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the Least Developed Countries:  
Towards an Industrial Action Plan  
Vienna, 19-23 August 1991

INDUSTRIAL POLICIES IN THE  
LEAST DEVELOPED COUNTRIES:  
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Prepared by the

UNIDO Secretariat

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## *Preface*

Pursuant to the Paris Declaration and a Programme of Action adopted at the Second United Nations Conference on the Least Developed Countries (LDCs), held in Paris from 3 to 14 September 1990. UNIDO, with financial support from the Government of Italy, decided to organize a Workshop on industrial development in the LDCs. The aim of the Workshop is to review the status of industry and to analyse key issues of industrial development in the LDCs. The proceedings of the Workshop will form the basis of an Industrial Action Plan for the LDCs to be submitted to the fourth session of the General Conference of UNIDO in November 1991.

Key issues concerning the process of fostering industry in LDCs have been identified for discussions during the workshop. This paper provides a summary account of the most significant industrial development issues and outlines the role of industrial policies in critical areas such as the promotion of the private sector, the fostering of domestic as well as the attraction of foreign investment, human resource development, small-scale industry promotion and industrial rehabilitation. Past policies in these areas are briefly reviewed and recommendations given for future policy requirements.

This paper has been prepared by staff of the Regional and Country Studies Branch of UNIDO.

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## 1. INTRODUCTION: PERFORMANCE OF LDCS AND CURRENT DEVELOPMENT PROBLEMS

LDCs are - ex definitione - the world's poorest countries, the criteria being low per capita income and/or a small manufacturing base (less than 10 per cent of GDP), and/or high levels of illiteracy.<sup>1</sup>

The Substantive New Programme of Action (SNPA), adopted in 1981 at the First Conference on Least Developed Countries convened in Paris, set a target for the annual of manufacturing value added (MVA) growth rate in LDCs of 9 per cent and a GDP growth rate of 7.2 per cent.

The actual performance of LDCs, however, failed to reach these expectations. The annual MVA growth rate of LDCs attained in the 1980s was just 2 per cent. This was significantly less than the target rate, less than half the growth rate reached during the 1970s, less than the average population growth rate in LDCs, and also less than the average annual GDP growth rate which stood at 2.2 per cent. Thus, manufacturing in the LDCs failed to play its expected role as a 'motor' for economic development. This accentuated the marginalization process of LDCs in the world economy. As a result, the share of LDCs in total world exports amounted to a mere 0.3 per cent in 1988, as compared to 1.4 per cent in 1960.<sup>2</sup>

Socio-economic development, including the development of the manufacturing sector, in the LDCs has been handicapped by long-run hindrances such as poor infrastructure in housing, health, transport, communications, education, power, industrial services as well as generally weak institutional and administrative capabilities to carry out development programmes. In addition, short-run successes of development efforts have often been dissipated by natural disasters as well as political upheavals, civil wars or regional conflicts. Population growth rates have remained high and have led to non-sustainable economic activities such as environmentally unsound farming, grazing, fishing and to deforestation thereby aggravating existing poverty.

The disappointing growth performance of the manufacturing sector in most LDCs has been the result of a number of well-known development constraints of which the following are the most typical:

### - Physical constraints

These include land-lockedness and remote insular location with resulting transport problems and dependency; large inaccessible regions and terrain unsuited for any development purposes (applying to both mountain areas, deserts, or coral islands), and, proneness to natural disasters such as devastating floods and cyclones;

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<sup>1</sup> The last criterion, a literacy rate of less than 20 per cent, does not apply anymore. In this respect, substantive progress has been made over the past decades.

<sup>2</sup> See United Nations, Paris Declaration and Programme of Action of the Second United Nations Conference on the Least Developed Countries, (Paris 3-14 Sept. 1990), p. 3.

- Resource and market constraints

With the exception of a few countries, most LDCs are relatively less well endowed with natural resources which could be made the backbone of a resource-based industrialization strategy. Moreover, the smallness of the local market in many cases sets severe limits to the achievements of economies of scale and economic diversification;

- Savings and foreign exchange constraints

Not surprisingly, all LDCs are characterized by low levels of domestic resource mobilization for development. Generally, domestic savings rates range below 10 per cent in most cases. Although investment ratios tend to be higher than savings ratios, due to the inflow of ODA, the overall gross fixed capital formation in LDCs amounted to just 7.2 per cent of GDP in 1988.<sup>3</sup> In addition to alleviating the savings gap, inflows of ODA - which in nearly half of all LDCs equal more than 20 per cent of their respective GNP - have provided much-needed foreign exchange to finance crucial imports.<sup>4</sup> Nevertheless, the relatively low natural resource-based export potential of most LDCs has left these countries with critical foreign exchange gaps;

- Human resource constraints

Limitations with respect to education and training of the labour force are prevalent at virtually all levels in LDCs. This applies to the company level where - from technicians to management - there is a lack of sufficient trained personnel. This has adverse effects on the acquisition and efficient operation of new production techniques. It is also true with regard to policy-making and promotional institutions at the sectoral and macro-levels where the required special skills are generally not available;

- Infrastructural and institutional constraints

Closely related to the above, weaknesses in both the physical and institutional infrastructure for industrial development often limit the absorptive capacity of LDCs for external capital inflows and constrain their planning and implementation capabilities;

- Social stability constraints

There are only a few LDCs which have not suffered from civil unrest, including civil wars. Many LDCs are trapped in a political environment characterized by severe tensions which - because of widespread poverty - are likely to erupt at any time. Such an environment is clearly detrimental to any type of long-term planning and investment activity.

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<sup>3</sup> Source: Regional and Country Studies Branch LDC Database, PPD/IPP, Vienna 1991.

<sup>4</sup> See OECD, 1990 Report - development co-operation, Paris 1990, p. 26

While LDCs share a number of common features, it must be stressed that they are a very heterogeneous group. LDCs include countries like Bangladesh with more than 100 million inhabitants as well as some tiny island countries with less than 100,000 people. Among LDCs, one can find land-locked countries in deserts, in rain forests of Africa, in the Himalaya region, etc. as well as mainland countries with direct access to the sea and also a number of island countries.

The major objective in singling out a set of countries as "Least Developed Countries" has been to indicate to the donor community that it is these countries which - because of the poor state of their economies - most urgently need the assistance of the international community. However, in order to arrive at useful conclusions which go beyond general statements applicable to all LDCs it would be required to undertake country analyses, or at least analyses based on regional groupings of LDCs.

Taking a regional approach, 29 - or 70 per cent of all 42 LDCs - are situated in Africa,<sup>5</sup> 12 in Asia and 1 in Latin America (Haiti). Out of a total LDC population of 428.9 million, 221.3 million (or 51.5 per cent) are African, 47.1 per cent Asian and around 1.3 per cent Latin American. Given the total population of Africa (around 610 million in 1988) and Asia (3,000 million in 1988, without USSR) it is obvious that LDCs are of a far greater significance to Africa than to other developing regions.

#### African LDCs

According to the latest available statistics, the GDP/capita (in current US dollars) - the indicator most frequently used as a proxy for the status of economic development and the well being of the population in a country - for LDCs as a group was US\$280.2 in 1989.<sup>6</sup> With an average per capita income of US\$267.6, the African LDCs fall below this average figure. As a whole, LDCs were able to increase their GDP/capita by more than 18 per cent during the eighties. However, in African LDCs, GDP/capita declined by more than 15 per cent in the same period, showing quite clearly the extremely negative performance of African LDCs as a group.

The performance of the manufacturing sector can be summarily assessed in terms of manufacturing value added (MVA). MVA/capita (in current US dollars) - an indicator for the status of industrialization - stood at US\$18.05 for African LDCs compared with US\$17.7 for all LDCs in 1988. This indicates that African LDCs, on average are slightly more industrialized than their Asian counterparts (but significantly less than Haiti, the only Latin American LDC, with a MVA per capita of US\$55). However, whereas all LDCs showed an increase of more than 18 per cent in MVA/capita over the 10 year period up to 1988, African LDCs suffered a decline by nearly 4 per cent. This decline is even more marked if one takes 1980 as a reference year.

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<sup>5</sup> This excludes Namibia which is yet to become a full member of the LDC group.

<sup>6</sup> All figures are taken from REG Database, PPD/IPP, 1991.

African LDCs thus have not reached the target goals set out by the Paris Conference on the Least Developed Countries in 1981. They have also fallen short of the expectations of the IDDA I (the First Industrial Development Decade for Africa) and the Lagos Plan of Action which foresaw a more rapid industrialization of African states to overcome poverty and dependency in those countries. Given that the great majority of LDCs are Sub-Saharan African countries and that the development prospects in this region appear bleaker than ever - as a result, *inter alia*, of crop failures, the southward spread of the Sahelian/Sudan dry belt and the high population growth - these countries demand special attention.

### Asian LDCs

The Asian LDCs - even more than those in Africa - are characterized by a tremendous diversity. In terms of sub-regional groupings, the major groups to be distinguished are the Asian island LDCs (the Maldives and the Pacific islands LDCs Tuvalu, Kiribati, Vanuatu and Western Samoa), the Asian landlocked LDCs (Afghanistan, Nepal, Bhutan, Lao PDR), and the Asian mainland LDCs with access to the sea (Yemen, Bangladesh, Myanmar).

Like the African island LDCs,<sup>7</sup> the Asian island LDCs have shown some promising results. This is largely due, however, to the good performance of one country, the Maldives, which achieved a 10 per cent GDP growth rate in the seventies and a rate of close to 7 per cent during 1981-86. It may indeed be the only LDC in the region to have achieved the 7.2 per cent growth target set by the 1980 Substantial New Programme of Action.

The Asian landlocked countries are at the initial stage of industrialization. Although they too have the potential to increase their MVA/capita ratio, it is still extremely low at just US\$4.5. At the same time, however, it is interesting to note that they have enjoyed a GDP/capita ratio actually above the Asian LDC average (US\$-281.0 in 1988).

Finally, the Asian mainland LDCs with access to the sea, had a GDP/capita of US\$258 in 1989 which was below the Asian LDC average. However, they managed to increase their GDP/capita ratio by nearly 64 per cent in the decade from 1979 to 1989. Their MVA/capita ratio on the other hand, with US\$19.5 is already above the Asian LDC average. It increased by more than 52 per cent in the decade to 1988.

### Arab LDCs

Arab countries include the African countries Mauritania, Sudan, Somalia and Djibouti as well as one Asian country, Yemen. The inclusion of Yemen in the category of Arab LDCs is mainly responsible for the better overall performance of the Arab LDCs taken as a group. Their GDP/capita amounts to US\$622.0 which is significantly above the LDC average. They managed to increase their GDP/capita in the decade to 1989 by nearly 50 per cent. This good general performance of the group was bettered by their progress in the field of industry. Their MVA/capita increased to US\$39.5.

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<sup>7</sup> The African island LDCs have a MVA/capita of US-21.2 which is above the African LDC average.



i.e. an advance of nearly 65 per cent in the decade to 1988, and more than 220 per cent above the LDC average. Nevertheless, the short-term and medium-term outlook for these Arab LDCs is rather bleak. Sudan is suffering from famine and civil war. In Somalia, a devastating civil war has led to the ousting of the former president without a definite end to the ongoing civil war in sight. The Gulf crisis has effected Yemen very negatively as a result of repatriation of Yemeni migrant workers (more than half a million), the dramatic decline of workers' remittances and the non-disbursement of aid from Arab and Kuwaiti funds which, to a large extent, have been responsible for the good overall performance in the past.

#### Latin American LDC

Haiti is the only LDC in Latin America. Despite overall economic difficulties and political turmoil, Haiti recorded a MVA/capita of US\$55.0 which is above the LDC average. Between 1980 and 1988, the share of MVA in GDP oscillated between 15 and 20 per cent compared with less than 10 per cent for most other LDCs. However, the crises of the 1980s severely affected productive sectors in Haiti and by the end of the decade per capita GDP had dropped some 21 per cent from its 1980 level, returning to the level of 1960. Manufacturing suffered an even greater decline (24 per cent) during this period.

#### Summary

LDCs face a number of major constraints which, when combined, severely impede the full development of their economies. These include physical constraints, resource and market constraints, savings and foreign exchange constraints, human resource constraints, infrastructural and institutional constraints as well as social stability constraints. The previous analysis has shown that it was African LDCs in particular that suffered most from these constraints in the 1980s. MVA/capita in African LDCs as well as their GDP/capita declined whereas Asian LDCs - as a group - managed to show some positive results. In the 1990s, therefore, industrial development still presents formidable challenges, especially for African Governments. It is to these challenges both in terms of developing an appropriate macro-economic framework and, above all, in formulating a consistent and realistic set of industrial policies, that we now turn.

## 2. DEVELOPMENT OF AN APPROPRIATE MACRO-ECONOMIC DEVELOPMENT FRAMEWORK

Although it is obvious that LDCs, like all developing countries, need to develop an appropriate macro-economic framework, this point still warrants emphasis. A flexible macro-economic policy framework should be developed in each LDC to take specific account of the changing circumstances and structural rigidities of individual countries. Particular attention should be paid to developing linkages between various economic activities and especially the interface between macro-economic goals and sectoral and subsectoral restructuring, as well as ensuring the appropriate sequencing and combination of macro-economic policy instruments.

In response to persistent balance of payments difficulties as a result of structural imbalances, a growing number of African LDCs have undertaken structural adjustment programmes to provide an appropriate macro-economic framework for sustained economic development. Two new facilities were established by the IMF in 1986 and 1987 - the structural adjustment facility (SAF) and the enhanced structural adjustment facility (ESAF), respectively - to help low income countries, particularly LDCs, with protracted balance of payments problems.

In Africa, in recent years Guinea, Mali, Somalia, Equatorial Guinea, Gambia, Mauritania, and Togo have fully accepted the policy changes required by the World Bank and IMF in order to qualify for structural adjustment loans. Benin, Burundi, Burkina Faso, Mozambique, Madagascar, Niger, Sierra Leone, Tanzania and Uganda have partly accepted the requirements proposed by the Bretton Woods institutions. In Sudan and Ethiopia, the reforms required by the World Bank and IMF have been rejected or forestalled.

