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EXPERT GROUP MEETING ON

**INDUSTRIAL STRATEGIES AND POLICIES
MANAGERIAL AND ENTREPRENEURIAL SKILLS**

**UNDER CONDITIONS OF
GLOBAL AND REGIONAL CHANGE**

Bahrain, 20-23 November 1995



ESCWA

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INTRODUCTION

In recent years, the global economy has undergone radical changes with important implications for future industrial development and for the operation of industrial enterprises in developing countries, particularly those of the ESCWA region. These changes include the transformation of most of the centrally planned economies into market economies, the establishment and strengthening of large regional economic blocs, the recently concluded international trade agreement leading to the globalization and liberalization of trade, and the increasingly rapid advances in the application of high technologies. Increased pressure to adhere to the requirements of ISO 9000 quality standards and related codes and specifications has amplified the impact of these changes, as has the introduction of other quality and environmental controls and specifications. Regional events, particularly the situation emerging as a result of the peace process, pose additional challenges; they are expected to lead to radical changes in economic and trade relations and hence have serious implications for the operation of companies and firms in Western Asia.

In response to regional and global changes, most ESCWA member countries have begun to place greater emphasis on economic reforms and deregulation, industrial restructuring and the promotion of the private manufacturing sector. While new policies and policy measures are being formulated and implemented, the Governments of the region need to introduce far more radical changes in their industrial strategies and policies to allow them to cope more effectively with the challenges created by the new international environment and the new regional realities. At the firm level, managers need to review their traditional approaches and to restructure their companies and management systems in order to keep pace with fast-changing global and regional conditions and to facilitate the observance of new policy measures that may be introduced in their own countries.

It is still too early to predict how deeply the emerging global and regional environment will affect the operation and performance of firms in most ESCWA member countries. Nor is much known about how managers will respond to cope with these radical changes. Firms cannot form appropriate responses in the absence of clearly formulated industrial strategies and policies that take into account global and regional realities or in the absence of specific government policies aimed at the enhancement of entrepreneurship and private enterprise. Through such policies, appropriate changes could be introduced at the national and enterprise levels which would enable entrepreneurs to deal with uncertainties and identify new business opportunities. The formulation of new industrial strategies and policies by ESCWA member countries requires, among other things, a review and analysis of the attitudes of managers towards current and expected future government policies in various related areas such as investment, trade, finance and fiscal and tariff policies.

The liberalization of the international market, the potential emergence of Israel as a new economic and trading partner in the region and the proposed modalities for regional cooperation are major issues that can be expected to play a primary role in shaping the reformulation of industrial strategies and policies and the restructuring of the industrial sector all the way down to the firm level in the ESCWA region. Governments must formulate new industrial policies which are defined within the framework of overall economic development strategies, and the role of industrial sectors in economic development must be clearly determined. Equitable industrial growth which takes into account the eradication of poverty would be an essential component of new government strategies regarding industry. While most Governments in the ESCWA region have traditionally tended to favour the development of large industrial enterprises, paying relatively little attention to small and micro enterprises, the emerging socio-economic realities in the region may very well lead to a reversal of this trend. Industrial strategies and policies for regional cooperation will be more heavily influenced by the emerging bilateral and multilateral economic and trade agreements and the new global and regional arrangements.

The current proceedings incorporates a series of papers selected from among those presented at the Two Concurrent Expert Group Meetings on Industrial Strategies and Policies, and Managerial and Entrepreneurial Skills, under Conditions of Global and Regional Change held in Manama, Bahrain, from 20 to 23 November 1995; it also includes a brief summary of the major conclusions and a list of recommendations. The meetings were co-sponsored by ESCWA, Friedrich Ebert Stiftung (FES) of the Federal Republic of Germany, and the Economic Research Forum for the Arab countries, Iran and Turkey, in cooperation with the United Nations Development Programme Office in Bahrain, and were hosted by Bahrain's Ministry of Development and Industry.

The objectives of the two concurrent meetings were as follows:

- To review the new global environment and its impact on the region within the context of major economic and political events such as the conclusion of the Uruguay Round, the emergence of the Single European Market, the formation of other regional economic blocs and the transformation of the Eastern European countries, and in the light of increasing requests for adherence to ISO 9000
- To discuss the impact of the peace agreement, particularly its effect on the region's industrial sector
- To discuss new options for industrial strategies and policies in the region under conditions of change

- To formulate appropriate policies and measures to enhance the entrepreneurial skills of managers under conditions of uncertainty
- To identify entrepreneurial characteristics in the region and to assess the capabilities and potential of entrepreneurs to deal with the effects changing regional and international conditions have on the operation of individual firms

The papers presented at the two meetings centred around four major themes:

- The changing international environment and its impact on the region
- The changing regional environment, particularly the peace prospects and their implications
- Industrial strategies and policies within the context of the changing international and regional environment
- The operation of firms and the development of managerial and entrepreneurial skills under conditions of change

The papers and related discussions emphasized the need for ESCWA member countries to build a competitive industrial sector to meet the challenges of the new, rapidly changing global and regional economic environment—mainly by adopting outward-oriented industrial strategies, accelerating human capital accumulation, broadening the industrial and technological base, and fostering broader intraregional economic cooperation. The ESCWA member countries need to develop and implement new economic and industrial strategies and policies that will enable them to move away from the rentier economies of the past into more productive economies based on high-value-added and sustainable production and on the building of competitive fundamentals and region-specific comparative advantages.

The meetings called upon the ESCWA member countries to develop a stronger presence in the new knowledge- and information-based world economy and to build their innovative and entrepreneurial capabilities. More specifically, the ESCWA member countries need to stimulate high-value-added production, develop industrial linkages and networks among themselves, define a new role for their Governments, accelerate the development of local and regional technological capacities, empower and help restructure the private sector, and promote entrepreneurship in knowledge-based industries.

CONCLUSIONS AND RECOMMENDATIONS OF THE MEETINGS

A. BACKGROUND

Arab countries are currently wrestling with some of the greatest economic challenges they have ever faced. The future of the Arab economies depends primarily on their ability to cooperate with one another and on how their Governments, business people, investors, workers, and communities respond to the challenges before them.

There is a critical need for broad-based agreement among the Arabs on what has gone wrong in the past and on what it takes to succeed in the new global economy. The Arab countries need a common sense of purpose and a shared vision that will help them improve their productivity, competitiveness, structures, institutions, and overall standards of living. Individual countries, acting alone, cannot meet the challenges associated with today's global markets and giant transnationals.

The need for a new industrial framework stems from the following basic factors:

- The global and regional economic environment is changing rapidly.
- The Arab economy must overcome some severe structural problems.
- New competitive advantages must be identified and developed.
- A critical mass of experts and researchers must be developed to establish viable and sustainable national capabilities in strategic economic domains.

The international economic environment the Arab countries are facing in the 1990s is dramatically different from that which existed in the 1950s or even the 1980s. International competition is intensifying and the basis of economic success is changing. With the conclusion of the Uruguay Round negotiations and the establishment of the World Trade Organization (WTO), major changes are taking place in world trade, and the dominance of multinational corporations is increasing. Regional trading blocs dominated by the United States, Japan and the European Union are emerging and consolidating their markets. Newly industrialized countries are increasing the competitive pressure in many industries and are setting strong examples for others to follow.

The pace of technological change has quickened, increasing the value and importance of research and development as the basis for competitiveness in world markets. New technologies are changing the nature of economic activities. Worldwide advances

in information technology are translating into improved productivity in all industries; further, such technology is widely accessible and relatively inexpensive. Software is now replacing hardware as the major ingredient in improving efficiency and achieving a competitive advantage. Furthermore, technological innovations have resulted in drastic declines in the resource intensities of products; Japan's industrial production almost tripled between 1965 and 1985, while its consumption of energy and raw materials increased very little.

Worldwide concern for the environment is growing steadily. Governments in industrialized countries are strengthening environmental specifications and restrictions, and are adopting more efficient and cleaner technologies to conform with environmental regulations and to meet mounting consumer demands.

Global finance, decoupled from production, is now virtually unregulated. A multi-country electronic financial network operates round the clock, with weekly transfers totalling multiples of the value of international trade over an entire year. Resources are exchanged freely across borders at lightning speed; in seconds, financial wizards in New York or Tokyo can be connected with even the most remote areas of the world. The network is centred in cities, not States, and has developed a supranational power of its own: Governments are increasingly beholden and accountable to external bond markets rather than to their own citizens. Their options in exchange-rate policy, fiscal and monetary policy, and industrial and trade policy have all become constrained by the linkage of their financial interests to the global economy.

At the regional level, the Arab-Israeli peace process is creating new conditions and a new economic environment—and is also generating new challenges and new problems for the Arab economies that must be squarely confronted and dealt with.

Widespread income and wealth disparities within and between Arab States continues to be manifested in social and political tensions and in limited domestic purchasing power. This reduces the capacity of local markets to sustain a viable local production sector and undermines health and education opportunities, thus hampering labour productivity growth.

B. ELEMENTS OF A NEW MACROECONOMIC STRATEGY

Building a competitive industrial sector is now the single most critical component of a vital strategy for survival and success in the rapidly changing new world economic environment. The following are among the most important aims of such a strategy:

- Promoting outward-oriented industrialization
- Raising domestic savings and investment levels

- Deepening and broadening local and regional industrial and technological bases
- Developing and enhancing the services sector
- Accelerating human capital accumulation to accommodate labour market needs, primarily through the extensive review and possible restructuring of educational and vocational programmes and systems
- Building and maintaining an efficient, production-linked infrastructure
- Creating a sound and accommodating macroeconomic environment
- Facilitating a more equitable distribution of income and wealth
- Fostering broader economic cooperation among Arab countries within the framework of wider international cooperation

The development of innovative and outward-looking industrial strategies and policies is part of a broader agenda for economic renewal which will allow the Arab countries to overcome severe structural problems resulting from weak and limited industrial bases and heavy dependence on oil and oil rents. The Arab response does not require elaborate blueprints for economic restructuring or the establishment of an array of expensive government programmes; all that is needed is a framework that enables all segments of society to work together as partners. Grand schemes and large government programmes in the Arab region have generally failed to bear the expected fruit, and while some of them may have been acceptable at the earlier stages of Arab development, they are no longer workable. Development is now too complex a process to be encompassed by a single blueprint or entrusted to a single social group.

C. RECOMMENDATIONS

The development of a new strategy requires efforts at the national and regional levels and also at the macro and enterprise levels. Bearing this in mind, the meetings called on Arab Governments, with the assistance of regional and international agencies and institutions, to develop and implement new economic and industrial strategies and policies that take the following recommendations into consideration.

1. The macro level

Arab countries need to move away from the rentier economies of the past and concentrate on developing more productive economies based on high-value-added and sustainable production and on the building of region-specific comparative advantages. Success in shifting towards greater productivity will increasingly depend on the building of innovation capabilities and entrepreneurial and technical skills, and on the full-fledged and deliberate entry into the new knowledge-based economy. To move into high-value-added and sustainable production, the Arab countries must build and strengthen their competitive fundamentals by means of the following:

1. Industrial linkages and networks should be developed within each State and among Arab States, beginning with subregional cooperation among smaller groupings of States and working up to larger and broader regional cooperation.

2. Greater economic cooperation with European and Mediterranean regions and with other regions of the world should be fostered in order to maximize Arab interests and to allow Arabs to voice their concerns and participate actively and effectively in shaping policy initiatives that affect the future of the region.

3. A new role should be defined for Governments; action should be taken in several critical areas that can have the greatest impact on strengthening Arab competitive fundamentals, namely the following:

- Placing strong emphasis on investing in people, training and knowledge
- Emphasizing the development of sectoral strategies, strategic groups of companies, community initiatives and industrial entrepreneurship
- Reforming the civil service in each country, stressing efficiency, merit, accountability, transparency and integrity
- Changing the balance between the public sector and civil society by balancing fiscal and monetary policies; empowering the institutions that mediate between the State and citizens; and strengthening democratic institutions and practices
- Building the State's capacity to design and implement industrial policies, and fostering a strong political commitment to development and a political will to override vested interest groups

- Building the State's capacity for flexibility in changing the nature, scope and extent of State intervention in response to new issues and challenges that emerge at different stages of industrialization
- Diverting part of the current public expenditure allocated to the military and security sectors to enhance economic and industrial development, and increasing expenditure in the critical areas of health services, poverty eradication, research and development, and education. In other words, public expenditure should be rationalized and balanced.

4. High-value-added production should be stimulated in the Arab region. It is essential to move away from the heavy dependence on oil and oil-related production, concentrating instead on the higher-value-added upstream and downstream oil processing. Arab countries should also gradually move away from oil and their dependence on natural resources; by diversifying their economic structures, markets, technological capabilities and skills, they can greatly reduce the rampant rentierism in the Arab economy while building up a dynamic comparative advantage.

5. Arab countries should develop a stronger presence in the new economy (i.e., in knowledge- and information-based production).

6. Investment development offices should be established and/or enhanced to coordinate, disseminate and facilitate the exchange of information, to reduce detrimental or injurious competition for investors, and to develop an investment climate that will benefit local economies (including, but not restricted to, "home-based manufacturing and product mandates").

7. Networks and linkages should be created among firms in the region operating in related fields to help them overcome size-related difficulties. Networks of linked firms, industries and institutions can work together to develop a competitive advantage that would be impossible for individual firms acting alone to achieve. Arab Governments must foster cooperative relationships which help to create competitive advantage by stimulating technology transfer, continuous innovation, and skill development and training. There is also a need to build on the synergies generated through cooperation among firms and institutions—to spark new cooperative initiatives among Arab States, create a vested interest in regional cooperation, and cement the integration of markets and energies.

8. Sector partnership funds and other sectoral initiatives should be developed among regional private-sector institutions and firms to facilitate networking and increase the intensity of their contacts. More public investment in network-specific types of infrastructure will be needed, particularly in the information infrastructure.

9. Small and micro enterprises face particular difficulties in building their international competitive capabilities, mainly owing to the lack of information, know-how and investment funds. The long-term success and growth of these firms frequently depends on whether they are able to take advantage of international trade, investment, and technology-acquisition opportunities. Arab Governments should make every effort to strengthen small- and medium-scale enterprises (SMEs), in part through the establishment and/or enhancement of trade promotion offices in key international locations (embassies could also be used for this function).

10. The development of local and regional technological capacities could be accelerated and Arab technological infrastructures strengthened through the establishment of national and regional "Arab centres for excellence" in technology, and through the development and diffusion of technology incubators.

11. Arab Governments should attach greater importance to the social dimensions of industrialization, focusing on the following:

- Increasing the participation of women in all aspects of the industrialization process within the context of the region's social and cultural environment
- Contributing to poverty alleviation and the more equitable distribution of income through employment generation

12. The private sector, NGOs and the community should be empowered to develop and carry out initiatives designed to increase productivity and competitiveness, and partnerships should be promoted between these groups and the public sector. Efforts should be made to promote increased cooperation and better working relationships among private-sector institutions at the regional level as well.

13. Assistance should be provided in the restructuring of the private sector to facilitate the development of new attitudes and behaviour so that this sector can carry out its responsibilities.

14. Environment-friendly industrialization should be promoted, with particular emphasis placed on cleaner production and greener industries.

2. The micro level

15. Small entrepreneurial businesses are now responsible for creating the bulk of new employment opportunities the world over, and Arab Governments need to proactively promote such enterprises by establishing special training programmes, developing support mechanisms for financing, marketing and management, providing tax incentives, carrying out relevant studies, and setting up appropriate monitoring and information systems.

16. Technology and business incubators can offer integrated support to promising innovative firms in one affordable package as part of a national SME strategy. Incubators and other such support mechanisms should initially be provided with State support as an investment in nurturing entrepreneurship.

17. Chambers of industry and commerce and other private-sector institutions, when properly isolated from direct government interference, can effectively represent the interests of the private sector and enhance its participation in economic activities. These institutions need to be strengthened to enable them to provide training, advisory, information and promotional services. Other specialized private-sector institutions and mechanisms should be established and/or strengthened for this purpose as well.

18. The entrepreneurship development programmes undertaken by ESCWA, often in cooperation with Friedrich Ebert Stiftung, should be raised to higher technical levels as the needs of managers and start-up companies become more sophisticated.

19. Entrepreneurship programmes should be integrated into the overall educational system; efforts should begin at the primary level and continue through higher education, with specialized executive courses and training programmes provided as needed.

20. ESCWA should initiate activities in new areas, focusing on the development of innovation strategies and consultancy capabilities, the management of technology, and the regular exchange of trade and technology information.

21. Engineering and other technical programmes at colleges and universities have to be modified to provide training, research and consultancy (TRC) services so that graduates will be better prepared to meet societal needs in a rapidly changing global environment.

22. Arab countries must mobilize their efforts and resources to progress beyond traditional industries (such as the garment, food and light mechanical industries) into selected higher, knowledge-based industries and services such as communications, computer software and hardware, micro-electronics, pharmaceuticals and new materials

technologies. Each country should identify and develop its comparative advantages based on its prevailing conditions and resources.

23. The private sector in each country should play a leading role in selecting which knowledge-based industries and services to develop and which niche markets to enter. Partnerships and alliances are crucial for gaining access to foreign know-how and experience and for developing linkages (South-South as well as South-North) with key international players. The private sector is better equipped to identify and develop local capabilities in these advanced industries and services; however, government support is required to ensure the provision of a suitable business environment and to foster the necessary in-house research and development.

24. Technology-based enterprises require access to risk (venture) capital. Financial markets in the countries of the region should be encouraged to support venture capital initiatives through the establishment and/or enhancement of innovative mechanisms.

25. SMEs—and large enterprises—should be provided with the support they need to enhance and ensure product quality; in particular, the appropriate testing facilities and other types of assistance should be made available which will allow them to conform to international standards and intellectual property rights requirements. ESCWA initiatives developed to promote adherence to quality imperatives and practices—particularly efforts related to ISO 9000—should be enhanced through additional seminars, training, workshops and conferences.

26. The rising concern over quality standards must be addressed and the impact of their application to manufactured products in industrialized countries evaluated. Attention must also be given to environmental concerns and to the emerging ISO 14000 standard. The process of standardizing and harmonizing the specifications prevailing in Arab countries must be enhanced and supported.

27. Expatriate nationals (Arab professionals now residing abroad) should be provided with encouragement and special incentives to re-transfer their skills—and capital—to their countries of origin and to participate in efforts to establish the new economy in the region.

28. Business communities in the Arab countries must allocate the necessary (but limited and balanced) resources to investigate the perceived threat of massive Israeli encroachments into their markets. Thorough and in-depth studies of the various aspects of the Israeli market and economy must be undertaken so that Arab countries (particularly their industrial sectors) can develop and mobilize their comparative advantages in order to meet Israeli challenges.

29. Arab countries must exert serious efforts to create additional forums for discussion and interaction between entrepreneurs, private-sector institutions, decision makers, academicians and experts concerning the development and elaboration of new industrial strategies and policies and the requirements for their implementation.

30. In-depth studies should be undertaken in selected industrial sectors at the commodity level to assess the impact and challenges of the Uruguay Round agreements and other relevant global and regional changes.

Part One

OVERVIEW

I. INDUSTRIAL STRATEGIES AND POLICIES IN THE ESCWA REGION WITHIN THE CONTEXT OF A CHANGING INTERNATIONAL AND REGIONAL ENVIRONMENT

by the ESCWA secretariat

Introduction

This study addresses issues relating to the emerging trends in economic development and industrialization in the ESCWA region under changing international and regional conditions. The study was presented as a background paper in the Expert Group Meetings on Industrial Strategies and Policies, and Managerial and Entrepreneurial Skills, under Conditions of Global and Regional Change that was held in Manama, Bahrain, from 20 to 23 November 1995. The meeting was held under the joint sponsorship of ESCWA, Friedrich Ebert Stiftung (FIS), and the Economic Research Forum for the Arab Countries, Iran and Turkey.

Section one of the study is concerned with issues relating to major international and regional challenges facing industrial development in the ESCWA member countries. This includes the following: the Uruguay Round agreements; the formation of large regional economic groupings; international standardization and related specifications; advancement in the application of industrial technology; and economic implications of the peace process.

The first part of the section presents a preliminary analytical review of the implications of the Uruguay Round agreements on industry, particularly on trade in manufacturing, and on selected major industrial commodity groups in the region. This part also examines briefly the various differential and more favourable treatment the Uruguay Round agreements grant to developing countries, including the ESCWA member countries, with respect to scope, longer transitional periods, flexibility and other factors. This is undertaken with the aim of highlighting the opportunities opened to member States to benefit during the transitional period from the special consideration given to developing countries. It also aims at emphasizing the opened opportunities that countries in the region should promptly prepare themselves to take advantage in the longer run of the wide range of concessions made by developed countries to other contracting members in the Uruguay Round agreements. Finally, this part briefly presents some options opened to member States to maximize their benefits and to minimize their losses under the Uruguay Round agreements.

The second part of the section presents briefly the consequences of the formation of new large regional trading blocs for developing countries, including the ESCWA member countries, within the context of liberalization of international trade. It indicates

that greater internal efficiencies may affect traditional trade between the regional economic groupings and the third world, and may divert capital flows from these countries to the North. Trade blocs may also protect their trade in high-technology products but will not protect as vehemently their low- and intermediate-technology industries. The third part of the section introduces the concept of standardization and quality management under the systems of the International Organization for Standardization (ISO) 9000 and total quality management (TQM). It attempts to highlight the importance of the application of these standards for accessing world markets. The fourth part relates to advancement in industrial technology and deals with rapid technological change and its impact on industrial strategies and policies in developing countries. It briefly introduces the science and technology revolution (STR) and its elements, namely information technology, genetic engineering and biotechnology, and new materials. The ever-widening gap between industrialized and developing countries and the ever-increasing pressure of liberalization and globalization, induced at least partially by the STR, have been imposing on developing countries the necessity to review their industrial strategies and policies to take into consideration the main implications of rapid technological changes.

The last part of this section presents some preliminary thoughts on the economic implications of the peace process. It briefly demonstrates that the economies as well as the manufacturing sectors of ESCWA member countries are less prepared to enter the international market than the more advanced Israeli manufacturing sector. It summarizes the anticipated effects of the peace process on the macroeconomic level and briefly discusses the various constraining factors limiting the development of economic relations and the diversion of trade in the short run. This part of the section concludes that detailed, in-depth studies need to be carried out to accurately identify possible areas of cooperation in manufacturing activities in the Arab and Middle East region, including not only Israel but other neighbouring countries as well such as Turkey, Cyprus and Iran, with a broad industrial coverage to create what is coming to be called the Middle East market. In-depth industrial studies also need to be carried out at the commodity level, to identify the comparative advantage of each country in the region in specific commodities, taking into consideration the increasingly competitive world market.

Section two is concerned with issues relating to the reformulation of industrial strategies and policies in the region. This includes the role of the State, privatization, the outward-looking industrial strategy, and the role of private-sector institutions. The first part of this section is on the emerging new role of the State in industrial development. It gives an analytical review of relevant reform trends now under way in the ESCWA member countries, identifying the driving force behind these reforms, highlighting differences in the commitment to change in different countries. It then presents a conceptual analysis of the changing role of the State in the countries of the region, in which it emphasizes the institutional dimension. This part of the section briefly introduces a new dimension in economic development, namely institutional changes and their effects on economic performance. Selected aspects in the successful experience of East Asian

economies are highlighted, and an indigenous approach to treating the role of the State in the countries of the region is called for.

The second part of this section deals with trends in privatization in the countries of the region. It shows that different countries have different commitments to the privatization of public enterprises. It briefly presents privatization policies in countries of the region and examines the extent of commitment in terms of actual sales of public enterprises. It then summarizes some of the constraints facing the privatization process. This part of the section indicates that in most countries, privatization is implicitly conceived of as the means of addressing the fiscal crisis facing the State, and not as a developmental question. Only three countries in the region have taken an outright decision to privatize large parts of public enterprises: Egypt, Kuwait and Yemen. In the Gulf Cooperation Council (GCC) subregion, most countries are still considering the issue, and tend to maintain public ownership in heavy and strategic industries. In the more diversified economies (MDEs), privatization has started only in Egypt, for which a more detailed analytical review is presented. Despite the positive effects of privatization, the negative effects of the process in the transitional period are forcing most countries in the region to take a gradual approach to privatization or to be cautious in introducing it.

The third part of this section is on the emerging new outward-looking industrial strategy in the region. It presents some of the problems facing expansion in manufacturing, and focuses on some aspects of the challenges confronting this strategy. This includes: the comparative advantage of existing industries; export promotion centres and information technology; transparency of the economy; the regional market and neighbouring export markets; foreign direct investment (FDI); and the legal business system. Some of the problems mentioned relate to the sponsorship system in the GCC countries and high cost of production in the MDEs. This part of the section indicates that the strategy's success will greatly depend on investment expansion and on the anticipated participation of repatriated Arab capital and FDI.

The last part of the section is concerned with the new role of private-sector institutions. It focuses on selected areas where private-sector institutions together with government institutions need to take action to assist industrial firms to cope with the new challenges. This includes: simplifying administrative procedures; designing specific financing schemes for small enterprises; establishing centres and networks of information services; and providing entrepreneurial encouragement, advisory services and training. This part of the section emphasizes that private-sector institutions must shoulder greater responsibilities in the industrialization process to compensate for the continuous decrease in the role of the State.

Section three is an attempt to formulate a framework for industrial strategy in the ESCWA and Arab region. It briefly describes the challenges of the international economic environment that the region is confronting, contrasted against the structural

problems it is facing in its economy and in manufacturing. Elements of an industrial framework are drawn. These include: strengthening competitive fundamentals; increasing value added content; adopting a new policy towards transnationals; and strengthening regional cooperation; balancing production structures, regional allocations of investment, income and consumption, domestic savings and investment, and income and production are necessary conditions for a more secure and sustainable future. Reducing dependence on natural resources calls for exploiting other sources of income, particularly from renewable sources of production. Knowledge-based industries are key activities to consider for the future.

A. MAJOR INTERNATIONAL AND REGIONAL CHALLENGES FACING INDUSTRIAL DEVELOPMENT IN THE ESCWA REGION

In recent years the global economy has undergone radical changes with important implications for future industrial development and for the operation of industrial enterprises in developing countries, particularly the countries of the ESCWA region. These changes include the transformation of most of centrally planned economies into market economies, the establishment and strengthening of large regional economic blocs, the recent conclusion of the Uruguay Round agreements leading to the globalization and liberalization of trade, and increasingly rapid advances in the application of sophisticated technologies. The trends are emphasized even further with the implementation of ISO 9000 standards and related codes and specifications, as well as with the introduction of other quality and environmental controls. Furthermore, regional events, particularly the emerging new situation in the region in the aftermath of the peace process, constitute yet more challenging issues that will bring about radical changes in economic and trade relations and hence in the operation of the companies and firms in the ESCWA region.

The liberalization of the international market, the potential emergence of Israel as a new economic and trade partner in the region and the proposed new modalities for regional cooperation are major issues that will shape, to a great extent, industrial strategies and policies and the restructuring of the industrial sector down to the enterprise level in the ESCWA region. New government industrial policies, however, need to be clearly defined, within the framework of overall economic development strategies; the role of the State, as well as the industrial sector, in economic development needs to be explicitly determined. Industrial growth with equity, taking into account the eradication of poverty, would essentially be an important component of new government industrial strategies. While most Governments in the ESCWA region tended in the past to favour the development of large public industrial enterprises without due attention to small and micro enterprises, the emerging new socio-economic realities in the region may very well lead to reversed trends, shifting emphasis more towards the promotion of private small- and medium-scale manufacturing enterprises. In regional cooperation, industrial strategies and

policies will be influenced more by the emerging bilateral and multilateral economic and trade agreements, by new global and regional arrangements.

In response to regional and global changes, most ESCWA member countries have already started to give more emphasis to economic reforms and deregulation, to industrial restructuring and to promoting of the private manufacturing sector. New policies and policy measures are being formulated and implemented, yet Governments of the region need to introduce far more radical changes in their industrial strategies and policies, in order to face the challenges and impact of the new international environment and the new regional realities. At the level of the firm, managers need to review their operations and to restructure their own companies in order to adapt to fast-changing global and regional conditions, as well as to the new policy measures that may be introduced in their own countries.

However, little is yet known about the effects of the emerging global and regional environment on the performance and prospects of the industrial sector and the firm in most ESCWA member countries. Industrial managers need to introduce changes at the level of the firm to cope with expected radical changes. In this respect, firms cannot make appropriate responses in the absence of clear government industrial strategies and policies that would take into account recent global and regional realities. This study attempts to present a preliminary review of the new global environment as well as changes in regional conditions and their impact on the region. This is undertaken within the context of major economic and political events such as the General Agreement on Tariffs and Trade, the application of ISO 9000, the formation of large economic blocs, and the challenges of the peace process. Against this background, the study addresses selected major industrial issues relating to the role of the State in industrial development, privatization, outward-looking industrial strategy and the role of private-sector institutions. Finally, an attempt is made to formulate a framework for a new industrial strategy for countries in the region which takes into account new options in the region and which would respond to global and regional challenges.

1. The liberalization of global trade: preliminary notes

According to a GATT Secretariat forecast (GATT, 1994a), the Uruguay Round liberalization of goods and increased market access are expected to increase world income by \$510 billion per year by the time the market access commitments are fully implemented in the year 2005. Of the projected income gains, more than 60% goes to the three developed countries and region, namely the EU (\$164 billion), the United States (\$122 billion) and Japan (\$27 billion). The developing countries' share, including ESCWA member countries and other Arab countries, is expected to be around 23% of total increase in income (\$116 billion). For ESCWA oil-exporting countries, the increase in world income would increase demand for oil products, which would boost the growth of income in the oil-exporting economies, particularly the Gulf Cooperation Council (GCC)

countries. The GATT Secretariat indicated that world income gains would reportedly be substantially greater, with other lasting effects related to higher investment, accelerated growth and a healthier climate for global research and development and new product development. In terms of international trade, the GATT Secretariat forecast that the volume of world trade would increase by 4.1% to 5% annually till the year 2005 and by 12% annually thereafter.¹

Although part of the gains in this expansion would relate to exports of developing countries, including the ESCWA member countries, the decline in tariffs and the reduction in non-tariff barriers in goods such as food products and textiles would be to the advantage of countries most efficient in production, at the cost of countries whose exports depended more on most-favoured-nation (MFN) treatment and other restrictions to help them secure their share of the international market. Increased competitiveness of the European Union (EU), for instance, due to trade liberalization, would involve some transition costs to some Arab Mediterranean countries, as their competitiveness would be increasingly challenged by their competitors from other developing countries of Asia and Eastern Europe. If countries of the region are able to develop more diversified production structures and to improve productivity and product quality, they will benefit in the longer run from the wide range of concessions reached between developed countries and extended to all other contracting members in the Uruguay Round agreements. Nonetheless, as more than 93%² of world trade originates in World Trade Organization (WTO) Member countries, it is clear that it will now be very costly for any country, including ESCWA member countries, to be non-Members of the WTO and outside the multilateral trading system. Furthermore, to be outside the international multilateral trading system would make it more difficult for countries in the region to attract the needed foreign direct investment (FDI) and technological know-how associated with it to diversify their industrial base and compete in the international market.

Only a few countries in the ESCWA region became GATT Contracting Parties (Helal, 1995a), namely Bahrain (1993), Egypt (1963), Kuwait (1963), Qatar (1994) and the United Arab Emirates (1994), while two other ESCWA member countries, namely Jordan and Saudi Arabia, are in the process of acceding to the World Trade Organization. Yemen is a *de facto* WTO Member³ and can easily become a contracting Member. The rest, namely Lebanon and the Syrian Arab Republic, were among the 23 establishing members of the GATT in 1947; both of them are currently considering rejoining the WTO, after withdrawing from GATT in the 1950s. However, whether Members or non-Members

¹ For more details of the results of the Uruguay Round, see GATT Secretariat, *The Results of the Uruguay Round of Multilateral Trade Negotiations* (Geneva, November 1994) [GATT, 1994b]; and for details of the legal text, see GATT Secretariat, *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts* (Geneva, June 1994) [GATT, 1994c].

² ESCWA estimates.

³ A founding member of GATT in 1947.

of the WTO, all countries in the region are expected to be affected in the short run (the transitional period) by the liberalization of world trade; already being a member of the WTO will only slightly reduce its effects. This is because the WTO has greatly expanded the scope of multilateral discipline with regard to developing countries, with the introduction of the trade-related investment measures (TRIMs), trade-related aspects of intellectual property rights (TRIPs) and the General Agreement on Trade in Services (GATS). As a result, the WTO will require its Member countries to introduce a considerable number of policy and institutional changes concerning, for example, product standards, services and intellectual property protection and customs.

(a) Trade benefits in industry

Benefits expected to be drawn from the liberalization of international trade in industrial products are related to notable tariff reductions and the phasing out of quantitative restrictions, including those falling under the Arrangement Regarding International Trade in Textiles (also known as the Multi-fibre Arrangement, or MFA), which would stimulate exports, particularly those of developing countries, including the ESCWA member countries. Under the Uruguay Round agreements, the average tariffs of developed countries on industrial products, with the exclusion of petroleum, dropped from 6.3% before the Uruguay Round to 3.9% after the Uruguay Round, an average cut of 38%. The general reduction in tariffs on selected industrial products for all countries ranges from an average of 62% on metals, to the lowest cuts of 20% on textiles, garments and leather products and shoes. The deepest cuts (above average) generally affected seven groups of products: metals; minerals; precious metals and gemstones; electric machinery; wood, paper, pulp and furniture; non-electrical machinery; and chemicals. On the other hand, textiles and clothing, fish and fish-based products, and leather and footwear not only remain subjected to duties greater than the average in the developed countries, but the average cut was lower (Arab Federation of Chambers of Commerce, Industry and Agriculture, 1994; Namfua, 1994).

None the less, under the Uruguay Round, the share of imports of industrial products that were allowed duty free into the developed countries has doubled from 20% to 43%, mainly owing to the increase in the share of imports of minerals (59% to 70%), wood, paper pulp and furniture (50% to 84%), and metals (36% to 70%). Although the share of imports of developed countries subject to "peak tariffs" (15% and above) in their overall imports declined from 7% to 5%, an important part (28%) of imports of textiles and clothing into developed countries, which are important exports for developing countries, falls into this category (Namfua, 1994).

In developing countries, the general tariff on industrial products is reduced by 34%, the highest being on metal products, at 70%, followed by metals at 67%, wood, pulp and furniture at 63%, non-electrical equipment at 60%, fabricated products at 48%, electrical equipment and chemicals at 44%, textiles and garments at 21%, leather, rubber,

and rubber products at 19%, and transport equipment at 18%. Other aspects of the General Agreement on Tariffs and Trade (GATT) that will have important implications on manufacturing industries include agreements relating to TRIPs, TRIMs and GATS (Saudi Consulting House, 1995).

Some of the reviews on the implications of the General Agreement indicate that, at least in the short run (transitional period), most developing countries will be facing losses as a result of the liberalization of global trade. Countries that enjoyed MFN treatment from developed countries and regions, such as the Mediterranean ESCWA member countries, or products that enjoyed the benefits of the Generalized System of Preferences (GSP), will gain less from the implementation of the General Agreement than other developing countries, as the former countries are liable to lose their privileges and will be exposed to tough competition from other exporting countries. The implementation of the agreement on intellectual property rights is expected to increase the cost of production for several industrial products (such as pharmaceuticals in Jordan) due to the relative increase in the fees of patent rights.

Countries of the region have developed in the last 15 years some export industrial capacities, particularly in the GCC subregion, in petrochemicals, refining, fertilizers, aluminium, iron and steel. This is aside from expanding the region's export production in the textile and garment industries, particularly in the more diversified economies. Although exports of these industries will be affected by the implementation of the WTO Agreement, it is still not clear what the real effects will be. However, it is anticipated that while petrochemicals, chemicals, iron and steel, and food industries are expected to gain from the liberalization of world trade, the textile and garment industries may face very tough competition, and phosphate fertilizer exports to the EU may be reduced, mainly owing to environmental constraints. The findings of an ESCWA study on the implications of the Single European Market on manufacturing exports (ESCWA, 1995a) indicate that, despite the conclusion of the Uruguay Round agreements and their implications on the liberalization of global trade, it is likely that the EU, a major market neighbouring the ESCWA region with a huge absorptive capacity, will resort to various schemes to reduce competition in its high-technology and high-income-generating industries against imports from other regions, including those of the ESCWA region which might be developed jointly with other countries, and will not protect as vehemently its low-technology and low-income-generating industries. It adds that the EU is likely to protect its manufacturing production which is less harmful to the environment and will likely liberalize its trade in goods whose production is more harmful to the environment.

In petrochemicals, some products seem to have fewer chances than other products in the liberalization of barriers to trade.⁴ The main reason was that their inclusion was not requested by the main exporters during the Uruguay Round negotiations. This was because some of the main international producing and exporting countries of petrochemicals, such as the Arab Gulf countries, China, the Russian Federation, and some Eastern European countries, were not members of GATT at that time, and were not part of the negotiations. The trend in all these countries during 1994 and 1995 was to join the WTO. Bahrain, Qatar and the United Arab Emirates, which have signed the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, are already applying for full membership in the WTO and can request to negotiate the part of the agreement relating to petrochemical products. This could help the petrochemical industry in the ESCWA region to prove its competitiveness. The application of fair trade rules, i.e., on national treatment, anti-dumping, and subsidies by exporters and importers, could help ESCWA member countries to enhance their export production capacity. The unilateral action that was taken previously by the EU against imports of petrochemical products from the GCC countries could be handled under the fair trade discipline of the WTO.

Although the GATT Secretariat report on the evaluation of the Uruguay Round (GATT, 1994b) indicates that a horizontal reduction in some petrochemical product items has been introduced, in-depth studies at the commodity level are still needed to evaluate the impact of these reductions and their effects on various petrochemical products in the Arab Gulf States and their impact on this region's comparative advantage under changing global conditions.

Although the GCC countries have a comparative advantage in a specific constellation of petrochemicals, petrochemical exports from the GCC countries could face some problems in the international market, as they are subsidized (in the form of interest-free loans, low utility prices and land leases for factory sites), and because they enjoy the benefit of cheaper inputs and energy prices. The reduction of subsidies in compliance with the terms of the Uruguay Round agreements will increase competition for this industry in the short run on the international market (especially the EU market), particularly from

⁴ Some recently published preliminary data on reductions in tariffs on petrochemical products show that the agreements provide for the gradual reduction of tariffs on imports of the products. The agreements stipulate a gradual reduction of tariffs in developed countries, from their existing levels of 10% to 15% to 5.5% to 6.5%. The allowed period for tariff reductions varies with the various tariff levels, starting from five years effective January 1995 for tariffs of less than 10%, to 15 years for countries with existing tariffs more than 25%. For more details see: (a) Richard Zind, "Impact of the GATT Uruguay Round on GCC trade in petrochemicals," *Al Ta'awon Al Sina'e*, Gulf Organization for Industrial Consulting (GOIC), Doha, No. 61 (July 1995); (b) Working papers of the Fifth Conference of Industrialists in Countries of the Arab Gulf Cooperation Council: the Future of Industrialization in Countries of the Arab Gulf Cooperation Council under the New World Trade Order, Bahrain Ministry of Development and Industry, Secretariat of the Gulf Cooperation Council, GOIC, and Bahrain Chamber of Commerce and Industry, Manama, 15-16 May 1995; and (c) Henry Azzam, "Saudi Arabia's external sectors and the impact of GATT", *The NCB Economist*, vol. 5, No. 3 (Jeddah, April/May 1995).

countries such as China and the Republic of Korea. None the less, Arab primary petrochemicals are expected to continue to enjoy a comparative advantage due to their low cost of production and to their proximity to the European market. As mentioned earlier, with respect to the EU, despite the conclusion of the Uruguay Round, the GCC exports of petrochemicals continue to be covered by certain arrangements under which petrochemicals are subject to tariffs of between 7% and 15% until the EU completes the rationalization of its petrochemical industries during the coming 10 years (ESCWA, 1995a).

In the chemical industries, the reduction in tariffs on imports from developing countries, which is estimated to be around 44% (Saudi Consulting House, 1995; Arab Federation of Chambers of Commerce, Industry and Agriculture, 1994), is expected to open increased export prospects in chemical products for countries in the region, particularly Egypt. For chemical fertilizers, exports are anticipated to face some restrictions, particularly due to environmental constraints in the EU, the major neighbouring export market.

In the basic iron and steel and aluminium industries, countries in the GCC subregion are expected to gain from the reduction of restrictions that were imposed by developed countries on imports from the ESCWA region, namely voluntary export restrictions. The energy-intensive industries of the region enjoy a comparative advantage in the low cost of production and the quality of the product. However, the issue of the pricing of energy consumption by producers in these industries may arise and will have to be negotiated. The region has great mining potentials in iron and steel and possibly in bauxite (in Saudi Arabia); if properly exploited, the backward integration of these industries could be expected to increase significantly the comparative advantage of these intermediate basic industries under liberalized world trade.

In the textiles and garment industries, while the dismantling of the MFA will create new export opportunities, it may also enhance other problems by unleashing tougher competition, particularly from low-cost countries such as China and from the Eastern European and the Former Soviet Union countries. The major textiles and garment exporting countries in the ESCWA region are Egypt, the Syrian Arab Republic, Lebanon and Iraq. Although in most cases, countries never exhausted their export quotas to the EU or the United States of America,⁵ the dismantling of the MFA will eliminate quota constraints in the future, seemingly creating new export opportunities, but also tougher competition. The exporters of textiles and garments in the ESCWA region should be able to benefit from the interim period allowed by the Uruguay Round to adjust their products partly to suit the needs and tastes of the major developed markets, particularly the

⁵ Partly because producers shied away from exporting to restricted markets, and partly because most of these countries were not export-oriented or dynamic enough to take advantage of these export outlets.

neighbouring EU market, which is the world's largest importer of textiles and clothing. Furthermore, suppliers in the region will eventually have to face international standardization and quality requirements, even in their own domestic markets, in order to compete with foreign products (ESCWA, 1995a).

Although the MFA will be dismantled under the Uruguay Round, this will be done at a slow pace, over a period of 10 years starting 1 January 1995. The Uruguay Round Agreement on Textiles and Clothing, however, gives countries such as Egypt,⁶ with low levels of exports in textiles and garments (less than 1.2% of their total exports, base year beginning end-1991) higher rates of quota growth, averaging 25% starting the date of implementation of the Uruguay Round international trade agreements, followed by 27% at the beginning of the fourth year, compared to 16% and 25% respectively offered to other suppliers. The Uruguay Round agreements allow exporters of such countries to enjoy preferential treatment in the export markets, with the aim of developing their future export potentials and trade. The gradual phasing out of the MFA will be affected by the expansion of the EU and its trading agreements with the countries of Eastern Europe and the former Soviet Union, as most Arab exports in textiles and garments to the EU are admitted free of duty within bilateral preferential agreements (ESCWA, 1995a).

In the food industries, the ESCWA study mentioned earlier indicates that the reduction of subsidized agricultural products in the developed countries (particularly in the EU) under the Uruguay Round agreements may tend to decrease levels of production of such products in the EU. This will encourage exports of agricultural products and related processed food products from non-EU countries. With respect to developing countries, including ESCWA member countries, opportunities may arise to export agricultural products and related processed food products in which they have comparative advantage. However, the food industry in the developed countries, particularly those of the EU, is a highly regulated industry, with specific high standards, as it affects public health and the environment. This makes it difficult for ESCWA region exporters to sell to the developed country markets, unless they meet the required standards. Consequently, competitiveness in the market will require a strict application of international standards, which means that the concerned Governments in the region must take positive action to ensure adherence to the required standards.

(b) *Differential and more favourable treatment*

In general, the Uruguay Round agreements grant developing countries differential and more favourable treatment, as indicated in the respective agreements. Least developed countries and countries with per capita gross national product (GNP) of less than \$1,000,

⁶ The Syrian Arab Republic is not yet a Member of the WTO, and thus the importers' decision to continue imposing the quotas on non-Member countries may still prevail, reducing the chance of this country to benefit from the lifting of these quotas.

which includes many ESCWA member countries, are accorded treatment notably more favourable than that provided to other developing countries. Differential treatment mainly involves longer transitional periods, higher or lower thresholds for undertaking specific obligations and flexibility in commitments and procedures.⁷ The main task of producers and Governments in the ESCWA region is to take advantage of the transitional period and other differential treatments allowed to developing countries under the various Uruguay Round agreements. Producers may have to restructure their industries in order to improve their competitiveness in the international and domestic markets, while Governments may have to introduce policies and measures to support producers in this endeavour.

(i) *Safeguards*

The Uruguay Round agreements revised the rules on safeguards, in order to reinforce and clarify the rules drawn up to protect industries in difficulty; this was done by allowing temporary import restrictions. The new rules intend to discourage countries from using discretionary, uncontrolled and non-transparent measures of emergency protection. In this respect, the Uruguay Round Agreement on Safeguards eliminates the use of all voluntary export restraints (VERs) and similar unclear ("grey area") measures. According to the Agreement, Governments of contracting countries have the right to apply measures to protect a domestic industry against unexpectedly rapid import growth for a specific product which could cause a threat or a serious injury to this industry. In this case, the Agreement allows the importing country to apply one of the following measures:

- Impose quantitative restrictions on imports of the product
- Impose additional tariffs
- Secure a tariff concession from the exporting country on the imported product, which would provide compensatory liberalization remedies

The duration of safeguard measures is limited to four years, subject to an extension to eight years provided continued injury to industry is proven. For developing countries, the safeguard period can extend to 10 years (Helal, 1995a; Helal, 1995b). The implications of the new Uruguay Round safeguards agreement for the manufacturing sector in the ESCWA member countries are not clear yet. In principle, the elimination of VERs should help countries in the region to enhance exports in petrochemical products, particularly to the EU. It should also allow countries in the region to provide protection to industries, particularly infant industries, during a specific period of time, from imports that could threaten or injure these industries. There are some fears that the use of

⁷ For more details, see UNCTAD, *The Outcome of the Uruguay Round: an Initial Assessment, Supporting Papers to the Trade and Development Report, 1994* (United Nations publication, Sales No. E.94.II.D.28).

safeguard measures may expand due to the fact that the agreement eases the non-discrimination and retaliation rule, and weakens the obligation to provide compensatory liberalization remedies. Other fears relate on the one hand to the emergence of measures that would have similar effects to those of VERs and on the other hand to other safeguard measures involving unfair trade treatment. In this case, the extent to which countries in the region can benefit from (or lose) their rights in the new safeguards under the agreement will greatly depend on the new rules on countervailing and anti-dumping duties and the strength of the new discipline in preventing the re-emergence of measures to substitute for VERs (Safadi, 1995).

(ii) *Anti-dumping*

The Uruguay Round agreements revised the Kennedy Round Anti-Dumping Code with the aim of clarifying its rules and strengthening the requirement of importing countries to establish a clear relationship between dumped imports and injury to the domestic industry. Revised rules relate to the mode of identifying the dumped product, calculating the margin of dumping, determining the injury it causes to domestic industry, the definition of domestic industry, standards of evidence, the anti-dumping measures and their implementation. However, the ability of a multilateral authority to challenge national anti-dumping laws through dispute settlement remains limited. The agreements allow, under specific conditions, for cumulative injury estimation arising from the aggregation of imports from several exporting countries. The duration of the imposition of anti-dumping duties should not last more than five years, unless it is proven that the elimination of the duty may result in the continuation of dumping and injury to domestic industry. In cases where the value of dumped imports from an exporting country represents less than 3% of the domestic market for the product, anti-dumping procedures will be stopped. Additionally, the agreements introduce greater flexibility for developing countries, requiring an examination of the possibility of initially using positive remedies before applying anti-dumping measures against exports.

The implications of the Uruguay Round anti-dumping rules for the manufacturing sector in the ESCWA member countries will greatly depend on the extent to which these rules will be subject to discretionary interpretations by national authorities. Since the real effects of the anti-dumping provisions greatly depend on national laws and administrative practices, countries in the region liberalizing their trade regimes need to review or introduce anti-dumping legislation to protect their domestic markets from anti-competitive practices. The question of anti-dumping measures under the Uruguay Round agreements needs to be studied thoroughly. This will help countries in the region to fully benefit from the new rules by protecting their domestic industries from dumping practices by other exporting countries, and by avoiding anti-dumping actions against their exports.

(iii) *Subsidies*

The Agreement on Subsidies and Countervailing Measures reached during the Uruguay Round aimed at protecting access commitments to the domestic as well as the foreign market. It restricts the use of subsidies and strengthens and improves the rules on countervailing duties. The Agreement applies only to industrial products and arranges subsidies into three groups: prohibited, actionable, and non-actionable subsidies. Prohibited subsidies are those subsidies that are totally banned and which are based on export performance or on local content requirements. Actionable subsidies are those subsidies that can be granted or maintained provided that they do not induce injury to the interests of other Members. Non-actionable subsidies are subsidies to industrial research and for pre-competitive development activities, disadvantaged regions, and environmental adaptation. Subsidies linked to privatization, which are non-recurring in nature, are not considered actionable. The Agreement gives special consideration to developing countries, where prohibited subsidies are not applied for five years from the date of entry into force of the WTO Agreement, and to least developed countries for eight years. Additionally, countries with per capita GNP of less than \$1,000 per annum, which is the case for many ESCWA member countries, are exempt from the requirement to remove such subsidies for products where their share in world trade is less than 3.25%. The prohibition of export subsidies based on export performance will not apply to the least developed countries and countries with per capita GNP of less than \$1,000. When these countries reach export competitiveness in one or more products, export subsidies should be phased out within eight years. For developing countries other than the above, the export subsidy will be phased out in eight years, subject to extension under specific conditions, and in two years if export competitiveness is attained in any product (UNCTAD, 1994).

(iv) *Trade-related investment measures (TRIMs)*

The Agreement on Trade-Related Investment Measures acknowledges that some investment measures can have distorting effects on trade. It is concerned only with investment measures relating to trade in goods and aims at abolishing some of the imposed restrictions which are in dispute with the GATT Articles. The Agreement stipulates equal treatment between foreign and national investment projects, and it annexes an illustrative list comprising the different kinds of banned TRIMs, namely, requirements relating to local content, trade balancing and measures restricting exports of a product. More flexibility is allowed with respect to the implementation of the Agreement for developing countries, whereby they are permitted to depart temporarily from a general provision requiring that no Member is allowed to apply any TRIMs inconsistent with the relevant provisions of the General Agreement on Tariffs and Trade. Developing countries are allowed to apply TRIMs on a temporary basis and under specific conditions for reasons relating to balance of payments or infant industries. Furthermore, they are required to abolish existing non-conforming TRIMs over a period of five years, extendable under

certain conditions, and for least developed countries seven years, also extendable under certain conditions, as against two years for developed countries.

(v) *Trade-related aspects of intellectual property rights (TRIPs)*

Negotiations during the Uruguay Round and the Agreement on TRIPs were directed at protecting intellectual property rights and contributing to the promotion of technological innovations and the transfer of technology, for the joint benefits of both producers and users of technological know-how. The Agreement provides a multilateral framework of principles, rules and disciplines dealing with international trade in imitated goods. It attempts to reduce distortions in the conditions of international competition arising from vastly different standards in the protection and enforcement of intellectual property rights. The Agreement gives special consideration to developing countries, where it will be implemented within a transitional period of five years (for least developed countries 10 years), subject to further extension under certain conditions, as against one year for developed countries. Member countries in the WTO are required to develop procedures and remedies under their domestic laws to guarantee that protection of property rights of foreign right holders as well as of nationals can be effectively enforced.

The impact that the Agreement on TRIPs will have on industry in the ESCWA member countries differs from one country to another. Those countries that adopt the Agreement will be creating the pre-conditions for the transfer of technology and may experience an increase in the flow of FDI in high-technology industries. Countries who have already started to develop and export technology-based industries may benefit from the Agreement as well. In the case of protection rights for inventions concerning pharmaceutical and agricultural chemical products, Jordan, like other developing countries, will still have to provide exclusive marketing rights. Benefits may be less for those countries that have limited potential to attract FDI and install technology-intensive industries (Safadi, 1995).

(c) *The Uruguay Round and the European Free Trade Association (EFTA) option*

Detailed preliminary studies have been published on the future effects of Uruguay Round trade liberalization on manufacturing production and exports in developing countries in general and in the ESCWA region in particular (see UNCTAD, 1994; Namfua, 1994; Hoekman, 1995; and Dadush and others, 1995). Among the few studies published on this topic as it relates to the region, was an experimental study (see Diwan, Yang and Wang, 1995) on the implications of the Uruguay Round and the option being extended to Arab Middle East and North Africa countries (referred to here as the Arab region or Arab countries) to be part of the EU free-trade area. The study is based on three scenarios (see box 1).

Box 1. Summary of scenarios from "The Arab economy, the Uruguay Round predicament and the EU wild card"

In **scenario I**, the Uruguay Round will have an unfavourable impact on the Arab region compared with other regions of the world, with changes in real export flows indicating that trade will be diverted away from the Arab region. Exports of the region to most other regions, except Japan and the newly industrialized countries (NICs), decline in almost every sector (except machinery and manufactured intermediates). The NICs and East Asia obtain major benefits from the phasing out of the MFA, and there is a US\$ 27.5 billion increase in their net exports of wearing apparel, largely to the markets of North America and the EU, partly to replace more than US\$ 0.5 billion of such goods originally exported from the region to those markets. Trade with the EU that will be diverted from the Arab region to other regions is estimated to be more than US\$ 3 billion. The study partly attributes the net loss in trade for the region to the fact that most countries in the region have not undertaken important tariff reductions under the Uruguay Round agreements; compared with prevailing tariff reductions in other countries, and in domestic policy reforms, they are considered far behind most other middle-income countries. Structural change in production in the Arab region caused by the Uruguay Round involves an expansion in capital-intensive and semi-skilled-intensive manufacturing sectors. Global competition increases as a result of the reduction of tariffs on industrial goods under the Uruguay Round. It also increases as developing low-income countries with cheaper unskilled labour become contracting members of GATT. This works to the detriment of light manufacturing sectors which use a large proportion of unskilled labour. The largest structural change caused by the Uruguay Round is in the textiles and garment industries. In the past, most Arab countries exported below their MFA quotas, while exports of most Asian counterparts were limited by these quotas.

In **scenario II**, where Eastern Europe, the former Soviet Union and the EU establish a free trade area, the negative external environment changes for the Arab region will be magnified, and the structural adjustments of factors moving out from labour-intensive sectors in the region and entering the machinery and manufactured intermediate sectors will be rather stronger.

In **scenario III**, in which the Arab region is assumed to join the enlarged EU free trade bloc, longer-term dynamic effects will create a significantly favourable shift in the trade and production structure: the revival of preferential access to the EU market will spur the Arab region's exports to the EU in all sectors, especially in wearing apparel, manufactured intermediate products (the natural-resource-based industries, mainly in petrochemicals, aluminium, and iron and steel), and manufactures that make intensive use of unskilled labour and semi-skilled labour. This scenario anticipates the total expansion in bilateral trade between the EU and the Arab region to be more than US\$ 40 billion. The free trade association with the EU would give the countries of the region preferences relative to Asia, and give it opportunities equal to those of Eastern Europe and Turkey. Under this scenario, countries of the region are to pursue two policies simultaneously, namely domestic policy reforms and joining the EU free trade bloc.

Scenario I considers the impact of the Uruguay Round on the Arab region; scenario II considers the impact of the Uruguay Round on the region if there is free trade between

Eastern Europe and the former Soviet Union with the EU, with the Arab region remaining outside this free-trade area; and scenario III considers the impact of the Arab region's becoming part of an enlarged EU free-trade area. It is to be noted that these empirical results should be dealt with cautiously as they are controlled experiments and not forecasts of performance of the Arab region.

The study concludes that the region would experience a 0.6% loss in base year gross domestic product (GDP) as a result of the implementation of the Uruguay Round. These short-term losses could turn into long-term decreases for the region if Arab countries were to compete with East Asian countries on the basis of labour cost only, and they could be magnified if the region were to compete with the middle-income countries of Eastern Europe and the former Soviet Union as part of a free-trade area formed with the EU, with the Arab region outside this area. However, if the Arab region joins EFTA, the losses could be slightly reduced, to 0.5% of base year GDP, in which case, the Arab region must respond to policy issues, mainly to move ahead at a faster pace with its domestic policies and reforms.

Joining the EU free-trade bloc, the study concludes, would help the region compensate for the loss of exports in other regions and would confer a preferential status on the EU market as against its Asian competitors. Joining the EU free-trade bloc would open opportunities for countries in the region, by preparing these countries to compete with the low-cost producers from East Asia. It would also give Arab countries the same market access enjoyed by their competitors from Eastern Europe, the former Soviet Union and Turkey. In the case of preferential access to the EU, Arab output in labour-intensive wearing apparel would increase by 9% and exports by 32%, while in the absence of preferential access, output would decline by 4% and exports by 12%. Furthermore, with this access, trade between the Arab region and the EU would increase by about \$31 billion, while in its absence it would decrease by \$5.5 billion. As part of the EU free-trade area, countries in the region could enhance the transfer of technology as part of larger and longer-term investments and could upgrade their medium-skilled labour.⁸

(d) Concluding remarks

A vital condition for Arab economies to minimize their losses and maximize their benefits from the Uruguay Round relates, as concluded by Marcel Namfua (1994), to the

⁸ Other studies reached somewhat similar conclusions, indicating the importance of the Arab region's going ahead with its domestic reform policies, and attempting not to fall too far behind, as most of the region's competitors will be more open and private-sector friendly and more dynamic. While it may not be possible for countries of the region to go ahead with their domestic reforms at the pace of other competitors, joining the EU free-trade area may help to assure investors of the region's far-reaching integration commitment with the EU. For more details see Bernard Hoekman, "The WTO, the EU and the Arab world: trade policy priorities and pitfalls," Workshop on Strategic Visions for the Middle East and North Africa", Economic Research Forum for the Arab Countries, Iran and Turkey, and the World Bank, Gammarth, Tunisia, 9-11 June 1995.

fundamental importance of the institution of a well-studied and feasible pan-Arab free-trade area in the region based on clearly defined mutual economic interests and not on rhetorical ambitions. This is becoming a very serious issue that needs to be addressed promptly under fast-changing global conditions, the emergence of powerful regional economic groupings, and the opportunity that countries of the region have to join the EFTA. According to the Uruguay Round, trade within an economic bloc is considered an internal rather than an external matter. This would help Arab members of the free-trade area negotiate greater accessibility to foreign markets for export-oriented products like aluminium and petrochemicals. Members of a free-trade area are still able to provide subsidies to their infant industries geared to the domestic markets or to a free-trade area or a unified regional market. There is a need for an empirical analytical study on the gains (and losses) to member countries (with projections at the regional, subregional and individual country levels) of forming (or not forming) such a regional economic grouping within the context of joining the WTO and EFTA.

The establishment of a free-trade area in the region would strengthen the negotiating power of member States to achieve better terms in multilateral trade negotiations as well as in the prospective partnership association with the EU. Smaller units in such multilateral arrangements can better maintain their regional identity. As to the creation of a viable regional free-trade area, it should be at the pan-Arab level, large enough to ensure overall complementarity, and not limited to a number of countries whose production structure is competitive and who have the same comparative advantage. Such an entity would eventually develop conflicting economic interests instead of evolving into complementary production structures and economies.

It is important to emphasize again here that the above findings are only preliminary results that need to be verified. Understanding properly the implications of the Uruguay Round agreements for the industrial sector of the region cannot be pursued without first understanding its implications for the individual branches of industries. Policy makers need first to comprehend the implications for manufacturing in order to formulate appropriate policy. This is to help the private sector cope with the liberalization of international trade and benefit from the interim period. For the Government to succeed in its job, in-depth empirical studies need to be undertaken at the micro level, addressing implications for individual branches of industries at the commodity level. To undertake this task, various advisory expert bodies in the various branches of industry may need to be formed. Their job would be to sponsor these studies and follow up on the implementation of the Uruguay Round agreements and their implications in their respective fields.

Industrialists in the region need to increase their efforts to improve their competitiveness in the international market, primarily by improving productivity and the quality of their products. This would help them cope with the increasingly tough competition in the international market and eventually in their own domestic markets.

Governments in the region need to introduce policies and measures to help industrialists, particularly private-sector SMEs, in this endeavour.

2. The formation of large regional economic groupings

Many new international developments are making it more difficult for the economy of the region to continue along its old development path. Among the most important developments to which the region must respond are the following.

First, it is very likely that some of the traditional trade between the trading blocs and the third world may be diverted to countries in the North. These trading blocs will likely introduce developmental policies favourable to selective countries on which they have strategic dependence—Mexico, Chile and the Mediterranean and Eastern European States. To avoid excessive compensations to industries in southern and eastern Europe, the EU may impose some form of protection on goods produced in third-world countries, as the factor endowments of some countries in the third world may be similar to the endowments in these States.

Second, the new trading blocs (the North American Free Trade Agreement [NAFTA] countries and the EU) are likely to bargain for favourable terms of trade and/or to restrict trade strategically with countries in the third world.

Third, there are sufficient grounds for suggesting that the demand for third-world exports in these trading blocs may increase as the incomes of the latter rise. Market integration in these blocs will improve the efficiency of their internal markets. This will substantiate the growth rates in these blocs and sustain their future improvement. Due to the proximity of some third-world countries (primarily Arab North African and Western Asian countries) to the EU, Caribbean and Latin American countries to the NAFTA region, the demand for their exports in these blocs may increase.

Fourth, trade flows are not the only balance-of-payments component that will improve with greater internal efficiencies. Capital flows are more likely to move to these giant trading blocs from third-world countries. There are two reasons for the emergence of this pattern of capital flows:

- The rapid growth of the trading blocs' economies must be sustained by a higher level of investment than in the past.
- The formation of these blocs introduces market security for its members. Monetary integration further reduces the exchange rate risk within the trading blocs. As the domestic market in these economies becomes more secure than within its trading partners, investments will move towards the more stable market. Industries with high mobility costs, such as those

that are capital- and technology-intensive industries, are usually more sensitive to the security of their markets than others. This could cause an interest rate differential between the trading blocs and third-world countries. Interest rates (rates of return on invested capital) in the third-world countries will have to rise (as a risk premium) to compensate for the relative insecurity brought about by the improved market security in the EU and NAFTA regions. Foreign investors will demand this risk premium before they choose the ESCWA region instead of EU or the NAFTA region.

Fifth, the migration of skilled workers will continue to flow from third-world countries to these trading blocs. The migration pattern of skilled workers will be similar to the pattern of capital flows, for similar reasons. Human capital is complementary to physical capital, particularly at the high end of the skill ladder. Less and less unskilled labour will be permitted to enter into these countries from the third world. There is strong preference now for the utilization of Eastern European labour.

Sixth, the EU and the NAFTA region will protect their high-technology products against exports from the third world, and will liberalize their trade in low-technology products. Technology is quantified according to its intensity embodied in a product, and is viewed according to its position along a technological ladder. The ability to move up the technological ladder, according to the New Growth Theory, will depend on the industry's current position on the ladder. Hence, the EU and the NAFTA region will strategically protect their high-income-generating, high-technology industries. They will not protect as vehemently its low and intermediate technology. In some sense the argument here is that low and intermediate technologies will be complementary to the high technology, often supplying intermediate inputs for the higher stages of production using higher levels of technology. It is the contention of this study that the basic or low-technology products from third-world countries are less vulnerable to these trading blocs' protectionism and exclusion. It is believed that the elasticity of demand for lower-technology products by the EU is therefore low. Alternatively, the elasticities of import demands for high-technology products in the EU and the NAFTA region are high due to availability of alternative sources of production from within their blocs. The asymmetry of elasticities in the high-technology and low-technology products between these trading blocs and third-world countries leads to the proposition above. The above arguments imply that direct investments in high-technology products in the third world, together with the transfer of technology that they will bring about, will diminish. The lack of export demand for third-world products in the trading blocs will hold back the advancement of high technologies in these industries.

Seventh, in some high-technology products, the possibility of intra-industry free trade exists. Some may argue correctly that trade between trading blocs and the third world in high-technology products can be in differentiated products: free trade can only

add to the product variety with a negligible sacrifice of demand for each product. However, in the theory of intra-industry trade, the pattern of trade is indeterminate: that is, which product a country will produce cannot be determined by economic factors, such as a country's comparative advantage. This means that the EU and the NAFTA region, with their strong bargaining power, can lay claims on those products that have a high technological advancement potential and exclude their deployment in the third world.

3. Requirements of non-tariff barriers to trade such as international standardization and related specifications (total quality management and quality standards)

Summarizing the views of many economists concerned with "quality" in developing countries, Anwar El-Tawil states the following:

“The improvement of quality of products and services is the key to the solution of economic difficulties encountered by most developing countries. Better quality of goods and services leads to customer satisfaction, permits substitution of imported products by local ones, and offers better chances of reaching export markets.”⁹

This statement echoes the rising concern in the past few years about quality, particularly with increasing requests by suppliers and customers for compliance with International Organization for Standardization (ISO) 9000 and other quality standards.

The concept of total quality management (TQM), which is becoming more and more a concern of managers in the region, has long been the top priority of managers and executive officers in industrialized countries and worldwide. A leading quality expert (Pike, 1994) summarized the reasons, or "quality imperatives", as follows:

- Increasing competition and the loss of "sheltered markets"
- Rising consumer expectations
- "The demands of large consumers" for quality assurance, for example, adherence to ISO 9000
- Advancing technology: extending what is possible

⁹ Most information in this section is adapted from a paper by Anwar El-Tawil, "Role of ISO 9000 in improving quality in developing countries" (E/ESCWA/ID/1995/WG.1/3) (Delivered at the Regional Seminar on Total Quality Management Based on ISO 9000, Beirut, 17-19 January 1995).

- Concern for people and the environment: quality is everyone's responsibility
- The cost of mistakes: the economics of quality

(a) *TQM and ISO 9000*

The basic management philosophies of TQM and ISO 9000 are the same. However, the major difference between ISO 9000 and TQM lies in the motivation to implement either ISO 9000 or TQM. The ISO 9000 is a standard that can be audited by a third-party accredited institution as requested by many customers. Many companies select to comply with ISO 9000 primarily to achieve certification, adopting a fundamentally different approach than companies adhering to the TQM approach, whose only goal is customer satisfaction. Having the certification as the primary objective may put the emphasis of the company's "quality system" on the certification procedure, creating an environment where customer satisfaction is second to certification.

(b) *The ISO 9000 standards*

ISO 9000 standards are practical standards for quality management systems that can be applied by all types of businesses including manufacturing, distribution and services. They have found wide application as a basis for agreement between buyers and suppliers. The standards are based on two main foundations:

- Management responsibility and commitment to quality, expressed in a formal policy statement and implemented through appropriate measures
- A set of requirements that deal with any aspect of company activity or organization that affects quality

An important condition for conformance to the standards is the appropriate documentation of the quality system procedures and instructions which, put together, form the quality manual of the company. Observance by a company of the relevant ISO 9000 standards is considered a necessary and sufficient condition for achieving adequate quality of the products or services offered by that company.

(c) *Applying ISO 9000 in industrialized and developing countries*

It is estimated that by the end of 1994 some 70 countries had adopted ISO 9000 standards as national standards. It is estimated that some 70,000 companies are registered as applying the standards and that 150,000 more companies are in the process of implementing them. Unfortunately, the number of companies in developing countries that

have achieved registration with ISO 9000 accounts for less than 0.7% of the number mentioned above.

With the continuing expansion of ISO 9000 implementation worldwide, those companies in developing countries that are not yet registered with ISO 9000 risk losing their share of the export markets. Managers in developing countries have to face up to the decision to adhere to ISO 9000—or to any other quality system—not only to keep their export market, but also to benefit from the advantages that such systems offer in improved productivity, efficiency, internal communication and personal involvement of all staff.

Governments in developing countries also have to consider seriously the impact and implication of adhering to ISO 9000 in their manufacturing sectors. Acting to adopt these standards at the national level would enhance steps that may be taken by local firms to adhere to these standards. However Governments must also consider national plans to assist small- and medium-scale local industries in the transition stage, from the prevailing operation traditions to the more organized environment required by these standards, with all the expenses entailed for restructuring and for the rehabilitation of personnel.

4. Advancement in the application of industrial technology

Human civilization is now witnessing an era that may rightly be called the science and technology revolution (STR), or the Second Industrial Revolution, which has deeply and radically affected all aspects of life and all economic sectors. The economic structures of industrialized countries, as well as those of developing countries, are slowly being forced into fundamental changes by this revolution, characterized by the following signs:

- A radical shift of the prime mover industries, from heavy industries to light, knowledge-based industries and to services
- Globalization of markets and the means of production
- Restructuring of production systems, through automation and flexible manufacturing
- Stricter requirements of quality and environmental standards
- A radical change in management systems and human relations within the firm

Rapid technological changes and the resulting globalization of the economy have led to radical changes in the global division of labour, reshaping the geographic maps of production, investment and trade. New economic theories, and new economic development theories, are being elaborated to face the questions, problems and challenges brought about

by this revolution and by others, as radical global changes have led to the emergence of what may be called the new world order.

The impact of the STR has not been limited to global changes in macroeconomic structures and policies. This revolution is having a deep-rooted impact, even in developing countries, and goes all the way down to the firm level, even within small- and medium-scale enterprises, owing to changes effected in the management systems and in the relation between the office/design floors and the shop floors, and to the radical changes in the means, methods and tools of production and manufacturing.

The ever-widening gap between industrialized and developing countries, and the ever-increasing pressure of liberalization and globalization (induced at least partially by the STR) have been imposing on developing countries the necessity to review their industrial strategies and policies to take into consideration the most important implications of these changes, such as:

- The growing role of science and technology in economic development
- The changes in the elements and functions of production
- The radical changes in the structure, system and relations of production

The development objectives of industrial and technological strategies and policies, in developing countries, have been the following:

- Acceleration of the industrialization process
- The generation of employment
- Better utilization of natural resources
- Attainment of a higher level of technological self-reliance
- The building up of national technological capabilities and a local industrial base

The rapid nature of technological changes and their radical impact even at the firm level necessitate the continuous review of national plans to implement these objectives, particularly with the high cost of technology transfer and the difficulties of adaptation to local environments and needs.

(a) The science and technology revolution

Many economists previously viewed the STR as another link in the chain of technological changes that started with the invention of the steam engine. However, the

STR is radically different in its impact and its implications. The first revolution, or the "machine revolution," led to the amplification of the physical power of man, the mechanization of production and the facilitation of the transport of goods and services. To a great extent the machine revolution was considered a slow-working factor, exogenous to the production process and to the economic system.

The STR, particularly the rapid explosion of information technology, is radically different, in that it is a rapid and ever-expanding amplification of the brainpower of man, with a deep impact on all factors of production. Besides the continuous change in production technology, it has led to the automation of production, closer relations between those involved in the production processes, and the facilitation of transport of information and goods across barriers, borders and distances.

Thus, the most important implication of this revolution for economic and development theories is the necessity to integrate the technology factor, and technology change, into the production function and to consider its generic effect on all other elements of production, even in traditional and mature technologies.

(b) *Elements of the science and technology revolution*

The STR covers almost all branches of science, technology and industry. However, the most important and far-reaching innovations are those related to information technology and its applications. Innovations in biotechnology, genetic engineering and new materials have been picking up in the last decade or so, promising a profound and widening impact with the turn of the century. Other important innovations that may be considered include laser technology, space technologies, photovoltaic technologies and miniaturization technologies.

Before considering the details of various technological innovations and their impact, it may be relevant to note that technology in this context must be given the widest possible interpretation: it is the state of the art relating to a given production process, that is, the best available know-how. Technological innovations thus mean any improvement on a given process that may lead to improvement in productivity, decrease in production cost, or improvement in the marketability/quality of the product or service.

Technological innovations may lead to radical changes in products or processes and thus may have radical economic implications. They may, however, be only incremental in nature, leading essentially to a shift in the comparative advantages of competing producers. In this respect, it is important to note that while radical changes and innovations have serious impacts in both industrialized and developing countries, they are usually developed and exploited first in industrialized countries. Technological innovations in developing countries are usually incremental in nature and are related to improving the comparative advantages of those local producers capable of performing

specific technological tasks on acquired (and usually imported) technologies, to adapt these technologies to local conditions and/or to increase local technological input and local value added. This might involve the adjustment of equipment, substitution of certain raw materials for others, adaptation of the product to local values or local prevailing environmental conditions and so forth.

The incremental innovation that may be developed in developing countries is of crucial economic importance, mostly because it may be just the right change for a developing country to gain the potentially available export market niche, or to recover the local consumer from an outside producer. Thus, the industrial strategy and policy questions to be asked related to technological changes can be stated as follows:

- Which technology should be acquired? At what cost?
- What level of effort and resources is to be allocated to developing innovations and to adapt transferred technologies to the local environment, or to better suit an export market niche?
- How much should be spent on local R&D? And to develop local technological capabilities?

The answers to all these questions must be country-specific, even firm-specific, so that resources expenditure on technological innovations can be commensurate with expected economic and social returns.

(c) *The impact of information technology*

Information technology (IT) has been one of the fastest growing sectors of the global economy in the past few decades, with a profound impact on the various social and economic sectors of societies. It includes various functional technologies related to the production, storage, processing, transmission, distribution, retrieval and display of all forms and content of information. These functional technologies were not always compatible and interrelated. It is the adaptation of fast-growing innovations in the microelectronics and computer industries that has enhanced integration within and between these functions.

IT has had a profound effect on the ways in which people communicate: it has increased the amount of information being disseminated and provided rapid means of information exchange, which is now a crucial socio-economic resource. Societies are competing for access to vital information which facilitates decision-making. The increased role of information has forced most Governments (and firms) to establish programmes to plan and supervise the diffusion of IT.

IT is a balanced union of previously separate technologies and industries: microelectronics, computers, software, communications and materials. The rapid nature of innovations in most of these fields has led to cheaper and easier handling of IT and its applications and to increasingly larger and more diversified functions of IT. Development in the communications industry has linked computers in networks, providing end-users access to large databases and data banks, changing the whole concept of IT and promising even more radical revolution in the technical capabilities for long-distance transmission of large-volume and high-value information.¹⁰

(d) Selected areas for information technology applications

In manufacturing industries two trends are emerging:

- Greater advances in production automation, leading to reduced prices and performance improvement
- A growing tendency towards flexible manufacturing, to better suit end-user requirements through greater integration of computer applications

Separate areas of office automation have developed, with an emerging trend towards integrating office functions into the "office of the future": multifunction work stations covering text, voice, data and picture processing and transmission, through local area networks (LAN), and through multi-user systems throughout the world with access shared resources and common databases. The ever-improving tools for office automation include word processors and microcomputers, electronic mail, facsimile, videotext, PAX, LAN, laser printers, multi-media display technologies and speech synthesis.

(e) Genetic engineering and biotechnology

After IT, biotechnology is one of the most promising of the advanced technologies, affecting radically many aspects of life, with generic applications in various fields: medical and health care, nutrition, agriculture, industry and environment. The last decade of the twentieth century is witnessing the marketing of an ever-increasing number of biotechnology-derived products, coexisting with conventional products or replacing them.

The main driving force in biotechnology has been genetic engineering, that is, the manipulation of the genes of living cells in humans, animals and plants to inject more

¹⁰ See, for example, "The revolution begins, at last", the cover story of the 30 September 1995 issue of the *Economist*.

desirable traits so as to harness the capability of manipulated cells to synthesize and/or transform to produce new products or new processes.

A unique feature distinguishing biotechnology-related activities is the high interaction between science and technology research on the one hand, and industrial commercialization on the other hand, as well as between academia and commercial firms. Universities have been the major sources of innovations, with their intensive R&D efforts heavily supported by public funds, as well as by private firms and by venture capital looking for equity and partnership in successful undertakings. Entrepreneurial intermediaries, through their establishment of small-scale enterprises, provided the successful links between researchers and universities on the one hand and sources of finance and industrialization firms on the other hand.

(f) New materials

Materials processing can be defined as the art, technology and science of the control of inner structures to produce and exploit the desired properties and performance of materials in a cost-effective manner. Since the beginning of civilization, breakthroughs in materials exploitation and processing have significantly enhanced economic and technological progress: from stone, to bronze, to iron and more recently to plastics and semiconductors.

In recent decades the pace of change in materials technology has broadened and accelerated. The global trend in this regard has been towards the development of materials with improved information/knowledge content of end-products, leading to a drastic shift away from conventional products based on natural raw materials, to quality materials manipulated to give them specific desirable qualities: smallness, lighter weight, strength, durability, recyclability, made from renewable or cheaper resources and so forth. The emerging and fast-growing materials industries is characterized by strong links to R&D and uses high information content to develop products and processes with a high degree of consistence, quality, reliability, durability and processability.

It is to be noted, however, that many of the new materials are derived by systematic improvement of existing and conventional materials and by incremental improvements on natural properties. It is to be noted also that research in the usage of new materials has led to new opportunities for using the derived products in areas which are very different from those for which they were originally intended.

All industrial sectors are more and more affected by the introduction of advanced materials, which are becoming widely used as substitutes for conventional materials or which are selectively used as basic components of complex systems and thus are critical to these systems' successful operation and performance. Some of the most successful usages of new materials are listed below:

- Structural materials: substitution of plastics for metals; use of composites and special alloys; and biomaterials
- Functional materials, with unique specifications and with one or more functional properties:
 - a. Electronics industries (silicon, gallium and arsenic alloys, as semiconductors)
 - b. Communications (fibreglass for long-distance transmission)
 - c. Automotive (ceramics for combustion engines)
 - d. Environment (biodegradable and recyclable materials)

5. Economic implications of the peace process: preliminary thoughts

It must be emphasized that the subject matter of this section comprises only preliminary thoughts on the peace process and does not cover all its economic implications, but rather only some aspects of it. Furthermore, certain considerations need to be stressed from the outset, primarily that the type of peace that may be reached will to a great extent shape and chart the economic consequences at both the country level and the regional level. Also, the time factor, including the various phases that this process requires to arrive at a final peace settlement, is another important factor to be taken into consideration. In addition, internal economic policies in individual countries, particularly those related to making progress on economic reforms and restructuring, are vitally important in translating the potential peace dividends into concrete economic progress. Finally, the timing of the peace process by itself is important since it is being instituted when global trends in economic liberalization are gaining strength, particularly with the recent conclusion of the Uruguay Round.

(a) A brief contrast of the economies of the countries concerned¹¹

To begin with, the entry of Israel into the regional economy may add a sizeable economy and market. In 1992, Israel's GDP amounted to about \$65 billion, an economy that is about 50% greater than that of Egypt and close to one half of that of Saudi Arabia, the largest economic entities in the ESCWA region. In terms of stages of economic and industrial development, Israel has reached a quasi-industrial stage, with its manufacturing

¹¹ This section and the following one (on anticipated effects of the peace process at the macroeconomic level) are excerpted from ESCWA, *Review of Recent Development of Manufacturing Activities and Prospects in the ESCWA Region, 1993: Issues Related to the Peace Process and Regional Cooperation* (E/ESCWA/ID/1993/11/Add.1).

sector contributing more than 21% of the country's GDP. In contrast, the contribution of manufacturing in ESCWA member countries to total GDP averaged about 10% in recent years. Although these figures are not strictly comparable, and the ESCWA average figure hides diversity among member States, with Egypt standing out, with a 20% share of industry in GDP, the fact remains that they reflect a decidedly high gap.¹²

Generally ESCWA member countries have been less prepared to enter the international market, since they have limited supplies and varieties of industrial products to export, as well as a limited ability to compete, both in term of quality and price. This contrasts with the more advanced Israeli manufacturing sector. The 1970s witnessed the process of deepening the industrial development of Israel, a process that was given impetus by Israel's gaining preferential trade status with the EU, a privilege that is continuing. This is reflected in the increasing share, in total manufacturing output, of intermediate, engineering and capital goods industries, the backbone activities in the second or quasi-industrial stage.¹³ In 1992, basic metals, metal products, machinery, electrical and electronic equipment, transport equipment and chemicals contributed about 50% of the industrial production in Israel.

Since the 1970s, Israel has been developing more export experience, especially the export of manufacturing products. Exports of manufacturing products have been gaining both in absolute and relative terms. Military products comprise a sizeable share in export as well, and are dominant in exports of metal products, electrical and electronic products, and transport equipment and machinery. Additionally, Israel has been developing high-tech industries, both software and hardware, in specific fields of micro-electronics and medical equipment. These high-tech industries, though modest (the total value of output was estimated at \$3 billion in 1991, about 7% of GDP), have been growing in importance—particularly in the export market (Avishai, 1991).

¹² The figure for Israel represents the share of industry in the "business sector," which excludes the "public sector." The latter sector comprises about one quarter of GDP in Israel.

¹³ These developments in the industrial sector were the subject of a number of studies. See table, Morris and others, "Learning and the rise of Israel's exports of sophisticated products," *World Development*, vol. 14, No. 12 (1986); and Maurice Falk Institute, "Israel's changing industrial structure: years of growth and years of slowdown," Institute for Economic Research in Israel, David Horowitz programme on the Israeli Economy, Discussion paper No. 84, December 1984. Both studies classified branches of industries into conventional (C) and sophisticated (S). Broadly speaking, the former industries are usually developed at the first stage of industrialization while the second group of industries, which includes intermediate, engineering and capital goods industries, are developed in second stage. Other studies include: Naum Gutentag and A. Shaliv, *Changes in the Structure of the Israel Industry following the Establishment of a Free Trade Area Agreement Between Israel and the EEC* (Tel Aviv: David Horowitz Research Institute for Developing Countries, Tel Aviv University, 1979); and R.W.T. Pomfret, "Manufacturing export expansion in semi-developed economy: the Israel case," *Economia Internazionale* 23, Nos. 3-4 (August/November 1975).

(b) Anticipated effects of the peace process at the macroeconomic level

An overview of the economic implications of a peace settlement in the region anticipates trade diversion to dominate, in the short-term period of five years, while trade creation is expected to play the more dominant role in the long-term phase extending over a time span of 10 years. The latter arises from expansion in existing production and the creation of new production capacities to accommodate an expanding market.

Opening trade on an equal footing with neighbouring trade partners would, according to trade theory, allow trading in commodities having the advantages of geographic proximity. This qualifies for potential trading those products with a low transfer cost, arising from lower transport, marketing and services costs between border States. With the implementation of the WTO Agreement and the emergence of open markets, a trade diversion would be the first potential peace dividend, provided that traded manufacturing products are internationally competitive in both cost and quality terms and are able to compete with products of other more developed economies including neighbouring economies such as Turkey and Cyprus, who also enjoy some of the advantages of geographic proximity that other countries of the region have, as well as the advantage of cost and quality.

Various constraining factors and administrative practices could continue to limit the development of economic relations and the diversion of trade in countries of the region in the short run, particularly between Israel, Jordan, and the occupied territories. Although political restrictions will be lifted between Israel and its neighbours after the signing of the Agreement, more difficulties will be faced in addressing the rigidities of the Israeli economy to promote free trade. Additionally, it is more likely in the short term that the manufacturing sector in the Arab countries will be slow in their restructuring efforts and in preparing to expand their exports to face competition with the generally more advanced manufacturing sector of Israel and other countries. Within the globally emerging open markets under the new WTO Agreement, more competitive products, in terms of cost and quality, would be flooding the Arab market, which would make it more difficult for the Israeli products to compete. Finally, Israeli and Arab exporters would need time to learn and adapt to the nuances and marketing needs of the other's market, i.e., product adaptation and learning about trading practices. These factors and other constraining and administrative practices are expected, in the immediate and short term, to limit trade diversion.

In the intermediate and long term, greater trade potential may be expected as a result of overcoming some of the short-term factors, but more important, as a consequence of trade creation. The latter would arise from changes in the economic structure, which is expected to be enhanced in the concerned countries, including Israel, to take advantage of and adjust to expanded markets benefiting from the comparative advantage of specialization and economies of scale. The future economic outlook may be given further

impetus by gains from the ongoing economic reforms in ESCWA member States that include economic liberalization and the drive towards privatization. Similarly, the Israeli economy has been undergoing economic liberalization and privatization, as part of Israel's commitment to the EU and to the free-trade agreement with the United States. The recently signed agreement between EFTA and Israel that came into effect in January 1993 is an added push in this direction. In Israel it is expected that by 1996 trade restrictions will be lifted, except on certain agricultural products (the latter may affect seriously trade growth with the occupied territories and other Arab States).

An important long-run impact of the peace process will be the anticipated reduction in military expenditure. An equally important factor is expected to be an increase in internal investment and savings and in the flow of external investment arising from a long-term improvement in the political and economic environment. Military expenditure by Arab countries and Israel takes a high percentage of their national resources. Thus for the period 1972 to 1988, the direct military cost (excluding foreign-assistance-funded components), averaged about 10.1% of GDP for the countries of the region, or almost double the average rate (5.3%) recorded for developing countries in general. Higher figures are obtained when one adds indirect costs, which, according to one estimate made for Israel, accounted for an additional 50% of the direct expenditure (El-Naggar and El-Erian, 1993).

There are fears, however, that most of the peace dividends under the new regional economic order could go to Israel, since it would help that country, with its stronger and more advanced economy, to optimize its exploitation of the economic and technological resources of the region. In this connection, a new division of labour may emerge within the Arab region and between the Arab economies and that of Israel in favour of the latter, whereby the Arab countries would become exporters of raw materials and intermediate goods to the Israeli economy through intra-industry trade, while Israel would export final products, including capital goods and high-tech products, to the Arab countries. This would further deepen the development gap between the Arab economies and that of Israel (Abdel Fadil, 1994).

In this connection, detailed, in-depth studies need to be carried out to identify more accurately possible areas of cooperation that would include more countries and have a broader industrial coverage. This should be done, taking into consideration what comparative advantage each country would have within the increasingly competitive world market. Besides the traditional industries, the industrial coverage should include sophisticated industries (engineering and high-tech industries) to take advantage not only of the abundance of unskilled labour but also of the skilled manpower and high-level managerial capabilities available in, for example, Egypt, Lebanon and the occupied territories.

(c) *Progress in the implementation of peace*

Although the initiation of the peace process in the Middle East raised some hopes for better future prospects for the manufacturing sector, particularly with anticipated regional cooperation, the delay in implementing the political and economic aspects of the peace process has led to delays in meeting the earlier expectations of growing economic development in the region; in particular, Israel's frequent closure of the occupied territories leads to much more difficult access between the territories and each of Jordan and Israel. Furthermore, economic agreements have been recently concluded between each of Jordan and Israel, the Palestinian Authority and Israel, and Jordan and the Palestinian Authority. In-depth studies need to be undertaken with respect to these agreements, and their implementation requires further monitoring to identify their implications for the manufacturing sector in the countries concerned. These agreements and their implementation will either eventually cement or frustrate economic cooperation and integration among the three entities or between any two of them. It is to be noted that the agreement between the Palestinian Authority and Jordan goes against the expectations of an open market, as was anticipated during the earlier stages of the peace process. As a result of the above developments and the progress of peace negotiations, this will delay further the expected growth of economic cooperation in the region.

Large inflows of capital into the occupied territories are anticipated, which might initially reach \$2 billion to \$3 billion in aid (though only to help cover initial current expenses and some infrastructure). Repatriated capital, as well as Arab and foreign capital, is expected to flow into the occupied territories for the implementation of the ambitious proposed seven-year Palestinian reconstruction plan (\$11.6 billion). For its implementation, the plan counts to a large extent on migrant Palestinian funds, estimated at tens of billions of dollars, and the Palestinian expertise scattered worldwide. If expectations of improved economic and political stability materialize in the occupied territories, this would lead, in the short term, to some revival in the manufacturing sector, particularly in construction-related industries. The way in which the economic agreements among the three entities would be implemented would influence the movement of factors of production—capital, skilled labour and material inputs—for the undertaking of reconstruction works in the occupied territories, regarding whether the majority of these factors would have to pass through Jordan and/or Israel or not.

Within the three entities of Jordan, the occupied territories and Israel, the immediate economic benefits of the peace process are expected to be more in the services than in the manufacturing sector, particularly when talking about the formulation of joint projects in tourism. There is need to include in the above-mentioned agreements the opening up of the Palestinian market to Jordanian products, and the provision of access through Jordan to the Arab inland for Palestinian products. There is talk about opening Mediterranean ports (Ashdod, Haifa and possibly Gaza) to Jordanian shipping, which might reduce transportation costs, specially to Europe, and thus industrial production and

services cost. Furthermore, the opening of the occupied territories would open notable investment opportunities in manufacturing to Jordanians and would present an important additional manufacturing export market, compared with the current situation where traffic is in one direction towards Jordan. This will be important enough, given the small size of the Jordanian economy.

Detailed studies need to be made to identify possible areas of cooperation in manufacturing activities in the Arab and Middle East region, including not only Israel, but also other neighbouring countries as well such as Turkey, Cyprus, Iran and perhaps Greece, and having a broad industrial coverage, to create what is coming to be called a Middle East market. This should take into consideration what comparative advantage each country of the region would have within the increasingly competitive global market.

B. TRENDS IN THE REFORMULATION OF INDUSTRIAL STRATEGIES AND POLICIES

1. The emerging new role of the State in industrial development

The industrialization effort in the region during the last three decades was led by the public sector. This is clearly indicated in the national economic plans and programmes, and by the levels of investment, output and employment in the public industry. The large oil revenues, particularly early in the 1980s, created good opportunities for Gulf economies (and indirectly the non-oil-based economies) to achieve rapid growth. They accelerated their industrialization process within a relatively short period of time. A relatively dominant public industrial sector emerged in most countries of the region, except Lebanon and increasingly Jordan. While the emergence of a dominant public sector was the result of an earlier political commitment to a more controlled economic system in some countries of the more diversified economies such as Egypt, Iraq and the Syrian Arab Republic, in the GCC countries it was only a corollary of prevailing investment conditions in the subregion and the weakness of the private industrial sector, which had no traditions of risk-taking or long-term investment.

The dominance of the public sector was accompanied in most of the countries by protection policies in regulated markets, and infant industry and import substitution policies. Controlled economies in which the State played a dominant role emerged in Iraq, Egypt (up to the 1970s) and the Syrian Arab Republic. Egypt (since the 1980s), Jordan and the GCC countries followed a more open economic system. In Jordan, the State played an important role in industrial development. In the GCC countries, it played a dominant role in establishing mainly capital- and energy-intensive industries. Subsidized production and investment policies emerged in the GCC subregion, to promote resource-based industries, enhancing further the weight of the State in the industrial sector.

During the 1980s, promotional laws and regulations were introduced and/or reformulated, including investment promotion laws and measures. In Egypt and the Syrian Arab Republic, investment promotion laws could not achieve the desired results in a public-sector-dominated economy. The controlled economies were an important deterrent to the expansion of domestic private-sector activities. Regulated markets and mismanaged economies in most of the rest of the countries were partly responsible for limiting expansion in private foreign investments, particularly in downstream industries.

(a) Current reform trends in the ESCWA member countries

(i) The driving force behind reform efforts

From the mid-1980s until the beginning of the 1990s, the GCC countries experienced economic recession caused mainly by the sharp decline in oil prices and revenues. This reduced the funds available for industrial development in most GCC countries. Domestic demand for manufactured products in the Gulf countries declined, substantially reducing manufacturing exports of Jordan and Lebanon. Reduced oil revenues in the GCC countries also led to significant cuts in concessional aids and loans to most of the more diversified economies (MDEs) whose development efforts depended in varying degrees on grants from the GCC countries. A direct result of this has been further aggravation of the economic problems that were already facing many countries in the more diversified economies. In the Syrian Arab Republic, for instance, allocations for new industrial development projects and for maintaining existing public industries were substantially reduced. In the GCC countries, allocations to defence expenditures increased markedly, causing increased budget deficits in most of these economies.

Inherent deficiencies in the industrialization process and in social evolution in most countries in the ESCWA region did not help these countries to manage suitably their deteriorating economic conditions. On the contrary, they have aggravated fiscal problems in these countries, more so in Egypt and the Syrian Arab Republic, and to a lesser extent in Jordan. This was reflected in the slow (and sometimes negative) economic growth, and deterioration in the balance of payments and budget deficits. Added to that, most of the MDE suffered from high inflation rates, depreciating currencies, heavy external debt and high levels of unemployment.

Governments in many countries of the region recognized the need to redress the structural imbalances in their economies during the last decade. The current trend in liberalizing world trade has enforced the growing trend to curtail government intervention in the economy and has also helped to spread the economic reform process. It was with the aim of revitalizing private-sector activities, reforming the public sector and promoting its efficiency in production and economic management, that the GCC countries' economic deregulations concerning foreign investment were initiated early in the decade. These deregulations aimed at improving the operation of the market economy, especially in

helping to promote local and foreign private investment in manufacturing. In Egypt and the Syrian Arab Republic, new laws were legislated and old ones adjusted, as in the case of Bahrain, Jordan, Saudi Arabia and the United Arab Emirates. This should enhance the transformation of the economy into a more liberalized one, creating a new economic setting for a more favourable environment.

(ii) *A gradual change in the role of the State*

In the current reform efforts, particularly in the more diversified economies, a new role is being envisaged for the Government in industrial development, though it is emerging at a slow pace. In most countries, however, the transformation is being made gradually. Many Governments intend eventually to be less involved in the management of production, and more in the promotion of private-sector production, with more emphasis on the Government's role of providing support services and introducing incentives and promotional services, measures and legislation. There is, however, a need for a more concrete vision and time schedule for this transfer. The pace of transformation will also have to be faster, taking into consideration both domestic changes and rapid global changes, as well as the pace of transformation in the competing countries in other regions.

In Egypt, the declared general intentions are to confine the role of Government in the coming period to the promotion of an investment climate commensurate with the needs of the private sector. In terms of policies and project management, this means trying to leave the management of production to the private sector. It seems, however, that there will remain a large portion of industries with the public sector. This includes the strategic industries of iron and steel—which require heavy investments and are less profitable. The Government aims to ensure that the management of the economy is guided by economic and not political objectives.

In the Syrian Arab Republic, the Government has not yet formulated a new policy regarding the public sector, generally including the industrial sector. There is strong evidence that the State will continue, at least in the short term, to be involved in the management of industrial production. The modality of the new policy would be different, however. The Government has announced that no capacity expansions are to be undertaken in the public industrial enterprises. Increases in public industrial production are intended to be achieved mainly by improving production and management efficiency, partly through enterprise rehabilitation and restructuring. However, the transformation into a more market-oriented economy may continue to be undertaken at a slow pace, partly because an important sector of senior bureaucrats seems to support the established mode of public-sector ownership and operation. This is partly indicated in the delayed negotiations of the General Agreement on Tariffs and Trade.

A committee, chaired by the Deputy Prime Minister for Economic Affairs, has recently been formed to study a new mechanism for the functioning of the public sector, including the public industrial sector. The Government has requested the Centre for the Development of Administration and Productivity in the Syrian Arab Republic to prepare a study on the restructuring of the Ministry of Industry and associated bodies; the first draft has just been finalized. It may be more appropriate to carry out this task in the light of the re-defined role of the State.

The trend in the Syrian Arab Republic seems to promote the coexistence of the public, the private and the mixed sectors. The private industrial sector is now allowed to involve itself in most industrial activities except in basic heavy industries, like petroleum refining. However, private-sector involvement in industrial activities requires prior government approval.

In the GCC countries, Governments continue to assume a major role in industrial activities, but are putting more emphasis on the private manufacturing sector, particularly the foreign sector, to make up for retrenchments in public industrial investments.

In Lebanon, the industrial sector has emerged from 17 years of civil strife severely damaged, at a time when it also has to face the challenges of the dramatic changes taking place in the world economy. The Government, however, continues to advocate the same position as before the war, namely private-sector initiatives in a free market economy.

(iii) The continued drain of military expenditures

Increased priority continues to be given to defence expenditures in many countries in the region. This is the case despite the initiation of the peace process and the degree of progress being achieved in its implementation, and the conclusion of the Uruguay Round agreements and the strength it has given to economic liberalization in the region. Persistent increase in military expenditures will continue to divert an increasingly important part of resources away from development in many countries in the region, accentuating conditions of structural imbalances and tight budgets. It may also impede the required change in the role of the State and may continue to inhibit the required socio-economic changes.

(b) Some of the socio-cultural particularities of the ESCWA region

(i) Industrial development pursued under special conditions

At this point, it is important to point out the hardship conditions under which industrial development efforts have been pursued in the region. During the last two decades, political stress factors led to upheavals that added to the deteriorating conditions in the manufacturing sector, including the following: the long-lasting Arab-Israeli conflict;

the 17 years of civil war in Lebanon; the eight years Iraq-Iran regional war that drained earlier achievements in manufacturing efforts in both countries and had negative effects on industrial development efforts in the GCC countries; the embargo imposed on Egypt by the Arab States from 1978 until 1991, when the Camp David accords were signed; the destructive events of January 1986 in the former Democratic Republic of Yemen; the outbreak of the *intifadah* in the West Bank in late 1987, leading to additional deterioration in the economy and manufacturing activities in the occupied territories; and more recently, the destructive events of the Gulf war in 1990, the civil strife in Yemen in 1994, and the embargo imposed on Iraq since 1990.

(ii) *Some of the socio-political results of these developments*

Aside from their devastating economic effects, these events had socio-political implications that were not conducive to the evolution of societies in these countries into more modern societies or to the emergence of more modern business communities and governance. At the same time, competitors in other developing regions were faster to adjust to a more modern community and State.

In the ESCWA member countries, based on anecdotal evidence, modern industrial business communities that had been evolving for some time before the 1950s and 1960s, have either been partly destroyed or suppressed. The evolution of indigenous entrepreneurship was inhibited in many countries in the region. In some countries, many people have accumulated vast wealth from rents from significantly appreciated real estate. A profound "rentier" class was created from this process and other processes, bringing with it inherent "non-market practices".¹⁴ It was nurtured by the existing socio-economic system and benefited from "spilled over" business from government activities. This helped to distort well-established business practices in many countries in the region, and inhibited their evolution in others. In some instances, these events have justified the existence of a dominant but faltering public sector and sometimes helped in creating a bureaucratic class with vested interests not necessarily in harmony with national interest and development objectives. Under some extreme cases, former army officers turned into business, having a pre-capitalist business mentality, and added gravely to distortions in the operation of the market.

In most cases, the business environment created did not foster the emergence of indigenous entrepreneurship or the conservation of existing entrepreneurs. In many instances, most of the people who owned significant amounts of wealth and enjoyed high levels of income were unfamiliar with the ways a modern productive system works and grows. The emergence of new business communities was, in most instances, the function of the prevailing dominance of the culture and norms of the tribe and family. This has

¹⁴ Practices inconsistent with the expansion of productive investment.

negatively affected the nature of the governance that evolved over the years in some of these countries, the kind of civil service that was formed, and the developmental ability of the State.

These conditions represent crucial impediments to the appropriate transfer of modern and civil ideologies and ideas into the culture of society and the State, and to the evolution of a development-oriented governance. Hence, reforms, including those in the legislative and the regulatory regimes in countries of the region, are not enough to bring about the desired change. The existing institutional environment continues to take its toll on the State and its ability to pursue its economic developments and reform objectives. A primary condition for the evolution of a modern society and State is the institution of political reforms geared towards deepening the process of democratization in countries of the region.

(c) *The need for a modified approach in treating the role of the State in industrial development*

None of the member countries of ESCWA have so far visualized the importance of redefining the duties and functions of the State. Part of the institutional reform required is to change from traditional into more modern governance ideologies and ideas. However, this still seems to be far from being understood by many policy makers, particularly in developing countries such as the ESCWA member countries, which have their own web of social, cultural, political and economic conditions.

It would be beneficial to draw on successful, relevant experiences in other developing as well as developed countries to help visualize some of the opened options to redefine the role of the State. In attempting to do so, however, caution should be applied concerning the socio-political and economic conditions that differentiate the ESCWA member countries from other regions. In undertaking this exercise, the particularities of the region should be taken into consideration and the specificities of each country should be weighed. In making the adjustment, member countries should keep in mind that "... the diversity of experiences and learning produced increasingly different societies and civilizations with very different degrees of success in solving the fundamental economic problems of scarcity" (North, 1994).

(i) *Institutions and economic performance*

The importance of institutions and the effect of institutional changes on economic performance is a new dimension in economic development and has recently been the subject of in-depth studies. It emerged as a new field in economics known as "new institutional economics". It attempts to incorporate a theory of institutions into economics,

an approach that has been appreciably developed lately by Douglass C. North.¹⁵ North has studied various explanations for the enormous differences in performances of economies over long periods of time:

“That institutions affect the performance of economies is hardly controversial. That differential performance of economies over time is fundamentally influenced by the way institutions evolve is also not controversial. Yet neither current economic theory nor clinometric history shows many signs of appreciating the role of institutions in economic performance because there as yet has been no analytical framework to integrate institutional analysis into economics...” (North, 1993).

As defined by North, institutions in a country consist of informal constraints (conventions, norms of behaviour and self-imposed codes of conduct), formal rules and regulations (the constitution, common law, regulations) and the enforcement characteristics of both (North, 1994). While formal law can be changed easily, informal norms and conventions can only be changed gradually. This should partly explain why applying the political and economic rules of successful market economies to third-world economies is not a sufficient condition for good economic performance.

The emerging new economic theory of institutions builds on the neoclassical economic theory of scarcity of resources and competition but nullifies the assumption of instrumental rationality by adding institutions as a critical constraint. It studies the role of transaction costs as "the connection between institutions and the costs of production." Transaction costs consist of wages paid for services such as accounting, legal, security, finance, insurance and sales services and relate to the processing of business documents, negotiation and conclusion of contracts, litigation of violated contracts, and so on. Transaction costs "consist of those costs that go through the market ... and therefore are measurable, and of hard-to-measure costs that include time acquiring information, queuing, bribery, and so forth, as well as the losses due to imperfect monitoring and enforcement ... In third world countries telephone systems that do not work, the inability to get spare parts, endless production interruptions, long queues and waiting time to get permits...are overwhelming evidence that an effective institutional infrastructure does not exist" (North, 1993).

