economy and the continuing trend toward market liberalization have led to the emergence of industrial competitiveness, incidentally one of the root causes of the crisis, as one of the critical success factors for sustainable industrial development. Yet, industries in the region often lack competitiveness.

7. The past decades of strong growth was largely built on high investment in physical capital, which has become increasingly inefficient. There has not been enough emphasis on investment in building indigenous technological capabilities. Even the more advanced economies are depending highly on foreign technology as evident from their high import content and low level of product sophistication. Moreover, the industrial structure of the economies is often lopsided, either with predominance of inefficient large industries or weak linkages between the large industries and SMEs.

8. Therefore, a prerequisite for the region to attain higher industrial competitiveness is to seriously undertake industrial reform as a means to alleviate the structural weaknesses of its industry. How then should industrial reform be undertaken to alleviate structural weaknesses of Asian industries? What should be the focus of the reform? How can SMEs be developed to be an engine of industrial growth? As the region moves toward the new millennium, what should be its strategic vision *vis-a-vis* industrial development? Is there a need for the region to consider alternative policy paradigm for industrial development in the next decade? These were some of the issues that the forum hoped to address.

### **Structure and Main Themes of the Forum**

9. The forum was organized into three main sessions, each with a separate theme relating to sustainable industrial development. Each session commenced with a paper presentation which was followed by discussion among 3-4 panelists and a general discussion by the participants of the forum (see Annex 2: Programme). At the concluding session, the moderators of the sessions presented the summarized discussions for each of their respective session.

10. The first session of the forum dealt with the Asian crisis and its implications on industrial policy. It reviewed the causes of the crisis, its implications on industry in the region and the measures taken by the governments to contain the crisis and revive economic and industrial growth. Such measures appeared to have yielded positive results although it may be too early to conclude that the crisis-hit countries are on the path to sustained recovery. The session evaluated the past industrial policies of selected East Asian countries, presented the economic environment that these countries will likely confront and attempted to propose an appropriate framework for industrial policy in the new environment. The theme paper was presented by Mr. Sung-Hee Jwa. The session was moderated by Mr. Mohamed Ariff while the panelists comprised Mr. Pana Janviroj, Mr. Padma Jyoti, Mr. Benigno M. Ricafort and Mr. Agus Tjahajana.



11. The second session focused on the issues and challenges in industrial restructuring and its implications on the development of SMEs. It highlighted the main structural weaknesses of industry in the region and the need for industrial reforms to ensure sustainable industrial development. Some of the best practices for industrial reform were reviewed during the session with the view to suggesting the future direction and focus of industrial restructuring in the region. The issues and challenges facing SMEs, best practices and the role of regional organizations in SME development in the region were also discussed in the light of the rapidly changing world economic environment. The session was moderated by Mr. M. Salazar Jr. and the theme paper was presented by Mr. Manu Leopairote. The panelists for the session were Mrs. Shashi Singh Choudhary, Mr. Nilmadhab Mohanty, Mr. Khemdhat Sukondhasingha and Mr. Shou Zhang.

12. The third session concerned with strategic vision and industrial policies for the new millennium. It was moderated by Mr. Rakesh Mohan and the theme paper was presented by Mr. Sanjaya Lall. The panel members included Mr. Ajit Kumar, Ms. Christine Wallich and Mr. Huijiong Wang. The session reviewed the changing context for industrial development in the new millennium and the ability of the region to cope with the new challenges in building prosperity and competitiveness in industrial activities. It discussed the main features of the new world economic setting and highlighted how industrial competitiveness is changing in response. It dealt with the role of industry in the future, the need for new industrial strategies, focussing on the main determinants of success: technology, skills, direct investment flows and the policy context. The implications for the role of government and international organization were also discussed.

## The Asian Crisis and Implications for Industrial Policies

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*Moderator:* Mohamed Ariff  
*Paper-presenter:* Sung-Hee Jwa  
*Panelists:* Pana Janviroj  
Padma Jyoti  
Benigno Ricafort  
Agus Tjahajana

### Financial Crisis and Its Impacts on Industry

1. The Asian crisis, which started with the devaluation of the Thai baht in July of 1997, was essentially a case of financial sector problems spilling over to the real sector of the economy, not the other way around. There was no evidence of a sudden loss of competitiveness in the manufacturing sector, the main engine of growth, although exchange rate overvaluation had blunted its competitive edge. Evidently, banks and other financial institutions especially in South Korea, Thailand, Indonesia and Malaysia, had overstretched themselves by lending beyond what prudence would permit. Apparently, bank lendings were based on relationships rather than best practices.
2. The rapid pace of financial sector liberalization in recent years was a major source of the financial crisis, which permitted unrestricted flow of short-term speculative capital, the so-called "hot money". It is noteworthy that a significant proportion of the current account deficits in the crisis-hit countries was financed by short-term capital inflows. The practice of financing long-term projects with short-term loans was seen as a cause of the financial meltdown in the affected countries.
3. Ironical or paradoxical as it may seem, the session felt that the factors or features which were hitherto seen as the main ingredients of the East Asian Miracle, such as the Nations Inc. concept and the Confucianist paradigm, are now viewed as the main contributors to the crisis at hand. Although the crisis was spawned primarily by the private sector behaviour, the Governments cannot be absolved of the blame, as the private sector's conduct is influenced greatly by the policy environment put in place by the Governments.
4. The session noted that industry in the region, especially in Thailand, Indonesia, South Korea, and Malaysia was severely hit by the crisis. There was a sharp rise in the number of corporate bankruptcies in these countries due to

difficulties in rolling over large amount of short-term debts denominated in foreign currencies.

5. During the crisis, domestic demand for industrial goods fell sharply as a result of high interest rates, inflation and income losses arising from massive layoffs and salary cuts. In addition, SMEs supplying parts and components to larger firms that went bankrupt suffered severely. As a result, capacity utilization dropped significantly throughout the region, notably for auto-parts and electronics industries and other import-intensive industries. Only the traditional export industries benefited from the devalued currencies throughout the region.

6. Manufacturers, especially SMEs, were also badly bruised by the abrupt tightening of lending by financial institutions. Sharp increases in domestic interest rates and the cost of imported inputs due to currency devaluation caused severe pain for these manufacturers. The exporters' advantage resulting from currency devaluation, which made exports cheaper abroad, was negated to some extent by the rising cost of imported inputs and soaring prices at home due to inflationary pressures, a phenomenon described as the "pass through effects" of exchange rate changes.

7. However, the manufacturing sector in the affected economies is beginning to show signs of revival, with unused capacity being reduced significantly. Empirical evidence suggests that the manufacturing output is growing not only to meet increased demand but also to replenish inventories which have been run down during the height of the crisis.

### **Economic Restructuring and the Role of Government**

8. The region undertook a comprehensive economic restructuring programme to survive the crisis. The programme comprised mainly two components, namely financial and corporate restructuring, and was supported by large amount of public money. Financial restructuring involved closures and/or takeovers of insolvent financial institutions, the transfer of non-performing assets to a central agency, and the recapitalization of the remaining financial institutions. Along with restructuring, most countries strengthened their prudential standards in the financial sector and their legal framework concerning loan classification, minimum capital-adequacy ratios, and regulations to enhance supervision of financial activities.

9. In the area of corporate restructuring, agencies were set up by the Government to deal with corporate debt restructuring and bankruptcy-related laws were revised in some countries. In addition, state corporations were privatized by selling shares to foreign investors in order to finance the cost of restructuring.

