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# INDUSTRIALIZATION IN THE LEAST DEVELOPED COUNTRIES: THE POTENTIAL ROLE OF DEVELOPMENT PROJECTS IN OTHER SECTORS

V.90 85798

This report was prepared by the Regional and Country Studies Branch.

## PREFACE

As part of its work on regional policy issues, the Regional and Country Studies Branch of UNIDO carries out policy-oriented studies and provides advisory services in key issues of industrial policy that affect groups of developing countries. This includes issues of economic integration, issues in the relationship between technological change and industrial organization and policy, and issues in international co-operation for industrial development. One area of analysis has been the industrialization policies and options of the least developed countries (LDCs). These constitute a group of developing countries whose economic and industrial development is still in its initial stages and whose prospects for future progress are hampered by profound socio-economic difficulties.

The Substantial New Programme of Action (SNPA) for the Least Developed Countries, adopted in 1980 at the Conference on Least Developed Countries, set out a target for the growth rate of manufacturing value added in these countries, which they were to achieve over the following ten years, of an annual average of 9 per cent. In fact, the rate actually attained over the period was of the order of 1.9 per cent, according to recent estimates. Many developing countries experienced growth rates much lower than this, some even being negative.

Ten years after the adoption of the SNPA, it is proposed to hold another International Conference on the LDCs, and this will take place in Paris in September 1990. In spite of the poor performance of the manufacturing sector in LDCs over the present decade, the aspirations of these countries for a new growth in their industry remain. The target adopted in 1980 of a growth rate of 9 per cent on average for the sector does not seem to be regarded as inappropriate: rather the need is seen for more precise and effective instruments, for individual LDCs and for the international community, in order to make greater progress than has been the case up to now. For this reason it is important that the industrial component of any new actions to be agreed on for the LDCs should be carefully prepared and be chosen in a way which is both reasoned and transparent. What is needed is a new and thorough analysis of key areas of industrial policy with respect to the LDCs, so that steps to be taken may be precisely defined and responsibilities clearly allocated.

A number of external issues make the question of industrialization in LDCs a particularly complex one. They include the following:

- The heavy dependence of the economies of LDCs on development assistance (In 1986 it amounted to over 65 per cent of all LDC imports). This means that both the central administration and much of the functioning formal economy is particularly influenced, not to say directly involved with, external influences which are not part of any formal market system but which nevertheless have considerable effect.
- The very small part allocated to industry in this assistance (Only an estimated 2.4 per cent of all multilateral and bilateral ODA commitments in the years 1984 and 1986 went to the combined sectors industry, mining and construction.). This reflects, at least partly,

public perceptions in donor countries that LDCs must have as a priority the assurance of food supplies, the improvement of public health facilities, the reduction of illiteracy, etc.

The first of these problems, the magnitude of external assistance as in some sense a distortion of the economy and a heavy demand on the administration of the recipient country, has been recognized in conscious efforts on the part of the international community to improve aid co-ordination, both multilaterally and at the country level. A further response has been an increased emphasis on assistance to regional groupings among the developing countries, since the administrative overheads may in certain cases be lower with such an approach. However, this has been complicated by the weakness of many of the regional organizations of developing countries and the fact that in some cases their membership includes both LDCs and non-LDCs, or overlaps with that of other organizations. In such cases it may be felt by the donor that the regional approach will be too diffuse and fail to reach the right targets.

The magnitude of external assistance also raises difficulties for the industrial sector if its potential participation is not taken into account. Even though allocations to the industrial sector as such may be small, an assistance programme in sectors such as agriculture, health or education may have an important positive effect on local industry, if this is planned for.

As part of its preparations for the Conference on the Least Developed Countries, UNIDO has identified a number of issues in connexion with the design of successful industrialization strategies for LDCs. These include, in particular, the question introduced above, that of the relationship between manufacturing industry in the Least Developed Countries and development projects in other sectors. The present paper is a preliminary analysis of this question. It has been prepared by Mr. Roger Riddell of the Overseas Development Institute, London, United Kingdom, as contractor to the Regional and Country Studies Branch.

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## 1. INTRODUCTION

One of the reasons for being classified as a member of the "least developed" countries is because of a low share of manufacturing in total output[1]. It is not surprising, therefore, that the level and degree of industrialization in the 42 least developed countries (LDCs) is the lowest in the world. It follows that the scope for utilizing domestic industrial capacity in both capital and recurrent projects in the LDCs - be they initiated by external donor agencies, the state, the private sector or individuals within particular countries - is likely to be severely limited.

What is more, the effects of a small industrial base together with severe economic problems across all productive sectors, minimally-developed infrastructure and the fact that the dominant form of livelihood lies within subsistence agriculture (and in some cases in fisheries), mean that immediate development priorities for the LDCs lie outside the manufacturing sector. This is well illustrated by the allocation of aid money to different sub-sectors and sub-categories: in the period 1984-86, only 2.4 per cent of non-OPEC member official aid commitments, and only 4.3 per cent of that provided by OPEC member countries, were destined for the combined manufacturing, mining and construction sectors[2]. What is more this is an even lower share of aid money to manufacturing than in earlier years of the decade[3].

On the other hand, a predominant characteristic of LDCs is not only a high proportion of foreign aid in overall resources available for development in their economies, but a far higher share than for other developing countries. Thus in 1986, total official development assistance (oda) to the LDCs amounted to 12 per cent of their gross national product (compared to 2 per cent for all developing countries) and to some 92 per cent of total domestic investment. In that year, oda accounted for 65.3 per cent of total imports, compared with a figure of 13 per cent for all developing countries. For 30 out of the 40 LDCs for which data are available, the oda/import ratio was in excess of 50 per cent in 1986, and over 100 per cent for one quarter

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[1]. Specifically a share of manufacturing in total GDP of 10% or less (see the report of the Committee for Development Planning on its seventh session, Official Records of the Economic and Social Council, Fifty-first Session, Supplement Bo. 7 (E/4990), para 60.

[2]. The ratio is higher in particular countries. Thus in Myanmar (Burma) in 1987, 12% of all oda was channelled to industry (Development Co-ordination Report 1987).

[3]. In the period 1981-83, 2.7% of non-Opec member and 5.1% of Opec-member official aid commitments were destined for industry. Additionally, official aid to the LDCs from Arab sources constituted about 10% of all official aid to LDCs in the early 1980s, but less than 5% by 1988; yet 5.1% of Arab aid in the early 1980s was channelled to the manufacturing sector. (See UNCTAD 1989a: Tables A-51 and A-63).

of all LDCs (United Nations Conference on Trade and Development [UNCTAD], 1989a: Table A-22)[4]. What is more, oda accounts today for more than 90 per cent of total external financial flows to the LDCs - up from 72 per cent in 1980. This marked rise in the share of oda is mainly the result of a significant fall in both private foreign investment (accounting for less than one per cent of the total in 1986) and export credits going to the LDCs (Organization for Economic Co-operation and Development [OECD], 1988:30).

What these latter figures point to is the **capacity** for aid funds to influence the pattern of growth and development in the LDCs - and in a far more significant way than would be possible for other groups of developing countries. This in turn suggests that there is a major potential role for aid money to be used in the promotion, expansion, and deepening of the manufacturing sector of the LDCs **over and above the direct use of aid funds** targeted explicitly at industrial sector development - setting up factories, training factory managers and technicians, and drawing up industrial sector plans etc.

This could happen in three principal ways.

* Firstly, where suitable industries are already in existence in an LDC, non-industrial donor projects could purchase domestically-manufactured products rather than obtain them from abroad.

* Secondly, the creation of new industries could be furthered in cases where there is at present no domestic source of manufactures but where information on the demand for manufactured goods arising from a series of planned projects are pooled together and a joint assessment would point to sufficient domestic demand to justify the establishment of local industries[5].

* Thirdly, institutional arrangements, rules and regulations of aid agencies could be designed in a manner which further encourages domestic sourcing of manufactures from the LDCs.

The purpose of this paper is twofold. First, to examine the extent to which these opportunities are exploited for the benefit of manufacturing industry in the LDCs; secondly, to put forward specific proposals for furthering this particular potential for promoting manufacturing development. The next section of the paper examines the available evidence to judge the extent to which aid projects in non-manufacturing sectors in the LDCs do make

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[4]. The oda/import figure for Botswana and the Yemen Democratic Republic was 15% in 1986, followed by 28% for the Yemen Arabic Republic. for all other LDCs, the ratio is in excess of 30%. Other figures in this paragraph are derived from Organization for Economic Co-operation and Development [OECD] (1989a: 308-327).

[5]. There may also be cases where some LDCs might be able to supply goods to aid projects being executed or planned in other LDCs. This possibility is discussed further below.

use of domestically-manufactured goods or exploit the potential provided by aid projects for expanding domestic manufacturing capabilities. It also highlights a series of factors which inhibit local sourcing. Although the paper stresses major data inadequacies, it suggests that sufficient is known to argue that there is a potential for donors further to exploit local sourcing opportunities. In the final section, a series of proposals are made both to address the problem of data-gaps and to indicate how this potential may be further tapped at the local and international level.