(ii) *Transaction costs*

In the production process, the new theory indicates that inputs and outputs have to be traded among buyers and sellers in the local as well as the foreign markets. In the

¹⁵ North is a Nobel prize winner for his pioneering work on institutional economics.

process, different kinds of costs are incurred in dealing with the established rules and regulations and other constraints defined as the institutions. In this process, transaction costs have significant effects on the performance of an economy, the form of its comparative advantage, and its competitiveness on the international market. Within this context, ideas and ideologies are incorporated into the economic analysis, considering the political process as a critical source of differences in the performance of economies and the reason for inefficient markets. This should lead to the conclusion that economic factors relating to highly skilled and educated manpower, motivated entrepreneurs, high rates of savings and investment, and high rates of technological change and innovation are all important for the performance level of an economy and the development of its competitiveness. They are not enough, however. The performance of the economy is significantly affected by the relationship among transaction costs, institutions and institutional change.

(iii) *Bargaining power*

According to North, institutions are not usually created to be socially efficient, but rather to serve the interest of those with the bargaining power to create new rules. In a world of positive transaction costs, bargaining strength affects the efficiency of outcomes and shapes the direction of long-run economic change (North, 1994). This is because what counts is the bargaining strength of the individuals and organizations, "hence, only when it is in the interest of those with sufficient bargaining strength to alter the formal rules will there be major changes in the formal institutional framework" (North, 1993). Economic reforms are important for achieving the goals of economic growth and industrialization, but they must be accompanied by institutional reforms in governance as well as in the society as a whole.

(d) *The role of the State: successful experiences in the East Asian countries*

The question of the relationship between active State intervention and economic development remains a controversial issue, particularly between development and neoclassical economists; both success stories and failures are associated with each school of thought. In this light, the successful experiences of the East Asian countries in their developmental efforts and growth have introduced a new element to this question which would be beneficial to highlight at this point.

(i) *The developmental versus the neoclassical approach*

Under the influence of development economists, most developing countries focused on the central role of the State in development in their economic development efforts of the 1950s and the 1970s. It was implicitly assumed that the State had an unlimited capacity to direct economic development. Economic development theory was based on the existence of market imperfections, whereas in real life there were many

"market failures" and externalities that prevented the smooth functioning of free market systems. As a result, countries could not achieve optimal allocation of their resources without government policy intervention. Development economists justified public intervention as being necessary for the removal of existing bottlenecks in an imperfect market to allow the market mechanism to function smoothly.

Limited successes and in many instances failures in economic development efforts were partly attributed to the adoption of a wrong strategy, namely import substitution, which was concomitant with government strategy to dominate the economy. These failures have helped since the early 1980s to strengthen neoclassical thinking, advocating an economic development strategy that gives a central role to market forces and leaves only a marginal role for government intervention. Followers of this school express grave doubts about the ability of the State to intervene and remedy market failures. They believe that market imperfections by themselves are insufficient justification for public intervention. Economic development should therefore be pursued in a free market with minimum government intervention. They stress that State intervention not only cannot solve problems of market imperfections, but that it aggravates them.

(ii) *The East Asian approach*

East Asian countries have achieved miraculously high economic growth, which was mainly due to the adoption of the right industrial strategy, namely an export-oriented strategy, together with appropriate State intervention.¹⁶ It is true that ultimately the best system to instigate sustained industrial development and growth is the free-market and free-trade system. But the question that continues to raise strong debates is whether or not "getting prices right" is enough by itself to induce the functioning of market forces in developing countries, with all their existing market imperfections and market failures, and whether or not State intervention is justified for the elimination of market imperfections in order to lay the foundation for the operation of a free market at the early stages of industrialization.

a. *Active and systematic role of the State*

In most of these countries, there was active yet systematic intervention of the State in the economy in various forms, with the scope of intervention changing at the different stages of industrialization. State intervention targeted specific industries, including export

¹⁶ For detailed analysis of the experience of the East Asian countries, see World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (New York: Oxford University Press, 1993); and Se-Hark Park, "The East Asian Industrial Policy: Its Relevance and Lessons for Developing Countries", Two Concurrent Expert Group Meetings on Industrial Strategies and Policies and Managerial and Entrepreneurial Skills under Conditions of Global and Regional Change, ESCWA, Friedrich Ebert Stiftung (FES), and Economic Research Forum for the Arab Countries, Iran and Turkey, Manama, Bahrain, 20-23 November 1995.

industries, and provided them with export subsidies and other financial incentives, protecting these industries in the domestic market and manipulating relative prices to shift resources to the targeted sectors. Policies pursued in support of their strategy of high growth included the following: investment in human resources through quality education; the provision of a stable macroeconomic environment and a reliable legal framework; pursuing an outward-looking industrial strategy; and abolishing or reducing policies leading to price distortions.

At the initial stage, State intervention was quite extensive, as it involved building up appropriate physical and social infrastructure and institutions, a precondition for building and promoting industrial capacity. At this stage, State intervention also involved direct investment in production activities including industrial activity. Public investment in industry was undertaken because the private sector was not yet capable of investing in large projects. As the countries advanced in their industrialization process, the scope of intervention diminished gradually, allowing the role of market forces to gain prominence. In the advanced stage, the role of the State became restricted to establishing and maintaining a competitive environment for the private sector. At this stage, the allocation of resources was basically directed by the pricing mechanism in the market and incentives (Park, 1995).

b. Quality in State intervention

It is to be noted, however, that the main lesson of the experiences of the East Asian economies is not whether or not State intervention is good, but rather whether it is efficient and effective. The quality and nature of the State intervention is most important. It is the crucial issue in "the capability of the State to initiate and guide market-friendly structural transformation" (Park, 1995). This requires political commitment to change. It also requires the presence of an efficient government machinery which is "capable of overriding the pressure of vested interest groups and of disciplining various economic actors to implement technocratic policies" (UNIDO, 1993).

(e) The need for an indigenous approach in countries of the ESCWA and Arab region

Within this context, lessons regarding the role of the State in industrial development should be drawn from experiences of the countries of the region, and not just from successful experiences in other regions. Research into the nature of the existing (formal and informal) institutional environment in each country, at the national level and for specific industries therefore needs to be carried out. This should be done with the objective of identifying and addressing the main institutional barriers to the developmental efforts of the State and the prevailing non-market practices associated with the operation of some business communities in the various countries in the region.

2. Privatization¹⁷

In order to prevent further deterioration in their economies, countries in the region are considering relinquishing control over a significant number of public industrial enterprises. Privatization is implicitly conceived of in most countries of the region as the only option for responding to the fiscal crisis facing the State. In some countries it is being pursued with the support and encouragement of international organizations and institutions.

Nevertheless, in some of the more diversified economies, privatization is seen as part of a general process of liberalization and deregulation, a giving back to market forces their normal role, and limiting the role of the State. Privatization should be a means of alleviating the unemployment problem in the long run and widening the ownership base by increasing the role of the private sector in the ownership and management of the national economic resources.

In some GCC countries whose economies are more market-oriented, privatization was initially conceived of as a means to improve the efficiency of the market economy. Since the Gulf war in 1991, it has been looked upon as a way of improving the Government's liquidity and reducing the budget deficit. In this subregion, where privatization is still in its infant stage and citizens are affluent, it seems to be an attractive government alternative for raising funds and more acceptable than imposing taxes where nationals are accustomed to a generous welfare system. However, privatization is considered to be a gradual and lengthy process, with some believing that implementation takes five to eight years on the average.

Most GCC countries state that their manufacturing companies are efficient profit-making ventures representing a good source of income to the Government. Hence, their privatization would be more linked to widening the ownership base and attracting private investment in the manufacturing sector, thus increasing the role of the private sector in industrial development and, to a lesser extent, reducing the financial and administrative burdens on the State. This strategy comes at a time when the private sector has already accumulated large levels of liquidity compared to the limited domestic opportunities available for investment.

Privatization should help reduce the excess liquidity in most markets in the region, and it should also affect the ability of some Governments to raise funds for the establishment (or initiation) of needed additional large industrial capacities. This is

¹⁷ This section is mainly based on Section A of Chapter II of *Review of Recent Development of Manufacturing Activities and Prospects in the ESCWA Region, 1994* (E/ESCWA/ID/1995/6). (See ESCWA, 1995c.)

particularly true in the GCC subregion, where potentials for large industries exist, and from which the private sector still shies away. These additional capacities are required to widen the base of large industries operating in these countries, increasing the opportunities for a wider range of products that could be produced by small and medium-sized enterprises (SMEs). Linking privatization to the offset programme may encourage FDI in viable industrial projects in the GCC countries. In the more diversified economies, part of the funds to be generated from privatization could be used to improve or expand government support services to promote private manufacturing.

Different member countries have different levels of commitment to the privatization of public enterprises. While countries such as Egypt and Kuwait have already formulated their privatization policies and plans and have gone ahead with the implementation process, in Bahrain and the Syrian Arab Republic they are still exploring the options available. In Egypt, privatization is pursued within the framework of economic reforms and structural adjustment. In the Syrian Arab Republic, where the economy is dominated by the public sector, economic reforms are undertaken without a clear policy regarding privatization. In Saudi Arabia, there is reference to privatization in the current five-year development plan (1996 to 2000). Here, privatization is advocated through the objective of attracting the private sector to the ownership and management of basic public industries. Neither policy directives nor a schedule for privatizing industrial companies has been formulated yet, however.

While there are positive effects of privatization, the negative effects of the process in the transitional period is making some countries in the region (including the GCC countries) hesitate. Most ESCWA member countries are reluctant to privatize public industrial enterprises or to enhance the privatization process for fear of causing unemployment. In the GCC countries there is a fear that nationals may lose their jobs, since the new private management may try to increase foreign workers at the expense of locals owing to wage and salary differentials and to more flexible labour laws governing expatriate labour. This is taking place at a time when most Governments of countries in the subregion are trying hard to persuade the private sector to employ more nationals and reduce reliance on expatriates. Another possible worry that should be mentioned is that Governments may be more hesitant to accept the loss of their control over an important segment of the economy. This could be one reason why some of them are reluctant to accelerate the privatization process, aside from the declared reason that it may lead to higher prices for consumers, as the switch to private-sector ownership would remove government subsidies. Other voiced concerns in some of the GCC countries relate to the question of how to value public-sector industries offered for sale and the likelihood that such offers may depress stock market prices.

In the more diversified economies, the negative effects of the process are forcing Egypt to take a gradual approach to privatization, while the Syrian Arab Republic remains quite hesitant. The slow approach in Egypt may have been caused by other reasons as

well. The strategy regarding the tendering process has changed since 1994, setting higher privatization targets by changing methods of privatization from private bids to sales through the stock market. In this way, the ownership base in industry was widened. Internal adversaries to privatization are strengthened by the absence of new policies limiting the activities of the public sector in manufacturing. This raises fears among industrialists that the public sector may continue to dominate the growth of manufacturing.

Nevertheless, the success of privatization greatly depends on the availability of fully functioning stock markets supported with the necessary legislative infrastructure and by sophisticated financial services. This is another constraint imposed on the process of privatizing public industrial enterprises. However, company ownership in most countries is dominated by limited family partnerships, while corporate shareholding is still not favoured. The presence of fully functioning stock markets should provide efficient market vehicles for the transfer of ownership, while the privatization of public-sector enterprises would help provide depth for the stock markets in a region that suffers from the lack of a broad industrial base to support a strong equity market (The NCB Economist, 1994).

(a) *Privatization: policies and forms*

(i) *The GCC countries*

Many GCC countries have shown some concern for maintaining public ownership in the subregion's heavy and strategic industries such as oil production and refining. The countries indicate that these industries require a long time to realize a return on investment, while the need of marketing and capital structure are beyond the present capabilities of the private sector. Strategic companies in Kuwait also include the Kuwait Flour Mills and Bakeries Company, of which the Government is planning to retain its ownership. Many Governments, however, have indicated that initially they are likely to start reducing public holdings in companies whose shares are listed and traded on the stock exchange. In Saudi Arabia, commercially viable public-sector establishments whose assets can be assessed to give estimates of share values will then follow. These reportedly would include various petrochemical plants and refineries (The NCB Economist, 1994). As to the forms of privatization, the GCC countries tend to favour two types, namely contracts granted to the private sector to manage government projects and the outright sale of publicly owned enterprises. Other schemes, namely build, operate and transfer (BOT) and subcontracting to the private sector, are being considered for utilities projects. This could prove to be a successful step to wider application, especially since Kuwait is currently considering using a BOT structure to fund the construction of its North Shuaiba power station (The NCB Economist, 1994).

Kuwait was perhaps the first GCC country to take an outright policy decision in the wake of the Gulf war to privatize large parts of its public sector, including the manufacturing sector (box 2). In this connection, the Ministry of Finance, through a

ministerial committee, handles most sales involving government interests in privatized companies; the Kuwait Investment Authority (KIA) evaluates offers, while the World Bank assists the country with technical advice on the privatization programme. Sales of public enterprises take three main forms, sales through the establishment of holding companies, direct sales by auction in the financial market in Kuwait or through tendering, and sales through floating shares in the stock market. Government companies may be sold through tendering to a group of Kuwaiti or foreign investors, or to a group composed of Kuwaiti and foreign investors, on the basis of the best price offered. A percentage of the stake in these companies is to be allotted to sales to foreigners under established conditions preventing the emergence of monopolies. In addition, privatization on the basis of leasing companies to the private sector, including the foreign private sector, is also being considered in Kuwait; this involves operation and management contracts.

Box 2. The privatization approach and procedures in Kuwait

The general approach to privatization in Kuwait, which also applies to other GCC countries, includes privatization as part of a comprehensive economic reform programme. This is supported by the issuance of new legislation and the amendment of existing laws such as the commercial law, company law, agency law and tendering law, with the aim of simplifying these laws and addressing their shortcomings in areas relating to property rights, production rights, patent rights, attracting foreign investment, the different categories of shares, holding companies, and others. Subsidies will be abolished or at least their forms will be changed, and a strategy will be established that addresses the issue of employment.

The procedural steps in the privatization process included the following: the initial transfer of the ownership of companies to a privatization office; rehabilitating companies and running them on a commercial basis; evaluating the assets of these companies in preparation for floating their shares on the market; negotiating with investors interested in acquiring a specific stake in these companies and providing the necessary information to them; in cooperation with other parties, drafting the law of privatization, revising and amending the laws concerning economic activities, and drafting the anti-dumping law; and seeking temporary technical assistance from consulting houses, as the need arises.

Privatization policies are stated in the development plan of Saudi Arabia. The plan focuses on increasing efforts to attract private-sector investment in new government projects and related services in manufacturing, and in projects that are labour-saving and that conserve on the use of other limited input resources such as water. In this connection, the plan expects private sector's share in total planned manufacturing investment to be around 65%, amounting to more than \$7 billion (28 billion Saudi Arabian riyals) during the plan period. Forecast participation of the private sector in the financing of manufacturing projects within the privatization process is around \$17 billion, including \$9 billion of private-sector anticipated participation in the offset programme. In the process, the private sector is expected to continue repatriating capital and balances of

funds held abroad, which is currently estimated to have reached around \$100 billion (Council of Saudi Chambers of Commerce and Industry, 1995).

In Bahrain, where there is relatively quite a significant number of large public industrial enterprises, there is only talk about government policy regarding privatization. The manufacturing sector seems to be up till now low on the priority list, except for Bahrain Aluminium Extrusion Company (BALEXCO). Furthermore, government's policy is towards privatizing the management of public industrial companies.

(ii) *The more diversified economies*

Among the ESCWA member countries, Egypt and Yemen have each formulated a policy framework of privatization through the issuance of a law of privatization, in 1991 in Egypt, and in 1995 in Yemen. While the latter is still in the policy formulation stage, the former has reached a relatively more advanced stage. Notwithstanding this, the process in Egypt has been gradual and rather slow, justified by the Public Enterprise Office (PEO) as a way to implement privatization in a well-studied way.

The policy framework of privatization of manufacturing enterprises in Egypt was formulated in 1991, with the issuance of the law of privatization (Official Gazette, 1991). This law established the Public Enterprise Office (PEO), the Government's Technical Bureau for the Public Business Sector, responsible for the implementation of the privatization of the public sector.

According to the PEO, the country's policy remains one of gradual privatization through the stock market, with the employees of the companies to maintain 10% ownership of the shares. Companies can, however, be sold to anchor investors, if acceptable and when available. The sales policy is to sell any company that is ready for sale, defined by the PEO as companies that have no problems, the market value of which can be identified, and which have achieved acceptable profits for buyers. Sales policy is based on studies undertaken by foreign consultants regarding the price ceiling of shares, the maximum number of shares to be floated at a time, sales through the stock market and outside the stock market, and conditions under which employees are to own shares.

Sales of public industrial companies are undertaken through holding companies. This entailed the reorganization of the public sector, reducing the number of public enterprises and converting them into 17 holding companies with diversified portfolios. Nine of these companies are associated mainly with manufacturing subsidiary companies. According to the PEO, the estimated current book value of the total portfolio of holding companies amounts to \$26.6 billion (89 billion Egyptian pounds [LE]), with an estimated

market value of \$93.4 billion (LE 312 billion).¹⁸ Of these, the book value of the total assets of 120 manufacturing subsidiary companies associated with seven manufacturing holding companies¹⁹ amounts to \$14.3 billion (LE 47.67 billion) with an estimated market value of around \$36 billion (LE 120 billion).²⁰

In Yemen, the Council of Ministers issued resolutions No. 150 of 1994 and No. 99 of 1995. These set policies and procedures for the privatization of public enterprises and established the Industrial Sector Committee to be in charge of matters relating to privatization. However, there seems to be no clear policy yet on the extent to which the Government is planning to relinquish its ownership in these industries. These resolutions were more concerned with improving the productivity and efficiency of public enterprises and with how to deal with enterprises recording losses; the solution here is either to transform them into shareholding companies or to liquidate them. The resolutions also ban extending subsidies to commercial enterprises.

As Yemen is still in an early stage of industrialization, the privatization process has barely started, and the Government seems to be taking a flexible approach. It tends to adopt the different forms available, namely transferring ownership of public enterprises to the private sector or allowing the private sector to be involved in production activities previously confined to the public sector. Nevertheless, the Government gives more priority to encouraging joint private/public production projects, such as leasing assets of public enterprises to the private sector (ESCWA, 1995b).

In the Syrian Arab Republic, the public industrial sector is expected to maintain its dominant role in strategic industrial areas. The private and mixed sectors will receive additional support and will basically be allowed to compete in the non-strategic industrial areas. There are no signs yet that the public industrial companies will be privatized, and there is only talk, so far, about reforming the public sector.

The Government continues to favour the promotion of the coexistence of the public, the private and the mixed sectors. The public-sector companies are expected to be given more autonomy and more management responsibility. It was recently reported that downstream operations in the hydrocarbon sector (refining and distribution) could be

¹⁸ Based on PEO estimates, with the book values of companies being multiplied by a factor of 3 to 4 to obtain their market values. The calculations in this study used an average multiplier of 3.5.

¹⁹ This does not include the Mining and Refractors Holding Company, which has 19 subsidiary companies, and the Rice and Flour Mills Holding Company, which has 20 subsidiary companies, most of which seem to fall under manufacturing, and the total value of the portfolio of which is not reported.

²⁰ Based on PEO estimates, with the book values of manufacturing companies being multiplied by a factor of 2.5 to 3 to obtain their market values. In the calculations in the present study, an average multiplier of 2.5 was used.

opened up to private- and mixed-sector participation. Nevertheless, public industrial expansion continues to be planned within the framework of the five-year development plan of 1992 to 1996.

The Government's conceived expansion in production is to be realized through improved efficiency and productivity rather than through adding new capacities. However, shortages of funds seem to be compelling the Government to freeze investment expenditures on the maintenance and modernization of many existing public manufacturing enterprises. In fact, with the trend of liberalization of trade and deregulation of the market, the Government is becoming more inclined to leave the task of overhauling and modernizing public enterprises to self-financing. Given the tight financial conditions of the public enterprises and the government policy regarding privatization, great concerns are raised regarding the future of these enterprises and their ability to keep abreast of rapid developments and to compete fairly with the more competent emerging private sector. The continued absence of a clear policy regarding the public manufacturing enterprises is delaying crucial decisions that need to be made promptly regarding badly needed reforms and overhauling these enterprises. This is increasing the risk that losses in the sector will be aggravated.

(b) *Commitment*

(i) The GCC countries

Kuwait and Oman seem to be the only countries in the subregion that have formulated a programme for privatizing public enterprises. In Kuwait, a five-year privatization programme was proposed by the World Bank in late 1993 for the privatization of 74 enterprises, 10 of which are manufacturing companies, including the New Petrochemical Industries Company (NPIC). The ministerial committee on privatization contracted the Gulf Investment Corporation (GIC) to prepare a study to identify potential areas for privatization in Kuwait. This study reportedly produced results similar to that of the World Bank (Kuwait Chamber of Commerce and Industry, 1995).

The privatization of manufacturing companies has already started. Prominent amongst these is the joint venture, Equate, which will be building the \$2.1 billion North Shuaiba petrochemical complex. It will be capitalized at \$292.55 million, with the Kuwait Petrochemical Industries Company (PIC) and Union Carbide of the United States each having 45% of the capital. The remaining 10% will be offered to the private sector through the private company Bubiyan Petrochemical Company (BPC). The latter is the first private-sector petrochemical company and was established by decree in April 1995, with capital of \$102 million. The founding members (basically PIC) hold 10% of capital, and the rest was put on sale on the stock market in April 1995 in the form of shares offered to the public. In the petroleum industries, the Petroleum High Council approved the

privatization of the liquefied gas industry and the oil canning industry (Middle East Economic Survey, 1995).

In Oman, a privatization programme was launched in 1993 with a total estimated value of assets of \$650 million to \$780 million belonging to public companies that are up for sale to Omani as well as private Gulf investors. Until recently, the only manufacturing company that had been privatized was the Oman Cement Company. This was done through increasing its equity capital by around \$14 million (36 million rials Omani [RO]), of which around \$6 million (RO 15 million) consisted of shares floated on the stock market. The production capacity of the company was expanded, and the company was partially privatized, with the Government maintaining majority shareholding in equity. In this connection, the Government is setting up jointly with the private sector a \$700 million petrochemical complex and a \$9 billion gas liquefaction plant (Oman Chamber of Commerce and Industry, 1995).

In Saudi Arabia, no privatization programme has as yet been formulated, despite a government declaration in May 1994 on privatizing the Government's holdings in public enterprises. The Government has expressed enthusiasm for the participation of foreign companies in industrial ventures. The aim is to benefit from their management, marketing and technological expertise. In September 1994, the Government officially called upon the private including foreign sector to invest in petrochemicals. Actual sales of assets of industrial companies, however, have not started yet. It is also still not clear what the next step will be (Economist Intelligence Unit, 1994). On the crucial issue of privatizing the Saudi Basic Industries Corporation (SABIC), the Government has not indicated yet its intention regarding the sales of its shares in the company (70%). There are, however, signs that private-sector ownership in the company will be increased. This is because the private sector seems to be more keen to acquire SABIC shares than to launch new petrochemical projects.

In the United Arab Emirates, privatization by the federal Government is not full-fledged. In fact, only the Emirate of Abu Dhabi, where most of the large industries are located, is expected to see some progress in this direction. Feasibility studies are being prepared for the privatization of nine small and medium-sized industries associated with the Abu Dhabi Public Industrial Enterprise. The local government is considering the issuance of shares for sale to the private sector on the stock market, relinquishing 49% of its ownership in these enterprises and retaining the 51% controlling interest.

In Bahrain, there are a relatively significant number of large public industrial companies, but no privatization programme has yet been announced regarding these companies. Privatizing manufacturing companies relates mainly to minor industries such as most of the food industries, where the Government has a minority share of 10%-20%. Only Bahrain Aluminium Extrusion Company (BALEXCO), a relatively large industrial

enterprise, is subject to privatization. Prior to the Gulf crisis, 20% of the company was privatized, and currently another 20%-30% is undergoing the same process.

(ii) *The more diversified economies*

Except for Egypt (see box 3), only Yemen has made a relatively firm commitment to privatizing public industries. The Yemeni Government earlier identified 14 public industrial enterprises for privatization, and the privatization committee at the Ministry of Industry has announced the soliciting of buyers with respect to privatizing the first batch of industrial enterprises. The industries to be tendered include the following: the Revolution Factory for Metal Products, the Leather Shoes Factory, the Public Bakery, the Losan Establishment for Biscuits and Sweets and Al Mansoura Automated Bakery, the Public Establishment for Dairy Products, and Al Mansoura Vegetable Oil Factory. Implementation of Yemen's privatization programme is receiving support from the various relevant international organizations, particularly the United Nations Industrial Development Organization (UNIDO). In this connection, the latter is helping the country in the privatization of a number of public industries in Aden.

In the Syrian Arab Republic, *de facto* privatization may emerge, despite the Government's declared intentions not to relinquish its ownership (in part or in full) to the private sector. This development has its roots in activities of the private manufacturing sector, which has in recent years become more dynamic, with manufacturing value added increasing significantly, superseding by far that of the State. This has so far been achieved through the country's "cautious" liberalization policy which has been pursued since the mid-1980s, especially with the recent introduction of the investment promotion law of 1990 (Ayubi, 1995).

(c) *Constraints*

(i) *The GCC countries*

The privatization process has been progressing at a relatively slow pace, and most Governments have not yet translated their privatization decision into concrete targets. Although most countries continue to advocate the need for economic austerity since the Gulf war, they do not seem to be facing a serious cash crisis, which is one of the main reasons that the privatization process is expected to continue at a slow pace.

Box 3. Progress in the sales of public companies in Egypt

According to the Public Enterprise Office (PEO), there are 7 specialized manufacturing holding companies with 120 manufacturing subsidiaries associated with them. Very few manufacturing subsidiaries do not fall under these holding companies, for example, Ahram Beverages and Egyptian Vineyards. Specialized holding companies have specialized subsidiary companies in the same field, representing not less than 65 per cent of the holding companies's portfolio. In the pharmaceuticals holding company, the pharmaceuticals subsidiaries represent 100 per cent of the company's portfolio, while for the holding company of Textiles Spinning and Weaving, textiles subsidiaries represent more than 70 per cent of its portfolio, the rest being subsidiary companies specialized in cotton ginning, trade and the distribution of consumer goods.

In the process of privatization, public companies were divided into three categories. The first included companies in good condition that could be directly sold to the public for a good price; this category of companies represented around 20 per cent of total public companies. The second category included those companies that needed restructuring and rehabilitation; this category represented the bulk of companies, 75 per cent. The rest were slated for liquidation.

According to the PEO, of the 120 manufacturing subsidiary companies, 80 companies were subject to sale. Of these 80 companies, the Government was expecting 40 per cent to be sold over a period of three years and 60 per cent over a period of five years. However, as of 1993, only 13 industrial companies had been sold. Presently, around half of the 120 manufacturing companies are ready for sale as long as their assets have been evaluated.

Shares of manufacturing companies that were floated on the stock market represented around 30 per cent of the total number of shares held by manufacturing holding companies, with a share of 10 per cent being sold to each of the following groups: employees, investment funds, and to the public. Subsidiary companies whose shares were floated until June 1995 and sold on the stock market totalled twenty companies, including four companies in pharmaceuticals, three in food industries, three in chemical industries, three in textiles, three in non-metallic mineral products industries (cement), and one in engineering industries. In addition, Egyptian Bottling Company (Pepsi Cola), El Nasr Bottling Company (Coca Cola), and El Nasr Boiler and Pressure Vessel Manufacturing Company were privatized by selling them to an anchor investor through private placement transactions. Although this way of selling does not activate the stock market, most of the shares of the two bottling companies were bought by foreigners, whereby the buyers agreed to expand production, to maintain present workforce levels, to float 20 per cent of equity on the stock market and to offer 10 per cent to workers in the following two to three years. Of all the above companies, 50 per cent of the book value of their assets was offered for sale, of which 20 per cent was floated as shares on the stock market, with a book value of \$1.5 billion (LE 5 billion) and an estimated market value of \$3.7 billion (LE 12.5 billion).

Currently, the Government's sales plans include an additional 25 subsidiary companies, on which preliminary agreement of sales has been reached, and an additional 10 companies the sales of which are under negotiation. Presently the Suez Cement Company is being prepared for sale while the capital of Egyptalum is expected to be increased after the evaluation of the company is completed by end-1995.

Box 3. (continued)

Manufacturing companies for which shares have already been floated on the stock market include, among others, the following: Tora Portland Cement, Alexandria Portland Cement Company, Helwan Portland Cement Company, El Nasr Clothing and Textile Company (KABO), United Arab Spinning and Weaving Company (UNIRAB), Alexandria Pharmaceuticals and Chemical Industries Company, Arab Drug Company, Nile Pharmaceuticals Company, Egyptian Electro Cables Company, Extracted Oil and Derivatives Company, China/General Ceramics and Porcelain, Aracemco/Arab Ceramics, and El Nasr Glass and Crystal Company.

To accelerate the pace of the privatization process, the Government recently announced its intention to offer 10 per cent stakes every two weeks in profitable public companies, including manufacturing companies, increasing the stake to 20 per cent at a later stage. Furthermore, in an attempt to streamline the operations of the public enterprises, the Government recently declared its intention to introduce strict measures against loss-making companies.

These measures have helped the Government's plan to sell, by June 1995, public-sector shares in manufacturing companies worth around \$3.7 billion (LE 12.3 billion). According to the PEO, of the total book value of the portfolio of all holding companies, 30 per cent are debts to banks, which leaves the Government with only 70 per cent of the book value of these companies.

Another impediment to privatization is the inadequate legislative framework in some countries of the subregion. The complete success of the privatization process requires the introduction of new legislative frameworks and the provision of ownership transparency and accountability to the public sector.

The form of ownership of most private companies also stands in the way of privatization. Most companies are individual, partnership, family or limited shareholding companies. The private sector still shies away from establishing large manufacturing projects, preferring to acquire shares in secured profitable ventures. This has prompted the Government in countries such as Oman to continue to launch manufacturing projects, with the aim of attracting private-sector investments in joint public/private ventures, to expand Oman's relatively limited industrial base, and encourage increased private-sector involvement.

The success of privatization greatly depends on the ability of the State to promote the process of financial deepening, yet the region lacks efficient and fully operational stock markets. The private sector in the GCC countries has already accumulated significant amounts of wealth and liquidity over the years. Privatization could thus be a vehicle for the creation of new domestic investment opportunities for Gulf investors. This would partly be enhanced by establishing stock markets. The problem remains, however, that the public and private sectors are linked in a complex manner. In many instances, members

of powerful interest groups occupy positions in both public office and private business. A paradoxical situation may emerge where the private sector becomes the main factor constraining and slowing down the privatization process in these countries.

In Kuwait, the sale of public-sector companies and government shares in companies has already been initiated, but not enough shares have been floated on the market. Demand has far exceeded supply, frustrating the investors and prompting the Government to increase the number of floated shares on the market. In some instances, the sales of equity or shares have been above the estimated value, with perhaps no relation to the future prospects or current returns of the company. The case of the National Industries Company (NIC), which is the country's largest industrial concern, is noted. In this respect, the Government recently announced that its returns on sales of 48.5% of its share in NIC were \$640 million, around \$375 million in excess of the original estimated value of the shares (Bureau of Lebanese and Arab Documentation, 1995).

If this sales policy continues, it might cause distortions in the operation of the market.

(ii) *The more diversified economies*

In the more diversified economies, particularly in the Syrian Arab Republic, public enterprise managers and technocrats (and enterprise employees and workers) continue to enjoy great political influence. Many of them are the main forces against the privatization process. Success in privatization efforts will greatly depend on the political and economic weight of supporters (interest groups in the public and private sectors) for the sale of public industrial enterprises.

The only country that has real experience in privatization is Egypt. Reference will therefore be made to difficulties faced in the privatization process in that country. Initial difficulties encountered involved determining methods to evaluate the assets of manufacturing companies and securing good prices. These were the main factors that delayed sales of enterprises. Other difficulties encountered included the insufficient number of competent enterprise managers and the Government's justified worry regarding the implications of privatization, particularly on unemployment and social dislocation. The privatization process was slow, also because of the piecemeal method adopted by the holding companies. They offered only partial stakes in their affiliates. In the earlier stages, the main problem was in the tendering process itself, with some companies' privatization offer attracting hardly any bidders.

The PEO follows a policy of gradually floating shares, in order to avoid the depreciation of the values of floated shares. Since the start of the selling off of public companies in late 1992, the pace of implementing the privatization programme of major manufacturing enterprises has been slow, according to the schedule agreed upon with the

World Bank. The Government's plan was to have the whole portfolio of 314 public enterprises ready for sale by end-1994. The slow pace is justified by the limited absorptive capacity of the Egyptian market, particularly since government bonds and treasury bills are currently being offered.

To improve efficiency in selling off public enterprises, Egypt has changed its privatization strategy since early 1994. It has set higher privatization targets, by changing its method of privatization from private bids to sales through the stock market. Initially, major investors were asked to tender for companies with only a small portion of the available stock reserved for a public issue. Sales of shares of industrial companies were made through contracts. The criteria in selecting the best bid did not depend only on the best price offered, but also on a proposal that ensured the company's sound economic value, as well as its continuity and its contribution to economic development. This method did not achieve the expected results, however.

Now, available shares are to be offered through public issue. The aim of selling shares through the stock market is to ensure greater transparency of sales and to have a larger volume of shares listed on the stock exchange. In terms of demand for sales, the new selling strategy has so far proved to be more successful. Indeed, the demand for State shares has been excessive, in most instances resulting in heavy oversubscription. This is due to the relatively small number of shares offered on the stock market, disappointing investors (Economist Intelligence Unit, 1995).

The extent of investor interest in acquiring the limited floated shares has been very promising; investors—particularly small investors—are very eager to find investment outlets. However, this has led to a phenomenal increase in the market prices of floated shares, reaching in some cases severalfold. Moreover, the floating companies have not increased the number of shares floated by their companies to meet the overwhelming market demand. The phenomenal increase in prices perhaps has no basis, either in terms of the rate of returns of these companies or in anticipated productivity.

To accelerate the pace of the privatization process, the Government recently announced its intention to offer 10% stakes in profitable public companies, including manufacturing companies, every two weeks. The stake will increase to 20% at a later stage. Furthermore, in an attempt to streamline the operations of the public enterprises and thus accelerate the privatization process, the Government recently declared its intention to introduce strict measures against loss-making public-sector enterprises, and for the first time allowed foreign consultants to be appointed as board members.

There is a need, however, for a more flexible policy in the sale of shares, whose volume must be commensurate with the market demand, to try to avoid undue increases in share prices and to allow market forces to determine the true value of company shares.

This would also help preserve stability in the stock market, which is an important aspect of the privatization process.

The slowly unfolding process in Egypt may be partly attributed to the Government's continued reluctance to completely relinquish its ownership of the large public industrial enterprises. Instead, through the slow-paced process of formulating joint ventures between the public and the private sector, the State bureaucracy may be hoping to have more time to allow it to redistribute ownership in a way that would leave an important stake of the industries under State control. So far, the State continues to play a dominant role in these enterprises, with the State bureaucracy being quite large. This has raised some fears that the privatization process in Egypt remains a public policy adopted by the State for its own purpose, with privatization not necessarily involving deregulation, but rather becoming more concerned with re-regulation (Ayubi, 1995).

3. The emerging new outward-looking industrial strategy

Since the beginning of the 1990s, various national, regional and global developments have compelled most Governments in the ESCWA region to consider deregulating business activities and introducing economic and trade reforms. These Governments have also begun to support strategies of industrial export growth. In the GCC countries, a more aggressive manufacturing export strategy is being pursued. In some of the MDEs, the inward-looking industrialization strategy through aid is being supplemented by an outward-oriented industrialization strategy through trade. The success of this strategy will, in most countries, depend on investment expansion and on the anticipated participation of repatriated Arab capital and FDI.

In the GCC countries, manufacturing exporters of basic industries in petrochemicals, fertilizers, aluminium, and iron and steel, and others have been facing increased difficulties in marketing their products, particularly in the very large neighbouring EU market. This has contributed to surplus capacities in these industries. As a result, levels of production, performance, and profits of manufacturing companies in the subregion have been affected. The focus is now shifting to the diversification of the export market and the development of new export products in the form of joint projects with foreign partners.

Foreign partners are needed to provide access to know-how and marketing techniques, as well as guaranteed export markets and additional confidence in the manufactured products. Within this context, offset investment programmes were introduced in many GCC countries. Economic deregulations concerning foreign investments in manufacturing started to receive some attention early in the 1990s. These aimed at improving the operation of the market economy and at promoting national and foreign private investment. Improvement and continued development of the countries'

legal and institutional environment have been initiated; new rules and regulations have been introduced, and old ones have been revised.

In the more diversified economies, the limited domestic market, caused by low purchasing power, particularly in Egypt and Lebanon, continued to limit manufacturing expansion. However, the introduction of economic reforms and market deregulation, particularly in Egypt and to a lesser extent the Syrian Arab Republic, have already had noticeable effects. These factors encouraged private producers to expand production for the export market, especially major sophisticated markets such as the EU and the United States of America. Some producers are already engaged in joint ventures with foreign partners. Many others, including SMEs, have engaged in contractual agreements to supply foreign customers with specific products.

(a) *Some of the problems facing expansion in manufacturing in the region*

(i) *In the GCC countries*

Some of the problems just discussed continue to restrict manufacturing expansion in the countries of the subregion. This is particularly true regarding SMEs. Such problems include:

- The absence of an appropriate institutional structure in industry itself, and the weakness of institutional infrastructure (support services)
- The sponsorship system in foreign joint manufacturing ventures. On the one hand it discourages foreign investment in manufacturing projects, and on the other hand, although it yields a "rent" to the local "silent" partner, in many instances it discourages the development of indigenous entrepreneurship. Instead, the sponsorship system promotes the "rentier" business mentality, which limits the scope for future expansion in indigenous manufacturing activities
- The dominance of trade capital
- Constraints on FDI regarding investment in manufacturing SMEs

Although there are efforts to deregulate foreign investment, constraints on FDI in general are caused by:

- Limited national markets with continued non-tariff barriers among the GCC countries, and strong competition among them through the offset programmes

- Slow adaptability to new management systems and inadequate upgrading of technology and skills
- The imposition of requirements for local control of capital (51)%
- Disallowing foreign investors to own property in some countries
- Employment laws imposed on expatriates, and government policies to increase dependence on national labour
- The family-owned limited partnership, which is the most common form of company in the Gulf subregion
- The lack of proper transparency of the economy

(ii) *In the more diversified economies*

Among the most important problems facing manufacturers are high production costs, which are attributed mainly to:

- Shortages of water and electricity supplies and recurrent electricity cuts in some countries
- High investment in warehousing
- The high rate of self-financing
- High labour cost (particularly in Lebanon), especially in relation to competitor countries such as China and other Far Eastern countries such as Indonesia and Malaysia
- Limited industrial areas
- Indirect expenses relating to complicated tax systems and customs, and complicated bureaucratic procedures
- Underutilization of capacity, partly caused by electricity cuts, shortages in water and local supply inputs, and inappropriate maintenance

To face the increasing price competition on the international market, many producers are trying to improve the productivity of their plants, particularly in Egypt, and are perhaps reducing profit margins. Exporters are also contemplating the shift in production into higher-quality, higher-value-added products, particularly in Lebanon and,

to a lesser extent, the Syrian Arab Republic. The conclusion of the Uruguay Round will result in increased competition, putting additional pressure on exporters in the subregion, even in their own markets, to improve productivity as well as quality of their products. The new international standardization and related specifications system should be looked upon by the MDE as opening good opportunities for viable exporting industries by improving the quality of their products to meet international standards.

Exports in these countries are focused on resource-based agro-industries (food and textiles). Difficulties should be expected, however, in shifting to higher-quality products. These difficulties may be caused by several factors which have not yet been addressed adequately, among them:

- The inferior quality of some of the local materials used in producing quality products for the export market, and the lack of variety in raw materials in the domestic market, compelling producers to import part of their supply needs, which increases production costs
- Inconsistency in the quality and supply flow of certain local inputs, negatively affecting the ability of producers of exports to produce according to customer specifications and taste in foreign markets
- Shortages in skilled labour, making it harder for industrialists to shift to higher-quality products in the short and medium term

(b) *Some of the challenges facing the emerging outward-looking industrial strategy*

Export awareness in the ESCWA member countries, particularly in the more diversified economies, is gaining momentum. This momentum needs to be strengthened. In pursuing the new outward-looking industrial strategy and accessing major markets, various challenges face countries in the region: identifying specific market needs and tastes for manufactured imports, particularly in major markets, including the neighbouring EU market; and improving the competitiveness of products destined for export and for the local market. This can be achieved by the following: adhering to international quality standardization and related specifications and requirements; developing more flexible production processes; and developing more sophisticated marketing techniques, with continued product development. These factors are further elaborated below.

(i) *Comparative advantage revisited*

Improved productivity may be one way to meet emerging competition. The basic issue, however, is the question of comparative advantage of existing industries. This should be considered within the context of changing global and regional conditions. In the past, many of the industries in the region thrived under protection, subsidies, and

provision of other facilities for exports. Now, however, liberalizing trade and deregulating the market may render industries less competitive, even in their domestic markets. Therefore, in-depth sectoral studies at the commodity level in the relevant branches of industry need to be undertaken to evaluate the competitiveness of these industries within the context of global liberalization of trade. In the more diversified economies, the industries that need to be addressed are mainly the labour-intensive industries of foodstuffs, textiles, garments and leather products.

In some GCC countries the current trend is to promote SME feeder industries. These industries are believed to have a comparative advantage as they have local bases and service large, heavy industries that are located in the subregion. It is likely that large existing industries will provide a wide base for such SMEs, if they prove to be viable. This is an area that calls for in-depth study. Feeder industries could include those based on supplying industrial raw materials such as paint raw materials, oil-field chemicals, and engineering components such as pipes, fittings, pumps, fire extinguishers, and so forth. Furthermore, investors in the subregion will have to take into consideration the technology component of industry in identifying the products that they wish to manufacture.

The GCC countries aim to improve the competitiveness of their industry by substituting locals for high-cost expatriate labour; the participation of women in knowledge-intensive industries with decent working environments could be promoted, taking into consideration the Gulf countries' web of social, cultural and economic conditions. This option has potential, particularly since more than 50% of women graduates in many GCC countries are graduates in the sciences but are unemployed (Qatar, unpublished). The issue becomes more critical, when the fact is taken into consideration that the pattern of choice of job by Gulf men is in general more oriented towards either running their own commercial business or working for a business company or in a government office. Possible areas for women's participation include those industries that are now being promoted, namely technology-based industries, which require higher educational achievements and specialized training.

(ii) *Export promotion centres and information technology*

Outward-looking industrial strategies need to be supported by export promotion centres in the countries of the region. Despite the dramatic developments that have been taking place in information technology, countries of the region are still far behind, particularly in the MDEs. Most of the countries are using outdated modes of collecting, processing and transmitting the information they require. Exporters should have easily accessible information on export markets. This is particularly critical to SME industries, as they, unlike large industries, do not have ready access to needed information. These industries also need support to build up capabilities to exploit marketing information.

Although some countries in the region have established trade information centres, they are exceptions. Only Egypt, Jordan, and Saudi Arabia have established export promotion centres. Bahrain is currently considering establishing an export promotion centre. Export promotion centres could provide the following services: identify international marketing channels; provide information on specific markets regarding trade systems, supply and demand, customers and their tastes; serve as facilitators to export producers that have no experience in selling to foreign markets; help exporters strengthen their in-house export promotion capabilities, such as marketing techniques; and provide information to exporters about the underlying commercial and country risks involved in the transactions.²¹

(iii) *Transparency of the economy*

The success of information and export promotion centres greatly depends on the availability and flow of a wide range of unrestricted and reliable, up-to-date industrial statistics and information. In this respect, despite efforts made to deregulate the business environment in the region, and to improve the efficiency of the market economy mechanism in the GCC subregion, there is still a long way to go regarding availability of and easy access to information. It is hoped that the establishment of such centres in the new era of liberalization will help solve part of the problem regarding information and statistics and will improve the scope and reliability of published vital industrial statistics and deregulate their restrictiveness.

Efficient functioning of market economy requires transparency of the economy and easy access to unrestricted, up-to-date economic and industrial information. Previously, the availability of information was not a serious problem, as expansion in most manufacturing activities was undertaken by the public sector (which was inward-looking in most MDEs). Promoting a private-sector-led outward-looking growth, particularly in SMEs, in addition to increased competition from more transparent economies, requires that the economies of the region become more transparent.

²¹ Technical assistance should be sought from international organizations to provide expertise for the setting up and initial running of these centres. Export promotion centres should have in-house information centres linked whenever possible with the Internet and/or major international export information centres and networks in major export markets. They should be adequately equipped and supported with highly capable and well-trained staff. They should be provided with appropriate budget allocations for the continuous training of staff and upgrading of their capabilities, as well as for maintenance of equipment. Where such centres exist, they may need to be strengthened and upgraded.

The experience of some Asian countries and areas such as Taiwan Province of China, in the establishment of export promotion complexes suggests another option for the GCC countries that is worth studying, as it may be more suited to the Gulf's socio-economic environment, and may appeal more to the temperament of Gulf producers. In these complexes, all facilities are located, including the hotel, the exhibition, and company offices, supporting and simplifying marketing efforts to producers and importers.

Industrial statistics in many countries of the region lack comprehensiveness and are not always reliable or up to date, nor are they collected on a continuous basis or published regularly in many countries of the region. They are also often restricted.

(iv) *Exploiting the "natural" neighbouring export market*

A sustainable export strategy will have to be able to meet some of the needs of the "natural" neighbouring export market. In the case of ESCWA member countries, this includes the region embracing Arab and other neighbouring countries. Thus, member States will have to consider that their competitive edge (particularly in downstream bulk product industries, on which they are focusing) lies in proximity markets. This is even more true with the global liberalization of trade whereby competition is becoming tougher in the other export markets. Furthermore, since FDI is usually associated with the promotion of export industries, investors will not be attracted by an improved investment climate alone, but also need to be assured concerning the prospects of export to the regional market.

It is to be expected that the current economic reforms and trade liberalization should help eliminate some of the regional trade barriers. This, however, is a long process. There is an immediate need for a clear policy commitment to free intraregional merchandise trade in manufacturing. This can be done by introducing measures eliminating or reducing the various existing non-tariff barriers (for example, complicated trade procedures, undue delays of clearances for entry of shipments at borders).

(v) *Finding other export outlets*

For the outward-looking industrial strategy to succeed in the ESCWA region, new export outlets for the region's manufactured products in neighbouring major regions need to be found. The European Union and (for the GCC) the Far East are good outlets. Various challenges will be faced in accessing the European Union (and other major markets). Particular reference is made to the difficulty in adhering to the coming international standards²² and related tools and specifications and to other quality controls and environment considerations. This entails serious efforts on the part of exporters in the region to meet these requirements.

As mentioned earlier in the section on the Uruguay Round agreements, one option for countries in the region is to consider joining the EU in a free-trade area, a proposed partnership association. This preferential access to the EU market, given to Eastern Europe and Turkey, would give preferences to exports from countries of the region relative to their Asian competitors. This could partly compensate for possible export losses that

²² Including ISO 9000 and related standards.

may result from the liberalization of trade under the Uruguay Round. Under this partnership association, relations with each region are based on specific needs and capacities. The EU gives countries of the region a grace period of 10 years to adjust their socio-economic conditions to EU requirements. Countries of the region should investigate the possibility of maximizing their benefits in the negotiation of the proposed arrangement, as the EU has invariably declared that it has a vital interest in helping its neighbouring Mediterranean countries to overcome the difficulties they are facing. A free-trade arrangement with the EU may help the region in its economic revival in the long run and boost its manufacturing exports to the European market. This is an opportunity that should be given serious consideration from member States, because of its important socio-economic implications for the region.

(vi) *Attracting foreign direct investment*

The ability to attract foreign direct investment is becoming critically important in pursuing the new industrial export strategy, because competitive export industry is usually built on foreign technology linked to FDI. Foreign firms, if well negotiated, not only bring with them capital and technical know-how, but also capabilities in marketing exports.²³ The success of the outward-looking industrial strategy in the region would greatly depend on accumulating marketing capabilities, particularly in the downstream industries. Exports of intermediate manufactured commodities greatly depend on price competitiveness and on product quality that meets world standards. Manufactured products with higher value added need to look for potential export markets. Exporters also need to identify and design the product for these markets, and this is a process that FDI usually facilitates (UNIDO, 1993).

Countries in the region find it difficult now to attract FDI, as worldwide demand for foreign capital has increased, owing to increased trade liberalization and the introduction of economic reforms in other developing countries. Another factor is the transformation of the economies of Eastern Europe and the Commonwealth of Independent States (CIS), and to a lesser extent China, into market economies. Added to this is the unification of the European market and the attraction it holds for foreign capital. These developments demonstrate how important it is for most countries of the region to improve the viability of their economic reform programmes and to implement them efficiently. They should aim at developing a more competitive and stable investment environment, particularly in regard to foreign investment.

²³ Export prospects and the transfer of technology are not automatic components of FDI. However, the receiving country can negotiate to include as a condition in the contract the export of products, the gradual transfer of technology and a gradual increase in local content.

(vii) *Reforming the legal business system*

In line with GATT requirements, most of the countries in the region need to make their rules and regulations more transparent. Particularly, attention should be given to regulations relating to foreign investments, trade and property rights. Sound business conditions cannot exist unless the legal system is reformed to ensure the proper enforcement of contractual obligations, the protection of ownership rights, the guarantee of income repatriation, and provision for recourse against abuses. It should be noted that the ownership system in some countries of the region yields a "rent" to the local partner in a joint foreign partnership. Whether or not this discourages the development of manufacturing entrepreneurship and limits the expansion of manufacturing activities needs to be examined.

4. *The role of private-sector institutions*

Private-sector institutions are expected to bear greater responsibilities in industrialization to compensate for the continuous decrease in the role of the State.

In today's international environment, which is moving towards the liberalization of international trade and the deregulation of economies, industrial strategy and policies will no longer be shaped only by the State or be a monopoly of Governments. Until recently, industrial strategies, whether import-substitution and/or export-oriented, were formulated by Governments and implemented through policy measures and instruments such as subsidies, incentives, protection of industry, reduced tariffs and so forth. These promotional measures will be gradually phased out with the implementation of the Uruguay Round trade agreements. Private-sector firms and institutions must share more and more in the formulation and implementation of industrial strategy and industrial policies. Government, in cooperation with the private sector, will have to base its strategy on considerations oriented to market demand; it will be more interested in serving society's needs, rather than pursuing industrialization for industrialization's sake.

However, the existing private-sector institutions are not yet prepared to cope with the increasing needs of private industrial firms, particularly small and medium-scale enterprises. These firms face considerable problems, mainly in the following four areas:

- Administrative and bureaucratic procedures (registration, licensing, import-export regulations, tax and customs duties systems, etc.)
- Access to finance (collateral, high cost incurred by financial institutions, etc.)
- Access to information (on sources of raw and intermediate materials, on equipment and on technology, as well as on marketing outlets)

- Management problems (entrepreneurial skills, lack of training, etc.)

These problems require that private-sector institutions, together with government institutions, adopt policies and measures that may assist industrial firms in the following areas: simplifying administrative procedures; designing specific financing schemes for small enterprises; establishing centres and networks of information services; and entrepreneurial encouragement, advisory services and training.

(a) Simplifying administrative procedures

One of the most significant barriers to enterprise development in most ESCWA member countries is the complexity and number of procedures—forms and approvals—related to the establishment and operation of an industrial enterprise. This problem is made worse by the long delays that occur in the processing of the forms and the fact that several institutions and hidden intermediaries deal with the issuance of licences and approvals. Many entrepreneurs have difficulty obtaining information on what approvals and forms are required in establishing and running a business and on who the relevant authorities are to approach in this regard. In Egypt, for example, some private industrialists claim that it takes up to 30 official approvals and many intermediaries before a start-up is possible, with a resulting loss in time and money (ESCWA/UNDP, 1992). Thus, government bureaucracy and hidden intermediaries increases transaction costs for firms, and therefore reduces their competitiveness and discourages investors from starting up a business.

Several attempts have been made by a number of countries to simplify administrative procedures or to establish one-stop shops for the administration of approvals. However, these attempts have not generally been successful, in view of the vested interests operating in many public institutions, and the considerable difficulty in reducing bureaucracy, which is inherent in the system of government institutions.

In view of the above problems and facts, it is recommended that a private institution such as the chamber of industry and commerce take responsibility for handling all paperwork and whatever official approvals are required at the time. Such an institution should also provide the entrepreneur with the information related to the kind of approvals and forms required. A fee should be charged for the service provided by the private institution, but this fee should be lower than the costs that would be incurred by the entrepreneur if he or she handled his/her own paperwork. There is no doubt that such a service would greatly facilitate the operations of private firms and would encourage investors, particularly disadvantaged groups of the society (those who have no relations/connections with government officials), to start businesses.

(b) *Designing specific financing schemes for small and medium-sized enterprises*

Lack of access to financing is considered one of the most important constraints on the industrial sector in the region, particularly in regard to small- and medium-scale business development projects. The difficulties facing industrial enterprises are not generally due to lack of funds in the region, but to four major reasons: The first is the relatively high costs that have to be borne by the financial institutions when administering loan financing, costs that are usually transmitted in an amplified form to industrial ventures. The second difficulty relates to the conditionalities imposed on credit by commercial banks as well as by most industrial and development banks. One of the most important conditions is the provision of collateral, which in most cases far exceeds the amount of the requested loan. This situation is further aggravated by the fact that machinery and equipment cannot generally be considered as part of the collateral. The third reason is that banks consider industrial enterprises, and even more so the small ones, as risky clients. The last reason involves the inexperience of small entrepreneurs in dealing with the complex procedures of the banks.

Box 4. Financial support initiatives for small enterprises in Egypt

Several initiatives have been made by institutions in the region, particularly in Egypt, to assist small industrial enterprises and meet their financial needs. The Social Fund for Development has a special programme for financing start-up and existing small and medium enterprises, where the lowest possible collateral requirement is imposed; equipment and final products can generally be considered part of the collateral. Two innovative schemes were introduced in the late 1980s: the first is the credit scheme of the Alexandria Businessmen's Association, which provides loans to small enterprises without collateral requirements; the second is the credit guarantee scheme introduced by the Credit Guarantee Corporation for Small-Scale Enterprises, whereby the Corporation guarantees up to 50 per cent of the total loan provided by commercial banks.

Similar financial schemes have been established in several other countries: the Development and Employment Fund in Jordan, the Small Enterprise Development Unit in Yemen, credit institutions in the occupied territories and various international and local NGOs

Innovative financial schemes need to be established and developed by private-sector initiatives. However, to have an effective impact on private-sector development, such schemes must:

- Develop the capabilities of credit officers in the management of loans, and the evaluation and monitoring of industrial projects
- Simplify the procedures followed by the credit institutions

- Promote the establishment of a credit guarantee scheme. Such schemes have the double advantage of solving the problems associated with collateral requirements for entrepreneurs and reducing the risk of non-payment of debts to credit institutions
- Coordinate the institutions that provide financial support with institutions that provide non-financial support (training, counselling, management advice)
- Assist entrepreneurs involved in new start-ups in improving their business plans

(c) *Establishing a network of information services*

In the modern business world it has become increasingly apparent that access to business information is a critical factor in the effective start-up and efficient operation of an industrial unit. Entrepreneurs in most ESCWA member countries lack ready access to information services and require information to enable them to make sound decisions on all facets of their operations. Small- and medium-scale businesses need:

- Technical information on equipment and products
- National and regional import and export statistics to guide investment and marketing decisions
- Details on local, regional and international suppliers of equipment and raw materials
- Information on regional and international companies offering technology transfer and product-licensing opportunities
- Schedules of international trade fairs and exhibitions
- Linkage and subcontracting information
- Market statistics
- Details on existing companies and competitors in the country where the business is operated and in the region
- Lists of foreign buyers/importers

- Information on support institutions (training bodies, consultancy firms, etc.) in the region
- Government regulations covering business activities
- Sources of finance

In the highly developed industrial economies of Europe and the United States, access to computerized databases on all kinds of business information is readily available. It is vitally important that ESCWA member countries act now to upgrade their sources of information, particularly for the small- and medium-scale enterprises who can least afford to waste scarce management time on lengthy searches for necessary information. It is recommended that a private-sector institution in each of the countries of the region establish a small-business information centre engaged in the collection and dissemination of relevant data, act as a "one-stop shop" for the provision of business information, and develop a working relationship (network) with similar private institutions in other ESCWA member countries in order to facilitate the flow of information among the countries of the region.

The advantages of this proposed information network would be the following:

- Facilitating of access by small- and medium-scale enterprises in each country to the national-level information necessary to operate their businesses effectively
- Making possible a greater degree of regional cooperation by making available to companies in individual countries information from their neighbouring countries on:
 - a. Suppliers of equipment and raw materials in the region
 - b. Opportunities for regional linkage and subcontracting
 - c. The availability of technical expertise in the region
 - d. Support organizations in the region, for example training courses, consultancy firms
 - e. Regional joint-venture, technology-transfer and licensing opportunities
 - f. Import and export statistics

g. Trade fairs and exhibitions in the region

- Ensuring access by local companies to international sources of information

(d) *Entrepreneurial encouragement, advisory services and training*

The provision of advisory services, counselling and appropriate training to small- and medium-scale enterprises is an important ingredient of any national enterprise-development programme. The services being offered in most ESCWA member countries reveal the infrastructure for the provision of such services to be underdeveloped.

As small enterprises are generally numerous and scattered, it would be difficult and costly to reach them all. The organization of SME into mutual support groups or associations based on occupation would facilitate the provision of consultancy and advisory services and the sharing of experiences among entrepreneurs. Common problems faced by the owners/managers could be addressed within the support group or association. When dealing with individual enterprise problems, counselling services need to be provided, preferably at the workplace. It is therefore recommended that associations of producers be established in all industrial branches, in order to facilitate the delivery of services to small and medium-scale enterprises.

The problems encountered by SMEs need to be identified through an adequate survey of the target group of entrepreneurs. This should be undertaken before planning for or defining the services to be provided to entrepreneurs. A survey of this kind would make the entrepreneurs aware of their problems and their need for managerial and technical assistance. Many small entrepreneurs are not aware of their needs and or of the existence of small-business advisory agencies.

Private-sector institutions are also required to secure the appropriate training courses for existing and potential entrepreneurs. Upgrading the managerial and entrepreneurial skills of enterprise owners constitutes an important factor in the survival and success of firms. As the countries of the region are undergoing drastic changes at the political and economic levels, it is essential to train entrepreneurs how to manage their enterprises under conditions of change, to enable them to cope with the new environment. Such training programmes would assist them at identifying and understanding the changes taking place at the national, regional and international levels. Training would also help them exploit the new opportunities brought about by these changes, and introduce the required changes in their own enterprises.

The major problem faced in the provision of training courses would be to identify and locate these potential small-scale entrepreneurs. Start-Your-Own-Business (SYB) courses could be one of the means used to identify would-be entrepreneurs. SYB selects

individuals possessing certain character traits as potential entrepreneurs, through course promotion and selection interviews. SYB helps the selected individuals develop their entrepreneurial capabilities and transform their business ideas into real projects. It aims at increasing self-employment and the number of new businesses. It is important to note that without proper training, many new start-up businesses may fail.

C. A FRAMEWORK FOR AN INDUSTRIAL STRATEGY

The ideas presented here are an attempt to formulate a framework for a new industrial strategy for countries in the ESCWA region to help them face the challenges of the coming century. In a comparative assessment of the global economy and the capacities of States and societies to adjust to its endemic changes, the American historian Paul Kennedy observes that "more than any other developing region" the countries of the Middle East and North Africa are the least prepared to meet the challenges of the next century (Kennedy, 1994). Equally pessimistic and critical of Arab chances in the next century is a 1995 World Bank study entitled *Global Economic Prospects and the Developing Countries*. It gives a bleak and pessimistic outlook for economic growth and development in the Middle East and North Africa. During the 1980s, according to this study, the region's economic growth averaged less than 1%, with the world average being over 3%. A combination of population growth rates of around 3%, falling real oil revenues, dismal export performance, the terrible cost of two Gulf wars and several civil wars, and unending wasteful expenditure on military procurement have coalesced to undermine any meaningful future economic prospects for the region.

While indeed the 1980s represent a lost decade for the region and the early 1990s do not augur much improvement, the critics above fail to recognize the delimitating effects of hostile external influences, rapid and unpredictable structural changes in the new economy and some positive Arab achievements in the areas of education, health and basic infrastructural development. The real issues, however, remain: Why has development remained so illusive in the Arab world? What are the basic explanatory factors of this abysmally slow growth? What accounts for the success of the East Asians and many other developing regions that outperformed the Arabs? What is needed to reverse the economic slide? Can a collective Arab industrial strategy contribute to a brighter economic future for the region? Where does it begin?

1. Anticipating global change

The international economic environment that the region faces in the 1990s is dramatically different from the world of the 1950s or even the 1980s. International competition is intensifying, and the basis of economic success is changing. Successive rounds of trade liberalization under GATT have led to major changes in world trade and to the rise of transnational corporations. Regional trading blocs dominated by the United States, Japan and the European Union are emerging and consolidating their markets.

Newly industrialized countries and areas such as the Republic of Korea, Taiwan Province of China, Singapore and many others are increasing competitive pressures in many industries and setting strong examples for others to follow.

The pace of technological change has also quickened and has increased the value and importance of research and development as the basis of competitiveness in the world markets. New technologies are changing the nature of economic activity. Worldwide advances in information technology are improving productivity in all industries. They are widely accessible and relatively inexpensive. Software has replaced hardware as the major ingredient for improving efficiency and realizing competitive advantage. Advanced materials are replacing natural resources, resulting in drastic declines in the resource intensities of products. Japan's industrial production almost tripled between 1965 and 1985, while the consumption of energy and raw materials hardly increased.

Concern for the environment has grown. Governments in the industrialized countries are strengthening environmental standards. More efficient and cleaner technologies are being adopted to meet mounting consumer demands and to satisfy regulations stipulating environmentally sound products and services.

The personal computer, flexible manufacturing, the information highway of the INTERNET and the World Wide Web, telematics, fibre optics and bioengineering have transformed the classical international economy. The new economy in its most fundamental arrangement is *global*, just as the classical economy was in its essential aspect *national*.

The new global economy comes in the wake of flexible, split and high-tech manufacturing replacing old Fordist economies of scale and smokestack integrated production. It is organized by transnational companies based on a web of relationships that run laterally across national boundaries, and it inverts the pyramidal structure of industrial decision-making and production cycles associated with the classical nation-State economy. Global manufacturing within the new arrangements takes advantage of split production runs to locate in different national jurisdictions, sets up one jurisdiction against another to maximize cost reductions, increases savings in taxes, avoids environmental regulations, enhances control and discipline over workers and unions, and offers political favours without demands for national accountability.

Global finance, decoupled from production, is now virtually unregulated and maintains a multicountry round-the-clock electronic network transferring on a weekly basis multiples of the international volumes of trade over a whole year (Drucker, 1986). It moves freely across borders at lightning speed, bringing together remote Moroccan villages with financial wizards on Wall Street in New York or in Tokyo. The network is centred in cities and not States and has developed a supranational power of its own in which Governments are increasingly beholden and accountable to external bond markets

rather than their own citizens. Their options in exchange rate policy fiscal and monetary policy, and industrial and trade policy have all become constrained by financial interests linked to the global economy.

A survey by the Bank of Canada of the Canadian foreign exchange market in April 1992 estimated average transactions in excess of \$22 billion per business day. Put on a yearly basis, this amounts to \$5.5 trillion. The value of all Canadian exports and imports in 1992 was approximately \$304 billion. Seen in this light, financial dollar transactions are 18 times larger than trade. A decade earlier this ratio was less than 7 to 1. Explosive growth in speculation in international currency exchange can also be traced to deregulation in financial markets and the prevailing system of floating (market-determined) exchange rates. Today, no country is immune from the speculators. Their reach is so pervasive that even the United States, the largest economy in world, has experienced pressure on its currency from speculators. There is an estimated trade of United States currency of one trillion dollars per business day. Prices of currencies no longer reflect cost or preference differentials or other relevant economic conditions but rather mirror the fancies of currency speculators. Reacting to rumours, these people can change the fate of a currency and with it the economic well-being of millions of people. Recent research has demonstrated that financial markets usually overreact to any new information. Overreacting means that the price fluctuation will be larger than what is warranted by economic conditions. On the other hand, multinational corporations have become more autonomous than Governments, while international finance looms autocratically over the real economy.

The third-world debt problem will take precedence over other development difficulties. Under structural adjustment programmes, States are required to impose domestic austerity, which has the effect of raising unemployment, domestic prices and social tensions. Often the weakest groups in society are left to shoulder the brunt of the adjustment costs of these harsh measures that are ultimately designed to ensure that these countries can and will pay their debts to first-world banks and Governments.

2. Structural problems of the ESCWA region economy and industry

The structural weaknesses in the region's economy and industrial sector have been the main reason for its inability to adjust to global change. They may also impede the region's effort to meet the challenges of peace, as well as those posed by the changes in the international economic environment. During the 1970s and 1980s the economic growth of the region masked many of its structural problems. These problems are now emerging with force and posing serious threats to future development. Below, a brief account of the salient problems in the economic structure and manufacturing sector is presented.

(a) *Structural economic problems*

The following features characterize most of the economies of the ESCWA member States.

- *Heavy reliance on revenues from oil.* Often it is argued that the difficulties in the 1980s were caused by falling oil prices. However, the fact that oil prices can so adversely affect all economic indicators of performance is itself revealing. In this respect, the continuous heavy dependence on oil revenues is symptomatic of economic failure. This dependence has propagated an "Arab disease" that raised the exchange values of most currencies in the region to the detriment of effective manufacturing exports. It inflated costs of production and undermined local industry and agriculture. It flooded domestic markets with large volumes of cheap imports that ultimately compromised the balance of payments of even the richest States, and engendered unsustainably high consumption patterns divorced from high levels of production. It encouraged investments in large projects that were often unnecessary and unproductive, and ultimately saddled the economy with large maintenance costs. It also bloated the bureaucracies with overlapping rings of rent seekers, divorced income from production and exposed the domestic economies to the wide fluctuations of the world market for oil, over which the region had little control.
- *Income and wealth inequalities within and between countries of the region.* This is manifested in limited domestic purchasing power, a phenomenon that has reduced the capacity of the local market to sustain local production. It has also undermined health and education opportunities for the masses, which hampers the growth of labour productivity.
- *Heavy reliance on precarious external sources of finance at the expense of developing domestic savings or developing effective vents for regional savings.* Domestic savings are in fact exceptionally low. This phenomenon perhaps is the most visible drain on sustainable economic development in the region. No economy can enjoy continuous growth without strong domestic sources of development finance. All high-performing economies of the NICs enjoyed high savings ratios (in the Republic of Korea the savings ratio amounted to 37%). The oil producers in the ESCWA region had some very high savings ratios in the 1970s and early 1980s, but these ratios have since dropped dramatically. Jordan shows a negative ratio; investment in Jordan is financed from external sources. The fact that for many Arab countries, domestic savings

ratios are below the investment shares in GDP signifies that they are resorting to foreign aid or borrowing to finance their investment activity. This recourse is surely unsustainable.

It should not, therefore, be surprising to know that the ESCWA member countries are the recipient of the highest per capita official development assistance (ODA) in the world. As a percentage of GDP this aid is over 3.4%. Only in sub-Saharan Africa is the share of ODA in GDP higher. Revenues from natural resources, foreign aid and other external sources of aid together reduced the incentive to develop savings from domestic and other sources of income. There is ample evidence that countries that depend on natural resources and unearned finance tend to lag behind economies that have to rely on domestic productive activities.²⁴

Dependence on external sources of finance is also manifested by a high level of indebtedness in the ESCWA member countries. Egypt's public foreign debt in 1990 was put modestly at \$34.2 billion. This debt was less than \$1.5 billion in 1970. It was twice as large as that of the Republic of Korea. By 1990, Kuwait accumulated a total external debt of \$34 billion. The debt of the Syrian Arab Republic amounted to \$16 billion and that of Jordan to \$7.5 billion. External debt as a ratio of exports is over 180% for all the Arab countries in 1990. It was over 52.6% of the region's GNP in the same year. The latter ratio is the highest for all developing regions except sub-Saharan Africa. Servicing the debt exacts a heavy toll from the economy. Measured as a percentage of exports, it exceeded 24.4% in 1990, rising from 16.4% in 1980. Interest payments alone on this debt absorb 8.1% of the export proceeds of the region. The average effective interest rate on this debt was 7.7% in 1990; it was about one percentage point above the average interest rate charged on the external debts of low- and middle-income countries. The average maturity of Arab external debt was 13 years, compared with 18 years for low- and middle-income countries in 1990. The maturity average was 17 years in 1970. This suggests that the burden of external indebtedness in the region is rising. Debts have to be paid more rapidly, the interest rates are higher and the export income from which payments can be effected is falling.

²⁴ Jeffrey Sachs and Andrew Warner of Harvard's Institute for International Development document the evidence that over the long run, exports of natural resources are negatively correlated with high growth. *The New York Times*, 21 September 1995.

- *High levels of illiteracy, particularly among females, as well as low levels of education among the labour force*
- *Large, excessive and perhaps wasteful expenditures on military hardware and systems*
- *Very high overall GDP growth rates in the ESCWA region between 1965 and 1980. Only East Asia and the Pacific showed higher rates. These high rates were apparently triggered by high oil prices. GDP growth rates slipped to less than 0.5% between 1980 and 1990, the lowest performance among all regional groups of developing countries. Very low growth rates in industry are responsible for this dismal performance, but again, the main reason is the drastic fall in oil prices and the major declines in the incomes of the oil-rich Gulf States.*
- *The food imports of the ESCWA region, the largest among all regions in the developing world. Most ESCWA member countries also received high levels of food aid. Fertilizer consumption per hectare, which proxies for modern agriculture, is below the average of low-and middle-income countries. Food production indices show below-average production increases in the region, with 1979/1981 as the base.*
- *Growth of public consumption at unprecedented rates in the 1970s, supported by oil revenues and aid from oil-rich countries. All these rates declined drastically between 1980 and 1990. Private consumption growth rates increased between 1965 and 1980, and then the rate of growth declined between 1980 and 1990. The rate of decline in private consumption was significantly less pronounced than that in public consumption during the same period. The most dramatic economic difficulty is reflected in the negative growth rates of gross domestic investment. The excessive reliance of most ESCWA member countries on external sources of finance to support their domestic investment is responsible for the negative growth rates in investment.*
- *The export-oriented nature of all ESCWA region economies. The foreign trade percentage (exports plus imports as percentage of GDP) is very high. Arab oil-producing countries typically show export shares that exceed 40% and even 60%. Non-oil-based Arab economies are also highly exposed to trade. This exposure, measured by the share of exports of goods or nonfactor incomes (exporting the producer) in GDP, is also relatively high. It is perhaps important to note that the high share of exports to GDP is more the result of nonfactor incomes than the exports of merchandise.*

- *Decline in the terms of trade and export.* While exports from East Asia and the Pacific grew at 9.8% annually between 1980 and 1990, they declined in the Arab region at the rate of 1.1% per year. Taking 1987 as the base year, the terms of trade (ratio of export prices to import prices) declined from 130% in 1985 to 96% in 1990. The slide has continued into the mid-1990s. Most regions of the developing world experienced similar declines in their terms of trade but none as severe as that of the Arab region.

(b) *Structural problems in manufacturing*

The following can be said about the structural problems that have negatively affected the development of the manufacturing sector:

- *Low levels of research and development and slow rates of technological diffusion.* Egypt is one Arab country that has mounted a credible research and development programme, but it underperforms its competitors in the third world and is far below the record of developed countries. ESCWA member countries have shown a perverse tendency to pursue turnkey technological projects with limited or no transfer of technical knowledge to the local labour market. There is also in several ESCWA member countries slowness in adopting new technologies.
- *Lack of established clusters of firms.* It has become widely recognized that over the long run, sustainable competitive advantages develop in clusters of linked industries. The industrial structures of ESCWA member countries are typically fragmented and weakly articulated. There have been some successful attempts in building large industrial cities (for example, Yanbu and Jubail in Saudi Arabia), but much more is needed than building on technical affinities.
- *A shortage of medium-sized and large firms with a home base in the ESCWA region.* The branch plant organization of multinationals has often resulted in poor development of local skill and fewer spin-off industries than in other regions of the world. Small firms can not undertake research and development and are too fragile to compete in the increasingly globalized world markets.
- *Under-investment in training and slow adoption of flexible workplace organizations compared with other more advanced developing countries*
- *Inadequate financing for technology- and export-oriented companies*

- *Lopsided industrial structures.* Many of the region's economies cannot on their own provide for sustainable investment nor do they have the ability to create an environment that would provide local opportunities for local labour.
- *Relatively modest manufacturing activity in most ESCWA member countries.* The region seems to depend rather strongly on primary production, and manufacturing activity has remained limited or stagnant. Primary products accounted for over 98% of ESCWA members' exports in 1965. This share declined to 87% in 1990. This very excessive proportion indicated reliance on the export of oil. Machinery and equipment were less than 1% of total exports in 1965 and in 1990. Chemicals and refined petroleum exports increased, and so did textiles and clothing, but these increases remained modest, particularly in comparison with other successful developing regions. For most regions, exports of machinery and transport equipment increased between 1965 and 1990, but this was not true of the ESCWA region.
- *Per capita manufacturing value added in the region that is below the average of low- and middle-income countries.* It is significantly below Latin American and Caribbean countries, for example.
- *Domination by textiles, clothing, agro-food and chemicals in the ESCWA region's manufacturing sector.* Machinery and transport equipment manufacturing show very low shares by all standards.
- *Drastic drop in total factor productivity (residuals in production functions) and partial factor productivity (average input productivity) in textiles and in engineering manufacturing in Egypt between 1980 and 1990.* Both indicators were rising in the 1970s. Comparable data in the rest of the Arab world is not available, but the experience of other Arab countries in this regard is likely to be the same as that of Egypt.

In conclusion, the economies of the ESCWA member countries today, as in 1970, lack diversity. Oil exports are still the exclusive economic engine of the region. Rentierism is a widespread phenomenon and is not restricted to the oil-rich countries. There is now a secondary dependence on oil revenues throughout the region. Exports of manufactured renewable commodities and services contribute very modestly to the external sources of finance of all Arab countries. Non-oil-producing ESCWA member countries have exported their producers to the Gulf and have enjoyed the convenience of remittances at the expense of the development of domestic exports. Manufacturing activity outside oil is limited, disarticulated, traditional, inward-looking and

technologically dependent on outside sources. Only limited technological capabilities have developed within the region, and there is strong preference for turnkey projects. Expenditures on research and development are modest if not totally absent. Regional cooperation is a slogan without any real economic transactions behind it. Most ESCWA member countries are linking up with non-Arab economic centres with little or no concern for their Arab neighbours. External indebtedness is massive and is beginning to sap the energies of the region. The ESCWA region is still gambling on "sunset" industries and old Fordist and smokestack manufacturing activities. There is little evidence of the new economy in the industrial structures of most Western Asia economies. Domestic savings are inadequate; they rarely finance investment. High and unproductive consumption habits have been staunchly ingrained in the operating systems of most Arab societies. Illiteracy is still excessively high. Mean years of schooling have increased but remain far below other successful developing countries. Industrial policies are either too stringent or absent altogether.

Surely these are serious problems, and there is little that an industrial policy framework can do to deal with them. However, an appreciation of what went wrong and the acknowledgement that simplistic and borrowed solutions will not suffice is critical for reversing the negative operating mechanism of the region's slow-down and underdevelopment.

(c) A framework for an industrial strategy

The future of the Western Asia economy depends on collective action and on how Governments, business, investors, workers and communities respond to the challenges before them.

There is a critical need for broad-based agreement among the countries of the region on what it takes to succeed in the global economy. They need a common sense of purpose and a shared vision that will help them improve their productivity, their competitiveness in the world, their structures and institutions and the overall standard of living of the common people. Individual State action is necessary but not sufficient; it will always be small and insignificant in today's global world markets, next to today's giant multinationals. ESCWA member countries need a collective, cooperative and innovative industrial policy as part of a broader economic renewal agenda. This effort is not about setting out elaborate blueprints for the economy, nor is it about establishing an array of expensive government programmes. Rather, it is about providing a framework that enables all segments of society to work together as partners. Grand schemes and large government programmes did not bear the fruits they were supposed to in this region. While some of these blueprints and grand schemes were necessary at the earlier stages of development, they are no longer workable. Development is too complex a process for a single sector or scheme to carry through.

The need for a new industrial framework stems from four basic factors:

- The global economic environment is changing.
- The Arab economy must overcome some severe structural problems
- New competitive advantages must be created
- Critical masses in strategic domains must be established.

(i) *Strengthening competitive fundamentals*

The ESCWA region needs to move away from the rentier economies that emerged from the increase in oil revenues in the 1970s: what constituted an advantage in the past could become a constraining factor in the future. The economy of the region must be anchored on a diversified industrial structure and on high-productivity activities sustaining high-value-added and renewable production. This will increasingly depend on building capabilities for innovation, as well as entrepreneurial and technical skills, and on a full-fledged and deliberate entry into the new economy.

To move into high-value-added and renewable production, the countries of the region must build and strengthen their competitive fundamentals. These call for both macroeconomic and sectoral policies outside the industrial sector. The latter will not take root in the economy of the region without the accommodating influence of a favourable macroeconomic environment that includes:

- Massive literacy campaigns
- Improving, balancing and reforming the education systems
- Serious de-bureaucratization and reduction of administrative procedures
- Empowerment of the private sector and community initiatives through partnerships with the public sector
- Effective policies and institution-building to encourage and develop domestic savings
- Raising skill levels (learning by doing and massive training programmes)
- Increasing domestic technological capabilities (building centres of excellence and technological incubators)

- Developing linkages and networks within each State and among Arab States
- Building international capabilities
- Increasing the share of the new economy
- Continuous innovation

Each one of these elements is a subject requiring extensive research. What is intended here is a general outline of the fundamentals that have to be debated. These variables have been selected because they are proven ingredients in the success of other advanced and rapidly developing countries: they address directly observed weaknesses in the Western Asia economies; they build on the region's strengths as a means to meet the challenges facing it; and they create large indirect and spin-off benefits throughout the region's economies.

Focusing on the competitive fundamentals and increasing value-added activities that are divorced from natural resource dependency have implications for change throughout the economy—for business, for sectors, for individual State Governments, for regional institutions and for the region's economy and society as a whole.

Governments will still have to act in the following critical areas that can make for a competitive society:

- Changing the role and composition of investment by placing more emphasis on investment in human resources: investing in people, training and knowledge
- Changing the way the public sector relates to the private sector: emphasizing development of sectoral strategies, strategic groups of companies, community initiatives and regional cooperation
- Changing methods of managing economic change: finding winners and creating flexible systems for a more adaptable economy
- Changing the structure of bureaucracy: emphasizing efficiency, merit, accountability, transparency and integrity
- Changing the balance of power between the public sector and civil society: emphasizing balance and empowerment of institutions that mediate between the State and the citizens

(ii) *Increasing value-added content*

Although Governments have a vital role to play in the economic development process, they alone cannot make the policy work. There should be a collective approach in order to develop an economy with the capacity to upgrade and move continuously to higher value added so as to be compatible with the newer realms of the international economy.

The industrial policy defined here is not a budget, nor a short-term stabilization policy nor even a plan. It is a framework that is intended to create a shared vision and a common sense of direction to shape the way all segments of the economy and society can work together.

Value added is the difference between an industry's total sales and the cost of raw materials and the goods and services it buys from other industries. The higher the value added, the larger the income that can be shared by business, labour and Government. Companies can increase their value added by becoming more efficient and reducing unit costs. Alternatively, they can produce something that is worth more to their customers. Higher value-added-activities include continuous improvements in design and engineering, research and development, training, marketing, quality control and customer service. Other activities such as organizational innovations, greater workplace flexibility, adoption of state-of-the-art technologies and reducing cycle times can dramatically reduce cost or material inputs and thereby increase value added.

Moving into higher value added is not a one-time event or a destination. It is a process. Higher value added is the result of both doing different things and doing them differently. In the ESCWA region, moving into higher value added takes the following principal directions:

- Moving away from exclusive dependence on oil and oil-related production. There is indeed higher value added in moving upstream and downstream in oil processing, and this should be exploited. But the ESCWA region should also increasingly move away from oil and from its dependence on natural resources. This is needed to diversify economic structures, markets, technological capabilities and skills and to circumvent rampant rentierism in the Arab economy.
- Developing a stronger presence in the new economy, where industries grow rapidly, are less volatile and create new knowledge
- Emphasizing renewability (sustainability). It does not make any sense to build industrial foundations on a nonrenewable resource that will disappear in the lifetime of the present generation's grandchildren.

- Moving into higher value added will require a great deal of research and development and an emphasis on technological capabilities. These are precisely the areas in which a fundamental structural weakness exists in the region's economy of today.
- It is to be noted that depending on low wages to compete on the world market is no longer possible. Most wages in the region are under pressure from wages and alternative employment in the Gulf that are relatively high.

Moving to a more diversified and higher-value-added economy is not a matter of Governments deciding which industries are going to be "winners" in the future and which are going to be "losers." The higher value added concept is relevant to all participants in the economy. Indeed, ESCWA member countries will have to encourage the shift to higher value added by strengthening their competitive fundamentals. This shift also depends on creating the appropriate economic environment for entrepreneurial growth and choice. It is promoted as well by increasing knowledge about the new economy, and also by furthering the development of local and regional technological capacities and strengthening the region's technological infrastructures by promoting Arab centres of excellence in technology. These centres can be housed in universities or even manufacturing institutes. Governments all over the world are nurturing and promoting the development and spread of technological incubators, where small inventions are developed and transferred to the market. Developing technological capabilities is not divorced from technological diffusion. It is typically the case even in the most advanced economies that individual companies do not invest in the R&D that is optimal for the economy. Governments are called upon to support these initiatives. Tax holidays have proven less efficient than direct support, including direct support for the creation of centres of excellence or technological incubators.

(iii) Adopting a new policy towards transnationals

Foreign investment may or may not be totally and unequivocally beneficial to the national economy. It is beneficial to the extent that it develops home-based activities for branch plants of transnationals in the region. Global corporations sometimes have multiple home bases—various countries are the home base for different lines of business. Transnationals should produce sufficient benefits in the domestic economy. These benefits tend to rise when these transnationals give "product mandates" or some similar arrangement to their branches in the region. In the absence of meaningful Arab economic cooperation and integration, there are no real chances for meaningful and productive foreign investment in the Arab world.

Split production (where developing countries obtain the manufacturing of a fraction of a product), the abuse of political favours, tax holidays, and treating developing countries as environmental sinks have reduced the benefits of foreign investment and transnationals in the pursuit of higher-value-added renewable production. It is hoped that countries of the region will insist on product mandates and home-based manufacturing from the transnationals. It is only then that branches of transnationals will accelerate economic development by expanding the pool of technology skills available to other industries in the ESCWA region. In addition, home-based companies help create strong linkages with other local or regional Arab companies and sectors in their drive to innovate continuously, and they are more likely to demand and support innovation from their local or regional Arab suppliers and to have valuable information on future industry developments to share with other firms.

An Arab investment development office should be established to negotiate with foreign investors on behalf of the region to reduce harmful and injurious competition among the Arabs for the same investors and to derive more accommodating conditions for the benefit of the local economies.

(iv) *Strengthening regional cooperation*

Medium- and large-sized enterprises have shown a stronger tendency to engage in R&D and to innovate. There are not many firms with the appropriate size in the ESCWA region. This is because most State economies among ESCWA member countries are too small to permit efficient scales of production. Enterprises in the region are small because state markets are small. Moving to world markets would require more than efficiencies in size, although this latter factor is also essential for other competitive advantages. Creating networks and linkages among firms can be an indirect way of overcoming size difficulties. Networks of linked firms, industries and institutions could achieve competitive advantage more readily than an individual firm or industry. Such networks would be characterized by an interplay of competitive and cooperative relationships, which would help to create competitive advantage by stimulating technology transfer, continuous innovation and skill development and training. The synergies generated through cooperation among firms and institutions could spark new cooperative initiatives among ESCWA member countries, create vested interest in regional cooperation and cement the integration of markets and energies. Through cooperation, companies could carry out projects or make investments that would be too large or ineffective for a single firm to tackle alone. Cooperation would enable firms to undertake complementary initiatives and make mutually reinforcing investments. Information flows that guide strategic decisions are also accelerated through linkages and networks. Networks tend to agglomerate together and spawn new supporting initiatives. Although linkages offer many benefits to companies, Arab companies have not fully capitalized on these potential benefits, as few linkages have been established so far.

The countries of the region should develop sector partnership funds and other sectoral initiatives among regional private sectors to consolidate their networks and intensify their contacts. More public investment in network-specific types of infrastructure will be needed, particularly in the informational infrastructure.

Small enterprises face particular difficulties in building international capabilities because of the lack of information, know-how and investment funds. The long-term success and growth of these firms frequently depends on their taking advantage of international trade, investment and technology-acquisition opportunities. ESCWA member countries should therefore establish trade promotion offices in key international locations or use their embassies for such functions. However, this presupposes a development of alliances among companies across States to share marketing campaigns, know-how and information. Alliances here should involve foreign firms. It is these alliances that provide access to international markets and new technologies.

(d) Summary and conclusion

Natural resource dependency has reduced ESCWA member countries' incentive to diversify their economies, develop alternative manufacturing capacities, promote export-oriented industries, encourage domestic savings and anchor income on solid productivity grounds. Traditional economic activities and structures have been maintained. Dependence on external sources of finance has deepened and economic performance has slipped. Although large oil revenues brought about significant improvements in health, education and infrastructure throughout the ESCWA region, they diminished the incentive to capitalize on these achievements. The region's economic performance in the 1980s is symptomatic of an "Arab disease" that is more fundamentally damaging than the "Dutch disease" that afflicted Holland in the 1940s following the discovery and commercialization of natural gas. ESCWA member countries have weak manufacturing structures, high illiteracy rates, limited industrial skills, poor savings ratios, low levels of manufacturing exports, inadequate R&D, high indebtedness, small companies with limited international experience, limited regional cooperation and trade, heavy dependence on Government, inefficient bureaucracies, limited private-sector participation, and above all a very unfavourable and hostile international economic environment. The region's competitive fundamentals are weak and deficient. However, negative economic trends can be reversed; the required effort is massive and the conditions are unfavourable, but it can be done.

The framework for an industrial strategy developed here calls for cooperative efforts among all participants in the economy and among ESCWA member countries. Regional cooperation is vital. Synergies among industries are critical. Moving into higher-value-added activities is imperative. Rentierism must be cleansed from the operating mechanisms of the society and economy. A necessary condition for a more secure and sustainable future is a proper balancing of production structures, regional allocations of investment, income and consumption, domestic savings and investment, and

incomes and production. Reducing dependence on natural resources calls for supplementing the rent on these resources with other sources of income, particularly from renewable sources of production. Knowledge-based industries are key activities to consider for the future. Networks and linkages must be forged among firms and States. Collective action in the face of the region's diminishing political and economic bargaining power is a prudent option.

The framework is neither a blueprint for the economy nor a government programme. It is above all a brutal diagnosis of the region's economic failures of the 1980s and an attempt to sketch a vision of a common purpose for all to work harmoniously together. ESCWA member countries have perfected individual action, particularistic pursuits and the fragmentation of effort. The challenges are difficult and many but the rewards of success would be substantial. The price of failure is subordination and dependency.

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Part Two

THE INTERNATIONAL SETTING

II. THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS AND THEIR EFFECT ON ESCWA MEMBER COUNTRIES

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A. HISTORICAL BACKGROUND

The decision to launch a new round of GATT multilateral trade negotiations (MTNs) was taken in September 1986, when ministers meeting during a special session of the Contracting Parties at Punta del Este adopted the Ministerial Declaration on the Uruguay Round. This initiative was preceded by long and difficult preparatory negotiations. When the idea of embarking on a new round of MTNs emerged soon after the 1982 GATT Ministerial Meeting, it was not favoured by developing countries, which saw the implementation of the commitments provided for in the 1982 work programme as a prerequisite for initiating a new negotiating process; they also opposed the introduction of services and other new issues and sectors under the aegis of GATT. It took the Contracting Parties several years of consultations, followed by tough bargaining in the Preparatory Committee (November 1985), to have their trade policy priorities included in the agenda and to reach a decision on the launching of a new round.

The negotiating structure for the Uruguay Round reflected the complexity and variety of the issues to be addressed. At the top of the pyramid was the Trade Negotiating Committee (TNC), designated as the principal body for supervising the negotiations and providing guidelines for the activities of the Group for Negotiations on Goods (GNG) and the Group for Negotiations on Services (GNS). Actual negotiations on trade in goods were carried out by the Fourteen Individual Negotiating Groups, which covered each of the subjects listed in part one of the Uruguay Round Declaration; these groups reported to the GNG and sought its advice. Negotiations on trade in services, covered by part two of the Punta del Este mandate, were conducted by the GNS. It was also agreed that the implementation of the standstill and rollback commitments would be monitored by a surveillance body established for that purpose.

The Uruguay Round was unique in the history of GATT both in its coverage of issues and in the related complexity of its negotiating structure. The negotiations were launched against the background of commitments by all participants not to introduce new trade restriction measures (as per GATT provisions) and to gradually phase out existing ones. The Uruguay Round inherited a number of deep-rooted problems which could not be effectively addressed at the Tokyo Round or in the subsequent work programmes adopted by the Contracting Parties. It was recognized that the lack or inadequacy of multilateral trade-related disciplines in such areas as agriculture, textiles and subsidies bore

heavily on multilateral relations and constituted one of the principle causes of the erosion of the multilateral trading system.

The scope of the Uruguay Round extended beyond the traditional issues covered in previous multilateral trade negotiations, which primarily addressed the reduction of barriers against trade in goods at country borders. Sectors of particular and priority concern to developing countries were included in the negotiations, as were new sectors related to the evolving international structures of production and trade, including the movement of capital in the form of foreign investment, the development of new technologies, and the production of services including the movement of labour. The outcome has already significantly influenced the patterns of trade, competition, production, investments, domestic regulations and so on. The results of the Uruguay Round will therefore have a profound effect on developing country interests and on their prospects for accelerating their development processes.

Contained in the ministerial declaration launching the Uruguay Round were a number of general principles governing negotiations (the need for transparency and for balanced concessions within a broad range of trade-related areas were underlined), but there were also several specific provisions incorporated to safeguard the interests of developing countries and to improve their negotiating prospects:

- The principle of differential and more favourable treatment and other GATT provisions were applied to the outcome of the negotiations.
- Developing countries were not expected to make concessions inconsistent with their individual development, financial or trade-related needs.
- Any increases in a developing country's concessions would result in the progressive development of its economy and improvement in its trade situation.

While the different developing countries emphasized individual subjects and issues of interest to them (including agriculture, textiles and services), they all accorded top priority to obtaining more liberal and secure access to the markets of developed countries, seeking specific concessions with respect to tariffs and non-tariff measures and the strengthening of multilateral rules, principles and disciplines to reduce restrictions on their trade.

During the negotiations, developing countries emphasized the need to strengthen the multilateral trading system and protect trade liberalization through:

- Full respect for the principle of non-discrimination, including the automatic and unconditional application of most-favoured-nation treatment
- The effective contribution of the international trading system to their development processes (allowing developing countries flexibility in their use of trade measures and allowing them to expand their exports in international markets)
- The prohibition of market-sharing and managed trade arrangements
- The prohibition of any unilateral actions outside the legal framework of the General Agreement on Tariffs and Trade
- The strengthening of the dispute settlement system

The Final Act Incorporating the Results of the Uruguay Round is the instrument which certifies that the entire set of agreements and schedules attached constitutes the results of the negotiations. By adopting the Final Act on 15 December 1993 and signing it at the ministerial level in Marrakesh on 15 April 1994, the participating countries made a commitment to place the results before their national authorities for final approval and ratification according to their respective constitutional procedures.

The implementation conference held on 8 December 1994 confirmed 1 January 1995 as the date the Marrakesh Agreement Establishing the World Trade Organization (the WTO Agreement) would enter into force. More than 100 countries, including Bahrain, Egypt, Kuwait, Qatar and the United Arab Emirates from the ESCWA region, completed this step necessary to become WTO Members.

B. THE RESULTS OF THE URUGUAY ROUND

1. The WTO Agreement

The WTO Agreement creates a common institutional framework that encompasses the General Agreement on Tariffs and Trade as modified during the Uruguay Round (GATT 1994), all the agreements and instruments concluded under its auspices, and the comprehensive results of the Round.

The highest-level body of the WTO is the Ministerial Conference, which meets at least once every two years. As provided for in the Agreement, the Ministerial Conference has established the Committee on Trade and Development, the Committee on Balance-of-Payments Restrictions, and the Committee on Budget, Finance and Administration. It is important to mention that the Committee on Trade and Development

must periodically examine the special provisions in the agreements which favour least developed countries (LDCs) and submit reports to the General Council for the adoption of appropriate measures.

The General Council is in charge of supervising the implementation of the WTO Agreement and the application of the ministerial decisions, and meets as appropriate. The General Council has the authority to deal with all trade-related issues covered by the Final Act and to set up subsidiary bodies. The Council for Trade in Goods, the Council for Trade in Services, and the Council for Trade-Related Aspects of Intellectual Property Rights have been established and operate under the general guidance of the General Council. The General Council also discharges the responsibilities of the Dispute Settlement Body and the Trade Policy Review Body.

The main functions of the WTO are as follows:

- To facilitate the implementation and administration of the WTO Agreement and to promote the achievement of its objectives
- To provide a forum for future negotiations within the multilateral trading system
- To administer the settlement of disputes
- To administer the trade policy review mechanism
- To cooperate with the International Monetary Fund, the World Bank and related bodies

With the establishment of the WTO substantial modifications have been introduced in the overall system of rights and obligations. Contracting Parties to GATT 1947 wishing to become Members of the WTO are required to accept all of the multilateral trade agreements¹ in the Final Act without reservation,² and to submit country schedules of tariff concessions and specific sectoral concessions for trade in services.

Most of the ESCWA member countries were not Contracting Parties to GATT 1947; before and during the Uruguay Round negotiations, Egypt and Kuwait were the only two. The main reason for this may be that the major countries of the region had no need to secure increased market access; most of them have traditionally relied upon crude oil,

¹ See annex I to the present report.

² Except the four plurilateral agreements (see annex I to the present report).

a few agricultural products, and a limited number of industrial items as their main export commodities.

Between the end of the 1980s and the beginning of the 1990s most of the ESCWA member countries began to consider joining the multilateral trading system; many of them adopted market-oriented economic policies and started implementing national plans for economic reform. These plans aimed at the liberalization of foreign trade, with export promotion one of the main targets of the reform. In the meantime, the outcome of the Uruguay Round encouraged many countries in the region to apply for GATT/ WTO membership.

Kuwait joined GATT in 1963 and Egypt in 1970, and both countries participated in the Uruguay Round negotiations; Bahrain, Qatar and the United Arab Emirates were *de facto* members and joined GATT between the end of 1993 and early 1994. All five of these ESCWA member countries signed the Final Act in April of 1994. Saudi Arabia, Jordan and Lebanon have applied to become WTO Members, and a working group has been established for the negotiation of their accession. Yemen has been considered a *de facto* GATT member for some time.

2. Tariffs

Tariffs are of particular interest to many developing and least developed countries, including those in the ESCWA region.

A considerable number of ESCWA member countries have not joined the WTO. However, the issues of market access and international trade have a direct impact on all countries, and non-WTO Members may be more seriously affected than WTO Members by tariffs and non-tariff measures. All of the ESCWA member countries will be affected by the provisions of the agriculture, textile and clothing, and other Uruguay Round agreements.

Previous rounds of GATT negotiations succeeded in reducing the import tariff levels maintained by industrialized countries. As a result of the Uruguay Round negotiations, global tariff levels will be reduced by an estimated 33% to 40%, bringing the industrialized countries' tariff levels down from between 5% and 6% to an average of 3% to 4%. While this percentage reduction in the overall tariff level is large, the value of the actual tariffs in developed countries is quite low, so tariffs cannot be considered a trade barrier. The achievements of the Uruguay Round with respect to trade liberalization fall more in the area of non-tariff measures, whose incidence has been increasing in recent years (past negotiations failed to produce any satisfactory results in this regard).

Preliminary studies have confirmed that some ESCWA member countries will experience an erosion of their preference margins for most of their exports to industrial

markets (under the Generalized System of Preferences, GSP); other countries have preferential agreements with the EU and will be similarly affected.

3. Non-tariff measures (NTMs)

During the Uruguay Round, the NTMs applied against certain product sectors (mainly agriculture and textiles) were dealt with, and the Tokyo Round Codes on NTMs such as subsidies and countervailing duties, technical barriers to trade, and customs valuation were revised. The Final Act contains separate agreements covering most of these issues, as well as two others related to rules of origin and preshipment inspection.

The Agreement on Preshipment Inspection recognizes the need to establish an international framework for the rights and obligations of both importing and exporting Members, and provides for transparency in the operations, laws and regulations related to preshipment inspection.

The Uruguay Round Agreement on Implementation of Article VI of GATT 1994 contains an improved anti-dumping code which strengthens the requirement for importing countries to establish a clear causal relationship between dumped imports and injury to the domestic industry. It is important to mention that anti-dumping cases will be dropped (i.e., not considered by the WTO Dispute Settlement Body) if the volume of dumped imports from the exporting country constitutes less than 3% of its exports of that commodity to a particular importing country.

The Agreement on Subsidies and Countervailing Measures prohibits most types of export subsidies; however, there are certain exceptions. WTO Members whose per capita income levels amount to less than \$1,000 a year are not required to remove such subsidies on products whose share in world trade is less than 3.25%; this applies to most of the countries of the ESCWA region and to a number of other developing countries as well.

4. Agriculture

One important output of the Uruguay Round was an agreement formulated to liberalize trade in agriculture, a sector which has been highly protected through the extensive use of subsidies, tariffs and non-tariff measures.

There are commitments to reduce domestic support for agriculture. Domestic support for products, as determined by the aggregate measurement of support (AMS), should be reduced if it exceeds 5% of the value of production (10% for developing countries). It is important to mention that developing countries are exempt from this commitment in the areas of investment subsidies and agricultural input subsidies for low-income or poor producers. There are a number of domestic support policies to which

reduction commitments do not apply; the government service programmes included in this category relate to research, pest and disease control, training, extension and advisory services, inspection, marketing and promotion, and infrastructural services.

There are specific commitments for countries to open up their import markets through tariff reductions and to eliminate all border measures which restrict imports. Developing countries have two thirds of the reduction commitments of developed countries and a longer application period (10 years instead of the six years for developed countries).

Export subsidies on agricultural products have to be reduced over a six-year period to the extent of 36% on budgetary outlays and 21% on quantities benefiting from such subsidies. Developing countries have to undertake smaller reductions of 24% and 16% respectively over a 10-year period and do not have to reduce subsidies related to export marketing costs.

Most ESCWA member countries, as net importers of food and other agricultural products, will be affected by the agricultural reform programme: food import prices are expected to be higher over the short term owing to the reductions in domestic and export subsidies in developed countries. On the other hand, over the long term the programme may allow ESCWA member countries to enhance their production, which will affect price trends. After the Marrakesh meeting, the Food and Agriculture Organization of the United Nations (FAO) began to review estimates of the additions to the food import bills for these countries. Previous studies conducted by international bodies and some individual countries need to be revised—with the final schedules of reduction commitments considered item by item—to reflect more realistic figures. The results of the revised studies are important for decision makers.

A ministerial decision on measures concerning the possible negative effects of the Agreement on net food importing countries is intended to provide a mechanism to assist adversely affected countries. Although this decision lacks a concrete mechanism and operational guidelines, it is notable that the international community has recognized the problem and the need to negotiate related details during the implementation of this decision. Non-WTO Members will not be able to benefit from this compensation mechanism.

5. Textiles and clothing

International trade in textiles and clothing has been constrained for a number of decades by the Arrangement Regarding International Trade in Textiles (also known as the Multi-fibre Arrangement, or MFA), under which industrialized countries have protected their domestic textile and clothing sectors by imposing quotas on imports from

developing countries. Major textile exporters in the ESCWA region have quotas on some of their yarn, textile and clothing exports to the United States, the European Community and some of the other Organization for Economic Cooperation and Development (OECD) countries.

A major achievement of the Uruguay Round is the Agreement on Textiles and Clothing, which provides for the gradual integration of this sector into GATT. In other words, the MFA will be phased out, with integration occurring in four stages over a period of 10 years (1995-2000). The 10-year transition period provides some lead time for textile and clothing exporting countries in the ESCWA region—and those in other regions—to improve their competitiveness. Policy makers should take anticipatory steps during the transitional period, as they may not be able to take full advantage of certain opportunities once the MFA has been completely eliminated. All ESCWA member countries are small suppliers (the textile exports of each country do not amount to more than 1.2% of a country's imports of textiles), so they can benefit from the higher growth rate for the remaining quotas during the 10-year transition period.

ESCWA member countries that have not joined the WTO are at a disadvantage, as the Uruguay Round agreements constitute commitments between Members only; for this reason, importers may not consider the elimination of quotas on textiles and clothing exported by non-WTO Members.

6. Trade in services

The objective of establishing a multilateral framework of principles and rules for trade in services and for the liberalization of trade in this sector was achieved through the General Agreement on Trade in Services (GATS). The Agreement covers trade in services which occurs within the context of the following modes of delivery:

- Cross-border supply
- Consumption abroad
- Commercial presence
- The presence of natural persons

An important general obligation under the GATS is the provision of most-favoured-nation (MFN) treatment for the services and service suppliers of any WTO Member country. Members have also agreed to progressively liberalize their imports of services to improve market access, and to make their laws and regulations relating to the services sector more transparent. The GATS provides for the progressive liberalization of trade in services through the scheduling of commitments. Market access and national treatment provisions apply to the service activities specified in the schedules of commitments and are subject to the terms and conditions specified therein. The GATS explicitly provides for future rounds of negotiations with a view to achieving

progressively higher levels of liberalization; the first round is to commence within five years of the entry into force of the Agreement.