10. The restructuring programme had borne some results in most countries. Macroeconomic indicators of these countries started to show signs of stabilization and recovery in the economies in late 1998. Real GDP and industrial production figures improved markedly, notably in Korea. The local currency regained some strength. Foreign investors' confidence had improved, and private

capital inflows had resumed. The relaxed monetary policies adopted in these countries had resulted in lower nominal interest rates. Capacity utilization was expected to improve and the number of expansion plans of the corporate sector was increasing.

11. The session felt that sustained economic recovery and further economic development require political stability and the successful completion of the financial and corporate restructuring processes. It also requires appropriate government policies and role in economic management during the recovery process.

12. With regard to the role of government, there are two schools of thoughts. The first school believes that government should get the basic right by providing a stable macroeconomic environment and a reliable legal framework in order to create an environment where market forces can act unhindered. Minimum intervention with the lowest degree of relative price distortion is a virtue. The government should follow the lead of the market rather than trying to actively direct it.

13. On the other hand, the 'revisionists' school believes that government should take a much more active role in the economic development process to the extent of leading the market. It should set relative prices at deliberately 'wrong' levels in order to create profitable investment opportunities. Market failures are often widespread in developing countries and it is therefore important for government to play a positive role to rectify these failures as markets consistently fail to guide resource allocation toward the highest growth areas in the economy.

14. The session recognized the importance of the role of the governments, provided that this role is confined to enabling the private sector to perform better. Instead of using market failures as an excuse for intervention, it was argued, the governments should strive to remove impediments, e.g. bureaucratic red tapes, absence of effective property rights, etc. which frustrate the private sector, and create an environment in which the private sector can perform well. For the risks associated with government failures are far more serious than that associated with that of the private sector. It was noted that the business of the government is to govern and not to get into business. The argument was in favour of better government, not about less or more government interventions.

15. In the past, all East Asian countries have adopted an export-oriented development model which had contributed significantly to the rapid growth of these countries. However, the crisis could not discredit the export-oriented industrialization strategy adopted by the crisis-hit countries, as the crisis had nothing to do with their export orientation. On the contrary, the crisis-hit countries were able to register trade surpluses during the crisis, although some of the surplus was due to import compression as well. Evidently, exports were helping the crisis-hit countries in their recovery efforts, contributing significantly to the recovery process.

16. The session noted that the financial markets in East Asian countries were immature. In particular, the development of their equity and bond markets was very slow despite a rapid growth of financial assets. Thus, banks had played an increasingly important role in allocating capital. However, the majority of the

banks in these countries lacked the capacity to select borrowers and to monitor their performance. Hence, the government intervened in the process of capital allocation. Moreover, the government influenced banks' lending decisions through the allocation of savings deposits that it directly held. State-owned banks had been used to finance priority projects. In these countries, a very large share of the financial system's total deposits was held in publicly owned commercial banks. Although these countries had started to liberalize their banking system, with some as early as the 1970s, progress remained slow.

17. The session also noted that sequencing of policies does matter. It is important to ensure that the real sector liberalization precedes financial sector liberalization. Trade liberalization through tariff reductions and removal of non-tariff barriers was considered far more urgent than financial sector deregulations. Financial sector liberalization alone would lead to short-term capital inflows and exchange rate overvaluation that would in turn hurt trade in goods and services.

18. The session reviewed the past industrial policies of East Asian economies, in particular, those of Korea, and noted that these countries, notably Korea and Malaysia adopted interventionist industrial policy, targeting certain strategic industries or firms for development. While according to one point of view these policies had generally not been successful and were the cause of various distortions, the predominant view was that the phenomenal industrial and economic development of the East Asian economies including Korea and Malaysia in the post-World War II period was mainly brought about as a result of the various industrial and trade development strategies and policies adopted by these countries. No doubt, there have been some mistakes but by and large these have been successful in transforming the industrial and production structures of these countries. The international organizations like UNIDO should analyze these experiences and draw lessons for appropriate policy-guidelines for the other developing countries.

19. It was felt that the Asian crisis was primarily a financial crisis and such (financial) crises have also occurred elsewhere in the past. While the main corrections are needed in the financial sector, it would also be necessary to bring about changes in other economic policies including industrial development policies in order to mitigate the ill-effects of various distortions that have cropped up over the years.

20. The session underscored the need for industrial restructuring in the crisis-hit countries, so that their manufactures could compete internationally on the basis of both price and quality. It was noted that such efforts were already underway in East Asia. In some countries, heavy industries have been saddled with high costs and have survived thus far thanks only to protection. It is competition that would force these industries to be efficient.

21. The session noted that post-crisis restructuring process had paid too much attention to changing outward characteristics, rather than setting the correct underlying institutional and incentive structures. Without providing appropriate institutional foundation, these government-led restructuring will not have a lasting effect. Systematic approach such as establishing economic environment en-

couraging voluntary restructuring in the process of competition is more favourable to the economy.

22. The proper role of the government is to change laws and institutions and enforce them so as to provide corporate management with an external environment that will ensure the normal functioning of the various disciplinary systems. Then, as these systems begin to operate, firms will start restructuring at a faster pace as they realize that their survival depends on it. This system is far more favourable to the market economy than the government-led restructuring system.

23. The session felt that any restructuring programme should also include strengthening of the standards and legal frameworks of the economy to global levels. As the economy is liberalized, governments' ability to intervene in the economy will greatly diminish. As such, these economies will have to comply with global standards.

### **Industrial Policy under the New Global Economic Environment**

24. The session dwelt at length with the challenges and opportunities presented by globalization which was seen as something unstoppable, irreversible and even uncontrollable, a trend that all countries must learn to live with or cope with. Countries that get ready for globalization stand to benefit from it, while those that do not will have much to worry about.

25. Under this economic environment, preferential and discriminatory policies will become increasingly ineffective. As a result, government-led economic development strategies and policy instruments to protect targeted industries would eventually constitute obstacles to further economic development. Generally speaking, globalization will ensure that economic policy-making and implementation will proceed according to the principle of non-discrimination and market mechanisms.

26. In the process of globalization, knowledge, information, and technology will be the most important forces behind economic development. A few industries in the traditional sense would not constitute a sufficient mass for economic growth. Technology would cut across all industries and product life cycle would be significantly shortened. Rapid technological development would therefore greatly affect production systems and market structures.

27. Rapid globalization implies the advent of an age of uncertainty. In information and knowledge-based societies, the sources of value-added shift from the manufacturing industry to the service industry. Successful economic and industrial strategies of the past decades might not necessarily be applicable to the new society of globalization and information. Any effort to search for an appropriate industrial structure for the new millennium might prove to be futile.

## Policy Recommendations

28. It is, therefore, not easy to make policy recommendations that would apply to all crisis-hit countries in a uniform fashion. Nevertheless, the session is of the view that some broad policy prescriptions are in order.

29. *Fix the financial sector quickly:* For the financial sector malaise can spread to the real sector rapidly. Even the well-managed enterprises can succumb, if the financial sector problems are not sorted out soon enough. Financial sector reforms can include mergers and acquisitions, the adoption of best banking practices and delinking political connections. However, forced marriages among banks would not work. A bottom-up carrot approach is preferred to top-down stick approach.

30. *Liberalize the current account before the capital account:* There is a need to reduce trade barriers both tariff and non-tariff. This would reduce the anti-export bias built into the structure of protection and expose domestic industries to increased foreign competition. Unrestricted speculative capital inflow can cause problems not only because the eventual outflow would create a vacuum but also because the inflow would undermine the domestic monetary policy.

31. *Establish institutional infrastructure before opening up:* It is important to ensure that institutional supports are readily available in the event of any externally induced shocks. For open economies do not have to be inherently unstable. They can well be resilient, if they can learn to ride the surf.