## 2. SURVEY OF AVAILABLE INFORMATION

### 2.1 Overview

Projects executed by different multilateral and bilateral agencies in LDCs require a whole variety of different manufactured products, some relatively simple, some more complex. Thus, capital and infrastructural projects would need construction materials such as cement, bricks, cement blocks, concrete, building and roofing materials, glass, putty, window frames, paint, wood, furnishings and fittings. Health projects might additionally require supplies for hospitals and health centres or spray cans for insect eradication, educational projects equipment for schools and colleges of education, agricultural and/or fishing projects equipment and supplies such as fertilizers, pesticides, fishing tackle, boats and related equipment. Then there are the large or complex supporting items such as vehicles, transport and computer equipment, the less complex such as bicycles and parts, as well as the more mundane items such as the food, drink, clothing, medicines, and other consumables of both foreign and domestically-employed aid personnel (permanent and temporary).

In the ideal world, donor projects (particularly the larger ones) would be integrated into and form part of the long term development plan of a particular LDC with progress assessed on an annual basis. Donors requiring manufactured products for their projects would check whether these were available locally before sourcing internationally. They would have available information on domestic sources of supply of items required for particular projects, their price, quality and availability. Equipped with this information, they would incorporate domestic purchasing into their overall purchasing profile.

Plans for future donor projects and programmes would be discussed with relevant government officials and integrated, where appropriate, into the planning framework for the country. Donors would not only communicate the progress of projects and programmes with the relevant government authorities but, through both the mechanisms of formal round tables as well as the informal exchange of information, would keep other donors constantly up-dated and informed on project progress, seeking co-operation from them as deemed appropriate in a constant two-way flow of information. At the macro-level the requirements of all projects, present and future, would be assessed and combined together in order to evaluate whether, and if so when, viable domestic industry could be established to supply products that are imported now or, in the absence of new industries, would continue to be imported.

The real world, however, is far removed from the ideal one. While this particular project has been limited in its access to all relevant sources of information on the issue of aid projects and local sourcing[4], the scattered

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[4]. Time and budget constraints meant that it was not possible in this preliminary study either to analyse project documents housed in other multilateral or bilateral agencies or to visit particular LDCs to examine

data that are available in Vienna suggest that there is very little local sourcing of manufactured products required in aid projects from the LDCs in question: most are still imported. Although this is in part understandable - arising because of the low prevailing level of industrialization - it would appear, more importantly, that very little is being done to redress the problem. Equally, there is little evidence to suggest that there are satisfactory mechanisms in place either to increase local sourcing or, more importantly, even to raise the importance of either present or future local sourcing. In particular, the series of institutional rules and regulations encouraging local sourcing tend to be eclipsed and over-ridden by other rules and regulations and a series of direct and indirect pressures.

2.2 Information Inadequacies

A basic and all-pervasive problem is simply **lack of information**. In most LDCs there would appear to be an ubiquitous ignorance about local sourcing possibilities even among government officials'. This in itself is a reflection both of the inadequacies of planning mechanisms and of data inadequacies about local industry. It affects, in particular, manufacturing products originating in small-scale and informal sector enterprises. In many LDCs, no industrial census has ever been conducted and no industrial statistics are gathered on a regular basis'. Even in instances when national or sectoral plans have been written, they have very incomplete data on the availability of local manufactures. As a result, information on local sourcing is not available (in easily accessible form) from within the government and so cannot easily be passed on to donors. While some of the LDCs, such as Bangladesh, Tanzania, Botswana, Malawi and Nepal, have detailed development plans, often including details of the present status and future expansion of the manufacturing sectors, most of them do not.

But this is only the start of the problem. Even if a comprehensive database listing local manufactured products **were** available this, in itself, would be insufficient for donor purposes. It would be necessary to have three

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projects documents there. It became clear during this particular exercise that, with the exception of some world Bank project documents, very few detailed projects documents of other UN agencies and no project documents of bilateral projects are kept in the main registry and filing system at UNIDO.

'. This problem is less serious (at least for formal sector manufactured products) for those countries with larger manufacturing sectors and detailed development plans, including Bangladesh, Myanmar, Nepal, Sudan, Tanzania and the Yemen Arab Republic. In Uganda, however, which has (in LDC terms) a sizeable manufacturing sector, there are large gaps in knowledge about domestic manufacture, largely because so much is derived from small-scale and informal sector sources. (See Friedrich Ebert Foundation 1989.)

'. For example, in the Maldives, a ministry of trade and commerce was only established in 1983.

further pieces of information: first, levels of capacity utilization and the extent to which demands by donors for products could be met; second, delivery times, and third, the quality of the domestically-manufactured goods.

UNIDO has done some work to fill these gaps in basic data retrieval and availability. For instance in 1987, it provided technical assistance to the Government of the Maldives to prepare an industrial plan and the data contained therein would clearly contribute to information on domestic industrial sourcing. Another potential initial source of information about industry in particular LDCs is contained in country-specific industrial sector study reports undertaken by and/or published by UNIDO[9]. One problem here is that the series of publications most widely known remain incomplete. Thus, UNIDO's computerized data-base reveals that studies of only nine LDCs (21 per cent of the current total) in its series "The Potential for Resource-Based Industrial Development in the Least Developed Countries" were produced from 1982 to 1986[10]. In the UNIDO "Industrial Development Review Series", publications on only 18 LDCs (43 per cent of the current total) had been produced to December 1989[11]. Twenty three LDCs - over half of them - have been the subject of neither of these two UNIDO series of publications.

Another problem is that these reports and studies attempt to address a wide range of issues related to industry and, especially in relation to the smaller Pacific LDCs, contain far less concrete data on industry than do, for instance, the reports on the countries with larger industrial sectors such as Tanzania, the Yemen Arab Republic and Bangladesh. Neither these nor any other UNIDO publication series have been specifically designed to address the problem of bridging the particular information gap of concern to us here, namely by providing an up-dated data-base of locally available manufactured products to which donors requiring manufactured inputs might refer[12].

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[9]. These are likely to be the first source of information on industry in the LDCs that other UN agencies, especially, would have access to or make use of.

[10]. These were as follows: Botswana (1982); Comoros (1982); the Lao People's Democratic Republic (1983); Lesotho (1982 and 1986); Malawi (1983); Nepal (1984); Rwanda (1982); Somalia (1983) and Tanzania (1982).

[11]. These were as follows: Bangladesh (1986, 1989); Botswana (1987); Central African Republic (1986); Democratic Yemen (1989); Djibouti (1989); Kiribati (1986); Malawi (1987); Mali (1986); Mauritania (1989); Myanmar (1987); Nepal (2988), Samoa (1986); Somalia (1988), Sudan (1985 and 1989); Tuvalu (1989); Tanzania (1986); Vanuatu (1986) and the Yemen Arab Republic (1989).

[12]. It should, perhaps be added, that such a data-base embracing sourcing from small and informal-sector manufacturers is not even provided by industry ministries of the more advanced developing countries either on a one-off or continually up-dated basis.

It thus seems safe to conclude that donors drawing up projects do not have anything like sufficient information about the range of products which are available locally. This is especially true for simpler consumer-good products including clothing (uniforms) and furniture, and for the range of goods manufactured by small-scale or informal sector enterprises which, in the LDCs particularly, constitute a high proportion of total manufacturing output. As a result, it is likely that opportunities for local supply are missed because of ignorance of availability. The most that usually happens is that donors know about or are made aware of the existence of the three or four major (formal sector) industrial plants in the country, particulary those in the construction sector (cement, bricks etc.) and domestic procurement investigation initiated by the government frequently stops at this crude level of assessment.

## 2.3 <u>Gaps in Donor Information Exchange Procedures</u>

Besides information gaps about local products, gaps in donor information exchange and procedures provide additional constraints to exploiting local sourcing. While the recent institutionalization of more formal round table meetings among donors in the overwhelming majority of LDCs, together with less formal exchanges of information (initiated frequently by the United Nations' Resident Representative) has certainly improved intra-donor communication and information exchange, this usually falls short of exchanging information on domestic sourcing. <u>A fortiori</u>, there is even less exchange of information about the potential local sourcing of **future** projects, or planning between donors and with the government's planning agency, ministry or department about possibilities for establishing new industries as a result of increased demand from these projects[11].

The exchange of information on projects among different donors tends to be <u>extremely limited</u>, and where is does occur it tends to be confined largely to the broad outline of projects, not to the technical details. The need for more detailed information has recently been argued by a number of senior UN officials on the ground. Thus, the 1988 report of the Resident Representative in Fiji comments that:

- the key to co-ordination and harmonization is transparency: donors must tell each other what they are doing and what they are planning to do.

The limitations of current information-exchange has been pointed out in the 1987 Report of the Resident Representative for Somalia which comments thus:

- In many areas, donor co-ordination has been limited to the exchange of information about their respective activities. What is needed is closer consultation and co-ordinated actions at the

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[11]. Of course future demand for particular would not have to originate exclusively in donor-funded aid projects for new industries to be economically viable.

various levels of project development to avoid over-lapping and to increase net development effect.

