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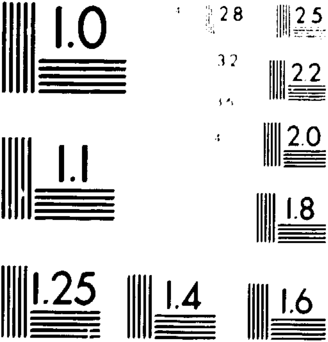

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(ANSI and ISO TEST CHART No. 2)

14638-E

Distr.
LIMITED

ID/WG.439/3
10 May 1985

ORIGINAL: ENGLISH

United Nations Industrial Development Organization

Meeting of High-Level Experts
on Africa's External Debt in Respect of
the Industrial Sector

Vienna, Austria, 14 - 17 May 1985

EXTERNAL DEBT AND THE INDUSTRIAL SECTOR IN AFRICA:

OUTLINE OF AN APPROACH

Prepared by

the UNIDO Secretariat

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V.85-25998

I. INTRODUCTION

1. The purpose of this note is to provide a brief description of a project now in progress within UNIDO on the relationship between external debt and the industrial sector in Africa.

2. The project is obviously of direct relevance to the broad topic of the meeting. Since, however, the actual work on this project has only recently started, the note can just outline the main objectives and the approach used and attempt to single out the key issues which the project is addressing itself to.

II. BACKGROUND

3. Africa is in the confluence of several major crises. Those crises interact and deterioration in one field makes problems still more acute in others. The project tries, within the context of generalized crisis, to concentrate on two interrelated problems, viz external debt and the industrialization of Africa. In plain language, the project asks the question: what has been the impact of the particular pattern of the past industrialization process? This question leads to another and more fundamental one: By which approach would it be possible to put into practice in some African countries a process of industrialization which would contrast the pattern followed in the quarter of century since independence in that it provides the basis for sustained socio-economic growth and would not be a permanent drain on meagre foreign exchange resources?

4. The concern over the design and implementation of industrialization strategies and plans aiming at utilizing domestic resources and building up a viable structure has been an ever present issue of development planning in Africa since the early 1960s. Yet throughout those plans have tended to be composed of separately conceived industrial investment projects and their implementation has been intimately linked to the availability of foreign exchange. The projects foresaw or finally required foreign inputs not only covering the provision of investment funds (used to purchase consultancy services, civil engineering, capital equipment and machinery) but also on-going costs of operations (purchase of intermediate inputs and use of expatriate manpower). Industrialization in Africa in the post-independence period has thus been largely tied to foreign exchange availability and that availability has always been circumscribed both in quantity and conditions.

5. The acute debt crisis has meant a crisis for industry built up under these conditions and with assumptions that proved to be subject to drastic revisions, as a result of major changes in international economic environment during the beginning of the 1980s. The shortfalls in prices of primary commodities, which have always represented the only element of 'autonomous' foreign exchange earning capabilities for African countries, the dramatic increases in the value of the dollar (the currency in which a large proportion of foreign exchange transactions are denominated) the substancial rises in real interest rates, and the growing reluctance of donor agencies to provide foreign exchange on the same scale as in the past have all led to an acute worsening of the debt situation and of the manufacturing production.

6. It is against that backcloth that the industrial sector has now come under sharp scrutiny. Since it is seen as the sector with inherent features of an absorber of foreign exchange without generating any, the reaction of many influential groups both within and outside Africa has been to advocate that from now on manufacturing industry be cut back so as to diminish its demand for foreign exchange and to confine itself to those operations where the foreign exchange loss is minimal.

7. This approach begs several key questions. First, by far the major cause of the current debt problem is the result of the international environment rather than the domestic one. It follows that unless the fundamental nature of Africa's relationship with the international economy is altered, other changes will not do more than reduce the total debt burden by minor amounts. Secondly, given the existing conditions the prospects for repaying debt are, in the large majority of African countries, very slim. The situation bears some resemblance to that of Germany after the 1919 Versailles Conference: debt burdens which cannot be repaid given current production capacity and demand requirements in the major creditor nations.

8. Thirdly, while much is made of the need to orient industry towards exports, there is a lack of concrete evidence to show that such projects are in fact possible in more than a handful of cases (and even fewer countries). Consequently, the injunction to move away from import substituting activities towards export-oriented ones cannot, save for

a few instances, be seen as a real option. Fourth, to concentrate on updated versions of the standard division of labour as it affects Africa, i.e. with the continent as an area from which agricultural and mineral resources are extracted and which imports its requirements of industrial goods and services, offers not greater prospects of sustained improvement in living conditions in the mid-1980s than it did at the time of achievement of independence. Indeed, the industrial sector cannot be set aside as the key contributor to long-term development.

III. THE FOCUS OF THE ANALYSIS

9. The research project is aimed at trying to harness evidence relevant to an informed debate regarding the actual role of implemented industrial projects for the present debt burden and the real prospects for an enhanced development of industry considering the foreign debt situation. This means also describing the main characteristics of current industry structures: the import substitution emphasis, the bias towards larger projects with heavy inputs of foreign capital and technology, the involvement of the State and foreign firms as owners of capital, the huge gaps in the inter-industry structure with their consequences for dependence on imported inputs, the narrowness of domestic markets for industrial products due to low income level, the minimal prospects both for intra-African industrial trade and exports outside the region, and the low levels of utilization of existing capacity.