32. *Redefine the role of the government:* It should play a facilitating role, creating an enabling environment in which the private sector can thrive. Government intervention in the market place is justified under two circumstances i.e., provision of public goods in which the private sector is not interested and market failure due to market imperfections. The solution to the latter is not government replacing the private sector but removing the impediments that contribute to market imperfections. It is important for the government to play a neutral role without bias.

33. *Uphold transparency, accountability and good governance:* The current crisis has exposed the dangers and risks associated with policy actions shrouded in secrecy. Transparency, accountability and good governance can expose policy mistakes and missteps quickly so that corrections can be made in time, lest they will be swept under the carpet until it bulges and blows up as a crisis.

34. *Ensure sound macroeconomic policies:* It is critical that macroeconomic policies remain sound at all times. All other policies, no matter how well conceived or implemented, will not work, if the macroeconomy is mismanaged. Thus, for instance, the underpricing or overpricing of capital (i.e., interest rates) or for that matter, the undervaluation or overvaluation of the exchange rate can cause serious resource misallocations and render microeconomic management unduly difficult.

# **Industrial Reform to Enhance Industrial Competitiveness: Implications and Strategies for SME Development**

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*Moderator:* Melito Salazar Jr.  
*Paper-presenter:* Manu Leopaïrote  
*Panelists:* Shashi Singh Choudhary  
Nilmadhab Mohanty  
Khemdhat Sukondhasingha  
Shou Zhang

## **Structural Weakness of Industries in Asia and the Pacific**

1. Even before the Asian crisis, industries in the Asia and Pacific region suffered from inefficiencies and lack of competitiveness. A high degree of protectionism (tariff and non-tariff barriers) and the easy, liberal access to financing masked these weaknesses.
2. A survey of a few representative countries in the region shows that this inefficiency and lack of competitiveness stem from: an unfocused broad-based industrial development strategy; heavy reliance on imported raw materials and components; excessive investments in some sectors leading to overcompetition and excess capacities; low-value added, volume-based and low-end product lines; a dominant domestic-market focus; the absence of meaningful linkages with the agriculture sector; and weak supporting industries. For a few, the dominance of “lumbering” state enterprises marginalized the domestic private sector.
3. While most industries exhibited these weaknesses making them easy prey to the onslaught of the Asian crisis, the SMEs have structural weaknesses that make them especially vulnerable to competitive thrusts brought by liberalization. Many produce low-tech products and require labor-intensive operations; these will not allow them to hold on to their competitive advantage in the medium term. Many suffer from the use of outdated technologies, lack of skilled labor, lack of professional management as well as low productivity and poor quality products. SMEs hardly invest in product and process technology upgrading and innovation. Technological acquisition through in-house development is barely practised in SMEs. In many Asian and Pacific countries, lack of institutional and physical infrastructure hampers the growth and development of SMEs.
4. The Asian crisis and the continuing trend towards globalization highlight the urgency for the public and private sectors of the Asia and Pacific countries to



introduce the necessary reforms to assist the industries to overcome their structural weaknesses. In this respect, regional cooperation schemes and other assistance schemes led by international agencies, like UNIDO, would be most useful.

### **Need for Industrial Restructuring and Institutional Reforms**

5. The session noted that with or without the trend toward globalization, the drive towards industrial competitiveness was still a desired action by governments/countries in the region. The recent Asian crisis has highlighted the urgency to adopt industrial reform to enhance industrial competitiveness.

6. In response to the weaknesses and the challenges of globalization, countries have instituted industrial restructuring and institutional reforms. These consist of economic stimuli packages, the privatization of economic development councils, and the formulation of various restructuring and competitiveness-enhancement plans not only in industry development, but also in SME, export and countryside development.

7. A survey of the promotion plans indicates a wide array of interventions ranging from improvements in the workforce; the adoption of global professional administrative and management systems; the reform of tax and duty structures; the development of research and development (R&D); and the stimulation of cross-border/intra-Asian cooperation. Assistance is required to enable countries to prepare and utilize the most appropriate packages. International organizations, like UNIDO, would be helpful in this respect.

8. Extremely useful for many countries is the identification of best practices. Notable among them are industrial restructuring, innovation centers and business development services. The need to disseminate these practices through observation visits and case study publication should be instituted by international organizations like UNIDO.

9. The session noted that all sectors in industry had suffered to some extent due to the Asian "debacle". However it viewed with concern the effects on small and medium industries, considering that these enterprises are community-based, labor-intensive, and have been prime engines in alleviating poverty in the countryside. Greater attention should be focused on the need to assist SMEs to adjust to globalization and to survive the Asian crisis.

10. While many economies have rushed to open markets to foreign businessmen, the experience of a few in cautiously opening their economies should be closely examined. Such an approach may have helped lessen the impact of the Asian crisis. It is also a strategy that provides more time for adjustment for SMEs that are the most vulnerable to globalization.

11. A focus on joint ventures rather than 100% foreign ownership especially in the SME sector may provide greater opportunities for local business to acquire technology and learn new systems for coping with global competition. However,

major infrastructure projects that need large capital and are necessary for SME development may be owned 100% by foreigners.

12. The session noted that almost all the policies were for promotion rather than for protection. However, there is a need to evaluate the efficiency of these policies. It would seem that greater attention is focussed on the inputs (the policies) rather than the outputs (the results). The support of international organizations, like UNIDO, in this regard would be most useful.

13. The concern was raised that massive government resources are going into assistance programs (training, credit, technology development, marketing, etc.) for the SMEs. This seems contrary to the globalizing trend of lessening direct government intervention while focussing on managing the proper policy environment. The increasing participation of the private sector should be vigorously promoted.

### **SME Development**

14. The development of SMEs is important because their development reconciles economic growth with social and democratic growth. The support and activities of international organizations in this regard can ably complement the effort of governments. Notable are UNIDO's projects in Asian countries addressing issues such as appropriate policies for SME development, promotion of SME networking and cluster development and fostering backward linkages between multinational corporations and local producers. The session commended UNIDO's role in complementing the various efforts in SME development in the region and called for greater resources in order to intensify and broaden these worthwhile activities.

15. The session was in accord on the need to classify and define SMEs in order to ensure that the appropriate policy environment and promotion programs would be target/market specific. It noted the difficulty to arrive at a common definition for all countries.

16. It was further suggested that in classifying the sector, it should be clear, the micro and cottage enterprises are being supported to advance poverty reduction objectives while the modern small and medium enterprises can be directed to industrial competitiveness in a global setting.

17. The concern was raised that without this classification, the tendency may be to provide assistance to all SMEs. The large number, the fast birth and deaths and the variety of needs may be too difficult for any government to handle, due to logistical and administrative reasons.

18. There is a need to pay attention not only to small and medium industries but also to the small and medium enterprises in the rural/agricultural sector.

19. There is much to be learned from the experience of countries/continents with large numbers of SMEs in developing the sector. Notable in their experi-

ence has been the formulation of a strategic vision, vigorous and phased restructuring of SMEs, a wide range of support services from financing to technological innovation, and a well-coordinated government and private sector support mechanism.

20. Much can be learned from the experiences of developed countries in building up strong SMEs. In these countries, there are many SMEs producing customized products in small, specialized batches for niche markets. There is another group of small enterprises working as suppliers and sub-contractors to large firms. Very few SMEs compete with large enterprises in standardized mass products. In order to be efficient or competitive, SMEs in the developing countries must try to organize themselves along this pattern. International organizations should devote attention to intensifying exchanges of experiences in this regard.