Advocacy for closer co-ordination of activities is, however, not universally shared within the donor community, for it raises the question of the extent to which it is - or should be - the responsibility of either individual donors or even of donor co-ordinating bodies to go beyond exchanging information about current and future projects and - in the case we are considering here - take on the additional role of overseeing the potential for local procurement opportunities and of advocating their exploitation. One view expressed by some UN resident representatives[14] is that their role stops, and ought to stop, at co-ordinating information exchange. This is articulated, on the one hand, because of lack of staff to carry out such functions, but also on the other hand, at a more fundamental level. The filling of such a role, it is argued, is a task that should properly be undertaken by the recipient government. The fact that the job is not done, or done inadequately, is seen principally as a problem of inadequate manpower capability of the recipient government. It is this problem which needs to be addressed, and it is argued that the remedy lies more in resolving the problem of manpower shortages within government than in attempting to short-circuit the problem by donors (mistakenly) taking on the job themselves. As the 1988 report of the Resident Representative in Fiji puts it:

> It is the responsibility of the recipient government (i.e. not the agencies) to provide the necessary coherence and assure the linkages.

This view is supported in the 1988 report of the Resident Co-ordinator in Samoa. Although his statement refers to the more general issue of aid co-ordination it could be applied with even more force to the more technical matter of local procurement:

> ... if the purpose of aid co-ordination is to increase coherence between programmes and projects of different donors, to avoid overlaps or duplication between them and to create maximum mutual effect, then obviously there are limits to what can be achieved by increased contact between donors alone. First and foremost is required a coherent strategy on the side of the recipient.

In contrast, the 1987 report from Nepal places the issue of procurement squarely on the shoulders not of the recipient government but of the relevant donor:

> The question of procurement should be put to the executing agencies whose responsibility it is to procure goods and services. This is not a role that should be played by the Resident Co-ordinators.

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[14]. Or at least among those who have expressed an opinion on the issue.

If one accepts the argument that the job of exchanging information and co-ordinating projects among donors with a view to increasing local sourcing is not the role of the Resident Representative or UN aid co-ordination staff, is this a job which should be carried out by the UN agency with overall responsibility for industry, namely UNIDO? There are a number of issues which need to be considered in this context. First is the practical point that UNIDO does not have a permanent representative in most LDCs and so does not have the information needed to monitor the extent to which account is taken of local industry in supplying goods to donor projects.

But even if it had the staff, it could be argued that UNIDO's main task on the ground - in common with that of other specialized donor agencies - is simply to promote industrial or industrially-related projects at the specific request of the government. Where it is called upon to draw up or participate in constructing a national industrial plan or programme or, more specifically, to assist in creating a data-base of local manufactures, this is undertaken within the parameters of a particular contract which has a defined beginning and end. It has never included a "watching brief" to promote local industry through, for instance, providing information and trying to persuade other donors and donor agencies to increase the domestic sourcing of (all) their aid projects. Similarly, there is no institutional requirement for other UN agencies to provide UNIDO with their detailed project documents and thus to exchange information about sourcing goods from domestic industries.

If such an attitude is adopted in a rigid manner, a major problem can result: it removes any obligation from other donors (especially those which are part of the UN system) from informing UNIDO of activities which are or could be of relevance to UNIDO's specialized concerns. That this is far from an academic point is borne out by briefing notes put together by UNIDO on Laos in October 1989:

> In analyzing the list of projects financed by UNDP, we must come to the conclusion that UNIDO has neither been consulted nor involved in most of the industry-related projects.

And negatively, the 1988 Resident Co-ordinator's report for the People's Democratic Republic of Yemen expresses criticism of UN agencies which carry out projects but which fail to formulate their own sectoral strategies.

It is thus by no means clear that UNIDO ought predominantly to play a passive and receptive role. What is more, there are precedents for taking a more positive, innovative, co-ordinating and promotive role from other UN agencies at least in relation to the matters of particular concern to these agencies. A number of examples are provided, for instance, in the 1988 report of the Resident Co-ordinator in Tanzania which points to the following initiatives:

> UNICEF, UNFPA and the WHO hold regular co-ordination meetings to exchange information, harmonize programmes and approaches to achieve greater complementarity.

> UNFPA acts as a focal point on health and population issues for visiting missions such as the World Bank, USAID, IPPF...
>
> The WFP has been instrumental in the establishment of inter-ministerial committees where relevant government ministries/departments and UN agencies are presented.

Of even more relevance to the present discussion, other UN agencies have even taken initiatives in relation to procurement issues and promoting at least regional industrial integration, albeit it in a restricted and limited fashion. Thus the same Tanzania report points out that:

> UNICEF is actively involved in a regional network of supply officers which aims to decrease the Southern African Development Co-ordination Conference's (SADCC's) dependence upon external sources of supply.

## 2.4 Procurement in Theory and Practice

We consider in this section the more technical aspects of procurement and procurement procedures, especially as they apply to multilateral agencies within the UN system, highlighting some details of particular projects executed by one of the most important specialized agencies to provide project aid to the LDCs, the World Bank[15].

### 2.4.1 General Overview

The procedures of obtaining goods (and services) required for projects in LDCs fall within the umbrella of common principles and practices governing procurement and co-ordinated by the Inter-Agency Procurement Services Office (IAPSO). In general, the supply of goods for development projects in the LDCs is determined principally through the system of **competitive bidding**, most commonly at the international level but sometimes at the local level, under the following basic procurement principles (UNDP and IAPSO, 1989:75):

> **All organizations strive:**
>
> **(a) to procure equipment and services of the requisite type and quality within the time prescribed, at the lowest possible cost;**
>
> **(b) to provide access to procurement opportunities for interested and qualified parties;**

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[15]. Commitments to the LDCs through the Bank's International Development Association (IDA) amounted to US$ 1.5 billion in the period 1985-88 (World Bank 1989:1). In 1987, total (net) oda receipts originating from the IDA amounted to US$ 1.4 billion, 38% of all multilateral aid to the LDCs and more than total oda receipts from the UN agencies (OECD,1989a:308-9).

**(c) to undertake competitive bidding on an international basis; and,**

**(d) to secure a wide geographical distribution of procurement from developing countries and under-utilized major donor countries.**

**The principal means used by the UN organization to achieve procurement at the lowest possible cost is through competitive bidding in line with each organization's established financial regulations and rules. In order to give all potential suppliers world-wide a chance to compete, the competitive bidding is mostly international in nature, and special efforts are made to identify procurement sources in developing countries.1**

Within this overall framework, different agencies have more detailed particular regulations, a summary of which is contained in the June 1989 edition of the UNDP and IAPSO publication General Business Guide for Potential Suppliers of Goods and Services to the United Nations System (UNDP and IAPSO: 1989).

There is, however, a potentially important general exception to these principles. Since 1977, the possibility has existed for suppliers in the developing countries to receive a price preference in international bidding of up to 15 per cent of the purchase price of indigenous equipment and supplies originating in all[16] these countries, on the condition that the purchasing country agrees to this arrangement. For its part, UNIDO has been in the forefront of similar initiatives to promote industrial development in the developing countries; in October 1988 its Industrial Development Board recommended to the Director-General that 25 per cent of a developing country project's services and equipment should come from this group of countries[17].

For the LDCs in particular, there are no accurate figures on the share of goods which originate in the country where the project is being undertaken and which have been obtained in multilateral aid projects through competitive bidding procedures[18]. However, international data show that in 1987, only

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[16]. Thus wider than solely the LDC or developing country in which the project is located.

[17]. The following decision was taken by UNIDO's Industrial Development Board at its Fourth Session in October 1988:

> Requested the Director-General to have recourse to the greatest possible extent to experts, services and equipment from developing countries in technical cooperation projects of UNIDO in order to substantially increase - to a minimum share of 25% - the share of the total contract value and equipment purchased by the Organization from those countries, in the shortest possible time. (IDB. 4/Dec.15.)

[18]. With or without the 15% preference.

20 per cent of all[19] procurement supplies from UN agencies originated in developing countries (Joint Inspection Unit [JIU], 1989:7). The overall figure for the LDCs is likely to be minute - less than 1 per cent - and only to be of any significance for countries with relatively larger manufacturing sectors (see Table 2), of which the most important would be Bangladesh.

There are a whole range of factors which work against the procurement of products from the LDCs which are required in aid projects. Two major ones are clearly the low level of industrialization of these countries, and (as noted above) the paucity of information about domestic sourcing. There are also the inter-related problems of product quality and price, speed of delivery and reliability of supply. Then there is the major practical difficulty of the impact of applying the 15 per cent preference rule for LDCs. Specifically, if an LDC accepts the higher priced goods, the recipient countries' budgets are **charged with the full cost of goods and services including the 15 per cent premium**. As a result, the effective purchasing power of the available pool of aid money is reduced. In practice this acts as so great a deterrent as to render the preference almost meaningless.

Another important set of causes is wider in scope. One is that UN analysis reveals that developing countries frequently prefer to purchase from major donor countries in the belief (often mistaken) that developing country products are inferior[20]. Clearly this problem is likely to apply with even greater force to products from the LDCs. Another is the low level of awareness that particular donors have to the whole issue of local industry promotion and development. Unless their attention is specifically drawn to the possibility of looking (or searching) for local supplies, donors will (understandably) devote attention to their own immediate and particular concerns and priorities which, except for UNIDO, are unrelated to industrial issues. One illustration of this would be the World Bank's contribution to the May 1989 meeting of donors preparing for the Second UN Conference on the LDCs; it fails to mention industry at all, either in relation to current programmes of the Bank or in the outline of its plans and priorities for future long term projects and programmes. It would thus appear that for as pivotal an agency as the World Bank, neither the particular issue of local sourcing nor, more generally, concern for industrial promotion and development of the LDCs are high priorities.