At the present time, Benin, Equatorial Guinea, Lesotho, Mali, Sao Tomé and Príncipe have structural adjustment arrangements (SAF) with the IMF. In addition, Gambia, Madagascar, Malawi, Mauritania, Mozambique, Niger, Togo and Uganda have enhanced structural arrangements with the IMF.\*

In the eighties - mid-1981 to mid-1989 - five of the 11 Asian/Pacific LDCs carried out structural adjustment programmes (SAPs). These structural adjustment programmes were supported by the IMF with stand-by credit and/or extended credit arrangements. The countries undergoing SAPs were Bangladesh, Lao PDR, Maldives, Nepal and Samoa. An assessment of these programmes undertaken by ESCAP suggests that the performance of SAPs has been very uneven across the various countries. The smaller countries were relatively more successful in overcoming their balance-of-payments crises, while the larger ones had to sacrifice growth and substantially reduce their social expenditures, especially on poverty alleviation.

Furthermore, it was found that the success of SAPs was critically dependent on a continued access to foreign assistance. In other words: The policy changes adopted during the adjustment process - removal of price distortions and changes in public expenditure patterns - were feasible only if combined with substantial inflows of ODA to prevent further increases in balance-of-payments disequilibria.

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\* IMF, International Financial Statistics, Volume XLIV, no. 3, March 1991, p. 23.

In Arab LDCs, besides Sudan, several countries have recently undertaken IMF sponsored SAPs. For example, Somalia, has undergone several adjustment programmes under IMF stand-by agreements, the most recent one being in 1987.

In the early 1980s, Haiti implemented an IMF stabilization programme. A structural adjustment programme was begun in 1986 but derailed by civil disturbances in 1987.

Macro-economic reforms, however, do not necessarily themselves guarantee economic rejuvenation. Indeed, unless provided with a social safety net for some of the poorer sections of society they can be particularly brutal. Witness the recent civil disturbances that have occurred in many African countries as a result of the adverse effects of SAPs on the poorer segments of society. In Liberia, for example, there were severe riots as a result of increases in the price of rice as part of a general attempt to decontrol producer prices.

Nonetheless, macro-economic policy reforms can help correct many inefficiencies in industry in LDCs. Successful devaluation can help eliminate excess capacity by encouraging enterprises with under-utilized plants to export more. At the same time, a devaluation by giving a stimulus to exports may provide the foreign exchange for essential imports of spare, replacement parts and other machinery. A lowering of the general level of tariffs and a move towards more uniform tariff rates would also lead to more uniform rates of effective protection across sectors and thus induce enterprises to find ways to improve productivity. A more neutral and open trade regime may orientate domestic industry towards more export production and away from domestic markets. A stronger export orientation of domestic enterprises could lead to increased efficiency and productivity.

But since macro-economic reforms often hurt before they help, their beneficial effects may require a longer time-frame. In addition to the social dislocations mentioned earlier, these reforms generally cause imports of essential machinery, spare parts, components and raw materials to be more expensive. Easier access to credit with a liberalized banking and financial system runs counter to the demand-dampening objectives of stabilization policies, and the liberalization of the import system will cause many inefficient enterprises to shut down.

However, although macro-economic reforms are essential to provide the appropriate framework to ensure economic growth they can do little for industrial inadequacies such as a lack of an indigenous entrepreneurial cadre, or a thriving private sector, inadequate technology, and insufficient supplies of appropriately trained and experienced managerial and supervisory personnel. These are the very real impediments to economic development at the industry and enterprise levels in African LDCs. Also, the often diagnosed weakness of vertical integration in much of LDC domestic industry is not readily amenable to macro-economic reforms. Thus macro-economic reforms are a necessary but not a sufficient condition for industrial regeneration and expansion. There is therefore a clear need for a focused industrial policy to attack structural weaknesses at the industry and enterprise level.

### 3. NEED FOR COMPREHENSIVE INDUSTRIAL POLICY

#### 3.1 Nature and scope of industrial policy

Given the diversity of LDCs, it is clear that no single set of industrial policies is 'best' for all of them. Yet despite their diversity, LDCs share a common need to develop a comprehensive industrial policy which seeks to maximize their strengths and minimize their weaknesses. The strengths of LDCs are basically their natural resources - particularly agriculture, forestry and minerals. The weaknesses of LDCs include the small size of domestic markets and populations, low per capita incomes, industrialization, human resource, infrastructural and institutional development.

It is clear therefore that for industry to become the motor for overall economic development it must be closely allied with agriculture and other natural resource bases. Agro-industry, including agro-forestry and mineral and other natural resource-based industries, must therefore be the priority focus of industrial policy. In addition, given the limited resources available for industrial development, LDCs cannot afford to dissipate scarce human and other resources over too wide an area. This fact would call for most LDCs to focus industrial policy on selected areas, sectors, subsectors, industries and even on specific priority enterprises. This targeted approach would ensure that scarce resources are used where they would have most benefit.

The difficulty with this approach is that it requires the correct choice of targets whether they be sectors, subsectors, industries or enterprises. In an ideal world, the best approach would be for LDC governments to be facilitators and support whatever choice made by private entrepreneurs on the basis of their willingness to put their own capital into particular areas. Unfortunately, in most LDCs there is little or no formal private sector. Or, if the private sector exists, it is only in an insignificant small-scale sector or in an extremely heterogeneous informal sector. To state this, is not to deny the great potential of the informal and small-scale industry sectors in LDCs. It is only to say that as yet the potential of these two sectors is not fully realized and it will probably take some time to do so. In lieu of significant private initiatives, LDC governments with the assistance of international agencies such as the World Bank and UN agencies such as UNDP, UNIDO and ILO may have to identify the focal areas of industrial policy. These areas would obviously have to be those in which the private sector and indigenous entrepreneurs could play a role and ultimately a lead role.

The above discussion, therefore, has a number of important implications for industrial policy. First, industrialization will have to be based on better use and/or exploitation of natural resources. This would call for a rural-based industrialization strategy in most LDCs. Second, this strategy must capitalize on the latent dynamism of local entrepreneurs in the informal and small-scale industry sectors. Third, the strategy would call for de-centralization of economic decision-making and a regional approach to foster rural development. Fourth, and most important, the approach would call for a concentration in the provision of supporting institutions, infrastructure, human resource development, policies and financial support on the key areas/subsectors or enterprises selected as priority.

### 3.2 Decentralization of industrial policy and a regional/rural development focus

LDCs are characterized by extreme heterogeneity in terms of geographic location, climate, ecology, economic, ethnic, cultural, social and political conditions. Not surprisingly, the development needs and potential of the various segments of the population in LDCs will differ as well the contribution these segments make to society itself. This variety results in the need for diversity and differentiation in the policy instruments used by LDC governments and particularly, a decentralized administrative structure. In this context, decentralization would mean not only the existence of administrative offices and branches of government services in the various regions of the countries, particularly rural areas. But, above all, also the assignment to these regional bodies of decision-making powers, monetary and fiscal resources and the autonomy to use these as they see fit. Clearly such a regional decentralization approach would make strong administrative and political demands on LDC governments. In particular, many LDCs do not currently have the decentralized administration and political institutions required. For this approach to be feasible the requisite decentralized political and administrative machinery would have to be developed, probably with outside assistance.

But it should be stated that although de-centralization is increasingly the focus of economic and political reforms efforts in many developing countries, currently few, if any, LDCs have actually enacted such a policy in a significant way. And, some LDCs are so small that it is questionable whether a de-centralization policy would have much meaning in these countries. However, for larger LDCs such as Tanzania or Bangladesh, decentralization may be a significant fillip to economic development and moves towards increasing democratization. De-centralization would also assist rural development since most of the population in LDCs live in rural areas. In terms of African LDCs in 1990, 58 per cent of the population in Benin lived in rural areas; 76.5 per cent in Botswana; 91 per cent in Burkina Faso. With regard to Asia in 1990, 78.3 per cent of the population in Afghanistan lived in rural areas, 86.4 per cent in Bangladesh, and 94.7 per cent in Bhutan. In Haiti, the figure was 69.7. In Arab LDCs for example, in 1990, 78 per cent of the population in Sudan lived in rural areas, 63.6 per cent in Somalia and 57.9 per cent in Mauritania.<sup>9</sup>

An important dimension of the industrial restructuring and regeneration process in LDCs, therefore, will be regional development. Structural crises and potential for growth in individual regions will need to be examined and dealt with at the level of the region itself within a new framework of overall economic policy. The design of policies for promoting local initiatives and identifying regional growth potentials warrants due consideration by LDC Governments. Given the scarcity of resources, support should be applied to selected regions especially those which have the potential for major restructuring. To this end, detailed regional surveys would be needed to be undertaken as a basis for regional development initiatives to be launched by regional development councils or authorities.

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<sup>9</sup> World Resources Institute, World Resources Institute, New York 1990.

Within this programme of regional development, it is important to give equal support to domestic investment as to foreign investment and hence to facilitate the start-up of small-scale enterprises from private initiatives and entrepreneurship development. This would provide an essential element in industrial restructuring at the regional and especially rural levels in many LDCs. On the basis of detailed regional surveys, investment project preparation and appraisal, training and technical support would need to be built-up and developed in each region as part of an efficient institutional infrastructure in which regional development councils or authorities will form an integral part. Thus, regional development councils would provide the means for key decision makers and actors in industrial restructuring in LDCs to be in a better and more informed position to conceptualize and launch industrial regeneration at the regional level. Local actors will be much better acquainted than a central government with the key determinants, constraints and prospects which have a bearing on industrial development efforts. They will also be able to more realistically assess the challenges ahead and the available and suitable policy responses that are amenable at a local level and therefore more effective.

Finally, decentralization of economic policy and of administration would also be in keeping with a policy of targeting key subsectors, industries and even enterprises. Such a policy requires a lot of detailed information about these targeted entities if policy support is to be appropriately developed and implemented. In this connection, local institutions and, regional bodies such as regional development councils would have a comparative advantage in generating this information. They will certainly be more sensitive to local needs, aspirations and idiosyncracies.

A targeting policy would also imply decentralization of policies and decision making to rural areas or growth poles where key subsectors or enterprises are or could be located in LDCs. Such an approach would imply an unbalanced development strategy by favouring/supporting key regions with economic growth potential. This will imply some hard political choices. However, given the scarcity of resources, it is difficult to suggest an alternative strategy which would not involve dissipating resources over a wide area. LDC governments may have to build on key regions or potential growth poles, with key sectors and/or priority areas and enterprises with good growth prospects. However, it would be more important for LDCs to move away from regions where there is still little or no potential for growth. Though this approach would have important social and political implications, it may be cheaper in the long-run. It should also be remembered that foreign investors do not invest generally but in selected key areas with the appropriate supporting services and infrastructure.

In sum, the establishment of regional enterprise development boards or councils will be a critical ingredient in establishing a regional network of mutually supporting activities, services and enterprises. Such an enterprise board could help realize economies of association and the establishment of such mutually supporting activities would be much more conducive to attracting direct foreign investment.

#### 4. KEY AREAS OF INDUSTRIAL POLICY

##### 4.1 Small-scale industry development

##### 4.1.1 The development contribution of small-scale industries (SSIs)

The predominantly rural character of most LDCs puts small-scale industries (SSIs) - which generally are strongly linked with the agricultural sector - in a very important position. Indeed, it is SSIs which tend to cater for the needs of the rural population and primarily process agricultural products for consumption and supply low-cost clothes, utensils, tools, equipment and fixtures for agriculture, fishing and construction. Hence, food processing, wood and furniture and agricultural implements are the most important sub-sectors of small-scale activities, apart from wearing apparel, leather products, and non-metallic mineral products. Informal industries are tightly interwoven with agricultural activities. They provide employment on a seasonal basis, often in slack periods of crop activities, generate employment for women with few opportunities in other sectors and generate self-employment for the landless. Small and informal industries, therefore, play an important role in poverty alleviation and generally serve to promote a more equitable distribution in development than medium and large industries.

In general, the importance of SSIs is based on the following characteristics:

- SSIs mobilize human and other resources for industrial activities in the urban and rural areas which can not normally be absorbed by the agricultural and large-scale industrial sector;
- most SSIs do not require large capital investments and highly specialized managerial and technical skills;
- SSIs tend to be regionally dispersed thereby reducing product distribution costs as well as lowering regional imbalances and improving the income distribution;
- SSIs provide local processing of agricultural products which increases product value to the grower;
- SSIs are an important source of income and employment of the lowest income population and, particularly, women;
- SSIs are a major source of technical and entrepreneurial training for the poor and assist in the development of industrial skills at relatively low cost.

After a period of emphasizing large public sector projects as an instrument for industrial growth, most LDC governments now recognize that further industrial development appropriate to the country's scale and needs should largely involve privately owned small-scale enterprises.

In order to address the market, managerial, technological and financial development constraints of SSIs on a systematic basis, the governments of LDCs need to design strategies and policies aiming at a strong and sound promotion of small-scale and informal industries. Such policies as pursued in some selected LDCs are briefly reviewed in the next section.

#### 4.1.2 Small-scale industry development policies

Small and informal industries deserve special attention in LDCs since they are the seed-bed for industrial growth. Small firms form a large pool of indigenous entrepreneurship and potential managers. As in developed countries small firms can grow into medium and large enterprises. Those enterprises that mature in a market-based growth process generally have better long-term prospects for profitable operation than large companies which are set up by state-owned corporations. This market-based growth process does, however, not occur automatically but ought to be supported by small-industry schemes aiming at strengthening the entrepreneur's capability to survive. Often the entrepreneurship potential cannot be translated into business success because of lack of finance, access to raw materials or lack of technical and accounting knowledge.

The promotion of SSIs is a major component of the national industrial policies and programmes of many LDCs.