21. With globalization and given the range of assistance programs, it seems important to adopt a "paradigm shift in the government role". Key elements in this new paradigm are self-reliant policy (helping SMEs help themselves); stronger private sector empowerment (membership organizations, self-regulation, policy-making); private and non-governmental business development services (with government funding but without direct government intervention); information technology-driven assistance (use the information superhighway); greater linkage between SMEs and large enterprises (creating the missing middle); and industry clusters for critical mass. Considering the reluctance of government bureaucracies for reform in this direction, the participation of UNIDO will be most necessary.

22. The session emphasized that SME development starts with human resource development, especially in entrepreneurship development and the proper orientation and attitude.

23. Countries should guard against erecting barriers to entry, which would prevent potential entrants which could add to the vitality, creativity and innovativeness of the small and medium enterprise sector.

24. Experience and case studies suggest that improvements in governance, especially deregulation, have the greatest effect on the success of SMEs.

25. As economies liberalize, the greatest threat to SMEs is in the area of distribution systems, where SMEs in the developed economies are more adept than those in the developing countries. Case studies, research and training by international organizations, like UNIDO, would assist SMEs in the developing countries to hold their own in domestic markets and enable them to venture successfully in the global market.

26. In a globalized economy, greater attention should be given to provide SMEs the resources and capabilities to be successful in the services sector, information technology and e-commerce. Support could be given to SMEs to go into "branding" and acquire latest, not second-best, technology.

27. Given the magnitude of the challenges of globalization and the inadequacies of individual economies, the role of regional bodies in SME development has been magnified. International organizations and regional bodies should complement their efforts in this respect.

28. Given the higher levels of sophistication and logistical support required by institutional mechanisms to assist SMEs in becoming world-class, IT proficient organizations in a highly competitive global setting, the possibility of regional cooperation leading to regional institutes rather than national centers should be explored.

## Strategic Vision and Industrial Policies for the New Millennium

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*Moderator:* Rakesh Mohan  
*Paper-presenter:* Sanjaya Lall  
*Panelists:* Ajit Kumar  
Christine Wallich  
Huijiong Wang

1. Thinking on “Industrial Policy” has undergone a great change over time. The session felt that industrial policies in the future would have to be much broader than they have been in the past. Earlier thinking on industrial policy had been too narrow and was often focussed on specific sectors and sometimes — even firms. Such policies will no longer be appropriate in the new global environment. There was general agreement that the new thinking on industrial policy will have to be centered on the notion of competitiveness.
2. There was broad agreement that sound macroeconomic policies were essential for sustained industrial development. The minimum preconditions for putting in place strategic industrial policies required specific attention to sound macroeconomic conditions. The maintenance of appropriate fiscal balance and flexible and realistic exchange rates, open trade policies and the like are now recognized as the standard constituents of appropriate macroeconomic policies.
3. The session felt, however, that thinking on industrial policy had to go further and that each country would have to articulate its strategic vision for industrialization in the future in order to derive the appropriate industrial policies for the future. The session was strongly of the view that it is not possible to prescribe generalized industrial policies for all developing countries since there is great heterogeneity among them. It is only feasible to arrive at some general principles which can guide each country in designing industrial policies for the new millennium.
4. It was noted that the twentieth century has been a period of rapid change in the manufacturing sector. At the beginning of the century almost all manufacturing capability was centered in Europe and North America. Automobile manufacturing was just beginning; petrochemicals were still to be manufactured; air travel was a distant dream. Over these past hundred years, not only have there been many discoveries and entirely new areas of manufacturing started, there has also been a great spread of industrialization to almost all parts of the world. In the developing world, Latin America, and Southeast and East Asia have developed considerable manufacturing capabilities.

5. The issue for discussion now is how this spread of capability can be continued in the coming century so that the remaining areas of the developing world can also benefit from faster industrialization. How is the pattern of industrial development changing that will necessitate new approaches to continued industrialization? What are the measures that the newly industrialized countries have to take that will ensure that they can retain their competitiveness in the future? What are the challenges that developing countries will face in the coming decades in the area of industrial development? These were the issues that this third session sought to address.

### **Reasons for a New Approach**

6. It was recognized that the global industrial economy has undergone very significant changes in recent years, which necessitates new modes of thinking. Four major reasons were suggested why a new approach to industrial policy would be necessary in the future:

#### ***Accelerating pace of technical change***

7. The pace of technical change has accelerated considerably so that the acquisition of manufacturing capability is not enough. What is now required is the capacity to change and upgrade on a continuous basis to be able to keep up with the competition. "The way forward is not to rely on free markets to make use of existing endowments but to create new endowments and distribute them better". The new pattern of competition is based on acquired knowledge rather than the existing factor endowment. Thus any industrializing country has to focus on the means of knowledge creation and maintenance if it expects to compete in the new knowledge based world.

8. Technological change in information technology has made the flows of information much faster so that the costs of acquiring simple technologies are becoming increasingly lower and are becoming more easily accessible. Similarly, information technology has made the flow of capital also much faster across borders enabling the creation of manufacturing capital at a rapid pace whenever manufacturing capabilities become evident at a particular location. There have been remarkable falls in both transportation and communication costs. Consequently, the natural protection afforded by distance is no longer available to developing countries.

9. There is also the emergence of new organizational structures that are aiding the spread of manufacturing, but in a concentrated manner. Some of the newly successful countries or regions in terms of industrialization are those which have created dense technological and productive networks such as industrial clusters, industrial districts, business alliances, outsourcing mechanisms and the like. Such organizational arrangements have enabled the achievement of significant productivity enhancement through major reductions in costs. The session felt that promotion of such new organizational structures in developing countries will help greatly in aiding the competitiveness of their industries.

10. One of the key insights discussed in the session related to the rising share of knowledge based manufacturing. The main consequence of greater knowledge based manufacturing is that a higher proportion of value addition in goods is now taking place outside the core areas of manufacturing. This kind of value added can be characterized as being high on “information content”. Upstream activities such as R&D and design, and downstream activities such as marketing and advertising add considerably to the basic manufacturing value added. It is therefore not enough to just manufacture: if industrialization in a country has to be successful then it has to acquire capability in these areas as well. The creation of these skills would then constitute an important component of new approaches to industrial policy.

11. Thus thinking on appropriate industrial policies for the future has to be much broader than it has been in the past. Education policy, labour policy, technology policy and the like all need to be considered within the broad framework of a strategic vision for industrial development. The session noted in particular that the achievement of low cost through low wages is no longer enough as it was for the rapidly industrializing countries in South East Asia in the 1970s and 1980s. The achievement of quality, flexibility, design, reliability and marketing are now more important.

### *Globalization of production*

12. The session recognized the importance of the different forces that have been unleashed by globalization. With the drastic fall that has taken place in both communications and transportation costs, the production base of different products is also shifting much faster than before. With the increase in competition, each enterprise, particularly the multinationals, has to be very nimble in shifting base as the need arises to attain higher levels of competitiveness. One of the consequences of globalization is that multinational corporations have assumed even greater importance as carriers of technological innovation.

13. Although manufacturing is far less concentrated than it was in earlier times, the spread into developing countries is however very concentrated in a few countries and regions. Foreign direct investment has flowed in much greater volumes towards developing countries in the 1980s and 1990s, but this has also been very concentrated in a very small number of countries. Thus developing countries have to be much more conscious of the capabilities they need to acquire in order to attract the kind of FDI they would like to aid in their industrialization efforts.