Yet another restraint on local industry promotion has its origins in those tasked with drawing up donor projects. With few exceptions, they are highly trained, often with considerable professional experience and expertise in designing and setting up similar sorts of projects across different

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[19]. And hence including supplies to projects in one developing country from other developing countries. An important example of this would be goods supplied to Bhutan from Indian producers.

[20]. This point is made in the May 1989 report of the Joint Inspection Unit, Practice and Procedures aimed at a More Equitable Geographical Distribution of Sources of Procurement for Technical Co-operation Projects, (JIU 1989).

countries. But these attributes, together with severe constraints on their time, bias them towards looking for sources of supply that are well known to them and easily accessible. These will tend to be international and from the major industrialized countries. It is therefore not surprising that they will know little of available or potential supplies in the least industrialized countries or, importantly, have the time to go out and search for this information. As the 1989 report JIU observes (1989:10):

> International project managers are a powerful influence in the final determination of the source of equipment and should be recognized as such... Recognition must be given to the fact that international personnel are themselves attracted towards the products, facilities and services of developed countries through familiarity among other reasons.

A further set of constraints inhibiting local sourcing arises from applying the principle of "fair treatment" implicit in the UN's desire for international bidding. The Common Principles and Practices Governing Procurement of Goods and Services by the United Nations System of Organizations (April 1989) state that to qualify as a prospective supplier a firm should (UNDP and IAPSO, 1989:76):

(a) register with the individual UN organizations which commonly procure the goods offered;

(b) document its qualifications as a supplier of the particular goods to be procured;

(c) provide documentary proof of its financial standing;

(d) have no affiliations with countries designated by the General Assembly of the UN as unacceptable sources of supply;

(e) be able, as required:

(i) to arrange delivery and provide installation, commissioning and after-sales service in the country where the equipment is to be used;

(ii) to supply technical manuals, instruction booklets and spare parts lists in the required language(s);

(iii) to provide support services, including training, by technical staff proficient in the required language(s);

(iv) to dispatch company staff to the project site at short notice in case of emergencies;

(v) to ensure proper administrative, technical and quality controls;

(vi) to provide all documentation needed in connection with the shipment of the goods.

In striving to be "fair", the qualifications necessary and regulations laid down for a manufacturer even to be considered as a potential source of supply for equipment under this system are clearly biased against small producers and those located in the LDCs. They are handicapped by having limited resources themselves either to find out about the opportunities which exist, or to communicate rapidly through widely-used modern communications systems (telephone, telex and fax) their ability to supply the goods required.

The price of goods presents another important set of real or potential problems for local sourcing. The most common concern is that local supplies in the LDCs are disadvantaged because they tend to be priced higher than internationally-traded goods, often because of economies of scale and/or special characteristics of international markets. A particular example here would be that of clinker produced by the joint venture CIMAO located in Togo in West Africa which in the early 1980s attempted to sell its output in neighbouring Côte d'Ivoire at a price 74 per cent higher than clinker imported from Europe. Part of the reason for the price difference was because of over-capacity in Europe which led to international dumping of the product (Mytelka, 1989:40-41).

Even if the quoted price of the imported product is lower than a domestic alternative, this needs to be weighed against the time-consuming process (and hence cost) of going through international bidding procedures. As the Third Five Year Development Plan for Bangladesh argues (Republic of Bangladesh [ROB], 1985:223):

> Procurement against international competitive bids is time-consuming and not always in conformity with the urgency of requirement of particular items for certain enterprises. Since cash is scarce and procurement has to be made under commodity assistance, the buyer, in order to be on the safe side, always tries to make over-booking of stores with borrowers' money and bank interest.

A related issue is the effect on costs (and therefore on prices) of establishing industries in inter-linked industries: the establishment of an industry in one sub-sector can lead to a reduction in price of other (high-cost) manufactures, thereby increasing the opportunities for local sourcing. Thus in Mauritania in 1981, a cement packaging factory was opened using bulk cement brought in from Spain, followed in 1985 by the establishment of plaster manufacturing unit. As a direct result of these initiatives, it was reported that the price of building materials dropped considerably (Economist Intelligence Unit Country Profile 1989-90, p. 76-77).

Further insights into the problems of procurement and the LDCs come from the UNDP's continually up-dated Guidelines on Project Formulation (UNDP, 1984). When officials embark upon the drawing up a project, their attention is drawn to a number of "special considerations" which they need continually to bear in mind. In particular, they are alerted to "those economic and social goals which have been established on a global basis by the governing authorities of UNDP and in furtherance of which UNDP is required to undertake necessary actions" (UNDP, 1984:105.1.1). Specific mention is currently made to four considerations: women, the poorest and most vulnerable sections of the population of a country, the environment and the need to promote technical co-operation among developing countries. What is of relevance here is that there is no special consideration given to the promotion of domestic industry in countries where projects are undertaken and, in particular, to the need to look for domestically-produced goods when drawing up projects. Indeed the section in the Guidelines discussing inputs not only fails to make any recommendation to look for local sources or to promote local industry, but appears (at least implicitly) to assume that inputs will normally be sourced externally (section 109.6):

> With regard to equipment, note that they should be functionally relevant; that their potential economic and social impact should be attuned to the economic and social goals of the Government (eg those relating to employment, integration of disadvantaged groups of population in the development process, environment etc.) and that the country receiving them (emphasis added) has appropriate repairing and servicing facilities. Make adequate provision for spare parts that are unavailable or difficult to obtain in the country.

A good summary of some of these major constraints is contained in the annex to the 1989 JIU report, reproduced here in full:

> Constraints to procurement from developing countries[31]
>
> "Efforts to increase procurement from developing countries are beset with a number of constraints - some on the part of the United Nations system and the others in the developing countries. These are:
>
> (a) Inadequate knowledge in the United Nations system and relative difficulty in identifying competent and experienced consulting engineering organizations and reliable manufacturers and vendors in the developing countries;
>
> (b) Conditioning, attitudes and inertia of international project staff and procurement officers who have been accustomed to certain types of equipment and services from established sources and their reluctance to try out untested sources in developing countries;
>
> (c) Limited experience of suppliers in the developing countries regarding requirements to be met in submitting bids or proposals;
>
> (d) Inadequate interest by some suppliers from developing countries in overseas sales, given the size of the local markets, the internal price structure and/or the quality control requirements;
>
> (e) Lack of information in developing countries on opportunities for the supply of equipment and services to projects undertaken by the United Nations system;

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31. Source: DP/1987/19, paragraph 7.

(f) Asking, in invitations for services, for international, regional or in-country experience, which the bidders from developing countries may not have, thus simultaneously eliminating them from current contracts and depriving them of the experience to qualify in the future;

(g) Inadequate infrastructure and high transportation costs preventing the rapid and economical movement of goods between developing countries;

(h) The changing content of the equipment component of projects reflecting their high-tech nature;

(i) Attitudes in some developing countries that may favour goods and services from developed countries or maintain the traditional sources; and

(j) Considerations concerning standardization, warranties, start-up, training and availability of after-sales service, including long-term arrangements for spares, which sometimes preclude participation of suppliers and manufacturers from developing countries."

Finally, however, it is important to note that even if procurement rules and the practice of donor agencies tend not to favour local sourcing they are not immutable. Not only is there evidence of change at the level of individual agencies to encourage further local sourcing, but it is apparent that different donors can and do treat the issue quite differently. Thus, the ILO has recently increased the share of procurement it will permit to originate in developing countries, has raised the financial ceilings for local procurements and made waiver procedures more flexible. More specifically in Tanzania, the FAO increased the local procurement limit from US$ 10,000 to US$ 20,000 per item, which has enabled important equipment items such as vehicles to be purchased locally[22].

### 2.4.2 Some Project Evidence

Detailed examination of the documents (yellow cover) of a number of World Bank projects in LDCs illustrate a number of these points and highlight some of the more practical difficulties with procurement methods and procedures which can or could inhibit the current use and encourage the further development of local industry. One problem is that even when it has been decided that goods could be procured locally, it is common practice to stipulate that these be obtained through the system of competitive bidding, frequently with a minimum of three bids. Such a condition simply excludes large slices of industry in the majority of LDCs. What is more, when the Bank waives tendering procedures and engages in what it refers to as "prudent local shopping" for equipment, it always tries to keep these purchases to an absolute minimum, avoiding this method of purchase wherever it can. Further,

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22. Reported in the 1988 Resident Co-ordinator's Report for Tanzania (p.10). Procedures for the UN Secretariat require that "single purchases in excess of US$ 10,000 are subject to international bidding unless there are exceptional factors which preclude bidding" (UNDP and IAPSO, 1989:12).

it only adopts these procedures under specific circumstances. These include: when existing contracts are extended, when there is no need for standardized or proprietary equipment[23], when delivery is urgent or when competitive bidding has been unsuccessful (Jepma, 1989:21).