None of the services sectors are excluded from the scope of the Agreement; however, during the Uruguay Round negotiations the participants were free to specify the services for which they would provide market access and national treatment. As a result, there are important differences in the coverage of the various participants' schedules. The schedules of the major developed country participants, for example, cover almost all sectors, with exceptions in some areas such as maritime transport and audiovisual services. The sectoral coverage of commitments is generally lower for developing countries than it is for developed countries.³ Tourism-related services have the highest level of commitments, reflecting the current importance of this sector to the foreign exchange earnings of many developing countries. Some developing countries have also made commitments regarding financial services, business services and construction services. Negotiations are currently under way to expand existing commitments related to maritime transport, financial services and the movement of natural persons. Basic telecommunications, with respect to which it was generally agreed that commitments would not be made in this Round, are the subject of ongoing negotiations as well.

7. Trade-related aspects of intellectual property rights

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) was motivated by a desire to reduce distortions in international competition resulting from widely varying standards in the protection and enforcement of intellectual property rights and from the lack of a multilateral framework of principles, rules and disciplines applicable to international trade in counterfeit goods. The TRIPs Agreement will be implemented during transition periods of one year for developed countries and five years for developing countries (a 10-year transition period also applies under particular circumstances outlined in the Agreement).

Subject to limited exceptions, WTO Members must accord one another national and MFN treatment. The Agreement specifies minimum substantive standards of protection (building on those in the Paris Convention for the Protection of Industrial Property and the Berne Convention for the Protection of Literary and Artistic Works) with respect to: copyright and related rights applicable to various types of works including computer programs, databases, sound recordings and films; trademarks and service marks; geographical indications including appellations of origin; patents; industrial designs; the layout-designs of integrated circuits; and undisclosed information including trade secrets.

³ See annex II for the specific commitments of ESCWA member countries that belong to the WTO.

WTO Members must provide procedures and remedies under their domestic laws to ensure that intellectual property rights can be effectively enforced for both domestic and foreign rights holders; specifically required are provisions regarding evidence, damages, injunctions and other civil remedies including the right of judicial authorities to order emergency provisional action to be taken, special border measures against the importation of counterfeit (trademark) and pirated (copyrighted) goods, and criminal action including imprisonment and/or fines to deter wilful counterfeiting and piracy on a commercial scale.

C. THE OUTCOME OF THE URUGUAY ROUND AND ITS PRELIMINARY IMPACT ON THE ESCWA MEMBER COUNTRIES

The Final Act (28 texts) reflects the wide range of issues negotiated in the Uruguay Round and the comprehensive coverage they received; this Round clearly represented the most ambitious effort to negotiate the multilateral rules of international trade in the history of GATT. Uruguay Round coverage of the traditional area of trade in goods included sectors which had been accorded exceptional treatment in GATT for decades (agriculture and textiles), as well as completely new areas such as international trade in services and intellectual property rights. The new World Trade Organization is expected to establish and administer new international rules for these enlarged areas of activity.

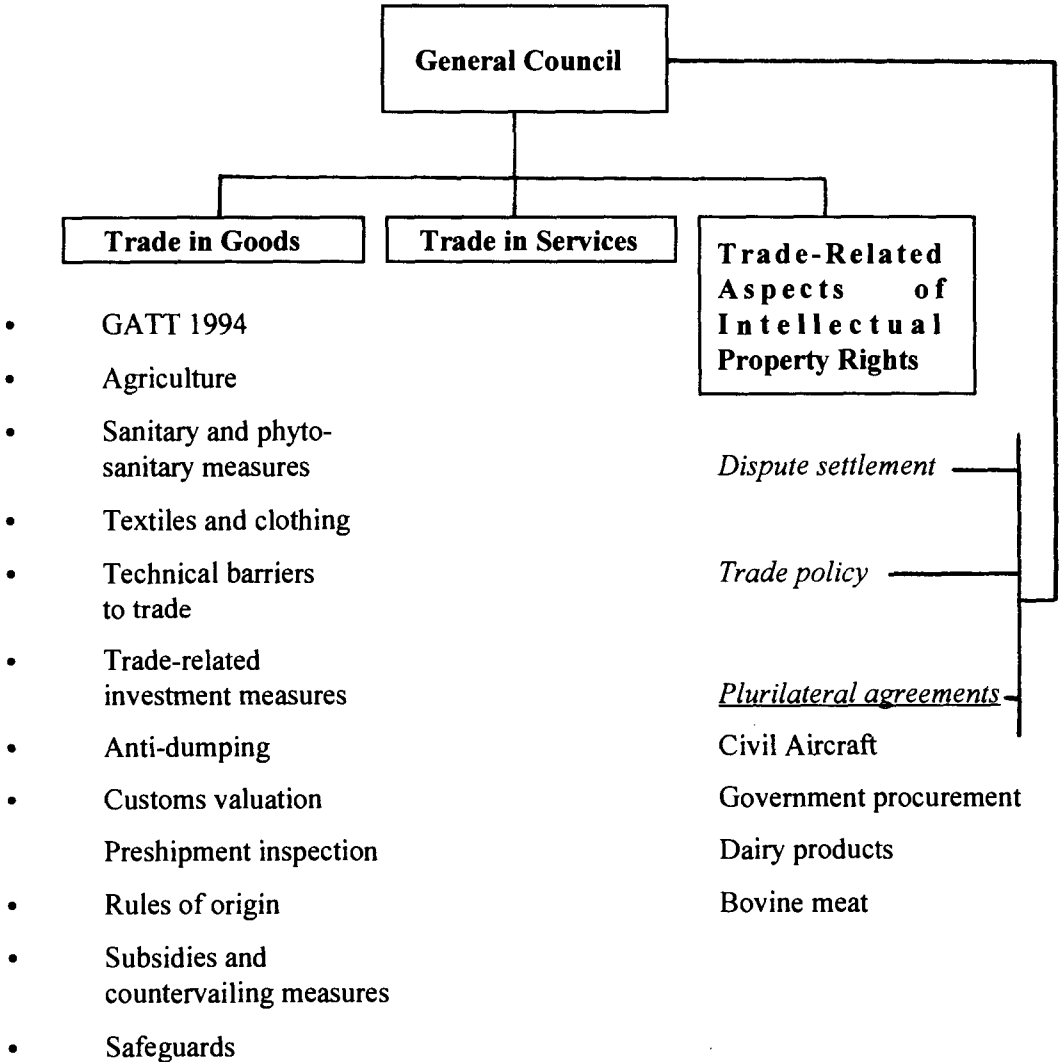
One of the main aims of this paper has been to provide a preliminary evaluation of the results of the Uruguay Round and their impact on ESCWA member countries. The most salient points in this regard include the following:

- Some of the countries of the ESCWA region are Members of WTO, while others are not (see annex III); however, it should be noted that the implementation of the Uruguay Round agreements will directly and/or indirectly affect both groups.
- Non-WTO Members will not be able to benefit from the increased market access associated with the tariff reductions and the elimination of non-tariff measures in sectors such as agriculture and textiles; in fact, they may even face more restrictions on their trade.
- Most of the ESCWA member countries are net food-importing countries and may therefore be negatively affected by the implementation of the Agreement on Agriculture in the short term, as the prices of agricultural products are expected to rise. However, the same countries are expected to gain from this scenario over the medium and the long term.

- All of the ESCWA member countries are either developing or least developed countries and are therefore eligible for special treatment in the provisions of all agreements.
- The textile and clothing sector is important for some ESCWA member countries. The Agreement on Textiles and Clothing aims to integrate this sector into the new world trading system, under which it is subject to the rules of fair competition.
- The specific commitments related to GATS among WTO Member countries of the ESCWA region can lead to increased investments in these areas, and can also facilitate the transfer of technology. The countries of the region should study the specific commitments of other Members with a view to promoting market access for their services sectors in the international market.
- The Agreement on Trade-Related Aspects of Intellectual Property Rights may have a negative impact on some industries in the ESCWA region (mainly in the area of patents, and particularly in relation to chemical and pharmaceutical products); however, it may also lead to increased foreign investments in these areas.
- In-depth studies must be carried out on the outcome of the Uruguay Round and its impact on various sectors of the economy in order to provide Governments and decision makers in the agriculture, industry and services sectors with the information they need to reach appropriate decisions.

Annex I

**WORLD TRADE ORGANIZATION:
FRAMEWORK AND AGREEMENTS**



Annex II

THE SUBJECTS OF SPECIFIC COMMITMENTS RELATED TO THE GENERAL AGREEMENT ON TRADE IN SERVICES AMONG THE ESCWA MEMBER COUNTRIES BELONGING TO THE WTO

- Bahrain:** Insurance, reinsurance
- Egypt:** Construction and engineering
Tourism
Banking, insurance and reinsurance, and capital market services
Maritime transport
- Kuwait:** Business construction and engineering
Environmental services
Health-related services
Tourism and travel
Recreational and sporting services
- Qatar and
United Arab
Emirates:** Business services
Communication services
Construction and related engineering
Environmental services
Financial services
Tourism and related services

Annex III

THE STATUS OF ESCWA MEMBER COUNTRIES *VIS-A-VIS* GATT/WTO

Contracting Parties

Bahrain
Egypt
Kuwait
Qatar
United Arab Emirates

Requesting accession

Jordan
Lebanon
Saudi Arabia

Non-Members

Iraq
Oman (*observer*)
Palestine
Syrian Arab Republic
Yemen (*de facto*)

III. THE IMPACT OF THE URUGUAY ROUND AGREEMENTS ON THE MANUFACTURED EXPORTS OF THE ESCWA MEMBER COUNTRIES

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Introduction

The present paper assesses the impact of the Uruguay Round agreements on the ESCWA member countries' exports of manufactured products. The assessment is made with reference to the liberalization achievements in industrial countries, and explores the issue of whether the agreements will bring about changes that will effectively provide exporters of manufactured products in the ESCWA region with more markets in industrial countries.

The paper is divided into five sections. The first section establishes the baseline scenario by identifying and analysing the trends that have underlined the ESCWA member countries' manufactured and total exports. The second section reviews the principal elements of the Uruguay Round negotiations and agreements that may have an impact on trade in manufactured products. The analysis then focuses, in the third section, on a quantitative assessment of the potential benefits of these agreements for the ESCWA region's exporters of manufactured goods. The fourth section provides a more complete analysis of the effects of the Uruguay Round by considering the other elements that will have an impact on international trade in goods. The last section concludes the study and offers some suggestions for further research.

The calculations done for this paper were carefully designed to reflect a comprehensive package of cuts in tariffs on trade in manufactured products in the Organization for Economic Cooperation and Development (OECD) markets. The results suggest that the implementation of the Uruguay Round agreements will lead to a net increase of \$178 million in the manufactured exports of ESCWA member countries to the main OECD markets, which represents a 4% expansion over 1993 exports. The technical limitations inherent in all exercises of this type are such that the net benefits have almost certainly been underestimated.

Indeed, there are good reasons to believe that the benefits to ESCWA member countries from the Uruguay Round will go well beyond what is quantifiable. In particular, quantitative studies do not take into account the effects of strengthening and extending General Agreement on Tariffs and Trade (GATT) rules and disciplines across new areas—thereby making competition fairer and more transparent, or the effects of easing bilateral trade tensions and associated political conflicts. Nor do they reflect the

advantages associated with the fuller integration of developing countries and former State trading economies into the multilateral system. Finally, the numerical results fail to reflect the benefits gained from the enhanced efficiency which will come about with the ESCWA member countries' own liberalization commitments (whether unilateral, regional or multilateral). The results here are reported with respect to gains in OECD markets, where ESCWA member countries exported some 42% of their combined 1992 total; excluded from the analysis are those countries for which reliable data are hard to come by.

A. TRENDS IN THE LEVEL AND STRUCTURE OF THE ESCWA REGION'S EXPORTS

Table 1 presents the trend for the ESCWA member countries' total exports from 1950 to 1992. It shows that the Gulf Cooperation Council (GCC) countries have been responsible for the bulk of the region's exports, with petroleum and related products dominating all other commodities. Moreover, the table reveals that the participation of ESCWA member countries in world trade did not change much between 1950 and 1992. In 1950, the ESCWA region's share in total world exports was 2.3%; this share remained reasonably steady throughout the years covered, except during short periods characterized by oil price booms. In contrast, the ESCWA member countries' share in total developing country exports rose during the period 1950-1992. This indicates that the exports of ESCWA member countries were more dynamic than those of all developing countries taken together, but less so in comparison with those of industrialized countries. Table 2 provides a clear indication of the underlying trends for the years 1980 and 1990, showing the number of commodities exported by selected ESCWA member countries,¹ the commodity diversification index, and the market concentration index (where 1 represents maximum concentration in both cases).

The diversification index indicates the degree to which a particular country's commodity shares have deviated from the world commodity structure. This index discriminates more precisely between countries that are relatively more diversified. It is evident that between 1980 and 1990, all of the ESCWA member countries for which data were available experienced a deterioration in their commodity diversification, in spite of the general increase in the absolute number of products exported; the commodity structure of the ESCWA member countries has thus diverged from the trend underlying the structure of world exports.

¹Number of products exported at the three-digit SITC, rev. 2 level; the figures include only those products which amounted to more than \$50,000 in 1980 or \$100,000 in 1991, or to more than 0.3% of the country's total exports.

Table 1. Total exports of individual ESCWA member countries, 1950-1991
(Millions of US dollars)

Country	1950	1960	1970	1975	1980	1985	1990	1991	1992
GCC countries	670	2 220	5 590	50 200	162 700	62 490	84 880	80 248	82 355
Bahrain	110	190	274	1 147	3 598	2 897	3 761	3 513	3 368
Kuwait	195	1 000	1 901	9 184	19 854	10 479	6 956	875	6 690
Oman	2	2	206	1 416	3 748	4 972	5 215	4 874	5 428
Qatar	21	126	236	1 809	5 711	3 541	3 529	3 107	3 600
Saudi Arabia	340	900	2 424	29 676	109 111	27 480	44 417	47 979	42 769
United Arab Emirates	3	2	550	6 970	20 678	13 124	21 000	19 900	20 500
Other ESCWA member countries	715	907	1 335	3 789	7 398	5 339	9 237	9 342	8 874
Egypt	513	568	762	1 402	3 046	1 838	2 582	3 618	3 071
Jordan	4	11	34	153	574	790	1 063	1 131	1 220
Lebanon	15	40	198	1 121	868	482	850	800	840
Syrian Arab Republic	70	110	203	930	2 108	1 637	4 062	3 143	3 093
Yemen	113	178	138	183	802	592	680	650	650
Total (a)	1 385	3 127	6 925	53 989	170 098	67 829	94 117	89 590	91 229
Memo items	1950	1960	1970	1975	1980	1985	1990	1991	1992
All developing countries (b)	18 900	28 300	57 900	214 800	573 500	456 500	743 000	777 500	830 200
World (c)	60 700	129 100	315 100	875 500	1 998 200	1 935 600	3 447 200	3 433 600	3 662 400
a/b (%)	7.3	11.0	12.0	25.1	29.7	14.9	12.7	11.5	11.0
a/c (%)	2.3	2.4	2.2	6.2	8.5	3.5	2.7	2.6	2.5

Source: United Nations, COMTRADE Database.

Note: Totals may not add up because of rounding.

Table 2. Export concentration and diversification indices for selected ESCWA member countries, 1980 and 1990

Country	1980			1990		
	(a)	(b)	(c)	(a)	(b)	(c)
Bahrain	58	0.77	0.79	110	0.87	0.75
Kuwait	189	0.70	0.73	79	0.71	0.51
Qatar	3	0.79	0.93	34	0.87	0.71
Saudi Arabia	183	0.76	0.94	169	0.85	0.79
United Arab Emirates	197	0.73	0.87	202	0.80	0.73
Egypt	80	0.67	0.58	154	0.70	0.44
Syrian Arab Republic	114	0.67	0.62	116	0.83	0.67

(a) Number of commodities exported.

(b) The diversification index calculates the absolute deviation of the country's commodity shares from the world structure, as follows:

$$S_j = \frac{\sum_i |h_{ij} - h_i|}{2}$$

Where: h_{ij} = share of commodity i in total exports of country j ; and h_i = share of commodity i in total world exports.

(c) The concentration index is the Herschmann index normalized to produce values ranging from 0 to 1 (maximum concentration), according to the following formula:

$$H_j = \frac{\sqrt{\sum_{i=1}^{239} \left(\frac{x_i}{X}\right)^2} - \sqrt{\frac{1}{239}}}{1 - \sqrt{\frac{1}{239}}}$$

Where: j = country index; x_i = value of exports of commodity i and X = the sum of i ; and 239 = the number of products at the three-digit SITC, rev. 2 level.

The concentration index, on the other hand, discriminates more precisely between countries which are relatively more concentrated in their export structure. With the exception of the Syrian Arab Republic, all of the countries covered in the table experienced moderate improvement in their export concentration. This means that the countries concerned are moving away from their over-dependence on a relatively small number of commodities. Unlike the diversification index, the concentration index takes into account the number of commodities exported by any one country in addition to the share of those products in total world exports.

Table 3 presents the 1992 distribution and destinations of the ESCWA member countries' exports by country grouping. The figures show how important OECD markets have been to the ESCWA member countries in terms of exports. There are a number of specific observations. First, 55% of GCC exports found their way to OECD markets, as opposed to 42% of those of the other ESCWA member countries. Second, within the OECD markets, Japan bought the lion's share of GCC country exports (29% of the OECD total), while the European Union (EU) received the bulk of the non-GCC ESCWA member countries' exports (31% of the OECD total). Third, most of the exports of Bahrain (82%), Lebanon (63%), Jordan (62%), Yemen (62%) and Oman (51%) found their way to other developing countries, most of which were in the region or elsewhere in Asia. Finally, the export interests of Qatar, the United Arab Emirates and Oman were highest in the Japanese market, while Saudi Arabia's export interests were evenly distributed among the major OECD partners (16% for the EU, 14% for North America, and 20% for Japan).

In 1993, OECD markets were the destination of some \$61.6 billion worth of exports from ESCWA member countries (see table 4, part A). Japan led the OECD countries, with a total of \$24.1 billion; the EU and the United States of America followed, with \$20.4 billion and \$12.7 billion respectively. Saudi Arabia contributed more than half (\$31.8 billion), followed by the United Arab Emirates (\$11.8 billion) and Kuwait (\$6 billion) (see table 4, part B). The table makes it clear that the export interests of the ESCWA member countries are heavily dependent on developments in the OECD markets—mainly those in Japan, the EU and the United States. Therefore, the conclusion of the Uruguay Round, the signing of the North American Free Trade Agreement (NAFTA), and the EU expansion together with its enhancement through association agreements all have direct implications for the export potential of the ESCWA member countries.

Table 3. Destination of ESCWA member countries' exports in 1992, by major country grouping
(Percentage)

Country	OECD countries (total)	European Union	North America	Japan	Other OECD countries	Developing countries	Others
<i>GCC countries</i>	55	13	10	29	3	43	2
Bahrain	17	3	3	11	1	82	1
Kuwait	51	24	7	19	1	42	7
Oman	40	2	3	35	0	51	10
Qatar	62	3	2	57	0	31	7
Saudi Arabia	55	16	14	20	4	44	1
United Arab Emirates	64	9	6	46	3	35	1
<i>Other ESCWA member countries</i>	42	31	5	2	6	36	21
Egypt	63	39	10	2	11	27	10
Jordan	13	5	2	2	5	62	26
Lebanon	32	10	8	0	13	63	5
Syrian Arab Republic	43	42	1	0	1	23	34
Yemen	38	23	8	7	0	62	
Total	53	15	9	26	3	42	4

Table 4. OECD countries' total imports from ESCWA member countries, 1980-1993
(Thousands of US dollars)

A. By OECD partner	1980	1985	1990	1991	1992	1993
Japan	35 366 575	26 456 897	25 922 425	25 552 192	25 705 573	24 079 386
United States	17 117 579	3 228 333	13 732 824	13 637 485	13 425 637	12 662 151
France	12 420 684	3 067 953	4 270 812	4 822 513	4 287 794	3 890 057
Italy	10 482 383	5 004 032	4 587 348	4 223 736	3 980 128	3 514 027
The Netherlands	7 190 478	2 078 446	2 880 498	3 062 958	2 934 051	3 447 736
United Kingdom	7 440 958	1 565 844	2 323 058	2 490 395	2 881 426	3 261 288
Germany (FRG)	8 057 258	1 927 054	2 913 434	2 514 133	2 541 485	2 349 553
Turkey	320 511	371 409	1 140 667	2 370 268	2 244 190	2 114 853
Spain	4 939 652	923 333	1 096 823	1 676 174	1 748 320	1 669 733
Australia	1 556 006	895 584	1 138 668	983 865	1 014 090	1 119 271
Greece	1 534 575	1 058 561	349 518	426 563	644 102	795 598
Canada	2 299 884	42 852	691 282	545 658	529 713	540 538
Sweden	1 982 625	93 550	290 046	122 359	345 837	498 789
New Zealand	547 905	184 992	488 347	428 927	385 969	373 071
Portugal	673 746	539 421	575 652	472 851	480 005	327 383
Switzerland	664 157	210 558	374 478	372 026	271 003	301 793
Belgium & Luxembourg	4 934 339	613 281	679 684	1 117 442	1 187 828	287 833
Austria	529 022	210 740	287 501	218 260	316 919	275 090
Denmark	364 178	338 117	359 839	46 535	34 123	29 145
Finland	781 055	219 121	225 943	252 662	173 665	24 161
Norway	471 000	41 268	37 599	82 828	15 509	16 707
Ireland	319 635	8 131	13 833	30 600	17 516	15 486
Iceland	18	24	41	111	111	108
EU subtotal	61 650 606	17 647 608	20 854 030	21 477 292	21 573 310	20 385 987
Total	119 994 223	49 079 501	64 380 320	65 450 541	65 164 994	61 593 757

Table 4. (continued)

B. By ESCWA member country_origin	1980	1985	1990	1991	1992	1993
United Arab Emirates	18 361 032	11 327 435	12 886 590	14 332 531	13 424 728	11 747 826
Egypt	4 427 184	4 051 568	3 632 028	3 146 395	3 890 631	3 806 293
Syrian Arab Republic	1 439 335	907 883	1 803 736	1 823 689	2 099 522	2 309 715
Lebanon	164 275	113 709	220 399	238 542	204 067	236 307
Jordan	85 872	268 060	189 131	150 646	153 931	163 555
Saudi Arabia	77 531 015	20 256 258	33 842 143	39 339 007	37 274 887	31 772 436
Yemen	10 784	37 326	1 344 146	457 246	352 351	495 465
Kuwait	9 870 270	5 357 314	4 722 663	363 919	2 506 709	6 035 878
Bahrain	770 328	595 599	675 828	766 259	637 972	727 100
Qatar	4 545 741	2 867 497	2 310 219	2 320 219	2 333 446	2 305 595
Oman	2 788 387	3 296 852	2 753 437	2 512 088	2 286 750	1 993 587
Total	119 994 223	49 079 501	64 380 320	65 450 541	65 164 994	61 593 757

Of the total of \$61.6 billion worth of the ESCWA region's exports to OECD countries, only \$5.1 billion, or 8%, were manufactured goods. Of these, 68% were destined for the EU market; the American market came in a distant second, with 18% of the OECD share (see table 5, part A). Once again, Saudi Arabia had the lion's share, with 34% of the OECD total (see table 5, part B); Egypt came second with 20%, and the rest of the countries in the region, with the notable exception of Yemen, were more or less equally divided.

The small share of ESCWA member countries' manufactured exports in their total exports to the OECD countries and to the world is directly related to the predominance of oil and oil products in the region: mineral fuels are by far the largest product group, accounting for approximately 74% of the region's total exports. This figure is roughly three times higher than the share of energy products in the exports of all developing countries combined. The export profiles of the largest exporters in the ESCWA region reveal the continuing over-reliance on mineral fuels for export earnings; it is extremely rare to find a non-mineral fuel product making it onto the list of the top 20 export products (see annex tables 1 to 9). Such a concentration limits the region's opportunities to reap larger benefits from the Uruguay Round agreements; equally importantly, it substantially reduces the scope for developing mutually beneficial intraregional trade.

B. THE URUGUAY ROUND AGREEMENTS

The Uruguay Round was the most comprehensive and hence the most complex round of GATT multilateral trade negotiations (MTNs) ever undertaken. It had a big agenda which included, among other things, the mandate to deal with certain GATT shortcomings that were undermining the institution's systemic integrity. The venues for launching the Uruguay Round and for signing the Final Act had more than symbolic significance. Developing countries engaged more and more actively in the Round as their interest in its outcome heightened. At stake were issues that concerned the following:

- Extending trade liberalization in both established (traditional) areas and areas not yet covered by GATT
- Bringing trade that had moved outside the multilateral framework back into GATT
- Bringing discipline to the trade-related aspects of intellectual property rights
- Enhancing the provisions concerning trade-related investment measures
- Providing a framework of principles, rules and disciplines for trade in services

Table 5. OECD countries' manufactured imports from ESCWA member countries
(Thousands of US dollars)

A. By OECD partner	1980	1985	1990	1991	1992	1993
Canada	11 537	4 320	35 501	18 908	19 426	20 016
United States	60 619	162 249	474 814	506 919	771 679	928 926
Japan	1 482	124 999	329 271	337 616	265 141	355 513
Australia	252	6 885	13 922	15 023	17 496	18 294
New Zealand	31	4 382	9 576	6 966	10 405	13 745
Austria	6 887	18 555	35 886	32 961	27 872	26 533
Belgium & Luxembourg	51 034	102 724	194 628	181 601	186 147	199 708
Denmark	6 820	12 669	32 082	14 904	14 672	15 364
Finland	1 545	5 020	30 126	19 057	15 023	10 050
France	39 735	83 419	218 350	230 339	240 517	269 690
Federal Republic of Germany	106 364	149 535	360 256	372 995	336 389	396 764
Greece	4 989	3 053	42 510	64 787	61 649	42 086
Iceland	2	4	26	91	97	83
Ireland	2 012	2 829	8 960	26 789	9 949	12 469
Italy	40 707	154 478	335 864	383 823	503 905	892 275
The Netherlands	22 129	55 131	93 568	94 992	121 015	206 229
Norway	2 293	5 746	34 976	18 945	9 717	14 948
Portugal	4 960	3 013	5 978	9 334	8 525	13 891
Spain	4 082	24 139	109 058	125 003	120 114	111 409
Sweden	5 351	9 488	42 830	38 795	36 543	33 837
Switzerland	60 945	126 679	309 304	316 008	222 708	241 446
Turkey	14 090	14 861	64 891	64 926	58 095	56 880
United Kingdom	411 903	507 448	810 458	824 211	1 141 435	1 228 177
EU subtotal	708 520	1 131 505	2 320 580	2 419 682	2 823 852	3 458 565
Total	859 769	1 581 626	3 592 835	3 704 993	4 198 519	5 108 333

Table 5. (continued)

B. By ESCWA member country origin	1980	1985	1990	1991	1992	1993
United Arab Emirates	51 000	138 036	561 718	572 621	819 300	876 875
Egypt	230 114	241 227	774 039	804 788	1 016 007	1 031 719
Syrian Arab Republic	22 746	12 212	46 395	58 476	78 621	87 703
Lebanon	78 736	52 595	144 414	166 900	150 668	206 441
Jordan	24 841	146 890	96 295	64 125	75 949	344 909
Saudi Arabia	302 966	688 884	1 484 614	1 494 398	1 458 394	1 761 358
Yemen	1 819	5 726	8 865	12 933	24 538	20 681
Kuwait	48 106	86 095	69 837	107 789	77 028	235 648
Bahrain	34 979	77 564	166 270	176 544	217 283	235 387
Qatar	16 571	45 314	84 641	121 134	104 189	121 206
Oman	47 891	87 083	155 747	125 285	176 542	186 406
Total	859 769	1 581 626	3 592 835	3 704 993	4 198 519	5 108 333

- Improving the rules and the dispute settlement system of GATT
- Creating the World Trade Organization (WTO)

The Uruguay Round was also unique from the point of view of the ESCWA member countries. The ESCWA region's GATT Contracting Parties engaged ever more actively in the Round as their interests came into play.² There were a number of important issues that the Uruguay Round sought to deal with, but the heightened interest among the ESCWA member countries was mainly related to their increasing emphasis on openness and market-based policy reform programmes (Egypt and Jordan) and to their increasing involvement in world trade and investment. Since the launching of the Uruguay Round in 1986, Egypt has unilaterally lowered its barriers to imports, mainly in conjunction with a reorientation of its domestic policies.³ Bahrain, the United Arab Emirates and Qatar have since joined GATT/WTO, Jordan and Saudi Arabia are in the process of acceding, and the Syrian Arab Republic and Lebanon have expressed an interest in becoming members.

The successful conclusion of the Uruguay Round is expected to bring about increases in the levels of trade, investment, income and welfare in most ESCWA member countries. Direct benefits will result from both increased market access to the developed countries' markets, and from enhanced efficiency related to the ESCWA member countries' own liberalization commitments. Benefits which are potentially even more important will accrue to these countries from the improved rules for trade and investment coupled with the stronger institutional reinforcement of these rules, and from the greater exposure to global competition within a more predictable, secure and credible international trading environment.

The distribution of these benefits among the individual ESCWA member countries will, however, be uneven. ESCWA member countries with open domestic markets will be favoured, mainly because their openness implies a relatively greater capacity to adjust and adapt to new and emerging market opportunities. In the sphere of trade in manufactured products, some ESCWA member countries may lose their market share as

² The countries in the ESCWA region which joined GATT include the following (date of accession in parentheses): Kuwait (May 1963), Egypt (May 1970), Bahrain (December 1993), United Arab Emirates (March 1994) and Qatar (April 1994). Other ESCWA member countries are either in the process of acceding to the WTO or have declared an interest in doing so. As of the end of October 1995, membership in the WTO included 110 countries, and another 28 are currently seeking membership in the Organization.

³ It is worth noting that since the launching of the Uruguay Round in 1986, over 60 developing nations have unilaterally lowered their barriers to imports, generally in conjunction with a reorientation of their domestic policies. Twenty-six have since joined GATT/WTO, while more than 20 are in the process of acceding.

the result of an erosion in their trade preferences. However, even if such effects do exist, they must be weighed against the increased overall efficiency expected from the implementation of the Uruguay Round agreements. Moreover, since the reforms agreed upon during the Uruguay Round will be instituted gradually, these countries should seize the opportunity in the interim to implement reform programmes designed to make their domestic economies more open and more flexible.

Market access

Ever since its inception, the GATT system has sought to establish non-discriminatory tariffs as the principle means of trade protection. The Uruguay Round marked the eighth time that the GATT Contracting Parties had negotiated the reduction of trade barriers in a multilateral framework. The success of these MTNs has been remarkable. The seven rounds of MTNs prior to the Uruguay Round succeeded in lowering the average (trade-weighted) most-favoured-nation (MFN) tariff rates on industrial goods from a high of 40% at the end of the Second World War to around 6% at the conclusion of the Tokyo Round (1974-1979).⁴ In addition, these rounds brought about the dismantling of most of the import quotas on non-agricultural products in developed countries.

Nevertheless, market access still represents perhaps the single most important trading issue between the developing and developed countries. The developing countries' strongest demands are not only for continued access to industrialized countries' markets, but also for increased access. Developed countries are demanding that developing countries participate more effectively in the negotiations, and that some of them contribute more and assume more GATT obligations; in other words, some developing countries should "graduate". For both groups of countries, market access has been hindered by tariffs, as well as non-tariff barriers (NTBs) such as anti-dumping and countervailing duties, safeguards, and voluntary export restraints.

(a) Tariff levels

The objective of achieving a one-third tariff cut has been exceeded; the average trade-weighted tariff rate on all industrial products from all sources has been reduced by 38%. However, the average trade-weighted tariff imposed by industrialized countries on developing countries' exports has been lowered by only 34%—four percentage points below the overall cuts by industrialized countries. Moreover, the average rate masks lower commitments with respect to three sensitive product categories in the manufacturing sector: transport equipment (where the reductions will average 23%); textiles and clothing

⁴ The MFN principle is the cornerstone of the GATT system—the basic provision guaranteeing non-discrimination.

(22%); and leather, rubber, footwear and travel goods (18%). Together, trade in these three products accounted for 24% of the total value of developed countries' imports in 1993. However, as will be described later, these low cuts will be supplemented by the removal of NTBs resulting from the phasing out of the Arrangement Regarding International Trade in Textiles (also called the Multi-fibre Arrangement, or MFA) and from the elimination of VERs, especially on footwear, electronics and travel goods. Eight other industrial product groups with an import share in 1993 equal to the remaining 76% will experience reductions in their tariff levels that will exceed the target. For example, there will be a reduction in tariff rates of about 69% for wood, pulp, paper and furniture products. The corresponding reduction affecting metal products is 59%. Thus, the tariff cuts affecting all tropical and resource-based products in developed countries will exceed the overall target; the trade-weighted average cuts will be 45% and 34% respectively. The corresponding cuts affecting developing countries' exports to developed countries will be even higher, at 57% and 35% respectively. The lowering of tariff rates is being phased in through five equal annual reductions; the first occurred on the date of the entry in force of the Agreement Establishing the World Trade Organization (WTO Agreement) on 1 January 1995.

Zero-for-zero agreements in seven major industrial sectors will increase the share of developed countries' duty-free imports from 20% to 43%. It is interesting to note that the products marked for above-average tariff reductions will also experience a substantial rise in the level of duty-free trade; in contrast, those sensitive products with tariff reductions below the average will experience moderate changes in the distribution of tariffs. For example, the share of high duties or tariff peaks imposed by developed countries on imports of textiles and clothing will only be reduced from 38% to 28%.

(b) *Tariff peaks and escalation*

One method of increasing the proportion of developing countries' trade in fabricated goods is to increase the processing of natural-resource-based products now exported in primary form. However, a factor often cited as working against efforts to increase domestic processing is the structure of tariffs and other trade barriers in major import markets. Specifically, zero or low tariffs are generally applied to industrialized countries' imports of primary (unprocessed) commodities, with the duties increasing, or escalating, as the product experiences increased fabrication. Tariff escalation produces a trade bias against processed goods, as higher import duties are imposed on these items.⁵ The result is increased protection of value added, "which twists the worldwide distribution of value added along processing chains in favour of the industrial countries" (Abreu, 1989).

⁵ Representative studies that document the existence and impact of tariff escalation in developed countries include Yeats (1979) and Safadi and Yeats (1993). The analysis here is based on the latter.

The importance that developing countries attach to tariff escalation is reflected in the extensive policy debates on this subject that have occurred in major international forums. For example, developing countries were instrumental in having a clause inserted in the 1982 GATT Ministerial Declaration (the forerunner of the Uruguay Round of MTNs) which stresses that “prompt attention should be given to the problem of escalation of tariffs on products with a view to effective action toward the elimination or reduction of such escalation where it inhibits international trade, taking into account the concerns relating to exports of developing countries.” Further, the Punta del Este Declaration states that “negotiations shall aim to achieve the fullest liberalisation of trade in natural-resource-based products, including those in processed and semi-processed forms. The negotiations shall aim to reduce or eliminate tariff and non-tariff measures, including tariff escalation.”

One way to identify a change in tariff escalation is to calculate the absolute change in tariffs, since what matters is the decline in the tariff-inclusive price in the importing country. For example, in principle, a 50% cut in a 2% tariff would lead to a 1% decline in the tariff-inclusive price, and a 25% reduction in a 36% tariff would result in a 9% reduction in the tariff-inclusive price. It is therefore instructive to conduct an analysis of tariff escalation with reference to absolute change in tariff. Table 6 shows pre- and post-Uruguay Round tariff levels for industrialized countries by product and processing stage, as well as the absolute differences in tariffs achieved during the Uruguay Round. It should be noted that tariffs increase significantly from the raw-material to the finished-product stage: the average post-Uruguay Round tariff for all industrial products climbs from 0.8% on raw materials to 4.8% on finished products. However, a product-by-product examination of the absolute differences between tariffs on goods at various processing stages reveals that de-escalation has occurred for almost all of the commodities analysed; jute and cocoa are the two exceptions, where the tariff reductions applied to intermediate products are larger than those for final-stage products.

(c) Tariff bindings

Prior to the successful conclusion of the Uruguay Round, MFN tariffs in many sectors were not legally bound and could therefore be raised quite easily. This situation created a lack of security in market access, and may have had a detrimental effect on trade. A major goal of the Uruguay Round was to increase the proportion of industrial tariffs that were bound, thus providing added protection to trade liberalization commitments. This goal has been successfully met: the percentage of developed countries' imports of industrial goods under bound rates rose from 94% to 99%, leaving only 1% (corresponding to 1% of tariff lines) not bound; the corresponding figures for developing economies are 14% and 59% respectively; and those for economies in transition are 74% and 96% respectively.

Table 6. The effects of Uruguay Round concessions on tariff escalation in industrialized countries

Description	Processing stage	Tariff rate (percentage)			Change in escalation indicator	
		Pre-Uruguay Round	Post-Uruguay Round	Absolute change	Stage comparison	Absolute change
<i>Hides, skins and leather</i>		5.2	4.2	1.0		
Raw hides	1	0.1	0.1	0		
Semi-manufactures	2	4.5	3.5	1.1	2 with 1	Decreased
Finished products	3	8.7	7.3	1.5	3 with 2	Increased
<i>Rubber</i>		3.3	2.2	1.1		
Crude rubber	1	0	0	0		
Semi-manufactures	2	5.5	3.2	2.3	2 with 1	Decreased
Finished products	3	5.1	3.5	1.6	3 with 2	Decreased
<i>Wood</i>		2.0	0.9	1.1		
Wood in the rough	1	0	0	0		
Wood-based panels	2	9.4	5.4	4.0	2 with 1	Decreased
Semi-manufactures	3	0.9	0.4	0.4	3 with 2	--
Wood articles	4	4.7	0.5	4.3	4 with 3	Decreased
<i>Paper</i>		3.5	1.5	2.0		
Pulp and waste	1	0	0	0		
Paper and paperboard	2	5.3	2.6	2.7	2 with 1	Decreased
Printed matter	3	1.7	0.3	1.4	3 with 2	--
Paper articles	4	7.3	1.9	5.4	4 with 3	Decreased
<i>Jute</i>		5.1	1.8	3.2		
Jute fibres	1	0	0	0		
Yarns of jute	2	5.4	0.1	5.2	2 with 1	Decreased
Jute fabrics	3	5.7	3.2	2.5	3 with 2	Increased
<i>Cocoa</i>		4.4	2.5	1.9		
Cocoa beans	1	2.1	0	2.1		
Paste, powder and butter	2	4.6	2.8	1.8	2 with 1	Increased
Chocolate	3	8.8	7.2	1.6	3 with 2	Increased
<i>Tobacco</i>		17.3	11.2	6.1		
Unmanufactured	1	14.7	11.5	3.2		
Manufactured	2	22.1	10.7	11.4	2 with 1	Decreased

Table 6. (continued)

Description	Processing stage	Tariff rate (percentage)			Change in escalation indicator	
		Pre-Uruguay Round	Post-Uruguay Round	Absolute change	Stage comparison	Absolute change
<i>Copper</i>		1.7	0.8	0.9		
Unwrought	1	0.9	0.5	0.4		
Semi-manufactures	2	4.3	2.0	2.3	2 with 1	Decreased
<i>Nickel</i>		0.7	0.3	0.4		
Unwrought	1	0.5	0.3	0.2		
Semi-manufactures	2	2.6	0.4	2.2	2 with 1	Decreased
<i>Aluminium</i>		3.0	2.0	1.1		
Unwrought	1	2.1	1.6	0.5		
Semi-manufactures	2	5.9	3.1	2.8	2 with 1	Decreased
<i>Lead</i>		2.4	0.9	1.6		
Unwrought	1	2.4	0.9	1.5		
Semi-manufactures	2	4.5	1.8	2.7	2 with 1	Decreased
<i>Zinc</i>		2.2	0.4	1.8		
Unwrought	1	2.1	0.3	1.8		
Semi-manufactures	2	4.7	2.3	2.4	2 with 1	Decreased
<i>Tin</i>		0.1	0	0.1		
Unwrought	1	0.1	0	0		
Semi-manufactures	2	3.9	0.2	3.7	2 with 1	Decreased
<i>All industrial products</i>		6.4	4.6	1.8		
Raw materials	1	1.8	0.8	1.0		
Semi-manufactures	2	5.3	2.8	2.5	2 with 1	Decreased
Finished products	3	7.4	4.8	2.6	3 with 2	Decreased

Source: A. Yeats, "A quantitative assessment of the Uruguay Round's effects and their implications for developing countries, World Bank PRE Working Papers Series. Pre-Uruguay Round data were drawn from the World Bank-UNCTAD SMART Database.

Notes: Two dashes (--) indicate that the item is nil or negligible. Totals may not add up due to rounding.

At the regional level, North America and Latin America were the greatest achievers, as all of their industrial imports as well as their corresponding tariff lines became bound. Asia remains the region least committed to binding its tariffs on industrial goods: only 67% of its tariff lines, which cover 70% of its industrial imports, are now bound.

Increases in tariff binding have increased the security of market access; another positive step has been the reduction of bound tariff rates. Seventeen per cent of developed countries' tariff lines affecting imports of industrial goods are now bound at a duty-free rate; of the remaining 83%, 67% have been bound with reductions, another 10% have been bound without any reductions (and remain at their current levels), and the last 7% of currently dutiable industrial items have remained without any offer. Developing countries, where no item has been granted duty-free access, have bound 44% of their tariff lines with reductions and another 25% without reductions, leaving 31% of their tariff lines under the category of "no offer".

(d) *Non-tariff measures*

Aside from the phasing out of the MFA, the most important achievement of the Uruguay Round with respect to trade in industrial goods has been the almost complete elimination of VERs and other, similar measures affecting imports and/or exports (such as orderly marketing arrangements, discriminatory import systems, and consulting arrangements) whose unchecked proliferation would have meant the complete erosion of the non-discrimination principle.⁶ The economic effects of VERs, as well as the reasons behind their proliferation, have been well documented. Such arrangements have been said to constitute "first order" protectionism in the light of their unequivocal protectionist design and discriminatory nature.⁷ According to the World Bank-SMART Database, VERs covered some 400 tariff lines in the United States and about the same number in the EU in the pre-Uruguay Round trading environment, affecting such sectors as metals, transport equipment, footwear, and domestic appliances.

The total elimination of VERs implies a significant relaxation of non-tariff barriers. Table 7 presents the incidence of all NTBs affecting developing countries' exports to industrialized countries' markets during the pre-Uruguay Round period, by type of NTB.

⁶ Only one VER arrangement remains in operation: the EU wishes to continue to restrict Japanese auto imports. However, this single exception, which is permitted to each party, will be in effect only until 31 December 1999.

⁷ See, for example, Low (1993) and Wolf and others (1984), especially the tabular summary in the latter.

Table 7. Pre-Uruguay Round trade coverage ratios of industrialized countries' non-tariff measures against imports from developing countries, by type of non-tariff barrier (NTB)

Product group (SITC)	Trade coverage ratios ^a					
	All non-tariff measures ^b	Variable levies and surcharges	Quantitative restrictions	Voluntary export restraints	Price-control measures	Other entry-control measures
<i>Ores and metals (27+28+67+68)</i>	10.0	0.1	0.5	5.5	6.5	0
Iron and steel (67)	35.6	0	1.0	20.2	23.6	0
Non-ferrous metals (68)	0	0	0	0	0	0
<i>Mineral fuels (3)</i>	16.5	2.4	14.1	0	0	0
<i>Chemicals (5)</i>	3.4	1.1	2.2	0.1	0	0
<i>Other manufactures (6 to 8 minus 67 and 68)</i>	21.6	0.4	1.7	18.3	0.5	2.1
Leather (61)	56.6	0.8	0.3	0.2	0	55.2
Textile yarn and fabrics (65)	52.1	1.7	6.2	49.0	0	0
Clothing (84)	64.3	0.8	3.4	59.3	0	3.3
Footwear (85)	34.0	1.2	1.0	29.9	0	3.3
<i>All items (0 to 9)</i>	18.0	2.0	5.0	9.5	1.2	1.8

Source: World Bank-UNCTAD SMART Database.

^a Non-tariff measure (NTM) groups are defined as follows: variable levies and surcharges include all variable import levies (including variable components), product-specific surcharges, minimum, reference, or basic import price regulations, price surveillance and voluntary export price restraints; quantitative restrictions include prohibitions, quotas (global or country-specific), State monopolies and non-automatic licensing requirements; "voluntary" export restraints (VERs) include measures under the MFA and similar textile quotas as well as other VERs (on quantity) that were negotiated outside the textile and clothing sectors; and other entry-control measures include a variety of restrictions such as local content regulations.

^b The coverage shares for the individual types of NTMs may add up to more than the total of the "all NTM" coverage ratio owing to "stacking" (the multiple application of NTMs on a specific product). Industrialized countries here refer to Australia, Austria, Canada, the European Union, Finland, New Zealand, Norway, Sweden, Switzerland and the United States.

The table shows that VERs were among the most commonly used form of quantitative restrictions, accounting for more than half of all quantitative measures affecting the imports from developing countries. In descending order, the clothing, leather, textile, ferrous metals and footwear sectors were the most seriously affected by high NTB coverage, with figures ranging from 34% to 64%.

The effect of pre-Uruguay Round non-tariff measures on various regional groupings is presented in table 8. Eastern Europe appears to have been the region most affected, with a coverage ratio exceeding 67%. The memo item in table 8 points to a major scaling down in the use of NTBs following the conclusion of the Round. The trade coverage ratios for all regions (except Eastern Europe) will fall dramatically in the post-Uruguay Round trading environment. Ferrous metals are the products that give rise to the relatively high coverage ratio of 11% for Eastern Europe. As shown by table 8, products originating from the Middle East experienced a relatively lower incidence of NTBs than all other regions, with the notable exception of East Asia. As will be seen later, such low NTB coverage ratios limit the extent of benefits ESCWA member countries can hope to obtain as a result of the successful completion of the Uruguay Round.

The accomplishments of the Uruguay Round in lowering and eliminating NTBs are significant not only in terms of their overall importance, but also in relation to the remaining types of trade-related measures and the sectors that will be affected; table 9 provides a summary of these achievements. Quantitative restrictions are the only important non-tariff measures remaining; they are highest on coal and coke products (where the trade coverage ratio is 81%), followed by rubber manufactures (10%).

(e) *Elements of the Uruguay Round negotiations on trade in textiles and clothing*

Successive GATT arrangements legitimized textile and clothing protection *de facto* under the rubric of the MFA. The MFA has essentially been used to select targets on a discriminatory basis, challenging one of the most basic tenets of GATT—the MFN rule. Unlike in other sectors such as steel, fair trade rhetoric has hardly ever been employed to justify protection of the textile and clothing sector.

Table 8. Pre-Uruguay Round trade coverage ratios of industrialized countries' non-tariff barriers (NTBs) against imports from developing countries, by region

Product group (SITC)	East Asia	Eastern Europe	Latin America	Middle East/North Africa	Middle-income Europe	South Asia	Sub-Saharan Africa	All countries
<i>Ores and metals (27+28+67+68)</i>	19.5	25.1	11.4	24.1	9.1	2.2	7.9	12.4
Iron and steel (67)	45.2	67.3	55.1	54.9	59.0	20.8	61.1	59.2
Non-ferrous metals (68)	2.2	1.5	3.2	1.6	1.8	0	0.1	1.7
<i>Manufactures (5+6+7+8-68)</i>	33.2	31.1	18.2	9.6	30.1	44.9	18.2	29.1
Chemicals (5)	11.5	9.5	8.4	11.0	5.0	6.7	0.5	6.7
Leather (61)	28.1	32.1	18.7	9.9	16.1	8.9	0.1	17.9
Textiles (65)	69.9	81.4	77.5	19.6	50.0	58.5	1.8	58.3
Clothing (84)	71.1	81.2	68.3	24.9	48.0	78.7	9.5	63.7
Footwear (85)	16.7	81.9	9.7	22.4	10.2	62.9	68.4	33.4
Memo item: Non-tariff measure (NTM) ratios after Uruguay Round								
All goods	5.9	10.6	3.9	6.5	4.1	2.0	3.5	4.3
All non-fuel goods	6.2	10.8	4.9	6.3	4.3	2.2	3.0	5.2

Source: World Bank-UNCTAD SMART Database.

Note: The country/area composition of the regional groupings is as follows:

East Asia: China, Cambodia, Indonesia, the Lao People's Democratic Republic, Viet Nam, the Democratic People's Republic of Korea, Malaysia, Papua New Guinea, the Philippines, Thailand, the Republic of Korea, Macao, and Pacific Trust Territories and islands (Hong Kong, Singapore, and Taiwan Province of China are not included);

Eastern Europe: Albania, Bulgaria, Poland, Romania, former Czechoslovakia, Hungary, the former Soviet Union, and former Yugoslavia;

Latin America: all Western Hemisphere countries except Canada and the United States;

Middle East/North Africa: Afghanistan, Iran, Jordan, Lebanon, Syrian Arab Republic, Yemen, Bahrain, Iraq, Oman, Saudi Arabia, Egypt, Algeria, Morocco, Tunisia, and the Libyan Arab Jamahiriya;

Middle-income Europe: Turkey, Gibraltar, Greece, Isle of Man and Portugal;

South Asia: India, Bangladesh, Bhutan, Maldives, Myanmar, Nepal, Pakistan, and Sri Lanka;

Sub-Saharan Africa: all African countries except those in North Africa (see above) and the Republic of South Africa.

Table 9. Sectors which remain affected by post-Uruguay Round non-tariff measures

Product group (SITC)	1992 imports from developing countries (millions of US dollars)	Trade coverage ratio by type of intervention or measure (percentage)							
		Tariff quotas	Product-specific charges	Anti-dumping and countervailing actions	Reference prices	Minimum import prices	Non-automatic authorizations	Quantitative restrictions	
Crude fertilizers and minerals (27)	3 258.1	0	0	7.9	0	0	0.1	5.0	
Metalliferous ores and scrap (28)	12 188.9	0.3	0	0.7	0	0	0	5.1	
Crude animal, vegetable materials n.e.s. (29)	3 879.6	0	0.1	0.1	0	0	8.6	4.9	
Coal and coke (32)	4 902.6	0	0	0	0	0	2.5	81.3	
Chemical elements and compounds (51)	11 243.4	0	1.2	1.4	0	0	1.4	4.1	
Mineral tars and crude compounds (52)	496.0	0	0	0	0	0	0	5.0	
Dyeing and tanning materials (53)	866.0	0	0	0.3	0	0	0	2.2	
Medicinal and pharmaceutical products (54)	1 442.2	0	0	0	0	0	5.4	2.5	
Manufactured fertilizers (56)	1 723.4	0.8	0	1.1	0	0	11.7	5.6	
Plastic materials (58)	3 193.7	0	0	12.8	0	0	1.0	7.6	
Chemical materials n.e.s. (59)	1 644.4	19.6	0	0	0	0.1	2.3	9.6	
Leather and related manufactures (61)	3 740.6	0.4	0	0	0	0	0	5.6	
Rubber manufactures (62)	2 921.9	0	0	9.5	0	0	0.8	10.3	
Wood manufactures (63)	6 336.7	18.7	0	0	0	0	0	0.8	

Table 9. (continued)

Product group (SITC)	1992 imports from developing countries (millions of US dollars)	Trade coverage ratio by type of intervention or measure (percentage)						
		Tariff quotas	Product-specific charges	Anti-dumping and countervailing actions	Reference prices	Minimum import prices	Non-automatic authorizations	Quantitative restrictions
Paper and related manufactures (64)	2 297.5	3.6	0	5.5	0	0	0	3.6
Non-metallic mineral manufactures (66)	16 578.6	0	0	1.2	0	0	0.6	0.7
Iron and steel (67)	11 063.9	0	0.2	16.5	4.7	0	0.2	2.1
Metal manufactures (69)	10 921.8	0	0	2.6	0	0	0.9	0.7
Non-electrical machinery (71)	47 809.6	0	2.6	0.3	0	0	0.4	3.4
Electrical machinery (72)	64 094.9	0	0	4.8	0	0	0	1.6
Transport equipment (73)	20 611.5	0.3	0.4	2.5	0	0	0.3	2.1
Sanitary fixtures (81)	2 362.7	0	0	6.4	0	0	0	0.5
Travel goods (83)	6 095.2	0	0	12.8	0	0	0	0.2
Footwear (85)	15 844.3	0	0	0.1	0	0	0	4.3
Scientific instruments (86)	10 778.6	0	0	0	0	0	0	1.7
Miscellaneous manufactures (89)	42 280.1	0	0	0.7	0	0	0	0.8

Source: World Bank-UNCTAD SMART Database.

The Uruguay Round Agreement on Textiles and Clothing provides for the phase-out of the MFA and the gradual integration of the textile and clothing sector into GATT 1994.⁸ This will be effected over a 10-year period under the supervision of the WTO Textiles Monitoring Body (TMB). A minimum of 16% of the total 1990 volume of imports covered by the MFA was to be integrated into GATT 1994 upon the entry into force of the WTO Agreement. A further (minimum of) 17% of the volume of 1990 imports will be integrated at the beginning of the fourth year of the phase-out period. An additional minimum of 18% will follow at the beginning of the eighth year, while the remainder should be fully integrated by the end of the 10-year transition period. Each phase-out must include products from four different groups: tops and yarns, fabrics, made-up textile products, and clothing.

The Agreement also provides for the expansion of outstanding quota restrictions by the prevailing quota growth rates plus 16% annually for the first three years. A further annual expansion of 25% will take place in the subsequent four years, and an additional 27% per year during the final three years. This arrangement will tend to favour countries with high existing quota growth rates. The Dispute Settlement Body of the WTO may authorize adjustment to these annual quota growth rates in cases where country Members are not complying with their obligations.

Transitional safeguards, which may be applied selectively to particular exports, may also apply to products not yet integrated into GATT 1994 at any stage. Safeguard actions may be taken only in cases where the importing country can demonstrate serious damage or the threat thereof. Safeguards can only be maintained for a maximum period of three years, during which time they must be phased out. Finally, the Agreement provides for anti-circumvention measures to deal with transshipment, rerouting, false declaration of origin and falsification of official documents.

There has been a considerable amount of empirical research work done on the impact of the MFA and on the benefits resulting from its removal. Trela and Whalley (1990) put the benefits in terms of net world welfare gains arising from the liberalization of both quotas and tariffs at \$23.4 billion, with about one third of the total accruing to developing countries as a group.⁹ For several developing economies the welfare gains would exceed \$1 billion: China (\$1.8 billion), the Republic of Korea (\$1.6 billion), Taiwan Province of China (\$1.2 billion), and Brazil (\$1.1 billion). If, on the other hand, the liberalization scenario were restricted to MFA quotas alone, world welfare gains would

⁸ Integration means that trade in these products will be governed by general GATT rules and disciplines.

⁹ A general equilibrium model was used. Results are based on 1986 data and cover quotas negotiated between the United States, Canada and the EU, and 34 developing-country suppliers under the provisions of MFA-III (see Trela and Whalley, 1990, for the results; especially tables 3 and 4). Unfortunately, the analysis did not examine the interests of ESCWA member countries in this sector.

total about \$22 billion, only \$3 billion of which would accrue to developing countries as a group. Under this scenario, some developing countries would stand to lose (through the loss of quota rents); among the major losers would be Hong Kong, Macao, Pakistan, Singapore and Thailand.

In a 1984 study by Kirmani and others, it was predicted that if all trade barriers were removed, developing countries' exports of textiles to major industrialized countries' markets would expand by 82% and those of clothing by 93% under the assumption of infinitely elastic supply. In 1986, the United Nations Conference on Trade and Development (UNCTAD) estimated that complete liberalization could raise developing countries' exports of clothing and textiles by 135% and 78% respectively. It should be noted that all these estimates can be considered at the low end, as they do not incorporate the existence of a significant degree of quota underutilization by many suppliers, including those in ESCWA member countries. Suppliers facing uncertainty about future quota levels may be reluctant to invest to increase their production capacity, especially in view of the fact that a significant amount of investment may be required to fill the remaining 15% to 20% of unfilled quotas.

Although the liberalization of trade in textile and clothing products will take some time to be phased in, it will go a long way towards levelling the playing field for ESCWA member countries. This is especially relevant in the light of the fact that many countries in the ESCWA region have a comparative advantage in the production of labour-intensive textiles and clothing. Furthermore, ESCWA member countries will experience large cost savings as a result of the removal of the discriminatory application of the MFA.

C. PROJECTING THE URUGUAY ROUND'S TRADE-CREATION EFFECTS ON ESCWA MEMBER COUNTRIES

Many countries in the ESCWA region did not show much enthusiasm for the Uruguay Round. On the face of it, such an attitude is to be expected; after all, the exports of many countries (especially non-oil exporters) in the region enjoy special preferential treatment in the three major OECD markets (see table 10). Any reductions in MFN tariffs will necessarily cut the margin of preferences for preference-receiving countries. For the oil exporters in the region, border barriers do not present serious problems for market access into OECD countries; fuels, ores and non-ferrous metals are generally imported

duty-free or face relatively low OECD tariffs and non-tariff barriers.¹⁰ Given the importance many countries in the region attach to preferences, it is instructive to review the economic rationale behind such discriminatory schemes.

Table 10. ESCWA member countries which are beneficiaries of preference schemes of the major OECD countries

	European Union	United States	Japan
Bahrain	x	x	x
Kuwait	x		x
Oman	x	x	x
Qatar	x		x
Saudi Arabia	x		x
United Arab Emirates	x		x
Egypt	x	x	x
Jordan	x	x	x
Lebanon	x	x	x
Syrian Arab Republic	x		x

At the theoretical level, trade preferences and regional agreements can be examined within the same analytical setting; this is because both kinds of arrangements share discriminatory properties in that they involve geographically selective trade liberalization. The static trade and welfare effects of regional agreements and trade preferences have to be examined in a "second best" context, in which the final judgement as to any economic benefits that might accrue is based on empirical findings. The

¹⁰ As an illustration, Kuwait, Qatar, the United Arab Emirates and Saudi Arabia receive preferential treatment in the EU and Japan, although petroleum is excluded from Japan's preference scheme. Kuwait also gets preferential treatment in the United States. Crude oil and refined petroleum products enter the EU duty-free. In Japan, crude oil is charged a specific tariff of 315 yen per kilolitre (y/kl), while refined products are taxed at 3,750 y/kl; the corresponding rates in the American market are \$0.0525/barrel and \$0.84/barrel (note the practice of tariff escalation). Saudi Arabian petrochemical exports enter the EU duty-free unless (a) the product is classified as "sensitive" or (b) the exporting country has more than a 20% market share; in addition, value limitations apply. Crude oil and refined petroleum products from the United Arab Emirates enter the EU duty-free.

Vinerian concepts of trade creation and trade diversion provide a comparative static partial equilibrium framework within which to consider the consequences of the removal of trade barriers on a preferential basis. Trade creation occurs when a preference involves trade liberalization that displaces less competitive production in the preference-giving country. Trade diversion occurs when a preference-giving country switches its imports to a preference-receiving country, thereby displacing imports from a producer that does not benefit from the preference. In this case, the preference margin is sufficient to divert trade from a more efficient to a less efficient producer. While this raises income in the preference-receiving country, it does so at the expense both of the preference-giving country and the third country outside the preferential arrangement. One might argue that trade diversion is itself a worthy goal of preferential trade schemes, as this allows the preference-giving countries to channel the benefits of trade in directions that are deemed desirable for foreign policy reasons. Whatever the merits of such a view may be from a *political perspective, they are not consistent with the economic precepts of an open trading system.* Deliberate efforts to manipulate the composition and direction of trade flows for non-economic reasons, however well-intentioned they may be, can quickly take the members of the trading community down a slippery slope towards managed trade.

In order for the economic benefits of a preferential arrangement to be judged positive under this type of analysis, trade creation must exceed trade diversion. However, the picture becomes more clouded when possible dynamic effects are introduced. The argument is that trade liberalization, whether discriminatory or not, may unleash positive dynamic effects, leading to a virtuous circle of growth and development. Preferences may open up new market opportunities, attracting resources into export industries. Particularly where such investment comes from foreign sources, it may bring additional advantages such as new technologies and skills, and may contribute to productivity growth. Economies of scale may come into play, neutralizing the constraints of market size and further enhancing productivity growth.

These kinds of arguments are closely related to the infant industry case for protection. The case for infant industry support is tied in with the existence of dynamic external economies, or more specifically, with learning-by-doing effects. According to this argument, the inability of investors to capture the full gains from the learning-by-doing that takes place in the initial stages of production means that there will be under-investment in the activity concerned. Strictly speaking, this is an argument not for tariff protection but for addressing capital market imperfections or for directly subsidizing labour.¹¹ Awarding tariff preferences that provide a competitive margin for nascent industries in export markets can be regarded as an alternative means of protecting infant

¹¹This proposition derives from the optimal intervention theory, which holds that distortions (or market failures) should be addressed at the source of the problem (or as close to the source as possible). The use of tariffs for infant industry protection introduces an additional consumption problem.

industries, assuming that such arrangements do not involve the allocation of resources to industries which have no hope of being competitive once they face international competition in the absence of a preference margin.

Another argument—one which does not rely on dynamic effects—is that preferences serve to diversify the economy and support industrialization. According to this line of reasoning, diversification is intrinsically desirable, principally because it helps countries move away from reliance on the production of primary goods, which over the long term have a low income elasticity of demand; countries relying on primary-product output thus face a decline in their terms of trade. It is further argued that primary products experience a high level of price volatility against which it is difficult to hedge. For various reasons, all of these arguments are the subject of some contention in the literature; the case for industrialization is easier to defend on theoretical grounds if it is presented as a dynamic learning-by-doing or infant industry argument.

What are the economic arguments against preferences? One that has already been discussed is the possibility of trade diversion as a consequence of geographically selective trade liberalization. In general terms, the greater the substitutability of production between a preference-receiving and an MFA country, the more likely trade diversion is to outweigh trade creation. The reverse is true where there is less substitutability in production between the preference-receiving and the preference-giving country.

Another, closely related reason for being cautious about the economic benefits of preferences is that unless preference margins benefit industries or sectors in respect of which a preference-receiving country enjoys a comparative advantage, any additional investment attributable to the preferences may prove to be suboptimal. This may seem unimportant to the beneficiary country while preferences are in place, but their eventual erosion or removal could give rise to adjustment costs. Finally, it has sometimes been argued that rather than inducing diversification, preferences may encourage specialization, leading beneficiary countries to maintain and even expand uncompetitive sectors that would otherwise have atrophied and died. The examples of sugar and banana production in certain beneficiary countries under the Lomé Convention are sometimes cited as cases where costly and inappropriate specialization has occurred.

In determining the effect preferences have had on various countries, all analysts point to the difficulties associated with estimating their costs and benefits. Even the simplest calculations of trade diversion and trade creation require uncertain assumptions about supply, demand and substitution elasticities and can only be relied upon to indicate broad orders of magnitude. Dynamic estimates of gains and losses are even more fraught with difficulty. In looking at the relationship between investment and preferences, for example, it is exceedingly difficult to distinguish the effect of preferences from the effects of a wide range of other factors that influence investment decisions. In some instances,

while the existence of preferences and increased investment may, on the face of it, appear to be linked, the presence of preferences may simply be irrelevant.

Matters are further complicated by the need to identify who actually gains from preferences—importers or exporters. The answer to this question depends on the distribution of the scarcity rent associated with the preference margin, which in turn is influenced by institutional arrangements and the degree of monopolistic and monopsonistic power underlying particular transactions. If exporters receive little or none of the scarcity rent, the beneficial effects of preferences are likely to be correspondingly modest. Similarly, a careful analysis of the economic effects of preferences would need to take into account the full array of product-specific exclusions and limitations often associated with preference schemes, as well as the low level of utilization of preferences sometimes encountered under schemes such as the Generalized System of Preferences (GSP).

In summary, economic arguments for and against preferences can readily be made, and the calculus of actual costs and benefits is specific to particular preferential arrangements, countries, and products. Potential dynamic and static effects both need to be taken into account, as well as the specific limitations of the arrangements. Even the best empirical estimates of the effects of preferential arrangements will be somewhat tentative. A review of the pertinent literature suggests that on the whole, the benefits for preference-receiving countries have been rather modest and have been severely constrained by exclusions and different kinds of conditionality. The evidence also suggests that the absence of a significant trade response to preferences in some beneficiary countries reflects a limited capacity to attract investment and increase production.

With the above-mentioned arguments and qualifications in mind, an attempt is made here to quantify the likely magnitude of the ESCWA member countries' export gains from manufactured goods following the successful implementation of the Uruguay Round agreements. Towards that end, the previously described partial equilibrium analysis (Viner's framework) is employed to simulate the impact of the tariff and NTB reductions. The model is similar to that used by Cline for evaluating the Tokyo Round. In particular, two separate reduced form equations are used to calculate trade creation and trade diversion respectively for each market at the most detailed tariff-line level.¹² In MFN-based liberalization, exporters who previously enjoyed preferences suffer an erosion in tariff margins, while other exporters enjoy improved market access. The trade creation effect is the increased demand in country j for commodity i from exporting country k resulting from the price decrease associated with the assumed full transmission of price

¹²See IMF (1984) and Sapir and Baldwin (1983) as well for similar model applications. Within these specifications, trade creation is the increase in total trade that comes about as a result of lower prices from reduced protection. Trade diversion is the substitution among suppliers as a result of changes in prices. The summation of trade creation and trade diversion gives the net trade effect for each market.

changes when tariffs or NTB distortions are reduced or eliminated altogether. The formula used is as follows:

$$TC_{ijk} = M_{ijk} \varepsilon_m * \frac{dt_{ijk}}{1 + t_{ijk}} * \frac{1}{1 - \frac{\varepsilon_m}{\varepsilon_x}}$$

Equation 1

Where:

M_{ijk} = imports of country j of commodity i from exporter k

ε_m = elasticity of import demand with respect to domestic price

t_{ijk} = *ad valorem* tariff rate imposed by country j on the imports of commodity from country k

ε_x = elasticity of export supply with respect to export price

On the other hand, the trade diversion effect reflects the tendency of importers to substitute goods from one source with goods from another in response to a change in the import price of the goods from the first source but not from the alternative source. The formula used to measure trade diversion is expressed as follows:

$$TD_{ijk} = \frac{M_{ijk}}{\sum M_{ijk}} * \frac{\varepsilon_s * \sum M_{ijk} * \sum M_{ijk} * \frac{d(P_{ijk} / P_{ijk})}{P_{ijk} / P_{ijk}}}{\sum M_{ijk} + \sum M_{ijk} + \varepsilon_s * \sum M_{ijk}} * \frac{d(P_{ijk} / P_{ijk})}{P_{ijk} / P_{ijk}}$$

Equation 2

Where:

M_{ijk} = imports from non-preference-receiving country k

ε_s = elasticity of substitution between preference-receiving and other goods

P_{ijk} = prices of goods in the preference-receiving country

P_{ijk} = prices of goods in the non-preference-receiving countries

1. Elasticities

As is evident from equations 1 and 2 above, the key inputs to the model—besides trade flows, tariffs, and NTBs—are three sets of elasticities: import (price) demand elasticities; elasticities of supply; and cross (price) elasticities of substitution.

For *import demand elasticities*, what were judged to be the best estimates available were used.¹³ These estimates did not constitute a consistent set, in terms of estimation methods or the markets or specific years they pertained to. In spite of this, the elasticities broadly reflect the differences across products. As an added precaution, however, the sensitivity of the results was tested by modifying the vector of elasticities to reflect low- and high-case assumptions.

The scenario uses an infinite *elasticity of supply* across the board. As long as increases in exports are incremental, this may be a reasonable assumption. For large increases, especially in small countries, obviously this is not realistic; in the absence of any reasonable estimate for such cases, the present author checked this assumption by doing sensitivity analysis with a unitary and a finite elasticity within generally accepted ranges.

A critical input is the *cross elasticity of substitution*, which determines the scope of trade diversion. This elasticity was assumed to be 1.5 for all products. Estimates of this elasticity are sparse, and in any case, as any estimate is specific to the product and to the pairs or groups of countries in question, there is an enormous number of possible combinations. In adopting a value for the present scenario, the author's judgement was based on a survey of the literature, particularly the work done by Cline.

2. The treatment of NTBs

For the Uruguay Round liberalization scenario, estimates of the *ad valorem* equivalents of NTBs were incorporated directly into the database. The primary source of data on NTB *ad valorem* equivalents was a 1990 survey by Laird and Yeats, supplemented by information drawn from several United States International Trade Commission studies.

3. Time horizon

A static model measures the impact of an exogenous change—in this case MFN liberalization—in terms of short-term adjustments. These adjustments typically exclude the instalment of new capacity, efficiency gains in existing production activities, and the development of new exports. It is customary to assume that the time horizon for these shorter-term adjustments is not much longer than a year.

¹³ See Cline (1978), Laird and Yeats (1986), and Stern (1975).

4. Shortcomings of the model

When interpreting the results, it is useful to keep in mind the following limitations of the partial equilibrium model:

- It omits economy-wide and international interactions through production activities.
- As a static framework, it excludes investment, technological changes, and new product lines, and is relevant only to the short term.
- The crucial elasticities used are rough estimates.
- It essentially deals with tariff cuts alone; the impact of changes in NTBs are incorporated in a rudimentary fashion.

Given these drawbacks, one might enquire as to the usefulness of the exercise. While the computation is basically an accounting or “summing up” exercise, it does provide an idea of the magnitude of the Uruguay Round agreements’ short-term impact on the ESCWA member countries’ exports of manufactured goods. This is of some value, given the large number of products involved and the diversity of tariff rates and preference margins.

Table 11 presents the projections derived from the model for most of the countries in the region relative to the three most important OECD markets (the EU, Japan and the United States). It is expected that the combined manufactured exports of the ESCWA member countries will expand by \$180 million as a result of tariff and NTB reductions—a mere 4% increase over their 1993 manufactured exports to the three largest OECD markets. It is predicted that the largest potential gain in manufactured exports will go to the United Arab Emirates, especially in Japan’s market. Next in line are the manufactured exports of Egypt, which are expected to increase by about \$43 million. The increase for Egypt will likely be highest in the American market (\$25 million), reflecting the expectation that Egyptian manufactured exports will become more competitive owing to reductions in tariffs and NTBs, and despite the fact that the preference margins accorded to Egypt’s exports in the United States are to be eroded. The reason for such an apparent anomaly is simple: on the one hand, Egypt will experience a loss in manufactured exports as a result of the erosion of its preference; on the other hand, such a loss will be more than compensated for by export gains Egypt will experience as a result of the erosion of preferences for other countries that have enjoyed relatively larger preferences in OECD markets than Egypt has. Next in line comes Saudi Arabia, with a potential net benefit of about \$36 million; however, Saudi Arabia seems positioned to experience the largest loss in any one single market (the EU) owing to the erosion of preference in that market.

Table 11. Projected effects of Uruguay Round tariff cuts on ESCWA member countries' manufactured exports
(Thousands of US dollars)

Projected change:					
Country	Actual exports	European Union	North America	Japan	Total change
<i>GCC countries</i>	3 416 880	(1 802)	42 179	72 154	112 532
Bahrain	235 387	2 636	17 466	989	21 091
Kuwait	235 648	(330)	(377)	(1 909)	(2 616)
Oman	186 406	1 640	1 734	5 667	9 041
Qatar	121 206	12	1 576	3 563	5 151
Saudi Arabia	1 761 358	(14 091)	8 102	42 273	36 284
United Arab Emirates	876 875	8 330	13 679	21 571	43 581
<i>Other ESCWA member countries</i>	1 670 772	17 373	27 445	22 461	67 279
Egypt	1 031 719	3 095	24 864	14 650	42 610
Jordan	344 909	(1 897)	2 621	7 933	8 657
Lebanon	206 441	16 350	(330)	(227)	15 793
Syrian Arab Republic	87 703	(175)	289	105	219
Total	5 087 652	15 571	69 624	94 615	179 811

Note: Totals may not add up due to rounding.

The estimations above notwithstanding, perhaps the most important impact the Uruguay Round agreements relating to market access will have on ESCWA member countries will be generated by these countries' own liberalization drives and commitments. Should the countries in the region commit themselves to lowering tariffs, binding most of their tariff lines, and effecting some significant scaling down of their NTBs, their economies will go a long way towards supporting the shift of incentives in the direction of tradeables, especially exportables, leading to a more efficient allocation of resources.

D. THE WIDER PICTURE

All of the Uruguay Round agreements were approved as a single block. As discussed earlier, the quantitative estimates presented in the previous section understate the full potential effects of the Round; far more than cuts in tariffs and NTBs were covered. The Uruguay Round negotiations were undertaken with the aim of producing a fairer, more

a fairer, more transparent multilateral trading system. It is therefore necessary to take into account intangibles such as greater competition, the existence of a much more predictable trading system and environment, and the increased exposure to scrutiny of less transparent NTBs. Of major importance are the liberalization achievements in the new areas (which for technical reasons could not be included in the calculations) and the extension of GATT disciplines to these areas. In what follows, an attempt is made to explain those achievements relevant to the manufacturing sector and to analyse their likely impact.

1. Rules

(a) Safeguards

Under the old rules, the application of measures against imports, including quantitative restrictions, were based on the GATT safeguard provision (Article XIX: Emergency Action on Imports of Particular Products). Safeguards were permitted when unexpectedly rapid import growth caused or threatened serious injury to a domestic industry as the consequence of obligations assumed under GATT. However, import-restricting measures under the safeguard provision were temporary in nature; affected parties were expected to be compensated through additional trade liberalization commitments. Although there was no clear statement on the matter, it was generally accepted that Article XIX should be applied on a non-discriminatory basis.

The compensation principle, as well as the implicit non-discriminatory application of import-restricting measures, may have been among the most important elements which discouraged Governments from using the safeguard provision. The availability of other, less burdensome and more popular means of protection may also have contributed to their less frequent use. Among these other measures were VERs (which offered exporters the opportunity to avoid the inferior outcome of import restrictions and to extract economic rents from the restrictions) as well as anti-dumping and countervailing duties. The unwillingness of countries to observe the safeguard rules constituted a major breach of GATT disciplines.

The Uruguay Round negotiations on safeguards aimed to strengthen and clarify the rules that had been established to protect industries in difficulty—rules relating to temporary import restrictions (which might include tariffs or NTBs). A second objective was to deter countries from using other "grey area" measures to restrict imports.¹⁴

¹⁴ Aside from VERs, grey area measures include orderly marketing arrangements, export moderation, export-price or import-price monitoring systems, export or import surveillance, compulsory cartels, and discretionary export or import licensing schemes.

The Agreement on Safeguards provides for a more flexible use of safeguards under tighter disciplines. It eliminates the use of all VERs and similar "grey area" measures that may restrict imports or exports within a period of not more than four years following the entry into force of the WTO Agreement. All existing safeguard measures are to be eliminated within five to eight years. A country wishing to apply any new safeguard measure must demonstrate serious injury or the threat thereof, and must immediately notify such measures to the WTO Committee on Safeguards; after reviewing the case and consulting with the concerned parties, the Committee will decide whether a safeguard measure should be applied.

Overall, the Agreement is a mixed blessing. Safeguards may discriminate among suppliers, but only in exceptional cases, where imports from a country Member increase disproportionately. Under such circumstances, the country applying the restrictions may *seek agreement with respect to the allocation of the quota among Members with substantial interest in the affected product*, or, alternatively, the restricting country may allot shares to the Members concerned which reflect the latter's historical performance. Furthermore, no compensation or retaliation is foreseen during the first three years that a measure is applied.

On the positive side, the duration of safeguard measures is limited; further, a measure cannot be renewed for a period of time equal to that during which it was originally applied, and in any event not until two years has elapsed since the previous application of the measure.¹⁵ Additionally, safeguard measures must be progressively liberalized during their application and are subject to surveillance and review if they last for more than three years.

The Agreement contains three special provisions that provide developing countries with greater flexibility. First, developing countries can maintain safeguard measures for a period of ten years instead of eight. Second, they may reimpose safeguard measures after half the time of a previous application, as long as the minimum two-year period of non-application has elapsed. Third, developing country exports which account for less than 3% of a country's imports of a specific product are exempted from safeguard action, provided that all developing country Members with less than a 3% share account for less than a 9% share overall.

The Agreement tightens procedures in significant ways, adding greater accountability and discipline in the use of safeguard measures. Its commitment to eliminating all VERs is perhaps one of its most important components. However, on the

¹⁵The application of safeguard measures is limited to four years initially but can be extended for an additional (maximum) period of four years, provided conditions warrant this and there is evidence that the concerned industry is adjusting. Developing countries can maintain safeguard measures for a maximum of 10 years.

less positive side, the Agreement weakens the obligation to provide compensatory liberalization remedies once a safeguard measure is taken. Also of concern is the fact that the Agreement relaxes both the non-discrimination and retaliation rules. The combination of these factors could lead to the more widespread use of safeguard measures. (One should note, however, that a primary goal of the revised rules on safeguards has been to push countries away from using discretionary, non-transparent and largely uncontrolled measures of contingency protection.)

Allowing quota allocations to be discriminatory under certain circumstances deprives GATT of one of its most important pillars: the MFN clause. Perhaps equally serious is the issue of allowing quota allocations to be agreed upon between the importing and exporting countries. Within such a context, there is a risk that concealed VER-type measures could re-emerge.

The net impact these diverse elements will have on ESCWA member countries is hard to predict at this stage. Indeed, much will depend on the extent to which Governments take advantage of their new rights under the Agreement to apply quantitative restrictions rather than price-based measures when they take safeguard actions. The impact on ESCWA member countries will also depend on whether the new disciplines relating to anti-dumping and countervailing duties are strong enough to prevent the *de facto* substitution of VERs and other safeguard measures with unfair trade remedies. Further research on this topic will be warranted as events unfold.

(b) *Anti-dumping*

The anti-dumping code, formally called the Agreement on Implementation of Article VI, allows for the imposition of anti-dumping duties following proof that dumping has taken place and a domestic industry has been injured, and that the dumped imports are the cause of injury. Under the old rules, anti-dumping duties against unfair trade practices have increasingly lent themselves to protectionist ends. The code's detailed and complex procedures have left many issues lacking in clarity. Thus, national statutes have increasingly developed beyond the reach of the code, and may have conveniently served as surrogates for selective safeguards.

The Agreement seeks to strengthen the rules on anti-dumping, and contains some improved provisions with respect to dumping-margin calculations, injury determination, the definition of domestic industry, investigation procedures, and standards of evidence; further, it imposes disciplines with regard to the transparency of anti-dumping procedures.

The Agreement contains a specification of *de minimis* provisions related to the margin and volume of dumping for terminating proceedings: anti-dumping cases are to be dropped if the margin of dumping is less than 2% (of the export price), or if the volume of dumped imports from a particular country represents less than 3% of imports of the

same product in the importing Member country (or less than 7% collectively among exporters that each supply less than a 3% share). Under such provisions, the cumulation of imports from more than one country in an injury investigation is not permitted. Otherwise, the Agreement allows for "cumulation"—the assessment of injury by aggregating imports across several exporting countries.

The Agreement requires that anti-dumping duties remain in place for no longer than five years unless a review demonstrates that the removal of duty would likely lead to the continuation of dumping and injury. Moreover, it limits the freedom of WTO dispute settlement panels to examine the merits of disputes concerning anti-dumping actions. The panels are limited to a consideration of "whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective" (Article 17, paragraph 6, of the Agreement). If these standards are satisfied, a decision by a national authority cannot be overturned, even in cases where the panel might have reached a different conclusion. Furthermore, the Agreement does not include any provisions for anti-circumvention measures designed to penalize exporters who shift the location of production in order to avoid anti-dumping duties. However, the Ministerial Declaration on Anti-Circumvention was issued in recognition of the problem and the need to develop appropriate rules as soon as possible.

Finally, the Agreement stipulates that developing countries are to be given special consideration, stressing that the possibility of constructive remedies should be explored prior to the initiation of anti-dumping actions against their exports.

Although the Agreement provides clearer and firmer rules in many instances, it remains to be seen whether these rules will continue to be subject to discretionary interpretations by national authorities. This is especially relevant in view of the limited extent to which a multilateral authority can challenge national anti-dumping laws through its own dispute settlement procedures.

The number of anti-dumping cases brought against ESCWA member countries' exports has grown lately—as has the tendency for these countries to resort to anti-dumping actions of their own. These trends may undermine the expected gains from trade liberalization. This issue merits further exploration as new anti-dumping measures are initiated.

(c) Subsidies and countervailing measures

The code on subsidies and countervailing duties is formally known as the Agreement on Interpretation and Application of Articles VI, XVI and XXIII. The code provides rules that are intended to protect access commitments with respect to domestic markets and to control intrusions into foreign markets via government assistance (through subsidy payments).

In the pre-Uruguay Round trading environment, the code outlawed export subsidies on manufactured products and indicated that subsidies on primary products should be avoided. In cases where primary products were being subsidized, a country was not to acquire more than a fair share of trade in the subsidized product. The rules and disciplines for production subsidies were regarded as being weak; the only stipulation was that such subsidies could not be used in ways that adversely affected the industry of another country or that nullified or impaired in any way the benefits that would otherwise accrue under the GATT provisions.

The aims of the Uruguay Round negotiations were to restrain the use of all subsidies and to improve the rules on countervailing duties. The resulting Agreement on Subsidies and Countervailing Measures has gone a long way towards clarifying the rules and disciplines in both areas.

Rules on subsidies are now classified under three different categories: prohibited, actionable, and non-actionable. Prohibited subsidies include all non-agricultural subsidies and subsidies contingent upon domestic content requirements. They will be subject to new dispute settlement procedures, the main feature of which is an expedited timetable for action by the WTO Dispute Settlement Body (DSB). Actionable subsidies are those that cause injury, the nullification or impairment of benefits, or serious prejudice;¹⁶ matters related to this category of subsidies may also be referred to the DSB. Finally, non-actionable subsidies include specific subsidies or non-specific subsidies which help support industrial research and pre-competitive development activity, those which constitute assistance to disadvantaged regions, and those used for environmental adaptation. Agricultural subsidies are not covered by the provisions of this Agreement.

The Agreement also: sets out disciplines relating to the initiation of countervailing cases, investigations by national authorities, and rules of evidence; outlines disciplines for the calculation of subsidy; and establishes the basis for the determination of injury to domestic industry. It provides for the termination of countervailing investigations in cases where the amount of subsidy is less than 1% on an *ad valorem* basis. In general, all countervailing investigations must be concluded within one year, and in no case can the proceedings stretch beyond 18 months. Finally, all countervailing duties are to be terminated within five years of their imposition, unless such an action could lead to the continuation or recurrence of subsidization and injury.

Several provisions in the Agreement introduce greater flexibility for developing countries. Any developing country with an annual per capita income of less than \$1,000 is allowed to maintain export subsidies. Furthermore, non-recurring subsidies in

¹⁶ Serious prejudice occurs in cases where the amount of the total *ad valorem* subsidy exceeds 5%, where subsidies are used to cover operating losses, or where there is direct debt forgiveness.

developing countries which are linked to privatization programmes are not actionable under this Agreement. Once a developing country graduates (i.e., when its per capita income exceeds \$1,000), that country is given a maximum of eight years to phase out export subsidies (there is, however, some provision for extension). Economies in transition are given a maximum of seven years to do the same. The prohibition of subsidies linked to domestic content requirements will not apply to developing countries for five years, or to least-developed countries (LDCs) for eight years. Finally, *de minimis* provisions exempt developing countries from countervailing duties when their subsidy levels do not exceed 2% (or 3% in countries accelerating the timetable for eliminating export subsidies), or when their import shares represent less than 4% of a particular product (or less than 9%, cumulatively, among the countries benefiting from this provision).

Table 9 presents some evidence with respect to the sectors that remain subject to post-Uruguay Round measures affecting developing countries' exports into developed country markets; among such measures, anti-dumping actions and countervailing duties have become the most important. Their trade-coverage ratios (based on 1992 trade flows) are as high as 16.5% for iron and steel products and 12.8% for both travel goods and plastic materials. However, it should be understood that anti-dumping actions and countervailing duties can be justified by unfair behaviour on the part of foreign suppliers—unlike safeguards, which carry with them a domestic industry's implicit admission that it is unable to compete. The Agreement contains incentives for developing countries to curtail the practice of offsetting domestic protection with export subsidies; this should contribute greatly towards curbing their open-ended use. Further, under the provisions of the Agreement, it is now much harder for certain industrial markets to use countervailing duties for protectionist purposes. The combination of these factors will do much to reduce friction in this area.

2. *New areas*

The Uruguay Round dealt with a number of traditional and contentious issues affecting the multilateral trading system, but it also took on other challenges. The new issues it sought to bring under the GATT umbrella included trade-related aspects of intellectual property rights, trade-related investment measures, and trade in services. Bringing these issues under GATT was regarded as necessary to keep the system relevant in the face of widespread changes in international economic relations. Globalization trends in the world economy have made it imperative to search for international rules and regulations to address the new realities. Their introduction has extended the purview of the trading system beyond goods markets to include factor and services markets as well. Some of these new issues are discussed below.

(a) *Trade-related aspects of intellectual property rights (TRIPs)*

The Agreement on Trade-Related Aspects of Intellectual Property Rights can be described as far-reaching, given that it covers substantive issues related to intellectual property rights and contains specific measures for their enforcement. It develops rules designed to extend the protection of such rights to all participating countries. The Agreement establishes that national treatment and MFN treatment are to apply with respect to all intellectual property rights covered by the Agreement. It also establishes minimum standards for the protection of these rights, provisions for their enforcement and for dispute settlement and prevention, and transitional arrangements. The minimum standards of protection cover seven areas: copyright, trademarks, geographical indications, industrial designs, patents, layout-designs of integrated circuits, and undisclosed information. The Agreement also addresses matters relating to the control of anti-competitive practices in connection with contractual licences; it calls for consultations among Governments, stressing that remedies against such abuses must be consistent with other provisions of the Agreement.

The enforcement provisions are designed to ensure that the intellectual property rights recognized under the Agreement can be effectively enforced by foreign rights holders as well as by a country's own nationals. Consultations and the settlement of disputes are to be handled according to WTO dispute settlement procedures; however, under the dispute settlement provisions, non-violation complaints are excluded for a period of five years.

Developed countries were given one year following the establishment of the WTO to implement the Agreement, while developing countries and economies in transition are given a five-year transition period (except with respect to national treatment and MFN commitments). Least-developed economies are afforded up to 11 years to follow suit, with the possibility of further extensions. No action is to be taken during the transition period (i.e., changes in laws, regulations or practices) that may result in lessening the degree of consistency with the provisions of the Agreement. Moreover, all inventions relating to pharmaceuticals and agricultural chemical products which are patented after the entry into force of the WTO Agreement are protected regardless of any transitional commitments, except in least-developed countries; however, LDCs will still be required to provide exclusive marketing rights.

Benefits from the Agreement will accrue to those ESCWA member countries that have already started to develop and export technology-intensive products and services. Some ESCWA member countries may experience a rise in foreign direct investment in high-technology industries resulting from their adoption of the Agreement—a substantial benefit in the light of the fact that this may be regarded as a precondition for the transfer of technology. The potential benefits for ESCWA member countries will also depend on the extent to which the absence of intellectual property protection affects the supply of

research and development (R&D) in their own countries. Moreover, to the extent that a particular country or countries have been penalized for property rights infringements, the Agreement will further serve to reduce tensions.

The impact may be different for those ESCWA member countries that have less scope for attracting technology-intensive investments or exporting technology-intensive products and services, or whose market size precludes their benefiting from the protection of intellectual property rights. Empirical research in this area is of paramount importance; it would be useful to conduct an industry-by-industry analysis, and to match each industry with particular patterns of consumption in the ESCWA member countries and determine their respective market sizes.

(b) *Trade-related investment measures (TRIMs)*

The Agreement on Trade-Related Investment Measures explicitly acknowledges that certain measures governing the treatment of investment have restrictive or distorting effects on trade. The Agreement, which applies only to investment measures related to trade in goods, provides that no signatories shall apply any TRIM inconsistent with Articles III (on national treatment) and XI (on the general elimination of quantitative restrictions) of the General Agreement on Tariffs and Trade 1994. An illustrative list of TRIMs considered inconsistent with these articles has been annexed to the Agreement; the list covers the following types of prohibited TRIMs:

- Those that require particular levels of local sourcing by an enterprise (i.e., local content requirements)
- Those which restrict the volume or value of imports which an enterprise can buy or use to the volume or value of products it exports (i.e., trade-balancing requirements)
- Those that restrict the volume of imports to the amount of foreign exchange inflows attributable to an enterprise
- Those which restrict the export of products by an enterprise, whether specified in terms of the particular type, volume or value of products or in terms of a proportion of volume or value of local production

Prohibited practices under the Agreement include both those that are mandatory in nature and those with which compliance is necessary to obtain an advantage.

The Agreement requires that Members notify the WTO Council on Trade in Goods of all TRIMs they are applying that are not in conformance with the provisions of the Agreement (notification was to be made within 90 days of the entry into force of the

WTO Agreement). Such TRIMs must be eliminated over transition periods of two years from the entry into force of the WTO Agreement for developed countries, five years for developing countries, and seven years for least-developed countries. The Agreement provides for the establishment of a Committee on TRIMs to monitor the implementation of commitments. Consultations and the settlement of disputes under the Agreement are to be handled within the integrated WTO dispute settlement system. No later than five years following its entry into force, the Agreement is to be reviewed with a view to proposing, as appropriate, amendments to its text (including a broadening of the illustrative list) and considering the scope for complementary provisions on investment and competition policy.

Developing countries have the option of temporarily applying TRIMs contained in the illustrative list, but only in accordance with the provisions outlined in Article 4 of the Agreement.

Limiting the use of measures relating to both local-content and trade-balancing requirements will serve the interests of those ESCWA member countries that are most committed to creating a neutral trading and investment environment. Performance requirements not only have trade-distorting effects; they also create disincentives for foreign firms, because they act as an implicit tax. In attempting to counterbalance these disincentives, countries more often than not grant investment incentives; however, the latter distort the free-trade pattern of investment in the same way tariffs do. In most cases, the overall impact of such practices has been welfare-reducing. Curtailing their use will therefore save ESCWA member countries lost income and opportunities. Further research is warranted on the nature and sectoral incidence of the remaining TRIMs in ESCWA member countries, as well as on the broad typology of investment barriers which would likely be the object of more comprehensive rule-making in the future.

3. Institutional arrangements

(a) An integrated dispute settlement system

The Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) brings the GATT dispute settlement system up to date by building upon existing GATT practices and extending them in significant ways. This has been achieved through the introduction of greater speed and automaticity into dispute settlement procedures—and the consequent elimination of competing forums within the system. The integrated system was set up to ensure procedural and interpretative consistency in dispute settlement practices across all issues. It provides for greater automaticity in the following areas:

- The establishment of a dispute settlement panel if bilateral consultations fail

- The adoption of reports by dispute settlement panels
- The right of retaliation in the event of non-compliance with adopted panel recommendations. Adoption of panel reports has been changed from “consensus to accept” to “consensus to reject”; in other words, the arrangements virtually guarantee the adoption of panel findings, which can only be blocked by a consensus decision.

Furthermore, the Understanding establishes an appellate review body whose rulings are binding, as are the findings of adopted panel reports. The Understanding also provides for a system of surveillance and follow-up of the implementation of dispute settlement decisions.

Under prescribed conditions, the Understanding also allows for the possibility of cross-sectoral retaliation in the areas of goods, services and intellectual property rights. All of these steps are governed by strict timetables, as the entire proceedings must be completed within 18 months of the first request for consultation. Moreover, the Understanding limits unilateral actions by requiring that multilateral dispute settlement procedures be followed; unilateral determinations must not be made on whether a violation has occurred or whether benefits have been nullified or impaired. Finally, the Understanding establishes that central Governments are responsible for the actions of local authorities and must pay compensation or face retaliation in the event that the latter violate any WTO provision(s).

The automatic panel adoption provisions (which make it procedurally difficult to block findings) and the limitations imposed on unilateral actions will serve the interests of the ESCWA member countries. Both will go a long way towards reducing trade friction, and will therefore contribute to a more stable trading environment. Finally, the more demanding rules leave less room for manoeuvring and intensify pressure on countries to comply with rulings.

(b) *The World Trade Organization (WTO)*

The Marrakesh Agreement Establishing the World Trade Organization—more commonly known as the WTO Agreement—is one of the most important achievements of the Uruguay Round. It enhances GATT surveillance mechanisms (through regular reviews of Members’ trade policies and annual review of international trade), improves the overall effectiveness of the institution (through regular ministerial meetings), and increases its contribution to coherence in policy-making (through collaboration between the WTO, the World Bank and the International Monetary Fund).

The WTO brings all the Uruguay Round agreements, among them GATT 1994 and four plurilateral agreements,¹⁷ under one umbrella. The WTO replaces the provisional accession instruments through which countries joined GATT from 1947 onward; this implies the elimination of the grandfather clause contained in the provisional accession protocols, under which countries could avoid any GATT discipline that contradicted pre-existing mandatory legislation.

Under the WTO, the new multilateral trading system is legally established as a single, indivisible undertaking. WTO membership is conditional upon countries having schedules of concessions and commitments on market access for industrial and agricultural products and for services; it also implies acceptance of GATT 1994 (which comprises GATT 1947 and all amendments to it, including the Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994) as well as all of the other Uruguay Round agreements. This concept of a single undertaking underlying the WTO means that developing countries are assuming more extensive and higher levels of obligations than ever before (notwithstanding special provisions of the various agreements which allow for longer transitions, extensions, waivers and so on).

The tendency of the multilateral trading system to splinter into different layers is held in check under this new, unified structure. The ESCWA member countries that belong to the WTO must make every effort to exercise their rights and fulfil their obligations within this context; countries that do so may be expected to benefit greatly.

E. CONCLUDING REMARKS AND SUGGESTIONS FOR FURTHER WORK

The present paper assesses the impact of the Uruguay Round agreements on the ESCWA member countries' exports of manufactured products. The assessment is made with reference to liberalization achievements relating to tariff and NTB reductions in the three main OECD markets; also considered are the "intangibles" that may affect trade in manufactured goods.

The empirical results suggest that the implementation of the Uruguay Round agreements will lead to a net increase of \$178 million in the ESCWA member countries' manufactured exports to the main OECD markets, which represents a 4% expansion over 1993 exports. The technical limitations inherent in all exercises of this type are such that the net benefits have almost certainly been underestimated.

¹⁷ These include the Agreement on Trade in Civil Aircraft, the Agreement on Government Procurement, the International Dairy Arrangement, and the International Bovine Meat Agreement.

Indeed, there are good reasons for believing that the benefits accruing to ESCWA member countries from the Uruguay Round negotiations and agreements will go well beyond what is quantifiable. In particular, quantitative studies do not take into account the effects of strengthening and extending GATT rules and disciplines across new areas (thereby making competition fairer and more transparent) or the effects of easing bilateral trade tensions and associated political conflict. Nor do they reflect the advantages associated with the fuller integration of developing countries and former State trading economies into the multilateral system. Finally, the results fail to reflect the benefits from enhanced efficiency evolving from ESCWA member countries' own unilateral, regional and multilateral liberalization commitments. As mentioned before, the results are reported with respect to gains in OECD markets, where ESCWA member countries exported some 42% of their combined 1992 total (gains in developing countries where reliable data are hard to come by are excluded from the analysis).

Various sections of the paper call for additional research as events unfold. Certain topics merit further detailed analysis, so that appropriate sets of policies can be developed which will allow the ESCWA member countries to take full advantage of the achievements of the Uruguay Round; since many of the agreements will be phased in over an extended period, the countries of the region will be given ample time to adjust in an optimal manner.

ANNEX TABLES

Annex table 1. Export profile of Bahrain

	1990-1991 value (in US dollars)	Percentage of country's exports	Percentage of total developing country exports	Percentage of world exports
All commodities	3 635 411	100.00	0.53	0.11
Petroleum products, refined	2 808 082	77.24	7.72	3.03
Aluminium	436 534	12.01	9.12	1.51
Inorganic elements	60 794	1.67	2.75	0.48
Alcohol, phenols, etc.	50 466	1.39	3.43	0.63
Pearls, precious, semi-precious	37 362	1.03	0.69	0.14
Gas, natural and manufactured	35 861	0.99	0.26	0.10
Crude petroleum	23 986	0.66	0.02	0.01
Hydrocarbons	18 341	0.50	1.05	0.12
Electrical equipment	15 042	0.41	0.64	0.11
Aircraft, etc.	14 574	0.40	0.75	0.02
Measuring, controlling instruments	12 364	0.34	0.82	0.03
Fish	9 585	0.26	0.24	0.06
Rubber tyres	9 219	0.25	0.40	0.06
Gold, silverware	8 629	0.24	0.23	0.06
Women's outerwear, non-knit	8 383	0.23	0.08	0.03
Structures and parts n.e.s.	7 596	0.21	0.92	0.08
Remainder	78 593	2.17		

Annex table 2. Export profile of Egypt

	1990-1991 value (in US dollars)	Percentage of country's exports	Percentage of total developing country exports	Percentage of world exports
All commodities	3 137 320	100.00	0.45	0.09
Crude petroleum	1 088 458	34.69	0.75	0.56
Textile yarn	350 956	11.19	5.00	1.49
Petroleum products, refined	200 227	6.38	0.55	0.22
Aluminium	183 617	5.85	3.84	0.64
Cotton	134 815	4.30	3.53	1.49
Cotton fabrics, woven	96 127	3.06	2.07	0.63
Vegetables, fresh, simply preserved	74 827	2.39	1.74	0.41
Gas, natural and manufactured	66 108	2.11	0.48	0.19
Fruits, nuts, fresh, dried	60 021	1.91	0.82	0.30
Men's outerwear, non-knit	58 276	1.86	0.76	0.32
Outerwear, knit, non-elastic	51 069	1.63	0.45	0.19
Furniture, parts thereof	49 942	1.59	1.25	0.16
Perfumery, cosmetics	37 410	1.19	3.72	0.36
Textile articles n.e.s.	36 064	1.15	1.28	0.42
Rice	29 553	0.94	1.44	0.72
Floor coverings, etc.	27 887	0.89	1.41	0.33
Remainder	591 963	18.87		

Annex table 3. Export profile of Jordan

	1990-1991 value (in US dollars)	Percentage of country's exports	Percentage of total developing country exports	Percentage of world exports
All commodities	900 325	100.00	0.13	0.03
Fertilizers, crude	332 417	36.92	27.29	20.44
Fertilizers, manufactured	123 209	13.68	5.23	0.84
Vegetables, fresh, simply preserved	59 262	6.58	1.38	0.33
Medicinal, pharmaceutical products	55 714	6.19	2.39	0.14
Lime, cement, building products	38 557	4.28	2.53	0.51
Polymerization (etc.) products	22 805	2.53	0.38	0.05
Soap, cleansing (etc.) preparations	20 091	2.23	2.49	0.29
Other inorganic chemicals, etc.	19 259	2.14	2.42	0.24
Fruits, nuts, fresh, dried	13 546	1.50	0.19	0.07
Textile yarn	13 403	1.49	0.19	0.06
Eggs, birds, fresh, preserved	11 290	1.25	12.24	0.87
Gold, silverware, jewellery	9 230	1.03	0.25	0.07
Paper (etc.), precut, arts	8 251	0.92	0.59	0.06
Live animals for food	7 695	0.85	0.51	0.09
Articles of plastic n.e.s.	7 294	0.81	0.14	0.02
Pesticides, disinfectants	6 890	0.77	1.29	0.10
Remainder	151 412	16.82		

Note: Totals may not add up due to rounding.

Annex table 4. Export profile of Kuwait

	1990-1991 value (in US dollars)	Percentage of country's exports	Percentage of total developing country exports	Percentage of world exports
All commodities	3 914 837	100.0	0.57	0.12
Fertilizers, crude	1 940 453	49.57	1.34	1.00
Fertilizers, manufactured	1 422 640	36.34	3.91	1.53
Vegetables, fresh, simply preserved	140 111	3.58	1.01	0.41
Medical, pharmaceutical products	35 197	0.90	1.81	0.05
Lime, cement, building products	32 678	0.83	4.45	0.64
Polymerization (etc.) products	25 781	0.66	1.09	0.18
Soap, cleansing (etc.) preparations	24 850	0.63	0.39	0.01
Other inorganic chemicals, etc.	21 963	0.56	1.40	0.12
Fruits, nuts, fresh, dried	18 727	0.48	2.40	0.08
Textile yarn	17 075	0.44	0.35	0.03
Eggs, birds, fresh, preserved	15 002	0.38	3.93	1.00
Gold, silverware, jewellery	12 928	0.33	0.55	0.09
Paper (etc.), precut, arts	12 407	0.32	1.55	0.11
Live animals for food	12 169	0.31	0.55	0.10
Articles of plastic n.e.s.	11 979	0.31	0.85	0.09
Pesticides, disinfectants	10 891	0.28	1.32	0.11
Remainder	159 985	4.09		

Note: Totals may not add up due to rounding.

Annex table 5. Export profile of Oman

	1990-1991 value (in US dollars)	Percentage of country's exports	Percentage of total developing country exports	Percentage of world exports
All commodities	5 044 498	100.00	0.73	0.15
Crude petroleum	4 497 794	89.16	3.10	2.33
Passenger motor vehicles, excluding buses	116 411	2.31	1.81	0.07
Aircraft, etc.	40 400	0.80	2.08	0.06
Motor vehicle parts and accessories n.e.s.	36 748	0.73	1.13	0.04
Copper, excluding cement copper	30 812	0.61	0.43	0.14
Fish, fresh, chilled, frozen	29 051	0.58	0.72	0.19
Civil engineering equipment	19 197	0.38	1.86	0.11
Tobacco, manufactured	18 859	0.37	1.22	0.16
Petroleum products, refined	16 603	0.33	0.05	0.02
Zoo animals, pets, etc.	14 926	0.30	19.83	5.30
Special transactions	12 865	0.26	0.26	0.02
Watches and clocks	11 397	0.23	0.31	0.08
Aluminium	10 903	0.22	0.23	0.04
Undergarments, non-knit	10 245	0.20	0.24	0.14
Outerwear, knit, non-elastic	10 177	0.20	0.09	0.04
Shellfish, fresh, frozen	9 394	0.19	0.14	0.08
Remainder	158 715	3.15		

Note: Totals may not add up due to rounding.