In Bangladesh, a number of government and private voluntary organizations are involved in the promotion and development of small and cottage industries (SCI). The most important of the government organizations is the Bangladesh Small and Cottage Industries Corporation (BSCIC) which provides various extension services. Its objectives are to provide finance, infrastructural and marketing facilities, training and technology support. As part of its programme the Corporation has developed industrial plots with provision of roads, water, power, drainage and other common facilities such as banks, repair-workshops, etc. Industries Service Centres in each district are to help small entrepreneurs in project identification, formulation and appraisal and to provide regular post-investment counselling. In collaboration with other government institutions like the Bangladesh University of Engineering and Technology and the Bangladesh Industrial Technical Assistance Corporation (BITAC), technical training is provided to specific target groups of entrepreneurs. A particular entrepreneurship training is offered by BSCIC for technically qualified people who lack the requisite means for setting up industries. BSCIC runs its own Small and Cottage Industries Training Institute for conducting its training programmes with an attached research faculty for undertaking research and consultancy in the field of small industries. As part of BSCIC an Industrial Design Centre was set up with a view to improving through training the design of SMI products and to providing prototypes for new products. Various credit schemes aim at alleviating SSI's lack of financing. A credit guarantee scheme has operated through the central bank, the Bangladesh Bank, to help small entrepreneurs lacking of collateral to get access to commercial bank lending. BSCIC has introduced the Lead Bank Programme with commercial banks acting as lead banks through which BSCIC finances small firms; BSCIC itself, however, does not own any credit fund. The recovery rate of the credit programme with 51 per cent on the average, is poor by international comparison but not abnormal under Bangladesh's conditions. As part of its SMI financing programme, BSCIC has launched a hire purchase programme for supplying machinery on lease. Leasing of machinery does not require collateral since the machine remains the property of the lessor while the lessee can generate returns. Despite BSCIC's broad approach there is wide scope for improving extension services to Bangladesh's small enterprises since the sector has stagnated during the last two decades.



SSIs and handicrafts in Ethiopia account for about 45 per cent of total employment in the manufacturing sector, 23 per cent of total fixed assets, 13 per cent of gross production value, and 23 per cent of manufacturing value added. Due to the underrecording of informal, unregistered enterprises these figures are likely to underestimate the importance of SSIs and handicrafts to the economy significantly. Entrepreneurs are attracted to the SSI sector by the freedom to determine product prices which allows them to benefit from scarcity rents by charging high margins.

However, high domestic market prices, relative to world market prices at the official exchange rate, and the requirements to surrender foreign exchange earnings to the National Bank of Ethiopia discourage SSIs from exporting their products. Furthermore, the private sector does not have access to the facilities needed to conduct export trade: communication with buyers and attendance at trade fairs are particular problems. Besides, acquisition of an export license is a time-consuming process. Yet, despite the sector's domestic orientation, several enterprises have been able to develop export sales of such products as shoes, semi-processed leather and garments. There is considerable potential for the expansion and diversification of exports if a suitable incentive environment can be created.

Recent changes in the legislation governing private sector investment have sought to stimulate the expansion of SSIs. Clearly, SSIs offer a cost-effective means of tackling urban unemployment, one of Ethiopia's most pressing social problems. Successful SSIs will also transfer the liquidity within the trading community that fuels the smuggling trade and parallel market, to more productive purposes.

Guinea' new policy orientation emphasizes the role of the private sector as the engine of growth. Until now, private initiative has been largely in the field of trading. The intention is to encourage entrepreneurs to enter the field of small- and medium-scale industry. General support institutions have been set up including Centre de Création et de Développement des Entreprises (CCDE), Centre National de Promotion des Investissements Privés (CNPIP) and the Centre des Opportunités Industrielles (OIC).

Togo has also adopted a policy of privatization and strengthening of private initiative. A joint State-Chamber of Commerce Consultation is in progress to work out a Comprehensive Action Plan for promotion, development and support to small and medium enterprises including training, management consultancy, acquisition of technology, project preparation and financing.

In Congo, the public sector is dominant. An effort is being made to encourage the growth of small and medium industries through the support services of ADPME (Agence de Développement des Petites et Moyennes Entreprises), the small- and medium-scale enterprises (PME) unit in the National Development Bank and the Fund for Guarantee and Support to Small and Medium Enterprises (FGS). An Expert Centre for preparation of feasibility studies has also been established with the help of UNIDO.

Lesotho has a special agency for small industry promotion, BEDCO, Basotho Enterprises Development Corporation. BEDCO needs strengthening to enable it to provide adequate support services. The setting up of a "sub-contracting exchange" has also been suggested. The principal assistance given at present is the running of an industrial estate.

The small-scale private sector industry in Yemen is generally referred to as the "unorganized sector" by the Ministry of Industry, Trade and Domestic Supply, a term that reflects the degree of government intervention. Little information is available about the scale or scope of these enterprises since licenses are awarded by municipal authorities. Recently, however, the Government has begun to examine the potential for development of small-scale industries as a means of attracting the resources of migrant workers into productive sectors and producing a range of simple goods for the domestic market and thereby substituting for imports. Council of Ministers' Order No. 12 of 1989 permits selected small-scale industries to bypass the procedures outlined in the Investment Code and receive their licenses directly from the municipality thereby greatly facilitating project implementation. The Ministry of Industry has also established a section to prepare and implement a small-scale industries development programme but the appropriate strategy is, as yet, undecided.

#### 4.1.3 Suggested policies to promote small-scale industries

In order to realize maximum benefits from the SSIs and to avoid wasteful use of resources, LDC governments need to encourage SSIs on a selective basis. This means that support should be provided for those enterprises which have the ability to compete in free market conditions and are commercially and technically sound. In general, industrial policy aimed at the promotion and development of SSI should be directed toward the establishment of a favourable economic climate which would stimulate development and remove constraints. This policy should widely use instruments such as taxes, registration requirements, securities for bank credits and their administration, as well as promotional measures and incentives by establishment - for example, of special grants for specific purposes, tax privileges, favourable credit terms, export subsidies and so on. Governments should create and maintain facilities for the development and promotion of entrepreneurship where entrepreneurs can receive advice and guidance on how to set up and successfully operate businesses. These facilities are particularly necessary for small businesses because they are usually set up and run by individuals who may have little or no education or may have no previous experience in running such businesses.

Entrepreneurship development and promotion can be achieved through appropriate human resource development policy covering government, parastatals and private medium and large firm employment. This can be arranged through the establishment and maintenance of industrial centers, particularly in small towns and rural areas where individuals can learn skills in an industrial or commercial environment.

Through appropriate industrial policy measures, limited protection of domestic SSIs from import competition may be established. Protection may be particularly important for the small enterprises in the early stages of development because of their general inability to carry out aggressive

marketing strategies which require expensive specialized skills and network facilities. Protection, however, should be considered as a temporary measure. This requires the understanding and support of industrialists and the government.

Another problem which will also have to be addressed by industrial policy is the resource allocation for SSIs. Given the general shortages of foreign exchange in LDCs the SSIs are often unable to obtain only small amounts of foreign exchange. Consequently, governments should take measures to allocate foreign exchange for the importation of essential equipment and raw materials required by the SSIs but which cannot as yet be fabricated domestically.

#### 4.2 Industrial rehabilitation

##### 4.2.1 The need for rehabilitation

Industry in many LDCs consists of a very limited number of formal sector enterprises. If these enterprises are producing inefficiently at low levels of installed capacity and are making significant losses, this has a major effect on industry in general. Rehabilitation of these enterprises is, therefore, important for industry and overall economic growth.

So far, the majority of UNIDO's work on rehabilitation of industry has concentrated on Africa. However, a variety of recent UNIDO and other reports, have found similar requirements for the rehabilitation of industry in Latin America, Asia and Arab LDCs. Rehabilitation in these other regions is clearly an issue that will warrant due attention in the years to come.

Recent studies, by UNIDO in particular, have found that many enterprises in African LDCs are in urgent need of rehabilitation.<sup>10</sup> The underlying causes of the present situation in African LDCs are both macro and micro-economic in nature. Being highly dependent on imports (both raw materials, components and equipment), industry in LDCs has been seriously affected by the need to reduce imports as a result of balance-of-payment crises in individual countries. Furthermore, in the early stages of industrialization in LDCs, projects were often based on assumptions of domestic market demand growth, export prospects and the development of supportive infrastructure. In addition, macro-economic policies and specific pricing, trade and industrial policies have in many cases distorted product markets and production conditions.

At the micro-economic level, in many instances, investments have been made on the basis of project concepts that were technologically too complex to be sustained over the long term without significant foreign assistance. In many projects, insufficient support in the form of training and other

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<sup>10</sup> See among others, reports on The regeneration of Liberian (PPD/R.23), Tanzanian (PPD/R.26) manufacturing industry with emphasis on agro-based industries; UNIDO industry sector programming mission to Uganda (PPD/R.36); and Regenerating African manufacturing industry: Country Briefs (PPD.97).

essential auxiliary inputs, tended to drastically affect productivity. In other cases, especially in the food processing industry, expected raw material supplies to manufacturing proved to be insufficient, irregular or even non-existent.

The result of the above is that capacity utilization rates in African LDCs are very low. Utilization rates well below 40 per cent are not uncommon. In the mid-1980s, for example, the rate was 33 per cent in Sudan (private sector), 36 per cent in Liberia, under 35 per cent in Sierra Leone and 25 per cent and less in Tanzania. UNIDO's current diagnostic rehabilitation surveys of manufacturing industries in Liberia and Tanzania show that the situation has not improved; indeed in some cases, it has become worse.

Thus, significant and increasing under-utilization of industrial production capacities is one of the major factors hindering the renewal of economic growth in LDCs. If this trend could be reversed, greater utilization of installed capacity and improved productivity would be the most economical means of restoring dynamism to the industrial sector and overall economic growth in LDCs.

#### 4.2.2 The approach to rehabilitation

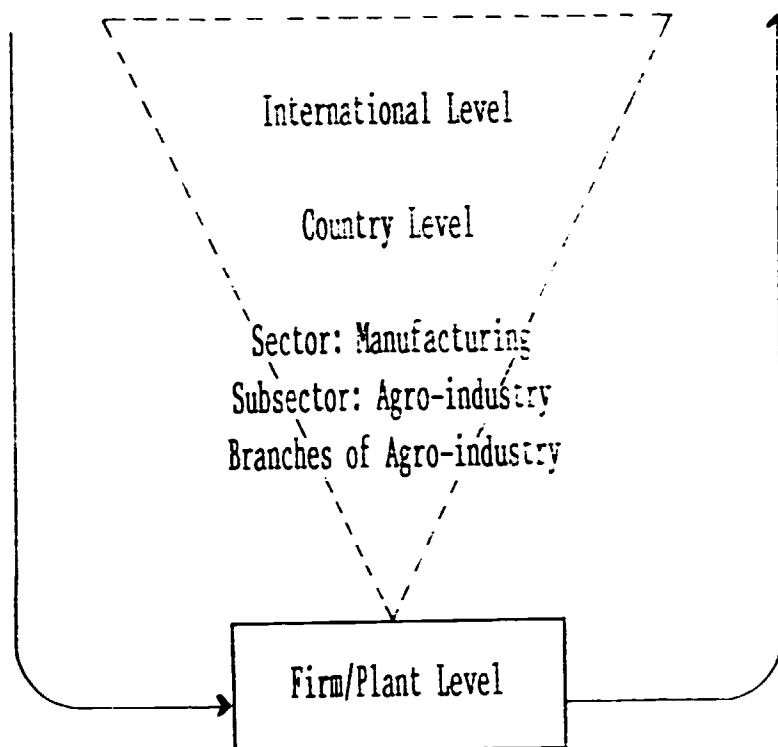
However, before a serious effort can be made to carry out detailed rehabilitation of industry in LDCs, LDC governments need to diagnose in depth the precise reasons and scope of the problems and constraints presently faced by industry and the increasing challenges being built up in a particular subsector and in specific industries or enterprises. It is also important in this diagnosis to avoid treating industrial rehabilitation as a mere micro/technical issue.

It is essential to fully assess the nature and magnitude of underlying constraints for two reasons: First, to be able to assess the general viability of any rehabilitation effort; and second, to identify the precise type of measures, investment studies, market studies, policy and institutional issues, and technical matters which need to be examined in-depth as part of the subsequent effort of detailed rehabilitation work at subsector, enterprises and plant levels. In other words, only with the broad classification of current problems and their causes, with an initial estimation of the appropriateness (in economic terms) of rehabilitation, can targeted technical assistance projects be designed and launched for selected activities of the industrial sector in the various African LDCs.

The concept of industrial rehabilitation obviously needs to be broadened and integrated: it should combine an understanding of both macro-economic forces and real problems at the plant-level. It should encompass a broader diagnosis and recommend a wider range of action. Manufacturing enterprises are not 'islands unto themselves'. They exist in an economic environment which is ever-changing. Manufacturing enterprises should therefore be studied in relation to their total economic environment. Diagnostic analyses and remedial action programmes should cover the entire range of technical, managerial and technology issues at the plant-level as well as the overall financial, commercial and structural issues at the branch, subsector, sector and macro-economic levels. An

issues at the branch, subsector, sector and macro-economic levels. An approach covering all these issues would be a top-down/bottom-up approach (see Figure 1).

Figure 1: The plant in its working environment:  
Top-down/Bottom-up approach



Top-Down:  
Analysis of Working  
Environment as it  
Affects Individual Plants

Bottom-up:  
Recommended  
Changes in the  
Working Environment

The integrated, multidisciplinary approach proposed is summarized in Figure 1. In order to assure that rehabilitation is not impeded by environmental factors, a "top-down" analysis should be followed by an assessment of each enterprise in terms of its rehabilitation climate, from the "bottom-up". In other words, a major effort should be made to assess what changes in the economic and institutional environment (e.g. government tariff policies, regulations concerning allocation of foreign exchange, etc.) constitute preconditions to successful plant-level rehabilitation.

From a top-down perspective, a country should be first viewed in its international context. This involves macro-economic or country level analyses which examine the key characteristics of a country's economic policy and institutional framework. At the sectoral level, manufacturing industry should be assessed in terms of overall characteristics, potential and major problems and constraints.

Special attention should be paid to policies and institutions relating to the sector. The relationship of manufacturing to agriculture should also given special consideration, since for most countries agro-based industries are the most important. This is for a number of reasons. Most African LDCs have the goals of self-sufficiency in food production and food security. The development of agro-based industries would initiate an industrial tradition based on locally available raw materials. In addition, the development of agro-based industries plays a key role in attempts to diversify exports and overcome foreign exchange constraints. Thus, at the subsector level special emphasis in terms of agro-based industries should be given to those related to the food processing subsector. Again, at the subsector level there should be an analysis of the characteristics, potential, major problems and constraints, linkages, and policies that are related to the key subsector being analyzed. The subsector should also be examined at the branch level.