In a World Bank forestry project in Ethiopia in 1986[24], it was decided that "small off-the-shelf items costing less than US$ 20,000 each, which are required urgently, and purchased by prudent local shopping with at least three price quotations" (p.24) could be obtained. However, the report of the project goes on to add that "the total value of procurement through prudent shopping would not exceed US$ 200,000" (p.24).

Local sourcing is also discouraged by the practice of combining together sets of equipment requirements into different "packages". Such a practice severely reduces the ability of an LDC supplier to be able to provide all elements in the package, while it is not uncommon for these packages themselves to be procured under international competitive bidding (ICB)[25]. Thus the Forestry Project report states that "vehicles, equipment, tools, nursery supplies, machinery and fertilizers valued at US$ 12.7 million would be packaged up as far as possible into contracts valued at US$ 100,000 and above and procured in accord with ICB procedures" (p.24.). In relation to construction work and the supply of local construction material, while recourse was to be made in part to local sources (US$ 0.8 million out of total material costs of US$ 5.7 million), local sourcing was clearly viewed as the second-best option (p.22):

> Contracts for civil works amounting to US$ 14.1 million include construction for building, housing, roads... These contracts would not be suitable for international competitive bidding (ICB) because the works would be too small-scale and dispersed to attract international interest.

Reports by the World Bank on a series of substantial irrigation projects in Myanmar (Burma) would appear to confirm the absence of co-ordination of either current and planned projects with a view to encouraging local industry. The issue is illustrated in relation to the construction industry. World Bank documents for the 1986 US$ 26 million irrigation rehabilitation project in Myanmar make the comment that no private contracting industry exists in the country and so (understandably) state that the work would be

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[23]. This still leaves unanswered <u>who</u> is to decide this important question.

[24]. World Bank Staff Appraisal Report, Ethiopia: Forestry Project, May 29, 1986. 6096-ET.

[25]. It should be noted that international competitive bidding does not preclude local manufacturers - indeed in this instance specific reference is made to their being allowed the 15% local preference of the cif bid price.

undertaken by foreigners[16]. What is of particular interest is that the report on this project refers to the suitability of foreign contractors because they have worked so well not in one but in two previous projects as well as on one other current project - (Irrigation I ($17 million), Paddyland I ($30 million) and Paddyland II ($34.5 million). What is more, the documents state that the 1986 project is to be the first stage in a 25 year **master plan for irrigation rehabilitation in the country**. While further knowledge of the different irrigation projects and of the construction industry in Myanmar might provide clear answers, it is striking that no mention is made of the possibility of creating a local construction capability arising from what is clearly a significant demand for construction materials over an extended period.

On the other hand, it is equally apparent that some World Bank personnel make particular efforts to source locally, highlighting the key role that project officers can play here. Such differences occur in part because the wording of directives about sourcing would appear to allow scope for initiative. Thus the 1989 General Business Guide reports (UNDP and IAPSO, 1989:54) that "The Bank generally requires use of international competitive bidding procedures unless other procedures are more appropriate for specific procurements". In this connection, a Bank staff appraisal document of an electrification project in the southern provinces of the Lao People's Democratic Republic[17] reports on the local availability of wire and switches thus (p.20):

> Provision will be made in the bidding documents to allow partial supply from domestic manufacturers. Some small-scale local industries in Vientane manufacture house-wires and switches. According to EDL (Electricite du Laos), the quality of their products is acceptable, but their quantity of production has been limited.

The project document fails to explain why the quantity of production has been limited. Neither does it explain why local construction companies were granted permission to erect the warehouses necessary for the project but why the building of the wooden-pole treatment factory was to be a turn-key "single responsibility" contract for the supply of goods and equipment, civil construction, equipment installation, testing and commissioning.

## 2.5 The Problem of Aid Tying

Tying goods and services to the country of origin of the donor is a problem that challenges local procurement directly. It applies particularly

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[16]. World Bank Ye-U Irrigation Rehabilitation and Modernization Project, Report No. 5524-BA, July 1986.

[17]. World Bank, Staff Appraisal Report, Lao People's Democratic Republic, Southern Provinces Electrification Project, May 1987, 6733-LA.

to bilateral aid[18]. The latest figures (for 1987) show that the LDCs received $10.6 billion in official development assistance (gross). Of this, $6.2 billion, or 58 per cent consisted of bilateral aid from the major western donors who are members of the Development Assistance Committee (DAC) of the OECD. What is more the share of bilateral to total aid to the LDCs has increased in recent years, having risen from 52 per cent in 1984[19].

Now, as is well known, all the major donor countries in practice tie a proportion of their bilateral aid to the purchase of goods and services produced in their own countries. Clearly when this occurs there is **no** possibility of the LDC utilising the aid funds to promote its own industrialisation programme. What is not known is the extent to which the major donors do in practice tie the aid they provide to the least developed countries to the purchase of goods and services produced in their own countries. The sketchy evidence we have, however, confirms that **the practice does exist and its effect is substantial**.

First some individual country evidence. Reference is made in the 1988 Resident Representative's report for Samoa that goods identical to those that are produced locally are imported from Australia, New Zealand and Japan, while the 1988 Resident Representative's report from Guinea comments that bilateral assistance continues to be tied to the procurement of goods from the donor country. In Tanzania, a Japanese aid project utilizes imported cement when the cement factories in that country are under-utilized and Tanzania is, in most years, an exporter of cement (Wangwe, 1989:37 and personal communication, December 1989).

More generally, an overall indication of the extent of aid-tying by bilateral donors can be gleaned from Table 1 which compares the ratio of bilateral aid from the main DAC donors which is tied with their contribution to total oda to the LDCs. This shows that overall, 51 per cent of aid commitments by the DAC donors is tied or partially tied. What is more the share of tied to total aid appears to be rising, having risen from 48 per cent in 1985 and 50 per cent in 1986 (Jepma, 1989:18).

It is likely, however, that the extent of aid tying is even higher than the figures in Table 1 would suggest. One reason for this is the rise in mixed credit and associated financing schemes which link the provision of, usually, soft loan finance to purchases of equipment from donor countries. Another, highlighted by Cassen, is less tangible but equally important (1986:286):

> There are many ways in which donors can influence procurement without formal tying. They can choose particular sectors or commodities that are more susceptible to procurement from the

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[18]. However, the 1988 Report of the Resident Co-ordinator for Bhutan comments that the UN is a guilt as the bilateral donors in creating a proliferation of equipment sources.

[19]. These figures are from OECD (1989a:308-309).

donor. More or less subtly, they can indicate that the recipient would be wise to place orders with the donor. Such practices, combined with traditional commercial links which may create inertia in the choice of suppliers, can result in much bigger procurement orders out of aid than formal tying practices alone would produce.

Table 1. Aid Tying and Total ODA commitments by DAC bilateral donors to the LDCs, 1987

| Country | % of Tied and partially-tied ODA commitments | ODA commitments to LDCs $M. | % Total |
|---|---|---|---|
| Australia | 48 | 59.8 | 0.5 |
| Austria | 28 | 11.8 | .. |
| Belgium | 57 | 84.4 | 0.7 |
| Canada | 43 | 304.5 | 2.4 |
| Denmark | 17 | 186.1 | 1.5 |
| Finland | 82 | 93.1 | 0.7 |
| France | 47 | 793.2 | 6.3 |
| Fed.Rep.of Germany | 43 | 872.4 | 6.9 |
| Ireland | .. | 11.0 | .. |
| Italy | 62 | 1337.0 | 10.6 |
| Japan | 44 | 1094.5 | 8.7 |
| Netherlands | 43 | 429.8 | 3.4 |
| New Zealand | 45 | 10.4 | .. |
| Norway | 31 | 123.9 | 1.0 |
| Sweden | 10 | 5.9 | .. |
| Switzerland | 25 | 126.1 | 1.0 |
| United Kingdom | 58 | 338.8 | 2.7 |
| United States | 64 | 827.0 | 6.6 |
| Total DAC | 51 | 6709.6 | 53.1 |

Source: OECD data base, quoted in Jepma (1989).

Evidence from studies of particular donors tends to confirm this picture, Thus, "most of France's aid to its former dependencies and the DOM/TOM returns to France regardless of tying conditions" (Cassen, 1986:287). Even in the case of Canada - considered to be a donor less prone to tie its aid than many other DAC bilateral donors - it was found in the early 1980s that "over 82 per cent of its aid was tied to the procurement of Canadian goods and services although DAC figures state(d) that only 51.75 per cent of Canadian bilateral aid" was tied (Riddell, 1987:208). For the UK, a 1986 report puts the figure at 74 per cent, compared with the figure of 58 per cent given in Table 1, above (Jepma (1989:20). Overall after a thorough examination of all the evidence, Jepma comments (1989:20) that:

> On the basis of ... information on individual countries, it can be concluded that some 70 per cent of bilateral aid of the European Community (EC) countries has led to procurement in the donor countries. This is 20 percentage points more than procurement based on tying alone.

There are two principal ways in which industrial development in LDCs is held back as a result of aid tying. To the extent that products supplied by the donor could have come from local sources, the expansion of local industry is impaired. But additionally, studies have consistently indicated that tied aid tends to cost between 10 per cent and 30 per cent more than products obtained competitively[10]. To the extent that this represents a loss of international purchasing power to the aid recipient[11], potential overall growth and development is constrained because of a reduction in import purchasing capacity. This particular difficulty is highlighted in the following comment from Bangladesh's Third Five Year Plan (ROB, 1985:223):

> Under these (aid-related imports) arrangements, the buyer is to buy from a particular market or group of markets and not from the competitive or cheapest source... As such, every year corporations and enterprises are constrained to make a substantial amount of uneconomic purchases. These purchases have far-reaching effects on the cost of finished products and their marketing...