Annex table 6. Export profile of Qatar

	1990-1991 value (in US dollars)	Percentage of country's exports	Percentage of total developing country exports	Percentage of world exports
All commodities	3 317 968	100.00	0.48	0.10
Crude petroleum	2 508 940	75.62	1.73	1.30
Petroleum products, refined	186 820	5.63	0.51	0.20
Iron, steel shapes, etc.	158 074	4.76	5.34	0.84
Polymerization (etc.) products	142 391	4.29	2.37	0.29
Gas, natural and manufactured	111 677	3.37	0.81	0.33
Fertilizers, manufactured	97 054	2.93	4.12	0.67
Hydrocarbons n.e.s., derivatives	37 634	1.13	2.16	0.24
Inorganic elements, oxides, etc.	26 098	0.79	1.18	0.21
Products of condensation, etc.	18 824	0.57	1.41	0.12
Men's outerwear, non-knit	7 736	0.23	0.10	0.04
Soap, cleansing (etc.) preparations	3 730	0.11	0.46	0.05
Sulphur, unstd in pyrte	3 655	0.11	0.96	0.24
Meat, fresh, chilled, frozen	2 386	0.07	0.07	0.01
Hides, skins, excluding furs	2 151	0.06	0.45	0.04
Gold, silverware, jewellery	1 617	0.05	0.04	0.01
Structures and parts n.e.s.	1 428	0.04	0.17	0.02
Remainder	7 753	0.23		

Note: Totals may not add up due to rounding.

Annex table 7. Export profile of Saudi Arabia

	1990-1991 value (in US dollars)	Percentage of country's export	Percentage of total developing country exports	Percentage of world exports
All commodities	45 784 351	100.00	6.63	1.36
Crude petroleum	34 497 894	75.35	23.76	17.85
Petroleum products, refined	4 539 971	9.92	12.49	4.89
Gas, natural and manufactured	1 946 642	4.25	14.04	5.70
Polymerization (etc.) products	794 932	1.74	13.21	1.64
Alcohol, phenols, etc.	410 914	0.90	27.97	5.13
Hydrocarbons n.e.s., derivatives	293 422	0.64	16.86	1.91
Inorganic elements, oxides, etc.	187 105	0.41	8.46	1.49
Wheat (etc.), unmilled	154 329	0.34	14.58	1.05
Other organic chemicals	106 035	0.23	20.58	1.50
Sulphur, unstd in pyrte	105 416	0.23	27.61	7.03
Fertilizers, manufactured	89 217	0.19	3.79	0.61
Gold, silverware, jewellery	81 036	0.18	2.20	0.60
Engines and motors n.e.s.	72 265	0.16	9.27	0.32
Residual petroleum products n.e.s.	71 111	0.16	9.69	1.39
Iron, steel shapes, etc.	70 667	0.15	2.39	0.38
Lime, cement, building products	60 745	0.13	3.99	0.80
Remainder	2 302 650	5.03		

Note: Totals may not add up due to rounding.

Annex table 8. Export profile of the Syrian Arab Republic

	1990-1991 value (in US dollars)	Percentage of country's exports	Percentage of total developing country exports	Percentage of world exports
All commodities	3 822 020	100.00	0.55	0.11
Crude petroleum	1 902 339	49.77	1.31	0.98
Petroleum products, refined	342 816	8.97	0.94	0.37
Perfumery, cosmetics, etc.	249 080	6.52	24.80	2.39
Cotton	194 648	5.09	5.10	2.16
Live animals for food	190 407	4.98	12.69	2.16
Fabric, woven, man-made fibre	173 874	4.55	2.13	0.77
Outerwear, knit, non-elastic	92 672	2.42	0.81	0.35
Vegetables (etc.) fresh, simply preserved	85 318	2.23	1.99	0.47
Fabrics, knit, etc.	73 609	1.93	2.75	1.14
Fertilizers, crude	48 751	1.28	4.00	3.00
Undergarments, knit	39 547	1.03	0.64	0.30
Women's outerwear, non-knit	33 345	0.87	0.30	0.12
Fruits, nuts, fresh, dried	32 589	0.85	0.45	0.16
Men's outerwear, non-knit	28 616	0.75	0.37	0.16
Fruits, preserved, prepared	22 677	0.59	0.69	0.25
Cereal (etc.) preparations	18 008	0.47	2.18	0.18
Remainder	293 724	7.69		

Note: Totals may not add up due to rounding.

Annex table 9. Export profile of the United Arab Emirates

	1990-1991 value (in US dollars)	Percentage of country's exports	Percentage of total developing country exports	Percentage of world exports
All commodities	16 013 959	100.00	2.32	0.48
Crude petroleum	11 909 687	74.37	8.20	6.16
Gas, natural and manufactured	1 053 371	6.58	7.60	3.08
Petroleum products, refined	1 015 536	6.34	2.79	1.09
Aluminium	248 797	1.55	5.20	0.86
Residual petroleum products n.e.s.	106 973	0.67	14.57	2.09
Gold, non-monetary n.e.s.	81 486	0.51	4.40	0.54
Gold, silverware, jewellery	66 814	0.42	1.82	0.49
Undergarments, knit	58 234	0.36	0.95	0.44
Special transactions	56 293	0.35	1.15	0.09
Fruits, nuts, fresh, dried	54 352	0.34	0.74	0.27
Women's outerwear, non-knit	53 606	0.33	0.49	0.20
Undergarments non-knit	51 930	0.32	1.21	0.70
Lime, cement, building products	50 463	0.32	3.31	0.66
Fertilizers, manufactured	43 455	0.27	1.84	0.30
Engines and motors n.e.s.	42 136	0.26	5.41	0.18
Nonferrous metals, scrap n.e.s.	41 812	0.26	6.10	0.69
Remainder	1 079 014	6.74		

Note: Totals may not add up due to rounding.

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IV. A PRELIMINARY ANALYSIS OF OPPORTUNITIES AND CHALLENGES RESULTING FROM THE URUGUAY ROUND AGREEMENT ON TEXTILES AND CLOTHING

by the UNCTAD secretariat

Introduction

International trade in textiles and clothing has been governed for decades by a special trade regime. After the inception of the cotton textile arrangement in the early 1960s, this regime progressively increased its product and country coverage and intensified its discriminatory character. While developing countries have gained an important share in world trade in textiles and clothing, the opportunities for export growth have been seriously restricted by the Arrangement Regarding International Trade in Textiles (also known as the Multi-fibre Arrangement, or MFA). In 1992, the value of world trade in textiles and clothing amounted to \$285 billion, which was equivalent to about 8% of total world trade in goods. Textiles and clothing accounted for nearly 26% of developing countries' exports of manufactures and 15.5% of their total exports of goods.

In the sections that follow, the paper summarizes the main provisions and elements of the Agreement on Textiles and Clothing (also referred to here as the Agreement or the ATC); identifies the trading opportunities and improvements in market-access conditions in this sector resulting from the implementation of the ATC, including tariff reductions and other trade-liberalization measures undertaken by all countries; examines measures and issues that may affect the implementation of the ATC; and assesses the implications of the ATC for the international trading system as a whole.

A. MAIN FEATURES OF THE AGREEMENT ON TEXTILES AND CLOTHING

The Agreement on Textiles and Clothing is not merely a plan for phasing out the MFA; it is also an integral part of the Marrakesh Agreement Establishing the World Trade Organization (the WTO Agreement). The ATC is applicable to all WTO Members, whether signatories to the MFA or not; all their trade in textiles and clothing is subject to the provisions of this Agreement, with the exception of those products phased into the General Agreement on Tariffs and Trade (GATT) 1994 under the integration programme described below. In contrast, the MFA was only applicable to trade in textiles and clothing among MFA signatories, and thus could only be legally applied against those exporting countries which had agreed to be subject to its provisions.

First and foremost, the Agreement provides for the phasing out of the MFA, leading to the complete integration of the textile and clothing sector into GATT by the end

of the 10-year transition period. The phasing-out process comprises two aspects: the integration of the sector into GATT through the gradual elimination of the export restraints contained in bilateral agreements; and the increases in growth rates for the quotas of the products still remaining under restriction during the 10-year transition period.

The main market-access elements of the ATC are summarized below.

1. Integration programme

The Agreement requires that the products listed in its annex (in terms of Harmonized Commodity Description and Coding System [HS] lines and categories), including those subject to MFA restrictions, be integrated into GATT 1994 in four stages, as follows:

- *Stage one:* by 1 January 1995, not less than 16% of the total volume of the Member's 1990 imports of the products listed in the annex
- *Stage two:* by 1 January 1998, not less than an additional 17% of the total volume of the Member's 1990 imports of the products listed in the annex
- *Stage three:* by 1 January 2002, not less than an additional 18% of the total volume of the Member's 1990 imports of the products listed in the annex
- *Stage four:* by 1 January 2005, the textiles and clothing sector shall stand integrated into GATT 1994, all restrictions under this Agreement having been eliminated.

The Agreement stipulates that the integration at each stage must include products from each of the four groups of tops and yarns, fabrics, made-up textile products and clothing. The selection of products is left up to the importing countries.

2. Increases in growth rates for MFA quotas

Article 2, paragraphs 13 and 14, of the ATC provides for an annual increase of the established growth rate (i.e., that of the former MFA restraints carried over into this Agreement) for the remaining restrictions during each of the first three stages of the integration programme, as follows:

- For *stage one* (1 January 1995 to 31 December 1997), "the level of each restriction under MFA bilateral agreements in force for the 12-month period prior to the date of entry into force of the WTO Agreement shall

be increased annually by not less than the growth rate established for the respective restrictions, increased by 16%”

- For *stage two* (1 January 1998 to 31 December 2001), “the growth rate for the respective restrictions during stage one, increased by 25%”
- For *stage three* (1 January 2002 to 31 December 2004), “the growth rate for the respective restrictions during stage two, increased by 27%” (GATT, 1994b)

3. Increases in growth rates for MFA quotas for small suppliers

Under Article 2, paragraph 18, of the ATC, small suppliers whose exports subject to restrictions represented 1.2% or less of the total volume of the restrictions applied by an importing Member as of 31 December 1991 shall be granted meaningful improvement in access for their exports during the duration of this Agreement, through the advancement by one stage of the growth rates; in other words, their growth rates shall be increased at the beginning of each stage by 25%, 27%, and 27% respectively, instead of 16%, 25%, and 27%.

4. The phasing out of other non-MFA restrictions

The Agreement on Textiles and Clothing also stipulates that all GATT-inconsistent non-MFA restrictions shall be either brought into conformance with GATT 1994 within one year of the entry into force of the WTO Agreement or phased out progressively under a programme during the period covered by the ATC.

5. The transitional safeguards mechanism

Parallel to the progressive phasing out of both MFA and GATT-inconsistent non-MFA quantitative restrictions, the Agreement (under Article 6) permits the continued imposition of new quantitative restrictions by all WTO Members on a product or products (i.e., those listed in the annex that have not yet been integrated into GATT 1994 under the integration programme) of a specific Member or Members on a discriminatory basis for up to three years during the transition period under the so-called transitional safeguards mechanism. Members which were signatories to the MFA but not maintaining MFA restrictions were permitted to retain the right to use the transitional safeguards as long as they notified the WTO Textiles Monitoring Body (TMB) of their intention within 60 days of the entry into force of the WTO Agreement. Members which were not signatories to the MFA after 1986 were required to notify the TMB within six months of the entry into

force of the WTO Agreement of their intention in this regard.¹ If Members from either group chose not to do so, their trade in textiles was considered to have been integrated into GATT 1994 at a stroke. However, if a Member decided to retain the right to use the transitional safeguards, that Member had to notify the TMB of its intention within 12 months of the entry into force of the WTO Agreement, providing full details with regard to which products were to be integrated into GATT 1994 during the first stage (Article 2, paragraph 7 [b]).²

With the eventual elimination of MFA quotas and other non-MFA restrictions, tariffs will become the main instrument of border protection in this sector, and textiles and clothing will thus be accorded the same treatment as other industrial products. In this sense, the tariff reductions made by the major developed countries will, in the long run, effectively improve the access conditions of developing countries to their markets and provide increased security and predictability for developing countries' trade in textiles and clothing. However, in the short run, the MFA quotas will remain a real obstacle.

B. TRADING OPPORTUNITIES ARISING FROM THE MAIN PROVISIONS OF THE AGREEMENT ON TEXTILES AND CLOTHING

1. The phasing out of MFA restrictions

Market-access opportunities in the textiles and clothing sector can be expected to expand with the implementation of the integration programmes designed to progressively abolish MFA quotas, as referred to above. Several studies following different methodologies have estimated the likely volume of trade expansion resulting from the dismantling of the MFA. For example, a recent study projects that without the MFA, exports from MFA exporters to MFA importers will increase by 26% for clothing and 10% for textiles (Yang, 1993). According to a recent United States International Trade Commission (USITC) report, the ATC will have a greater impact on the American textile and clothing sector than any of the other Uruguay Round agreements. It projects that American textiles imports are likely to increase by between 5% and 15% and imports of clothing by over 15%. The increase in American imports is expected to be greatest from developing countries subject to MFA restrictions (USITC, 1994).

¹In other words, non-MFA-signatory Members of the WTO that were not currently maintaining any quantitative restrictions but wished to retain the right to use the transitional safeguards had to notify the TMB of their intention to do so by 1 July 1995.

²When Members chose to retain the right to use the transitional safeguards, their trade in textiles and clothing as defined in the annex to the Agreement was considered completely outside of GATT 1994; such trade must therefore be gradually integrated into GATT 1994 under the four-stage integration programme outlined above. By 1 January 1996, these Members had to notify the full details of 16% of the total volume of their 1990 imports of textiles and clothing to the TMB for integration into GATT 1994. In future, such notification should be made 12 months prior to the beginning of each integration stage.

The integration programmes may not bring about any immediate trade liberalization, however, mainly because the annex to the ATC contains many HS lines which have never been specifically restricted in any country; it is estimated by S. Bagchi (1994) that such lines accounted for 47% of total 1990 imports in Canada, 34% in the European Union (EU), and 37% in the United States, and for as much as 93% in Austria, 81% in Finland, and 83% in Norway. Since Austria and Finland became Members of the EU on 1 January 1995, their integration programmes are covered by that of the EU.³

Given such a situation, the major restraining countries can fulfil their obligations under the Agreement in the first two stages without touching MFA quotas. Trade opportunities (on a modest scale) may therefore only become perceptible from the beginning of the third stage, in the year 2002.

(a) *Stage-one integration programmes*

As required by Article 2, paragraph 6, of the ATC and by the provisions of the associated Ministerial Decision taken at Marrakesh in April 1994,⁴ Austria, Canada, the EU, Finland, Norway and the United States submitted their lists of products scheduled to be integrated during the first stage of the programme. A preliminary analysis has been carried out with respect to the lists of Canada, the EU, Norway and the United States; the findings are summarized in the paragraphs that follow.

For Canada, the import value of the products integrated in the first stage is around \$650 million, or nearly 13% of its total 1990 imports of textiles and clothing as defined in the annex to the ATC.⁵ As Canada has not provided a description of the correlation between the HS lines and the categories integrated, it is not possible to ascertain whether its first stage will have any impact on world trade in general, or on its imports from developing countries in particular.

The EU has apparently met the 16% requirement in volume terms, but only because some “ex-items” have been included in the product list.⁶ Although in many cases these ex-items constitute only a fraction of the HS lines at the six-digit level, the EU added

³The implications of the new framework of EU restrictions for developing exporting countries are still unknown, as the consultations with regard to the base levels of restrictions of the enlarged EU-15 are still under way. The new base levels of restrictions of the EU must also reflect the levels of restrictions in both Austria and Finland; Sweden was not maintaining any MFA restrictions by 31 December 1994.

⁴The Decision on Notification of First Integration under Article 2, paragraph 6, of the Agreement on Textiles and Clothing (see GATT, 1994b, p. 450).

⁵The integration list of Canada was given at the HS 10-digit level. Because data for 1990 were not available, data for 1991 at the HS eight-digit level were used, possibly resulting in an overestimate.

⁶“Ex-item” refers to an excerpt (i.e., part) of an HS six-digit code (or line). For example, of the products covered by HS line 6406.10, only the sub-item “footwear uppers and parts, of which 50% or more of the external surface area is textile material” is covered by the ATC as defined in its annex.

the full HS six-digit volume when calculating the amount of imports integrated. When these lines are disaggregated at the eight-digit level, in most cases it is difficult to identify the textile material sub-items. Therefore, if only a percentage of the HS six-digit trade is included, say, for example, 50%, then the share of trade (the percentage volume) integrated amounts to less than the 16% required by the Agreement. It should be noted that none of the 10 product categories included in the EU list was subject to an MFA quota in 1994. Although products of two categories were subject to EU regional quotas for a few exporting countries in 1990, these quotas were later eliminated with the creation of the Single European Market in 1992.

The products integrated by the EU in the first stage have a 1990 import value of \$3.7 billion, or 8.7% of total EU imports of textiles and clothing for 1990 as defined in the annex to the ATC. However, if consideration is limited to Section XI of the HS nomenclature (textiles and textile articles including clothing), the products integrated represent less than 2.3% of EU textile and clothing imports. The import value of the products integrated by the EU in the first stage represents less than 8% of developing countries' 1990 exports of textiles and clothing to the EU.⁷

The first-stage integration list of the United States does not include any products covered by MFA restrictions.⁸ The 1990 import value of the products integrated is \$2.3 billion, or 6.9% of the United States' total imports of textiles and clothing for that year. The import value represents less than 5% of developing countries' 1990 exports of textiles and clothing to the United States. Among the products integrated, 40% fall outside Section XI of the HS nomenclature and are mainly from the made-up textile products and clothing segments. Ex-items can also be found in the segment of made-up textile products.

Norway's integration list is based on HS lines and contains a number of ex-items, many of which represent only a fraction of the full HS lines at the six-digit level. Like the EU, Norway added the volume of imports for the full HS six-digit lines when computing the amount of imports integrated. If only a portion of the HS six-digit trade has been included, say 50%, then the volume of trade actually integrated is less than the 16% required by the Agreement. In value terms, the products integrated in the first stage are equivalent to \$143 million worth of imports, or 7.4% of Norway's total imports of textiles and clothing in 1990. It is important to note that among the products integrated, only about 2% fall within Section XI of the HS nomenclature.

To summarize, products that have not been subject to restrictions have been integrated first, while the integration of the more sensitive products in each category has

⁷ This is also confirmed by D. Spinanger, Hong Kong Polytechnic University. See WTO, 1995, table AV.4, p. 202.

⁸ The United States' list was given at the HS 10-digit level, which allowed for the fine-tuning of product selection for the first stage of integration.

been postponed. Furthermore, the products integrated in the first stage from each of the four groups (tops and yarns, fabrics, made-up textile products and clothing) by the EU, Norway and the United States are uneven. For example, the share of clothing is minimal: in the EU list, clothing accounts for less than 3.1% of the total volume of developing countries' exports of that segment to the EU in 1990; for Norway, this figure is only 1%; and for the United States, 1.72%. The analysis included the following conclusions:

- The integration target was set in volume terms; the products integrated so far have been high in volume and low in value; further...
- None of the products integrated into GATT 1994 by the EU, the United States, Norway or (perhaps) Canada was covered by the quantitative restrictions under the MFA; therefore...
- The first stage of the integration programme will not lead to any trade liberalization; therefore, it will have no impact on world trade in textiles and clothing and will offer no new market-access opportunities to developing countries.

A recent analysis carried out by the International Textiles and Clothing Bureau (ITCB, 1994) also finds that the first-stage integration programmes of Canada, the EU and the United States have not provided meaningful market-access opportunities for developing countries, as a result of the following:

- Most of the product groups chosen from the annex to the Agreement are those outside Section XI of the HS nomenclature (i.e., products not subject to MFA restrictions); they have been included merely to inflate the total volume of imports for integration.
- None of the 280 HS lines in the United States' list is included in its traditional textile category system.
- Tops and yarns have been given priority in Canada and the United States and account for more than 50% of their integration items. The fabric group constitutes a significant portion in the EU integration programme owing to the inclusion of jute fabrics, laminated fabrics and luggage. Clothing has been given minimal attention in all three countries (very few clothing items have been included).

The ITCB analysis also refers to a positive development related to the removal of some residual EU restrictions on jute products, luggage, umbrellas, parachutes and watch straps; this might benefit developing countries such as Bangladesh and India, which supply some jute products.

It was projected early on that the products that had never been subject to restrictions would be integrated first, while the integration of more sensitive products in each category would be postponed as long as possible (UNCTAD, 1994). Indeed, there were indications that the EU was contemplating taking only token steps towards the first stage of the integration programme (*Financial Times*, 17-18 September 1994). These programmes were not designed to phase out the MFA restrictions in the first stage of integration; taking full advantage of this, the United States in its Uruguay Round Agreements Act requires the Administration, in determining which products should be integrated, to ensure that the integration of the most sensitive products be deferred until the end of the 10-year period.⁹ In the light of all this, the first stage of integration is not expected to bring about any material change in the protection of domestic industries in the restraining countries. Consequently, it is not likely to entail any need for structural adjustment. However, it could make the process of adjustment more painful in the subsequent stages.

(b) *The American integration programmes for stages two and three*

Article 2, paragraph 11, of the ATC stipulates that products to be integrated at the second and third stages must be notified in detail to the TMB 12 months before the beginning of each stage. However, as outlined in Section 331 of its Uruguay Round Agreements Act of 1994, the United States decided to publish a list of the products it intended to integrate in the second and third stages no later than 120 days after the WTO Agreement entered into force for the United States, and to notify this list to the TMB no later than 30 days after its publication (United States, 1994). Accordingly, on 1 May 1995, this list was published in the *United States Federal Register* (vol. 60, No. 183).¹⁰ According to an estimation made by the UNCTAD secretariat, the American programme of integration in the second and third stages represents 10.7% and 11.3% of the total 1990 import values respectively. As a result, more than 70% of the 1990 value and nearly 50% of the 1990 volume of American imports will not be integrated until the very end of the 10-year transition period.

As to which exporting countries are expected to gain from the above-mentioned American programme in the second and third stages, the estimation shows that the benefits of integration will very much depend upon the scope of the restrictions imposed by the developed importing countries on the developing exporting countries. Among such

⁹ Indeed, the United States Congress, in the Uruguay Round Agreements Act, has also required the Administration to determine which products should be integrated in order to ensure that the integration of the most sensitive products is deferred until the end of the 10-year period (see United States, 1994), p. 771.

¹⁰ Prior to the publication of the final list, a proposed list was published (at the end of January 1995) in the *Federal Register* for comments from all interested parties including individuals, trade associations, certified firms and recognized unions, groups of workers, and representatives of foreign Governments from exporting countries.

exporting countries, those that are faced with a much larger number of restrictions, such as China (if it becomes a WTO Member), Hong Kong, the Republic of Korea, Taiwan Province of China (if it becomes a WTO Member), Pakistan, the Philippines and Singapore, will probably benefit from the liberalization of a few marginal restrictions (on babies' garments, down-filled coats and hosiery, for example) at the beginning of the second stage. The beneficiaries in the third stage will mainly be the large- and medium-scale exporting countries, including Bangladesh, Brazil, China (if it becomes a WTO Member), Haiti, Hong Kong, India, Indonesia, Jamaica, the Republic of Korea, Macau, Malaysia, Mauritius, Myanmar, Pakistan, the Philippines, Romania, Singapore, Sri Lanka, Taiwan Province of China (if it becomes a WTO Member), Thailand, Turkey and the United Arab Emirates. Countries that are small exporters will likely have to wait until the very end of the 10-year transition period to realize any benefits (for details, see table 1).

Table 1. The United States' programme of integration under the Agreement on Textiles and Clothing

Stages	Products for which MFA restrictions will be phased out	Beneficiaries
I	None	None
II	Baby garments and related parts (except cotton diapers); down-filled coats; and hosiery	China (if it becomes a WTO Member), Hong Kong, the Republic of Korea, Pakistan, the Philippines, Singapore, and Taiwan Province of China (if it becomes a WTO Member)
III	Knit fabrics; gloves and mittens (except non-unit); dressing gowns; headwear, dish towels; handbags; luggage; bar mop; other staple fibre yarn; brassieres; polybag; WG coats; MB suit-type coats; dresses; skirts and gloves not knit; skirts, MB suits; trousers, breeches and shorts; nightwear, etc.	Bangladesh, Brazil, China (if it becomes a WTO Member), Haiti, Hong Kong, India, Indonesia, Jamaica, the Republic of Korea, Macau, Malaysia, Mauritius, Myanmar, Pakistan, the Philippines, Romania, Singapore, Sri Lanka, Taiwan Province of China (if it becomes a WTO Member), Thailand, Turkey and the United Arab Emirates

Source: UNCTAD/ITCB estimation based on information provided by the United States (a) to the Preparatory Committee of the WTO in October 1994 and (b) in the *United States Federal Register*, vol. 60, No. 83 (1 May 1995).

2. Increases in annual growth rates and other flexibility provisions

Parallel to the integration programme, the Agreement provides for increases in the growth rates of the remaining quotas during the transition period. This will result in substantial improvements in developing countries' access to markets in the sector of textiles and clothing—particularly for small suppliers, given their entitlement to the advancement of growth rates by one stage. Because the growth rates are calculated as percentages of percentages (see table 2), the increases will be meaningful to the extent that

significant growth rates were incorporated in the bilateral agreements existing the day before the entry into force of the WTO Agreement.

The MFA quota-weighted average growth rate for all the restraining countries was around 3%; however, by the beginning of the third phase of the transition period, the growth rate could rise to 5.52%. Thus, by the end of the 10-year period, quotas may have increased by as much as 54%. Certain exporting countries enjoyed higher growth rates under the MFA; by the beginning of the third phase, a 6% growth rate could rise to about 11%, resulting in a quota increase of 134% by the end of the 10-year transition period.

The ITCB estimates that the total volume of quotas will increase by 102% in Canada, 64% in the EU, and 89% in the United States by the end of the transition period (see table 3). These estimations are based on the assumption that the existing quotas will remain intact until the end of the transition period.

With regard to specific developing countries, the ITCB projects that for Bangladesh, which enjoyed a 7% growth rate in the United States market, MFA quotas will increase from 255 million square metres equivalent (SME) in 1994 to 683 million SME in 2004. For India, with a growth rate of around 3%, exports of MFA-restricted products to the EU will increase from 176,625 tons in 1994 to 264,304 tons in 2004. Brazil, enjoying a growth rate of around 6%, will increase its exports of MFA-restricted products to the United States from 303 million SME in 1994 to 706 million SME in 2004. For Jamaica, with a growth rate of 6%, exports of MFA-restricted products to Canada will increase from 4 million SME in 1994 to 9 million SME in 2004 (see table 3).

It should be noted that major suppliers have been cut back to low growth rates over the last several years; one example is the Republic of Korea, whose annual growth rates for the United States market are currently limited to an average of about 1%. Thus, in the first three years of the integration programme, a 16% increase in the Republic of Korea's 1% annual growth rate will only yield a new rate of 1.16%. In the second stage, the annual growth rate will move up to 1.45%, and in the third stage, it will reach 1.84% (see table 2).

Table 2. Illustrative increases in growth rates provided for in the Agreement on Textiles and Clothing (Percentages)

Increases envisaged in the Agreement		Growth factor (percentage) ^a	Original growth rate of 1% ^a (2)	Increase in quota ^b	Original growth rate of 3% ^a (4)	Increase in quota ^b	Original growth rate of 5% ^a (6)	Increase in quota ^b (7)	Original growth rate of 6% ^a (8)	Increase in quota ^b (9)
Stage of integration	Year									
A. In accordance with paragraphs 13 and 14 of Article 2:										
I	1	16	1.16	101.16	3.48	103.48	5.80	105.80	6.96	107.00
	2		1.16	102.33	3.48	107.08	5.80	111.94	6.96	114.45
	3		1.16	103.52	3.48	110.81	5.80	118.43	6.96	122.41
II	4	25	1.45	105.02	4.35	115.63	7.25	128.21	8.70	133.00
	5		1.45	106.54	4.35	120.66	7.25	137.50	8.70	144.57
	6		1.45	108.09	4.35	125.91	7.25	147.47	8.70	157.15
	7		1.45	109.66	4.35	131.38	7.25	158.16	8.70	170.82
III	8	27	1.84	111.67	5.52	138.64	9.21	172.70	11.05	189.70
	9		1.84	113.73	5.52	146.29	9.21	188.61	11.05	210.66
	10		1.84	115.82	5.52	154.36	9.21	205.98	11.05	233.94
B. In accordance with paragraph 18 of Article 2:										
I	1	25	1.25	101.25	3.75	103.75	6.25	106.25	7.50	107.50
	2		1.25	102.52	3.75	107.64	6.25	112.89	7.50	115.56
	3		1.25	103.80	3.75	111.68	6.25	119.95	7.50	124.23
II	4	27	1.59	105.45	4.69	116.91	7.94	129.47	9.53	136.07
	5		1.59	107.13	4.69	122.40	7.94	139.75	9.53	149.04
	6		1.59	108.83	4.69	128.14	7.94	150.85	9.53	163.24
	7		1.59	110.56	4.69	134.15	7.94	162.83	9.53	178.80
III	8	27	2.02	112.79	5.96	142.14	10.08	179.24	12.10	200.43
	9		2.02	115.07	5.96	150.62	10.08	197.31	12.10	224.68
	10		2.02	117.39	5.96	159.59	10.08	217.20	12.10	251.87

Source: Calculations by the UNCTAD secretariat based on data in GATT document COM.TEX/SB/1799/Add.1, and the ITCB data base.

^a The rate foreseen in the bilateral agreement under the MFA.

^b Obtained by applying to the original bilateral growth rate the additional increase (growth factor) provided for in the Agreement on Textiles and Clothing (see col. 1).

Table 3. Quota enlargement resulting from the application of growth factors, 1994 and 2004

Supplier	Canada		European Union		United States	
	1994	2004	1994	2004	1994	2004
	(million SME')		(tons)		(million SME')	
Argentina			31 486	58 655		
Bangladesh	31	84			255	683
Brazil	22	56	114 098	171 710	303	706
Colombia	2	5			28	69
Costa Rica	1	2			40	100
China	213	418	255 093	433 410	1 358	2 171
Egypt					154	378
El Salvador						
Hong Kong	126	193	152 963	184 272	1 123	1 349
India	26	59	176 625	264 304	375	861
Indonesia	24	57	65 976	131 710	444	1 038
Jamaica	4	9			47	117
Republic of Korea	166	314	127 010	192 776	934	1 192
Macau	5	13	24 005	30 776	88	228
Maldives						
Mexico					206	474
Pakistan	32	77	142 795	258 357	435	1 053

Table 3. (continued)

Supplier	Canada		European Union		United States	
	1994	2004	1994	2004	1994	2004
	(million SME [*])		(tons)		(million SME [*])	
Peru			15 490	37 485		
Sri Lanka	15	35	9 221	28 009	211	490
Turkey	33	77			452	1 028
Uruguay	1	3			14	24
Malaysia	22	47	35 973	64 454	274	638
Philippines	22	55	24 711	52 479	515	1 022
Singapore	13	26	19 205	33 838	185	285
Thailand	26	53	74 609	140 736	530	1 195
Total	784	1 583	1 269 260	2 082 971	7 970	15 101
Increase		101.91%		64.11%		89.47%

Source: ITCB estimates.

Note: Totals may not add up because of rounding.

* Square metres equivalent.

With respect to the application of flexibility provisions, Article 2, paragraph 16, of the ATC stipulates that there shall be no quantitative limits placed on the combined use of swing, carryover and carry forward. In other words, all such limits applied under the MFA had to be removed immediately after the entry into force of the WTO Agreement. This amounts to an improvement in market-access conditions for some developing exporting countries, since it facilitates the full use of their quotas during the transition period.

3. The phasing out of other non-MFA restrictions

As discussed, quantitative restrictions maintained by the Members under the MFA must be phased out over the 10-year transition period under the ATC; however, Members were also required to notify all their other (non-MFA) restrictions on textile and clothing products, in detail, whether consistent with GATT 1994 or not, to the TMB within 60 days of the entry into force of the WTO Agreement. This notification had to specify whether or not the restrictions were justified under GATT 1994 provisions. Members are also allowed to make reverse notifications in this regard or concerning any restrictions that may not have been notified under the provisions of this Article.

Non-MFA restrictions can be grouped into three general categories, as follows:

- Restrictions falling outside the MFA imposed by some developed MFA-signatory countries. Such restrictions include Japan's import restrictions against China and the Republic of Korea on silk yarn, and against Pakistan on cotton yarn (GATT, 1990; GATT, 1992; GATT, 1984); the price surveillance system of Switzerland applied to imports of textile and clothing products (GATT, 1991); and the EU restraints on imports of textiles and clothing from Turkey, Egypt, Japan, Honduras, Costa Rica and El Salvador (GATT, 1993a).
- Restrictions imposed by MFA signatories against non-MFA signatories, including EU actions against imports of textiles and clothing from Morocco, Tunisia, Malta, some Latin American countries and some countries in transition (GATT, 1993); and the restrictive measures applied by the United States against Bahrain, Mauritius, Haiti, Lesotho and others (GATT, 1994f)
- Measures applied by other countries (including developing countries), whether MFA signatories or not, except those justified under the provisions of GATT 1994. Such measures include restrictive licensing systems, State trading, quotas, prohibitions, restrictions, and government

assistance plans and schemes (GATT, 1994e; GATT, 1993b; GATT, 1984; Stewart, 1992).

The usual conceptual and definition-related problems have made it difficult to determine the extent to which the non-MFA restrictions were applied. In any case, with the strengthening of GATT rules and disciplines, particularly in areas such as safeguards, balance-of-payment provisions, and notification procedures, these GATT-inconsistent non-MFA restrictions had to be brought into conformance with GATT 1994 within one year of the entry into force of the WTO Agreement or plans had to be initiated to phase them out progressively over a 10-year programme (i.e., over the duration of the Agreement). Countries affected by these GATT-inconsistent non-MFA restrictions can also make reverse notifications to the TMB.

The above will undoubtedly bring developing countries increased security and predictability in terms of their access to the world textile and clothing market. However, in most cases it is unlikely that the restraining countries will bring their above-mentioned non-MFA restrictions into conformance with GATT 1994 by converting them into global quotas under Article XIX of the General Agreement on Tariffs and Trade when MFA restrictions on the same products will continue to apply until they are integrated. It is more realistic for these countries to phase out the non-MFA restrictions in synchronization with the integration programmes for the concerned products. Since there is no provision in Article 3 of the ATC requiring restraining countries to provide the increases in annual growth rates as in the case of MFA restrictions, these restrictions may be maintained under existing conditions during the phase-out period. Therefore, it is important for developing countries to take full advantage of the increases in annual growth rates permitted to them.

4. Special treatment for small suppliers

As noted above, the special treatment provisions for certain categories of WTO Members are formulated along the same lines as those of the MFA and its 1986 Protocol. Most of the special treatment provisions contained in the ATC are of a “best endeavour” nature (applying to, for example, least-developed countries, wool-producing countries, and countries dependent on outward processing trade); the only new feature is a quantified definition of (and the setting of a specific threshold for) a second list of the products it intends to integrate in the second and third stages of small suppliers with regard to MFA restrictions and to special treatment for non-MFA-signatory Members.

The ATC stipulates that small suppliers, defined as those whose exports under MFA restrictions represent 1.2% or less of the total volume of the restrictions applied by an importing Member as of 31 December 1991, shall be granted “meaningful improvement” in access for their exports during the implementation of this Agreement. Meaningful improvement is achieved through the advancement by one stage of the growth rates provided for products remaining under restriction. In other words, the growth rates

of small suppliers will be increased at the beginning of each stage by 25%, 27% and 27% respectively, instead of 16%, 25% and 27%.

The countries that qualify as small suppliers on the basis of their 1991 volume of trade under restriction are listed in table 4 (ITCB determinations). Two examples of the growth rate progression under these special provisions are provided below:

- Sri Lanka's MFA quota-weighted average growth rate in its bilateral agreement with the EU was 7.3% in 1994. As a small supplier to the EU market, Sri Lanka's growth rate could rise to nearly 15% by the beginning of the third stage of integration, resulting in the enlargement of its quotas by more than 170% at the end of the 10-year transition period.
- Jamaica enjoyed a 6% growth rate under its bilateral agreement with the United States in 1994; by the beginning of the third stage, its growth rate could rise to 12%, resulting in the enlargement of its quotas in the United States market by around 152% at the end of the 10-year transition period.

Table 4. Small suppliers of textiles and clothing

Importer	Canada	European Union	Finland	United States
Supplier	Colombia Macau Uruguay	Peru Sri Lanka	Sri Lanka	Argentina Costa Rica Jamaica Macau Peru Uruguay Former Yugoslavia

Source: ITCB estimates, based on specific limits set in the bilateral agreements under the MFA.

Note: "Small suppliers" refers to those suppliers whose restrictions represent 1.2% or less of the total volume of the restrictions applied by an importing Member as of 31 December 1991 (see Article 2, paragraph 18, of the Agreement on Textiles and Clothing).

* Allows for group limits in the bilateral agreements.

C. TRADING OPPORTUNITIES RESULTING FROM TARIFF REDUCTIONS BY QUAD COUNTRIES AND FROM TRADE LIBERALIZATION MEASURES INSTITUTED BY DEVELOPING COUNTRIES

1. Tariff reductions by Quad countries

With the gradual phasing out of MFA quotas and the elimination of other GATT-inconsistent non-MFA restrictions, tariffs will become the main instrument of border protection in this sector; textile and clothing products from developing countries will therefore be treated as regular industrial products. As a more transparent form of import protection, tariffs ensure predictability and allow market signals to have a greater influence on the orientation of textile and clothing production and consumption decisions. In this sense, tariff reductions in the markets of the major developed countries will, in the long run, effectively improve the market access of developing countries and provide increased security and predictability for their trade in textiles and clothing.

The average tariff level for the textile and clothing sector has always been considerably higher than that for all industrial products in the developed countries. In the developed countries as a group, the pre-Uruguay Round average tariff for textile and clothing products was 15.5%, compared with 6.3% for industrial products. As a result of the Uruguay Round negotiations, the average tariff level was reduced to 12.1% for the textile and clothing sector and to 3.9% for all industrial products; even at the reduced level, the average textile and clothing sector tariff still stands at more than triple the average tariff for all industrial goods. The depth of cuts in this sector was also significantly less, totalling 22% in comparison with 38% for all industrial products (GATT, 1994a).

An analysis of the Quad countries' tariff reductions for imports from all sources shows that while Canada and Japan cut their tariffs in the textile and clothing sector by 37% and 33% respectively, reductions in the EU and the United States amounted to only 16% and 13% respectively. Among these four entities, the average tariff level for the textile and clothing sector in the post-Uruguay-Round period is lowest in Japan, at 8.1%, followed by the EU at 9.7%, Canada at 12.6%, and the United States at 13.6% (see table 5). It is important to note that the reductions were smaller on imports of interest to developing countries, and that the average tariff levels in Canada and the United States remained higher for imports from developing countries than for imports from all sources; this is mainly because the Quad countries did not offer tariff reductions on products of which non-GATT-Contracting Parties such as China were, and still are, major suppliers (USITC, 1994).

*Table 5. Quad countries' reductions in trade-weighted tariff averages for imports of textiles and clothing in 1992
(Percentage)*

Importing market	Imports from all sources						Imports from developing countries					
	Value (millions of US dollars)	MFN ^a tariff averages			Value (millions of US dollars)	MFN tariff averages			MFN/GSP ^b tariff averages			
		Pre-UR ^c	Post-UR	Reduction		Pre-UR	Post-UR	Reduction	Pre-UR	Post-UR	Reduction	
Canada	4 967.5	20.1	12.6	37	1 572.1	21.4	13.5	37	20.4	13.3	35	
European Union	51 172.1	11.6	9.7	16	29 473.3	12.1	10.3	15	0.4	0.4	19	
Japan	16 208.1	12.0	8.1	33	5 810.7	11.5	7.8	32	4.8	4.6	4	
United States	42 201.3	15.7	13.6	13	28 752.1	17.1	15.2	11	16.8	15.0	11	

Source: UNCTAD Trade Control Measures Information System.

^a Most-favoured nation.

^b Generalized System of Preferences.

^c Uruguay Round.

There is some noticeable tariff escalation among the Quad countries; disaggregated tariff averages have a clear tendency to rise with the stage of production in each of the four countries. The post-Uruguay Round average tariff (on imports from all sources) for tops and yarns is around 4% in the EU and Japan, 7.1% in Canada, and 6% in the United States. The average tariff for clothing is 9.4% in Japan, 11.5% in the EU, 15% in Canada, and 15.7% in the United States (see table 6).

The textile and clothing sector in developed countries is doubly protected—by a higher average level of tariffs and by MFA restrictions. According to a 1989 study by the USITC, the average tariff-equivalent of MFA clothing restrictions was 28.3%. Without the removal of discriminatory MFA restrictions against developing countries, the reduction of tariffs simply provides additional advantages for exporters from (mainly developed) countries that are not subject to MFA restraints. Therefore, in the short run, the net trade effects of tariff reductions on products covered by the ATC are likely to be negligible, as tariffs have not been a major barrier to the expansion of the textile and clothing trade from developing countries; quotas have constituted the real obstacle.

To qualify the last statement somewhat, it should be noted that the tariff peaks in the textile and clothing sector have often retarded trade flows to such an extent that the need for quotas has been obviated. Nearly one third of the total imports of textiles and clothing in all developed countries were facing tariff peaks of at least 15% during the pre-Uruguay Round period; most of these peaks applied to clothing products. The tariff peaks are supposed to come down for some 28% of total imports, which should certainly lead to some trade expansion.

2. Trade liberalization measures taken by developing countries

Although developing countries are traditionally considered exporters of textiles and clothing, in recent years they have become increasingly significant importers, with a number of them emerging as important new markets for textile trade. In 1992, developing countries as a whole imported \$87 billion worth of textile and clothing products, which accounted for over 30% of total world imports of these items; this represented an increase of nearly 58% over their 1989 imports, which totalled \$55 billion. During the period 1989-1992, developing countries' imports of textile and clothing products from Organization for Economic Cooperation and Development (OECD) countries increased 41%, or from \$19.1 billion to \$27 billion, while their exports to OECD countries increased 30%, from \$62.9 billion to \$81.5 billion.

Table 6. Quad countries' reductions in trade-weighted tariff averages for imports, by textile and clothing group, 1992
(Percentage)

Importing market	Imports from all sources				Imports from developing countries							
	Value (millions of US dollars)		MFN ^a tariff averages		Value (millions of US dollars)		MFN tariff averages		MFN/GSP ^b tariff averages		Post-UR Reduction	
	Pre-UR ^c	Post-UR	Pre-UR	Reduction	Pre-UR	Post-UR	Pre-UR	Reduction	Pre-UR	Post-UR	Pre-UR	Reduction
Tops and yarns												
Canada	657.1	12.1	7.1	41	111.3	12.5	8.1	35	11.6	8.0	31	
European Union	4 740.7	7.6	4.1	45	1 763.6	7.0	3.7	47	0.4	0.1	72	
Japan	1 452.1	5.7	3.9	31	990.3	5.8	4.0	32	2.5	1.8	26	
United States	1 625.4	7.6	6.0	21	519.9	7.3	6.5	11	6.4	5.6	12	
Fabrics												
Canada	1 355.8	19.5	12.4	37	285.7	18.8	11.9	36	17.7	11.9	33	
European Union	8 270.1	9.6	7.1	26	3 393.8	9.8	7.3	26	4.5	4.3	4	
Japan	2 881.9	9.5	7.1	25	927.9	9.4	7.4	22	13.0	11.2	14	
United States	5 886.5	13.6	11.0	19	2 721.7	13.4	11.4	15				
Made-up articles												
Canada	962.1	19.1	11.6	39	174.1	16.9	10.8	36	13.5	9.4	30	
European Union	5 571.6	8.8	7.5	15	2 775.1	8.8	7.8	11	1.3	1.1	17	
Japan	1 677.3	8.8	5.3	39	526.9	8.5	5.1	40	4.0	2.8	29	
United States	4 048.8	7.0	4.5	36	2 186.5	6.2	4.4	29				
Clothing												
Canada	1992.5	23.8	15.0	37	1 001.1	23.9	15.1	37	15.0	8.4	36	
European Union	32 589.7	13.2	11.5	13	21 540.9	13.3	11.6	13	0.6	0.5	14	
Japan	10 196.7	14.2	9.4	33	3 365.6	14.2	9.5	33	6.1	6.1	0	
United States	30 640.6	17.7	15.7	11	23 324.1	18.8	16.9	10	18.7	16.8	10	

Source: UNCTAD Trade Control Measures Information System.

^a Most-favoured nation.

^b Generalized System of Preferences.

^c Uruguay Round.

During the same period, the trade between developing countries in these products also increased considerably. In 1992, intra-developing-country imports reached a record high of more than \$59.3 billion, an increase of 73% over the 1989 figure (see table 7). Prospects for the rapid expansion of intra-developing-country trade in textiles and clothing are strong, particularly for the emerging new markets in Asia and Latin America, as most of these countries have simultaneously been taking steps to liberalize their import and exchange control regimes, and rising standards of living will further increase the demand for store-bought and non-traditional clothing. This expansion of trade in textiles and clothing has also created new opportunities for the international trading community, particularly for those developing countries that until now have been almost totally dependent upon the markets of developed countries.

In the past, many developing countries protected their domestic textile and clothing production from import competition by pursuing an import-substitution policy based on the infant industry argument. Since the late 1970s and early 1980s, however, more and more developing countries have adopted trade liberalization as a general strategy to sustain economic growth. During the course of the Uruguay Round negotiations, almost all of the Latin American countries autonomously removed restrictions on their imports of textile and clothing products. At the same time, several Asian countries opened their markets to imports as part of their economic liberalization programmes.

Within the context of the Uruguay Round agreements, developing countries have also made significant contributions by undertaking tariff reductions, tariff bindings and the elimination of non-tariff measures with respect to textiles and clothing. It is not possible at this stage to calculate the average depth of the reductions in textile and clothing tariffs for this group of countries because for many of them the *ad valorem* equivalents of specific duties and the trade-weighted averages of tariffs are not available. However, the information that does exist in this regard provides an idea of the general situation. The data available indicate that tariff reductions in the textile and clothing sector (in trade-weighted tariff averages) range from 9% in Zimbabwe to 52% in India. Argentina, Brazil, Chile, Colombia, Costa Rica, El Salvador, Indonesia, Jamaica, Mexico, Peru, Uruguay and Venezuela have bound all their tariffs, while the scope of tariff bindings in China, India, Turkey, Singapore, the Republic of Korea, Malaysia, the Philippines, Thailand and Tunisia range from 61% to 98%; Senegal and Zimbabwe have also bound 44% and 22% of their tariffs respectively (see table 8).

*Table 7. Emerging markets for textiles and clothing in developing countries
(1989 = 100)*

	Imports from world					Imports from DEMC					Imports from developing countries						
	1989	1990	1991	1992	1989	1990	1991	1992	1989	1990	1991	1992	1989	1990	1991	1992	
	(million of US dollars)	(index)	(index)	(million of US dollars)	(index)	(million of US dollars)	(index)	(million of US dollars)	(index)	(million of US dollars)	(index)	(million of US dollars)	(index)	(million of US dollars)	(index)	(million of US dollars)	(index)
China	5 939	100	115	1 084	170	1 020	100	94	136	2 189	215	4 810	100	120	147	7 808	162
Hong Kong	15 413	100	115	25 077	163	3 608	100	115	125	5 605	155	11 764	100	115	139	19 433	165
Republic of Korea	3 205	100	106	4 575	143	2 107	100	106	120	2 800	133	566	100	110	280	1 719	304
Indonesia	694	100	148	1 495	215	281	100	129	142	476	169	408	100	162	193	1 015	249
Malaysia	1 536	100	125	2 863	186	565	100	131	164	1 141	202	967	100	121	149	720	178
Philippines	599	100	121	942	157	131	100	127	315	273	208	243	100	229	385	687	274
Singapore	4 408	100	119	6 315	143	2 223	100	118	125	3 134	141	2 162	100	119	140	3 166	146
Thailand	1 429	100	128	2 560	179	554	100	146	164	1 197	216	845	100	116	131	1 346	159
India	442	100	108	406	92	265	100	100	63	254	96	172	100	122	73	148	86
Argentina	138	100	167	508	950	78	100	137	374	584	749	59	100	168	608	723	1 225
Brazil	700	100	117	712	102	536	100	117	113	515	96	160	100	121	171	195	122
Mexico	1 442	100	120	2 981	207	1 185	100	122	151	2 237	189	239	100	113	161	741	310
Total for developing countries	55 033	100	113	87 000	158	19 139	100	115	127	27 014	141	34 256	100	114	144	59 344	173
			(US\$ 62,088 millio n)	(US\$ 74,086 millio n)				(US\$ 22,058 millio n)	(US\$ 24,274 millio n)					(US\$ 38,958 millio n)	(US\$ 49,322 millio n)		

Source: UNCTAD secretariat calculations based on United Nations Statistical Office data.

Table 8. Imports of, and scope of bindings, tariff averages and coverage of final schedules for textiles and clothing
(Imports in millions of US dollars)

Import market	Total		Scope of bindings						Trade-weighted tariff averages		
	Number of lines (NBL)	Import value	Percentage of NBL		Percentage of imports		Pre-UR	Offer	Pre-UR	Offer	Percentage change
			Pre-UR	Offer	Pre-UR	Offer					
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)		
Argentina	1 097	34	0	100	1	100	32.1	35.0			
Brazil	1 341	135	1	100	5	100	77.4	32.3			
Chile	184	121	100	100	100	100	34.9	24.9	-29		
China	985	2 999	0	91	0	70	58.9	47.4			
Colombia	923	133	0	100	4	100	46.9	36.1			
Costa Rica	183	57	100	100	100	100	60.0	44.9	-25		
El Salvador	168	18	100	100	100	100	47.8	39.0	-18		
Hong Kong	1 084	25 336	0	2	1	6	0	0			
India	809	185	0	26	0	61	127.9	61.1	-52		
Indonesia	1 861	615	0	100	0	100	27.8	39.9			
Jamaica	421	140	0	100	0	100	26.4	50.0			
Republic of Korea	1 304	1 527	9	100	11	98	26.2	16.0	-39		
Macau	1 303	732	0	2	0	11	0	0			
Malaysia	1 843	609	0	95	0	98	26.2	19.4			

Table 8. (continued)

Import market	Total		Scope of bindings						Trade-weighted tariff averages		
	Number of lines (NBL)	Import value	Percentage of NBL		Percentage of imports		Pre-UR	Offer	Pre-UR	Offer	Percentage change
			Pre-UR	Offer	Pre-UR	Offer					
Mexico	1 137	330	100	100	100	100	100	49.7	34.9	-30	
Peru	401	26	2	100	5	100	100	45.1	30.0		
Philippines	958	1 147	0	97	0	98	98	38.1	27.5		
Senegal	338	38	34	36	39	44	44	16.2	16.8		
Singapore	987	1 968	0	78	0	74	74	14.6	7.2	-51	
South Africa	3 005	784	5	100	5	99	99	57.2	24.8	-57	
Sri Lanka	1 566	643	0	0	0	0	0	53.7	53.7	0	
Thailand	982	676	0	94	0	94	94	59.3	28.9		
Tunisia	978	768	0	93	0	98	98	39.6	56.5		
Turkey	3 050	235	10	11	62	65	65	68.0	46.8	-31	
Uruguay	682	25	2	100	6	100	100	30.7	33.9		
Venezuela	920	208	100	100	100	100	100	50.0	34.7	-31	
Zimbabwe	327	51	1	5	1	22	22	20.8	18.9	-9	

Source: GATT secretariat estimates, 1994.

Note: Tariff lines and imports for which *ad valorem* equivalents are not available (specific duty) are excluded from columns 2, 3 and 9.
 * Uruguay Round.

Thailand recently decided to cut its tariffs on nearly 4,000 tariff lines, which will bring the country's import duties down from 100% to a maximum of 30% by 1997. The new tariff cuts, which became effective on 1 January 1995, will reduce the average tariff on all imports except agricultural products from 39.24% to 17.61% when fully implemented. For example, the duties on artificial and knitted fabrics will be cut from 60% to 40% in 1995 and to 20% in 1997. It is reported that the new tariff cuts are generally deeper than what is required by the General Agreement on Tariffs and Trade (*Financial Times*, 29 December 1994).

India, with the recent conclusion of its bilateral textile agreements with the United States and the EU, has also agreed to liberalize its textile import regime by removing all yarns, fibres, and some industrial fabrics from its restricted list of imports. For certain other fabrics and garments, the removal will start in 1998, and the restrictions for most other garments will be phased out by the year 2002. As part of its Uruguay Round commitments, India has agreed to reduce tariffs on various textile items to 20% or less from the current rate of between 65% and 70%. As an intermediate step, tariffs on these products will be cut to between 40% and 50% within three years (*International Herald Tribune*, 1995; *Asian Wall Street Journal*, 1995; *Financial Times*, 5 January 1995).

Recently, the Government of Pakistan decided to phase out its concessional credit facility and dual cotton-pricing system, and to improve the access of the textile and clothing industry to fibres, yarns and cotton substitutes by allowing imports at reduced tariffs. The tariffs on selected textile products are to be reduced during the transition period of the ATC to 35% for clothing, 25% for fabrics, and 15% for fibres and yarns (Pakistan, 1995). Even more recently, South Africa declared its intention to liberalize its textile trade (*Financial Times*, 1 March 1995).

The above-mentioned commitments by developing countries with respect to tariff reductions and tariff bindings, the obligations for phasing out GATT-inconsistent non-MFA restrictions, and the strengthening of GATT rules and disciplines (particularly with respect to elements such as safeguards, balance-of-payments provisions, and notification procedures) will undoubtedly bring about increased security and predictability in terms of access to their textile and clothing markets.

D. MEASURES AND ISSUES THAT MAY AFFECT THE SUCCESSFUL IMPLEMENTATION OF THE AGREEMENT ON TEXTILES AND CLOTHING

1. The "end-loading" of the integration programme

The annex to the ATC incorporates all of the textile and clothing products contained in Section XI of the HS nomenclature (excluding some fibres); included in this list are many products that have never been specifically restricted under the MFA in any

importing country. The list also contains items from certain other HS sections which, strictly speaking, are not textile products but have some textile components, such as soft luggage, footwear uppers, umbrellas and seat belts. Some of these products found their way into the textile category system of the United States and were covered by its bilateral textile restraint agreements under the MFA. The EU currently applies non-MFA restrictions to some of these items as well. As previously indicated, these products account for more than 34% of the total 1990 volume of imports in the EU, 37% in the United States, 47% in Canada, and 83% in Norway. The inclusion of unrestricted items inflates the volume of total imports that forms the base level for the integration programme. As discussed above, this has enabled developed importing countries to meet the integration percentage required by the ATC and to avoid liberalizing the existing MFA restrictions during the early stages of integration. Table 9 contains a list of MFA and MFA-type restrictions applied by the importing country Members against other GATT Contracting Parties/WTO Members.

With respect to the integration ratio:

- In volume terms, as laid down in the ATC, only 51% of the products covered in the ATC annex will be integrated into GATT 1994 over the 10-year transition period (during the first three stages), leaving the balance of 49% to be integrated on the very last day of this period.
- In value terms, the United States is integrating less than 30% of the value of its 1990 imports of these products during the first three stages, leaving more than 70% to be integrated at the very end of the transition period.

Because the ATC allows each restraining country to choose the range of textile and clothing products it prefers to integrate at each of the first three stages, postponing the phasing out of the most sensitive MFA restrictions until the final stage is a fairly easy task. Such an “end-loading” programme evokes some doubts as to the efficacy of the integration programme, as the protectionist forces in the developed countries’ textile and clothing industries will seize every opportunity to lobby their Governments to delay the integration process, and as it will make the process of structural adjustment more difficult in the final stage. In this regard, the United States’ approach of publishing a list of the products to be integrated at each stage 120 days after the entry into force of the WTO Agreement should serve to facilitate the process.

Table 9. MFA or MFA-type restrictions (including growth rates) applied by importing countries against GATT Contacting Parties /WTO Members

Suppliers	Restricting importers											
	European Union			United States			Canada			Norway		
	Specific limits (number)	Growth rates (percentage)		Specific limits (number)	Growth rates (percentage)		Specific limits (number)	Growth rates (percentage)		Specific limits (number)	Growth rates (percentage)	
Argentina	4	1.7 - 6.0										
Bahrain			4	6.0								
Bangladesh	*		21	7.0	12	6.0 - 7.5						
Brazil	11	4.0 - 6.0	27	1.0 - 6.0	5	6.0 - 7.0						
Colombia	*		2	1 - 6								
Costa Rica			5	1.0 - 6.0	1	6.0						
Cuba					1	6.0						
Czech Republic			5	1.0 - 6.0	3	3.5 - 6.0	3	3.0				
Dominican Republic			13	1.0 - 6.0	3	6.0						
Egypt			19	0 - 6.4								
El Salvador			1	6								
Fiji			2	6								
Guatemala	*		5	1 - 6								
Hong Kong	33	0.2 - 5.0	79	0.1 - 2.67	24	0.75 - 6.0	3	1.2 - 3.0				
Hungary			9	1.0 - 6.0	1	4.0	3	5.0				

Table 9. (continued)

Suppliers	Restricting importers											
	European Union			United States			Canada			Norway		
	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)
India	19	1.75 - 6.0	23	4.0 - 7.0	14	6.0			3			1.5 - 5.0
Indonesia	14	3.0 - 6.0	47	1 - 10	12	6.0			4			4.0
Jamaica			9	1 - 6	2	6.0						
Kenya			2	6								
Lesotho					2	6.0						
Macao	20	1.0 - 3.0	33	1 - 6.25	18	6.0			3			3.0
Malaysia	10	3.0 - 6.0	46	1 - 6	11	3.0 - 6.0			4			3.0
Mauritius			16	1 - 6	3	6.0						
Mexico	*											
Myanmar					4	4.0						
Pakistan	15	2.5 - 6.0	37	5 - 7	11	6.0 - 8.0			3			2.0 - 5.0
Peru	2	5.0 - 7.0										
Philippines	12	3.5 - 6.0	39	1 - 9	18	5.0 - 8.0			3			4.0
Poland			9	1 - 6	12	3.0 - 6.0			4			5.0
Republic of Korea	46	0.5 - 7.0	76	0.1 - 2.5	31	0.3 - 10.0			4			5.0

Table 9. (continued)

Suppliers	Restricting importers											
	European Union			United States			Canada			Norway		
	Specific limits (number)	Growth rates (percentage)		Specific limits (number)	Growth rates (percentage)		Specific limits (number)	Growth rates (percentage)		Specific limits (number)	Growth rates (percentage)	
Romania			21	1-7		18	3.0-6.0		4		5.0	
Singapore	8	3.0-5.0	28	1-6		13	3.0-6.0		3		3.0	
Slovak Republic			4	1		4	3.0-6.0		3		3.0	
Slovenia	*											
South Africa						3	6.0					
Sri Lanka	4	7.0-8.0	33	1-6		15	6.0		3		3.0	
Swaziland						15	1.0					
Thailand	20	3.0-7.0	49	1-6		19	4.0-6.0		4		2.0-4.5	
Turkey			36	1-6		5	6.0					
Uruguay	*		9	1-6		1	6.0					
United Arab Emirates			24	0-6		13						

Sources: (a) WTO documents: G/TMB/N Series; and WT/TPR/S/3 of 30 June 1995, pp. 99-103; and (b) GATT, Trade Policy Review: United States, 1994, vol. 1 (Geneva), pp. 164-168.

Note: These restrictions were in force on 31 December 1994.

* Double-checking surveillance agreements, no restrictions.

Finally, it should be noted that the categorization systems for textiles and clothing in the major importing countries are both complex and different from one another, making it very difficult to monitor the various integration programmes.¹¹

2. Transitional safeguards and the influence of the MFA

As a transitional arrangement aimed at achieving progressive trade liberalization in the textile sector, the ATC has succeeded in strengthening the criteria applied under the MFA. For example, the ATC has dislodged a divisive element related to low-priced imports¹² from the transitional safeguards provisions by introducing a positive new approach to determining serious damage or the actual threat thereof, whereby the country imposing the transitional safeguard measure should also examine, “on the basis of the level of imports as compared with imports from other sources”, whether the serious damage in question has been caused to the domestic producers of products by the totality of imports from all sources. This can be viewed as an important step towards the dismantling of an MFA that was based on the concept of “market disruption”. In a situation of market disruption, the MFA required the determination of causality between the disruptive imports and the existence of serious damage. In other words, the serious damage had to be caused by a sharp and substantial increase in imports from a particular source at prices substantially below those prevailing in the market of the importing country.

Further, transitional safeguard measures can now only be applied in situations where imports have actually caused serious damage or the actual threat thereof. There is no possibility of taking preventive action to avoid “real risks” of serious damage, as was the case under the MFA. This is viewed as an improvement, as it helps prevent the misuse of the transitional safeguards mechanism in practice.

While the ATC has managed to remove certain disturbing features of the MFA, it is in many ways an extension of that arrangement that will continue to influence trade in this sector over the transition period. Under the transitional safeguards provisions, discriminatory measures can still be applied to products covered in the ATC annex (except those integrated into GATT 1994) for up to three years on a Member-by-Member and/or a product-by-product basis against former MFA- and non-MFA-signatory WTO Members to whom serious damage (or the actual threat thereof) is attributed. Under the ATC, the determination of serious damage must be only product-specific (while under the MFA, the

¹¹For example, the EU has 114 categories under which textile and clothing products are classified based on the degree of processing; the United States has nearly 200 categories (including part categories) listed under five category series which are classified based on fibres.

¹²It was this element that permitted the developed importing countries to derogate from the GATT rules and to discriminate against developing exporting countries under the MFA.

determination of market disruption was both product- and country-specific),¹³ and once such a determination is made, an importing country can seek a quota against any supplier whose exports of a specific product are “increasing sharply and substantially”, no matter how minimal its exports to the importing country are. As a result, there could be a proliferation of very small quotas that might not have been justifiable under the MFA.

Some new elements such as wages and domestic prices have been added to the list of factors for determining serious damage;¹⁴ overall, this may have a negative effect on developing exporting countries. In addition, transitional safeguard actions can be taken by mutual agreement; following consultation; or unilaterally, subject to examination by the TMB.

The new concept of cumulative damage caused by increased imports from more than one source (or by the totality of imports, as referred to above) implies that more than one Member can be held responsible for serious damage, and that a transitional safeguard measure can therefore be imposed on several Members at the same time. In this regard, it is important to note the concern caused by the United States’ “calls” against imports of underwear and nightwear made of cotton and man-made fibres from eight countries (the Dominican Republic, Honduras, Costa Rica, Thailand, Turkey, El Salvador, Jamaica and Colombia) based on the concept of cumulative damage (International Trade Report, 12 April 1995).

The United States has initiated such calls in spite of the fact that the ATC entreats Members to avoid frequent recourse to such actions and to ensure that transitional safeguards are applied “as sparingly as possible”. In fact, since the entry into force of the WTO Agreement on 1 January 1995, the United States, under the transitional safeguards mechanism, has reportedly made more than 20 calls to institute new quotas against imports of textile products from developing countries. Most recently, the United States issued three calls against certain wool garments from India, Honduras and Hong Kong (*International Trade Report*, 16 August 1995). In some cases, the United States has even tried to impose specific limits on certain textile products (such as cotton and man-made-fibre underwear from Thailand) that are already subject to group limits, even though Article 6, paragraph 4, of the ATC stipulates that no transitional safeguard measure shall

¹³ See paragraph II (i), annex A of the Arrangement Regarding International Trade in Textiles (GATT, 1974, p. 20).

¹⁴ The determination of a situation of “market disruption” under the MFA (annex A) was based on an examination of the factors having a bearing on the evolution of the state of the industry in question, such as turnover, market share, profits, export performance, employment, volume of disruptive and other imports, production, utilization of capacity, productivity and investments. Under the ATC (Article 6, paragraph 3), in making a determination of serious damage, the Member shall examine the effect of the imports on the state of the particular industry, as reflected in changes in such relevant economic variables as output, productivity, utilization of capacity, inventories, market share, exports, wages, employment, domestic prices, profits and investment.

be applied to the exports of any Member whose exports of the particular product(s) are already under restraint under the ATC. Such developments have caused major concern among many developing countries and could lead them to question whether the ATC provisions are being effectively implemented by the major importing countries, and whether the WTO Agreement as a whole is credible.

The ATC is an integral part of the WTO Agreement and is applicable to all WTO Members' trade in textiles and clothing. Following from this, some WTO Members, including many developing countries whose exports are continuously subject to MFA quota restrictions during the 10-year transition period, have decided to retain the right to employ transitional safeguard measures against imports of textile and clothing products from other countries. Some developing countries may therefore find themselves facing transitional safeguards in their export markets (whether or not they were signatories to the MFA) while also imposing such safeguards against imports from other developing or developed countries.

3. ATC linkages with commitments under other Uruguay Round agreements

The provisions of Article 7 of the ATC establish a linkage between the benefits of the economic package of the ATC and some of the obligations set forth in other Uruguay Round agreements. Within this context, the Members are required to make specific commitments to achieve improvements in market access; to ensure the fair and equitable application of policies with respect to dumping, subsidies and intellectual property protection; and to avoid discrimination against imports of textile and clothing products. In the case of non-fulfilment of these commitments by a Member, another Member can refuse to apply the growth rate increases.

Such a linkage, particularly as unilaterally interpreted or defined, could give rise to disputes and may pose a threat to the effective implementation of the ATC. In this regard, it is important to note that some major importing countries, within the context of their national implementing legislation, have linked the integration process, the increases in growth rates for MFA quotas, Generalized System of Preferences (GSP) status, and other such considerations with the further opening up of markets by developing countries for the former's exports of textiles and clothing. For example, the United States has attached a note to Section XI of its tariff schedule which stresses that the concessions in its schedule "on all textiles and clothing products covered by the Agreement on Textiles and Clothing, as specified in the annex to that Agreement, are established based upon the fundamental understanding that the maintenance of the balance of rights and obligations under the Agreement on Textiles and Clothing, in particular Article 7 thereof, means Members will provide effective market access to textiles and clothing entering their territory from the United States. An assessment of effective market access is based upon the following criteria: (i) the reduction and binding of tariff rates at levels no higher than 35% for apparel, 30% for fabric and made-ups, 15% for yarns, and 7.5% for fibres; and

(ii) the elimination of all non-tariff barriers within three years and a commitment that no new non-tariff barriers will be established” (GATT, 1994d).

The United States Uruguay Round Agreements Act contains a provision similar to the one quoted above. The Act also requires the American Administration, in the light of the stipulations mentioned above with regard to the key exporting Members, to review the latter’s tariff bindings in the area of textiles and non-MFA restrictions (i.e., those notified to the TMB under Article 3 of the ATC). The first review was to be carried out no later than 120 days after the entry into force of the WTO Agreement, with subsequent reviews to be conducted periodically. The reviews are to serve as a guide for the Administration, which will take measures, as appropriate, to obtain market-access commitments from “any signatory to the WTO Agreement that is a significant exporter of textiles and apparel to the United States” and has failed to provide adequate access to its market for American textile and clothing products.

The term “significant exporter of textiles and apparel to the United States” is subject to unilateral interpretation by that country; thus, it is not clear which exporting countries will be targeted. This certainly poses a threat to the effective implementation of the ATC.

During the course of the Uruguay Round negotiations, developing exporting countries argued that the concessions they made in this area should be compatible with their developmental, financial and trade-related needs, and that as a matter of principle, they should not be asked to “pay” for the abolition of what constituted a derogation from GATT. India, however, in order to safeguard its interests, has linked its tariff reductions on textile and clothing products to the integration programme for MFA restrictions under the ATC. The explanatory notes (iii) for Section II of India’s tariff schedule provide a detailed description of India’s intentions in this regard:

“In the case of items falling under chapters 51 to 59, the reduction of tariffs to the level of 25% or 40%, as the case may be, will be achieved over a period of 10 years. The reductions will be calibrated to the integration process envisaged in the Agreement on Textiles and Clothing. That is, the reduction in duty will be achieved by reducing the difference in percentage points between the base rate of duty and bound rate of duty to the extent of:

- “Fifteen per cent on the first of March following the date of the entry into force of the Agreement on Textiles and Clothing
- “Twenty per cent on the first of March following the first day of the 37th month that the Agreement on Textiles and Clothing is in effect

- “Twenty per cent on the first of March following the first day of the 85th month that the Agreement on Textiles and Clothing is in effect
- “Forty-five per cent on the first of March following the first day of the 121st month that the Agreement establishing the World Trade Organization is in effect

“If the integration process envisaged in paragraphs 6 and 8 of Article 2 of the Agreement on Textiles and Clothing does not materialize in full or is delayed, duties will revert to the level prevailing on 1-1-90” (GATT, 1994c).

This is perhaps the first time a developing country has used a “snap back” clause to link its tariff concessions with the multilateral trade commitments of developed countries.

4. The implications of trade liberalization in the textile and clothing sector for some developing countries

In the long run, the tariff reductions by developed countries and the gradual phasing out of MFA and GATT-inconsistent non-MFA restrictions may have an impact on developing countries benefiting from preferential market-access arrangements and/or enjoying duty-free treatment, as there will be some erosion in the margin of preferences. Included in this group are the Caribbean countries and Mexico as beneficiaries of the preferential market measures taken by the United States (relating to United States imports under its Harmonized Tariff Schedule Subheading 9802 and the Guaranteed Access Level programme); and Morocco, Tunisia, Turkey, and Central and Eastern European countries as beneficiaries of the EU passive processing traffic programme (or the so-called “outward processing trade”), which, in combination with the Lomé Convention and Mediterranean agreements, has extended preferential market access in the form of lower tariffs and higher volume allowances under the quantitative restriction arrangements for clothing imports assembled from EU inputs.

5. Conceptual and definition-related problems of the ATC

Unlike those of the other Uruguay Round agreements, the articles of the ATC are without headings. Whether this is accidental or not, it could create problems of vagueness and affect the faithful implementation of the ATC. In particular, it could lead to the inequable application of the Agreement. For example, some importing countries have notified some of their former MFA restrictions as non-MFA restrictions (see table 10), with the possible objective of accelerating the phase-out of these MFA restrictions rather than gradually eliminating them under the integration programme as stipulated in Article 2 of the ATC, thus creating inequitable treatment in the integration programme.

Table 10. Non-MFA restrictions maintained by WTO Members

Restricting importer	Affected suppliers	Remarks
European Union (E.U.)	Czech Republic Hungary Poland Romania Slovak Republic	The quantitative limits negotiated in the Additional Protocols to the Europe Agreement are preferential in nature. The Additional Protocols provide for the elimination of these restrictions by 1 January 1998 for each of these countries. These restrictions were maintained by the EU earlier under the North American Free Trade Agreement (NAFTA).
European Union	Egypt Malta Morocco Tunisia Turkey	The consultation levels maintained in the context of the preferential trade agreements.
United States	Kuwait Mexico* Myanmar Pakistan** Haiti Laos Former Yugoslav Republic of Macedonia Qatar Ukraine	* Under NAFTA. ** Referring to two restrictions which the United States intends to eliminate as soon as Pakistan files its notification to bind its tariff in accordance with the bilateral agreement between the United States and Pakistan.
United States	Costa Rica Dominican Republic El Salvador Guatemala Haiti Jamaica	Under the Special Access Programme for imports from participants in the Caribbean Basic Economic Recovery Act (CBERA), which provides additional access through the establishment of Guaranteed Access Levels (GALs)

Table 10. (continued)

Restricting importer	Affected suppliers	Remarks
Republic of Korea	Imports from all sources (silk fabrics, grey, satin, crepe de Chine, other woven fabrics, wholly of silk other than grey)	Restraints under the General Agreement on Tariffs and Trade, Article XVIII:B. The programme of liberalization provides for the elimination of these restrictions on 1 July 1997.
Egypt	Imports from all sources (more than 70 products)	
Mexico	Imports from all sources (used clothing)	For public health reasons.
Thailand	Imports from all sources (silk yarn and jute bags)	Imports subject to non-automatic import licensing under the General Agreement on Tariffs and Trade, Article XVIII:C.
India	Imports from all sources (593 tariff lines)	Maintained under the General Agreement on Tariffs and Trade, Article XVIII:B. As of 15 February 1995, 280 tariff lines are permitted to be imported freely without import licenses by all persons, while 313 tariff lines are permitted to be imported with special import licenses.
Bangladesh	Imports from all sources (for details, see GATT Document BOP/323 dated 21 February 1995)	Maintained under the General Agreement on Tariffs and Trade, Article XVIII.
Pakistan	Imports from all sources (for details, see GATT Document L/6830 and BOP/R/221)	

Table 10. (continued)

Restricting importer	Affected suppliers	Remarks
Japan	Republic of Korea China Taiwan Province of China and other countries and areas (silk yarn and silk fabrics)	Republic of Korea made a reverse notification on woven fabrics of pure silk.
Japan	United States (cotton fabric sheeting, cotton fabric printcloth and man-made fibre fabric of polyester filament yarn, $\leq 170\text{g/m}^2$) European Union (woven fabric of synthetic filament yarn)	Under Import Approval System in accordance with the foreign exchange and foreign trade control law.
Peru	Imports from all sources (used clothing)	For public health reasons.

Source: WTO document, G/TMB/N Series.

Note: As notified by restricting importers or affected suppliers under Article 3, paragraph 1, of the Uruguay Round Agreement on Textiles and Clothing.

6. The role of the TMB

Among the Uruguay Round agreements, the ATC is integral; however, the process for settling disputes related to the implementation of the ATC is not very straightforward. A partial role in this regard has been assigned to the TMB. Consequently, in matters remaining unresolved by mutual consultations, country Members of the WTO are required to resort first to the TMB rather than appealing directly to the Dispute Settlement Body (DSB) under the integrated dispute settlement system. In some cases, this is bound to prolong the settlement of disputes, as certain matters may eventually have to be pursued under the provisions of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) if the TMB process fails to produce a satisfactory resolution.

Moreover, in contrast to the DSU provisions, the TMB is required to arrive at all its decisions through consensus among its members. Although such consensus does not require the assent or concurrence of TMB members appointed by the WTO Members connected with an unresolved issue under review by the TMB, the fact is that the lack of a consensus among any of the other eight or nine TMB members can potentially block the process. This directly contradicts the DSU, under which the adoption of a panel report is to be automatic unless there is a consensus *not* to adopt the report.

In the final analysis, the TMB process and procedures can effectively prevent WTO Members from receiving a speedy and/or satisfactory resolution to disputes arising from the implementation of the ATC. The use of such a system could result in a repetition of the situation under the MFA, where countries were left to slip into bilateral deals, often weakening the multilateral disciplines.

7. The new EU GSP scheme

The new EU GSP scheme (Council Regulation, 1994) has a number of developing countries concerned; its real impact may need to be analysed in detail. Under the scheme, which is drastically different from its predecessor, quotas are replaced by tariff modulation: 85% of the MFN duty rate is imposed on very sensitive textile products; 70% on sensitive products; and 35% on semi-sensitive products; while non-sensitive products are duty-free.

8. The new rules of origin for textiles in the United States

In Section 334 of the United States Uruguay Round Agreements Act, the United States Treasury Department is asked to change the rules of origin affecting a broad range of products (including T-shirts, pants and dresses) by 1 July 1996. The rules of origin determine which country's quotas should be charged for a particular import when the manufacturing of the good occurs in more than one country. The new rules will make the

country in which assembly occurs the country of origin; countries that do a great deal of assembly work on parts cut in other countries will be greatly affected by the change.

9. The relationship of the ATC with other GATT-consistent measures

The phasing out of MFA and GATT-inconsistent non-MFA restrictions might lead to the increased application of GATT-consistent trade-remedy measures such as anti-dumping and countervailing actions against imports of textiles and clothing.¹⁵

10. The impact of regional arrangements

While participating in the Uruguay Round negotiations, some countries were also engaged in forming or enlarging regional trading arrangements. These developments, particularly the formation of the North American Free Trade Agreement (NAFTA) bloc and the enlargement of the EU (through the Europe Agreement), could have a considerable impact on the textile and clothing trade of developing countries; a study may be required to evaluate their potential effects. For example, EU preferential arrangements for the Europe Agreement countries provide for a programme of eliminating MFA restrictions on 1 January 1998 (WTO, 1995).

11. Implications of the ATC for non-Members of the WTO and the impact of their non-participation in the multilateral trading system

The Uruguay Round implementing legislation of both the United States and the EU contains different provisions with respect to the application of quantitative restrictions against imports from countries that are not Members of the WTO. In most cases, these non-Members will not benefit from the trade liberalization programme set out in the ATC; in particular, they will not be able to take advantage of the integration programme's phasing out of MFA and MFA-type quotas against their exports of textile products, or of the increase in growth rates for products still remaining under restriction during the 10-year transition period. Non-WTO Members could even be challenged by new restrictions applied against their textile exports without any time limits. Further, these countries could be affected by the changes in the implementation legislation of the major importing countries, such as the new rules of origin for textiles in the United States (discussed above).

Although it is logical that the countries which do not contribute to the trade liberalization package should not benefit from it, the existence of such a dual arrangement could weaken the multilateral trading system rules and disciplines that have just been

¹⁵In this regard, it is important to note that Japan recently imposed anti-dumping duties on cotton yarn from Pakistan.

strengthened through the Uruguay Round—particularly in the area of safeguards, where the scope of GATT-prohibited measures such as voluntary export restraints (VERs) and orderly marketing arrangements (OMAs) could be extended and the efforts to bring these measures under GATT control hampered. Even though these countries are small in number, they represent a considerable proportion of world textile and clothing trade, both as exporters and as importers. Non-WTO Members whose exports of textile products have been affected by MFA and MFA-type restrictions are listed in table 11.

The potential impact of these countries' non-participation on the effective liberalization of this sector and on the world trading system as a whole should not be underestimated. China serves as an excellent example. As a significant textile-exporting country, a signatory to the MFA, and a full participant in the Uruguay Round, China was actively involved in the negotiations leading to the finalization of the Agreement on Textiles and Clothing. However, China failed in its last attempt to regain its GATT Contracting Party status before the entry into force of the WTO Agreement, and its terms and conditions for becoming a WTO Member have still not been agreed upon between it and the present WTO Members. China will therefore not be able to enjoy the benefits deriving from the phasing out of the MFA restrictions and the increases in growth rates. Such a situation may create problems for China as well as for WTO Members. Until China becomes a Member, it appears that WTO Members will have considerable discretion in establishing the terms of trade and the size of the trade volume originating from China and entering their territories. They are free to determine their own policies *vis-à-vis* China as a non-Member. Following from this, it is uncertain to what extent China's textile exports will influence the implementation of the transitional arrangements. China is also free to influence its trade relations with individual WTO Members. The Members may need China's cooperation to prevent circumvention by transshipment, even though, unlike the MFA, the ATC does not include such a provision. As discussed earlier, in the course of the Uruguay Round negotiations, the Quad countries did not offer tariff reductions on a number of textile and clothing products of which China is a major supplier; this could also hamper market accessibility for many developing countries that are supplying the same products to these markets. It is important, as well, to remember that China's import restrictions do not have to be abolished. Finally, China is emerging as a new market for textile and clothing trade, and many WTO Members may wish to have guaranteed and increased access to the Chinese market—which they cannot obtain while China remains outside the WTO.

12. The Uruguay Round implementing legislation of the major developed importing countries

The effective and meaningful integration of this sector into GATT 1994 will greatly depend on the extent to which the provisions of the Agreement are respected by the major restraining countries in their national implementing legislation; the impact of this legislation should therefore be carefully examined.

Table 11. MFA or MFA-type restrictions (including growth rates, if any) applied by importing countries against non-WTO Members

Supplier	Restricting importing countries									
	European Union		United States		Canada		Norway			
	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)
Albania	****									
Armenia	*									
Azerbaijan	*									
Belarus	****									
Bosnia and Herzegovina	***									
Bulgaria	**		3	1	7	3.0 - 5.0				
Cambodia					14					
China	33	1 - 6	106	0.2 - 3	33	3.0 - 7.0	4	4.0		
Croatia	***									
Estonia	*									
Georgia	*									
Kazakhstan	*									
Democratic People's Republic of Korea	***				15		4	1.0		
Kyrgyzstan	*									

Table 11. (continued)

Supplier	Restricting importing countries									
	European Union		United States		Canada		Norway			
	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)
Laos People's Democratic Republic					14	6.0				
Latvia	*									
Lebanon					1	6.0				
Lithuania	*									
Former Yugoslav Republic of Macedonia	***									
Moldova	*									
Mongolia	2	4.0								
Nepal			7	6	1					
Oman			6	0-6	3	6.0				
Qatar					14					
Russian Federation	34				1	6.0				
Syrian Arab Republic					5	6.0				

Table 11. (continued)

Supplier	Restricting importing countries							
	European Union		United States		Canada		Norway	
	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)	Specific limits (number)	Growth rates (percentage)
Taiwan Province of China	***		77	0 - 2.5	45	0.2 - 6.0	4	
Tajikistan	*							
Turkmenistan	*							
Ukraine	34							
Uzbekistan	2							
Vict Nam	54				20	3.0 - 6.0	4	3.0

Sources: (a) WTO documents: G/TMB/N Series; and WT/TPR/S/3 of 30 June 1995, pp. 99-103; and (b) GATT, Trade Policy Review: United States, 1994, vol. I (Geneva), pp. 164-168.

Note: These restrictions were in force on 31 December 1994.

- * Double-checking surveillance agreements, no restrictions.
- ** Europe Agreement country.
- *** Autonomous arrangements.
- **** Details of these agreements are not available.

Apart from the elements already discussed with respect to the integration programme and the market-access commitments undertaken by other exporting countries, the United States Uruguay Round Agreements Act contains detailed provisions on transitional safeguards, circumvention and rules of origin.

In contrast to the detailed American legislation, the European Union Uruguay Round implementing legislation simply codifies previous EU practices (under Regulation 3030.93 on Common Rules for Imports of Textiles) to make them compatible with the provisions of the ATC.

F. SUMMARY AND CONCLUSION

The Agreement on Textiles and Clothing, a transitional arrangement with a definite life-span, represents an essential step towards trade liberalization in a sector which is of enormous importance to developing countries. Such liberalization will be achieved through the phasing out of the restrictions applied under the MFA by means of a four-stage integration programme over a 10-year transition period, with trade in textiles and clothing increasingly covered by GATT rules and disciplines. By the end of the 10-year transition period, the ATC and all restrictions under it will be terminated, and there shall be no extension of the Agreement (such was not the case with the MFA). In the long run, the ATC will contribute to restoring the credibility of the multilateral trading system and also to providing guaranteed and increased market access for developing countries' trade in textiles and clothing.

Carried out concurrently with the integration process, the increases in growth rates for MFA quotas remaining in place during the transition period will also bring about substantial improvements in market access for developing country Members exporting textiles and clothing. Given that the increases in growth rates are calculated as percentages of percentages, this could mean significant quota increases for these Members, particularly the medium- and small-scale exporters that enjoyed relatively high growth rates under the MFA bilateral agreements in effect the day before the entry into force of the WTO Agreement.

The elimination of quantitative limits on the combined use of swing, carryover and carry forward is considered an improvement for some developing exporting country Members in terms of their access to market opportunities.

Along with the 10-year phase-out of MFA restrictions maintained by the Members, GATT-inconsistent non-MFA restrictions must be brought into conformance with GATT 1994. This was to be done within one year of the entry into force of the WTO Agreement, though the option also exists of progressively phasing out the non-MFA restrictions under a programme extending over the duration of the ATC. This will no doubt increase the levels of transparency, security and predictability in developing

countries' access to the world textile and clothing markets. On a more cautionary note, because some provisions of the ATC are vague, certain country Members may implement the integration programme within a different time frame, which could lead to the inequitable application of the ATC.

The ATC provisions for the special treatment of small suppliers, especially the quantified definition (or specific threshold) with regard to MFA restrictions, could bring about meaningful improvement in access for their exports during the transition period through the advancement by one stage of the growth rates provided for products remaining under restriction.

The Uruguay Round negotiations cleared the way for increases in developing countries' imports of textile and clothing products from other countries, but most notably for increases in intra-developing-country trade in these products. While developing countries are traditionally considered exporters of textiles and clothing, in the past several years they have, as a group, become increasingly significant importers; a number of them have emerged as important new markets for textile trade. Prospects for the rapid expansion of intra-developing-country trade in textiles and clothing are bright, particularly for the emerging new markets in Asia and Latin America, as most of the countries in these regions have been taking autonomous steps to liberalize their import and exchange control regimes, and rising standards of living will further increase the demand for fashionable clothing. The expansion of trade in textiles and clothing is creating new opportunities for the international trading community, but particularly for those developing countries that until now have been almost entirely dependent on the markets of developed countries.

Within the context of the Uruguay Round agreements, developing countries have made significant contributions by undertaking tariff reductions, tariff bindings and the elimination of non-tariff measures. At this stage, the tariff cuts are not very large, and the scope of the tariff binding is limited; nevertheless, these commitments, together with the obligation to phase out GATT-inconsistent non-MFA restrictions and the strengthening of GATT rules and disciplines (particularly in areas such as safeguards, balance-of-payment provisions, and notification procedures) will no doubt make developing countries' access to the world's—and each other's—textile and clothing markets more secure and predictable.

It should be cautioned that the ATC integration programme may not bring about any immediate trade liberalization. Because the annex to the Agreement contains a number of HS lines which have never been specifically restricted in any country, the major restraining countries can fulfil their obligations under the Agreement in the first two stages without affecting MFA quotas. Thus, trade opportunities may only become perceptible from the beginning of the third stage (i.e., from the year 2002)—and even then, only on a modest scale. The findings of a preliminary analysis of the integration lists of Canada, the EU, Norway and the United States support the foregoing conclusion. Under the

specifications of the integration programme, only 51% of the volume of the products covered in the annex will be integrated into GATT 1994 over the 10-year transition period (i.e., in the first three stages), leaving the balance of 49% of the volume to be integrated on the very last day the ATC is in effect. In terms of value, the United States will integrate only about 30% of the products listed in the annex over the first three stages, leaving more than 70% to be integrated on the final day of the Agreement. The fact that such end-loading can occur calls into question the efficacy and credibility of the integration programme, given that the process of structural adjustment will be made more difficult in the final stage. In this regard, other major importing countries should, like the United States, notify their lists of products to be integrated at the later stages as soon as possible so that the process of structural adjustment may begin.

WTO Members should make every effort to avoid frequent recourse to the transitional safeguards provisions, and should also make sure that such provisions are applied as sparingly as possible. In this context, it is equally important to ensure that the TMB can effectively carry out its role in resolving disputes related to the implementation of the ATC.

The linkage between the ATC implementation process and other Uruguay Round commitments, including tariff concessions which may be unilaterally interpreted or defined, could give rise to disputes. Because such a linkage may also contribute to delays in the integration process, it poses a threat to the effective implementation of the Agreement.

Finally, the phasing out of MFA and GATT-inconsistent non-MFA restrictions could lead to an increase in the application of GATT-consistent trade-remedy measures such as anti-dumping and countervailing actions against the imports of textile products. In this regard, WTO Members should resist pressure from their domestic protectionist forces to seek alternative means of restricting trade in textiles once such products are integrated into GATT 1994.

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V. ASSESSING THE EFFECTS OF THE URUGUAY ROUND AND THE TURKEY-EU CUSTOMS UNION ON THE TURKISH MANUFACTURING SECTOR

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Introduction

In 1980, after 50 years of inward-oriented development strategies, Turkey began adopting outward-oriented policies. Since then, a number of steps have been taken to open up the economy even further. Turkey became a Member of the World Trade Organization (WTO), established on 15 April 1995, and just prior to that, on 6 March 1995, it was agreed at the Association Council meeting in Brussels that Turkey would join the European Customs Union starting 1 January 1996.

The purpose of this paper is to study the possible effects of these two major international commitments on the Turkish manufacturing sector. The first section concentrates on the effects of the new rules and disciplines introduced through the Uruguay Round and customs union agreements. The second section evaluates the effects of measures relating to market access in the relevant countries. In the third section, the implications of the Customs Union Agreement for textiles and steel products is considered. The paper ends with a summary of the main findings.

A. RULES AND DISCIPLINES ASSOCIATED WITH THE WTO AND THE TURKEY-EU CUSTOMS UNION

In signing the Customs Union Agreement with the European Union (EU), Turkey has agreed to carry out Herculean tasks relating primarily to the harmonization of commercial legislation in the areas of competition policy, State aid, and intellectual and industrial property rights, and to the adoption of new rules in connection with customs classification and valuation, rules of origin, technical regulations, standards and government procurement. Similar considerations apply with respect to the Marrakesh Agreement Establishing the World Trade Organization (also known as the WTO Agreement). Each of the new rules and regulations connected with these agreements is expected to affect the functioning of markets in the Turkish manufacturing sector.

1. Incentives

Throughout the 1980s and much of the first half of the 1990s, Turkey focused on three different tools of industrial policy: a system of investment incentives, a system of export incentives, and a specific policy relating to State-owned enterprises. In each case,

the Government tried to preferentially allocate resources, mainly through the use of subsidies. From 1985 on, however, Turkey gradually eliminated many of these subsidies: as steps were taken to integrate Turkey into the world economy, the country was often required to comply with certain rules and principles in connection with the General Agreement on Tariffs and Trade (GATT) and other such commitments. The trend has continued: Turkey recently eliminated most of the remaining subsidies, as this type of incentive is not compatible with the rules of either the WTO Agreement or the Turkey-EU Customs Union Agreement.

Articles 30 to 41 of the Customs Union Agreement require that Turkey adopt EU competition rules (including measures regarding public aid) within two years, that its legislation on competition rules be made comparable to that of the EU, and that such legislation be applied effectively. The Uruguay Round Agreement on Subsidies and Countervailing Measures prohibits Governments from granting subsidies contingent upon either export performance or the use of domestic products. According to this Agreement, Governments must use caution to avoid granting actionable subsidies that will adversely affect the interests of other WTO Members, but they may provide non-actionable subsidies for research and development (R&D), regional development and environmental regulation.

The first three subsections below contain descriptions of the incentives and the public enterprise policy mentioned earlier. Again, it should be kept in mind that while some are still in use, the vast majority have been eliminated. The details of this major shift in policy are covered in the fourth and last subsection.

(a) *Investment incentives*

Since 1967, the Turkish Government has granted a number of production incentives to promote investment in activities and areas regarded as desirable. The incentives, regulated by laws and decrees, have been directed at reducing the cost of investment, reducing the need for external financing, and increasing profitability.

There are certain peculiarities associated with the incentive scheme. First, incentives are differentiated on a regional basis. For the purpose of granting incentives, each area in Turkey falls into one of four categories: developed regions, priority normal regions, regions enjoying first priority in development, and regions enjoying second priority in development. The second feature of the incentive scheme derives from certain conditions attached to lower limits, investment totals, minimum levels of the investor's own sources, and exports. The third characteristic of the system is that all incentives originate from the central Government and are regulated by laws and decrees.

The agency which administers the incentive scheme is the Undersecretariat for the Treasury. The scheme operates on the basis of incentive certificates granted by this body; only investments made with investment certificates are eligible for incentives.

The various types of investment incentives provided during the 1980s and 1990s—most of which have now been eliminated—can be summarized as follows:

- *Customs exemptions.* Capital goods, raw materials and intermediate goods used for investment purposes can be imported without customs duties; the incentive is equivalent to the amount of unpaid duties.
- *Low-interest credit for investment.* To ease the effect of high interest on investment borrowing, investment credit was made available at concessional rates. The Government also guaranteed foreign exchange credit of external origin against unfavourable exchange rate developments. Concessional credit was made available to investment certificate holders, repayable over five years (with a two-year grace period). The amount (proportion) of support varied according to the sector and the type of investment.
- *Exemptions from taxes, fees and duties.* If an investment was guaranteed to generate a certain level of exports, the loan(s) taken out for this investment was/were exempt from taxes, fees and duties.
- *Resource-utilization support premium.* The resource-utilization support premium was created to support investments benefiting from the incentive scheme. The support premium was calculated as a percentage of the investment financed from one's own sources and varied according to the category of the region in which the investment was undertaken. Assistance was originally provided in the form of a grant; however, after February 1991, it was treated as an advance to investors. The size of the advance varied according to the cost, type and location of the investment. This credit was repayable—at subsidized rates—in four equal instalments over five years, with a two-year grace period.
- *Postponement of the value-added tax (VAT) and exemption from the construction fee.* The VAT accruing in the importation of investment goods is postponed until an actual reduction of the tax is possible. Additionally, all factories and manufacturing establishments are exempt from the construction fee.
- *Allocation of foreign exchange.* Foreign exchange was allocated by banks for investments accompanied by investment certificates, up to the amount indicated in the document. The allocations were for capital and intermediate goods.

- *Investment incentive allowance.* The investment incentive allowance represents a corporate tax deduction, the rate of which varies by regional category and type of investment.
- *Investment finance fund.* Corporations could set aside a percentage of their taxable income for future investments. The amount set aside at the discretion of the corporation was deducted from its taxable income and deposited in an interest-bearing account with the Central Bank. It could be withdrawn at any time with authorization from the State Planning Organization and used for investment.
- *Real estate tax exemption.* For investments qualifying for investment allowances, real estate taxes were waived for several years.
- *Accelerated depreciation and revaluation.* Accelerated depreciation could be claimed for machinery and equipment, and assets could be revalued at the end of every calendar year.
- *Incentive premiums.* This applies to investments in priority sectors. In 1993, for example, in the sectors of mining, electronics, pharmaceuticals, certain electrical and non-electrical machinery, transport equipment, and certain types of services, a 22% incentive premium was paid to investors when they purchased domestically produced investment goods. This investment serves as a counterpart to the customs duty exemption for imported investment goods.
- *Land allocation.* Land was allocated by the Government for tourism investments.
- *Incentive for additional employment.* Firms with at least 10 workers were not liable for contributions to the housing fund or to the savings-encouragement fund related to the employment of workers whose jobs were created through new investments.
- *Special incentives for scientific R&D.* In 1992 Turkey's expenditure on R&D amounted to 0.49% of its gross national product (GNP). In addition to the 100% investment incentive allowance for scientific R&D, the following R&D incentives were made available: 20% of corporate tax could be paid in nine equal instalments without interest over three years following the year in which the R&D expenditure was made, provided the postponed tax did not exceed the amount of such expenditures made in the corresponding year; and corporations carrying out scientific R&D could apply for tax-exempt status.

Through the application of the investment incentive measures summarized above, the Government was able to reduce the effective cost of borrowing for investors, thereby reducing the cost of investment and increasing profitability. According to the Commission of the European Communities (1989), investment incentives can lead to very high aid levels. It has been estimated that up to 77% of the investment cost of a project may be covered by aid in developed regions, and the proportion may be even higher in regions enjoying priority in development.

(b) Export incentives

During the 1980s and much of the 1990s, Turkey has used the following export incentives:

- *Export tax rebates.* Reimbursement of indirect taxes for exporters was originally introduced in 1963. In April 1981, 10 different lists of commodities became eligible for rebates, with the maximum rebate set at 20%; in 1988 the maximum rate fell to 8%.
- *Foreign exchange allocations.* The Export Promotion Decree, dated 25 January 1980, specified that exporters who held Export Encouragement Certificates granted by the Office of Incentives and Implementation at the State Planning Organization or a letter of credit could apply for foreign exchange. An exporter with a foreign exchange allocation had the right to import raw and intermediate materials duty-free. The policy aimed at supplying these inputs to exporters at world market prices; the amount was limited to a fraction of the free-on board (f.o.b.) value of the exports. The incentive value of the foreign exchange allocation was as follows: first, the exporter was not required to pay duties when importing intermediate and raw materials; second, foreign exchange during the early 1980s commanded a premium over the official exchange rate.
- *Payments from the Price Stabilization Support Fund.* In December 1986 a new system of cash incentives for exports was introduced. In general, the premium provided through the Price Stabilization Support Fund was determined by the weight (i.e., the number of tons) of the commodity being exported. When it was instituted, the policy's primary aim was to increase the profitability of exports such as consumer durables for which Turkey wanted to create greater competitiveness in the world market.
- *Duty-free imports of intermediates.* Exporters or manufacturer/exporters may—without paying customs duties or other, related taxes—import

intermediate and raw materials to be incorporated in products that will be exported either by themselves or through subsidiary industries.

- *Exemption from corporate income tax.* The corporate income tax law contains clauses on export exemptions which allow for a portion of the profits made on the export of industrial goods, fresh fruits and vegetables, and marine products, as well as the revenues from freight to countries abroad and tourism revenues in foreign exchange, to be deducted from corporate income.
- *Resource-Utilization Support Fund.* Towards the end of 1984 (by decree), the Government established the Resource-Utilization Support Fund at the Central Bank. The original purpose in setting up the Fund was to create additional resources for exports and investments in accordance with the objectives set in the five-year development plans and annual programmes. According to the regulations, all export commodities covered by the Price Stabilization Support Fund would receive a 2% subsidy from the Resource-Utilization Support Fund, and all other export commodities would receive a 4% subsidy. In April 1986, the 2% rate was reduced to zero and the 4% rate to 2%.
- *Rebates on freight charges.* According to a Money and Credit Board communiqué issued in April of 1986, a subsidy was to be paid for the transport of export products forwarded from Turkish ports to the ports of three groups of countries on the basis of gross tonnage, provided the forwarders were domiciled in Turkey. In the early 1990s, different rebate rates were applied to different commodity groups. The rates for textile products differed from those for steel products, but none were higher than 20%; in any case, the total rebate could not exceed 15% of the value of the exports.
- *Exemption from various taxes.* Exporters are not required to pay any taxes, duties or fees associated with various required export-related procedures; among these are: the credit supplied by banks with the proviso that it be used to finance exports; the fees charged by banks, insurance companies and public notaries for carrying out export-related tasks; taxes on bank and insurance company procedures; and stamp duties.
- *Fuel oil and electricity subsidy.* With a supplementary decree published in 1989, exporters could import the fuel oil used in the production of export goods without paying any customs duties or related taxes, and could buy the electricity used in producing exported goods at the Turkish Lira (LT) equivalent of \$0.01/kilowatt-hour (kWh). This policy was later

expanded to cover the use of liquefied petroleum gas (LPG) and natural gas in the production of exportable goods, as long as the cost of such energy was not less than 5% of the total cost of the good.

- *Deduction system.* Exporters could claim communication, food, tax and transportation expenses as corporate tax deductions as long as they were certified. Different rates applied for exporter-manufacturers and for exporters. Exporter-manufacturers exporting between \$1 million and \$10 million worth of goods could claim up to 4.5% of the value of their exports, and up to 5% for exports in excess of \$10 million. For exporters, the rate was 0.5% for exports valued at between \$1 million and \$50 million, and 1% for exports worth over \$50 million.

The Government, through the use of the export incentive measures summarized above, was able to increase the profitability of export activities. Table 1 shows the sectoral export subsidy rates that prevailed in Turkey over the 1980s. As indicated in the table, the average export subsidy rate in the manufacturing sector was relatively high during 1983 and 1984 but decreased considerably as the 1980s progressed.

(c) *Policy measures related to State-owned enterprises*

In discussing the policy on State-owned enterprises in Turkey, it should be noted that the Turkish public-enterprise sector is very large. For many years, the State had a monopoly on tobacco, war weapons, railways, air transportation, airport and seaport administration, postal services and telecommunications, and sugar production; in the manufacturing sector, State-owned enterprises were heavily concentrated in the production of basic metals, chemicals, petrochemicals, fertilizers, newsprint, paper, cement and textiles, as well as in oil refining.

State-owned enterprises generally show poor economic performance, mainly because of the soft-budget constraints they face. They follow objectives that are influenced by political pressure, such as agricultural income support and employment creation. Public firms are not subject to the commercial code and are therefore not affected by bankruptcy laws. Pricing, employment and investment decisions generally require the approval of the Treasury, the State Planning Organization, and sometimes the ministers themselves. State economic enterprises receive subsidies from the Government in the form of direct transfers, equity injections and debt consolidation. As mentioned, there are barriers to exit in Turkey; public firms are often not allowed to go bankrupt. To protect workers from unemployment, the Government subsidizes unprofitable firms. Exit barriers make firms more risk-averse in undertaking new activities and block a more decisive approach to resource allocation.