Finally, at the plant-level, a detailed analysis should be made of the rehabilitation needs of a few selected key enterprises with specific recommendations for rehabilitation efforts. The enterprises selected for detailed analysis should be important enterprises in key subsectors with good backwards and forwards linkages to other firms, industries and sectors, especially primary sectors such as agriculture and other natural resource sectors.

As mentioned earlier, LDCs in Africa have very limited financial and other resources. Thus, an emphasis on a few strategic enterprises with good linkages in key subsectors would concentrate resources where they can have most impact. It would also maximize the multiplier effects of any given investment - in that, should these enterprises be successfully rehabilitated, they would exert a significant "pull-effect" on other similarly placed enterprises. They thus become the motors to start the regeneration process going and provide the dynamism for more widespread economic growth.

In order to examine a plant in its total working environment a multidisciplinary approach would be required which includes an analysis of the enterprise in terms of the macro and industrial economic, financial, management and organization, human resource development, marketing, design and engineering, and technological dimensions. This multidisciplinary approach is absolutely essential in order to avoid the piece-meal approach and 'situate' the enterprise in its total working environment. This approach ensures that the real reasons why plants do not work to their optimum potential - which may not be just at the plant-level - are identified. The approach also allows the elaboration of a more appropriate and broader set of actions to rehabilitate the enterprise so that it is able to be profitable and compete successfully in an ever-changing environment.

#### 4.2.3 International assistance for industrial rehabilitation

It is clear that most African LDCs will not have the resources to undertake significant rehabilitation of industry without substantial external assistance. Most industrial rehabilitation projects require foreign technical and financial support, particularly in the acquisition of equipment and spare parts. Besides international financial assistance, African countries will require technical and managerial expertise to assist in selecting and procuring equipment and monitoring plant rehabilitation. An important effort should be made by international agencies, therefore, to mobilize and concentrate national and international resources and efforts to rehabilitate the plants. Intensified and focused international co-operation could generate a multiplier effect in industry and agriculture, thereby endorsing efforts to be undertaken by national entities.

Regional co-operation will also have an important role to play in regenerating manufacturing industries in LDCs. Given the small domestic markets and the difficulties in penetrating overseas markets, regional markets will be needed for growing industries. This implies measures such as harmonization of trade regulations, co-operation in improving the transport and telecommunications infrastructure, and organization of regional trade fairs. Regional co-ordination of rehabilitation and investment would also save resources in scarce supply. The shortage of qualified manpower, both at the enterprise level and in industrial development organizations, could in part be solved by pooling available planning resources and creating regional training institutes for higher-level manpower. Co-operation among African countries would also strengthen their position vis-a-vis overseas suppliers and in overseas markets.

It is important to stress that whatever the action taken at the national, regional or international levels, it must be taken swiftly. If remedial action - from the diagnosis stage all the way to actual implementation of a rehabilitation programme - is too slow, no matter how well formulated, rehabilitation programmes will fail. In the design stage, therefore, all the actors in the rehabilitation process must ensure the speedy delivery of their inputs and smooth uninterrupted action towards ultimate rehabilitation.

The biggest stumbling block to rehabilitation in African LDCs has been the often fatal interruption in the rehabilitation process caused by the need to hunt for funds to implement the diagnosed rehabilitation requirements. If rehabilitation programmes are to be successful, individual African Governments should, at the outset, in conjunction with the international community - especially the donor community - design mechanisms to guarantee funds for the comprehensive rehabilitation needs identified. African governments and the Donor Community appear to be slowly recognizing this essential point. The World Bank/IFC's African Project Development Facility (APDF) and the EEC and DEG's Rehabilitation Advisory Services (RAS) in particular, are good examples of what can be done in a positive way to ensure that the rehabilitation process is not stopped at the diagnostic level and that funds are available for actual

rehabilitation.<sup>11</sup> APDF and RAS are currently based in Kenya and do not incorporate the smaller scale enterprises commonly found in LDCs. In principle, the APDF and RAS concepts should be able to be adapted to the needs of LDCs.

#### 4.3 Investment policy and investment promotion

##### 4.3.1 Foreign direct investment (FDI) in LDCs: Recent trends

As is well known, foreign direct investment (FDI) can play an important part in the development of LDCs, whether this investment is in terms of new investment or rehabilitation. All LDCs are officially placing significant emphasis on attracting increased FDI flows as a means to obtaining investment capital, technology and, hopefully export market outlets.

While FDI has played a major role in the development of the South-east Asian countries, the LDCs in the Asia-Pacific region are in a clearly marginal position as FDI recipients. Nevertheless, there are some encouraging signs of a growing scope in the future. More conducive policies and appropriate legislation to attract FDI have been introduced in a number of the region's LDCs, including in countries which in the past were not appreciative of the positive development contribution of FDI. Examples include Nepal, Bangladesh - where the setting up of an export-processing zone in Chittagong deserves further study to glean possible lessons for other LDCs - and Myanmar. The latter joined the competition for FDI in late 1988 with a new Foreign Investment Law allowing foreign investors to establish either wholly foreign-owned enterprises or joint ventures.

The Asian-Pacific region has in recent years been characterized by a rapidly increasing degree of economic integration which has led to the emergence of a strong intra-regional division of labour. This is also true in the field of foreign investment. Many Asian countries are not only major recipients of FDI from OECD-based companies, but are also preferred targets for relocating relatively labour-intensive industries from the Asian NIEs in which industrial production has come under the dual pressure of rising wages and appreciating currencies. The Asian Development Bank therefore concludes that "the strong investment flows from Japan and the Asian newly industrializing countries to South-east Asia are likely to reshape the regional structure of production over the next decade ..... and make the region a more cohesive entity in the world economy".<sup>12</sup>

While being focussed on East and Southeast Asia, this remarkable trend towards increased regional integration has not left the LDCs of the region entirely untouched. Examples of their involvement include:

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<sup>11</sup> The Rehabilitation Advisory Services, Ltd. (RAS) is a new company based in Nairobi which started operations on 1 May 1989. It is an EEC-financed pilot project with the German Development bank, DEG (Deutsche Finanzierungs-Gesellschaft für Beteiligung in Entwicklungs Ländern GmbH) owning 51 per cent of total shares and the remainder owned by 3 Kenyan development banks. It is also associated with PREFUND, which is a financial company, wholly owned by DEG, that provides risk capital.

<sup>12</sup> Asian Development Bank, Asian Development Outlook 1990, p.39.



- Bangladesh, where almost 50 per cent of all joint ventures sanctioned since 1977 were proposed by companies located in other developing countries of Asia;
- Maldives, where in the newly established export-processing zone significant export-oriented investment has been undertaken by companies from Sri Lanka, Hong Kong and India;
- Lao PDR, where - as mentioned above - Thai industrial companies have been strongly involved in take-overs of local companies in the context of the privatization programme; and
- Myanmar, where again Thai investors are quite active and where the first industrial joint venture under the new Law - in the field of woodworking - was carried out with a partner from Singapore.

No doubt, the magnitude of FDI inflows reflected by these examples has remained small so far, yet there is a clear potential for Asian/Pacific LDCs to benefit from the region's economic dynamism and increasing integration and differentiation. To reap the potential benefits, efforts will need to be undertaken in these countries to improve the complementary physical and human infrastructure to productively absorb such investments.

Since 1983, FDI has fallen in Sub-Saharan Africa, particularly in LDCs. Total non-concessional financial flows from all sources dropped from US\$570.6 million in 1981 to US\$115.3 million in 1986. This drop in total non-concessional flows reflects the high risks perceived by lenders and investors in African LDCs. Concomitantly, FDI also dropped from US\$77.3 million in 1981 to US\$27.7 million in 1986. This was in spite of the attempts by various LDCs to improve their investment climate. The drop in FDI has meant that in recent years LDCs have experienced difficulties in servicing their debts and shortage of foreign exchange. These foreign exchange shortages have led to difficulties in importing essential spare parts and equipment which, in turn, has led to a severe drop in capacity utilization. For example, the average capacity utilization rate in African LDCs has been found in recent UNIDO studies to be less than 40 per cent. In specific cases, capacity utilization rates are much lower. For example, the capacity utilization rate in Uganda has been only 20 per cent.

There are a number of reasons why FDI in Africa has been falling in recent years. First, many investors require a large market with a large local demand. Most African LDCs, however, have small domestic markets which are too small to attract large-scale FDI. In addition, many African LDCs have population levels and a per capita incomes which are also too small to provide the demand for significant investment. About half of African LDCs have a per capita income less than US \$300. Uganda, in 1985, had a population of about 15 million inhabitants and a per capita income of about US \$150. This was less than 1/10 of the per capita income of Malaysia (over US \$2,000) which has a comparable population.

Mention should also be made of the fact that, until recently, there was a distinct hostility to FDI in many African countries. The political, social and economic upheavals in recent years in African LDCs have also been a deterrent to significant FDI flows.

#### 4.3.2 Past attempts to attract FDI

In the past, many investment codes adopted to stimulate private investments in productive activities have proved to be a hindrance more than a promotional tool. To be eligible for the incentives and favourable conditions of investment codes, potential investors were submitted to cumbersome and long formalities, red tape, and the necessity of prior agreements from a wide range of different institutions.

Moreover, some investment codes impose a minimum size on investment capital, which excludes small- and medium-scale enterprises which may be the most appropriate for LDCs.

In response to the above obstacles or constraints many LDCs have tried to improve the investment climate in their countries by enacting a number of changes to their investment codes and/or general rules and regulations concerning FDI.

Although the specific measures differ from country to country, in broad terms, African LDCs have undertaken a number of similar measures to enhance their business climate. Many countries have tried in their legal system to give equal treatment to foreign and domestic investors. For example, there is a special emphasis on equal treatment in Niger's new investment code, announced in December 1989. Tanzania's Investment Promotion act in 1990 also makes this special emphasis. Many LDCs give guarantees against expropriation of investments where this does not contravene national security or public interests. In cases of expropriation of investments, African LDCs are increasingly giving provisions in their investment codes for adequate compensation. For example, Uganda's Expropriated Property Act of 1983 seeks to attract back expelled entrepreneurs by returning properties to their former owners. Restrictions are also being eased on the expatriation of profits and dividends, and regulations and procedures relating to FDI are being simplified extensively. Tanzania, Uganda and Togo, in particular, have made special efforts in recent years to ease restrictions on the repatriation of profits and dividends and in trying to simplify procedures for licenses and permits for FDI.

The trends in Asian LDCs follow a similar pattern with Myanmar having joined the competition for FDI in 1988 with a new Foreign Investment Law allowing foreign investors to establish either wholly foreign-owned enterprises or joint ventures. The newly created Foreign Investment Commission has been empowered to grant wide-ranging investment incentives and guarantees against nationalization and for the repatriation of profits and dividends. Not surprisingly, given the continued political instability in Myanmar these measures have not triggered off FDI on a large scale. However, once political stability can be assured, Myanmar with its vast natural resources and labour supply, could become an attractive location for FDI in the region.

With regard to Arab LDCs, in Somalia in April 1987, a new law on foreign investment was enacted. The basic reason for enacting this legislation was the government's decision to involve the private sector to a much larger degree than in the past in the country's socio-economic development process. This legislation is in harmony with Somalia's new economic policies and objectives. Investment can be made in the form of

fiscal capital, machinery, equipment, current production inputs and intangibles. There are no outright ownership and sectoral restrictions to foreign investment or phase-out provisions. Nor does the law preclude the possibility of participating, or acquiring stock, in an existing Somali enterprise.

Many countries give incentives which differ according to priority sectors and indeed priority industries and products. For example, Tanzania gives preference for investments by Tanzanians and all collaborative joint-ventures involving the private sector. Priority is also given to agriculture and livestock, tourism, transport and construction. Niger and Nepal give priority to agro- and agro-related industries and investment in industries which use local raw materials.

Many countries are giving incentives conditional upon various requirements such as training locals, a minimum size of investment, the creation of a minimum number of jobs and the use of domestic raw materials. Niger and Mali for example, specify that incentives are conditional on investments in small-scale industries and also give guarantees of bank credits provided that investment flows to the artisanal sector.

To add a critical perspective to the above discussion, it should be pointed out that many of the instruments that had been used to make the business climate more attractive to FDI have also led to some unfortunate side effects. For example, many of the new investment codes seem to favour large capital-intensive projects. This is because concessions are made to foreign investors which are often linked to the level of capital inputs, or the government specifies a minimum amount that needs to be invested before it will assist investors - with the assistance being higher the greater the amount invested. This has led to large-scale capital-intensive projects in the public sector especially.

Another unfortunate side effect of recent attempts to change investment codes is that in many cases there is a danger that the proposed changes may put domestic or local investors at a disadvantage. This has been the case in Tanzania where local investors are in a weak position relative to foreign private investors as they have limited access to credit and new technology. Special care is therefore required to ensure that indigenous investors/entrepreneurs are not discouraged from playing a more significant role in the industrial regeneration of their countries by these changes in investment codes.

#### 4.3.3 Proposed policies to attract FDI

Although, as stated above, many LDCs are making enormous efforts to make the business climate in their countries more attractive to FDI, a number of policy changes and measures are still required. These changes are required in the macro-economic policy framework and in terms of specific policies to attract FDI. In the past, the role of new investment codes and generous investment incentives in attracting FDI has clearly been over-emphasized.

### Macro-policy framework

The small size of most domestic markets in LDCs is a major deterrent to FDI. In the short run, nothing can be done about this. However, in the long run, appropriate macro-economic policies and regional co-operation needs to be developed to encourage economic growth and increased per capita income.

The exchange rate is an important determinant of FDI. Special attention should be given to stimulate investment by avoiding an overvalued exchange rate. Recent UNIDO studies have found overvalued exchange rates in Mali, Uganda, Niger, as well as in a number of other African and Asian countries. Overvalued exchange rates make it difficult for investors to determine which exchange rate to use. Clearly this is a major constraint to investors.