Public sector procurement procedures remain cumbersome owing to the tendering formalities and conditions imposed by various aid-giving countries, and financial power in matters of import of materials is also limited.

A final point to note is the impact that the coming of the single market in the EC could have for the tying of bilateral aid. Although European donor countries have been reluctant to discuss the aid implications of "1992", it is the view of senior officials in Brussels and Luxembourg as well as of officials at the OECD in Paris[12] that come 1993 individual countries will no longer be able to tie their bilateral aid to their own nationals, goods or services. If this view is sustained, it would mean that individual European donors in their <u>bilateral aid programmes</u> will not, thereafter, be permitted to link the aid they give exclusively to the supply of their **own** nationals, in the case of technical assistance, their **own** goods, in the case of commodity aid and other product purchases, and their **own** banks, finance houses, export credit agencies, shipping and insurance, in the case of aid-related services. They will have to widen their tendering procedures to encompass all 12 EC member countries. This does of course raise the question of whether the <u>level</u> of bilateral aid will be maintained at current trend rates if the benefits to the donors are at least potentially curtailed.

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[10]. For a review see Riddell (1987:209).

[11]. For some donors, it is apparent that if aid were not tied to domestic purchases then the absolute amount on offer would fall.

[12]. Interviews with the author during June and July, 1989.

But if it is maintained, the impact in terms of reducing the cost of international purchasing could be quite significant. Such a step should also remove a major barrier to bilateral donors searching for locally-sourced equipment[33].

## 2.6 The General Economic Climate

While one common constraint inhibiting local procurement is clearly the low level of industrialization in the LDCs, there is no doubt that another major factor is the poor, and - for not a few LDCs the deteriorating - performance of their manufacturing sectors, especially in the 1980s. For all LDCs combined, the UNIDO data-base reveals[34] that manufacturing value added (MVA) per capita in 1987 stood at $18.76 (at constant 1980 prices), 9 per cent lower than the MVA per capita figure of $20.64 in 1975. In the ten year period to 1987, the rate of growth of MVA of the LDCs was 1.64 per cent, less than half the rate of 3.86 per cent achieved in the ten year period to 1977, and a staggering fall from the 13.47 per cent ten year average recorded for 1973[35]. The LDCs are far away from the target 9 per cent annual rate of growth of MVA[36].

Individual country data tend to confirm the deteriorating aggregate performance. Thus for the 37 countries for which time-series data are available, 24 (65 per cent) recorded lower rates of growth of MVA in the

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[33]. It needs to be added, however, that it is the view of many politicians in EC countries who have expressed an opinion on the subject that as aid constitutes an offshore activity, the rules of public procurement applicable within the EC should not - and will not - apply.

[34]. As with all statistics on the LDCs, these figures need to be treated with some caution even if the underlining trend seems to be clear. Even the country data recorded in Table 2 is not as accurate as the numbers of decimal places would suggest. For instance the MVA/GDP ratio for Chad is given as 8.4% in the Table whereas International Monetary Fund figures give a ratio of 16.1% for 1986; the UNIDO ratio for Burkina Faso is 10.7% whereas the World Bank gives the ratio as 15%.

[35]. Figures from UNIDO's Report Writer Retrieval System, Countries Time Series Data-Base, November 1989.

[36]. The reasons for this, however, include the fact that individual ldcs have set for themselves target rates of growth of MVA <u>lower</u> than the group target. Thus, in the first half of the 1980s, Bangladesh had a target rate of growth of MVA of only 8.4% (achieving 4.8% in practice), while the Third Five Year plan (1986-90) of the People's Democratic Republic of Yemen announced an effective moratorium on new industrial projects (other than the biscuit factory). In practice many LDCs which did have ambitious growth rate targets for MVA (Tanzania, Malawi and Somalia in Africa) are now engaged in short term structural adjustment measures, the primary concern of which is often rehabilitation rather than industrial expansion.

1980s than in the 1970s with 11 countries recording negative growth rates and a significant 25 countries (68 per cent) recording a rate of growth of MVA close to zero or negative. Significantly, too, of the 14 LDCs with MVA in 1987 valued at $100 million or more, only four - Ethiopia, Mali, Nepal and the Sudan - recorded average annual rates of growth of MVA higher in the 1980s than in the 1970s. The details are contained in Table 2.

What principally concerns us here is the effect that this dismal aggregate performance is having on local procurement. The majority of LDCs suffer from severe foreign exchange shortages resulting from large foreign debt commitments, high debt service payments and deteriorating international prices for their major primary commodity exports[37]. The effects of structural adjustment policies have been adversely to affect domestic demand through curtailing development project plans, trimming the public service, squeezing the imports of inputs to the manufacturing sector, exacerbating the shortages of spare-parts and delaying the replacement of equipment[38]. The main effects on industry have been the following:

- to delay the completion of industrial projects under construction;

- to reduce the levels of capacity utilisation of current industrial units and the reliability of delivery through shortages of imported inputs and a reduction in domestic demand;

- to increase the marginal cost of industrial products thereby rendering them less competitive with imports;

- through import liberalisation schemes to open up infant or incipient industries prematurely to international competition;

- to throw awry the planning of projects both to increase local capacity and to further integrate industry with the other leading productive sectors.

The effect of these constraints on local procurement has been to reinforce the factors already frustrating the use of domestically-made products in aid projects now and in the future. A major problem has been to disrupt the, albeit crude, planning mechanisms which were in place so that any ordered use of current local products has become even more difficult to promote. As a result, attempts to utilize donor funds in a co-ordinated way to plan for future industrial development have also been adversely affected. Disruptions to production caused particularly by lack of imported inputs and spare-parts has increased the unreliability of supply, heightening the already strong compulsion of donors to source externally. It has also tended to raise the costs of production, acting as a further deterrent to local sourcing.

[37]. The details can be found in UNCTAD (1989a and 1989b).

[38]. Details of the effects of structural adjustment policies are contained in UNCTAD (1989b).

Table 2. Basic Data on LDCs' Manufacturing Status: Population, MVA, Growth rates of MVA

| | Popul-ation M.1987 | MVA $M. 1987 | MVA/GDP $M. 1987 | MVA /capita 1987 | MVA/capita Growth rate 1980-1988 | MVA Growth Rate 1980-88 | 1970-80 |
|---|---|---|---|---|---|---|---|
| Bangladesh | 106.7 | 1,841.5 | 9.5 | 17.2 | 0.67 | 3.46 | 12.22 |
| Benin | 4.3 | 96.5 | 8.0 | 22.4 | 0.57 | 3.67 | -1.46 |
| Bhutan | 1.4 | 8.2 | 3.9 | 7.66 | 4.01 | 5.96 | 6.27 |
| Botswana | 1.2 | 68.8 | 3.4 | 59.4 | 0.41 | 4.05 | 11.25 |
| Burkina Faso | 8.3 | 161.0 | 10.7 | 19.4 | -0.08 | 2.46 | 3.27 |
| Burundi | 5.0 | 97.9 | 7.6 | 4.7 | 0.39 | 3.20 | 6.47 |
| Cape Verde | 0.4 | 9.1 | 5.3 | 26.2 | 4.41 | 6.72 | 1.71 |
| Central Afr. Republic | 2.7 | 83.1 | 8.4 | 30.8 | -1.61 | 0.69 | -1.95 |
| Chad | 5.3 | 71.5 | 8.4 | 13.6 | -6.79 | -4.62 | 0.05 |
| Comoros | 0.5 | 6.9 | 3.8 | 14.7 | 1.72 | 4.89 | -2.45 |
| Democratic Yemen | 2.3 | 55.6 | 6.6 | 24.4 | -3.07 | -0.33 | -2.06 |
| Djibouti | 0.4 | 36.8 | 9.8 | 98.6 | -1.93 | 1.20 | 6.19 |
| Equ.Guinea | 0.4 | 3.5 | 5.1 | 8.5 | -0.72 | 1.44 | -11.27 |
| Ethiopia | 43.8 | 525.3 | 11.2 | 12.0 | 2.40 | 4.27 | 3.89 |
| Gambia | 0.8 | 18.4 | 6.8 | 23.2 | 0.70 | 3.74 | 6.29 |
| Guinea | 6.4 | 43.0 | 3.0 | 6.7 | -3.94 | -1.66 | 2.73 |
| Guinea-Bissau | 0.9 | 2.4 | 1.2 | 2.5 | -4.50 | -2.41 | 1.31 |
| Haiti | 6.2 | 230.5 | 16.7 | 37.5 | -2.24 | -0.46 | 8.34 |
| Lesotho | 1.6 | 41.5 | 10.0 | 25.4 | 10.10 | 16.16 | 18.09 |
| Malawi | 7.6 | 172.7 | 12.5 | 22.7 | -7.78 | 1.40 | 7.26 |
| Maldives | 0.2 | 6.3 | 8.5 | 32.1 | 13.54 | 17.30 | 22.41 |
| Mali | 8.6 | 112.7 | 5.8 | 13.1 | 2.81 | 5.72 | 3.95 |
| Mauritania | 1.9 | 35.0 | 4.0 | 18.8 | -2.72 | -0.14 | 3.44 |
| Mozambique | 14.5 | 377.4 | 22.9 | 26.1 | -10.38 | -8.05 | -0.64 |
| Myanmar | 39.1 | 811.7 | 9.9 | 20.7 | 3.56 | 5.74 | 3.57 |
| Nepal | 17.8 | 111.2 | 4.3 | 6.2 | 1.28 | 3.93 | 3.01 |
| Niger | 6.5 | 96.7 | 3.9 | 14.9 | -2.33 | 0.48 | 2.64 |
| Rwanda | 6.5 | 240.3 | 18.0 | 36.8 | 1.91 | 5.38 | 10.41 |
| Sao Tome and Principe | 0.1 | 3.0 | 10.0 | 37.6 | -3.50 | -1.04 | 0.00 |
| Sierra Leone | 3.9 | 47.0 | 6.2 | 12.2 | -4.69 | -2.43 | 3.93 |
| Somalia | 6.9 | 88.7 | 4.6 | 12.9 | -2.91 | 0.75 | 3.62 |
| Sudan | 23.1 | 885.7 | 8.5 | 38.3 | -0.15 | 2.96 | -2.13 |
| Tanzania | 24.5 | 375.6 | 6.6 | 15.4 | -7.67 | -4.11 | 3.55 |
| Togo | 3.1 | 73.4 | 7.0 | 23.3 | -4.15 | -1.28 | -4.83 |
| Uganda | 16.6 | 121.0 | 4.1 | 7.2 | -1.33 | 2.03 | -8.45 |
| Vanuatu | 0.2 | 11.4 | 7.4 | 75.1 | 15.05 | 19.39 | 25.00 |
| Yemen Arab Republic | 7.3 | 636.2 | 13.7 | 87.0 | 16.61 | 19.94 | 12.18 |