14. However, the session felt that the entry of FDI in any country has to be calibrated to the needs of that country. The greatest benefits from FDI can be gained if it is seen as part of a broader strategic industrial vision and that other complementary policies related to education, technology and trade are designed in accordance with this vision. The absence of such a vision can often lead to footloose FDI, which moves as the wage advantage disappears and no lasting benefits of FDI are then observed. A view was expressed that “Globalization should be adopted gradually and equitably”. However, there was general agree-

ment that no sustainable industrial development can now take place unless it is adequately linked to the global industrial economy.

### *Policy liberalization*

15. The session noted that the greatest change that has taken place over the last two decades is the all round liberalization that has occurred in trade and industrial policies. This has happened both due to the completion of the Uruguay Round, which has affected the trade policies of developed and developing countries alike, but also because of the widespread influence of the IMF and the World Bank through the many stabilization and structural adjustment programmes that have been carried out in developing countries during this period.

16. The consequence is that there is an intensification of competition through freer trade, easier entry of both domestic and foreign enterprises, and through greater flexibility in both labour and capital markets. In fact, some problems have been caused by the lack of adequate reforms in factor markets commensurate with the freeing up of product markets. In theory, greater competition should lead to the attainment of greater efficiency, but this does not always happen.

17. The session noted with great concern that there could be some danger of deindustrialization under the pressure of greater competition. It was felt that this danger must be recognized and adequate measures must be taken through institutional development designed to build the skills required for attaining higher levels of efficiency. Thus the session felt that, whereas policy liberalization is now a fact of life and that it has to be welcomed, each country has to consciously design complementary policies so that its domestic industrial base is not adversely affected by the forces of liberalization.

### *New rules of the game*

18. The session noted that the world has also changed in terms of the enforcement of a greater number of international norms through new multilateral agreements. Some of the policy measures used in the past are no longer feasible because of the enforcement of these new agreements. Protection of infant industries, export subsidies, local content rules, selectivity in FDI inflows and similar measures are no longer acceptable. Thus developing countries do not have as many tools of industrial policy as some of the recently fast industrializing countries had in recent decades. Thus the emphasis has to be much more on building a greater absorptive capacity for technology and knowledge in general.

19. Another consequence of the new rules of the game is that firms have to practice much greater transparency in their practices of corporate governance. Firm level labour policies, environmental policies, civic practices, and the like, all come under the gaze of international organizations and NGOs in different ways. Finding international benchmarks and then adhering to them will also be helpful in achieving competitiveness in the new world.

20. Based on the above four changes in the world economy, the session con-



cluded that the new approach to industrial policy therefore has to concentrate on building broad capability to cope with the accelerated pace of technical change and globalization. Assistance for technical and skill development will have to be the cornerstones of such policies.

### **Patterns of Competitiveness**

21. The session examined patterns of competitiveness and agreed that the best indicator of competitiveness of a country could be found in the pattern of growth of its manufactured exports. The discussion was anchored around the background paper, which analyzed exhaustively the pattern of world growth in exports in the 1980s and 1990s. The session paid particular attention to exports of east and South Asian countries in analyzing indicators of competitiveness. Manufactured exports can be classified into four categories, resource-based, low technology, medium technology, and high technology exports.

22. The basic conclusions reached were as follows:

- World trade grew at very high growth rates during the period 1985-95, with growth being slower during 1980-85, and particularly slow after 1995.
- Developing country share in manufactured exports grew from about 10 percent in 1985 to about 25 percent by 1995.
- The fastest growing category of exports was of high technology products. This was true of developing countries also.
- However, East Asia accounts for most manufactured goods exports among developing countries. Its domination of high technology exports is even greater.
- South Asian exports were concentrated in the resource-based and low technology categories. Overall, resource-based products have lost in share to high technology products, whereas low technology and medium technology products have grown at about the overall average rate.

23. The session analyzed the reasons for success of each of the successful exporting countries. There was no one strategy that was found to characterize the different countries examined:

- Korea and Taiwan have emphasized the development of domestic skills and capabilities, which has enabled them to succeed in a strategy of technology accumulation.
- Singapore and Malaysia have used an FDI driven strategy to attain the capability for exporting manufactured goods.
- Indonesia, Thailand and China have used the FDI driven cheap labour strategy for expanding their manufactured exports.

- South Asian countries, India, Pakistan and Bangladesh have essentially used cheap labour driven import substituting strategies and not succeeded in attaining high export growth rates. To some extent, China has also used this strategy.

24. The session concluded that the main lesson to be drawn from this exercise is that, in the new circumstances, a strategy that emphasizes technology acquisition and skill upgradation is likely to be much more successful in the future. Technology based products are less vulnerable to price competition, to changes and exchange rates and the like and are therefore likely to be more stable. FDI based strategies will also not be successful in the long run if they are based solely on cheap labour since that advantage is lost as soon as wages start rising and the enterprises move to a new location. Investment in skill and technology absorption is also necessary if the FDI based strategy is to be successful in the longer run.

### **Role of Industry in the New Millennium**

25. The session noted that, with the increase in share of service activities in most countries, there are some who argue that industrial development is no longer essential for a country's development. In some countries, such as Hong Kong and Singapore, it may well happen that manufacturing activity declines very substantially and that they specialize in service activities of a high value added nature using high technology in the delivery of these services. However, most other developing countries will find it difficult to attain the skills necessary for specializing in services without going through the capability building experience of industrial development.

26. The session strongly felt that manufacturing will continue to have a large role in the development process. The transformation from low productivity agricultural activities to higher productivity activities takes place most easily first through simple manufacturing activities. The process of industrialization creates new skills, organizational and management capabilities, and scientific and technological skills. Manufacturing activity is also necessary for creating the employment opportunities necessary for weaning away people from the traditional agricultural activities.

27. The approach to industrialization will, however, have to change from the traditional import substituting one to that of achieving competitiveness in whichever sectors that emerge in this industrialization process. The basic incentive regime required for achieving competitiveness is now well accepted: macroeconomic stability, a realistic and flexible exchange rate policy, openness to trade, relatively free technology and capital flows, appropriate norms of corporate governance, constitute the basic framework for a progressive industrial policy. But these necessary components of policy are not sufficient. Care needs to be taken to open markets in such a manner that the economy is not excessively disrupted. Appropriate institutions are necessary for free markets to operate efficiently.

28. Industrial development in the future will need action in the following areas:

- Greater openness to FDI will be necessary in the future. FDI was regarded with suspicion in the past. This is no longer justifiable. The attainment of higher technological capability will be aided substantially by greater openness to FDI but this will have to be complemented by other measures.
- Support instruments will need to be designed to induce continuous technological development in domestic and foreign enterprises alike.
- With need for continuous technological upgrading, policies for skill development will be necessary. Thus educational policies for skill development will become an integral part of industrial policy.
- The technical change taking place internationally owes greatly to the changes that have taken place in telecommunications and information technology. Thus an integral part of progressive industrial policy will have to be investment in these areas.
- With open trade in products having become the norm and broad price equalization in the process of being achieved, it is the price of infrastructure services which will determine the comparative advantage of different countries. Thus investment in infrastructure will have to be part of the broad strategic vision for industrial development. Competitiveness of the industrial sector will become increasingly dependent on the efficiency of infrastructure services. Reduction in transport costs, communication costs and the like will be crucial. With the increasing role of the private sector in the provision of infrastructure services, new infrastructure will have to be designed in such a way that private investment in infrastructure is done in such a way that it brings broad benefits to the industrial economy.

29. In summary, future policies for industrial development will need to shift from the traditional narrow focus on import substitution to broader policies designed to enhance all round competitiveness.