Table 1. Sectoral export subsidy rates in Turkey, 1983-1990

Input-output (I-O) code	Sector	1983	1984	1986	1988	1990
1	Agriculture	7.713	7.707	4.539	22.900	5.588
2	Animal husbandry	9.880	9.032	6.120	6.169	4.175
3	Forestry	8.420	7.965	6.803	3.293	-0.492
4	Fishery	17.367	16.317	12.499	12.125	4.577
5	Coal mining	12.243	10.323	9.796	10.895	9.816
6	Crude petroleum	11.734	9.794	9.267	10.512	9.606
7	Iron ore mining	21.177	18.985	17.598	17.485	10.596
8	Other metallic ore mining	22.804	19.904	17.747	18.009	9.716
9	Non-metallic minerals	20.040	17.652	15.525	15.416	9.784
10	Stone quarrying	33.252	28.467	23.721	12.585	9.448
11	Slaughtering and meat	36.536	27.464	20.143	12.746	12.581
12	Fruits and vegetables	26.203	19.265	13.858	16.247	8.679
13	Vegetable and animal oil	27.056	22.181	18.879	20.591	13.264
14	Grain mill products	16.332	11.257	10.877	39.745	14.338
15	Sugar refining	29.334	22.735	18.184	16.625	16.616
16	Other food processing	21.589	15.937	-1.992	-1.666	0.365
17	Alcoholic beverages	31.286	23.903	18.461	21.295	7.586
18	Non-alcoholic beverages	29.818	22.971	18.420	21.132	8.176
19	Processed tobacco	7.439	1.127	11.768	11.570	13.485

Table 1. (continued)

Input-output (I-O) code	Sector	1983	1984	1986	1988	1990
20	Ginning	3.618	2.601	4.415	-11.469	7.366
21	Textiles	33.429	25.268	12.205	10.872	8.683
22	Clothing	44.860	35.461	15.448	10.893	8.076
23	Leather and fur production	44.847	36.803	117.327	24.339	20.648
24	Footwear	41.116	31.663	25.737	32.261	26.658
25	Wood products	72.747	31.360	23.999	25.825	8.835
26	Wood furniture	70.572	29.617	25.386	26.186	9.145
27	Paper and paper products	73.226	33.068	27.157	31.290	31.610
28	Printing and publishing	73.364	32.457	25.886	24.006	10.965
29	Fertilizers	40.691	33.061	27.761	20.906	13.099
30	Pharmaceutical production	35.327	27.897	22.598	28.094	10.056
31	Other chemical production	35.895	30.088	26.998	26.730	16.082
32	Petroleum refining	41.837	39.223	36.783	36.322	28.329
33	Petroleum and coal products	45.664	42.401	39.962	34.109	22.379
34	Rubber products	39.237	36.219	26.177	33.723	19.414
35	Plastic products	40.296	36.292	26.300	25.606	12.578
36	Glass and glass production	33.313	24.271	19.916	20.658	9.714

Table 1. (continued)

Input-output (I-O) code	Sector	1983	1984	1986	1988	1990
37	Cement	34.855	26.318	21.874	20.725	9.736
38	Non-metallic minerals	37.577	28.193	22.949	28.834	17.309
39	Iron and steel	54.366	39.705	30.149	45.550	37.657
40	Non-ferrous metals	57.351	41.347	31.101	31.385	15.199
41	Fabricated metal products	101.055	54.914	27.912	31.201	11.299
42	Non-electrical machinery	43.694	40.731	25.370	26.045	14.941
43	Agricultural machinery	47.752	45.895	31.074	43.489	21.504
44	Electrical machinery	59.189	32.787	26.692	28.007	19.491
45	Shipbuilding and repairing	33.625	26.766	15.295	12.324	-2.208
46	Railroad equipment	14.959	12.642	8.330	7.315	1.462
47	Motor vehicles	40.766	34.745	23.354	37.474	4.077
48	Other transport equipment	30.395	23.659	12.188	24.145	-4.008
49	Other manufacturing industries	41.001	32.850	34.367	30.603	12.148
	Mean	31.978	24.125	18.488	22.590	13.035
	Standard deviation	19.760	11.617	16.427	11.365	8.133

Source: S. Togan, *Foreign Trade Regime and Trade Liberalization in Turkey during the 1980s*. (Aldershot, Avebury, 1994).

(d) A major shift in policy

The investment incentive schemes were developed to encourage investment—not to remove barriers to entry into industry imposed by capital market imperfections and therefore not to increase competition in the country. As emphasized by J. Biddle and V. Milor (1995), there has been a lot of waste in the system; further, it has been impossible to properly monitor the outcomes of the investment incentive schemes. As a result of these factors, investment incentives have constituted a barrier to competition and structural change. Through the incentive system, established firms have been able to obtain unit cost advantages which have helped them to consolidate their market position. New entrants to the market, competing for scarce fiscal resources, have been at a disadvantage relative to well-informed incumbents. As a case in point, credit incentives, which were supposed to promote entry, have often been used to reinforce the position of large incumbents. Furthermore, the Government, with its dominant role in the banking system, has directly controlled the allocation of credit, and credit from public banks has often been extended on the basis of non-commercial considerations. It should also be noted that public-sector procurements have often been the product of collusion among preferred suppliers—another barrier to competition.

Table 2 shows the concentration ratios across 50 selected industrial products during the period 1989-1990 in Turkey; it is indicated here that concentration ratios were relatively high.

For a long time there was no specific competition legislation or competition policy enforced in Turkey. In the 1980s, to promote competition within the country, the Government eliminated quantitative restrictions on foreign trade and substantially decreased the nominal and effective protection rates, as reported in Togan (1994). However, reducing nominal and effective protection rates is not sufficient to ensure the proper functioning of the markets.

Similar considerations in Europe during the 1950s led to the adoption of competition policies, the objectives of which were to ensure effective competition and the more efficient allocation of resources and to create the best possible climate for fostering innovation and technical progress. Europe's competition policies now encompass a vast range of economic policies and activities; in principle, any governmental or private-sector action that undermines market contestability can be the subject of competition policies. These policies aim to create freer markets in the economy by removing entry and exit barriers in the industrial sector.

Table 2. Concentration ratios for selected goods, 1989-1990

Commodity	Concentration ratio 1 (percentage)	Concentration ratio 3 (percentage)
Televisions	35	74
Audio electronics	62	88
Vacuum cleaners	55	90
Sewing machines	50	100
Washing machines	80	100
Refrigerators	53	100
Electric irons	50	80
Household cooking ranges with ovens	63	100
Household heating radiators	47	90
Electrical porcelain goods	86	100
Audio tapes	75	100
Copper pipes and rods	50	80
Cardboard	50	100
Corrugated cardboard packaging	18	42
Sanitary paper products	59	98
Sanitary ceramicware	51	94
Beer	65	100
Toothpaste	72	99
Polyester fibre	73	100
Polyester yarn	36	86
Acrylic fibre	88	100
Machine-woven carpets	10	26
Pencils	95	100
Ballpoint pens	60	85
Steel cord and wire	70	90
LPG	50	75
Matches	60	100
Cosmetic goods (tons of production)	57	78

Table 2. (continued)

Commodity	Concentration ratio 1 (percentage)	Concentration ratio 3 (percentage)
Aluminium plates	60	100
Aluminium rolls and sheets	30	70
Plate glass	100	100
Margarine	52	81
Light bulbs	40	90
Electrolytic copper	30	70
Ceramics	39	70
Newspapers	27	68
Paints	29	60
Detergents	35	80
Pesticides	18	43
Trucks	46	80
Pick-up trucks	52	97
Buses	95	100
Minibuses	90	100
Passenger cars	55	100
Agricultural tractors	43	94
Automotive batteries	70	85
Automotive tyre cord	100	100

Source: M. Dutz, "Competition law and its relevance for Turkey," a paper presented at the International Conference on Competition Policies for Turkey held in Istanbul in November 1992.

Note: "Concentration ratio 1" refers to the share of total domestic sales accounted for by the largest producer, while "concentration ratio 3" refers to the share of domestic sales accounted for by the largest three producers.

A similar situation prevails in Turkey, where the need for competition policies arises because firms generally face entry and exit barriers and anti-competitive behaviour among incumbents. Besides the natural barriers such as economies of scale and financial market imperfections, there are barriers that protect incumbents from potential entrants and imports. In the light of these considerations, Turkey adopted the Law on the Prevention of Unfair Competition in Importation, which contains both anti-dumping and anti-subsidy provisions, in June of 1989; it also implemented its own competition policy, modelled largely on EU practice, during December 1994 with the Law on the Protection of Competition. The legislation forbids certain practices and contains provisions prohibiting the abuse of a dominant market position and regulating mergers and acquisitions. As a result of these changes, most of the investment incentives were dropped in 1995; only the investment incentive allowance, the customs exemption, the VAT exemption (postponement), the premium on domestically produced capital goods, and subsidies that fall within the category of State aid have been retained. Within the framework of State aid, credit will be provided from the Fund for the Encouragement of Investments and Services Providing Foreign Exchange Earnings for investment in R&D and the improvement of environmental regulation, for the support of small and medium-sized industries, for the improvement of product standards, and for the relocation of plants and equipment to regions enjoying priority in development.

With regard to the export regime, it should be noted that Turkey joined the GATT Subsidies Code in 1985, agreeing to eliminate export subsidies by 1989. Considerable progress was made both within and following this interim period: Turkey abolished the Resource Utilization Support Fund payments in 1986, tax rebates in 1988, Price Stabilization Support Fund payments in 1992, and the corporate tax exemption in 1993. With the elimination of the difference between the market rate and the official rate of exchange during the 1980s, the incentive value of the foreign exchange allocation schemes was substantially reduced. The deduction system and the rebate on freight charges were abolished at the end of 1994.

It is well known that market access has long been a major focus of GATT (and is now a WTO priority). Anti-competitive practices pursued by private enterprises have not been subject to GATT rules or disciplines. However, as stated previously, the Uruguay Round Agreement on Subsidies and Countervailing Measures prohibits Governments from granting subsidies contingent upon either export performance or the use of domestic products. According to this Agreement, Governments must use caution to avoid granting actionable subsidies that will adversely affect the interests of other WTO Members, but may provide non-actionable subsidies for R&D, regional development and environmental regulation. Within this context, Turkey introduced allowable incentives such as research and development subsidies and subsidies to facilitate the adaptation of plants in conformance with new environmental regulations on 11 January 1995.

Over the last decade or so, Turkey has changed its export and incentive schemes in conformance with various GATT and EC/EU practices and requirements; recently, to comply with the new WTO and Customs Union agreements, Turkey eliminated most of its remaining investment and export incentives. In the future, export subsidies in Turkey will be restricted to those provided for R&D activities, for environmental projects, and as financial assistance for export-promotion activities connected with, for example, participation in trade fairs, the contracting of market research, and the organization of educational activities such as seminars and conferences.

It may be remembered that, with respect to public-sector enterprises, there are barriers to exit in Turkey, that public firms are often not allowed to go bankrupt, and that the Government, to protect workers from unemployment, subsidizes unprofitable firms; however, it should also be noted in this context that Turkey does not have a social safety net that would facilitate the effective restructuring of industry. In spite of all this, the proper functioning of the price system requires that firms be able to enter and exit the market freely. One possible way of achieving this objective is through the privatization of public enterprises. Since 1983, privatization has been an important part of the Turkish structural adjustment programme. However, owing to various difficulties, privatization has not been able to gain momentum. A second alternative is to ask State-owned enterprises to operate according to market rules. Under such a policy, these enterprises would no longer face soft-budget constraints, they would be subject to the commercial code and could not escape bankruptcy laws, and they would no longer be subsidized by the Government (either directly or through equity injections or debt consolidation).

It might be useful here to consider the developments in Europe with regard to State aid. It was clear from the very beginning, when the European Coal and Steel Community (ECSC) was established in 1952, that the intervention of national Governments on behalf of some of their enterprises could threaten the efficient distribution of resources and thus the gains expected from the liberalization of trade. The Governments therefore decided to give the European Commission far-reaching control over national State aid; thereafter, as stipulated in Article 4 of the ECSC Treaty, subsidies and aid granted by States were to be abolished and prohibited. However, the strict prohibition against State aid in the iron and steel industry could not be sustained. Responding to the mounting pressure for national aid, the Commission authorized aid frameworks for the coal industry in 1965 and for the iron and steel industry in 1980. The currently applicable rules for iron and steel limit aid to R&D, environmental protection, the costs of plant closure, and investments in Greece and former East Germany provided they do not lead to an increase in capacity. For the coal industry, aid is provided for investment and employment and to cover operating losses. State aid is also provided to the agriculture, fishery and transportation sectors. Rules on State aid for the remaining sectors are contained in articles 92 to 94 of the Treaty of Rome (1957) establishing the European Economic Community. According to these articles, State aid, in so far as it distorts trade between Member States, is forbidden unless an exception is specifically accorded; possible exceptions are enumerated in Article 92. To obtain such

a derogation, Member States have to notify the European Commission of any plans to grant aid to their enterprises. If the Commission decides that such aid is compatible with the common market, it may be legally granted; however, if the Commission's decision is negative, any aid that has been allocated to an enterprise has to be repaid with interest. The Commission has issued numerous guidelines to clarify the rules on derogation. As explained in *European Economy* (1991), the rules are mainly concerned with particular forms of aid or types of aid schemes (such as regional aid) and with ensuring that the Commission has adequate information.

As previously mentioned, Turkey has adapted its export incentive system to the requirements of the Uruguay Round Agreement on Subsidies and Countervailing Measures. Further, in applying its competition law of 1994, Turkey should be able to remove entry and exit barriers in industry. Finally, Turkey recognizes that State aid, in so far as it distorts trade between Turkey and the EU, may lead to disputes between the parties. To comply with the rules of the Customs Union Agreement, Turkey will have to stop subsidizing its public enterprises at the prevailing rates, align its State aid policies with those of the EU, and apply the same competition policies to all firms, whether public or private. This adjustment will certainly be costly, but unless the system of State aid is aligned with that used in the EU, and unless competition rules are effectively applied to all private and public firms, the EU can use commercial defence instruments (anti-dumping and countervailing duties) against Turkey.

To solve the problems in this area, Turkey could set up an authority to assess its aid schemes. It could draw up an inventory of State aid and quantify the amount of such aid provided to different industries through investment and export incentives, the covering of operating losses, contributions to the capital of enterprises, and the non-pursuit of debts owed to the State, employing the same procedures as those used in the EU. In time, Turkey should be able to achieve a degree of effective enforcement and transparency which will be recognized as equivalent to that of the European Commission. Once this point is reached, the EU will probably decide to forego the use of anti-dumping and countervailing investigations against Turkish exports.

The new WTO and Customs Union rules on subsidies will increase competition in the Turkish economy. When faced with intensified competition, domestic industries—which may have reaped monopolistic and oligopolistic profits in a relatively protected domestic market—will be forced to behave competitively. The concentration ratios reported in table 2 are expected to decline over time. Furthermore, it is projected (following the work of Levinsohn [1993]), that price/marginal-cost mark-ups will decline in the private sector after the effective implementation of competition policies. Finally, public-sector firms, for which the profit-maximizing framework was inappropriate, would also begin to behave competitively after the effective implementation and enforcement of these policies.

2. Intellectual, industrial and commercial property rights

Intellectual property is usually defined as information with a commercial value. The main legal instruments utilized to protect intellectual property rights are patents, copyright and related rights, geographical indications and trademarks. Special forms of protection have also emerged for undisclosed information, industrial designs, and the layout-designs of integrated circuits. These instruments together form a national system of intellectual property rights protection. The institutions in charge of administering the system and the means available for enforcing these rights determine the system's effectiveness.

The following outlines the legislation on copyright and patents that prevailed in Turkey until recently:

- *Copyright.* Under Turkey's former Copyright Law (Law No. 5846 of 5 December 1951), copyright started from the date of publication; it belonged to the author during his lifetime and was inherited equally by his heirs after his death. Heirs could make use of the copyright for 50 years. In the case of infringement, the author could demand prosecution by the district attorney and could claim damages. Aliens residing in Turkey who registered copies of their work were equally protected under the law. However, works published in a foreign language could be freely translated into Turkish after a period of 10 years.
- *Patents.* Until recently, patent matters in Turkey were governed by a law dating back to the Ottoman period (23 March 1879), under which patents were issued without any verification of accuracy or novelty. Later, pursuant to Law No. 6563 of 21 May 1955, the Government could forward patent requests to the International Patent Institute in La Haye for study and verification of novelty. After the closing down of the International Patent Institute, Turkey signed an agreement with the European Patent Organization (in 1977) and a protocol with the Austrian Patent Office (in 1992). Under the agreements, patent requests made in Turkey could be sent to these institutions for study and verification of novelty. Within Turkey itself, all patent requests had to be registered with the Industrial Property Department of the Ministry of Industry and Commerce. Patents could be requested for 5, 10 or 15 years, and patent infringement could result in civil action as well as criminal prosecution. Pharmaceutical formulas, industrial designs and models, and financial schemes could not be patented. Turkey is a signatory to the Paris Convention for the Protection of Industrial Property (1883) and to the London and Stockholm Acts of this Convention (with the exception of the first 12 articles of the latter) signed in 1934 and 1967 respectively.

The shortcomings of Turkey's former Copyright Law can be summarized as follows:

- *Piracy.* The piracy of copyrighted works such as books, films, videos, sound recordings of musical works and computer software, though banned by the Copyright Law, could not be controlled, mainly because of the lack of an effective enforcement mechanism; the penalty in 1994 ranged from \$3 to \$75—a relatively negligible sum.
- *Rights related to translations.* According to the law prevailing until recently, works published in a foreign language could be freely translated into Turkish after 10 years.
- *Rights related to cinematographic works.* Under the former law, these rights were not properly protected.
- *Rights related to computer programs and compilations of data.* The law prevailing until recently did not cover these rights.

There were also a number of shortcomings associated with the old patent law. The Turkish patent law of the Ottoman period specified that patents would be available for any inventions, provided they were new and had the capacity for industrial application. The law did not require that the invention involve an inventive step.

Initially, patents were issued without any examination, and the burden of proof was on the applicant. However, after the adoption of Law No. 6563 of 21 May 1955, Turkey moved towards a system incorporating examination. Under the patent system that prevailed until recently, when Turkish citizens applied for patents, the administration would ask universities for their opinions on the patentability of the items in question. However, since the universities in Turkey did not have the necessary infrastructure for the study or verification of novelty, the opinions expressed by faculty members were sometimes inaccurate or biased. As a result, domestic investors were not willing to invest in new inventions, as they were afraid that the patent protection could be lost after some time. The Government forwarded the patent requests of foreigners to the European Patent Organization or the Austrian Patent Office for study and verification of novelty; thus, in the case of applications by foreigners, there was no chance that the patent protection would eventually be lost. Based on the above, the system was considered to be biased against Turkish citizens.

As previously mentioned, under the patent law prevailing until recently, patent infringements could give rise to civil action or to criminal prosecution. However, there were no special courts set up to deal with the settlement of disputes over industrial property

rights protection. The Turkish legal system experienced various difficulties in studying and evaluating the different issues and causes of disputes, and the settlement of such cases usually took a long time. There was a need for industrial property attorneys and special courts that could defend property rights, enforce the penalties for infringement, and carry out the other necessary functions in this regard in order to strengthen the system's credibility.

The Customs Union Agreement requires that Turkey ensure adequate and effective protection and enforcement of intellectual, industrial and commercial property rights, and that it implement the Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) by 1999. Furthermore, by 1 January 1998, Turkey must adopt legislation to secure the patentability of pharmaceutical products and processes. Regarding copyright, the Agreement stipulates that counterfeiting, bootlegging and other such forms of piracy must be effectively banned, and that the duration of protection in cases of translation should not be less than 50 years where the term is calculated on a basis other than the life of the person. The 50-year period is also applicable to corporations. For cinematographic works, the Agreement requires that title holders be given the right to authorize or prohibit the commercial rental to the public of originals or copies of their copyrighted works. The Agreement also requires that both computer programs and data compilations be protected as literary works under the Berne Convention of Literary and Artistic Works (1971), which provides protection for 50 years.

All of the shortcomings of Turkey's former Copyright Law were eliminated with the adoption of Law No. 4110 of 7 June 1995. Specifically, the new law increases the penalty for piracy to imprisonment for a period of three months to one year, stipulates that works published in a foreign language can be freely translated into Turkish after 70 years, and protects the rights related to cinematographic works, computer programs and compilations of data.

A number of significant changes have been made with regard to patents as well. The new Turkish Patent Law (Law No. 22326) became effective with Decree No. 551 published in the *Official Gazette* of 27 June 1995. As was the case with the copyright situation, the new law has eliminated all of the shortcomings of the previous legislation. Under this new law, a search report indicating the state of the art in the field of the invention and its status will be prepared after the patent has been applied for. Thereafter, the applicant has seven years to decide whether he wants to initiate a study for the determination of novelty; the cost of this study must be covered by the applicant. During the seven-year period, the invention is protected under the Patent Law. If the study conducted during the seven years confirms the novelty of the invention, the applicant is given protection for 20 years, starting from the date of the first application. If the applicant does not carry out the study during the seven-year period, he relinquishes his rights. Under this new law, the administration is responsible for preparing the search report and, if

requested, conducting a study to determine novelty. In order to meet these needs, the Turkish Patent Institute was established with Decree No. 544 of 24 June 1994.

The new Patent Law has a section deriving from French patent law outlining the “utility model”. A full-fledged patent is available for any invention, provided it is new, involves an inventive step, and has the capacity for industrial application at the universal level; however, the utility model requires only that the invention be new within the domestic economy. Protection is provided for 10 years. The advantages of the utility model are that the costs of application are lower and the time required for evaluation is shorter.

The new Patent Law contains a number of provisions. Rules are established for licensing agreements whereby patents must be used or licensed within the first three years of their patentability; if they are not, compulsory licensing rules adopted from Spanish patent law are applied. The new law also requires that patents be available for all inventions in all fields of technology. Finally, the new Patent Law requires that special courts be set up and the services of patent attorneys engaged for the settlement of disputes relating to industrial property rights. A patent attorney must have a comprehensive understanding of natural sciences and the ability to put new technical concepts and developments into words. While such an attorney is expected to be knowledgeable about a particular area of law, he must also have extensive knowledge in his field of legal practice; often, a solid understanding of domestic and international laws and the national laws of other countries is required. The patent attorney plays a very important role: he is responsible for applying his specialized legal and scientific knowledge in dealing with a new technical solution, and for properly wording patent specifications and patent claims to lay the foundation for new industrial property rights. The patent attorney is also expected to provide advice on know-how licenses, on the drafting of know-how agreements, and on the rights of employed inventors, and he should also advise clients of technical developments. Within the specially designated courts, judges chosen for their experience in patent and other intellectual property matters are required to deliver reliable and consistent decisions on issues related to validity, infringement and damages.

The Turkey-EU Customs Union Agreement incorporates the Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), which establishes minimum standards for intellectual property protection that must be observed by all WTO Members. According to WTO Agreement provisions, Turkey, as a developing country, must implement the TRIPs Agreement by the year 2000; for pharmaceutical products, Turkey can delay the application of the provisions until the year 2005. However, the terms of the Customs Union Agreement specify that Turkey must implement the TRIPs Agreement by the year 1999, and only has until 1 January 1998 to adopt legislation to secure the patentability of pharmaceutical products and processes.

The economic rationale for protecting intellectual property rights is expressed in terms of costs and benefits (Hoekman, 1995). The costs include the increased payments for proprietary knowledge, the price increases associated with greater market power for knowledge producers, the costs of displacing pirating activities, the costs of additional R&D, and the costs associated with administering and enforcing the protection of intellectual property rights. Potential benefits include the new inventions fostered by higher levels of R&D, better technology, increased foreign trade, increased foreign direct investment (FDI) flows—and consequently, increased per capita income within the country. Within this context, Turkey's main task will be to transform its intellectual property rights regime into an effective mechanism for promoting innovation and increasing income.

3. Customs classification, valuation and rules of origin; technical regulations and standards; and government procurement

Article 26 of the Customs Union Agreement requires that Turkey adopt EU customs provisions relating to the following: the origin of goods; the customs value of goods; the introduction of goods into the territory covered by the customs union; customs declaration; release for free circulation; the movement of goods; customs debt; and the right of appeal. Article 8 of the same Agreement specifies that, within five years, Turkey must incorporate into its legal system the EU instruments relating to the removal of technical barriers to trade. Furthermore, Article 46 of the Agreement requires that negotiations aiming at the mutual opening of the contracting parties' respective government procurement markets be initiated as soon as possible after 1 January 1996.

(a) Customs provisions

The term "customs classification and valuation" refers to the process through which customs authorities assign a tariff classification and value to any given import. If officials place goods under an incorrect classification to which a higher tariff applies or assign goods a value which is higher than appropriate, the valuation process may become a non-tariff barrier (NTB). The decision to include transportation and insurance costs in (or to exclude them from) the value of goods may also have a significant impact. Finally, customs officials may not accept the invoice presented by the importer as a basis for valuation in determining the amount of duty to be paid.

With respect to customs classification, since 1 January 1989 Turkey has classified its tariffs according to the Harmonized Commodity Description and Coding System (HS) nomenclature, which distinguishes between 18,610 tariff lines. Regarding customs valuation, it should be noted that Turkey ratified the Tokyo Round Agreement on the Implementation of Article VII (the Customs Valuation Code) on 13 January 1989. The Agreement entered into force for Turkey on 12 February 1989; however, there was a five-year delay, so the actual implementation of its provisions began in 1994.

Valuation is based on the invoice value of goods, i.e., the price actually paid or payable for the goods. In the determination of customs duties, the price normally includes added freight and insurance charges, commissions, and other expenses incidental to the sale of the goods and their delivery to the point of entry into the customs territory of Turkey.

A rule of origin is a criterion that is used to determine the “nationality” of a product. Where two or more countries are involved in the production of a product, the origin of the product is taken to be the country in which the last substantial transformation took place, i.e., that in which significant manufacturing or processing occurred most recently. The Uruguay Round Agreement on Rules of Origin specifies that for substantial transformation there must be a change in tariff heading within the specified nomenclature, which in Turkey is currently the HS (relevant provisions are contained in Article 19 of Turkey’s draft customs law). Turkey’s obligation to harmonize its commercial policy (including preferential agreements) with that of the EU requires it to keep abreast of developments relating to rules of origin. The Customs Union Agreement excludes, *inter alia*, the products that fall within the domain of the ECSC; for these products, a free-trade agreement was to be signed in 1995, after which the rules of origin would have to be applied for steel products as well.

The customs union can only function effectively if the customs system in Turkey is brought up to date; a number of positive steps have recently been taken in this direction. A new draft customs law has been prepared to replace the old customs law (Law No. 1615 of 19 July 1972); the new draft legislation aims for speedy customs release and the simplification and full automation of customs procedures. The customs administration has recently been involved in extensive training programmes. There are also plans to set up computer networks and introduce on-line declaration systems. With computers, each customs point will not only have the relevant information available for the collection of customs duties, but will also be able to access the information on preferential agreements and anti-dumping regulations that will be required to determine the correct amounts to be collected.

(b) *Technical regulations and product standards*

Product standards and technical regulations are essential for the functioning of market economies. Both are technical specifications for a particular product or production process, but they differ in that standards are voluntary and technical regulations are mandatory. Certification systems comprise a set of procedures that must be followed by producers in establishing that their products or production processes conform to the relevant standard(s)/regulation(s). Technical barriers to trade arise mainly because the standards/regulations of different countries are not the same, or because some countries do not accept the standardization systems (testing and certification) of other countries and request these countries to carry out new testing and certification procedures. As a result, standards/regulations raise the unit cost of production.

The Turkish Standards Institution (TSI) is the only organization authorized to prepare national standards for Turkey. Turkey is a full member of the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC), and is an affiliate member of the European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CENELEC). Roughly 80% of Turkish standards conform to international norms. There are some 11,000 Turkish standards, only a small fraction of which are compulsory. Mandatory standards are published in the *Official Gazette*. According to the Customs Union Agreement, EU rules and regulations pertaining to standards will become legally effective in Turkey by the year 2001. After 2001, the free circulation of goods must be permitted on the basis of the EU accord. A large number of European standards have already been adopted at the Turkish Standards Institution as TSI standards and were to be made available to the public as voluntary standards as of 1 January 1996.

(c) Government procurement

Government procurement policies often incorporate preferences for domestic over foreign firms bidding on public procurement contracts. The Uruguay Round Agreement on Government Procurement essentially prohibits preferences for domestic firms by imposing GATT national treatment based on non-discrimination principles. The Agreement generally applies to all central government, lower-level government and public utilities contracts that exceed 130,000 special drawing rights (SDR), SDR 200,000 and SDR 400,000 respectively, and to construction contracts above SDR 5 million. The aim of the Agreement is to reduce the scope for single and limited tendering by making the tendering process more competitive. Turkey has been an observer to the GATT Code on Government Procurement for some time. Public procurement in Turkey has been regulated by the Public Procurement Law (Law No. 2886) since 1984. The law applies to central, provincial and local governments but not to State economic enterprises or autonomous agencies. After the formation of the customs union, Turkey will probably have to apply the rules of the Agreement on Government Procurement (since the EU is a party to the Agreement) as well as all of the EU procurement directives.

4. Foreign direct investment

In Turkey, the Law for the Encouragement of Foreign Capital of 18 January 1954 provides the legal framework governing foreign direct investment, together with Communiqué No. 1 issued on 25 May 1986, and the Foreign Capital Framework Decree published on 4 March 1992. The legislation accords equal treatment to domestic and foreign investors and guarantees the transfer of profits, fees and royalties and the repatriation of capital. Investment incentives are equally available to foreign and domestic investors. Non-residents wishing to invest in Turkey must obtain authorization from the General Directorate of Foreign Investment (GDFI) at the Undersecretariat for the Treasury. The GDFI authorizes investments of up to \$150 million; investments above that amount

require the approval of the Council of Ministers. There are no limits set with respect to the equity participation ratio; nor are there any limitations associated with assigning managers or technical staff. The Treasury is required to guarantee the repatriation of proceeds from the sale of registered shares. Foreign investors can invest in Turkish securities and may remit all capital, dividends, interest and profits. Persons residing abroad are also permitted to buy real estate in Turkey, and can remit all proceeds from the rental or sale of properties purchased with foreign currency brought into the country. It should be noted that special incentives apply to the tourism and petroleum sectors.

Turkey signed the Organization for Economic Cooperation and Development (OECD) Codes on Liberalization of Current Invisible Operations and of Capital Movements in 1961, lifting its general derogation in 1986; it still maintains reservations with respect to the Codes. Since 1987, Turkey has been a member of the International Centre for the Settlement of Investment Disputes and the Multinational Investment Guarantee Agency. To date, Turkey has signed bilateral agreements with 27 countries for the promotion and protection of investments.

Turkey is a middle-income developing country with a fairly well-developed infrastructure (modern communications, transportation, finance and banking services and facilities). Although Turkey is geographically well placed to service a number of countries in the region, its FDI volume is low in comparison with that of several other developing countries at a similar stage of development. The literature on FDI determinants identifies political stability, low efficiency wage rates, natural resource endowments, per capita income levels, growth performance, price stability and exchange rate stability as the main factors considered in FDI decisions. It seems that the generous investment and export incentives provided for FDI in Turkey have not been sufficient to compensate for the adverse effects related to the other factors.

Notably, the Customs Union Agreement is silent on capital movements; the issue of FDI is not covered. The Uruguay Round Agreement on Trade-Related Investment Measures (TRIMs) recognizes that certain investment measures pursued by a host country restrict and distort trade. In particular, the Agreement on TRIMs identifies the local content requirement as being inconsistent with GATT disciplines relating to national treatment (Article III), and the foreign exchange balancing requirements as constituting quantitative restrictions (thus violating Article XI of the General Agreement on Tariffs and Trade). Turkey, as a developing country, is required to phase out GATT-inconsistent TRIMs over a period of five years. There are no local content or export performance requirements in Turkey. However, each individual foreign investor must bring in a minimum of \$50,000. Only investments worth \$500,000 or more are eligible for incentives.

With the establishment of its customs union with the EU, Turkey can no longer subsidize FDI. Before long, Turkey will have to implement the competition policies of the EU and to ensure the protection and enforcement of intellectual, industrial and commercial property rights within the country. These measures are expected to increase FDI flows into Turkey. However, Turkey will be adversely affected by the free-trade agreements the EU has concluded with Central and Eastern European countries and by those it will conclude with Baltic and Mediterranean countries. The scarce FDI funds will be channeled into these countries, and world competition for FDI funds will increase. With the formation of the customs union, Turkey will attract more capital inflow than before, as long as the country is also able to achieve political, social and macroeconomic stability (price and exchange-rate stability and relatively high rates of sustainable growth). Given the immobility of labour between the parties, EU investors will seek out the relatively cheap Turkish labour force. Capital is expected to flow into sectors where value added and hence profitability will increase—particularly the clothing, agriculture and services sectors, which until now have been shielded from competition.

B. MEASURES AFFECTING MARKET ACCESS

An important feature of both Turkey's Customs Union Agreement with the EU and the Uruguay Round agreements is the liberalization of trade. The purpose of this section is to study the effects of measures relating to market access in the relevant countries.

1. The Turkey-EU Customs Union Agreement

The customs union between Turkey and the EU allows for the free circulation of goods between the parties. Turkey must implement the European Union's common external tariff on goods from third parties and, by the year 2000, will adopt all of the preferential trade agreements the EU has concluded over time. To calculate the effect of these changes on the Turkish economy, nominal protection rates (NPRs) for trade with the EU and with third countries must be obtained for the periods before and after the formation of the customs union.

Table 3 provides estimates of NPRs for 1994 and for the period after the formation of the customs union. According to the table, the manufacturing sector's average 1994 NPR for trade with the EU amounted to 12.2% when weighted by sectoral import values; the corresponding figure for trade with third countries was 18.03%. With regard to the frequency distribution of NPRs among the 39 manufacturing industries considered, three (four) industries in 1994 had NPRs which were higher than 50% for trade with the EU (third countries), and 25 (20) industries had NPRs that were lower than 20% for trade with the EU (third countries). An examination of the structure of trade protection reveals that the highest NPRs for trade with the EU were granted to the following sectors: fruits and vegetables, with the input-output (I-O) code of 12 (72.49%); alcoholic beverages, I-O code 17 (72.1%); and non-alcoholic beverages, I-O code 18 (56.92%). For trade with third

countries, the highest NPRs were granted to the following sectors: processed tobacco, I-O code 19 (99.91%); alcoholic beverages, I-O code 17 (94.28%); and fruits and vegetables, I-O code 12 (72.62%).

The Additional Protocol to the Ankara Treaty signed on 23 November 1970 stipulated that Turkish imports from the European Community were to be divided into two groups. Those products in which it was thought that Turkey could achieve international competitiveness relatively early were placed on a 12-year list; other manufactured products were put on a 22-year list, to which the provisions of a customs union would not apply until 1995. With the formation of its customs union with the EU in 1996, Turkey has to reduce its nominal protection rates for all commodities on the 12-year and 22-year lists to zero.

There are basically three types of commodities other than those on the two lists: agricultural products; products that fall within the domain of the ECSC; and products that fall within the domain of the European Atomic Energy Community (EAEC):

- *Agricultural products.* To ensure the free movement of agricultural products, Turkey will have to adjust its policy and adopt a modified version of the common agricultural policy (CAP), which provides the main framework for agricultural support in the EU. According to the State Planning Organization in Ankara, if Turkey were to adopt a similar system, the required annual support would amount to \$3.1 billion. Since Turkey cannot devote this much of its own resources to the support of the agricultural sector, and since the EU will not contribute this amount annually, the free movement of agricultural products cannot be achieved in the near future. It is therefore to be expected that the NPRs for agricultural products will remain unchanged over the next few years.
- *ECSC and EAEC.* Through a resolution of the EU-Turkey Association Council, negotiations for the free movement of ECSC products were concluded in 1995, with the Iron and Steel Free-Trade Agreement signed between Turkey and the EU. Since similar considerations apply to products within the domain of the EAEC, it may be assumed that for both sets of products, tariff rates will be reduced to zero within no more than three years, as was the case with the products on the 12- and 22-year lists.

The second column in table 3 shows the NPRs for Turkey's trade with the EU that are expected to prevail from this point on (i.e., with the entering into effect of the customs union). From among the 39 tradeable-goods industries considered, there will be only one industry which will have an NPR higher than 50% for trade with the EU, and four (two) industries that will have NPRs which are less than 20% (between 20% and 50%). In 32 industries the NPR will be zero. With the formation of the customs union, the average nominal protection rate in manufacturing is to be reduced to 1.21% for trade with the EU;

Table 3. Nominal protection rates (NPRs) before and after the customs union with the European Union (EU)

Input-output (I-O) code	Sector	NPR with EU in 1994	NPR with EU after customs union	NPR with third countries in 1994	Average MFN tariff rates after customs union	Average tariff rates for GSP beneficiaries after customs union
11	Slaughtering and meat	10.21	10.21	10.21	10.21	10.21
12	Fruits and vegetables	72.49	68.01	72.62	68.01	68.01
13	Vegetable and animal oil	16.31	16.31	16.38	16.29	16.29
14	Grain mill products	41.33	41.02	41.33	41.02	41.02
15	Sugar refining	28.79	28.79	28.79	28.79	28.79
16	Other food processing	26.47	18.31	28.99	18.31	18.31
17	Alcoholic beverages	72.10	5.25	94.28	11.28	7.35
18	Non-alcoholic beverages	56.92	0	69.81	14.83	0
19	Processed tobacco	44.40	0	99.91	9.40	0
20	Ginning	0	0	2.22	0.72	0.72
21	Textiles	21.19	0	27.10	17.30	7.60
22	Clothing	14.75	0	20.65	19.90	9.30
23	Leather and fur production	7.85	0	12.57	10.20	2.80
24	Footwear	24.40	0	35.70	22.50	9.10
25	Wood products	15.25	0	18.97	2.00	0.05
26	Wood furniture	26.22	0	32.64	5.50	0
27	Paper and paper products	13.59	0	17.58	2.70	0
28	Printing and publishing	8.23	0	10.79	4.52	0
29	Fertilizers	8.22	0	16.38	8.10	0

Table 3. (continued)

Input-output (I-O) code	Sector	NPR with EU in 1994	NPR with EU after customs union	NPR with third countries in 1994	Average MFN tariff rates after customs union	Average tariff rates for GSP beneficiaries after customs union
30	Pharmaceutical production	3.33	0	8.99	5.30	0
31	Other chemical production	10.79	0	17.62	8.71	0.04
32	Petroleum refining	22.54	0	24.35	2.70	0
33	Petroleum and coal products	5.62	0	7.52	2.15	0
34	Rubber products	19.57	0	23.91	5.60	0.03
35	Plastic products	24.61	0	31.68	9.90	0
36	Glass and glass production	16.85	0	21.94	5.76	0
37	Cement	30.45	0	32.88	3.14	0
38	Non-metallic minerals	18.33	0	23.21	5.47	0
39	Iron and steel	8.00	0	10.70	5.50	3.30
40	Non-ferrous metals	4.52	0	8.43	3.20	0.50
41	Fabricated metal products	18.36	0	25.29	6.00	0.11
42	Non-electrical machinery	7.36	0	12.50	4.40	0
43	Agricultural machinery	6.98	0	12.18	3.50	0
44	Electrical machinery	9.69	0	16.64	8.30	0
45	Shipbuilding and repairing	6.13	0	12.89	0.50	0
46	Railroad equipment	0	0	4.61	4.04	0
47	Motor vehicles	27.33	0	33.10	9.40	0

Table 3. (continued)

Input-output (I-O) code	Sector	NPR with EU in 1994	NPR with EU after customs union	NPR with third countries in 1994	Average MFN tariff rates after customs union	Average tariff rates for GSP beneficiaries after customs union
48	Other transport equipment	0.01	0	1.76	1.60	0
49	Other manufacturing industries	2.92	0	8.19	2.95	0
Mean		12.20	1.21	18.03	7.25	1.97
Standard deviation		5.15	7.22	1.43	5.13	7.22

Source: Author's calculations for all sectors in columns 1-3; NPRs for sectors 21, 22, 23, 24, 39 and 40 in column 4 obtained from S. Laird and A. J. Yeats, *Quantitative Methods for Trade Barrier Analysis*, (London, MacMillan Press Ltd., 1990); NPRs for sectors 25, 26, 27, 30, 34, 35, 42, 44, 45, and 47 from GATT, *Trade Policy Review: the Republic of Turkey* (Geneva, 1994); and remaining NPRs from author's calculations. NPRs for sectors 21, 22, 23, 24, 39 and 40 in column 5 obtained from Laird and Yeats, 1990 (see above); remaining NPRs from author's calculations.

the highest NPRs will be granted to the sectors of: fruits and vegetables, I-O code 12 (68.01%); grain mill products, I-O code 14 (41.02%); and sugar refining, I-O code 15 (28.79%).

With respect to trade with third parties, a distinction has to be made between European Free-Trade Area (EFTA) countries, Mediterranean countries, Central and Eastern European (CEE) countries, Baltic countries, developing countries enjoying Generalized System of Preferences (GSP) treatment, and Lomé Convention countries. The EU has concluded preferential trade agreements with countries from each of these groupings. With the formation of the customs union, Turkey will, by the year 2001, have to apply the European Union's Common Customs Tariff and accept all of the preferential agreements the EU has concluded over time; therefore, within the next five years, Turkey will be faced with different sets of tariff rates for different groups of countries. For the EFTA countries, CEE countries, Baltic countries and Israel, which have free-trade agreements with the EU, Turkey's nominal tariff rates will be identical to those of the EU. Thus, the NPRs listed in the second column of table 3 will have to apply to 53.77% of imports, which is the average share of Turkish imports from Israel and the EU, EFTA, CEE and Baltic countries combined during the period 1991-1993. For these countries, not including the EU member States, the average tariff rate will decrease from 18.03% to 1.21%. The share of Turkish imports from developing countries enjoying GSP treatment is around 27.54%. Finally, the imports of countries such as the United States, Japan and Canada, to which the EU applies the Common Customs Tariff, account for a share of 18.46%. The fourth column of table 3 shows the average most-favoured-nation (MFN) tariff rates, and column five shows the average tariff rates for GSP beneficiaries. It must be assumed that the tariff rates Turkey will apply by the year 2001 are those shown in columns two, four and five of table 3. It should be noted that the average NPRs in manufacturing will be: 1.21% for EU countries and for the countries with which the EU has free-trade agreements; 7.25% for countries such as the United States, Japan and Canada; and 1.97% for GSP beneficiaries.

Economists have long recognized that the profitability of a business activity can be changed by measures which affect the selling price of the final product, the costs of the intermediate material inputs, or a combination of the two. The literature on effective protection maintains that when there are intermediate inputs, effective protection of value added is what matters, not nominal protection. Put another way, if both the final product and the material inputs used to produce that product could be bought or sold in world markets at given prices, under free-trade conditions and at a given exchange rate, this would provide a certain value added (the cost of labour, land and capital inclusive of an acceptable profit margin). Tariffs and tariff-like charges affect the product price and the cost to the enterprise of the intermediate input, thus increasing or decreasing the value added. Effective protection is simply the difference between the observed value added and what the value added would be under free trade; the effective protection rate (EPR) is this difference expressed as a proportion of the free-trade value added.

The EPRs for the Turkish economy are calculated here using the average NPRs reported in columns one and two of table 4 (weighted averages of the NPRs listed in table 3), as well as the input-output table prepared by the State Institute of Statistics for the year 1990. The third and fourth columns of table 4 reveal that the average EPR in manufacturing will decline from 22.08% in 1994 to -0.05% in 2001.

Table 4 shows that during 1994 the highest EPRs were provided to the following sectors: fruits and vegetables, I-O code 12 (291.43%); grain mill products, I-O code 14 (281.46%); and petroleum refining, I-O code 32 (180.44%). Ranking the sectors (from highest to lowest EPR value) reveals that those numbered 12, 14, 32, 19, 17, 18, 24 and 26 were the most protected sectors in the Turkish economy in 1994.

In the year 2001, the highest EPRs will be provided to the following sectors: grain mill products, I-O code 14 (301.45%); fruits and vegetables, I-O code 12 (285.8%); and slaughtering and meat, I-O code 11 (21.36%). Ranking the sectors from highest to lowest EPR value reveals that those numbered 14, 12, 11, 22 and 24 will be the most protected sectors in the Turkish economy in the year 2001. The data also indicate that the least protected sectors in the economy will be processed tobacco (I-O code 19), non-alcoholic beverages (I-O code 18), sugar refining (I-O code 15), alcoholic beverages (I-O code 17), shipbuilding and repairing (I-O code 45), other manufacturing industries (I-O code 49), and paper and paper products (I-O code 27).

The effects of the customs union on the value added of individual sectors is calculated by subtracting the value of each EPR for 1994 from the corresponding EPR value for the year 2001; the results are reported in table 5. The table indicates that the formation of the customs union will lead to an increase in value added for the grain mill products (I-O code 14), sugar refining (I-O code 15) and clothing (I-O code 22) sectors, and to a decrease in value added for the sectors of processed tobacco (I-O code 19), petroleum refining (I-O code 32), and non-alcoholic beverages (I-O code 18).

Turning next to the issue of market access, it may be noted that all countries will benefit from the reduction in nominal protection rates in Turkey. Table 6 shows the average share of imports from different country groupings, as well as the corresponding Turkish NPRs applicable to imports from these country groups before and after the formation of the customs union with the EU. For products exported from the EU, which constitute 46.02% of Turkish imports, the average NPR will fall from 12.2% to 1.21%. For products exported from Mediterranean countries, totalling 1.6% of Turkish imports, the NPR could go down from 18.03% to 1.21% once these countries, together with the EU, establish a free-trade area. For ESCWA member countries, the NPRs will drop from 18.03% to 1.97%. The share of the major oil-exporting ESCWA member countries in Turkish imports is 8.72%, mainly owing to Turkey's oil imports from the region; the share of the other ESCWA member countries is only 0.68%.

Table 4. Nominal protection rates (NPRs) and effective protection rates (EPRs) before and after the customs union with the European Union (EU)

Input-output (I-O) code	Sector	NPR (1994)	NPR (2001)	EPR (1994)	EPR (2001)
11	Slaughtering and meat	10.21	10.21	16.82	21.36
12	Fruits and vegetables	72.56	69.16	291.43	285.80
13	Vegetable and animal oil	16.35	16.30	6.62	8.76
14	Grain mill products	41.33	41.02	281.46	301.45
15	Sugar refining	28.79	28.79	-54.25	-35.98
16	Other food processing	27.74	18.45	29.37	5.33
17	Alcoholic beverages	83.24	6.93	145.43	-13.57
18	Non-alcoholic beverages	63.40	2.70	128.03	-40.69
19	Processed tobacco	72.28	1.71	159.71	-84.25
20	Ginning	1.12	0.35	-138.12	-139.98
21	Textiles	24.16	5.26	28.79	2.68
22	Clothing	17.71	6.21	7.44	17.35
23	Leather and fur production	10.22	2.64	10.73	0.43
24	Footwear	30.08	6.63	67.17	15.12
25	Wood products	17.12	0.38	37.28	0.67
26	Wood furniture	29.44	1.00	62.67	1.67
27	Paper and paper products	15.59	0.49	19.20	-0.04
28	Printing and publishing	9.52	0.82	4.42	1.04
29	Fertilizers	12.32	1.47	13.63	1.78
30	Pharmaceutical production	6.17	0.96	4.52	0.50
31	Other chemical production	14.22	1.60	12.61	1.45
32	Petroleum refining	23.45	0.49	180.44	3.75

Table 4. (continued)

Input-output (I-O) code	Sector	NPR (1994)	NPR (2001)	EPR (1994)	EPR (2001)
33	Petroleum and coal products	6.57	0.39	-6.14	0.08
34	Rubber products	21.75	1.03	33.95	1.29
35	Plastic products	28.16	1.80	48.45	2.22
36	Glass and glass production	19.41	1.05	25.54	1.26
37	Cement	31.67	0.57	46.02	0.65
38	Non-metallic minerals	20.78	1.00	26.79	1.30
39	Iron and steel	9.36	1.92	11.10	2.88
40	Non-ferrous metals	6.48	0.72	6.11	0.85
41	Fabricated metal products	21.84	1.12	35.90	0.66
42	Non-electrical machinery	9.94	0.80	8.37	0.45
43	Agricultural machinery	9.59	0.64	6.82	0.03
44	Electrical machinery	13.18	1.51	16.83	1.97
45	Shipbuilding and repairing	9.53	0.09	6.51	-0.83
46	Railroad equipment	2.32	0.74	-0.21	0.57
47	Motor vehicles	30.23	1.71	46.21	1.97
48	Other transport equipment	0.89	0.29	-0.84	0.23
49	Other manufacturing industries	5.57	0.54	1.91	-0.04
Mean		15.13	2.52	22.08	-0.05
Standard deviation		19.86	13.31	79.07	72.55

Table 5. Sensitive manufacturing sectors in the Turkish economy

Input-output (I-O) code	Sector	Effects of the customs union (change in value added, 1994-2001)
14	Grain mill products	19.99
15	Sugar refining	18.27
22	Clothing	9.91
33	Petroleum and coal products	6.23
11	Slaughtering and meat	4.55
13	Vegetable and animal oil	2.14
48	Other transport equipment	1.07
46	Railroad equipment	0.78
20	Ginning	-1.86
49	Other manufacturing industries	-1.95
28	Printing and publishing	-3.39
30	Pharmaceutical production	-4.02
40	Non-ferrous metals	-5.27
12	Fruits and vegetables	-5.63
43	Agricultural machinery	-6.79
45	Shipbuilding and repairing	-7.34
42	Non-electrical machinery	-7.92
39	Iron and steel	-8.22
23	Leather and fur production	-10.30
31	Other chemical production	-11.16
29	Fertilizers	-11.85
44	Electrical machinery	-14.87
27	Paper and paper products	-19.24
16	Other food processing	-24.04
36	Glass and glass production	-24.28
38	Non-metallic minerals	-25.49

Table 5. (continued)

Input-output (I-O) code	Sector	Effects of the customs union (change in value added, 1994-2001)
21	Textiles	-26.11
34	Rubber products	-32.66
41	Fabricated metal products	-35.24
25	Wood products	-36.61
47	Motor vehicles	-44.24
37	Cement	-45.37
35	Plastic products	-46.24
24	Footwear	-52.05
26	Wood furniture	-61.00
17	Alcoholic beverages	-159.00
18	Non-alcoholic beverages	-168.72
32	Petroleum refining	-176.69
19	Processed tobacco	-243.96

Table 6. The import share of different country groupings in total Turkish imports (1991-1993 averages) and corresponding Turkish nominal protection rates (NPRs) before and after the formation of the Turkey-EU customs union

Country grouping	Share	NPR (1994)	NPR (2001)
European Union (EU) countries	46.02	12.20	1.21
Countries with which EU has free-trade agreements	7.75	18.03	1.21
Generalized system of preferences (GSP) countries	27.54	18.03	1.97
Countries against which the EU applies the Common Customs Tariff	18.46	18.03	7.25
Mediterranean countries	1.60	18.03	1.97
<i>ESCWA member countries</i>	9.40	18.03	1.97
Major oil-exporting countries	8.72	18.03	1.97
Other ESCWA member countries	0.68	18.03	1.97

With regard to market access for Turkish exports in EU countries, it should be noted that the EU abolished the nominal tariff rates on imports of industrial goods from Turkey on 1 September 1971. However, certain exceptions were made. The European Community retained the right to impose import duties on some oil products over a fixed quota and to implement a phased reduction of duties on imports of certain textile products from Turkey. Trade in products that fall within the sphere of the ECSC have been protected by the EU through the application of non-tariff barriers and anti-dumping measures.

Finally, it should be noted that one effect of the customs union will be substantially reduced import tax revenue. During 1994 the value of imports amounted to LT 683.8 trillion, with import taxes totalling LT 136 trillion. Subtracting the VAT on imports that would be collected at the rate applicable for domestic production from the import tax figure of LT 136 trillion produces a net tax of about LT 68.9 trillion. Assuming that the sectoral import share vector derived from the 1990 input-output table prepared by the State Institute of Statistics remains unchanged, the hypothetical value of net import taxes can be calculated using the NPRs reported above. Using the hypothetical approach, the value of net import taxes is determined to be LT 90 trillion for 1994. The difference between the

hypothetical and actual value of net import taxes amounts to LT 21.1 trillion; this figure mainly reflects the various exemptions. As mentioned in the sections on export and investment incentives, the capital goods, raw materials and intermediate goods used for investment purposes and for the production of exportables can be imported free of customs duties, as can most imports for military and educational purposes. According to the Uruguay Round agreements, the imports exempt from duty represented about 38% of Turkey's total imports in 1992. However, calculations based on the information above indicate that the exemption rate was only 23.47% during 1994.

Imports, valued in US dollars, increased at an annual rate of 9.2% during the period 1980-1994, and it may be assumed that imports will increase at the same annual rate over the next decade. Assuming the NPRs calculated for trade with the EU and with third countries after the formation of the customs union remain in effect, the loss in average annual import tax revenue is expected to be around \$2,454 million, or about 10.55% of the total value of imports. The average exchange rate for 1994 was LT 29,704 per US dollar, translating into a loss in annual import tax revenue of LT 72.9 trillion, or 9.49% of public-sector revenues. A revenue loss of this magnitude is substantial for a country like Turkey. To compensate for the decline in tax revenue, the Government is planning to introduce a special consumption tax which will replace a large number of excise taxes; one aim is to simplify the collection procedures. The special consumption tax will be introduced for a large number of commodities; particularly important in this context are petroleum products, alcohol, tobacco and motor vehicles. Since tax rates on these commodities are already high, it will not be easy to raise the additional \$2,454 million through the special consumption tax. An alternative solution would be to increase the general VAT rate from the current 15%. Since 80% of VAT revenue is collected from large corporations, raising the VAT rate would mainly increase the tax burden on this particular group.

2. GATT 1994

Of particular relevance to market access in GATT 1994 are the Understanding on the Interpretation of Article II:1(b), which provides for the binding of all duties or charges other than tariffs in schedules of concessions, and the Marrakesh Protocol. According to the Protocol, the tariff reductions for non-agricultural products agreed upon by each Member and recorded in the national schedules of concessions annexed to the Protocol are to be implemented in five equal decrements. The first such reduction became effective upon the entry into force of the WTO Agreement, and the last reduction must be carried out no later than four years after that date.

The outcome of the tariff negotiations for the United States, the 12 EU countries, the Middle East and North Africa is reported in table 7, using the results of Harrison, Rutherford and Tarr (1995). The authors start with pre-Uruguay Round tariff rates; these are the applied MFN tariff rates reported in the GATT Integrated Data Base. For tariff lines where the bound tariff rate (recorded in the national schedules of concessions

annexed to the Marrakesh Protocol) is above the applied base rate, the authors conclude that no actual tariff cuts will take place, as is the case for Middle Eastern and North African countries in table 7. In cases where a country has offered to bind the tariff below the applied MFN tariff rate, the offered rate is considered the post-Uruguay-Round tariff rate. In this context, it should be noted that for developed countries, the rates for most manufactured goods were bound prior to the Uruguay Round, and the applied rates are generally the same as these bound rates. The data in table 7 reveal that United States and EU tariffs are normally below 5%. Tariffs on textiles and clothing imposed in conjunction with quotas of the Arrangement Regarding International Trade in Textiles (the Multi-fibre Arrangement, or MFA) are much higher. Kirmani and others (1994) report that the tariff commitments of developed countries reflect a 40% reduction in the average tariff on imports of industrial commodities, and that the reduction will be less than the 40% average cut for: textiles and clothing; leather, rubber and footwear; and transport equipment.

**Table 7. Pre- and Post-Uruguay Round import tariffs
(Percentage)**

		United States		European Union		Middle East and North Africa	
		Pre-UR*	Post-UR	Pre-UR	Post-UR	Pre-UR	Post-UR
TEX	Textiles	9.4	6.7	8.6	6.4	34.2	34.2
WAP	Wearing apparel	18.6	16.7	13.2	11.5	33.3	33.3
CRP	Chemicals, rubber, plastics	4.3	2.5	7.4	4.6	22.6	22.6
I-S	Primary iron and steel	3.7	0.3	5.1	0.7	16.6	16.6
NFM	Non-ferrous metals	0.8	0.6	2.1	1.7	24.5	24.5
FMP	Fabricated metal	3.8	2.3	5.8	2.8	30.1	30.1
TRN	Transport industry	2.3	2.2		5	25.5	25.5
MEA	Meat products and livestock	7.7	2.4	31.9	28.9	14.7	14.7
ENR	Energy and energy products	0.5	0.5	1	0.5	9	9
MIN	Minerals and mineral products	2.8	1.8	1.3	0.9	24.7	24.7
MAC	Machinery, equipment, other manufactures	4.2	2.4	6.1	3.3	24.3	24.3

Source: G.W. Harrison, T.F. Rutherford and D.G. Tarr, "Quantifying the Uruguay Round", a paper presented at the Conference on the Uruguay Round and the Developing Economies held by the World Bank in Washington, D.C.. in 1995.

* Uruguay Round.

The MFN tariff rates summarized in table 7 fail to reflect the underlying protection, as they do not include NTBs. It has been shown by various economists that in most industrial countries, the use of "grey-area" measures such as voluntary export restraints (VERs) increased significantly during the 1980s and became the key form of protection in industrialized countries. The Uruguay Round Agreement on Safeguards provides for the virtual elimination of grey-area measures within four years of the entry into force of the Agreement. The inclusion of non-tariff measures in numerical analysis is not easy; because of the limitations on obtaining reliable data on NTBs, empirical studies tend to disregard them. The present study is no exception; table 7 shows tariff rates, but does not reflect the effects of non-tariff barriers.

In studying the effects of the Uruguay Round agreements on the Turkish economy, one could follow the approach of François, McDonald and Nordstrom (1995) and consider the NPRs of 1988 as the base-year tariff schedule. A comparison of these figures with the bound tariff rates recorded in the Turkish schedules of concessions annexed to the Marrakesh Protocol reveals that the base-year tariff rates are higher than the bound rates. One might therefore draw the misleading conclusion that the Uruguay Round negotiations and agreements are responsible for the tariff reductions in Turkey, when actually they are a result of the liberalization of foreign trade achieved during the 1980s and 1990s. The applied tariff rates reported in table 4 are much lower than the bound tariff rates annexed to the Protocol. Hence, the approach adopted in the previous section in analysing the effects of the Customs Union Agreement is equally suitable for evaluating the effects of the Uruguay Round agreements. Here, it should be emphasized that the MFN and GSP tariff rates reported in table do not reflect the effects of the latter set of agreements. Uruguay-Round-related considerations can be incorporated into the analysis through a separate assessment of the effects of the Uruguay Round agreements on EU tariffs and thereafter on nominal and effective protection rates in Turkey.

C. THE IMPLICATIONS OF THE AGREEMENTS FOR TEXTILES AND STEEL PRODUCTS

In this section, the implications of the Customs Union and Uruguay Round agreements for the two sectors* with the highest shares in total exports are considered in some detail. The first sector comprises a combination of the clothing sector (SITC 84), with a share of 20.28%, and the textile sector (SITC 65), with a share of 10.37%; second is the iron and steel products sector (SITC 67), with a share of 11.87%. It is well known that the textile and clothing industry constitutes Turkey's largest single industrial sector, contributing some 20% to manufacturing output and employing about one third of all workers in manufacturing. Faced with competition from abroad, the industry has installed

* Although separate figures may be provided for clothing and textiles, the two industries are considered a single sector.

up-to-date machinery for the production of high-quality products. The output of cotton cloth increased from 504 million square metres in 1985 to 597 million square metres in 1992, and that of wool cloth from 44 million to 58 million square metres during the same period. Cotton yarn production has declined since 1987 but amounted to 224 million tons in 1992. The State sector accounts for about 30% of cotton textile output. The iron and steel industry, on the other hand, has grown significantly, with crude iron production rising from 3.1 million tons in 1985 to 4.6 million tons in 1994, and that of steel from 9.4 million tons in 1991 to 12.2 million tons in 1994. There are three large originally State-owned plants and about 20 smaller firms in the private sector.

As mentioned before, by 1973 the European Community had abolished virtually all customs duties and NTBs for Turkish manufactures. An important exception was made for trade in textiles and clothing, which came under the regime of the EC textile policy within the international MFA framework. Presently, such trade is regulated by voluntary restraint agreements concluded between Turkish textile exporters and the concerned authorities in Brussels. According to the provisions of the Customs Union Agreement, the current arrangements for trade in textile and clothing products (i.e., all export quotas) will expire as soon as it is determined that Turkey has effectively adopted and implemented the measures required under the Agreement with regard to: intellectual, industrial and commercial property rights; competition (including measures relating to public aid); and the alignment of its commercial policy with that of the EU in the textile sector.

The EU is known to protect its textile and clothing sector with relatively high tariffs and bilateral restriction agreements with developing countries. Over time, the EU has concluded bilateral restraint agreements under the MFA with a large number of countries including China, Hong Kong, India and Pakistan. In addition, the EU has export-restraint arrangements with Egypt, Malta, Morocco and Tunisia. In order to align its commercial policy with that of the EU in the textile sector, Turkey has to conclude bilateral restraint agreements and export-restraint arrangements with the same groups of countries. Finally, it should be noted that, according to the Uruguay Round Agreement on Textiles and Clothing, all of the bilateral quotas negotiated under the MFA are to be completely phased out over a 10-year period, after which there will be no quotas on textiles and the MFA will cease to exist. As a result of these developments, competition in the world textile and clothing trade will increase, and Turkey will have to compete with countries such as China, India and Pakistan for a share of the EU market. Diwan, Yang and Wang (1995) estimate that as a result of the Uruguay Round agreements, EU import prices for textiles will go down by 1.8%, and those for wearing apparel by 5.3%. The decreases in North American import prices for textiles and wearing apparel are expected to be about 1.6% and 9.5% respectively. Since exports of textiles and clothing form 38.6% of Turkey's total exports and 56.2% of its exports to the EU, Turkey is expected to be adversely affected by these developments in the long run.

As emphasized above, products falling within the province of the ECSC are not covered by the Customs Union Agreement. Following a resolution of the EU-Turkey Association Council, negotiations for the free movement of ECSC products were concluded in December 1995, and the Iron and Steel Free-Trade Agreement was signed between Turkey and the EU.

By the early 1990s, it was clear that the steel market had become oversupplied. In July 1992 all iron and steel products covered by the ECSC Treaty became subject to retrospective European Community surveillance. In 1993 the Community introduced a programme of capacity reductions in the steel industry. For imports, prior and *ex post* surveillance was instituted. State aid to the sector has been replaced with aid for R&D, environmental protection, the partial or total cessation of production, and investment in certain EU areas such as eastern Germany; in any case, support should not result in capacity expansion. As reported by Wang and Winters (1993), the EU has provided the bulk of its protection for iron and steel in the form of NTBs. The VERs used during the 1970s were eventually supplemented by a system of basic prices. According to this system, non-EU countries are required to ensure that the invoiced prices of their deliveries of iron and steel products are compatible with the levels of guidance prices and basic prices published by the European Commission. Any price under-quotation creates a presumption of dumping or of subsidization and exposes the supplier concerned to the opening of anti-dumping or anti-subsidy inquiry.

The 1995 Iron and Steel Free-Trade Agreement covers 630 products. For 498 of them, the customs duties on imports and exports in trade between Turkey and the EU will be abolished on the date the Agreement enters into force. In the case of the remaining 132 products, the customs duties will be abolished over a three-year period: a 50% reduction will be introduced during the first year of the Agreement, and a 25% reduction during each of the second and third years. Other quantitative trade restrictions and measures having an equivalent effect will also be abolished on the date the Agreement enters into force. The Free-Trade Agreement contains rules similar to those on competition policy and State aid included in the Customs Union Agreement; according to the former, Turkey must, within two years of the entry into force of the Agreement, adopt the rules necessary for the implementation of competition policy, and each party must ensure transparency in the area of public aid. The parties recognize that until the year 2001 Turkey may, exceptionally, grant public aid to iron and steel companies; however, this aid should not lead to increases in capacity for hot-rolled products.

Table 8 indicates that iron and steel products comprised 11.9% of all Turkish exports during 1993 and that the share of iron and steel product exports to the EU in total exports of the commodity during the period 1991-1993 averaged 6.24%. Turkey has been exporting mainly billet and long products, and the main export market has been the Far East. The sector has apparently benefited disproportionately from export assistance; the subsidy rate in the iron and steel sector amounted to 45.5% in 1988 and 37.7% in 1990.

Table 8. Export and import shares in trade between the European Union (EU) and Turkey, by commodity
(Thousands of US dollars)

SITC	Commodity	Total exports (1993)	Total imports (1993)	Share of exports to EU in total exports of commodity (1991-1993)	Share of imports from EU in total imports of commodity (1991-1993)	Share of exports to Turkey in total EU exports (1991-1992)	Share of Turkish exports to EU in total EU imports (1991-1992)
00	Live animals, chiefly for food	283 500	103 209	0.84	35.26	0.720	0.037
01	Meat and meat preparations	26 807	32 294	25.47	85.64	0.125	0.023
02	Dairy products	12 326	30 604	14.74	55.29	0.069	0.010
03	Fish and fish preparations	53 940	23 179	75.47	25.86	0.043	0.289
04	Cereals and cereal preparations	271 656	347 258	4.22	20.34	0.124	0.146
05	Vegetables and fruit	1 670 214	101 468	58.51	13.63	0.033	2.711
06	Sugars and sugar preparations	214 322	10 213	17.87	88.35	0.142	0.440
07	Coffee, tea, cocoa, spices	128 187	58 595	24.86	37.72	0.244	0.154
08	Feeding stuff for animals	3 038	110 750	19.50	17.51	0.275	0.009
09	Miscellaneous edible products	130 301	21 411	6.10	90.77	0.200	0.121
11	Beverages	24 561	8 948	51.27	93.44	0.067	0.106
12	Tobacco and tobacco manufactures	441 025	327 284	26.02	3.93	0.223	1.835
21	Hides, skins and furskins, raw	2 148	214 873	61.83	33.93	2.442	0.050
22	Oil-seeds and oleaginous fruits	15 383	72 004	51.69	2.45	0.080	0.102
23	Crude rubber	4 236	145 481	27.04	35.75	1.905	0.013

Table 8. (continued)

SITC	Commodity	Total exports (1993)	Total imports (1993)	Share of exports to EU in total commodity exports (1991-1993)	Share of imports from EU in total imports of commodity (1991-1993)	Share of exports to Turkey in total EU exports (1991-1992)	Share of Turkish exports to EU in total EU imports (1991-1992)
24	Cork and wood	13 328	344 951	46.37	21.56	1.042	0.063
25	Pulp and waste paper	134	103 589	74.59	16.64	0.759	0.002
26	Textile fibres and their wastes	198 291	586 717	52.47	31.06	2.670	1.244
27	Crude fertilizers and crude minerals	201 265	89 167	49.51	28.75	0.594	1.855
28	Metalliferous ores and metal scrap	51 614	893 326	33.85	49.14	4.313	0.146
29	Crude animal and vegetable materials	68 055	48 387	86.99	56.62	0.240	0.736
32	Coal	105	336 518	29.53	2.45	0.478	0.009
33	Petroleum and petroleum products	167 027	3 040 153	73.89	6.29	0.387	0.192
34	Gas, natural and manufactured	9 375	587 208	12.17	1.47	0.199	0.012
35	Electric current	0	0	0	0	0	0
41	Animal oils and fats	1 671	37 795	0.39	6.77	0.382	0.002
42	Fixed vegetable oils and fats	97 885	354 885	13.27	13.87	1.507	0.700
43	Animal and vegetable oils and fats, processed	87 272	10 557	17.60	57.07	0.543	0.207

Table 8. (continued)

SITC	Commodity	Total exports (1993)	Total imports (1993)	Share of exports to EU in total commodity (1991-1993)	Share of imports from EU in total imports of commodity (1991-1993)	Share of exports to Turkey in total EU exports (1991-1992)	Share of Turkish exports to EU in total EU imports (1991-1992)
51	Organic chemicals	73 989	869 884	45.25	56.46	1.107	0.126
52	Inorganic chemicals	115 292	356 228	46.72	45.62	1.210	0.475
53	Dyeing, tanning, and colouring materials	30 483	439 268	8.95	65.76	1.815	0.030
54	Medicinal and pharmaceutical products	76 363	394 848	18.40	60.50	0.707	0.055
55	Essential oils and perfume materials	90 367	140 939	7.78	79.97	0.602	0.060
56	Fertilizers, manufactured	16 832	309 487	31.06	11.21	0.863	0.348
57	Explosives	134 926	567 510	36.86	63.84	1.019	0.184
58	Plastic materials	28 769	135 927	17.45	82.02	0.535	0.048
59	Chemical materials and products n.e.s.	44 379	345 434	10.61	75.60	1.063	0.026
61	Leather and leather manufactures	16 441	164 996	30.51	68.64	1.605	0.080
62	Rubber manufactures	193 273	184 072	34.07	57.85	0.591	0.461
63	Cork and wood manufactures	15 316	53 044	31.68	63.80	0.262	0.054
64	Paper and paperboard	49 837	441 314	20.03	39.97	0.409	0.031

Table 8. (continued)

SITC	Commodity	Total exports (1993)	Total imports (1993)	Share of exports to EU in total exports of commodity (1991-1993)	Share of imports from EU in total imports of commodity (1991-1993)	Share of exports to Turkey in total EU exports (1991-1992)	Share of Turkish exports to EU in total EU imports (1991-1992)
65	Textiles	1 590 616	1 019 748	59.04	38.35	0.521	2.006
66	Non-metallic mineral manufactures	420 702	248 285	46.96	65.04	0.369	0.625
67	Iron and steel	1 821 136	1 993 096	6.24	46.60	1.253	0.252
68	Non-ferrous metals	145 345	408 359	45.47	39.50	0.650	0.256
69	Manufactures of metals	211 412	474 383	50.71	76.48	0.789	0.330
71	Power-generating machinery and equipment	69 157	705 128	64.98	62.84	0.927	0.121
72	Machinery specialized for particular industries	102 052	2 269 727	23.92	68.51	1.738	0.050
73	Metalworking machinery	16 231	353 192	53.74	60.85	1.338	0.083
74	General industrial machinery and equipment	110 368	1 475 058	35.44	73.76	1.260	0.063
75	Office machines	10 227	587 762	73.26	52.74	0.569	0.021
76	Telecommunications apparatus	184 832	440 734	79.00	41.20	0.644	0.578
77	Electrical machinery	429 493	1 531 259	60.38	58.16	0.996	0.287
78	Road vehicles	295 323	2 008 650	44.93	55.34	0.379	0.063

Table 8. (continued)

SITC	Commodity	Total exports (1993)	Total imports (1993)	Share of exports to EU in total exports of commodity (1991-1993)	Share of imports from EU in total imports of commodity (1991-1993)	Share of exports to Turkey in total EU exports (1991-1992)	Share of Turkish exports to EU in total EU imports (1991-1992)
79	Other transport equipment	75 885	1 864 500	20.98	25.59	0.334	0.049
81	Sanitary, plumbing, heating and lighting fixtures and fittings	87 617	67 526	63.04	77.13	0.435	0.773
82	Furniture	45 415	49 740	36.55	86.31	0.144	0.064
83	Travel goods	30 519	5 245	78.28	52.98	0.062	0.757
84	Clothing	4 339 181	45 615	78.19	71.90	0.049	4.995
85	Footwear	94 243	45 129	21.59	25.99	0.057	0.124
87	Professional, scientific and controlling instruments and apparatus	19 044	528 288	35.11	61.19	0.950	0.026
88	Photographic apparatus and optical goods	2 549	236 112	53.46	58.11	0.758	0.007
89	Miscellaneous manufactured articles n.e.s.	179 724	626 888	58.40	56.91	0.425	0.118
90	Commodities and transactions not classified elsewhere	93	171	1.98	80.17	0	0
	Total	15 345 097	29 428 370				

Table 5 shows that the sector will be adversely affected by the formation of the customs union. It seems that Turkish exporters of iron and steel products to the EU will face anti-dumping inquiries as long as State aid to the sector continues. In order to benefit from the Iron and Steel Free-Trade Agreement, Turkey will have to stop subsidizing the iron and steel sector completely.

D. CONCLUSION

Turkey realizes the importance of both the Customs Union Agreement with the EU and the Uruguay Round agreements. From Turkey's point of view, the EU and Uruguay Round agreements and their implications are similar, though in many respects the requirements of the former are more stringent than those of the latter. Under the Uruguay Round agreements, the tariff rates on industrial goods will fall below the applied MFN rates centred around 1988, while the requirements of the Customs Union Agreement are more demanding. With the formation of the customs union, goods can circulate freely between Turkey and the EU, Turkey must implement the European Union's common external tariff on goods from third parties, and by the year 2001 Turkey must adopt all of the preferential trade agreements the EU has concluded over time.

Under the Uruguay Round Agreement on Textiles and Clothing, bilateral quotas negotiated under the MFA are to be completely phased out over a 10-year period, after which there will be no quotas on textiles and the MFA will cease to exist. Under the Customs Union Agreement, the EU will eliminate all of the quotas on Turkish textile and clothing exports as soon as Turkey has effectively implemented certain measures regarding intellectual, industrial and commercial property rights as well as those relating to competition (including the measures relating to public aid), and has adopted the European Union's textile and clothing agreements with third countries.

Under WTO rules, Turkey will have to adopt the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) by the year 2000, while the Customs Union Agreement requires that Turkey implement the TRIPs Agreement by 1999 and that it adopt legislation to secure the patentability of pharmaceutical products and processes by 1 January 1998.

The Uruguay Round Agreement on Subsidies and Countervailing Measures defines three categories of subsidies: prohibited subsidies (those contingent upon export performance or the use of domestic rather than imported goods); actionable subsidies (those that have demonstrably adverse effects on other country Members); and non-actionable subsidies. The Agreement also places restrictions on the use of countervailing measures introduced in response to competitors' subsidies. The Customs Union Agreement requires that Turkey adopt the competition policies of the EU, which are much more demanding than the Uruguay Round agreements' requirements.

The effects of the Uruguay Round and Customs Union agreements can be illustrated using the “production possibility frontier” (PPF) concept. The new rules and disciplines imposed by the agreements will certainly force the Turkish economy to move from an inefficient production point within the PPF towards an efficient production point on the PPF, and the technical progress to be achieved over time will shift the PPF outward. While changes in protection rates will lead to movements along the PPF, the elimination of quotas and VERs will cause the economy’s “consumption possibility frontier” to shift outward.

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Part Three

IMPLICATIONS OF THE PEACE PROCESS

VI. ISSUES OF ECONOMIC INTEGRATION AND INDUSTRIAL DEVELOPMENT IN THE ESCWA REGION FOLLOWING THE PEACE SETTLEMENT

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Introduction

In the Middle Eastern context, one of the greatest challenges is determining how best to handle political contradictions and economic disparities in shaping potential regional arrangements which reflect the free will and aspirations of the region's people. Various studies have been written on the possible formation of a free-trade area (FTA) in the Arab east (involving Egypt, Israel, Palestine, Jordan, the Syrian Arab Republic and Lebanon), modelled along the lines of the European Union (EU). It should be noted, however, that European economic integration has been based on internal trade liberalization, and leading Japanese economist Ippei Yamazawa argues that differences in the levels of development, stages of industrialization and resource endowments in the Middle East militate against integration along such lines, particularly in the light of the Latin American and Asian integration experiences (Yamazawa, 1992).

One of the most distinctive features of intra-EU trade liberalization has been the growth of intra-industry trade rather than intra-industry specialization; "economic integration in the EEC model [has] led to specialization within industries rather than movements of resources from import-competing to export industries" (Sapir, 1992, p. 1,496).

The North American Free Trade Agreement (NAFTA) model of regional cooperation is more limited in scope, lacking the deeper integration of the European Union. With NAFTA, the United States has aimed at enhancing its competitive position in world trade through its association with a low-cost supplier—mainly Mexico (Brown and others, 1992b). What has happened, however, is that the differences and disparities in the physical capital, human capital and raw labour endowments in the economies of Mexico, on the one hand, and the United States and Canada, on the other hand, have led to serious problems in intersectoral specialization between the two groups. Many studies have concluded that capital formation in the form of inward-oriented foreign direct investment (FDI) has dominated the minor welfare gains from trade liberalization (Brown and others, 1992a).

As for the Asia-Pacific region, much of the "interdependent" growth in East Asia has been achieved without much in the way of a formal integration framework. According to Yamazawa, "East Asia has not been enthusiastic about formal economic integration of

the EC type. There has been neither a Rome Treaty nor a region-wide free-trade agreement. East Asia has not reached that stage of integration yet” (Yamazawa, 1992, p. 1,527).

Within its loose economic cooperation framework, “the main mechanism underlying the increasing interdependence in the Asia-Pacific region is the transfer of industries, particularly manufacturing industries, from early starters to latecomers” (Yamazawa, 1992, p. 1,523), or more specifically, from Japan to the Asian newly industrialized economies (NIEs), and from the Asian NIEs to the Association of South-East Asian Nations (ASEAN) countries—following what is known as the “flying geese pattern” in industrial development.

A. THE VIABILITY OF A MIDDLE EASTERN FREE-TRADE AREA

In a major policy document circulated by the Brussels-based Commission of the European Communities in September 1993, it is stated that “one of the most urgent priorities for virtually all the countries of the Middle East, in particular the countries of the Mashreq and Israel, is to encourage trade and thereby foster an optimal division of labour between them.” It is conceded in the same document, however, that a free-trade area between the Mashreq countries and Israel seems to inspire more fear than hope among the potential partners, especially the least developed ones (Commission of the European Communities, 1993).

This type of analysis, conducted at such a high level of abstraction, conceals the real problems of political economy relating to the distribution of potential gains from an FTA encompassing the above-mentioned territories.

A Middle East free-trade area (MEFTA) arrangement might prove to be an inadequate means of ensuring dynamic gains in efficiency for all participating countries. Given the highly diverse development and per capita income levels among the countries which could be expected to participate in a MEFTA scheme, the bulk of intraregional trade flows would likely be of the intra-industry variety; a new pattern of specialization in economic activities among these countries would evolve over time in response to disparate levels of resource and skill endowments. If economies of scale were strongly present (as would be the case in high-technology industries), the gains for the advanced participating countries would likely be much larger.

Furthermore, in the absence of a customs union among the Arab countries of the Mashreq (including Egypt), Israel would become the “central” country in a MEFTA arrangement. The formation of a customs union among participating Arab countries—prior to any MEFTA association—would probably increase the bargaining power of these countries. Such a step would require a relatively long period of transition and adjustment, however.

The partner countries in any regional cooperative scheme would need to cross a certain threshold of similarity in their economic and strategic objectives before surrendering any of their national autonomy. This process would have to occur smoothly and voluntarily so that none of the countries of the Arab Mashreq would be subordinated or would be subjected to exogenous rules or to the strategic preferences of another, more powerful regional player (Israel or Turkey); any set of “forced” regional solutions, schemes, or rules of behaviour would run the serious risk of being politically unacceptable and unsustainable.

B. INDUSTRIAL DEVELOPMENT AND THE SPECTRE OF THE “HEGEMONY EFFECT”

Intraregional arrangements between countries at different levels of development may reflect a hegemonic power relationship. “Regional hegemons can exploit bilateral asymmetries in interdependence to exercise monopsony power over smaller and poorer trading partners and to extract policy changes which favour the regional hegemon” (Fishlow and Haggard, 1992, p. 13). Such hegemonic power can ultimately be used to accomplish political objectives, as has been the case in the United States-Mexico relationship within the NAFTA regional arrangement.

The sectoral composition of potential intraregional trade and production is an equally good indicator of the likely occurrence of the hegemony effect. The composition of trade between developing Asian countries and Japan clearly reveals the asymmetrical character of such a trade relationship (Fishlow and Haggard, 1992).

The familiar formula among Israeli strategists of fusing Israel’s sophisticated technology with high-quality Arab labour conceals the future dynamics of restructuring the division of labour within the region for the benefit of the Israeli economy. A Harvard study entitled “Securing peace in the Middle East: project on economic transition” (1993) validates this perception, with the admission that establishing a free-trade area in the region for goods, services and capital would open up enormous opportunities for Israel. A free-trade area would “not only wipe out the old Arab boycott but [would also] allow the Palestinian entity and Jordan to become Israel’s economic doorway to the Arab world, just as Hong Kong is the doorway to mainland China” (Hausman and Thurow, 1993).

While the Israeli economy still has some way to go before it ranks among the world’s blue-chip economies, it has some underlying strengths and policies which are serving to propel the country forward in this respect. Israel’s spending on research and development (R&D) amounts to 3% of its gross domestic product (GDP)—proportionately higher than that of the United States, Japan and other leading industrial economies. The booming high-technology sector in Israel owes its improved economic fortunes to defence contracting; most of the country’s high-tech companies started out as suppliers to the Israeli military sector.

With the opening of Arab markets to Israeli-based transnational corporations, Israel hopes to realize its latent economic potential. This complementarity between transnational and local inputs is expected to play a distinctive role in sustaining Israeli economic growth.

A sample survey conducted by a research foundation on American, European, Japanese and Israeli multinational corporations indicated a clear bias in favour of Israel. All of the companies involved in textiles, food, tourism and light chemicals wished to locate in Egypt under a comprehensive peace scenario. In contrast, Israel was clearly a preferred location for high-technology companies, as it could offer the benefits of a highly skilled labour force, R&D facilities, and better proximity to end-user markets.

In the light of all this, many transnational corporations can be expected to establish their regional headquarters in Tel Aviv. In addition, foreign direct investment flowing into Israel for high-tech industries would likely be connected with the substantial transfer of technology, leading to significant productivity gains in the long run. Even within the same industry (or line of activity), the distribution of gains from potential subcontracting arrangements and intra-industry trade would be inequitable for the Arab countries participating in an FTA scheme.

The textile industry may be taken as an illustrative example. It is suggested by some Israeli economists (see Hirsch, 1989) that under a new Middle Eastern trade regime, Egypt could specialize in the labour-intensive production of cotton yarns and ready-made garments, while Israel would specialize in design, printing, marketing and other skill-intensive and high-value-added activities. Such an unequal division of labour would not be conducive to the development of Arab economies and would only serve to consolidate the uneven industrial development within the region.

Given the initial uneven distribution of manufacturing activities between Israel and the Arab countries of the ESCWA region, the creation of a free-trade area which included Israel could be expected to lead to asymmetric industrial development in the Middle East. Israel would continue to specialize in skill- and technology-intensive industrial products such as non-electrical machinery, electrical and electronic equipment, transport equipment, and scientific instruments, while Arab countries would continue to focus on the production of traditional manufactures such as food products, textiles, wearing apparel, leather goods and footwear, wood products and furniture.

In the light of these considerations, movement towards liberalized trading arrangements between Israel and the Arab countries of the ESCWA region should not be expected any time soon.

Within any broad regional grouping, uneven levels of development among the participating countries generally pose a serious problem for the creation of an FTA. In the

case of the ASEAN countries, for instance, while Singapore and Brunei are currently ready to join a free-trade area arrangement, other countries such as Malaysia and the Philippines need some time, and countries such as Indonesia and Viet Nam need an even longer period of adjustment and transition before they are ready to take such a step.

There are many fears—both expressed and implicit—of Israeli dominance under an FTA agreement. The Arab countries of the ESCWA region must make serious efforts to initiate schemes which bring them closer together and facilitate greater economic cooperation and integration among Arab country subgroupings—prior to joining any regional integration schemes involving Israel. This approach (the strategy of “Arab integration first”) has a concrete parallel in Latin America. Because of fears of dominance by the United States under a free-trade arrangement, Argentina, Brazil, Uruguay and Paraguay formed the Southern Cone Market (Mercosur) in March 1991, and new life has been breathed into the Andean Common Market with the establishment of ground rules for a free-trade zone by the end of 1991 (Fishlow and Haggard, 1992).

Within the Arab context, the very least that could be done would be to build Arab regional or subregional cooperation from bilateral deals without the benefit of a formal regional organization or governance structure. A strategy of “Arab integration first” would lead to a gradual deepening of economic relations and the harmonization of macroeconomic policies among Arab countries. Whatever form inter-Arab cooperation in trade, investment and macroeconomic policy-making might take, the process of Arab economic integration would be more likely to follow the model of the Andean Common Market or the less structured ASEAN formula. There is no reason to believe that past failures in inter-Arab economic cooperation and integration efforts predetermine the outcome of future attempts in this regard.

Prior to any drive towards regional cooperation and integration, coherence and coordination among the countries of the region must be improved in all areas of macroeconomic policy-making, including credit policy, the exchange rate, investment licensing, and the targeting of foreign aid flows; this constitutes one of the most important preconditions for effective economic integration.

The coordination of macroeconomic policies at the regional level would increase the externalities resulting from national policy decisions. Coordination and policy coherence efforts should mainly be directed towards the control and harmonization of debt and budget deficit levels through the adoption of broadly agreed-upon fiscal rules.

Respecting “convergence criteria” in monetary, foreign-exchange and fiscal policy-making would enhance the regional coordination and integration process. The gains achieved from macro-policy coordination could pave the way for much closer cooperation and integration in the formulation of investment and growth policies.

C. THE EURO-MEDITERRANEAN ECONOMIC PARTNERSHIP

The principal document submitted by the Commission of the European Communities to the Barcelona Conference held in November 1995 advocates the establishment of a Euro-Mediterranean partnership based on free trade to be progressively completed by the year 2010, covering most trade, based on the opportunities offered by and the obligations connected with the World Trade Organization.

Within this free-trade area:

- **Manufactured products would move freely, without tariffs or non-tariff barriers.**
- **Taking traditional trade flows as the basis, and as far as the various agricultural policies allow, trade in agricultural products would be progressively liberalized through reciprocal preferential access.**
- **Progressive liberalization would also occur with respect to the establishment of companies, the provision of cross-border services, and capital movements, with due regard for the provisions of the Uruguay Round trade agreements.**

To return to an important theme: since regional cooperation is a key factor in promoting the creation of FTAs, it is important for trade to develop first at subregional levels (for example, among the Arab ESCWA member countries), as this would pave the way for wider free-trade areas.

In 1975, B. Balassa and A. Stoutyesdijk wrote about two methods of achieving regional integration: trade liberalization and cooperation in joint regional projects. The problem in the ESCWA region relates to the sequencing and interface between the two methods. The cross-border subcontracting of industrial activities could also serve as a catalyst for strengthening regional integration, and might very well bring about enhanced intersectoral and intraregional trade. It is to be noted that the Arab Mashreq countries—and the countries of the ESCWA region in general—are weak in this regard, and have done very little to develop a system for subcontracting industrial activities subregionally. These countries should develop a strategy of industrial redeployment with the following goals in mind:

- **Ensuring the efficient production of final and intermediate products destined mainly for the regional market**
- **Gaining access to the world market through the manufacture of a limited range of competitive products**

These two points will be discussed in greater detail in the section that follows.

D. THE FUTURE OF REGIONAL COOPERATION AND INDUSTRIAL DEVELOPMENT IN THE ESCWA REGION

The sophistication, complexity and range of manufactured goods vary from country to country in the ESCWA region. An industrial structure is normally considered mature when it has passed the assembly stage in equipment production and is able to produce broad-based equipment (including automotive) manufactures, and when it possesses considerable indigenous design capabilities (Lall, 1990).

Economic cooperation and integration schemes would allow scale-intensive industrial processes to expand in an efficient manner over time. More specifically, during a transitional period, regional cooperation schemes in the ESCWA region could help promote industrial development among the participating members—long before their association with any free-trade arrangement. The partners could encourage industrial development by means of the following:

- Joint public investment in key industrial sectors, with strong technological spillovers and low financial returns. In this context, R&D should be seen as an investment for the “public good”.
- Joint ventures between private industrial businesses that would involve the following:
 - a. Vertical integration across partner countries for certain industrial activities and certain types of production facilities
 - b. Marketing arrangements (for domestic and export markets)
 - c. Subcontracting and licensing
 - d. The building of a cooperation infrastructure
 - e. The development of technology and standards for tradeable goods and services
 - f. The exchange of information on industrial and technological developments through networking

It should be noted that economic liberalization alone will not resolve the structural problems of industrial development in the countries of the ESCWA region. The root

causes of the problems of unemployment and outdated production facilities and ancillary services ought to be tackled through the implementation of long-term measures aiming at educating and retraining the workforce, encouraging industrial investment and the modernization of the productive base, and promoting R&D at the regional level. It is self-defeating for individual countries to try to alleviate the structural problems of industrial development by means of financial and monetary measures alone.

As a matter of sequencing, investment liberalization should precede trade liberalization in the context of the ESCWA region.

In sum, during this post-peace-settlement period, the Arab countries of the ESCWA region should develop various mechanisms and measures for closer economic integration, such as preferential tariff arrangements (PTAs), joint industrial projects (sharing the large-scale production of high-tech industrial projects), and the development of common parts supply networks.

The success of such forms of association depends on the extent of the concessions made by the ESCWA member countries. As for other regional partners—Israel, Turkey, and Iran—a consultative body may be established to discuss and resolve problems related to cross-border business and trade and to resolve disputes without any unnecessary and unproductive emotional confrontation; bilateral and multilateral consultations are far too often marred by geopolitical conflicts.

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VII. THE ECONOMICS OF PEACE: THE ARAB RESPONSE

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A. THE DIVIDENDS OF PEACE: WHO GAINS AND WHO LOSES?

Peace is being touted as a comprehensive solution with promising benefits for the Palestinians and for the Arabs in general. The presumed “peace dividends” are expected to derive from an increase in external aid, the rebuilding of indigenous institutional capacities to guide economic and reconstruction efforts, greater and guaranteed access to the Israeli market and possibly other Western markets, increased Palestinian control of domestic natural resources, the expected increase in international tourism, the decrease in military spending, and a reduction in the political instability and general uncertainty which in the past militated against foreign investment in the region. The Israeli benefits are less discussed but are very likely far more important and certain than the Arab benefits. In bargaining situations such as the one that presently exists, the relative net benefits are what count; a balanced evaluation of the dividends of peace calls for a thorough and objective assessment of both sides of the peace ledger.

The alleged Arab gains rest on some strong claims which have to be examined and evaluated against the background and experience of the Palestinians under occupation and also through the traditional economic analysis of opportunity costs and alternatives. This calculus of peace is of interest not only to the Palestinians but also to neighbouring Arab countries, which are monitoring the events and results closely and carefully. What is unfolding in the occupied territories represents a test case and a precedent of what is likely to await the Arab economy at large. The general presumption is that the more realistic, credible and visible the positive net benefits of peace are, the less sceptical the neighbours will be of the peace process and the less inhibited they will be in accepting it and joining in.

The economic problems the Palestinians endured under occupation provide a context and a yardstick for judging the promises and achievements of peace. Israel’s occupation of the West Bank and Gaza was very costly for the Palestinians and other Arabs; this should make even modest achievements under peace all the more palatable. These costs manifested themselves in many areas, but primarily in the loss of control over water, the loss of prime agricultural land, severance from traditional markets, constrained and limited industrial growth, disarticulated and precarious education, inadequate and insufficient investment in the physical infrastructure, the loss of an indigenous public sector that could have protected and guided the process of development, the subjugation of the Palestinian population to the occupiers’ tax and import regimes, the transfer of the Palestinian social surplus to Israel, the export of local producers to either Israel or the Gulf,

and political disruption and violence as people rebelled against the humiliating tyranny of their oppressors.

B. HISTORICAL BACKGROUND: THE ECONOMICS OF ISRAELI OCCUPATION

While the occupation may not have been strictly a zero-sum game, Israel derived enormous gains from its occupation of Arab land by tapping into the Palestinian water supply, exploiting a captive export market, drawing upon cheap labour whose income was spent primarily on Israeli products, confiscating prime agricultural land and skimming all the free rents derived from it, collecting tax revenues far in excess of the occupation's administration costs, and scooping up the large foreign exchange flows from Palestinian remittances from the Gulf and elsewhere.

It is natural to expect that under peace most of these negative factors will be eliminated, some positive gains will be realized, and the Palestinians will be compensated for their losses and suffering; that is why it is imperative that the difficulties and losses under occupation be tallied. Justification also exists for tallying all the losses that the Palestinians suffered from the loss of Palestine in 1948. Strangely, little mention is made of these enormous losses when the economics of peace is discussed.¹

Under occupation, the West Bank and Gaza were forced into an economic union with Israel. A small, fragmented, disarticulated, poor and labour-intensive economy was confronted with a relatively rich, advanced, capital-intensive, strategy-oriented and highly centralized and subsidized economy. Denied both control over their most vital resource (water) and unimpeded access to the Israeli market or to their traditional Arab markets, the Palestinians were unable to sustain a sufficient level of agricultural production—the mainstay of the pre-occupation economy and the largest employer of people.

Displaced from agriculture and unable to find alternative employment in industry, labour from the territories went to work in Israel, generally at higher pay than in the territories but at the lowest end of the Israeli wage scale. Although they represented no more than 7% of total employment in Israel, they accounted for the majority of construction workers and a large share of agricultural labour. They also represented over a third of all employed residents of the occupied territories, with their earnings amounting to about one quarter of the gross national product (GNP) in the West Bank and 40% in Gaza. This export of labour and the rise in labour costs in the occupied territories destroyed both existing manufacturing activity and any possibility of developing domestic manufacturing production. Earnings in Israeli shekels ultimately went to buy Israeli goods; Israeli net exports to the territories were over \$1 billion dollars last year.

¹ For a detailed account of these losses, see Kubursi (1988).

Israeli manufacturing could have taken advantage of cheap, unemployed and uprooted labour by locating in the territories, but this did not happen. Some subcontracting of clothing- and textile-related activities occurred, but only on a limited scale; further, such activities were restricted to minor tasks generally performed by women. Some have argued that the security situation in the occupied territories and the general uncertainty about the future of the areas scared investment away (Kleiman, 1995). The territories were held within the tight grip of the Israeli Defence Forces (IDF) for a long time, and no meaningful investment was undertaken there. The insecurity during the *intifadah* and the uncertainty about the future fate of the territories might explain the lack of investment in the late 1980s, but what about the lack of investment between 1967 and 1987?

The communal pauperization of the Palestinians which occurred as a result of their being denied access to their resources (water and land) and ultimately their own labour cannot be dismissed as a pure accident of history or as an unintended and incidental effect of the occupation. Rather, it was part of the Israelis' longstanding denial of the existence of the Palestinians as a people and as a community entitled to lead an independent national existence. Improving the economic prospects of the Palestinians requires their reconstitution as an independent national community. No amount of international aid can make up for the loss of land and water, and water is the most critical economic factor in reconstructing the primarily agrarian Palestinian economy, at least in the initial stages of socio-economic reconstitution.

The financial requirements for the development and reconstruction of the Palestinian economy are finite but massive; the list of urgently needed roads, schools, hospitals, ports, airports, sewage systems and so on is very long. However, finance without real resources will only perpetuate the Palestinians' economic dependence on Israel and others. Any large investments made now will go through the Israeli economy and will most likely be unsustainable. This pessimistic view follows from a review of the fate of the Arab economy in the 1980s, when the growth rate of the region's gross domestic product (GDP) fell far below that of other regions, including sub-Saharan Africa.

C. THE "ARAB DISEASE"

The collective growth rate for the Middle East and North Africa averaged less than 0.5% a year between 1980 and 1990, while the third world as a whole grew at an average rate of 3.4% during the same period.

There are a number of underlying structural weaknesses in the Arab economy that hamper its ability to adjust to global change, meet the challenges of peace, and protect itself from the adverse effects of changes in the international economic environment. Over the 1970s and 1980s, the "success" of the Arab economy masked many structural problems which now have important implications for future economic performance. Those

involved in setting up and developing the nascent Palestinian economy are well advised to learn from these Arab economic problems.

The most fundamental problem afflicting the Arab economy is its heavy (and in some cases exclusive) dependence on the rent from oil, the region's major natural resource. This dependence has propagated an "Arab disease" which has had the effect of raising the exchange values of most currencies in the region, thereby hampering the development of manufactured exports; inflating production costs and undermining local industry and agriculture; flooding domestic markets with large volumes of cheap imports that have ultimately compromised the balance of payments of even the richest States; engendering unsustainable high-consumption patterns that are unrelated to high production; encouraging investments in large (and often unnecessary and unproductive) projects which ultimately saddle the economy with large maintenance costs; bloating domestic bureaucracies with overlapping rings of rent-seekers; divorcing income from production; and exposing domestic economies to the wide fluctuations of the world oil market, over which the Arabs have had little control.

While it might be convenient to attribute Arab economic difficulties in the 1980s to falling oil prices alone, the truth lies elsewhere. The fact that oil prices can affect all economic indicators of performance so adversely is itself revealing: the heavy dependence on oil rents is symptomatic of general economic failure.

The Arab economy today remains almost as undiversified as it was in the 1970s. Oil exports are still the exclusive economic engine of the region. Rentierism is a widespread phenomenon that is not restricted to the oil-rich countries; there is now a "secondary dependence" on oil revenues throughout the region. Exports of manufactured renewable commodities and services represent a very modest source of external income for all Arab countries.

Non-oil-producing Arab countries have exported their producers to the Gulf and have enjoyed the convenience of remittances too much to bother about developing domestic exports. Manufacturing activity not associated with oil is limited, disarticulated, traditional, inward-looking, and technologically dependent on outside sources. Little has been done to develop technological capabilities in the region; there is a strong preference for turnkey projects, and expenditures on research and development (R&D) are negligible. Regional cooperation is a political slogan unsupported by any real economic interaction (even now, Arab intraregional trade exclusive of oil represents only 4% of the region's total international trade; with oil, it is less than 9%). Most Arab countries are linking themselves to non-Arab economic centres, with little or no concern for their Arab neighbours. External indebtedness is massive and is beginning to sap the energies of the region. In most Arab countries, "sunset" industries and old Fordist smokestack manufacturing activities still prevail; there is little evidence of the "new economy" in their industrial structures. Domestic savings are inadequate; they are rarely sufficient to finance

investment. High and unproductive consumption patterns have become the norm in most Arab societies. Illiteracy is still excessively high, particularly among females; while educational levels have increased, they still remain far below those of other successful developing countries. Industrial policies are either too stringent or non-existent, and there is a tendency to adopt “policy fads” peddled by the International Monetary Fund (IMF) which are inappropriate for Arab development and values.

In short, dependence on the rent from oil has reduced the incentive for Arabs to diversify their economies, develop alternative manufacturing capacities, promote export-oriented industries, encourage domestic savings, and anchor income on a solid foundation of productivity. During the 1980s, traditional economic activities and structures were maintained. Dependence on external sources of finance deepened and economic performance slipped. Although large oil revenues brought about significant improvements in health, education and infrastructure throughout the Arab world, they diminished the incentive to capitalize on these achievements. Arab economic performance throughout this period was symptomatic of the “Arab disease”, which has been fundamentally more damaging than the “Dutch disease” that afflicted Holland in the 1940s following the discovery and commercialization of natural gas; Holland had fertile land, abundant water, a highly skilled labour force and a European infrastructure and market.

While the need for foreign aid is urgent, the Palestinians must balance their immediate requirements against a negative and potentially disastrous dependence on precarious international charity. There is no need for them to repeat the Arab experience of the 1970s and 1980s or to contract the crippling Arab disease. The earlier they begin developing local and regional financing sources, the better.

D. WATER ISSUES: THE ARABS' ACHILLES HEEL

While there are water issues still to be negotiated, none of the agreements concluded so far augurs well for sufficient Palestinian control over this vital resource. There is a lot of discussion about “unitizing” the management of the water resources “shared” by the Israelis and the Palestinians. Indeed, there are efficiency arguments which support the joint management of these resources, but before any such mechanisms are put in place, it is critical that water-related “property rights” be established. Agreement after agreement (Oslo I, the Paris Protocol and Oslo II) has treated Palestinian water as an Israeli charity to the Palestinians.² With each new agreement, Israel raises the Palestinian share by a modest amount; this presupposes exclusive Israeli control and management of water resources. Peace will be credible and visible only to the extent that the Palestinians are

² The Protocol is formally known as the Protocol on Economic Relations between Israel and the PLO as Representing the Palestinian People. It is incorporated (as annex IV) in the Cairo Agreement signed on 4 May 1994.

able to reclaim their lost land and water. Even under the third and last phase of Oslo II, the Palestinians will have authority over only one third of their land and one fifth of their water.

E. THE PARIS PROTOCOL: A CRITICAL EVALUATION

With the dismantling of the occupation, Palestinians should be allowed to manage their economic affairs as they choose and to protect and guide their economy in the manner they believe will best serve their interests. However, the Paris Protocol puts the Palestinian economy under the Israeli import and tax regimes. Israel, perhaps fearing that the territories could be used to smuggle duty-free goods into Israel (or act as a tax haven) moved quickly to impose its own tariff regime (i.e., the same tariffs on all foreign goods in both the territories and Israel). Few exceptions are allowed under the well-defined schedules, though the Palestinians do have some latitude with respect to goods imported from countries that do not (or did not in the past) trade with Israel. This is a definite improvement over the previous situation, where the Palestinians were denied the right to import from other Arab countries.

As mentioned above, the Protocol requires the Palestinians to impose the same import tariffs as the Israelis. These tariffs have evolved to protect and promote the Israeli economy; however, they are not necessarily consistent with the needs or interests of a fledgling economy with limited productive capacity. The Palestinians have been promised easier and guaranteed access to the Israeli market; even more importantly, however, Israel has secured guaranteed and unimpeded access to the Palestinian economy. With this, the Palestinians have forfeited any chance to protect their infant economy; the real price is apparently greater integration with the Israeli economy. What the Palestinians have worked out with the Israelis is a sort of combination customs union and common market. While such an arrangement generally involves trade creation and trade diversion, one wonders whether giving the Israelis full and unimpeded access to the Palestinian market will allow them to build a diversified and productive economy. For all practical purposes, this agreement perpetuates and legitimizes the economic structures that emerged under occupation. Accepting the trade-diversion implications of the agreement simply means that, for the time being, the Palestinian Authority prefers to tie its economic fortunes to Israel rather than to the Arabs.

Defenders of the agreement cite the many advantages that economic theory generally predicts will be gained by the poorer partner from freer trade, particularly the widely believed supposition that the smaller and poorer countries will benefit most, with their access to the markets of richer partners. There are certain elements and conditions upon which the theory is built, however, and many of these are missing in the Palestinian case, including the mobility of the factors of production. In a broader context, if this theory is correct, why are there depressed regions in the most advanced economies? (Examples include Appalachia in the United States, Newfoundland in Canada, and Sicily

in Italy.) Economists tend to exaggerate the blanket effect of free trade and underplay the “backwash effects” described by Myrdal as well as the adjustment costs. Myrdal’s ideas on backwash effects have been given a new theoretical thrust by Paul Krugman, who has shown that under monopolistic competition, strong agglomeration effects tend to develop which make regions with limited natural resource bases and low transport costs very vulnerable to the dominant region in a free-trade situation. It is only by protecting their natural resource bases and raising their transport (friction) costs that the poorer regions can ward off the centrifugal forces of the richer and more dominant regions. The implications of this theory for the Palestinians are obvious; they need to protect their water rights, build their agricultural resource base and increase transaction costs when dealing with the Israeli economy until they are able to produce a large array of products over which they have some market power. At present they are doing exactly the opposite.