Source: UNIDO data Base, November 1989.
Note: The Table excludes Afghanistan, Kiribati, the Lao People's Democratic Republic, Samoa and Tuvalu for which MVA data are not available.

The sorts of problems of the majority can be illustrated with reference to particular difficulties experienced by a selection of LDCs[19]:

* In **Nepal**, capital development projects for the production of cement, textiles, paper and sugar have all slowed down because of a squeeze on the construction industry. Plans for the production and substitution of imported fertilizer have been delayed.

* In **Afghanistan**, manufacturing sector growth has severely contracted due to the war. Energy and skill shortages, out-dated machinery and transport problems are all inhibiting the sector's development. A major concern is to rehabilitate cement, textile, cotton and sugar plants in order to reduce imports.

* **Myanmar** is suffering from acute shortages of foreign exchange needed to purchase spares, raw materials and equipment needed by the industrial sector.

* In **Bangladesh**, macro-economic problems have led to a substantial shortfall in the expansion of local production of fertilizer, cement and steel ingots to replace imports. A major requirement is to rehabilitate a range of industries whereas donors still prefer to fund new projects and are reluctant to increase their funding of local costs.

* In **Sierra Leone**, capacity utilization levels are less than 40 per cent due particularly to shortages of raw material inputs into the manufacturing sector, shortages of spare parts and problems of supply of electrical power. For instance in 1987, paint production was 88,000 litres and soft drink production 3.9 million litres compared with levels, respectively, of 454,000 and 10 million litres in 1982.

* Manufacturing in **Guinea** is inhibited by obsolete capital stock, equipment failures, raw material shortages and poor management. A 1985 survey indicated an average capacity utilization rate of around 10 per cent.

* **Mali's** industry has been adversely affected by severe drought with oil-seed crushing particularly affected. Additionally, the country's pharmaceutical plant has been subject to periodic closures because of import supply problems, resulting in erratic production and supplies to customers.

* **Togo's** substantive plans for industrial expansion in the 1970s were effectively abandoned at the start of the 1980s when an IMF programme led to severe contractions. Major plants, including the clinker factory, have closed with ripple effects in other sub-sectors, such as the cement plant.

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[19]. Data in this paragraph are obtained from the following sources: Briefing Notes on individual LDCs obtained from the Least Developed Country Branch, UNIDO, Vienna; UN Resident Co-ordinator and Representative Reports for 1988 and 1989; and Country Profiles and Reports of the Economist Intelligence Unit (London).

* Most construction materials in the **Central African Republic** are imported. Plans for a local cement factory and a small steel works to produce rods for the construction industry were highlighted in the 1982-85 development plan. But increasingly severe problems in the economy meant that nothing materialized. In 1984, the local brick company went into liquidation.

* Political upheaval in **Haiti** has meant that many of the 200-odd US companies located in the country in the early 1980s to assemble goods for export to the US have now left the country.

It is important to note, however, that these sorts of problems have neither affected all countries equally or, indeed, have they affected <u>all</u> LDCs. Thus, industrial expansion in Botswana and the Yemen Arab Republic in the 1980s has been sustained and vigorous, while in Lesotho both the construction and manufacturing sectors have performed well in spite of poor aggregate performance[43].

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43. The Lesotho experience was due in no small measure to the Highland Water Project.

# 3. PROPOSALS AND POLICY IMPLICATIONS

## 3.1 General Approaches to Obtaining Further Information

A series of proposals are put forward here which could help to promote the use of locally-produced industrial inputs in the projects and programmes of donors. Many of these follow directly from the analysis of the previous section of the paper. A first conclusion arising from this analysis is that in spite of all the difficulties highlighted, there are grounds for arguing that **there is considerable potential for non-industrial donor-funded projects both to use currently-available manufactures and to help promote future industrial expansion to a far greater extent than occurs at present** . Yet it is equally important to state that the more detailed proposals made here must be seen more as **tentative rather than firm recommendations** because of severe constraints of time and data-availability under which this report has been compiled. Data gaps are enormous, both in relation to the **details of current sourcing of equipment** and to the **approaches used and methods of decision-making utilized by donors to source** their equipment supplies.

Thus the first proposal is that further work is done to increase our knowledge in both these areas. This could be done in two particular ways. **Detailed country studies of aid projects and procurement processes could be undertaken.** These would require, at minimum, visits to the countries, discussions with the relevant UN and other donor officials[41] and analysis of detailed project documents, using similar terms of reference to those drawn up for the present exercise (see Appendix)[42]. Given the diversity of both the levels of industry in different LDCs and the varying extent to which macro-constraints inhibit their manufacturing sectors, it is **proposed that a range of countries be selected including representatives of those with larger industrial sectors, those with minimal industrial capacity, those which have been particularly affected by macro-economic constraints and those which have managed steady industrial expansion in the 1980s.** Table 2 provides basic data upon which possible selection might initially be based.

**Another (complementary) approach would be to select a number of the major multilateral and bilateral aid agencies which dominate the aid projects of the LDCs and examine the extent to which they source or attempt to source locally and the extent to which the considerations of local sourcing are integrated into their project cycle deliberations.** To undertake such an analysis, it would clearly be essential to visit the headquarters of the organizations selected. At minimum it is proposed that one multilateral and

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[41]. For some of the smaller island states, donor representatives are located in neighbouring states. For instance, Fiji is a central location for aid personnel overseeing projects undertaken in a number of Pacific islands.

[42]. The discussion of particular World Bank projects, above, suggests that it is insufficient solely to read project documents, especially if one wants to understand why local sourcing did <u>not</u> take place.

one bilateral donor is selected; given the variety of experience of different agencies recorded above, however, it would clearly provide a far richer source of data if at least two of each were to be investigated. The previous discussion suggests that, for the multilateral agencies, UNICEF and the World Bank, while, for the bilateral agencies, France or the UK together with a Scandinavian country, the Netherlands or Canada would highlight different approaches of the two types of donor.

## 3.2 Proposals at the Country Level

As the discussion in Section B has pinpointed a number of key information-gaps which together limit the potential for domestic sourcing of donor projects, it is not necessary to repeat the points made there. On the basis of that analysis, however, some specific recommendations can be made. The over-riding objective is to raise the profile of domestic sourcing possibilities; this can be done by putting forward proposals to inject both information about and awareness of the issue in the donor community. Action will be required on a number of fronts.

One reason for limited local sourcing is because individual LDC governments, and therefore the donors, have no or limited information about local sources of supply. To address this problem a series of initiatives could be undertaken. First, **assistance could be given to LDC governments (and where they exist ministries of industry) to provide a data-base of locally-manufactured products, by pooling information which is at hand or could fairly easily be made available.** For such a data-base to be useful to donors it would need to contain the following information: product name and brief description; comme^t on quality (standards norm or specification); size of order that could be met; delivery time; actual or potential supply problems; name of manufacturer(s) contact address/telephone number and person.

Besides providing a data-base of accessible information on locally-manufactured products, in most countries there is an additional need to compile an inventory in particular of products produced by the small and/or informal sector. Hence a second (albeit related) exercise **would be to provide assistance for the seeking out of information and concomitant compiling of data on manufactures produced by the small/informal sector and for putting this information on the data-base.** In contrast with the proposal in the previous paragraph, this initiative is likely to require some detailed survey work in most if not all of the LDCs.