Tariff protection in certain cases may be an incentive for FDI but this should be used sparingly to avoid distortions and ensure that there are net social benefits. It is often the case that tariff protection leads to long-term net social costs.

One of the most important requirements to improve the macro-economic framework is to develop an efficient banking sector and especially capital markets. Very few LDCs have developed capital markets and most are suffering from the poor state of the banking sector with adverse effects on the provision of complementary domestic capital to FDI.

### Specific policies to attract FDI

Given the constraints mentioned earlier in LDCs, there is an urgent need to adopt targeted policies to attract FDI. In particular, there is a need to identify specific priority sectors, industries, enterprises and even products and processes for which FDI is desirable. This would involve purposely going out to attract FDI in specific countries and even going out to attract specific enterprises/individuals by use of Embassies, Investment Promotion Tours, Trade Fairs, and so on. It is important that this targeted approach to attract FDI is undertaken with the specific priorities of the government in mind.

In many cases, the priority industries would be mineral- or agro-processing industries. Special attempts should also be made to attract FDI from other developing countries at a more advanced stage of development.

It is necessary to state, however, that FDI is not beneficial per se and has, in some LDCs, led to major difficulties. It is important, therefore, that the most appropriate FDI flows be attracted, that is those of benefit to the economy in general and not just to specific enterprises.

Therefore, LDCs cannot afford to just have an open-door policy for FDI, but also need to develop concepts and a capability for project preparation, evaluating project proposals, and project monitoring and evaluation.

Foreign exchange controls are also a major impediment to the import of spare parts and equipment essential to maintain investment in LDCs. Governments in African LDCs therefore should really consider whether the continuance of foreign exchange controls are to their net benefit.

In addition, Governments should try to provide greater guarantees for the investments of foreign investors. As of 1990, only 3 African LDCs and 3 Asian LDCs had joined the Multilateral Investment Guarantee Agency (MIGA). These countries were Lesotho, Malawi and Togo as well as Bangladesh, Samoa and Vanuatu. At present, some countries, such as Tanzania, are considering joining the International National Centre for the Settlement of Investment Disputes. Many countries need to redouble their efforts to undertake bilateral agreements concerning investment protocols with various developed countries. At present, some African countries have established bilateral agreements with various developed countries concerning foreign investments and investments disputes. For example, Benin has made an agreement with the Federal Republic of Germany in 1987, and Switzerland in 1986, Guinea with France in 1982 and Germany in 1962, Mauritania with Germany in 1982, and Lesotho with Germany in 1982, and Malawi with Denmark in 1966.

Export processing zones (EPZs) may be one way of attracting FDI by offering tax concessions and other incentives such as a plentiful supply of low-wage labour, together with the provision of various infrastructural services in clearly defined areas.

One of the first LDCs to establish an EPZ was Bangladesh, where such a zone was set up in 1983 near the seaport of Chittagong. The Chittagong EPZ has been relatively successful in attracting foreign investors. As of July 1989, 24 companies were operating. They produce a range of industrial products, including predominantly garments, but also electronics, plastic molded components, steel chains, artificial leather, shoes, chemicals and costume jewellery. These products serve export markets in the EEC, USA, Canada and the Middle East. Investors had come from Hong Kong, Japan, Pakistan, Singapore, Republic of Korea, Sweden, UK and USA. Plans to establish a second EPZs with a focus on electronics products are under consideration.

Furthermore, Bangladesh has created in 1989 the Board of Investment which serves as a one-stop-shop for foreign investors outside the EPZ. This Board provides required pre-and post-investment services to entrepreneurs.

Many African LDCs are considering setting up these export processing zones, and indeed, Togo, Gambia, Liberia and Sudan have already established export processing zones.

However, EPZs are not the panacea of all ills. Recent UNIDO work suggests that they will only work if they are an integral part of an overall policy framework geared towards export promotion and are well-linked to the domestic economy. If they become an enclave as they have done in many other developing countries they can be more costly than the benefits they bring. In addition, it was found that the most important determinant of investment in export processing zones is not necessarily the incentives that are given to foreign investors but the provision of a network of supporting industries and services, especially telecommunications, and information processing. In short, UNIDO recent studies of the determinants of FDI in EPZ in developing countries show that what is required is the existence of an extensive human, technological and infrastructural supporting network. If this is not available then it is unlikely that the EPZ will attract significant foreign investment and hence provide the stimulus for overall economic growth.

#### 4.3.4 International co-operation in the promotion of foreign investment

International co-operation has a valuable role to play in attracting foreign direct investment to LDCs by providing technical and other assistance to improve the investment climate. Many LDCs have already approached regional banks and multilateral agencies for such assistance. For example, UNIDO and other UN agencies are assisting LDCs to re-design their investment codes. The World Bank has provided structural adjustment loans to support policy changes to improve the policy environment to make it more conducive to outside investors. The International Finance Corporation (IFC) has established the African Project Development Facility (APDF) in a number of African countries, for example, Côte d'Ivoire and Kenya. The aim of the APDF is to assist African entrepreneurs develop projects to their fruition, from the design stage through to the financing and implementation stages.<sup>13</sup> AMSCO, the African Management Services Company has been developed to provide management assistance. The Multilateral Investment Guarantee Agency (MIGA) has been established by the World Bank to provide guarantees for foreign investors against political risk. MIGA has also instituted a variety of practical ways to reduce risks to investors, especially transfer risk due to shortages of foreign exchange. For example, MIGA has developed a number of foreign currency retention schemes and foreign currency auctions to allow investors to obtain their exchange requirements at market exchange rates. These are all valuable new developments. What is required for the future is for more LDCs to join MIGA and for MIGA's services to be extended in a wider area.

Technical co-operation needs to develop more schemes - such as the IFC's recently established African Enterprise Fund (AEF) to finance the development of small-scale industries which predominate in African LDCs. Special attention needs to be given to the provision of adequate risk capital and resources for long-term loans. Attention also needs to be paid in international technical co-operation to improve the financial and banking sectors, especially development finance institutions, in African LDCs. The World Bank and the IFC are making important moves to support the restructuring of the financial sectors in many African LDCs, but clearly a lot more work needs to be done.

The fourth Lomé Convention, which was signed in December 1989, has introduced some important new and novel ways to support industrial investment in African countries and especially in LDCs. In addition to financing industrial infrastructure, the Convention is providing for co-financing of public and private investment by the Risk Capital Facility available in the European Investment Bank. In addition, the Center for Industrial Co-operation (CDI) in Brussels, a joint EEC and Africa, Caribbean and Pacific Country (ACP) body provides technical assistance, information, investment promotion for joint ventures and other projects. In particular, Lomé IV provides investment promotion support to ACP countries, which includes many African LDC countries, to improve the legal, financial and institutional environment to encourage private investment.

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<sup>13</sup> The African Project Development Facilities (APDF) was established in Nairobi in a joint effort by the African Development Bank, the United Nations Development Programme, the International Finance Corporation and several donor countries to assist African entrepreneurs in promoting viable medium sized businesses. It provides advisory services in the preparation of viable projects. While APDF does not provide project financing, it works with entrepreneurs in securing financing from banks and appropriate sources of capital. It also helps them in obtaining technical and managerial assistance needed to start up projects.

In a similar fashion to the World Bank and the IFC, the Lomé Convention also provides assistance to improve domestic financial institutions and domestic savings. Under special conditions, the EEC will also assume the exchange risks on investment to help domestic industries which predominantly sell in local markets but which need external funds.

In order to mobilize financial, technical, managerial and other resources required for the implementation of industrial investment projects UNIDO provides assistance to individual developing countries in identification, formulation and promotion of investment projects which are in need of inputs from a foreign partner.

A culmination of these activities is an investment project promotion forum organized in the developing country concerned to enable local project sponsors and potential foreign partners to discuss specific investment projects that have been identified and promoted by UNIDO through its information system and investment promotion offices (IPS) in a number of developed countries.

However, since industrial activities in most of the LDCs are less diversified than in other developing countries and limited by the small size of the industrial base, it is difficult to render efficient investment promotion services to individual LDCs. This partly explains low coverage of LDCs by UNIDO's industrial investment services. In this connection, a regional or subregional approach may be much more effective. This approach means that investment promotion services can be provided to a group of LDCs thereby multiplying their capabilities and reducing the risk, which will be particularly beneficial for industries where economies of scale are required.

#### 4.4 Private sector promotion and privatization

##### 4.4.1. Recent evidence of privatization efforts in LDCs

Privatization programmes which have been launched by an increasing number of LDCs pose a tremendous challenge in the context of limited resources, a lack of a sophisticated financial system, a long history of public sector dominance in industry and a narrow base of domestic private entrepreneurship. Despite these difficulties, privatization figures prominently on the policy agenda of many LDCs - spurred by examples in both industrialized and developing countries and encouraged by multilateral and bilateral donor agencies. Below, examples are briefly reviewed of such programmes in African and Asian LDCs. The examples given and issues discussed are also relevant to other LDCs in Latin America and the Arab region.

##### Privatization in Africa

In many African LDCs, there are a number of policies which restrict private access and participation in mining, manufacturing and the public utility sectors. In many cases, activities are reserved only for State enterprises or joint ventures with majority government ownership - and/or are specified in investment codes and other legislation concerning industrial investment. In other cases, public sector control has been acquired by nationalizing privately owned enterprises. This has taken

place in a number of African countries during the 1970s, for example, in Sudan, Somalia, Togo, Ethiopia, among others.<sup>14</sup>

In Ethiopia, the government took over the ownership and the operation of 100 private sector enterprises during the 1970s. Public sector enterprises now account for over 90 per cent of total value added in enterprises with 10 or more workers. Not surprisingly, there has been no new foreign equity participation in manufacturing industry in Ethiopia since these nationalizations took place. However, since 1983, the Ethiopian Government has adopted a new policy. This policy was launched in terms of a Joint Venture Proclamation in 1983 and invites foreign investors to participate in joint ventures in which the government holds at least 51 per cent of the shares in order to introduce technology and much needed know-how into the country.

In Guinea, since 1962 up to the period 1975-76, the government has made massive public sector investments and supported the proliferation of parastatal enterprises. Over 100 public sector enterprises have virtual total control of the manufacturing, trade and service sectors in the country. There are only three important private sector enterprises outside the public sector. In addition, there are three major private sector mining companies (CBG, FRIGUIA and AREDOR) but in these companies the government still holds 49 per cent of the shares. As of 1985, the Guinean Government has embarked on a major programme of reform of the economy. An essential part of this programme is to return protected activities back to the private sector.

Sudan is another country where extensive nationalization of private sector enterprises occurred during the 1970s. The result has been a large-scale parastatal sector which unfortunately has seen over recent years its equity base eroded and accumulated vast losses, financed through bank overdrafts. In 1983, however, at the Consultative Group Meeting in Paris, the Sudanese Government announced its intention to introduce a major privatization programme within which many parastatals were to be converted into private companies.

Despite the above mentioned moves towards privatization in many African LDCs, few countries have developed a comprehensive policy towards privatization. Many countries in addition to those briefly reviewed above - for example, Togo, Niger, Tanzania, Uganda - have announced intentions to launch the privatization process. But few have developed a coherent policy in this connection. Countries typically state - as Togo has done since it adopted a structural adjustment programme in 1983 - that the Government intends to gradually withdraw from the industrial sector and promote private sector initiatives. There is thus much uncertainty about Government intentions in LDCs towards privatization.

### Privatization in Asia

In general, a significant shift in the industrial strategy and policy approach has occurred in many of the Asian LDCs in the eighties. While the continued important role of the state in stimulating and promoting industrial development is acknowledged, there have been moves in the direction of reducing direct state involvement in industrial production and

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<sup>14</sup> Keith Marsden, Thérèse Bélot, World Bank Discussion Paper No. 17, Private Enterprise in Africa, Creating a Better Environment.



easing restrictions on private sector activities. 'Privatization' and 'deregulation' concepts have been embraced by many policy-makers though sometimes more through policy statements than in practice. This overall trend is exemplified below by recent measures and experience in four countries, namely Bangladesh, Laos, Myanmar and Nepal.

In Bangladesh, a thorough policy correction against the previous dominance of nationalized industries was taken in 1982 with the announcement of the "New Industrial Policy". This new industrial policy contained a significant privatization module. The list of industries reserved for the public sector was reduced to six sectors: arms and ammunition, atomic energy, air transport, telecommunication, generation and distribution of electricity and mechanized forest extraction. A concurrent list covered 13 industrial sub-sectors where public and private investments could take place. The key part of the denationalization was the return of jute and textile mills to their former Bangladeshi owners, while the units abandoned by West-Pakistanis during the war were retained in the public sector. Within one year, 27 textiles mills and 33 jute mills - most of which had incurred losses - were privatized. This represented 38 per cent of the jute processing capacity, 45 per cent of the spinning, and 57 per cent of the weaving capacity of the textile industry. The privatization programme faced, however, tremendous resistance from unions and workers and after the initial enthusiasm no further units were divested after 1984. The plan to convert the public sector corporations into public limited holding companies and to offer up to 49 per cent of the shares to the private sector was not implemented.

With the "Revised Industrial Policy" of 1986 a further policy correction was undertaken to breathe new life into the privatization programme and the private sector-based industrialization. The scope of the "New Industrial Policy" was broadened and the emphasis shifted from "regulating" to "promoting" industries. The concurrent list was dropped, but a list for priority industries and a "discouraged list" were added. Until 1988, further eleven large enterprises were handed over to the private sector. The establishment of the Board of Investment in 1989 to provide one-stop services to private investors was a further important step towards a private sector-oriented policy. The policy shift since 1982 has, however, not brought the expected upswing in private investments which fell, with an implementation ratio of only 37 per cent during 1985 to 1988, far short of the targets set in the Third Five Year Plan.<sup>15</sup> Although the privatization program in Bangladesh was, with more than 600 units affected, one of the largest in developing countries, its success has so far been limited. Many companies inherited debts incurred during the period under state ownership and a refractory labour force which resisted any staff reduction. Numerous units were closed down soon after privatization. The Bangladesh case clearly shows that a privatization program has to be supported by an appropriate macro-economic environment and very specific measures to assist effectively the new private companies.