Actually, bargaining theory is perhaps clearer and more realistic about the outcomes of bargaining among unequal partners than the static comparative advantage trade theory. The former predicts that the party with many options is likely to dictate the terms and impose its interests on the party with few or no options. It does not stretch the imagination much to suggest that all of the Palestinian-Israeli agreements to date have been concluded between unequal partners and under duress, and that little can be expected from them other than benefits and advantages weighing heavily in favour of the Israelis. The most alarming prediction, however, is that the Palestinian economy will evolve into—and remain—a poor appendant to the richer Israeli economy.

F. FOREIGN INVESTMENT: WHERE WILL IT GO?

With peace, the region is expected to attract greater and more certain foreign investment flows; however, much (if not all) of this investment is likely to go to Israel. A good portion of the foreign investment taking place today is of the tariff-jumping kind. The more customs unions the Israelis succeed in forming in the region and the more clauses they can eliminate from the Arab boycott, the more foreign investment will come to them.

There are many reasons why foreign investment will be concentrated in Israel rather than in the Arab world; the following are among the most significant:

- The Israelis are making a concerted effort to woo investors; there is a special minister in Israel (Tulman) and special offices in the major Western capitals for this purpose (the American office is run by Mrs. Newt Gingrich, wife of the Speaker of the House for the United States Congress). Further, they are aiming at the complete convertibility of the shekel within two years.

- The Israelis have developed a sophisticated network of relationships with many multinationals and Jewish-dominated institutions that can be drawn upon to encourage new investment in Israel now that there are no longer any real barriers.
- The United States and Europe appear to be providing direct official encouragement to multinationals to locate in Israel to service the Arab and other Asian markets.
- The highly skilled Israeli labour force (more than 40,000 of the new Russian immigrants hold a Ph.D.) and the advanced research centres in Israel are far more attractive to multinationals than the workforce and facilities available in many other Middle Eastern countries.
- The new agreements bring stability to the region and provide Israel with a confirmed market and cheap labour flows. Further, the Palestinians can be counted upon to serve as experienced intermediaries in selling Israeli-made products in the region.

The Arab boycott was very costly for the Israelis; some estimates place the figure at \$40 billion, but it could be argued that the amount is even higher, particularly if a real present value approach is adopted and if the estimated amount of foreign investment that Israel could have attracted in the absence of the boycott is included in the determination of the total cost.

The Israelis have become increasingly concerned about their dependence on foreign aid from the United States. As pressures mount to balance the monumental American federal budget, foreign aid will most likely be one of the first areas targeted for cut-backs. While Israel currently claims the lion's share of American foreign assistance, its aid package is bound to be affected sooner or later. Peace will only give Israel some breathing space. The one reliable alternative is to secure foreign investment which produces annual revenues of around \$3 billion to \$4 billion. Israel was unable to attract much foreign investment in the past (only \$200 million to \$300 million per year on average); however, the picture can be expected to change dramatically with no Arab boycott and a few customs unions ensuring unimpeded access to several Arab markets. Ironically, Israel's gain here could easily be the Arabs' loss. The benefits are already beginning to surface. The Bank of Israel released foreign investment figures for the first six months of 1995; by June of that year, foreign investment in Israel had reached \$673 million. Leading American and European companies have been racing to take advantage of the new developments with the open encouragement of their own Governments: among others, Shamrock is in with \$252 million, Volkswagen of Germany with \$220 million, Cable and Wireless with \$120 million, and Intel with a huge amount. The foreign investment figures for January through June of 1995 were twice as high as the full amount

for 1994; with the elimination of the Arab boycott, this figure could easily reach \$4 billion a year.

Foreign investment in the Arab region has drastically declined from the high levels of the 1950s. The share of the region in total world foreign investment is now less than 3%. Access to world markets, new technology, advanced management systems and large investments are the almost exclusive preserve of multinationals. The Palestinians are well advised to take advantage of the current favourable international climate to attract foreign investment. They should proceed with caution, however, as foreign investment is not always totally beneficial to the host country. There are numerous examples of multinationals exploiting the local market, wresting substantial concessions that far outweigh their positive contributions, and providing little or no technology transfer. It is invariably the case that positive net benefits from foreign investment are derived by enlightened Governments that obstinately negotiate favourable terms from these multinationals, including product mandates, home base operations, and a systematic transfer of technology. However, in the absence of a free and representative national Government, the Palestinians are in a weak position to negotiate favourable terms. Further, their chances of obtaining a respectable share of foreign investment may depend on the extent to which they are able to guarantee access to the wider Arab market. The more closely the Palestinians tie their economic fortunes to those of the Israelis, the less likely they are to derive concessions from their Arab brethren that might make the territories more attractive to foreign investors.

G. INTERNATIONAL TOURISM: LIMITED GAINS AT BEST

Greece, which is an hour's flying time from Palestine, attracts 12 million international tourists a year; Israel attracts no more than 2 million. With peace, international tourism is likely to increase rapidly. Unfortunately, the Arab region is not prepared for the expected influx; the Arab tourism infrastructure is limited, and international linkages are almost non-existent. Lebanon's once competitive tourism infrastructure was destroyed during the civil war; today, it is not even sufficient to meet the demands of the Lebanese returning for visits. Egypt is the only Arab country with the capacity to benefit from the increased flow, but its share of the total is not yet certain; outside Sinai, Egypt's experience thus far is not very encouraging.

The objective in tourism is to separate the tourist from his or her money. The bottom line is length of stay: the longer tourists stay in a country the more they spend and the greater the benefits from tourism are to the host country. If the Arabs fail to adequately plan and prepare for the time when peace truly "breaks out" in the area, they stand to forfeit the benefits increased tourism will bring; there may even be diversion from traditional Arab tourist centres, with tourists from Gulf States visiting Israel instead of Lebanon or Egypt.

The potential rewards from increased tourism would be more certain with proactive preparation and planning. The development of a concerted Arab tourism strategy is required to mount joint marketing and advertising campaigns and to connect tourism flows. In the absence of such proactive planning and Arab coordination—which is a tall order under the present circumstances—Israel will get the tourists and will determine how long they stay, how much they spend, and where their tourist dollars go. At most, the Arabs will get day-trippers and short-term visitors; most tourists will come to Israel and make occasional, brief forays into Arab lands. The Jordanians are already experiencing some of these negative effects.

H. BEATING SWORDS INTO PLOUGHSHARES

For every dollar spent on education in the Arab world, \$166 is spent on defence. The Middle East has the dubious distinction of having the highest military expenditure as a proportion of GDP than any other region in the world. If peace proves to be just and enduring, there could be substantial savings in wasteful military expenditures. Israel has already reduced its share of defence in GDP; in GNP terms, the defence share has declined from 22% before the Camp David Accords to 10% now. Israel stands to benefit far more than the Arabs from the reallocation of resources from the military to the civilian sector, given the high differential between the average productivity of military resources in Israel and those in the Arab world; most of the military resources in Arab countries are surplus labour with low or negative marginal productivity in the civilian sector.

I. ISRAELI EXPORTS AND ARAB TRADE

The products exported by Israel correspond very closely to those imported by Arab countries. The present author's calculation of the concordance indices (indicating structural similarity in trade composition, by commodity), shows that the degree of Israel's concordance with Saudi Arabian, Iraqi and Syrian trade is twice as high as its corresponding concordance with Europe or the United States. These estimates suggest a doubling of Israeli exports under peace. Geographical proximity is another advantage for Israel, and using the Palestinians as marketing agents can speed up the process and raise the growth potential for Israeli trade in the region (Kubursi, 1980).

Israel has already gained from another trade-related development brought about by the mere discussion of peace with the Palestinians. In the past two years, Israel has had a booming trade surplus, while Europe and the United States have been facing economic difficulties. The reason for this is Israel's increased trade with China, India and Japan—countries that would not have dared to do business with Israel if the new arrangements with the Palestinians were not in place.

J. ISRAEL'S NET GAINS

The real gist of the arguments presented here is that Israeli peace dividends are massive and real, while Palestinian and Arab gains are conditional, precarious and highly illusory. Even when these gains are positive, they pale in comparison with those that have been or are expected to be realized by the Israelis. The peace agreements concluded so far not only guarantee Israel the economic benefits it enjoyed during occupation; they also open up new trade vistas, allow for the reduction of defence expenditures and the dismantling of the Arab boycott, and create new opportunities for foreign investment and international tourism.

The Israeli-Palestinian playing field is not level; the agreements reflect the vertical organization of power and the options in existence. What is concluded under duress cannot last. In the interests of peace, immediate and unconditional independence for the Palestinians is called for. The Palestinians need massive technical transfers and solid and productive foreign investments.; it is only when they have established a firm foundation on which to build that they can be expected to conclude meaningful and lasting agreements. The Arabs are watching both the Israelis and the Palestinians; what they have seen so far is not very encouraging.

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VIII. THE POTENTIAL FOR ISRAELI MANUFACTURED EXPORTS TO ESCWA MEMBER COUNTRIES: RISKS AND OPPORTUNITIES

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Introduction

Progress on the peace front is expected to have a positive impact on regional stability once just and comprehensive settlements are reached. Peace will open up areas for cooperation between previously contentious neighbours who now share the view that for the region to best utilize its resources, protracted conflict must be resolved. New economic relations with Israel are, however, expected to involve both risks and opportunities. An attempt is made in the present paper to assess the main elements of the risks and opportunities associated with the emergence of Israel as an economic partner in the region.

A. THE ISRAELI ECONOMY: AN OVERVIEW

Israel is a small, open economy, poorly endowed with natural resources but distinguished from the rest of the Middle East and North Africa (MENA) region by its exceptionally well-educated population and labour force. In 1994, Israel's population of 5.4 million accounted for 2.1% of the region's total, while its economy was responsible for generating 22.7% of the region's gross domestic product (GDP); Israel's GDP totalled \$78.4 billion, second only to Saudi Arabia (\$121 billion) in the MENA region. The manufacturing sector accounts for 21.5% of gross national product (GNP)—well above the average of 10.5% for the Arab countries—and services account for 45.4%, agriculture for 2.4%, and construction for 8.9% of GNP.¹

While the rest of the region went through a period of unprecedented growth during the 1970s, Israel experienced its rapid growth phase a decade earlier. Between 1960 and 1970, the Israeli economy grew at an average rate of 8.1%. Following the 1973 war and the two subsequent upsurges in energy prices, however, growth rates started to slide back down.

The economic slump of the 1970s and early 1980s cannot be explained in isolation from a group of factors that affected the performance of the Israeli economy during these so-called lost years. Mainly responsible for the economic backslide were increasing

¹Transport, storage and communications (7.6%), commerce and hotels (11.6%), and ownership and dwellings (7.3%) account for the remainder of Israel's GNP.

defence expenditures, which by 1980 accounted for 40% of total government expenditure;² low and occasionally negative immigration; the negative effects of the two major supply shocks caused by the sudden hikes in energy and raw materials prices (1973-1974 and 1979-1980); and sustained hyperinflation.

Private consumption was also increasing at the expense of investment during this period. Despite falling growth rates, the mounting pressure of debt accumulation, inflation, and internal and external economic problems, the standard of living (as measured by per capita private consumption) continued to rise. In 1973 private consumption accounted for 38% of domestic absorption, while investment accounted for 27%; by 1984, the corresponding figures were 49% and 19% respectively (World Bank, 1995).³ Foreign loans were increasingly relied upon to finance the emerging gap between the economy's productive capacity and the overall level of consumption spending. By 1991, Israel's foreign debt stood at \$33 billion, accounting for 54% of GNP and 24% of the MENA region's foreign debt.

The Israeli economy experienced a sharp decline following the boom of the 1960s, with the average annual rate of GDP growth falling to 4.1% over the period 1970-1982. The inability of the Government to keep spending in check was manifested in a soaring budget deficit that averaged 12% of GNP between 1980 and 1984, leading to spiralling inflation which reached 304% in 1985. In mid-1985, facing economic deceleration, the Government instituted a comprehensive economic stabilization programme⁴ consisting of major price realignments and fiscal and monetary restraints. The key was a remedial adjustment in the exchange rate in 1985 whereby the shekel was devalued by 402% against the dollar (from 0.29 new shekels [NIS]/\$1 in 1984 to 1.179 NIS/\$1 in 1985) (World Bank, 1995).

Stabilization measures brought some improvement: the government budget deficit declined to 0.6% of GNP in 1986, and inflation fell to an annual average of between 10% and 20%. The most important benefit of the stabilization programme, resulting from the setting of the exchange rate at a more realistic level, was improved export competitiveness: exports increased from \$5.6 billion in 1984 to some \$16.5 billion in 1994.

The stabilization programme initiated in the mid-1980s failed to bring a resurgence of the high growth rates experienced in the 1960s; the average annual growth rate over the period 1980-1993 was sustained at 4.1%. Prospects for the future are none the less quite promising; GDP grew by 7% in 1994 and by 8% during the first half of

²By 1993, military defence expenditure as a percentage of total government expenditure had been reduced to 20%.

³By 1993, these shares were relatively stable at 45% and 22%.

⁴For comprehensive coverage of the 1985 stabilization programme, see Razin and Sadka (1993).

1995.⁵ Economic targets set for the year 2000 project that GDP growth will be sustained at 4.7% per year, so that by the end of the current decade GDP is expected to be 40% higher than it is at present. The ability to maintain such a level of growth will require an increase of 8.5% per year in commodities and services exports and an annual increase of 5.3% in fixed investment.

Future growth is contingent upon the ability of the Israeli economy to capitalize on the anticipated positive impact of the peace process. Israeli exports are expected to gain access to neighbouring MENA markets, and regional stability will bring about higher investment levels, both domestic and foreign.

B. THE ROLE OF THE STATE IN THE ECONOMY

Among the most distinctive features of the Israeli economy is the depth of government involvement through both its institutions and its policies. The share of Israel's public sector⁶ in production, employment and total investment is one of the highest in the world. Between 1980 and 1991, public-sector employment remained steady at around 29% of total employment.⁷ The Government is a major player in the industrial arena, concentrating mainly on military production. In 1990, State-owned enterprises (SOEs), which were valued at some \$6 billion, accounted for 7.14% of total employment in the business sector. The public sector has traditionally been regarded as an employer of last resort and has mitigated the effect of rising unemployment, particularly during periods when job creation in the private sector has failed to keep up with the flow of immigrants. Israel's 200 SOEs range from small firms to giant corporations;⁸ they accounted for 13.5% of total exports and 15% of total industrial output during the 1980s (*Israel Economic and Business Review*, 1985). By the end of the 1980s, the Government of Israel was the owner of almost all land, water, energy sources, radio and television facilities, mines, defence industries and airline transportation (Aharoni, 1991).

The Government has played an integral role in contributing to the growth of high-technology exports through its support of research and development (R&D) activities. According to published statistics, during the period 1989-1991 national expenditure on R&D as a percentage of GNP averaged 3.1%, less than half (40.5%) of which was provided by businesses (Abdel Jaber, 1995). The Government also provides financial support for business investments; between 1974 and 1979, private investors received

⁵ As calculated by the Economist Intelligence Unit (1995).

⁶ Besides the Government, the Israeli economy is composed of the Histadrut and the private sector; more specifically, the Histadrut, the Private Employers Association and the Government constitute the main pillars of the political and economic system in Israel.

⁷ Compared with 13% in the Republic of Korea and 22% in Egypt.

⁸ Examples include the Bank of Industrial Development, oil refineries, the Bezel (telephone and telecommunications) Company, Israel Chemicals, and the electric company.

roughly half of every dollar invested as a free government grant (Mayshar, 1986). Prior to the devaluations of the 1980s, the Government supported export-oriented industries, in the face of an inflexible exchange rate, by providing material compensation. An estimated \$485 million in export subsidies were provided in 1985 (Aharoni, 1991).⁹

C. IMMIGRATION AND FOREIGN AID: THE DECISIVE MIX

From a macroeconomic perspective, key variables that have influenced the dynamics of the Israeli economy include immigration and foreign sources of finance.

1. Immigration: the wheel of growth

Immigration has influenced growth by stimulating demand and by increasing productive capacity through the supply of highly skilled and professional labour. Unlike other countries in the MENA region, whose most daunting challenge has been to direct sufficient investment towards upgrading their human resource base, the challenge facing the Israeli Government has been how to best utilize the existing stock of human capital.

When immigration slowed during the 1970s the economy almost stagnated, with growth in per capita output declining to less than 1%, compared with 10% over the period 1950-1951 (Razin and Sadka, 1993). The immigration target for the year 2000 is an annual average of 80,000 (compared with an average of 20,000 over the last decade) (Israel, 1995). Immigration plays a decisive role in the drafting of alternative scenarios for the economy's overall rate of growth, and for the future growth of investment, private consumption and employment.

2. Foreign aid: the catalyst of growth

Unilateral transfers to Israel have mainly been supplied by the German and United States Governments and by world Jewry. World Jewry has supported Israel through direct contributions and presently finances 10% of the country's import surplus¹⁰ (compared with 28% in 1970). German government reparations and American government loans have provided Israel with two other important sources of finance. United States government grants and loans have been considered the most important source of foreign finance since 1973 and have been responsible for financing more than 70% of Israel's trade deficit. During the second half of the 1980s, American aid amounted to \$3 billion per year in nominal dollars—\$1.8 billion for military aid and \$1.2 billion for civilian purposes

⁹ An important question becomes whether or not such a form of support can be sustained in the light of the Uruguay Round agreements, which explicitly forbid export subsidies but allow R&D-related subsidies.

¹⁰ An import surplus is defined as the amount by which imports of goods and services exceed exports of the same.

(Aharoni, 1991). Ironically, Israel's "problem in recent years has been what to do with the [foreign] money, rather than how to get it" (Mayshar, 1986).

As mentioned above, foreign sources of finance have played an important role in supporting the country's import surplus. Israel's persistent import surplus (which reached \$6 billion in 1994) has been a central economic issue since the establishment of the State (Ben-Porath, 1986). An import surplus can be viewed as a double-edged sword: lowering it would result in lowering the total available resources by at least the same amount (i.e., a decrease in the import surplus would mean a decrease in essential imports), thus lowering domestic product (Halevi, 1986). While foreign exchange reserves and short-term borrowing could temporarily maintain a foreign trade deficit in the face of declining long-term transfers, the whole economy—in fact, the whole production process—would be placed in a precarious position.

In many economies, the initial development phase was characterized by a high import-surplus-to-GNP ratio which later declined; in Israel, however, the import surplus fluctuates but does not show any signs of sustained decline.

D. TRADE POLICY AND INDUSTRIAL POLICY: TWO SIDES OF THE SAME COIN

Like most "small" countries, Israel is heavily dependent on foreign trade. In order to sustain its imports, the economy has to channel a significant share of its production towards export. Since 1950, in acknowledgement of this fact, the industrial sector has been producing for export purposes rather than catering primarily to the domestic market. At present, 65% of all imports are covered by exports, down from 81% in 1989.

Israel has emerged with a relatively liberal trade regime; in 1990 import duties averaging 10% (weighted average) of the import value were levied (Razin and Sadka, 1993). This means that there has been little scope for production that does not run along the lines of comparative advantage.¹¹ In this respect, trade policy has served as an industrial policy by increasingly driving production along such lines.

Export-led growth has been characterized by a major shift in production away from traditional products towards sophisticated, high-tech products. This structural transformation has had a major impact on the commodity composition of exports, since the significant rise in exports has mainly been generated by high-tech products, which now account for 70% of industrial exports (excluding diamonds). High-tech firms operate predominantly in the defence sector (Aharoni, 1991), which falls within the domain of

¹¹ There are, however, a large number of exceptions outside the industrial sector; the most commonly cited example is the heavily protected agricultural sector.

government ownership. It has been estimated that the defence sector accounts for one quarter of all industrial exports. (*Israel Economic Business Review*, 1985).

In contrast to the other economies in the ESCWA region, the Israeli economy is both open and globally integrated. The ESCWA region's economies can be categorized into two groups: non-oil-exporting economies, which are closed and not integrated (with the exception of Jordan); and oil-based economies, which are open but are also not integrated (see figure).

The implication here is that the Israeli industrial sector is well-positioned to penetrate the ESCWA region's markets once the Arab boycott is lifted. The important question, however, is whether the outcome will be a zero-sum game, whereby Israeli exports to the ESCWA region increase at the expense of Arab exports. The following section attempts to shed some light on the risks and opportunities associated with the emergence of Israel as a trading partner in the region.

E. ARAB FIRMS FACING ISRAELI FIRMS: RISKS AND OPPORTUNITIES

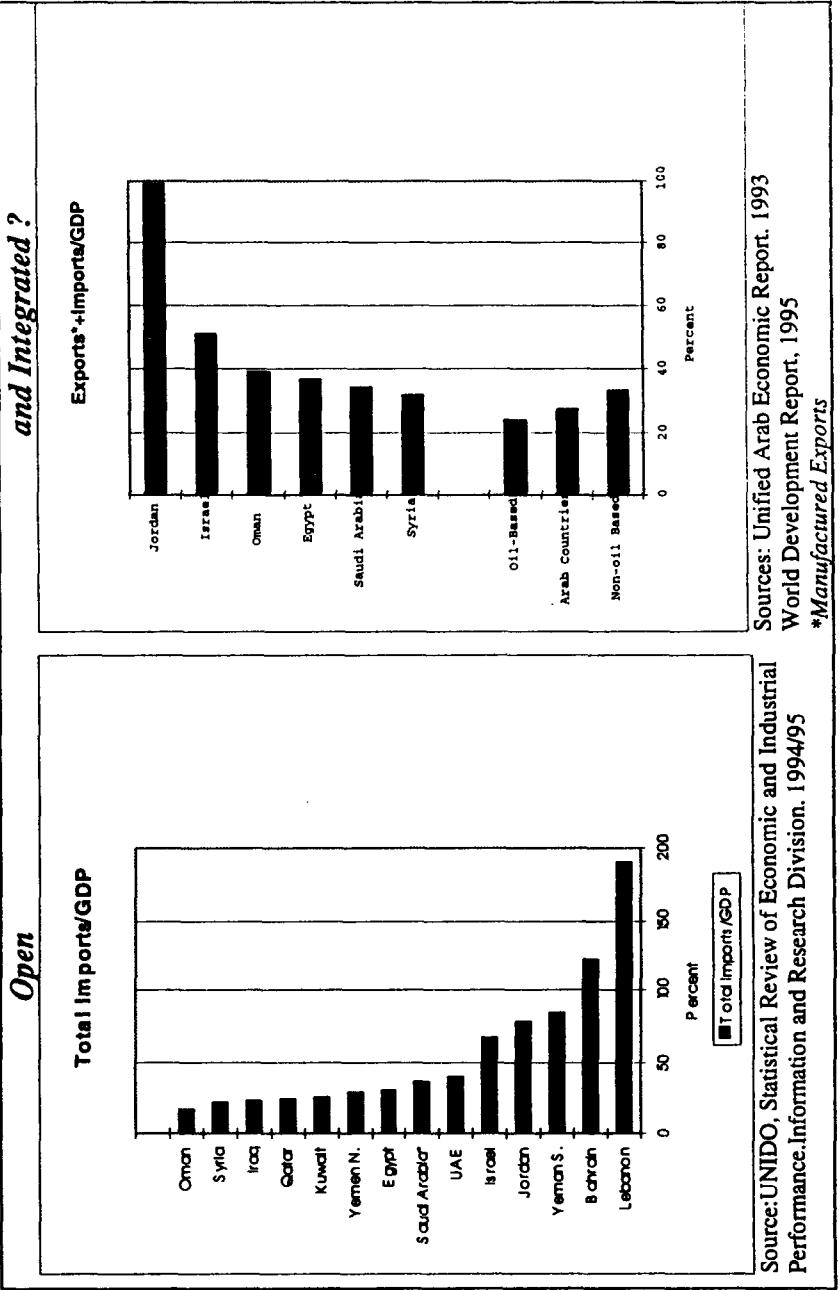
The speed (and sometimes secrecy) characterizing progress on the peace front has, to a considerable extent, outpaced the expectations of observers who have witnessed the frequent deadlocks the process has come up against. In spite of the fact that the protracted conflict between Israel and its Arab neighbours has been only partially resolved, "business" is already under way.¹² While the advent of peace will open up areas for cooperation, it has provoked concern over future arrangements that might affect the performance of Arab firms in the region's markets. An attempt is made in this section to assess the dimensions of the perceived threat posed by the impending entry of Israel into regional trade.

1. Risks

In analysing the ability of Israeli firms to compete in Arab markets, two main determinants must be considered: tariff structures facing individual competitors in markets in which competition is likely to occur; and the nature of the competing products.

¹²Qatar has made progress on an arrangement to ship liquefied natural gas to Israel, so that "when the boycott is lifted everything is in place".

Figure. The openness and integration of Arab and Israeli markets



(a) Markets

Competition is likely to occur over markets that are open, markets that are characterized by less diversified industrial output which does not sufficiently meet domestic demand, and markets in which purchasing power is high. In other words, competition is likely to occur between Israel and those ESCWA member countries with a more diversified manufacturing output (and hence a more diversified commodity composition of exports) than the oil-based markets. Competition is likely to be more intense between Israel and ESCWA member countries whose intraregional trade forms a significant portion of their global exports. At present, intraregional trade accounts for 14% of global exports in Egypt, 30% in Jordan, 50% in Lebanon, and 20% in the Syrian Arab Republic (Yeats, 1995; *Unified Arab Economic Report*, 1993).

In the absence of preferential trading arrangements, Israeli exports will enter the ESCWA region's markets on the basis of existing tariff structures. The prospects for Israeli exports enjoying preferential access to these markets are at present quite remote. The systematic failure of the Arab countries to come up with the preferential trading agreements required to take them a step further towards drafting a free-trade agreement supports this contention. In the numerous agreements forged by Arab Governments to promote intraregional trade, preferences have generally been granted to a wide range of raw materials, agricultural products, and the products of joint Arab industrial projects—leaving out most manufactured goods, which continue to be subject to increased tariff barriers. Competition in the short run is likely to be through tariff structures that generally do not discriminate between Arab producers in the region.

Potential enlargements of the proposed subregional trading blocs in which Jordan, Israel and the occupied territories constitute the nucleus are equally distant, and hence involves no immediate risks. The longer-term prospects for granting Israeli exports preferential access to the ESCWA region's markets none the less deserve attention, particularly in connection with foreign direct investment (FDI), which is likely to be attracted by host countries enjoying preferential access to the region's markets. The average annual inflow of FDI into Egypt over the period 1982-1987 was \$809 million, compared with \$110 million into Israel over the same period. If Israel were granted preferential access to the ESCWA region's markets, FDI would likely favour locating in Israel, where export support services and a highly skilled workforce are available and, most importantly, where the "soft infrastructure"¹³ is already in place. Egypt and other ESCWA member countries would continue to attract FDI, but only in accordance with their existing comparative advantage in labour-intensive areas. Unless ESCWA countries invest in upgrading the existing skills possessed by their workforces, Israel is likely to

¹³The term refers to the institutional settings (such as a legal framework) needed to do business.

continue attracting FDI in production areas that are both skill-intensive and knowledge-intensive.

(b) Products

The production structures of Israel and the Arab countries in the ESCWA region are inherently different. Variations in natural resource endowments, factors of production, and the endorsed industrial policies underlie such differences (see table 1).

Table 1 shows that the bulk of manufacturing output is accounted for by petroleum refining, food products, industrial chemicals, non-metallic mineral products and fabricated metal products. The output of the Israeli manufacturing sector is more evenly distributed among various subsectors, with electrical machinery, food products, and fabricated metal products accounting for the largest percentage. There is relatively little convergence between the production structures of the ESCWA member countries and those of Israel, as is reflected by the shaded percentage shares in table 1.

These variations show that, in reality, Arab countries (both net oil exporters and non-oil exporters) have emerged with a commodity composition of exports that is not very similar to that of Israel. It is safe to argue that once the boycott against Israel is lifted, there will be relatively little competition between Israeli exports and those of the ESCWA member countries. To verify this assumption, an index of export similarity¹⁴ involving 128 products at the three-digit SITC level was conducted between Israel and some selected ESCWA member countries (see table 2).

Table 2 reveals that the export patterns of the ESCWA member countries are becoming only slightly more similar to those of Israel. The implication is that their economic structures are coming closer to that existing in Israel; this is particularly true for the non-oil-exporting countries. All of this notwithstanding, the most important implication of the index figures is that competition is unlikely to be generated between Israeli products and those of the ESCWA member countries in the short run.

In terms of commodity composition, Israel's global exports are currently dominated by worked diamonds, which account for 29% of total exports; this is an area where potential competition between Israeli and Arab firms is negligible (see table 3).

¹⁴An index of export similarity is calculated using the formula $S(ab,c) = \{\Sigma, \text{Minimum } [Xi(ac), Xi(bc)]\} 100$, which measures the similarity of the export patterns of countries *a* and *b* to market *c*. *Xi(ac)* is the share of commodity *i* in *a*'s exports to *c*. If the commodity distribution of *a*'s and *b*'s exports are identical, the index will take on a value of 100. If the export patterns of *a* and *b* are totally dissimilar, the index will take on a value of 0.

Table 1. Structure of manufacturing outputs for selected ESCWA member countries and Israel (Percentage)

Item	Syrian Arab Republic 1990	Kuwait 1988	Iraq 1986	Qatar 1991	United Arab Emirates 1985	Jordan 1992	Saudi Arabia 1989	Egypt 1992	Israel 1991
300 Total manufacturing	100	100	100	100	100	100	100	100	100
311 Food products	20	4.4	16	4.1	11.2	17	8.7	17.5	15.8
313 Beverages	2.5	1.2	3	1.2	4.4	2.7	1.5	1.1	1.5
314 Tobacco	5.5	0	5	0	0	4.9	1.1	2.6	0.2
321 Textiles	17.8	0.5	6.2	0	0	2.1	0.7	17.4	4.6
322 Wearing apparel, except footwear	0.9	2	1.3	2.9	0.5	1.2	0.1	0.8	4.2
323 Leather products	2.5	0.1	0	0.2	0	0.5	0.1	0.3	0.2
324 Footwear, except rubber or plastic	2.5	0	1.8		0	0.5	0	0.3	0.6
331 Wood products, except furniture	0.8	0.4	0	1.8	1.4	0.9	0.2	0.3	1.2
332 Furniture, except metal	1.9	1	0.3	0.3	1.4	2.5	0.8	0.2	1.3
341 Paper and paper products	0.4	1	2.3	0	0.7	3	2.2	3.5	2.5
342 Printing and Publishing	0.7	1.7	1.2	1.8	4.7	1.7	0.8	1.5	3.7
351 Industrial chemicals	1	2.6	4.3	31.8	3.6	7.5	18.4	4.4	5.7
352 Other chemicals	10	0.9	11.8	1.2	3.5	7	2.9	6.6	7
353 Petroleum refining	13.9	70.7	16.7	32.3	0	21.3	30.2	11.7	
354 Miscellaneous petroleum and coal products	0.6	0.1	1	0.7	1.2	0	1.3	1.8	
355 Rubber products	2	0.2	0.4	0.1	0.1	0.3	0.2	0.7	0.7
356 Plastic products	1.4	1.3	1.5	1	5.7	3.7	2.7	2.1	4.9
361 Pottery, china, earthenware	0.3	0	0	0	0	0.4	0.2	0.8	0.2
362 Glass and products	0.4	0.3	0.8	0	0.1	0.6	0.4	0.9	0.4
369 Other non-metallic mineral products	3.8	4.6	11.9	4.5	22.4	8.4	6.8	4.8	4.2
371 Iron and steel	0	0.6	1.3	13	0.7	5.5	3.7	0.8	2.2

Table 1. (continued)

Item	Syrian Arab Republic 1990	Kuwait 1988	Iraq 1986	Qatar 1991	United Arab Emirates 1985	Jordan 1992	Saudi Arabia 1989	Egypt 1992	Israel 1991
372 Non-ferrous metals	1.9	0		0	16.7	1.2	0.5	3.1	0.6
381 Fabricated metal products	3.2	3.3	2	3	17.2	3.5	7.3	3.3	10.2
382 Machinery, except electrical	1.8	0.8	4.5	0	0.9	1.4	2	2.1	2.7
383 Machinery, electrical	2.1	1.2	4.8	0	0.6	1.6	3.4	3.7	17.5
384 Transport equipment	0.7	0.5	2	0	1.2	0.2	0.9	1.9	5.1
385 Professional and scientific equipment	0	0	0	0	0.1	0.2	0.1	0.5	1.1
390 Other manufactured products	1.4	0.3	0	0.1	1.7	0.1	2.8	0.2	1.5

Source: Compiled from UNIDO data, Information and Research Division, Industrial Statistics Branch, 1994/1995.

* Classified according to the United Nations International Standard Industrial Classification (ISIC).

Shnwi. Table 2. Indices of export similarity

	1970-1972	1980-1982	1990-1992
Lebanon-Israel	31	37	36
Jordan-Israel	15	40	32
United Arab Emirates-Israel	8	20	32
Egypt-Israel	16	15	26
Syrian Arab Republic-Israel	24	14	17
Saudi Arabia-Israel	5	8	16
Bahrain-Israel	3	9	12

Source: Calculated using data compiled from Alexander Yeats, "Export prospects of the Middle Eastern countries: a post-Uruguay Round analysis", a paper presented at the Economic Research Forum Conference on Liberalization of Trade and Foreign Investment held, in Istanbul from 16 to 18 September 1995.

Note: Exports to OECD countries.

Table 3. Israel's largest global exports
(Thousands of US dollars)

SITC	Item	1980	SITC	Item	1993
667	Pearls, precious, semi-precious stones	1 672 004	667	Pearls, precious, semi-precious stones	4 113 837
733	Road vehicles, non-motor	369 163	719	Machines n.e.s., non-electric	1 358 759
051	Fruits, fresh, nuts, fresh, dry	301 897	724	Telecommunications equipment	745 249
698	Metal manufactures n.e.s.	274 065	733	Road vehicles, non-motor	673 164
841	Clothing not of fur	247 609	841	Clothing not of fur	571 471
599	Chemicals n.e.s.	236 885	729	Electrical machinery n.e.s.	522 945
561	Fertilizers, manufactured	199 915	599	Chemicals n.e.s.	505 702
734	Aircraft	183 075	714	Office machines	471 105
719	Machines n.e.s., non-electric	158 998	897	Gold, silverware, jewellery	416 173
512	Organic chemicals	133 187	718	Machines for special industries	334 468
292	Crude vegetable materials n.e.s.	105 331	734	Aircraft	333 333
263	Cotton	101 574	512	Organic chemicals	297 492
053	Fruits, preserved, prepared	96 117	861	Instruments, apparatus	278 371
724	Telecommunications equipment	90 808	893	Articles of plastic n.e.s.	273 965
897	Gold, silverware, jewellery	79 694	512	Organic chemicals	268 219
698	Metal manufactures n.e.s.	71 360	561	Fertilizers, manufactured	238 125
514	Other inorganic chemicals	66 931	051	Fruits, fresh, nuts, dry	216 791
651	Textiles and thread	62 614	722	Elec-pwr mach, switch-gear	186 202
893	Articles of plastic n.e.s.	57 965	514	Other inorganic chemicals	182 901
			695	Tools	178 737

Source: United Nations, COMTRADE Database for the years 1980 and 1993.

Note: Three-digit SITC.

The main product groups among Israel's top global exports which overlap with Arab export profiles are clothing (SITC 841), chemicals (SITC 599) and fertilizers (SITC 561). With regard to chemicals and fertilizers, the main export markets of the ESCWA region's producers are outside the region. As for clothing, competition is likely to be with Egypt and the Syrian Arab Republic, the two major exporters in the ESCWA region. However, it is questionable whether Israel will be able to maintain such a high share of clothing in its global exports. The gradual phasing out of the Arrangement Regarding International Trade in Textiles (also known as the Multi-fibre Arrangement, or MFA) will mean that Israeli firms can expect to face fierce competition from other global exporters in their main export markets, the EU and the United States. In the light of such global changes, and given that the wage levels in the Israeli clothing sector are relatively high,¹⁵ it is expected that Israeli firms will gradually lose their shares in their main export markets to more competitive producers. The same argument holds for competition in the ESCWA region's markets.

The problem with the above argument is that it rests on the assumption that the ESCWA member countries' manufacturing sectors will fail to go through any structural changes that might influence the commodity composition of their exports. Potential dynamic changes are not accounted for. Dynamic changes will be shaped by the impact of the post-Uruguay Round tariff reductions on industrial structures and will also be contingent upon product groups that are expected to account for the growth anticipated on the export front.

A look at Israel's most dynamic global exports reveals that there is still relatively little scope for competition (see table 4).

Among Israel's most dynamic exports, three areas are of export interest to ESCWA member countries, namely medicinal products, woven textiles and woven cotton fabrics. Egypt and Jordan are the region's two largest exporters of pharmaceuticals; however, unlike Egypt or Israel, Jordan enjoys a strong comparative advantage in the production of this commodity. Neither does Israel have a strong comparative advantage in the production of woven textiles or woven cotton fabrics.¹⁶

¹⁵ Annual wages and salaries per employee in Israel's wearing apparel industry were \$9,307 (1991), compared with \$3,496 in the Syrian Arab Republic (1990) and \$1,325 in Egypt (1992).

¹⁶ As measured by the revealed comparative advantage index. For comprehensive computations of the region's revealed comparative advantage indices, see Yeats (1995).

**Table 4. Average annual growth rate for
Israel's most dynamic global exports
(Percentage)**

SITC	Item	1980-1985	SITC	Item	1985-1993
679	Iron, steel casting, unworked	57	718	Machines for special industries	79
683	Nickel	49	941	Zoo animals, pets	55
863	Developed cinema film	32	679	Iron, steel castings, unworked	51
632	Wood manufactures n.e.s.	29	693	Wire products, non-electrical	45
714	Office machines	29	691	Structures and parts n.e.s.	39
731	Railway vehicles	29	931	Special transactions	38
861	Instruments, apparatus	24	554	Soaps and cleansing preparations, etc.	36
693	Wire products non-electrical	23	671	Pig iron, etc.	32
663	Other non-metal mineral manufactures	23	685	Lead	30
726	Electro-medical, X-ray equipment	23	533	Pigments, paints, etc.	28
724	Telecommunications equipment	21	541	Medicinal and related products	28
722	Elec-pwr mach, switch-gear	18	553	Perfumes, cosmetics, etc.	27
725	Domestic electrical equipment	17	864	Watches and clocks	27
654	Lace, ribbons, tulle, etc.	15	891	Sound recorders, products	26
897	Gold, silverware, jewellery	14	661	Cement and other building products	26
581	Plastic materials, etc.	14	653	Woven textiles, non-cotton	25
512	Organic chemicals	13	729	Electrical machinery n.e.s.	24
729	Electrical machinery n.e.s.	12	652	Cotton fabrics, woven	23
621	Materials of rubber	11			
Total manufacturing		3	Total manufacturing		11

Source: United Nations, COMTRADE Database for the years 1980, 1985 and 1993.

Note: Three-digit SITC.

While conducting the analysis at the three-digit SITC level serves to illustrate that the degree of risk associated with the potential inclusion of Israel as a trading partner is at present relatively moderate, a more detailed analysis based on comparisons at SITC levels of four or more digits is needed to identify specific products that will be candidates for future competition.

2. Opportunities

Trade flows from Israel to the ESCWA member countries are expected to begin immediately after the boycott is lifted: the trade redirection potential is estimated at \$2.2 billion. Cooperation with respect to third-country trade has been identified as one area with very good prospects. It has been suggested that Jordan could be the transit country for Israeli exports to the Gulf area and Israel the transit country for Jordanian exports to Europe and North America (Halbach, 1995b). Opportunities for increased boarder trade are also promising, particularly for products that are perishable and products for which transportation costs are high.

In the industrial sphere, opportunities for cooperation are expected to include intra-industry trade¹⁷ and coordination with third parties; with respect to the latter, it has been proposed that Arab manufacturers have Israeli firms market their products outside the region. Out-sourcing is another area where cooperation between Israeli and Arab firms can be mutually beneficial. It is worth mentioning that the establishment of joint venture projects is already under way; Israeli entrepreneurs have begun moving some of their operations (particularly in the food processing and textile sectors) to Jordan, where wages are 10% of what they are in Israel, and to Egypt, where wages are even lower. Additionally, Egypt and Israel are currently working on securing financing for a \$1 billion petrochemical refinery—the first major joint project between the two countries—to be located in Alexandria.

G. CONCLUSIONS AND POLICY IMPLICATIONS

With the existing manufacturing structures dictating the commodity composition of exports, competition between Arab and Israeli manufacturers in the ESCWA region is not expected to intensify in the short run. However, Arab countries—particularly those that are Members of the World Trade Organization—should incorporate in their future strategies the potential element of competition with Israeli and other global exporters who can be expected to enjoy increased access to the region's markets. Industrial restructuring should take the long-term implications of both regional and global challenges into account.

¹⁷ An area of cooperation into which some Egyptian manufacturers have already ventured.

Opportunities for cooperation are by definition based on non-zero-sum assumptions; any sign of a zero-sum game evolving is very likely to stall the process of trade expansion and cooperation.

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Part Four

INDUSTRIAL POLICY ISSUES

IX. INTRAREGIONAL TRADE IN INDUSTRIAL PRODUCTS: PAST TRENDS AND FUTURE PROSPECTS

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Introduction

Over the past three decades, there has been considerable interest among ESCWA member countries in the role that diversification and industrialization policies can play in accelerating growth.

Two successive strategies have been followed in developing the industrial potential of Arab countries. First came the era of import substitution to protect domestic industry, which was seen as essential for development. During this period, huge investments were made in State-owned industrial enterprises and in the formation of human skills, as both were unsuited to a competitive market economy. Since the mid-1980s, however, many Arab countries have shifted from import substitution to a more market- and export-oriented policy. Consequently, the focus of discussion has switched to the contributions made by industrial exports to raising the growth rate of both domestic output and exports.

The increased interest in industry-oriented export diversification is also linked to the efforts of Arab oil-exporting countries to reduce their reliance on one commodity; most of these countries have diversified into petrochemical and energy-intensive industries whose products are being exported mainly to industrial markets.

The relative importance of the ESCWA region's trade in industrial products has grown fairly steadily since the 1970s, more or less in line with the slightly increased share of manufacturing in gross domestic product (GDP). A shift in production took place in virtually all Arab countries in the region between 1970 and 1993; notably, in the oil-exporting countries, the share of energy products in total output declined (though it remains predominant), while that of industrial products expanded. There has been a dynamic shift in the region's export structure; however, while the share of manufactured exports has steadily increased, these exports have become neither an engine of growth for Arab economies nor a basis for regional cooperation in intra-industry trade. In fact, trade among the ESCWA member countries has expanded very little during the last three decades; its share in total regional trade has never exceeded 10%. Moreover, data on the product composition of intraregional exports show that energy products are still the largest product group, accounting for more than half of all intraregional exports.

There have been major changes in the international trading environment that have important implications for both regional and intraregional trade prospects. Many countries in the region have embarked on comprehensive liberalization and reform programmes to take advantage of opportunities to attract greater foreign investment. The global liberalization of trade and services linked to the implementation of the Uruguay Round agreements is expected to result in new trading opportunities for countries that are well integrated into the world economy. The regional integration efforts in North America and Europe and the recent European Union (EU) initiative to create free-trade areas with neighbouring southern Mediterranean countries are all directed towards increasing competitiveness and facilitating the development of mutually beneficial economic relations among the member countries of the respective unions.

The present paper aims to identify the trends in the evolution of intraregional trade in industrial products and includes a discussion of how the aforementioned changes may be expected to affect the future direction and development of such trade. The first section provides some evidence related to recent trends in intraregional export diversification into industrial products. The factors that limit intraregional trade expansion are then examined, with particular attention given to the restrictive commercial practices affecting intraregional trade in industrial products. The future prospects for such trade are examined in the second section: the regional export prospects for industrial products are discussed in the light of the ESCWA member countries' existing export capacity, then an attempt is made to determine how intraregional trading prospects will be affected by both the global liberalization offered through the Uruguay Round agreements and the EU initiative to create free-trade areas with the neighbouring Mediterranean¹ countries in the ESCWA region. The paper's main conclusions are presented in the final section.

A. RECENT TRENDS IN INTRAREGIONAL TRADE IN INDUSTRIAL PRODUCTS²

This section focuses mainly on how changes in the product composition of industrial exports from ESCWA member countries to other countries in the ESCWA region compare with changes in the structure of such exports to all destinations, and on the extent to which these changes are caused by shifts in underlying comparative advantage or in trade policies.

¹ Including one or more countries (such as Jordan) which do not physically border the Mediterranean Sea.

² In the present paper, the term "industrial products" comprises chemicals (SITC section 5), manufactured goods (SITC section 6), machinery and transport equipment (SITC section 7), and miscellaneous manufactured articles (SITC section 8).

1. Characteristics of intraregional trade in industrial products

In the following analysis, trends in intraregional trade are examined from the export perspective, since by definition³ intraregional imports are equal to intraregional exports plus transport and insurance costs.

The overall trade structure of the Arab countries in the ESCWA region changed during the period 1974-1993. As can be seen from table 1 and figure I, the average share of energy exports declined, while that of industrial products expanded significantly from 3.5% in 1974 to around 19% in 1993. This shift in trade partly reflects the growing trend towards export diversification in the ESCWA region, especially in the oil-exporting countries, where the export share of downstream petrochemical products is increasing against that of traditional raw materials such as crude oil, basic chemicals and metals.

A by-product of the change in the ESCWA region's overall trade structure is the increased share of industrial products in intraregional trade. The statistics reported in table 2 indicate that while the average share of energy products in intraregional exports declined from 78% in 1974 to about 51% in 1993, the average share of industrial exports increased almost four-fold during the same period from 8% to 29%. The countries that achieved the greatest gains between 1974 and 1993 in terms of their industrial export share in total exports to the ESCWA region were Jordan, Lebanon, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. In 1993, Lebanon's manufactured export share in total intraregional exports was highest, at 79%, and Jordan's was second, at 51%—an indication that these two countries are exporting a wider range of industrial goods to their neighbours than other Arab countries in the ESCWA region.

The flow of intraregional trade in industrial products has been predominantly bilateral. Since information on the direction of intraregional exchange in industrial products is not available for many ESCWA member countries, table 3 employs a 1993 matrix of the origins and destinations of all intraregional trade. As the table shows, two ESCWA member countries, namely Saudi Arabia and the United Arab Emirates, account for over 60% of the ESCWA member countries' intraregional exports. Saudi Arabia's exports to Bahrain (mostly crude oil) constituted the single largest bilateral trade flow (about \$1.3 billion), followed by Saudi Arabia's exports to the United Arab Emirates (\$0.9 billion), and the United Arab Emirates' exports to Saudi Arabia (around \$0.6 billion). It should be noted that these figures understate the relative importance of the ESCWA region's markets to Lebanon and Jordan, whose intraregional exports accounted for 48% and 27% of their respective exports to all destinations.

³ Actually, the trade statistic reported for the ESCWA member countries show wide differences between intraregional imports and intraregional exports after the approximate cost of transport and insurance are added. It appears that many of the discrepancies are related to the different recording methods and product classifications used by the various ESCWA member countries.

Table 1. ESCWA member countries: developments in industrial product exports and manufacturing output, 1974-1993

Country	Total exports (millions of US dollars)		Share of total exports (percentage)				Total output (millions of US dollars)		Share of total output (percentage) ^a			
	1974	1993	Manufactured products		Energy products		1974	1993	Manufacturing		Energy	
			1974	1993	1974	1993			1974	1993	1974	1993
Bahrain	1 271.7	6 497.0	12.2	31.3	85.8	66.1	773.5	4 504.0	16.3	15.2	46.8	17.4
Egypt	1 516.3	4 918.0	26.1	37.4	8.5	49.8	10 732.4	44 178.0	17.8	17.7	2.6	8.0
Jordan	153.4	998.0	16.8	51.1			752.6	4 765.0	12.2	13.7	4.5	3.3
Kuwait	10 324.9	8 707.0	3.2	4.3	96.4	94.8	13 004.8	23 913.0	4.5	8.6	79.2	43.4
Lebanon ^b	1 427.3	663.0	71.9	75.0	0.5	0.8	3 495.6	6 208.0	16.6	9.1	0	0
Oman	1 137.7	7 251.0	0	15.2	99.8	78.6	1 645.9	11 480.0	0.3	4.3	68.4	43.1
Qatar	1 489.9	3 176.0	0.4	13.6	98.2	83.3	2 403.5	7 326.0	1.0	11.2	80.5	32.6
Saudi Arabia	31 242.0	42 395.0	0.1	7.4	99.8	91.1	27 842.3	116 039.0	5.1	9.2	79.4	35.7
Syrian Arab Republic	784.3	3 274.0	8.4	11.5	55.0	66.7	4 273.1	13 766.0		7.0		7.1
United Arab Emirates	5 300.7	22 118.0	0.7	38.3	98.7	56.2	7 867.9	35 677.0	1.0	8.1	80.5	36.3
Yemen		1 167.0		1.6		74.7		4 730.0		12.6		8.4
<i>Memo: All ESCWA member countries</i>												
Total Average	61 781.3	101 164.0	3.5	18.6	93.2	76.6	84 128.2	358 746.0	6.4	9.9	58.7	21.8

Source: Arab Monetary Fund, Joint Arab Economic Report Data Base (Abu Dhabi).

^a Individual country GDP at factor cost.

^b Data for 1973 were used.

Figure 1. ESCWA member countries: developments in the share of total and intraregional exports

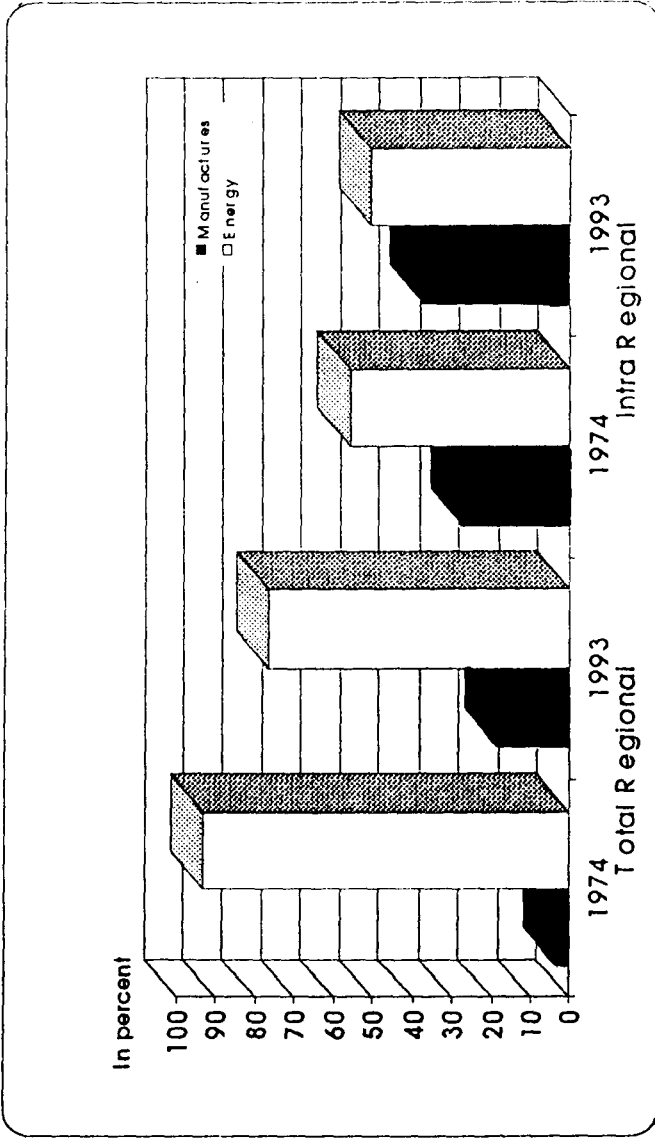


Table 2. ESCWA member countries: developments in the intra-regional exports of industrial products, 1974-1993

Exporter	Value of intraregional exports		Share of manufactured exports in all intraregional exports		Share of energy exports in all intraregional exports	
	1974	1993	1974	1993	1974	1993
	(millions of US dollars)		(percentage)		(percentage)	
Bahrain	217.0	370.0	8.1	9.0	91.0	75.0
Egypt	73.0	353.0	19.1	13.7	0	1.4
Jordan	57.0	274.0	39.0	51.0	0	0
Kuwait	267.0	292.0	30.0	35.0	29.8	35.0
Lebanon	784.0	318.0	75.0	78.7	0	0
Oman	1.0	596.8	3.8	6.8		60.3
Qatar	15.0	263.0		10.1	99.8	87.0
Saudi Arabia	1 242.0	3 058.0	0.5	29.5	99.0	61.8
Syrian Arab Republic	90.0	665.0	26.4	23.8	15.5	16.6
United Arab Emirates	96.0	1 916.0				
Yemen	1.0	69.0		1.0	10.0	10.0
<i>Memo: ESCWA member countries</i>						
Total Average	2 843.0	8 174.6	8.3	29.0	78.3	50.5

Source: Arab Monetary Fund, Joint Arab Economic Report Data Base (Abu Dhabi).

Zrk. Table 3. Escwa member countries: origins and destinations of intraregional trade, 1993

Exporter (partner country)	Importers (millions of US dollars)													Share of intraregional exports in total exports (%)
	Jordan	United Arab Emirates	Bahrain	Saudi Arabia	Syrian Arab Republic	Oman	Qatar	Kuwait	Lebanon	Egypt	Yemen	Total (intraregional)	Total (world)	
Bahrain	13.9	69.9		200.4	0.5	12.0	24.0	45.4	1.3	2.5	0.2	370.1	6 497	5.7
Egypt	38.9	20.9	3.9	216.6	35.3	2.6	9.8		24.8			352.8	4 918	7.2
Jordan		44.0	20.5	115.7	27.6	3.3	14.4		25.3	6.6	16.2	273.6	998	27.4
Kuwait		96.7	18.8	111.6	14.3	12.7	11.3		11.0	15.2		291.6	8 707	3.3
Lebanon	47.0	63.6	10.6	106.8	58.5	1.8	11.7			17.8		317.8	663	47.9
Oman	1.5	505.3	45.9	32.5			5.4		5.8	0.1		596.5	4 813	12.4
Qatar	7.5	132.9	8.4	92.8	1.8	8.8				10.5		262.7	3 176	8.3
Saudi Arabia	58.0	868.6	1 332.7		48.1	66.8	83.3	416.8	43.0	74.5	66.0	3 057.8	42 395	7.2
Syrian Arab Republic	62.1	20.2	6.7	151.4			7.6	42.8	356.1	18.0		664.9	3 274	20.3
United Arab Emirates*	55.5		190.3	565.5	43.3	104.2	350.8	380.9	49.5	32.9	142.7	1 915.6	22 118	8.7
Yemen		13.6		55.0								68.6	1 167	5.9

Source: Arab Monetary Fund, Joint Arab Economic Report Data Base (Abu Dhabi).

* Exports and re-exports.

Table 4 shows that intraregional industrial exports accounted for only 9% of all industrial exports from the region in 1993. The Organization for Economic Cooperation and Development (OECD) countries in Europe and North America have constituted the largest outside market for the region's industrial exports.

Even more striking is the fact that the ESCWA member countries as a group absorb less than 1% of the world's industrial exports. The ESCWA member countries therefore appear to be more inclined to trade with each other in industrial products. The share of industrial products in intraregional exports was considerably higher for several ESCWA member countries than for the group as a whole; some 50% of Lebanese and 42% of Syrian industrial exports stay within the region, as do between 27% and 29% of Jordan's, Kuwait's and Saudi Arabia's industrial exports.

2. The product composition of intraregional industrial exports

There are a number of industrial products which are of primary importance in intraregional trade; these are grouped into the seven main categories shown in table 4 and figure II. The basic commodity trade data in the table are classified under various headings arranged according to factor intensity; one broad group includes capital- and skill-intensive products such as chemicals, machinery and transport equipment, and electrical goods, while the other contains the generally more labour-intensive consumer goods such as textiles and clothing, leather, footwear and travel goods.

Table 4 indicates that the capital-intensive product group ranked highest for the region as a whole in 1993, accounting for 67% of intraregional manufactured exports. Within this product group, the share of chemical exports (including organic petrochemicals and inorganic chemicals, both used as fertilizers) had grown rapidly and ranked highest by 1993, accounting for more than 38% of intraregional manufactured exports. It should be noted, however, that the relative importance of chemicals has varied in the intraregional export baskets of individual ESCWA member countries; for instance, chemicals accounted for 40% of Saudi Arabia's and 63% of Jordan's manufactured exports to the region in 1993, making them the largest intraregional exporters of chemicals.

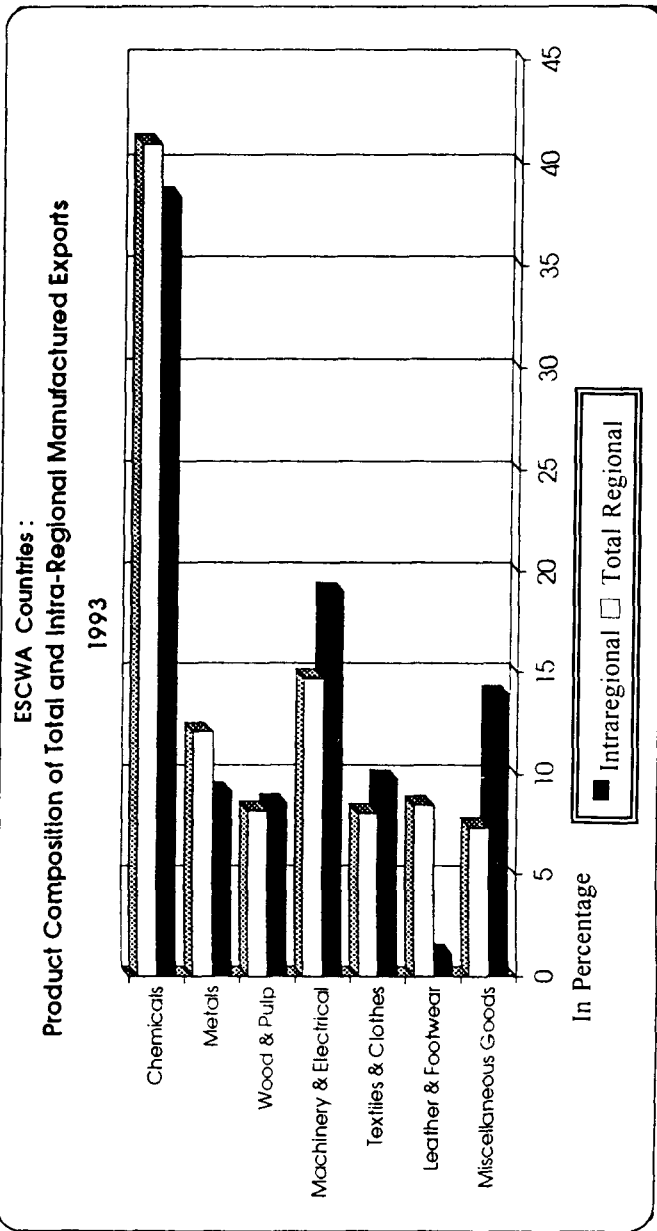
The share of machinery and transport equipment (also in the capital-intensive category) ranked second in intraregional industrial exports, accounting for 19% in 1993. Products of particular importance in this category include electrical equipment and machinery as well as transport equipment; in 1993, Saudi Arabia, Lebanon and Jordan were the largest exporters of these commodities to the region. Metal manufactures (iron and steel) ranked third in intraregional exports of capital-intensive products, with a share of 9%; major exporters to the region in 1993 were Egypt, Qatar, Lebanon and Yemen.

Table 4. ESCWA member countries: the product composition of intraregional manufactured exports, 1993
(Value in millions of US dollars; share expressed by percentage)

Country	Value of intra-regional manufactured exports	Share of intra-regional manufactured exports in total manufactured exports	Share of products in manufactured exports									
			Chemicals	Machinery and transport equipment	Metal manufactures	Wood and furniture, pulp and paper	Textiles and clothing	Leather, footwear, travel goods	Other manufactured articles			
Bahrain	33.3	1.6										
Egypt	48.4	2.6	14.5	4.0	40.8	6.0	18.4	2.6	13.6			
Jordan	139.7	27.4	63.0	4.8	4.4	3.1	4.9	1.1	18.7			
Kuwait	102.2	27.3										
Lebanon	250.3	50.3	16.8	9.7	12.4	8.2	20.8	8.1	24.0			
Oman	40.6	3.7										
Qatar	26.6	6.2	28.8	0.2	69.0	0.1	0.2	0	1.7			
Saudi Arabia	902.0	28.7	40.0	21.6	7.7	9.2	8.8	0.2	12.5			
Syrian Arab Republic	158.3	42.0	2.1	1.3			14.6		82.0			
United Arab Emirates												
Yemen	0.7	3.7	0	0	0	0	0	0	40.0			
<i>Memo: ESCWA member countries</i>												
Intraregional exports:												
Value of manufactured exports	1 702.2											
Share of total manufactured exports		9.1	38.4	19.0	9.2	8.6	9.8	1.1	13.9			
Exports to the world:												
Value of manufactured exports	18 792.0											
Share of total manufactured exports	18.6		41.0	14.7	12.1	8.2	8.1	8.5	7.4			

Source: Arab Monetary Fund, Joint Arab Economic Report Data Base (Abu Dhabi).

Figure 11. ESCWA member countries
 Product Composition of Total and Intra-Regional Manufactured Exports, 1993



Source: see Table (4).

Within the labour-intensive industrial products group, the share of textiles and clothing ranked highest in 1993, accounting for 9.8% of intraregional exports of manufactured goods; the highest individual country shares in this regard were Lebanon (21%), Egypt (18%), and the Syrian Arab Republic (15%).

The remaining industrial product categories encompass (generally) labour-intensive industrial goods produced by import-competing and infant industries in the ESCWA member countries. The wood-and-furniture/pulp-and-paper category accounted for an 8.6% share in intraregional industrial exports in 1993, while the leather/footwear/travel-goods group totalled only 1%. The share of other manufactures was 14% (comprising a multitude of unrelated products, each representing a small share of the total for this category).

With regard to the comparative evolution of the intraregional and total regional export baskets of industrial products over the period 1974-1993, the data show that a similar pattern underlies both. Such a result is consistent with comparative advantage expectations, i.e., that countries will export a particular range of goods based on their factor endowments. Nevertheless, it should be mentioned here that the rapid gains in comparative advantage in petrochemicals and other downstream energy-intensive products by oil-exporting countries occurred not in the regional markets but in the larger and relatively more open markets of the industrialized countries. Jordan's share of chemicals in its basket of industrial products exported to the region was higher than that of any other ESCWA member country in 1993; an explanation might be that Jordan has used regional markets as a "launching platform" for chemical exports (mostly pharmaceuticals and phosphatic fertilizers) in order to acquire a new comparative advantage in such goods.

To conclude, although there has been increased regional trading in industrial goods (chiefly chemicals, electrical articles, machinery, and clothing and textiles), the non-competitiveness and the lack of sophistication and diversity of industrial products in the ESCWA region have been important factors inhibiting intraregional expansion.

3. The effect of trade policies on intraregional trade in the ESCWA member countries

It is generally acknowledged that the level and pattern of intraregional trade in industrial products has been influenced by the trade policies of the various Arab countries in the ESCWA region. Import substitution pursued with the help of tariffs and non-tariff barriers (NTBs) has been widely employed. Tables 5 and 6 show the extent of tariffs in the ESCWA member countries. Table 5 reveals that the high unweighted tariffs in Egypt, Kuwait, Lebanon, and the Syrian Arab Republic range between 90% and 150%, and that Yemen's is actually as high as 200%. The average import-weighted tariffs shown in the table are generally lower; some were even reduced during the period 1981-1990. In such

cases, particularly in Egypt and Jordan, tariffs which were predominantly used as an instrument for maximizing government revenues have been substituted with other internal taxes as a result of trade policy reforms. High import-weighted tariffs in the other ESCWA member countries might largely be viewed as a form of protection for domestic industries.

Table 5. ESCWA member countries: average tariffs on imports of industrial products

Country	Unweighted tariff average			Weighted tariff average ^a		
	Low	High	Tariff year	1981	1988	1990
Bahrain	5.0	35.0	1993	1.7	3.4	3.0
Egypt	2.5	120.0	1990	35.3	29.0	14.9
Jordan	0	50.0	1994	24.6	21.3	17.8
Kuwait	4.0	100.0	1993	3.5	7.0	
Lebanon	0	90.0				17.5
Oman	4.0	20.0		1.5	3.5	2.5
Qatar	4.0	20.0		1.8	2.6	5.0
Saudi Arabia	0	30.0	1991	2.5	8.0	11.0
Syrian Arab Republic	10.0	150.0		12.4	15.1	16.4
United Arab Emirates	0	4.0		1.2	0.6	0.4
Yemen	5.0	200.0	1994			19.1
Average for developing countries	22.0^b	81.0^c	1987			

Source: Components of the weighted tariff averages are taken from the Arab Monetary Fund, Joint Arab Economic Report Data Base (Abu Dhabi); unweighted averages are from national sources.

^a The weighted tariff averages for each ESCWA member country are obtained by dividing the values of imports duties by the total import values.

^b The lowest tariff average is found in East Asia (see World Bank, *World Development Report, 1991: the Challenge of Development* (New York, Oxford University Press, 1991)).

^c The highest tariff average is found in the southern Asia region (see *World Development Report, 1991*).

Table 6. ESCWA member countries: tariff escalation on imports of industrial products

Country	Chemicals		Processed foods		Textiles and clothing		Machinery and transport equipment	
	Low	High	Low	High	Low	High	Low	High
Bahrain	0	5.0	5.0	10.0	5.0	10.0	5.0	10.0
Egypt	0	30.0	10.0	100.0	7.0	80.0	7.0	30.0
Jordan	0	28.0	20.0	85.0	20.0	85.0	0	25.0
Kuwait	4.0	20.0	15.0	25.0	0	15.0	0	20.0
Lebanon	0	28.0	18.0	90.0	18.0	90.0	7.0	90.0
Oman		5.0		5.0		5.0		5.0
Qatar	4.0	20.0		4.0		4.0		4.0
Saudi Arabia	12.0	20.0	12.0	20.0	12.0	12.0	12.0	20.0
Syrian Arab Republic	1.0	40.0	50.0	100.0	50.0	100.0	1.0	40.0
United Arab Emirates		4.0		4.0		4.0		4.0
Yemen	0	25.0	50.0	100.0	50.0	25.0		50.0
Average for developing countries*	0	100.0	5.0	150.0	8.7	150.0	0	34.0
Average for developed countries*	0.1	7.2	4.4	10.5	1.7	14.6	0.4	6.3
Average (European Union)	0	17.5		24.0		17.0	0.4	15.0

Sources: UNCTAD, *Trade Control Measures in Developing Countries* (Geneva, 1987); IMF, *Exchange Arrangements and Exchange Restrictions, Annual Report*, several issues; and GATT, *International Trade: Trends and Statistics*, (Geneva, GATT secretariat, 1994).

* Pre-Uruguay Round average tariff levels.

ESCWA member countries also practice tariff escalation, where the tariffs imposed on industrial imports increase with the stages of processing. This tariff escalation is illustrated in table 6, which reports high and low tariff levels for four industrial product categories. The ranges are generally widest and the actual tariffs highest for consumer

goods, including textiles and clothing and processed food products. In addition, there are wide variations in the levels of tariffs on consumer goods across ESCWA member countries. For instance, tariff rates on processed food products range between 5% in Bahrain and 100% in the Syrian Arab Republic, Egypt and Yemen. High tariff rates on textiles and clothing range from 4% in Qatar to between 80% and 100% in Egypt, Jordan, Lebanon and the Syrian Arab Republic, indicating that the ESCWA member countries have continued to provide high levels of protection for import-competing industries.

ESCWA member countries have also resorted to para-tariffs (non-tariff barriers) to restrict imports of industrial products from other countries in the region. The NTBs frequently imposed by these countries include high special charges and import fees, import prohibitions, import licensing, and government monopolies on imports of intermediate products.

4. Policy intervention and intraregional trade in industrial products

In an effort to lower the level of protection in many ESCWA member countries and stimulate intraregional trade, a number of Arab countries have signed bilateral and multilateral agreements involving the exchange of tariff exemptions on a product-by-product basis. However, many Arab countries trade in similar industrial products, and such a product-by-product negotiating process allows them to pick and choose, with the result that very few Arab manufactured products remain candidates for tariff exemptions. Moreover, the disparities in tariff levels among the ESCWA member countries can cause difficulties in motivating relatively low-tariff and non-tariff countries (such as the Gulf Cooperation Council, or GCC, countries) to exchange concessions with high-tariff and non-tariff countries that are commensurate with the likely gains.

The apparent reluctance of Arab countries to come up with a complete preferential scheme covering all industrial products of Arab origin has limited the scope of intraregional trade expansion; however, intraregional coordination could still be achieved by means of bilateral and multilateral trade arrangements developed through the League of Arab States.

B. FUTURE PROSPECTS FOR INTRAREGIONAL TRADE IN INDUSTRIAL PRODUCTS

This section contains a brief discussion and assessment of intraregional trade prospects in the light of some major new developments in internal and external markets, including the move towards greater openness as a development strategy in ESCWA member countries, the new trading opportunities created through the global liberalization of industrial trade as a result of the Uruguay Round negotiations and agreements, and the formulation of the European Union's Mediterranean initiative.

1. Unilateral trade liberalization in the ESCWA region

As shown previously, the restrictive trade policy regimes that have prevailed in many of the ESCWA member countries over the past two decades have discouraged domestic producers from exploiting economies of scale in the larger regional markets. More recently, there have been shifts towards liberalizing international trade. Lebanon and the GCC countries (Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and the United Arab Emirates) have all enjoyed relatively open trading regimes, and now countries such as Egypt, Jordan and Yemen are taking serious steps to liberalize their economies and make them more “outward-oriented”. Such openness constitutes the channel through which the ESCWA member countries can achieve greater integration with the world economy and with one another.

Internal liberalization allows for greater competition in products and factor markets. Competition is also fostered when an area opens up to foreign producers, and when the administrative mechanism of its trade regime is simplified and made more transparent. All of these are prerequisites for successful investment and trading activity; there must be as little uncertainty as possible with regard to quality control regulations, customs valuation, service provision in ports, taxes due, the time spent for customs clearance, and other such factors.

Most ESCWA member countries have taken steps to stabilize their economies and are at various stages of implementing trade policies to improve competitiveness. Moreover, many countries have dynamic entrepreneurial traditions, and the reform incentives may provide the impetus for investment in export-oriented activities, particularly those directed towards neighbouring markets in the ESCWA region.

The recent changes in many ESCWA member countries—specifically, the reductions in and increased transparency of tariffs and non-tariff measures and the simplification of administrative mechanisms governing trade regimes—constitute an incentive for the region’s exporters to exploit trading opportunities in other ESCWA member countries’ markets. Reciprocal market liberalization among these countries should improve the transparency and predictability of their trade regimes *vis-à-vis* each other—a prerequisite for substantial growth in intraregional trade in industrial products.

Most of the ESCWA member countries have similar factor endowments and have thus acquired comparative advantages in similar products. In order to expand intra-regional trade in the future, these countries should pursue what is commonly called intra-industry trade, which involves the exchange of similar but slightly differentiated products.

There is reason to believe that intra-industry trade will become increasingly important to the ESCWA region. The importance of such trade tends to grow with rising

per capita income and the diversification of industrial capacity. As more countries in the region diversify their industries and integrate them into the world markets, growing intra-industry specialization will provide the impetus for the expansion of intra-industry trade within the region. Finally, intra-industry trade will increase to the extent that the ESCWA member countries are able to lower tariffs on imports from one another to levels comparable to those applied by industrialized countries.

2. Global liberalization

As a result of the Uruguay Round negotiations, commitments were secured for the substantial liberalization of manufactured goods. Developed country tariffs on industrial products will be reduced from an average of 6.3% to 3.8% (an overall reduction of 40%), though tariff reductions will be lower than average for products of importance to ESCWA member countries, such as textiles, clothing, footwear and some machinery.

A number of the preferential arrangements that have benefited most countries in the ESCWA region (such as the Arrangement Regarding International Trade in Textiles, also known as the Multi-fibre Arrangement, or MFA) are being phased out under various Uruguay Round agreements. Global liberalization is also eroding the preference margins which have benefited some of the industrial exports of ESCWA member countries under the Generalized System of Preferences (GSP). The region's exports will therefore face increasing competition in their traditional developed markets. If they wish to become more competitive in world markets and take advantage of the enhanced market-access opportunities now offered, ESCWA member countries have to restructure their industries, reduce their costs, and improve the quality of their products.

In the meantime, the likely displacement of ESCWA member countries' industrial exports to industrialized country markets raises some questions about compensation through other access opportunities. Arguably, the answer might lie in the ESCWA member country markets themselves. As shown previously, the ESCWA member countries as a group are more inclined to trade in industrial products with each other than with the world as a whole. This suggests that there are regional trading opportunities involving industrial products which some ESCWA member countries should take advantage of. As part of the effort to achieve potential gains in intraregional trade, ESCWA member countries should accelerate their unilateral liberalization programmes and open up to each other so that domestic firms can take advantage of the enhanced regional market-access opportunities and expand intra-industry trade within the region.

3. The European Union's Mediterranean initiative

Another major change with important implications for the trading prospects of the ESCWA member countries involves the European Union's initiative to conclude free-trade agreements with the Mediterranean countries in the region (see table 7).

Table 7. Proposed Euro-Mediterranean free-trade agreements

<p>A. Objectives</p> <ol style="list-style-type: none"> 1. Reciprocal free trade in all industrial products 2. Preferential and reciprocal access for agricultural products 3. Gradual liberalization of trade in services and capital 4. EU support for the integration of Mediterranean countries 	<p>Candidates</p> <p>ESCWA member countries: Egypt, Jordan, Lebanon and the Syrian Arab Republic</p> <p>Other Arab Mediterranean countries: Algeria, Morocco and Tunisia (Tunisia concluded a free-trade agreement with the EU in 1995.)</p>
<p>B. Trade liberalization for industrial products</p> <p><i>The phasing out of tariffs and non-tariff barriers on all imports:</i> <i>Duration:</i></p> <ol style="list-style-type: none"> 1. Intermediate inputs and capital goods (front-loaded) Five-year transition period 2. Consumer goods (textiles, clothing/apparel, leather, footwear, furniture, and other items) Twelve-year transition period (back-loaded) 3. Industrial products not mentioned in one of the categories above Immediate liberalization (upon the entry into force of the Euro-Mediterranean agreement) 	

The initiative is expected to bring about improved market access for the industrial exports of some ESCWA member countries. Moreover, a key implication of the agreements is that the ESCWA region's signatory countries should commit themselves to harmonizing their domestic laws and standards with international norms—thereby making it easier for the region's domestic producers to penetrate foreign markets. The European Union has committed itself to providing financial assistance for the adjustment costs incurred in connection with the implementation of the free-trade agreements.

The expected pay-offs of these free-trade arrangements are improvements in productivity, greater specialization in production, and the export of higher value added industrial products to the European market. The initiative also provides a way to ensure that the Mediterranean countries in the ESCWA region benefit from the growth- and income-generating effects of global liberalization. Counterarguments against the European initiative stress that “locking in” policy commitments for domestic market access with the World Trade Organization (WTO) and adopting international (rather than European) standards and norms constitutes a superior option which would allow the countries of the ESCWA region to take advantage of world market openings. However, it should be noted in this regard that most learning-by-doing in export-oriented industries starts with a country aligning its production standards with those of one major foreign market for access before learning to adapt production to international norms.

As far as intraregional trade prospects are concerned, it is expected that the free-trade agreements with the EU will create strong incentives for ESCWA member countries to open up to each other, with intraregional trade expansion the likely result of such a process; without intraregional coordination, the individual ESCWA member country signatories to these agreements could offer market access to EU investors to discourage them from diverting their trade to other, more attractive countries in the region. Intra-industry integration among the ESCWA member countries, supported by the rules of origin provisions in the agreements, could also serve as a deterrent against this type of intraregional trade diversion. Such integration could enhance backward and forward linkages among ESCWA member countries and usher in intra-industry trade increases.

C. SUMMARY AND CONCLUSIONS

Intraregional trade in industrial goods as a proportion of total regional trade has grown slowly over the past two decades, but has none the less stayed relatively small, amounting to only 9% of the region’s total exports of industrial products. At the same time, the ESCWA region absorbs less than 1% of world exports of industrial products. The ESCWA member countries therefore have a greater tendency to trade in industrial products with each other than with the world at large.

In the paper’s review of intraregional trade in industrial products, several options are identified that seem likely to stimulate further increases over the medium to long term:

- Liberalizing trade and eliminating domestic distortions would enhance the competitiveness of industrial products produced in the ESCWA member countries.
- In many ESCWA member countries, similar factor endowments (such as oil and oil products) have led to similar processes of product diversification; the development of manufacturing and increased intra-

industry specialization would provide the stimulus for regional intra-industry trade expansion.

- The ESCWA member countries should make every effort to take advantage of the new trading opportunities created through the global liberalization of trade in manufactured products during this post-Uruguay Round period, and those that are eligible to do so should seek increased market access in the European Union through free-trade agreements under the EU Mediterranean initiative; the gains achieved in these areas will create new incentives for ESCWA member countries to open up to each other, and greater intraregional trade in manufactured products is likely to be achieved.

The trading environment is becoming more and more favourable, and the time is right to promote further regional cooperation in intraregional trade; one promising prospect is an Arab free-trade area, through which a solid basis could be established for the regional integration of markets for industrial and agricultural production. The formation of such a regional grouping would stimulate domestic as well as foreign investment and would also strengthen the negotiating positions of individual ESCWA member countries seeking integration with the outside world based on reciprocal trade liberalization.

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X. A NEW MANUFACTURING STRATEGY FOR ARAB COUNTRIES: COMPETING IN THE GLOBAL MARKET

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A. THE CHALLENGE

“For the Arab region, the challenge is to redeploy its significant industrial base so that it takes advantage of its installed capacity, restructures its weaker segments and turns from its inward orientation to become a dynamic competitor on the world market. Actions are needed on the macro and micro policy front, at the institutional and incentives levels, both domestically and regionally” (Handoussa, 1995a).

Arab countries vary widely in terms of size, structure, resource base and per capita income, yet they all share a common feature: the wide gap between the actual and potential performance of their manufacturing sectors. Aggregate figures for the contribution of the manufacturing industry to the economy in the Arab region compare very poorly with those of all other developing regions except sub-Saharan Africa. In spite of the significant investments made in industry by most Arab countries during the years of their economic boom, amounting to as much as 20% of their aggregate investment expenditure, and in spite of the fact that the share of the region’s manufacturing value added (MVA) in world MVA has doubled over the past two decades, reaching 3.4% in 1994 (UNIDO, 1995), the manufacturing sector has yet to become the engine of growth for any of the Arab economies.

Evidence shows that it is only an outward-oriented manufacturing sector that will allow the economy to “take off” in the Arab region. Future prospects for the oil sector are poor, and the same is true of oil-related revenues that have so far sustained both the oil-rich and oil-poor economies of the region. There is a growing awareness that the region must turn away from its dependence on rents (oil revenues, aid transfers and worker remittances) and move towards dependence on the more reliable activities of production, employment and trade in manufactured products.

Growth trends for the population and labour force point to the need for industry to create most of the 47 million new jobs that will be required over the next 15 years (World Bank, 1995b). Agricultural indicators also point to the region’s growing dependence on net food imports, which will have to be paid for through the increased contribution of manufactures to export income. Moreover, the manufacturing sector has the potential to attract foreign direct investment (FDI) and increase the region’s share of

global FDI from its present 2% in order to secure much-needed capital flows, technology transfer and the opening of export markets.

At the international level, the challenges facing Arab countries relate to the impact of the Uruguay Round and the regional blocs on international trade liberalization, and to the implications of the revolution in information and communications technologies. Passive support of the older, public-sector-dominated development models and insulation from the world economy can only bring about the further loss of opportunities and the threat of total marginalization for the Arab countries. What is needed is an aggressive strategy that aims at maximizing the potential growth of the private-sector and export-led industry—one which modifies both the policy framework and institutional support measures to accelerate the absorption of new technology and the transition to industrial maturity.

With the growing importance of regionalism, the projected impact of the World Trade Organization (WTO), and the continued ascendancy of the Association of South-East Asian Nations (ASEAN) countries, trade is likely to be diverted away from Arab countries to members of the new and established trading blocs (the European Union [EU], the North American Free Trade Agreement [NAFTA] countries, and the ASEAN countries) and to selected developing countries that are able to respond to the global challenges. Arab countries are thus faced with a world market situation in which their prospects for growth are not at all promising; these countries must make a concerted effort to change the structure of their economies, or more specifically, to shift away from dependence on the export of raw materials and low-value-added intermediates towards the export of high-value-added manufactures.

The first section of the present paper provides an overview of the relative performance of the Arab countries' manufacturing sectors relative to that of other developing regions and outlines the key weaknesses that have hampered the achievement of sustainable growth in the manufacturing industry. The second section analyses the changing role of the State in promoting industrial development in the Arab region. The third section presents what might be considered the region's window of opportunity and attempts to sketch some essential features for a new manufacturing strategy for the Arab countries, focusing on the potential for cooperation and economic integration within the region. The fourth and last section provides some concluding remarks.

B. OVERVIEW OF THE ARAB MANUFACTURING SECTOR'S PERFORMANCE

Arab countries have given special priority to the growth and diversification of their manufacturing sectors over the past three decades, with a large proportion of public investment budgets allocated to heavy industry and its infrastructure needs. Arab MVA has grown at a much faster pace than international MVA, with its share in world MVA

more than doubling from 1.5% in 1970 to 3.4% in 1994 (UNIDO, 1995). However, the growth path achieved is far from optimal in the sense that it has not incorporated those elements necessary to make it self-sustaining, generating its own steam for continued growth and diversification.

In spite of the rapid growth of manufacturing for the Arab region as a whole, indicators show that the contribution of Arab MVA to gross domestic product (GDP) is still very modest, at 11%, especially when compared with the corresponding (1994) rate of 21.3% for the developing world as a whole (UNIDO, 1995). MVA figures range from 2.4% for Oman to 18.4 % for Morocco, with relatively low rates prevailing for many countries in relation to the extensive period during which industrialization has been at the forefront of their development plans. The structure of the Arab manufacturing sector is also relatively underdeveloped, with 48% of MVA concentrated in the food and textile sectors of the non-oil-exporting Arab countries and more than 50% in the petroleum refining sector of the oil-based Arab economies (Handoussa, 1995a).

A second characteristic of Arab countries is that they still rely heavily on the extraction and primary processing of their raw materials (petroleum, basic chemicals and metals in the oil-based economies; and cotton, other agricultural products, phosphates and other ores in the non-oil-based economies). The further processing of these intermediates (e.g., the production of downstream petrochemicals, synthetic fibres, rubber, plastics, metal products, specialized chemicals and clothing) would contribute significantly towards raising value added (wages and profits). The Arabs would also benefit considerably from a more open intraregional trading system, which would allow for the more efficient dispersal and allocation of investments and the creation of new opportunities based on location-related advantages and economies of scale.

A third characteristic of Arab manufacturing activity is its inward orientation (with the exception of oil refining and petroleum products). The share of Arab manufactured exports (including refined petroleum) in world exports of manufactures is only 1%, compared with the region's MVA share of 3.4% in global MVA (UNIDO, 1995). This reflects the import-substitution strategy adopted by most Arab countries, a strategy which has slowly been discarded since the late 1980s.

A look at the commodity composition of Arab exports reveals that despite the dynamic shifts occurring between the three major export sectors (agriculture, mining and manufactures) and the increase in the share of manufactured exports in total exports from 4% between 1970 and 1974 to 20% during the period 1990 to 1992, the share of petroleum in total exports has remained excessively high, accounting for 63% of total exports between 1990 and 1992. Excluding petroleum refining (whose exports totalled \$14.5 billion in 1992), manufactured exports more than doubled between 1982 and 1992 to reach \$17.5 billion, but they still covered only 20% of manufactured imports, which amounted to \$82 billion in 1992 (UNIDO, 1994).

The poor performance of Arab industry in relation to the vast resources allocated to that sector can be explained by four sets of policy-related factors: technology acquisition, market orientation, industrial policy and regional coordination.

1. Technology acquisition

The Arab countries are characterized by a weak technological base and full dependence on imported technology and turnkey projects from advanced countries. Research and development (R&D) expenditure has been low, fragmented and disassociated from industrial sector needs. Educational and vocational training systems have not been modernized and suffer from a lack of coordination with the needs of the labour market and the development of industry. The mismatching of labour supply and labour demand has seriously affected employment and labour productivity in the region, and has contributed heavily to the Arab brain-drain. Many countries in the region have not instituted the mechanisms necessary to absorb technical progress and maintain their competitive edge: the engineering sector was developed early on by some medium-sized Arab countries but has failed to keep up with technical developments (the automotive industry is one example); additionally, a number of pharmaceutical industries were established more than 20 years ago in certain Arab countries, including Egypt, Tunisia and the Syrian Arab Republic, but have failed to become exported-oriented or to undertake sufficient investment in R&D to increase their domestic market share. In neglecting technological development, a large number of industrial subsectors in the Arab world are losing their capacity to compete in the international market and to grow along a sustainable path that generates employment, savings, and foreign currency.

2. Market orientation

As a result of the Arab countries' import-substitution industrialization (ISI) strategy, manufactured imports now exceed manufactured exports by a factor of five, and industrial expansion is having a negative effect on the balance of payments. The ISI policies pursued by almost all non-petroleum-exporting Arab countries over the last few decades have resulted in diminishing returns, the reasons for which relate to the following:

- Domestic markets cannot grow as fast as the production capacity of new and existing enterprises. In contrast, outward-oriented industry is not constrained by domestic market limitations.
- Industrial expansion along an ISI path means diversifying into fields that require increasing capital, skill and technology intensities which are not easily attained.
- Once ISI continues beyond the stage where the rewards of economies of scale and natural advantage (transportation costs) can be reaped, a

country foregoes the opportunity to specialize in areas in which it has acquired knowledge and skills with which it can enter foreign markets and instead diversifies into areas where it has less scope for becoming competitive.

- A country which persists in following an ISI strategy actually increases its dependence on imports, since it must gradually enter fields in which it has fewer and fewer domestic resources that are suited to the production of further import substitutes. The experiences of several Arab countries give evidence of their having prolonged the ISI phase beyond the period dictated by economic viability.
- Insulation from global competition constrains total factor productivity (TFP) growth, a situation for which a country pays dearly in the long run, as evidenced by the former socialist economies. Most Arab countries pursued ISI with great vigour until recently; in many cases ISI strategies were also combined with a heavy dose of socialist-type central planning, State-ownership and bureaucratic control.
- The oil boom is over. Many of the inward-oriented sectors that expanded rapidly during those years, especially non-tradeables such as building materials, have no further scope for rapid growth; the only alternative is reorientation and restructuring.
- Excessive protection leads to serious price distortions, and the greater the departure from a unified level of protection, the greater the degree of relative price distortion. Price distortions, in turn, lead to unintended biases against particular activities, namely those that are oriented towards exports and those related to the production of capital goods and intermediates.

3. Industrial policy

The Arab countries lack a forward-looking industrial policy that focuses on dynamic comparative advantage. As a result, they have continued to concentrate on upstream activities which have limited value added and contribute very little to employment or revenue generation. The practice of transforming natural resources (energy, phosphates, cotton) into intermediates gives clear evidence of their failure to move consistently and rapidly into downstream activities. Another side effect is the vulnerable position of these sectors in international markets, which are far more volatile than downstream industries that cater to final consumption. There is strong evidence that State intervention has played a significant role in the transformation of those developing countries which have “graduated” to become newly industrialized countries (NICs). With

respect to the nature of intervention that has characterized successful growth models, mounting evidence points to the existence of special features which fit neither the strictly neoclassical nor the socialist prescription for growth and development.

Research is making it clear that dynamic comparative advantage—the key to successful industrialization—can only be achieved if enterprises involved in the production, trading and services sectors are able to acquire knowledge with sufficient speed and adapt to the rapid changes now characterizing the global economy. Several elements of the structural adjustment and economic reform programmes currently under way in Arab countries will have a positive impact on redirecting industry towards self-sustaining growth. Other elements are needed to enhance technical progress and ensure adequate support to industry during its transition. These can only be provided by a well-designed industrial policy formulated by the Government in consultation with the private sector.

Until recently, the Governments of the advanced market economies believed that State intervention in the industrial sector should be minimal and were therefore opposed to the concept of an "industrial policy". However, after witnessing Japan's and the ASEAN countries' penetration of the global market, even the United States has begun instituting new forms of government promotion for technology acquisition, skill formation, better organization and management, and export growth in the manufacturing sector.

4. Regional coordination

The Arab countries have had no success in integrating their regional industry-related markets. In spite of numerous regional efforts to stimulate Arab economic integration, neither specialization and trade nor intrasectoral cooperation (in car assembly or computers, for example) has taken place. Attempts to cooperate through the creation of joint ventures have not been successful either (as measured by growth rates and market share). Intra-regional trade among Arab countries still accounts for only 10% of their total trade (excluding petroleum), up from 7% in 1980. In contrast, the share of intra-regional trade in total trade for the three new regional blocs has increased rapidly, accounting for 58.9% in the EU, 37.4% in East Asia and 36.3% in North America in 1989.

Another feature of the Arab countries' industry structure is the similarity in the choices that have been made to expand certain subsectors (steel, aluminium, petrochemicals, fertilizers and other basic chemicals) and neglect others (capital goods, downstream petrochemicals, processed metals and various engineering products).

Closely linked to the Arab economies' ISI strategies of the past few decades has been their narrow investment focus; each country has concentrated on its own domestic market rather than on the larger regional or global market. This approach has resulted in the replication of many capital-intensive projects across Arab countries and to the

increased dependence of each project on the rest of the world. The same resources would have been better directed towards the development of regional economies, regional interdependence and regional integration. This inward-looking strategy is unsustainable for a number of reasons:

- The rapid pace of regionalization in the rest of the world means that Arab countries are facing an increasingly aggressive international market characterized by higher real barriers to entry for non-members of regional blocs.
- Net financial flows to Arab countries from the West (especially Europe and the United States) are declining as a result of the priority that has been placed on responding to the unusually high demands for capital in Eastern Europe.
- Arab countries face the threat of further marginalization in the global market if they do not act cooperatively in response to the ascendancy of Far Eastern exports (including those of the ASEAN countries and China). The share of the seven tigers alone (the Republic of Korea, Hong Kong, Singapore, Taiwan Province of China, Indonesia, Malaysia and Thailand) in total developing country exports rose from 21% in 1980 to 46% in 1990.
- The peace settlement with Israel has serious implications for the competitive positions of domestic producers—even within their own territories. First, with the lifting of the embargo on foreign firms doing business with Israel, a large number of multinationals will seriously consider shifting their regional bases from Arab countries to Israel, diverting significant foreign direct investment away from Arab countries. Second, lifting the embargo on Israeli products can be expected to result in Israel's exports to the Arab countries exceeding its imports from them. Although much of this trade diversion may be at the expense of other world exporters to the region, some Arab exporters should expect to lose a certain portion of their markets. Third, Israel has expressed an interest in forming a regional bloc with its immediate neighbours (at least Palestine and Jordan); if such a bloc were established, whatever mode of economic integration was chosen would place this group in a much stronger position than the rest of the Middle East region if the latter were to remain fragmented.

All of the above factors point to the need for Arab countries to pool their resources and take a common stand on a number of issues that concern their industrial development. One

area worthy of policy revision concerns the functions of the State in the realm of industrial development.

C. THE CHANGING ROLE OF THE STATE IN INDUSTRIAL DEVELOPMENT

From the 1960s onward, the State played a major role in the industrial development of most countries in the Arab region. The initiation of large investment projects operated by State-owned enterprises (SOEs) in critical industries was combined with the adoption of ISI policies including extensive protection and a negative stance towards the operation of transnational corporations (TNCs).

This approach persisted until recently; in the last few years, one country after another has been reconsidering the size and role of SOEs, and an increasing number have begun to recognize the urgent need to reorient industrial policies towards export marketing, towards making better use of private domestic capital and developing entrepreneurial capabilities, and towards attracting TNCs in order to capture the benefits of frontier technologies and international marketing.

The major challenge to the State in the new global context is to overcome the domestic rigidities which have been inherited from decades of over-regulation and the insulation of domestic markets. It is recognized in all of the countries of the region that accumulated oil wealth and oil-related incomes no longer constitute the engine of growth, and that export orientation and reliance on a vigorous private sector are the only viable and sustainable options over the next two decades.

In the ongoing debate over the role of the State in industrial policy, the major issue is whether the State should intervene in the market, and if so, in what form and to what extent. The interpretation of the Asian success story is at the centre of the controversy over the nature and amount of State involvement required.

1. The role of the State in stabilization and structural adjustment

The Government's role in maintaining stability has long been recognized as one of the most important components of the South-East Asian countries' successful growth experience. As part of a country's "growth fundamentals", fiscal, monetary and exchange-rate policies must ensure that inflation is avoided and price distortions are kept to a minimum—a strategy that serves to promote business confidence, discourage speculative investment and prevent the development of an anti-export bias (World Bank, 1993).

In addition to the negative impact oil price shocks and capital outflows have had on the Arab region since the mid-1980s, the continued dominance of the oil sector has negatively affected the competitiveness of manufacturing activity. The economies in

question have been slow in adjusting, and by 1993 the cumulative debt of the region had reached \$140 billion (*Unified Arab Economic Report*, 1993).

Most Arab countries have experienced the artificial appreciation of their local currencies as a result of their excessive reliance on petroleum exports, workers' remittances and/or related transfers. Dependence on a few large but volatile sources of income has created an overvaluation of domestic currencies and a strong bias against tradeables other than petroleum. This means that the cost of production in domestic manufacturing is often very high relative to competitive international prices, and this discourages production for either the export or the domestic market (it is cheaper to import many commodities). Other, related problems have been skill shortages caused by labour migration to the oil-exporting countries and the corresponding rise in real wages ahead of increased productivity, both of which have contributed to the reduced competitiveness of manufacturing at home and abroad.

Economic reform and structural adjustment programmes (ERSAPs) have been undertaken by most of the countries in the region, some (Morocco and Tunisia) ahead of others (Egypt and Jordan). ERSAPs may be considered the main prerequisite for many Arab economies in the sense that they enable these countries to face the challenges of the global economy; the short-term costs of restructuring industry will be more than compensated for by the large payoff of raising its long-term competitiveness.

Liberalizing the incentive structure in each economy involves "getting prices right" to reflect international prices and opportunity cost. Domestic producers are having to restructure their investments and revise their product mix in the face of reduced protection, a reduced bias towards import substitution and reduced distortions in the cost of intermediates. Industries that do not enjoy a comparative advantage will gradually be eliminated, many of them displaced by more competitive export-oriented industries.

The elimination of price distortions in the market is equally important for certain factors of production, including capital, labour and foreign exchange. Domestic interest rates have been too low for quite some time in a number of countries; increasing them would correct the traditional bias towards excessive capital intensity in production techniques and stimulate the adoption of new technologies that are capital-saving and hence more internationally competitive. The respective ERSAPs are also working to improve labour market flexibility and reduce real wage rates, especially in labour-abundant economies, whose industries would regain their competitive edge in labour-intensive sectors. Exchange-rate liberalization constitutes perhaps the most important measure for solving the problem of overvaluation and restoring the balance of incentives between tradeables and non-tradeables.

Liberalizing trade and exchange-rate regimes is expected to facilitate the process of transforming protected domestic industries into competitive export industries. Those

industries that fail to restructure and remain non-competitive will ultimately be displaced as the inflow of competitive manufactured imports increases and as other industrial ventures are created which utilize the elements of Arab comparative advantage (labour-intensive industries in labour-surplus economies and energy-intensive industries in oil-exporting economies) and which are able to benefit from the revision of overvalued exchange rates. Such reform measures are expected to enhance the competitiveness of manufactured exports, thus increasing the region's potential to attract investment resources which can benefit from an expanding regional market and from the use of the region as a platform for manufactured exports.

2. The role of the State as regulator

The regulatory role of the State relates to its ability to manipulate the policies that have both direct and indirect effects on the market mechanism guiding the allocative process. Within the context of its regulatory objective, each Arab State must promote increased competition in the business sector by relaxing the legal and administrative framework governing market entry and exit. The stock of capital held abroad by citizens of the region is estimated at about \$350 billion (World Bank, 1995b). While in some cases productive capital inflows have been discouraged by stringent investment rules, in most cases the problem is the absence of an enabling environment: simple bureaucratic procedures, transparent legislation, effective information and communications networks, and competitive product and factor markets. The State can obviously play a key role in providing such an environment and in ensuring the economic stability that will enhance business confidence and help raise the level of aggregate investment above the 1992 level of \$112 billion for the region as a whole (*Unified Arab Economic Report*, 1993).

One of the Government's basic functions is to provide a set of rules and market-supporting institutions through which property rights can be protected, contracts enforced, and a stable economic environment established so that productive activity can flourish. Stability, predictability and the transparency of policies form the basis of sound government action in the economic sphere. Within this framework, the Government can establish an incentive structure and support the accumulation of critical productive capabilities which will drive the economy towards the efficiency frontier. Even at this basic level, there are a multitude of impediments that are encountered in many Arab countries. One major problem is that existing laws and regulations tend to be restrictive, and there is a high degree of overlap; further, many of them are inconsistent with one another. There is a plethora of government departments responsible for implementing the laws, and this translates into enormous costs to the entrepreneur in the length of time it takes to conduct business. Given the dynamic nature of the global market in which enterprises must now compete, there is no possible way for such a slack institutional environment to survive.

Arab countries must also resolve the issue of the public/private divide in the manufacturing sector by reversing the structure of ownership in favour of the private sector—a prerequisite for ridding the institutional environment of all vestiges of the public-sector monopoly and bureaucratic mentality that have plagued Arab economic systems. The region has the highest market concentration of State-owned firms in the manufacturing sector outside of the former Soviet bloc (World Bank, 1995a). Another fact that argues for less State involvement in industry is that growth opportunities for the future are no longer to be found in large-scale, homogeneous product industries that rely on capital-intensive and slow-changing technology. The seven fastest growing industries—micro-electronics, biotechnology, new materials, telecommunications, aerospace, machine tools and robotics, and computers and software—are all technology- and skill-intensive; they require flexible production and organizational structures that are neither compatible with nor adaptable to the high degree of centralization found in the older generation of industries, to which the style of public ownership and management is well suited (Lall, 1995).

3. The role of the State in “catching up”

The pace of technological progress in the information and communications industries has accelerated the globalization of production and markets. TNCs are diversifying the locations of their industrial operations and significantly increasing their investments in developing countries. It is worth noting in this context that the Arab region captured only \$2 billion of FDI in 1993, while \$4 billion flowed into Malaysia alone during the same year. Moreover, international and regional agreements on trade liberalization are making quality competition more intense, and more often than not require compliance with industrialized country norms regarding property rights and the environment.

Initiating the process of catching up is one of the most important roles the State can play with regard to the industrial sector. It is vital to ensure that total factor productivity (TFP) responds to reforms in the institutional and incentive structures so that the returns on existing and new investments can be maximized. Enhancing knowledge acquisition is the key to future advancement and will determine the level of industrial, technological and scientific progress each country is able to achieve. The quality of human capital has been mainly responsible for the newly industrialized nations' success in achieving modernization and sustained progress. Arab countries need to make a serious effort to eradicate illiteracy, upgrade basic education and introduce state-of-the-art training programmes.

Comparative advantage must now be sought in industries where labour is abundant and skilled rather than in industries with cheap, unskilled labour alone. Skill-intensive and knowledge-intensive industries will be the leaders in the future, and Arab countries will find their niche only if they are willing to invest in human resources now.

The State can also commit itself to following an active industrial policy involving the careful selection of a number of leading sectors and the promotion of their rapid development through the choice of appropriate policies in the fields of technology, education and training, and market information. The growth model of the South-East Asian countries depicts a deliberately interventionist State that has used three major approaches to promote rapid structural change and productivity growth: high levels of selective protection for targeted subsectors over a limited period; a comprehensive assault on all institutional fronts in order to maximize the flow of knowledge to all economic agents; and effective measures to transform the bureaucracy from a passive if not obstructive player in the economy to an active agent of development via the creation of an elite technocracy (Handoussa, 1995b).

In terms of its functional role, the State should limit its efforts to eliminating market distortions and ensuring a competitive environment (static efficiency) while at the same time promoting innovation and change (dynamic efficiency) via its education, science and industrial policies. Unless the State intervenes to facilitate the processes of catching up, structural transformation, and changing the "inherited" comparative advantage, Arab countries will experience very low levels of growth and diversification, risking stagnation in a global environment that is now far less benign for developing countries than it was during the past three decades.

Planning is one of the principal institutional tools utilized by developing countries to support the process of catching up. State intervention through planning should be thoroughly revised. First, public investment expenditure should be reduced so that it is confined to the allocation of resources in specific fields where the probability of potential market failure is high. Second, the focus of government intervention must shift from the planning of projects to the planning of policies. A plan should reflect a development strategy that promotes structural change by means of providing correct market signals. Policy makers must now design an industrial policy that focuses on a selected group of industries and fields of activity which are expected to enjoy evident future comparative advantage. Leading sectors would be entitled to State support for technology acquisition, training, restructuring, market access and information dissemination to enable them to grow and to compete within the domestic market and, more importantly, on the international front. South-East Asian economies constitute examples of successful government intervention in industry. The important lesson to be gained from their experience relates to the adoption of a mode of planning based on a selective interventionist policy in the incentive system geared towards minimizing conflict with the operation of market forces.