### **Future Industrial Strategy**

30. In view of the foregoing, the session concluded that future industrial strategy would have to be based on the following four main areas of action:

#### ***Technological development***

31. Programmes would have to be designed for continuous technological development that is appropriate for the country concerned. There is a popular misconception of R&D activity being mainly for the purpose of making new inventions. In fact, a good deal of R&D activity is necessary adaptation of existing technologies, for absorption of foreign technologies, for continuous improvement of existing manufacturing processes and for incremental learning. Programmes and incentives in developing countries have to be designed so that all these activities are encouraged in different ways. There are many examples available from different countries such as Korea, Taiwan, India, Brazil, Malay-

sia, United Kingdom, Singapore, and the like. Each example is different from the other and there is much to learn from each.

32. An often-neglected method of encouraging technological development is the setting of standards, which aims at improving the level of technology among all manufacturers. Similar are the practice of benchmarking and the documentation of best practice. Such activities are particularly important for small and medium enterprises that typically do not have the resources to invest in these activities themselves. Experience in different countries suggests convincingly that such activities be best carried out in a cooperative manner between government institutions and private enterprises through appropriate institutions, rather than using top down approaches for technical development. Specific efforts must be made to link research institutions with technology-based enterprises.

### *Skill formation*

33. The attainment of technological capability is crucially dependent on the development of appropriate skills at every level of the labour force. As the pace of technical progress accelerates and as competition increases, specialized state of the art skills become more crucial for industrial development. The first necessity is to ensure a minimum level and quality of basic education that obviously forms the base of the whole education system. Many developing countries still do not have adequate levels of basic literacy.

34. Now even the simplest areas of manufacturing presuppose the existence of basic literacy among the workers. Ensuring this basic minimum is the first task. But this will not be enough in the future. Much greater attention will have to be paid to the provision of technical education at different levels so that the skills of workers entering industry are such that they can attain high levels of efficiency. Moreover, workers in the future will require continuous programmes in enterprise training. Thus their basic abilities will have to be such that they are capable of absorbing such training throughout their careers. In enterprise, training is largely absent in most developing countries. But countries such as Korea and Malaysia are giving increasing attention to providing incentives to enterprises to provide in-house training to their workers.

35. Examination of the data suggests that the countries that are giving greater attention to skill development are progressing better in their quest for continuous industrial development. A particularly important area for attention is that of vocational training of school leavers. Many different types of vocational training systems are found in different countries around the world. The most successful systems can be characterized as "cooperative" systems, mainly found in the North European countries of Germany, Switzerland and Austria and increasingly in Latin American countries. These systems are based on the formation of social partnership between the government at different levels, enterprises, industry associations and the trainee. Such social partnership results in co-financing of the costs of training, widely acceptable certification of training and cost effectiveness in the whole system of training.

36. Partnership also results in the imparting of relevant training as distinguished from government dominated systems which rapidly lose touch with the kind of skills that are actually demanded by the market. Developing countries would do well to examine the different systems that are prevalent and then devise systems appropriate to their requirements.

#### *Foreign direct investment*

37. It is found that multinational corporations increasingly account for a large proportion of all international trade: almost two thirds of all world trade. Countries that are not hospitable to FDI would therefore lose substantial opportunities in participating actively in world trade. A good deal of world trade is intra firm among the different arms of the multinationals. The entry of multinationals therefore helps developing countries to participate in a particularly dynamic segment of world trade.

38. But FDI has so far been very concentrated in a few countries, largely those that provide hospitable regimes and conducive environments for investment. Although it is advisable to have open policies towards FDI, they should not be merely passive. The appropriate use of incentives (though not excessive tax giveaways), factor market interventions, and the expression of progressive visions of industrial strategy all help in attracting the most beneficial kind of FDI.

#### *Incentive systems*

39. The new paradigm will necessitate much greater market openness than before in terms of the trade and industrial policy regime. But the way forward is not to rely on free markets to make use of the existing endowments but to create new endowments and distribute them better.

### **Creating the Right Conditions for Progressive Industrial Policy**

40. The background paper prepared for the session had placed technology and skill development at the centre of future industrial strategy for developing countries. Discussion in the session suggested that there are other broader policy issues which also need to be addressed for healthy development of the industrial sector. Mention has already been made of the importance of appropriate macro-economic policies as a backdrop for industrial policy making. The discussion focussed on the following other areas of policy action which were thought to be important for ensuring healthy industrial development.

41. *Development of a long term vision:* The session noted that each country has different objective conditions and factor endowments. Countries are also found to be at different stages of development. It was therefore deemed important that each country prepared for itself a long term vision which can then guide its industrial policy. Such a vision would be based on the recognition of the existing conditions but should set out the strategy for changing these conditions for progressive industrial development.

42. *Capital markets and financial sector:* The session discussed the importance of the capital market and financial sector failures in relation to the East Asian crisis. The development of healthy practices in banking and in the capital market should be given much greater importance for aiding healthy and sustained industrial development. Crony capitalism must be avoided so that difficulties such as the East Asian crisis do not arise.

43. *Small and medium enterprises:* Although the forum had discussed issues related to the development of small and medium enterprises in a different session it was felt that future industrial policy should give special attention to the promotion of small and medium enterprises since they are incubators of industrial entrepreneurship. Here also the importance of skill and technology development was explicitly recognized and emphasized.

44. *Corporate governance:* The rapid changes resulting from technical change and globalization imply the need for continuous industrial restructuring. Thus rigidities in corporate ownership and operations must be avoided. Where industrial reorganization or bankruptcy is necessary, the legal and regulatory system should be designed so that such restructuring can take place. This requires attention to be given to appropriate legislation in terms of bankruptcy law and procedures and appropriate design of company law to aid in corporate governance.

45. *Factor market flexibility:* The session also recognized the importance of factor market flexibility in promoting healthy industrial restructuring on a continuous basis. It was observed that in many countries various rigidities in labour policy and social security provisions make it difficult for labour to move in response to changing circumstances. Industrial strategy in the future will therefore also involve the evolution of a flexible labour policy which promotes labour movement but nonetheless provides for adequate social security for the affected labour. The existence of effective bankruptcy laws and procedures and an active capital market would make capital mobility feasible as well.

46. *Infrastructure investment:* As mentioned earlier, the session noted the importance of efficiency in infrastructure as a core element leading to competitiveness. Even if core manufacturing activities are efficient, a country's manufactured product can become uncompetitive by the addition of excess transport and other handling costs arising from poor infrastructure provision. It was felt therefore that a strategic vision for industrial development should incorporate a corresponding vision for infrastructure development as well, incorporating effective programmes for investment in infrastructure through public-private partnerships.

### **Role of UNIDO**

47. The wide ranging discussion in the session indicated the continuing need for industrial policy making in developing countries even though the new kind of industrial policy would be quite different from what used to be known as industrial policy. It was felt that UNIDO could help greatly in the formulation of a strategic vision in industrial development in different countries and in the fram-

ing of the new wave of industrial policy as the need arises. Key components of UNIDO assistance could include the following:

48. *Analysis of competitiveness:* The designing of strategic vision in any country would need to be preceded by an exhaustive analysis of competitiveness of its industrial sector. Such analysis can then help in making choices and assigning priorities among the vast range of policies mentioned above which can aid in industrial development. UNIDO should assist developing countries in such analysis.

49. *Sectoral competitiveness strategies:* The competitiveness analysis mentioned above can lead to the design of specific strategies for different sectors which are seen as having the potential of being competitive in the future. UNIDO could assist in the preparation of such sectoral strategies and in designing a general framework for such strategies.