10. The project further seeks to identify the implications and the actual handling of the foreign exchange burden. Tentatively, it can be argued that the existing financial structure means that the public sector debt in fact becomes the critical variable. In these conditions, the pressures imposed on African countries for short-term adjustment thus become part of the long-term situation. As long as the capital investment options of the public sector are cut back and foreign direct investment in industry is small, then there are only two routes through which additional investments can come,viz. private local entrepreneurs or funding from aid agencies. Preliminary results indicate that the prospects in these two directions are not bright. Consequently, the question still remains as to the role of the public sector in future industrial development.

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11. It is against this background that the project attempts, albeit in a necessarily sketchy fashion, to draw some lessons from recent case studies regarding the organization and operation of industrial projects in Africa. It is frequently asserted that the central problem with such projects is that they are badly mismanaged and that a prime reason for such mismanagement is the influence of the public sector. Preliminary findings seem to show that this criticism is but a part of the whole picture. The initial pre-feasibility studies show alarming tendencies to overestimate returns from industrial projects. Since in most cases those studies are conducted by bilateral or multilateral agencies or by foreign firms, questions arise as to reasons for such consistent errors. Furthermore, the frequency with which these projects fail to be monitored and improvements made in them is likewise a reflection of deficiencies in both foreign and African organizations. The project tries to make an initial attempt to specify such difficulties more carefully and suggest ways in which improvements could be made both in Africa and abroad.

12. Recognizing that African industrialization in the next few years will continue to be closely connected with the foreign exchange issue, it is hoped that a first sketch of likely conditions affecting foreign exchange availability can be drawn. In doing so, an attempt will be made to concentrate on identifying possible action which African countries themselves can take to improve prospects in this regard.

13. The key questions the project seeks to focus on can thus be summarized as follows:

- To what extent has the past pattern of industrial investments contributed to the external debt burden of Africa and/or to the problem of debt servicing?

- What was the impact of the organization of industrial investment projects and of the subsequently operating plants?

- What were the main forms of external financing of industrial investment projects and what was their impact?

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- What key assumptions underlying major industrial investments proved to be erraneous?

- How do the interrelated economic problems, in particular the debt burden and the foreign exchange crisis block current industrial production, rehabilitation, modernization and expansion?

- What lessons can be drawn from the past "indebted industrialization" and what forms and modalities could be found to facilitate a resumption of viable industrial growth?

- What internal and external policies and measures could be conceived to facilitate improvement of the current situation and the future organization and financing of industrial investment projects?

IV. THE SCOPE AND APPROACH OF THE RESEARCH PROJECT *)

14. It is the aim of the project to attempt to bring into the international debate and to the intra-African debate on Africa's industry two important contributions:

First, it is attempted to attain the direct linking of the issues of industrial development with the issue of industrial finance. There has been the tendency in the past to separate these two issues institutionally and organizationally. The link needs to be put into focus.

Secondly, it is attempted to bring in new sets of data and a new analytical approach into the debate, so as to provide a more factual basis for conceiving suitable measures and policies.

Against these ambitious goals, it is important that some crucial limitations on the current phase of the research project be emphasized.

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*) "Analysis of the Relationship between Industrial Projects and External Debt in Africa"

First, the work is being conducted in an extremely short time period; the project was begun only in early April and a draft report is required to be ready for the OAU Summit Meeting, which implies completion of the drafting by end-May. Secondly, the time constraint imposes important simplifications of the work; discussions with several key organizations as well as the opportunity to investigate the availability of statistical information have been effectively precluded. Thirdly, the budget for the project is very small and thus does not permit extensive use of commissioned inputs from knowledgeable sources. Fourth, the internal resources which UNIDO is able to assign to the project are limited, and this too curtails possibilities for more extensive work.

15. In view of these limitations, it is expected that subsequent to the submission of a first report, prepared for end-May on the preliminary findings obtained until that time, a further more comprehensive and systematic research phase can be launched.

16. The organization of the work in this current phase can be briefly outlined. The w[illegible]as concentrated on three areas of investigation. First, an attempt to bring together data on the existing debt and industrial situations; in this respect the co-operation of regional and international organizations such as the World Bank, UNCTAD, OECD, Bank of International Settlements, ECA, ADB, Commonwealth and others has been excellent. From such data the project tries to build up a picture of the relationship between industrial projects and foreign exchange inputs. Secondly, an attempt is being made to provide up-to-date synopses of the current prospects as viewed from major OECD donor countries. To obtain such materials, surveys were commissioned in six countries, i.e. Canada, France, the Federal Republic of Germany, the Netherlands, Sweden and the UK. Those surveys endeavour to collect quantitative and qualitative information on the current involvement of public and private capital from those coutnries in African industrialization and the views held there on possible direction of industry in coming years. Thirdly, in-house analysis of aggregate and case study materials with a view to highlighting the major findings and sketching areas for further investigations. This work is supported where possible by discussions with experts in international financial organizations as well as with individuals closely associated with on-going industrial projects in Africa.

V. CONCLUDING COMMENTS

17. The approach sketched here should be viewed with the limitations of the current project in mind. It is hoped that on this basis, the Expert Group can provide valuable advice and suggestions for the report now under preparation and permit the UNIDO Secretariat to ensure that the document reflects the main ideas and the concerns of African policy-makers and institutions on this matter.

18. Moreover, and most importantly, the experts are invited to advise UNIDO on the scope for and approach of the possible continuation of this research work in a second phase and on the appropriate involvement of various African authorities and institutions in this detailed follow-up work.