In Lao PDR, a major economic strategy shift was initiated in 1985 with the so-called New Economic Mechanism which induced a number of further decrees, inter alia, covering privatization or divestiture of public

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<sup>15</sup> Planning Commission, Mid-Term Review of the Third Five Year Plan 1985-90, Dhaka 1989, p. 67.

enterprises.<sup>16</sup> The privatization decree issued in March 1990 states that public sector disengagement is sought from "non-strategic" industries, i.e. excluding public utilities, banks and insurance, mining etc. Since mid-1989, the pace of privatization has significantly increased, largely driven by the Prefecture of Vientiane as supervising agency of 70 mostly medium-scale enterprises. In November 1989, half of the manufacturing companies (accounting for 35 per cent of the total number) had already been privatized and initial action had been taken on another 20 per cent.

The privatization programme in Lao PDR was obviously facilitated by the relatively small size of companies offered so that they could be taken over also by private investors with only limited capital and/or managerial expertise. Moreover, foreign investors have not been excluded from the programme. This applies mostly to Lao expatriates and, above all, to investors from Thailand who have the advantages of geographical proximity, language similarity, and considerable export experience.

The approach adopted by the authorities has so far largely been on a case-by-case basis. The different forms of privatization as well as the specific terms of the privatization contracts have not followed predetermined rules or guidelines. It is remarkable that in most cases privatization was not effected by outright sale of ownership but more frequently through rent agreements of up to 10-15 years duration. This clearly is only a second-best solution with the inherent risk of investors realizing short-to-medium term profits rather than building up companies with a long-term viability. It is also to be noted that a number of institutions with different mandates and approaches are active in the privatization programme which has created unnecessary overlaps and inconsistencies.<sup>17</sup>

A significant strategy shift was initiated though not carried through in Myanmar at the end of the eighties.<sup>18</sup> While a policy reform had already taken place in September 1987 with the abandoning of price controls for rice and other basic commodities, it was only in September 1988, following a severe economic crisis and widespread political unrest, that dramatic economic policy changes came to be announced. The new State Law and Order Restoration Council (SLORC) officially discarded the centrally planned approach in favour of a more market-oriented and open economic policy framework. While the specific policy changes have yet to be implemented, and the degree of the planned "opening up" of the economy and the precise role to be played by market mechanisms are still unknown, the Government has declared its intention:

- to encourage and enlarge the scope for international industrial co-operation, specifically in the form of foreign direct investment;

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<sup>16</sup> Cf. World Bank, Lao People's Democratic Republic. Issues in Public Economics, Report No. 8532-LAO, 10 August 1990; Livingstone, I., Industry, Trade and Tourism in the Lao People's Democratic Republic: Issues and Recommendations, February 1991 (mimeo).

<sup>17</sup> These include the Prefecture of Vientiane, the High Committee of Supervision of the New Economic Mechanism, the Central Investment Board, the Ministries of Commerce, of Economy, of Plan and Finance, and the Prime Minister.

<sup>18</sup> Cf. UNIDO, UNIDO Industry Sector Review Mission to Myanmar (12-29 June 1989). Report, PPD/R.30, 12 October 1989.

- to infuse modern technology into the country's industry in order to increase its productivity and competitiveness and to achieve a diversification towards production and the export of non-traditional manufactured products;
- to partially deregulate the economy by (a) granting more autonomy to private, co-operative and state enterprises in areas such as trading activities and entering into joint ventures; (b) privatization and/or commercialization of state economic enterprises; and (c) adjusting and increasing the flexibility of the price structure.

Only tentative information is available at present on the government's approach with regard to the future role of state economic enterprises (SEEs) in the industrial sector. In general, privatization of SEEs is being discussed, inter alia, by returning some nationalized companies to private hands. Furthermore, SEEs would be required to adopt a commercial business orientation and to generate profits. The implications of this demand for loss-generating SEEs have not been spelled out so far, however. An important change has occurred insofar as SEEs are now allowed to enter into technical co-operation agreements and joint venture with any other company, be it a private domestic firm or a foreign firm. This may be seen as an important avenue to commercialize some SEEs. Indeed, following the long period of inefficient operations under monopolistic conditions, the gradual commercialization of the SEE's activities may be more appropriate than their immediate privatization. Management contracts with competent foreign partners may be seen as one possible approach in this respect.

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

The disappointing results of privatization programmes in Nepal have also been explained by lacking "institutional structures and skilled staff to perform major tasks pertaining to the privatization, such as publication of independent up-to-date audits on enterprises, assignment of responsibilities for assets and liabilities, etc." <sup>19</sup> This clearly demonstrates the close interlinkages between the institutional framework, human resource development and industrial policies and points to action required to alleviate critical skill bottlenecks. Along these lines, the Government is now seeking to revitalize the privatization programme with technical support from IFC.

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<sup>19</sup> Cf. World Bank, Nepal. Maintaining Structural Reforms and Managing Public Resources, Report No. 8352-NEP, 30 March 1990.

#### 4.4.2 Privatization issues

In order to fully launch the privatization process in their countries, LDC governments need to undertake a realistic assessment of the major issues involved and the requirements and capabilities needed to carry out successful privatization - in terms of policy initiatives, financial and institutional support, investment promotion and most importantly, human resource development. These issues are dealt with in this section.

##### The ownership question

It is important to recognize that efficiency gains expected from privatization are not simply a product of the transfer of ownership rights from the public to the private sector but depend crucially on the extent to which the new owners have a direct interest in managerial efficiency. More is required to secure improved efficiency than merely the conversion of a public monopoly into a private monopoly. Unfortunately, the typical LDC has a relatively small economy which is usually oligopolistic in structure and heavily protected. This presents a dilemma. In order to attract private buyers for ailing state enterprises, it may be necessary to offer 'sweeteners' in the form of protection from competing imports or tax breaks. However, high effective rates of protection may create a policy environment in which private investors have no more interest in economic efficiency than had their predecessors.

Of course, in many LDCs in the 1990s, the ability of policy-makers to offer concessions to private investors is fairly tightly constrained by the requirements of World Bank/IMF Structural Adjustment Programmes (SAP). Under such programmes all that is supposed to be on offer to investors is the prospect of a 'realistic' and progressively lower exchange rate, tariff neutrality, positive real interest rates and access to foreign exchange for the purchase of essential inputs. This kind of policy environment is unlikely to be attractive to foreign investors interested in manufacturing consumer goods for the domestic market.

##### Political resistance to privatization

Disposal of publicly-owned assets is complicated not only by technical but also by political factors. In an administered economy, as in many LDCs, there are no 'real' measures of the costs of inputs and outputs resulting in substantial distortions in the pricing of capital, labour and material inputs. Output prices are subject to manipulation. Domestic production is often highly concentrated, if not monopolistic. Consequently, the benefits to be obtained from increasing the influence of market determined prices are difficult to estimate and diffuse. By contrast, the losers from the short-run income distributional effects of privatization are likely to be a narrowly defined section of the community and can be expected to resist strongly.

It is also important to remember that any move towards privatization is superimposed on existing underlying structural problems such as high import dependence and severe foreign exchange constraints. Yet foreign investors will seek guarantees for a repatriation of interest payments, dividends and royalties. Without prior and substantial structural

adjustment. private production will remain dependent on government licensing and therefore exposed to the possibilities of political interference. Will this vitiate the dynamic effects of increased managerial autonomy?

LDC Governments will also be dependent on the co-operation of senior management in implementing a privatization policy. There seems to be no good reason, however, for believing they will be enthusiastic about being exposed to competition. Hence, there is a real danger that the newly privatized public sector will seek political connections for a wide variety of monopolistic privileges. To help forestall this possibility, it is important to encourage the formation of widely-based institutions which can represent the interests of the private sector, such as the Chamber of Commerce or manufacturers' associations, as the political system widely lacks staff with commercial experience or knowledge. The more pressure is applied to try to speed up the process of privatization without due attention to liberalization and competition policy, the greater the risk that opportunities to improve performance of many industries will be missed.

#### Privatization, management efficiency and manpower

Dynamic efficiency gains, particularly through improved human resource management, are difficult to estimate. Nonetheless, they are likely to be the most important source of improved economic efficiency to be obtained from privatization. Improved human resource management depends crucially on the competence and quality of managers and skilled technical personnel. With shortages and low levels of capacity utilization widespread in LDC enterprises, the priority for management has, of necessity, been to keep production going. Product and process development, marketing and financial management skills are likely to have been neglected in the struggle for survival. On the positive side, there is some evidence that state enterprises have spent more on human resource development than comparable firms in the private sector, especially on management and technical training. However, it is often difficult to establish the extent to which this training is economically justified. Sometimes it seems to have been distributed as a reward for loyal service and/or is provided as highly subsidized or 'free' technical assistance from aid agencies.

It is generally agreed that in most LDCs there is only a limited pool of industrialists. Therefore, privatization requires a massive manpower development programme in support of enterprises that are left to fend for themselves in a liberal market. For example, the World Bank in its criticism of the weak information and accounting systems prevalent in the parastatal sector in Tanzania, observed that one of the bottlenecks in any effort to improve industrial efficiency was the shortage of trained accountants. There were only 145 authorized auditors and 382 authorized accountants in 1986.

A variety of projects have been undertaken on different aspects of manpower development in LDCs by donor agencies but there appears to have been little inter-agency co-ordination in the past. Many of the benefits of training have been lost as a result of public sector organizations distributing training opportunities as a fringe benefit for poorly paid staff.

### Financing privatization

A critical pre-requisite for the successful launching of a privatization process in LDCs is the availability of an adequate supply of funds and of capital markets when public companies are to be transformed into private companies with share-holders.

However, most industries in LDCs suffer from a severe liquidity crisis. The dependence on imported raw materials, spare parts, components and essential machinery, external shocks, and, particularly in Africa, the disruptions caused by SAPs - especially substantial and continued devaluation of the currency - have imposed enormous strains on most enterprises. At the same time, the almost universal absence of capital markets in LDCs and the common imposition of credit controls as part of structural reforms impact adversely on investments in new equipment and inventory by industrial enterprises.

It has therefore been suggested that Development Finance Institutions (DFIs) would have to be key actors in any privatization process - especially to on-lend funds for privatization. However, most DFIs in LDCs are plagued with political interference and lack of trained personnel in project appraisal, monitoring and general financial management skills. As a result, most DFIs are technically insolvent with a bad loan portfolio consisting largely of ill-considered loans to the public sector which are unlikely to be repaid. The Tanzania Investment Bank (TIB) is typical of DFIs in LDCs. At the end of 1986, 54 per cent of TIB's loans to the parastatal sector were in arrears, as were 27 per cent of loans to the private sector (Tsh 1,565 million and Tsh 319 million in arrears on the total amount outstanding of Tsh 4,080 million).

A major part of the difficulty DFIs are facing, above all in Africa, is the inability to sell off any of their equity holdings because of the absence of capital markets.

A further obstacle to the privatization process in LDCs is the fact that there are simply not enough indigenous entrepreneurs with financial resources to take over more than a small proportion of parastatal enterprises. Most enterprises intended to be privatized will have to be joint ventures between private investors (local and/or foreign) and quasi-public investors and particularly the DFIs - once restructured.

#### 4.4.3 Required policy and other initiatives to support privatization

From the above, it is apparent that there still remain significant obstacles to privatization in LDCs. Without a re-orientation in Government policy and support, privatization will flounder in LDCs. Government initiatives are required in a number of areas.

#### An inventory of the private sector's strengths and weaknesses

The scope and nature of private sector industrial activities in many LDCs is largely unknown. There is an urgent need to establish and detail the potentialities of existing private enterprises in order to be able to support and encourage private enterprises. In this connection, LDC

governments may wish to approach various international agencies for assistance. UNDP and UNIDO and other international agencies would be in a position to assist LDC governments in carrying out an extensive survey and assessment of the strengths and weaknesses of the private sector.

#### Financial restructuring and rehabilitation before privatization

Collapsed or collapsing public sector enterprises in LDCs are generally of no interest to investors except as a source of second-hand machinery. This means that any realistic policy of privatization must include provisions for financial restructuring and rehabilitation before disposal. To ensure that there are long-term efficiency gains to the economy following privatization, it is also important to ensure that monopolistic privileges are not automatically transferred to the new owners. While there may very well be persuasive arguments in favour of licensing a limited number of producers on economies of scale grounds, this should not imply protection from competition as well.

#### Human resource development

Public sector enterprise managers in LDCs are not experienced enough to operate companies under the pressure of competition. The long-term efficiency gains from liberalization and privatization can only be obtained, however, by managers who have the capacity to re-orient these enterprises to the market. There is, therefore, a need for a case-by-case review of the technical and management development needs of each enterprise in the run-up to privatization, paying particular attention to the requirements for engineering, marketing and financial management training. This review of human resource development might be usefully co-ordinated with the review by development finance institutions of the financial requirements of individual enterprises.

#### Development of the investment promotion policy and institutions

Investment Promotion Centres (IPCs) should be established and/or positioned to assume a strategic role in facilitating the reformulation of the Government's relationships with a substantially privatized economy. IPCs should be located to provide access and accountability to the key decision makers in the political system. In the last analysis, the effective liberalization and privatization in LDCs depends on political will.

A promising start has been made towards investment promotion and investment policy in many LDCs but further amplification is required. There is an urgent need for technical assistance to help develop the necessary institutions required to support the new policy. In particular, work needs to be carried out on developing policies and procedures for evaluating licensing and joint venture proposals and for monitoring them in operation. The behaviour of government institutions responsible for dealing with private sector investors will be interpreted widely as indicative of the Government general attitude to investment. It is vital that staff are carefully selected and well-trained.

### The need for international assistance

While industrial regeneration requires domestic political initiative, it also needs to be supported by multilateral and bilateral assistance. Privatization as a policy will only work if the environment is conducive and clear benefits can be demonstrated to flow from the policy. To start the process, LDCs require a number of carefully planned and executed demonstration projects in which donors and local and/or foreign industrial interests collaborate to rehabilitate selected existing enterprises.