50. *Benchmarking:* There is now a growing literature on benchmarking as well as practical experience of firms being able to improve their efficiency and competitiveness through benchmarking best practices. UNIDO could make a significant contribution to such activities by launching a programme for benchmarking of industrial sectors relevant for different sets of developing countries. Country programmes can then be designed to help firms adopt such benchmarks for improving their efficiency and competitiveness. Benchmarking can be used as an important vehicle for technological development at the firm level.

51. *Improvement of technological infrastructure:* Apart from the promotion of R&D activity, an important contributor to technological development can be the adoption of industry standards and the setting up of competent standards institutions. Since developing countries are importers of technology they can benefit greatly from the availability of industrial standards. Diffusion of standards information and procedures for certification would aid greatly in progressing technical development at the firm level. UNIDO programmes could help in this process.

52. *Support for small and medium enterprises:* In many developing countries most industrial enterprises are of a size not different from what are regarded as small and medium enterprises in the developed world. UNIDO has considerable experience in the observation of different policies for SME support in different countries. The session felt that UNIDO could make a significant contribution in compiling best practices in industrial support policies particularly related to technology and skill development in small and medium enterprises.

53. *Technology finance:* Since the analysis of the competitiveness has revealed the importance of technological development on a continuous basis, it is essential that arrangement should be made for the financing of technical development at the firm level in developing countries. This requires attention to building institutions which could both help in diffusion of technology and the financing of technology development. UNIDO could compile the experience of best practices in this area also and therefore assist developing countries in the development of such institutions.

54. *Enterprise training of workers:* Continuous industrial restructuring and technology development is not possible without skilled development of workers already employed in industrial enterprises. Most developing countries do not have programmes and practices through which workers have the opportunity of upgrading the skills while they are employed in industrial enterprises. Experience in developed countries shows that there is a wide variety of programmes and methods by which skill development takes place within enterprises. UNIDO could make a significant contribution in this area by increasing the importance of this issue in developing countries and by documenting and diffusing best practices in the area.

55. In conclusion, the session was of the strong view that the development of a strategic vision for industrial development will require considerable activities on the part of governments even though such activities would be quite different from the kind of industrial policies practiced in the past. The pace of change in the industrial world has accelerated considerably particularly due to technical change and faster communication. UNIDO as an organization will also have to keep up with such change and adapt itself to be able to assist developing countries in the future.



## **ANNEXES**

## LIST OF PARTICIPANTS

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### Government Representatives

1. Mr. Ou Orhat  
Undersecretary of State  
Ministry of Planning  
*Cambodia*
2. Mr. Huijiong Wang  
Vice President of Academic Committee  
Development Research Centre of State Council  
*China*
3. Mr. Ajit Kumar  
Secretary, Department of Industrial Policy and Promotion  
Ministry of Industry  
*India*
4. Mr. Agus Tjahajana  
Director General for  
Metal, Machinery, Electronics and Multifarious Industries (ILMEA)  
Ministry of Industry and Trade  
*Indonesia*
5. Dr. A. Kermanshah  
Deputy Minister of Industry for Research and Technology  
Ministry of Industry  
*Iran*
6. Dr. Souphanh Keomixay  
General Director  
State Planning Committee  
National Economic Research Institute  
*Lao People's Democratic Republic*
7. Mr. Abdul Razak Hj. Ramli  
Director  
APEC and Regional Cooperation  
Ministry of International Trade and Industry  
*Malaysia*

8. Mr. Hamdun A. Hameed  
Deputy Minister  
Ministry of Planning and National Development  
*Maldives*
9. Mrs. Baldan Chimedtseren  
Head of Industry and Trade Office  
Department of Strategic Planning and Integrated Policy  
Ministry of Agriculture and Industry  
*Mongolia*
10. Mr. U Thein Tan  
Rector  
Department of Advanced Science and Technology  
Ministry of Science and Technology  
*Myanmar*
11. Dr. Bimal Prasad Koirala  
Special Secretary  
Ministry of Finance, His Majesty's Government of Nepal  
*Nepal*
12. Mr. Muhammad Iqbal  
Deputy Secretary (Investment)  
Ministry of Industry and Production  
*Pakistan*
13. Mr. Melito S. Salazar Jr.  
Member of the Monetary Board  
Central Bank  
*Philippines*
14. Mr. Roy Jayasinghe  
Additional Secretary  
Ministry of Industrial Development  
*Sri Lanka*
15. Mr. Manu Leopairote\*  
Director General  
Department of Industrial Promotion  
Ministry of Industry  
*Thailand*
16. Mr. Thamnu Vasinonta  
Deputy Permanent Secretary for Industry  
Ministry of Industry  
*Thailand*

17. Mr. Le Dang Doanh  
President  
Central Institute of Economic Management (CIEM)  
Ministry of Planning and Investment  
*Viet Nam*

### **Private Sector Representatives**

1. Prof. Shou Zhang  
President  
China International Cooperation Association of SMEs  
*China*
2. Ms. Shashi Singh Choudhary  
Chairperson  
Consortium of Women Entrepreneurs of India  
*India*
3. Mr. Iman Sucipto Umar  
Secretary General  
Indonesian Chamber of Commerce and Industry (KADIN)  
*Indonesia*
4. Mr. Fazal Ur-Rehman Dittu  
President  
Federation of Pakistan Chambers of Commerce and Industry  
*Pakistan*
5. Mr. Benigno M. Ricafort  
Director and National Chairman, SME  
Philippine Chamber of Commerce and Industry (PCCI)  
*Philippines*
6. Mr. Padma Jyoti  
Vice President  
*SAARC Chamber of Commerce and Industry*
7. Mr. Khemdhat Sukondhasingha  
Secretary-General  
The Federation of Thai Industries  
*Thailand*
8. Mr. Pana Janviroj  
Editor  
The Nation  
*Thailand*

9. Mr. Vu Tien Loc  
General Secretary  
Vietnam Chamber of Commerce and Industry  
*Viet Nam*

#### **Academics/Paperwriters**

1. Dr. Rakesh Mohan  
Director-General  
National Council of Applied Economic Research  
*India*
2. Dr. Mohamed Ariff  
Executive Director  
Malaysian Institute of Economic Research  
*Malaysia*
3. Dr. Sung-Hee Jwa\*  
President  
Korea Economic Research Institute  
*Republic of Korea*
4. Prof. Sanjaya Lall\*  
Professor  
University of Oxford  
*United Kingdom*

#### **International/Regional Organizations**

1. Dr. Christine Wallich  
Director  
Infrastructure, Energy and Financial Sector (West)  
*ADB*
2. Dr. Suthad Setboonsarng  
Deputy Secretary-General  
Economics, Industry and Trade matters  
*ASEAN Secretariat*
3. Mr. B.P. Dhungana (Mr. M. Proksch)  
Officer-in-Charge, a.i.  
Industry and Technology Division  
*ESCAP*
4. Mr. Natsuki Hiratsuka (Mr. Romeo A. Reyes)  
Regional Representative, a.i. in Thailand  
*UNDP*

5. Mr. Konji Iwaguchi  
President  
*Japan International Cooperation Agency (Thailand Office)*
6. Mr. H. Kuwata  
President  
*Japan External Trade Organization (Thailand)*

## **UNIDO**

1. Mr. Carlos Magariños  
Director-General
2. Mr. N. Mohanty  
Managing Director  
Field Operations and Administration Division
3. Mr. Jang-Won Suh  
Director  
Asia and the Pacific Bureau
4. Mr. G. Robyn  
Director  
Statistics and Information Networks Branch
5. Ms. Judith Evans  
Sr. Adviser to the Director General on Public Information
6. Mr. Chin-Pen Chua  
Field Operations Officer  
Asia and the Pacific Bureau
7. Ms. Nancy da Costa  
Sr. Secretary  
Asia and the Pacific Bureau