The current process of structural adjustment, which gives the State's role in the economy a new dimension, provides a real opportunity for domestic reforms to translate into regional coordination and cooperation—which in themselves would enhance the prospects for the accelerated growth and increased competitiveness of the manufacturing

sector in each Arab country. Parallel to the ongoing process of economic reform and structural adjustment, Arab countries should design effective industrial policies that would allow them to respond to new challenges and to take advantage of opportunities to expedite the “catching up” of their industrial sectors; the benefits would be even greater if these individual industrial policies were well coordinated among Arab countries.

D. A PROPOSED INDUSTRIAL STRATEGY FOR ARAB COUNTRIES

If the drive towards industrial development is to succeed, Arab industries must overcome the two most critical constraints on efficient growth, namely the lack of foreign market access and the lack of access to technological advances and innovations. At the national level, two policy options are envisioned to surmount these obstacles: the first involves developing indigenous skills and talent in order to penetrate export markets and catch up on the technological level; the second involves attracting transnational corporations which have the most developed marketing networks and their own frontier technologies.

Global trends imply that Arab countries will soon face fierce competition from other developing countries with the opening up of both the advanced countries’ markets (accounting for 60% of developing countries’ exports) and the markets of the developing countries themselves. What is equally obvious is that the gradual enforcement of WTO rules on tariff and non-tariff protection will pose an enormous problem for non-competitive domestic producers in the Arab region. The only viable strategy for each Arab country is to pursue a vigorous programme of rationalization, restructuring and reorientation. In addition, there are several benefits to be reaped if national programmes are deliberately designed to capitalize on regional opportunities via policies and measures that enforce the regional harmonization of investment and trade policies, with a view to eventual long-term regional integration.

Three sets of opportunities evolve with the deepening of regional economic integration and can be taken advantage of to raise the level of competitiveness and the degree of diversification in the manufacturing industry across the Arab world; these include opportunities for further import substitution, opportunities for forward integration, and opportunities for horizontal integration. With the opening up of Arab markets to liberalized intraregional trade and capital flows, every Arab country would enjoy a larger share of the region’s total trade and capital flows, and the manufacturing activity in each country would expand rapidly. In 1992, the manufactured goods imported by Arab countries totalled \$83.4 billion, only \$5.8 billion (6%) of which were from the region. This compares with intraregional shares of between 35% and 50% in the total trade of the ASEAN, EU and NAFTA regions. Moreover, Arab exports of manufactured goods in 1992 stood at \$32 billion (\$17 billion excluding petroleum refining), representing only 1% of world manufactured exports (\$3 trillion). This figure contrasts with an Arab share of

3.4% in world MVA, reflecting the large gap between actual and potential Arab exports of manufactured goods.

Opportunities for import substitution are still important at the regional level to allow these countries to take advantage of the vast Arab market as a single market. There are a number of industry segments where economies of scale on the supply side have prevented any one country from making a viable investment based on its local market potential alone. Examples are particularly striking in capital goods, which accounted for \$30 billion of Arab imports in 1992.

A second set of industries would benefit from opportunities for the forward integration of existing sectors whose resource advantages provide the Arab region with low-cost intermediates which can be further processed into high-value-added products for both the regional and export markets. This group includes a wide range of petrochemical industries for the oil-rich countries and textile and garment industries for the non-oil-based economies.

Regional integration would also create opportunities for exploiting the benefits of horizontal rationalization including mergers and subcontracting arrangements among the firms of different Arab countries. Taking advantage of this third option would bring about trends similar to those observed in Asia, Europe and NAFTA countries, where a single location is no longer solely responsible for all the activities of a large firm. The liberalized movement of capital and commodities along with a harmonized institutional environment across all Arab countries would thus enhance productive efficiency, competitiveness, and the scope for rapid expansion to meet the demand of a fast-growing regional market.

The trade (tariff and non-tariff) and investment (licensing) barriers currently imposed by many Arab countries constitute the major reason why the flow of industrial capital and trade in manufactured products among the countries of the region has been so limited. Removing these restrictions would have positive effects that went beyond the gain in opportunities for Arab firms; it would also encourage investments by TNCs seeking a larger Arab market to make their operations viable. All of the industries falling into one of the opportunity groups described above would benefit greatly from the reduction in trade barriers and investment constraints, as both limit the scope for effective competition and cooperation among firms across the region. The experience of regional blocs in other parts of the world gives evidence of the large gains to be achieved by each member of the Arab regional community in both the medium and the long term.

Arab States could also be proactive in jointly designing a plan that develops a number of key industries in the region for which dynamic comparative advantage is identified and growth prospects are expected and in which cooperation would raise the rate of return. Among the industries and subsectors that deserve attention and study are capital goods, downstream petrochemical products, special metals, micro-electronics, and

software. In each of these fields, a number of specific lines can be identified as potential niches. Collaboration should seek to forge alliances not only between firms in the region but also between these firms and TNCs which can be induced to locate their activities in the region.

E. CONCLUSION

There is a real need for Arab countries to shift away from their traditional concept of industrial cooperation—often understood to mean the flow of grants and financial assistance from the richer to the poorer countries to finance industrial projects in the latter. Arab countries should also avoid implementing joint ventures across the region that are motivated solely by political and/or Arab nationalist goals, even though such objectives can boost cooperation. Meaningful and sustainable cooperation is only possible if it serves each and every member's objective of achieving real economic gains; in other words, it should not be a zero-sum game. Such gains include higher commercial profits from equity participation in projects, a growing regional and international market share for the industry in question, lower operation and technology acquisition costs, and greater leverage in negotiating with transnational corporations over regionally focused projects.

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XI. EAST ASIAN INDUSTRIAL POLICY: ITS RELEVANCE AND LESSONS FOR DEVELOPING COUNTRIES

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A. OVERVIEW

In recent years there has been a fundamental shift in the way that economists and policy makers think about industrialization, and particularly the role of State policy interventions, in developing countries. The key factors in this regard appear to be the demise of the inward-looking import-substitution industrialization (ISI) strategy based on State intervention, and the ascendancy of the export-oriented industrialization (EOI) strategy based on trade liberalization and free-market principles.

“Getting prices right” is clearly the slogan of the day. Market reforms and trade liberalization have constituted the heart of stabilization and adjustment programmes supported by the International Monetary Fund (IMF) and the World Bank in developing countries. In particular, inward-looking industrialization through aid has been replaced by outward-oriented industrialization through trade. Presently, the most crucial questions relate to:

- The universality of free-market and free-trade principles, or more specifically, their efficacy across a broad range of economies with widely disparate industrialization levels and social and economic conditions
- The relative importance of trade as opposed to non-trade factors in accelerating industrialization

The neoclassical doctrine based on free-market principles and minimal government involvement owes its success largely to the miserable failures of the actively State-interventionist “industry first” development strategy pursued in developing countries between the 1950s and the 1970s. It has become evident that the failure of the industrialization drive in many developing countries during this period was primarily attributable to the adoption of the wrong strategy, namely ISI. Conversely, the spectacular success stories of rapid industrialization in East Asian countries have shown that an appropriate industrial policy, that is, one incorporating the EOI strategy, can make a critical difference in the success or failure of industrialization efforts, and more importantly, that State policy interventions *do* matter, which directly challenges the validity of the neoclassical doctrine.

The East Asian experience—particularly the aspect of State policy intervention—has not conformed to neoclassical free-market policy prescriptions, and the neoclassical school has been challenged to explain the East Asian success. This challenge is accepted by the World Bank in its recent publication, *The East Asian Miracle: Economic Growth and Public Policy* (World Bank, 1993). The study offers a contrived explanation, distinguishing between good policies and bad policies: good policies, which contributed to the miracle, include market-friendly functional (or non-selective) interventions in such areas as capital formation, human resource development, technological upgrading and export promotion; bad policies relate to selective policy interventions affecting inter-industry resource allocation in favour of government-targeted industries. The study concludes that the selective intervention of picking “winners” is not justified on theoretical grounds and has contributed little, if anything, to East Asia’s success.

Caution is called for, however. It is often difficult to make a conceptual distinction between functional and selective interventions. First of all, any intervention that removes market failure, whether it is functional or selective, is market-friendly. Second, any market-friendly measure such as skill formation or export promotion can be formulated along functional lines or on a selective-industry basis. Finally, because of imperfections in capital and technology markets, strong selective policy interventions are needed for the acquisition, adoption, adaptation and indigenous development of new technologies.

The debate on industrial policy in general and on selective policy intervention in particular is likely to continue unabated for some time in the light of the East Asian success. The present paper aims to contribute to the debate. In subsequent sections, the study reviews conceptual issues surrounding the State and the market and evaluates trade policy interventions geared towards developing export industries, then highlights the industrial policy experiences of Japan and the Republic of Korea. The study concludes with a summary and evaluation of the main points, with particular emphasis on certain lessons to be learned from the East Asian miracle.

B. THE MARKET AND THE STATE

In earlier decades, from the 1950s to the 1970s, the strong role of the State in the process of economic development was predicated on its perceived ability to protect against market failures and externalities. Within the last decade, however, the dominant thinking in development economics has focused more critically on the State’s central role in such development, and the widespread acceptance of a managed and even planned economy has been replaced by the supremacy of the neoclassical school’s increased reliance on market forces and consequent economic and trade liberalization.

The case for the free-market system as a means of achieving optimal dynamic resource allocation and welfare maximization under a set of restrictive assumptions can hardly be disputed. It is equally evident, however, that certain preconditions have to exist for the price mechanism to achieve optimal dynamic resource allocation and production. As cogently explained by Scitovsky (1954), there must be complete and functioning markets, which requires the following: perfect information and resource mobility among numerous economic agents, none of which is big enough to influence prices or production in all (i.e., product, labour, financial and capital) markets; the absence of economies of scale; and complete tradeability. Obviously, these preconditions rarely exist in reality.

There are numerous specific market failures and externalities which may, in the absence of corrective policies, result in a socially sub-optimal allocation of resources. Four different types of market failures are identified here. One oft-cited example relates to labour market distortions resulting from labour training externalities: labour training benefits cannot be appropriated by a firm, since trained labour may move to other firms, and this may cause firms to invest less in training than is socially desirable. There are also institutional and legally imposed barriers to the perfect functioning of the labour market, such as minimum wage and the bargaining power of trade unions, which keep urban and industrial wages higher and employment rates lower than would be the case in the absence of such barriers. Second, there are informational and technological externalities associated with entrepreneurial activities that are related to the development of new production techniques or the exploitation of new markets whose benefits can accrue to other entrepreneurs at no cost, a situation which may force them to underinvest and underproduce. Third, in the case of economies of scale, the firm produces at a level where price equals average cost but is less than marginal cost, which means it is producing less than is socially optimal. Fourth, the financial and capital markets in many countries are inadequately developed to induce long-term industrial investment; this is particularly true in developing countries.¹

It is against this backdrop of hotly debated market imperfections that the Latin American structuralists and other development economists emerged in the 1950s, beginning with the works of Prebisch (1950), Singer (1950) and Hirschman (1958). Among other things, they pointed out structural rigidities and institutional barriers which interfered with the smooth functioning of free-market systems, and asserted that State intervention was required to remove these bottlenecks and create an environment conducive to the perfect functioning of free-market systems. They reasoned that such intervention was justified particularly during the early stages of industrialization, when market imperfections were likely to be more pervasive; the later stages of development were generally characterized by greater economic integration.

¹ For a more complete discussion on the subject, see Roderick (1992).

The structuralists' advocacy of an active State role in initiating and accelerating industrialization during the 1950s and 1960s was eventually challenged by an avalanche of anti-interventionist reactions, culminating in the recent dominance of neoclassical thought, which firmly espouses free-market principles, free trade, and the "minimalist Government". The theory of development economics constructed around active State intervention has been attacked on various fronts. The central argument of the neoclassical critique is that market distortions *per se* do not provide the rationale for State intervention, even if the sources of such distortions are identified and their quantitative importance can be gauged—tasks which are extremely difficult to perform. The representative view of the neoclassical school is that State intervention not only fails to correct market distortions, but that it actually exacerbates the problem; in other words, government failures are worse than market failures (Bauer, 1984; Lal, 1985). This view also asserts that State intervention creates a breeding ground for rent-seeking or "directly unproductive profit-seeking" activities (Bhagwati, 1982). The supposition is that seeking government favours and competing for government contracts and other largesse distorts normal economic activity, which leads to sub-optimal resource allocation.

The crux of the issue surrounding the State-versus-market controversy between traditional development economists and neoclassical followers seems to relate to the ability of the State to "get things right" and bring about the desired structural transformation through intervention. The neoclassical camp shows profound distrust in active public policy purportedly directed towards correcting market failures, while development economists have implicit faith in the State's unlimited capacity to direct the development process. In many cases, development economists have correctly pinpointed the causes of underdevelopment, but they have contributed little to explanations of how, when and where to intervene, or to the development of a coherent theory of policy intervention valid for diverse economic and social conditions.

Empirical evidence on the relationship between active State intervention and economic development is not conclusive. There are a few economies like that of Hong Kong, which has thrived on the relatively *laissez-faire* free markets and free-trade regimes. The other major option, active State economic intervention, has produced a number of successes but also some notable failures. Today, it is clear that many of the successful East Asian countries such as Japan, the Republic of Korea, Taiwan Province of China, and most of the Association of South-East Asian Nations (ASEAN) countries are strongly interventionist. In one particular example, during the early stages of its industrialization in the 1960s and 1970s, the Republic of Korea heavily supported targeted export industries through the provision of export subsidies and other financial incentives, while at the same time shielding these industries from foreign competition in the domestic markets, where their products could be sold at prices higher than those in the world market. In fact, Amsden (1989) argues that the relative prices were manipulated on purpose to shift resources to the key targeted sectors. This directly contradicts the principle of "getting prices right".

The scope for intervention seems to depend on the stage of industrialization at which a given economy finds itself. Based on his study of European industrialization, Gerschenkron (1962) argued long ago that the nature and extent of State intervention changed at different stages of industrialization. At the initial stage, where there are no functioning markets, the State has to engage in “pump-priming” in order to mobilize resources and create an enabling environment for the smooth functioning of market systems. However, as the economy advances along the trajectory of industrialization and its structure becomes more complex and sophisticated, the task of selective policy intervention aimed at specific sectors becomes increasingly difficult to implement without unforeseen distortions in other sectors. In the advanced stage of industrialization, the role of the State is restricted to establishing and maintaining a competitive environment for private enterprises, and resource allocation is primarily guided by price signals and market incentives.

Important interventions during the initial stage of industrialization include public investment in infrastructure for transport, communications and utilities, as well as institution-building for the development of an indigenous business class, educational and legal systems, and financial and capital markets. Adequate social and physical infrastructures and institutions constitute a necessary precondition for building industrial supply capacity; the correct price signal alone may not be sufficient to induce or enhance such capacity. In this regard, it must be noted that public investment should be viewed as a complementary support mechanism for private investment, since the availability of adequate infrastructure services may be required to induce private investment; in industrialized countries with a well-developed infrastructure and other supporting systems, public investment might only serve to “crowd out” private capital and raise interest rates.

State intervention is obviously not a panacea for extricating an economy from the vicious cycle of underdevelopment. As correctly pointed out by the neoclassical school, there are many historical cases where bad government interventions have actually exacerbated the disease they were designed to cure. However, there are also a number of success stories related to active government intervention in the development process, particularly in East Asia. The issue is not whether State intervention *per se* is good or bad; what matters is the nature and quality of the intervention. The outcome of an intervention is critically dependent not only on strong political commitment to reforms, but also on the objective of the intervention (for instance, the development of an inward-looking or outward-oriented economy) and, above all, the capability of the State to initiate and guide market-friendly structural transformation. In the past, active policy interventions in most East Asian countries were targeted at the creation of export industries and an outward-looking economy after the initial phase of import substitution. This process was greatly facilitated by political flexibility (the willingness and ability to change) and the development of a government machinery capable of overriding the pressure from vested interest groups and of getting various economic actors to implement technocratic policies. In a number of developing countries outside East Asia, State interventions were just as

active, but many failed because development efforts were misdirected towards an unsustainable strategy such as inward-looking industrialization, and this was compounded by the problem of relatively weak government capacity and the lack of a political commitment to pursue a coherent policy.

Finally, the debate on industrial policy should include a comparative assessment of the errors of commission and omission that have been made. Bad government intervention is clearly an error of commission. Failing to remove market failures through selective policy intervention (and therefore possibly stymying industrial development) constitutes an error of omission; this can be just as damaging as bad government intervention.

In particular, strong selective policy interventions may be needed to achieve industrial and technological “deepening”, which is essential to shift the economy from labour-intensive manufactured exports to more technology- and skill-intensive manufacturing and exports. The failure to act may be costly—an argument for which there is some compelling empirical evidence. S. Lall (1995) contends that Hong Kong, which is well known for its *laissez-faire* economy characterized by free trade, the absence of selective interventions, and free foreign direct investment (FDI) flows, started and has stuck with predominantly labour-intensive manufacturing industries; since there is little scope for “learning” with light manufacturing, little industrial or technological deepening has taken place in Hong Kong’s economy. By sharp contrast, Singapore, a city-State of similar size, followed a highly interventionist policy combined with free trade and built a far deeper industrial structure than Hong Kong in terms of technological sophistication of manufacturing and exports, and it now enjoys steady, sustained industrial growth.

The Lall study (1995) also cites examples of two non-Asian countries, Chile and Ghana, which pursued vigorously market-friendly reforms but did not implement selective policy interventions as encouraged by the World Bank and the IMF. By and large, the same conclusion is drawn for the two countries: although they enjoyed some success in manufacturing light labour-intensive and resource-based products for export, the absence of selective promotion stunted industrial and technological deepening, and there was no progression beyond low-value-added manufacturing towards the building of a sophisticated high-value-added industrial base which would allow them to compete in the world market.

C. TRADE REGIME AND INDUSTRIALIZATION

It is evident from the foregoing discussion that the nature and extent of State interventions should differ substantially according to the kind of industrial strategy and trade regime adopted. For instance, an ISI strategy by nature relies on market restrictions to protect domestic industries from external competition; State intervention thus has an anti-export bias. Conversely, EOI may require the kind of State intervention that facilitates

the transformation of protected domestic industries into competitive export industries. In the light of such divergent requirements, the incentive structures and their implications for the rent-seeking activities of special interest groups are likely to differ markedly for the two strategies.

The paradigm of the day is undoubtedly the EOI strategy. It must be noted, however, that export promotion in this context usually involves manufactured exports, while exports of primary products are excluded. It is well known that the export of raw materials is not a viable growth strategy, mainly because of the low price and income elasticities of demand for primary goods relative to manufactured goods. Commodity exports may be subject to frequent boom-and-bust cycles accompanied by violent price fluctuations, and their export revenues may fall short of manufactured import bills in the long run. Worse, any productivity increase in raw materials decreases world commodity prices instead of generating income and employment gains in the producer country.²

In recent years, attention has been increasingly focused on the link between exports and industrialization in the light of the export-led success stories of East Asia. The favourable effects of the EOI strategy are numerous and are extensively discussed in the literature. Among other things, this strategy has a proven capacity for promoting efficient resource allocation, exploiting economies of scale, removing foreign-exchange constraints, stimulating competition, generating production externalities (such as the creation of new skills and technological upgrading), facilitating technology transfer, limiting the use of quantitative restrictions, removing the distortions of economic incentives caused by such restrictions, and above all, increasing productivity growth rates.

It appears that the link between exports and productivity is central to the EOI strategy. Concentrating on manufactured exports can increase industrial productivity by means of the following:

- *Improved resource allocation.* Exports and foreign competition can force a resource transfer from the less productive sectors to those that are more productive.
- *Improvements in technical efficiency,* involving a potential output increase for the same inputs

²This is part of the so-called Singer-Prebisch thesis, which argues that primary-product-exporting developing countries have been experiencing a systematic deterioration in their terms of trade, and have had to export increasing amounts of primary products to import the same amount of manufactured goods from developed countries. This was considered to be one of the major causes of economic stagnation in developing countries. See Prebisch (1950) and Singer (1950). The present paper is mainly concerned with manufactured exports; hereafter, any reference to exports is to manufactured exports rather than to exports in general unless otherwise specified.

- *Raising scale efficiency.* Increased efficiency in production can result not only from greater capacity utilization in industries where the minimum efficiency size is large relative to the domestic market, but also from moving the optimum scale itself from one level to another as exports expand.

Empirical evidence seems to suggest that industrial performance is likely to be affected by trade more through allocative efficiency than through technical efficiency, particularly during the early stages of an export orientation (Bergsman, 1974; Leibenstein, 1966). However, as a country advances along the path of EOI, the potential efficiency gain from reallocating disequilibrium factor markets rapidly diminishes, and any further gain in real income has to come from improved technical efficiency and/or total factor productivity growth, as in the case of the East Asian countries. In short, export-led industrial growth from better resource allocation may be limited to the early stages of export orientation, while further sustained growth must be driven by increases in productivity growth and/or technical efficiency. It should be noted that empirical evidence is inconclusive on whether export orientation generates greater productivity growth than import substitution (Pack, 1992).

It is widely accepted that certain preconditions need to be established before the launching of an EOI strategy. Above all, export supply capabilities must be built, and this can be done by providing a period of protection for infant industries in the domestic market. Almost every successful exporter started with import substitution of light consumer goods. The rationale for the infant-industry argument is that a period of protection is required during which a country can increase its technical efficiency and improve its competitive edge in the world market. The argument is based on the premise that it is worth taking the risk of “getting prices wrong” temporarily—by instituting tariffs, other forms of protection, and domestic price controls—in order to reap the dynamic benefits of production externalities associated with economies of scale, learning-by-doing, and other elements of growth. The key element in infant-industry intervention is the relatively quick transition by protected industries from domestic production to exports, supported by the political will to phase out protection for laggards once production externalities and the learning-by-doing potential are exhausted, or at least substantially reduced. Without such a phase-out, the strategy of infant-industry protection is doomed to failure, and the production inefficiency of protected industries is perpetuated. The costs of protracted protection can be considerable indeed, in terms of the artificially high profits maintained for the protected firms, the higher costs of local inputs induced by the higher costs of imported inputs, and the higher protection costs associated with a lower scale of production for small domestic markets—added to which are the social and political implications of encouraging unproductive rent-seeking activities.

The Republic of Korea is often cited as a successful example of the selective protection and promotion of infant industries, effected through interventionist tariffs and export subsidies and the subsequent rapid graduation of these industries to export competition in the world market. The Government made extensive use of a “carrot and stick” scheme for export promotion: export targets were set for protected industries, and those that achieved or surpassed the targets were generously rewarded, while those that failed were severely punished in terms of export subsidies and other financial incentives. In fact, the continuation of the protection and incentive schemes was linked to export performance.

It is argued that trade-related reforms, particularly import liberalization, are necessary conditions for export promotion because producers cannot be induced to compete in foreign markets while protected domestic markets offer them assured profits. There is no empirical support for this argument. In Sierra Leone and many other African countries, import liberalization was introduced in the 1980s but was soon abandoned following a surge of imports for which no foreign finance could be found (UNCTAD, 1989). Ghana prematurely exposed itself to intense competition in the world market before building a strong enough export capacity, a move which wiped out not only inherently uneconomic activities but also a budding labour-intensive manufactured-exports industry (Lall, 1995). This problem is typically encountered when a small, undiversified economy with a small manufacturing base liberalizes trade.

What is needed most, before trade-related reforms are undertaken during the early stages of industrialization, is the building up of supply capability. The conventional wisdom is that import substitution precedes export promotion to develop supply capability, which underpins the strong growth of manufactured exports in the long run. In fact, it may be logical to introduce import liberalization only after domestic supply capability has been sufficiently developed and a successful export drive has been launched. Deliberately managing the pace of import liberalization in step with the export drive, as opposed to the so-called “big bang” approach to trade liberalization, may warrant serious consideration.

Well after an export base is firmly anchored, managed import liberalization may be achieved through a combination of the following: the time-phased relaxation of import controls; the selective opening of domestic markets to foreign suppliers; rationalizing the tariff structure; establishing realistic exchange rates; and providing more transparent effective protection via tariffs rather than quantitative restrictions. In this manner, a foreign exchange squeeze can be avoided: growing export revenues can be used to pay for the increasing imported inputs used in the export drive.

On the other hand, adopting a big-bang approach to trade reform might establish the credibility of the reform programme, prevent the build-up of vested interest groups’ resistance to the reforms, and lay the foundation for sustained growth during the early stages of development. However, the success of such a radical approach would likely

depend on the existence of a political commitment to undertake drastic reforms and on the ability of the bureaucracy to formulate and implement the reform programme, as well as on the availability of adequate supply capabilities. In a typical developing country, with its relatively narrow manufacturing base and limited domestic supply capability, the radical approach could bring about a severe balance-of-payments deficit and macroeconomic disequilibrium such as hyper-inflation. In an economy with limited manufacturing capacity, the export response to real exchange rate changes would obviously be almost nil.

It appears that the first step required in an EOI strategy—even before trade reform is considered—is the development of export supply capabilities. Price signals such as realistic exchange rates favouring production for export are necessary but are insufficient for building an export base. There are basic conditions for rapid industrialization which must be laid down first; these include many interrelated elements which are not directly linked to trade and precede the design of a policy framework for export promotion. For instance, a basic physical infrastructure (adequate transport, communications, water, electricity, gas and other such resources, services and facilities) is essential for manufacturing. Human capital accumulation and skill development through education and training, along with the development of an entrepreneurial class, are equally if not more important. Also necessary, and closely related to human resource development, is the development and continuous upgrading of technological capacity (for the assimilation of the latest technology) and product design capacity (through science and technology institution-building). Institution-building should include the development of efficient public administrators and a corps of competent technocrats.

The initial task of building human capital, physical infrastructure, and economic and social institutions—often from scratch, as in the case of many sub-Saharan countries—is a daunting and time-consuming process. Market failures most often occur during the development of institutions and human resources, and it is during this period that effective State intervention (rather than non-intervention) may be called for. However, a large number of developing countries in the initial stages of industrialization may lack the administrative capacity to mobilize resources and direct human and physical capital formation and institution-building to support or strengthen manufacturing capacity. A partial solution to this problem may be the development of a manufacturing industry through foreign direct investment. FDI often brings with it not only foreign capital, inputs and technical know-how, but also export marketing capabilities. Manufactured exports, unlike primary commodities, do not depend solely on price competitiveness and world-standard product quality; for manufactured goods, potential export markets must be sought, and products must be designed for and targeted towards such markets. FDI may facilitate the process of market penetration as well as initial import substitution for domestic markets.

Leaving aside the problem of providing adequate financial and fiscal incentive packages, many developing countries may find it difficult to attract FDI unless they have

an adequate infrastructure already in place and a reasonably skilled labour force readily available; the focus shifts, once again, to the crucial importance of human capital formation and infrastructure-building. However, there is another critical factor for attracting FDI which is often left out of the analysis: the need for a legal system capable of protecting ownership rights, enforcing contractual obligations, granting recourse against abuses, and guaranteeing the repatriation of profits. The absence of such a legal framework presently constitutes a major deterrent to foreign investment in Eastern Europe and the former Soviet Union, despite the availability of a skilled labour force and a basic infrastructure.

One cautionary note, however: FDI is not a panacea for rapid industrialization. Foreign firms bring with them skills, technology, capital, and marketing capabilities, but they cannot, by themselves, override the more dominant effects of macro- and micro-economic mismanagement. Moreover, there are a number of potential disadvantages associated with foreign ownership, relating to the exploitation of natural resources, pollution and many other factors and practices which run contrary to the interests of a host country. The benefits of an alternative to FDI should therefore be assessed. For instance, foreign capital and inputs can be imported through loans, technology acquired through licences, and marketing capability built through marketing consultancy and national trade promotion agencies. Japan, the Republic of Korea, and Taiwan Province of China have developed indigenous manufacturing industries in this manner, without depending on FDI, while China, Malaysia, Thailand, Indonesia and Singapore have relied heavily on FDI for industrial development. The latter group has been highly selective in the FDI choices they have made; Singapore, for example, has favoured high-tech, high-value-added investment.

Once industrial supply capabilities are established through skill development, social and economic infrastructure-building, and macroeconomic stabilization, export promotion measures can be carefully selected and the machinery for implementing them developed. Export incentive schemes involve, *inter alia*, preferential export financing, fiscal and investment incentives, export processing zones, bonded warehouses and factories, duty drawbacks and tax rebates on imported inputs, credit for new exports, pre-shipment financing, export credit guarantees, and the establishment of export-import banks. Meanwhile, protective measures designed for initial import substitution, particularly those geared towards infant industries, should be streamlined and rationalized. If possible, quantitative restrictions should be replaced by tariffs, since quantitative restrictions supplant the price mechanism and yield an economic rent to the winner of an import quota or licence, further encouraging rent-seeking activities and possible corruption, while tariffs are transparent and revenues go to the Government. However, it takes more than the transparency and rationalization of the structure of trade incentives to build an export base. What is needed most is the stability and predictability of incentive schemes over time, with *ad hoc* measures and amendments kept to a minimum. A stable and predictable policy environment is required to elicit individual responses to trade

incentives. Once export competitiveness is established, however, most incentive schemes can be dismantled.

It is apparent from the foregoing discussion that the proper sequencing of the various policy reforms is critically important to the EOI strategy. At the risk of oversimplifying the process, the following sequence is suggested. First of all, apart from setting up the crucially important basic infrastructure, overall manufacturing capacity must be developed before export supply capability is built up; this is based on the premise that industrial supply capacity leads to export capability and not vice versa. If such is the case, then during the early stages of industrialization, the role of manufactured exports in accelerating the process becomes less important than non-trade policy measures focusing on: the selective industrial targeting and promotion of infant industries; the strengthening of intersectoral linkages between manufacturing and agriculture, and between manufacturing and services; the creation of linkages within the manufacturing sector; the promotion of rural industrialization; and so on. Export supply capability should be built up after a reasonably broad industrial base has been developed. At this juncture, macroeconomic stability may be necessary to create a favourable macroeconomic environment for rapid industrial growth; therefore, macroeconomic stabilization should exist before structural reforms (including trade reforms) are instituted. Moreover, import liberalization should be introduced well after the upsurge of exports. Finally, the liberalization of capital markets should come after the adoption of trade reforms so that some degree of control may be gained over international capital flows, which is essential for an orderly transition to an export-oriented economy and for stability in financial and capital markets.

D. JAPAN'S INDUSTRIAL POLICY

Much has been written about Japan's industrial policy.³ Broadly speaking, Japan's industrial policy encompasses four major areas. The first area includes policies designed to facilitate the provision of infrastructure services and facilities such as industrial sites, transport and communications, water, gas and electricity to industry. The second policy area focuses on resource allocation among industries, targeting certain strategic industries and providing the necessary infant-industry protection, including import restrictions. In most cases, import barriers have been dismantled as particular industries have become strong enough to compete in the world market (such barriers were removed for trucks and buses in 1961, for colour televisions in 1964, for colour film in 1971, for cash registers in 1973, for large-memory integrated circuits in 1974, and for computers in 1975). The third area comprises policies that affect industrial organization, focusing on such aspects as: industrial restructuring; cartelization among firms during recession and for the purpose of rationalization (when, for example, automation and/or

³ For a comprehensive bibliography of Japan's industrial policy, see Itoh and others (1991).

labour-saving technologies are introduced); and central coordination in reducing operational capacity, plant investment and production in order to prevent “excess competition”. The last policy area is concerned with the promotion and protection of small- and medium-scale industries.

The Ministry of International Trade and Industry (MITI) played a central role in designing and implementing specific industrial policies. Japan’s industrial policy was implemented in four different stages. The first stage corresponds to the period of recovery and reconstruction after the Second World War in the late 1940s and the 1950s. More specifically, during the period 1946-1948, Japan’s industrial policy resembled the central planning model of the former Soviet Union and Eastern European bloc. The Government intervened directly in the market, channelling resources to certain strategic industries such as the iron and steel and coal industries. Policy interventions included price controls, subsidies, the preferential allocation of domestic raw materials and imported inputs, and loans and credits for the targeted industries. In the 1950s, the emphasis shifted from direct resource allocation to the rationalization of selected industries which were focusing on the introduction of automated and other labour-saving machinery. For instance, accelerated depreciation and tariff exemptions were permitted for machines imported by the targeted industries. Initially, the targeted concerns included the steel, coal, shipbuilding, electrical power, synthetic fibre and chemical fertilizer industries; in the late 1950s, the petrochemical, machine tools and parts, and electronics industries were added to the list.

The second stage occurred during the 1960s, as the Japanese economy began to integrate itself into the world economy by joining various international organizations such as the IMF, the World Bank, and the Organization for Economic Cooperation and Development (OECD), and by becoming a signatory to the General Agreement on Tariffs and Trade (GATT)—all of which exposed Japan to external pressure to liberalize and deregulate its own economy. As a result, policy emphasis shifted to strengthening industrial competitiveness within a strict, externally imposed schedule of trade liberalization and economic deregulation. To improve industrial competitiveness, MITI concentrated its efforts on merging large companies such as Japan Steel, coordinating capital investments to prevent overcapacity, instituting special support measures to strengthen small and medium-scale industries, and formulating a comprehensive energy policy.

The third stage covered much of the 1970s. During this period, new policy objectives were added to enhance industrial competitiveness. Policies focused on pollution control and environment-friendly industrialization, and on the stricter application of anti-monopoly laws. In addition, greater reliance on market mechanisms was facilitated through further deregulation.

During the last stage, in the late 1970s and the 1980s, the MITI industrial policy incorporated measures to minimize both trade conflicts with other countries and the consequent damages resulting from the rapid growth of Japanese exports.

To provide a context for the discussion to come, it is important to understand how industrial policy has been formulated in Japan.⁴ Japanese industrial policy is developed within a tripartite consultative framework comprising the following:

- The *genkyoku*: groups of bureaux, divisions and sections of MITI and other ministries and agencies, some of which are responsible for particular industries and some of which coordinate inter-ministerial affairs
- Numerous industry associations such as the Japan Iron and Steel Federation, the Japan Automobile Manufacturers Association, and the Shipbuilders Association of Japan
- Policy councils, or *shingikai*. These consultative bodies are made up of private citizens (e.g., academics, bankers and financiers, industry leaders, journalists and former bureaucrats); the function of each council is to advise the individual ministries on particular aspects of industrial policy. The Industrial Structure Council is one example.

MITI has nine bureaux which constitute the most important element in the formation of industrial policy in Japan. Five of the nine bureaux (Heavy Industry, Chemical Industry, Textile and Light Industry, Coal and Mining, and Public Utilities) are responsible for drawing up a detailed industrial policy for each type of industry, focusing on components such as pricing, market and production sharing, reorganization and mergers, and the control of investments. These bureaux are called “vertical *genkyoku*” because each specializes in a certain industry or industries. Furthermore, every bureau is subdivided into divisions and then into sections, and many of the individual sections are in turn responsible for a particular part of the relevant industry; for instance, within the Heavy Industry Bureau, there are sections for iron and steel, industrial machinery, electronics and electrical machinery, automobiles, aircraft, and so on. The remaining four bureaux (International Trade, Trade Promotion, Enterprise, and Safety and Environmental Protection) are called “horizontal *Genkyoku*”, because they specialize in issues that cut across industries. The major functions of the *Genkyoku* include: (a) drawing up and implementing various industry laws such as the Petroleum Law of 1961, the Machine Industry Law of 1956, and the Electronics Law of 1957; and (b) drawing up various regulatory measures related to production and trade, focusing on elements such as special

⁴ This part draws heavily from Komia, Okuno and Suzumura (1988).

tax provisions, tariff rates and import quotas, foreign direct investment, patent and technological agreements, joint ventures and credit allocation.

Industry associations participate in the formulation of industrial policy through close consultation with each respective *Genkyoku* to ensure that the policies adopted are favourable to their industries. Many of the policy councils are consulted on major issues, and their deliberations are taken into consideration in the process of formulating industrial policy. In 1970, for instance, there were 27 different councils and advisory committees for MITI; 15 of these advised the Ministry on the respective areas of industrial policy.

The machinery of industrial policy, and particularly the vertical *Genkyoku* system, played a central role in the 1960s and 1970s; however, since the early 1980s, its importance has diminished rapidly, while the horizontal bureaux of MITI have become more important in policy-making. During the early post-War period, MITI possessed tremendous leverage over industries and firms, as it was responsible for the approval of import licences, foreign capital inflows, technology import licences, and the use of Japan Development Bank loans, and for providing special tax privileges. However, MITI lost most of this leverage during Japan's rapid economic growth period in the 1960s and 1970s. In other words, MITI changes from an industry-oriented to an issue-oriented ministry, dealing with newly emerging problems related to trade friction, environmental protection and energy conservation, overseas investment and industrial relocation, high-tech industries, and so on. Put differently, Japan has graduated from the early stages of industrialization, when industrial policy mattered more, to a more mature, advanced economy whose complex and sophisticated structure renders the application of selected policy interventions extremely difficult and ineffective. To use the World Bank terminology, the policy focus has shifted from selectivism to functionalism.

Finally, there is some controversy regarding the effectiveness of Japan's industrial policy; opinions are sharply divided and empirical evidence is inconclusive on this issue. Policy supporters point to the fact that most of the key industries targeted by MITI have developed as planned (particularly the iron and steel, shipbuilding and computer industries), that the cooperative partnership formed between Government and industry has eliminated investment duplication and excess competition, and that tariffs and non-tariff barriers have ensured a stable domestic market for producers.

Others offer counter-examples to show that industrial policy in Japan has not worked effectively. Many industries have succeeded without government support; during the 1960s, for example, the sewing machine, camera, bicycle, motorcycle, piano, zipper, transistor radio, colour television, tape recorder, audio equipment, fishing gear, watch and clock, calculator, electrical wire, machine tool, textile machinery, insulator, agricultural machinery, communications equipment, ceramics, and robotics industries all experienced substantial growth and development without government intervention. Moreover, the implementation of industrial policy has often been frustrated by the resistance of private

enterprises. The most notable case involved the attempt by MITI to cartelize and rationalize the automobile industry in the 1950s and early 1960s; stiff opposition from automakers stopped the plan. Finally, the direct and indirect costs of supporting the declining coal mining, textile, shipbuilding, non-ferrous metals and petrochemical industries have been enormous.

As discussed earlier, the sole economic justification for State intervention is market failure. However, Japan's industrial policy has been influenced by non-economic objectives such as "catching up with Western countries", improving international competitiveness, and facilitating recovery and reconstruction after the Second World War—none of which meet the economic criteria for market failure. It is fair to say, though, that all countries have industrial policies of some kind—often in disguised forms. While they are not designated as such, the Chrysler bailout and the support for the National Aeronautics and Space Administration (NASA) in the United States, along with the agricultural support and strategic trade policies typically found in industrialized countries, are all part of an undeclared industrial policy.

It is also important to recognize that Japan's present industrial policy is anything but collusive, coercive or interventionist; the capacity of MITI to control and regulate industries has diminished to almost nothing in comparison with the Ministry's heyday during the 1950s and 1960s. Today, the focus is on creating a vision by encouraging cooperation.

E. THE REPUBLIC OF KOREA'S EXPERIENCE

The Republic of Korea represents a well-known success story of export-led industrialization steered by active and selective State interventions. Having emerged from an initial period of easy import substitution, which lasted from the end of the Korean War in 1953 to 1960, the Republic of Korea reached a turning point in its industrialization drive in 1963, when the first five-year economic development programme (1962-1966) was launched espousing a clear shift to an export-oriented strategy. The first programme focused on expanding the production and export of light manufactured goods. The second programme (1967-1971) was an extension of the first and stressed further consolidation of the economic growth and export expansion achieved in the first period. It was during the third programme (1972-1976) that the development of heavy and chemical industries was fostered to allow the country to broaden its industrial base and upgrade its international competitiveness. The progress made in the third programme was further consolidated in the fourth programme (1977-1981), evidenced by the increased sophistication of the industrial structure, the expansion of capital and intermediate goods industries, and science and technology institution-building. The emphasis shifted to macroeconomic stabilization in the fifth programme (1982-1986), however, because of various macroeconomic disequilibria caused by rapid growth during the previous periods, such as price instability and worsening income distribution.

The overall picture emerging from this succession of five-year development programmes reflects a shift in policy emphasis from the export of light manufactured goods in the 1960s to the development of heavy industries (mainly iron and steel) and capital goods industries (especially transport equipment) in the 1970s, and finally to the consolidation of these industries' export capabilities, the upgrading of the industrial structure, economic stabilization, and trade liberalization in the 1980s.⁵

During the period 1975-1985, export-led growth brought about a phenomenal structural change in the Republic of Korea. Real gross domestic product (GDP) grew 2.7 times between 1975 and 1985—an average annual rate of more than 10%. The share of agriculture in total output declined sharply from 13.6% in 1975 to 7.7% in 1985, while the manufacturing share increased from 44.2% to 50% during the same period. The services share fell slightly from 33.2% in 1975 to 31.2% in 1985. Particularly notable is the structural change within the manufacturing sector. The production of capital goods increased rapidly at an average annual rate of nearly 19%, with its share in total output rising sharply from 5.7% in 1975 to 12% in 1985 (see table 1). The intermediate goods industry also experienced rapid growth, averaging just over 12% per year, with its share in output increasing from 18.4% to almost 22% during the same period. By contrast, though light manufacturing grew at an average annual rate of around 8%, its share in total output dropped considerably from 20.1% to 16.4% between 1975 and 1985.

Manufactured exports, whose share in total exports increased from 71.9% to 77.5% between 1975 and 1985, grew by an average of 13.1% per year over the same period, or by almost 3.5 times, rising from 6,245 billion won in 1975 to 21,481 billion won in 1985 (see table 2). The most striking change in trade occurred, again, in the capital goods industry. Capital goods exports jumped six-fold between 1975 and 1985, from 1,364 billion won to 8,149 billion won; this increase represents an impressive real annual growth rate of almost 20%. The share of capital goods in total exports also rose steeply, from 15.7% in 1975 to 29.4% in 1985. It would appear that the active policy interventions instituted to promote exports, carried out between 1962 and 1986 within the context of a series of five-year programmes, cumulatively resulted in rapid economic growth and the structural transformation of the country's economy. Such export-led transformation was made possible by the existence of a skilled labour force, rapid capital accumulation, and most importantly, the State's political commitment to development and its capacity to direct the private sector towards export promotion.

⁵For a detailed account of industrial policy in the post-Korean-War period, see S.J. Kim (1993).

Table 1. Structural change in the Republic of Korea, 1975-1985
(1985 constant prices)

	1975		1980		1985		Annual growth rates		
	Production (billion won)	Percentage	Production (billion won)	Percentage	Production (billion won)	Percentage	1975-1980	1980-1985	1975-1985
1. Agriculture, forestry and fisheries	9 702.0	13.6	11 410.7	8.9	14 643.3	7.7	3.3	5.1	4.2
2. Mining and quarrying	938.5	1.3	1 145.5	0.9	1 353.5	0.7	14.3	11.8	11.5
3. <i>Manufacturing</i>									
Light manufacturing ^a	31 525.7	44.2	62 089.8	48.5	95 300.3	50.0	14.5	8.9	11.7
Intermediate goods ^b	14 308.8	20.1	24 261.8	19.0	31 262.2	16.4	11.1	5.2	8.1
Capital goods ^c	13 119.5	18.4	27 572.7	21.5	41 243.2	21.6	16.0	8.4	12.1
	4 097.4	5.7	10 255.3	8.0	22 794.9	12.0	20.1	17.3	18.7
4. Electricity, water and gas	1 299.9	1.8	2 559.9	2.0	4 459.4	2.3	14.5	11.7	13.1
5. Construction	4 237.2	5.9	9 422.6	7.4	15 462.5	8.1	17.4	10.4	13.8
6. Services	23 625.6	33.2	41 374.9	32.3	59 445.1	31.2	11.9	7.5	9.7
Total	71 328.9	100.0	128 003.4	100.0	190 664.2	100.0	12.4	8.3	10.3

Source: Bank of Korea, 1975-1980-1985 Link Input-Output Tables (Republic of Korea, 1989).

Note: Totals may not add up due to rounding.

^a Food, beverages and tobacco; and textiles and leather.

^b Lumber and wood products; paper, printing and publishing materials; chemicals and chemical products; primary metals; and non-metallic minerals.

^c Fabricated metals, electrical and non-electrical machinery; transport equipment; and scientific instruments.

Table 2. Structure of exports in the Republic of Korea, 1975-1985

	1975		1980		1985		Average annual growth rates		
	Exports (billion won)	Percentage	Exports (billion won)	Percentage	Exports (billion won)	Percentage	1975-1980	1980-1985	1975-1985
1. Agriculture, forestry and fisheries	625.3	7.2	615.7	3.6	554.3	2.0	-0.3	-2.1	-1.2
2. Mining and quarrying	69.5	0.8	51.3	0.3	27.7	0.1	-5.9	-11.6	-8.8
3. Manufacturing	6 244.8	71.9	12 655.4	74.0	21 480.7	77.5	15.2	11.2	13.1
Light manufacturing ^a	2 874.9	33.1	4 668.8	27.3	6 513.5	23.5	10.2	6.9	8.5
Intermediate goods ^b	2 006.3	23.1	4 224.2	24.7	6 818.4	24.6	16.1	10.0	13.0
Capital goods ^c	1 363.6	15.7	3 762.4	22.0	8 148.8	29.4	22.5	16.7	19.6
4. Electricity, water and gas, and construction	26.1	0.3	51.3	0.3	194.0	0.7	14.5	30.5	22.2
5. Services	1 719.7	19.8	3 762.4	21.8	5 432.5	19.6	16.7	7.8	12.2
Total	8 685.4	100.0	17 136.1	100.0	27 689.2	100.0	14.5	10.1	12.3

Source: Bank of Korea, 1975-1980-1985 Link Input-Output Tables (Republic of Korea, 1989).

Note: Totals may not add up due to rounding.

^a Food, beverages and tobacco; and textiles and leather.

^b Lumber and wood products; paper, printing and publishing materials; chemical products; primary metals; and non-metallic minerals.

^c Fabricated metals; electrical and non-electrical machinery; transport equipment; and scientific instruments.

Among other things, the Republic of Korea's experience underscores the crucial importance of the State's dedication and commitment to economic development and its bureaucratic capacity to guide the structural transformation process, especially the shift from protected import substitution to a more open, export-oriented strategy during the initial stages of industrialization. This experience may not constitute a good model for developing countries where the Government's competent stewardship of the private sector does not exist.

At this juncture, it is interesting to note a close historical parallel between Japan and the Republic of Korea in the pattern of industrialization and particularly in the evolution of industrial policy. Shifting away from light manufactured exports such as textiles, Japan's MITI targeted the iron and steel, automobile, shipbuilding and machine tool industries for rapid development in the 1950s and 1960s. In particular, the iron and steel industry was designated as a strategic sector under the Five-Year Plan for Economic Self-Reliance and the New Long-Term Economic Plan in the second half of the 1950s, and the automobile industry was accorded the same status under the National Income-Doubling Plan during the second half of the 1960s. In the 1970s MITI shifted the industrial policy focus to high technology, concentrating on the computer, semiconductor, robotics, new materials and other such industries.⁶ The growth of these industries was generally fostered by various protective measures such as import controls, restrictions on foreign investment in the targeted industries, preferential treatment for selected industries importing foreign technology, and various fiscal and financial supports.

The list of strategic-sector industries chosen by the Republic of Korea's Government was strikingly similar to that of Japan, whether by design or by coincidence; again, the focus was on automobiles, shipbuilding, machine tools, iron and steel, and semiconductors. Today, both Japan and the Republic of Korea enjoy a high degree of international competitiveness in these sectors. It must be noted, however, that in both countries, State intervention and the development of these key industries was greatly facilitated by a favourable macroeconomic environment characterized by high domestic savings, stable prices, favourable conditions for technological change, and above all, a highly skilled labour force.

F. CONCLUDING REMARKS

One of the major conclusions of this paper is that the nature, extent and objectives of industrial policy and the consequent implications for State intervention in the economies of developing countries may change over time. Successive policy changes may be viewed as an evolution towards a completely functioning free market. This further implies that

⁶ For further details, see Francks (1992).

no single optimal industrial policy exists for all developing countries; rather, there are different optimal policies for different groups of developing countries at different stages of industrialization. Put differently, the initial conditions present in a given country may, to a large extent, dictate the kind of optimal policies needed and the nature and scope of the State intervention required to implement them.

During the initial stages of industrialization, when there are no functioning markets, State interventions may be quite extensive, including public investment in infrastructure and institution-building and forced industrialization, given the inability of the private sector to mobilize resources and undertake huge investment projects. In the early stages, building manufacturing supply capacity is the primary focus; trade policies, particularly trade liberalization, become relevant only after basic supply capacity is firmly in place and a strong base for manufactured exports has been developed.

The East Asian experiences suggest that even after the labour-intensive light manufacturing base for exports is firmly established, strong selective policy interventions are still needed to achieve industrial and technological deepening. Such policy interventions, designed to broaden the industrial base and deepen technological capacity, must be selectively targeted at specific industries, since resources are too scarce to extend to all industries.

It should be noted, however, that as an economy advances along the trajectory of industrialization and its structure becomes more complex and sophisticated, selective policy interventions aimed at specific sectors become increasingly difficult to implement without unforeseen distortions in other sectors. At the advanced stages of industrialization, the role of the State will be restricted to maintaining a competitive environment for private enterprises, and resource allocation will be guided primarily by price signals and market incentives.

The experiences of Japan and the Republic of Korea are cases in point. As described earlier, both Governments were heavily interventionist during the early stages of industrialization. Today, in sharp contrast, there are visible signs of a policy shift towards a diminished State role and greater reliance on market mechanisms in both economies. In Japan, MITI no longer has the strong leverage over individual industries it once enjoyed. Japan's current industrial policy is more focused on broad cross-sectoral issues such as economy-wide deregulation and trade liberalization. In a similar vein, the Republic of Korea's next Five-Year Plan for the New Economy (1993-1998), launched on 2 July 1993, aims at deregulating fiscal, financial and administrative systems, and at accelerating the liberalization of trade and investment.⁷ Evidently, the Korean economy has outgrown the need for State "nurturing".

⁷ For further details on the Republic of Korea's new Five-Year Plan, see Yi (1993).

It may be that the East Asian export success stories based on selective intervention constitute a historically unique experience, and hence may not be replicable in other developing countries. As mentioned earlier, the central question is not whether State intervention *per se* is good or bad; what matters is the nature and quality of the intervention. The outcome of intervention will depend not only on its objective (whether it is geared towards facilitating inward- or outward-oriented industrialization, for example), but also on the capability of the State to initiate and guide structural transformation leading to the functioning of a free market. The State can play an important role in such an economic transformation; it takes an efficient and competent bureaucratic machinery to accomplish certain basic tasks in the early stages of industrialization—such as creating price stability, establishing a transparent legal framework, promoting competition, and investing in education. In this regard, one of the key variables often overlooked in the study of industrialization is the need for both a strong political commitment to industrialization and the bureaucratic capacity to implement well-conceived industrial policies.

Finally, it should be noted that many industrialized countries are presently pursuing a variant of industrial policy—so-called strategic and trade policies set up to enhance their national competitiveness in manufacturing. Such policies entail, among other things, a wide range of government interventions designed to assist firms in developing and adapting new technologies for commercial applications. In most cases, high-technology industries are targeted for such proactive innovation and technology policies. In contrast to the traditional trade theory based on comparative advantage, the new trade theory provides the basic rationale for proactive government intervention. In other words, while traditional theories focused on a pattern of trade determined by a country's relative factor endowments (comparative advantage), the new theories attempt to explain the trade pattern in terms of trade among countries with similar factor endowments and the dominance of intra-industry trade in similar products rather than trade in different products among countries with different factor endowments. Justification for government intervention is derived from theories related to imperfect competition, dynamic scale economies, and positive externalities which accompany research and development and high-technology industry. It is further argued that in such a world, competitive advantage can be created through a wide range of government interventions such as the provision of government support for research and development, the targeting of knowledge- and technology-intensive industries for support, the creation of access to intellectual property, the modification of competition rules to permit national firms to gain a dominant position, the restricting of foreign investments in strategic sectors, and the placing of restrictions on exports of technology-intensive goods and services. Whatever theoretical and empirical validity might exist for strategic technology and trade policies, the simple fact is that these policies call for proactive State intervention, and are hence basically no different from the industrial policies pursued in developing countries.

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Part Five

CAPACITY-BUILDING ISSUES

XII. CAN EGYPT GROW WITHOUT INSTITUTIONAL REFORMS? IF NOT, WHICH INSTITUTIONS MATTER MOST?

by Ahmed Galal¹
The World Bank

Introduction

It is being increasingly recognized that both market reforms and institutional reforms are necessary before private agents (as producers) can contribute positively to economic growth. A recent World Bank publication entitled *The East Asian Miracle: Economic Growth and Public Policy* (1993) indicates that the fast-growing economies of East Asia have not only got prices “righter” but have also established institutional mechanisms such as deliberation councils to reduce transaction costs and enhance policy predictability. Micro-level studies (for example, Galal and Nauriyal, 1995; and Levy and Spiller, 1995) suggest that credible commitment is critical for inducing private investment.

The logic dictating the necessity of combining economic and institutional reforms is both simple and compelling. The behaviour of entrepreneurs depends not only on the incentive structure provided by markets but also on that provided by institutions. Consider the following example. An entrepreneur is considering whether to invest in country A or country B. The countries offer two projects which are identical in all respects (including size, technology, input and output prices, and market size), but which exist within two very different institutional environments. In contrast to that in country A, the behaviour of the Government in country B (say, with respect to taxes) is unpredictable, disputes (over tariff bases, for example) are not settled fairly, and the costs of satisfying or avoiding certain regulations (relating to labour hiring and firing, for instance) are high. Other things being equal, the entrepreneur will invest in country A rather than in country B. Similar institutional variations across sectors within the same country can be just as distorting.

Saying that institutions matter for private decisions is not equivalent, however, to identifying which institutions matter and how they matter. This is not an easy task, for the institutional concept is often defined in very broad terms. For example, Douglass North (1991, p. 97) defines institutions as “the humanly devised constraints that structure political, economic, and social interactions. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct) and formal rules and regulations (a constitution, laws, and property rights).” In other words, almost all aspects of the way society is organized have a bearing on the decisions taken by private

¹ Special thanks go to Eliana Cardoso and Heba Handoussa for their helpful comments. Appreciation also goes to Integrated Development Consultants for assisting in the firm interviews.

entrepreneurs. Clearly, this view of institutions is too broad to tackle in the short run—a period during which societal features such as traditions are exogenous to policy makers.

Alternatively, the institutional relationship between firms and a Government can be viewed as a contract, where the Government pledges to establish certain rules of the game (in the form of regulation), and the agents respond to these rules (see, for example, Williamson, 1989).² However, this contract is, by definition, incomplete because it is both costly and difficult to foresee and fully specify all eventualities. As a result, success in motivating firms to invest and operate efficiently is far more likely to be achieved if the Government adopts appropriate incentive schemes, ensures that contract enforcement is not too costly, and institutes safeguards to protect firms against the expropriation of property. Meeting these conditions is particularly critical where investment is specific, in the sense that its redeployment to alternative uses by alternative users involves a sacrifice of productive value.

In order to translate this view of institutions into specific reforms, two questions must be answered. First, how much regulation or deregulation of business is desirable? Second, which regulation(s) is/are the most costly and thus the most worthy of policy makers' expenditure of political capital? Neither question is easy to answer. Defining optimal regulation empirically is complicated by the difficulties associated with measuring the costs and benefits of regulation. Measurement limitations also make it hard to determine how restrictive various regulatory constraints are (and to rank them accordingly).

There are, of course, cases where the benefits of regulation clearly outweigh the costs. For example, the absence of regulation for weights and measures can lead to chaotic and costly market imperfections. Similarly, the lack of regulation for health-threatening food additives can have serious consequences. In most cases, however, the net benefits of regulation are not clear, be it with respect to labour, intermediate inputs, capital or taxes. In each of these cases, there are benefits to be had—from, for example, protecting child labour, the standardization of inputs, and compliance with taxes. However, the Government (and ultimately taxpayers) incur costs in monitoring and enforcing regulations, entrepreneurs expend time, money and effort in complying with or circumventing them, and society pays in foregone investment if risk-averse entrepreneurs are sufficiently fearful of arbitrary changes in the rules of the game. These and other benefits and costs are difficult to identify fully, let alone measure.

² In the language of the principal-agent literature, the problem is that the Government (the principal) and private firms (the agents) have different objective functions, differential information (that possessed by the agents is better), and differential risk aversion (the agents are more risk averse). The principal's task is to devise an *ex ante* contract to motivate the agents to exert more effort, and to figure out a premium to be paid to the agents to compensate them for the added risk. These issues were first elaborated by Ross (1973) and Stiglitz (1974), and were recently reviewed by Sappington (1991).

To get around this problem, the present paper relies on a survey of the private sector to identify the most restrictive regulatory constraints. This approach has certain limitations: private entrepreneurs may exaggerate the costs of complying with or avoiding government regulations; they are likely to take their own costs into account and ignore the benefits of regulation to society; and they may incur transaction costs that vary with firm size. Notwithstanding these limitations, the survey approach produces a reasonable ranking of the various regulatory constraints from most to least restrictive. This ranking can be used by policy makers to determine which problem(s) should be tackled first. In most developing countries, business is thought to be overregulated; some deregulation is therefore likely to be considered beneficial to society.

The first section below summarizes the broad changes Egypt has made in its incentive structure within the context of a series of economic reforms begun in the early 1990s, and provides an assessment of the corresponding performance of the economy. In the second section, the most serious constraints on Egypt's private sector are examined; the third section contains a ranking of these constraints based on the results of a survey of 45 firms chosen at random from the food-processing, textile and engineering industries. The last section offers some policy conclusions.

A. MACROECONOMIC REFORMS, INCENTIVES AND ECONOMIC PERFORMANCE

Up until 1990, the incentive structure which existed for the public and private sectors in Egypt was highly distorted. In 1974, the Government had attempted to break away from decades of inward-looking public-sector-led development; however, it is generally agreed that the "open door policy" brought about only partial economic liberalization, leaving the previous development strategy fundamentally in place (see, for example, Handoussa, 1995; and Kheir El-Din, El Baradei and El Sayed, 1989). The economy continued to be dominated by the public sector, price controls on key goods and services, multiple and overvalued exchange rates, negative real interest rates, and excessive control over credit allocation and trade flows. During the period 1974-1985, gross domestic product (GDP) grew at an impressive average annual rate of 8.5%, but this growth was actually a reflection of capital inflow from foreign assistance, borrowing, oil-related exports, workers' remittances, tourism, Suez Canal revenues, and foreign direct investment (FDI). Most of these flows are subject to dramatic fluctuations, which means they cannot be relied upon to generate sustained economic growth.

The distorted incentive structure persisted through the 1980s, during which time the economy experienced a number of external shocks, including a decline in oil prices and an increase in interest rates. Rather than adjusting the economy to these shocks, the Government responded by drawing on external financing and restricting imports. This approach proved counter-productive. Import restrictions, high tariffs, and an overvalued exchange rate exacerbated the anti-export bias, thereby reducing foreign exchange

earnings from exports. The accumulation of foreign debt eroded the country's creditworthiness. The continuing increase of public expenditure over revenue led to massive fiscal and current account deficits. Eventually, cuts in imports and investment brought about a sharp decline in the GDP; by the late 1980s, annual GDP growth averaged only 2.5%. At the same time, inflation accelerated from 12% in 1985 to about 20% in 1990. The inability of the country to service its external debt provided the impetus for economic reform, which by that time was unavoidable.

1. Recent changes in the macroeconomic investment structure

The year 1990 saw the beginning of significant improvement in the macroeconomic incentive structure. There were a number of key reforms. Public absorption was markedly reduced to ensure price stability and leave more room for private investment (see table 1). The fiscal deficit was reduced from 18% of GDP in 1990 to an estimated 2.5% in 1994. The growth rate of both the money supply and government demand declined. In parallel, financial liberalization was pursued by removing the ceiling on the nominal interest rate, phasing out administrative credit allocation, and using Treasury Bill auctions to manage liquidity. Foreign exchange controls were abolished, and the exchange rate was unified.

During the same period, Egypt liberalized foreign trade by removing all quantitative restrictions on imports (except for those associated with the Multi-fibre Arrangement, or MFA) and by reducing and rationalizing import tariffs. The maximum tariff was reduced from 160% in 1988 to 50% in 1994, and the average tariff fell from 31% to 28% over the same period. A global income tax law was passed in December 1993, under which the marginal tax rate was reduced from 65% to 48%. The new law exempts corporate dividends to prevent double taxation. It lowers the corporate tax rate to 42%, and the rate for manufacturing even further, to 34%. Finally, the prices of tradeable goods were liberalized and those of non-tradeable goods revised upward. The domestic selling prices of both types of goods had been lower than their market values in most cases; the lifting of price controls on industrial goods and the upward revision of the prices of, for example, railway services, electricity, and natural gas meant higher domestic prices and signalled better resource allocation.

As a result of tight fiscal and monetary policies, inflation declined from 17.5% in 1990 to an estimated 8% in 1994. After a 35% devaluation of the Egyptian pound against the US dollar, the nominal exchange rate was kept relatively stable within a narrow band by means of an active monetary policy. The current account deficit, excluding official transfers, declined from 6.8% of GDP in 1990 to an estimated 1.7% in 1994. International reserves increased to about \$14 billion (14 months of merchandise exports) in 1993, thanks to a significant inflow of private capital.

Table 1. The Egyptian economy, selected economic variables, 1989-1994
(Percentage of GDP unless indicated otherwise)

	1989	1990	1991	1992	1993	1994
Budget deficit	-18.1	-18.4	-17.2	-5.2	-4.1	-2.5
Current account balance (excluding official grants)	-4.1	-6.8	-0.4	9.9	0.7	-1.7
External debt (billions of US dollars)	50.9	48.4	38.4	41.7	42.0	42.4
Money supply (growth rate of M2)	17.4	19.7	27.5	14.3	16.4	11.3
Inflation (percentage)	16.7	17.5	22.4	19.4	10.4	8.2
Nominal exchange rate (Egyptian pounds per US dollar)	1.94	2.61	3.01	3.32	3.33	3.37
Real effective exchange rate (1992 = 100)	95.7	110.4	106.4	100.0	91.8	87.5
Percentage change (minus sign = appreciation)	-1.2	15.4	-3.6	-6.0	-8.2	-4.7
Nominal interest rate (3-month Treasury Bills)	..	..	19.0	19.0	16.3	13.0
Real interest rate (Treasury Bills; percentage)	..	..	-2.8	-3.0	5.3	4.5
Maximum tariff rate on imports (percentage)	160	..	..	80	80	50
Top marginal tax rate (percentage)	65	65	65	65	48	48

Source: World Bank, "Egypt—into the next century," Country Economic Memorandum, Report No. 14048-EGT (Washington, D.C., May 1995).

Note: Two dots (..) indicate that the item is not available.

* Estimated.

The success of the stabilization programme was helped by the forgiveness of some of Egypt's debt in the wake of the Gulf war, the result of which was a decline in the country's total external debt from \$51 billion in 1989 to about \$42 billion in 1994.

Beyond stabilizing the economy, these reforms reduced the "crowding out" effect of government borrowing, aligned key prices better with the scarcity of resources, and reduced the anti-export bias. Although additional reforms are still needed, at issue here

is whether or not the improved incentive structure has induced the economy to grow, exports to flourish, and the private sector to expand.

2. Economic performance

The simple answer is no. Egypt's GDP grew at an annual rate of 1.4% between 1989 and 1994. This modest increase was more than wiped out by population growth; per capita income actually declined at an average annual rate of 0.7% during the same period (see table 2). Simultaneously, unemployment rose, amounting to over 10% in 1994. Total fixed investment (at constant 1992 prices) remained fairly stagnant, and was expected to pick up only slightly in 1994. Perhaps even more disappointing was the trend in merchandise exports, whose decline in 1992 and 1993 was expected to continue in 1994.

Table 2. Selected economic indicators, 1989-1994.
(Percentage of GDP unless indicated otherwise)

	1989	1990	1991	1992	1993	1994*	Average (1989-1994)
Real GDP growth rate (percentage)	3.0	2.4	2.1	0.3	0.5	2.0	1.4
Real GDP per capita growth rate (percentage)	0	-0.6	-0.4	-1.4	-1.7	0	-0.7
Inflation (percentage)	16.7	17.5	22.4	19.4	10.4	8.2	15.8
Unemployment (percentage of labour force)	7.0	7.6	8.4	9.2	10.1	9.8	8.7
Investment (billions of Egyptian pounds [LE] at 1992 prices)	24.5	24.2	23.1	20.8	21.0	22.6	22.7
Investment (percentage growth rate)	0	-0.9	-4.6	-9.8	1.5	4.5	-1.6
Merchandise exports (billions of US dollars, at 1992 prices)	3.0	3.1	3.7	3.6	3.5	3.2	3.9
Export growth rate (percentage, 1992 prices)	-17.8	5.1	19.7	-2.4	-2.9	-10.2	-1.4

Source: World Bank, "Egypt—into the next century," Country Economic Memorandum, Report No. 14048-EGT (Washington, D.C., May 1995).

* Estimated.

Why have growth, investment and exports been so sluggish? One possible answer is that stabilization measures typically lead to a recession initially, followed by a recovery. This has been the experience of other countries, as illustrated in table 3, and Egypt should be no exception. Accordingly, it may be concluded that recovery in Egypt is inevitable, and that the country will soon begin to reap the benefits of reform.

Table 3. Comparison between Egypt and three successful reformers
(Percentage of GDP unless indicated otherwise)

	GDP growth (%)	Inflation (%)	Fiscal balance	Unemployment (%)	Current account balance	Foreign direct investment	Gross domestic investment
Egypt							
Before (1985-1989)	3.6	18.9	-21.4	..	-7.0	0.5	23.2
During (1990-1994)	1.5	15.6	-9.3	9.0	0.3	0.7	20.0
Argentina							
Before (1975-1990)	0.2	569.3	-8.7	5.5	-2.3	0.9	21.5
During (1991-1993)	7.9	69.1	-0.9	7.7	-3.1	1.9	16.9
Chile							
Before (1971-1974)	0.8	240.3	-14.7	5.4	-5.5	-3.1	14.0
During (1975-1988)	3.1	67.8	-3.1	15.8	-7.6	0.9	15.5
After (1982-1993)	7.1	18.6	0.6	6.1	-2.4	1.5	21.4
Thailand							
Before (1975-1983)	6.8	8.5	-5.4	1.3	-5.4	0.5	26.0
During (1984-1987)	6.4	1.9	-6.4	3.7	-2.5	0.6	27.3
After (1988-1993)	11.3	4.8	0.6	4.1	-5.9	1.9	37.6

Source: World Bank, "Egypt—into the next century," Country Economic Memorandum, Report No. 14048-EGT (Washington, D.C., May 1995).

Note: Two dots (..) indicate that the item is not available.

While this answer is valid in part, two factors suggest that the expected recovery may not be sustainable in the long run. First, Egypt has yet to undertake significant reforms to restructure the "real" side of the economy, especially in the areas of public enterprise, education and health (see Shihata, forthcoming; and World Bank, 1995c). Second, Egypt has thus far failed to reform its institutions to make them more compatible with a more dynamic market- and private-sector-oriented economy.

B. INSTITUTIONS AND ECONOMIC PERFORMANCE

There is increasing support for the view that institutional reforms are critical for economic growth. For example, North (1990, p. 54) asserts that “the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World”; this is because insecure property and contractual rights discourage investment, and by extension, economic growth. This assertion is supported by a number of empirical studies. For example, Knack and Keefer (1994) find that property rights (measured by assessing such variables as contract enforceability, the rule of law, and the risk of appropriation) have a significant impact on investment and growth.³ Country case-studies (for example, World Bank, 1993; and World Bank, 1995a) suggest that the Governments of countries where macroeconomic reforms have been successful in bringing about sustainable economic growth have also deregulated economic activity, strengthened contract enforcement, and taken a firm stand against arbitrary policy reversal. The question is: How does Egypt fare on all these counts?

As will be illustrated below, the Egyptian economy is overregulated, contract enforcement is relatively weak and costly, and investors believe the Government’s commitment to reform to be less credible than is the case in other countries. The overregulation of inputs (labour, capital and so on), outputs (especially exports), and tax administration, together with the weak enforcement of contracts and uncertainty, increases the transaction costs of investment and the operation of firms.

1. Overregulation

Although it is difficult to establish a benchmark against which to measure excessive regulation, an examination of various regulations in Egypt suggests that the economy is overregulated. Two examples—labour regulation⁴ and tax administration⁵—are presented below.

³ Recent growth regressions used other proxies in testing the impact of institutions on growth—most frequently political stability and civil liberties (see, for example, Barro, 1991; and Levine and Renelt, 1992).

⁴ The discussion of labour regulation here focuses on formal regulations; as will be shown in section C below, however, formal labour regulations are not binding in practice.

⁵ Another example of excessive regulation in Egypt’s export sector can be found in Schouten (1995).

(a) Labour regulation

Law No. 137 of 1981 regulates several aspects of the labour market. Among other things, the law places severe constraints on hiring, requires that restrictive conditions be met for firing to the point of prohibition, and establishes complicated procedures for settling labour disputes.

By law, firms employing 10 or more workers can only recruit new staff from a pool of candidates nominated by a government agency called the Manpower and Training Directorate (MPTD). The process is supposed to work as follows. The employer provides the MPTD with a profile of each vacancy within seven days of its occurrence.⁶ The MPTD identifies qualified candidates, giving precedence wherever possible to those who registered earliest, to veterans of the armed services, and to the handicapped. The MPTD furnishes the employer with a list of twice the number of persons required within seven days of receiving the vacancy notice. If the MPTD does not nominate candidates for the vacant position(s) within one week, the employer has the right to fill it/them on his own. The employer is forbidden to hire through employment agencies or labour contractors.

By law, firing is permitted without the concurrence of the MPTD only under the following conditions:

- Expiry of the contract period
- The end of the season for seasonal workers
- The completion of casual or temporary work
- The resignation or death of the worker
- Unfitness demonstrated during the probation period

Firing is not allowed without the concurrence of the MPTD when the cause involves reasons specified in an organization's regulations and penalty sanctions, or when the employee:

- Is absent for more than 10 consecutive days or 20 intermittent days during one year without an acceptable reason.
- Is completely disabled or has a permanent partial disability which prevents him from doing his job in a situation where no suitable substitute work exists.

⁶ This process is described in greater detail in a recent World Bank report (Integrated Development Consultants, 1991).

- Has impersonated someone else or submitted forged certificates or other documents.
- Causes a grave material loss to the employer, provided that the loss is reported to the MPTD within 24 hours.
- Fails to observe safety precautions, even though appropriate warnings have been issued to this effect, provided safety instructions are posted in a location visible to all workers.
- Fails to fulfil substantial obligations associated with the employment contract.
- Releases firm secrets.
- Is found guilty of a felony or of any crime bearing on honour, honesty or public morals.
- Is found to be under the influence of alcohol or narcotics.
- Attacks or assaults the employer or the manager responsible for reasons associated with work or during working hours.

In all such cases, the dismissal of an employee requires that a request be submitted to a tripartite committee composed of the Director of the MPTD or his representative (as chairman), the worker or his representative, and the employer or his delegate. The committee reviews the documentation and hears the arguments of both parties. If an amicable solution to the dispute is reached, the matter ends; if not, the case may be taken to the Court of Urgent Matters for a hearing. The decision of this court is not binding and can be appealed further. The process can be very costly and time-consuming.

(b) Tax regulation

The regulation of taxation appears to be very costly as well, in that the tax law gives tax inspectors too much discretion, induces tax disputes, and relies on principles that are too costly to administer.

Procedurally, commercial and industrial entities are required to file tax declarations within 30 days of the General Assembly meeting. Failure to submit the declaration on time results in a penalty of 20% of the taxes due, which can be reduced to half in cases where a compromise is reached between the declarer and the Tax Authority without referring the matter to the Appeals Committee.

Tax collection is based on the principle of auditing all taxpayers, a practice seldom followed in other countries. The Tax Authority has up to five years for inspection. Tax officers receive bonuses on the basis of collected taxes, which may lead them to overestimate the taxes due. Further, the criteria for tax assessment are ambiguous at times, forcing tax officers and taxpayers into extreme initial bargaining positions. If a tax officer does not approve an amount due, a taxpayer has one month to object to the Appeals Committee, which consists of three Tax Authority officials (including the head, who is appointed by the Minister of Finance), as well as two members appointed by the taxpayer (if he/she so chooses). Decisions are taken by majority vote but are not necessarily final. Each party has the right to dispute the Committee's judgement before the primary court within 30 days of its announcement, whatever the disputed amount may be. Tax disputes are known to take years to settle, and the number of cases pending legal resolution is increasing.

2. Contract enforcement

The settlement of labour, tax and other such disputes is often not very costly if the court system is impartial, efficient and consistent; when the opposite is true, contract enforcement among concerned parties or between firms and the Government can be very costly. The latter seems to be the case in Egypt.

According to a World Bank study (1995c), the businessmen, lawyers and judges involved in administering justice in Egypt all feel that the system is simply too slow, expensive and uncertain. In 1993/1994, the clearance rate of commercial cases was only 36%, compared with 80% in Japan and 88% in Belgium. Moreover, the situation seems to have deteriorated over time; the average duration of commercial cases tripled from about two years in the early 1970s to more than six years in the early 1990s (Naguib, 1988). There is about one pending case for every three Egyptians.

3. Commitment

Finally, since firms invest today and recover their money tomorrow, the fear of future arbitrary policy reversal is critical. This fear is reduced where: the Government exhibits a history of maintaining consistent policies; there are internal restraints on policy reversal (such as laws or constitutional restrictions, or checks and balances among the different branches of Government); and the Government is bound by international restraints (such as treaties or aid conditionality).

On these three accounts, Egypt scores modestly compared with successful reformers. According to the 1995 *Institutional Investor's Country Credit Ratings* publication, Egypt ranks far below Thailand, Chile, and to a lesser extent, Argentina (see table 4). Egypt's ranking has improved somewhat during the 1990s as economic reforms

have proceeded, but at no time has its ranking been comparable to that of Chile or Thailand.

Table 4. Institutional Investor's Country Credit Ratings

Country	1980	1984	1988	1992	1995
Egypt	34.9	32.7	23.1	26.8	32.9
Argentina	64.3	23.2	23.2	26.2	38.9
Chile	54.9	26.4	28.9	45.9	55.6
Thailand	..	53.4	56.0	61.3	63.5

Source: Institutional Investor's Country Credit Ratings, various issues.

Note: Two dots (..) indicate that the item is not available.

The executive branch in Egypt—unlike that of Argentina, Chile (after Pinochet) or Thailand—enjoys considerable influence over policy formation. It rules by majority in Parliament and exerts significant influence over other branches of Government. As a result, policies can be changed without much opposition. External restraints do not seem to curb policy reversal either; foreign aid has generally been tied to political rather than economic conditionality. Further, although Egypt signed the General Agreement on Tariffs and Trade, it is only bound to the less restrictive provisions reserved for lower-income countries.

Uncertainty can be reduced somewhat if the Government and the private sector engage in a productive dialogue through organizations such as business associations. Unfortunately, the effectiveness of business associations in Egypt is limited, as they are largely controlled by the Government or dominated by large firms; their participation in policy formulation is thus either limited or biased in favour of more influential business groups.

In sum, important reforms must be carried out on the institutional front if Egypt is to reap the full benefits of macroeconomic reforms.⁷ The question is, in which area(s) is deregulation likely to have the biggest impact? This issue is taken up next.

⁷ This general point has also been made by Biblawi (1989) and Handoussa (1995).

C. THE PATTERN AND RANKING OF INSTITUTIONAL CONSTRAINTS: SURVEY RESULTS

To identify the constraints private firms find the most restrictive, a survey of 45 randomly selected manufacturing firms was carried out. Fifteen companies were selected from each of three industries: food processing, textiles and engineering. Representatives of all of the firms answered a series of questions (see annex) designed to determine the regulatory constraints on the firms' inputs and output (labour, capital, intermediate inputs; and profit), the firms' perceptions of the state of economic activity (measured by demand for their output), and the level of uncertainty (arising from both economic and non-economic factors). Personal interviews were conducted with each representative. The profile of the sample is given in table 5. As expected, the smaller firms have a much lower capital-labour ratio than the larger firms (representing 16% on average), they rarely export, and their initial debt-equity ratio is much lower than that of the larger firms.

Table 5. Sample profile

	Food processing		Textiles		Engineering	
	Small	Large	Small	Large	Small	Large
1. Number of firms	8	6	8	7	9	6
2. Fixed assets (thousands of Egyptian pounds/firm)	182	28 355	69	5 599	458	18 733
3. Number of exporting firms	0	5	0	5	2	3
4. Initial debt/equity ratio (percentage)	15	51	0	15	10	26
5. Capital labour ratio (thousands of Egyptian pounds/worker)	11	89	4	48	15	47

Source: A. Galal, survey of 45 Egyptian firms.

Note: "Small firms" refers arbitrarily to entities with an average of 10 employees or less.

1. Overall ranking of constraints

The questionnaire results indicate that as a group, the firms believe the most restrictive constraints to be policy uncertainty, tax administration, access to finance, and the availability of material inputs, in that order. Labour regulation and demand are considered the least restrictive (see table 6). The finding that policy uncertainty is the most restrictive constraint is consistent with the analysis of the previous section. However, the fact that labour regulation is not as restrictive as the laws suggest is somewhat surprising; in the personal interviews, it was revealed that this was the case because firms were able to disregard labour regulations on hiring and firing by, for

example, agreeing to pay relatively insignificant penalties for violations,⁸ renewing contracts annually, or obligating workers to sign employment contracts and undated letters of resignation at the time of recruitment.

Table 6. Ranking of institutional constraints by sector

Constraint	Food processing		Textiles		Engineering		Average	
	Score	Ranking	Score	Ranking	Score	Ranking	Score	Ranking
Policy uncertainty	0.85	1	0.72	2	0.74	2	0.78	1
Tax administration	0.55	2	0.82	1	0.66	3	0.67	2
Access to finance	0.51	3	0.54	4	0.78	1	0.60	3
Access to material inputs	0.43	4	0.58	3	0.47	4	0.49	4
Labour regulation	0.18	6	0.37	6	0.32	5	0.30	5
Demand	0.31	5	0.39	5	0.18	6	0.29	6

Source: A. Galal, survey of 45 Egyptian firms.

Note: The figures are normalized to a scale of 0 to 1, where 0 means that the constraint is not restrictive at all, and 1 means that the constraint is prohibitive.

Another general finding is that the ranking of the institutional constraints is very similar across industries; while the severity of an individual constraint varies according to industry, the relative ranking is essentially the same. For example, policy uncertainty is considered the most restrictive constraint in the food-processing and engineering industries, and the second most restrictive in the textile industry. Similarly, labour regulation and demand are regarded as the least restrictive constraints by all three industries. Economy-wide institutional reform is seen as the key to better performance.

2. The severity of institutional constraints according to type of industry

The severity of institutional constraints varies by industry (see table 6). For example, tax regulations are more binding in the textile and engineering industries than in the food-processing industry; part of the reason for this is that many food-processing

⁸ The fines for violating labour laws range between 10 and 20 Egyptian pounds (LE), or \$3 and \$10, per incidence.

firms enjoy temporary tax holidays, which means they do not have to deal with the Tax Authority on a regular basis.

Table 6 also indicates that while financing is more problematic for engineering firms, textile businesses suffer the most from difficulties associated with labour regulation and the availability of intermediate inputs. Labour regulation problems are felt more acutely by firms in the textile industry because this industry is more labour-intensive than the others. In the same sector, the shortage of State-owned enterprises in ginning and spinning activities; this is discussed further below. material inputs (for weaving and ready-made garments) is caused primarily by the domination

3. The severity of institutional constraints according to firm size

The impact of most of the institutional constraints discussed here also varies with the size of the firm. In general, the smaller the firm, the more restrictive the constraint (see table 7). This pattern is particularly apparent with respect to tax administration, demand, and access to finance and intermediate inputs. The major exception is labour regulation, which the smaller firms in all three industries find less binding than do the larger firms—mainly because labour regulation is not as strongly enforced for firms employing fewer than 10 workers.

Table 7. Ranking of institutional constraints by firm size

Constraint	Small firms		Large firms		Average	
	Score	Ranking	Score	Ranking	Score	Ranking
1. Policy uncertainty	0.77	2	0.78	1	0.77	1
2. Tax administration	0.78	1	0.67	2	0.73	2
3. Access to finance	0.68	3	0.60	3	0.65	3
4. Access to material inputs	0.58	4	0.49	4	0.54	4
5. Labour regulation	0.25	6	0.30	5	0.27	6
6. Demand	0.39	5	0.29	6	0.34	5
Average	0.58		0.52		0.55	

Source: A. Galal, survey of 45 Egyptian firms.

Note: The figures are normalized to a scale of 0 to 1, where 0 means that the constraint is not restrictive at all, and 1 means that the constraint is prohibitive.

The fact that smaller firms have greater difficulty than larger firms in gaining access to credit is not surprising. There is ample evidence worldwide to support the hypothesis that lending to smaller firms entails a greater risk of default and higher processing costs, so banks generally prefer to lend to the larger concerns.

Variations across industries with respect to the problems encountered in obtaining intermediate inputs frequently appear to be industry-specific. As part of the survey, the firms were asked to identify the nature of the problem, or more specifically, whether price, quantity, quality and/or delivery time affected their access to intermediate inputs. The results, given in table 8, suggest that firms in the textile industry suffer the most, while firms in the food industry are the least affected. One explanation for this is that private firms in the garment industry get their yarns from State-owned enterprises. Given that State-owned enterprises enjoy a monopoly in the ginning and spinning markets, and that they only sell what is left over to the private sector after meeting their export targets, it is not surprising that downstream private firms suffer. In contrast, firms in the food industry are either self-sufficient (chicken farms fall into this category) or have access to multiple suppliers in both the private and public sectors, so most of them do not have the problems encountered by firms in the other industries.

Table 8. Constraints on the securing of intermediate inputs by industry

	Food processing	Textiles	Engineering	Average
Quantity	0.02	0.43	0.08	0.17
Price	0.30	0.57	0.25	0.37
Quality	0	0.57	0	0.19
Delivery time	0.17	0.57	0.25	0.33

Source: A. Galal, survey of 45 Egyptian firms.

Note: The figures are normalized to a scale of 0 to 1, where 0 means that the constraint is not restrictive at all, and 1 means that the constraint is prohibitive.

In sum, the survey results support the broad conclusion that a high-level commitment to institutional reform is the most critical element in Egypt's efforts to make its institutions more compatible with the recent macroeconomic reforms. The results also suggest that tax administration and regulations constitute a key priority for reform. Finally, while some institutional constraints cut across industries, others are industry-specific; for that reason, a two-track (national- and industry-level) approach to institutional reform is desirable.

D. CONCLUSIONS AND POLICY IMPLICATIONS

The upshot of the analysis is that the incentive structure in Egypt has improved in recent years. Through the macroeconomic reform programme begun in the early 1990s, the Government has been able to align exchange and interest rates more closely with market values, increase competition through trade and price liberalization, and reduce inflationary pressures and the crowding out of the private sector by cutting the fiscal deficit. Further reforms are still needed on the macroeconomic front to correct for the distortions which have accumulated as a result of decades of inward-looking-policies, and reforms on the institutional front lag behind as well. Egypt's economy is characterized by excessive regulation, weak contract enforcement and policy uncertainty; these problems must be addressed, as macroeconomic reforms alone are not likely to bring about sustainable long-term economic growth.

The survey results support this conclusion. Policy uncertainty is seen as the most restrictive constraint, followed by tax administration. This ranking suggests that the pay-off from institutional reforms is likely to be higher if efforts are focused first on reducing policy uncertainty and second on instituting reforms to rationalize tax administration. The survey results also show that the severity of the constraints varies from industry to industry, which suggests that attention should be given to industry-specific problems; in some cases, allowing more competition and facilitating privatization might constitute the best solution.

One final thought: Many of the existing regulations were created with good intentions. Tax regulations were created to enhance tax collection and reduce tax evasion, and labour regulations were created to protect employees in general, but most particularly unskilled, female and handicapped workers.⁹ The problem is that the current regulations do not seem to have achieved their intended objectives; tax evasion is reportedly widespread, and labour regulations are often disregarded. At the same time, scarce resources are being wasted to follow or circumvent these regulations. A country as poor as Egypt cannot afford to spend these resources on dispute settlement, bribery and foregone productivity. Institutional reforms constitute the next step on the road to economic progress.

⁹ Examples: (a) the current law forbids employing women for tasks representing a risk to health or morals. Female workers are entitled to a total of three 50-day maternity leaves at full pay, and are not allowed to work during the first 40 days after giving birth. Mothers of infants of up to 18 months may have two extra paid daily rest intervals of at least half an hour each. In firms employing 50 or more workers, a female worker may take up to three 1-year unpaid leaves to care for her children. Firms employing more than 100 workers at one location must provide nursery care for the children of these workers; (b) juveniles aged 12-17 may work under restricted conditions, but not for more than four continuous hours or on official holidays. Special health care is required for juvenile workers, including a yearly physical exam, maintenance of medical records, and the provision of a daily cup of milk of at least 200 grams; and (c) firms with 50 or more workers are required to include handicapped workers as 5% of their total labour force.

Annex

SURVEY QUESTIONNAIRE

A. OVERVIEW

1. Name of enterprise: _____
2. Year established: _____
3. Nature of activity: _____
4. Type of company:
_____ sole proprietorship
_____ limited liability
_____ joint stock
_____ other (specify)
5. Which company law is your firm registered under? Law No. _____
6. Number of employees:
_____ at start-up
_____ at present
7. Value of fixed assets:
_____ at start-up
_____ at present
8. What was the volume of sales in 199-? _____
What is the expected value for next year? _____
If there is a difference between the two years, what is the main reason?

9. What are your main sales items (express as a percentage of total sales)?
(a) _____
(b) _____
(c) _____
(d) _____
10. What is your estimated domestic market share? _____ (percentage)

11. Do you export any products?
 Yes _____ (percentage of exports in total sales)
 No _____
 If yes, what are your main export items?

12. Your production technology is:
 _____ mostly by hand _____ mostly mechanized _____ mostly automated
13. Why have you selected this production technology?
 _____ labour regulations
 _____ availability of skilled labour
 _____ cheap finance
 _____ other (specify)
14. What was the ratio between debt and equity at the start-up of your business?
 _____ (percentage)

B. PROCUREMENT

15. What are your major material inputs?
 (a) _____
 (b) _____
 (c) _____
16. What are their main sources (percentage of the total cost of material inputs)?
 _____ imported
 _____ local products from the private sector
 _____ local products from the public sector
17. If imports constitute an important source of inputs, does their procurement constitute a problem? _____ yes _____ no
18. If the answer to the question above is yes, which organizations are the most problematic to deal with?

19. How many sources are available for local material inputs?
 _____ private firms _____ public firms

20. Do you encounter problems in obtaining domestic inputs?

- no
- yes, in terms of quantities available
- yes, in terms of price
- yes, in terms of quality
- yes, in terms of delivery time

Please explain _____

21. Is the price of any of your major inputs fixed by the Government?

- no
- yes; specify input and government agency

22. Can you obtain these inputs at the official price? yes no

If not, how high is the market price relative to the official price?

Input _____ Official price as a percentage of market price _____
 Input _____ Official price as a percentage of market price _____

C. REGULATORY ENVIRONMENT

23. Please rank the severity of the following obstacles on a scale of 1 to 5:

	<i>Minor</i>		<i>Moderate</i>		<i>Major</i>
(a) Tax administration	1	2	3	4	5
(b) Labour regulation	1	2	3	4	5
(c) Access to inputs	1	2	3	4	5
(d) Access to finance	1	2	3	4	5
(e) Demand	1	2	3	4	5
(f) Policy uncertainty	1	2	3	4	5
(g) Other (specify)	1	2	3	4	5

24. Please explain the major obstacles (if any) in greater detail:

25. Which obstacle is the most costly?

Tax administration _____ Labour regulation _____
 Access to material inputs _____ Access to finance _____

26. For the most costly items, please estimate the added cost of these obstacles over the past year (as a percentage of the cost of the item itself, with a statement of how this percentage is arrived at).

<i>Item</i>	<i>Estimated percentage</i>	<i>Remarks</i>
_____	_____	_____
_____	_____	_____
_____	_____	_____

27. What recommendations can you make for relaxing the restrictions listed above?

<i>Item</i>	<i>Recommendations</i>
_____	_____
_____	_____
_____	_____
_____	_____

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XIII. MANAGEMENT OF CHANGE AND TRAINING TECHNIQUES

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Introduction

Political conflicts and instability, changes in political systems (with the consequent changes in economic systems and policies) and economic turbulences have characterized the region during the past 50 years. Most of the changes that have taken place have been unpredictable and have adversely affected the operation of industrial enterprises. Regional events and uncertainties have created instability in a number of areas, including labour mobility and availability, capital transfers and remittances, trade relations between Arab countries, economic systems, and national economic planning and policies (see Mansour, 1995). These factors, which continue to have a negative impact on the operation of enterprises, have been affected by economic decisions, but are mainly the result of political instability and conflicts in the region.

Recent global and regional events have created even greater instability and unpredictability; many of them pose serious challenges to industrial enterprises. At the global level, these changes include the recently concluded Uruguay Round trade agreements aimed at globalizing and liberalizing trade, the establishment and strengthening of large regional economic blocs, the increasingly rapid advances in the application of high technologies, and the application of international quality standards (such as ISO 9000) and environmental controls (including the emerging ISO 14000 standards). Regional changes are linked to the continuous fluctuations in oil prices and revenues, as well as to the peace process and its implications for economic and trade relations and for the operation of firms in the ESCWA region.

In this paper, the term "conditions of change" relates to the radical changes witnessed in both the global economy and the region. These changes and their impact have already been extensively reviewed and discussed; this paper takes the next step, focusing on how best to deal with change at the enterprise level. Presented first is a discussion of the concept of change, the relation of change to innovation, the need for enterprises to introduce changes, and some guiding principles for successful change. These factors formed the basis for a pilot entrepreneurship workshop held by ESCWA and others in 1994. The second part of the paper offers a summary of the workshop proceedings, including a description of the techniques used by ESCWA to train a group of managers of industrial firms facing rapidly changing conditions. The aim of such training was to upgrade the managers' entrepreneurial skills to enable them to deal more effectively with changing conditions, predict change, and introduce appropriate responses.

A. THE ENTREPRENEUR AND CHANGE

In order to stay competitive in the market and deal with the challenges associated with trade liberalization, the impact of the peace process and other major events, a firm has to adapt to the new environment, introduce appropriate changes, and exploit the opportunities arising from the new situation. The ability of a firm to cope with change depends to a large extent on the entrepreneurial and managerial skills of the top managers and on their capabilities in motivating middle management and other employees. The changes that are introduced by a firm to enable it to deal more effectively with a new environment may be considered changes *within* an existing situation (the Austrian mode of entrepreneurship); this may be contrasted with Schumpeterian entrepreneurship, which brings about the change *of* an existing situation (see Volberda and Cheah, 1993). In the first case, the entrepreneur generally copes with external changes by introducing only incremental or limited innovations/changes in the firm; in the second case, the changes carried out by an enterprise are reflected in radical innovations and do not merely constitute a response or adaptation to major global or regional events. The Schumpeterian entrepreneur is able to predict the future, set new and challenging objectives, create new opportunities and induce changes. This imaginative creator of new futures is a willing risk-taker and increases or creates uncertainty (see Hyvarinen, 1993), while the entrepreneur who adapts to change tries to reduce the general level of uncertainty over time.

Formulating appropriate responses and inducing changes in the environment both require that the manager of an industrial firm be innovative and creative. Incremental innovation involves the *adaptation and/or development* of innovations, and can include the exploitation of opportunities that may not yet have been perceived by others; activities may include the development of adapted products, processes, markets and marketing channels, as well as administrative and organizational changes. Inducing changes in the environment entails the *creation* of innovations and new opportunities—or more specifically, the creation of a new product, and the promotion of radically different new production processes and new technologies. It is worth mentioning in this regard that, though they are different, these two forms of innovation and modes of entrepreneurship complement each other, in the sense that a firm is required to continuously adapt, develop and renew itself; incremental innovations constitute a normal daily concern for the entrepreneur, while radical innovations tend to be initiated only every few years or so.

The innovation process for small and medium-sized enterprises (SMEs) differs from that of large corporations. The smaller the firm, the more likely it is that the innovation will be produced by the top management or the owner-manager. In larger firms, the success of an innovation process depends on the input of top, middle and lower managers; in this case, entrepreneurial attitudes and behaviour should work their way down through top management to all units and sections of the firm. Human relations—motivating employees, expressing appreciation and encouragement, and

stimulating enthusiasm (see Hyvarinen, 1993)—are more important in large firms and can be considered a key factor in promoting creativity among employees, better performance and the success of the innovation.

A firm's ability to adapt to changing conditions and/or to induce changes in the environment depends on its internal flexibility. In this context, flexibility is determined by the variety of actual and potential procedures an organization possesses, as well as by the speed with which it can implement any one of these procedures (see Volberda and Cheah, 1993) and respond to changes in the manufacturing environment. Flexibility enables a firm to gain a competitive advantage. The faster a firm is in adapting to change, the more competitive and the less vulnerable it is. The type and degree of flexibility will determine the extent to which an organization may succeed in bringing about the required changes.

Firms that do not have the capabilities to cope with changing conditions and/or to exploit opportunities might still possess an *operational flexibility*. This type of flexibility, found in many firms, applies to routines based on the existing structures or goals of the firm, and relates, for example, to the ability of the firm to introduce variations in the volume of production and the number of employees.

Some firms have *structural flexibility*, which refers to the capacity to modify the organizational structure to suit changing conditions. Such flexibility is characterized by, for example, a firm's ability to use multi-purpose equipment, to produce a new product design through the efficient conversion of the manufacturing process (product flexibility [see Levary, 1992]), and to substitute labour with equipment and export markets with the local market. Flexibility also helps managers establish an effective manufacturing strategy that will allow them to survive—and even to thrive—in the dynamic global environment.

Firms that are capable of inducing changes, dealing successfully with uncertainties and introducing radical innovations have *strategic flexibility*. This quality, which is rarely found in developing countries, characterizes only those firms which are willing and able to make revolutionary changes—such as transforming or renewing existing structures and processes, and possibly restructuring the firm itself—that will enable them to create radical innovations (Levary, 1992).

B. THE MANAGEMENT OF CHANGE BY JORDANIAN ENTREPRENEURS

A 1994 survey of 84 industrial enterprises in Jordan, carried out by ESCWA in cooperation with Friedrich Ebert Stiftung (FES) and the University of Jordan, revealed that many of these firms were relatively inflexible; very few were internally prepared to cope with the impact of global and regional events, particularly the Gulf crisis, and most of them did not have a strategy for dealing with the impact of the peace process. The flexibility that existed—if it existed—was generally an operational flexibility, in the sense that the firms

were able to introduce changes in the volume but not in the kinds of activities carried out. Only a few had dealt successfully with the events, demonstrating structural flexibility, by shifting from the export to the local market or by diversifying the production and/or sources of raw materials and equipment. Strategic flexibility was not found among Jordanian enterprises.

It is worth mentioning that the events which have had the most negative impact on Jordanian firms during the last 10 years have been regional crises: rated first in this regard was the second Gulf crisis of 1990-1991, reported by 88% of the survey sample; second was inter-Arab relations, indicated by 70% of the respondents. The Gulf crisis affected the production plans of 84% of the enterprises surveyed, the local sales of 82%, the export sales of 72%, and the imports of raw and semi-finished materials of 75%. Most seriously affected were marketing and sales (reported by 85% of the firms). Most manufacturers had been exporting to Iraq and the Gulf countries, and their sales to these countries were interrupted. Though many enterprises were able to cope by increasing their sales to the local market, those that were totally oriented towards the Iraqi market were forced to close down or to operate at very low production capacity.

Less than a third of the firms surveyed had introduced changes in the kinds of activities they were involved in, over and above changes in the volume of production or labour. To better cope with changing markets, 28% of the sample had shifted, during the three-year period following the Gulf crisis, from single-use equipment to multi-purpose equipment, and 21% from lower-quality to higher-quality raw materials. Some 50% of the firms showed even greater dynamism and exploited the new opportunities, entering new markets by introducing new products after 1991.

Jordanian managers responded to the impact of regional events by focusing on the marketing aspect. About 85% reported that they had paid more attention to the local market, and 81% had pursued a strategy of finding alternative export markets. Of secondary importance were strategies related to technology: around a third of the firms reported that they were employing more modern technologies, improving equipment, and using information technology. Rated third in importance was a strategy followed by around a fifth of the firms: terminating the production of old products.

The impact of the peace process was still unclear for most of the managers, although the majority expected a significant increase in competition from Israeli products (84%), as well as an expanded market (mainly the West Bank and Gaza) for their own products (61%). Managers of Jordanian enterprises did not seem to have any vision for the future, which they felt was full of uncertainty. This would explain why they had no concrete plans for dealing with the peace process, and why they were following a "wait and see strategy". Of those who had ideas for the future, 33% indicated that they were developing plans to improve the quality of their products to enable them to deal with the

increased competition in the local and regional markets, and 27% intended to follow a strategy of expanding their sales in the West Bank and Gaza.

C. PRINCIPLES AND CONDITIONS FOR SUCCESSFUL CHANGE IN A FIRM: THE ROLE OF TOP MANAGEMENT

A number of principles must be followed and conditions met if the changes to be introduced by companies (to allow them to adapt in response to major events or to induce radical innovations) are to be successful. In this respect, the role, attitude and actions of top management are crucial. In order to successfully implement a plan for change, top management must motivate subordinates, secure their support, and involve them in all activities related to the change process, from the planning to the implementation stage. Such involvement generally serves to prevent employee resistance to the change programme, as it allows them to contribute ideas and to feel a certain sense of responsibility for the programme's success. Achieving firm-wide participation and support requires that top management set clear and realistic objectives, provide only *general* guidelines and directives rather than detailed instructions, and give subordinates considerable leeway to make decisions. Top managers should view subordinates as people who can take the initiative, generate new ideas, and (independently) find the appropriate ways to achieve the objectives and follow the guidelines (see Maynard, 1989).

Middle management and skilled employees are becoming the principal driving force behind successful change programmes. Qualified personnel are becoming more important than capital. Human resources are no longer regarded as a mere "factor of production", to be managed like other factors. In today's world, knowledge is a vital, valuable and scarce strategic resource, and it is becoming one of the most important assets of an enterprise, enabling it to adapt to the fast-changing and competitive global environment. The ability of top management to exploit knowledge—through direct and personal interaction with middle managers and employees, to motivate them and enable them to take the initiative—is what gives companies their competitive advantage (Bartlett and Ghoshal, 1995).

Top managers must have an "entrepreneurial orientation" if their change programmes are to be successful. They can no longer be mere "administrators" who carry out the day-to-day activities of the firm, solve daily problems, carry out planning exercises, allocate resources, establish limits for themselves and for the company to keep the system operating, and who are just concerned with "doing things right". Modern managers need to have entrepreneurial vision and strategic capabilities (see Hinterhuber and Popp, 1992), and must be risk-takers if they are to succeed in dealing effectively with and/or inducing changes. Furthermore, change, by definition, requires creating a new system, which in turn always demands leadership—one of the main characteristics of an entrepreneur (Kotter, 1995). The change process, if it is to succeed, requires a

certain kind of manager with excellent leadership skills. While a traditional manager tends to adopt an impersonal, if not passive, attitude towards goals, leaders adopt a personal and active (rather than reactive) attitude, shaping ideas instead of responding to them (Zaleznik, 1992), and taking high risks when introducing changes.

Entrepreneurial vision is more an orientation for the future than a goal, and is needed from the beginning of an entrepreneurial activity or any restructuring or change programme. Managers should be able to adopt a strategy that allows them to adapt to continuously changing conditions. For example, a central element of any strategy is the creation of permanent competitive advantages in the market (Zaleznik, 1992). Strategic management competence, one of the main characteristics of an entrepreneur, is reflected in the ability of top managers to promote creative behaviour and initiative among subordinates by reducing the hierarchical structure and the vertical lines of authority and communication to a minimum and by facilitating team work and lateral communication between the various units and sections of the enterprise. While the manager-administrator regards perturbations in the environment as dangerous to the enterprise, the entrepreneur has what is called a "tolerance for ambiguity" and sees these perturbations as opening up new opportunities and as catalysts for change.

D. TRAINING TECHNIQUES USED IN THE ESCWA PILOT WORKSHOP ON UPGRADING ENTREPRENEURIAL AND MANAGERIAL SKILLS UNDER CONDITIONS OF CHANGE

There is a strong belief that entrepreneurs are made, not born; in response to this assumption, a number of programmes involving counselling, training, seminars and so on have been initiated to address the upgrading of the entrepreneurial skills of managers of industrial firms. It is widely held that managers can, with the appropriate training, now be taught not only how to adapt to unpredictable, changing conditions and to cope better with instability, but also how to be introducers of positive changes/innovations when conditions are stable.

A training programme, if it is to help managers learn to deal with and/or induce changes in the environment, must do the following:

- Enhance creative thinking and innovative behaviour among managers
- Increase awareness of the importance of human relations in a firm. Managers need to learn how to improve communication within the firm, motivate employees, stimulate enthusiasm, and express appreciation and encouragement
- Upgrade personal skills in the areas of risk-taking, leadership, decision-making, and strategic management capabilities

- Help managers learn how to identify, manage and predict changes
- Teach managers how to see change as an opportunity, not as a threat, and make them aware of how important it is to continuously review the situation so that they can carry out continuous improvements within their firms

ESCWA was able to apply these principles and practices during the pilot workshop described below.