While the recent emphasis on deregulation and private sector-led industrial development in many of the Asian/Pacific LDCs is an adequate response to inefficiencies built up in the past, such programmes must not be overburdened with too high expectations. Privatization efforts can play a positive role in increasing the efficiency of resource utilization; they can reduce the structural strain on public budgets and thus free resources for other purposes than subsidizing public companies; they can also contribute to a better supply of the population with essential consumer goods and thus are not at all in conflict with basic-needs-oriented development strategies. However, by putting too much stress on privatizing existing industries as industrial strategy element, there is a danger of neglecting policies aimed at building up new industries. Such policies in turn would have to include a wide array of inter-related measures in areas such as investment promotion, the provision of infrastructural facilities, human resource development, technology enhancement, entrepreneurship development and others.

#### 4.5 Human resource development

It has become widely recognized that human resource development has been a "neglected dimension of development strategy". In the context of industrial development in LDCs, this neglect has contributed to the shortcomings of industrialization efforts and rising unemployment. Measures to build up industrial human capital should be a priority and form an integral part of industrial restructuring policies to ensure sustainability of industrial progress. Correction of the apparent mismatch between skill supply and demand cannot be left to market forces alone. A comprehensive set of measures will be required targeting important areas on the supply and demand side within an overall macro-economic policy framework. Thus it is important that HRD is compatible with and complementary to the emerging economic trends in many LDCs:

- the public sector, and with that a major portion of the modern large-scale manufacturing, is shrinking and/or being privatized;
- most of the productivity gains and industrial growth in the near future will come from rehabilitation of existing manufacturing plants utilizing domestic natural resources;
- the most dynamic and numerous entrepreneurial talents exist in the informal sector and these skills have to be brought out and developed to support the production transformation into modern small- and medium scale sector;
- attracting FDI and technology transfer to enhance international competitiveness will be increasingly determined by availability of skilled manpower, management capabilities, communication infrastructure and conducive and stable macroeconomic environment.



**Training and education**, especially higher education, often is too theoretical and more geared to fulfilling the requirements of the public sector rather than meeting the skill demands of the private business and industry. Secondary and tertiary education together with vocational training have to be made much more responsive to the demand of the labour market. There is a need to establish a national co-ordinating mechanism which would bring together representatives from government, private sector and training institutions not only to discuss training strategies but in cases of critical shortages of trained manpower also allocation of graduates between various sectors of the economy. For example, in 1984, the Botswana Presidential Commission on Employment Opportunities recommended equal allocation quota for graduates to public, parastatal and private sector.

**On-the-job training** is the most important part of skill training and development. Foreign direct investment and technology transfer, have contributed disappointingly little to learning and capacity building among the domestic labour force as there has not been a consistent and deliberate policy, neither on the exporter or the importer side, to link these processes. This needs to be remedied in future efforts by LDC governments. The lack of incentives and an acute lack of senior staff qualified in training has led to little progress in localization. Therefore, in the next few years relatively large amounts of national and corporate educational budgets must be devoted to the training of trainers and the development of valid educational material in easily accessible form. It still remains true that formal education needs to be supported by appropriate on-the-job training. In this regard, a valuable role can be played by direct foreign investment and joint-ventures. This is particularly important for building up more advanced technological skills.

The demand for skills is reflected in the changing pattern of employment/unemployment which is the result of changing composition of economic activities and changing production structures due to new technologies.

**Employment opportunities.** The public sector and parastatals have been the largest provider of wage employment, in many countries providing over half of the total wage employment. Since the early 1980's the public sector has started shedding employees, women being proportionately more affected than men. Neither could the private sector due to its size and level of development provide alternative wage employment opportunities. Given that the modern sector wage employment accounted for only 10 percent of the total African workforce in 1980 it can be estimated that its present share has dropped to about 8 percent. The annual rates of manufacturing employment declined from 2.6 percent in the period 1975-80 to 0.1 percent between 1980-85. The share of industrial employment in all new jobs created in the corresponding periods fell from 24 to 2 percent. Thus the informal sector has become one of the most important labour sponges in Africa, estimated to employ about 60 percent of the urban labour force, absorbing estimated three quarters of the incremental urban labour force, with trade and services being the predominant activities.

**Skill shortages.** Reported lack of quality labour covers the whole spectrum from top to middle level managers, engineers and technicians in quality control and maintenance, and skilled and semi-skilled labour in production. However, most references to skill shortages are based on perception, only few support the argument with qualitative and quantitative evidence and causalities. Thus remedial measures often addressed the symptoms but not the causes with a short lasting results. Statistics on

occupational skill structures by industrial branch are either missing or incompatible with other data. Official statistics and occasional investigations often omit gender and miss large proportions of the population under survey.

In order to make education a force for development, a radical revision of the formal education system is being undertaken in many LDCs. Human resource development, therefore, is an important element in national industrial policies as is demonstrated by the following examples from African LDCs.

Botswana has an acute shortage of skills at all levels, which is one of the principal constraints to industrial development. HRD is one of the Government's priority areas. As such, it has developed programmes to expand educational facilities from primary school to university, changing the curriculum content to include technical subjects and apprenticeship schemes.

Burundi, at the time of Independence, had only fifteen university graduates. Most of the skilled industrial workers were expatriates. A major effort is being made to expand technical education at the school and university levels. This effort will be supported by training institutions such as L'Institut de Gestion des Entreprises (ISGE), Le Centre de Perfectionnement et de formation en cours d'emplo (CPF) and Lagos Plan of Action Centre de formation et de Perfectionnement Professionels (CFPP).

Cape Verde is currently undertaking a reform of its educational system to promote technical education and courses in economics and business management at the university level.

Ethiopia has adopted a well-documented approach to human resource development. It has worked out estimates of the demand and supply of professionals and semi-professionals in the public manufacturing sector. It aims to provide training to ensure a steady growth of labour productivity and industrial output, to improve the competitive position of the industrial sector and to achieve a certain degree of mastery on technological self-sufficiency. A detailed plan (1991-2000) for overseas training has also been worked out.

Mauritania is promoting apprenticeship centres and is examining the possibility of negotiating "conventions" with enterprises for in-house training.

Uganda conducted a National Manpower Survey in 1988 which revealed a total of 5,325 posts vacant because of the lack of skilled candidates. Uganda assesses that this situation is due to low economic activity, low salaries, lack of housing facilities and lack of adequate planning and regular assessment of industrial needs. Skills are proposed to be developed through formal education, on-the-job training, vocational training, apprenticeship and informal education. The programme also contains proposals to strengthen the Polytechnic at Kyambo, the Management Training and Advisory Centre, vocational training institutes and technical institutions and Makerere University.

LDCs in Asia typically suffer from lack of technical training. Higher education is biased towards social sciences and against natural sciences and engineering. In Bangladesh, for example, total public expenditure on education amount to only 1.5 per cent of the GDP and is heavily biased towards university education. Students tend to prefer subjects with high social prestige such as law and aim at employment in the

public sector. Only a minor fraction of graduates in the field of business administration have ambitions in entrepreneurship.

Despite these efforts, the lack of highly qualified and experienced staff is still a problem in both public and private sectors in LDCs. The main bottlenecks in human resources for industry are closely connected with two major features of the education system. Firstly, there has been a long-standing government predominance in the use of educated human resources. Industry has often been regarded as a residual and, therefore, is progressing slowly. Secondly, there has been an over emphasis on academic training, and a corresponding shortage of people with technical and vocational skills.

#### 4.6 The development of new supporting industries and institutions

##### 4.6.1 New supporting industries and institutions

A major weakness of industrial development in LDCs permeating the earlier discussion is the absence of supporting industries - particularly services - and institutions. This lack of supporting industries, services and institutions is a major obstacle to development, especially to the attraction of FDI flows.

Invariably, the competitive advantage of an enterprise based on exploitation of a special asset or skill depends on the enterprise's customers, suppliers and competitors. In order to meet demand, enterprises must depend on the quality, quantity and reliability of suppliers of raw materials, machinery and labour, distributors, banks and other institutions and services. And often, how close these supplies are located to the enterprise. In short, the competitiveness and efficiency of enterprises often depends on the available infrastructure and supporting services and institutions of the markets in which they operate.

The ability of firms to respond to buyers' demands depends on whether they can produce efficiently and this, in turn, depends on the skill and capability of suppliers and the availability of required infrastructure. Thus the skills and assets which create comparative advantage and competitiveness in one sector depend to some extent on the skills and assets developed by upstream and downstream enterprises and related sectors and subsectors. Comparative advantage thus develops in clusters of mutually supporting activities and services. Many recent studies on the emergence of international competitiveness document and substantiate this simple point.

Enterprises in LDCs are no different from those in other countries in that they cannot function efficiently as isolated units. They, therefore, have to establish a variety of strong linkages with the rest of the economy. The economy, in turn, has also to provide a variety of inputs, services, especially information, infrastructure, standards and rules to enable it to produce, invest and grow. Most LDCs have a very weakly developed infrastructure and are not very proficient in providing all these linkages and services. Some of these weaknesses can be remedied by private actors in response to market initiatives or market signals. Other deficiencies would require direct government intervention and the setting up of institutions specifically to provide such services.

Many other developing countries have deliberately systematically built up institutional support for priority industries and indeed to supplant market forces. For example, they have built up institutions for industrial standards, for testing, supporting exports, quality assurance,

design, training, technology acquisition, dissemination and adoption, information, and for research and extension services. Without this array of services and infrastructure, general economic growth and dynamism cannot be developed in any major way in LDCs.

Clearly, certain institutions already exist in several LDCs. However, where these institutions exist, they seem to be poorly staffed and managed. They also tend to have conflicting objectives and often seem to have to exist on inadequate funds. LDC governments, therefore, have to seriously consider - where these supporting institutional industries and services do not exist - ways to develop them. In particular, current studies, especially by UNIDO, have shown that services, institutions and new industries are required in the following areas in:

- marketing, design and packaging;
- training of purchasing agents;
- provision of legal advisory services;
- setting up of entrepreneurs clubs' to facilitate deals between enterprises;
- starting up advisory services;
- providing access to credit lines and business advice;
- giving support for ongoing enterprises, especially in sustaining sales and general selling techniques and for the control of finance and cash flows especially accounting support;
- providing low cost market research and market planning advisory services;
- providing appropriate repair and maintenance services, especially on site;
- establishing trading agency;
- and especially, in providing technological and telecommunication services.

Clearly, not all LDC governments can provide all these services in one integrated package. But, the important thing is to attempt to provide a combination of complementary services and institutions to buttress existing priority sectors, subsectors and industries in selected branches and regions so that there is a synergy of supporting industries that will be able to launch regional development initiatives and hence attract more private investment.

It is also important to emphasize that this cluster of supporting services, industries and institutions should, as far as possible, be run on commercial lines. Special attention should be given to providing these supporting requirements for small-scale industries and informal sector enterprises in rural areas.

#### 4.6.2 Institutional support framework for promotion and development of SSIs

Any strategy for promotion and development of SSIs requires an appropriate institutional framework with each organization assigned specific functions to undertake. The clear identification of the functions and the functional relationship between the various institutions involved is of paramount importance. Equally crucial is the extent and limit of the authority to be exercised by each institution, in the execution of the assigned responsibilities. The existing institutional arrangements for the promotion of small-scale industries differ in individual countries but, in most cases, are inadequate.

In many countries the focal point of SSIs are either the Ministries of Industry (Uganda, Mauritania), while in others like Tanzania, Malawi, Ethiopia and Botswana, the legal responsibility for the promotion of the SSI sector is given to a parastatal body called in many cases the Small Industries Development Organization.

The major functions to be undertaken by such institutions include:

- Policy formulation. Usually, policy-making is left for the Government, although truly workable policies can only be developed on the basis of proposals from various bodies, especially private sector institutions charged with responsibilities for the SSIs as well as in consultation with institutions which are expected to implement the policies.
- Financing. This function is within the orbit of the banking sector and/or other recognized financial intermediaries. However, in some cases the SSI sector may need a special financial institution or a department within existing institutions to meet special requirements of the sector, particularly relating to the availability of credit.
- Management. It is evident that the day-to-day management is the responsibility of the owners and/or appointed managers. However, in many LDCs, management skills are inadequate, therefore, promotion and development of the SSI sector requires prompt and systematic consultancy services to identify problems and find solutions. Moreover, project preparation assistance to individual entrepreneurs and owners is an indispensable part of services to be provided by a specialized consultancy institution.
- Human resource development. The training of intermediate and high-level technical manpower can adequately be accomplished in existing technical schools and/or training centres. However, the requirements of the SSIs may have to be met through specially designed training programmes.
- Procurement. Due to the lack of exposure to existing technologies and materials and their prices, small-scale entrepreneurs find it impossible to find the right machinery, equipment and materials. Open market retail prices are often too high for small-scale entrepreneurs. There is, therefore, a need to provide advice to small-scale industry operators on the choice of the most suitable machinery and technology as well as to the bulk purchase and supply of raw materials from both local and foreign sources at competitive prices and on easy terms.
- Marketing. In most LDCs, there is no organization and infrastructure through which products from small units are marketed and/or market analysis is undertaken. Small producers, therefore, need to be encouraged and organized with the assistance of relevant government departments and/or other responsible institutions.
- Research and development. A major constraint to the development of SSIs in LDCs is the virtual lack of a market information system (products, consumer preference, etc.) Most small-scale industrialists have little knowledge of new technologies and services and if they do not have this knowledge, they do not have funds to

obtain them. It is necessary, therefore, to establish and maintain appropriate information collection and dissemination systems for local and imported machinery and materials.

Promotion and development of SSIs can only be achieved through an integrated supporting service system. This requires the establishment of an autonomous co-ordinating institution which will harmonize the efforts of government, private companies, co-operatives and parastatals.

## 5. REGIONAL CO-OPERATION

In The Paris Declaration and Programme of Action of the Second UN Conference on the Least Developed Countries held in September 1990 it was emphasized that co-operation between LDCs and other developing countries at the regional and subregional level can play an important role in the development of LDCs in the 1990s.

As mentioned earlier, the small size of the domestic market in LDCs is one of the major constraints to industrial development. The size of domestic markets creates obstacles particularly for industries where economics of scale are necessary preconditions for production such as intermediate and capital goods industries. Therefore, enlarging of the markets through regional integration can potentially be a useful vehicle for promoting development. Regional demand could stimulate industrial rehabilitation and lead to the increased utilization of industrial capacities.