*\* Paperwriter*

## PROGRAMME

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**Thursday, 23 September 1999**

08:00-09:00 Registration

***Inaugural Session***

09:00-09:40 Opening of the Forum:

- H.E. Chuan Leekpai, Prime Minister, Kingdom of Thailand
- Mr. Carlos Magariños, Director-General, UNIDO

09:40-10:00 Coffee break

***Session I: The Asian Crisis: Implications for industry and industrial policy in Asia and the Pacific***  
**Moderator: Dr. Mohamed Ariff, Malaysia**

10:00-10:30 Paper Presentation by Dr. Sung-Hee Jwa, Republic of Korea

10:30-11:30 Discussion by panelists:

- Mr. A. Tjahajana, Indonesia
- Mr. B. M. Ricafort, Philippines
- Mr. P. Jyoti, SAARC CCI, Nepal
- Mr. P. Janviroj, The Nation, Thailand

11:30-13:00 General discussion among participants

13:00-14:30 Lunch: Hosted by Director-General, UNIDO

***Session II: Industrial reform to enhance industrial competitiveness: Implications and strategies for SME development***  
**Moderator: Dr. Melito S. Salazar Jr., Philippines**

14:30-15:00 Paper Presentation by Mr. Manu Leopairote, Thailand

15:00-16:00 Discussion by panelists

- Mrs. S.S. Choudhary, India
- Prof. S. Zhang, China
- Mr. N. Mohanty, UNIDO
- Mr. K. Sukondhasingha, Thailand

16:00-16:30 Coffee break

16:30-18:00 General discussion among participants

18:30 Dinner: Hosted by the Government of Thailand

**Friday, 24 September 1999**

***Session III: Strategic vision and industrial policies for the new millennium***

**Moderator: Dr. Rakesh Mohan, India**

09:00-09:30 Paper Presentation by Prof. Sanjaya Lall, United Kingdom

09:30-10:30 Discussion by panelists  
- Mr. A. Kumar, India  
- Mr. H. Wang, China  
- Ms. C. Wallich, ADB

10:30-11:00 Coffee break

11:00-12:30 General discussion among participants

12:30-14:00 Lunch

***Concluding Session***

**Moderator: Mr. N. Mohanty, UNIDO**

14:00-14:30 Presentation by Mr. G. Robyn, Director, Statistics and Information Networks Branch, UNIDO:  
Preview of the upcoming Industry Forum of UNIDO

14:30-16:30 Adoption of recommendations:  
- Session I : Dr. Mohamed Ariff  
- Session II : Dr. Melito S. Salazar Jr.  
- Session III : Dr. Rakesh Mohan

Conclusion

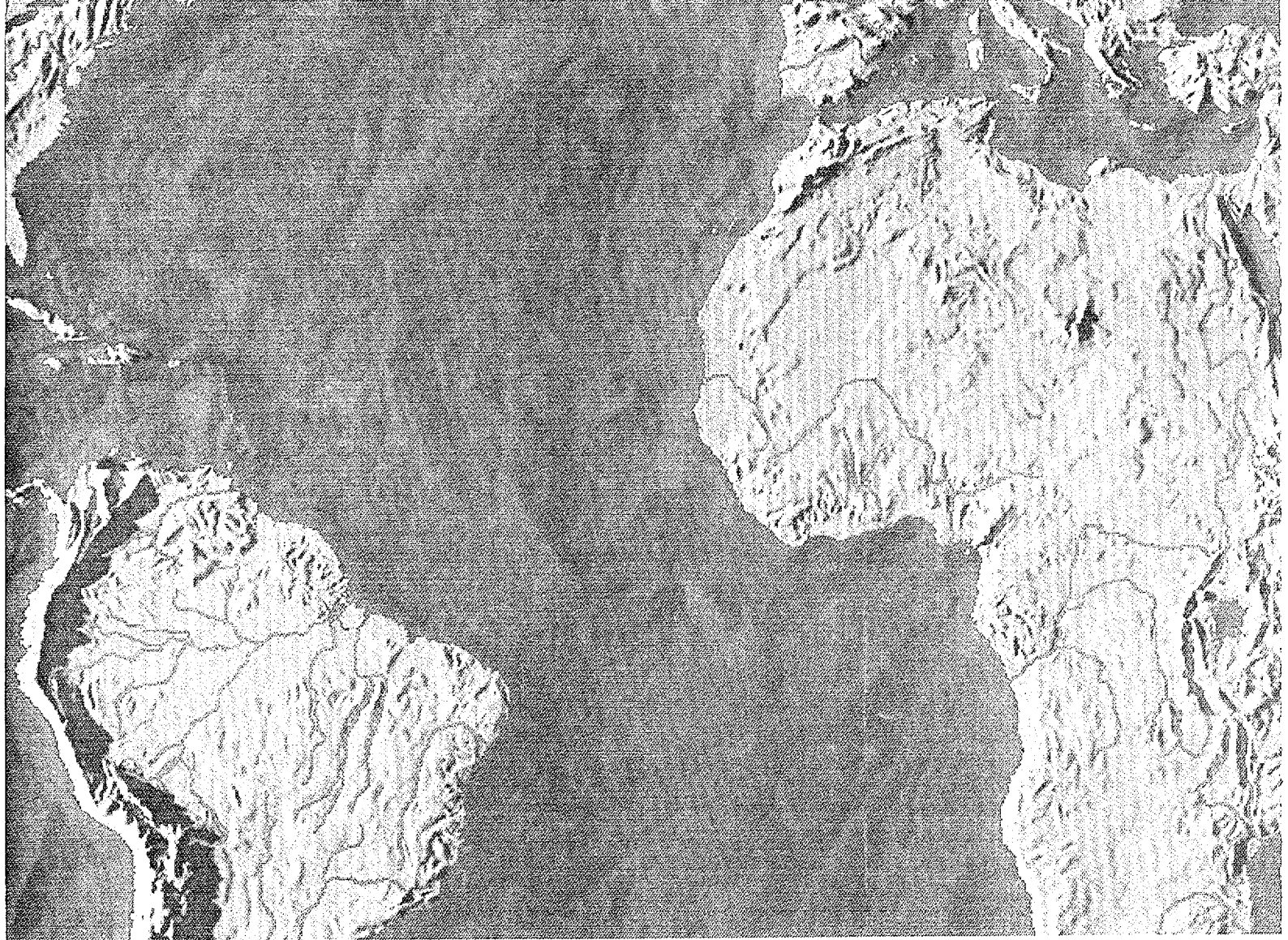


## List of Abbreviations and Acronyms

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The following abbreviations and acronyms are used in this publication:

ADB	Asian Development Bank
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South East Asian Nations
ESCAP	Economic and Social Commission for Asia and the Pacific
FDI	Foreign direct investment
GDP	Gross domestic products
IMF	International Monetary Fund
IT	Information technology
MNC	Multi-national corporation
MVA	Manufacturing value-added
NGO	Non-governmental organization
NIC	Newly industrializing country
R&D	Research and development
SAARC	South Asian Association for Regional Cooperation
SME	Small and medium enterprise
UN	United Nations
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization



*For further information about the Forum, please contact:*

Mr. J. W. SUHI  
Director, Asia and the Pacific Bureau  
Field Operations and Administration Division  
United Nations Industrial Development Organization (UNIDO)  
Vienna International Centre  
P.O. Box 300, A-1400 Vienna, Austria  
Telephone: (+43-1) 26026-3370/3957, Fax: (+43-1) 26026-6321  
E-mail: [Jsuhj@unido.org](mailto:Jsuhj@unido.org)