Clearly the final decision to embark on either of these exercises would rest with the respective LDC governments. There would, however, be two clear benefits for **UNIDO to offer its services to assist with the gathering and presentation of the data.** First, it would have a comparative advantage in being able to design a system common to all the LDCs. Secondly, as the UN agency with responsibility for industrial issues, UNIDO is in the unique position of having the potential to ensure that donors take note of and utilize this information in planning and executing their projects.

The next step, therefore, would be to seek means for UNIDO to bridge the gap between the donors and the information on locally-made products. There are a range of proposals that can be made, ranging from the long term to the more immediate. Perhaps the most basic objective is for **UNIDO to raise the profile of industry among the donor community: to help them always to "think industry" when approaching all the different aspects of their own work.** There are a number of ways in which this could be done. It is apparent, however, that many of them can be facilitated through **UNIDO having more staff members permanently in the field**[43].

A number of tasks for such staff can be outlined together with the benefits which should accrue. First, it would enable UNIDO to be able repeatedly to insert an industry perspective into formal and informal gatherings and round table meetings of the donor community. Second, UNIDO would then be in a better position to keep in regular touch with other donors projects and to take the initiative within the donor community in co-**ordinating the actual or potential industrial impact of their projects so as to ensure that maximum use is made of local resources**[44].

Third, UNIDO would then be in a position to discuss the potential of local content sourcing directly with project leaders of other donor agencies responsible for planning, designing and implementing future projects, and, in particular, to raise the profile of local sourcing into decisions being made for equipment sourcing. Clearly much more can be done before decisions are finalized to influence the sourcing of equipment, its unpackaging, its design and appropriateness and the method (ranging from direct local purchase to international competitive bidding) of purchase. Clearly, too, however, this is an area of potential sensitivities between donors and the host government. Thus, both in order that this task to be done, and for it not to be seen in any way as a challenge to the government's own role, it would be important for UNIDO to undertake this work either explicitly for or in extremely close collaboration and liaison with the government. In countries, such as Bangladesh, where the government already injects such information into the overall planning process, such data are already being processed. In most countries, however, up-to-date information on the potential use and especially the integration of equipment needs is not gathered in any comprehensive manner. What is more, even in countries such as Bangladesh, there would appear to be a role for UNIDO to play - if only to raise higher on the agendas of the donor community the issues of the potential for local sourcing and donor co-ordination[45].

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[43]. In the first half of 1989, UNIDO had only six Senior Industrial Development Field Officers located in the 42 LDCs.

[44]. As pointed out above, this role of co-ordination is now frequently undertaken inter alia, by UNICEF, UNFPA WFP and WHO.

[45]. Clearly the tasks outlined here for a permanent UNIDO presence on-the-ground are substantial. It is not within the competence of the consultant to assess the extent to which this additional workload could be absorbed by those UNIDO staff who are already resident in the (larger) LDCs.

In parallel with this initiative and with the same objective of raising the profile of industry among the donors, **UNIDO could both expand upon the present level and co-ordinate the dissemination of information about industry in the LDCs to other donors in a more systematic manner than occurs at present**[44]. The manner in which this could be done ought to be the subject of further discussion. **The following proposals constitute one set of ideas: embarking upon a comprehensive country by country series on industry in <u>all</u> the LDCs; initiating a new series whose specific purpose is to disseminate information on local sourcing; offering technical assistance to produce industrial sector surveys in the case of those LDCs where such information does not exist; offering to up-date information which is old or no longer relevant to the current problems of industry in the LDCs.**

Assembling such information should not be seen as an end in itself; it is important to pass the information on and attempt to ensure that it is acted upon. There would, however, appear to be no institutional mechanism in place at the present time for UNIDO either to disperse such information to other donors, at the international or local levels, or to ensure that this information is acted upon.

### 3.3 <u>Altering the International Agenda</u>

Improving the data-base and raising the consciousness of donors about the potential for local procurement through initiatives that are within the specific competence of UNIDO need to be complemented by a series of parallel but broader initiatives at the international level. While a number of the proposals in the following paragraphs are clearly beyond the scope and competence of UNIDO to execute or even to promote in isolation, they could be brought by UNIDO to appropriate international fora, beginning, perhaps, with the September 1990 Second United Nations Conference on the Least Developed Countries in Paris.

It is apparent that the actual and potential use of donor project procurement is severely limited because of the current adverse macro-economic climate in most LDCs. These problems are likely to persist well into the 1990s unless and until there is both a major additional injection of external funds into the economies of the LDCs and a reduction in the annual amounts paid in debt servicing. It is thus clearly important **for UNIDO to give its full support to the efforts of both the LDC governments and other UN agencies to attempt to increase the level of donor funds channelled to the LDCs. One approach would be for UNIDO to undertake its own analysis of the external resource gaps of the LDCs, but perhaps a more efficient way is for UNIDO to feed its own data into that of the lead agencies (UNCTAD and, perhaps the World Bank). Either way it needs to play a more prominent role in the**

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[44]. UNIDO would need to co-ordinate its efforts in this field with those of the World Bank to avoid any duplication. Recent examples of parallel industrial studies undertaken by the World Bank and UNIDO in both Côte d'Ivoire and Zimbabwe with little to no inter-action between the efforts of the respective institutions suggests that there is scope for change in this area.

**international discussions about external financial resource short-falls. One way it can do this is by playing a more active role in the deliberations of the OECD's Development Assistance Committee.**

As highlighted on page 14, in drawing up projects, all UN agencies are required always to pay special attention to four "special considerations": the environment, women, the poor and most vulnerable groups of the population and the promotion of technical co-operation among developing countries. **It is proposed that UN agencies add a fifth "special consideration", namely the need always to look for opportunities to promote domestic industry in the LDCs.**

It is also suggested that in the case of the least developed countries, current rules and practices which tend to favour international competitive bidding and are biased towards the supply of equipment in relatively large packages be altered. In particular, **it is proposed that normal international competitive bidding procedures should be adopted only <u>after</u> an assessment is made of domestic sourcing potential[47] and that if domestic products are available there should be flexibility in procedures to allow project managers to purchase directly from domestic sources (prudent local shopping) if there are fewer than three local manufacturers[48], and that there be no pre-determined upper limit to the amount of project funds which can be used for local procurement[49]. It is additionally proposed that the packaging up of "small" orders for equipment supplies be undertaken only <u>after</u> an assessment is made of domestic sourcing potential and that such packaging does not prejudice supplies of equipment from domestic manufacturers. In both instances, it is proposed that the common rules applicable to prospective suppliers to UN projects are set aside.**

There are clearly problems with the practical effectiveness of the 15 per cent procurement benefit of sourcing from developing countries. In relation to the LDCs, it is **proposed that "the individual project budget ... be disburdened and a suitable home for the burden found elsewhere"** (JIU, 1989:12). In this context, The Joint Inspection Unit proposes three possible alternatives. To charge any appropriate current reserve account, widening its provisions if necessary; to set up a special reserve by charging the Programme's general resources at the beginning of each new quinquennial IPF

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[47]. The term "domestic sourcing potential" refers to manufacturing capabilities and not to the supply of foreign goods brought in by local merchants. It is proposed that international "rules of origin" clauses currently applicable to LDCs be used to determine foreign as opposed to local manufacture.

[48]. In such a situation, it is unlikely that local tendering could take place.

[49]. It may be necessary to provide an upper percentage limit for particular countries. This would need to be investigated. The general point made here is to remove the bias against local sourcing which currently exists.

cycle; to charge the Programme's general resources at the end of a financial year or at the end of each IPF cycle.

**It is proposed that non-UN and all bilateral donors be encouraged to adopt similar approaches to local procurement to those being proposed for the UN agencies.** In addition, there are a series of particular measures related to bilateral aid donors which, it is proposed, UNIDO place on the agenda of appropriate international fora. These should have a direct and indirect impact on the promotion of local industry both through encouraging local procurement and through raising the efficiency of domestic industrial establishments.

In particular, **it is proposed that bilateral donors untie their aid to the extent of refraining from providing equipment to the LDCs which is manufactured in the recipient country or for which an appropriate local substitute exists.** Additionally, **it is proposed that, through the medium of the DAC, bilateral donors publish details of the extent to which the aid they channel to the LDCs is tied**[10].

Finally, given the acute problems many LDC industries face in relation to low capacity utilisation levels and requirements for rehabilitation, it is **also proposed that bilateral donors** not only raise the level of their oda commitments to the LDCs but that they **double the amount of funding they currently channel to the industrial sector directly.** Three particular uses for this expanded industrial aid are proposed. First and, where appropriate[11], **donors should utilize or expand commodity aid funds in order to provide imported inputs, spare-parts and replacement machinery to existing industry.** Second, **donors should raise the level of funding of local and recurrent costs in industry.** Third, **donors should utilize additional funds to help bridge the gap in the training of indigenous management and technical skills for industry.**

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[10]. Using agreed DAC definitions of tied and partially tied aid.

[11]. Clearly it is wishful thinking to propose that tied aid should be abandoned. The qualification "where appropriate" is made here to suggest that donors should only be encouraged to provide tied commodity aid for those goods which they themselves produce at internationally competitive prices.

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