1. Workshop objectives

The one-week Pilot Workshop on Upgrading Entrepreneurial and Managerial Skills under Conditions of Change, organized by ESCWA in cooperation with Friedrich Ebert Stiftung and the University of Jordan, was held in Amman from 14 to 20 September 1994. Jordan was selected as a pilot-case-study country in view of the fact that it has been one of those in the region most affected by inter-Arab conflicts and regional wars, and is directly concerned with the peace process. Furthermore, the results of the ESCWA survey of 84 industrial firms in Jordan, reviewed above, confirmed the need for management training, as most of these firms were facing difficulties in coping with and/or inducing changes. The Workshop was designed to meet the needs of managers of industrial firms operating within fast-changing environments. It was open not only to chief executives, but also to functional managers who possessed top management potential and whose positions were likely to be crucial to the future of their companies.

The Workshop aimed at helping Jordanian managers upgrade their entrepreneurial skills to enable them to identify, predict, measure, manage and better cope with both regional changes and fast-changing global conditions, including the emerging peace situation.

More specifically, the Workshop aimed at the following:

- Enhancing managers' sensitivity to change and changing environments as a prerequisite for the promotion and development of an entrepreneurial culture within Jordan
- Identifying the appropriate strategies for transforming changes and changing environments into "investment-grade" business opportunities
- Creating an action plan to enable managers to tap the hidden entrepreneurial and managerial dynamics within their companies under conditions of continuing change

2. Workshop methodology

The Workshop included three core modules: “Identifying Change”, “Predicting Change”, and “Coping with Change”. Various active learning methods were applied to address the participants’ expectations in each module. These methods consisted of a minimum of lectures and a maximum of role-playing, business gaming and simulations, panel discussions, the sharing of experiences and ideas, consensus-generation, and video presentations. The number of Workshop participants from private industrial firms was limited to 20 (managers) to provide the maximum opportunity for personal interaction and participation, as well as confidence- and team-building.

3. Enhancing entrepreneurial orientation

The Workshop used various games and simulations, as well as video presentations, to enhance the entrepreneurial behaviour and skills of the participants, particularly in the areas of risk-taking, motivation, decision-making, leadership, team-building, teamwork, creativity and innovation. The concept of “coopetition” (simultaneous cooperation and competition) between companies was introduced through various simulation exercises.

4. Events and changes as defined in the Workshop

Throughout the Workshop proper, the following terms were defined and applied:

- *Events* (in this context) happened in the immediate past or are still happening now. Many of these events are *exogenous* to the enterprise—occurring within the realm of geopolitical, cultural, demographic, technological, economic or other such macro systems, or in the form of natural disasters—and are therefore outside the control of managers and entrepreneurs. Events, as defined here, do not happen everyday; they are generally radical, drastic, and often unexpected. They change the status quo and consequently create very high uncertainties for the future. They should not be confused with trends (which may still be in the early stages of unfolding). Events generally cause future *changes* to happen. The Uruguay Round trade agreements, the collapse of the Soviet Union, the Gulf crisis and the recently concluded peace accords with Israel are examples of radical events.
- *Changes* are the future results of events. The changes of concern here are those that are rapidly occurring, profound, surprising, abrupt, seemingly unpredictable and revolutionary. When they happen, they alter the rules of doing business. When the rules are changed, more threats (and opportunities) are created. While change can have happened in the past,

the Workshop concentrated on changes that were expected to occur in the very near future. Such changes are interesting to managers and entrepreneurs because they can be anticipated and therefore managed when they finally happen. Some changes are positive (here, these are called *effects*, and refer to opportunities that can at some future time be exploited), others are negative (here, these are called *threats*, and refer to changes that can challenge the very survival of the enterprise), and still others can even be neutral (having no effect within the relevant time frame).

5. *Anticipating change*

To be able to anticipate change, managers should take the following into consideration (based on Canela, 1994):

- The probability of the change occurring
- Impact areas or areas affected by this change
- The time frame for the occurrence of change (When will it occur?)
- The path that this change is likely to take, or its direction (positive, negative or neutral)

These four elements formed the basis of an analysis that was undertaken by the Workshop participants with the aim of formulating appropriate responses at the firm level. The approach used in the analysis—the Change Analysis Planning System (CAPS)—was employed to ease the manager’s task of managing change. CAPS is a structured set of techniques, procedures and instruments for:

- Predicting future changes triggered by events that are presently occurring or occurred in the immediate past
- Describing future changes
- Planning a systematic response

The CAPS approach has several advantages:

- It ensures extensive participation by all concerned persons in the task of predicting, planning and managing change.

- It develops appropriate responses that are transparent and easily understood by all concerned decision makers.
- It defines realistic and definitive responses to changes and turbulence in a business environment.
- It forms a solid basis for an integral approach to introducing and managing change.
- It can harmonize the expectations and opinions of the concerned parties through consensus-based event-predicting and change-planning processes.
- It helps managers to visualize future changes, consequential problems and scenarios.

The managers participating in the Workshop carried out the CAPS analysis by going through five main steps:

- Change analysis
- Spatial analysis
- Time profile analysis
- Vector analysis
- Response analysis

(a) *Change analysis*

Change analysis involves analysing the existing situation by examining relevant events surrounding a given business environment, and identifying or forecasting major future changes caused by past or present events.

In undertaking the change analysis, each participant was asked to identify, through the use of the card system, two major events that had occurred since 1984 and were affecting his or her business in Jordan. The events identified by the participants were clustered into 23 major events, the most notable of which were the following:

- *Political events:* regional disputes, the peace process, the collapse of the Soviet Union
- *Global economic events:* the Uruguay Round trade agreements, the EU subsidy for meat exports, international standards such as ISO 9000

- *Regional economic events:* the Gulf countries' policies towards Jordanian labourers, returnees, the relaxing of the Arab boycott
- *National economic events:* the devaluation of the Jordanian dinar, new investment procedures, the easing of the Central Bank's foreign currency restrictions, the introduction of sales tax, the economic restructuring programme
- *Environmental events:* the 1992 United Nations Conference on Environment and Development, held in Rio de Janeiro, Brazil

The participants were divided into four groups and asked to list three changes for each event. More than 60 changes at the macroeconomic and firm levels were identified. Some of these changes were positive, creating new opportunities for the firms; other changes were negative, adversely affecting the national economy and the operation of the firms (see annex table: "Change analysis: the workshop results").

(b) *Spatial analysis*

Spatial analysis involves identifying the potential area(s) that may be directly affected by the occurrence of an event. Each participant was asked to identify the area within the enterprise most affected by change, from a list which included marketing and competition, production and technology, human resources, finance and capital structure, and R&D. The results indicated that marketing was considered the most affected, followed by finance, production, human resources and R&D (see annex table). Notably, marketing was also considered the area most affected in the ESCWA survey of 84 industrial firms in Jordan.

(c) *Time profile analysis*

The participants were requested to specify the time profile of change, assuming that the direction of change varied within each of three time periods: during 1994 (the time of the Workshop), from 1994 to 1996, and from 1997 on. On that basis, the participants were asked to decide when each of the changes would be most likely occur, to estimate the timing for a certain change becoming manifest, maturing and dissipating, and finally, to draw a change profile for every change (see annex table).

(d) *Vector analysis*

Vector analysis aims at analysing the directions of the impacts of various changes—or in other words, whether a particular change has had a positive, negative or neutral effect on an enterprise (an opportunity = "+"; a threat to survival = "-"; and no impact at all = "0"). This analysis was carried out during the Workshop, and the results

indicated that the impact of the changes that had taken place was considered positive in slightly more than half of the cases, while the remaining changes were considered threats to the enterprise (see annex table).

(e) Response analysis

The participants were requested to undertake a response analysis at the firm level. In this exercise, each participant was asked to identify the changes most relevant to his/her company, to identify alternative approaches and options for introducing and managing the response to a change or set of changes, and to select one or more potential strategic responses to be adopted by the enterprise. The final responses formulated by the participants concentrated mainly on the following:

- Developing new products and services to satisfy the needs of customers
- Providing high-quality products and working towards the implementation of the ISO 9000 standard, with the aim of improving the competitiveness of Jordanian industries
- Learning and applying total quality management techniques
- Searching for new business opportunities, starting businesses in the West Bank and Gaza, and forming joint ventures with local companies in these two areas
- Decentralizing the organizational structure of the companies
- Cooperating with other local companies to challenge foreign competition both at home and abroad
- Establishing trade and export houses to reduce expenses when entering new markets
- Setting new import and export policies
- Establishing joint ventures with well-known international environmental companies
- Investing in new technologies to create environment-friendly factories
- Investing in productive projects with long-term profit potential and high returns on investment

E. CONCLUSION

There is no doubt that the economies of the region, as well as the individual firms, will continue to be affected in the future, both positively and negatively, by radical global and regional events; this means that entrepreneurs will have to be continuously prepared to adapt to new environments and exploit new opportunities. The factors of instability that have characterized the region during the last five decades will continue to prevail to some extent (possibly to a large extent) in the future, even under conditions of peace. Inter-Arab conflicts and political instability in the region cannot be attributed solely to the existence of Israel or to the Arab-Israeli conflict. The factors contributing to instability are inherent in the social systems of the Arab countries and are a legacy of the colonialist era: colonialist geopolitical machinations have been largely responsible, whether directly or indirectly, for Lebanese confessionalism; the conflicts between Iraq and Iran, Iraq and Kuwait, the Syrian Arab Republic and Turkey, Egypt and Sudan, and Algeria and Morocco; and the conflicts within some of these countries. The entrepreneurs in the region will continue to face instability related to these circumstances, as well as the challenges of the peace process and its aftermath. Peace with Israel will bring major changes, and unpredictable political events will continue to occur in the region; entrepreneurs must be prepared to deal with this reality—to adapt when necessary, but also to take advantage of opportunities that may present themselves.

If entrepreneurs are to do a better job of coping with and adapting to fast-changing conditions and exploiting opportunities, much greater emphasis must be placed on the upgrading of managers' entrepreneurial skills to enable them to manage change successfully and anticipate changes through the introduction of innovations.

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Annexe

Annex table. Change analysis: the Workshop results

Event	Change	Mkt	Prd	HR	Fin	R&D	Impact	Vectors
1. Regional disputes	1.1. Cost of living goes up	■						-
	1.2. Exports to Gulf go down	■						-
	1.3. Exports to Iraq increase via humanitarian agencies		■					-
	1.4. Decrease in capital movement among Arab countries				■			-
	1.5. Investments discouraged				■			-
	1.6. Increase in unemployment				■			-
	1.7. Decrease in imports from Arab countries		■					+
	1.8. New selling opportunities (Iran-Iraq war)		■					+
2. Devaluation of the Jordanian dinar	2.1. Cost of living goes up			■				-
	2.2. Imports go down		■					+
	2.3. Exports go up		■					+
	2.4. Increase in tourism-related activities	■						+
3. Increased capital flow since Gulf war	3.1. Increase in overall liquidity				■			+
	3.2. Increase in new business formation					■		+
	3.3. Booms in certain sectors		■					+
4. Opening of Jordanian banks in the West bank	4.1. New facility for Jordanian companies				■			+
	4.2. Innovation and upgrading of quality of services				■			+
5. New investment procedures	5.1. Jordan's stock market goes down	■						+
	5.2. Loss of potential investors							-

Annex table. (continued)

Event	Change	Mkt	Prd	HR	Fin	R&D	Impact	Vectors
6. Easing of Central Bank of Jordan's foreign currency restrictions	6.1. Increase in foreign currency inflow				■		/	+
	6.2. More foreign investment encouraged	■					/	+
7. Aqaba blockade and lifting	7.1. Increase in insurance and shipping prices				■		/	-
	7.2. Loss of shipping lines	■					/	-
	7.3. Massive losses in land transport opportunities							
8. Increased role of women in the economy	8.1. Improvement in women's social and labour status			■				+
	8.2. Increase in unemployment among men			■				0
	8.3. Improvement in management practices		■				/	+
	8.4. Demand for household services and products increased	■					/	+
9. EU subsidy for meat exports	9.1. Affects non-EU meat exporters (such as vegetable producers)	■					/	-
	10.1. Increase in competition	■					/	+
10. New WTO Agreement (GATT 1994 and other agreements)	10.2. Increase in imports (e.g., trade deficits will rise)				■		/	-
	10.3. Quality of local products improves		■				/	+
	11.1. Cost of complying with new environmental regulations		■				/	-
11. United Nations Conference on Environment and Development (UNCED, Rio de Janeiro, 1992)	11.2. Introduction of new technologies				■		/	+
	11.3. Finding alternatives to chlorofluorocarbons		■				/	+
	11.4. Increase in public environmental awareness					■	/	+

Annex table. (continued)

Event	Change	Mkt	Prd	HR	Fin	R&D	Impact	Vectors
12. ISO 9000 standard	12.1. Entry into international markets	■						+
	12.2. Improvements in the quality of local products		■					+
	12.3. Increase in competition	■						-
13. Collapse of the socialist system	13.1. New business opportunities				■			+
	13.2. Increase in the prices of imports				■			-
	13.3. Market economy dominant worldwide				■			-
	13.4. Liberalization of international markets	■						+
14. Prime Minister's decision to minimize foreign labour	14.1. Increase in labour costs			■				-
	14.2. Lower labour productivity (increased dependence on local labour)			■				-
	14.3. Shortages in unskilled labour			■				-
15. Gulf workers return to Jordan	15.1. Surplus (and consequently unemployment) of skilled labour			■				-
	15.2. Increase in general price levels	■						-
	15.3. Increase in purchasing power	■						+
	15.4. Decreased remittances to Jordan				■			-
	15.5. Increase in construction activities and the need for building materials			■				+

Annex table. (continued)

Event	Change	Mkt	Prd	HR	Fin	R&D	Impact	Vectors
16. Introduction of sales tax	16.1. Increase in the cost of production (decreased profit)				■		/	-
	16.2. Decrease in demand	■					/	-
	16.3. Increase in the vulnerability of local industries					■	/	-
17. The peace process	17.1. New business opportunities	■					/	+
	17.2. Increased competition (more and better competitors)	■					/	-
	17.3. Increase in government spending				■		/	+
18. Democratization in Jordan	17.4. Market expansion into West Bank and Gaza	■					/	+
	18.1. Increased power of labour unions			■			/	+
19. Radical change in Gulf country policies towards Jordanian labourers	18.2. Increased lobbying power			■			/	+
	18.3. More freedom for the private sector	■					/	+
	19.1. Increased labour surplus (lower wages)			■			/	-
20. Relaxing of Arab boycott	19.2. Availability of highly skilled labour			■			/	+
	20.1. Wider markets (particularly for banks)				■		/	+
	20.2. Increase in competition	■					/	+
	20.3. New customers	■					/	+

Annex table. (continued)

Event	Change	Mkt	Prd	HR	Fin	R&D	Impact	Vectors
21. Socio-economic restructuring programme (World Bank and International Monetary Fund)	21.1. New and higher taxes				■			+
	21.2. Decreased inflow of hard currencies		■					+
	21.3. Higher import prices (higher production costs)		■					-
	21.4. Increase in competition							
	21.5. Government subsidies minimized				■			-
22. Introduction of computers and high-tech communication systems	22.1. Higher efficiency in production and services		■					+
	22.2. Easier exchange of information					■		+
	22.3. Higher production rate		■					+
23. Decrease in foreign aid to Jordan	23.1. Fewer business opportunities				■			-
	23.2. Less economic security					■		-

Legend: Mkt = Marketing and competition
 Prd = Production and technology
 HR = Human resources
 Fin = Finance and capital structure
 R&D = Research and development

XIV. TECHNOLOGICAL ENTREPRENEURSHIP UNDER CONDITIONS OF GLOBAL CHANGE

by Rustam Lalkaka
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Introduction

The elimination of poverty is a major priority in most countries and in the international development dialogue. It is widely recognized that employment creation is the most meaningful approach to alleviating poverty. Success in creating the 1 billion new jobs the world will need by the end of this century depends to a critical extent on the creation and growth of small enterprises. This, in turn, depends on the fostering of entrepreneurship in the private sector within the framework of supportive national policies.

This paper reviews the process of creating new technology-based ventures and the special characteristics of “techno-entrepreneurs”. Recent approaches to the promotion of such ventures are outlined, together with the roles of the key players. Attention now needs to be focused on the practical problems of fostering entrepreneurship, in the same way that environmental preservation and social development issues have been placed on the global agenda.

A. THE CHANGING GLOBAL ENVIRONMENT

As an agent of change and progress, an entrepreneur starts by identifying a market opportunity and matching this with social or technological innovations, then proceeds to mobilize the resources necessary to drive his or her business concept to its commercial realization. The development of a product or service with a high-technology content—never easy anywhere or at any time—poses a significantly greater challenge for the Arab States in today’s rapidly changing global environment. It calls for restructuring technology and business development systems and developing the skills needed for a new breed of techno-entrepreneurs to transform innovations into market opportunities. It also requires a reorientation of the present processes and priorities of international technical and economic cooperation.

A torrent of new technology-based goods hits the market every week, improving the quality of life while at the same time creating disruption in social patterns and volatility in financial markets. The pace of progress in information and space technologies, robotics, advanced materials, biomedical sciences and other advanced technologies continues to quicken, significantly changing the way the world lives. For instance, it took over a century for the invention of photography to be commercialized (1727-1839), 65 years for

the electric motor (1821-1886), 10 years for the nuclear reactor (1932-1942), three years for the transistor (1948-1951), and only four months for the laser disc (1981).

How can the industrializing countries keep pace, much less catch up, with the industrialized countries when the research and development (R&D) budget of a single company, say General Motors (GM) or International Business Machines (IBM), is considerably larger than that of even large developing countries such as China, India or the Republic of Korea? This predicament reinforces the necessity for cooperative research, know-how licensing and joint-venturing between the countries of Western Asia, in addition to North-South cooperation in these fields.

“Trade not aid” is a worthy slogan, given the sharp curtailment and growing conditionalities of conventional donor assistance. However, trade itself is in jeopardy. The post-Uruguay Round environment has seen the strengthening of regional trading blocs. As labour costs rise in one country, the assembly operations of multinational corporations (MNCs) move to another, helping exports but not necessarily strengthening technological capabilities.

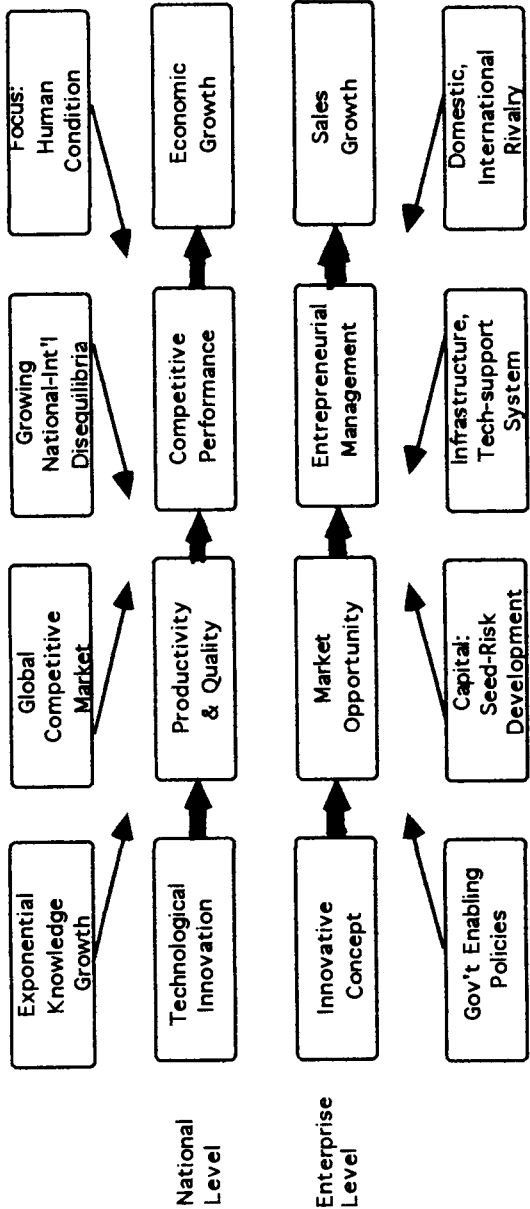
B. TOWARDS COMPETITIVE PERFORMANCE

In this environment of change, continuous innovation is the only constant: the Minnesota Mining & Manufacturing (3M) Company in the United States plans for 30% of its annual sales to come from products less than four years old; Toyota has recently opened the world’s first post-modern car factory, where only 10 man-hours are required per vehicle produced—roughly half the American average; Canon snatched the lead from the competition with its ubiquitous copier; and Chrysler did the same with its minivan. The pace of advanced new product introduction is relentless.

The imperative of competitive performance has serious implications for developing countries if they are to keep pace and succeed. It calls for national efforts to achieve greater systemic efficiency and productivity growth, the move from an investment-driven to an innovation-driven economy, and sustained higher-order competitiveness, all directed towards enhanced customer satisfaction at home and the penetration of selected markets abroad. Concurrently, Governments and businesses have to address such intractable problems as alleviating poverty, combating corruption and halting environmental degradation.

Further, technological change is taking place against a background of growing intra- and international disequilibria. While the transformation from State-centred to market-oriented development is opening up enormous opportunities and options, it has also caused severe short-term hardships. In order to survive and prosper in these changing times, developing nations and their enterprises need enlightened government policies, good technical infrastructures and strong cultural roots (see figure I).

Figure 1. National innovation process: Innovation-Competitiveness-Growth



Traditional production factors are giving way to a new paradigm characterized by new patterns of trade, investment and employment, and by informal networking, lifetime learning and technological entrepreneurship. The manufacturing sector in much of the Arab world continues to be dominated by food products, textiles, chemicals and other traditional industries, many of which are in the public sector. Change is coming, albeit slowly. State enterprises are being corporatized pending privatization, and the share of knowledge-based and information-related activities is rising perceptibly. Restructuring policies now place emphasis on the role of the private sector, even if this is often rhetorical. The legacy of decades of centrally planned development has generally been inimical to private enterprise; in turn, the private sector has been slow to respond to economic liberalization and has generally failed to generate the new employment necessary to absorb new entrants into the labour force.

The regulatory problems connected with an onerous tax structure and administration, poor access to finance and raw materials, the over-regulation of labour and land use, pervasive bureaucracy, and restricted markets have all been significant barriers to entrepreneurial growth. It is vital that the infrastructure for technological entrepreneurship be strengthened. While the macroeconomic indicators are encouraging, the living standards of ordinary people in many Arab countries are declining.

Conditions are especially acute in areas such as the occupied territories. Recent work done in Gaza and the West Bank has pinpointed the enormous difficulties faced; particularly significant are the problems related to the free movement of goods and people, personal security and the general rule of law, the fairness and predictability of regulations, and the undependability of electricity and communications. Efforts must be made to establish stable legal frameworks, incentives and special tax treatment, facilitated access to supplies and markets, and appropriate support systems for new venture creation. Conditions in Palestine are difficult but not unique; similar barriers to enterprise development can be found in a number of Arab countries and in other developing nations.

The Arab techno-entrepreneur may derive some hope from his historical context: this region has been the cradle of some of the richest civilizations ever known. The golden years of Islamic science, from around A.D. 800 to about A.D. 1100, saw the contributions of Al-Biruni and Abu Bakr Al-Razi to natural sciences; Ibn Al-Haytham to optics; Al-Tusi and Ulug Beg to astronomy; and Al-Khwarizmi (now pronounced “algorithm”), Al-Jebr (now pronounced “algebra”) and Arabic numerals to mathematics. The Arab technologist might be interested in knowing that Syrian glass-making technology and raw materials were transferred by a “licensing agreement” between Behemond VII of Antioch and the Doge of Venice—secrets which the Doge then guarded zealously!

C. CREATING NEW TECHNOLOGY-BASED VENTURES

Starting a new business in a developing country is a hazardous task. The challenges are compounded when the venture is technology-based:

- Capital requirements are generally larger, and traditional banks are ill-equipped to process the perceived risk. Venture capital generally only becomes an option when the venture has documented the merits of its management, market and innovation.
- Knowledge-based ventures can benefit from linkages to sources of knowledge such as technical universities or research laboratories; such mentoring needs to be cultivated.
- Often techno-entrepreneurs have technical skills but do not possess the business management and marketing skills necessary for success; they frequently lack credibility and contacts within business networks.
- In fields where technology is changing rapidly, it is often advantageous to make technology-acquisition arrangements. Sourcing such innovations, negotiating technology licensing agreements and protecting the intellectual property itself require special skills.
- Knowledge-based innovations are inherently more risky than others. The management of this unique risk requires certain assessment techniques and vision.
- Technology-based ventures often have social and environmental implications which need to be managed carefully.
- Penetrating a competitive niche market requires market intelligence, a sound strategic plan and good luck.

While figure I depicted the innovation process from the national perspective, figure II outlines the progressive steps to be followed by the entrepreneur himself.

As a product development cycle moves from concept to full-scale production, capital requirements increase significantly; similarly, as a venture progresses from start-up through the early stages to growth and maturity, its staff and sales grow. If it crosses the threshold of, say, 20 employees and commensurate annual turnover, it becomes a modern medium-sized undertaking. Its chances of surviving crises and reaching stability are better if its growth is evolutionary rather than explosive. The bulk of enterprises, however, will experience stifled growth and remain small (see figure III).

Figure II. The venture-creation process

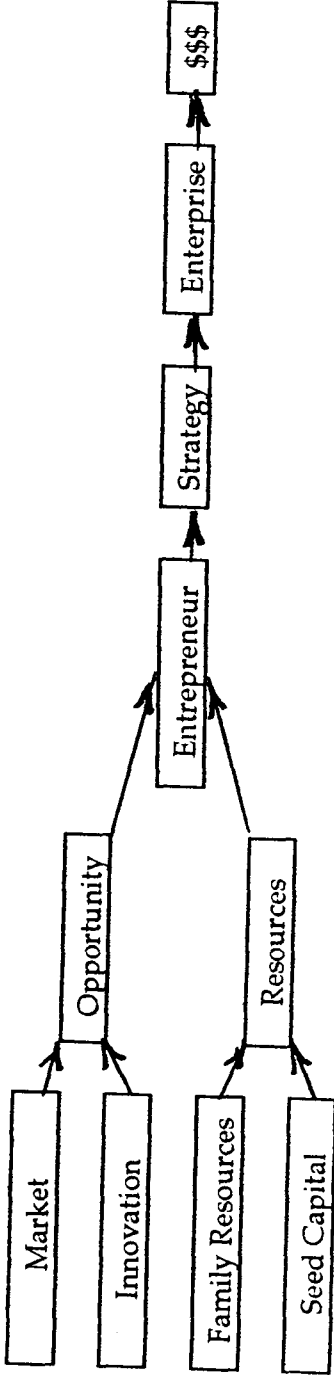
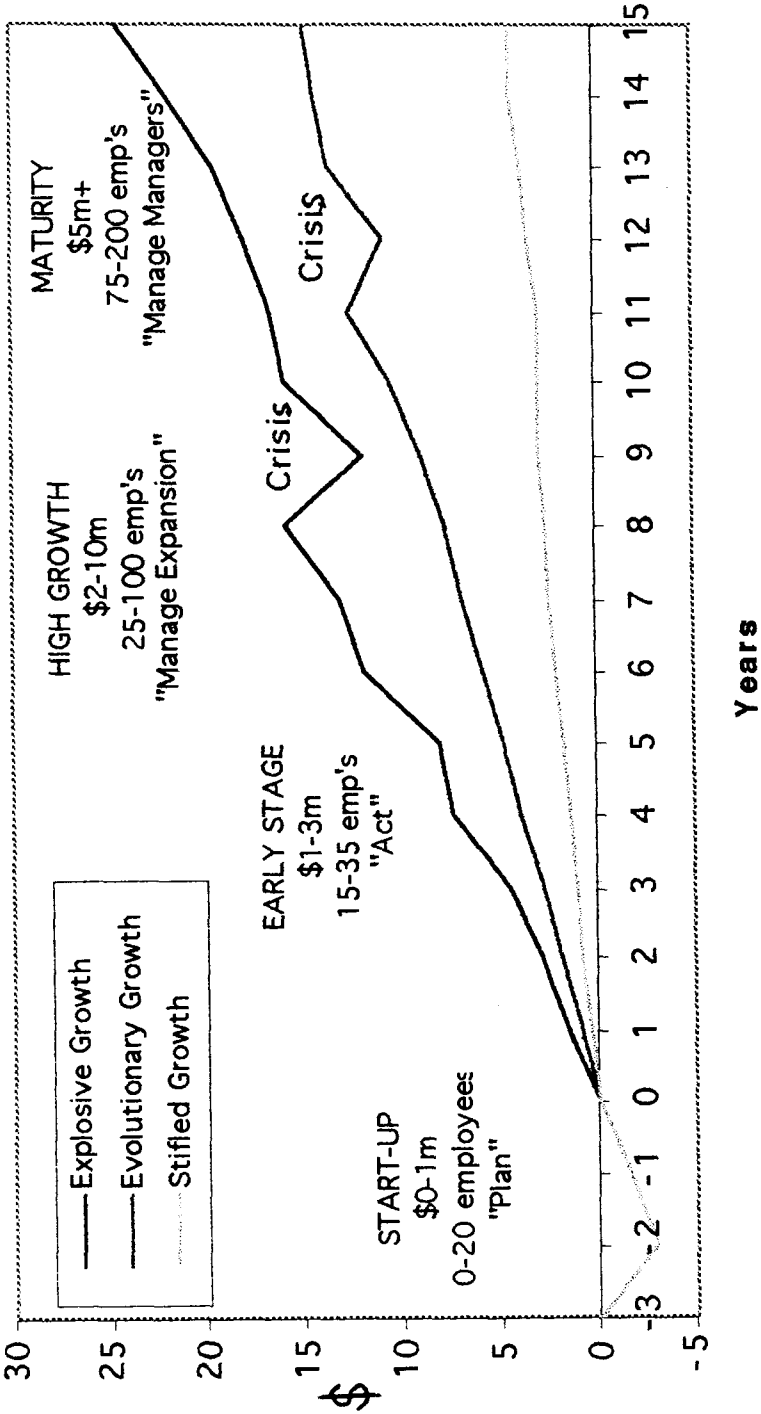


Figure III. Stages of economic growth



In agreement with the National Institute of Science and Technology, the National Society of Professional Engineers formulated the engineering stages of development for a new product. The traditional approach was linear, where different specialist groups addressed problems stage by stage. The current practice is to address problems concurrently, with a multidisciplinary product team working simultaneously on several stages, as shown in table 1. A small business or individual inventor may have to engage outside help to accomplish what needs to be done to complete product development.

Table 1. New product development by a multi-specialty project team involved in simultaneous engineering tasks at all stages

Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6
Conceptual	Technical feasibility	Development	Commercial validation and production preparation	Full-scale production	Product support
<i>Project team</i>	<i>Project team</i>	<i>Project team</i>	<i>Project team</i>	<i>Project team</i>	<i>Project team</i>
<ul style="list-style-type: none"> * Inventor * Research engineer 	<ul style="list-style-type: none"> * Research engineer * Development engineer * Marketing/business representative * Manufacturing engineer 	<ul style="list-style-type: none"> * Development engineer * Manufacturing engineer * Test engineer * Marketing/cost estimator 	<ul style="list-style-type: none"> * Design engineer * Test engineer * Manufacturing engineer * Development engineer * Buyer * Q&A engineer * Marketing representative 	<ul style="list-style-type: none"> * Manufacturing engineer * Test engineer * Construction engineer * Process engineer * Marketing representative * Sales representative * Product cost analyst * Field service representative * Buyer * Suppliers 	<ul style="list-style-type: none"> * Marketing representative * Sales representative * Q&A engineer * Training officer * Distributors * Product improvement personnel * Surveyor * Field service representative * Suppliers

As an enterprise becomes successful, the focus shifts from planning and surviving to managing, and then to managing managers. As it makes the transition from the first crisis of leadership to the second of autonomy, the chief executive officer (CEO) has to change roles (from promoter to entrepreneurial manager) or to recruit staff with the requisite managerial skills (see table 2).

Table 2. The changing role of the manager-entrepreneur

Creativity	Inventor	Entrepreneurial manager
	Promoter	Administrator
Management skills		
Crisis	First Crisis Leadership	Second Crisis Autonomy
Solution	More structured Organization	Decentralized Organization
CEO's Task	Transition to entrep. manager	Transition to decentralization

In many developing country situations, the optimum national strategy involves the following progression: equipment and know-how are imported; higher-level design and operating experience is acquired, then adapted, improved and applied; and the final stage includes indigenous innovation and exportation, both of technology-based goods and of know-how itself.

The flexibility and creativity of an entrepreneurial techno-venture may lead to more incremental and breakthrough innovations than can be generated by larger-sized firms in many sectors (see table 3). Clearly, in the chemical, automotive and other such industries the enormous research budgets of large multinational corporations are needed; however, in some of the advanced information technology and biotechnology fields small entrepreneurial groups can still achieve major breakthroughs. This is especially true when it comes to quick responses to new technological opportunities. "Time to market" is increasingly critical to success in high-technology areas where product life cycles can be measured in months. One of the major competitive advantages that entrepreneurial start-ups possess is that they can typically rush a new product to market more quickly than can

large, established firms. The latter try to generate demand for their products and protect their market share through expensive marketing campaigns, intellectual property protection, and so on. Small firms often cannot afford these measures, but they can still win by being fast on their feet.

Table 3. Innovations of firms in selected countries

Country	Firm size	Breakthrough	Major shift	Improvement
United States	Small	25	27	34
	Medium	8	11	15
	Large	30	33	48
United Kingdom	Small	8	0	0
	Medium	0	3	0
	Large	13	8	8
Germany	Small	1	2	2
	Medium	0	1	1
	Large	2	6	3
Japan	Small	0	1	0
	Medium	0	1	3
	Large	2	11	6
France	Small	1	3	1
	Medium	1	3	0
	Large	1	5	1

A number of entrepreneurial groups in developing countries have now achieved advanced capacity and are becoming multinationals: the Mittal family has built or acquired mini-steel mills based on complex direct reduction technology—first in India, then in Indonesia, Trinidad-Tobago and Mexico, and more recently in Canada and Germany; Acer, from Taiwan Province of China, is a world force in computing; and the city of Belo Horizonte, Brazil, has become a hub for biotechnology companies, many started by women entrepreneurs.

At another level, Malaysia has 600 micro-electronics firms producing \$12 billion of goods and employing 200,000 workers. Another sector of enormous potential for the South is the \$400 billion software market; some countries are already significant players. This ferment is creating opportunities for professional work abroad—and shortages of skilled workers at home.

D. SPECIAL CHARACTERISTICS OF TECHNO-ENTREPRENEURS

Some popular misconceptions about techno-entrepreneurs are that they are born, not made; that they take risks with other people’s money; and that they fail more often than they succeed. Actually, entrepreneurial skills can be identified and developed. The

entrepreneur is typically an innovator who formulates new solutions to existing problems, mobilizes resources, and stimulates others to join the team. These aptitudes develop over time, often starting in childhood, as the person faces new challenges and learns from failure. One interesting finding is that socio-economic and cultural differences among countries affect entrepreneurial activity (see table 4).

Table 4. Entrepreneurial culture in different societies

Category	Industrialized country	Industrializing country
Business opportunities	Plentiful, but contacts help	Largely limited to influential groups
Risk	Risk-taking, individualistic	Risk-averse, group-oriented
<i>Financing:</i> For start-ups	Family, home equity, credit cards	Family and small credit mechanisms
For growth	Venture capital	Development banks
Management	Both professional and family-based	Family-based, insecure
Authority	Usually delegated	Usually centralized
Information	Easily available, diffuse flow	Closely held, top-down flow
Motivation for growth	Strong: to stay competitive, get rich, expand	Constrained: avoid attention, protect markets
Government support	Good: SME promotion as a social investment	Often rhetorical, discriminatory

Entrepreneurial opportunities can be found in every industrializing country, community and family. The principal sources of entrepreneurs for knowledge-based ventures are often university and government research laboratories, large industrial and military establishments, and professional service firms. Reasons for becoming an entrepreneur generally relate to the desire to be independent, create value, contribute to society, earn recognition, and/or to become rich; quite often, one becomes an entrepreneur simply to avoid being unemployed. Value-adding ventures with good growth potential can best be developed in an open market and in a culture which supports risk-taking.

It is not surprising that Arab nationals who overcome bureaucratic obstacles at home often flourish as immigrant entrepreneurs abroad. It is also worth noting that in the United States—the stronghold of immigrant techno-entrepreneurs—80% of all millionaires are first-generation millionaires, and that at any given time there are 3 million people starting their own businesses—more people than are getting married or are having children!

The techno-entrepreneur anywhere faces the challenge of moving a concept through the prototype and production phases towards a product which meets market needs at a price consistent with the value created and with the ability of customers to pay. Equally important, the market itself has to be developed and sustained. It is not enough to be first with a better mousetrap if one does not have the skills to educate and reach potential buyers and to set the market standard.

The history of innovation is replete with examples of the latecomer and of the second-best overtaking the best, through what has been called the “self-reinforcing advantage”. Sony’s Beta was overshadowed by the longer-playing VHS and the user-friendly Apple Macintosh operating system by the standard-setting Windows; however, the QWERTY typewriter keyboard, first used in the 1870s at schools teaching typing, has beat back many an improved layout!

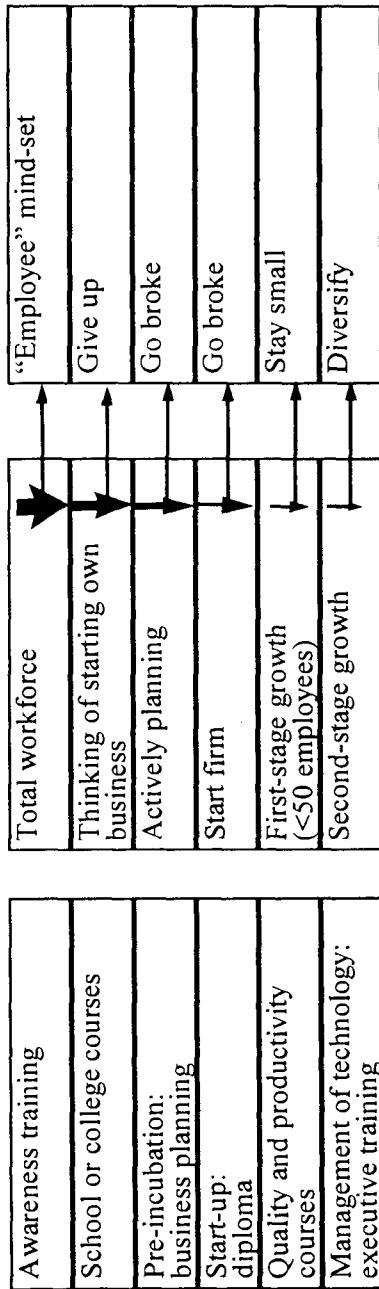
Here, one has to distinguish between the inventor and the innovator. The inventor is typically a creative person who pursues his goal of acquiring knowledge and/or producing new products, without determining in advance whether a real market exists for his inventions. The innovator, on the other hand, draws on existing knowledge and the talents of others to develop or adapt a product or service at a volume and cost that can capture a significant portion of an identified market. As mentioned before, the flexibility and creativity of a small entrepreneurial techno-venture may lead to more incremental and breakthrough innovations than can be generated by the larger-sized firms in many sectors.

There is also the maligned but pervasive practice of “reverse engineering”—that is, taking a machine apart, analysing each component, and putting it back together, often with improved design characteristics. Sir Francis Newton, in describing his proposed research laboratory, related that “for the several employments and offices of our fellows, we have twelve that sail into foreign countries under the names of other nations (for our own conceal), who bring us the books and abstracts, and patterns of experiments of all our parts. These we call Merchants of Light.” Presently, however, in the interests of both the innovator and the consumer, intellectual property rights are best respected.

E. UNIVERSITY RESEARCH AND DEVELOPMENT

Entrepreneurial attitudes can now be identified and strengthened through special techniques as an adult matures, increasing his or her chances of becoming a successful entrepreneur. As figure IV indicates, some individuals may prefer to be employees rather than business owners, and many of the more enterprising may go broke or stay small. Starting with a large potential pool of would-be entrepreneurs, there is attrition at each step along the way. A small number survive, and an even smaller number experience strong first-stage and second-stage growth.

Figure IV. Entrepreneurship training needs at different stages in developing countries



Entrepreneurship in technology-based enterprises requires economic incentives and socio-psychological reinforcement, together with the institutions to create the science and its linkage to production processes, technical products and viable businesses. Most technical universities in the South do precious little scientific research and have weak linkages to industry; exceptions include universities in Chile and Cuba, and the interface mechanism of the Centre for Technological Innovation at the National University of Mexico.

In this context, the terminology used for the research process itself should change from R&D to the “r&D” used in Japan, and then to “market-engineering-design-research” (MEDR), the term used for today’s paradigm, signifying a “market pull-production engineering-technological development-scientific research” continuum, which is carried out by an integrated team covering these disciplines.

Hampering the sharing of research, expertise and training opportunities among developing countries are the lack of (small) funds needed for triggering interaction, the lack of information, and the mutual lack of confidence in each other’s capabilities. In an effort to break this impasse, the World Association of Industrial and Technological Research Organizations has been promoting South-South and South-North collaborative research arrangements between laboratories.

An affiliation or linkage with a strong technical university gives the techno-entrepreneur access to faculty, facilities, services and graduate students, as well as the cachet of intellectual respectability, which is equally important. Universities can organize themselves to meet entrepreneurs’ specific needs as businesses move from the concept stage to maturity (see table 5).

Entrepreneurship development (ED) needs and learning programmes vary as the potential entrepreneur moves from school to university, from plan to project, and from first-stage growth to expansion and diversification. Organizations providing practical help to techno-entrepreneurs include the public-private SEBRAE in Brazil and KOSGEB in Turkey. International non-governmental organizations (NGOs) such as the Foundation for International Training in Toronto have also been effective in enterprise creation.

At the international level, the United Nations Industrial Development Organization (UNIDO) offers a comprehensive human resource development programme of upstream services on policy, communications networks, and learning for enterprises, and the Interman programme of the International Labour Organization (ILO) has a useful database of selected ED service providers. The United Nations Conference on Trade and Development (UNCTAD) Empretec scheme, based in national banks and managed by local foundations, has created hundreds of “empretecos” at both the national and inter-country levels. Finally, ESCWA has organized a range of ED programmes for Western Asia.

Table 5. Starting a technology-based business

Stage	Learning needs
1. Idea to valid concept ("conception")	Information on sources of ideas Acquire motivation/commitment Technical skill to make it? Self-evaluation
2. Valid concept to determining scale, resources ("embryo")	Market research and pricing Testing, developing Process planning Estimates of know-how
3. Scale-up to start-up ("infant")	Business planning Access to funds Management/marketing skills Protecting know-how Quality/productivity
4. Start-up to survival/growth ("adult")	Cash planning Selling capability Leadership skills Management control systems Continuous advisory follow-up

F. FINANCING THE TECHNOLOGY-BASED ENTERPRISE

In most of the surveys carried out to determine the type of assistance needed by entrepreneurs, particularly those in early-stage technology businesses, mobilizing capital ranks as one of the highest priorities. Friends and family usually help get a business started. For the next stage, additional capital (say \$150,000) can come from short-term seed-capital schemes. Then, in the commercialization phase, larger financing is needed (\$200,000 or more), preferably as equity from venture funds.

Venture capital funds pool \$10 million to \$20 million from various public and private investors, both local and foreign. Active technical and management assistance is provided, and investments are carefully made in a diversified portfolio of ventures. In liquidating the portfolio over six to eight years, a small proportion of high-flying companies can bring in an attractive overall return for investors.

Countries such as the Republic of Korea and India have had some success with venture capital. In Indonesia, there is government venture capital (an oxymoron perhaps), with a State company, P.T. Bahana, taking a 20% stake in various provincial venture capital companies. Revolving funds are another possibility, where capital is provided to match the equity of the entrepreneur, who is committed to paying a royalty of say 1% to 5% of sales over a defined period.

G. TECHNOLOGY BUSINESS INCUBATION

Of the 1,500 business incubators worldwide, some 20% are linked to technical universities and deal with technology enterprises. Interestingly, of the estimated 250 incubators in the developing and transition economies, perhaps two thirds are technology-based. In a business incubator, early-stage entrepreneurial businesses are carefully selected, then provided with an affordable package of work-space, shared facilities, focused advice on management and marketing problems, and access to networks of other professionals. Companies leaving the incubator (they must do so in two to three years) have a better chance of survival and success than those set up in the outside world.

The United Nations development system has helped 25 countries to design and establish incubators. In 1991 the United Nations Development Programme (UNDP) Special Unit/TCDC sponsored a workshop in Cuernavaca, Mexico, for the exchange of experiences in creating and strengthening technology-based enterprises. Technology business incubators have been in operation for a few years now, and UNDP, UNIDO and the Organization of American States (OAS) recently arranged for assessment studies to be conducted on the incubator experiences in Brazil, Mexico, Nigeria, Turkey, Poland, the Czech Republic and China. In September 1995, a workshop was held in Tianjin, China, to discuss the impact of incubators on enterprise creation, employment and economic development.

The preliminary findings are that where an entrepreneurial culture, a technical infrastructure and patient State support are available (as has been the case in at least three of the seven countries studied), the incubators have helped create a variety of viable businesses and good jobs (each worker receives an average of \$2,500 per year), they have been instrumental in transferring research results to the market-place, and they have had a significant impact on enhancing partnerships and the "culture" for entrepreneurship.

H. INTERNATIONAL COOPERATION

The technology incubation system represents a good example of a strategic concept which was initiated under multilateral aegis and implemented in the form of State-university partnerships, and is now being assessed, documented and disseminated among developing countries. Within the context of these linkages, countries with incubators are being made aware of improved practices, while those planning to set up incubators are being properly informed of the prerequisites, potentials and problems.

Cooperation in technology-venture creation can be achieved through informal exchanges among peers at international gatherings and trade exhibitions, formal twinning between institutions and alliances between companies, commercial franchises and joint ventures, and government protocols. Another intervention of value is encouraging countries to start national associations for technology-based business-related

activities—bodies that can be progressively developed into subregional and regional organizations. This is happening in Latin America with, for instance, the Comision Latinamericana de Ciciena y Tecnologia (COLCYT), Red de Informacion Tecnologica Latinamericana (RITLA), and the Mexican Association of Technology Parks and Business Incubators (AMIEPAT); it is also occurring with even greater urgency in the Arab States.

The pace and pattern of a nation's economic development now depend in large measure on its technical resource base. In this context, success depends mainly on whether a country possesses and utilizes the skills required (a) to apply technology in a way that will enhance competitiveness and (b) to create technology-based ventures. Techno-entrepreneurs have to be supported by appropriate national structures and international linkages if they are to survive and flourish in an intensely competitive world.

XV. TOTAL QUALITY MANAGEMENT AND ISO 9000 FOR SMALL AND MEDIUM-SCALE ENTERPRISES

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PART ONE

Introduction

Summarizing the view of many economists concerned with quality in developing countries, a study by A. El-Tawil¹ on quality management begins with the following statement:

“The improvement of quality of products and services is the key to the solution of economic difficulties encountered by most developing countries. Better quality of goods and services leads to customer satisfaction, permits the substitution of imported products by local ones, and offers better chances of reaching export markets” (El-Tawil, 1995).

This statement echoes the rising concerns about quality, exemplified by the increasing requests among suppliers and customers that the producers and providers of goods and services comply with ISO 9000 and other quality standards. Applying the concept of “total quality management” (TQM) has long been the top priority of managers and executive officers in industrialized and other countries worldwide; it is now becoming increasingly important to managers in the ESCWA region. A 1993 survey carried out in the United Kingdom of Great Britain and Northern Ireland (Pike, 1994) revealed that 90% of chief executives placed total quality at the top of their agendas. Likewise, recent surveys in the United States of America have shown that “producing high quality” ranks number one on top executives’ lists of the key strategic competitive capabilities needed.

Why has the concern for quality become the dominant issue for managers worldwide, and why should it be the top concern for managers in this part of the world? A leading quality expert, Professor R.J. Pike (1994) summarizes the reasons, or “quality imperatives”, as follows:

¹ Mr. A. El-Tawil is Director of the Developing Countries Programme at the International Organization for Standardization (ISO).

- *Increasing competition and the loss of sheltered markets.* To survive, companies need to improve their competitiveness in the market; this is best achieved through improvements in quality and productivity.
- *Rising consumer expectations.* Customers do not pay for goods or services—they pay for satisfaction. What were once regarded as luxuries have, for many, become necessities. Companies are forced to add extra value to their products/services without raising their prices.
- *“Large consumer” demands for quality assurance.* Large companies, as consumers of others’ products and services, have placed increasing pressure on their suppliers to comply with quality standards such as ISO 9000.
- *Advancing technology—extending what is possible.* New technologies can have a significant impact on the quality of products and services. The principles of TQM—particularly the involvement of all personnel—may lead to better decision-making relative to the acquisition of new technology.
- *Concern for people and the environment.* First, it is vital to enlist the support of all employees at all levels, as the involvement and commitment of people has a tremendous impact on quality improvement: quality is everyone’s responsibility. Second, environmental concern is growing worldwide. The ISO 14000 international environmental standard recently developed to address such concerns is not far from being adopted and linked to ISO quality standards.
- *The cost of mistakes—the economics of quality.* Making mistakes wastes time, effort and financial resources; quality management leads to the development of a “zero defect” concept. Attention to quality can result in considerable savings. Some surveys estimate that the cost of mistakes in companies amounts to as much as 25% to 30% of turnover; at the national level, that cost may translate into 10% of sales. This is too much to pay for mistakes, but the greatest and most important cost to a company comes from business and market share losses resulting from customer dissatisfaction.

A. HISTORICAL BACKGROUND

The concepts of quality and the methods of achieving it have evolved over many centuries. Until the time of the industrial revolution, quality was the responsibility of the individual craftsman who conceived and produced a product or service. With the

introduction of machines and factory-based mass production, quality became the responsibility of a supervisor or inspector who was usually selected from among the most experienced workers, and whose assessments were based on the visual inspection of the end-products.

The setting up of inspection departments in companies came about with the large-scale production and widespread manufacturing of interchangeable components. This functional separation of the production and quality-assessment processes led to the assignment of specialized inspectors and to the development of sophisticated measuring and testing equipment to ensure quality control.

It was soon recognized that the variability of interchangeable parts was inevitable, as no two parts were likely to be manufactured to exactly the same specifications. It became necessary to differentiate between acceptable variation and unacceptable variation, and to introduce a statistical basis for sampling large numbers of exchangeable parts (which reduced the work of inspection, but involved the taking of calculated risks for both producers and users). This eventually led to the training of qualified professional inspectors (Juran, 1989) to supervise quality control, and to the emergence of leading quality experts such as W.E. Deming and J.M. Juran.

In the 1950s Deming and Juran were invited by Japanese top managers to assist in defining quality systems for companies involved in Japan's reconstruction effort. Their visit led to the development of quality management and continuous improvement concepts. In his book *Total Quality Control*, A. Feigenbaum (1961) pointed out for the first time that the concept of quality should not be limited to production processes alone; it had to be applied to all aspects of a company's business.

Shortly before that, military, nuclear and pharmaceutical industries in the United States had realized that it was too late to carry out inspection after the component was manufactured. They came to understand that, before an order was ever placed, suppliers had to be requested to comply with certain standards, or to provide "quality assurance", which involved an assessment of a supplier company's overall competence and performance rather than an evaluation of the quality of its end-product alone.

The concept of quality was further developed with the realization that customer satisfaction with a product or service was linked to all of the activities carried out within a company, and that satisfying a customer began with identifying his exact needs and continued through to the assessment of whether those needs had been adequately satisfied. The stages of this process constituted what is called the Deming Quality Loop (Deming, 1988), which inspired the concept of integrated quality control or "total quality control". Eventually, ensuring total quality control necessitated the development of a mechanism for TQM, which led to the establishment of total quality systems.

Most of the industrialized countries devised their own total quality systems and standards, and supplier companies found themselves faced with a large number of stringent and diverse requirements. This led to the development of the “third-party certification” concept. Eventually, the ISO 9000 was formulated to standardize quality assurance requirements for supplier firms and certifying bodies.

B. DEFINITIONS

To clarify the major concepts related to TQM, it is important to understand the following definitions:

Quality:

- The totality of features and characteristics of a product or service that bear upon its ability to satisfy stated or implied needs (ISO 8402)
- A predictable degree of uniformity and desirability, at low cost and suited to the market (Deming, 1988)
- The total composite product and service characteristics of marketing, engineering, manufacturing and maintenance through which the product and service in use will meet customer expectations (Feigenbaum, 1961)

Quality control:

- The operational techniques and activities that are used to fulfil the requirements of quality (ISO 8402)

Quality assurance:

- All those planned and systematic actions necessary to provide adequate confidence that a product or service will satisfy given requirements for quality (ISO 8402)

Process:

- Any activity that accepts inputs, adds value to these inputs for customers, and produces outputs for those customers (BS 7850)

Inspection:

- Activities such as measuring, examining, testing and gauging one or more characteristics of a product or service, and comparing the results with specific requirements to determine conformity (ISO 8402)

Total quality control:

- An effective system for integrating the quality development, quality maintenance and quality improvement efforts of various groups in an organization instituted to allow marketing, engineering, production and service efforts to be carried out in the most efficient and economical manner possible, with the ultimate goal of providing full customer satisfaction (Feigenbaum, 1961)

Total quality management:

- A concept incorporating a management philosophy and company practices that aim to harness the human and material resources of an organization most effectively to achieve the objectives of the organization (BS 7850)
- Quality management is that aspect of the overall management function that determines and implements the quality policy. In this sense it is no different from any other set of managerial processes, except that these processes are applied to quality rather than to other aspects of business (BS 4778)

C. FROM INSPECTION TO TOTAL QUALITY MANAGEMENT²

Presenting the concepts covered thus far in a chronology of sorts allows for a better understanding of the evolution of quality assessment (Mandl, 1995):

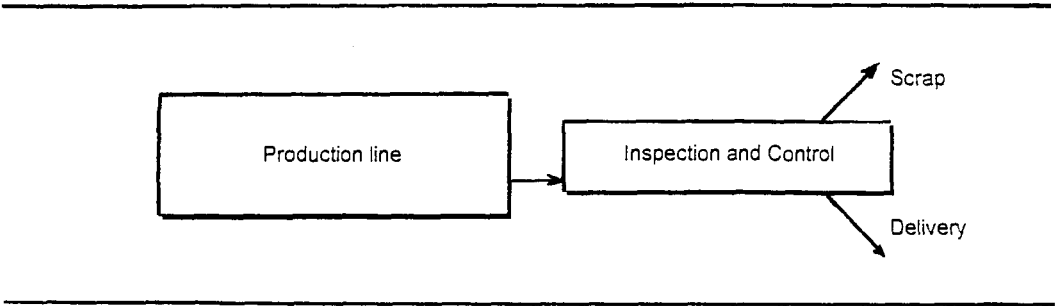
1. Inspection of the end-product

Very early on in industrial mass production, it became clear that to gain the confidence of customers, certain specifications had to be met, and delivered products had to be of an acceptable quality. Inspection mechanisms were installed to assess the quality of the end-products before their delivery to customers, as shown in figure I. The

² Adapted from a paper by Mr. Cristoph Mandl (1995).

inspection control mechanism classified products into two groups: products acceptable for delivery; and unacceptable products to be scrapped.

Figure I. End-product inspection/control



2. Quality control

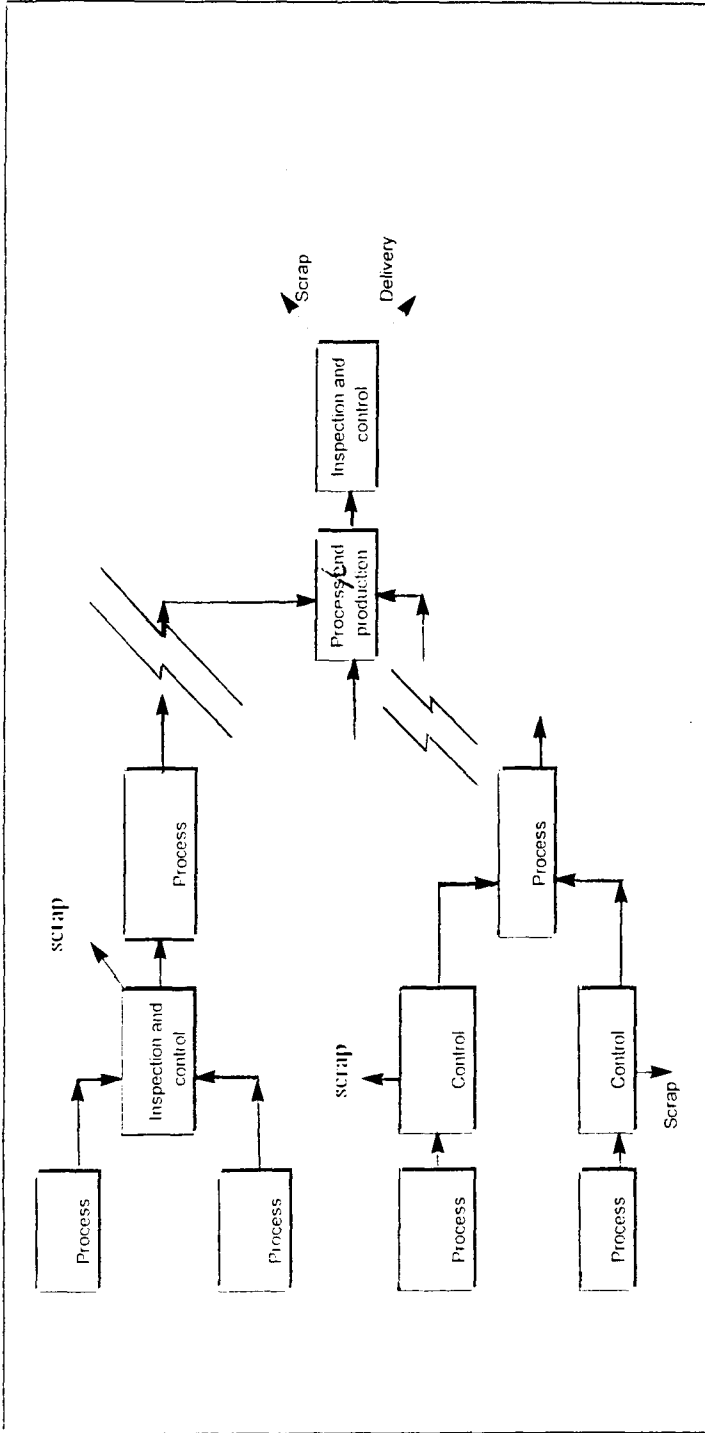
Inspecting end-products proved to be a very expensive process. First, inspecting every deliverable product took a lot of time, money and effort, especially when the number of end-products was sizeable. Statistical inspection methods and the acceptable statistical risk concept were introduced to address this problem. Second, having to scrap the end-product that had gone through the entire manufacturing process was both costly and wasteful. To solve this problem, inspection or control mechanisms were installed at various stages of the manufacturing process, as shown in figure II. This process allowed for the replacement of intermediate parts and for the elimination of defective items (and the costs they incurred) very early on in the manufacturing process.

The “on-line quality control” concept gave rise to two questions:

- How many inspection points should be installed, and where should they be located (keeping in mind that every inspection point entails additional cost)?
- Is it feasible to apply statistical methods at every inspection point?

The answers to these questions eventually led to the development of the quality management concept.

Figure II. Quality control



3. Customer-oriented quality control

Until very recently, quality controls were based on acceptance criteria set by designers and manufacturing companies. With experience came the realization that the customer paid for *his* satisfaction, and not for quality as defined by the company. New concepts were developed: quality criteria now had to incorporate customer requirements in the design and inspection of various parts of the end-products. Marketing and sales departments were gradually brought into quality management systems and provided companies with the answers to the following questions:

- What are customer expectations?
- How can customer expectations be met?
- To what extent does the delivered end-product satisfy customer expectations?

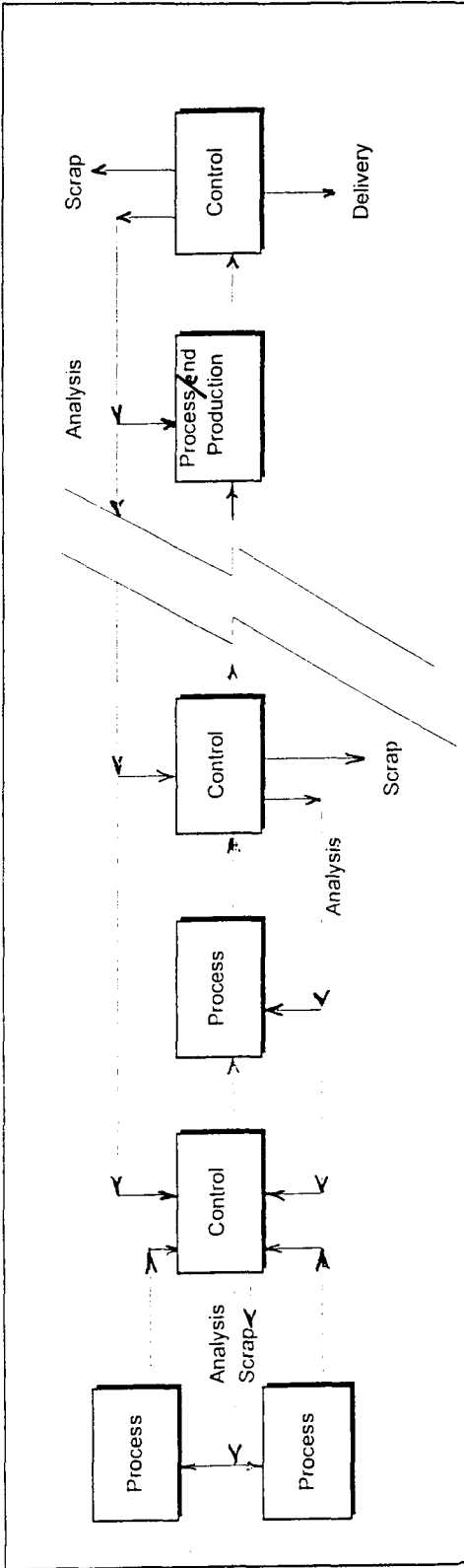
4. Process control

Concerns about end-product costs and quality assurance led to further improvement in quality control concepts. First, the following questions were asked:

- Why and where are defects produced?
- How can defect recurrence be reduced?

The answers to these questions led to the development of the “process control” concept (shown in figure III). Here, whenever a defect is identified, the item in question is removed from the production line, and the production process is analysed to identify the point at which the defect occurred, to diagnose how and why the defect was produced, and to determine what can be done to reduce the probability of recurrence. This created the need for product “traceability” along the production line to make it easier to identify exactly where the defect occurred, and led to the practice of documenting all processes (providing a record of what had been done to avoid recurrence and a reference for future diagnosis).

Figure III. Process control/control/management



5. Quality management

Efforts to detect and eliminate causes of defects led to further improvements in the process control concept and to the development of the integrated approach inherent in the quality management concept. Quality control became an integral part of every single activity in the production process; any time or anywhere a defect was detected, preventive and/or corrective action was taken to prevent recurrence. Within this context, as mentioned above, traceability and documentation became part of process control. Preventive and corrective actions and concerns were no longer restricted to production and maintenance personnel; they became the concern of everyone in the company, including the sales department, which was given the task of conveying customer expectations and complaints.

Continuous improvement also became everyone's responsibility. Now, preventive and corrective action is taken whenever it is realized that a process might lead to the production of an item that does not meet quality requirements, as shown in figure IV. The whole control process follows a particular plan and has been formally documented.

6. Total quality management (TQM)

TQM is a management philosophy—an approach focusing on quality, based on the involvement of all personnel, and aiming at long-term success through customer satisfaction. In TQM the concept of quality relates to the achievement of all managerial objectives. The difference between TQM and quality management is that in TQM the concepts of quality management are not restricted to the production processes only, but are applied to all processes within a firm, including the services provided to both internal and outside customers.

To facilitate comparison of the concepts that have been discussed in this section, the table below identifies the major elements associated with each.

D. BASIC RULES OR GUIDELINES OF TOTAL QUALITY MANAGEMENT

The philosophy of TQM is simple and easy to accept, but there is no unique way to translate it into “rules” to be applied and practised. Nevertheless, a series of fundamental guidelines has evolved over time, based on the experiences of a large number of companies that have adopted the TQM approach; these are described in some detail below.

Figure IV. Quality management.

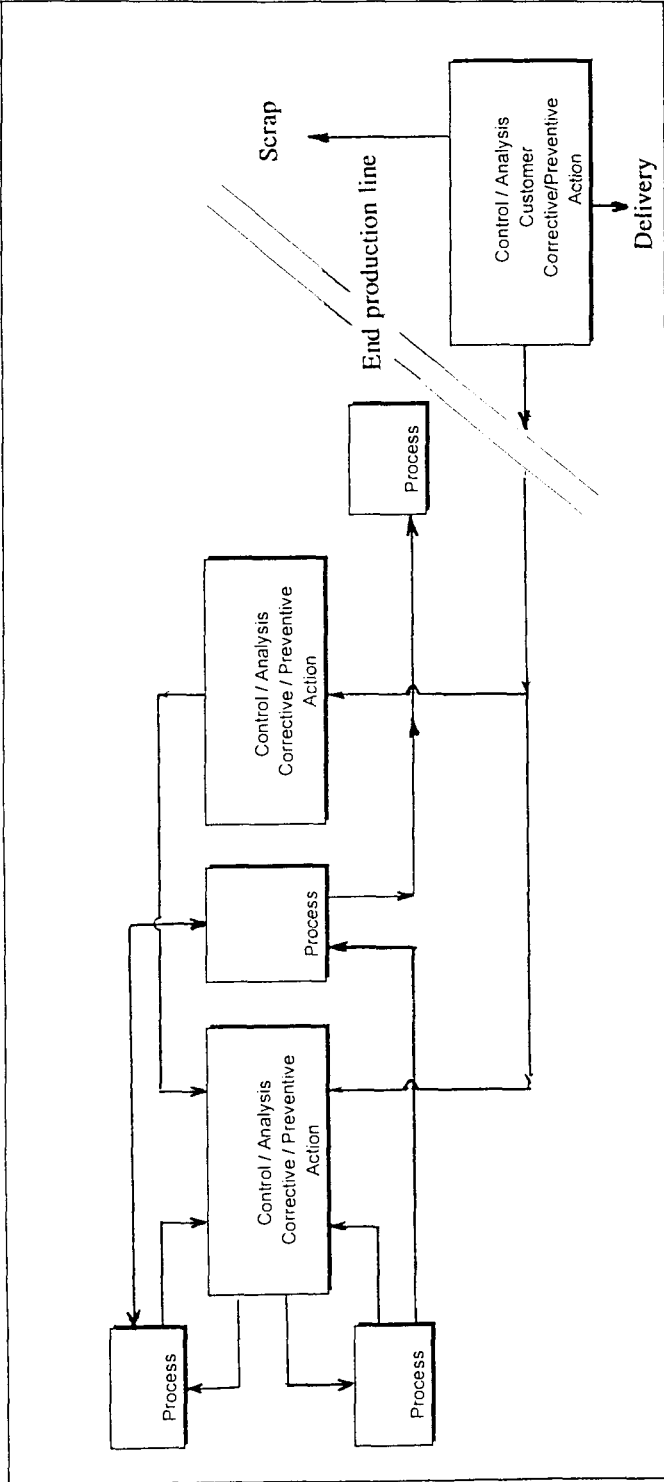


Table. Comparison of quality control, quality assurance, total quality control and total quality management

	Quality control	Quality assurance	Total quality control	Total quality management
Philosophy	Inspecting quality	Building quality	Planning and organizing quality	Managing quality
Quality principles	Final product inspection	Process monitoring	Design of system and standards	Continuous improvement
Quality system	Detection through inspection	Prevention through inspection	Design/conformance	Managing cultural change
Benefits	Fewer faulty products reach customer	Higher product quality	Reduced cost and increased reliability	Improved ability to manage change
Perceived responsibility for quality	Inspectors	Quality assurance	Designers and quality assurance department	Everyone, with strong management support
Starting point	Product specifications	Procedures	Design and cost of quality	Customer needs

Source: Cris Blakeborough, addressing a seminar on TQM held in Damascus in March 1994.

1. Customer satisfaction

In TQM the first objective of the management and of all company activities is to satisfy the customer; this is an orientation that should prevail throughout the firm—at all levels, among all personnel and in all processes. An inherent principle of TQM is the understanding that sales and marketing departments cannot achieve customer satisfaction without support from all of the other departments in the firm, or without customer satisfaction in turn affecting the actions of everyone in the firm.

Furthermore, if it is understood that in a firm everyone is producing or providing a service or product for someone else, whether inside or outside the firm, then the customer orientation of TQM must be translated into practice through the concept “everyone has a customer that must be satisfied”. TQM does not work unless everyone within the firm does his share in fulfilling the quality requirements of his own customer.

2. Continuous improvement

TQM is not an objective that can be achieved once and for all. It is necessary to understand that satisfying all customers at all times is an impossible task, and that everyone must therefore strive continuously to help the company recognize and fulfil customer requirements. Continuous improvement in performance thus becomes the concern of everyone, all the time.

In TQM, dealing with problems or defects is viewed as the most important way to improve a company's ability to meet customer requirements; problems must be used to increase one's understanding and skills relative to the task undertaken. The aim of the TQM continuous improvement approach is problem prevention rather than problem-solving, a concept the Japanese call *kaizen*.

3. The system approach

Common sense dictates that any system which depends on human reliability is unreliable—a fundamental principle of TQM. Humans are not perfect machines and will therefore make mistakes; thus, one basic principle of TQM is that processes fail, not people. The task of the manager is not to search for those who commit mistakes and punish them, but to find out what can be done to improve the process where the defect occurred so that it will not happen again.

Achieving the system approach in a firm takes time, as it cannot be copied from other firms. It has to be incorporated gradually—through a mixture of preaching, training, skill acquisition, technical support and communication—until it becomes common practice.

4. Quality as a shared value

The statement that “everyone has a customer to be satisfied” has very important implications: if everyone assumes responsibility for ensuring that a customer's requirements are met, it follows that each and every person assumes responsibility for total quality within the firm. However, this important principle cannot be effectively applied unless there is a clear and shared understanding of what quality means for the firm as a whole, and unless there is company-wide conformance with the “requirements” that follow from such a concept. Within the firm, different people may have different concepts of what quality means. For example, the production department may consider the most important quality requirement to be a defect-free product, while the main objective of the marketing department may be to meet defined schedules and deadlines. Although these views may not be contradictory, the lack of a common set of priorities can lead to a customer's needs not being met. Quality must be a shared value, derived from the common understanding of customer requirements.

E. THE ROLE OF MANAGEMENT IN TQM

TQM is a basic philosophy, an integrated approach that requires the involvement of everyone in the firm and a common understanding of what quality is meant to be. It is geared towards making things happen at different stages—from the design to the development, production and delivery of products and services—so that customers get what they ask for. This approach entails a number of very important tasks to be carried out by the top management of a firm, the most important of which are related to the following:

- Assuming responsibility for the ongoing improvement of the process
- Diffusing information about quality requirements among all levels of staff and facilitating a common understanding of the firm's priorities in this regard
- Encouraging change
- Communicating with everyone in the company, and remaining open to new ideas and suggestions from below

In the implementation of the TQM approach, the role of top management is to systematically create the right atmosphere for the continuous improvement of processes so that this concept becomes an integral part of the work ethic of all personnel in the firm. Generating such an atmosphere requires what is known as “the three C’s”: the Commitment of top management; good Communication throughout the firm, and an appropriate Culture (Blakeborough, 1994). It should be noted, however, that good communication and top management commitment cannot create a TQM culture overnight; it takes months and possibly years for even a small company, to institute the necessary changes and to move smoothly along the track required for TQM.

What does top management commitment really mean? First, it must be stressed that without the commitment of middle management, it is not easy for top management to compel everyone in the firm to adopt the culture of continuous improvement and TQM. Even more critical, however, is the fact that without the real support and direct involvement of top management, middle management cannot carry out the required tasks. Top management must maintain its commitment to TQM at all times, at all levels and at all stages in order to sustain both the momentum of the approach and the long-term efforts needed to instil the TQM ethic, without ever allowing these efforts and the decisions needed to become secondary priorities. The commitment of top managers should be manifested by their direct involvement in planning, decision-making, diffusing concepts, and carrying out all necessary actions within the context of TQM, so that the prevailing

attitude of everyone in the firm is changed from “Have I done the job *correctly*?” to “How can I do the job *better*?”.

In building a well-ordered TQM system, the specific tasks of top management can be described as follows (Pike, 1994):

- Create a vision and set the cultural tone.
- Establish a quality strategy and plan.
- Establish systems and procedures for all processes.
- Support and participate in quality education and training.
- Participate personally in quality-improvement programmes.
- Promote an error-friendly environment.
- Base the reward system on being active rather than reactive.
- Provide the appropriate resources for managing the improvement process.

Winning the hearts and minds of employees is the most difficult task of managers in setting up a quality management system. Managers have to understand the needs of people at work—what encourages them to do their best and what demotivates them. The needs of a business to set control mechanisms may conflict with the needs of individuals to be free to exercise their own judgement, make the most of their abilities, and follow their own direction. Continuous quality improvement management emphasizes the importance of the facilitation process—empowering people by expanding their areas of freedom to exercise responsibility and creativity.

F. THE TOTAL QUALITY MANAGEMENT SYSTEM

As mentioned before, there is no single guideline for adhering to the TQM philosophy and approach or for setting up a TQM system. Every firm or organization must design its own unique quality management system appropriate to its needs and internal structure, so that the best use can be made of its materials, equipment, manpower and other resources.

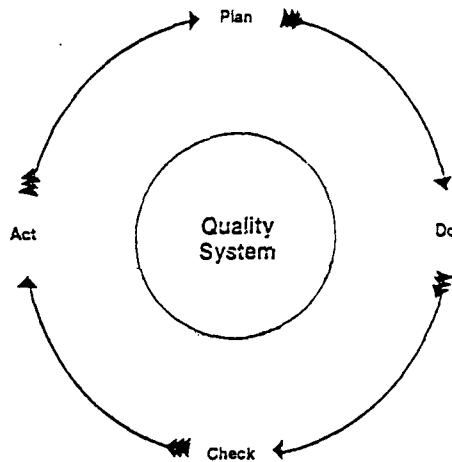
Many quality systems and standards have been created over the past few decades in various countries. In 1987, the ISO 9000 was formulated to harmonize all standards into one globally acceptable standard. Its basic concepts can be summarized as follows (Pike, 1994):

- Say what you do.
- Justify what you do.
- Do what you say.
- Record what you did.

Deming made the point that improvement is not achieved in a single stride, but by continuously going round the improvement cycle of “plan-do-check-act”, as illustrated in figure V; this adds another two concepts to the original ISO 9000 list:

- Review what you have done.
- Revise what you will do.

Figure V. The Deming quality loop

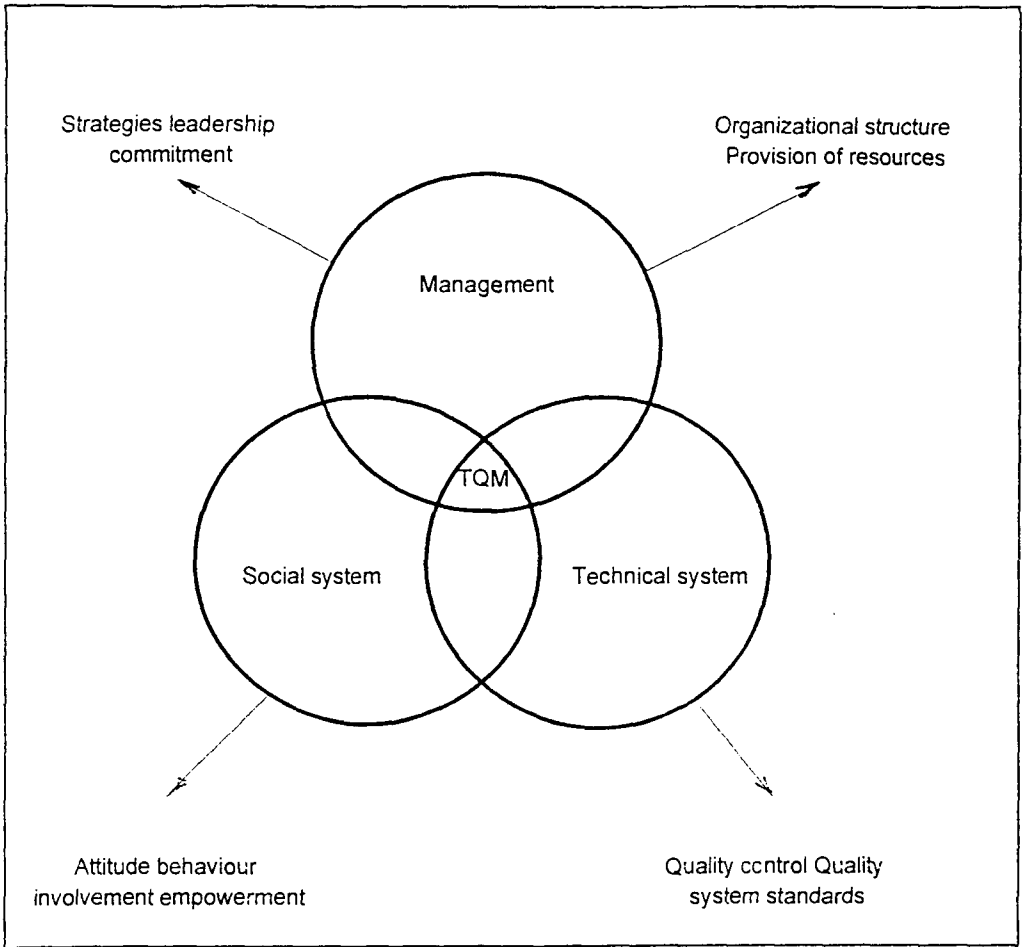


Conceptually, a quality system is based on the overlapping of three sub-systems, as shown in figure VI.

Briefly, what the figure depicts is that the ability of an organization to deliver quality products and services is a function of the following:

- A technical system which includes quality control and quality assurance systems
- A social system which is concerned with the attitudes and behaviour of employees
- A management system whose function is to integrate the above sub-systems into a well-ordered control system, creating the right attitudes, habits, abilities and behaviour among personnel through managerial leadership, example and practices.

Figure VI. TQM integrates all aspects of the firm



As has been emphasized, TQM requires that top managers be directly involved in fulfilling managerial objectives and ensuring the firm's quality performance.

G. TOTAL QUALITY MANAGEMENT AND ISO 9000

The basic management philosophies of TQM and ISO 9000 are the same, and the results should be the same if each is implemented correctly. The major difference between ISO 9000 and TQM lies in the firm's motivation. The ISO 9000 is a standard that can be audited by an accredited "third party" institution (a common customer request). Many companies comply with ISO 9000 primarily to achieve certification. Companies often require their suppliers to have ISO 9000 certificates, and the Government puts political pressure on certain companies to adhere to the ISO 9000 standard, especially those bidding for public projects. Companies fulfilling ISO 9000 requirements primarily to be certified have a fundamentally different approach from companies that have adopted the TQM approach and whose only goal is customer satisfaction. The ISO 9000 also has the objective of achieving customer satisfaction, but when certification is the primary goal, the emphasis in implementing the company's quality system may be on adhering to the certification procedures rather than on creating an environment where customer satisfaction ranks first.

PART TWO

Introduction

Part one of this presentation dealt with TQM, emphasizing the vital importance of quality in achieving success in the highly competitive markets of today.

Part two looks at another side of the issue of quality and its attainment. Quality is a relative rather than an absolute term; to determine whether a product or service is good or bad, there must be a reference—or standard—against which it can be measured.

In the sections that follow, standards and standardization are defined, some advantages of standardization are described, and the main elements of standardization are explained, with special emphasis on the needs of developing countries. The main focus of this presentation is the ISO 9000, a series of international standards designed specifically to facilitate the establishment and management of quality systems.

A. STANDARDS AND STANDARDIZATION

Standards can be defined in many ways; for the purposes of this paper, the definition provided by the International Organization for Standardization (ISO) will be used.

According to the ISO 8402, standards are documented agreements containing technical specifications or other precise criteria to be used consistently as rules, guidelines,

or definitions of characteristics to ensure that materials, products, processes and services are fit for their purposes.

The ISO 8402 defines standardization as the activity of establishing, with regard to actual or potential problems, provisions for common and repeated use, aimed at the achievement of the optimum degree of order in a given context. In particular, this activity consists of the processes of formulating, issuing and implementing standards.

Modern manufacturing of any kind is unthinkable without standards. Engineers and planners apply standards throughout every phase of the production process. Manufacturers also use standards in contracting, in inspecting their own products, and in deciding whether to accept or reject the products they receive from their suppliers.

The technical content of standards varies considerably according to the type of problem the standard is established to solve. Most standards deal with specific products such as detergents or services such as the transfer of funds by banks. They may also deal with a group of products such as earth-moving equipment or a group of services such as banking telecommunications.

A standard can cover one or more aspects of the subject in question, depending on the objectives. For instance, a standard's primary concern may be to rationalize the range of product sizes or capacities to satisfy the needs of different users while keeping costs and wastage to a minimum; examples of such standards are paper sizes and container capacities. The purpose of a standard may be to specify a particular characteristic or property of a material or product required for a specific application, such as the tensile strength of a certain kind of steel. Further, a standard may relate to the overall performance of a product such as a car engine, expressed through a number of important parameters such as net power, noises and exhaust emissions.

Certain standards concentrate on product safety, or more specifically, on the amount of protection provided against explosion, electric shock, and fire, chemical and radiation hazards. These standards apply to most types of products and equipment, from smaller items such as safety belts and children's toys to larger goods such as upholstered furniture and bulldozers. Other standards concentrate on the environmental aspects of products and processes. Some involve an assessment of their impact, while others relate to the monitoring of water, air and soil quality. Many standards cover the dimensional accuracy and interchangeability of parts such as screw threads, or the compatibility and interoperability of products such as computers with other products such as peripherals.

Most standards incorporate testing methods; these may be described separately or combined with the specifications of the product characteristics. Sampling methods are also standardized when the tests are not performed on all products of a delivered lot.

One important group of standards provides rules for engineering functions, to be used in the design of concrete structures or in calculations for a building's thermal insulation, for example. Such standards greatly facilitate the work of engineers and that of the regulatory authorities who check their work. These standards are usually used as a basis for national building codes and other mandatory regulatory instruments.

An important objective of standardization is to facilitate communication and the exchange of information. Most standards contain terms and definitions related to the product or service in question. Standards devoted entirely to this purpose are known as terminology standards. In addition to the terms and definitions, such standards may include explanatory notes, illustrations and examples; standardized graphical symbols used, for example, in buildings and on equipment serve as an important tool of communication. A number of international standards are devoted to the global harmonization of these symbols.

To facilitate contractual relationships, many standards specify the data that should be provided by the suppliers of the product/service in question and/or by the buyers who wish to order the products/services or to invite tenders from suppliers. The data to be provided by suppliers on consumer products are often regulated by law, and are based on the requirements of national and/or international standards.

B. THE ADVANTAGES OF STANDARDIZATION

The advantages that can be realized through the establishment and application of standards are numerous and have been widely discussed and publicized; they can be summarized as follows:

- Well-prepared standards represent optimum economic solutions to recurring technical problems in the design, manufacture, packaging, transportation and delivery of goods.
- Standards protect people's health, safety, property and the environment against hazards related to the production, use and disposal of products. They provide rules for the prevention and fighting of fires and explosions and for controlling chemical, radiation and other hazards.
- The application of standards facilitates the interchangeability, interoperability and compatibility of products and services within an industry and between industries.
- Standards can reduce variety to its optimum level, thus leading to overall savings in the design, production, handling, storage, ordering and use of goods and services.

- Standards can provide a solid basis for assessing the quality of products and services. Their application facilitates the contracting and ordering of goods and services and reduces disputes over specifications and quality.

In a free-market economy, while most industry- and national-level standards are adhered to voluntarily, they are generally observed by a majority of companies. This is mainly due to the way standards are set up; they are based on the widest possible participation of all concerned parties to achieve true consensus. Manufacturers in a competitive market apply standards to gain certain economic advantages and because such standards are demanded by their customers. Companies that do not apply generally accepted standards risk becoming isolated and losing their share of the market.

Although abiding by most standards in a free-market economy is voluntary and the customer is free to choose which goods to buy based on his assessment of quality, price and availability, there are cases where the application of standards is made compulsory by the Government through its regulatory bodies to protect individual consumers who have no means of assessing certain hazards related to the use of products, or to protect the environment and other national and global resources. Examples of such compulsory standards can be found for such items and areas of concern as food and drugs, fire prevention and fire-fighting, building materials and construction, toys, equipment safety, electrical and gas appliances, and environmental protection.

In industrialized countries, standards bodies exist at the national and industry levels; for both, the usual procedure for developing standards involves the following stages:

- Establishing the need for a standard based on the industry or trade situation
- Drafting the standard. This task is usually entrusted to a technical committee that possesses adequate expertise and experience and is representative of all major interests in the specific field in question. The drafting process represents a distillation of ideas and often involves accepting the most reasonable compromise from among a variety of conflicting solutions that cater to the various interests. At this stage, testing and research is often needed to verify and validate the technical content of the standard.
- Facilitating wider consultation among all concerned parties through a circulation-and-comment process

- Resolving the differences expressed during the consultation by carefully studying the comments and, if necessary, modifying the draft
- If necessary, repeating the consultation and modification procedure until consensus is reached
- Securing formal approval of the standard by the governing body of the standards organization, then publishing said standard
- Carrying out periodic reviews, using the same consultation and technical committee procedures to update and revise the standard if necessary

C. THE STANDARDIZATION INFRASTRUCTURE

The standardization infrastructure in developed countries includes the important function of providing standards information to users. Part of this information is available on the spot, since most standards libraries in these countries keep full collections of national and international standards and of relevant regional standards.

Most standards information services in developed countries offer a service known as technical help to exporters (THE) which specifically targets this group and caters to their needs. Information is made available on foreign standards and technical regulations; tailored services are offered such as the carrying out of comparative studies of regulations in several countries, and help is provided with respect to procedures and formalities for submitting products for type testing and obtaining approval for import into foreign countries. The assistance may also include diagnosis of a product to ascertain its degree of conformance with the standards and technical regulations it may be required to adhere to in foreign markets.

Testing is the function most closely related to the writing of standards. Initially, a certain amount of research and testing is needed before a standard is written to identify the test methods and conditions that will allow for the determination of important properties of the product during its use. This testing is often performed collaboratively with the industry in question in specialized testing laboratories. After the standards have been established, routine testing is done by various parties such as manufacturers, users and traders; the tests are carried out in laboratories set up by these parties or in specialized private or public testing laboratories that cater to different needs in the particular field.

Testing plays an important role in national and international trade. Many sophisticated products require some form of testing for compliance with specifications and safety regulations before their release into the markets of developed countries. Even simple products and commodities are traded on the basis of test results. This trend means that valid test data produced by reliable laboratories are a necessity of modern trade.

A manufacturer or service provider that offers a certain product or service to the market often declares that that which is being offered conforms with a certain standard (which may be a company, industry or national standard). This so-called supplier's (or first-party) declaration of conformity is often sufficient to satisfy buyers. However, in many cases, large-scale buyers (second parties) who have access to testing facilities prefer to carry out their own conformance assessments of the products/services they buy.

Specialized certification bodies offer third-party certification to buyers or suppliers who want assurance that the products or services they buy or sell conform with certain standards but prefer to have the actual certification done by a specialized and independent body. The reasons for such a choice might include the lack of appropriate testing facilities and experienced personnel, the distance between the manufacturer and the buyer (if considerable), the lower costs associated with assessment by specialized certification bodies, and the increased credibility attached to assessments made by impartial third parties of good reputation.

Third-party certification offers numerous advantages to the different parties involved in the exchange process:

- It permits manufacturers to extend their markets, based on their enhanced reputation and on the advantage they have over competitors who do not comply with the same standards; this applies particularly to new products and markets.
- It provides manufacturers with a means of ascertaining that their quality assurance systems are functioning properly, in accordance with recognized quality management techniques.
- It provides manufacturers, stockists, and exporters with acceptable proof that their products conform with the technical regulations of local and export markets.
- It provides traders/middlemen with assurance of the quality of the goods they stock and sell, thus enhancing their reputation and offering them protection if there are complaints.
- It facilitates the establishment of vendors' ratings by buyers and traders.
- It provides large-scale purchasers with an efficient, economical and time-saving means of assessing the quality of the products they purchase.

- It provides the individual or non-professional purchaser with an unbiased assessment of the product he is buying (especially with regard to health- and safety-related aspects).

In many developed economies, inspection, testing and certification services are offered by more than one body. This situation entails a certain amount of risk if some of these bodies do not operate according to universally accepted rules with regard to proficiency and impartiality. Rather than limiting the number of authorized bodies and imposing rigid operational rules, the tendency in most developed countries is to allow all operators of testing and certification schemes to operate freely, while ensuring the proficiency and impartiality of their assessments through some kind of accreditation mechanism. Accreditation schemes exist in many developed economies; their main function is to check the structures and working procedures of testing laboratories and inspection and certification bodies to strengthen customer confidence in the validity of independent test and inspection results.

The role played by accreditation is similar to that of certification—it assures those seeking testing or inspection services that the procedures are carried out according to recognized standards. From the perspective of testing laboratories and inspection and certification bodies, requesting accreditation represents an attempt to gain wider recognition of their proficiency and impartiality from potential customers, as well as an attempt to ascertain whether their working methods conform to recognized standards. A description of such universally accepted standards is contained in a joint publication of the ISO and the International Electrotechnical Commission (IEC)—ISO/IEC Guide No. 25, entitled *General Requirements for the Competence of Calibration and Testing Laboratories*.

The past decade has witnessed the emergence of numerous national accreditation systems for laboratories, especially in developed countries. Detailed information on this subject is provided in ISO/IEC Guide No. 58, entitled *Calibration and Testing Laboratory Accreditation Systems—General Requirements for Operation and Recognition*.

The application of universally accepted rules in the field of accreditation clears the way for mutual recognition of national accreditation systems and, consequently, of test results obtained in other countries; bilateral agreements are currently being negotiated to facilitate this process. This is an extremely important development which could lead to the effective dismantling of those technical obstacles or barriers to trade related to testing and certification.

D. STANDARDIZATION IN DEVELOPING COUNTRIES

Developing countries have traditionally exported primary commodities and raw materials such as agricultural and mineral products. During the last two or three decades, however, vigorous efforts have been made by developing countries to expand and diversify their exportable product ranges to allow them to meet the increasing demand for the foreign exchange needed to support their national development efforts. In most cases, these efforts have resulted in the introduction of manufacturing processes.

In comparison with primary commodities, manufactured goods require more complex processes and machinery, more highly skilled labour, and better management and control systems. Standard specifications for these products are more extensive and demanding. If developing countries are to secure and maintain markets abroad, standardization is essential.

In most developing countries, standardization has been instituted to ensure that the weights and measures used in commerce are fair and accurate. This applies primarily to scales, thermometers, fuel pumps, watt-hour metres, taxi metres and other measuring devices commonly used in daily commerce, and to the measurements used in business and government service activities. A second, related reason for introducing standardization has been to protect consumers from dangerous products and substances (i.e., to ensure health and safety).

Greater awareness in developing countries of the standardization requirements of developed countries would facilitate exportation to such economies. National standards in industrialized countries constitute a barrier to exports from developing economies when exporters in the latter group do not know, cannot attain, or cannot certify that they have attained the performance or safety standards required within the importing country's market. To compete effectively in the world market, developing countries must familiarize themselves with the standards of the markets to which they will be exporting, establish internationally recognized testing and certification organizations, and institute national quality assessment systems which operate according to international criteria. All of this requires the existence of an appropriate standardization infrastructure, which must include or be able to provide the following: standards information services; all metrological services; calibration services; testing laboratory accreditation services; testing laboratory accreditation; product certification; quality systems registration; and training in quality control and quality assurance. One of the most critical—and possibly most difficult—functions of such an infrastructure is to make producers and the population as a whole conscious of the vital importance of quality.

In this new international climate of rapid technological change and increased emphasis on quality and environment, developing countries must focus on instituting more

extensive, dynamic and flexible standardization systems that can keep up with rapidly evolving national and international needs and requirements.

As developing countries become more industrialized and depend increasingly on the export markets in developed countries, they must shift the focus of their standardization programmes from legal/metrological and basic health and safety concerns to the more specific concerns of industry and commerce. Industry standards are needed to facilitate interchangeability and interconnection and to promote specialization. Standards are also needed which will allow industries to take advantage of economies of scale and enable them to sell products in foreign markets.

As has been mentioned, the content of standards varies considerably; this factor largely depends on the type of problem a standard is established to solve. Most standards deal with specific products and services; some specify the characteristics of products for specific applications.

One important group of standards provides rules and guidelines for the establishment, management and assessment of quality management systems. The need for this special group of standards in industrialized countries can be traced back to the Second World War. The failure of many military products to perform as required was a matter of life and death; the people responsible for procurement began to look more closely at how the quality of the products they were purchasing could be improved to reduce unnecessary casualties. In the 1960s, quality assurance standards were published in the form of military specifications in the United States and the United Kingdom. A number of major industrial purchasers evaluated the newly issued defence standards to determine whether they could improve their production efficiency through the selection of better suppliers and the use of quality assurance principles. This led to a proliferation of quality assurance specifications which, although similar, contained requirements specific to each purchaser. For example, each of the major manufacturers in the automotive and aerospace industries developed its own quality assurance standards which were used as a basis for evaluating and selecting suppliers; as a result, suppliers were being forced to comply with many different sets of criteria. Additionally, as the specifications were not the same, each purchaser felt it necessary to conduct his own evaluation of a supplier, as that of another purchaser could not be accepted as equivalent; these multiple assessments caused enormous problems.

In 1973, the British Standards Institution (BSI) produced BS 5179 as a series of guidelines rather than definitive standards; other national standards organizations took similar actions. In the United Kingdom, the proliferation of quality assurance standards issued by various purchasing and second-party organizations, together with the growing demand for the application of quality assurance principles in contracts, highlighted the need for a national standard. The publication of BS 5750 in 1979 addressed this need, providing a common standard for quality systems in the United Kingdom. BS 5750

provided obvious benefits, the most practical being that major British purchasers were able to apply it in place of their own individual quality assurance specifications; however, as BS 5750 was purely a British standard, its relevance outside the United Kingdom was limited.

The benefits of such standards were increasingly recognized. The ISO set up a technical committee to develop an international standard for quality management systems, and in 1987 the ISO 9000 series of standards was published.

E. THE ISO 9000 SERIES OF INTERNATIONAL STANDARDS

The ISO 9000 series is a set of practical standards for quality management systems that can be applied by manufacturers, distributors, service providers, and all other types of businesses. The two main features of ISO 9000 are as follows:

- Management's responsibility and commitment to quality should be expressed in a formal policy statement and implemented through appropriate measures.
- ISO 9000 contains a set of requirements that apply to each aspect of the company's activities and organization that affects quality.

An important condition for conformance with these standards is the appropriate documentation of quality system procedures and instructions which, when put together, constitute the company's quality manual.

The ISO 9000 series of standards prescribes three models for quality management systems applicable to three types of companies/organizations:

- ISO 9001 is for organizations engaged in the design/development, production, installation and servicing of a product.
- ISO 9002 is for organizations that carry out only the production and installation of the product.
- ISO 9003 is for organizations that produce a product or service but do not carry out the design/development, installation or servicing.

The models prescribed for the quality systems of these three types of companies include requirements related to the various organizational elements and activities affecting quality. In the most extensive model (ISO 9001), there are 20 such elements/activities:

- Management responsibility
- Quality system
- Contract review
- Design control
- Document and data control
- Purchasing
- Control of customer-supplied product
- Product identification and traceability
- Process control
- Inspection and testing
- Control of inspection, measuring and testing equipment
- Inspection and testing status
- Control of non-conforming product
- Corrective and preventive action
- Handling, storage, packaging, preservation and delivery
- Control of quality records
- Internal quality audits
- Training
- Servicing
- Statistical techniques

In the other two models some of these requirements are either absent or less stringent since the relevant categories do not exist or have a lesser effect on quality.

Once a company observes the relevant ISO 9000 standards in the areas listed above, it is considered to have met the necessary conditions for achieving quality with regard to the products/services it offers. The difficult part is evaluating the conformance of these different elements with the requirements of the standard, a task carried out by means of elaborate assessment and registration procedures.

F. OTHER INTERNATIONAL QUALITY STANDARDS

Other important international standards relating to quality include:

- ISO 8402, which contains a complete vocabulary of quality terms and their definitions

- ISO 9000, the first standard in the series, which is basically a guide to the selection and use of the other four standards (ISO 9001, 9002, 9003 and 9004)
- ISO 9004, which provides general guidelines for developing and implementing quality management systems. It also contains general considerations related to the economics of quality, marketing, specification and design, training and motivation, and so on.
- ISO 10011, which deals with the auditing of quality systems

G. THE ASSESSMENT AND CERTIFICATION/ REGISTRATION OF QUALITY SYSTEMS

The publication of national and international standards for quality systems did not constitute the final solution to the problems faced by suppliers. For some time, they continued to be subjected to multiple assessments of their quality systems' conformance with the new ISO 9000 standards. Gradually, the purchasers themselves recognized the absurdity of this situation. Some of them started to exchange the results of their assessments with other purchasers. Finally, the idea of having third-party certification bodies carry out assessments and issue certificates that would be accepted by all buyers presented itself as the most efficient and logical solution.

Over the last few years, demand for third-party certification has been growing very rapidly in all developed and in some developing countries. To satisfy this demand, a number of registration bodies have been established, some within the framework of existing standards and/or quality bodies and some outside that framework (often as professional or industry associations or private registration bodies). This has raised a new issue—that of the credibility of certifiers/registrars and the assessment of their competence as a basis for their recognition.

H. THE ACCREDITATION OF CERTIFICATION BODIES

In industrialized countries, certification and registration is an open activity. Accreditation bodies have been established to assess the competence and impartiality of quality system certification bodies and to ensure their formal recognition. ISO has prepared international guidelines containing sets of requirements for both assessment/certification bodies and accreditation bodies. The application of these guidelines by the two types of bodies establishes their credibility at the national level and paves the way for recognition outside the country.

The ISO 9000 series of standards provides a framework for the establishment, documentation and maintenance of an effective quality system—a sign to customers that

a company is committed to quality and is able to supply products and services which meet their needs. In many ways, these internationally accepted standards are based on simple common sense. The standards are applicable to all sectors of industry and to organizations of all sizes. It does not matter whether a company manufactures sophisticated military hardware or ball-point pens, or whether it employs two people or 10,000; the requirements are equally applicable.

I. THE ADVANTAGES OF COMPLYING WITH ISO 9000 STANDARDS

Compliance with ISO 9000 can produce numerous benefits for businesses, among them the following:

- A better company image
- A better employee spirit
- A greater degree of internal control
- Reductions in scrapped/reworked items and customer returns
- Acceptance of ISO 9000 (and what it signifies) by major customers
- Easier retention of existing customers
- Reductions in lost business
- Gains in new business
- A reduction in quality-related costs
- Above all, greater cost-effectiveness

The implementation and independent certification of the ISO 9000 management system is becoming a normal part of doing business; it has become the rule rather than the exception. In industrialized countries, many large purchasers require evidence that a potential supplier can comply with ISO 9000 as a condition of bidding for a contract; the companies that cannot provide such evidence, normally through independent certification, will not even be invited to bid.

Obviously, there are costs involved in implementing an ISO 9000 quality management system, and these may be significant. There is, however, overwhelming evidence that these initial costs can be recouped time and time again through the greater efficiency and reduced wastage associated with the standard. Establishing an ISO 9000 system is not the end—it is only the beginning. The system should be dynamic, with improvements being made constantly; the standard encourages this through its requirements for corrective action, internal auditing and management review.

Modern technology is inconceivable without standards; to a large extent, technology is expressed through standards, which provide a coherent summary of information about current technical practices and serve as a means of conveying technological information. Standards define a technology in clear, concise language and

represent the best thinking of world experts. They also play a critical role in the process of technology transfer, because they help to specify how the technology has to perform, they address issues related to the quality and compatibility of materials, components and products, and they define various services that are required.

The ability to compete in global markets is now directly linked to standards, which constitute an “international language” for market access. Developing countries in particular must take steps to understand and apply the standardization process, as international standards represent the conduit carrying a country’s products, services and technologies into the international arena and the global market-place. Standards and a standardization infrastructure form a strategic imperative that simply cannot be ignored.

Adopting the ISO 9000 standards represents both a challenge and an opportunity for developing countries. Adherence to the standards, while voluntary, is becoming a prerequisite for doing business in many sectors within the European Union, and this trend is expected to extend to the North American Free Trade Agreement (NAFTA) countries and to the East Asian trade area revolving around Japan. The challenge is that the ISO 9000 certification process is quite rigorous and demanding; the opportunity is represented by the fact that the system spells out proven practices and the essential operational elements that constitute a basic but effective quality assurance and quality management system appropriate for a wide range of enterprises.

In developing countries, producers must be motivated to adopt and implement these standards and to develop a credible quality assessment and registration component within their national standards systems which will be accepted by their trading partners.

In conclusion, as a leading expert has put it, with increasing competition, the question to be asked is not “Can I afford to implement ISO 9000 in my organization?” but “Can I afford not to?”.

J. AWARENESS PROGRAMMES FOR QUALITY MANAGEMENT IN THE ESCWA REGION

The ESCWA secretariat (Industry Section), in collaboration with other international and regional organizations—especially the International Organization for Standardization (ISO) and the Arab Industrial Development and Mining Organization (AIDMO)—has initiated an awareness programme designed to address quality control and standardization questions in general, but particularly those related to ISO 9000. The programme’s first activity was the Regional Seminar on Total Quality Management Based on ISO 9000 held in Beirut from 17 to 19 January 1995.

The next scheduled activity is a regional workshop in the United Arab Emirates in 1996, in collaboration with the General Industry Corporation of Abu Dhabi. The main subject of the workshop will be the introduction of total quality management and the ISO 9000 series of international standards to the industrial sector in the region.

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