A central feature of market integration is the establishment of a preferential trade regime to promote intra-regional trade through harmonization of tariffs and the gradual elimination of all trade barriers. The flows of intra-regional trade can be substantially increased if the market integration is supplemented with integration of production. This integration can be promoted by identifying and locating industrial projects in countries of a particular region that have the greatest comparative advantage. In order to encourage regional industrial co-operation, national laws and regulations concerning subsidiaries and mergers should be less restrictive, economic policies will have to be co-ordinated, and capital and entrepreneurship should be free to cross national borders. Open and liberal trading regimes are necessary preconditions for genuine regional integration.

It is obvious that since LDCs - for example in Africa - are spread all over the continent they cannot form a special regional/subregional organization. Therefore, co-operation between LDCs and with other countries in Africa is maintained by a number of regional organizations. The largest and the most significant are the following:

- Economic Community of West African States (ECOWAS) - The principal objective of this organization is to promote development in all areas of economic activities: industry, agriculture, monetary and financial matters, trade and so on. However, little progress has been achieved in the main sectors such as industry, agriculture and trade. Many of the joint industrial projects failed. Attempts to intensify trade has not been very successful. One of the main hindrances has been the multiplicity and non-convertibility of currencies.
- Preferential Trade Area (PTA) - A primary mandate of the organization was to liberalize trade and to develop a payments mechanism. As a result of the progress achieved, a common list of commodities to be granted preferential access to the PTA markets has been agreed on and the trade flows have been facilitated by simplification of trade documents and removal of barriers to free movement of cross-border traffic.

The member states of PTA have initiated co-operation for industrial development. At the ninth summit of the PTA in 1990, a Charter for Multinational Industrial Enterprises was adopted. Its main purpose is to promote joint ventures in member states. To this end, a programme of rationalization and gradual harmonization of investment codes has been launched.

- Southern Africa Development Co-ordination Conference (SADCC) - SADCC has developed a different approach to integration. With each country assigned responsibility over a specific sector, emphasis was placed on co-ordination of sectoral regional projects and programmes. For instance, Tanzania co-ordinated industry and trade development. The SADCC approach emerged out of the bitter lessons drawn from the collapse of the East African Community (EAC), which was once the most promising economic community. Political differences, disagreements over the sharing of the costs and benefits, and conflicts of interests among members (Kenya, Tanzania, and Uganda) were the main factors behind its collapse. Drawing on EAC's experience, SADCC adopted an incremental, project-oriented regional co-operation approach. To encourage industrial development, co-ordination of policies and identification of selected priority areas were considered important. Towards the end of the 1980s, a new strategy outlining priorities for industrialization was set in motion. A cross-border investment facility has been established.

An analysis of the results achieved by African countries in fostering regional co-operation shows that they have not been very impressive. One of the main impediments has been the multiplicity of currencies, which has discouraged trade among African countries and induced the search for trading partners in Europe, the United States or elsewhere. Another factor explaining the unsuccessful attempts at regional co-operation has been the lack of effective strategies for the implementation of national industrial policies. Many countries in the same subregion produce similar types of goods, which, consequently, cannot be easily marketed in other countries. Apart from the foregoing, an adequate level of support to regional organizations through contributions from their member states has not been forthcoming because of the economic and financial difficulties faced by most of the countries in Africa, especially LDCs.

Institutionalized regional co-operation among LDCs in the Asia/Pacific region is taking place within two different arrangements.

The first is the South Asian Association for Regional Co-operation (SAARC), initiated in 1980 by Bangladesh and substantively launched in 1985 by the First SAARC Summit Meeting. SAARC membership comprises the four South Asian LDCs: Bangladesh, Bhutan, Maldives and Nepal plus India, Pakistan and Sri Lanka. SAARC's agreed areas of co-operation have so far been confined to postal services, telecommunications, science and technology, health and population planning, sports, arts and culture, meteorology, transport services and agriculture. It excludes the critical areas of trade and industry. Also, no firm institutional structure has been established so far by the member countries.



The second form of regional co-operation takes place in the South Pacific and comprises the LDC and non-LDC Pacific island countries as well as Australia and New Zealand. As early as 1979, the South Pacific Forum (SPF) was founded with the South Pacific Bureau for Economic Co-operation (SPEC) acting as official Secretariat. A number of more specific institutions were created in this framework, including the University of the South Pacific, the Pacific Forum Line, the Forum Fisheries Agency and Trade Commissions. Regional projects and programmes are being implemented in the areas of energy, telecommunications, tourism, environment and sea-based mineral exploitation.

Both SPF and SAARC have had very limited impact so far on economic and industrial development in their LDC member countries. On the whole, it appears that too many hopes have been nurtured in the past with regard to the impact of institutionalized forms of regional co-operation among LDCs. Even in the case of ASEAN - starting from a higher level of industrial development and under much more favourable conditions - regional co-operation has not led to the expected intensification of economic integration. Considering that most LDCs are characterized by similar structural weaknesses, that none of them has a diversified industrial production structure and that, accordingly, the potential for trade and specialization is low, it appears questionable whether a focus on co-operation among LDCs is justified and can lead to viable programmes. Above all, in the Asian context - given the increasing intra-regional trade and investment flows as outlined above - it can be argued that economic co-operation between LDCs and other developing countries in the region has a much greater potential. It is here that different resource endowments and different cost structure open up considerable specialization potentials. These potentials can be exploited by companies from industrially more advanced developing countries which often command a long-standing experience in the production and marketing of manufactured goods.

This is not to say that co-operation among LDCs could not be beneficial in specific areas. For example, in the case of the South Pacific islands which are facing very much common challenges, a pooling of expertise and resources in key areas of industry-related research (such as the exploitation and processing of marine resources) could yield significant scale economies.

## 6. CONCLUSIONS AND OUTLOOK

If the 1990s are not to be a lost decade for LDCs - especially for African LDCs - as the 1980s turned out to be, Government policies must take a new approach. This paper has highlighted a number of key issues and areas that should be considered in any new approach.

First, the need for LDCs to develop an appropriate macro-economic framework was highlighted. Although it is obvious that LDCs should develop such a framework, it was argued that this point still warrants emphasis. A flexible macro-economic policy framework should be developed in each LDC to take full account of their specific characteristics and circumstances, and particularly, the structural rigidities of individual countries. Special attention should be given to developing linkages between various economic activities and especially the interface between macro-economic goals and sectoral and subsectoral restructuring.

In addition, it is extremely important for LDC governments to provide the right incentive structure for industry. The correct policy response may be to liberalize domestic and foreign competition, permit easier entry to potential private investors and ensure that incentives are more neutral between domestic and foreign markets. But this does not necessarily support a case for wholesale laissez-faire or uniform rates of protection for infant industries in LDCs. It may be important to give initial, temporary protection to fledgling key industries - and related supporting industries - where difficult learning of new technologies is called for. However, it is important that protection is granted for a limited time period and progressively phased out.

It was further pointed out that macro-economic reforms do not necessarily by themselves guarantee economic rejuvenation and that LDCs, therefore, need, in addition, to develop a complementary and focused industrial policy to combat structural weaknesses at the industry and enterprise level.

Yet given the extreme diversity of LDCs - in Africa and Asia, in particular - there is no single set of industrial policies that is 'best' for all of them. Individual LDCs must carefully select those policies which are appropriate for their particular circumstances.

On the other hand, it is true that despite their diversity, LDCs share a common need to develop a comprehensive and flexible industrial policy. Such a policy would emphasize the basic potential of LDCs in the exploitation and processing of their natural resources. It is clear that if industry is to become the motor for overall economic growth it must be closely allied with agriculture and other natural resource-based industries. There must therefore be the priority focus of industrial policy.

It was also argued that given the limited resources available for industrial development, LDCs cannot afford to dissipate scarce human and other resources over too wide an area. This fact would call for most LDCs to focus industrial policy in selected areas, sectors, subsectors, industries and even on specific priority enterprises. This targeted approach would ensure that scarce resources are used where they would have most benefit.

Two other key elements of an industrial strategy for LDCs should be highlighted. First, the strategy would call for decentralization of economic decision-making and a regional approach to foster rural development. Second, in connection with the processing of domestic raw materials there is a need to have a rural-based decentralized industrial strategy. However, it should be stated that such a strategy would not be without problems. It would clearly not be applicable to some of the smaller LDCs.

In addition, the problem with a decentralized approach is that for it to be effective any assignment of decision-making powers and resources to regional bodies would require giving these bodies the autonomy to use these powers as they see fit. This would make strong administrative and political demands on LDCs. Indeed, at the present time, many LDCs do not have the required decentralized administrative and political institutions. For this approach to have any chance of success LDCs need to develop the requisite decentralized political and administrative framework, probably with outside assistance. While a decentralized strategy may be questionable in smaller LDCs it should be a priority in the larger LDCs to give a much needed boost to economic development and moves towards greater democratization. Decentralization would particularly help rural areas where most of LDC populations live and where many small-scale and informal sector industries are located. Irrespective of size, LDCs must move the development process forward by building up centres of excellence, growth poles or target industries with clusters of supporting institutions, services and infrastructure.

In addition to small-scale industries and the informal sector, the discussion also highlighted other key areas to be the focus of industrial policy. One key area that was highlighted was rehabilitation of industry, particularly in African and Arab LDCs. An integrated top-down bottom-up approach was suggested for rehabilitation: a top-down diagnostic of the broad rehabilitation requirements to be followed by a bottom-up assessment of the required changes in economic and institutional environment in LDCs as a pre-condition for successful plant-level rehabilitation. This approach has been tested successfully by UNIDO in its diagnostic survey programme of rehabilitation needs of manufacturing industry in Africa.<sup>20</sup>

The importance of attracting foreign direct investment (FDI) to assist the regeneration of LDC economies was also stressed. But it was pointed out that the attraction of FDI might be a double-edged sword in that it has costs and benefits. Thus a balanced perspective should be taken to the attraction of FDI.

In connection with FDI, it was stressed that though many LDCs in recent years are making great strides to re-design investment codes and simplify legislation concerning FDI, this was not enough. Particularly important in this regard was the need to establish a network of mutually supporting services, institutions and infrastructure to attract FDI.

A significant part of the discussion was given to the promotion of the private sector, privatization, and particular issues and problems involving the privatization process. It was stressed that it was important not to turn public sector monopolies into private sector ones, the need for restructuring of domestic finance institutions (DFIs) and the banking

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<sup>20</sup> Regenerating African manufacturing industry: approach and programme, PPD.101, 29 December 1988, The UNIDO integrated approach to rehabilitation in Africa, PPD.168, 10 July 1990.

restructuring of domestic finance institutions (DFIs) and the banking sector, the need to establish capital markets, develop supporting industrial promotion and administrative policies, and industrial promotion centres. It was also emphasized that there was a need for international assistance to help LDC governments re-design their investment codes, simplify their legislation and administrative procedures and establish supporting industries, services and institutions.

It is important to emphasize that because of the enormity of their development problems, most, if not all, African LDCs will be unable to overcome their problems solely from their own resources. The persistence of budget deficits implies that LDCs have no hope of financing their development needs without external financial assistance. Thus future Official Development Assistance (ODA) has a crucial role to play in the development of LDCs in years to come.

It is also clear that donors will have to re-double their efforts to improve the use of ODA so that it can bring lasting benefits. This will require better co-ordination and targeting of ODA than in the past. Also a greater concentration on the promotion of the private sector could bring greater returns.

The key question permeating the whole discussion - in the overall context of a stronger role to be played by the private sector - is what should be the critical contribution of government policy and public investments for industrial development. Evidently, the past emphasis in most LDCs on public sector enterprises in a broad range of manufacturing areas has run into operational and financial constraints and led to an inefficient allocation of economic resources. It has diverted attention away from the central role of government - that is, the establishment of an environment and infrastructure conducive to overall industrial development to which also private entrepreneurs could make a stronger and lasting contribution. "Government failure may have consisted as much in failing to provide the infrastructure in which government has a large comparative advantage as it has in providing poorly things in which it does not have a comparative advantage."<sup>21</sup> Recognizing this, does not imply at all that government would have to confine itself to a very limited developmental role, let alone to adopt a laissez-faire attitude. The creation of the basic infrastructure for industrial development is a demanding, costly and long-term effort requiring a lead role and an active involvement of the government. In this context, it is important not to adopt too narrow a definition of infrastructure.<sup>22</sup> The most essential elements of a broader concept of infrastructure for LDCs would comprise:

- physical infrastructure: this refers to transport services such as feeder roads; power and water supply; communications facilities, above all telecommunication services at least for those areas and industries linked with regional and international markets.

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<sup>21</sup> Krueger, A.O. Government failures in development. in: The Journal of Economic Perspectives, Vol. 4, No. 3, Summer 1990.

<sup>22</sup> Cf. ESCAP, Economic and Social Survey of Asia and the Pacific 1990, New York 1991.

and training of human resources for modern industrial development:

- institutional infrastructure: this refers to the creation of a basic set of promotional institutions geared at fostering industrial development by providing critical services in areas such as financing, entrepreneurship development and training, technology acquisition and adaptation, and others.

Focused human resource development was also seen to be key issues in a comprehensive and appropriate industrial strategy in LDCs. It was stressed that human resource development should be targeted on the selected subsector, sector and individual priority industries.

Apart from regional co-operation to overcome the small size of national markets and to pool resources, emphasis should also be placed on international co-operation to assist LDC governments, particularly in the areas of small-scale industry, industrial rehabilitation, the promotion of the private sector and privatization, the attraction of FDI and the promotion of regional institutions and regional co-operation.

As a caveat, it should be stated that whatever the policies LDC governments may wish to adopt, without the capacity to implement them the best designed policy framework will do little to promote industrial development in LDCs. It is therefore essential that LDC governments not only build up the capacity to properly design policies but also a capacity to monitor, implement and evaluate policy. In this regard, LDCs may well require significant assistance from the international community.

As a final word it should be stated that the key to industrial regeneration in LDCs is political will. Without strong political will all the best intentions will have little or no hope of success. This calls for strong leadership by LDC governments and most appropriately the vision and the confidence to give full rein to the latent dynamism of entrepreneurs in the small-scale and informal sectors in LDCs.